



Direct Cash Transfer in India

May 2012

Submitted By:

Suman

IIM Calcutta

Mentored By:

Mr. Skand Tayal

**Former Ambassador of India to Uzbekistan and
Republic of Korea**

Disclaimer: This report is an outcome of a student project and the content of this report represents the views of its author. Neither the report nor any of its parts represent the views of Rakshak Foundation and/or any of its affiliates and officials in any capacity whatsoever. The figures and facts used in the report are only suggestive and cannot be used to initiate any legal proceedings against any person or organization. However, the author shall be extremely grateful to acknowledge any inaccuracies in the report brought to author's notice.

Please email your suggestions or concerns to: hr@rakshakfoundation.org

Table of Contents

Preface.....	3
Acknowledgement.....	4
Executive Summary.....	5
Introduction	6
Advantage of Cash Transfer in Indian Context.....	8
Pre-requisite Conditions for Introduction of Cash Transfer System	10
Barriers in Introduction of Cash Transfer System	12
Recommendation	13
References	15

Preface

I am Suman. I am from Ara, Bihar. I did my schooling from Sainik School Goalpara in Assam. I did my undergrad in Chemical Engineering from Birla Institute of Science and Technology Pilani. After completing my graduation, I joined Reliance Industries Limited. At present, I am doing Post Graduate Diploma in Management from IIM Calcutta. My hobbies are playing cricket and badminton and solving mathematical puzzles.

Rakshak Foundation is non-profit organization with an objective to help strengthen the foundations of our society and bolster the confidence of a common man in the system by creating awareness about the issues affecting him. I choose to participate in Rakshak Foundation internship program because it provides the students with an opportunity to experience real-world problems to which they must apply fundamental academics and interpersonal skills. It provides an opportunity to recognize true passion, potential and links academic program contents with workplace. It provides an opportunity to be creative in finding innovative solutions to actual problems and introduces to the roles of non-profits in community and beyond.

Acknowledgement

I would like to express my sincere gratitude to Mr. Sachin Bansal, CEO, Rakshak Foundation for having collaborated with IIM Calcutta and thereby given me this opportunity to familiarize with the current ongoing public policy issues. It provides an opportunity to work on complex real life social/ national problems under the mentorship of experts and policy makers.

I am grateful to Mr. Skand Tayal, Former Ambassador of India to Uzbekistan and Republic of Korea for sharing his invaluable time and expertise throughout the span of my project work. His able guidance has truly helped in the timely progress of the project work.

I would also like to thank all those who helped me in giving the direction and guidance through the course of the project.

Executive Summary

India population is 1.2 billion, out of which near about one third of population is living below the poverty line. There are very high administrative costs associated with the current food and fuel subsidies and also there are a lot of leakages in the system through which the subsidies do not reach to the desired people who needed it most. So, to remove these loopholes the government is planning to introduce Direct Cash Transfer (DCT) system which can be easily accessible by the poor people. The cash transfer schemes are already implemented in Brazil and Mexico and they are highly successful. The cash transfer scheme will reduce corruption, eliminate wastage, reduce administrative cost, remove duplication, consolidate cash transfer and frees the administrative system. But there are certain pre-requisite conditions which have to fulfill before implementing the direct cash transfer in India. The pre requisite conditions are direct banking access to all, unique identification card for all, financial inclusion and databases for transfer and linked with unique identification. The direct cash transfer system appears to be a much suitable system to help the poor and reduce poverty in India but there are a number of barriers which has to be surpassed to make it successful. The barrier associated with the cash transfer systems are high initial infrastructure and administrative cost, identification of poor and access of banking for all. Direct cash transfer scheme could be a game changer in delivering welfare directly to the poor, but only if it is properly designed in terms of supporting infrastructure, institutions and monitoring mechanisms. Few of the recommendations that can be included when this scheme will be introduced are introduction of ultra-small braches for banking, more information to be collected by Aadhaar card, conditional cash transfer and Monitoring of price of essential commodities by government.

