

# **EXCESS FOOD STOCKS, PDS AND PROCUREMENT POLICY**

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Any views expressed in this paper are the personal views of the authors and do not necessarily reflect those of the Planning Commission.

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## EXCESS FOOD STOCKS, PDS AND PROCUREMENT POLICY

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## **1 INTRODUCTION**

A fairly long series of normal monsoons has coincided with a policy of ensuring relatively higher returns on production of rice and wheat and led to a surplus of food grains accumulated in the FCI godowns, which is well beyond prescribed buffer stock norms. The problem facing the country today is not one of shortage of food grains but finding ways and means of managing the accumulated surplus. The stock of food grains available with the government agencies as on 1-4-2002 was 50.95 million tonnes, which constituted of 24.91 million tonnes of rice and 26.04 million tonnes of wheat. This stock level was well above the normative buffer stock, prescribed by the government. In this paper we try to examine some of the factors that have led to accumulation of excess food grain stocks and make policy prescription on how to deal with the problem.

## **2 FOOD CONSUMPTION PATTERN**

It is now widely recognized that dramatic changes in food consumption patterns have taken place in India in the post green revolution period (Meenakshi: 2001). For example, at the all-India level, cereal consumption declined from 15.3 kilograms per capita per month in 1972/73, to 13.4 kg per capita, per month in 1993-94 in rural areas. In urban areas, the corresponding decline was more modest--from 11.3 to 10.6 kg over the same period. At the same time, the consumption of milk and meat products has increased. Such changes in the diet, in the direction of greater variety, have come to be expected as one outcome of the process of economic development.

Between 1972/73 and 1993/94 the food basket has become much more diversified. In particular, cereal shares have seen a dramatic decline of ten percentage points in most regions--in both rural and urban India. Similarly, the share of meat and milk products, and vegetables and fruits has increased over time.

The trend towards a more diversified diet can be discerned not just on average, but among the poorest 25 percent of the population as well. Thus although cereals continue to dominate food expenditures, over time their importance has decreased; while at the same time, cereals have become cheaper in relation to other food groups.

For example, in rural areas of Uttar Pradesh the per capita monthly consumption of cereals for the lowest quartile income group has declined from 13.6 kg in 1972-73 to 12.3 kg in 1993-94. During the period coarse cereals consumption declined from 5.0 kg to 0.8 kg per capita per month. Which was only partly offset by increase in consumption of rice from 2.6 kg to 3.5 kg and that of wheat from 6.1 kg to 8.1 kg. Between 1972-73 and 1993-94 in Uttar Pradesh the share of cereals in total food expenditure among the lowest quartile income group declined from 69 per cent to 49 per cent while that of milk and meat increased from 7 to 12 per cent, that of vegetable and fruits also by the same amount and that of other food items from 17 to 28 per cent.

Professor C.H. Hanumantha Rao (Rao: 2000) has also noted that over a period of two decades that is between 1972-73 and 1993-94 the per capita consumption of cereals has shown a steeper decline (by around 12 per cent) in rural areas than in urban areas (around 5 per cent). He attributes this difference to the spread of the road network to rural areas and the increased availability of manufactured goods in rural areas. The message we can derive from all this is that the demand pattern for food consumption is undergoing a change in India.<sup>1</sup> People today prefer to consume more of non-cereals and among cereals the preference is for rice and wheat as against coarse cereals. There is a shift in the consumption pattern of the population in favour of superior food items like milk, vegetables, fruits, and animal foods. Thus the growth of aggregate demand for cereals in the country is slowing down because of deceleration in the pace of population growth and a shift in consumer preference towards non-cereals. This is one of the factors that have contributed to accumulation of excessive food stocks in FCI godowns.

## **2.1 Cereal Demand**

Tim Dyson and Amresh Hanchate (Dyson: 2000) have made forecast of demand for cereals in India for 2020. Dyson and Hanchate stress the need to incorporate the vastly different demographic pattern in states and their implications

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<sup>1</sup> See also [the Tenth Five Year Plan Working Group Report on Public](#)

for population forecasts. Dyson and Hanchate's demand forecasts for 2020, based on a population of 1315 million, are as follows:

Food: 193.5 million tons

Feed: 30.1 million tons

Total: 223.6 million tons

They acknowledge the feed forecasts to be 'rough and almost certainly on the high side.'

