IV Reforming Central Subsidies

A comprehensive reform of the subsidy regime in India is urgently called for. Although, as DP had revealed, states are responsible for a major portion of budgetary subsidies, a lead must come from the central government in this direction. In this chapter, we consider a policy framework for reducing central budgetary subsidies.

Reducing Central Budgetary Subsidies: A Policy Framework

The earlier DP had outlined some general directions for subsidy reforms by asking for (i) reduction in the overall scale of subsidies; (ii) making subsidies as transparent as possible; (iii) using subsidies for well-defined objectives; (iv) focusing subsidies to final goods and services with a view to maximising their impact on the target population at minimum cost; (v) instituting systems for a periodic review of subsidies; and (vi) setting clear limits on the duration of any new subsidy schemes. Subsidy reduction can be approached through four directions, *viz.*: (i) reducing government participation in the provision of a service; (ii) improving targeting; (iii) increasing recoveries; and (iv) reducing inefficiency, and thereby reducing per unit cost.

Reducing Governmental Participation: Where subsidy reduction is to be based on a reduction of budgetary support, we need to identify sectors/services/goods where participation of the government is required to a lesser extent than the current levels. Many of the economic services would fall in this category.

Improving Targeting: By improving targeting, the volume of subsidies would automatically go down as unwarranted subsidies are withdrawn from the segment of population which does not merit subsidies.

Increasing Cost Recoveries: Cases where service levels are to be maintained (or increased), subsidy reduction needs to be approached basically from the side of revenues. Many social sector services and economic services where matters cannot be left to private initiative alone would fall in this category.

Reducing Inefficiencies: Overstaffing, wasteful use of inputs like electricity, water, petroleum in the government sector, costly delays in the completion of projects, are obvious avenues where costs can be reduced. As both the tax and subsidy regimes are reformed, costs will go down in the economy as a whole, as also in the government sector, owing to the removal of allocative distortions.

In order to work out a concrete plan for reducing the extent and degree of subsidisation, it would be useful to fix recovery targets in three phases: (i) short term (for the year 2000–01); (ii) medium term (in a period of five years); and (iii) long term (ten to fifteen years). The long term targets would need to be determined on the basis of desired or optimum degrees of subsidisation. The short term targets can be more modest, keeping in mind the relative priorities, and considerations and feasibility. Some of the ways and means of achieving these targets are listed below.

Operationalising the Strategy of Subsidy Reduction

- Each department/ministry/enterprise providing a chargeable service, should prepare an index (or indices) of per unit cost and per unit receipts;
- Each unit should announce when the relevant user prices were revised last;
- Each unit should prepare a plan for reducing staff strength, by putting in place: (i) an attractive VRS; (ii) limit on fresh recruitment; and (iii) a scheme for redeployment of staff;
- Strategies of private provision of publicly provided private goods by sub contracting, unbundling of public sector activities, and privatisation should be explored;
- Mechanism for automatic (or linked to an index of cost) upward revision of fees and user charges should be introduced; and
- No new public enterprises should be set up.

Using the 1996-97 data, the potential for additional recoveries, has been worked out for the short term and medium term. In fixing the targets, a distinction has been made between provision of direct services and investment. The targets have been determined at the disaggregated level of services (minor or sub-minor heads). Targets for direct services are lower than that for investment. In fixing the targets, a distinction has been made between the three categories of services. For *Merit 1* services, recovery target of 5 percent in the short run and 10 percent in the medium-term with respect to current cost has been set. For *Merit 2* services, a short-term target has been set for recovering 30 and 40 percent of current costs, respectively, for the social services, and economic services, and for the medium-term, targets of 50 and 70 percent respectively for the social and economic services, have been set. In certain cases (where recoveries are already higher than these targets), higher targets have been specified (details in endnote 5). For *Non-Merit* services, a short term target of recovering 70 percent of current costs in the short run, and 90 percent in the medium term for both services are provided. Examining the structure of the present recovery rates, in the case of selected services, somewhat higher targets have been set (endnote 5). For returns on investment covering both equity investment and loans, the following short and medium-term targets (as percentage of average cost of borrowing funds) have been set: *Merit 1* (40 and 60), *Merit 2* (50 and 70), and *Non-Merit* (60 and 90) percent. With reference to the 1996–97 figures, in the short-term, additional recoveries of about Rs. 15,000 crore can be achieved. In the medium-term this can be increased to nearly Rs. 27,000 crore. By applying the ratio of aggregate revenue expenditure to different subsidy aggregates in 1996-97 to the budgeted revenue expenditure in 1999–2000, we estimate that the additional revenue in terms of short term targets would be about Rs. 22,200 crore and, in the medium-term, about Rs. 40,600 crore for the current year (1999–2000).

TABLE 6:
Additional Annual Recoveries: Short and Medium-Term Targets

(Rs. crore)

	Additional Recoveries at 1996-97 Prices					
	Short Term			Medium Term		
	Direct Services	Invest -ment	Total	Direct Services	Invest -ment	Total
Social and Economic Services	**13398.9**	**1633.3**	**15033.0**	**24310.2**	**2490.2**	**26801.3**
Social Services	**1827.3**	**58.4**	**1886.4**	**3108.1**	**79.3**	**3188.2**
Education, Sports, Art and Culture	476.9	1.2	478.2	812.9	1.6	814.5
Health and Family Welfare	271.9	1.5	273.4	378.3	2.0	380.3
Housing and Urban Development	454.8	23.6	479.2	839.2	32.9	873.1
Information and Broadcasting	415.7	0.0	415.7	767.1	0.0	767.1
Other Social Services	208.0	32.1	240.1	310.5	42.7	353.3
Economic Services	**11571.6**	**1575.0**	**13146.6**	**21202.1**	**2411.0**	**23613.1**
Agriculture and Allied Activities	4331.1	110.3	4441.4	7726.2	227.6	7953.8
Rural Development	247.5	0.0	247.5	433.3	0.0	433.3
Irrigation and Flood Control	90.9	2.8	93.7	166.2	4.1	170.3
Energy	470.3	700.1	1170.4	303.7	1159.9	1463.6
Industry and Minerals	1725.2	504.6	2229.8	2485.4	783.9	3269.3
Transport (excluding Railways)	224.0	256.6	480.5	318.8	343.3	662.0
Postal Services and Satellite Systems	535.1	0.0	535.1	732.9	0.0	732.9

Source (basic data): As in table 2.

In this discussion, only central budgetary subsidies were considered. Nearly 69 percent of the budgetary subsidies, however, emanate from the state budgets. Further, most of the state level subsidies are hidden subsidies. It is important, therefore, that state level subsidy reforms be constructed based on state-specific studies that identify and unearth the hidden subsidies, trace the history of fees, charges, and user prices, and construct a plan for reforming the subsidy regime. Such a series of studies, possibly categorised as *Merit 2*, may even be subsidised.