NYAY, PM-KISAN, KALIA…

A layman's guide to Universal Basic Income

The intense debate on NYAY, the version of Universal Basic Income (UBI) proposed in the Congress manifesto is likely to endure whichever way the election tally swings. For one thing, this is not just about the efficacy and fiscal viability of NYAY or its merits relative to the incumbent government's PM-Kissan. The idea of a minimum income guarantees (MIG) or targeted Universal Basic Income scheme is gaining popularity at the state level too, with state governments' in Sikkim, Jharkhand, West Bengal and Andhra Pradesh announcing their own versions. Orissa and Telangana have already implemented their own basic income schemes in 2018. Thus, some form of unconditional (unlike say the MGNREGA that is contingent on work) direct income transfer is integral to the agenda of inclusive growth. Therefore, the public policy debate over its benefits and shortcomings needs to be examined.

A little background to start with. UBI or MIG is not a new concept. It was a central feature of economic policy during the 1960s and 70s across Western Europe and the US. In the US, UBI was pushed by the Nixon government (1969) to make into a federal law but later lost steam with a shift in political ideology during the Reagan-Thatcher era. There has been renewed interest in UBI, in recent years with countries as diverse as Finland, Canada, Kenya, Brazil, and US undertaking pilot experiments to explore its applicability and benefits.

- ***Developed countries are toying with the idea to address employment issues due to increased automation,***
- ***Developing countries such as India are trying to address the high poverty levels in the country, especially in rural areas through the UBI.***

There is some evidence from international experiences that show that UBI can be effective.

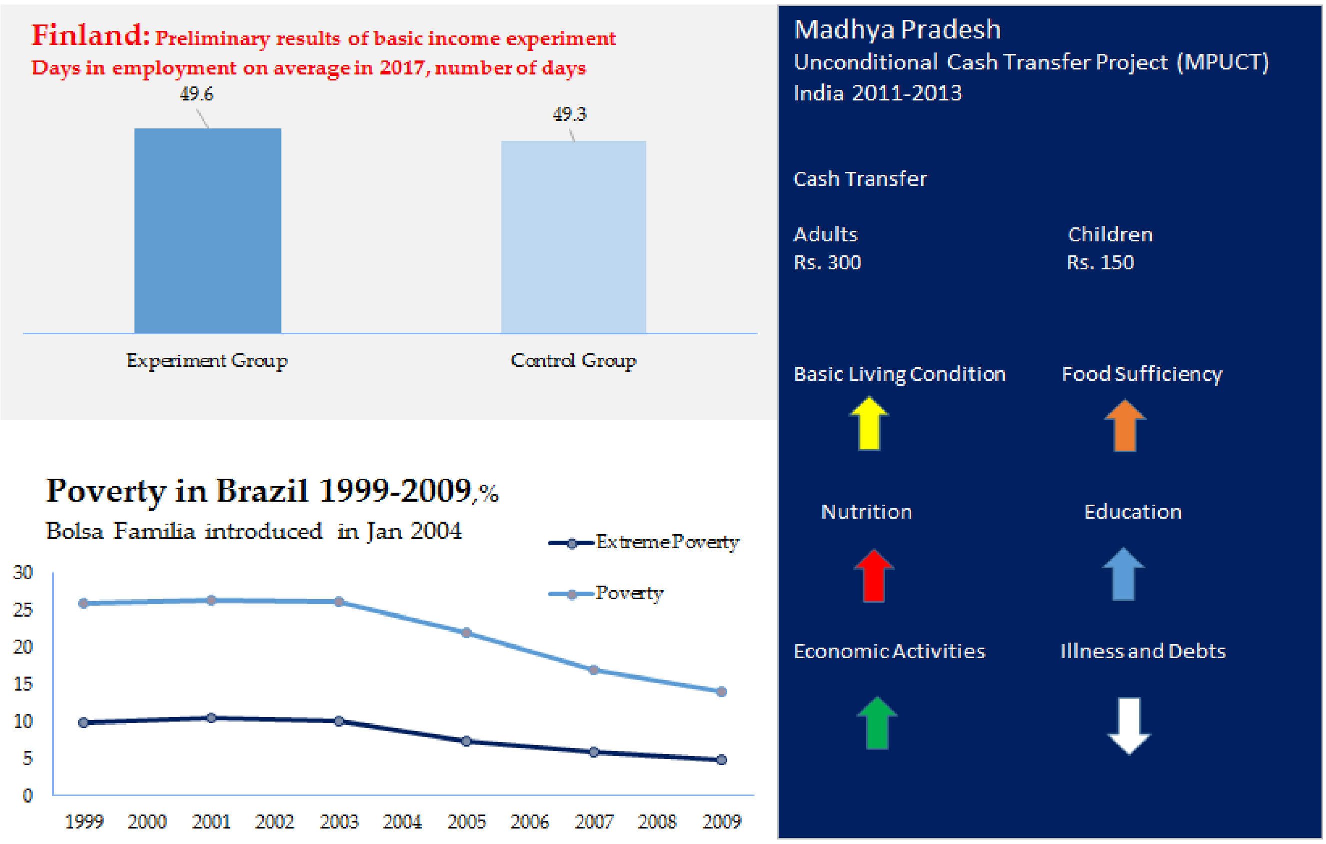
The cash transfer scheme (Bolsa Familia) in Brazil is one such example. The program, initiated in 2004, has led to a 20% drop in inequality and a 28% drop in poverty in Brazil. **Other pilot programs have <u>broken myths</u> that a cash transfer scheme:**

