

The Fallacies of Subsidies

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THERE is an unwritten law in economics that says, 'You can borrow but you cannot steal'.

The Nobel laureate Milton Friedman put it in another way when he coined the immortal phrase, 'There is no such thing as a free lunch'.

What these refer to is the simple idea that for every benefit there is a cost and a consequence for every cause. Sooner or later, a price has to be paid for all the 'free lunches' and often times that price is higher than one expects or thinks.

Take corruption. Some think of this shadowy activity as a crime without victims. In this part of the world, bribe taking and giving is regarded as almost culture, a natural birthright.

This is far from the truth. The link between political corruption and third world poverty, starvation and disease are all very strong. Leaders can and do steal aid money from the very ones they are supposed to help. Just ask any aid worker who has worked in the field.

Even something that seems harmless like avoiding work can have heavy costs. Low productivity means little, if any, profitability, small investment and slow growth.

Countries where workers are paid more than what they produce usually suffer from high unemployment. Where there is a big gap between wages and productivity, the difference is usually made up by either high inflation or high real interest rates.

Either way there is an unavoidable cost to be borne.

Yet what Dire Straits' Mark Knopfler called 'money for nothing' is quite common. In trying to be popular with the public and win elections, governments quite often resort to handouts and subsidies that become next to impossible to remove.

Nor are the costs only in the form of money. The effects of subsidies in creating social dependency and reducing psychological motivation and resilience, or the infamous 'subsidy mentality, are well known.

Is it any wonder then that the world's major religions teach that it is wrong to take what does not belong and to impose unfair obligations on one another?

Of course, not all subsidies are bad. No one would quarrel with financial assistance for the aged, handicapped and sick. In countries that can afford it, help is also extended to the unemployed, single parents and the very poor.

It is not merely out of a sense of generosity that we help these segments of society. It is our moral duty and responsibility as citizens and decent human beings.

More debatable but widely practiced is the subsidising of certain industries for limited periods. This is known in the trade as the 'infant industry' argument.

(The main reason why this argument is debatable is that just like humans, subsidies tend to ensure that the infants never grow up!)

But where subsidies are given out indiscriminately, where they fall into the hands of the deserving and undeserving, where they are treated as a right and entitlement, they become a problem for all.

It is fallacious to argue that the case against subsidies is entirely constructed by academics or rightwing ideologues.

The harmful effects of subsidies are readily observable facts. And not only have capitalist governments sought to remove them but socialist and communist ones as well.

It is fallacious to argue that subsidies do not hurt anyone so long as they can be afforded.

Many countries have literally gone down the drain because governments had to ensure that the greedy continued to be fed and the needy continued to be taken care of. And this does not even begin to take into account the social and psychological toll.

It is fallacious to argue that subsidies help an economy to achieve any kind of higher purpose or goal.

There is no evidence that any country has managed to make the leap from developing to developed status while saddled with all kinds of handouts. There is a lot of evidence, however, that subsidies can do damage.

For example, financial assistance that rich countries give to their farmers encourage over-production and depress prices so much that farmers in the developing world are kept at or driven below poverty.

Rent controls have been found to be responsible for significant underinvestment in affordable housing and promoting homelessness.

Most notably for Malaysia, economies that have the fastest and most sustained growth rates are precisely those that are energy deficit and not surplus.

The most resilient economies are those that have learned to properly price energy, especially petroleum, and not those that artificially depress prices.

Subsidies result in markets getting the prices wrong. This means that there are incentives to do the wrong things and disincentives to do the right things.

We end up being discouraged to save resources and, at the same time, encouraged to waste what little resources we have.

This is bad economics, it is bad ethics and it is bad public policy.

Nevertheless, removing subsidies is never an easy or popular task. Governments that do so are either very desperate financially or very responsible economically.

Those that are prepared to do so, however, can take comfort in the fact that they are preparing themselves for the tough times when they come.

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