Smart policies for redistribution

If the latest World Economic Forum (WEF) report is to be believed, 60 per cent of the Indian population was poor according to the World Bank (WB) poverty line of 3.2 PPP (purchasing power parity) dollars per person per day. For Indians, the interpretation of a PPP poverty line is easy because although the World Bank has never formally admitted it, it has always defined the poverty line to be near identical to the official Indian poverty line. In other words, the WB poverty line is the official (Tendulkar) poverty line. In 2011, the poverty line based on either the Tendulkar or World Bank poverty line was equivalent to PPP $1.91 and the poverty rate was 14 per cent (based on NSS survey data with a seven-day recall period for perishable food items like fruit and vegetables).

The WEF result of 60 per cent poor in 2017 is obtained by raising the poverty line from PPP $1.91 to PPP $3.2 and keeping nominal consumption levels identical to those observed in 2011/12. Correcting this mistake (by allowing consumption to increase by the actual nominal compound growth of 10 per cent in per capita consumption as observed in national accounts data), one obtains the result that in 2017/18, the poverty rate was 36 per cent and not 60 per cent as per the WEF. Further, the percentage of poor according to the Tendulkar poverty line (PPP $1.91) in 2017/18 is under five per cent.

It is critical to appreciate the transformation that has happened in India over the last two decades. Absolute poverty, from close to 50 per cent in 1993/94, is now less than five per cent. India is now close to a middle economy, not a poor economy. Which means its own Tendulkar poverty line needs to be raised, in real terms, by 61 per cent to Rs 2,000 per person per month in 2017/18 prices. Our suggested poverty line implies 33 per cent poor (the higher Rs 2,100 WEF poverty line yields 36 per cent poor).

This bottom third of the population, we believe, should be targeted via a reformed welfare system, a system which emphasises redistribution through direct benefit transfers (DBT). The gains from such a reformed welfare system are enormous, and the extra expenditure involved is minimal. A central message, for politicians and policymakers alike, is that India is no longer a “poor” country in the traditional World Bank dollar a day poor sense. That concept was there in the early 1990s. India is today a lower middle-income economy, and should be thought of as such. It is the lower-middle class that should be the prime focus of policy, for both moral and political reasons; and the lower-middle class (the emerging middle class) is about a third of the population.

That a new welfare policy is needed is also made clear by the following calculation. Existing welfare subsidies (food, fertiliser, petroleum, interest rate subsidies etc) in 2017/18 are estimated to have been Rs 2.73 trillion. The average consumption level of the bottom third of the population, with a Rs 2,000 a month poverty line, is Rs 1,600. In other words, to make the poor non-poor, and perfect targeting, the government will have to spend Rs 4,800 (400 for 12 months) per person per year. For a third of the population (390 million), this will mean an expenditure level of Rs 1.9 trillion. With a 20 per cent leakage (contrast that with an average 70 per cent leakage in the present system), the expenditure needed, with a smart card, to have a minimum expenditure level of Rs 2,000 per month for all, is Rs 2.4 trillion — less than the existing level of Rs 2.73 trillion.

There is, therefore, a distinct possibility of replacing leaky welfare expenditures with targeted cash transfers. More money to the bottom third and not much additional expenditures — the phase-out from the old welfare system should not take more than three years. In addition, in the fiscal space, tax revenues for both corporate and personal income tax are buoyant — both up approximately 19 per cent in 2017/18, despite nominal GDP growth, at 9.5 per cent, being the fifth lowest since 1980. GST will stop being a new policy in another six months, and enhance indirect tax buoyancy.

This tax buoyancy opens doors for a reformist fiscal policy — doors that can lead to greater tax collection, lower tax rates, and greater, and more efficient, tax redistribution. We expect that a blueprint will be laid out for such reforms in the Budget to be presented on February 1. The Unique ID number (UID)/Aadhaar) provides the base for a comprehensive reform of India's welfare expenditure system. Elements of this have already been put in place, through the conversion of LPG and 84 schemes across 17 departments using DBT. A comprehensive reform will ensure that every deserving person is identified and gets his/her welfare entitlement, with leakages minimised.

Latest available data shows that 88.5 per cent of the total population and roughly 99 per cent of the adult population over 18 years of age has an Aadhaar number. The Budget must make an allocation usable by all welfare departments and district collectors to ensure that the residual one per cent gets an Aadhaar number, using photo ID if there are finger-print problems. This provides the basis for a comprehensive tax-transfer system, which can be layered (for ID protection and privacy reasons) by providing a separate Welfare Identification Number (WIN) and a welfare card with this number, linked confidentially and within the firewalls of the government to Aadhaar.

We propose that all subsidies be linked to Aadhaar and be paid as DBT. This means that all petroleum product-linked subsidies (kerosene, diesel, petrol) must be integrated with the LPG subsidy and renamed petro-product subsidy. Though a large part of the fertiliser subsidy is a petroleum-linked urea subsidy, it also has other mineral-linked components. As it is directed at farmers undertaking crop agriculture, it can be kept separate for the time being. The third major subsidy of food/PDS should either be converted to DBT or a monetary entitlement for purchase of food from any registered food shop, including currently licensed PDS outlets. Similar entitlements must be defined for health insurance and health expenditures and on basic education, job training. All these would be incorporated into a smart welfare card — all the benefits (transfers) mentioned above linked to the Aadhaar database behind the firewall. The goal is to ensure that each and every citizen in the bottom third of the population receives all the welfare benefits she is entitled to.

The recent ASER study shows that roughly 50 per cent of 14-18 year-olds, despite having been schooled, cannot read, write or do basic arithmetic. Worse the actual learning seems to have deteriorated over the years. This is despite the government spending five per cent of the GDP and households 3.5 per cent on education (NSS data 2011/12). The solution must be a combination of public education reforms by increased use of e-learning (for teachers and students), good regulation, competition and empowerment of the poor and marginalised. Spending power in the hands of the people should ensure accountability of public education institutions.

There is dissatisfaction also about the effectiveness and quality of the public health system, particularly the primary and secondary health care system on which the government spends Rs 5,00,000 crore (three per cent of the GDP) and households are forced to spend more than six per cent of their budget (or 4 per cent of the GDP). Increased public expenditures on health must be forthcoming, and the normal refrain "where will the money come from" is not applicable post the era of tax buoyancy. Is India ready for a modern welfare system? We think, yes. The future should be clearer starting February 1, 2018.

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