February 2017

Murali Nair

Can Modi make the elephant dance?

Modi's commendable plan to transform India's welfare system and bring in sustainable development through radical market-driven reforms is challenged by infrastructure bottlenecks and the realities of rural India.

India, 2013: The political stasis caused by a series of corruption scandals and an indecisive United Progressive Alliance (UPA) government led by the Congress Party scuttled the economy, which had until 2010 experienced one of the highest growth rates for a major economy. The atmosphere of a weakened government trudging into an election year shattered investor confidence and the economic outlook. This situation, dubbed by observers "policy paralysis," prepared a receptive ground for Narendra Modi's campaign, which promised to cleanse the government of corruption and inefficiency. A communication-savvy Modi captured the imagination of both the lower and middle classes using slogans like "Acche din" (Good Days) and "Sabka saath, sabka vikaas" (With Everyone, Development for Everyone). His message of a better tomorrow and his proven track record of high economic growth in his home state of Gujarat hit a home run in the 2014 election and delivered him a simple majority, the first time this happened in India in 30 years.

Murali Nair is Senior Project Manager in the Bertelsmann Stiftung's Germany and Asia Program.

All over the world, only a tiny share of the proposals included in election manifestos make it to parliament and become implemented, and this government is no different. The more interesting aspect is the departure in Modi's approach regarding development, considering his track record in Gujarat. The combination of robust infrastructure development and a (big) business-friendly policy sets him apart from the typical left-of-center Indian politician who wants extensive state control of the economy in order to extract rents and disburse favors to his or her political base.

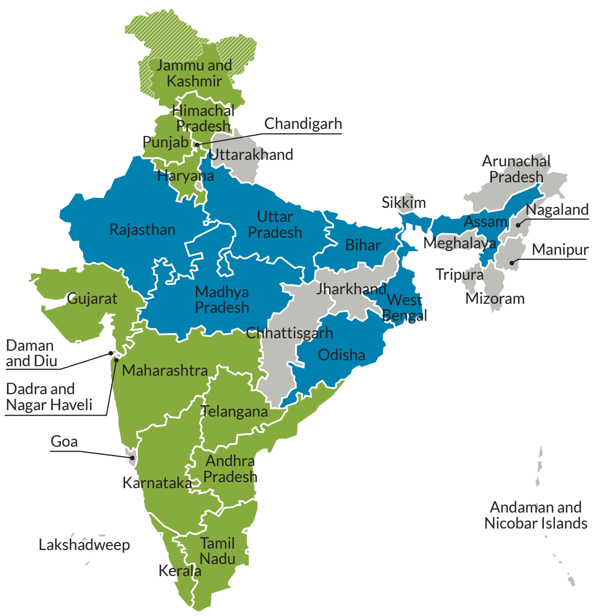
As prime minister, Modi started off announcing a string of initiatives to make India an easy place to do business, build 100 smart cities, set up a high-speed railway network, etc. On the economic front, Modi has delivered on some of his major promises. Politically charged reforms are progressing, like the Goods and Service Tax Bill, which many observers thought would never see the light of day and which is now on its way to becoming a reality (although watered down in certain aspects). A new bankruptcy code, active government support for start-ups and ambitious renewable energy targets for the power sector are some of the reforms which have brought cheers from the business community.

On the social reform front, the Modi government announced a departure from previous governments by making a fundamental shift from the concept of entitlement to empowerment. This was to be achieved by focusing on making the delivery of public services more efficient and giving the market a bigger role in providing some of these services. Among others, the Indian bureaucracy is infamous for two reasons: inefficient delivery (an estimated 54% of the wheat meant for the poor is diverted from the intended beneficiaries) and suspicion of the markets / private sector. Modi's audacious plan to reform and energize the social sector using the slogan "Minimum Government, Maximum Governance" was applauded even by his critics still reeling from the election defeat.

