Opinion | An unfashionable view on freebies and subsidies

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The sweeping victory of KCR in Telangana puts the spotlight on handouts and if the win could be attributed to them

The sweeping victory of K. Chandrashekar Rao (KCR) and his Telangana Rashtra Samithi (TRS) party in Telangana has left the Bharatiya Janata Party (BJP), Congress and other parties gasping. It has also triggered a debate about the causes of this massive victory. Was it the KCR government's performance record, was it his saturation publicity campaign, was it his appeal once again to Telangana nationalism, or was it the handout of freebies?

Probably the victory is attributable to a combination of all these factors. In this column, I will focus on the array of freebies that the TRS has handed out. We should note in this context that he state is responsible for maintaining market efficiency as well as equity. Hence, in assessing freebies, subsidies, income supplements, etc. we must judge them by their effects on efficiency, as well as on social equity, eschewing emotional indignation about the selfishness of ambitious politicians. For this purpose, I classify "populist" programmes into three categories: (i) one-time freebies such as handouts of consumer durables, productive inputs, durable or productive assets, even cash, (ii) one-time benefit transfers such as loan waivers, and (iii) recurring benefit transfers such as subsidies for consumption (e.g, food) or subsidies for production (such as irrigation or fertilisers), and income supplements such as employment under the National Rural Employment Guarantee Act (MNREGA).

KCR has introduced several freebie handouts as well as income supplement schemes. The one-time handouts include a ₹ 1 lakh wedding gift for women under the Shaadi Mubarak or Kalyana Lakshmi schemes. Pregnant women are taken to hospital for delivery and later dropped home by a free ambulance service, along with a mother and child gift "KCR kit" consisting of clothes, toiletries, toys, etc. He has leveraged the central governments Pradhan Mantri Awas Yojana to offer one million 2-bedroom apartments at an estimated cost of ₹ 7.5 lakh a piece. Herders are given sheep, fishermen are given fish seeds, washermen are given washing machines. Under the Rythu Bandhu scheme, crop farmers are given a grant of ₹ 4,000 per acre per crop to supplement their incomes.

These handouts push the equity needle in favour of women and babies and offer a critical asset for poor households who need homes. They also add to the productive assets of relatively poor communities like herders and washermen or supplement incomes of farmers.

None of these schemes distort the market or impair market efficiency. Some of them improve equity. Others improve equity and also add to productive capacity. All of them contribute to the spending power of the disadvantaged with multiplier effects on local incomes in Telangana's distressed rural sector.

If there is any public expenditure theory which says that such spending is in principle wrong, at least I am not aware of it. Certainly there are trade-offs, since the total pool of resources is limited. We economists have our own views about what kind of spending is more important for growth or equity or both: basic education, basic health care, infrastructure, etc. However, typically such handouts are not provided at the cost of either education or health or infrastructure, except at the margin. So it is important to ask why, for such decisions at the margin, the spending priorities of an economist accountable to no one should take precedence over that of a political leader accountable to the electorate.

There remains the issue of cost. Are the freebies affordable? Individual freebie schemes may not cost too much, but the collective bill of all freebies may be quite significant. Nevertheless, it is likely to be much smaller than, say, loan waivers. The latter are also one-time handouts, but would typically entail a much larger fiscal cost.

Under particularly stressful conditions, such as a drought or the ongoing agrarian crisis, loan waivers may become inevitable. But then the repayment obligation must be borne by the concerned state government instead of burdening the banks with unrecovered loans. That would destroy the credit culture on which the banking system rests. Unfortunately, that culture has already been compromised by the thousands of crores worth of non-performing loans of large borrowers written off every year, especially by public sector banks. It would be shameful if the central bank's efforts to clamp down on such defaulting large borrowers is undermined by powerful special interests.

Finally, there are recurring handouts like subsidies, including the unrecovered cost of publicly provided social and economic services, or income supplements like MNREGA and KCR's Rythu Bandhu scheme mentioned earlier. These are of an altogether different scale, not comparable to the one-time hand outs discussed above, because they entail a recurring fiscal cost. Recent estimates by Satadru Sikdar of NIFPF and myself indicate that these added up to 12.12% of gross domestic product (GDP) in 2015-16.

Leaving aside the income supplements, and subsidies on merit goods and services like food, basic education, health, water supply and sanitation, the total budget spending on non-merit subsidies amounted to nearly 6% of GDP.

Tax expenditure, i.e., revenue forgone on account of tax exemptions and concessions offered for doubtful national benefits, typically amounts to another 4% to 5% of GDP. Eliminating just these two items of expenditure would free up fiscal space of about 10% of GDP, enough to wipe out the entire combined fiscal deficit of the central and state governments and still allow for additional public capital spending amounting to 3-4% of GDP. Those complaining about the relatively small amounts of freebies handed out to poor and disadvantaged citizens should perhaps ponder over that fiscal arithmetic.

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