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SUBSIDY: THE MEANS TO OVERCOME THE FINANCIAL CRUNCH

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ABSTRACT

The word subsidy is derived from the Latin word subsidium, meaning "troops stationed in reserve", and literally implies 'coming to assistance from behind' Subsidy means grants. This grant may be in the form of either cash or kind and is generally given to promote an economic policy or social policy. Subsidy leads to the fall in the price of the subsidised product. Lower price of the product increases the demand of the subsidised product and hence affect the market. Subsidies are one of the quintessential attributes of any welfare state. The subsidy is given to fulfil the objectives to promote social welfare through food subsidy, subsidizing electric vehicles, solar equipments, education loans, kerosene, oil subsidy etc., to encourage economic activity by inducing higher consumption as well as production, Offsetting market imperfection, achievement of social policy objectives including redistribution of income, population control etc., to promote eco-friendly technologies like solar energy, electric vehicles which may not be able to create its market due to higher upfront cost and competition.

INTRODUCTION

A subsidy or government incentive is a form of financial aid or support extended to an economic sector (business, or individual) generally with the aim of promoting economic and social policy. Although commonly extended from the government, the term subsidy can relate to any type of support – for example from NGOs or as implicit subsidies. Subsidies come in various forms including: direct (cash grants, interest-free loans) and indirect (tax breaks, insurance, low-interest loans, accelerated depreciation, rent rebates).

Furthermore, they can be broad or narrow, legal or illegal, ethical or unethical. The most common forms of subsidies are those to the producer or the consumer. Producer or production subsidies ensure producers are better off by either supplying market price support, direct support, or payments to factors of production. Consumer/consumption subsidies commonly reduce the price of goods and services to the consumer. For example, in the US at one time it was cheaper to buy gasoline than bottled water.

Subsidy can be administered through various modes i.e.

1. Subsidy to producer
2. Subsidy to consumer
3. Subsidy to producers of inputs
4. Providing incentives instead of subsidizing
5. Production or sales through Public enterprises.
6. Cross subsidization, i.e. charging higher price to one group of consumer to subsidize lower price of another group.

Subsidy leads to various economic effects which can be grouped into

1. Allocative Effect: These relate to the sectorial effect of subsidy. A subsidy helps in increasing the resource allocation in the subsidized sector. For example, subsidies provided to solar

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equipment can create market for solar goods and subsequently higher demand can see new investment from private sector.

2. Fiscal Effect: Subsidies are the fiscal policy instrument and they have fiscal effects. They directly increases fiscal deficit. Subsidies can also indirectly affect the budget adversely by drawing resources away from tax- yielding sectors towards sector that have a low tax- revenue.
3. Trade Effect: Subsidy to domestic producers may enable them to offer competitive price in global market and can lead to import substitution of such goods or it may even increase export. On the other side, subsidies given in foreign country can substantially lower the market price of good in importing country thereby stimulating imports.

TYPES OF SUBSIDY

1. Direct Subsidy: Whenever a subsidy takes the form of a cash payment or grant to a recipient, it is typically considered as Direct Subsidy. E.g. Direct farm subsidies are the kind of subsidies given to farmers in which direct cash incentives are given to farmers in order to make their products competitive in the global market. Other example of direct subsidy is subsidy on LPG cylinder in which subsidized money is transferred to beneficiary's bank account. Direct subsidies are very important as they provide direct purchasing capacity to the farmers, thereby having multiplier effect in enabling farmers to invest in agriculture and eventually increasing their standard of living.

2. Indirect Subsidy: Any non-cash benefit that a recipient receives that helps it operate or compete is typically considered an indirect subsidy. For example, a government bailout of the automobile industry is a direct subsidy, while passing a law easing emission standards that has the related benefit of making it cheaper for car companies to manufacture cars is an indirect subsidy. Indirect subsidies are provided in terms of tax breaks, insurance, low-interest loans, depreciation write-offs, rent rebates. For example- Indirect farm subsidies: These are the farm subsidies which are provided in the form of cheaper credit facilities, farm loan waivers, reduction in irrigation and electricity bills, fertilizers, seeds and pesticides subsidy as well as the investments in agricultural research, environmental assistance, farmer training etc.

AGRICULTURE SUBSIDY IN INDIA

Subsidies on agriculture input have their root in Green Revolution. That time input subsidies were given on Hybrid seeds, fertilizers, pesticides, etc. Main aim of agriculture subsidies are:-

1. To keep cost of the food grains minimum and avoiding food inflation.
2. To ensure the income security of the farmers.
3. To achieve objective of food and nutritional security.