Demand forecasts arising out of International Food Price Research Institute's (IFPRI) IMPACT model are somewhat higher at 237.3 million tones:

	<u>Food</u>	<u>Feed</u>	<u>Total</u>
With 3-4% p.a. pc income growth	223.6	13.3	237.3

G. S. Bhalla et al (Bhalla: 1999) has estimated that with a 3.7% rate of growth in per capita incomes cereal demand can be as high as 296 million tones in 2020, of which over one-fifth would be on account of feed grain. G. S. Bhalla et al's demand estimates are high because as some of the recent research indicates, and as is apparent from the pattern of cereal consumption outlined above, income effects on consumption are not only non-linear, but non-monotonic as well. Quadratic generalizations of popular functional forms such as the Linear Expenditure System and the Almost Ideal Demand System inevitably explain demand behaviour better than the linear counterparts. This implies that there is a 'curvature' to the income elasticity of demand for cereals, which decrease substantially with income (growth).

Secondly, in 1993, feed grains constituted less than 3% of total cereal demand. The 11 and 25 per cent implicit in the forecasts represent extremely high rates of growth in the indirect demand component of total cereal demand. Although there are other countries, which achieved such high rates of growth, the circumstances are sufficiently different to invalidate a direct comparison with the Indian scenario. Even though changes in taste away from cereals to meat products implies that the

indirect demand for cereals will increase over time, it is unlikely to occur so quickly and dramatically.

## **2.2 Cereal Supply**

How does the demand situation compare with supply? The policy of recommending relatively higher MSP for wheat and rice as compared to the MSP for other crops served the cause of the country well in the eighties and nineties. However, in recent years, it has started encountering certain problems. This is mainly because of two reasons, firstly, the scenario of agricultural production has undergone significant changes over the past four years. Surpluses of several agricultural commodities have started appearing in several states and this trend is likely to continue in the coming years as well. Former deficit states like Bihar, Assam and Eastern UP have started generating surpluses of certain cereals. At the macro level, the position can be seen by the fact that the average production of food grain, which was 187 million tonnes during the Eighth Five Year Plan, is expected to have increased to 205 million tonnes in the Ninth Five Year Plan. Thus the increase in average total food production is in excess of total food grains requirements of around 196 million tonnes as at the end of the Ninth Plan as worked out on the basis of normative approach according to the Ministry of Agriculture.

## **2.3 Supply Projections**

The available evidence suggests that there is likely to be no problem in meeting the lower end of cereal demand projections from domestic supply. A number of researchers have made supply forecasts (million MT), some of which are summarised below.

Praduman Kumar's (Kumar: 1998) estimates:

With constant growth in total factor productivity	309
With deceleration in total factor productivity	270

G.S. Bhalla's estimates:

Extrapolating 1965-1993 trend	347
Increased fertilizer use and irrigation	251

IMPACT model (IFPRI):

Base calculation	256
With additional land degradation	234
With reduced land degradation	271

The supply forecasts therefore range from 250 to over 300 million tons. Thus there appears to be no cause for concern over cereal demand outstripping cereal supply in the Indian context.

## **2.4 Conclusion**

The message we can derive from the discussion so far is that the demand pattern for food consumption is undergoing a change in India. People today prefer to consume more of non-cereals and among cereals the preference is for rice and wheat as against coarse cereals. There is a shift in the consumption pattern of the population in favour of superior food items like milk, vegetables, fruits, animal foods and so on. Thus the growth of aggregate demand for cereals in the country is likely to be restrained by two factors; the slow down in the pace of population growth and shift in consumer preference towards non-cereals. However, some of the studies made on cereal consumption requirements in the country have not taken into consideration the full implications of changing consumer preferences and have led to exaggerated demand projections for cereals. The demand projections for cereals, which take into consideration changing consumer preferences, come out with demand estimates for cereals, which match favourably with the supply projections indicating that the requirements of cereals in the country will be adequately met by domestic supplies during the period of at least upto the year 2020. Thus there is no need for undue concern on this front.



### **3 PUBLIC DISTRIBUTION SYSTEM**

#### **3.1 Food Subsidy**

It is now recognised that availability of food grains is not a sufficient condition to ensure food security to the poor. In addition to availability of food grains it is also necessary that the poor have sufficient means to purchase food. The capacity of the poor to purchase food can be ensured in two ways. You can either raise the level of incomes of the poor or you can supply food grains to the poor at subsidised prices. Employment generation programmes for the poor try to ensure that the poor have sufficient purchasing power. The Public Distribution System (PDS) tries to supply food grains to the poor at subsidised prices.