- **leads to a decline in labour participation**
- **increases consumption of sin goods like alcohol**

For instance, <u>a pilot experiment in Finland</u> shows that UBI had no negative effects on the level of employment but did increase the level of health and well-being in the controlled group. In Kenya, where the per capita income levels and the rural orientation is comparable to India, the ongoing basic income scheme (pay out of $23 per month) showed that people did not spend the cash on liquor or other sin goods. Also, studies show that the unconditional cash grants made to Kenyan households cut the day's children went without food by 42% and increased livestock holdings by 51%.

In India, the most convincing evidence that UBI does work can be drawn from the pilot program (MPUCT) conducted in Madhya Pradesh between 2011-2013. Over 6,000 individuals in 9 villages received small monthly transfers over the course of 18 months. The pilot found that beneficiaries saved more money and used the money to improve their standard of living at higher rates than control groups that received normal state subsidies.

Performance of UBI schemes/experiments across the world



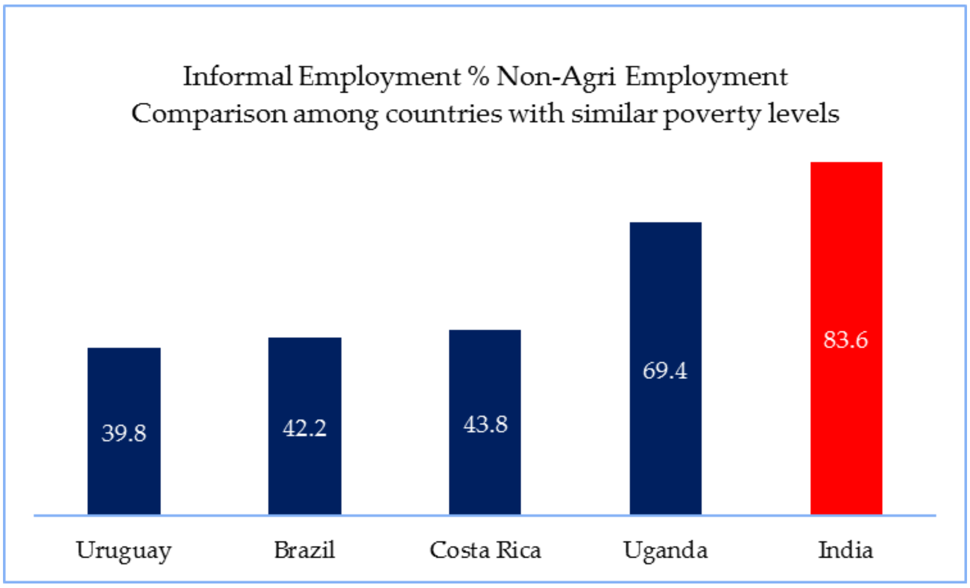
Source: HDFC Bank, MPUCT Program, KELA

Who and How to Target?

