Democracy, Populism and Free Lunches

by

Jayaprakash Narayan

(This paper is written for Er. Yarlagadda Sreeramulu First Endowment Lecture)

LOK SATTA

401/408 Nirmal Towers
Dwarakapuri Colony, Punjagutta
Hyderabad – 500 082
Tel: 91-40-23350778/23350790; Fax: 91-40-23350783
E-mail: **loksatta@satyam.net.in**; url: **www.loksatta.org**

Democracy, Populism and Free Lunches

Dr Jayaprakash Narayan*

Over the years Indian democracy has certainly stood the test of time. Among the nations liberated after the Second World War, India has a unique record of successive elections and, stable and peaceful democracy.

Judged by four key criteria, our democracy is robust and real. Government leaders are chosen in competitive elections; all parties have the right to propagate their ideas and openly seek public support; there is peaceful transfer of power and losers are not punished by winners; and elected governments exercise real authority and are accountable to the electors. When we criticize our democracy in operation, we tend to take our blessings for granted.

Participation trends in successive elections clearly establish that our democracy is deepening. The voter turnout for state Assembly elections has shown a steady increase from 45% (1952) to 64% (1993-95). The polling percentage for Lok Sabha too is around 60%. Among countries with first-past-the-post system, this is a high rate of polling. The poll percentage in the US is only around 50, and even in the UK it is around 60%. Only countries with proportional representation record consistently higher voter participation. Considering the defects in our electoral rolls, this polling percentage is high. Even more heartening is the fact that the poor, illiterate and rural voters participate more earnestly than others.

Our democracy also has given space for accommodating regional diversity and various social groups. Regional parties have grown, and now occupy pride of place in many states. Various caste groups which have been historically underprivileged have now become politically powerful. Monolithic, centralized governance has given way to more genuine federalism and increasingly important local governments. Despite the multiplicity of parties, unity of India has been preserved. Almost all recognized political parties pursue centrist policies and practice consensual politics. This is a remarkable accomplishment in an extraordinarily diverse polity and society. As a result, in most states there is either a two-party system, or two stable alliances competing for power. Even at the union level, a culture of coalition governments is gaining ground, providing stability and continuity of policies, even as there is genuine clash of ideas and competition for power.

A democracy has to be judged more by the liberties enjoyed by citizens and constitutional checks against abuse of power than by mere periodic elections and change of governments. Here again India ranks high. There is real constitutional protection of a

* The author is the National Coordinator of Lok Satta movement, E-mail: loksatta@satyam.net.in; Url: www.loksatta.org

variety of freedoms, and independent judiciary, strong and impartial Election Commission and many other constitutional functionaries and practices act as sentinels of liberty and guardians of democracy. As a result, India witnessed national unity, reasonable social harmony and moderate economic growth for over five decades.

But there are many warts in our democratic system, which hold us back. Political parties have become private estates, with little intra-party democracy or freedom of choice to members. Given the single-member constituencies in the first-past-the-post (FPTP) system, there is an oligopoly of parties operating, denying people real choice or political competition. Electoral verdicts are broadly reflective of public opinion, and there is no state-sponsored rigging. However, at the constituency level, criminal gangs, bogus voting, and illegitimate and unaccounted expenditure for vote-buying play an important role. A system of compensatory errors is in place, by which the malpractices of one candidate are neutralized by those of his rival!

Vast expenditure and polling irregularities may not ensure victory; but the candidates who cannot deploy money and muscle are almost certain to lose! This forces parties to nominate only “winnable” candidates who can muster the money and muscle power required for success. The link between vote and public good is tenuous. Consequently many voters have become short-term maximisers, seeking money and liquor, or succumbing to anger, populist promises, or primordial loyalties like caste or religion. As the voters have become short-term maximisers, the political class is increasingly dependent on populist policies that at best may have short-term political gains. This dependence on populist policies has resulted in fiscal profligacy and is having deleterious impact on the finances of governments, especially the state governments.

