

# INDIA NEED NOT LIVE WITH POVERTY

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## 1. Introduction

Most of the poverty we continue to see in India is system induced. Our 50-year old love affair with socialism has fostered, through its barriers to efficiency and negative effects on incentives, poverty on a scale unprecedented in the history of the modern world. We therefore need to compensate the perennial losers generated by our system. As Hegel said in 1821, “Not only caprice ... but also contingencies, and factors grounded in external circumstances may reduce men to poverty” (Caporaso and Levine, 1992: 211). This random outcome at the household level, of a bad state of nature arising either from genuinely natural or man-made causes, is an affliction which seriously compromises human existence and dignity.<sup>1</sup> When even *one* family goes hungry and without shelter while others do not, that constitutes an untenable level of inequality in a civilised human society. Bonded labour, child labour and even the sale of wives and children arise from this complete lack of control over basic economic resources of those below the poverty line. Even worse, research shows<sup>2</sup> that poorer parents, maximizing their utility in an uncertain environment, are less likely to want to educate their children, thus setting up the well-known “vicious cycle of poverty”,<sup>3</sup> making even the future eradication of poverty difficult.

Today, the wider acceptance of economic reforms in India is hindered by the continuance of abject poverty extending to about a third of our population. The debates and analyses on the trends in poverty which are currently raging across the country (e.g., Dubey, et al., 2000; Saxena; Aiyar, 2000), while possessing some merit in themselves, are taking us into needless controversy over trifles. Liberalization will surely affect poverty when properly implemented. But that will *at best* be a medium-term outcome. What is missing in the debate, or at least that which does not come through prominently, is that the liberals, who are propelling the thought process behind reforms, also strongly believe in a simultaneous, powerful and immediate role for government in the *elimination* of poverty.<sup>4</sup>

Today, government can eliminate poverty with a small fraction of the expense being incurred in the name of the poor. Therefore, if poverty elimination is made an explicit part of the liberalization package, that would make liberalization and system-reform far more palatable to many political and social leaders. Success in eliminating poverty will release a huge ‘*equity dividend*’ which can propel the country on to a dramatically higher growth.<sup>5</sup>

This paper begins with an attempt to understand the theoretical and constitutional roles of government in India in dealing with the challenges posed by chronic poverty. I compare the implications and current manifestations of this role with the far more elegant and efficient alternative – negative income tax (NIT), and show that with NIT, government can do

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<sup>1</sup> Poverty is a very complex and multidimensional problem. In particular, the poor are frequently deprived of the direct benefits which are supposed to accrue to them under various government programmes, and also access to public goods which are mostly provided for the rich in urban areas. For a larger discussion of poverty and inequality, see Sen (1999). In this paper, we treat the poor as those below the poverty line.

<sup>2</sup> See, for example, Sabhlok, 1999.

<sup>3</sup> See a modern treatment in Basu, 1997.

<sup>4</sup> For example, see Chapter 12 of Friedman (1982).

<sup>5</sup> Growth and equity need not be conflicting goals (Rodrick, 1994).

much more, more fairly, and with far less expenditure. I then discuss the actual position on the ground of some of the large number of programmes which are in place purportedly to minimize poverty, and analyse the fundamental short-comings of these activities.

## 2. Role of Government

### 2.1 *Equality under the Constitution*

The Constitution of India guarantees equality of opportunity and status under the Preamble. Article 38 (1) speaks of economic justice; 38 (2) talks of minimizing inequalities in income and elimination of inequality of opportunity. Article 39(c) specifies that the State shall attempt to secure “that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment”. Article 39 also talks about providing adequate means of livelihood for all, equal pay for equal work, and prevention of exploitation on the basis of economic causes. While many of these are merely pious statements of intent largely representing the personal predilections of the framers of the Constitution, the general tenor of these provisions has been used over the years to lay down the ground for various forms of public intervention against poverty and inequality.

### 2.2 *Speeches of Leaders*

In the famous speech made to the nation on the eve of the departure of the British on the 14th of August, 1947 Nehru talked about the task of *ending* poverty and removing of inequality of opportunity. Indira Gandhi later coined the slogan *Garibi Hatao*, emphasizing the challenge of eliminating poverty. Others have also spoken at length on this issue. For example, on the 15th of August, 1997 I. K. Gujral declared that “Poverty ... should be

<sup>6</sup> Thus there has been at least some lip-service paid over the years to the concept of *elimination* of poverty. And yet our socialist leaders have invariably promoted the much humbler goal of *alleviation* of chronic poverty, while simultaneously and liberally plying the middle and upper classes with subsidies and tax exemptions and holidays.