Introduction

India is a land of villages where more than two-third of the population is residing in rural areas. At present India population is 1.2 billion, out of which near about one third of population is living below the poverty line. To help these people to fulfill their basic amenities of life the central government of India together with the various state governments provides food and fuel aid subsidy. There are very high administrative costs associated with these subsidies and also there are a lot of leakages in the system through which the subsidies do not reach to the desired people who needed it most. So, to remove these loopholes the government is planning to introduce Direct Cash Transfer (DCT) system which can be easily accessible by the poor people.

Direct Cash Transfers are programs that transfer cash directly to the poor households with or without conditions. They are generally of two types – unconditional and conditional. Cash transfer programs that do not impose any conditions for making the transfers are called unconditional cash transfers. Conditional cash transfers transfer cash on the condition that those household will fulfill the pre-specified condition attached to transfer. The purpose of a cash transfer could be:

- Direct Subsidy - To provide a direct subsidy for specific products – such as for food, fuel, agricultural inputs, electricity, books, etc.
- Direct income support – To provide old age income support through a pension, unemployment assistance through an unemployment benefit, etc. This is predicated on the assumption that there is a need to redistribute income as a public policy objective. Often, the purpose is to enhance private consumption levels and achieve a minimum consumption floor.
- Monetary Benefit - To provide a monetary benefit for a specific purpose or use - such as for education through a scholarship, for healthcare through a medical assistance program, etc.

Cash transfers both conditional and unconditional are used by many countries across the world. Some of the famous cash transfer programs are:

- Brazil set up its conditional cash transfer program with the name of Bolsa Familia in 2001. By 2006, the Bolsa Familia was reaching over 11 million households living below the official poverty line, or over 44 million people. The scheme is nominally means-tested, with the transfer amount determined by number of children in the household. Recipient can choose how to spend the money, but the conditionalities are restraining, and include school attendance by children aged 5-15, anti-nasal classes for pregnant women and vaccination for the children under the age of seven.
- Mexico's Oportunidades covers 25% of the population with 5 million households and provides transfers which are 20% of household consumption. The cash transfer consist of three components – a household nutrition allowance, a schooling subsidy for each school age child that rises in amount by grade and that is higher for girls of secondary school age and an annual payment to cover the cost of books and uniform. This replaced inefficient subsidies and poorly targeted cash transfers and gave beneficiaries the freedom to choose how they used the transfers as long as they committed to certain behaviors.
- Other schemes similar to Bolsa Familia are Colombia's Familias en Accion, Jamaica's Programme of Advancement through Health and Education, Honduras' Programa de Asignacion Familiar.

The direct cash transfer schemes in these countries have shown encouraging and positive results. The important results to be noted are:

- They are generally well targeted and have managed to concentrate their benefits on the poorest households and those least likely to invest in human capital.
- Recipients have spent more on food and on higher quality food.
- They have helped reduce poverty and child labour.

- They have modest or no negative effects such as crowding out private transfers and private investment or reducing labour supply or impacting wages.
- They have managed to enhance household consumption when the transfers are substantial. This is very important as transfers need to be sizable.
- They can address transient problems and transient poverty such as sudden shocks (calamities, distress, economic shocks) if they are unconditional and are counter-cyclical