**Table: Food Subsidy of the Central Government**

Year	Amount (Rs. Crore)	% of Total (Govt Expenditure)
1990-91	2450	2.33
1991-92	2850	2.56
1992-93	2785	2.27
1993-94	5537	3.90
1994-95	4509	2.80
1995-96	4960	2.78
1996-97	5166	2.46
1997-98	7500	3.23
1998-99	8700	3.11
1999-00	9200	3.03
2000-01	12125	3.61
2001-02	17612	4.83
2002-03	21200	5.17

With a network of more than 4.62 lakh Fair Price Shops (FPS) distributing annually commodities worth more than Rs 30,000 crore, to about 16 crore families, the PDS in India is perhaps the largest distribution network of its type in the world. All is not well with the Public Distribution System in India. The annual food subsidy involved in maintaining the system is huge (see Table). For the year 2002-3 an amount of Rs.21200 crore is budgeted for the food subsidy. This volume of food subsidy accounts for 5.2 percent of the total budgeted expenditure of the central government. A close look at the Table would show that the level of food subsidies in India as a proportion of total government expenditure has gone up from a level of about 2.5 percent or below during the beginning of the 1990s to more than 5 percent today. The per capita food subsidy expenditure by the government in 2002-3 was about Rs 200 or nearly Rs 17 per head per month. This, however, does not mean that consumers got Rs 17 per head per month, for the cost of distributing this subsidy has to be deducted from the subsidy expenditure by the government.

A part of the subsidy also accrues to the cereals producers/surplus farmers, as the increase in food subsidy is also due to high carrying cost of stocks in excess of the buffer norms. There are indications that the proportion of food subsidy accruing to farmers has increased over time. To reverse this trend, the Expenditure Reforms Commission has recommended that the cost of holding stocks in excess of the requirement for National Food Security and for PDS, arising from very generous MSP and procurement, be reflected in the budget as producers' subsidy rather than consumer subsidy. The Public Distribution System needs to be improved through better targeting of the subsidy on the relatively less well off lower 50% of the total population and reducing leakages. The efficiency of the Public Distribution System can be improved by introducing innovative ideas such food stamps and food credit cards in the system, as we shall see in the following section.

### **3.2 Food Stamps**

In order to ensure better targeting of the food subsidy major reforms are required in the pattern of marketing of food grains in the country. The concept of

having fair price shops over the length and breadth of the country needs to be re-examined. It may be more efficient to move towards a new system of providing food subsidy through the normal food supply shops that exist through out the length and breadth of the country (including the current FPS), supplemented by new/additional Fair Price Shops in remote and inaccessible regions where such shops may be absent. This could be achieved through the introduction of food stamps or the food credit card system as outlined below:

Under the system of food stamps, instead of issuing ration cards, the states could issue a subsidy entitlement card (SEC). The SEC should show the number of members in a poor family, their age etc, and indicate their entitlement level for food stamps. There could, in principle, be different levels of entitlement based on age. All adult members from a poor family could be entitled to “a” number of food stamps per month while the entitlement for a child could be “b” number of food stamps. There could also be a higher subsidy entitlement based on old age or infirmity. The SEC will indicate the total number of food stamps a family is entitled to every month.

The members of a family would produce their SEC and collect their monthly quota of food stamps from prescribed distribution centres. By using these food stamps in any food supply shop the poor should be able to purchase food grains (rice and wheat) at a price (Rs x) below the market price. The retailer who sells food to the stamp holder could accumulate these food stamps issued by the state governments and claim (Rs x) per food stamp from the state treasury.

There is less scope for corruption under such a system of food stamps than under the existing system. Under the existing system, it is well known that Fair Price Shop owners declare on paper that they have sold a certain quantity of food to the poor at subsidised prices but actually make a big profit by selling the food at market prices. Under a system of food stamps there will be less possibility of such diversion of food supplies. The retailer can claim food subsidy only if he acquires food stamps by selling food to the poor at subsidised prices. Under this system it could be made mandatory for retail traders in food grains to display the selling price of food grains at a prominent place in their shops.

There are two potential problems with food stamps that need to be kept in mind while designing and introducing the system: One relates to the possibility of counterfeiting of food stamps and the other to the system of reimbursement of subsidy to the participating retailers. These problems are however miniscule in comparison to the problem of physically procuring, storing, transporting and delivering food grains to Food Price Shops across the country by the FCI and the State food corporations/agencies. One possible solution is to phase in the system by initially allowing food stamps to be redeemed only at the FPS currently used by the poor consumer along the lines of the current system in Andhra. This will allow food stamps to be printed with the identification number of the FPS so that the totals can be matched and crosschecked later thus reducing the scope for counterfeiting. This could be followed by allowing the consumer to designate any participating retailer and have its identification number printed on the food stamp. Normally consumers purchase their daily food provisions from the most convenient shop or in very rare cases two shops. As the difficulty of delivering money is a fraction of that for delivering food it should not be too difficult to set up a re-imbursement system perhaps by sub-contracting it to a financial service provider. To reduce malpractices, it is felt that food stamps should be issued to female members of the family who can be designated as heads of households for the purpose. The system should be introduced cautiously on an experimental basis where proper market infrastructure exists. The conventional FPS system may have to be continued in remote and inaccessible areas.

