

Dialogue on
Subsidy Management in Bangladesh
Efficiency and Equity Issues

Understanding Efficiency and Distributional
Equality of Subsidy in Bangladesh

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Dhaka: 2 May 2015



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Magnitude of Subsidy of Bangladesh

Subsidy Expenditure

As a share of GDP 0.41 percent in FY2001–2002
2.8 percent in FY2012–13 and
1.7 percent in budget of FY2014–15

As a share of total expenditure:
3.25 percent in FY 2001–2001
19.29 percent in FY2012–13
10.4 percent in budget of FY2014–15

As a share of total revenue:
3.48 percent in FY2001–2001
26.20 percent in FY2012–13
14.24 percent in budget of FY2014–15

Two questions need to be answered?

First, if such growth in subsidy fiscally sustainable in the short and long term

Secondly, even if one argues that from fiscal point the size of subsidy is not an issue, is this the best way to spend public money

Therefore, the main objective of this study is to try to answer these two questions

Methodology

Desk review of national and national literature published on this topic

Analysis of published data from the Ministry of Finance

Consultation with a senior level official from the Ministry of Finance

Limitations of the Study

It didn't attempt in-depth analysis of the individual subsidies as each of them is complex issues in their own right and requires much more probing subsidy by subsidy

It draws on available literature and published information and did not attempt to create any new information by undertaking in-depth consultation with stakeholders, beneficiary assessment and impact analysis