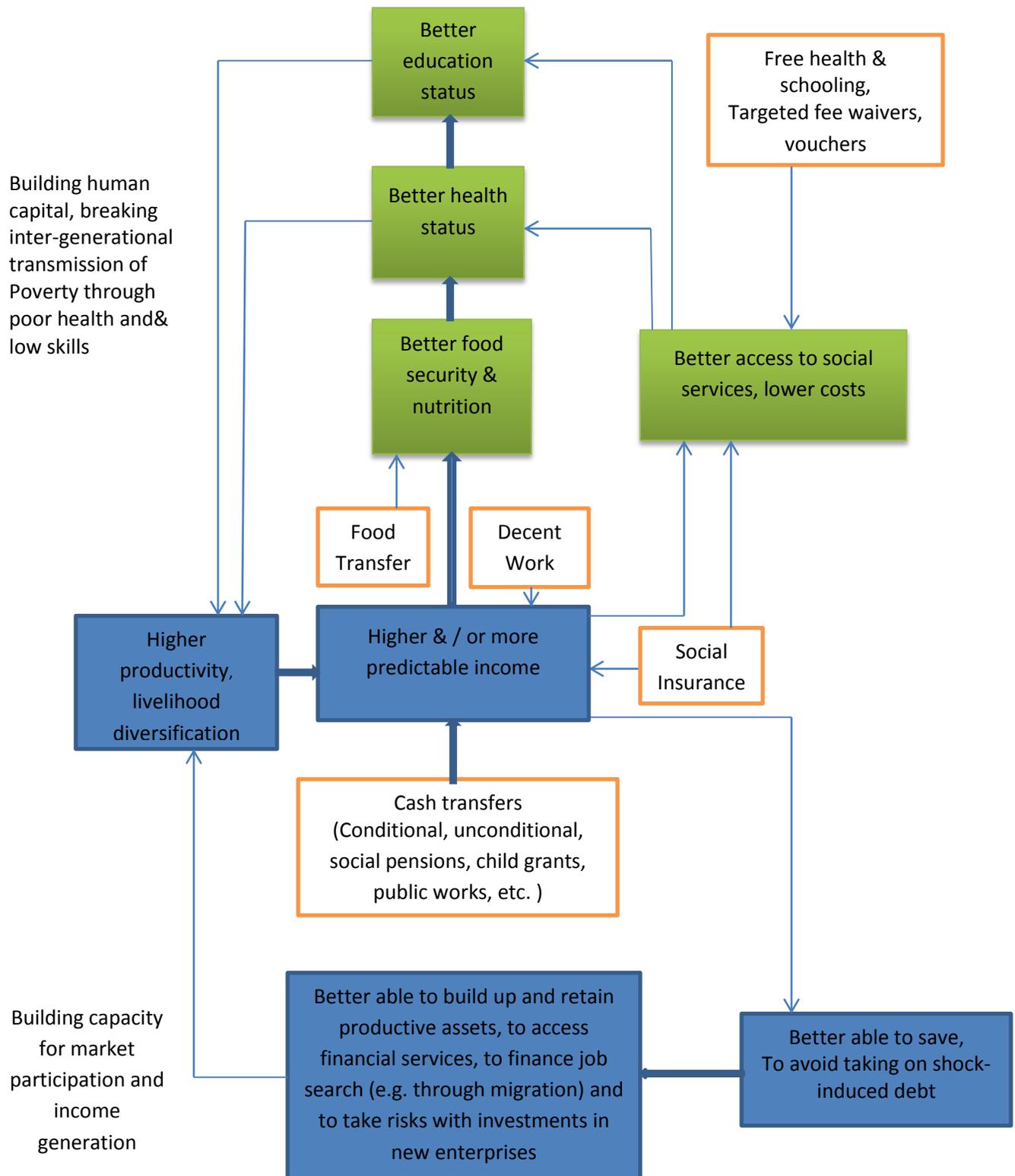
In most of these countries, cash transfer systems have become an important component of an arsenal of social safety nets and part of broader system of social welfare. As a country progress on its economic development curve, a cash transfer system becomes a potent institutional arrangement which can be the platform for modifying and transferring benefits to people depending on the immediate needs and circumstances thus achieving equitable growth.

Advantage of Cash Transfer in Indian Context

The Direct Cash Transfer will boost up the economy of India and also help in the eradication of poverty. The various advantages are as follows:

- Reduce Corruption – In the current food and fuel subsidies, there are a lot of leakages and the subsidies do not reach to the right person and in right amount. By implementation of Direct cash transfer system the transfer of benefit will directly reach to the right beneficiaries by eliminating the middle men and removing all unnecessary paper work.
- Eliminate waste – In the current system, there are lot of wastage of food grains and fuel due to the poor targeting and storage. The direct cash transfer system will remove the problem of storage and leakages while transferring.
- Reduce administrative cost – At present for every Rs. 1 procurement cost of food grains Rs. 1 is spend on distribution, storage and administrative cost.

Figure 1: pathways by which cash transfers can improve household welfare



In the direct cash transfer system the administrative cost reduce to just Rs. 1 for every Rs. 100 reach to the beneficiaries. Thus, direct cash transfer system leaves more amount to be spend on various social welfare programs by reducing the administrative cost.

