BRIEFING PAPER

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Effect of Direct Benefit Transfer Scheme on Competition in the Market

Improving the economic condition of the poor and the marginalised has remained a priority for governments in India since Independence. Several steps have been taken in this regard, such as employment generation programes, providing subsidies under various schemes etc. All such programes have had limited impact towards ensuring benefits to the poor due to various factors, such as wide spread corruption, faulty delivery mechanism etc.

In order to overcome these limitations and further focus its approach towards reducing economic vulnerability of the poor, the Government of India has come up with the concept of direct transfer of cash subsidies. The Aadhar scheme would provide cash directly in the hands of people under various government-sponsored welfare programes. The entire concept is considered to be a milestone towards ensuring direction of subsidies and attendant purchasing power to the intended beneficiaries, namely, the economically weaker sections of the society in an effort to bypass the perceived problems in the extant mechanisms.

This briefing paper throws light upon specific developmental objectives that could be achieved through proper implementation of the scheme. The paper focuses upon how direct transfer of cash would help establishing developed and competitive market, especially in rural India. It also deals with factors that could lead to a more conducive environment for infusing competition in the market. Finally, it discusses the international experiences related to direct transfer of cash to the poor and what lessons India could learn.

Introduction

The year 2013 began with commencement of the much-awaited and widely discussed Direct Cash Transfer (DCT) Scheme, now termed as Direct Benefit Transfer (DBT) in 20 districts covering seven schemes. These schemes include student scholarships and stipends, the *Indira Matrutva Yojna* and the *Dhanalakshmi* schemes. It has been estimated that at least two lakh beneficiaries will receive cash benefits during first phase of implementation of the scheme starting January 01, 2012. Initially, the plan was to implement the scheme in 43 districts covering 34 programes, but as a matter of abundant caution in the pilot run of the scheme, the numbers were brought down. However, there would be a gradual increase in the number of districts and programes to be covered under the scheme and it is estimated that by 2014 it would cover the entire country.

The phase-I could be considered as the pilot test for DBT project. It would provide inputs to the government in terms of identifying loopholes in the implementation mechanism and to take corrective measures at the subsequent stages.

The DBT launched in India is the world's largest cash transfer scheme in terms of volume and population coverage. The scheme would include several government-sponsored subsidy programes in order to directly transfer benefits in bank accounts of beneficiaries; however, some of the important items, such as food, fertilisers, kerosene etc. have not been included during first phase of the scheme. The government is planning to launch a pilot project starting from April 01, 2013, to test the feasibility of scheme for food subsidy. Another important aspect related to the DBT scheme is that it has been linked with the Unique Identification Number (UID). The cash would be transferred into the UID-enabled bank accounts of beneficiaries.

There are certain challenges related to effective implementation of DBT scheme. One of the major concerns is lack of infrastructure especially in rural areas. For example, banking services in rural parts of our country are very poor and might prove to be inefficient to handle large numbers of small transfers. Coupled with irregularities and wide spread corruption, it would not be easy for the government to reach out to the intended beneficiaries of the scheme.

However, if these challenges are addressed adequately by the government, as mentioned by Nandan Nilekani during a CUTS 30th Anniversary Lecture organised at Jaipur on 24th January, 2013 that *Aadhar* would enable people to withdraw money from their bank accounts from anywhere in the country. A micro ATM which is basically a mobile phone-enabled device has been developed for this purpose. A person can use this micro ATM to withdraw money from bank account through business correspondent (BC). There would be fair number of BCs present in any particular area which could be an *anganwadi* worker or *panchayat* office or grocery shop, hence eliminating the problems of people relying on one BC. It would provide option for people to approach any of BCs and at the same time create competition among BCs leading to improved services for common masses.

It is assumed that such corrective measures, if implemented in an adequate manner by the government, would result in overcoming certain limitations leading to a developed and competitive market.