This study can be consider as a starting point on which further work is required

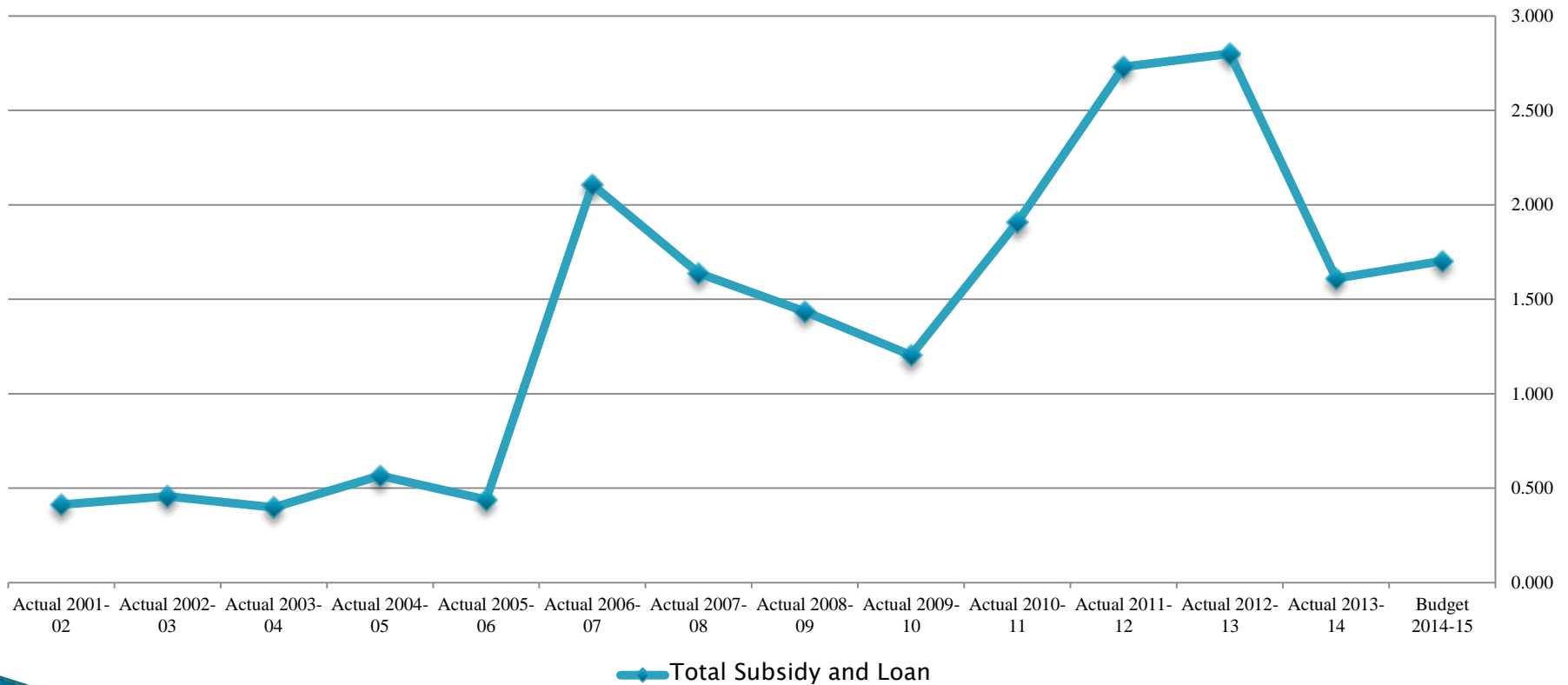
Contribution of the Study

The main contribution of this study is that it provides a comprehensive picture of subsidy expenditures in Bangladesh addressing various aspects of subsidy in Bangladesh

This is the first study of its kind where all the important aspects of subsidy are brought together and addressed even though may be not be with the full analytical rigor