Whenever we discuss about “populism” in our democracy, we often confine ourselves to specific economic or social polices of governments. In the process, we fail to understand or recognize the many dimensions of populism. An important dimension of populism, which needs to be explored is “ideological populism”, which strengthens and legitimizes many imprudent economic policies. Even today, there are many votaries for unwarranted state intervention and imprudent socio-economic policies. Surprisingly, it is not merely politicians, but the votaries of unwarranted state intervention include academicians, bureaucrats and social activists. I have used the word “surprisingly”, because I can understand the compulsions of politicians to indulge in populist rhetoric but one cannot fathom what propels social activists and academicians to advocate policies that harm the poorest of the poor in the long run.

Ideological Populism

As we all know, during the past fifty years, in the name of socialism, we undermined true entrepreneurship. And we became control freaks. I vividly remember that only 20 years ago we had cement control and dual pricing, and people had to beg for cement permits to build homes! We had bureaucrats controlling steel sales and seeking bribes and exercising patronage. On the other hand, the state’s failure in education, healthcare, rural technologies and infrastructure have been too well documented to need elaboration. In short, the state failed in its core areas of legitimate functioning, and did everything possible to undermine our self-esteem and enterprise. And yet, even today we hear arguments for increased state intervention in non-critical areas.

Let us compare and contrast the efficiency and competitiveness of public sector vis-à-vis private sector. Disinvestment ministry has quoted a NCAER study to conclusively establish that public monopolies cannot effectively respond to changed conditions. Comparisons of factor productivities, profitability and cost structure – all show the dynamism of private management and inertia of state control. As the total factor productivity in private sector recorded 3.4% growth since 1985, in public sector there is a negative growth of -1.1%. Manufacturing PSEs continue to show losses, while manufacturing private sector shows decent profits. From resource utilization point of view and competitiveness, the most critical comparison relates to cost structure of power and fuel, wages and interest as a ratio of net sales. In 1990-91, the public sector (minus oil sector) spent 37.7% of net sales on these three heads, as opposed to private sector's cost of 21.7%, with a net saving of 16 %. Amazingly, by 1997-98, this difference in cost incurred has increased to 38.3% of net sales, with public sector spending 54.5 % of net sales on these three items, and private sector 16.2 %! Increased competition and open markets forced private sector to reduce costs to a tune of 5.5 %, whereas public sector costs went up by almost 17 %! There cannot be a more severe indictment of public sector management. The managers are not at fault; the same personnel in private environment produce excellent results. We must recognize that even if all else is equal, public sector culture does not foster the best management practices. With the economy opening up, and competition growing, continued insistence on government controlling PSEs will only erode their assets, and eliminate them from the market.

The champions of state control must answer a fundamental question. Have people elected them to govern, or to run a business? Socialism took roots as a moral philosophy based on compassion and concern for equity at a time when predatory capitalism of robber baron variety led to extreme degrees of oppression and misery. But today's market economy adapted the best features of humanism, welfare and sustainability. Resorting to outdated arguments and shibboleths, and criminal waste of scarce public resources at the cost of justice, rule of law, education, health care and decent infrastructure is cruel to the poor and disadvantaged. Quality schooling, accessible health care, speedy justice and security net for the indigent are the best anti-poverty programmes. A government, which cannot provide these, has no moral authority to take upon itself other burdens, and discharge them incompetently. Ministerial office and bureaucratic sinecures have become private fiefdoms, and loss of patronage and control unnerves those in authority. But equating self-interest of those in power with public interest is an insult to the intelligence of the long-suffering people of the country, and a cruel irony in a society impoverished by bad policies and worse governance. Moreover, unnecessary and inefficient state interventions, and imprudent economic polices are pushing our governments into fiscal crisis.

