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TOWARDS A NEW INDIA: FREEDOM FROM FREEBIES

It is difficult to define freebies & welfare schemes in India as there is a thin difference between freebies and entitlements. Freebies do not differentiate between those who can afford to pay and those who can't, thus alleviating the crucial distinction between who should be and those who shouldn't be the beneficiaries. Entitlement or the welfare on the other hand, is a bonafide benefit for those who can't afford. A clear example being free power for everyone is freebies, while free food grain for the 80-crore population during pandemic is an entitlement!

Freebies have large fiscal costs and cause inefficiencies by distorting prices and misallocating resources. Some freebies may benefit the poor if properly targeted with minimal leakages, and the outcome may help the society in a more pronounced manner, as interest subvention to SHGs. However, during election campaign, political parities promise many things like free electricity, free water, cheaper food grains, smartphones, laptops, bicycles & farm loan waiver etc, which seem like motivating voters through promises and fulfilling them by taxpayer's money.

Besides, reverting to old pension scheme by some states also seems to be a tool used by states for political purpose. For example, 3 states, namely Chhattisgarh, Jharkhand and Rajasthan have already reverted to Old Pension Scheme or PAYG (pay as you go) scheme. Punjab is the latest one which is contemplating the shift. India had a PAYG scheme prior to 2004. Under this scheme, the contributions of the current generation of workers were explicitly used to pay the pensions of current pensioners. Hence a PAYG scheme involved a direct transfer of resources from the current generation of taxpayers to fund the pensioners. **It seems that the states moving back to the old schemes want to save money currently and use the amount to give freebies to gain popularity**. However, it must be emphasized that the money for pensions would be collected from the tax payers in future. It also seems unfair that only a certain section of people get this benefit of pension. **The pension liabilities of three states Chhattisgarh, Jharkhand and Rajasthan is estimated at Rs 3 lakh crore. When looked in relation to own tax revenue, pension liabilities of states is quite high for Jharkhand, Rajasthan and Chhattisgarh at 217%, 190% and 207% respectively. While for states contemplating the change, it would be as high as 450% of own tax revenue in case of HP, 138% of own tax revenue in case of Gujarat and 242% of own tax revenue for Punjab.**

If we look the state budgets, election promises recently made for forthcoming state elections range from 0.1 - 2.7% of GSDP for different states and around 5-10% of own tax revenue of the states. Further, there are contingent liabilities on the states which have been rising in recent years. As per the latest available information, the off-budget borrowings by states - loans raised by state-owned entities and guaranteed by the state governments - have reached around 4.5% of GDP in 2022. The extent of such guarantees have achieved significant proportion of GDP for various states. The guarantee amount is significant at 11.7% of GDP for Telangana, 10.8% of GDP for Sikkim, 9.8% of GDP for Andhra Pradesh, 7.1% of GDP for Rajasthan, 6.3% of GDP for UP. While the power sector accounts for almost 40% of these guarantees, other beneficiaries include sectors like irrigation, infrastructure development, food and water supply.

If we include the contingent liabilities along with freebies, then they come around 10% of the GSDP for all the states combined. We must find solution to this all encompassing problem of fiscal hara-kiri.

A recent argument to support freebies finding favour with some puritans is quoting the haircut taken by banks through IBC mechanism. Equating the haircuts with freebies or even the loan write-offs is at best a deeply flawed argument as the promoters cede control of businesses regardless of whether the default triggering admission into CIRP (Corporate Insolvency Resolution Process) is for genuine reasons or otherwise. Additionally, such loan write offs are purely technical in nature and are added back to bank books once recovered.

We expect SC panel should fix a band say 1% GSDP or 1% of state own tax collections or 1% to state revenue expenditure for these welfare schemes of the states. With this, the desired welfare schemes can be implemented in a proper way.

STATE SUBSIDIES & FREEBIES OFFERED BY STATES

- Recently, in India it has been seen that the political parties are promising to offer a number of freebies to get votes in the elections. Though, there is no precise definition of freebies, it is necessary to distinguish them from public/merit goods, expenditure on which brings economic benefits, such as the public distribution system, employment guarantee schemes, states' support for education and health. On the other hand, provision of free electricity, free water, free public transportation, waiver of pending utility bills and farm loan waivers are often regarded as freebies, which potentially undermine credit culture, distort prices through cross-subsidisation eroding incentives for private investment, and disincentivise work at the current wage rate leading to a drop in labour force participation.
- Some freebies may benefit the poor if properly targeted with minimal leakages, but their advantages must be evaluated against the large fiscal costs and inefficiencies they cause by distorting prices and misallocating resources.
- Additionally, the provisions of free electricity and water are known to accelerate environmental degradation and depletion of water tables.
- Now, the question arises that when taxpayers' money is used, whether such wasteful expenditure to please a section of voters is legal. Till now, there is no law to stop freebies not aimed at economic or social development. As these freebies are financially risky and may hamper States' financial position in future. After petitions were filled in Supreme Court, the Court has formed a panel to re-examine the rampant freebies schemes that has the potential to economically ruin the country.
- **However, if we follow Mahatma Gandhi's idea that there is enough on earth for everybody's needs but not enough for a single person's greed, we may get a comprehensive guideline for defining freebies. The principle could cover a minimal package of necessary food, clothing, shelter, health and education expenditure.**
- The state must guarantee this package for all. Unfortunately, we have failed to provide this minimum package. For example, in an eastern state, a retired teacher recently committed suicide after failing to get a pension three years after his superannuation.