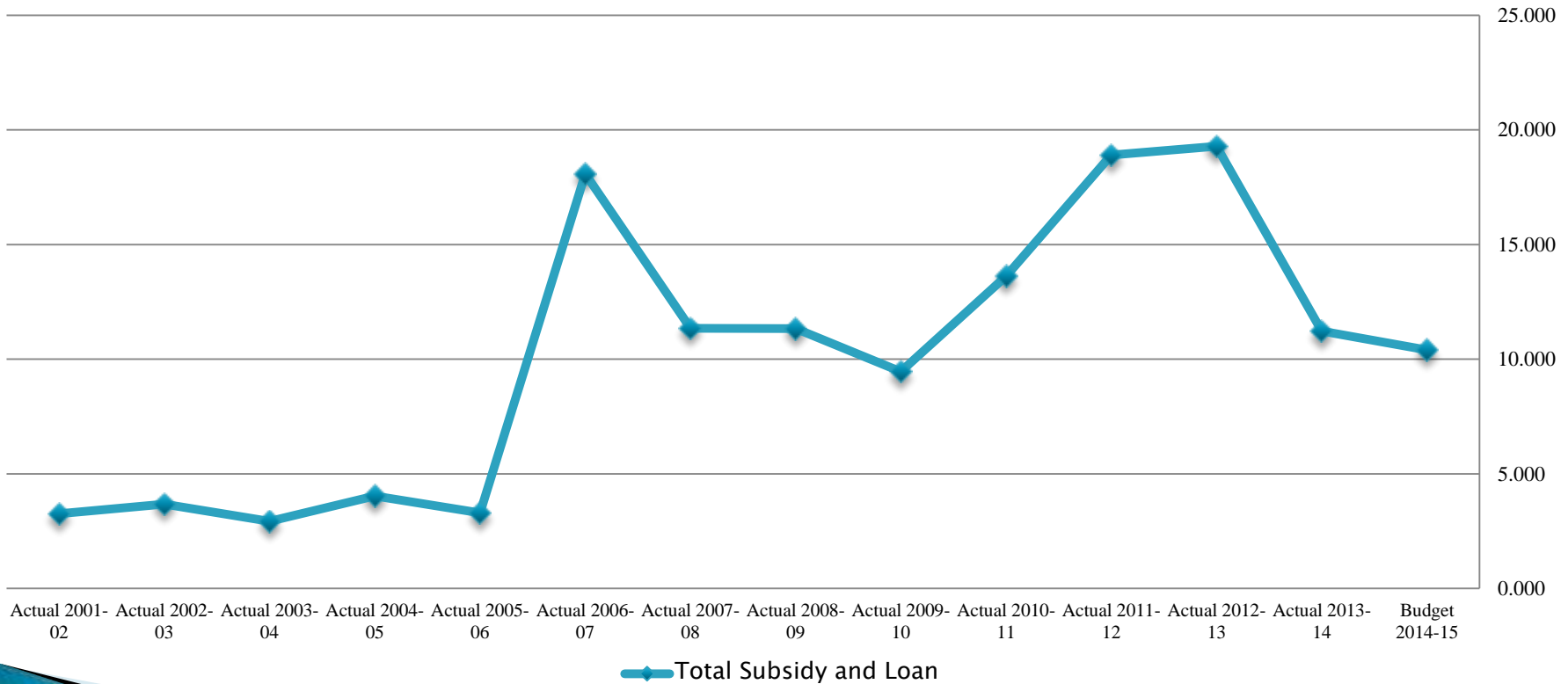
Subsidy overtime-1

Total Subsidy as a share of GDP (in percent)



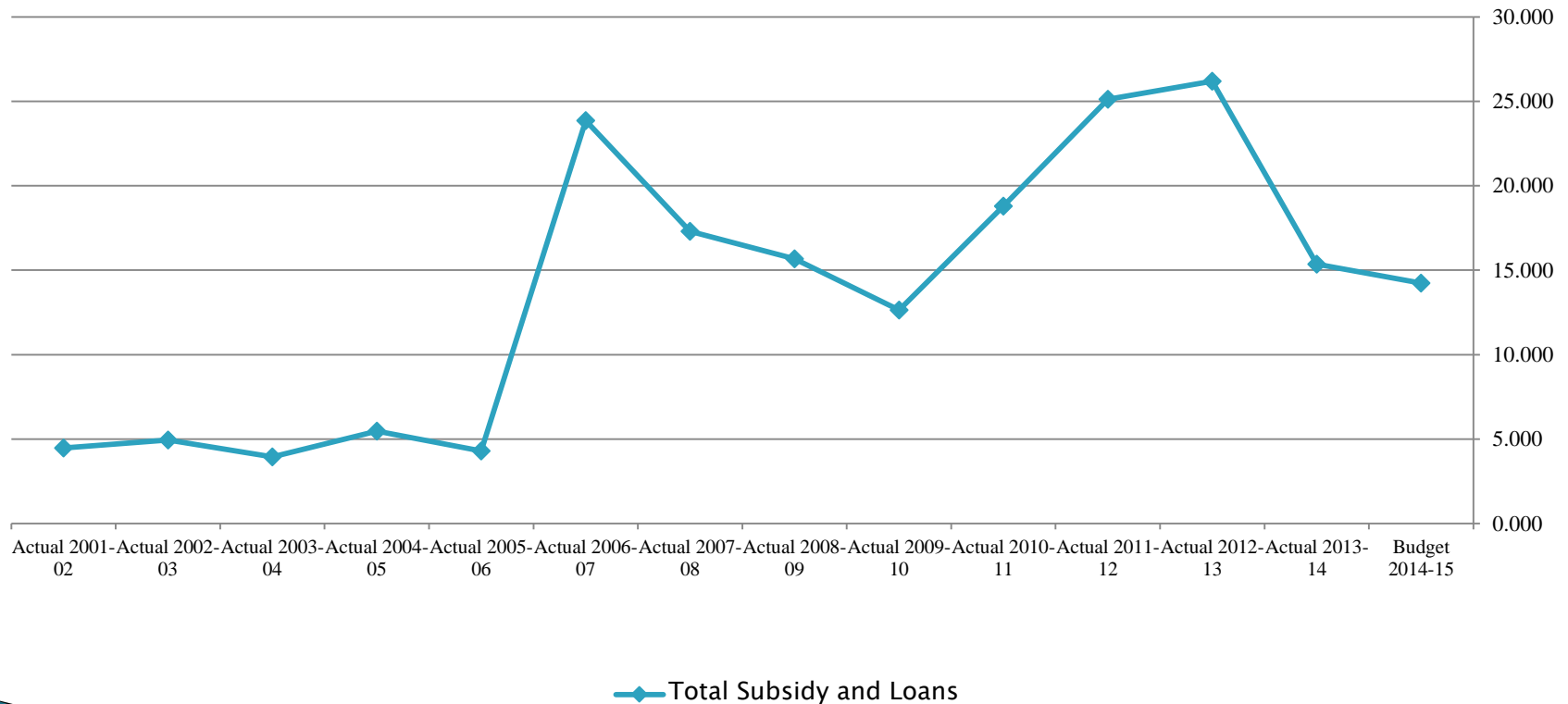
Subsidy overtime-2

Subsidy as a share of Total Expenditure (in percent)



