## CHAPTER 3.4

# PUBLIC DISTRIBUTION SYSTEM

3.4.1 A combination of good monsoon years and a policy of ensuring relatively higher returns on production of rice and wheat has ensured that the country has a surfeit of foodgrains accumulated in the godowns of the Food Corporation of India (FCI), far beyond the prescribed buffer stock norms. The problem facing the country today is not one of shortage of foodgrains but of managing the surplus. Ironically, even as the godowns of the FCI are overflowing, stray cases of starvation deaths are still being reported. A civilised society in the 21st century cannot allow this to happen.

3.4.2 Therefore, while there is need to produce adequate food grains domestically, supplementing with imports whenever required, it is also necessary to look at the food grain distribution network. The Public Distribution System (PDS) in the country facilitates the supply of food grains to the poor at a subsidised price. However, doubts have been raised about the efficacy and cost-effectiveness of the PDS, especially in the light of the growing food subsidy and food stocks. The PDS needs to be restructured and there is a need to explore the possibility of introducing innovative ideas such as smart cards, food credit/debit cards, food stamps and decentralized procurement, to eliminate hunger and make food available to the poor wherever they may be in cost-effective manner.

3.4.3 There are two aspects to the paradox of overflowing godowns and vulnerable sections of society not consuming adequate food. One is the issue of having enough purchasing power or income to buy food and the other is the access to food in terms of physical availability of food. Though the overall employment generation is closely connected to efficient economic growth, there are some issues that must be kept in mind. In remote, inaccessible and backward regions both job opportunities and access to food may be constrained. In such situations, food-for-work and related schemes are necessary. These may need to be supplemented by more innovative schemes like grain banks. Community grain banks can be set up in such areas from where the needy can borrow grain in times of need and repay the grain once the crisis is over. Natural disasters such as earthquakes also create conditions in which the Government must provide emergency assistance and the administration has to be alert to such situations. Finally, a minimal amount of social security must be provided to those who are old, sick or disabled and cannot take on work even if it is available. Special schemes must ensure that they do not go hungry.

### Changes in Food Consumption Pattern

3.4.4 Dramatic changes in food consumption patterns have taken place in India in the post Green Revolution period. Between 1972-73 and 1993-94, the food basket has become much more diversified, with the share of cereals seeing a dramatic decline of ten percentage points in most regions. At the all-India level, cereal consumption in the rural areas declined from 15.3 kg per capita per month in 1972-73, to 13.4 kg per capita per month in 1993-94. The corresponding decline in the urban areas was more modest — from 11.3 kg to 10.6 kg over the same period. At the same time, consumption of milk and meat products as well as vegetables and fruits has increased. Such changes are a natural outcome of economic development.

3.4.5 This trend towards a more diversified diet is also discernible among the poorest 25 per cent of the population. Thus although cereals continue to dominate food expenditures, over time their importance has decreased. At the same time, cereals have become cheaper in relation to other food groups. In rural Uttar Pradesh, for example, 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, the consumption of coarse cereals declined from 5.0 kg per capita per month in 1972-73 to 0.8 kg per capita per month. This was only partly offset by an increase in the per capita monthly consumption of rice from 2.6 kg to 3.5 kg and that of wheat from 6.1 kg to 8.1 kg. During the same period, the share of cereals in the total food expenditure among the lowest quartile income group in the state declined from 69 per cent to 49 per cent while that of milk, meat, vegetables and fruits increased from 7 to 12 per cent and that of other food items from 17 to 28 per cent.

3.4.6 Thus the growth of aggregate demand for cereals in the country can be said to have been kept in check due to two factors — slowdown in the pace of population growth and shift in consumer preference towards non-cereals. However, some of the studies 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. At the same time, other demand projections which take these changing preferences into account, come out with estimates which match the supply projections, indicating that the requirements of cereals will be adequately met by domestic supplies at least up to 2020. Thus there is no need for undue concern on this front.

## MSP and Food Procurement Policy

3.4.7 The stock of food grains available with the government agencies as on 1 July 2002 was 63.01 million tonnes (mt) — 21.94 mt of rice and 41.07 mt of wheat. This was well above the prescribed buffer stock norms.

