

Chapter 4

MANAGEMENT OF SUBSIDIES

4.1 Management of subsidies is without doubt one of the most complex issues a government faces. Subsidies account for a significant share of government expenditures, and are generally advocated when the social benefits of a particular service or commodity extend beyond the immediate beneficiaries. Examples of activities with such extended benefits are health, basic education, sanitation, and protection of environment. Because of the gap between the private valuation of the benefits of such services and their true value to society, normal market mechanisms do not adequately ensure an appropriate spread of such services. In such cases, subsidies provide the necessary corrective.

4.2 The general impact of a subsidy is to lower the price of a commodity or service since the government bears the extra cost. The government could provide subsidy to the consumer or the producer or it could provide a service subsidy on the inputs going in to the production of a commodity. In turn, such subsidies lead to lowering of the prices of goods or inputs, encourage greater production and consumption of the commodity.

4.3 According to a discussion paper presented by the government to Parliament in May 1997, subsidies administered to final consumption would be more effective since they can accrue to the target beneficiaries directly. Input subsidies, on the other hand, are prone to be easily dissipated to the non-target population thereby losing their effectiveness. It is, for instance, difficult to target input subsidies in fertilisers, electricity, diesel, irrigation, etc. to the right beneficiary. Further, even where subsidies are on final consumption such as food subsidy, targeting remains poor, and leakages are extensive, as brought out by the CAG's Report no 3 of 2000 on the Union government. Leakages as well as poor design of a subsidy regime tends to make it difficult to ensure equity objectives as well.

Implicit subsidies add to the non-transparency of budgets.

4.4 From a fiscal point of view, there is yet another difficulty. The annual financial statements state only a small part of the subsidies in an explicit manner. Substantial subsidies remain hidden in the budgeted expenditures,

implicit in the provision for social and economic services. This poses a major problem in their analysis. Being hidden, Parliament does not get to fully debate and monitor expenditure on subsidies. Resultantly, subsidies have easily tended to grow out of control.

Explicit Subsidies

Food and fertilizer subsidies hide inefficiencies. These have defied correction in spite of budget promises.

4.5 Table 4.1 presents a view of the subsidies, which the government provided explicitly during the last ten years on major items.

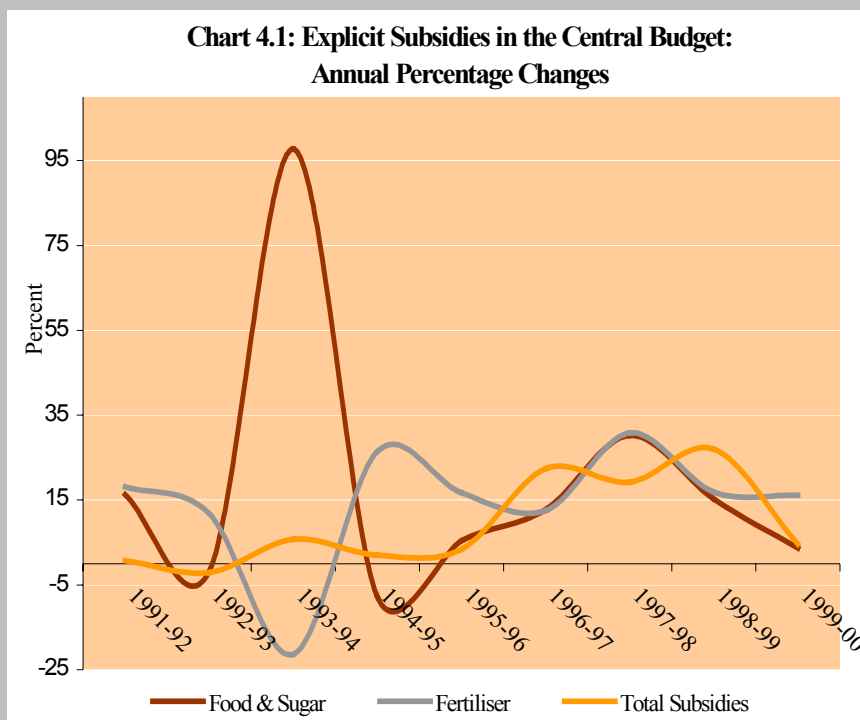


Chart 4.1 depicts annual percentage changes in the explicit subsidies in the central budget. The food subsidy including that for sugar shows a sharp rise in 1993-94. The growth rate fell thereafter, but has since been increasing up to 1997-98. Fertiliser subsidy exhibits fluctuations in annual growth rates which have been in the range of -21 to 30 percent in the late nineties.