Subsidy overtime-3

Subsidy as a share of Revenue (in percent)



Is subsidy too high in Bangladesh

Its absolute size in nominal and real term in relation to GDP, total expenditure and revenue has been on the rise and can be consider high. However, the size of subsidy expenditure is still not a major macro instability and unsustainably threat mainly because of the fact that the government has been able to maintain a “comfortable and manageable” level of fiscal deficit.

Unbundling the Aggregate Subsidy

Subsidy and Loan Components as a Percentage of Total Subsidy

Description	Budget 2014-15	2013-14	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06	2004-05	2003-04	2002-03	2001-02
Food	6.93	4.85	2.51	5.60	9.45	10.26	6.48	7.22	6.01	14.93	20.98	22.89	27.39	26.9
Rural Electrification	0.031	0.00	0.00	0.01	0.05	0.08	0.08	0.08	0.07	0.44	0.38	0.60	0.53	0.64
Internal Water Transport	0.004	0.01	0.003	0.002	0.003	0.005	0.005	0.005	0.004	0.055	0.048	0.076	0.066	0.081
Jute Goods	2.11	1.74	1.04	0.54	1.83	2.87	2.87	1.65	0.86	4.10	4.80	5.29	3.32	10.47
Export Subsidy	11.32	10.18	6.11	9.03	8.70	13.68	11.95	10.68	6.15	29.75	31.25	44.86	47.61	0.00
Fertilizer & Other Agricultural subsidy	34.54	41.24	35.75	24.30	32.63	51.28	51.24	37.61	8.98	32.60	36.92	15.18	10.84	16.10
Other Subsidies	3.22	0.71	0.05	0.49	0.40	0.02	0.37	0.50	5.18	0.27	0.24	1.13	0.07	0.08
PDB	26.87	28.03	13.37	22.06	22.90	10.35	9.95	5.83	2.59	0.00	0.00	0.00	0.00	0.00
BPC	9.21	11.39	40.39	29.67	22.90	9.38	14.82	34.97	70.14	0.00	0.00	0.00	0.00	0.00
BJMC & Others	5.76	1.87	0.79	8.33	1.15	2.08	2.22	1.46	0.00	17.85	5.38	9.97	10.17	45.65

Little bit about Subsidy as a fiscal tool

Definition: subsidy is any financial action by a government that reduces production cost compare to what could have been the market driven production cost. However, in the literature keeping purchase prices of goods and services below market prices directly for benefiting the consumer are also considered as subsidies

In practice subsidies can take the form of direct transfer to the producers in a particular sector and governments buy back guarantees. They can be embedded tax credits or exemptions; can be in the form of provision of low-cost inputs, infrastructure or services, exchange rate manipulation, control through application differential regulations

Grounds for using Subsidy

The government has two grounds for intervention:

1. Addressing market failures

Market failures can be in case of pure public goods, presence of externalities, monopoly situation, in case of incomplete markets and imperfect or asymmetric information

2. Improving equity

Anti-poverty activities, growth enhancing activity, financing, providing and delivering education and health

Subsidy also can be used on these two grounds

Grounds for using Subsidy

In practice subsidy is used not only to address market failure and equity but also to mitigate government failure. In many cases infrastructure is below standard and market mechanism in certain activities is not well regulated by the government. These cause costs of production to be high and discourage producers not to produce. To mitigate this situation government gives subsidy to some activities

Subsidy: a good or bad fiscal tool

Arguments in favor of subsidy: The arguments in favor of subsidy may include, from addressing market failure perspective, achieving different kinds of security (e.g. food security, energy security) at the national level, capturing positive externalities, eliminating negative externalities and ensuring environmental preservation.