The problem arises when universal basic income programmes are not actually universal and target certain categories. This leads to the fundamental problem of design and implementation --- ensuring that cash transfers reach the intended beneficiaries. Currently, the variants of UBI or MIG in India are targeted at either small and marginal farmers (like the PM-Kissan announced by the current government, KALIA in Odisha, Rythu Bandhu in Telangana) or at a percentage of the population (NYAY aims to target the bottom 20% of the population).

So how does one identify those who need the benefit the most. **This is the biggest impediment for the success of any quasi-UBI program in an economy like India that has a large informal sector.** Without compressive information on the earnings of a fast majority of the population (80% of the non-agri workforce earns livelihood from the informal sector (ILO, 2018)), identification of those who need the benefit becomes a challenge.

As a result of this significant ambiguity or uncertainty in determining the beneficiaries, a lot depends on the implementation of such programs.



Source: ILO, HDFC Bank

China's experience highlights the issues related to implementation of a targeted income scheme. The Minimum Living Standard Scheme (MLSS, Dibao) in China provides basic income to urban and rural households (since 2007). The scheme tops up recipients' income to a basic level below the minimum wage. The actual amount is set independently at the municipal level and is required to be higher in urban areas than rural ones. **The high degree of discretion in setting the cash transfer at the municipal level and identification of beneficiaries has led to inefficiencies and mis-targeting in the**

program. World Bank data suggests only one in 10 poor households in China's rural communities receive Dibao, and of those, three quarters are not actually poor.

On the other hand, Brazil has been successful in collaborating with local governments to implement its cash transfer scheme. **For its Bolsa Familia program, federal and municipal bodies have effectively worked together for the identification of beneficiaries, regulation and implementation of the scheme.**

<u>Both China and Brazil have taken the support of local governments for implementation of their schemes.</u> However, their contrasting experience highlights the importance of effective governance and the incidence of corruption (more accurately the lack of it) in determining outcomes for targeted basic income schemes.

The metric used for distributing the cash benefit and its magnitude are crucial for effective targeting.

The Metric

- **Poverty Line: Not a comprehensive metric to measure living conditions of households.**

    - The NYAY schemes proposes to target the bottom 20% of the population – essentially those below the poverty line.
    - Using a poverty line based system would imply high inclusion and exclusion errors in India (essentially means that people who don't need the benefit get it and those that need it don't). This can be understood by a case study (*Errors of inclusion and exclusion in income based provisioning of public healthcare, Bajpai V et all, 2017, NCBI*) that assessed the socioeconomic and below poverty line (BPL) card status among patients at the All India Institute of Medical Sciences, New Delhi. Out of the 374 study subjects, more than 69% of poor did not possess a BPL card (below poverty line card). On the other hand, 5.5% of the above poverty line patients among the respondents possessed a BPL card. **<u>The study suggested that the errors in providing BPL cards limits the access of the genuine poor to healthcare. A similar case can be argued for using the poverty line metric for basic income transfer schemes.</u>**
    - Moreover, from a purely theoretical perspective, the way the poverty line is calculated in India is also debatable. Using a minimum threshold of income that provides for basic nutritional requirement does not take into account the overall living conditions and health and education needs of a household.
    - Perhaps a more comprehensive measure of poverty needs to be devised for such income support schemes.

- **Land Records: Collection and maintenance of land records crucial. Given a large share of landless farmers, tenant farmers should not be excluded.**

- Another metric being used to identify beneficiaries, in schemes like PM-Kissan, is land ownership following the Rythu Bandhu and KALIA that target small and marginal farmers.