3.4.8 While the changing demand patterns is one reason for the accumulation of surplus food grains, another factor is the tendency of 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) (Table 3.4.1). While this has given the farmers an incentive to produce more, it has raised the market prices and reduced the demand for cereals. Studies conducted at the National Council of Applied Economic Research, New Delhi, show that fixing of procurement prices at levels higher than the CACP's recommendations has led to the procurement of an additional quantity of 12.8 mt of wheat and 3.4 mt of rice. This points to the need to strictly adhere to the recommendations of the CACP. A realistic MSP will help promote the diversification of cropping patterns.

**Table-3.4.I**
**Procurement/Minimum Support Prices of Foodgrains (Rs/Qtl.)**

| Comm -odity | Quality | Crop/ Marketing Year | Price Recomm -ended by CACP | Price Announced by Government |
|---|---|---|---|---|
| 1.Paddy | FAQ | 1980-81 | 100 | 105 |
| | | 1981-82 | 115 | 115 |
| | | 1982-83 | 122 | 122 |
| | | 1983-84 | 132 | 132 |
| | | 1984-85 | 137 | 137 |
| | | 1985-86 | 140 | 142 |
| | | 1986-87 | 146 | 146 |
| | | 1987-88 | 150 | 150 |
| | | 1988-89 | 160 | 160 |
| | | 1989-90 | 172 | 185 |
| | | 1990-91 | 205 | 205 |
| | | 1991-92 | 235 | 230 |
| | | 1992-93 | 260 | 270 |
| | | 1993-94 | 310 | 310 |
| | | 1994-95 | 340 | 340 |
| | | 1995-96 | 355 | 360 |
| | | 1996-97 | 370 | 380 |
| | | 1997-98 | 415 | 415 |
| | | 1998-99 | 440 | 440 |
| | | 1999-00 | 465 | 490 |
| | | 2000-01 | 510 | 510 |
| | | 2001-02 | 520 | 530 |
| 2. Wheat | FAQ | 1980-81 | 117 | 117 |
| | | 1981-82 | 127 | 130 |
| | | 1982-83 | 142 | 142 |
| | | 1983-84 | 151 | 151 |

Table 3.4.1 (Contd.)

| Comm -odity | Quality | Crop/ Marketing Year | Price Recomm -ended by CACP | Price Announced by Government |
|---|---|---|---|---|
| | | 1984-85 | 155 | 152 |
| | | 1985-86 | 157 | 157 |
| | | 1986-87 | 162 | 162 |
| | | 1987-88 | 165 | 166 |
| | | 1988-89 | 173 | 173 |
| | | 1989-90 | 183 | 185 |
| | | 1990-91 | 200 | 215 |
| | | 1991-92 | 225 | 225 |
| | | 1992-93 | 245 | 250 |
| | | 1993-94 | 305 | 330 |
| | | 1994-95 | 350 | 350 |
| | | 1995-96 | 360 | 360 |
| | | 1996-97 | 380 | 380 |
| | | 1997-98 | 405 | 475 |
| | | 1998-99 | 455 | 510 |
| | | 1999-00 | 490 | 550 |
| | | 2000-01 | 550 | 580 |
| | | 2001-02 | 580 | 610 |

3.4.9 The system of MSP served the country well in the past three and a half decades but has started encountering certain problems in recent years. This is because the agricultural production scenario has undergone significant changes over the past four years. Many states, including formerly deficit states like Bihar, Assam and Uttar Pradesh, have reported surpluses of several agricultural commodities, especially cereals and this trend is likely to continue in the coming years as well. The average production of food grains, which was 187 mt during the Eighth Plan, is expected to have increased to 205 mt in the Ninth Plan. Thus, the increase in average total food production is in excess of the total food grains requirements of around 196 mt at the end of the Ninth Plan as worked out on the basis of normative approach.

