

THE ENTITLEMENT ECONOMIES

While China remains reluctant to create such an economy, India seems to have begun to seriously tread the primrose path, says DEEPAK LAL

The growth of the entitlement economy in the US, particularly under Presidents Bush and Obama, has, as I expected, led to the US military budget being pared as signalled by Secretary of Defence Gates. Though US military spending will still be larger than that of the next 10 military powers combined, like Rome, entitlements to politically determined income streams are beginning to sap the sinews of its military strength. Despite its rhetoric, the Obama administration also seems to be reconciled to a nuclear Iran. Whilst Kim Il Jong continues to turn a deaf ear at any attempt to make him give up his nuclear weapons. The world is becoming a very dangerous place under his watch.

Though the ingenuity and enterprise of the American people remain undiminished and prognostications of the US' economic decline in both absolute and relative terms are rather premature, the growth of its entitlement economy could signal the beginning of the end of the US imperium. The world may thus be at a turning point similar to that at the end of the 19th century when the rise of two emerging economic powers — the US and Germany — began to challenge the economic, financial and eventually military hegemony that Britain had maintained for nearly half a century. Though it took two major World Wars and nearly 50 years to end the British Empire. Today, many are comparing the major emerging Asian giants in geopolitical terms to these emerging powers at the end of the 19th century, with India being cast in the role of the US and China in that of Willhemine Germany. I will examine the validity of this comparison in my next column. But before that, I want to examine the dynamics of the creation of an entitlement society and its effects on a country's existing and potential economic (and its close correlate military) power in this column.

As with medical experiments, the dynamics of an entitlement economy are best seen in microcosm in the small, natural resource-rich open economies of the Third World, like Jamaica, Sri Lanka, Tanzania or Peru. Reliant on commodity exports for their prosperity, they are subject to the volatility of their terms of trade linked to the cycles in world commodity prices. The export sectors also provide the main source of public revenues, which fluctuate with world commodity prices. During



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the boom, with public coffers flush, “rent-seekers” flock to obtain politically determined entitlements. Governments keen to expand their clientele find it expedient to succumb. With the turn in the commodity cycle, and expenditures inflexible because of the entitlements granted in the boom, and revenues falling, there is an actual or incipient fiscal crisis. This is met, in successive cycles, by ratcheting up export taxes. Eventually this rising tax burden on the productive sector leads to a permanent fall in output and revenues, and a full-blown fiscal crisis.

This is sought to be met by borrowing (usually from abroad). When its limits are reached, as lenders react to the fall in output by taking fright, the monetary spigots are turned on to raise the inflation tax. As the inflation tax rises, the populace escapes it by limiting holdings of domestic money, and the inflation tax actually starts declining. The government is then faced with a fiscal-cum-debt-cum-foreign exchange-cum-inflationary crisis. Often in this downward spiral, the government finds its revenues insufficient to even pay its functionaries providing public goods like the police, defence and utilities. It seems to be faced with the un-Marxian “withering away of the state”. It is only when it is staring at such an abyss that governments undertake the rescinding of the politically determined entitlements

to income streams, which are the ultimate cause of the multifaceted crisis they face.

The US is still a long way from this de-nouement. But as the current travails of California show, it is not unimaginable. Whilst the current debt crisis in Greece and the incipient ones in the UK and other European welfare states show, once the primrose path of the entitlement economy is trodden, it is politically very difficult to get off until close to the abyss.

What then of the emerging Asian powers which, in the future, could conceivably challenge the US? China under Mao had, in keeping with its Communist ideology, sought to create the ultimate entitlement economy. The recognition of its economic failure with Deng Tsiao Ping's economic liberalisation programme in the late 1980's, also led to smashing of the “iron rice bowl and the creation of the freest labour market in the world”. Being once bitten, twice shy, the Chinese remain reluctant to create a new entitlement economy, despite the advice from many welfare state proponents from the West who want China to raise domestic consumption by expanding entitlements. Instead, the Chinese are rightly following the classical liberal advice of raising the demand for labour in productive enterprises, which, by raising labour incomes (unlike entitlements), ensures sustainable alleviation of poverty.

India, by contrast, which seemed to have turned its back on Nehruvian dirigisme with the liberalisation following the economic crisis that its past dirigisme had caused, appears to have begun to seriously tread the primrose path of the entitlement economy. After the 2004 elections, the economic reformers responsible for the 1991 liberalisation, who once again came to power, were forced to trim their sails by their Communist coalition partners, particularly in rescinding the colonial labour laws which still hamper the labour-intensive industrialisation that India needs to alleviate its ancient poverty.

With the recent victory of the Congress and the decimation of its previous Communist allies, it seemed that the government could now speak with a unified voice and undertake the so-called second generation economic reforms. Instead, the reformers are again being hamstrung. The dirigiste Opposition is now present within the Congress led by the refurbished National Advisory Council set up by 10 Janpath. A vast expansion of the entitlement economy and the quotacracy have begun. Though — as in the small, boom-time, resource-rich open economies — these may seem to be easily financed by growth, the damage they can do to India's productive potential once this primrose path is trodden, makes me wonder about India's ability to achieve the great power status it craves for.