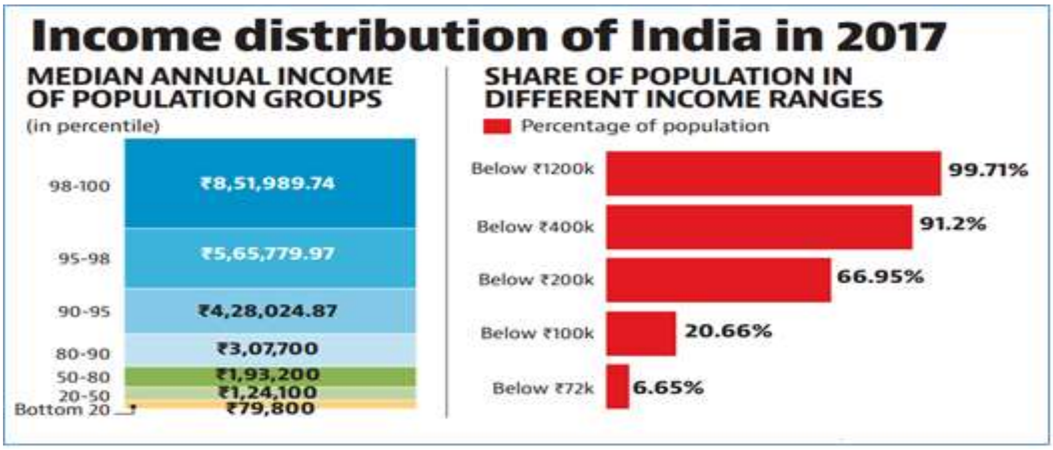
- Under Rythu Bandu, the Telangana government collected land ownership data and updated its records before the implementation of the scheme. **But, it did not exclude people who pay income tax, do not live on the land or are government employees.**
- **Also, since land records are not digitised across all states, this could pose a challenge for a Pan-India scheme like PM-Kissan and could have greater issues with collection of data.**
- **By making land records as the basis of the benefit transfer, the scheme ended up excluding tenant farmers who are often the most vulnerable.**
- **The model followed by KALIA scheme in Odisha is probably more inclusive as it provides benefits for landless farmers as well.**

The amount of cash transfer

The magnitude of the cash transfer also has a key role to play in targeting. Under NYAY, the cash transfer proposed is significant - accounts for 58% of median household income for the population as a whole. A high amount of cash transfer incentivises non-eligible households to game the system and increases the incidence of mis-targeting. NYAY promises a significant amount of Rs. 72,000 per year to each household. The CMIE survey suggests that the income of bottom 20% of the population is close to Rs. 77,000 and the median household income of the entire workforce is Rs. 1,24,100.

The pay-out has less chance of leakage in schemes like PM-Kissan where the cash transfer is much smaller at Rs. 6000 per year. On the flipside, it can be argued that this amount is so low that it (only 7.5% of the income of small and marginal farmers) might not result in any significant benefits for the households.

Therefore, the design of a UBI scheme must create a balance between having an amount that is not too high to create incentives for cheating but not too low that it has no impact.



Source: CMIE Consumer pyramid survey, HDFC Bank

Weighing costs and benefits: The issue of financing

In an ideal scenario, a basic income scheme that would be universal or intended to cover a maximum proportion of the population would be optimum. However, that entails a budget constraint. Neither the central nor state governments have much fiscal capacity to implement anything close to a true UBI, which could cost up to 5 per cent of gross domestic product every year (economic survey calculation 2016-17). **Therefore, one needs to keep in mind the trade-off between the coverage and cash transfer in the scheme with its fiscal burden.**

Financing a partial UBI or MIG could be a challenge. For instance, the proposed NYAY scheme is said to cost close to 3.6 trillion. NYAY accounts for more than a fifth of the Centre's net tax collections, exceeds the entire explicit subsidy bill of the 2019-20 Budget, and equals 13% of the total government expenditure.

So how does one finance a basic income scheme: 1) raise taxes or 2) replace current schemes.

Tax the rich:

- A wealth tax on the richest 0.1%, according to Nitin Bharti and Lucas Chancel at the World Inequality Lab, would generate annual tax revenue of more than 1% of GDP on its own.
- The case for higher taxes is supported by the fact that the personal income tax rate in India for the rich is below many countries like the US, Germany, China and Japan.

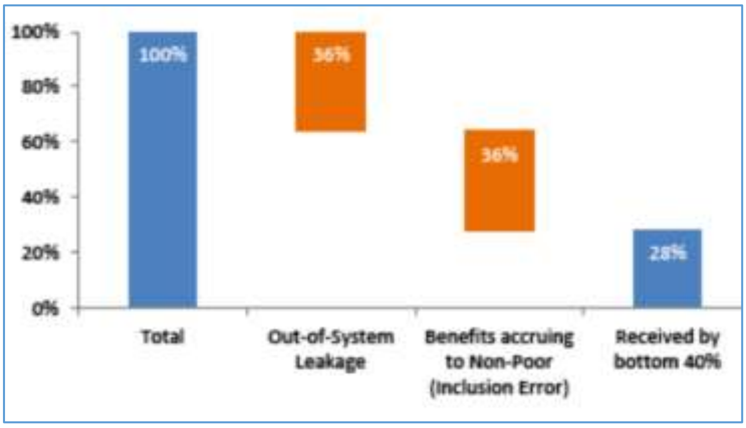
Replace other schemes with basic income:

Many countries that have implemented a UBI or basic income scheme have done so by replacing centrally sponsored schemes and subsidies with a UBI.