Consequences of Populism

Ballooning fiscal deficit is the major problem plaguing the minds of policy makers, economists and thinking citizens. Shorn of all jargon, fiscal deficit is nothing but the excess of government expenditure over revenues. The finance ministers of the past effortlessly bridged this gap by resorting to two 'simple' measures – deficit financing or borrowing. Deficit financing means liberally printing new currency; borrowing means taking our money in banks at absurdly low interest rates through the mechanism of statutory liquidity ratio (SLR), which led to high inflation and increased rates of interest for general investment. This in turn led to economic slow down resulting in the 'Hindu Rate of Growth'

Our combined fiscal deficit remains pretty high at about 10% of GDP despite valiant efforts of successive finance ministers. What are the causes for such high fiscal deficit? Let us take subsidies as an example. For fiscal 2002-03, major union subsidies account for Rs 37,392 crore. Food subsidy alone will cross Rs 21,200 crore. Power subsidies and losses (which will eventually be subsidized) in states will probably account for Rs 40,000 crore. And there are other subsidies in states too. To make matters worse, Inder Kumar Gujral's cabinet took the populist decision to implement the Fifth Pay Commission's recommendation to significantly enhance the wages of government employees but put proposals to improve productivity and reduce work force on the back burner. The increase in wages of the union's employees had a cascading effect on the wages in the states and public sector resulting in mounting fiscal deficits and borrowings. All these are contributing to ballooning fiscal deficit and there are no magic wands to control deficits. We must either raise taxes, or reduce subsides or control wages. Selling PSUs does not make a dent in deficits because even the modest projections of sale revenues of Rs 10,000 crores annually have never been realized, and even if realized will hardly make a difference.

While the tax revenues are increasing, they are not enough to match the expenditure growth, forcing governments to borrow more money to bridge the revenue gap. Investments in public sector are yielding negligible returns. As finance ministers no longer have the luxury of resorting to uncontrolled deficit financing or compulsory borrowings from banks at artificially low rates, borrowings had to be made at the market rates of interest. For instance, as early as in 1992, Dr Manmohan Singh, as Finance Minister, lamented the shackles imposed by these fiscal compulsions. The only two changes subsequently are: defence expenditure shot up significantly in recent years, and wage expenditure of both the union and state increased greatly with the acceptance of Fifth Pay Commission recommendations. The net result of all this has been less than adequate social expenditure and poor quality infrastructure. For instance, public expenditure accounts for 28% of GDP, the allocation for education, health care and social security is a meagre 5% of GDP, as opposed to 25% in OECD countries. Naturally, people do not see how their tax money is benefiting them. And when people have to pay bribes for the simplest of services, it is hard to summon the will to pay more taxes. Therefore, the only answer is de-subsidization.

De-subsidization and Political Risks

De-subsidization is easy to prescribe, but difficult to deliver in a poor country. The poor family that gets real income of Rs 100 every month as food subsidy cannot give it up to fill the fiscal hole. This is true everywhere. Obviously, it is not easy. De-subsidization anywhere in the world has always been painful, and politically risky. The peanut quotas and resultant subsidies increase the price of peanut butter in the US significantly. And yet, these quotas withstood Reagonomics and Gingrich revolution. The rise of Solidarity in Poland is linked in no small measure to the rising food prices from 1970 onwards, eventually precipitating the collapse of communism in Eastern Europe. The sudden increase in the administered prices of food in December '70 led to riots in the Baltic cities of Gdansk, Gdynia and Szczecin, and Gomulka was ousted from power. His successor, Edward Gierek had to again raise food prices in 1976, leading to violent strikes in Warsaw and Radom. Fresh price rises in 1980 touched off nation wide strikes, and that was when Solidarity was created at the Lenin Shipyard, Gdansk under Lech Walesa's leadership as an independent, self managing trade union. The rest is history.

In this context, is there a way of reducing these subsidies, retargeting them without inviting massive social unrest and political opposition? The answer lies in adopting a two-pronged strategy: First, looking for politically cost-effective and creative solutions sector-wise; Second, to ensure de-subsidization through decentralization. Let me now explain the problems afflicting the power sector due to populist policies and possible solutions to reduce the subsidy burden.

