MICHIGAN
ROSS SCHOOL OF BUSINESS

WDI
William Davidson Institute
AT THE UNIVERSITY OF MICHIGAN

note 1-428-648
February 1, 2009

Note on the Role of Subsidies in a Market Economy

Global subsidies are estimated to amount to "more than a trillion dollars per year, or four percent of world GDP."[1] These subsidies can play a major role in global and domestic trade, affecting businesses in many industries and appearing in a variety of forms.

A review of the topic of subsidies yields a wide range of perspectives. Many economists believe that subsidies, when used appropriately, are helpful because they can encourage market development and a more equitable distribution of benefits and resources in society. Others disagree, believing that subsidies distort markets, create inefficiencies, and misallocate of capital.

Despite this lack of agreement, developing an understanding of what subsidies are and how they are used is important for managers. Subsidies can impact key strategic decisions, such as market entry, target consumers, production levels, pricing decisions, resource allocations, and financial forecasts.

The purpose of this note is to 1) describe what subsidies are and why they are used, 2) examine subsidy types, 3) address the difference between recipients and beneficiaries, and 4) note some of the effects of subsidies on markets, the environment, and society.

The What and Why of Subsidies

The Elusive Definition of a Subsidy

While academics and institutions have tried for some time to define a subsidy, a consensus has yet to emerge. Within the current literature, definitions differ on a variety of criteria such as providers, recipients, benefactors, instruments, and intention. These differences can make the analysis and comparison of subsidies across countries, regions, industries, and companies challenging.

A look at a number of prevailing definitions on subsidies:

- **The Organization for Economic Co-operation and Development (OECD)**, a forum bringing together 30 governments that is committed to supporting economic growth and world trade, defines a subsidy as "a measure that keeps prices for consumers below market levels, or keeps prices for producers above market level or that reduces costs for both producers and consumers by giving direct or indirect support."[2]

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Published by GlobaLens, a division of the William Davidson Institute at the University of Michigan.

 Research Associate Moses Lee and Professor Ted London at the University of Michigan developed this note. They thank Professor Paul Clyde and Research Assistant Kwaku Sefa-Dedeh for their support.