

you have this mindset, you are already defeated”.

But nevertheless when a shark enters, the small fishes are either displaced or eaten up. Similar is the case here. When large MNCs enter the fray, they do take away a lot from the small and medium players. They eat into their market share and thus subsequently into their revenue. So what's debatable is the extent of such a trade off, but that such a trade off takes place is undoubtedly a resounding yes! The Government's policy initiatives like enactment of the new Micro Small and Medium Enterprises Development Act, 2006, pruning of reserved SSI list, advising FIs to increase their flow of credit to the SME sector, are all initiatives towards boosting entrepreneurship, investment and growth. The government of host countries must have stringent regulations over the activities of MNCs. They should bargain for better deals and demand that MNCs adhere to certain criteria set by the government. While some survive and find ways to tackle the competition unleashed upon them, others give in. And eventually it is the economy that wins!

Political Pull Vs Economic Reasoning

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II Year

“The first lesson of economics is scarcity: there is never enough of anything to fully satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.”

-Thomas Sowell

The disciplines of economics and politics constitute two different realms and their interaction might appear superficially inconsequential. However the larger truth is that in the context of a political system, there are two conflicting forces that necessarily influence development i.e. economic reasoning and politics. These forces, rarely in sync, interact and aim to satisfy the goals envisaged for development.

One such conflict exists between market efficiency and equity. According to Adam Smith's concept of the 'invisible hand of the market' the economy can reach the state of equilibrium in the long run without any state intervention and hence, the market is fully efficient. This classical notion, which forms the backbone of major economic reasoning, is challenged by populist government schemes like subsidies, minimum wage which aim at equity but create artificial conditions in the market and situations of market distortions.

Policy making through economic telescope

1) Subsidies

Today, subsidies extended to any economic sector with an aim to promote economic and social welfare, have become an intrinsic part of government measures. It not only induces higher production and consumption and serves distributional goals but also help in correcting market failures. However, according to public finance economist Ronald Gerritse subsidies “may have externalities that we did not bargain for”.

Subsidies create economic and market inefficiency by transferring resources from more productive to less productive use through sectoral allocation of the resources to the subsidized sector. It is also known to affect the fiscal budget by indirectly drawing resources away from the tax-

yielding sector to the less productive sector. Also black markets generated as a result of price control have contrary distributional effects of endowing greater benefits to well off people who can access the distributed good as against the poor people who face the brunt of shortages. However, contrary to economic reasoning, governments are unlikely to revoke subsidies as it may cause political agitation and evoke the displeasure of public.

Food security bill

The much hyped food security bill passed by the Indian parliament is an example of a subsidy measure that runs in conflict with economics and politics and has triggered much public debate. The ambitious bill envisages the distribution of wheat, rice and coarse grains at just Rs 2, Rs 3 and Rs 1 a kilo each to about 65% of the population. For fulfilling these promises the government plans to double the food subsidies to about 2% of GDP. But economists fear that such a policy would lead to disastrous outcomes for the Indian economy even though politically it would give leverage to the current government

According to the Financial Stability Report of the RBI, India's inflation risk remains high and slowdown in revenue collection and higher spending on subsidies may make it challenging for the government to achieve the fiscal deficit target of 4.6% of the GDP in the current financial year. Apart from the concerns about growing fiscal deficit due to large expenditures on subsidy, there are other serious issues about a widening trade deficit as well. It is expected that the government would resort to large scale import of food grains as the domestic food grain output is not adequate to handle such a voluminous expenditure programme which has a shortfall of about 70-80 million

tonnes of food grains per year that will have to be met by imports.

Since taxes are not viable in the current economic scenario, another economic concern is that the higher expenditure will have to be financed through higher borrowing that could crowd out private borrowing. Also private sector would have to increase interest rates so as to compete with the government sector which is detrimental for the economy. Moreover, since this is an open ended scheme with no expiry date or sunset clause, outlays would increase as the population grows thus inducing government to print money which would in turn lead to higher inflation. The problems associated with the procurement procedures also present a serious challenge before the economy. Food Corporation of India and the Central Warehousing Corporation together have the capacity to store 87 million tonnes of grain. The development of adequate infrastructure like storage houses for efficient functioning of the procurement system again requires a lot of expenditure. Also, there are issues about the diversity in crop production arising due to declaration of MSP for wheat and rice because this assured procurement gives an incentive to produce cereals rather than having a diversified production basket.

2) Price floors and price ceilings

Price floors and price ceilings are yet again another example of government measures that run in conflict with rational economics whereby they enact price control mechanisms if they believe that the market price of a good or service is unfair to buyers or sellers. The reason behind economists' scepticism over price controls is that they distort the allocation of resources. When government imposes a binding price floor it leads to creation of surplus, as sellers are unable to sell all they want at that price.

Similarly, price ceiling, if binding, results in the creation of shortages and contrary distributional effects. While price acts as the sole rationing mechanism in a free market, in a market with price controls and government intervention, there arises a need for several kinds of other rationing mechanisms that are often undesirable and inefficient.

Rent control legislations

Rent control legislations- a form of price control mechanism is the most effective example of government policies gone wrong by defying general economic rationale. According to Swedish economist and socialist Assar Lindbeck, "In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing." The statement sums up the general viewpoint of most economists about the rent control acts.

