

The Road Ahead

Time to Act to Preserve Financial Stability

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Elections to five state assemblies – Telangana, Madhya Pradesh, Chattisgarh, Rajasthan and Mizoram are due in November. The parties are making a flurry of promises – ranging from the reasonable to ludicrous, and in some cases outright dangerous, to attract the voters. Similar promises for individual short-term benefit were made in Karnataka earlier this year. Loan waiver up to Rs 2 lakhs, free gas cylinders, power, and travel, higher amounts of old age and other social security pensions, cash payments to women, farmers and parents of children in schools, the list goes on. In Madhya Pradesh, a party offered even the state's own IPL team! But the most dangerous promise in many states is the unfunded, unsustainable wage-index linked, old pension system (OPS) for the government employees (who constitute 3% of the work force) which will most certainly bankrupt the economy and seal the fate of the coming generations.

As a part of the campaign parties have a duty and right to propose various individual short-term welfare (ISW) programmes and seek public support. But elections are now reduced only to ISWs to the neglect of core functions. Government's primary role is to fulfill collective needs of infrastructure, rule of law, basic amenities, quality education and health and measures to grow the economy. If the purpose of government is largely neglected, and elections revolve around short-term ISWs, then the nation is in peril. Jawharlal Nehru admonished us long ago: "If India wins, who loses; but if India loses, who wins?". Several parties are sending a clear signal to us that they do not care if India loses; all they want is to get into power by any and every means!

Many people innocently believe that the Election Commission (EC) and the Supreme Court can intervene. The Court even entertained a petition on the subject some time ago. But the EC or courts have no role in election manifestos. Only in respect of obviously irrational promises beyond the constitutional duties of a government there

could be a limited role for the EC or courts. But so far they failed to exercise jurisdiction even in such cases. For instance I approached the EC in 2006 to intervene when DMK promised colour TVs to voters if they were elected to power. Distribution of colour TVs is not part of the constitutional role of a government. If that is permitted, why not distribute 10 gms of gold to every family, or even five bottles of free liquor to every family every month? Clearly, there is a line that cannot be crossed; and the logic is the constitutional role of the state. Sadly, neither EC failed to come out that limited role, nor did courts apply their mind judiciously even in this narrow area.

We must recognise that reasonable ISWs are necessary and legitimate tools in a democracy to alleviate the pain of poverty, and to give hope and confidence to all sections of society that their interests matter, and their voices count. But as the Chinese proverb says, it is better to teach a poor man how to fish and give him the tools than to merely give him a free meal.

What can we do to restore the balance between short-term ISWs and long-term incomes and economic growth? We can take a three-pronged approach. First, when the ISWs are manifestly beyond the reasonable role of the state – free colour TVs, gold, liquor etc – there should be outright ban of such practices.

Second, in respect of other ISWs which do reduce the pain of poverty, there should be fiscal rules to ensure that the next generation is not paying an unfair price in the form of unsustainable debt. The golden rule should be that all day-to-day expenditure of the government including salaries, pensions, interest payments and ISWs should be incurred from the current revenues. In other words there cannot be a revenue deficit. All borrowings should only be utilized for capital investment and infrastructure to promote future growth and incomes for the next generation, not to meet current revenue expenditure. Once the boundary conditions are met, the government should be free to implement any programmes they wish. That is how democracy works. People's mandate matters, and the sovereignty of a government should be respected, provided the current expenditure is met from current revenues, and borrowings go to finance investments for the future.

Finally, the real danger to our economy and future of our children comes from unfunded and growing liabilities incurred by governments at the cost of future generations. Reverting to OPS in several states, and reckless promises to that effect by parties are guaranteeing fiscal collapse, and ruining the economic future of our children. The answer to this challenge is simple. A government that makes a legally binding commitment of future expenditure should be duty bound to create a sinking fund now and deposit the required amount for future payments (calculated on discounted cash flow basis) in that fund in the present budgets as revenue expenditure. Then the burden of reckless decisions will not fall on future budgets. If the state fails to do so, the Union Government should treat future liability as deferred public debt, and enforce fiscal norms of debt, deficit etc on that basis. Then automatically there in transparency is budgeting and fiscal responsibility is assured while respecting the authority of an elected government.

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