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Politics of subsidy draining India's financial strength

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Ever since India's UPA government came to power in 2004, there has been a massive increase in subsidies, especially for oil and food. Subsidies now account for close to 35 per cent of the central government's tax revenue. -- PHOTO: REUTERS

By Kunal Kumar Kundu For The Straits Times

There is no lack of subsidies for the economically poor in India: food, electricity, fertilizer, diesel – you name it, they have it.

Yet they are none the better for it. Poverty continues to be stark, and hunger and malnutrition is still prevalent.

\Why haven't such assistance proven to be a boon, despite the best of intentions? The answer is enmeshed with politics – and the the politics of subsidy – in India.

Indian national politics have evolved from single-party domination to multiparty coalitions. Regional politics add to the mix – competitive populism become entrenched and even expanded.

The Indian National Congress (INC), the largest political party, formed the country's first government after independence in 1947. The first general assembly (or Lok Sabha) election was held in 1951.

The INC won with a huge majority. It went on to dominate national politics until 1977, when the Janata Alliance led by the Bharatiya Lok Dal (BLD) came into power. But the INC was back in power in the next two elections.

In 1989, the INC, despite being returned as the single-largest party with 197 seats, did not have the absolute majority required. It was the second-largest party, the Janata Dal (with 143 seats), that then formed a coalition government under a National Front umbrella.

The situation now is a fractured electoral mandate, with no single party receiving a clear majority at the national level since 1989. The sheen of the INC has been diminished, and the BJP is the second-largest national party. Other parties with strong regional bases have emerged.

These strong regional parties have helped national parties to hit the magic number – more than 50 per cent of total seats – to form the government. At every election now, be it at the national or state level, competitive populism rears up, which drains the exchequer.

Social sector spending is the vehicle through which the elected representatives reach out to their voters, without any concern for the outcome or of ways to tackle the corruption that results too.

In the case of the INC, when it lost power in 1996, it had to wait eight years to be returned to office. The election loss, coming five years after it ushered in tough economic reforms, seemed to have led it to concede that "good economics is bad politics".

Hence, when the INC came back to power along with its allies in the United Progressive Alliance (UPA) in 2004, so-called "social-sector initiatives" – subsidies and handouts – became the essence of its overall policy thrust.

There was the MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act), a farmers' debt waiver scheme costing approximately 500 billion rupees. A pay commission's recommendation of massive salary hikes for bureaucrats was implemented but its call for cutbacks in staff numbers and other cost-cutting measures were ignored.

During the UPA government's term, prices paid directly to farmers under its Minimum Support Price (MSP) scheme to procure foodgrains, went up manifold.

Not surprisingly too, ever since the UPA government came to power in 2004, there has been a massive increase in subsidies, especially food and oil subsidies.

And while expenditure on subsidies had increased at an annual rate of 14.9 per cent from 1991 (when economic reforms were ushered in), it increased at an annual rate of a whopping 21.6 per cent during the nine-year tenure of the current UPA government.

Subsidies now account for close to 35 per cent of the government's tax revenue. The massive increase in spending in corruption ridden and poorly targeted subsidies and other social sector projects have badly eroded the government's financial strength.

When the UPA came to power, the Indian economy was in a sweet spot. Growth rates were picking up, the global environment was conducive and inflation was under control. It was this strong macroeconomic environment that saw the ruling coalition give in to more populist schemes.

Ironically, then finance minister P. Chidambaram had actually announced the Fiscal Responsibility and Budget Management (FRBM) Act which sought to reduce the revenue deficit (difference between revenue expenditure and revenue income) to zero and the fiscal deficit to 3 per cent of GDP within five years.

But the government soon realised this would act as a constraint on greater social spending. So it pushed certain expenditures off its balance sheet by issuing oil bonds, fertiliser bonds, and so on, instead of granting direct subsidies. Since only bonds were issued and no transfer of actual cash took place, those expenditure items were kept off the balance sheet and the government could show a lower deficit.

Social spending remains unabated under the current UPA government – but it has a new game plan. First, it is making oil companies bear around 40 per cent of the total oil subsidy burden. And it is deferring a part of the subsidy payment to next year – the idea being to lower the subsidy size (ok?) for a particular year and hence to show a lower deficit.

But, with domestic growth tapering to dangerous levels and global growth weakening, the years of profligacy are back to haunt India in the form of an unsustainably high fiscal deficit level.

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