

# Subsidies – Have they Disadvantaged the Poor?

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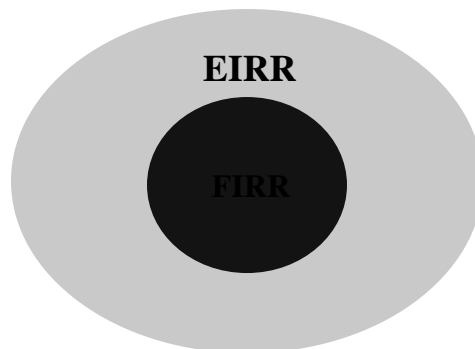
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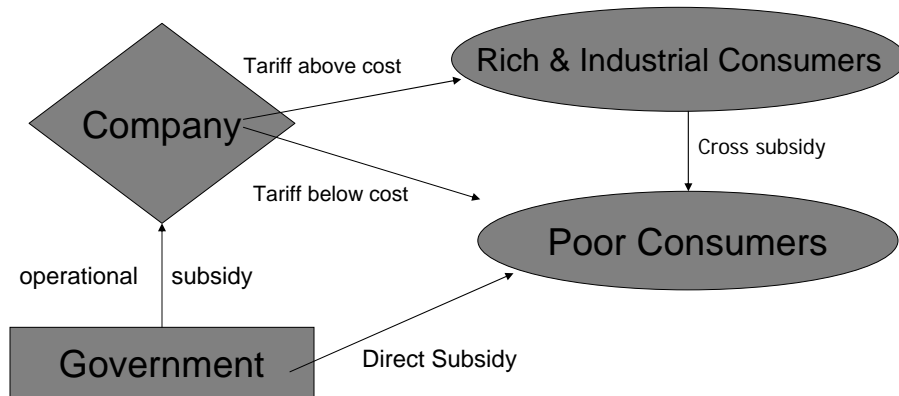
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## Subsidy is not a Dirty Word



The Case for Subsidies

## Subsidies and Cross Subsidies



## Subsidies Can Be Economically Efficient

- Subsidies do not always lead to misallocation of resources
- Under positive externalities, subsidies can lead to better allocation
- Differential pricing under cross subsidies can be economically efficient
  - Airlines
  - Toll Roads
  - Water Distribution

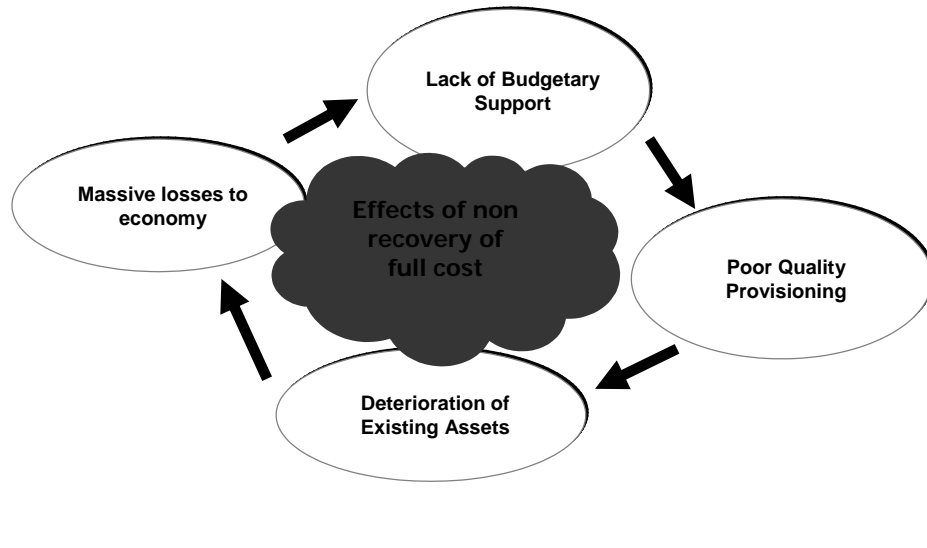
# Water Subsidy in India

- **State Subsidies** : US\$1.1 billion per year  
**Equivalent** to 0.5% of the GDP
- **BUT** *How well do the water subsidies perform in India ?*

# Subsidies Reach Everyone but the Poor

- **Indiscriminate Untargeted Subsidies**
  - Subsidy resources used for private taps: 90-95 %
  - Private tap owners above poverty line: 70%
  - Subsidy captured by the non-poor: 70%-80%
- **Public Taps most Effective**
  - But subsidies used to finance public taps: 5% - 10%

## Subsidy Led Vicious Cycle



## Solution – Better Targeting

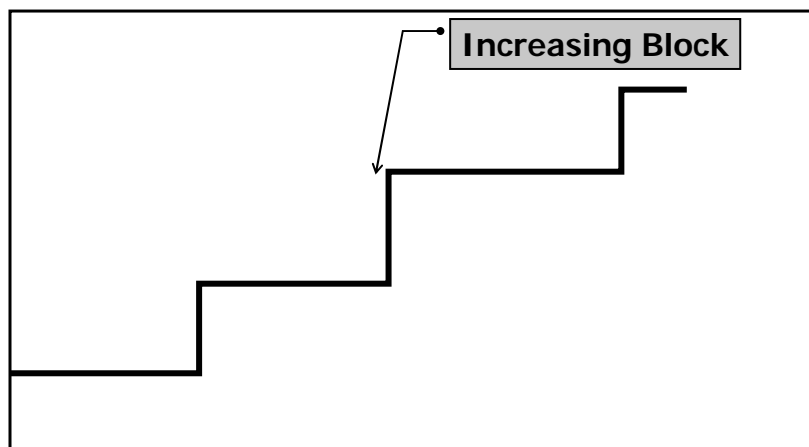
- TWO APPROACHES
  1. Targeted Consumption Subsidies
  2. Targeted Connection Subsidies

# Solution – Targeted Consumption Subsidies

## Three income proxies to allocate subsidies

1. Modified Increasing Block Tariffs
  - Reduce size of the first block
2. Geographic Targeting
  - Designated slums or colonies
  - Where at least 60% of the residents live below poverty line
3. Individual Targeting
  - Identify convenient variables that are good indicators of individual poverty

## Incremental Block Tariffs



## Targeted Consumption Subsidies - Implications

- Modifying the IBT does not Address the Issue
  - Difference in average water consumption between poor and non-poor is only approx 20%
  - No one gets much subsidy
- Both Geographic and Individual Targeting improve performance
  - But, large percentage of the poor get excluded
  - Individual targeting has high administrative costs

## Solution – Connection Subsidies

- Connection subsidies prove easier to target the poor
  - Much higher concentration of poor people among the unconnected population
- As shown by a Bangalore study, even untargeted connection subsidy performs better than the existing IBTs
  - The percentage of the poor left out of subsidies declines
  - The percentage of the rich getting the subsidies declines

## **Five Propositions**

- Properly targeted water subsidies can be useful
- However, typically water subsidies are very poorly targeted at the poor. The non-poor benefit most
- Huge subsidies deprive the water sector of much needed resources to expand and improve services. The poor suffer the most as a result
- Consumption subsidies are very unlikely to be effective in including the poor and excluding the non-poor
- Connection subsidies are considerably more effective by increasing coverage of the poor

## **Careful with the Subsidies!!**

- **A subsidy is like a surgeon's knife...**
- **If not wielded properly...it can kill the patient**

**Thank You**