Of course, Modi has not replicated Gujarat at a national level, not only because of the federal nature of the country, but also because of the diversity of its states in their levels of social and economic development. Though Gujarat is among the top states in India which attract domestic and international investment, it does not top the country in social indicators; in fact, in some indicators such as the under-five mortality rate, or child mortality rate, it was the worst performer in 2012 among the 11 states classified as rich. Using the parameters of the United Nations' Human Development Index, Figure 1 ranks the states in India and compares them to other countries based on 2015 data. The hypothetical global ranking would vary between 104 for Kerala and 163 for Bihar, with Gujarat coming in at 139, close to the Indian national average of 130. This goes to show that economic growth does not automatically lead to better social development in the Indian context.

Figure 1: Ranking of Indian states in the world according to 2015 Human Development Report

Indian States			Comparable Countries	
States	Constructed HDI score	Hypothetical HDI ranks	Countries	HDI score
Kerala	0.7117	**104**	Maldives	0.706
Himachal Pradesh	0.6701	**116**	Uzbekistan	0.675
Tamil Nadu	0.6663	**118**	Philippines	0.668
Maharashtra	0.6659	**119**	South Africa	0.666
Punjab	0.6614	**124**	Bolivia	0.662
Haryana	0.6613	**125**	Kyrgyzstan	0.655
Jammu and Kashmir	0.6489	**128**	Iraq	0.654
Karnataka	0.6176	**137**	Tajikistan	0.624
Andhra Pradesh	0.616	**138**	Tajikistan	0.624
Gujarat	0.6164	**139**	Honduras	0.606
All India	0.6087			
West Bengal	0.6042	**142**	Bhutan	0.605
Rajasthan	0.5768	**151**	Ghana	0.579
Odisha	0.5567	**154**	Bangladesh	0.57
Madhya Pradesh	0.5567	**155**	Bangladesh	0.57
Assam	0.5555	**156**	Cambodia	0.555
Uttar Pradesh	0.5415	**161**	Pakistan	0.538
Bihar	0.5361	**163**	Myanmar	0.536



Source: Mint on Dec. 17, 2015, http://www.livemint.com/Politics/3KhGMVXGxXcGYBRMsmDCFO/Why-Kerala-is-like-Maldives-and-Uttar-Pradesh-Pakistan.html

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Halfway into the Modi government's tenure is a good time to see if its welfare policy is actually a departure from previous ones. To do this, let us analyze two initiatives, one which the government touts as one of its key achievements and another which it has grudgingly carried forward from the previous government. The former is called JAM (Jan Dhan Aadhar Mobile), a new, technology-driven, market-oriented financial inclusion program to empower the poor; the latter is the Mahatma Gandhi National Rural Employment Generation Act (MGNREGA), a 10-year-old legacy welfare program of the UPA government which has job entitlement at its core.