Freebies Announced by the States in 2022-23

	(As a % of GSDP)	(As a % of Revenue Receipts)	(As a % of Own Tax Revenue)
Andhra Pradesh	2.1	14.1	30.3
Bihar	0.1	0.6	2.7
Haryana	0.1	0.6	0.9
Jharkhand	1.7	8.0	26.7
Kerala	0	0	0.1
Madhya Pradesh	1.6	10.8	28.8
Punjab	2.7	17.8	45.4
Rajasthan	0.6	3.9	8.6
West Bengal	1.1	9.5	23.8

Source: RBI

Outstanding Guarantees of State Governments

State/UT	% of GSDP	State/UT	% of GSDP
Andhra Pradesh	9.8	Odisha	1.4
Chhattisgarh	4.9	Punjab	3.7
Gujarat	0.2	Rajasthan	7.1
Haryana	2.7	Sikkim	10.8
Himachal Pradesh	1.4	Tamil Nadu	2.8
Jharkhand	0.5	Telangana	11.7
Karnataka	1.8	Tripura	1.3
Kerala	4.0	Uttar Pradesh	6.3
Madhya Pradesh	3.4	Uttarakhand	0.2
Maharashtra	1.5	West Bengal	1.1

Source: SBI Research, latest available as per RBI data and budget documents

- RBI in a recent paper have articulated major financial assistance/ cash transfers, utility subsidies, loan or fee waivers and interest free loans announced by the states in their latest budget speeches (i.e., for 2022-23). As per these estimates, expenditure on freebies range from 0.1 - 2.7% of GSDP for different states. The freebies have exceeded 2 per cent of GSDP for some of the highly indebted states such as Andhra Pradesh and Punjab.
- When giving grants, or free power or water or bus fare, the moral obligation of a government is to ensure it is targeted to provide relief to the poorest of the poor. In conclusion, we may wonder whether not taxing wealthy farmers is not a freebie. It is, however, a politically sensitive issue.

Announcements by Political Parties in States due for Election			
State	**Party**	**Announcements by Political Parities**	Amount (Estimated)
HP	Party 1	• 300-units free Electricity to households • Rs 1,500 per month to all women aged between 18 and 60 years • Old pension scheme (OPS) for government employees would be restored • Rs 680 crore will be kept aside to promote start-ups, with Rs 10-crore corpus money would be provided, free of interest, as seed money	Rs 1100 crore (3.0% of RR & 10.0% OTR)
	Party 2	• Providing bus tickets for women at 50% discount rate, under the 'Nari ko Naman' scheme, which will cost the government Rs 60 crores annually • 125 units of electricity to household consumers for free since July 1 • Waive water bills in rural areas, which accounted for annual revenue of Rs 30 crore.	Rs 210 crore (0.6% of RR & 1.9% OTR)
	Party 3	• 300 units of free electricity to households • To provide free treatment, medicines, tests, and operation facilities to everyone • Shaheed Samman Rashi, in which an amount of Rs 1 crore will be given to the families of the Indian Army and Himachal Pradesh Police personnel martyred on duty • Promised to provide Rs 1000 to every woman who is above 18 years of age under the 'Stree Samman Rashi'	Rs 320 crore (1.0% of RR & 3.0% OTR)
Gujarat	Party 1	• Rs 500/Gas Cylinder • 300-units free Electricity • Upto Rs 10 lakh medical insurance • Farm loan waiver upto Rs 3 lakh • 3000 English medium school • Rs 4 lakh compensation to families of COVID mortalities • Revise domestic/commercial power consumption tariffs and aiming to keep the rates down	Rs 15000 crore (8.0% of RR & 13.0% OTR)
	Party 2	• Rs 500 crore for protecting cows in the state under “Mukhyamantri Gau Mata Poshan Yojna • Rs 213 crore for ‘maintenance of cows for the farmers’ • Rs 8,300 crore worth of subsidised power for the farmers. Rs 734 crore for providing free electricity for waterworks to all gram panchayats	Rs 9013 crore (5.0% of RR & 7.8% OTR)
	Party 3	• Rs 10 lakh will be provided to every panchayat • A fixed monthly salary of Rs 10,000 for sarpanches and Rs 20,000 for VCEs • 300 units of free electricity • Monthly stipend of ₹1,000 for women in Gujarat above the age of 18 • Rs 3,000 per month to unemployed youths	Rs 12,023 crore (6.6% of RR & 10.5% OTR)
WB	Party 4	• Rs 60000 to 43,000 Durga Puja organizing committees in the state	Rs 240 crore (0.3% of RR & 0.1% OTR)
Source: SBI Research Note: RR: Revenue Expenditure of the State, OTR: Own Tax Revenue			