Informal trading of food stamps can also convert the food subsidy into an income subsidy. The use of smart cards in the form of a food credit/debit card can remove these problems and ensure provision of a food subsidy (i.e. a reduction in the relative price of food), as it can have inbuilt security features that make it difficult if not impossible to trade.

A food coupon system for distribution of rice and kerosene through PDS was introduced in Andhra Pradesh during 1998-1999 (Government of Andhra Pradesh: 2001). Basically, the scheme was aimed at improving the delivery system of kerosene and rice. Under the scheme mere possession of card was not adequate to draw PDS

rice, wheat or kerosene. Physical presence of the cardholder whose photo was affixed on the card was insisted upon for obtaining the coupons. Coupons are issued once in a year and coupon holders are entitled to draw rice and kerosene on monthly basis. To facilitate the coupon holder to draw rice and kerosene in easy instalments in a month, coupons have been distributed for denominations like 4 Kg, 8 Kg etc. Under coupon system, coupon holder/ beneficiary is aware of his entitlement. The State Government feels that this system has largely eliminated the scope of cheating of the beneficiary by dealers to deliver lesser quantity than entitlement. Coupon guarantees the stakeholder his right to draw the specific quantity every month. Unless coupon is produced rice or kerosene is not released. This facilitates proper accounting of actual quantity distributed in the month as it is reckoned based on the quantity covered by coupons produced by the beneficiaries. Quantity distributed vis-à-vis the coupons produced could be verified every month by the officials of the Civil Supplies/Revenue Department. This has reduced the scope of diversion of rice and kerosene to a great extent, if not totally eliminated it. Introduction of coupon system also resulted in reduction of number of cards by approximately 8 lakh, which were either bogus or with ineligible families. A quantity of about 20,000 tonnes of rice and 7,100 kilo litres of kerosene is saved due to this system every month. In financial terms, an amount of Rs. 9 crore per month on rice and Rs. 5.67 crore per month on kerosene is being saved in subsidy. Coupon system could be made more effective if the list of beneficiaries is computerized fair-price shop wise so that duplicate names, if any, could be identified and eliminated. This step would also reduce the cost of PDS substantially. However, steps should be taken to prevent counterfeit coupons by unscrupulous persons. Regular and staggered distribution of coupons could also prevent mischief and manipulation.

### **3.3 Food Credit Cards**

A food credit card system could be a superior alternative to the prevalent system of specialized Fair Price Shops and even a food stamp system. The customers to buy subsidized food grains from the market could use food credit/debit cards and the retailers can claim the subsidy from the government. Though the issue cost of a

food credit card are likely to be higher than for existing ration card or the food coupon system, the running costs may be lower than for specialized Fair Price Shops as the credit/debit card can be used in any existing retail shops that accepts such cards. This will eliminate the need for an exclusive FPS system and consequently its entire overhead cost. This will partly compensate for the initial costs of setting up a leakage proof credit card system using smart card technology. The rest would be compensated for by the elimination of leakage at all stages of the current food procurement, storage and distribution system (including the FCI). To minimise the cost, existing credit card companies could be induced to set up and run the food credit/debit card system at cost, in return for advertisement rights to this social service. Specialised credit card companies can also ensure that the food retailers are reimbursed the subsidy due to them, in a timely manner, thus maintaining the incentive to sell food to the poor.

A certain amount of basic infrastructure is however required to run an efficient credit card system. This may not be currently available in remote or inaccessible rural areas. In such areas, the smart card system may have to be preceded by a food stamp system. Further in very remote and inaccessible areas food banks and other approaches may be needed.

There is a fear among some academics that food stamps may be traded on the informal market and thus be effectively converted from a food subsidy to an income subsidy. The food debit/credit card, can obviate this problem as it is much more difficult to trade. Use of *smart card technology* can allow additional safety features such as identifying characteristics of the cardholder and periodic validation (and re-charging) can be built into the system, which will make it virtually non-tradable. The food debit/credit card can be made applicable to all cereals including coarse grains. If desired, a different subsidy rate can be specified for different cereals. As coarse cereal are consumed primarily by the poor, the smart card will allow some self-selecting/self-targeting features to be built into the system.