From improving income inequality perspective, argument in favor of subsidy may include supporting the poor (poverty reduction) and improving equity (redistributive), supporting domestic investment, production (growth) and generation of employment.

Arguments against subsidy:

Firstly, is argued in the literature that subsidies often do not reach the poor and deteriorate equity. In many cases the benefit of subsidy is harnessed by the high-income group.

Secondly, it also argued that because subsidy changes relative price structure it may lead to allocation inefficiency (in terms of where to investment), and technological inefficiency (in terms inefficient use of inputs of production).

Thirdly, subsidy can lead to wasteful consumptions of scarce resources, and lead to serious environmental deterioration in terms of over extraction of natural resources and creation of pollution.

Finally, if subsidy is given in terms of tax exemptions and loan guarantees it is not possible to calculate the magnitude of this expenditure.

Subsidy: Good or a bad fiscal tool

Conclusion: We can quote from Schrank (2010) “The issue of subsidy is complex in that there is no agreement even on what a subsidy is. There is no agreement on how subsidies can be measured. There is no agreement on when subsidies are useful and when they are harmful.” Thus it should not be too controversial to say that it is a complex and non-transparent fiscal instrument and should be used as little of possible

How subsidy is being used in Bangladesh

We looked at the relevant sector policies to
Identify the goals and objectives
Also highlighted interventions particularly use
of subsidy in reaching those goals

The policies that we looked at are
Export Policy 2012–15,
National Food Policy 2006,
National Energy Policy, 2004,
Power Sector Master Plan 2010,
National Agriculture Policy 2013

Comments about individual Policies and use of subsidy-1

Export Policy 2012-15

It can be concluded that some of the policy interventions are about improving infrastructures however many interventions are in terms of providing subsidies. The export activities are riddled with direct, indirect and cross subsidies and to much is These make administration of these supports to export activities complex, costly and ineffective, and the magnitude public subsidy non-transparent and non-measurable.

Comments about individual Policies and use of subsidy-2

National Food Policy 2006,

Interventions call for improving the functioning of the market mechanism, improvement of various aspects of agro-technology, strengthening food procurement system etc. However, use of subsidy and giving incentives by providing input subsidy to the producers of food grains with universal coverage, procuring food grains in the procurement zones at prices higher than the average production costs are recommended. In this case subsidies are not so multilayered, complex, non-transparent

Comments about individual Policies and use of subsidy-3

National Energy Policy 2004

Power System Master Plan 2010

The policy recommendations in these two documents do clearly suggests rationalization of the existing system and reducing price subsidies that to attain the stated objectives

However in practice government provides quite a large subsidy to both BPDB (electricity) and BPC (fuel)

Comments about individual Policies and use of subsidy-4

National Agriculture Policy 2013

In the policy document takes about strengthening management of fertilizer without mentioning government's future stand on subsidy on fertilizer. The policy also mentions improving agri-products' markets by removing various constrains however does not mention anything about government food procurement system.

Not clear how food policy and agriculture policy hang together

Focusing of individual subsidies

Relevant questions to ask

- ▶ How well various subsidies are achieving the goal/goals that they were introduced to achieve?
- ▶ Who are benefiting from these subsidies
- ▶ Are subsidies the best fiscal tools to achieve the set goals and benefit the target groups

We attempted understand these subsidies in terms of

Effectiveness of subsidies

Distributional aspects of subsidies

Food Subsidy: About Efficiency

The same ton of grain cannot simultaneously serve the three objectives of food safety net for poor, stabilizing market prices and providing emergency relief. There are inevitable 'trade-offs' between the objectives (BIDS, 2009a). With such trade-off it is possible that some of the objects are not being met and/or met partially

The performance of food-based safety nets often suffers from a number of weaknesses that undermine their effectiveness. These shortcomings include large administrative costs, corruption, inefficient implementation, and leakage. (Jha, 2008) BIDS

Export subsidies: About Efficiency

It is highly likely that export related subsidies are distorting investment structure as investments in domestic non-export oriented activities are discouraged in relation to export-oriented activities

On theoretical ground one can claim that subsidies of import of capital encourage capital intensive use of production technology.

