

A Critical Analysis of the Impact of Freebies on the Indian Economy in Recent Times

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ABSTRACT

An attempt will be made to understand and analyze the widespread impact of freebies and welfare schemes, announced by State and Central governments, on the Indian Economy. This paper emphasizes specifically on the adverse impacts of the growing trend of 'freebies', as a part of election campaigning.

Keywords: Freebies, Welfare Schemes, Indian Economy

1. Introduction

There actually isn't an official meaning of the term 'Freebies'. It is subject to personal interpretation, and that is exactly where the problem being discussed in this paper germinates from. Going through multiple news reports, editorials and documents, the most comprehensive definition of this term I could form was as follows- "Provision of a series of promises made by political parties by providing free electricity, free public transport, free water, and waiver of pending bills and loans are often regarded as freebies."

Whereas, Former Chief Election Commissioner of India OP Rawat has a more elaborate explanation for the same, claiming that anything that is handed free of cost and which has no justification is a freebie. Rawat says, "The continuation of free ration for 80 crore Indians for 5 more years can be called a freebie. Are we saying that India has so many hungry people? Again, a free bus ride for every woman-rich or poor-is a freebie. A '500 gas cylinder for a family above the poverty line is also a freebie. Even Ladli behna benefits for 1.32 crore women in MP will come under the category of freebies.

2. Recent discussions

While election freebies are not a new trend in Indian elections, the issue has become hotly debated in recent times. There have also been concerns raised on such largesse in recent years as the central government and the states try to become more fiscally responsible, while the finances of many states remain under pressure after the Covid-19 pandemic. There is also a growing realization that the cost of these schemes has to be eventually borne by the voter, often in the form of higher taxes. For now it seems that the central government's fiscal deficit goal of 5.9 percent of GDP will be met and it will remain conservative in its spending. "Competitive populism has remained a dominant theme in state elections, not just with the Congress, but also the BJP," brokerage Nomura has highlighted in a recent report.

Experts also note that often the exact fiscal impact of election-time promises on taxpayers may only be felt after about 12-18 months of the government being formed, by when the schemes have been fully implemented. Though the cost of such promises is often hard to gauge, a recent report by SBI Ecwrap on the Arithmetic of the Karnataka Budget estimated that almost Rs 60,000 crore annually would be required to fulfill the five pre-poll guarantees of the ruling dispensation.

3. Major Drawbacks

3.1. Economic Health

The provision of free electricity, water, public transportation, waivers of past-due utility bills, and farm loan waivers, according to the RBI, can be considered freebies even though the term is not clearly defined. It is considered so because they "potentially undermine credit culture, distort prices through cross-subsidization eroding incentives for private investment, and disincentivize work at the current wage rate leading to a drop in labor force participation. The economic impact must be kept in mind as to how it impacts the economic health of the state and must consider how it is going to enhance the life of the beneficiary. It is important to distinguish between welfare and freebies by the states, as stated by the Supreme Court. Also, to ensure there is no leakage in delivery and that it directly benefits the target audience.

3.2. N.R. Bhanumurthy, Vice Chancellor of Bengaluru-based Dr. B.R. Ambedkar School of Economics University-

3.2.1- He notes that there is a need to differentiate between freebies and social sector measures announced during polls that can have a long-term development impact. According to him, farm loan waivers have limited impact on consumption demand, but in the long term, have negative implications on the fisc and limit resources for other important social sector expenditure. "It is a

freebie as it does not have a long-term impact on growth and development, or on productivity,” he says.

3.2.2- However, a free bus service for women, as has been promised in many states, can have medium- to long-term implications on the female labor force participation rate. Similarly, the extension of the Pradhan Mantri Garib Kalyan Anna Yojana (PM-GKAY) will help address the nutritional status of the poor and their productivity. “Freebies add to the public debt burden. From day one, they impact the regular budget, public debt and the fiscal deficit. They do not add to the GDP in the current or the future period,” he adds.

3.3 Highlighting Free Electricity subsidies-

In 2021-22, Rajasthan spent as much as 97% and Punjab 80% of their total subsidy expenditure on electricity. “States have to reduce some of their subsidies, especially the most distorting ones like free electricity, to be able to raise capital outlays, ” says Krishnamurthy V Subramanian, executive director, the International Monetary Fund (IMF). “Electricity subsidy is the most unproductive and distortionary one. It depletes the groundwater and bleeds the discoms (power distribution companies).

