Down With Subsidies, Up With Reforms

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There is unemployment in India? There is poverty? The economy is stagnating? What is causing all this? Obviously the only villain on the scene is a gentleman called Mr. Subsidy. Because the State gives subsidies it causes the budget to imbalance, raises the fiscal deficit and prevents our patriotic, people-friendly businessmen from accessing capital with which they can promote industry and create new jobs. Abolish subsidies and India will be prosperous.

What exactly is India? Is it a largely middle class nation in which the poor are marginal? Rajiv Gandhi and his admirers such as Mani Shankar Aiyer talked of a hundred million middle class consumers who form the backbone of our society and economy. Because the population of India then was eight hundred million, that still left seven hundred million outside the pale of that section of society which had the money to buy goods and services. Government and its policies were aimed at promoting the consumerist elements of society and the question which I asked Rajiv then was whether the government no longer existed for the seven hundred million people who could not afford to consume and were living at the subsistence level. Our intelligentsia, our press and electronic media were so engrossed in highlighting the achievements of middle class India and the business houses which serve it that the reality of India was lost sight of. The reality of India is that of our five and a half lakh villagers at least half has no access to road communications, very large parts of the country are cut off during the monsoon, have poor bus connectivity, highly unsatisfactory power supply, with very little scope for employment except that which is directly linked with agriculture and allied activities. There is very poor schooling, not even minimum health care and certainly very few urban amenities available. It is this India which lies outside the consumerist society.

Almost all our small and medium towns are bereft of even basic sanitation and the villagers are only slightly better off because here open defecation takes place in fields rather than along roadsides. For mere survival rural India and small town India, which is only one slot above the totally rural society, are heavily dependent upon government for infrastructural improvement, basic social infrastructure and the type of investment which will bring about marginal improvement in the economy. To give an understanding of this India let me give one example. My institution was doing work on watershed management in Ghodadongri Block of Betul District. Though the area lies within the Tawa Basin it has very little irrigation, the land is undulating and hilly, there are very few roads and many villages lie outside the reach of motor transport. The watershed management programme has brought about improvement in ground water and has also provided fodder and fuel to the villagers through the afforestation programme. Part of the programme includes promotion of horticulture, including planting and nurturing of fruit bearing trees. The villagers told us that they did not need papaya and guava plants because the fruit bruises easily, with the condition of roads it is difficult to transport this fruit to market and, therefore, the villagers preferred more hardy fruits of the citrus variety which could be transported over rough terrain. To develop this region one needs to build roads and if the cost benefit analysis were to be done on a commercial basis we would not be able to justify any roads. However, if we add the social benefit flowing to people and, over a period of time the economic benefits that would follow, the roads would be justified. Private business looks at the gestation period of a project and, therefore, would not touch rural roads with a barge pole. The

State has to step in and the expenditure on the roads could be interpreted as a form of subsidy to rural areas. Should government stop building rural roads?

Before the nation adopts a particular stance on the subject of subsidies it might be worth considering what exactly is meant by a subsidy regime. In the United States, by no stretch of imagination a socialist country, the Federal Government has accepted as a matter of policy that social security, including pensions, will be made available to elderly people who have retired. There will be medical coverage but through a process of insurance, war veterans will be looked after by the State in the matter of health care, the unemployed will be helped to find jobs and in the meanwhile will be paid an adequate unemployment grant to keep body and soul together, education up to the school leaving level will be State funded and food stamps and unemployment insurance to pay rent for accommodation will be available to the poor and unemployed. Forty-seven percent of the population of the United States does not pay income tax because of the above welfare subsidies. How are subsidies paid? In a recent article published in The Guardian and reproduced in the Hindustan Times, Michael Cohen points out that first and foremost there is a basic social contract in the United States between the citizens and the State and health care, food, housing, unemployment benefits, etc., are all a part of this social contract. Senior citizens who have pension benefits have spent years when they were employed in paying social security fees and taxes and that what they are getting after retirement is only a deferred payment for what they have already contributed. Those who are unemployed and are receiving unemployment benefits are the very persons who, when they were employed, paid taxes and such social security fees, etc., as are prescribed and that these and taxes paid by the more fortunate citizens enable government to provide social security coverage to the less fortunately placed. In other words, subsidy in this case comes out of payment made in the past or payment made today because in the ultimate analysis even a capitalist State such as the United States of America has a clear understanding of its welfare role and its social responsibility to its citizens. Instead of looking at this as a subsidy it should be treated as a deferred payment for past taxes received and a financial accommodation temporarily for those who lost their jobs and are in immediate need of help. Similarly, State funding of education ensures that there is universal coverage up to the school leaving level and this represents an investment by the State in the future citizens of the country. This, too, is not really a subsidy because it is an investment the dividend of which is declared later but on which no quantifiable value can be estimated because the benefits flowing from an educated citizenry are virtually limitless.