Rent control legislations prevent rent from reaching market clearing levels since given the market rent, if the rent dictated by the government is higher, the demand for housing exceeds the supply that would result in shortage. Moreover, with the shortages in regulated housing sector, the excess demand would spill over to the unregulated, non-controlled sector where black market would flourish. Rent controls have an adverse impact on investment in the housing sector as it reduces the potential for increased profits through regulation of prices. It also decreases the quality of dwellings due to reduced incentive for maintenance presented before landlords. In free markets landlords try to maintain the buildings well since desirable apartments can command higher prices. This incentive is lost when ceilings are imposed. So, although the ceiling protects the sitting tenant, he receives no real

bargain because of improper maintenance of the apartments.

Minimum wage laws

The mechanism of minimum wage legislation envisions the accessibility of a minimum standard of living for all workers and is seen as a tool that protects them from exploitation of any kind. But it has come under great scrutiny because of the perceived ill effects that it has on the very people it aims to serve through job reduction. According to studies by Nuemark and Wascher, an increase in minimum wage by 10% can be expected to reduce jobs among a group of teenagers (less skilled group of workers) by about 1-3 %. This finds an explanation in the marginal cost and benefit analysis that goes behind the employment of an additional unit of labour.

An unskilled youth producing \$4 worth of good in an hour would have a hard time finding a job if he must by law be paid \$6 an hour since employers won't be willing to pay a worker more than the value of the additional product that he produces. Moreover, it makes unskilled workers more expensive relative to other factors of production. If skilled workers make \$15 / hour and unskilled workers make \$3/hour then skilled workers are five times as expensive as the unskilled worker but a rise of minimum wage to \$5 makes them only three times as expensive as the unskilled thereby harming the unskilled worker. Contrary to this, some researchers assert that workers are not really paid their precise marginal product and hence we shouldn't expect them to be laid off because of moderate wage increase and hence the minimum wage effects on employment are small.

3) Employment guarantee acts

The MNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) is the paradigm of the employment guarantee acts passed by the Indian government and has been defined as “the largest and most ambitious social security and public works programme in the world” It aims to provide 100 days of guaranteed employment to at least one adult member of the family every year in lieu of casual labour services. It is a highly populist measure that aims to provide an economic safety net for the rural poor. However like any other populist scheme MNREGA has been criticized on the grounds of economic non-viability and inefficiency. It has distorted labour markets and led to creation of labour shortages across all sectors specifically in the agricultural sector where there is increasing unavailability of labour for farm operations. Instead of enhancing employment it has substituted it and has led to increase in agricultural wages by almost 2.5%. Apart from the corruption due to leakages etc here is also the lackadaisical attitude of government administration whereby the workers are assembled for attendance and are let off with the day’s wages without performing any or little productive work. With no funds for skill development and raw materials MNREGA’s large potential for value addition to infrastructure has been squandered. Also, it is no secret that the MNREGA wages often end up at the local liquor shop thereby offsetting any foreseeable advantage of increase in wages. There is destruction of work ethic and promotion of dependency among the illiterate and unskilled population of the rural area.

In addition to this, MNREGA has been designed in such a manner that it has led to formation of sedentary population by containing India’s rural population in the village. Thus, it has come under the radar of

the World Bank, which describes this much hailed vote bank scheme as “policy barrier to internal mobility” in its World development report of 2009. Migration of villagers from rural to urban areas is considered important for poverty alleviation and full and better utilization of labour talent as villages cannot sustain large amount of unskilled labour. Thus, by inhibiting migration MNREGA is coming in the way of market driven economic development

Recently a proposal has been tabled in the Indian parliament to increase the wages under MNREGA. Thus, the government which stands to gain a dual advantage, is back to playing the cards that led it to win the previous general elections. If MNREGA scheme works it has a chance of coming back to power and if not then it will distort the economy to such an extent that it will take years for the new government to reverse the damage which could not be done without causing social unrest. The wheel will turn a full circle and the new government can be criticized for non-performance and the present government stands to gain.

Apart from these basic policies that form the crux of economic policy making, we also have inefficiencies in the transport sector as a result of conflict between economics of policy and politics. Every major country in the world today be it US, China or Japan, has a single integrated ministry of transport. Policies on various modes of transport i.e. roads, railways, civil aviation, ports; urban transport etc are not made in silos but integrated and coordinated. However in India political obligations perpetuate the practice of having separate Ministry for each mode of transport be it the ministry of civil aviation, ministry of railways, ministry of urban transport etc. These ministries formulate policies, which are not in sync

with other ministries and rarely consult each other. Economic reasoning suggest that we merge the ministries but political pull forces us to do otherwise even at the cost of inefficiency in the transport sector because India's political environment guarantees that 'all hell would break loose' were we to attempt the merger.

The naïve belief in noble intentions and ability of the government to bring about equitable, sustainable development is often misplaced, but at the same time, presence of market failure like externalities, public goods, monopoly and imperfect competition creates room for well designed public intervention to improve social welfare. We must recognize that good economics alone cannot guarantee good governance. Thus, the need of the hour is to recognize the conditions under which these forces run into conflict and attempt a balancing act wherein they are in synchrony with each other. We can ignore economics in public policy and politics in economic policy making only at its own peril.