### 2.3 *Theory of equality of opportunity and status*

Jean-Jacques Rousseau thought that equality “must not be understood to mean that degrees of power and wealth should be exactly the same, but rather that with regard to power, it should be incapable of all violence and never exerted except by virtue of status and the laws; and with regard to wealth, no citizen should be so opulent that he can buy another, and none so poor that he is constrained to sell himself”.<sup>7</sup> Equality has many interpretations and various implications, the most frequent classification being economic, legal, political and social equality. The basic connotation seems to be best captured by the concept of natural equality, whereby “... because men are equally free, they claim to be absolutely equal” (Aristotle, in *Politics*, 343 B.C).<sup>8</sup> As Thomas Jefferson said (in letter to George Washington, April 16, 1784), “The foundation on which all our constitutions are built is the natural equality of man”. This meaning has close affinity with political equality, even though Lord Bryce suggests how the two could be different.

Equality in justice or legal equality requires “Equal laws protecting equal rights” (James Madison, letter to Jacob De La Motta, August, 1820). Nozick deems equal rights to be limited to property rights. He is one of the few major theorists to believe that a society should focus only on the protection of property rights and not concern itself with the distribution of

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<sup>6</sup> Speeches of Prime Ministers of India are available on the web site of the PM’s Office.

<sup>7</sup> From *Discourse on the Origin and Foundations of Inequality*, 1755, cited in Carnoy (1984:22)

<sup>8</sup> Quotations in the rest of this sub-section are from Baker, 1992.

wealth (Caporaso and Levine, 1992: 205). Equal pay for equal work, another component of equality in justice, is confounded in many cases due to the difficulty of discerning between two pieces of allegedly “equal” work. Hence economists usually permit the free play of market forces under which the concept of marginal product takes into account matters such as the quality of output and commitment.

That component of equality which a government can relatively more readily and justifiably seek to operationalise is equality of opportunity to develop one’s talents. In this we are looking for “conditions under which each man obtains the chance to show the stuff that is in him when compared to his fellows” (Theodore Roosevelt, seventh annual message to Congress, December 3, 1907). This concept -- of providing the basic *equality of opportunity* to all including those whose circumstances may have been unfortunate, paves the way for public *economic* intervention in certain cases. Rawls takes this role much further through his “difference principle”, which emerges from behind the “veil of ignorance”. It is difficult to agree with this principle, though, according to which inequalities are *just* if they benefit the worst off since there appears to be no way known to us to identify and quantify such differentials or benefits, and we would possibly enter into a maze of confusion were we to attempt to operationalize it.

#### 2.4 *Doctrine of Legitimate Economic Intervention*

Empirically, while it is well known that economic equality beyond a point hinders creativity and growth (Becker, 1997: 66-67), there is also evidence that a reasonable level of equality and growth could go together (Rodrick, 1994). In other words, there is possibly an optimal level of economic equality which each society must determine for itself. That would perhaps operationalise the concept of ‘*equality of opportunity*’. One simple but objective and powerful instrumentality for this would be to go for a full-blown democratic market system (capitalism) in which there is no poverty or serious deprivation. Attempts to “rob” (tax) the rich to feed those below the poverty line can then be justified if the consequent benefits are focused precisely on the poor. On the other hand, attempts to spend a rich man’s money on a person not below the poverty line would meddle with individual liberty, and would amount to *pure* robbery, also compromising political and legal equality.<sup>9</sup> The following “doctrine” then commends itself for adoption.

- (a) Each society has to determine its own poverty line,<sup>10</sup> based on its unique environment and concept of living standards.
- (b) No society can justify direct transfer/subsidy from public funds to anyone above this societally defined poverty line under any circumstances.<sup>11</sup>
- (c) If resources and technology exist in the society, all persons below this poverty line should be elevated to this level. If not, the “assistance line” should be lowered until the public resources available for re-distribution are exhausted. In other words, the State can discriminate amongst the poor only if the resources available for distribution are lesser than those needed to eliminate poverty.
- (d) If resources available exceed this amount, either the taxes should be lowered, or a higher quality of public goods provided.

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<sup>9</sup> Of a kind which governments in India have long practised, but must now learn to forego. This robbery continues today despite the many tall claims to the contrary made in public forums. For example, P.V. Narasimha Rao said on 15th August, 1995, “All our programmes are to remove poverty. We have not given any money to the rich”. Now who possibly believes this?

<sup>10</sup> The poverty line must be indexed to the Consumer Price Index.

<sup>11</sup> Except possibly in the case of some completely uninsurable events.

### 3. The role the Government should play

I suggest that the only truly justifiable method for achieving the desirable re-distribution outlined in (c) above is the negative income tax (NIT) of Milton Friedman (1982). I have made a hypothetical analysis<sup>12</sup> of poverty elimination through NIT which shows that *all* poverty in India could have been eliminated in 1994 by targeting payments to the poor at a cost of approximately Rs. 18,300 crores, i.e., by a per capita *average* payout of Rs.570<sup>13</sup> to those below the poverty line, with individual benefits ranging from Rs.100 to Rs.1,500. Subsidies exceeded this requirement by a very wide margin.<sup>14</sup> The following Table summarises the results of my analysis.