Table 4.1: Explicit Subsidies in the Union Government Budget

Rs in crore

Year	Food*	Sugar	Indigenous (Urea) Fertiliser	Imported (Urea) Fertiliser	Fertiliser subsidy to small and marginal farmers	Export promotion and Market Development
1990-91	2450		3730	659		2742
1991-92	2850		3500	1300	385	1758
1992-93	2800		4800	996		818
1993-94	5537		3800	762		665
1994-95	5100		4075	1166		658
1995-96	5377		4300	1935		318
1996-97	6066		4743	1163		397
1997-98	7500	400	6600	722		429
1998-99	8700	400	7473	333		573
1999-00	9200	235	8670	293		520
TGR	16.34		9.66	-15.78		-15.77

Year	Sale of decontrolled Fertiliser with concessions to farmers	Debt Relief to Farmers	Interest Subsidies	Other Subsidies	Total	Total as % to GDP
1990-91		1502	379	696	12158	2.14
1991-92		1425	316	719	12253	1.88
1992-93		1500	113	968	11995	1.60
1993-94		500	113	1305	12682	1.48
1994-95	528	341	76	988	12932	1.28
1995-96	500		34	908	13372	1.13
1996-97	1672		1222	1101	16364	1.20
1997-98	2596		78	1180	19505	1.29
1998-99	3790		1434	2065	24786	1.41
1999-00	4500		1371	1120	25909	1.31
TGR	63.61		17.62	7.53	9.45	

Source : Expenditure Budget (Vol. 1) 2000-2001 upto 1998-99, for 1999-00 from Appropriation accounts.
Note: The TGR for sale of decontrolled fertiliser with concessions to farmers refers to period 1994-95 to 1999-00.

* Includes sugar subsidies up to 1996-97

4.6 Food and fertiliser subsidies have consistently grown among the explicit subsidies of the Union government. As can be seen from the table, food and fertiliser subsidies together accounted for Rs. 22898 crore in 1999-00, which amounted to 1.17 percent of the GDP at current prices.

4.7 The CAG's Reports no. 2 and 3 of 2000 describe in detail as to how both fertiliser and food subsidies hide inefficiencies. In the case of food subsidy, the economic cost has gone up at a very fast pace because of increased operational cost of the Food Corporation of India for storing, handling and transporting foodgrains. In the case of fertiliser subsidy, the system of retention prices ensures a common rate of return on capital whether the producer/plant is old or new, efficient or not efficient. The government needs to consider redesigning these subsidies.

Implicit subsidies

4.8 In addition to the above subsidies, explicitly provided in the budget, the Union government also bears expenditures, which are in the nature of implicit subsidies. Implicit subsidies arise when the government is unable to recover the costs it incurs in the provision of social and economic goods/services, which are mainly private goods/services in nature, even though sometimes these may have extended benefits. Some of these implicit subsidies are discussed below in an illustrative manner.

Budgetary Support to Nationalised Banks

4.9 The government provided budgetary support to nationalised banks to increase their share capital. The government arranged with the nationalised banks that they reinvested an equal amount in government securities, to make the government's additional capitalisation of the banks budget-neutral. Although the move was intended to restore the PSE Banks to better financial health, to the extent the dividends received by the government fell short of the interest (10%) it paid to the banks on the government securities, this step was tantamount to giving implicit subsidy to the nationalised banks. Table 4.2 presents the position of dividends received from the banks and interest paid to them on securities during the last ten years by the government, and focuses on the implicit subsidy given to the nationalised banks as a group on a yearly basis.

Table 4.2: Subsidy to Nationalised Banks

Rs in crore

Year	Total cumulative investment	Dividend received	Interest Paid by the government on reinvestment of share capital	Implicit subsidy to nationalised banks (Col. 4 - 3)
(1)	(2)	(3)	(4)	(5)
1990-91	2861	51	68	17
1991-92	2979	55	170	115
1992-93	3740	81	210	129
1993-94	9465	4	328	324
1994-95	14754	14	632	618
1995-96	13674	104	1342	1238
1996-97	13146	210	1408	1198
1997-98	15846	315	1538	1223
1998-99	13673	384	1278	894
1999-00	13376	395	1824	1429

There has been implicit subsidisation of state co-operatives and other non-nationalised banks.

4.10 The Union government received a total dividend of Rs. 44 crore, on its investment of Rs. 2451 crore in state co-operative banks and other banks (excluding nationalised banks, Industrial Development Bank and Reserve Bank) in 1999-00. This amounted to 1.78 percent as compared to 1.85 percent in 1998-99. National Bank for Agriculture and Rural Development (NABARD) in which the government had invested Rs. 550 crore up to 1999-00, did not pay any dividend. Further, Union government's total up to date investment in regional rural banks as on 31 March 2000 stood at Rs. 1192.22 crore.

Regional rural banks, too, have been subsidised by the government.

4.11 To strengthen the capital base of regional rural banks, Union government has been releasing capital through budgetary allocations. Capital invested by the government in regional rural banks during the last seven years is given in Table 4.3. Despite large investment in regional rural banks, no dividend accrued to the government since their inception.

Table 4.3: Recapitalisation Assistance to Regional Rural Banks

Rs in crore

Year	Investment during the year	Up-to-date total investment	Dividend received
1990-91	5.25	54.00	
1991-92	10.38	64.38	
1992-93	4.38	68.76	
1993-94	3.25	72.01	
1994-95	154.59	227.00	
1995-96	244.57	471.57	<u>Nil</u>
1996-97	200.00	671.57	
1997-98	200.00	871.57	
1998-99	152.65	1024.22	
1999-00	168.00	1192.22	

Subsidies to PSUs and Statutory Corporations

The return on PSU investments is dismally low, implying large implicit subsidisation.

