



Cash Transfer Subsidy: A Wise Step

KEYWORDS

Cash transfer subsidy

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ABSTRACT The government of India had implemented the scheme for cash transfer to the beneficiary's account in 51 districts from January 1, 2013. It is a poverty reduction measure in which government subsidies are given directly to the poor in cash rather than in the form of subsidies. It can help the government reach out to identified beneficiaries and can plug leakages.

Currently, ration shop owners divert subsidised Public Distribution System grains or kerosene to open market and make fast buck. Such Leakages could stop. The scheme will also enhance efficiency of welfare schemes. The money is directly transferred into bank accounts of beneficiaries. LPG and kerosene subsidies, pension payments, scholarships and employment guarantee scheme payments as well as benefits under other government welfare program will be made directly to beneficiaries. The money can then be used to buy services from the market. For e.g. if subsidy on LPG or kerosene is abolished and the government still wants to give the subsidy to the poor, the subsidy portion will be transferred as cash into the banks of the intended beneficiaries.

INTRODUCTION

The government of India had implemented the scheme for cash transfer to the beneficiary's account in 51 districts from January 1, 2013.

Electronic Benefit Transfer (EBT) has already begun on a pilot basis in Andhra Pradesh, Chhattisgarh, Punjab, Rajasthan, Tamil Nadu, West Bengal, Karnataka, Pondicherry and Sikkim. The government claims the results are encouraging.

Objectives of the paper:

1. To understand cash transfer subsidy scheme.
2. To know preconditions of cash transfer.
3. To know about cash transfer in lieu of subsidy in kerosene.
4. To know about cash transfer in lieu of subsidy in fertilizers.
5. To understand implications of CT subsidy.

Evolution in India:

The government in order to leverage technology solutions and in particular the Aadhaar i.e. the Unique Identification (UID) programme for this purpose, constituted a task force on "Direct Transfer of Subsidies on Kerosene, LPG & Fertilizer" headed by Nandan Nilekani, Chairperson of UID Authority. The task force proposed the Solution Architecture to achieve a fully electronic back-office process for direct transfer of subsidy. The system would automate all business processes related to direct subsidy transfer and can be customised according to the business rules. At the very core of the system would be: Aadhaar Integration, ERP Integration and Integration with nodal bank and payments gateway.

Definition of 'Subsidy'

A benefit given by the government to groups or individuals usually in the form of a cash payment or tax reduction. The subsidy is usually given to remove some type of burden and is often considered to be in the interest of the public.

Politics play an important part in subsidization. In general, the left is more in favor of having subsidized industries, while the right feels that industry should stand on its own without public funds.

CASH SUBSIDY SCHEME

It is a poverty reduction measure in which government subsi-

dies and other benefits are given directly to the poor in cash rather than in the form of subsidies. It can help the government reach out to identified beneficiaries and can plug leakages. Currently, ration shop owners divert subsidised Public Distribution System grains or kerosene to open market and make fast buck. Such Leakages could stop. The scheme will also enhance efficiency of welfare schemes. The money is directly transferred into bank accounts of beneficiaries. LPG and kerosene subsidies, pension payments, scholarships and employment guarantee scheme payments as well as benefits under other government welfare program will be made directly to beneficiaries. The money can then be used to buy services from the market. For e.g. if subsidy on LPG or kerosene is abolished and the government still wants to give the subsidy to the poor, the subsidy portion will be transferred as cash into the banks of the intended beneficiaries.

The main disadvantage if scheme is that, only Aadhar card holders will get cash transfer. As of today, only 39 crore of the 120 crore people have Aadhar cards. Two other drawbacks are that most BPL families don't have bank accounts and several villages don't have any bank branches. These factors can limit the reach of cash transfer. It is feared that the money may not be used for the intended purpose and men may squander it.

Annual subsidy spending on petroleum products and fertilizers. (Rs.in crore)

Year	PDS kerosene	Domes-tic LPG	Fertilizer	Petrol	Diesel	Food
2000-01	7522	6724	13811	-Zero-	7522	12010
2001-02	5310	5830	12596	-Zero-	5330	17494
2002-03	3018	5760	11015	5225	3018	24176
2003-04	3751	9158	11847	6292	-Zero-	25181
2004-05	10627	10146	15879	150	2154	25798
2005-06	15441	11851	18460	2723	12647	23077
2006-07	18853	12255	26222	2027	18776	24014
2007-08	20080	17186	32490	7232	35166	31328
2008-09	29199	19314	75849	5181	52286	43627
2009-10	18321	16071	61264	5151	9279	52490
2010-11	20496	23999	54977	2227	34384	60600