3.4.10 The policy of recommending a relatively higher MSP for wheat and rice as compared to the MSP for other crops served the cause of the country well in the 1980s and 1990s. It helped exploit the opportunity created by the Green Revolution and led to much higher average productivity of these two crops, compared to the average productivity of pulses or coarse cereals. The higher MSP 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 achieve surpluses. However, the need to rethink this approach is overdue.

3.4.11 There should be a marked incentive for growing pulses and oilseeds by increasing the MSP of these crops. The MSP for oilseeds should not, however, exceed the long-term international price. It should also be noted that attempts to support prices of some oilseeds through public procurement met with limited success despite the huge resources invested in the process. In this connection, it would be desirable to introduce commodity-specific limits on food procurement operations based on indicators like total production of a commodity during the previous five years. Such limits on total procurement operations during the year should apply to all commodities, including rice and wheat. The CACP or some other suitable agency could be asked to work out a suitable criterion on which such limits can be based.

## Public Distribution System and Food Subsidy

3.4.12 It is now well recognised that the availability of food grains is not a sufficient condition to ensure food security to the poor. 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 – by raising the incomes or supplying food grains at subsidised prices. While employment generation programmes attempt the first solution, the PDS is the mechanism for the second option.

3.4.13 With a network of more than 4.62 lakh fair price shops (FPS) distributing commodities worth more than Rs 30,000 crore annually to about 160 million families, the PDS in India is perhaps the largest distribution network of its kind in the world. This huge network can play a more meaningful role only if it ensures the availability of food to the poor households.

3.4.14 All is not well with the PDS. The annual food subsidy involved in maintaining the system is huge (Table 3.4.2). The food subsidy bill for 2002-3 is budgeted at Rs. 21,200 crore, which works out to 5.2 per cent of total Central Government expenditure. The level of food subsidies as a proportion of total government expenditure has gone up from a level of 2.5 per cent or below in the early 1990s to more than 5 per cent today. The per capita food subsidy expenditure by the government in 2002-3 is estimated at around Rs. 200 or 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.

**Table-3.4.2**
**Food Subsidy of the Central Government**

| Year | Amount (Rs crore) | % of total Government Expenditure |
|---|---|---|
| 1990-91 | 2450 | 2.33 |
| 1991-92 | 2850 | 2.56 |
| 1992-93 | 2785 | 2.27 |
| 1993-94 | 5537 | 3.9 |
| 1994-95 | 4509 | 2.8 |
| 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 |

3.4.15 The high carrying cost of stocks in excess of the buffer norms pushes up the food subsidy bill and actually amounts to subsidy to the cereals producers/surplus farmers. The Expenditure Reforms Commission (ERC) has recommended that the cost of holding stocks in excess of the requirement for food security and for PDS could be reflected in the budget as producers' subsidy rather than consumer subsidy.

## Targeted Public Distribution System

3.4.16 The PDS in its original form was widely criticised for its failure to serve the below poverty line (BPL) population, its urban bias, negligible coverage in the states with the highest concentration of the rural poor and lack of transparent and accountable arrangements for delivery. Realising this, the government streamlined the system by issuing special cards to BPL families and selling food grains under PDS to them at specially subsidised prices with effect from June 1997.

3.4.17 Under this Targeted Public Distribution System (TPDS), each poor family was entitled to 10 kg of food grains per month at specially subsidised prices. This was expected to benefit about 60 million poor families. The state-wise poverty estimates of the Planning Commission, based on the methodology of the expert group on the estimation of the proportion and number of poor chaired by late Prof. Lakdawala, defined the number of poor in each state. The identification of the poor is done by the states. The emphasis is on including only the really poor and vulnerable sections of the society such as landless agricultural labourers, marginal farmers, artisans/craftsmen (potters, tappers, weavers, blacksmiths, carpenters etc.) in the rural areas and slum dwellers and daily wagers in the informal sector (porters, rickshaw pullers and hand cart pullers, fruit and flower sellers on the pavements etc.) in the urban areas.