3.4. Pronab Sen, Former Chief Statistician of India-

Sen says the financial landscape of some states would have been more damaging had political parties implemented every promise they had made when they came to power. “The actual impact of freebies on the Indian economy is still limited because some promises remain unfulfilled,” he says, adding that legacy subsidies are the real problem. “At times voters don’t mind if a promise is not fully implemented. But once a freebie is given, no political party will dare to withdraw it, fearing a backlash,” he adds.

3.5. Sacchidananda Mukherjee, Professor (National Institute of Public Finance and Policy)-

He notes that it is the government’s discretion on where to spend, but there is a need for a cost benefit analysis of such measures to households. Some of these such as food subsidy or employment guarantee can be recurring expenditure, while others such as those on providing laptops and phones can lead to a one-time spike in expenditure. “It is important to note that some subsidies such as those on electricity and water can free up spending in households that can then be used for consumption and lead to higher revenue for the government as well,” he says.

3.6. Outstanding Liabilities of State Governments-

The PRS report also highlights that several states continue to budget revenue deficit, thus constraining capital outlay. The outstanding liabilities or accumulated debt of states has also

risen again in recent years, partly due to expenditure, such as farm loan waivers and debt takeover from the UDAY scheme. In 2020-21, states' fiscal deficit limit was increased to 5 per cent of GDP due to the adverse impact on revenue receipts because of the Covid-19 pandemic. Outstanding liabilities of states were estimated at 29.5 per cent of the GSDP at the end of 2022-23 as against 26.7 per cent at the end of 2019-20.

3.7. Dependency Culture-

3.7.1- Entitlement Mentality

The provision of freebies can foster a culture of dependency among beneficiaries. This entitlement may reduce individual motivation to seek employment or contribute to the economy, ultimately undermining productivity and innovation.

3.7.2- Reduced Tax Compliance

As citizens become accustomed to receiving benefits without contributing through taxes, there may be a decline in overall tax compliance. This situation can further exacerbate fiscal challenges for the government.

3.8 Inflationary Pressures

3.8.1- Increased Disposable Income and Demand

- **Surge in Consumer Demand:** Freebies often lead to an increase in disposable income for recipients. When individuals receive benefits such as free electricity, transportation, or cash transfers, their purchasing power rises. This increase in disposable income can result in heightened consumer demand for goods and services.
- **Demand-Pull Inflation:** As demand surges due to increased disposable income, it can outstrip supply capabilities, leading to demand-pull inflation. This phenomenon occurs when the overall demand for goods and services exceeds their supply, causing prices to rise. In India, this has been observed in various sectors where freebies have been implemented, particularly in urban areas where consumption patterns change rapidly.

3.8.2- Supply Chain Constraints

- **Strain on Supply Chains:** The sudden increase in demand can strain existing supply chains, especially if producers are unprepared for the surge. This strain can lead to shortages of goods, further driving up prices as suppliers respond to increased demand by raising prices.

- **Production Costs:** In some cases, the increased demand may also lead to higher production costs as manufacturers attempt to ramp up production to meet consumer needs. These increased costs can be passed on to consumers through higher prices, contributing to inflation.

3.8.3- Market Vulnerabilities

- **Cash Transfers and Market Exposure:** Programs that provide cash transfers rather than direct services expose recipients to market fluctuations. For example, when beneficiaries receive cash instead of subsidized goods (like LPG), they must purchase those goods at market rates. If inflation is high, the value of the cash transfer diminishes quickly, leading to increased financial strain on households.
- **Dependency on Market Prices:** Beneficiaries of cash-based welfare schemes may find themselves vulnerable to market price volatility. If prices rise due to inflation, the purchasing power of these cash transfers erodes, forcing families to either cut back on consumption or seek additional income sources.

3.8.4- Wage Disparities

- **Non-Inflation Adjusted Benefits:** Many welfare schemes provide fixed benefits that do not adjust with inflation. For instance, wage payments under schemes like the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) may not keep pace with rising living costs. As inflation increases while wages remain stagnant, workers' real incomes decline, exacerbating poverty levels among the most vulnerable populations.
- **Impact on Labor Markets:** The inability of welfare payments to keep up with inflation can discourage labor force participation. Individuals may opt to rely on government support rather than seek employment opportunities that may not offer sufficient wages to cover rising costs of living.