Effect of Direct Transfer of Cash on Competition

The initiative taken by the Government of India to directly transfer cash in hands of the poor has attracted debate across the country. Several arguments have been put forward in favour of and against the DBT scheme. According to many, DBT could be considered as a social policy instrument that could lead to several economic as well as social benefits. It is assumed that the scheme would play a major role in controlling widespread inconsistencies and corruption in various on-going welfare programes, thus enabling the government to reach out to the intended beneficiaries. On the other hand, critics argue that it is a one-shot transformative step. According to them, dismantling of programe like public distribution system (PDS) and replacing it with cash would lead to disruption as it is considered as a major source of security and nutritional support for poor families. Withdrawal of the programe would create a gap in their day-to-day life.

However, there are certain outcomes of the DBT scheme that have to be highlighted to place the entire concept in a proper perspective. One such outcome of the scheme could be improved competition in the market which is also mentioned in the Interim Report of the Task Force on Direct Transfer of Subsidies on Kerosene, LPG and Fertiliser released in June 2011. The scheme has all the components that could help ensuring better and competitive market in the long run.

The concept of giving cash directly to the beneficiaries under various welfare programes would certainly facilitate their economic freedom and provide enhanced purchasing capacity thereby giving them the power of choice.

A study entitled *Cash or Food Security through the Public Distribution System? Evidence from a Randomised Controlled Trial in Delhi, India* (Shubhashis Gangopadhyay, Robert Lensink and Bhupesh Yadav, India Development Foundation) on effects of the cash transfers has also revealed the fact that it helped improving services being provided by the PDS shops. This is primarily because the PDS shop owners started to face 'competition' from private shops as some of their clients started to shift to private shops.

These elements are missing from the current design of welfare programes which are aimed at subsidising basic requirements such as food, oil, sugar, fertilisers etc. The whole process restricts consumers from exercising choice and also restricts the ability of market to function, thereby resulting in underdeveloped and uncompetitive markets, particularly in rural India. Thus, it is apparent that direct transfer of cash would transform people from mere consumers to buyers having their own set of choices and demands for various commodities, creating pressure on market players, i.e. retailers, distributors, suppliers, producers etc. to be more competitive and focused towards serving consumer interest.

Transfer of money to beneficiaries

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Creation of choice/demand for goods and services

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Allocation of available resources/money according to need for different commodities

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Interaction of market forces, i.e. demand and supply or buyers and sellers

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Pressure on market players to provide better goods and services/entry of new players to meet the increased demand

