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A STUDY ON THE POOR STATE OF SUBSIDY IN INDIA

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ABSTRACT:

The Indian government has, since independence, subsidized many industries and products, from fuel to food. Subsidies, as converse of an indirect tax, constitute an important fiscal instrument for modifying market-determined outcomes and affect the economy through the commodity market by lowing the relative price of the subsidized commodity, thereby generating an increase in its demand. Subsidies can have a major impact in augmenting welfare of the society provided these are designed and administered efficiently to serve a clearly stated set of objectives. However, subsidies can also be very costly if they are poorly designed and inefficiently administered. Subsidies in areas such as kerosene, diesel , railways etc. advocated on grounds that their benefits are spread well beyond the immediate recipients, and are shared by the population at large, present and future. The paper attempts to highlight the state of the country's subsidy disbursement.

Key words: indirect tax, welfare, immediate recipients etc.

I. INTRODUCTION :

A subsidy is a benefit given by the government to groups or individuals usually in the form of a cash payment or tax reduction. The subsidy is usually given to remove some type of burden and is often considered to be in the interest of the public. It is often viewed as the converse of a tax and instrument of fiscal policy. Derived from the Latin word 'subsidium', a subsidy literally implies coming to assistance from behind. However, their beneficial potential is at its best when they are transparent, well targeted, and suitably designed for practical implementation. According to Reddy, K.S. (1987**),** in a developing country where market system is not competitive and its income distribution is skewed the interplay of forces of demand and supply does not always lead to socially desirable results. For instance, if market forces are allowed to operate freely, prices of important consumer as well intermediate commodities will be beyond the reach of a majority of consumers and producers. Hence, Government intervention in the market is needed to moderate these adverse influences. One of the policy instruments in this direction is the provision of subsidies, where the consumers or produces will be allowed to pay less than the market price and gap will be filled by subsidies. Hence subsidies can be defined as a payment made by the government to fill the gap between prevailing market price and the price paid by the buyers.

Like indirect taxes, they can alter relative prices and budget constraints and thereby affect decisions concerning production, consumption and allocation of resources. In India, as also elsewhere, subsidies now account for a significant part of government's expenditures although, like that of an iceberg, only their tip may be visible .Subsidies in areas such as education, health and environment at times merit justification on grounds that their benefits are spread well beyond the immediate recipients, and are shared by the population at large, present and future. For many other subsidies, however the case is not so clear-cut. Arising due to extensive governmental participation in a variety of economic activities, there are many subsidies that shelter inefficiencies or are of doubtful distributional credentials. Subsidies that are ineffective or distortionary need to be weaned out, for an undiscerning, uncontrolled and opaque growth of subsidies can be deleterious for a country's public finances. These implicit subsidies not only cause a considerable draft on the already strained fiscal resources, but may also fail on the anvil of equity and efficiency as has already been pointed out above.

Subsidies, by means of creating a wedge between consumer prices and producer costs, lead to changes in demand/ supply decisions. Subsidies are often aimed at:

1. inducing higher consumption/ production
2. offsetting market imperfections including internalization of externalities;
3. Achievement of social policy objectives including redistribution of income, population control, etc.

Effects of subsidies

Economic effects of subsidies can be broadly grouped into

1. Allocative effects: these relate to the sectoral allocation of resources. Subsidies help draw more resources towards the subsidised sector
2. Redistributive effects: these generally depend upon the elasticity of demands of the relevant groups for the subsidised good as well as the elasticity of supply of the same good and the mode of administering the subsidy.
3. Fiscal effects: subsidies have obvious fiscal effects since a large part of subsidies emanate from the budget. They directly increase fiscal deficits. Subsidies may also indirectly affect the budget adversely by drawing resources away from tax-yielding sectors towards sectors that may have a low tax-revenue potential.
4. Trade effects: a regulated price, which is substantially lower than the market clearing price, may reduce domestic supply and lead to an increase in imports. On the other hand, subsidies to domestic producers may enable them to offer internationally competitive prices, reducing imports or raising exports.

II. OBJECTIVES OF THE PAPER:

- To highlight the subsidies on gold, LPG, kerosene, electricity, aviation fuel and railways from the government.
- To assess the effectiveness in disbursements of the subsidies from the government.

III. METHODOLOGY:

The study is based on secondary data. For the purpose of study percentages and tabulation has been used to draw valuable insights. Various survey reports such as Economic Survey Report 2016, planning Commission report and journal papers are consulted to dig up the true facts.

IV. SIGNIFICANCE OF THE STUDY:

The study would throw light on the various subsidies to the needy sections of the society from the government. Also the effectiveness of disbursement of these subsidies would highlight whether these benefits are actually reaching out to the needy sections or not. The paper would assist the concerned authorities in reconsidering of the distribution of these subsidies ,so that the motive behind such benefits does not fail.

V. FINDINGS:

The following table is shows the effective subsidy rates and implicit subsidy going to the well-off sections of the society.

TABLE 1: Showing the effective subsidy rates and implicit subsidy to the rich

Commodity	Share of consumption		Subsidy / tax rates		Effective subsidy rates	Implicit subsidy to rich (in crore)
	Rich	Poor	Rich	poor		
Kerosene	49	51	-38	-38	88	5501
Electricity	84	16	-32	-49	51	37170

LPG	91	9	-36	-36	86	40151
Railways	92	8	-34	-69	53	3671
Petrol	95	5	61	61	-	-
Diesel	98	2	55	55	-	-
ATF	100	0	20	20	30	762
Gold	98	2	1.6	1.6	17.4	4093

Source: NSS, Ministry of Railways, PPAC, World Bank

NOTES:

1. All the figures are in percentage terms, except the last column (which is in crore).

2. Poor refer to the bottom 30 per cent of the population and rich refer to top 70 per cent population, divided based on expenditure distribution as per NSS data.