**Table: Estimate of funds required to eliminate poverty in India (1993-94)**

	<i>Units</i>	<i>Rural</i>	<i>Urban</i>	<i>Combined</i>
<b>Facts (1993-94)</b>				
Poverty line per capita p.a.	Rs.	2470.08	3376.20	
% below poverty line		37.27	32.36	
Number below poverty line	lakhs	2440.31	736.37	3176.68
<b>Assumptions</b>				
Death line = Half of PL	Rs.	1235.04	1688.10	
<b>Results</b>				
Total payout to eradicate poverty	Rs. lakhs	1068893	407919.9	<b>1476813</b>
Survey cost per person (pp)	Rs.	3	3	
Data entry/ distribution cost pp	Rs.	7	7	
Monitoring cost pp	Rs.	5	5	
Total cost of eradicating poverty	Rs. lakhs	1105748	418949	<b>1524697</b>
Add 20% toward excess identified and excess paid out	Rs. lakhs	221150	83790	
Final cost to exchequer	Rs. lakhs	1326898	502739	<b>1829637</b>
Average cost per person	Rs.	540	684	<b>573</b>

*Source:* Poverty statistics have been taken from Planning Commission (1999)

I would like to point out that this estimate does not use the NIT methodology of Friedman under which “[a]n extra dollar earned always means more money available for expenditure”. The current analysis is for supplemental income and should be taken only as a first approximation to NIT.

This has been confirmed by Pronab Sen of the Planning Commission in an e-mail in April, 2000, and subsequent personal discussions held in June, 2000.

<sup>12</sup> Available at <http://www.indiapolicy.org/debate/Notes/poverty-June00.xls> (Excel document) linked at <http://www.indiapolicy.org/debate/notes.html>. A more accurate estimate is beyond the scope of this paper as that will need much more data and resources. As P. Sen says, “The calculation ... involves taking the difference between the mean consumption expenditure of each NSS expenditure class below the poverty line and multiplying it by the number of people in that class and adding it up”. The Planning Commission should perhaps make it a practice to announce this calculation each year so that the country has a benchmark to assess the effectiveness of our poor-directed subsidies.

<sup>13</sup> In 2000, this would perhaps be in the vicinity of Rs. 1,000.

<sup>14</sup> Defining an expenditure as a subsidy is often fraught with controversy. Subsidies are explicit or non-explicit, budget-based or off-budget. Non-merit subsidies (net) amounted to Rs. 93,993.27 crores annually in 1994-95 in India (Department of Economic Affairs, 1997).

“[Y]ou are probably right that the amount being spent on subsidies and transfer payments today is considerably greater than the amount that would be needed to bring everyone above the poverty line with direct income transfers”.

### 3.1 Implementation of NIT

Before NIT is implemented, some very hard decisions have to be taken by Government. Putting into place a programme of NIT while subsidies and loss-making public sector undertakings continue as before, would be *completely disastrous*. The Government would have to gather the political will to expose the rich who have defaulted in repayment of thousands of crores taken from nationalized banks, raise power tariffs and fees in higher education, prices of kerosene and food, privatize undertakings run by Government in the business sector, and retrench the excess staff in Government. Sequencing of the withdrawal of subsidies would have to be organised in order to minimize possible social unrest. Once a firm decision to eliminate subsidies is taken, the procedures suggested below could be introduced.

#### 3.1.1 *Underlying Mechanism*

The mechanism underlying the NIT is the filing of annual income tax returns by all households across the country. A positive spin-off of this method would be that tax collections in the country will increase as wealthier farmers enter into the fold of income tax, thus reducing the net cost of poverty elimination.<sup>15</sup> The work will have to be carried out jointly by the Income Tax department<sup>16</sup> and State governments, which usually command a vast army of civil officials at the village level.<sup>17</sup>

#### 3.1.2 *Identification of the Poor*

On the pattern of the Census, an Income Tax operation will have to be organized annually. It is suggested that voters lists be used as the basis of the identification process.<sup>18</sup> Since perfection cannot be expected in the estimation of individual household income, suitable proxies will have to be framed. Suitable, easy-to-fill forms would have to be devised to capture the requisite information. Village bodies such as the Gram Sabha could be used to authenticate the data so collected. The data could then be captured into computers at the Block level (where computers are now being provided by the Ministry of Information Technology) or at the Sub-Divisional/ District level, or given to private operators for data entry, if necessary, in the prescribed software. Indeed, the very possibility of successfully carrying out such an enormous operation hinges crucially on the wide prevalence and use of IT and e-governance infrastructure.

#### 3.1.3 *Payments to the poor*

The computerized data and forms would then be transmitted to the Income Tax Office at the State Capital for processing. The poor will be identified on the basis of various econometric models and the transfers needed at the household level ‘netted out’. A printed

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<sup>15</sup> Some officials at the Planning Commission have suggested that a comprehensive income tax plan will be a non-starter due to resistance from these wealthier farmers who will resist paying income tax. Also, agricultural income is currently the most popular way to launder black money. In that case, a supplemental income strategy could be implemented initially.

