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Target, Transform, Transition: A Roadmap for Smarter Subsidies in India

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***Abstract*— India's subsidy framework is essential for providing social security and aiding vulnerable groups. Nonetheless, challenges such as inefficiencies, fiscal pressures, and leakages diminish its overall impact. This paper advocates for a streamlined subsidy system focused on Direct Benefit Transfers (DBT), dynamic targeting, and technology-enhanced monitoring. Embracing sustainable methods, behavioral incentives, and crop diversification can help decrease long-term reliance while fostering environmental sustainability. Public-Private Partnerships (PPPs) and the encouragement of agri-startups present innovative alternatives to general subsidies by introducing market-oriented solutions. By aligning subsidies with principles of efficiency, equity, and sustainability, India can develop a more robust welfare system that guarantees fiscal responsibility and supports long-term growth.**

***Index Terms*: Subsidy Rationalization; Direct Benefit Transfer (DBT); Targeted Welfare**

I. Introduction

Contemporary literature describes a subsidy as financial support provided by the government or public entities to reduce prices. A subsidy is frequently seen as the opposite of a tax. It originates from the Latin term ‘Subsidium,’ which means assistance from behind.

In the field of economics, a subsidy represents a type of financial aid given to a business or household sector. When a loan is subsidized, the borrower is not required to pay interest while repaying the loan. Subsidies can be employed to support businesses that might otherwise fail or to promote activities that would not otherwise occur.

Subsidies can be classified as a form of protectionism or trade barrier, as they help domestic goods and services become more competitive against imports. They may also distort market conditions and incur significant economic costs. While financial support in the form of a subsidy often comes from the government, the term may also refer to assistance provided by other entities, including individuals.

A subsidy consists of a monetary grant from the government to either a seller or a buyer of a specific product or service, thereby altering the price or cost in a manner that influences output. Essentially, it is a payment that decreases the buyer’s price below the cost, functioning as a negative tax, with the subsidy amount being the difference between the two. The impact of a subsidy on the quantity produced and consumed contrasts with that of a tax—the quantity is likely to rise. Similar to a tax, the advantages of a subsidy are distributed between buyers and sellers, depending on the relative elasticities of supply and demand, to illustrate the benefits received by both parties.

A direct cash payment to producers or consumers is a straightforward example of a subsidy. However, it can also take numerous less visible forms. For instance, it might be concealed within reduced tax obligations, low-interest government loans, or government equity participation. If the government purchases goods, such as food grains, at prices higher than the market rate, or sells them at lower than market rates, subsidies are implicitly involved.

I.1 . Subsidies in India

India's subsidy framework has seen notable transformations, including the deregulation of fuel prices, the simplification of LPG subsidies, and the implementation of technology-based delivery systems. Nevertheless, challenges remain, particularly in efficiently targeting food subsidies under the Pradhan Mantri Garib Kalyan Anna Yojana and maintaining static fertilizer Maximum Retail Prices (MRPs) despite increasing costs. Explicit subsidies have shrunk from 12.7% of the budget in FY23 to 9.3% in FY24. To achieve further rationalization below 1% of GDP, specific measures must be taken without compromising support for genuine beneficiaries.

Type of Subsidy	Description	Examples	Year of Introduction
Direct Subsidies	Financial assistance directly to beneficiaries	PM-KISAN Samman Nidhi	2019
Indirect Subsidies	Tax exemptions, reduced duties	Section 80C Tax Exemptions	1961 (IT Act)
Input-Based Subsidies	Reduced costs of inputs like fertilizer, power	Nutrient Based Subsidy (NBS)	2010
Consumption-Based Subsidies	Affordable essential goods/services	NFSA Grains, Senior Citizen Rail Fare	2013 (NFSA), 1995 (Rail)
Production-Linked Subsidies	Incentivize production in key sectors	PLI Scheme	2020
Export Subsidies	Make exports competitive	RoDTEP	2021
Cross-Subsidies	Higher charges on one group support another	Railways Passenger-Freight Cross Subsidy	1950s (Ongoing practice)
Climate & Environmental Subsidies	Eco-friendly practices, renewable energy	PM-KUSUM (Solar Pumps), FAME-II (EVs)	2019 (KUSUM), 2019 (FAME-II)
Food & Nutritional Subsidies	Food security and nutrition	Midday Meal (PM Poshan), ICDS Nutrition	1995 (Midday Meal), 1975 (ICDS)
Regional Subsidies	Promote growth in backward regions	NEIIPP, Vanbandhu Kalyan Yojana	2007 (NEIIPP), 2014 (VKY)

