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The Direct Cash Transfer v/s Subsidies Debate

Arushi Gupta-2nd year

Summary: This article makes use of microeconomic theory to further the case for cash transfers as against subsidies to be used as an instrument for social protection in India. However, at the same time, it also highlights the unrealistic assumptions underlying the microeconomic theory and seeks to establish the practical problems surrounding the implementation of the DCT scheme in India.

Since 2005, the government has indicated a preference for the policy of cash transfers in lieu of the subsidies it provides to the populace under various social welfare schemes (health, education, agriculture, food rations, etc.). The logic behind their preference is that with cash transfers, people are free to 'buy' these services in the open market.

The main approach to social protection in India has been the provision of subsidized food and kerosene via the public distribution system, involving a vast bureaucratic edifice. The initiative behind subsidized

food for 'the poor' presumes that if they are most deficient or lacking in something, then that is food. This may be true on an average. However, for an emerging market economy, the presumption that all poor people suffer from 'food poverty' may not be as reasonable as in the case of a traditional village economy. Other 'lacks' may be as or more important. The PDS is costly and provides low-quality food. Although its supporters claim that the PDS could be improved; inefficiency in the PDS is enormous, not marginal.

Keeping in mind equitable distribution of resources and not just efficient distribution, the government provides the economically weaker sections of the society with transfers in kind, or subsidies. From an economic viewpoint, we know that subsidies in kind constrain the consumer and narrow their choice set, which implies lesser utility or satisfaction. The second theorem of welfare economics states that any Pareto efficient allocation of resources is also the optimal allocation, (point of competitive equilibrium) if lump sum redistribution of income is done and then the

market is allowed to take over. This implies that if an economic authority wants to impose an efficient allocation as an outcome of social economic interaction, i.e. an efficient as well as an equitable outcome, it does not need to close the markets but instead apply the right fiscal policy that does not interfere with the allocative property of prices. In the case of subsidies versus cash transfer debate; it would imply that people should be endowed with cash rather than be given quantity or price subsidies. Subsidies tweak the prices and may disrupt the normal functioning of the markets. Cash transfers, on the other hand, affect the income or initial endowment and will lead to a competitive equilibrium as well as a Pareto efficient allocation; granted that all assumptions hold true.

If microeconomic theory is anything to go by, the government should do away with subsidies and replace them with cash transfers. But these theories cannot be directly applied to the real world because of the assumption set on which they work; people are assumed to act rationally and selfishly (*homo economicus* assumption). It is also assumed that there is perfect information in the economy and that preferences are convex. Also on further contemplation, the practical problems involved in replacing subsidies by cash transfers are brought to the fore. There is a problem of regular and timely indexation that takes inflation into account. In a developing country like India, where inflation is not stable and where the government takes almost 12 years to increase the old-age pensions; cash transfers would not obviously be very popular among people. Also with the existence of infrastructural constraints along with the dearth of markets in certain underdeveloped regions like the coastal towns, tribal settlements etc.; buying commodities with cash would be a challenge in itself. Given the patriarchal set-up of a majority of Indian communities, if cash flows are replaced by food, the money would not be spent on food grains but will be splurged on liquor, gambling and other such frivolous unproductive activities.

In the debate on cash transfers vs. subsidies, to further the argument in favor of cash transfers, positive experience of other countries that have implemented cash transfer schemes, especially Brazil and Mexico, are often cited. While there are many reasons as to

why their experiences cannot be used to justify cash transfers in the Indian context, there are three important differences that need to be kept in mind.

1. Both Brazil and Mexico fare better in terms of both poverty and human development index compared to India. For example, 46 per cent of the households in India have per capita income of less than \$1.25 a day as against 5 per cent or less in Brazil and Mexico. Therefore, whereas cash transfers are used in these countries to target only a small section of the population; in India a much larger population (which is poor and malnourished) is to be targeted that would place an enormous fiscal burden on the government.
2. In the same context, is the issue of supply of provision of social services. In cash transfers, especially in the case of conditional cash transfers for health and education, there is an implicit assumption that the problem is in the lack of demand for 'appropriate' services. Cash is therefore expected to act as an incentive for households to access services such as antenatal care or improve school attendance and so on. However, in India, where there is still a problem with supply of services in the form of non-availability of functional and good quality schools or health centers; the immediate need is to improve such services.
3. Further, it is important to note that while the debate in India seems to be looking at cash transfers as a complete substitute to the provision of services by the government; in countries like Brazil and Mexico cash transfers served to complement the provision of services by the government.

To conclude, if subsidies are replaced by DCTs (Direct Cash Transfers), there will be a wider choice set and people will be able to buy what they want according to their individual preferences. However, at the same time, in a country like India, DCTs may not serve their purpose. The basic idea behind replacing subsidies with direct cash payments is a bid to eliminate the graft. The scheme aims to plug leakages in the current subsidy regime and let the benefit percolate deep down. "They always say time changes things, but you actually have to change them yourself." Now the task is to see in which direction the newly deviated wind blows!

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Sluggish Growth in Industry-Inadequate Skill Development or Rigidity of Labour Laws?

Raavi Aggarwal -3rd year

Summary: *It is often said that India's population is both its strength and weakness. With a workforce rivaled only by China, and demographic dividend within reach, India's future seems bright. At the same time though, moving beyond the apparent, the big question is that "Will India be able to realise this potential?" The article deals with this and moves beyond the discussion of the hindrances faced by the Indian industries in the form of infrastructural bottlenecks, and the rigidity of laws, and questions the extent of the damage caused in the process.*

It is estimated that India will become the most populous country in the world by 2025. By 2020, its adult working population would comprise 66% of the total population. The country undoubtedly provides the largest share of skilled and unskilled labour witnessed in the global economy. Yet the growth of the industrial and manufacturing sectors remains dismal. In 2013-2014, the secondary sector grew at a paltry rate of 0.5%. Notably, there's been a high degree of variation across the last decade as well. While the growth rate touched a staggering 20% in 2006, it later plunged to -7.2% in 2009, (*Trading Economics Data, MOSPI*).

Perhaps greater FDI is the panacea to the industries' problems. However, factories in India face several structural bottlenecks including water and electricity shortages that can dissuade firms from producing, despite the availability of cheap labour. Mr. Modi's

central pitch with respect to FDI has been the motto, "First Develop India", rather than maintaining a singular focus on attracting foreign investment. Indeed, India's development policies play a key role in determining industrial growth in employment and output. Greater technological advancement and improvements in productivity can, in turn, aggrandize GDP growth. Nevertheless, this economic enigma requires a multi-faceted approach and other aspects yet to be examined.

"Democracy, Dividend and Demand is what India has to offer", reiterates the honorable Prime Minister, when addressing investors abroad. Democracy has its apparent benefits in a populous, multi-cultural country like India. The system ensures transparency, gives credence to public opinion and also prioritizes growing businesses. However, whether India will be able to capitalize on its favorable age structure and hence, realize its demographic dividend is, on the other hand, debatable. Advocates of the demographic bonus claim that with majority of its population being in the adult working age group (15-59 years), the Indian economy is sure to augment its growth since a greater portion of the population shall be employed (*K S James, 2008*). This age structure can be contrasted with that of the Japanese economy, which is progressing towards a comparatively ageing population with larger number of senior citizens who would, in turn, demand higher pensions and retirement schemes in the future.

Economic research establishes that the relationship