3.9 Fiscal Burden and Budget Deficits from Freebies and Welfare Schemes

3.9.1- Escalating Public Expenditure

- **Unsustainable Costs:** Offering free services like electricity, water, transportation, and cash transfers to large segments of the population can lead to skyrocketing costs for state governments. For example, the Tamil Nadu government's promise of free bus rides for women was estimated to cost over ₹1,200 crore annually. Such commitments are difficult to sustain over time without significant revenue increases.

- **Crowding Out Essential Spending:** Allocating substantial funds to finance freebies can divert resources away from critical areas like infrastructure development, healthcare, and education. A report by NITI Aayog criticized the Uttar Pradesh government's distribution of free laptops, noting that it diverted funds from more pressing needs like improving school infrastructure and teacher quality. This opportunity cost can hinder long-term economic growth.

3.9.2- Widening Fiscal Deficits

- **Strain on State Budgets:** Freebies can strain state finances by increasing expenditures without commensurate growth in revenues. For instance, the Karnataka government's recent announcement of free bus rides for women and free electricity up to 200 units will likely add to its fiscal deficit. Collectively, these commitments by various states contribute to India's overall fiscal imbalance.
- **Unsustainable Debt Levels:** To finance growing deficits, governments often resort to increased borrowing. This leads to higher public debt levels that can become difficult to service in the long run. A report by the Reserve Bank of India (RBI) highlighted that pension schemes like the Indira Gandhi National Old Age Pension Scheme (IGNOAPS) pose fiscal risks as they imply rising pension liabilities with an aging population

3.10 Impact on India's Rural economy

3.10.1- Impact on Rural Consumption and Demand

The sources highlight that rural consumption constitutes a significant portion of sales for FMCG companies in India. If the "revdi" culture leads to higher inflation as suggested, it could erode the purchasing power of rural consumers and potentially dampen rural demand for consumer goods. This could, in turn, impact the revenues and growth prospects of companies heavily reliant on rural markets.

3.10.2- Distortion of Rural Labour Markets:

While not explicitly mentioned in the sources, the "revdi" culture's emphasis on giveaways and subsidies could potentially distort rural labor markets. For instance, if free food grain programmes are expanded significantly², it might disincentivize some individuals from seeking employment in the agricultural sector or other rural industries. This could lead to labor shortages or wage inflation in certain areas.

4. Legal Precedents on Freebies in Election Campaigns

The legal landscape surrounding freebies in election campaigns in India is evolving, particularly as the Supreme Court addresses the implications of such practices on electoral integrity and fiscal responsibility. Here are the key legal precedents and ongoing cases related to this issue:

4.1 S. Subramaniam Balaji v. State of Tamil Nadu (2013)

- **Case Overview:** This landmark judgment addressed the legality of promises made by political parties to provide freebies, such as color televisions and kitchen appliances, during election campaigns. The Supreme Court ruled that such promises do not constitute corrupt practices under the Representation of the People Act, 1951.
- **Key Findings:** The Court acknowledged that while these promises could influence voters, they did not amount to bribery as defined under Indian law. The ruling emphasized that the legislature should determine what constitutes appropriate public expenditure, thereby leaving the door open for political parties to continue making such promises without legal repercussions.
- **Implications:** This judgment has been pivotal in shaping the discourse around electoral freebies, as it established a precedent that allows parties to promise welfare benefits without facing legal challenges under existing electoral laws.

4.2. Ashwini Kumar Upadhyay v. Union of India (2022)

- **Case Overview:** In this ongoing case, advocate Ashwini Kumar Upadhyay filed a Public Interest Litigation (PIL) seeking a ban on political parties promising freebies during elections. The petition argues that such practices amount to bribery and violate fiscal responsibility principles.
- **Supreme Court's Response:** The Court has expressed concern over the potential impact of freebies on state finances and electoral fairness. It has issued notices to the Election Commission of India (ECI) and the central government to respond to these concerns.
- **Key Issues Raised:**
 - Whether promises of freebies can be classified as bribery.
 - The distinction between legitimate welfare schemes and mere electoral handouts.
 - The need for guidelines from the ECI regarding election manifestos and promises.