The food debit/card card could also be integrated with a food-for-work programme without incurring the additional administrative and logistic costs of

transporting food to each area where there is need to provide work. Payment for the work would be done by incrementing the food credit of the worker. Once set up this smart card system could also be used to provide social security to the old, infirm, disabled and handicapped citizens. This could be done for instance by programming a higher subsidy proportion for such groups.

The food debit/credit card can also have the inbuilt flexibility of changing over from a food subsidy to an income transfer system if there is a subsequent change in the policy. In the not too distant future one could also hope to see the myriads of special programs for every conceivable age group, education level, caste, creed, income group and geographical area replaced by a single income supplement that can incorporate and integrate all these aspects. This could result in massive savings in delivery costs and leakages.

## **4 FOOD PROCURMENT POLICY**

### **4.1 Minimum Support Price**

The changing demand pattern for cereals, by reducing the demand for cereals from consumers from PDS, is one of the factors responsible for the accumulation of surplus food grains stocks in our FCI godowns as it leads to. Another, perhaps the main factor that has contributed to excess stocks is high procurement price. The fact that in recent years there has been a tendency among successive governments to fix Minimum Support Prices (MSP) for paddy and wheat in excess of the levels prescribed by the Commission for Agricultural Costs and Prices (CACP). While this increases farmers' incentive to produce more, it has raised the market prices and has reduced the demand for cereals. Studies conducted at The National Council of Applied Economic Research (Sharma: 2001) show that fixing of procurement prices above the level recommended by the Commission on Agricultural Prices (CACP) has resulted in additional procurement of 12.8 million tonnes of wheat and 3.4 million tonnes of rice. This points to the need for strictly adhering to the recommendations of the CACP while procurement prices for cereals are fixed.

The MSP Scheme served the country well in the past three and a half decades. It helped exploit the opportunity created by green revolution and led to much high levels of production of wheat and rice. Relatively higher prices of MSP for these crops increased the profitability of these crops and motivated the farmers to divert their areas to these crops from coarse cereals, pulses and even oilseeds as in the case of Punjab. This enabled the country to achieve higher output of food grains and reach a situation of surpluses. But in the changing context of the nineties the need for rethinking on this approach is overdue.

#### **4.1.1 Recommendation**

The procurement prices for food grains should not be fixed by the government at such a high level that can lead to accumulation of surplus stocks in FCI godowns much in excess of prescribed buffer stock norms. In this connection there is a need to strictly adhere to the recommendations of the Commission for Agricultural Costs and Prices and not resorting to fixation of procurement prices much in excess of the estimated costs of production.

Eliminating the gap between the MSP as recommended by the CACP and the MSP announced by the government will not, however, reduce the cereals stock mountain. The concept used by CACP may itself need to be modified. An economically sustainable MSP requires that we revisit the original intent of MSP. The key word in the expression is “Minimum.” Minimum Support Prices when they are fixed should cover only the variable costs of the farmers and should not be meant to cover their entire production costs. Such variable costs could cover all input costs including payment for labour comprising family labour also. It should not cover fixed cost such as cost of land owned by the farmers.

It should also be considered whether the period during which food procurement is conducted should be limited to a specified number of weeks after the harvest when there is highest probability of prices falling below this economically defined MSP.



## **4.2 FCI Efficiency and Buffer Stocks**

The high level of market prices of wheat (relative to global) now prevailing in India are due primarily to the rise in the procurement prices over the past three years or so and taxes and charges on cereals imposed by state governments. The difference between the economic cost of Food Corporation of India and the market price also contributes to the higher price. The Food Corporation of India's (FCI) monopoly must be eliminated through greater competition in food trade from other public, co-operative and private organisations. As is to be expected of any monopoly, FCI suffers from X-inefficiency. Most storage godowns with FCI are small-scale, low-quality structures; sometimes, grains are also stored in the open (known as covered and plinth storage-CAP) leading to heavy storage losses. A World Bank report (World Bank: 2001) states that half of FCI's grain stocks is at least two years' old, 30% between 2 and 4 years old, and some grain as old as 16 years. The situation could have further deteriorated during the period since the report was written.

A study done at the Indian Statistical Institute (Dutta & Ramaswami: 2001) using NSS data for 1993-4 along with other for two states (Andhra Pradesh & Maharashtra) estimated both the extent of leakage as well as the economic inefficiency of the public food procurement system relative to the open market. The study shows that only 56 to 58.5% of the total food subsidy (Centre and State combined) reaches the PDS consumers. Leakages can range from 15% to 28% of the subsidy while 16 to 26.5% of the subsidy is eaten up by the inefficiency of the government procurement and distribution system (FCI plus State level) relative to the market.

