Subsidies, as converse of an indirect tax, constitute an important fiscal instrument for modifying market-determined outcomes. While taxes reduce disposable income, subsidies inject money into circulation. Subsidies affect the economy through the commodity market by lowering the relative price of the subsidised commodity, thereby generating an increase in its demand. With an indirect tax, the price of the taxed commodity increases, and the quantity at which the market for that commodity is cleared, falls, other things remaining the same. Taxes appear on the revenue side of government budgets, and subsidies, on the expenditure side.

Subsidies can have a major impact in augmenting welfare of the society provided these are designed and administered efficiently to serve a clearly stated set of objectives. However, subsidies can also be very costly if they are poorly designed and inefficiently administered. Subsidies in areas such as education, health and environment are advocated on grounds that their benefits are spread well beyond the immediate recipients, and are shared by the population at large, present and future. Subsidies are also used with redistributive objectives, particularly for ensuring minimum consumption levels of food and other basic needs.

In this exercise, the focus is on budgetary subsidies and the main objective is to uncover implicit subsidies. Accordingly, subsidies are measured here as "unrecovered" costs of governmental provision of goods/services that are not classified as public goods. In particular, the goods/services under reference are those that are categorised as social services and economic services. The unrecovered costs are measured as the excess of aggregate costs over receipts from the concerned budgetary head. The study forms the basis for policy options to correct fiscal imbalances in the State of Utter Pradesh and warrants a careful calibration of budgetary subsidies with a view to make them more transparent and targeting to intended beneficiaries.

The present study is divided into seven chapters. The first chapter is of introductory in nature. The concept of budgetary subsidies (definition and taxonomy), objectives, rationale, and mode of administering subsidies, scope and importance of the study, hypothesis, methodology adopted, data sources and limitation of the study are discussed in this chapter.

Chapter 2 is divided into two parts. First part discusses a theoretical rationale for subsidies. That allow to analyse two kinds of policy failure. The first policy failure
focuses on the impact of hidden subsidies on welfare and on the effectiveness of other policies. The second policy failure results in the ineffectiveness of the subsidies themselves. Second part of the chapter covers the review of the empirical studies related to subsidies.

Chapter 3 analyses the trends of explicit Central budgetary subsidies in general and some of the major explicit subsidies of Central government in particular. This chapter also gives an overview of implicit Central budgetary subsidies as estimated by earlier studies.

Chapter 4 is a brief review of finances of the State of Utter Pradesh and changes took place in the recent years. This chapter is divided in three major parts. First part deals with the macro view of the economy of Utter Pradesh along with social indicators and reform initiated. Second part compares 14 major fiscal indicators of the State of Utter Pradesh with other major States of India. A time profile of revenues (tax and non tax), expenditure patterns and overall fiscal scenario of Uttar Pradesh is discussed in the third part.

Chapter 5 presents the estimation of budgetary subsidies in the Utter Pradesh. This chapter is divided into five parts. First part discusses about conceptual definition and adjustment for estimating budgetary subsidies in Utter Pradesh. Second part analyses transfer payments either made to individuals in the form of grants-in-aid and direct transfer or assistance to local bodies or public sector undertakings. Transfer payments are treated as explicit subsidies and are netted out before the estimation of implicit subsidies. In third part a macro view of implicit subsidies along with recovery rates, share of social and economic services in implicit subsidies, per capita subsidies on current and constant prices and as a percentage of GSDP are analysed. In the fourth section of the chapter, a macro comparison of the implicit subsidies with earlier studies is present. In the last part of the chapter, a detailed sector wise analysis of social and economic services with patterns of the surplus is given.

Chapter 6 deals with the classification of budgetary subsidies into merit and non-merit goods on the basis of externalities. The criterion of 'externality' determines whether and to what extent the services concerned should be subsidised.

Chapter 7 presents summery and findings of the study along with suggestions for the improvements of State finances in containing unnecessary burden of budgetary subsidies along with an agenda for future research.