STATE INTERVENTION

EXTENDED CORPORATE WELFARISM IS THE ANTITHESIS OF EFFICIENCY

Revisit fiscal paradoxes

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THE RECENT HEADLINES about government support for Vodafone Idea highlights an enduring fiscal paradox—public money is routinely used to prop up inefficiency. This is not a one-off event. Over the years, governments have repeatedly stepped in, offering bailouts and relief packages to struggling companies and even entire industries using taxpayers' resources in the name of protecting jobs, investors, or systemic stability. While well-intentioned, such interventions often keep inefficient and even unviable businesses afloat, undermining market discipline and sidestepping robust stress-resolution frameworks like the Insolvency and Bankruptcy Code.

Consider two firms, A (efficient) and B (inefficient), each deploying resources worth ₹100 to produce the same product. Firm A produces 100 units, while firm B produces 80. If A seeks a profit of ₹20, it would sell its units at ₹1.20 each to earn a total revenue of ₹120. At this market price, B earns only ₹96, incurring a loss of ₹4, and should exit the market, allowing resources to flow to more efficient uses. Thus, market logic rewards efficiency and weeds out waste.

Now, introduce taxation. Suppose A pays 20% tax on profits. To maintain its post-tax return, it raises its price to ₹1.25 per unit, earning ₹125 in total. At this higher price, B earns ₹100, breaks even, and survives without paying any tax. The tax on efficiency effectively shelters inefficiency. Scarce resources remain trapped in unproductive use and the market's natural corrective mechanism is blunted.

Take the logic further. If A reinvests its profits in research and development, it may produce 125 units with the same resources. To maintain its ₹20 profit after tax, it would sell at ₹1 per unit. At this price, B incurs a loss of ₹20 and should exit the market. But if the government, using taxes levied on efficient firms, subsidises B by ₹20, it continues to survive. The efficient firm contributes more to national income, employment, and technological progress. Yet, it bears a higher tax burden merely because it succeeds in doing so. The inefficient firm, which misuses scarce resources and adds little to national wealth, escapes this burden entirely.

In effect, the tax system, by forcing efficient firms to raise prices, protects inefficient ones from competitive pressure. Instead of rewarding enterprise and innovation, it dulls their edge. Instead of pushing out the inefficient, it keeps them afloat. The outcome is a market cluttered with firms that squander scarce resources and drag down productivity. This system sends a perverse message—being efficient attracts penalties, while inefficiency invites protection. This runs counter to the very grain of the market, causing deep market failure and leaving both costs and prices higher.

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Various justifications are advanced for such fiscal distortions—public interest, national security, the need for competition, or systemic stability. Some of these considerations may have merit, especially on strategic or essentiality considerations or during depressions. But they often amount to throwing good money after bad. Since determining genuine cases of national or economic necessity involves complex political-economy choices, the benefit of doubt tends to go to inefficiency. Moreover, there are ways to address most of these concerns; for instance, competition concerns with competition law and policy rather than fiscal distortions.

This paradox extends to personal income tax as well. An individual who earns more—often by being more productive, innovative, or risk-taking—parts with a larger share of income through higher tax rates. The higher the efficiency, the greater the share of income surrendered to the exchequer. In extreme cases, as seen historically with marginal tax rates touching 90% in some countries, such confiscatory systems have stifled enterprise and creativity. The message is unmistakable—efficiency does not pay; conformity does.

Recognising these disincentives, many modern economies have reduced marginal tax rates to allow individuals to retain a fair portion of the gains from their productivity. Yet, even with lower rates, progressive taxation still imposes a cost on efficiency, while profit taxes dissuade firms from expanding margins. Both forms of taxation extract a price from those who contribute most to economic growth.

These paradoxes illustrate how the fiscal system often distorts markets rather than enabling them. Despite being one of the oldest tools of statecraft, taxation still struggles to balance fairness, simplicity, and efficiency. Modern states have drifted far from the once-celebrated principles of neutrality and transparency in taxation—principles aimed at financing only core sovereign functions. By embracing an ever-expanding notion of welfare, governments have ended up taxing efficiency and using the proceeds to sustain inefficiency, all in the name of equity and redistribution.

A modern approach must break this cycle. With a robust insolvency regime now in place, India has the institutional tools to let market forces handle business stress. Fiscal policy must therefore be reimagined to align with competition and innovation. The efficient should not be penalised for success; rather, they should be encouraged to reinvest, expand, and innovate. Conversely, inefficient firms should vacate space so that more capable enterprises can use the same resources more productively.

A coherent economic framework must integrate taxation, competition, and innovation into a single, reinforcing design. The goal should be to reward the creation of value, not the mere existence of firms. Tax and subsidy policies should focus on encouraging efficiency, perhaps by modestly taxing the cost of sales across all firms regardless of profits while lowering tax rates for successful ones.

Welfarism of the state is both understandable and essential when directed toward the genuinely deprived. Those disadvantaged by circumstance deserve support for a life of dignity. But companies are not deprived; they operate in markets open to all, and their fortunes depend on their competence, efficiency, and integrity. When the state extends welfarism to them, it effectively rewards inefficiency and perpetuates waste, ironically financed by taxes collected from the efficient.

To foster long-term growth, fiscal policy must reward efficiency, not punish it. Efficient firms should be empowered to expand and innovate, while inefficient ones must not linger as protected wards of the state. Only then can India's economy realise its full potential, driven by productivity, disciplined by competition, and shaped by incentives that promote rather than impede progress. Taxing efficiency to fund inefficiency must end to sustain a market economy.