- Frees the administrative system - Direct cash transfer system frees the administrative system to focus on development rather than on exercise of controls. It will ensure that India can maximize the benefits from the expenditure on the welfare schemes and thus help in overall Human Development
- Consolidate cash transfer - A Cash Transfer system, once in place, can be used to consolidate cash transfers to households which are currently coming from multiple sources and in multiple forms. In the long run, cash transfer system will improve the efficiency of the social safety net. The administrative synergies of running multiple transfers through the same agency and using the same beneficiary database is a positive externality which has immense benefits in consolidating and analyzing data on transfers. In the long run, the Cash Transfer system can become a consolidated income support program for the poor and eliminate multiple sources of subsidy.
- Remove duplication - In the current system, a family is covered under the various schemes as each scheme works separately. In the direct cash transfer system this duplication of scheme benefits can be reduced and thus more number of right beneficiaries can be added.

Pre-requisite Conditions for Introduction of Cash Transfer System

The design and implementation of cash transfer system has many elements which need to be addressed in a proper manner so that the cash transfer system operates in a smooth manner without any problem. Once a decision is taken for introducing a cash transfer system, it needs to be designed and rolled out with lot of planning and advance action. Before a cash transfer system is launched, the following elements should take place:

- Access to banking for all – There is a need for every individual to have access to the banking system within a reasonable distance. The bank branch need not meet the classical definition of a branch and need not even be a brick or motor branch. However, the facility must be easily accessible.
- Unique identification card for all – It is necessary that every individual of the country have a unique identification card through which they are identified. This unique identification card should be linked for all the cash transfer schemes. At present, it is being done under the UIDAI's Aadhaar Scheme.
- Financial inclusion – In addition to having access to banking system, every individual must have a bank account. The Know your customer (KYC) norms are too aggressive and loaded against the poor. A mechanism which was supposed to prevent misuse of the banking system by anti-social elements has ended up raising barriers for poor. Making Aadhaar as an adequate KYC would enable financial inclusion.
- Databases for transfer and linked with unique identification - Apart from an identification system and financial inclusion, a cash transfer system need a database of beneficiaries. These databases will be different for different programs. Each benefit type can have a different target group. The linkage of the beneficiary databases with the unique identification numbers and also with the Bank account numbers is a critical component of the cash transfer. The implementing agency of a particular benefit program would need to ensure that the beneficiary database has the details of the Unique ID number while the Banking system will have to ensure the mapping of Aadhaar numbers to the bank accounts.
- Transfer Mechanism - There is a large back-end infrastructure that is needed which consists of payment systems, bridges between different IT systems and clearing systems. Each of which has to be linked up with the other to be inter-operable. Further, detailed rules and procedures have to be evolved and put in place for transfers to take place across all these systems. All these have to have inbuilt checks and balances for traceability, preventing fraud and facilitating audit of transactions.

Barriers in Introduction of Cash Transfer System

The direct cash transfer system appears to be a much suitable system to help the poor and reduce poverty in India but there are a number of barriers which has to be surpassed to make it successful. It was easier to implement direct cash transfer programs in Brazil and Mexico with 6 percent and 1 percent poverty ratios respectively compared to 32 percent in India. The targeted population for the direct cash transfer program in India is also more than the population of Mexico and Brazil combined. The various barriers associated with the cash transfer in India are:

- Access to bank account – In India, only 40 percent of all households has bank accounts and these are mostly at the top of the wealth pyramid. In rural areas of India, only 21 percent of the household have the access to the banking system. Banks may not be keen to simply open branches in rural areas and open no-frill accounts to help poor people. The banking system also needs to have the requisite infrastructure such as bandwidth, information technology and staff to effectively support the cash transfer system. For the implementation of the direct cash transfer it is necessary that at least one member in each household has a bank account.
- Unique identification card – In order to provide a unique identification for every citizen of India, Unique Identification authority of India has introduced the Aadhaar card. As of March 2013, the UIDAI has generated over 287 million identification numbers as part of what will be the world's largest biometric database. It is aiming to cover 600 million people by the end of 2014. Aadhaar cards contain data on the biometric and demographic characteristics of any individual and the data are centrally stored. Aadhaar Cards also do not record data on caste, religion, ethnicity or income. They also do not link members of the same family group so that a family does not take advantage of same scheme twice by producing two different Aadhaar cards of different members of same family. Aadhaar cards do not contain any information about the family or individual income so it will be difficult to find the right beneficiaries for a particular scheme.