<sup>16</sup> It is very important that funds for NIT be directly under the control of Government of India, and implemented by an independent body in order to avoid political pressures at the grass-roots and State levels.

<sup>17</sup> Village and Block level workers from the Education, Land Revenue, Agriculture, Food and Civil Supplies, Rural Development, and other departments.

<sup>18</sup> As used in Dhubri District in 1986-87 and beyond by this author, as Project Director, DRDA (details are in the book, “Dhubri Advanced Information System”, published by D.R.D.A. Dhubri in 1988).

statement would then be issued to the banks at the State headquarters, with authorization to credit the accounts of such persons in the amount necessary to bring the concerned family just above the poverty line.

Note that nationalized banks today have tens of thousands of branches operating widely across the nation. Virtually all branches possess the experience of dealing with the illiterate poor. Most of them operate old-age pensions, rural development loans, and other accounts. There is also no difficulty, in principle, in banks and field functionaries of the State Government helping the poor open accounts with designated Bank branches. Discussions with bankers indicate that there is almost no leakage/ corruption at the Teller's window, i.e., Banks are not likely to cheat at the time of disbursing money to the account holders.<sup>19</sup> At the bare minimum, attempts to cheat or steal at this stage will be a clearly discernible crime, while currently, leakages from subsidies are largely systemic and system-wide.

### 3.14 *Monitoring*

The Income Tax Department and State Governments can verify about 1% of the total cases annually to ensure cross-checking. Penalties can be imposed on those who have filed excessively incorrect returns. In the case of those whose returns were filled up wrongly by government functionaries, the concerned functionaries can be hauled up. The involvement of village bodies in this monitoring process will also help.

## 4. **The actual role played by Government in India**

As per (c) of Section 2.4 above, since resources available for re-distribution exceed the amount needed to lift all the poor above poverty, Governments in India cannot *discriminate* amongst the poor. Every year, without fail, it is our obligation to eliminate poverty, irrespective of caste, tribe, sex or age. But despite the big talk and slogans of political leaders, we continue, as a nation, to speak less of elimination of poverty than of poverty alleviation and asset redistribution. But even here, a closer look shows that we have performed very poorly with regard to achieving these limited objectives. Apart from low coverage and discrimination within the poor, there is the very large and persistent problem of mis-allocation of public resources to the rich. I examine an illustrative sample of such programmes below.

### 4.1 **Direct Poverty Alleviation**

#### 4.1.1 *Rural Development Programmes*

The fundamental defect of programmes like IRDP is that these try to *select* amongst the poor. The poor are also frequently made further indebted by various ill-conceived schemes. Further, even under ideal conditions, of no leakage of funds and complete success in achieving productive income by the poor, it would take well over a few hundred years to eliminate poverty in India. Combined with its enormous leakages<sup>20</sup> the IRDP has some extremely doubtful achievements, and no tears need be shed while showing it the door.

#### 4.1.2 *Land Reforms*

Land reforms in India were beset with the moral hazard problem from the very beginning, such that transfer has tended to be of low yielding assets (poor quality land). Despite this, most of these assets were of relatively higher value than the assets possessed by

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<sup>19</sup> Yogendra Sharma, Sr. Economic Advisor in the Finance Ministry feels that there might be a few cases of extortion, but that these will be negligible.

<sup>20</sup> "A study (evaluating IRDP from 1981-82 to 1992-93) conducted by the LBSNAA in 1994-95 in Tehri-Garhwal district of Uttar Pradesh shows the rich people bias in this programme" (Saxena: 81).

the poor to whom these were to be transferred, and such transfers would have at least done *some* good. But given our political-administrative structure, rent-seeking behaviour has been rampant in this area. Consequently, land reforms have remained largely on paper. On the other hand, NIT transfers national wealth from all sources, to *all* the poor, *every* year, without discrimination. Also, given the small size of individual transfers, rent seeking is not likely to infest NIT as it did in the case of land reforms.

Unfortunately, even in the best of conditions, land reforms would have still fallen far short of the requirement of asset transfer for the *elimination* of poverty. We must also bear in mind that this strategy suffers from the serious defect of violation of property rights and thus of liberty itself. Progressive taxation is acceptable; seizing someone's land without compensation is unsustainable. Therefore, land reforms must be abandoned,<sup>21</sup> particularly since the richer farmers will be required to pay income tax under NIT.

#### 4.1.3 *Micro-credit*

Due to the existence of unholy alliances in many ongoing government sponsored micro-credit programmes such as the KVIB and Weaver's Cooperatives,<sup>22</sup> such programmes need to be disbanded. Later, once NIT comes into force, micro-credit can exist on a much more commercial basis, with market rates of interest for everyone, and where each project is evaluated strictly on merit.