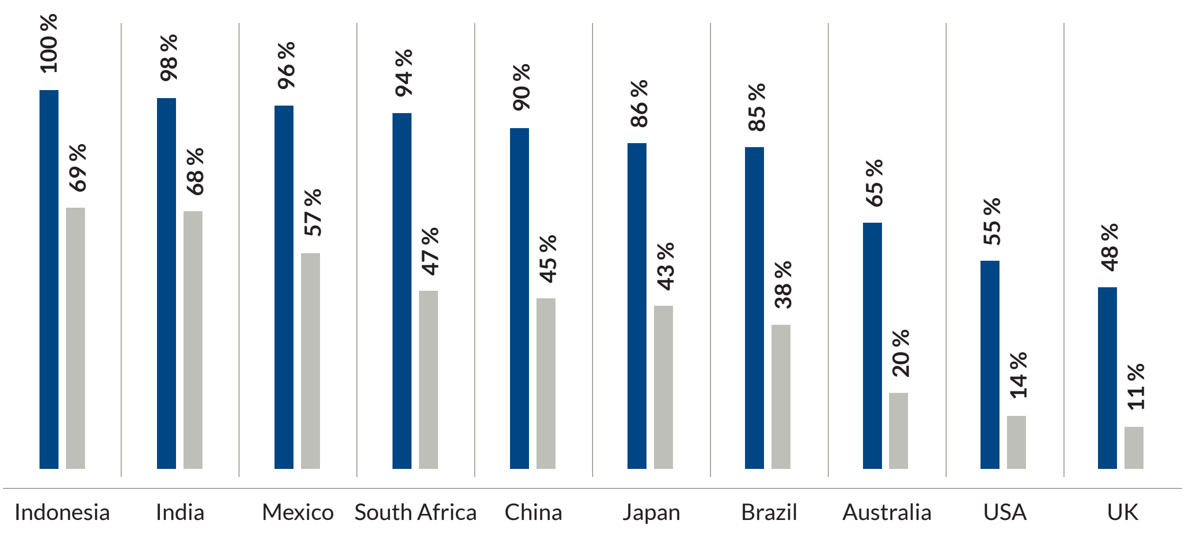
JAM, the financial inclusion program

Narendra Modi is one of the few political leaders in Asia who have an affinity for technology, demonstrated not least by his active presence on Twitter and other social media. This has found its way into some of his initiatives, especially in the field of financial inclusion. According to the 2011 census, 557 million individuals in India are not part of the banking network – the largest unbanked population in the world. The majority of these live in rural areas, due to higher default on credits, high transaction costs and the absence of collateral for loans. There has been a spate of initiatives, such as mobile ATMs) and post-office accounts, designed to remedy this situation, but success has been limited. India still remains a cash-heavy economy, with almost 13% of GDP accounted for in cash compared to 4% in Brazil, according to The Economic Times. As seen in Figure 2, the percentage of consumer transactions in cash is even higher, at 98%, the second highest in the world after Indonesia. The Reserve Bank of India spends more than €3 billion annually just to maintain its currency operations.

To increase banking coverage to the rural population and to reduce the cash component of GDP, the Pradhan Mantri Jan-Dhan Yojana (PMJDY) campaign was launched by Modi in his first Independence Day speech (August 15, 2014), targeting individual unbanked households in both urban and rural India. It encourages individuals to open no-frills and free savings accounts. In conjunction with the campaign, the JAM (Jan Dhan Aadhar Mobile) initiative combines the opening of millions of new bank accounts (Jan Dhan) with banking services that make use of a unique biometric identity (Aadhar) and mobile-based banking solutions in order to effectively deliver government services and disburse subsidies.

The Jan Dhan program also gives account holders extra benefits, such as life insurance coverage worth Rs.30,000, accident insurance worth Rs.1,00,000 and a debit card, and it allows them to overdraw up to

Figure 2: The Persistence of Cash in Consumer Transactions



Source: Disrupting Cash, Accelerating Electronic payments in India, Price Waterhouse Coopers, 2016 | BertelsmannStiftung

Rs. 5,000. Some two years after the program was launched, more than 250 million bank accounts had been opened, collecting deposits of more than Rs. 740 billion (more than €11 billion), as seen in Figure 3.

The government has combined this with a social security system of insurances. Every year, more than 39 million Indians fall back into poverty due to health-related expenses. Only 20 % of Indians have some form of insurance and not more than 11 % are covered by pensions. Introduced in combination with the Jan Dhan accounts by the government, the insurance and pension programs saw enrollments of 30 million and 3.4 million, respectively. Critics point out that opening bank accounts does not equal financial inclusion and that the program, completed in mission mode, focuses on increasing enrollment without putting the necessary banking infrastructure in place. India has only 18 ATMs per 100,000 adults, compared to a global average of 43. Sketchy digital connectivity in rural hinterlands makes the expansion of the banking network to these areas expensive and time-consuming. All of this means that users living in remote villages will have to travel to a nearby town to access an ATM, foregoing their daily wages. If the ATM does not work due to poor data connectivity, a repeated loss of wages is guaranteed. This can be seen in the almost 60 million accounts (24 % of all accounts) without any balance. Financial inclusion is being tackled seriously by the government, which has some legitimately good numbers to show, but it still has a fair distance to cover.