(Source: Indian public finance statistics 2009-10)

Subsidy on Fertilizers and Kerosene:-**Fertilisers**1:In India, the fertilizer subsidy had three major goals: (1) increase food grain output (2) ensure reasonable returns for farmers (3) help increase the domestic production of fertilizers industry. Historically, the prices of fertilizers in India have been kept below the cost of production and imports, with a subsidy filling the gap between the cost of production/imports plus distribution costs and their retail prices. These policies have led to a dramatic increase in the use of chemical fertilizers and concomitantly subsidies have grown exponentially during the last few year. It is increased Rs.13811 crore during 2000-01 to Rs 54977 crore in 2010-11. The domestic production of fertilizers spurted in the 1970s when the Indian government encouraged investment in domestic fertilizer production plants in order to reduce dependence on imports. It introduced a "retention price" subsidy in 1975-76 which led to a sharp increase in domestic capacity and production between the mid-1970s and the early 1990s. The total production of N and P2O5 rose from 1.51 million and 0.32million tonnes, respectively, in 1975-76 to 7.3 million and 2.6 million tonnes in 1991-92 and 11.9 million tonnes and 4.35 million tonnes by 2009-10.2 Amongst the large agricultural economies, Indian now has one of the highest rates of fertilizer use per unit arable land .

Direct Cash Subsidy and its Impact, Existing system and its challenges:

Under direct transfer, the difference between the market price and subsidized price is directly transferred to the beneficiary in the form of cash in proportion to the quantity uplifted from the market.

In the Union Budget 2011, the government announced a direct transfer of subsidies to BPL households which is a drastic departure from the existing indirect or price subsidy system wherein subsidies are routed through manufacturers who are required to sell goods below the market rate.

The change in subsidy policy follows in response to the following shortcomings in the current system.

- Dual-pricing
- Market distortions
- Unresponsiveness to customer needs
- Poor targeting of BPL population
- Diversion and leakages
- Under recoveries for Oil Manufacturing Companies (OMCs).

The new policy would help poor access basic goods by reducing demand constraints. Since now the manufacturers and retailers would be selling the commodities at market determined price universally; this policy would not only put a check on dual pricing, market distortions and leakages but would also remove the burden of under recoveries on OMCs. However, the real success of the policy lies in the accuracy and efficiency in identification of worthy beneficiaries, i.e. BPL Households.

As the task force proposed in its report, the new subsidy system for kerosene would be implemented in 2 phases:

Phase 1:

Direct transfer of subsidy through state governments/UT Administration

- States purchase commodity from manufacturers at market price

- Central government transfers the differential subsidy directly to the state govts./UT
- Subsidy amount is proportional to commodity uplifted from the retail points in a state/UT.

States reform their distribution system based on the CSMS system proposed by the Task Force.

Phase 2:

Subsidy transfer to beneficiaries

- The cash equivalent of subsidy is transferred directly to beneficiaries through their bank accounts by linking transactions to Aadhaar

The commodity purchase and then transfer of cash subsidy to their account will be based on successful authentication of the beneficiary through Aadhaar at the point of sale

Impact on government

- The new system is expected to reduce this cost and subsidy bill through better targeting
- In the Union Budget 2012-13, target is to keep 2012-13 subsidies under 2 percent of GDP and under 1.75 percent of GDP in the next 3 years 3
- Government endeavors to scale up and roll out Aadhaar enabled payments for various government schemes in at least 50 districts within next 6 months
- Public sector OMCs have launched LPG transparency portals to improve customer service and reduce leakage.

Critical success factors

- The government's efficiency in dealing with the fundamental issues like the basis of targeting, definition of poverty line & identification of intended beneficiaries
- Effectively subsidizing the poor for fertilizer or kerosene once the prices are market determined and are liable to fluctuate
- Devising a methodology to transfer the cash subsidy to the poor
- State government's endeavor in taking up fundamental reforms required in Public Distribution System (PDS)

Recommendations

Identification of beneficiaries

Selection criteria should be kept broad-based and inclusive. Lessons can be learnt from the successful implementation of Brazil's Bolsa Família Program.

Vulnerability to fluctuating market prices

Prices can be averaged out yearly based on forecasts. Cash subsidy should allow flexibility in the choice of commodity to the beneficiary. The amount of subsidy should be calculated based on the number of individuals per household rather than assuming an average household size.

Transfer of cash subsidy

To expedite the implementation, bank accounts can initially be opened for one member per household. The withdrawal can be done at bank branches and ATMs through debit cards and through the business correspondent model using smart cards, etc.