- The economic survey 2016-17, suggests that the cost of UBI can be financed through reducing non-merit subsidies (which are close to 5.5% of GDP). Non-Merit subsidies include - Middle class subsidies (1% GDP), other non-food subsidies – Petroleum, Fertilisers (1% GDP), Top 10 centrally sponsored schemes (1.4% GDP), and other 940 schemes (2.3% GDP).

- Alternatively, a study by World Bank argues that UBI could be implemented as a substitute for the Public Distribution System (PDS) which provides income support to individuals through price subsidies for Wheat, Sugar, Rice and Kerosene. It also argues that replacing energy subsidies in India which have huge targeting issues with the UBI could lead to net welfare gains for the system. **However, retracting current subsidies or centrally sponsored programs could be politically unpopular.**

Targeting of India's Public Distribution System



Source: Economic survey of India 2016-17, HDFC Bank

- Moreover, spending on health and education through centrally sponsored schemes is equally important. This brings us to the third issue related to the success of a basic income scheme.

Building state capacities: A pre-requisite to basic income schemes?

Having a fair distribution of wealth and equitable development, requires a total package of social, educational and fiscal measures, with basic income only being one element of it.

Internationally, the successful implementation of a UBI hinged on the fact that those countries treated the UBI as money delivered in addition to the expansion of the quality and coverage of essential public services in health, education, nutrition and so on.

In India, given the low level of spending on services such as health and education, replacing centrally sponsored schemes such as the ICDS might not be ideal.

- Public expenditure on health has stagnated at 1.3% of GDP between 2009-2013 and 2014-2018, and the investment in education even fell from 3.1% to 2.6% during the same period in India (Nitin Bharti and Lucas Chancel).
- India stood at 130 out of 189 countries in the UNDP's 2018 HDI ranking. Movement in the HDI are driven by changes in health, education and income.
- <u>Without adequate supply of basic state capacities, an increasing burden on these institutions could lead to an increase in service inflation, making basic amenities out of reach of the poor.</u>

Employment opportunities versus Cash Transfer

Given the issues with targeting, financing and state capacities in a quasi UBI framework, should we focus more resources towards employment generating schemes like MGNREGA that involves "self-selection "and hence better targeting?

It can be argued that instead of cash transfers it is better to create more employment opportunities in the economy. So essentially why spend on setting up a quasi UBI framework instead of diverting more resources to employment schemes like MGNREGA and attaching it to bigger initiatives like the PMGSY.

- MGNREGA has been successful is improving wage growth and incomes across states. Studies find that casual labourers are more inclined to avoid traditional employment for MGNREGS and the difference in wages is a significant factor in this decision.

- The program also ensures a **considerable degree of self-selection** as there is an opportunity cost associated with giving up an alternative means of income**.**

- **That said, the program has had its share of issues.** The limited number of employment days provided under the scheme has restricted the impact on the labour market as a whole. Further, the participants in highest income strata received 60 percent of total income generated under the scheme and individuals in bottom 40 percent did not even have a job card; the former indicating inclusion error and the latter shows exclusion error (Economic Survey, 2017).

Therefore, only with an overhaul in its implementation process, increase in coverage to urban areas and improvement in targeting, a case for the MGNREGA as a better policy option can be built.

Theoretically, the case for a UBI is strong. However, in India, where it is likely to be implemented in a partial format, targeting remains a major concern. Also, implementing a significant cash transfer scheme as an add-on would be fiscally unhealthy. Ending current schemes that involve direct provision of goods (food, services – healthcare & education) could be counterproductive with low supply of these basic amenities currently. The familiar problem of putting the cart before the horse – that of creating entitlement without ensuring supply is critical and involves a resource utilization choice.

In fact, a UBI that minimises targeting issues (by choosing the right metric and amount), replaces some middle class subsidies, and judiciously involves local bodies could be successful. But this would be a tough challenge!

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