Let us take three other areas of State concern. Unemployment benefits ensure that a person passing through difficult times does not starve and is able to either retrain himself to increase his employability quotient, or is able to arrange for an appropriate job without loss of dignity. Food subsidy by way of encashable food stamps prevents malnutrition and promotes health. This is equally true of medi-care, because ultimately speaking a healthy population is always a national asset. Of course Britain and most European countries carry the concept of social security much farther than do the Americans, but there is also the concept that a citizen with a substantial income base is responsible for looking after his less fortunate brethren who, in turn, by becoming part of labour force with a potential for high productivity, contribute to national prosperity through the employment that they get in due course. To call such a regime a subsidy regime is ridiculous.

There is another fallacy of a free market economy that it allows market forces to work and as a result of this the State does not need to provide subsidies. Market forces are largely a function of supply and demand and even the economies which pride themselves on being market based use the power of the State to influence or even manipulate the market. This is done in many ways, including by manipulating interest rates whereby the equivalent of the Reserve Bank of India regulates money supply by making money more expensive, thus reducing consumption and operating as deflationary measure. However, when money supply reduces because there are no takers it can lead to unemployment and unhealthy deflation. At this stage the Central Bank once again steps in and by reducing the interest rate it brings more money into the market. Why should administered interest rates be allowed to exist? Why should interest also not follow a demand and supply model, that is, if the demand for money increases the interest rates would naturally rise, but when this makes money too expensive and demand falls the interest rate would also decline. But that is not how the system functions because every government would like to ensure financial stability and not permit wild fluctuations based entirely on an unregulated market.

Let us take another case. About forty years ago the world faced a severe oil crisis because the oil producing countries deliberately reduced production. Petroleum prices rose exponentially, but countries such as the United States immediately intervened in the following ways:-

1. Diplomatic pressure on OPEC countries with a veiled threat of force hovering in the background.
2. Reduction in the demand of petroleum products through high taxes, severe speed limits so that consumption could be reduced and, in many countries, the promotion of public transport and a scaling down of privately owned people movers.
3. Release of petroleum stocks from reserves, especially in the United States. How should one view these measures? They were aimed at keeping petroleum prices under control, thus protecting the consumer. Does this not also form part of a subsidy regime?

Let us take another example, which is of agriculture in the United States. Every year the Department of Agriculture makes forecast about production, not only in the United States but worldwide. On this demand models of the consumption of various agricultural commodities are prepared and calculations made of the quantum of product available and its effect on prices. If glut of a particular commodity is estimated, then farmers are encouraged to reduce the area under that particular crop, with a specific target being assigned for such reduction and a State subsidy is given for not producing that crop and heavy taxes imposed for growing it. When a shortage of a particular product is forecast the process is reversed and tax concessions given for bringing more area under cultivation of that particular crop and heavy taxes levied for not growing that crop. Is this interventionist regime also not part of a subsidy regime in which there are positive subsidies and also negative subsidies by way of taxes?

We have talked about countries which have a relatively high GDP and per capita income. Let us come to India, where our per capita income is well below the level of the more developed countries. There are vast numbers of poor people and whereas various calculations have been made about those who are Below the Poverty Line (BPL) it would be safe to say that at least thirty percent of Indians live below any rationally calculated poverty line. Then there are a large number of people who are just marginally above the poverty line, which means that they are able to survive a little above the margin, but whose capacity and propensity to consume does not go beyond the bare essentials. By any civilised standard these people also will be deemed to be below the poverty line. That rules out about fifty percent of the population of India from being capable of consumption of items beyond the bare minimum. Actually when Rajiv Gandhi was Prime Minister he and his cohorts trumpeted the fact that India had one hundred million consumers, which still left seven hundred million people. The then population of India was eight hundred million. Even today barely fifteen percent of the people of India are in a position to consume commodities beyond the bare essentials and though fifteen percent of one thousand two hundred million people, that is, one hundred sixty five million people, is a sizable number of consumers, there are more than one thousand million people who, if they are to be made a part of the consumerist society, would need either a direct boost of income or some form subsidy to give them at least a minimum standard of living.

