Let's Build On Revdi Debate

A fiscal council can help government to streamline disbursement of freebies

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THE DEBATE that began with an RBI 2022 report on state finances followed by Prime Minister Narendra Modi's comment on "revdi culture" aka freebies, has garnered substantial attention — so much so that the Supreme Court is hearing on this issue. In a country where millions of people were only a pandemic away from being pushed back into poverty, freebies have now assumed more importance than ever.

Freebies could be defined as non-merit subsidies. Subsidies are money transfers (implicit or explicit) by the government in an attempt to drive prices artificially below market prices. As a National Institute of Public Finance and Policy (NIPFP) study by Sudipto Mundle and Satadru Sirkar puts it, budget subsidies, in particular, are defined as the unrecovered cost of economic and social services. However, all subsidies cannot be easily classified into merit or non-merit.

It could be said that providing freebies empowers the state to, first, deliver welfare as a welfare state should, by providing subsidised merit goods like health and education; second, to help households combat poverty (especially in economically stressed times characterised by fewer job opportunities, lower incomes, high inflation, etc.) by providing subsidised public goods like food, electricity, etc.; and third, to appeal to the electorate (through outright populist spending).

The boundaries between the aforementioned objectives begin to blur when it comes to classifying one form of freebie as a merit or a non-merit subsidy. For example, are corporate tax cuts non-merit subsidies or a measure to boost investment? Is making bus rides free for women in the national capital a non-merit subsidy or a way to boost women's mobility and labour-force participation? In a similar tone, are free laptops to students in Tamil Nadu not a way to bridge the digital divide in education? The existing arguments develop an understanding that freebies cannot be defined in a finite context, and that the definition varies across space and economic conditions.

Freebies cannot be defined easily, and constitutionally, any state government should be empowered to spend the way it wants, provided the fiscal policy is sustainable. Such a debate, therefore, warrants undertaking strategic measures via strengthening fiscal guidance through an institution like a fiscal council.

Regardless of which one gets classified as good or bad, freebies are simply expenditures or foregone revenues. Either way, they lead to an increase in fiscal deficit whose financing could necessitate taking on debt. The targeting of beneficiaries to ease the burden on the exchequer is one way to check these expenditures but lack of data has forced a situation wherein leakages and duplication of beneficiaries is commonplace.

Going ahead, any freebie-induced debt burden could have an adverse effect on the state finances if, one, it hasn't been properly accounted for through transparent budgeting procedures (including off-budget borrowings in debt calculations), and two, it threatens fiscal sustainability, ie, it limits the state's ability to service its debt-related commitments without making an unrealistic fiscal adjustment.

That said, in the absence of adequate avenues of revenue mobilisation, any fiscal adjustment achieved by contracting critical expenditures on the social sector and capital formation further jeopardises long-term growth and development. The emanating risk of fiscal sustainability means a "revdi" today would take a toll on tomorrow's generation.

A solution to this problem lies in setting up an independent fiscal council that has been recommended by the FRBM Review Committee (2017), and recently constituted Finance Commissions too, including the 15th Finance Commission. Incidentally, the FRBM panel and 15th FC were both headed by N K Singh. The FRBM report says, "the council will serve both an ex-ante role — providing independent forecasts on key macro variables like real and nominal GDP growth, tax buoyancy, commodity prices — as well as an ex-post monitoring role, and also serve as the institution to advise on triggering the escape clause and also specify a path of return."

Such a council should work for the union as well as the states. Furthermore, such monitoring of finances and fiscal rules could also help ensure that states comply with a medium-term fiscal policy framework, which has been long argued for by economists. For the above reasons, it is imperative to fill the widely recognised institutional void.

In summary, freebies cannot be defined easily, and constitutionally, any state government should be empowered to spend the way it wants, provided the fiscal policy is sustainable. Such a debate, therefore, warrants undertaking strategic measures via strengthening fiscal guidance through an institution like a fiscal council. That will enable the state to make informed economic decisions whilst attending to key development objectives.

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