Populism and Power Sector

The management of power sector will make or mar India's economic future. For over a decade, we have been incessantly talking of power sector reform, and yet the results, so far at least, have been disheartening. We focused on one area – generation, which has been our strong point and ignored distribution, which is our weakest link. As a result, hardly any private investment – domestic or foreign – materialized. Only about 6700 MW of private generation capacity came up – a third of the expected investment. Meanwhile, the annual losses in SEBs went up from Rs 3000 crore in 1991 to over Rs 30,000 crore in 2001. Some estimates put it closer to Rs 40,000 crore. During this period, the revenues realized by SEBs fell from 85% to 69% of the cost of supply, leaving a huge gap of 31%. Payments by SEBs to NTPC for power supplied fell to 69%. If this trend continues, there is every likelihood of many SEBs collapsing, and dragging down NTPC along with them.

While concerted efforts are being made to address the crisis in power sector, the recent political events have now led to a *domino effect* deepening the crisis. Three of the 'better' states have now announced free, unmetered power to agriculture and others will be compelled to follow suit. Maharashtra joined two other major states in reversing rational management policies in power sector. Congress swept to power in AP with the promise of free power in May, 2004. In Tamil Nadu, Ms Jayalalitha's government too reversed its earlier policy and opted for free power in the face of massive rejection of the ruling combine in the Lok Sabha elections. Sadly, Maharashtra and Tamil Nadu SEBs are two of the better managed ones in India, and both are now set up for failure. AP utilities were struggling for years to make ends meet, and free power and write-off of arrears set them back significantly. The Central Electricity Act, forbidding unmetered power, or realization of less than a minimum tariff, has been relegated to the dustbin.

In many ways, the fiscal and industrial future of the Indian states, their productivity and investments will largely depend on this key infrastructure sector. Let us look at the grim facts. The cost of power supply in AP in 2001–02 was 361 paise/KWH, whereas average tariff was 222 paise/KWH, resulting in a loss of Rs. 1,194 crores even after receiving a huge subsidy (Rs 1,626 crores) from the state. The corresponding figures for Maharashtra were 358 paise, 270 paise, and Rs 3524 crores losses; and for Tamil Nadu, 310 paise, 237 paise, and Rs 2260 crore losses. The total losses of the power boards of major states in 2001–02, after receiving subsidies, were a whopping Rs 24,837 crores!

Meanwhile, access and availability of power are at appalling levels. Less than 50 % of all population has access to electricity, and in rural access it is about 33 %! For over a decade, there is talk of reform. But results are dismal. The power availability, and losses speak for themselves. As opposed to 4-8% transmission and distribution (T&D) losses in developed countries, and 10-14% losses in South-east Asia and Mexico, T&D losses in India are about 28%! Nobody knows the real figures, because in many states there is no proper energy audit. For instance, in AP, only about 46% of all the power produced is metered and billed. The balance 54% goes towards unmetered agricultural power, or is lost in transmission, or stolen (euphemistically termed ‘commercial losses’), or lost due to poor distribution network (‘technical losses’)!

Even more importantly, very low fixed tariffs at slab rates, based on connected load, encouraged indiscriminate exploitation of ground water. Water levels are falling precipitously in dry lands. The benefits of free power go only to the few farmers who can invest huge sums in sinking borewells, and are lucky to strike water. Enticed by nominal tariffs, many small farmers borrowed at usurious rates and drilled several unsuccessful borewells. This indebtedness for indiscriminate drilling lies behind several farmers’ suicides. As agricultural power was not metered even earlier, the few lucky farmers raise water-intensive crops in rain-shadow zones, further depleting ground water. On top of it, there is no incentive for efficient use of energy, as a fixed slab rate was charged per HP of connected load earlier, and power is free now. Consequently, inefficient or high capacity motors are installed, sometimes in the hope that a larger pumpset will yield more water. The limited water available is wastefully used, and sometimes motors run idly as ground water recharging is slower than drawal of water. The consequences of unmetered power have clearly been horrendous to the economy, water table, and environment.

