EQUILIBRIUM EFFECTS OF FIRM SUBSIDIES

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ABSTRACT. Firm performance due to a subsidy program may be affected by two countervailing forces: "direct" gains from being eligible for a particular subsidy, and "indirect" losses through product market rivalry if a firm's competitors are eligible. I develop a general framework to estimate these two effects, accounting for multi-product firms and heterogeneity across different types of sectors of the effect of competitors' expansion. I exploit a 2006 expansion of the eligibility criteria for small-firm subsidies in India in order to estimate both how much the newly eligible firms grew, and how much of their growth was mitigated on aggregate due to crowd-out. The relative gains for the newly eligible firms are substantial, as they expand roughly 30% after gaining access to the subsidies. I find that while there is no crowd-out for traded products, for non-traded products the private gains are completely mitigated on aggregate. Furthermore, I do not find evidence that the expansion of the eligibility criteria improved the allocation of factors across firms.

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