3.4.18 In keeping with the consensus on increasing the allocation of food grains to the BPL category and to better target the food subsidy, the Government increased the allocation to BPL families from 10 kg to 20 kg per month at 50 per cent of economic cost from 1 April 2000. The allocation for above poverty line (APL) families was retained at the same level as June 1997 but the Central Issue Prices (CIP) was fixed at 100 per cent of economic cost from that date so that entire consumer subsidy could be directed towards the BPL population.

3.4.19 The number of BPL families increased with effect from 1 December 2000 because the base was shifted from the population projections of 1995 to the population projections of the Registrar General of India as on 1 March 2000. The change has resulted in increasing the number of BPL families to 65.2 million as against 59.6 million estimated when the TPDS was introduced. The allocation of foodgrains for the BPL category thus increased to 147 lakh tonnes per annum.

3.4.20 In order to reduce the excess foodgrains stocks with the FCI, the Government initiated the following measures under the TPDS from 12 July 2001:

1. The BPL allocation of food grains was increased from 20 kg to 25 kg per family per month with effect from July 2001. At Rs. 4.15 per kg for wheat and Rs. 5.65 per kg for rice, the CIP for BPL families is 48 per cent of the economic cost.

2. The Government decided to allocate food grains to APL families at the discounted rate of 70 per cent of the economic cost. The CIP of wheat was reduced from Rs. 830 per quintal to Rs. 610 per quintal and the CIP of rice reduced from Rs. 1,130 per quintal to Rs. 830 per quintal.

3.4.21 In addition, 25 kg of food grain was to be provided to the poorest of the poor families under the Antyodaya Anna Yojana at a highly subsidised rate of Rs. 2 per kg for wheat and Rs. 3 per kg for rice. The Public Distribution System (Control) Order 2001 was also promulgated which seeks to plug the loopholes in the PDS and make it more efficient and effective.

3.4.22 On 23 March 2002, the Government reduced the issue price for APL rice and wheat by Rs. 100 per quintal for a period of three months. The scale of issue for APL, BPL and Antyodaya households was also increased to 35 kg per month.

3.4.23 Cumulatively, the offtake under TPDS between April 2002 and June 2002 has been 23.54 lakh tonnes for rice and 16.09 lakh tonnes for wheat against 18.46 lakh tonnes and 9.87 lakh tonnes respecitvely for the corresponding period in 2001. Thus, there is a clear indication that offtake under TPDS has improved at the national level. However, the situation is not uniform across states and there are certain states where conditions need to be improved. For instance, between April 2001 and March 2002, total offtake of rice in Bihar was only 13.8 per cent of total allocation and in the case of wheat this was only 27.9 per cent.

## Restructuring of PDS

3.4.24 The following points need to be taken into consideration in order to make the implementation of TPDS more effective:

a) Items other than rice and wheat need to be excluded from the purview of TPDS. The main objective of providing food subsidy to the poor is to ensure food security. Since rice and wheat are the basic necessities for the poor, food subsidies must be restricted to these two commodities.

b) Sugar should be kept outside the purview of PDS. It should be decontrolled and the system of levy on sugar discontinued.

c) It is argued that encouraging production of coarse cereals in dry land areas can check environment damage like degradation of soil to some extent. However, there is difficulty in supplying coarse cereals through PDS and bringing them under the cover of food subsidy. The average shelf life of coarse grains is limited, making them unsuitable for long-term storage and distribution under PDS. The inclusion of coarse cereals under PDS cannot be taken up as a national level programme since there is no standard variety of coarse grain. However, initiatives on the part of state governments catering to the needs of specific localities are possible.

d) Kerosene oil is also supplied through PDS and is intended for the poor. However, there is large-scale diversion of this commodity and subsidised kerosene is used for adulteration with diesel. The subsidy on kerosene is thus cornered by the non-poor. A study of four states carried out by Indira Gandhi Institute for Development Research (IGIDR), Mumbai shows that there is huge leakage of kerosene meant for PDS. It is irrational, therefore, to continue to subsidise kerosene at such high rates and continue its distribution through the