## 4.2 **Direct Welfare**

### 4.2.1 *Basic Minimum Services*

In addition to the more direct attacks on poverty, there are a large number of schemes being implemented in the states with a view to providing certain basic minimum services to the poor. For example, in Meghalaya, the Rural Housing Scheme provides for CGI sheets worth Rs.10,000 each to about 4,000 not-so-poor families each year, in order to help replace the thatched roof of their house. Such schemes generally have two defects: (a) they help a few of the poor, not all,<sup>23</sup> and (b) they provide assistance much in excess to that needed to lift the concerned family above poverty line in that year. Such schemes should be summarily abolished as NIT is a much sounder scheme.

### 4.2.2 *Public Distribution System and Support prices*

Theoretically designed to cater to the poor, the PDS has become a complete farce. It should be wound up, lock, stock and barrel, irrespective of NIT. Only a few FCI godowns can remain for preventing famine and for test relief. Also, support prices for farm products are totally unjustifiable and must be abolished. NIT and crop insurance will eliminate the need to provide support to farmers in this inefficient way.<sup>24</sup>

### 4.2.3 *Fertiliser and Power Subsidies*

Most of these do not reach the poor since the poorest are agricultural labourers or marginal farmers, rarely using fertilizers and power. Most of the power subsidy goes to the richer farmers who can afford tube-wells, and who then over-exploit groundwater, heightening inequality of access to irrigation.

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<sup>21</sup> Of course, land reforms include things other than land re-distribution. Rationalization of land needs to be continued, as well as other improvements in the land records system.

<sup>22</sup> See Saxena, pp. 56, 79.

<sup>23</sup> Selection is a highly political process. In addition, the selection criteria generally exclude the poorest from getting such benefits.

<sup>24</sup> E.g., see Frank, 1997: 48-9.

### **4.3 Laws allegedly in favour of the poor**

#### *4.3.1 Minimum Wages Act*

This is an extremely distortive and troublesome provision. It not only increases inequality, but also dampens employment.<sup>25</sup> In any case, given the availability of S.26 under this Act, many of its provisions are easily violated by government itself.<sup>26</sup> Such restrictions on market forces for labour are uncalled for once NIT comes into place.

#### *4.3.2 Essential Services Maintenance Act*

The restrictions on movement of goods imposed by this Act are the bane of the small farmer. This Act merely fattens the implementing agencies, rich farmers, and the agro-processing industry. It must go, irrespective of NIT, as it generates poverty where market forces would have created wealth.

### **4.4 Indirect Welfare**

#### *4.4.1 Human Capital Formation*

Subsidy on higher education has no cogent justification at all and can be substituted by student loans schemes. Further, it is likely that the application of NIT would give a major fillip to primary education as poor parents begin to invest more on the education of their children, while requiring their services somewhat less than before in managing their productive assets such as land and cattle.

### **5. The long-term cure of poverty**

Under no circumstance do I argue for the direct income transfer approach as the permanent “solution” to the poverty problem. With reference to the existing subsidy route discussed above, direct transfers are clearly more desirable. We also saw how NIT is theoretically sustainable. But in the medium and long run there is clearly no better mechanism for reduction of poverty than good governance and sound economic policies, some of which have been enumerated in the Peoples’ Manifesto on the India Policy Institute forum at [www.indiapolicy.org](http://www.indiapolicy.org). In particular, market reform will eliminate barriers to trade in agriculture, generate demand for skilled labour, absorb surplus rural labour, create a demand for educating children, promote parental involvement in education, and in the meanwhile, before poverty is finally overcome by the households, enable basic goods and services to reach their doorsteps, having enabled the poor to purchase these with transfers provided under NIT. Comprehensive reforms will bring down absolute poverty successively through the years. The growth generated by system reform will finally break the backbone of poverty.<sup>27</sup> Strategies to promote growth are thus in no way less important than the direct transfers envisaged here.

At that stage, the transfers to the “losers” of our system will become a successively smaller burden on the taxpayer. What direct transfers will ensure is that we do not have to

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<sup>25</sup> This is easily to see theoretically. Empirical support is very strong, too. See, for example, Ehrenberg and Smith, 1988.

<sup>26</sup> Saxena: 75

<sup>27</sup> T.N. Srinivasan has shown that of the 17 percentage point reduction in population reduction below poverty line over the period 1951-55 to 1993-94, as much as 15 per cent is to be attributed to growth and only 2 per cent to redistributive policies (cited from his book *India’s Economic Reforms*. 2000. Oxford. At p.58 of *India Today* June 12, 2000).



carry the needless burden of society-wide poverty, hunger and malnutrition on our shoulders, and go around the world, begging bowl in hand.