Aadhar, the biometric identification card which the previous UPA government launched in 2009, is a cornerstone of the Modi government's welfare policy. The cloud-based system developed under the leadership of Nandan Nilekani (co-founder of Infosys, one of the largest IT companies in India) aimed to revolutionize identification of every Indian through fingerprint and iris scans, thereby reducing the diversion of subsidies and welfare benefits. Though the Bharatiya Janata Party (BJP) opposed the Aadhar project when in opposition, claiming data privacy concerns, it made a U-turn after coming to power and made participation mandatory in order to receive various welfare pay-outs. Almost a billion Indians (93 % of the population) currently have an Aadhar card and about $40 billion in welfare payments are paid out through this identification system. More than 70 % of the Jan Dhan accounts are linked to the Aadhar system, thereby ensuring that the neediest have their rightful benefit put directly into their account without having to pay a cut to bureaucrats.

The Aadhar verification system is now open to private industry as well. This is of significant importance to the financial sector as banks and other financial service providers in India, spend about €22 each time they must verify new client data thereby limiting their

Figure 3: Pradhan Mantri Jan-Dhan Yojana – Accounts Opened as of January 8, 2016

Bank accounts	
Rural	161
Urban	104
Total	265

No. of debit cards	209
Cards linked to Aadhar ID	152
Total amount deposited (million euros)	9,757
Percentage of accounts with no balance	24.61%

All figures in millions

Source: http://pmjdy.gov.in/account

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reach to the middle classes. With Aadhar, the cost drops to €0.15, thereby accessing the bottom of the pyramid of more than half a billion Indians. It has been used more than three billion times since 2010 and is promising to be a game-changer in market-driven financial inclusion. This combination of state-led modernization and opening the benefits of digital infrastructure to private enterprise fits in with Modi's stated policy of citizen empowerment combined with market access.

What many did not see coming was his decision on November 8, 2016, to withdraw the legal tender of the 500- and 1,000-rupee notes, announced live on television. These two denominations constitute 86% of the Indian currency in circulation, and withdrawing the legal tender when the Indian economy was growing at above 7.5% (overtaking China for the first time in decades) was akin to swapping the fuel tanks of an aircraft which was cruising at supersonic speed. The aim was to deliver a "surgical strike" on unaccounted wealth, around 6% of which is estimated to be held in cash, as most is stored in gold, real estate and foreign currency.

Since the announcement, the Jan Dhan accounts meant for the poor have seen an inflow of more than €4 billion, pointing to the use of these accounts to launder black money. The flurry of new regulations, the modification of the new regulations and even the rescinding of some of them by the Reserve Bank of India, added to the woes of wrongly calibrated ATMs, suggest the botchy execution of an ill-devised plan in the name of a lofty ideal. After queuing for days in front of banks to exchange cash in old denominations, the Indian public put up stoically with their everyday lives being disrupted and exchanged more than 80% of the outstanding cash as of November 8. Unofficial figures estimate the returned cash at 97% by the end of December, puncturing claims of the enormity of the country's unaccounted cash. Not all cash is unaccounted wealth, as most small-scale enterprises run entirely on cash. The informal sector employs more than 90% of the Indian workforce, consisting of migrant laborers, street vendors, etc., who depend solely on cash. Demonetization has disproportionately affected them and their support might be waning as the economy and employment stutter. The World Bank has marked down its growth estimate to 7% from its previous estimate of 7.6%. With regional elections coming up in early 2017 in Uttar Pradesh (the most populous state in India, with 200 million inhabitants, and one of its poorest), the political gains of taking an anti-rich stand is significant. The question is how much of the common people's pain is offset by their schadenfreude at the rich, who seem to have lost some of their ill begotten wealth.

MGNREGA & rural employment

Now let us look at a welfare program that was the core of the rural welfare policy implemented by the UPA government, which the current National Democratic Alliance (NDA) government continues. The Mahatma Gandhi National Rural Employment Generation Act (MGNREGA) is the world's biggest public works program. It was enacted in September 2005, guaranteeing 100 days of employment in villages to any household willing to do manual work at minimum wage. Under this law, any adult residing in a village can demand work from the government and is entitled to get it within 15 days. Anyone who does not is entitled to an unemployment allowance. A minimum of 60% of the allocated budget was to be spent on labor and the rest on material. In the last 10 years of its existence, the Act has generated 19.86 billion person-days of employment, paying out more than €51 billion and benefitting 276 million workers, with more than half the jobs going to women and 41% of the employed being Dalits (members of the lower castes) and Adivasis (indigenous tribes).