The vast majority of Indians cannot afford health care and are heavily dependent on medical facilities provided by government. We have allowed our government medical institutions to run down, thus forcing people into the arms of private medical institutions. We have a scenario in which people have no affordable medical facilities and the high fees of private medical care either deprives people of any health care or forces them to pay medical bills by cutting down fees on absolutely essential items. How can any sensible person oppose either State funded medical insurance for these people or a major investment by the State in medical facilities which takes health care to the poor?

Let us take the case of education. Our best institutions of education in the field of technology, management and medical education are now virtually beyond the means of a child coming from an ordinary Indian home. Murli Manohar Joshi, as Education Minister, had advised the Indian Institutes of Management that they should not make their fees so high that a middle class Indian cannot afford to educate his child there. He promised to make available a level of state funding to the IIsM which would enable them to operate at a level equivalent to that of the best business schools in the world. Unfortunately the IIsM did not agree, with the result that today a high fees paying student has only one objective in mind, which is to improve his employability to a level where he can command a high salary on passing out from the institute so that he can repay the loan that he had taken. Research, fundamental or applied, becomes the casualty.

Let us come to school education. Most State run schools are of such miserable quality that they are hardly able to impart even literacy, much less education to their children. A suggestion that the government should create ten thousand new Navodaya Schools, which would be rural-based, to upgrade the level of education met considerable opposition in government, but eventually six thousand such schools were approved because of the Prime Minister's intervention. But the Planning Commission and the HRD Ministry wanted them to be in the Public-Private Participation Mode and, therefore, the scheme is almost stillborn. Had these schools been set up would it be a subsidy or would it be an investment in our future? If affordability were the sole criteria for creation of infrastructure, no city infrastructure could ever be built. The entire Jawaharlal Nehru National Urban Renewal Mission is based on a policy of upgrading urban infrastructure and for this providing adequate funds, largely by way of grants but also by way of loans for assets which benefit individuals, such as social housing. A certain basic urban infrastructure improves the efficiency of cities and an efficient urban settlement also one to which employment generating businesses and industries are attracted. In turn this expands the employment base in that particular town, generates income for individuals, the enterprise, local government and the State and Central governments. Again, is this a subsidy or is it an investment?

One of the very successful examples of a healthy subsidy regime is the mid-day meals programme of Tamil Nadu and the provision of highly subsidised rice to the poor in the same State. These two programmes were considered as political gimmicks, but because the programmes have been administered efficiently and relatively honestly they have improved the levels of nutrition of school children, increased enrolment and reduced the drop out rate, while giving access to grain to the very poor who otherwise would not have been able to buy it. Whatever the cost, the social benefits of these two programmes have been universally accepted and most States are trying to replicate them. What marks out the Tamil Nadu programmes is the efficiency of delivery and unfortunately this is not universally replicated.

Another area of subsidies is the free or very cheap electric power to farmers. Electricity is the energy which moves a prime mover, the motor and pump which lifts water. Water is a direct input into agriculture and where irrigation is extended the farmers' productivity undergoes a dramatic change. Unfortunately this is one area where the economics of subsidised power was not worked out, with the result that most Electricity Boards are bankrupt, transmission lines are not well maintained, there is erratic power supply and commensurate benefit has not flowed to the farmers. The present government of Gujarat moved swiftly to separate the agricultural feeder from the normal feeder, guarantee ten hours of three phase supply at constant voltage to the farmers and also guarantee twenty-four hours supply at full tariff to every village. Every village in Gujarat is covered by this scheme, the Electricity Board has shown a dramatic increase in revenue and because it is now surplus in financial terms, it has added generating capacity to the system and line maintenance has shown significant improvement. Because power supply is guaranteed for twenty-four hours many small scale industries and businesses have come up in villages throughout Gujarat. In this case what is needed is efficiency and guaranteed supply of power, which completely obviates the need for a subsidy.