The free power policy cannot be reversed easily for the time being. We have to convert this challenge into an opportunity and address the real crisis afflicting the rural power sector. There are politically cost effective and creative solutions available.

First, farm sector undoubtedly is in distress. But to pretend that free power is the answer is sheer hypocrisy. The real answers lie not in additional subsidy but in increasing capital investment (irrigation and soil conservation), enhancing productivity (technology, extension and inputs), better infrastructure (storage, transport and marketing), and value-addition (agro-processing, grading and packaging). For instance, in AP, already agri-power was heavily subsidized, and the added relief on account of free power was only Rs.400 crores per annum – about 1% of state's budget! Farm sector deserves ten times more support, but by other means, not by undermining power sector.

Second, agri-power issue should be de-linked from economic tariffs and cost recovery. The issue must be linked to water and power conservation, and energy auditing. Unmetered power (free or with slab tariff) is a recipe for disaster, as it encourages high water and power consumption. Precious ground water in dry areas is depleted by indiscriminate use; water-intensive crops are raised by the few lucky farmers who strike water, at the cost of others. There is no incentive to save power, and inefficient pumps and motors and absence of capacitors in many cases are leading to criminal waste of power and environmental damage. There must be a reasonable ceiling of, say, 3000 units per annum for such freebies, and a modest, but progressively increasing tariff should be charged once consumption crosses that limit. The utilities can install meters at their own cost. Once there is incentive for energy conservation, farmers will install efficient, low-HP motors, and use energy-saving devices. Simultaneously, the benefits of free or concessional power should be limited only to dry crops. This is easy to monitor, as the crop raised is physically verifiable. Cropping area will increase with the same amount of water. Encouragement of dry crops, coupled with graded tariffs will significantly reduce agricultural power consumption. Most of all, unmetered power makes energy auditing impossible, and thefts, corruption and gross inefficiencies go unchecked. Metering, free or low-cost power up to a ceiling, graded tariffs linked to consumption, and targeting concessions to dry crops and small farmers are vital and necessary. Metering of power leads to another great benefit. There will be better energy auditing. Right now, in many states, we have no clue about power losses. Nobody really knows what is happening where. While we have a global picture of power sector deficits, what we need is precise energy auditing at the local level to address the problems systematically. Metering localizes problems, and enables us to reduce losses.

Finally, the real problem in power sector is distribution management. The 28% T&D losses (possibly over 30% in several states) must be brought down to 15% or lower. That needs proper metering of all consumers, energy balance at sub-station, feeder and transformer levels, specific local interventions to curb thefts, and investments to stop technical losses. The states no longer have that capacity. We need to decentralize distribution at sub-station and feeder level, and invite local entrepreneurs to manage them through competitive bidding process, giving proper incentives linked to reduction of distribution losses. Local knowledge, profit-motive, and their capacity to manage local, political economy will reverse the vicious cycle. What's more, a million youngsters can find employment all over India in distribution management, as local monitoring is a low-tech, labour-intensive job.

Along with sector specific measures, which have been enumerated above, we can also facilitate de-subsidization by transferring subsidies to local governments.

Decentralization and Subsidies

Local governments have been constitutionally mandated with the enactment of the 73rd and 74th amendments in 1993. Sadly, the Constitution only provides for over-structured and underpowered local governments. The results are mixed. The role of local governments as schools for democracy is well recognised. Chittaranjan Das, Vallabhai Patel, Jawaharlal Nehru, Subhash Chandra Bose, Prakasam Pantulu and several other stalwarts started their political careers in local governments. But their importance in reducing corruption and improving the economic management has not been adequately recognised.