3. Negative sign in the column of subsidy/tax rates denotes subsidy rate.

4 .Kerosene here refers to the consumption of kerosene under PDS only and not from other sources.

5 .There is a blank (_) in the effective subsidy rate for the category Petrol and Diesel as the tax rate on these categories is already higher than the normative 50 per cent. @ Effective subsidy rate (for the rich) is the difference between normative tax rate (50 per cent for energy related commodities and 19 per cent for others) and actual subsidy/tax rate for better-off. Implicit subsidy to rich is the effective subsidy rate multiplied by consumption of that commodity by rich.

GOLD:

Incase of gold, the top 20% of the population account for roughly 80% of the total consumption. So the 'rich' consume most of it. The poor spent negligible portion of their total expenditure on it. But state and Central government combined, tax rate on gold is about 1-1.6%. Now if this rate is compared with the tax rate on normal goods, about 26%, the tax rate on gold is almost zero. In other words, there is a huge subsidy of about 25 percentage points (the difference between average tax on other commodities and tax on gold) .About 98 per cent of this subsidy accrues to the better-off and only 2 per cent to the bottom 3 deciles (table1). And this is an underestimate because the data on consumption is from the NSS, which is known not to capture those at the very top end of the income and expenditure distribution.

LPG:

As in January 2016, consumers of LPG receive a subsidy of Rs. 238.51 per 14.2 kg cylinder. This amounts to a subsidy rate of 36 percent (ratio of subsidy amount to the market price). As per the table above, it is clear that 91percent of these subsidies are accounted by the better-off as their share in consumption of LPG in the total consumption is about 91%, while the poor accounted for only 9 percent of the LPG consumption and hence only 9 percent of subsidies go to them. Another important point to note is that LPG is subsidized heavily, as compared to other energy related commodities like petrol, diesel etc which are taxed at very high rates, hence the effective subsidy to the better-off on account of LPG is much more than the actual direct subsidy of 36 per cent.

KEROSENE:

As in 2016, there is a subsidy of Rs. 9.16 per litre on kerosene distributed under the public distribution system (economic survey 2016) which translates into a subsidy of about 38 percent for both rich and the poor (subsidy per litre as a ratio of nonsubsidized market price per litter). But kerosene accounts for only 1 percent of the consumption basket of the poor. However, under the Public distribution system , about 50 percent is consumed by the well-off and the rest by the bottom 3 deciles, showing that half of the subsidy benefit goes to the well-off section.

AVIATION TAX FUEL (ATF)

Aviation fuel is taxed at about 20 percent (average of tax rates for all states), While diesel and petrol are taxed at about 55 per cent9 and 61 per cent (as in January 2016) (economic survey 2016) .The real consumers of ATF are those who travel by air, who essentially are the well off. Hence there is an implicit subsidy for air passengers (the difference between taxes on diesel/petrol and aviation fuel) amounting to about 30 percentage points.

RAILWAYS:

There is a difference between the subsidy for the better-off and the poor in railways, because fares vary in different classes of travel. By combining the categories of A/C, first class, second class, sleeper as the primary modes of rail travel by rich and unreserved category as mode of travel used primarily by the poor and then compute the implicit subsidy rate for these categories, by comparing the actual fare charged to the consumers with the marginal cost of supply (i.e. difference between earning per km and cost per km). On this basis, the subsidy rate (implicit subsidy as a ratio of actual cost of journey to railways) amounts to 34 per cent for the better-off and 69 per cent for the poor. There is no provision for covering fixed costs, so the calculation understates, perhaps significantly, the subsidy than the actual direct subsidy of 36 per cent. The share of consumption railway services amounts to 92 percent for the rich and for the poor , a small percentage of 8 percent.

ELECTRICITY:

In the case of electricity, like railways, tariffs vary on levels of consumption, so there is de facto targeting of the subsidy. Based on data available for two states (Tamil Naduand Delhi), an estimate has been made in the economic survey 2016 about the subsidy for the better-off and poor by comparing the average billing rate, which depends on levels of consumption, with the average cost of supply of power. Implicit subsidy rate is the subsidy given per unit to domestic consumers as a ratio of the cost of supply per unit. The rates charged to the better-off are subsidized to the extent of 32 per cent, and the poor, 49 per cent (average for Delhi and Tamil Nadu). But given the magnitude of relative power consumption of the better-off in the total consumption of electricity (84 per cent), the better-off appropriate a substantial amount of the total subsidy.

SUGGESTIONS:

The government should take stringent measures to prevent dilution of the primary motive behind disbursement of subsidies i.e. improving the living standard of the needy sections of the society.

- In case of subsidies, the rate is not the only dominant force but the magnitude of consumption also needs to be considered. As for instance, in case of electricity subsidy, the subsidized rate for the poor is 49 percent, which incase of the well-off section is 32 percent. But, the difference in the magnitude of consumption is huge.
- Subsidies should be made more realistic. For instance, in case of aviation tax fuel. The real consumers of ATF are those who travel by air, who essentially are the well off.
- Proper monitoring of the Public Distribution System (PDS) outlets. The benefits for these distribution outlets accrue to the well-off sections of the society rather than the needy ones.
- Proper assessment of the beneficiaries before disbursement of any benefits in the form of subsidies.

V. CONCLUSIONS:

There are a fair amount of government interventions that help the relatively better off in society. In many cases, this help takes the form of explicit subsidization, which is surprisingly substantial in magnitude. Addressing these interventions and rectifying some egregious anomalies may be good not only from a fiscal and welfare perspective, but also from a political economy welfare perspective, lending credibility to other Market-oriented reforms.

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