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A better alternative to the Congress's poll promises in Karnataka

Most of the schemes being proposed by the Congress will immediately enhance demand without addressing the issues related to the supply-side-this will be inflationary

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Congress workers celebrate party's victory in the elections (PTI photo)

Highlights

- *The Congress's promises will amount to additional state expenditure of roughly 3.3 percent of Karnataka's Gross State Domestic Product*
- *Giving people the purchasing power to buy goods and services is no doubt necessary, but if there isn't adequate supply of these goods and services, inflationary pressures will build up*
- *A universal job guarantee (UJG) scheme as the most effective and sustainable scheme to target unemployment and poverty*
- *Integrating MNREGA with a wage goods strategy and progressively expanding its reach could be a superior strategy*

Soon after the Congress victory in the Karnataka elections, there are concerns being raised as to the impact of implementation of their poll promises on the state's exchequer. Reports suggest that their five major poll promises – free bus rides to women, Rs 2,000 per month to women head of families, Rs 3,000 unemployment allowance to graduates and Rs 1,500 allowance to diploma holders, 10 kg of rice to BPL families and 200 units of free power to every household every month along with other schemes to fishers and promises to purchase cow dung – will amount to additional state expenditure of some Rs 62,000 crore or roughly 3.3 percent of Karnataka's Gross State Domestic Product.

Given that the Congress will make any success in prompt implementation of these promises its major plank in forthcoming elections in other states, as well as in the general elections in 2024, it reopens a larger debate on 'freebies'.

Instead of getting mired with data on sources of funds for state government expenditures it is useful to look at the issue from a broader perspective. Modern Money Theory (MMT) can throw light on an issue that is only likely to get bigger given the challenges of widespread youth unemployment, growing economic inequalities and insecurities that people face.

From a purely financial angle, MMT has espoused that an economically sovereign government can never go bankrupt in its own currency. The government is often seen as being in the same position as the private sector including businesses and households. This is untrue – the government is the issuer of currency while the private sector is a user. Government debt is settled only through (re)issue of its own (new) financial liabilities whereas the private sector must settle debt with government (or commercial bank) liabilities. MMT, however, argues that it is only the *central* government that is truly in this privileged position. State and local governments as well as municipalities are not issuers of currency and should therefore be relegated to the position of the private sector.

While this is perhaps technically correct, state government debt is implicitly backed by the central government. A debt default by a state would throw its economy into recession that will ultimately have to be bailed out by the central government. It is interesting to go back to November 2019 when the RBI allowed retail investors to buy state development loans (SDLs) and note the **remarks** of the RBI Governor: "On the due date of repayment, RBI automatically debits the state government account and makes the repayment. So, there is an implicit sovereign guarantee... they [SDLs] would not and cannot be considered risky."

More than money and finances, MMT shifts the debate over freebies to the availability of real resources that are necessary to meet the objectives of such schemes. In other words, is there enough electricity to provide, is there enough rice to distribute and buses or bus seats for women and for all commuters? If there aren't, problems of shortages will arise when prices as a rationing mechanism are suppressed.

Providing cash transfers also faces the same question of real resource availability. Giving people the purchasing power to buy goods and services is no doubt necessary; however, is there adequate supply of these goods and services that they will want to buy in the market? If not, inflationary pressures will build up, ultimately hurting the poor most. On the positive side, cash transfers can be useful in boosting aggregate demand especially when business is sluggish. Moreover, more robust demand could also have a positive effect on investment spending.

The problem of moral hazard in the freebie debate must also be addressed – giving free grain to BPL families, many of them possibly marginal farmers, may result in them ceasing to engage in subsistence agriculture and look up to the government for free food instead. This could ultimately have an adverse impact on overall food production and food security in the longer term.

It is for these reasons that MMT advocates a universal job guarantee (UJG) scheme as the most effective and sustainable scheme to target unemployment and poverty. Most of the schemes being proposed by the Congress – many being in the nature of a basic income strategy – will immediately enhance demand without addressing the issues related to the supply-side. These will be inherently inflationary and the problem can get progressively worse as people choose to opt out of the labour market thereby negatively impacting supply.

Integrating MNREGA with a wage goods strategy and progressively expanding its reach across time (more days of work) and space (urban areas) could be a superior strategy to steps in the direction of universal basic income (UBI) plan. Macroeconomically speaking, a UJG is essentially a countercyclical automatic stabilizer – as was unequivocally seen during the Covid-19 pandemic crisis – while UBI is acyclical and inherently inflationary by adding to aggregate demand and not enhancing aggregate supply or perhaps worse, contracting it.

While it may be argued that the poor are in need of immediate measures to alleviate their condition and the schemes proposed by the Congress are politically astute, MMT calls for considering UJG as a superior and sustainable *economic* strategy to alleviate the problems of unemployment and poverty.

Sashi Sivramkrishna studies macroeconomics from a Modern Money Theory (MMT) perspective). Views are personal and do not represent the stand of this publication.

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