Table 1: An overview of various subsidy schemes prominent in India; Source:drishtiias.com

II. Critical Analysis of the Subsidy regime in India: Advantages and disadvantages

II.1. Problems with subsidies in India

- Price subsidies tend to be regressive: Several subsidies, such as those for electricity, fertilizers, and minimum support prices (MSP), are provided universally to all households, regardless of their socio-economic status. Because they are universal, these subsidies disproportionately benefit wealthier households over those that are poorer, thus being categorized as regressive.

- There are issues with leakages and corruption, including mistakes in inclusion and exclusion, duplicate and phantom beneficiaries, involvement of middlemen, and poor administrative effectiveness, exemplified by a 46% leakage rate in the Public Distribution System (PDS).

II.1.1. Negative effects on various economic sectors

- **Banking:** Farm loan waivers may negatively influence the credit culture, as farmers capable of repaying loans might choose to default, expecting the government to waive those loans. Additionally, the financially weak status of Distribution Companies (DISCOMs) and power generation firms has contributed to rising Non-Performing Assets (NPAs).

- **Power Sector:** The deteriorating financial condition of DISCOMs leads to increased Aggregate Technical and Commercial (AT&C) losses, a failure to compensate power generators, and a rise in NPAs for banks.

- **Railways:** Increased operating ratios and decreased profitability result in reduced capacity growth and modernization efforts, along with escalated logistics expenses.

- **Public Finance:** The heightened spending on subsidies diminishes the government's capacity to invest in infrastructure development, such as roads, railways, and ports, resulting in a decline in the overall productivity of the economy.

