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A World Bank study shows creating productive assets can help make MGNREGS cost effective
The Indian economy has turned the corner, says the latest India Development Update of the World Bank. Aided by a supportive external environment, in particular the sharp decline in oil and commodity prices, the Indian economy has taken strong strides towards higher growth and enhanced stability. Growth has accelerated, inflation has declined, the current account deficit has narrowed, and external reserves have increased.
According to the Update, a twice yearly report on the Indian economy and its prospects, Indias economic growth is expected to rise to 7.5 percent in 2015-2016, followed by further acceleration to 7.9 percent in 2016-2017 and 8.0 percent in 2017-2018. However, acceleration in growth is conditional on the growth rate of investment picking up to 11 percent during FY2016-FY2018[1], it adds.
To achieve higher investment growth, the Update calls for fiscal reforms that protect public capital spending; financial sector reforms; and reforms in the business environment - all of which can help unlock private investments. Specifically the Update calls for the timely implementation of the Goods and Services Tax (GST); rationalizing current expenditures, especially on subsidies; delivering on divestment plans, ensuring greater tax buoyancy than has been realized lately; encouraging PPP projects; addressing balance sheet issues of Public Sector Banks.
"The government has made progress in several policy areas and long-term prospects for growth remain bright for India," said Onno Ruhl, World Bank Country Director in India. "The current situation offers an opportunity to further strengthen the business environment and enhance the quality of public spending. Continuous strong momentum in these reforms will further unleash the productivity that Indian firms need in order to create jobs and become globally competitive."
Domestic and External Risks to Outlook
Oil and Commodity prices
The recent economic turnaround and the outlook also rest crucially on oil and commodity prices remaining low. Reiterating the need for the government to further insulate the economy from the global price of oil, the Update suggests weaning the fiscal outcomes more fully from oil prices; by encouraging alternative sources of energy; creating additional fiscal buffers by using petroleum taxation more actively, as well as rationalizing subsidies.
"India needs to explore alternative channels for long-term investment while reviving the PPP model of financing to meet Indias yawning infrastructure gap. Simultaneous efforts to increase the tax-to-GDP ratios, through the timely implementation of the GST, as well as complimentary measures to improve tax administration and compliance can generate additional fiscal space in the years ahead," said Poonam Gupta, Senior Economist, World Bank.
Potential tightening of US monetary policy
The Update sounds a word of caution on the risks from potential tightening of the US monetary policy. India being one of the larger financial markets, and a large recipient of capital flows, could be adversely affected by a rebalancing triggered by the tightening of the Feds monetary policy. "While the Reserve Bank of India has taken preventive measures to reduce external vulnerability, and has built international buffers as a "first line of defense", the risk remains, warranting vigilance," Gupta added.
Findings from a study of the MGNREGS
The current Update also specifically analyzes the performance of Indias Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) and draws on lessons from Bihar and other states to suggest a way forward.
Highlighting the findings, the Update says while the scheme has the potential to drastically cut poverty, analysis of household survey data from Bihar shows the programs actual impact on rural poverty in Bihar is only about 1 percentage point against its potential of reducing poverty by at least 14 percentage points.
The study highlights a number of reasons why the potential impact of MGNREGS may not be realized in practice: the supply side is too slow to respond to the demand for work on the scheme; workers are not paid the full scheme wage; delays in wage payment; and awareness of how to demand work is limited.
Paradoxically, the scheme has worked less well in poorer states, where it is needed the most. For example, in Bihar, more than two-thirds - about 10 percentage points - of the gap between the potential and actual impact of the scheme is due to unmet demand. Whereas in Andhra Pradesh the scheme is shown to have delivered significant positive impacts on a range of outcomes - from consumption and nutrition, to quality assets and productivity improvements, particularly for the poorest.
The study shows that asset creation is key to the effectiveness of MGNREGS. The MGNREGS has an in-built self-targeting mechanism and most studies show that despite substantial unmet demand, participation in the scheme favors people from poorer families. However, unless assets created under MGNREGS are of sufficient value to the poor, it is unlikely to be cost-effective relative to an income transfer scheme, even with better targeting, the study says.
"With over 50 million beneficiary households at its peak, and expenditures between 0.5 and 1 percent of GDP, the MGNREGS is amongst the largest anti-poverty programs in the world. While the scheme has the potential to drastically reduce poverty, its performance in practice has been mixed," said Ruhl. "To tilt the balance in favor of workfare, assets created need to be of sufficient value to the poor which can in turn serve as a vital ingredient for inclusive and expanded growth."
Discrepancies in the stipulated wage rates and actual wages received by workers is contributing to the gap between potential and realized impacts. In Bihar, on an average, wages received on the scheme were about 10 percent lower than the stipulated wage rate. More recently, payment delays have emerged as a major bottleneck and are a strong disincentive to participating in the program.
"If MGNREGS were to be implemented effectively, its design would ensure that there is no unmet demand for work. On-going efforts at convergence of the scheme with other programs will ensure that the assets created are productive and of lasting value," said Rinku Murgai, Lead Economist and one of the authors of the MGNREGS study.
[1] The financial years refer to fiscal year ending March 31.
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