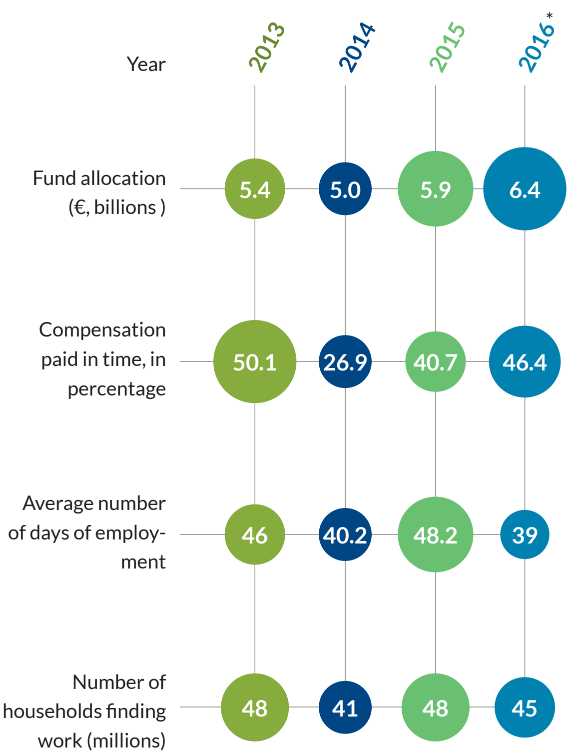
A study done by the National Council for Applied Economic Research in 2015 showed that the Act helped reduce poverty by 32% between 2005 and 2012 and prevented almost 14 million people from falling into poverty. Overall, 45% of the rural assets created through the Act were for sanitation, followed by 13% for rural irrigation – these two being the most urgent needs of rural India. The Act has indirect benefits, such as increasing rural wages and reducing gender wage gaps, thereby enabling better access to nutrition, health and education. It also improved the bargaining power of laborers when dealing with land owners and bailed them out in times of crisis. This scheme has thus been a life saver for many and has reduced migration to the cities.

Of course there have been significant leakages and corruption, as is true of most major programs implemented on a billion-plus scale in a vast country like India.

A Comptroller and Auditor General Report showed that between 2010 and 2012 only 20% of the total funds allocated under the program were released for the states of Bihar and Uttar Pradesh, which account for almost 40% of India's poor. Only about 40% of the workers get paid within the promised 15-day period.

With its "job entitlement" approach, MGNREGA was anathema to the newly sworn-in Modi government. Modi, however, decided to continue it to remind Indians of a "living monument of failures" of the UPA government. The government made fundamental changes like limiting the program to economically backward districts and reducing the labor share of the budget from 60% to 51%, thereby letting contractors substitute more machinery for labor. The two consecutive years of drought in 2014 and 2015 and falling global commodity prices led to an agrarian crisis, with farmers in distress. The attempt to pass a land reform bill in parliament which would make it easier for corporations to acquire undeveloped land for projects led the opposition to allege that the Modi government is a "suit boot ki sarkar" (a government for the suit-wearing elites). To prop up the rural economy and to shed its elite corporate image, the government then made a U-turn on the program and began increasing the budgetary allocation for the job-welfare imitative to an all-time high of almost €6 billion (Figure 4).

Figure 4: MGNREGA Key Figures



* March to December

Source: www.nrega.nic.in | BertelsmannStiftung

Bringing the technology and transparency initiatives into such a colossal social welfare program would go a long way in securing the livelihoods of the most vulnerable and invisible Indians: the landless rural poor.

Conclusion

It is neither easy nor fair to evaluate the social policy of any government based on an analysis of just two of its welfare projects, and only halfway into its legislative period. But the chosen two are representative of the "new" thinking which the Modi government promised to introduce, and they can help us review its direction and success.