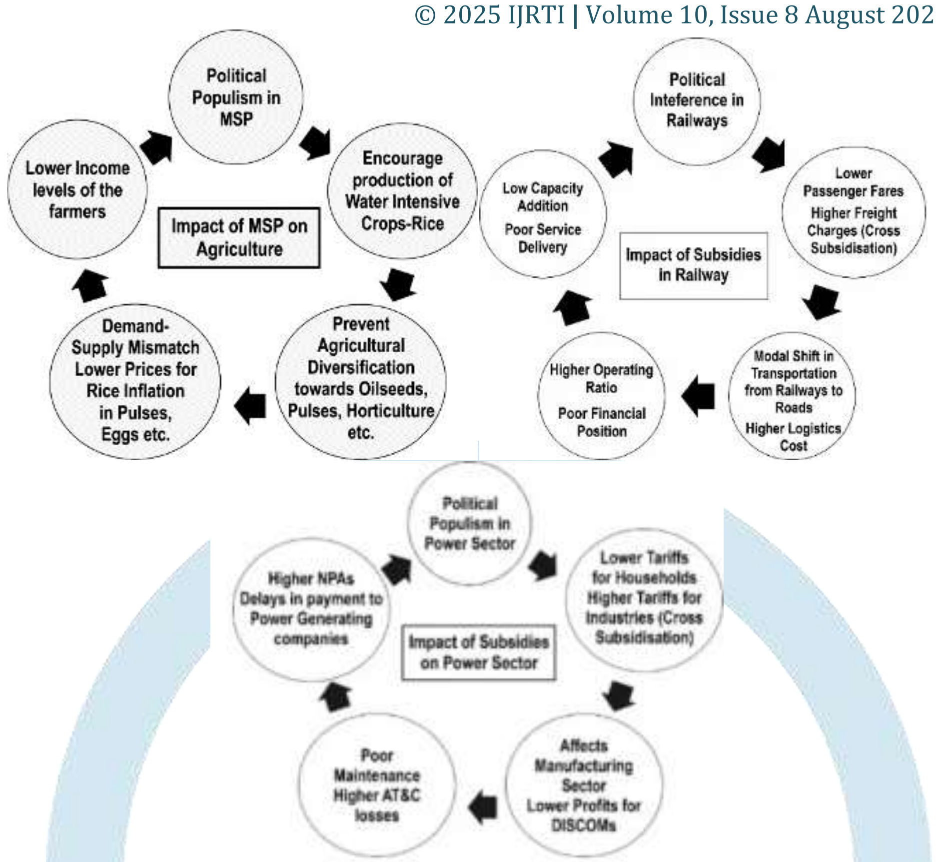

Figure 1: Circular economy of subsidies in India; Source: compass.rauias.com

II.2. Positives of Subsidies in India

- **Guaranteeing Food Security and Reducing Hunger**: Government support, especially for food, is essential for providing the most vulnerable groups in society with access to affordable nutrition. The distribution of subsidized grains through the Public Distribution System (PDS) and initiatives like the Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY) has effectively lessened hunger during emergencies such as the Covid-19 pandemic. For instance, 810 million recipients receive complimentary grains under PMGKAY. In the fiscal year 2025, the food subsidy spending is anticipated to reach ₹2.25 lakh crore, underscoring the government's commitment to food security amid global inflation and disruptions in the supply chain.

- **Assisting Farmers and Boosting Agricultural Efficiency:** Agricultural subsidies on fertilizers, irrigation, and energy help lower input costs for farmers, allowing them to sustain profitability and enhance production. In 2022, the central government more than doubled the fertilizer subsidy in response to rising prices, protecting farmers from inflation. Additionally, the central government has prolonged the special subsidy of ₹3,500 per tonne on di-ammonium phosphate (DAP) for an extra year, effective from January 1, 2025. The Pradhan Mantri Krishi Sinchayee Yojana - Per Drop More Crop (PDMC) program also provides financial aid of 55% for small and marginal farmers, and 45% for others, to set up these irrigation systems.

- **Encouraging Clean Energy and Sustainability:** Subsidies in the renewable energy sector, such as solar and wind, promote the shift toward green energy and diminish reliance on fossil fuels. For example, the Pradhan Mantri Kisan Urja Suraksha evam Utthan Mahabhiyan (PM-KUSUM) subsidizes solar pumps for farmers, decreasing diesel use and conserving groundwater. This initiative not only lowers carbon emissions but also ensures equitable access to energy.

III. Rationalizing Subsidy System in India

- **Enhance DBT and Optimize Targeting** : Expand Direct Benefit Transfers (DBT) beyond just LPG to include fertilizers and food, utilizing Aadhaar-linked, real-time monitoring to minimize leakages. Implement dynamic targeting based on SECC data, consumption surveys, and AI verification to ensure that subsidies are directed to legitimate beneficiaries.

- **Encourage Sustainable Methods and Crop Diversification :**Promote the use of nano urea, organic fertilizers, solar irrigation, and fertigation to lower costs and lessen environmental impact. Associate subsidies with a shift towards growing pulses, oilseeds, and horticulture instead of the more resource-intensive rice and wheat, thereby alleviating fiscal pressure and reducing buffer stock excess.

- **Utilize Technology and Public-Private Partnerships for Accountability :** Implement GIS and blockchain technology to prevent diversion and enhance transparency within fertilizer and Public Distribution System (PDS) frameworks. Improve service delivery through Public-Private Partnerships (PPP), particularly for promoting nano fertilizers, e-PoS systems, and rural distribution networks.

- **Encourage Responsible Use through Behavioral Strategies :** Merge subsidies with programs aimed at changing behavior—connect Ujjwala with PM Poshan for clean cooking initiatives, and align fertilizers with Soil Health Cards to ensure scientific application. Introduce performance-based "subsidy credits" that reward practices like micro-irrigation, LPG recharges, or decreased fertilizer wastage.

- **Develop a Gradual Exit Strategy and Foster Innovation :** Slowly phase out subsidies as the income of households and farmers increases, transitioning from free electricity to metered usage or partial LPG subsidies. Reallocate resources to agricultural startups under the Agri-Innovation Fund (AIF) that provide precision farming, AI soil testing, and sustainable alternatives, moving away from blanket subsidies towards promoting innovation.

IV. CONCLUSION

India's subsidy framework needs to transition from a model of broad support to one that emphasizes targeted, efficient, and sustainable interventions. By broadening Direct Benefit Transfer (DBT), utilizing advanced data technologies, and associating subsidies with accountable practices, we can reduce leakages while enhancing inclusivity. At the same time, reforming agricultural subsidies through diversification and sustainable resources can alleviate financial burdens and environmental challenges. Long-term plans should prioritize innovation, entrepreneurship, and a gradual decrease of subsidies to prevent dependency. Thus, a streamlined subsidy system holds the promise of reconciling welfare requirements with fiscal responsibility, allowing India to attain both social security and sustainable development.

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