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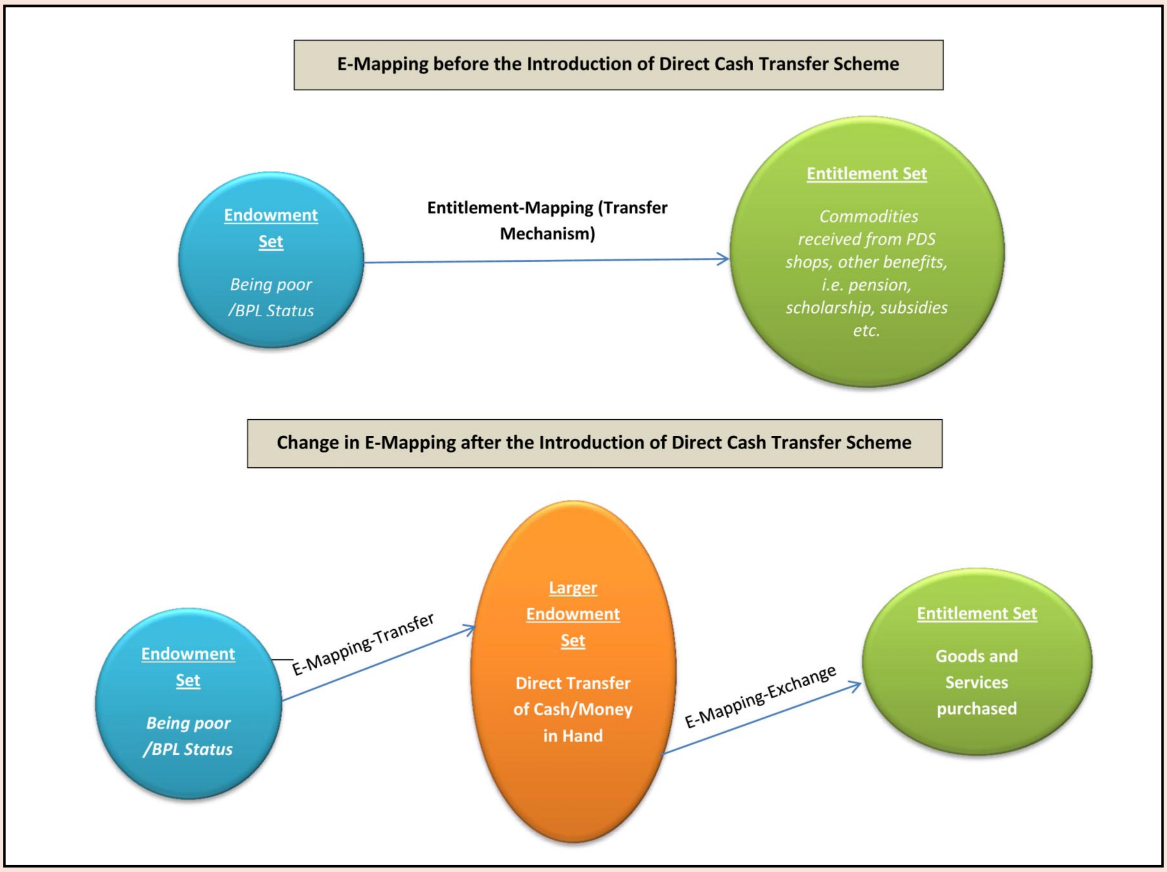
Development of an improved and competitive market

The flow chart below depicts various stages of how the DBT scheme would lead to a competitive market.

The above flow chart could be further clarified through a hypothetical situation where cash is provided to the people in place of subsidised food articles through PDS shops. In case of PDS shops people do not have control over quality and quantity of commodities they are getting. It is decided by the government. However, after receiving cash in hand, people would be free to make choices regarding type and amount of food articles they want to consume. Also, they would be directly approaching the open market for satisfying their needs. This process of interaction between buyers and sellers would certainly lead to an improved market and increase in the market demand would attract new players to enter into the market thus, intensifying the competition in market.

The scheme would allow recipients to allocate the money according to their needs and international experience also indicates development of entrepreneurship through direct cash transfers. Hence, it would lead to creation of market for new products.



Further, with more cash in hands of the people, the government would be under pressure to introduce required policy measures for making supply of goods and services more competitive. Otherwise, with increase in market demand and supply remaining the same, it would lead to inflationary situations, thus nullifying the impact of direct transfer of cash.

Another question that arises with the launch of DBT scheme is whether the scheme would help enhancing the existing entitlement set for poor people or would there be any adverse impact on the set. For this, there is a need to apply the Endowment-Entitlement framework and analyse that is there any paradigm shift taking place with the introduction of the new scheme.

As can be seen above, in the traditional method of providing subsidies to poor households, being poor/BPL status which could be considered as a part of endowment set, directly gets converted into entitlement set through transfer mechanism, comprising subsidised goods and services. On the other hand, under the recently-initiated DBT scheme, being poor or BPL status is getting converted into a larger endowment set in the form of cash in hand which is ultimately being exchanged for different commodities available in the market. Thus, the DBT scheme would help people to reach the market which was not the case with the traditional way of providing subsidies.

This is the major difference in the Endowment-Entitlement framework of traditional and the present form of providing benefits to the marginalised section of the society.