Elephants can dance, once they warm up: Modi captured the country's imagination by promising development. His market-oriented approach combined with a presidential style of functioning has accelerated the decision-making process. This works very well for international investors and big businesses, which prefer a clear line of decision-making to a messy coalition. Translating the decisions into reality is the hardest part in India, with its federal structure and slow bureaucracy. The welfare sector in India is much more complex than elsewhere, having a variety of actors all the way down to the village level who are given a say in how programs are implemented. The sector has a legacy of inefficient governance, inherent corruption and discretionary power.

Reforming this system is like cleaning the Augean stables, meaning execution is more important than making a quick cabinet decision. Even with the right intentions, the highly empowered bureaucrats in Delhi rarely understand the day-to-day challenges of the majority of poor Indians living thousands of kilometers away in hamlets with no basic connectivity. The speed at which Modi wants to transform India often runs up against the limits of bureaucratic implementation and the sheer lack of physical and social infrastructure. Creation of rural infrastructure in terms of banking, education, etc., is a prerequisite to accelerated financial reforms. Making radical changes, however good the intentions might be, would disrupt the lives of people who do not yet have a social safety net to fall back upon. Building infrastructure and human capital step by step takes a long time and does not make for good headlines, but they are what form the foundation for a sustainable economy and society.

Wealth does not trickle down that easily in India: The country's high GDP growth over the past two decades has not necessarily translated into jobs for the masses. Despite the abundant labor force, economic growth in India is quite capital intensive and, in view of technical developments like Industry 4.0, manufacturing is going to be more technology than labor intensive. Big-ticket investments like smart cities and high-speed trains would follow this pattern and cannot provide employment to the million people entering the labor market every month. As much as one may question making an unskilled laborer dig a canal with basic tools in a village as part of a government-subsidized employment program, there aren't many alternatives which India can pursue without massive investments in the education, health and skilling of its population. Given its caste system, India's social structure limits economic freedom, which is a prerequisite to the functioning of free markets. Following the recommendations of highly paid Ivy League-educated consultants to let the economy take care of itself would lead to destitution and social unrest. The BJP government has been politically astute in changing tracks and adapting to this reality. In his New Year's address, Modi promised to implement social security programs that would, for example, financially support pregnant women and offer interest rate subsidies for housing loans for the poor. India's poor are dependent on handouts and will remain so in the short to medium term before the economy can absorb them.

Self-help is the best help: India has the largest number of uneducated and deprived people on the planet who are routinely exploited by both the private sector, which flouts norms relating to safety and wages, and bureaucrats, who have discretionary power over them. The social security net which Modi is building through a combination of insurances and a seamless transfer of benefits is a big step in the right direction and needs to be pursued further. Initiatives which remove the middle men and empower the recipients through bank accounts and digital services are commendable measures and, combined with a strong focus on education and health initiatives, would go a long way in realizing the dream of "Sabka saath, sabka vikas".

Not all Indians are yogis: The promise of a better tomorrow is a standard feature of any election manifesto and the winner is usually the one who makes the most credible pitch. Modi's post-election announcements raised the bar quite high. Though halfway through his term most of the promises have yet to be realized, the 2016 Pew Research Center survey shows that 81% of Indians have a favorable view of Modi (compared to 87% in 2015). His government's gains are temporary, stemming from financial windfalls generated by historically low oil prices and cheap capital inflows due to quantitative easing in Europe and low interest rates in the US. In fact, oil is becoming more expensive and capital flows might switch direction after an interest rate hike in the US and the tapering of quantitative easing in the EU. The Modi government has only a narrow window of opportunity to build a strong base for socioeconomic development through massive investments robustly executed in education, health and infrastructure. The hard sell of a prosperous India needs a strong foundation to rest on. If it is lacking, the house would be shaken by global economic storms, the turbulences of which are growing thanks to a slowing China and a belligerent Donald Trump.

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Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
33311 Gütersloh
www.bertelsmann-stiftung.de

Stephan Vopel
stephan.vopel@bertelsmann-stiftung.de

Dr. Peter Walkenhorst
peter.walkenhorst@bertelsmann-stiftung.de

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ISSN 2364-8562

BertelsmannStiftung