4.3 Recent Developments

- **Referral to a Three-Judge Bench:** In August 2022, the Supreme Court referred the matter to a three-judge bench for extensive hearings, indicating that the issues raised require deeper exploration beyond what was addressed in previous judgments. The Court noted that there were significant concerns about how these practices might undermine fiscal discipline and fair electoral competition.
- **Formation of Expert Committees:** During earlier hearings, there was discussion about forming an expert committee to evaluate the implications of freebies on public finances and electoral integrity. The Chief Justice suggested that such a committee could include representatives from various governmental bodies to provide a comprehensive analysis.

4.4. Judicial Considerations

- **Balance Between Welfare and Fiscal Responsibility:** Chief Justice N.V. Ramana has articulated the need for a balance between social welfare initiatives and their financial implications for state budgets. He emphasized that while social welfare is essential, it should not come at the cost of fiscal health.
- **Potential Legislative Action:** There have been calls for new legislation to regulate how political parties can make promises regarding freebies in their manifestos. The Supreme Court has indicated that legislative action may be necessary to address these concerns comprehensively.

In summary, while past judgments like *S. Subramaniam Balaji* have allowed political parties to promise freebies without legal penalties, ongoing cases like *Ashwini Kumar Upadhyay v. Union of India* are challenging this status quo. The Supreme Court's current deliberations reflect a growing recognition of the need for clarity and regulation in this area, balancing electoral promises with fiscal responsibility and public interest.

5. CASE STUDY- SRI LANKA

Sri Lanka has been grappling with its worst economic crisis since independence, triggered by a combination of factors including tax cuts, money creation, and the impact of the COVID-19 pandemic. However, a key contributor to the crisis was the Sri Lankan government's excessive use of freebies to win votes, which ultimately led to the country's economic downfall.

- **Tax Cuts and Fiscal Sustainability:** In an effort to win elections, the Sri Lankan government implemented massive tax cuts that severely reduced government revenues. This decision was quickly criticized by global ratings agencies, which warned that such policies undermined fiscal sustainability. As a result, Sri Lanka's debt-to-GDP ratio began to rise sharply.
- **Rising Debt Levels:** By 2022, the IMF reported Sri Lanka's debt-to-GDP ratio at approximately 116%, indicating that the country owed more than its entire annual economic output. This level of debt is considered unsustainable and is often associated with economic crises. The situation worsened due to the COVID-19 pandemic, which further strained the economy and reduced revenue from crucial sectors like tourism.
- **Default and Economic Collapse:** The combination of rising debt and declining revenues culminated in Sri Lanka defaulting on its international debt obligations in 2022. This marked a significant turning point, as high debt levels became unmanageable without sufficient income to service those debts.
- **Long-term Consequences:** The ongoing economic crisis has led to hyperinflation, severe shortages of essential goods, and widespread public discontent. As of late 2023, the central government's debt as a percentage of GDP was reported to have declined slightly to 103.9%, primarily due to nominal GDP growth driven by inflation rather than effective fiscal management. However, the nominal value of total debt continued to increase, reflecting ongoing financial challenges.

The case of Sri Lanka illustrates how poorly directed government freebies can lead to fiscal irresponsibility and unsustainable debt levels. The initial appeal of such policies—winning voter support—has resulted in long-term economic instability, highlighting the need for careful management of public finances and a balanced approach to welfare spending.

6. CONCLUSION

While these lucrative 'freebies' and welfare schemes announced and implemented by political parties during election times prove to be beneficial with respect to electoral gains, they have a major negative impact on the fiscal and economic health of the government. There is no such thing as a freebie in an economy, as someone or the other has to pay the cost for it. Which in majority cases is the Tax-payer. State governments need to be wary of these freebies and subsidies. If after receiving them, citizens don't spend to support the state's economy, it can lead to a serious economic crisis, akin to what Sri Lanka is going through.

There needs to be a proper and thorough evaluation of each and every freebie rolled out by the government, so as to ensure that while it benefits the target citizen group, it is not harmful for the economy in the long run.

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