As far as effect on entitlement set is concerned, according to the Interim Report of the Task Force on Direct Transfer of Subsidies on Kerosene, LPG and Fertiliser, the process of providing cash directly in hands of beneficiaries would enhance the entitlement set as the traditional way of providing subsidies is mostly infested with pilferages at various stages in the delivery mechanism leading to reduced entitlement for the poor people. Further, one of the strong points in favour of DBT scheme is that it would help curbing leakages thus allowing benefits to reach to the intended beneficiaries and improving their entitlement set.

Lessons from the International Experience

The concept of direct transfer of cash is not new and has been implemented in several developing countries. 'Bolso Familia' in Brazil, 'Oportunidades' in Mexico, 'Keluarga Harapan' in Indonesia, 'Juntos' in Peru, 'Action Against Hunger' (AAH) in Uganda are few examples of providing cash directly in the hands of beneficiaries with a primary focus on reducing poverty and vulnerability. Moreover, various studies have proved that nations can achieve far-reaching developmental objectives through such direct cash transfers (refer to Box 1).

Box 1: Direct Cash Transfer leads to Increase in Demand

A study conducted on effects of social cash transfers in Zambia suggests that it has stimulated the demand for goods and services and also resulted in development of local markets.

According to the study, after the introduction of direct cash transfer under various welfare programes, demand for locally produced goods has shown upward trend as 80 percent of the social transfers are spent for procuring local items available in the market.

The whole process has also helped stimulating entrepreneurship in the rural areas. Thus, we can say that direct transfer of cash could also have a long lasting impact on growth of the local economy.

Source: Social Cash Transfers and Pro-Poor Growth, Available at: http://www.oecd.org/dac/povertyreduction/43280571.pdf*

A study (*The Impact of Cash Transfers on Local Markets: By Pantaleo Creti, April 2010: CALP*) carried out in Northern Uganda, Otuke County, on the effect of the direct transfer of cash to poor households revealed that it has wide impact on the scale of transfers, structure and level of market integration and local availability of goods. Initially the study was carried on the local livestock market to analyse the potential impact of direct cash transfer on various aspects of economy.

Before the introduction of the scheme, the local livestock market was mostly disintegrated because of information assymetries and high transaction cost due to restriction in movements, high tax rates and inadequate infrastructure.

Local availability of goods in the livestock market was not enough to meet the sudden increase in the demand for the livestock once the programme was initiated in the area. However, the study establishes the fact that there was increase in demand for goods.

The qualitative analysis of multiplier effects showed that cash transfers had a wider economic effect on the local economy. Medium-scale farmers were the main secondary beneficiaries. They invested the additional income in productive assets and diversification of livelihoods. This contributed to creating additional goods and production.

The Northern Uganda experience shows that despite the initial 'flash' inflation, due to sudden injection of liquidity in the economy, cash transfers will not have negative effects on market integration. The increased livestock availability would make local markets more integrated and level price fluctuations in the future. The multiplier effects show that cash transfers had a positive impact on different market players. It helped them to promote investment and production. Further, it would help making the supply-side more competitive which is due to improved demand for commodities in the market which again is the result of direct transfer of the cash.

Further, in some cases, direct transfer of cash has resulted in a positive effect on the supply of food items through generation of increased demand. Countries such as South Africa have witnessed steady demand for food leading to risk free market for producers. Also, Bolivia after implementing BONOSOL programme witnessed an upward trend of almost 165 percent of the value of the cash transfer, in food consumption in poor rural areas.

Direct transfer of cash has also encouraged beneficiaries to participate in entrepreneurial activities enhancing their income levels. For example in Mexico, substantial part of the cash transfer under the Oportunidades programme was invested to carry out activities, such as micro-enterprises. Further, a study conducted by World Bank indicates that cash transfer under the Bolsa Familia programme in Brazil has increased entrepreneurship in urban areas.

Box 2: Direct Cash Transfer: Making Supply Side Competitive

In some cases, cash transfers have a positive impact on the supply of food. Cash transfers results in increasing demand that can, in turn, trigger a supply response by local producers.

In remote rural areas of South Africa, cash transfers have stabilised the demand for food, reduced market risk for producers and traders, and supported local agricultural production.