4.12 Table 4.4 presents the trend of investment made in the PSUs and statutory corporations for the last ten years, which would show even larger implicit subsidisation. The government needs to consider how long can it carry such a huge burden on its overly constrained fiscal resources.

Table 4.4: Subsidies to PSUs and Statutory Corporations

Rs in crore

Year	*Total cumulative investment	Dividend received	% of dividend to investment	Effective rate of interest	** Implicit subsidy
1990-91	33449	301	0.90	8.02	2381.61
1991-92	37135	367	0.99	8.46	2774.62
1992-93	40121	592	1.48	8.76	2922.60
1993-94	41858	633	1.51	9.14	3192.82
1994-95	44116	824	1.87	9.22	3243.50
1995-96	47071	1216	2.58	9.29	3156.90
1996-97	49737	1577	3.17	9.81	3302.20
1997-98	53194	1820	3.42	9.71	3345.14
1998-99	57120	2384	4.17	10.01	3333.71
1999-00	60099	3973	6.61	10.61	2403.50

Excludes investment in LIC and GIC.

* Total investment refers to the beginning of the year.

** Estimated using the effective interest rate as the opportunity cost

Subsidy on Postal Services

Postal services are highly subsidised in an implicit manner.

4.13 Department of Posts provides traditional services to the consumers, which are another instance of implicit subsidisation. The CAG's Audit Report no. 6 on Post & Telecommunications has brought this fact in to focus regularly. Table 4.5 presents the average per unit cost and per unit revenue realised from the different postal services during the year 1999-00, which shows that the government subsidised postal services during 1999-00 by Rs 991.06 crore.

Table 4.5: Per Unit Gain/Loss in Operation of Postal Services

Sl. No.	Per Unit Cost (in paise)	Per Unit Revenue (in paise)	Unit Loss(-)/ Gain (+) (in paise)	Traffic Projected (in crore)	Total Loss/Gain (Rs. in crore)	
					Loss	Gain
(a) Classical Services						
1	Post card	452.81	25.00	(-) 427.81	42.52	181.9
2	Letter	520.22	534.65	(+) 14.43	116.63	16.83
3	Registered letter	2691.12	1366.67	(-) 1324.45	27.97	370.45
4	Letter card (inland)	448.84	191.67	(-) 257.17	56.99	146.56
5	Money order	3623.06	1827.14	(-) 1795.92	10.99	197.37
6	Newspaper (Single)	588.48	26.45	(-) 562.03	11.07	62.22
7	Newspaper (Bundle)	1139.47	66.47	(-) 1073.00	3.39	36.37
8	Indian Postal Order	1545.77	205.60	(-) 1340.17	2.58	34.58
9	Printed Card	453.01	191.67	(-) 261.34	14.81	38.7
10	Value payable letter and parcel	2230.58	452.94	(-) 1777.64	1.07	19.02
11	Other periodicals	1259.19	700.88	(-) 558.31	3.34	18.65
12	Acknowledgement	410.86	200.00	(-) 210.86	6.29	13.26
13	Book packets etc.	705.00	891.90	(+) 186.9	9.81	18.33
14	Telegraphic MO	4269.32	2027.14	(-) 2242.18	0.25	5.61
15	Printed books	1262.87	242.91	(-) 1019.96	4.55	46.41
16	Insured letter	3843.67	7882.46	(+) 4038.79	0.99	39.98
17	Parcel	4492.26	4504.98	(+) 12.72	6.29	0.8
18	Comp. Post card	463.35	383.33	(-) 80.02	0.54	0.43
(b) Value Added Services						
1	Speed post	2855.74	5513.00	(+) 2657.26	1.27	33.75
2	Foreign mail	1023.48	1640.55	(+) 617.07	11.47	70.78
Total					1171.53	180.47
Total subsidy= Rs 1171.53 – 180.47 = Rs 991.06 crore						

The government needs to activate follow up action on its 1997 discussion paper on subsidies.

4.14 The government had brought a Discussion Paper in May 1997 on the subject, which had made the following important suggestions:

- (a) Reducing the overall scale of subsidies.
- (b) Making subsidies as transparent as possible (and duly reflected in the budget of the government).
- (c) Using subsidies for well-defined economic objectives.
- (d) Focussing subsidies to final goods and services with a view to maximising their impact on the target population at minimum cost.
- (e) Instituting systems for periodic review of subsidies.
- (f) Setting clear limits on duration of any new subsidy schemes.

4.15 The government needs to activate further follow up action on the above points brought out by in its discussion paper. The government must consider appropriate revision of user charges in the areas of education, agriculture, irrigation, industries, power and transport, railways, etc so that the distortions in the economy because of misadministration of subsidies is contained, and fiscal resources are released for general socio-economic development.