The main objective of our food procurement policy should be stabilization of food prices rather than provision of subsidies to producers. Even today when food subsidies are provided to the BPL population only a limited proportion of the food requirements of the BPL population is met by the PDS. For the rest of their requirements even the BPL families have to depend on the private traders. Thus the objective of stabilization of food grain prices becomes important. This objective has

to be achieved by appropriate buffer stocking operations and market interventions by the FCI.

The Expenditure Reforms Commission (Ministry of Finance: 2000) has recommended that a food security buffer stock of 10 million tonnes – 4 million tonnes of wheat and 6 million tonnes of rice- would be adequate. The recommendation of the Expenditure Reforms Commission is based on a study carried out by Dr Kirit Parikh (Parikh: 1999) according to which a buffer stock of 10 million tonnes was adequate from a food security angle. The present levels of buffer stocks in the country are far in excess of requirements and create more economic instability than stability.

#### **4.2.1 Recommendation**

The FCI can maintain a minimum level of buffer stock and then undertake open market operations within a prescribed price band, e.g. when prices increase or decrease more than 15% as compared to a prescribed average. It can conduct open market operations by releasing stocks in the open market when shortages are prevalent and prices are high. The FCI can also purchase food grains from the open market when there is excess supply and prices are depressed. However its objective should not be to procure all that is offered by the farmers but only to maintain an optimum level of buffer stock. The FCI can therefore be instructed to limit its role in the future to more manageable and optimum levels, recognising the fact that a high level of buffer stock of food grains can itself be a factor contributing to inflation and higher food prices. The FCI could also play a role in the international market for food grains by resorting to imports when stock levels are low and exporting food grains when there are surplus stocks.

The FCI could continue to have a role in the maintenance of the food buffer stock to take care of fluctuations in year-to-year production of food grains. Its monopoly of food procurement must be ended by allowing State procurement agencies to operate in all parts of the country. The restriction on private food grain trade must be lifted and the bias against them removed so that competitive forces can have freer play in reducing intermediation costs. In particular the constraints and restrictions on entry of modern food procurement, transport, processing and

distribution companies must be removed so that the benefits of modern management practices like silo storage, logistics and large scale processing can flourish. This will benefit both farmers and consumers.

These guidelines could restrict the level of food procurement each year within broad limits and operate a market intervention scheme – purchasing from the farmers when prices are low and offloading in the market when prices are high. A price stabilisation scheme of this sort should take advantage of the possibility of exports and imports as well. It may not be desirable to extend the procurement policy to cover more and more commodities. The objective should be to reduce the number of commodities covered under the procurement scheme and finally restrict it to rice and wheat only.

### **4.3 Alternative Farmer Subsidies**

A paper on Agricultural Support Programme for Farm Income Protection prepared by a professor of Indian Institute of Management, Ahmedabad, (Naik: 2001) which suggest some alternatives to the present food procurement policy was circulated by the Ministry of Agriculture for discussion. This paper has led to a statement by the *minister of Food* on replacing MSP Scheme by an alternative scheme. The paper under consideration suggests formulating income protection policy. For income protection, two schemes are examined: first Direct Payment Scheme (DPS) and second, Income Insurance Scheme (IIS). Under the DPS farmers will be paid the difference between the market price prevailing during the harvest season and the MSP, for the actual production estimated through crop cutting experiments adjusted for on farm consumption.

In the Income Insurance Scheme average income levels are protected. Average income is calculated as the product of average yield and MSP. The premium rate will be based on actuarial considerations and the government could subsidize part of it. Income Insurance Scheme is proposed initially for rice and wheat, as the Scheme is likely to be sustainable in the long run. The total expenses estimated in a worse case scenario, under IIS are comparable with the current expenditure on MSP-procurement system. (Rs.17914 crore)

There may be no saving in terms of subsidy under the DPS and IIS schemes as compared to the existing MSP linked scheme. The proposed scheme will also lead to administrative difficulties when it is operated in the Indian rural economy where farmers do not maintain proper records and do not have standardized accounting practices. It will also not be easy to fix a particular price as a standard at which the farmers marketed their produce during a year. In fact, the remedies proposed may actually lead to more complications than what already exist without leading to any financial savings for the government. Practical solutions need to be found to these administration and implementation problems, perhaps through an experimental approach, before they are considered for wider adoption.