The list would be endless, but I would like to close this paper by discussing two areas of subsidised supply of a commodity, LPG and diesel. Government has increased the cost of an LPC cylinder in excess of six cylinders a year by approximately Rs. 350 per cylinder. Gas is supplied in Madhya Pradesh for Rs. 452 per cylinder, which will now go up to Rs. 798 per cylinder. That represents a seventy-six percent increase in the cost of L.P.G at one go. In the case of diesel the price has gone up by Rs. 5 per litre, but when taxes are added this come almost to Rs. 6 per litre. Even this represents an increase of approximately fourteen percent. Diesel is the fuel for all major prime movers in the field of transportation. The percentage of diesel used by car owners is about six to seven percent of the total. The balance is used by goods vehicles and by public transport such as buses. Some diesel is used by railways and a substantial amount is used in rural areas as tractor fuel, fuel for diesel pump sets, etc. In other words, over ninety percent of diesel is used a fuel for prime movers which serve the ordinary citizen of India. A person who drives a diesel engined Mercedes car would use an aircraft for long distance travel, the fuel of which could be aviation kerosene and not diesel. It is the poor and lower middle class citizens who travel by bus and must of the goods carriage vehicles actually transport commodities which are not luxury items. The bulk of commodities would come within the definition of essentials or a level or two above essentials. The fourteen percent increase in fuel cost would automatically lead to upward revision of tariff and this would be reflected in commodity prices in the retail market. A person living at or only slightly above the level of subsistence just cannot afford to pay this additional impost. By raising diesel prices government has hit the poor hardest of all.

The philosophy behind introduction of LPG into India was that this is a nonpolluting fuel, it is an excellent substitute for all other fossil fuels such as soft coal, firewood, etc., and it is cleaner than the kerosene used for cooking. Government as a matter of policy gave subsidised gas cylinders to people living in hill areas so that they would refrain from cutting down trees for fuel. LPG then became the symbol of the movement for saving our forests. By increasing the price of LPG by over seventy percent government is forcing people to revert to some of the fossil fuels they burnt in the past, thus jeopardising our forests, increasing pollution levels and making it virtually impossible for an urban household to afford even a minimum quantity of fuel for the purpose of cooking food. This is an atrocious decision of government and if a cost benefit analysis is done of the carbon foot print that would be enhanced as fossil fuels replace nonpolluting gas, the cost of forests chopped down for fuel wood and the health hazards that would follow the burning of fuels which emit smoke, one would probably find that the entire amount saved by reducing or eliminating subsidy is in fact totally negated by the costs mentioned above. Worst of all the totally precipitate increase in the cost of two absolute essential commodities will leave average India poorer than before, more unhealthy than before and less well fed than before.

I cannot claim to be an economist though, I have studied the subject for seven years in Delhi University, Cambridge University and Princeton University. Therefore, I am not always able to understand the logic of the World Bank trained economists who now seem to dominate the corridors of power in Delhi. The argument advanced is that subsidies have increased the fiscal deficit and imbalanced the budget, which prevents government from making investment in the future of this country and, therefore, if we eliminate subsidies there would be more money with government for useful work, investor confidence would strengthen and employment opportunities for the poor would flood the market. The question is, how? The National Rural Employment Guarantee Scheme costs the exchequer something like Rs. 65,000 cores per year and it is estimated that leakages in the scheme drain away approximately seventy percent of the funds. That amounts to Rs. 45,500 cores per year. If leakages are plugged either the programme could be made seventy percent larger or approximately Rs. 45,000 crores would be available to the public exchequer for more development work or for maintenance of existing levels of subsidy. Blocking a leakage is more difficult than abolishing the subsidy and, therefore, in this nation of lotus eaters, of whom the largest number are in government, our rulers have taken the easy way out and opted for abolition of subsidies. In the process they have imposed an almost unbearable burden not only on the poor but even on the middle class. What sort of economics is this? Connected to this whole line of thinking is the opening up of our markets to Foreign Direct Investment (FDI). This paper is already quite long and I shall leave the question of FDI in retail trade and in civil aviation for discussion on another day. However, the stand taken on subsidies and on FDI are both negative and representative of a mindset which is so utterly divorced from the ground realities of India that one wonders how we tolerate such absolute arrant nonsense.

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