complex subsidy schemes are not transparent it is difficult to understand which exports benefiting in a comparative sense

These export promotion subsidy schemes are often difficult to administer and are subject to manipulation for rent-seeking purposes

Agriculture subsidies: about efficiency

In agriculture sector “Subsidies in Bangladesh are often wrongly targeted and therefore the actual objective of the subsidies is not achieved.” (ILO, 2012)

There are also problems with the fertilizer subsidy system, because it encourages inefficiency in the domestic production of urea, given that inefficient factories also receive the same subsidy as efficient ones. (BIDS, 2009b)

Farmers frequently complain of fertilizer shortage. The current system involves high management costs to sustain the policies and controls. (BIDS, 2009b)

The distribution system suffers from several problems and maladjustments. There is dealer storage; licenses are given under political patronage. (Asaduzzaman, 2009)

Also, relatively higher subsidies are given to urea, compared to other has lead to unbalanced fertilizer use, which has probably depressed yields and may adversely affect soil fertility. (BIDS, 2009b)

Energy (Power and Fuel) subsidies: About Efficiency

Artificially kept low prices potentially discourage energy conservation, and fossil fuel subsidies are a disincentive to shifting to cleaner sources of energy. Moreover, the benefits of energy subsidies typically accrue to wealthier classes of citizens, as they use more energy. (IISD, 2012)

Lower price of energy alters investment decisions by discouraging energy diversification and reducing the incentive for energy suppliers to build new infrastructure. (IISD, 2012)

Subsidies encourage high fossil fuel consumption and adds to greater greenhouse gas emissions, local air pollution and resource depletion. (IISD, 2012)

When an economy is heavily supported by an exhaustible resource, sustaining its economic performance is an important issue because the resource will be depleted at some point in time. (Gunatilake and Raihan, 2014)

Subsidy: Distributional Aspects

Food

Who are the Beneficiaries

Food procurement in the domestic market helps in stabilizing income of the farmers.

Through open market operation essential food items are distributed to poor section of the population at a subsidized prices, however the largest amount of food under Essential Priority Channel through a rationing system food grains are provided to army, police, and border guard and to jails at a price below economic price. Other groups who receive food subsidies are university students, orphanages, and workers in the garment industries.

Are they most deserving

Subsidizing food to army and police can't be linked to poverty reducing justification of giving subsidy thus how justified these subsidies are can be questioned.

Orphans of the orphanages, and workers in the garment industries. can be considered as deserving groups to receive subsidy although the amount is very small.

Subsidy: Distributional Aspects

Rural Electrification

Who are the Beneficiaries	Are they most deserving
The beneficiaries of this small amount of subsidy is targeted to cottage industry	People engaged in this activity are generally poor and helping them to remain engaged in income generating activity thus is poverty reducing.

Jute

Who are the Beneficiaries	Are they most deserving
The beneficiaries of subsidy in jute are the jute growers, workers employed in the jute mills	This has poverty reduction implications for these specific groups of people.

Subsidy: Distributional Aspects

Export

Who are the Beneficiaries	Are they most deserving
Export subsidy mainly benefits the exporters and a large number of labors employed in exporting industries and industries linked to export activities. (Ministry of Commerce, 2013)	By creating job opportunities at various levels it helps reducing poverty among a large number of people.

Subsidy: Distributional Aspects

Agriculture

The main beneficiaries of agriculture subsidies are the farmers in the rural areas. (Ministry of Food and Disaster Management, 2006) (Ministry of Agriculture, 2013)

If we assume that all farmers are not by definition poor we can't justify this subsidy on poverty ground. It certainly helps some poor farmers but large farmer benefits relatively more thus not entirely pro-poor in nature. Also this subsidy is not progressive in nature as larger farmers get greater subsidy (in absolute taka amount) compare to the smaller farmers.