#### **4.4 Private Trade**

The FCI should gradually give over its role of MSP related procurement to the private trade. This requires a comprehensive reform of policies, rules and procedures to strengthen the role of modern private trade in the matter of storage, distribution and processing of food grains. Various restrictions that continue to inhibit private initiatives in this regard need to be removed. Only then private trade will have the incentive to make huge investment in grain handling operations and food processing.

Under the National Policy on Handling, Storage and Transportation of Food grains (Ministry of Consumer Affairs: 2000) bulk handling, storage and transportation facilities are to be created at identified locations through private sector participation. Under the policy, for storage of food grains procured by the FCI, integrated bulk handling facilities with silos of large capacity for wheat along with testing facilities for quality control would be created at about 20 identified central locations in producing and consuming areas as well as a few port towns. These facilities, including the infrastructure for bulk transportation to these centres, will be created and maintained in the private sector under the overall co-ordination of the FCI. Private sector participation in this sector will be sought and encouraged through measures such as Build-Own-Operate-Transfer (BOOT), Build-Own-Lease-Transfer (BOLT), Build-Own-Operate (BOO), Lease-Develop-Operate (LDO), and Joint

ventures etc. Several fiscal incentives are to be provided to make the scheme a success.

The locations for setting up these facilities have been identified and RITES has been appointed as consultant for short-listing the Developers-cum-Operators. Besides, conventional storage facilities, for 5.88 lakh metric tonnes at 78 locations in 14 states are also to be created through private sector participation. Expression of Interest (EOI) for these locations have been invited by FCI and terms and conditions for inviting financial bids has been finalised. FCI has invited financial bids for these locations.

While the National Policy is timely, its success is largely dependent upon highly regulated and controlled sectors of the economy. Unless the control regime governing storage and movement of food grains and other essential commodities is suitably relaxed, the degree of success would be limited. State governments have imposed many restrictions on the movement and storage of food grains. Even when the country has achieved food self-sufficiency, many of these controls, which have outlived their utility, are still continuing. There is need to withdraw them urgently, keeping in view the emerging economic environment. Legislative and administrative measures for removing impediments to storage and movement of food grains, as proposed, need to be accorded topmost priority.

Another set of controls emanate from the provisions of *Essential Commodities Act*. Most of the provisions in this Act have become irrelevant in the context of having achieved self-sufficiency in production. They hamper the market from performing its productive and commercial role. A large number of permits and licences are required to be obtained from the authorities under the Essential Commodities Act and periodically returns have to be submitted and inspections carried out, which add to transaction costs. Some notifications under the same Act restrict movement of goods from the surplus states to deficit states. These controls and restrictions, which include the ever present threat of arrest, act as disincentives to production and distribution of essential commodities by organised companies that can exploit economies of scale and modernise the entire food sector. Besides, there is

urgent need to upgrade market infrastructure, cold storage facilities, mandi facilities and roads for which the private sector should be encouraged to make productive investment.

## **5 POLICY REFORM**

The reform of the food procurement and supports system must be accompanied by a series of policy reforms that support crop diversification, strengthen agricultural demand and supply of technology. Among the Specific Policy Reforms needed are:

- **Single Market**
  - Amend *Essential Commodities Act* to make it an emergency provision that will have to be formally invoked by notification for a limited period.
  - Enact a Central Act to *ban controls on movement* within and between States.
- **Competitive Grain Procurement**
  - Phase out of all forms of monopoly purchase.
  - FCI godowns with staff could be transferred to states.
  - Private agencies could be hired by states to procure grain.
- The Central government should progressively move from running the food procurement system to merely financing it.
  - FCI should be restricted to Buffer stock operations. MSP operations should be phased out.
  - FCI assets more than that required for maintenance of a minimum buffer stock should be privatised.
  - MSP operations should be gradually handed over to private trade.
  - Private-Public partnership should be initiated for construction of modern procurement, transport, storage and logistics.
  - In the transitions the FCI could also conduct open market operations within a price band.
- Actual/announced Minimum Support Price (MSP) should be less than or equal to MSP recommended by CACP.

