Policy Debates on Subsidies

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Introduction

Subsidy refers to a transfer of resources by the government to the buyer or seller of a good or service that has the effect of reducing the price paid by the buyers, increasing the price received by the sellers, or reducing the cost of production of the good or service. Thus, only those government expenditures are considered as subsidy that reduce the market price of a good or service through any of the ways mentioned above; government spending for public provisioning of education, healthcare, and rural infrastructure etc. are not considered subsidies. The government in India has been subsidizing crucial items like food, fuel etc. since Independence. These subsidies have been very important in the Indian context where a significant share of the population (both in rural as well as urban areas) is not always capable of affording even the necessary goods and services at the market prices. However, in recent times, in the wake of the relatively high levels of Fiscal Deficit incurred by the Union Government, many in the policy community in the country have been asking whether subsidies are putting too much pressure on the budget of the Union Government and whether the money being provided for subsidies is getting utilized well.

Magnitude of Union Government spending on Subsidies

In the Union Government spending on subsidies (which accounts for a very large share of total government spending on subsidies in the country), subsidies on food, petroleum and fertilizer make up for over 90 per cent of the total subsidies (as per data from 2000-01 to 2012-13), with Food Subsidy accounting for the highest average share (44 per cent). The average annual growth rate of the Union Government spending on subsidies has been about 14 per cent from 2000-01 to 2012-13, with the growth rate during 2006-07 to 2012-13 being higher as compared to the previous phase of 2000-01 to 2005-06 (due to an overall increase in food prices as well as higher expenses towards petroleum subsidy over the last few years). In fact, inflation is often seen as one of the major reasons for heavy subsidization by the government, which results in the widening of the fiscal deficit. The Union Government spending on subsidies has increased from 1.2 per cent of GDP in 2000-01 to 1.3 per cent of GDP in 2006-07 and subsequently to 2.6 per cent of GDP in 2012-13 (Revised Estimates). The magnitude of Food Subsidy provided from the Union Budget has increased from 0.6 per cent of GDP in 2006-07 to 0.9 per cent of GDP in 2012-13. The magnitude of Fertilizer Subsidy from the Union Budget has gone up from 0.6 per cent of GDP in 2006-07 to 0.7 per cent of GDP in 2012-13. The Union Government spending on Petroleum Subsidy has registered a sharp increase from 0.1 per cent of GDP in 2006-07 to almost 1 per cent of GDP in 2012-13. However, there has been a decline in total allocation towards subsidies in the latest Union Budget compared to allocations in last year’s budget; the amount of total subsidy in 2013-14 (Budget Estimates) is Rs. 2,31,084 crore (2.03 per cent of GDP), which is lower than the Rs. 2,57,654 crore (2.57 per cent of GDP) in 2012-13 (Revised Estimates).

Divergent Views on Subsidies

Subsidies provided by the Union Government have been criticized both on account of the upward pressure they have put on the level of expenditure and consequently on the level of borrowing by the government (i.e. the Fiscal Deficit) and also due to the views held by many that these expenditures are not benefitting the poor as intended because of flaws in the design of some of these subsidies or loopholes in their implementation. The Kelkar Committee is an example of this school of thought, which opined that a gradual removal of subsidies would not only enable the government to spend more on economic growth oriented projects but would also help in attracting private investments. Further, the 12^{th} Five Year (2012-2017) has also recommended some control over the subsidies (without harming the interests of the lower sections of the society), emphasizing on the need to reduce the share of subsidy in the GDP from 2.4 per cent in 2011-12 to 1.5 per cent by 2017.. On the other hand, some of the economists advocating for an expansionary fiscal policy for the country have argued that government spending on Food Subsidy would raise the purchasing power of the poor as they would no longer need to purchase food at the market price and this additional purchasing power with the poor is likely to be spent on other local goods, thus raising employment and output in the economy.

Fuel subsidies are criticized on the grounds of inefficiencies and poor targeting. In a recent paper by Rahul Anand and others (IMF Working Paper No. WP/13/128, May 2013), the authors have suggested that, in India, most of the fuel subsidies are enjoyed by the people in the high income groups who have greater per capita consumption of fuel and have higher shares of expenditures going towards fuel consumption. However, they do not recommend a complete removal of the fuel subsidies and estimate that doing so would reduce the real income of the Indian households by about 4 per cent. It is also argued by many that higher fuel costs would aggravate the problem of inflation in the country by pushing up the costs for transportation of most of the goods.

Fertilizer subsidies are criticized on the distributional aspects. In a paper by V. P. Sharma and Hrima Thaker (IIM Working Paper No. 2009-07-01, July 2009), the authors have suggested that although inter-state disparity of subsidy distribution has reduced over the years (with higher concentration in states like Uttar Pradesh, Madhya Pradesh, Punjab, Maharashtra and Andhra Pradesh), it still is high. However, they also indicate that the distribution of the fertilizer subsidy has been equitable with small and marginal farmers having a larger share of the subsidy. Also, the share of the subsidies used for the unirrigated land has increased over the years. They have also suggested that reductions in fertilizer subsidies could have an adverse impact on farm production and incomes as farmers do not always benefit from higher output prices but are certainly helped by lower input prices.

According to the National Sample Survey (NSS) data for 2011-12, in the monthly per capita expenditure (MPCE) of households in the country, 53 per cent gets spent on food items for rural households and 43 per cent for urban households. With several regions across the country still reporting a high extent of hunger and malnutrition, ensuring food security has rightly been taken up as a priority by the Union Government. In this context, doing away with the Public

Distribution System (PDS) for foodgrains and a gradual shift to direct cash transfers to the poor has been put forward as a policy option for enabling better utilization of the Food Subsidy. However, lack of adequate banking infrastructure in the country, a high share of rural population and other such constraints have made some sections skeptical of the effectiveness of the proposed direct cash transfers mechanism. On the other hand, some states like Tamil Nadu and Chhattisgarh have managed to reduce the leakages in the PDS significantly by adopting appropriate transparency and accountability measures; thus, it could be argued that the PDS for foodgrains can be improved significantly for effective utilization of the Food Subsidy. A similar kind of argument holds for the petroleum subsidies as both rural and urban households spend close to 10 per cent of their monthly per capita expenditure (MPCE) on fuel and light. So given the inflationary trends in fuel prices, any drastic reduction in petroleum subsidies could again be socially undesirable at the current juncture.

Concluding Remarks

The preceding section attempts to capture the divergent views pertaining to subsidies in India, which implies that the issue of subsidies needs a lot more scrutiny and that the policy debates in this regard are far from being resolved. However, it may be worthwhile to add here that instead of focusing solely on the expenditure side of the budget, a lot more emphasis could be laid on the revenue mobilized by the government. Not many would disagree with the view that for a large developing country, India's tax - GDP ratio at less than 17 per cent is low and it needs to be stepped up to enable the government meet its expenditure commitments to a better extent.

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