Agriculture subsidies can be granted through distribution of inputs at prices that are less than the standard market price for these inputs. The magnitude of subsidies will therefore be equal to the difference between the two prices for per unit of input distributed. Naturally several varieties of subsidies can be named in this category.

FERTILIZER SUBSIDY

The need for fertilizer subsidy arises from the nature of the fertilizer policy of the government of India. This policy has been governed by the two objectives: 1. Making fertilizers available to the farmer at low and affordable prices. 2. Ensuring fair returns on investment to attract more capital to the fertilizer industry. To fulfill above mentioned objectives farmer gets fertilizers at predetermined low rate called Maximum selling price. The manufacturer is paid an amount, called the Retention price. The difference

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between retention price and selling price is subsidy paid by the government. Fertilizers subsidies are granted by the central government and fertilizers account for large fiscal subsidies (0.73 lakh crore) or 0.5% of GDP, the second highest after food. Only 17,500 crore or 35% of the total fertilizers subsidies reaches to small farmers.

IRRIGATION SUBSIDY

Irrigation subsidy arises because of the neglect of rational pricing for canal water. Irrigation subsidy is the difference between operating and maintenance cost of irrigation infrastructure in the state and irrigation charges recovered from farmers. This may work through provisions of public goods such as canals, dams which the government constructs and charges low prices or no prices at all for their use from the farmers. Irrigation subsidies is provided by the different state governments in India

POWER SUBSIDY

Power subsidy is granted on power that is used to draw groundwater. Accordingly it is a subsidy to privately drawing and privately-owned means of irrigation. Power subsidy is the difference between the price paid by the farmer for the usage of electricity and the actual cost of generating the electricity. Power Subsidy in India is granted by the state governments.

SEED SUBSIDY

Seed subsidy is granted through the distribution of quality seeds at a price that is less than the market price of the seeds. Many schemes such Rashtriya Krishi Vikas Yojana, Macro Management Agriculture, Integrated Scheme for oilseeds, pulses, oil palm and maize (ISOPOM); Technology missions for cotton, National food security Mission etc. provide for subsidized seeds. Some of them also provide incentives for investment in seed manufacturing infrastructure and up gradations.

CREDIT SUBSIDY

Agriculture credit is considered as one of the most basic inputs for all economic developmental activities. In order to provide credit to farmer's government provides credit subsidy. Under credit subsidy farmers are provided credit at concessional rate of interest.

NEGATIVE IMPACT OF SUBSIDIES

Subsidies do have benefits as they reduce cost of essential goods and services making them affordable to poor but they also have following negative impacts

1. Increasing subsidy amount leads to increase in revenue deficit and also creates fiscal imbalance.
2. Neglect of market based pricing mechanism sometimes causes wastage of resources e.g. Power is available to farmers at through away prices and therefore it is not used mindfully causing wastage of electricity and water.
3. Subsidies are also leading to environmental degradations: Free electricity to farmers has caused problem of overexploitation of groundwater. Similarly, it has distorted ideal NPK proportion because of fertilizer subsidies.
4. MSP is not market linked and do not reflect demand supply of market. It creates huge fluctuation in prices and unnecessary burden on state exchequer.
5. Subsidies are prone to leakages and misuse. Their benefits are siphoned off by rich and those who do not require them.

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6. Credit subsidies and loan waiver has contributed to bigger problem of Non-Performing Assets. Loan waiver disrupts credit discipline. Farmers may turn into willful defaulters as they wait for the next loan waiver scheme, which is bad for economy.

NUTRITION BASED SUBSIDY

Nutrient Based Subsidy (NBS) programme for fertilizer was initiated in the year 2010. Under the scheme, a fixed amount of subsidy decided on an annual basis is provided on each grade of subsidized Phosphatic and Potassic (P&K) fertilizers, except for Urea, based on the nutrient content present in them. It is largely for secondary nutrients like N, P, S and K and micronutrients which are very important for crop growth and development. The scheme is being implemented by the Department of Fertilizers. At present 22 grades of P&K fertilizers namely DAP, MAP, TSP, MOP, Ammonium Sulphate, SSP and 16 grades of NPKs complex fertilizers are covered under the NBS Policy. These fertilizers are provided to the farmers at the subsidized rates based on the nutrients (N, P, K & S) contained in these fertilizers. Additional subsidy is also provided on the fertilizers fortified with secondary and micronutrients as per the Fertilizer Control Order such as Boron and zinc. Under the NBS regime, MRP of P&K fertilizers has been left open and fertilizer manufacturers and marketers are allowed to fix the Maximum Retail Price at reasonable rates. Under this scheme, Maximum Retail Price of fertilizers has been left open and manufacturers and marketers are allowed to fix the Maximum Retail Price at reasonable rate.