- Methodology for calculating MSP by CACP should be changed to limit it to “Minimum.” This would include only the variable costs, namely inputs and wages (including family labour).
- *De-Licensing*: Remove licensing controls and *de-reserve* all agro-based and food-processing industries including sugar, its derivatives and milk processing, in a time-bound manner.
  - Phase out of controls on **sugar** and also removal of sugar from the PDS. Phase out State advised prices for sugarcane along with sugar de-control.
  - Remove the present restrictions on establishing new milk processing capacity under the **MMPO**.
  - De-reserve Roller Flour mills.
  - Remove rapeseed and groundnut processing units from SSI list.
  - De- reserve all pesticides and fungicides.
  - De-license and de-control fertiliser production.
- *Export De-Control*: Announce a policy renouncing the use of export restrictions on agricultural commodities. Domestic shortage should be met by imports, but not by imposing export controls.
  - Remove remaining restrictions on the export of agro-products.
- Lift the ban on **Futures Trading** and stocking of all agricultural commodities, and on institutional credit and finance for such activities.
- Amend Agricultural Produce Marketing Acts of States to allow direct purchase of grain and other produce from farmers by agro-produce trading, storage & processing companies.
- Remove all restrictions on supply of credit to agriculture trade and stocking.
- Support and promote provision of all types of insurance (health & hospitalisation, crop & weather) to farmers and other rural inhabitants.
  - Give income tax incentives to insurance companies for a specified promotional period (5 years say).
  - Allow 100% FDI in insurance for Agriculture and Rural areas.
- Modernise Information and Extension System for farmers.

- Overhaul the Agricultural R&D system so as to provide academic autonomy and peer review and replace the bureaucratic financial/administrative system with a modern system of professional management & accountability under the societies act.
- Remove spectrum fees, USO taxes and revenue shares & charges on rural telephony.
- Allow private sector access to telegraph wires and rural telegraph offices, at a minimal service charge, for provision of rural Internet access and Internet telephony.
- Remove all State taxes on production and marketing of cereals (including octroi).
- Remove all Central taxes on production and marketing of cereals and other food products.
- Tariff duties on import of wheat and rice should be brought down in line with the reduction in “peak” rates.
- Allow 49% FDI in Food Retailing. Such food retailers would also be free to sell other agro-based and rural industrial products.
- Integrate disparate food related laws into a single modern food regulatory act with a single food regulatory agency to be set up under this act.

These reforms will set the stage for large-scale entry of the private sector into agricultural procurement, transport, storage and processing. While these reforms are being phased in, two steps will have to be taken to start the process of replacing the FCI operations by private trade: (a) Privatisation of the existing assets of the FCI over and above those needed for Buffer stock operations. (b) Public-Private partnership in setting up modern food procurement, handling, storage and transport systems. The private parties would undertake the investment and running of facilities, while government would pay for the use of these facilities for the running of MSP related operation as per government-defined guidelines.



## **6 POST SCRIPT**

Since the initial draft of the paper and the circulation of its recommendations, the government has already undertaken a number of reforms.<sup>2</sup> These include the following:

In order to facilitate free trade and movement of food grains, and to enable the farmers to get better prices for their produce, achieve price stability and ensure availability of food grains in deficit areas, a Central Order titled, 'Removal of (Licensing Requirements, Stock Limits and Movement Restrictions) on Specified Foodstuffs Order, 2002 has been issued by the Government on 15-2-2002 according to which any dealer can freely buy, stock, sell, transport, distribute, dispose, acquire, use or consume any quantity of wheat, paddy/rice, coarse grains, sugar, edible oilseeds and edible oils and shall not require any license or permit therefore. Issue of any control order by the states under their delegated powers for regulating by licenses, permits or otherwise, the storage, transport, distribution, etc. of the specified commodities would henceforth require the prior concurrence of the Central Government. While these new measures can be considered to be steps in the right direction, more needs to be done at the State Government level to create an atmosphere of freedom among traders operating in this field. When the entire European Union is today one free trade area it is unfortunate that such hurdles exists restricting trade among various states in India.

In his budget speech for 2002-03 the Finance Minister proposed further decontrol and deregulation of agriculture along the following lines:

- Amendment of the Milk and Milk Products Control Order (MMPO) to remove restrictions on new milk processing capacity, while continuing to regulate health and safety conditions.
- Removal of small-scale industry reservations related to various agricultural equipment items.

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<sup>2</sup> Several of these recommendations were also made in the approach paper to the 10<sup>th</sup> Plan.

- Decimalization of the export of agricultural commodities and phasing out of remaining export controls.
- Expansion of futures and forward trading to cover all agricultural commodities.

In a further move towards price and distribution control, the compulsory levy on sugar was reduced from 15 to 10 per cent from March 1, 2002. Accordingly, the retail price of PDS sugar was fixed at Rs 13.50 per kg from March 1, 2002.

On 16<sup>th</sup> May 2002, the Cabinet Committee on Economic Affairs approved changes in the retention-pricing scheme for urea manufacturing units. The approved policy is aimed at bringing about improved energy consumption norms, higher capacity utilisation, reassessed production capacity and withdrawal of allowances based on plant vintage.

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