Hence, one can conclude that direct cash transfers could be effective towards incentivising suppliers to be competitive and serve consumer interest. It also encourages new players to enter into the market, further enhancing competition in the market.

Source: ***Cash Transfers*** *Literature Review, Policy Division 2011, Available at: www.dfid.gov.uk/r4d/PDF/Articles/cash-transfers-literature-review.pdf*

These is a strong argument that scope of direct transfer of cash is not limited only to achieving objectives, such as alleviation of poverty and inequality in the society. Rather, the approach could have long lasting impact on realising broader economic goals, such as establishment of developed and competitive market, i.e. enhanced purchasing power would lead to increase in the demand for products. It would further exert pressure on producers to meet the expectations of people. The whole process would certainly help developing a proper market and making it competitive.

Taking lessons from experiences of countries which have already implemented direct transfer of cash, India could learn how to extract greater results out of this initiative, rather than being restricted to conventional approach of reducing poverty.

One of the main problems with above mentioned examples from different countries is that not much effort has been made to carry out studies in the direction of determining the impact of these transfers on developing markets and infusing competition in them.

Taking this into account, India should focus upon developing a sound monitoring process in initial phase of the programme, so as to periodically evaluate the impact of direct transfers on aspects other than reducing poverty, such as development of a competitive market. Such a mechanism would help India to evaluate the overall impact of the scheme.

Conclusions and Recommendations

Direct transfer of cash has great potential in terms of delivering wide range of economic and social benefits. It is imperative for the government and implementing agencies to ensure that the approach is not solely directed towards reducing poverty and inequality, rather efforts should be made to harvest broader development goals through the scheme.

Development of competitive market is one such objective that could be achieved in the long-run through capitalising upon early effects of direct transfers. Though development of local market is not the primary objective of cash transfers, it can provide an impetus to the local economy by increasing demand for consumption goods.

However, a recent decision taken by the government, according to which beneficiaries of food subsidy have to buy rice and wheat from the fair price shops (FPS) only might impede the entire process. The stance mostly revolves around the idea that market price of rice and wheat would be much higher than prices at FPS. However, the government should be flexible in its approach by providing both options to beneficiaries of such schemes rather than restricting the movement of consumers. This would not create incentives for the market to develop and be competitive.

The Interim Report of the Task Force on Direct Transfer of Subsidies on Kerosene, LPG and Fertiliser has also strongly advocated for the empowerment and choice for beneficiaries. The report clearly mentions that the previous subsidy regime for various products was designed with the objective of delivering specific goods and services to pre-defined categories of citizens. In case of the PDS, consumers have to purchase their subsidised products from the designated FPS. In many of these cases, both the product eligible for subsidy and the location of its purchase is pre-defined. To this extent, the consumer's choice is restricted, both in terms of the product and the location of purchase.

According to the report, direct transfer of subsidy to beneficiaries would make it possible for the beneficiary to access the product or service from more than one pre-defined channel and location. But the recent development in this regard is completely against the idea put forth by Interim report.

In addition to this, there are other factors that might cause difficulties in achieving the objective of developed and competitive market. One of such limiting factor is that prices of all goods and services are subject to variances with time. Given this wide fluctuations in prices, the government should have option to revise the amount that would be provided to beneficiaries under various subsidy programes. The revision of wages with increase in the price of commodities under Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) is the best suited example in this case.

The following steps are required on the part of government to realise the above mentioned goals:

- Government needs to be instrumental in terms of developing infrastructure required for effective implementation of the scheme
- Government should focus upon institutional capacity building
- There should be an option for periodical revision of the amount transferred to beneficiaries
- Government should not limit consumer's access to FPS only.
- Sound monitoring and evaluation mechanism should be developed to evaluate overall impact of the scheme
- Policy reforms for removal of entry barriers would also be required as one of the pre-requisites for competitive market, i.e. fair number of suppliers and retailers at the market place

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