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Subsidies are a problem, not a way out for loss-making entities

LAHORE: Subsidy gives recipient businesses an economic advantage that they would not otherwise have enjoyed under 'normal market conditions'. It thereby confers an advantage to the aid recipient on a selective basis, which may distort competition in the relevant market.

One exceptionally large subsidy that is not talked about is the state aid that is directed towards state owned enterprises. Our own experience has proved that the regular government support to the loss making state owned enterprises gives them incentive to improve.

Global experience also points out that countries supporting their loss-making public companies finally realised that it is a futile exercise. Sri Lanka allocated more than 10 percent of its GDP in 1990s to keep its SOEs afloat. In China 95 percent of the state subsidies from 1990-2005 were directed towards loss making SOEs.

Both the government and the opposition justify the subsidy to loss making SOEs on the ground that it saves jobs of large numbers of employed. This is a flawed argument as most of the employees in SOEs were appointed without merit and most of the top brass getting fat salaries and perks are bureaucrats, retired army officers or appointees on political grounds.

Moreover, providing salaries without work or nominal work does not come under employment. It could at best be called welfare. Subsidy when provided as preferential public assistance by a government to a certain business or economic sector in the shape of grants, interest and tax reliefs, guarantees, provision of goods and services at preferential terms, or waiver of license fee provide the recipients an advantage not available to others.

These subsidies undermine the competitive process as they interfere with market signals and where provided on inputs lead to inefficient allocations as perceived prices deviate from cost base prices.

One cannot deny that state subsidies are sometimes inevitable to pull masses out of economic distress. However, the subsidies provided to businesses or influential segments of society are an implicit tax on the people of Pakistan.

No one opposes government aid or subsidy during times of natural disasters like earthquake or floods or in case of food price hike targeted assistance given to the lower segment of the society. In Pakistan, most of the subsidies are targeted to appease the favoured ones, and subsidies directed towards poor are criticised.

In developed economies for instance, the state subsidises the intra city transport system for commuters, but subsidies to industries or businesses are strongly opposed.

In Pakistan, we frequently subsidise sugar exports but are vocal in criticising the subsidy on metro buses that benefit hundreds of thousands of low income commuters on daily basis. In fact, efforts are afoot in Punjab to eliminate the subsidies provided on metro bus systems operating in different cities of the province. In Lahore, the one way fare has been raised from Rs20 to Rs30.

The subsidy was lower than the average subsidy provided to sugar barons on sugar exports in last 10 years. We must now realise that protective duties and export subsidies have kept our steel and sugar sectors uncompetitive globally.

Foreign investors are more attracted towards a country if there are no wasteful subsidies in the system or they are limited. The state would have to strengthen and empower its competition watchdog to eliminate wasteful subsidies.

In case subsidies are inevitable, the competition authorities should demonstrate that subsidies are targeted at market failure and there was no other effective way to tackle the issue.

There are spheres where subsidies could be avoided and level playing field be provided to all businesses. For instance, if the global rates of crude oil increase, the government has no option but to pass on the impact of this increase to the consumers.

The best it could do is to reduce the quantum of government levies on petroleum products if it is willing to reduce its revenues. In the same way, if it wants to reduce the rates of imported gas it will either have to subsidise or put that gas in the local gas system and charge average rates.

Again the option is with the state whether it wants to spare its resources for subsidies or has the courage to go for weighted average rates of local plus imported gas.

This formula of weighted tariff is applied in electricity, where all the power distribution companies charge the same tariff, passing on the inefficiencies of some to the consumers. These choices are limited and difficult to exercise.