## 6. Addressing various concerns on NIT

This concept of NIT has been discussed with many persons, including P. Sen, S.S.A. Aiyar (Consulting Editor, *Economic Times*), and many participants in the on-going debates on the internet-based India Policy Institute. Addressed below are a few of the concerns raised.

### 6.1 *Amount too small*

It is often said that only about 20% of the subsidies meant for the poor finally reach them. Given the magnitude of total non-merit subsidies, that would amount to about Rs.800 per capita per poor person per annum today. “Are ... [these poor who allegedly receive this amount] being lifted above the poverty line? If not, how will Rs. 650 do that?” asks Dharma Tejus.<sup>28</sup> The fact is that this Rs.800 does not reach the poor uniformly. Its distribution is erratic, goes in various unrelated schemes to some this year, to others in another year; goes in quantities unrelated to the depth of poverty in the family; goes to the relatively better off among the poor, or merely increases the indebtedness of many of the poor through defective loan-cum-subsidy programmes. In general, the distribution of this amount is extremely chaotic and serves no real purpose. On the other hand, the amount under NIT, say Rs.1,000 (average per capita today) will be specifically *targeted* and will be fully disbursed each year to *all* below the poverty line. That will eliminate poverty by definition.

### 6.2 *Recalculation of Poverty Lines*

P. Sen suggests that if NIT is to substitute subsidies, “all direct transfers will have to be netted out, preferably at the individual or household level, and the poverty lines will have to be recalculated to correct for all forms of commodity subsidies, particularly food subsidies”. In my view, depending on the methodology used to calculate the poverty line, this can and should be done. It does not detract in any way from the basic argument in favour of direct transfer.

### 6.3 *Estimation of the change in production and hence in resources available for consumption to the poor*

P. Sen has suggested that “the short run effects of removal of other subsidies, i.e., those on production goods, would need to be estimated as far as production is concerned, and then on consumption expenditure. This is not a trivial exercise at all”.

The major production subsidy somewhat relevant to the poor is fertilizer subsidy, which is only partially relevant since the bulk of this subsidy is availed by those *above* the poverty line. The reduction in incomes of these farmers on abolition of fertilizer subsidy can have two adverse effects: (a) a few of the relatively ‘well-to-do’ villagers might now be pulled below the poverty line and (b) less money would circulate within the village, thus marginally reducing the price of goods and services offered by those below the poverty line, and enhancing their poverty. The overall impact on the incomes of the poor 40% of the population is likely to be minimal, though.

But note carefully that direct transfers being made at the end of the year, the actual income in the *preceding* year has to be taken into account, rather than prospective income. This leads us to the following strategy. Let all subsidies continue as usual in Year 1. The possible ill-effects of elimination of subsidy would then not arise during Year 1. Let the survey of Year 1 income be done at the beginning of Year 2. Subsidy is eliminated in Year 2.

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<sup>28</sup> Names cited in this section without referencing are taken from the India Policy Institute debates.

By June-July of Year 2 the direct transfers would have taken place. While the vast majority is lifted above the poverty at the beginning of Year 2, some new poor might emerge in Year 2. These poor would be at the upper fringe of those below poverty line. In Year 3, all would be finally covered and lifted out of poverty, on an on-going basis. But even if production subsidy is partially phased out in Year 1, when we have not succeeded in eliminating poverty for 50 years, one more year of a slightly higher level of poverty will not matter so long as all poverty is subsequently eliminated.

#### 6.4 *Magnitude of administrative effort*

Aiyar rightly points out that, “Ideally, every Indian should have a personal identification number (like the social security number in the USA) which has to be mentioned for all important purposes like voter registration, driving and other licences, taxes, bank accounts and the like. That creates a system that can keep track of the poor and discover leakages and fraud. It is an enormous administrative undertaking, and fraud is rampant even in the US. Of course, the leakages are surely higher in various subsidy schemes in India, where the non-poor probably get 80 per cent of all benefits”.

If we are to introduce and maintain a NIT programme, it is obvious that a very large administrative effort will be needed. However, as already pointed out above, State Governments are perfectly capable of providing the supporting administrative infrastructure. Even after subsidies are eliminated and departments such as Food and Civil Supplies, Agriculture, Rural Development, etc., partially disbanded, there would still remain more than adequate manpower to carry out the operation at minimal additional expense. There is therefore no need, in my view, to contemplate the creation of another organization on the pattern of the Social Security Administration of USA, at least at this stage. As far as assigning an ID Number is concerned, that can and should be delegated to the State Governments to create at a child’s birth, to serve, among others, the multifarious purposes mentioned by Aiyar.<sup>29</sup>

#### 6.5 *This scheme will leak/ lead to large scale corruption*

P.Sen asks, “[H]ave you given thought to the extent of leakage can occur? The experience has been that the leakage tends to be less in schemes where a tangible final output is to be produced than in those where direct payments are made in cash or kind. I’m afraid that the Income Tax Dept. may simply not be in a position to handle a negative income tax scheme, since it is usually much more difficult even than tax collection”. Praveen Hombaiiah is convinced that “No matter what methodology is used to identify the poor, I have no doubt this will lead to large scale corruption and the scheme will leak, especially in a system where corruption is already institutionalised”. Venu Gopal suspects that “misuse and rampant false records in the proposed scheme will be unprecedented because of the direct money factor... Many rich people with incomes which are not susceptible for verification, will file negative returns”.