CONTINGENT LIABILITIES

- Contingent liabilities are the contractual obligations of the government to pay in the event of a default by the borrower, either on the principal amount borrowed or interest payments on such amount or both.
- The contingent liabilities of states have been rising in recent years. As per the latest available information, the off-budget borrowings by states - loans raised by state-owned entities and guaranteed by the state governments - have reached around 4.5% of GDP in 2022.
- The extent of such guarantees have achieved significant proportion of GDP for various states. The guarantee amount is significant at 11.7% of GDP for Telangana, 10.8% of GDP for Sikkim, 9.8% of GDP for Andhra Pradesh, 7.1% of GDP for Rajasthan, 6.3% of GDP for UP. While the power sector accounts for almost 40% of these guarantees, other beneficiaries include sectors like irrigation, infrastructure development, food and water supply.
- The Centre too used to have significant amount of such off-balance sheet borrowings; however, it has moved towards complete and greater transparency by reducing outstanding liabilities of FCI financed through NSSF funds and making it part of food subsidy bill. On similar lines the Government notified in March this year that off-budget borrowings of the states are to be equated with the their own debt and any such fund raised by them in 2020-21 and 2021-22 would need to be adjusted out of the borrowing ceiling this year.
- However, considering the magnitude of the off-budget borrowing of some states and difficulties expressed by states, the Centre decided that off-budget borrowing done by states up to the year 2020-21 may not be adjusted. Further adjustment on account of off-budget borrowing done by states in 2021-22 can be adjusted against their borrowing ceilings of next four years till March 2026.

REVERT TO OLD PENSION SCHEME

- 3 states, namely Chhattisgarh, Jharkhand and Rajasthan have now reverted to Old Pension Scheme, where in the Government pays the entire amount of pension to its employees based on the last salary drawn, without any contribution from the employee. Because of its unsustainable nature, the Centre shifted from it to the new pension scheme in which the employee as well as employer during the work life contribute towards the pension corpus to be received by the employee post retirement.
- However, now more states are moving back. Punjab is the latest one which is contemplating the shift.
- **We estimate that the current present value of aggregate pension liability if all states shift to old scheme will be of the order of Rs 31.04 lakh crore. In the absence of state specific data, the approximate burden on states can be made using the proportionate rule. Accordingly, total pension liability for the 3 states, Chhattisgarh, Jharkhand and Rajasthan comes at Rs 3 lakh crore.**
- **When looked in relation to own tax revenue, pension liabilities of states would be as high as 450% of own tax revenue in case of HP, 138% of own tax revenue in case of Gujarat. For Punjab, Jharkhand, Rajasthan and Chhattisgarh it is also high at 242%, 217%, 190% and 207% respectively. Interestingly, some of these state currently going to election and incumbent parties have promised a revert to old pension scheme.**
- It seems that the states want to save money currently and use the amount to give back freebies to certain set of people. However, it must be emphasized that the money for pensions would be collected from the tax collection in future. It also seems unfair that only a certain section of people get this benefit of pension.

Liability due to revert to Old Pension Scheme

State	Liability in FY20 (Rs crore)	Share in total liability	Liability due to revert to PAYG (Rs lakh crore)
Chattisgarh	6638	1.9%	0.60
Jharkhand	6005	1.7%	0.54
Rajasthan	20761	6.0%	1.87
Punjab	10294	3.0%	0.92
HP	5490	1.6%	0.49
Gujarat	17663	5.1%	1.59
Total	345505		

Source: SBI Research, RBI

Election Promises Made By Various Political Parties

State	Promised Expenditure as a % of Revenue Receipts	Promised Expenditure as a % of Own Tax Revenue
Himachal Pradesh	1-3 %	2-10 %
Gujarat	5-8 %	8-13 %

Memo: Unfunded Pension Liabilities as a % of Own Tax Revenue

State	% of Own Tax Revenue
Himachal Pradesh#	450%
Gujarat #	138%
Chhattisgarh	207%
Rajasthan	190%
Jharkhand	217%
Punjab	242%

HP and Gujarat have assured reverting to old system

Source: SBI Research, State Budget Documents

ARE FREEBIES THE SAME AS WELFARE SCHEMES?

- **There is no clear distinction between freebies from a welfare schemes**. It is also hard to criticise the term 'freebie' as there is no clear definition as discussed earlier, but broadly, it is a transfer of goods & services available to voters at free of cost as a poll promise, which has been used since independence.
- But, this is the time to rethink which are legitimate welfare measures and which are freebies. Sometimes freebies helps many such as free bicycle to girl child, free breakfast to school children etc but these schemes shouldn't bleed the national/state economy.
- **The SC panel should fix a band say 1% GSDP or 1% of state own tax collections or 1% to state revenue expenditure for these welfare schemes of the states. With this, the desired welfare schemes can be implemented in a proper way.**

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