DRAWBACKS OF NBS

- Urea is not covered under the scheme
- Delay in NBS subsidy payments. Hence, Fertilizer companies focus more on Urea than other fertilizers
- Increase in prices of Phosphoric and Potassic fertilizers
- Farmers overuse Urea. Hence, the ideal ratio of NPK is disrupted

Comptroller and Auditor General (CAG) in his report slams government on the following grounds:

1. By not fixing the benchmark price at a reasonable level for import of DAP (diammonium phosphate) fertilizer, which delayed finalization of contracts between international suppliers and domestic fertilizer companies, the government lost an opportunity to save a subsidy of Rs. 5,555 crore in 2010-11
2. There was no monitoring mechanism in the department of fertilizers to ensure prices fixed by fertilizer companies were based on their cost of production and that these were reasonable
3. The CAG report said there was no clear roadmap in the Department of Fertilizers to achieve the NBS objectives and the policy did not succeed in checking the imbalanced use of fertilizers.

DIRECT BENEFIT TRANSFER IN FERTILIZERS

Direct Benefit Transfer in fertilizer is a modified payment of subsidy in which the fertilizer companies are paid subsidy only after the retailer has sold the fertilizer to the farmer. The buyer identity is authenticated using a point of sale machine through Aadhaar authentication. An amount of Rs 70,000 crore has been sanctioned annually to distribute fertilizer subsidies. Seven small states and union territories were targeted initially with 11 big states also setting themselves ready for the implementation of the scheme.

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MERITS OF DIRECT BENEFIT TRANSFER IN FERTILIZERS

- Reduces leakages due to diversions and cross border smuggling.
- The point of sales machine generates a receipt which provides information about the money to be paid by the farmer. This protects the farmers from the overcharging by retailers by providing transparency about the price.
- Reduction of subsidy burden on the exchequer
- Based on NITI Aayog findings: 85% of farmers received transaction receipts and the grievance redressal mechanism has improved and 79% retailers are satisfied. A majority of farmers and retailers prefer the DBT system.
- Once the system functions fully, it will lead to better soil health management, balanced fertilization, and better productivity.

DEMERITS OF DBT IN FERTILIZERS

- DBT Introduction in the fertilizer sector seems a gigantic task as the beneficiaries and their entitlements are not clearly defined at present.
- Different inputs – urea, phosphatic and potassic fertilizers – have different rates of subsidies. Besides, it would be premature to accept that all the farmers would be able to buy their requirements of fertilizers at market rate and wait for 15 days or a month to get the subsidies.
- For farmers, there is no change in the system when DBT is rolled out except that the purchase will be recorded in a Point of sale machine. For retailers too, there is not much change, except that they have to upload data.
- An important issue has been connectivity, like other IT-based initiatives, especially in rural areas. Developing the systems and sensitizing all stakeholders to migrate to the new system was an arduous task.
- A major concern is of some dealer attrition, which is probably on account of declining margins and reduced possibility of diversion or sale at a higher price.

CHALLENGES IN IMPLEMENTING DBT IN FERTILIZER

- Connectivity issue is major hurdle in rural India but the Digital India mission has potential to overcome that.
- Dealers attrition because of reduction in margin should be dealt with priority as their distress will hamper the transfer.
- Generating awareness about this system and sensitizsing the stakeholders.
- To bring the farmers from financial stress to financially stable state and to double their income, farm subsidies effective penetration is must. So utmost care should be taken here.

Despite the huge impact of subsidies on the life of poor, there has always been a pertinent question whether amount of subsidy is reaching to worthy people? There was issue of "inclusion and exclusion error." In order to solve the issue of leakage government came with JAM TRINITY and BAPU.

JAM TRINITY

JAM trinity refers to - J-Jan Dhan Account Opening A- Aadhaar, a unique number to identify everybody with biometric details. M-Mobile phone number. Any customer applying for a bank account under the

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Pradhan Mantri Jan Dhan Yojana should provide Aadhaar number as identity proof. The applicant has to produce his mobile number for the Aadhaar enrolment in the account. This is the way of linking Trinity. Once the linking is complete, the customer will be identified by Aadhaar number. JAM has the following components: Economic Survey divides JAM into three components

1. Identification or First-Mile: Identification of beneficiaries by government. First-mile deals with identification of beneficiary. This layer has issues of ghost and duplicate names due to administrative and political discretion and use of pre aadhaar database. Aadhaar can help in better identification of the beneficiaries.
2. Transfer or Middle-Mile: Transfer of fund to beneficiaries by government. Middle-mile deals with the challenges of payment where government transfer benefits to the banks. But lack of bank accounts and its information with government put hindrances in the middle-layer connectivity. Jan Dhan can help beneficiaries to have bank accounts. Jan Dhan can help beneficiaries to have bank accounts.
3. Access or Last-Mile: Access of fund by beneficiaries. Last-mile layer faces issues of lesser Bank penetration, mostly in rural areas. It deals with actual transfer of money from bank to beneficiary accounts. It also deal with issues of exclusion of genuine beneficiaries. Mobile can inform about benefits and also allow easier fund transfer.