Subsidy: Distributional Aspects

power

Who are the Beneficiaries	Are they most deserving
<p>The beneficiaries are consumers of electricity. However, subsidy is higher for domestic consumption compare to if used for commercial purpose. Also this subsidy is for electricity usages in the urban areas. (IISD, 2013a)</p>	<p>This subsidy is not progressive in nature as wealthier people use larger amount of electricity the absolute amount of subsidy is higher for them compare to users (usually poor people) of small amount of electricity</p> <p>Also there is no subsidy in rural electrification, which in turns creates a situation where urban consumers are being subsidized and rural consumers are not. (IISD, 2013a)</p>

Subsidy: Distributional Aspects

Fuel

Who are the Beneficiaries	Are they most deserving
Fuel subsidies on various kinds of fuels are benefiting direct consumers of fuels or can benefit consumers in terms of lower prices of other goods or services. Fuel like kerosene is subsidized more because a large number of users of kerosene live in the rural area and are poor. (IISD, 2013a)	Subsidy on petroleum is not pro poor. Wealthier people tend to use more petroleum and enjoy higher subsidy compare to poor people. However, subsidy on kerosene can be considered as pro-poor. (IISD, 2013a)

Recommendations

Guiding principles for Subsidy reform

- Reducing subsidy expenditure wherever possible to ensure sustainability at macroeconomic level and also to ensure that this fiscal tool which is considered not “good” is used a little as possible
- Restructuring subsidy components to ensure its efficiency and effectiveness of public expenditure
- Subsidy should be consider only as temporary measures with a time phasing out strategy
- Identifying other ways to provide supports to deserving activities and sections of people
- Improving subsidy providing mechanism
- Improving public awareness about the negative impacts of the existing subsidies so that entitlement mindset can be countered

Recommendations

General policy recommendations

- Undertake a critical review of current subsidies analyzing the distributional impacts of the current subsidies on growth, poverty and welfare, impact of environment
- Trace the economic and social impacts by identifying and using the transmission mechanisms of different types of reform on specific areas and groups of people and also undertake beneficiary assessments of each subsidies.
- Prepare policy recommendations for designing and implementing pragmatic subsidy reform policies differentiated in terms of short, medium and long term
- Document the best practices from the experiences of other countries subsidy reform experiences to use those in reforming subsidy in Bangladesh
- Develop linkages with vehicles such as think tanks, networks, institutions and media that work for targeted policy audiences to ensure wider and effective dissemination and use of subsidy reform messages.

Recommendations

Energy (Fuel and Power):

- Introducing cash transfers (conditional and unconditional)
- Increasing social spending (increasing minimum wage, salary increases to low paid government employees)
- Ensuring transparency about prices. All forms of non-renewable energy are to be priced at their economic cost of supply.
- The price of coal is to be set at its economic cost of production and supply
- Phasing out of subsidies in a time bound gradual manner
- Monitoring the impacts of gradual phasing out of fuel and power subsidies and making adjustment if necessary
- Developing clear communications campaigns, stakeholder consultation to generate support for the reform
- Improving management and administration of subsidies
- Gradual withdraws of subsidy for consumers of electricity except those, who fall in the lifeline slab (0–100) units
- Subsidy, if required, is to be given at the end-user level

Recommendations

Agriculture and food

- Reduce agriculture and food subsidy gradually to a lower level and keep it as low as possible
- Undertake a systematic evaluation of the effectiveness and cost to the Government of each approach used regarding agriculture and food
- Ensure that fertilizers reach the farmer in time. BIDS research indicates that timeliness of getting fertilizer is more important than its low price
- Introduce a targeted subsidy scheme in place of the universal coverage for fertilizer subsidy. In this system the poorer farmers (such as landless, marginal and the small) will be allowed to pay a subsidized price, whereas the medium and the large farmers will be charged a cost recovery price administratively set by the government
- Reduce and eventually phase out food subsidy given under Essential Priority Channel

Recommendations

Export

- reform measure should be taken to simplify and streamline and restructure the export subsidies and incentives.
- Undertake a systematic evaluation of the effectiveness and cost to the Government of each approach used regarding agriculture and food

Finalizing the Report

- There are gaps in the current report that will be taken care of
- All the comments by the reviewers will be carefully considered and incorporated if possible
- All the comments from today's discussion will also be considered and incorporated if possible

That's All for Today!!

Thanks a Lot