While admitting the seriousness of the implementation problem in a system as rotten as the one we have built for ourselves in India, we cannot rid ourselves of poverty (and our past and present follies) by throwing up our hands in despair. Public vigilance, transparent procedures and strict action against those who do bad identification will minimise leakages. The Pilot Project should help tighten those areas of implementation which are found to be weak. Use of computers will help trace all transactions and thus pinpoint all levels and types of leakages much more clearly than under the current chaotic “system”.

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<sup>29</sup> A Smart Card suitable for Indian conditions could also be created. N. Seshagiri, retired DG, NIC had worked on its conceptualization more than 10 years ago. Today, the efforts in this area of the Election Commission, Transport Ministry and others need to be integrated.

## 6.6 *Crowding out of private transfers*

Aiyar feels that a “non-trivial issue is that poor people get money today from relatives and extended social groups (like the *biradari*). Once the centre steps in, these private transfers to the poor will dry up. Some research suggests that private transfers can be quite appreciable. I would hate to destroy private forms of distress alleviation and substitute it by a leaky bureaucratic effort”.

While not commenting on the research which apparently exists in the area of private transfers to the poor in India, I suspect that many of these transfers create unequal relationships, apart from being largely contingent on the expectation of realization of future services (as in the *jajmani* system). My suspicion is also that these private transfers vary across communities. There could be some, such as the Sikhs where such transfers help alleviate poverty considerably, as also in certain tribal areas. But on average, given the magnitude of the continuing problem of poverty in India, I suspect that such transfers have played a minimal role in alleviating poverty over the past fifty years. On the issue of drying up of these private transfers on the commencement of direct transfers from Government, the case is not quite convincing. The indirect and direct transfers made to the name of the poor today through various schemes and subsidies, already exceed the direct transfers which are being envisaged here. Therefore there is (possibly an absurd) counter-argument that private transfers might actually increase consequent to the introduction of NIT.

## 6.7 *Local bodies*

Aiyar then suggests: “There is a simpler alternative. Every gram panchayat can be given a cash allowance for relief to the five poorest families. There will have to be open discussion at a gram sabha on who are the most worthy beneficiaries. This was indeed tried in the old Antodaya scheme. It’s less ambitious than your negative income tax scheme but much easier to implement. It will reach people who cannot participate in rural employment programs (the aged, very young, sick and crippled). I suspect this might alleviate half the existing poverty without totally destroying private transfer mechanisms”.

There is no dispute whatsoever in involving Gram Sabhas in the process of identification of the poor. However, to give relief to only a few is not a satisfactory resolution to the issue, merely on the ground of its possibly greater ease of implementation. Poverty has to go completely, as long as a country can afford it. And India can.

## 6.8 *Politics and bureaucracy*

Aiyar concludes, “The real problem [is] in focusing subsidies on the poor in democracy. Democracies are majoritarian, not egalitarian. A subsidy that reaches only the bottom 30 per cent will have less popular appeal than a subsidy which reaches 70 per cent of a targeted section of the population like farmers or urban dwellers. What economists call ‘leakage to the non-poor’ is not leakage at all from the politician’s viewpoint, but accurate<sup>30</sup> asks, “People may agree about the textbook logic but no one is going to agree to give up indirect subsidies individually received for a national system which may be both more efficient and equitable”.

True. The fact that NIT can be successfully implemented, or that it is a “kind of” optimal solution to the contest between liberty and equality, does not mean that the Parliament or anyone else will buy it. It is also not the purpose of this concept paper to certify that politicians will do that. But I have much regard for the sagacity of many of our political leaders, and once a concept is properly offered to them, they are likely to work out a viable

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<sup>30</sup> Subroto Roy is Professor at VGSOM, IIT, Kharagpur.

plank to push through the concept. Our attempt to blame politicians for possible resistance to a programme which was never proposed to them in the first place, would therefore perhaps be unfair. It is even conceivable that the politician who first emerges with this scheme would gain popularity and hence longevity.

Instead, it is possible to argue that far greater resistance would emerge from “ground-bureaucracy which dislikes giving up its empires than from the dreaded politicians. In any case, it is ultimately upto the taxpayers to demand NIT so that India can be rid of its poverty once and for all, and the tax payer saved the loot of public funds that is going on in the name of the poor.