BENEFIT OF JAM

- JAM can effectively cut the leakage in the subsidy by enabling Direct Benefit Transfer to the beneficiary.
- JAM will lead to unique identification of beneficiary thus eliminating the problems of "inclusion error."
- JAM trinity is creating an atmosphere for enabling DBT and will also help in direct delivery of various government schemes like scholarship for students, Janani Suraksha Yojana, old age pension etc.

BAPU (BIOMETRICALLY AUTHENTICATED PHYSICAL UPTAKE)

BAPU is short term measure of solution to reduce leakages. Under BAPU model, beneficiaries certify their identity through scanning their thumbprint on a Point on sale (POS) machine while buying the subsidized product – say kerosene at the PDS shop. This reduces leakages considerably. Presently, the JAM agenda is facing the last-mile challenge of getting money from banks into beneficiaries' hands, especially in rural India. Until banking correspondent network develops and mobile phone connectivity spreads, BAPU model can solve the problem of leakage without the risk of exclusion.

WTO AND SUBSIDIES

WTO's agreement on agriculture was concluded in 1994, and was aimed to remove trade barriers and to promote transparent market access and integration of global markets. Agreement is highly complicated and controversial; it is often criticized as a tool in hands of developed countries to exploit weak countries. Agreement on Agriculture (AoA) stands on 3 pillars, viz.

1. **Domestic Support**: Under this agreement, the countries have to comply with reduction commitments such as to limit their Total Aggregate Measure of Support (AMS) within specified limits. The developed countries have to limit their domestic support (covered under amber box subsidies) within 5% and developing countries to limit within 10% of total agriculture production. The de minimis level or domestic support subsidies of total agriculture production to be calculated from base year 1986 –1988. The domestic support subsidies are categorized into three boxes that

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are as follows: • Green Box: These are subsidies which causes no or little trade distortion in agriculture sector. They tend to be programs that are not targeted at particular products and not include direct income supports for farmers. Examples of such subsidies include those given on research funding; environment protection; domestic food aid; disaster relief; farmer training programs etc. "Green box" subsidies are therefore allowed without limits • Blue Box: It includes subsidies that are linked to one product, but that do not increase according to production levels. At present there are no limits on spending on blue box subsidies. • Amber Box: It contains all domestic support measures that are mean to distort trade practices in agriculture. All these types of supports are subject to limits which are termed as 'de minimis' levels. Examples of such subsidies include input subsidies such as seed, irrigation, power, fertilizers, minimum support price etc.

2. **Market Access:** The Market Access requires that all non- tariff barriers such as Quotas be either abolished or converted into Tariffs. Thus this agreement seeks to end the quantitative restrictions on imports for agriculture products. As for as the maximum limit of tariff is concerned no country is permitted to impose tariff beyond a certain limit. Accordingly:

   - All industrialised countries are to reduce tariff by 36 % within six years
   - For individual agriculture tariff has to be reduced by at least 15%
   - Developing countries like India have to reduce tariff by 24% within 10 years.

3. **Export Subsidy:** The developed countries were to reduce the value of direct export subsidies by 36% over a period of six years and in volume terms by 21%. The base period for these cuts is 1986-90 or 1991- 92 if exports were higher in that period. Over the same period developed countries have to reduce the value of direct export subsidy by 24 % and in volume by 10%

   India's Food Security programs and Minimum Support Price is often criticized on the ground of exceeding subsidy limit of 10% under Agreement on Agriculture of WTO. India has following arguments in defending her food programs: 1. In 1986 USA agriculture production was far ahead of India. So their 5% De-minimis quota is far bigger than India's 10% quota (in absolute figure) 2. Input cost have skyrocketed in these decades. But, De-minimis does not consider inflation factor. 3. The subsidised food grains are meant for feeding the poor only, not to distort the international trade. 4. Every country has different requirements and different product mix, so enough flexibility is must in any agreement. 5. Further right to food is a global movement and is guaranteed by numerous UN Convention. So, ensuring food security is a domestic concern of a nation, International community can just advice but cannot coerce other sovereign nation.

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