- High initial infrastructure and administrative cost – There is a large back-end infrastructure that is needed which consists of payment systems, bridges between different IT systems and clearing systems. Each of which has to be linked up with the other to be inter-operable. The initial administrative cost will be also high as its implementation required highly trained people who can handle computers and various software associated with it.
- Right Identification of poor – The success of direct cash transfer will depend upon whether poor individuals are correctly identified and included; whether non-poor individuals are also correctly identified and excluded. In India, the income statement for family is based upon self-verification for most of the poor families and those involved in business. So, if cash is provided free to the people many families will try to get the benefit by showing less income and fraud documents.

Recommendation

Direct cash transfer scheme could be a game changer in delivering welfare directly to the poor, but only if it is properly designed in terms of supporting infrastructure, institutions and monitoring mechanisms. It is necessary to make sure that poor families who are mostly uneducated and illiterate have bank accounts and a UID number. The few of the recommendations are:

- Ultra small branches for banking - These bank branches need not meet the classical definition of a branch and need not even be a brick or motor branch. An Ultra- Small Branch would have an area of 100-200 sq. feet where the officer designated by the bank would be available with a laptop on a pre-determined day and time in a week with internet connectivity to the core banking solution. The bank officer will offer services provided by the bank, undertake field verification and follow up the banking transactions.
- More information to be collected by Aadhaar card – At present Aadhaar card act as a unique identification number to a citizen of India without any income or family

related information. Through Aadhaar card, the number of members in the same family and the family income should be collected. It will help in prevention of leakages of fund to the same family more than once due to having a unique identification number of each family member and help in providing benefit to more number of beneficiaries.

- Conditional cash transfer - Government should also make cash transfers conditional so that beneficiaries spend the money on intended goods and services. The *Bolsa Familia* scheme in Brazil comes with conditions such as attending school and vaccinations and has resulted in improvements to education and health outcomes as well as reduced poverty. In the same manner cash transfer in Indian context should be linked with the school attendance by children aged 5-15, anti-natal classes for pregnant women and vaccination for the children under the age of seven.
- Monitoring of price of essential commodities by government - If the PDS is dismantled and replaced by cash transfers it may skew the availability of food grains across regions. The private sector might exploit such a situation, which would not be good for food producers, food prices or food security. Direct cash transfers to the poor allowing them to buy basic services provided by the private sector can be effective only if the government monitor the price of essential commodities like food and fuel in a deregulated market to avoid un-affordability and subsequent vulnerability of the poor.

References

1. <http://www.eastasiaforum.org/2013/02/21/direct-cash-transfers-a-panacea-for-poverty-and-inequality-in-india/>
2. <http://www.eastasiaforum.org/2013/03/26/indias-direct-cash-transfers-present-an-illusorywelfare-scheme/>
3. <http://www.eastasiaforum.org/2011/10/22/india-s-unique-identification-system/>
4. <http://planningcommission.gov.in/sectors/dbt/min0911.pdf>
5. http://www.isid.ac.in/~pu/conference/dec_09_conf/Papers/StephenHowes.pdf
6. http://planningcommission.gov.in/sectors/dbt/back_2611.pdf
7. <http://www.kpmg.com/in/en/issuesandinsights/articlespublications/kbuzz/pages/gov.aspx>

RAKSHAK FOUNDATION

Rakshak Foundation is a 501(c) (3) non-profit organization headquartered in Santa Clara, California. It partners with Rakshak Foundation NGO, New Delhi, India. It researches different public policy issues and creates awareness about them. Rakshak Foundation sponsors Seminars on public policy matters, sponsors activities to involve the youth in social issues including volunteerism and supports programs to help the needy. Rakshak's Summer Internship Program is aimed at providing an opportunity to highly motivated college students to work on complex real life social/national problems under the mentorship of experts and policy makers.

2784 Homestead Rd, #235

Santa Clara, California - 95051

United States of America

Tel: +1 (408) 329-1492

Email: secretary@rakshakfoundation.org

www.rakshakfoundation.org