#### 6.9 *Effect on work incentives*

There is surely a small section of the poor which is not poor because of natural causes or our socialistic policies, but because of its own vices and bad habits. This segment would perhaps perennially remain poor, much on the pattern of drug addicts in the USA. To minimize the possibility of adding to this ‘natural’ population of the poor and reducing incentives to work, the Income Tax Department should perhaps phase out the NIT over the years. Thus X may receive 100% of the transfers needed to bring him above poverty line in Year 1, but should receive successively smaller percentages over the subsequent years unless he is physically or mentally disabled. A full-blown NIT scheme would do this automatically. Similarly, a limit should be in-built on the number of children assisted under NIT.

#### 6.10 *Rationality and Misuse of cash grants*

One of the major objections to NIT is that those who are very poor are unable to decide for themselves what is good for them, and hence giving them cash will not serve a useful purpose. For example, Tejus feels that “The rationality of the poor, firmly embedded in their particular circumstances, produces behaviour that we term ‘sub-optimal’ even though it is quite optimal to them”. While it is true that due to the existence of power differentials within households, at least some of the cash grants would be spent on the purchase of alcohol, thus leading to infructuous expenditure, the overall situation is surely not so bad. The households, on average, will allocate the funds efficiently due to the superior local knowledge they possess of their circumstances. The underlying difference between the knowledge as well as opportunity set of the poor and the rich does not mean that the poor are irrational. They also maximise their utility just like us. As evidence, we need only observe that they have managed to survive for decades in free India at levels of support from government which can at best be described as minimal. To doubt their essential rationality would be extremely condescending and unwarranted.

According to some, Due to persistent apprehensions about the rationality of the poor, policy makers might be more readily persuaded to accept a food stamps programme instead of NIT. But the analysis of food-stamps in USA<sup>31</sup> shows that the programme in no way benefits all the poor equally. There is also an underground market for food-stamps in USA in which excess food-stamps are sold at about 80 percent of their value to the non-poor, defeating the purpose of the programme and needlessly increasing bureaucracy and paperwork at all levels. Except in the rarest of cases, therefore, direct cash grant is more beneficial, particularly when leakages have been minimized.

#### 6.11 *Neglect of the underlying causes of poverty*

Venu Gopal feels that “The proposed scheme does not address any direct factors which help in keeping a family poor. Availability of resources, control of resources, skills,

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<sup>31</sup> See Frank (1997), for example.

entrepreneurship, raw material, marketing problems, technology, quality assurance, packaging, procuring bulk scale orders, scope for other interventions like, for example, by self help groups, coming together to promote common economic activities -- all these issues are ignored by mechanically considering poor people as mere recipients of NIT in cash". Tejus feels, "The underpinning of the proposal is that handing out a certain amount of cash to those below the poverty line will eradicate poverty and create a more-or-less level playing field for the whole society enabling it to gainfully face the rigours of free market capitalism that will make life better for everyone except the tardy and the slothful. I am not convinced and I question that axiom... Can [the poor] ... really escape poverty without removing the institutionalised chains and barriers and the gross inequalities of opportunities and access to productive resources that are entrenched in our society?"

In reply to this, I would like to suggest that NIT is intended to eliminate on-going poverty and provide a more level playing field with greater equality of opportunity. The long-term solution to the continuance of poverty hinges crucially on building up of the demand for education and fostering its supply, outlined in Section 5.

#### 6.12 *Rise in prices in rural areas*

Parameswar asks, "What is the guarantee that new market forces which are unfolding do not increase prices of essential commodities that cash [given under NIT] is evaporated just in few days". This is an important possibility that should not be discounted. On the other hand, theoretically, six times more money than is currently envisaged to be spent on NIT is already being pumped into the society in the name of the poor. If so, the withdrawal of subsidies to the wealthier sections will reduce demand, and the effect on prices may even turn out to be negative. The better provision of public goods financed through the concomitant savings to the exchequer would also lower transportation and production costs of many goods, lowering prices in turn.

### 7. **Conclusion**

The welfare implications of NIT are starkly clear. The marginal utility of one rupee to the very poor is much greater than that to those above the poverty line. In other words, each rupee spent directly on the poor provides the greatest total utility and welfare to the country. This makes the negative income tax scheme (NIT) the most justifiable in every respect. On the other hand, it is scandalous, extremely unjust, and a matter of immense shame for Government to continue to subsidize the well-being of the upper and middle-classes in the areas of power, transportation, PDS, banking, higher education, etc., while even one poor family remains hungry.

NIT should be adopted as the only constitutionally valid scheme of income redistribution. It will help reduce the pressure on urbanisation, apart from saving many thousands of crores which can be used for enhancing the national infrastructure. It will also make equality of opportunity, guaranteed under the Constitution, a reality.

An Experimental Project needs to be explored in one Block first, to determine the procedures and to resolve the practical problems faced. Sample surveys before and after this Project will have to be implemented to evaluate its effectiveness. Later, a Pilot Project can be taken up in small states such as Meghalaya and perhaps the ten poorest districts in the country, before extending it to the rest of the country.

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