Local governments are important mechanisms for reducing subsidies in a politically acceptable way. Let us suppose the administration of food subsidy (the consumer part of it) is transferred to local governments. We can actually quantify the amount of subsidy based on the food grain off-take and price differential at the local level. Then the union or state can ask the local government to retarget the subsidies to reach the deserving poor and cut down on leakages. This will work if the subsidy amount so saved is made available to the local government for other desirable activities, say infrastructure building or social expenditure. Once local government is assured of additional resources based on performance (cut in subsidies), it will have an incentive to reduce subsidies and unlock these resources. The money saved can thus be used for schools, drains, water supply, roads, health centres and sanitation. Since there is a clear link between subsidy reduction and alternative public goods and services, a powerful local constituency will be built favouring reduction in subsidies. In centralized administration, there are only losers in subsidy reduction, and no corresponding gainers. But once it is decentralized, and savings are alternatively deployed, the same family which loses a subsidy will gain directly through better public goods and services. Or there will be as many or more gainers as losers. We will then have achieved two objectives. Subsidies would be reduced, and expenditure is directed towards more desirable goals. This principle can be applied to several subsidies – food, agricultural power, irrigation, etc.

The key to de-subsidization is creating alternative stake-holders or alternative stakes at the local level. This is possible only when we are willing to go outside the box, and redesign institutions. A centralized democracy cannot exercise painful options, because people perceive all pain and no gain. If the taxes raised or resources saved are perceived to go to a centralized, callous administration, or to fill the huge hole called fiscal deficit, then people are unlikely to accept de-subsidization calmly. What appears to be a criminal waste for an economist or administrator is often the real income which sustains a poor family. When a family has to make do with reduced income, it makes choices willingly because all members know where the money is going. It is easier to accept privation if you have alternative gain, or if your loved ones get something in return. This applies to individuals, families, and societies as well.

But to apply these lessons, we need to redesign the Indian state and reinvent the citizen-centered government based on the principle of subsidiarity. Our fiscal crisis and governance crisis are inseparable, and need to be addressed together.

As to wages, we cannot realistically reduce this burden. In reality the number of government employees as a proportion of population (1.3%) is not high by global standards. Wages are not translated into public services because of two reasons. First, most employees are wrongly deployed. We have too few teachers, health workers, judges and policemen, and too many clerks, peons and drivers. Second, in a centralized milieu employees are utterly unaccountable. Authority has never fused with accountability, and we have a system of alibis for non-performance. Only in a local government can we retrain employees and re-deploy them in desired sectors, and institute effective systems of accountability.

Conclusion

Our fiscal crisis, misgovernance and corruption cannot be addressed by budget documents and by efforts of finance ministers alone. The problems are far more fundamental, and need restructuring of our governance apparatus. Local governments will not automatically reduce corruption, nor will they promote better leadership overnight. The promiscuous administrative and political culture is bound to permeate into local governments too. But as employees are held to account locally, we can check corruption. And the citizens have a greater capacity to confront corrupt local government leaders and force them to respond to their demands. If taxes and services are clearly linked in local governments, people will make sure that they got good value for every rupee spent. And they would be more willing to pay taxes, since they know where the tax money is going.

People are going to accept higher taxes only if they are certain that they can get something in return. Lower subsidies are not politically feasible, unless the poor are compensated in some other form. Reducing the number of employees or the wage bill is a pipe dream in a country with exceptional job security and low level of political legitimacy. All these are not merely fiscal problems; they are fundamental governance problems. Fiscal deficit cannot be addressed by budgets and laws; it requires political will and skill to restructure governance. There are no short-cuts. Time is running out. Further delay and dithering will deepen the fiscal crisis, and lead to a possible fiscal collapse with runaway inflation, resulting in breakdown of public order and severe political and social strife. A decade ago, the erstwhile USSR collapsed precisely because the crisis was not addressed squarely and in time, and the results were horrendous! Now is the time for the governments to pursue the long overdue fundamental governance reforms and for the people to seek the link between taxes and public services and authority and accountability. But it takes patience, faith and painstaking institution-building.

* * *