PDS. The subsidy on kerosene should be phased out by raising its supply price under PDS while eliminating all domestic central (e.g. Cenvat) and state (e.g. sales tax) taxes on it so as to encourage private supply through petroleum retail outlets and small dealers rather than FPS. Alternately, if kerosene is to be retained under PDS, the extent of subsidy given should be reduced so that there is less incentive for diversion.

e) All further attempts to include more and more commodities under the coverage of food subsidy should be resisted.

f) The FPS should be permitted to sell all commodities (other than rice and wheat) at full market prices in order to ensure their economic viability.

g) The coverage of TPDS and food subsidy should be restricted to the BPL population. For the APL population, which has the purchasing power to buy food, the Government needs to only ensure the availability of food grains at a stable price in the market. Stability in food grain prices should be ensured through the maintenance of buffer stock and open market operations of the FCI. Any attempt to revert to the old concept of a universal PDS will be a retrograde step and needs to be resisted. However, in the current situation, where the FCI has huge surplus stocks of foodgrains, it may be necessary to continue supply of cereals under PDS to the APL population at below economic cost as a temporary measure.

h) With the liberalisation of external sector, the operation of the buffer stock can be supplemented by timely exports and imports and this will effectively mean that a smaller buffer stock will be required.

i) Ration cards should not be used by the administration as an identification card for various purposes. That role should be assigned to multi-purpose identity cards.

j) There are several Plan schemes involving distribution of foodgrains which are in the nature of welfare or income transfer schemes. Such schemes could be merged and some sort of convergence achieved.

## Food Stamps and Food Credit Cards

3.4.25 In order to contain the level of food subsidy, major reforms are required in the system of marketing of food grains. All restrictions on inter-state movement of food grains should be removed once and for all. Second, the system of private trade and marketing of food grains must be strengthened. Third, the idea of having FPS across the length and breadth of the country should be looked into afresh. It may be more efficient to move towards a new system of providing food subsidy through the normal food supply shops (including the FPS), supplemented by new/additional FPS in remote and inaccessible regions where such shops do not exist. This could be achieved through the introduction of food stamps or the food credit card system.

3.4.26 Under the system of food stamps, the State Governments could issue a subsidy entitlement card (SEC) instead of issuing ration cards. The SEC should show, among other things, the number of members in a poor family and their age and indicate their entitlement level for food stamps.

3.4.27 There could, in principle, be different levels of entitlement based on age. All adult members from a poor family, for example, 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 for old and infirm people. The SEC will indicate the total number of food stamps a family is entitled to every month.

3.4.28 Each family would collect its monthly quota of food stamps from prescribed distribution centres on showing their SEC. They could then use these food stamps at any food supply shop to buy food grains (rice and wheat) at a price (Rs x) below the market price. The retailer will then be reimbursed by the State Government.

3.4.29 There is less scope for corruption under a system of food stamps. Under the existing system, FPS owners declare on paper that they have sold a certain quantity of food to the poor at subsidised prices when, in fact, they have made huge profits by selling the food at market prices. There is less possibility of such diversion of food supplies under the system of food stamps. 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 to display the selling price of foodgrains prominently in their shops.

3.4.30 Two potential problems with the system of food stamps need to be kept in mind while designing the system. There is a distinct possibility of food stamps being counterfeited. Secondly, reimbursement of subsidy to the participating retailers can run into logistical problems. These problems are, however, minuscule compared to the problem of physically procuring, storing, transporting and delivering foodgrains to FPS across the country by the FCI and the state food corporations/agencies.

3.4.31 The food stamp system can be introduced in phases. Initially food stamps can be allowed to be redeemed only at the FPS currently used by the consumer. This will allow food stamps to be printed with the identification number of the FPS so that the totals can be matched and cross-checked later, thus reducing the scope for counterfeiting. This could be followed by the consumer designating any participating retailer and having the identification number of that shop 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 problem of reimbursing money is a fraction of the problem of delivering food, it should not be too difficult to set up a re-imbursement system, perhaps by sub-contracting the task to a financial service provider. To reduce malpractices, there is an opinion that the 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 in areas where a proper market infrastructure exists. The conventional FPS system may have to be continued in remote and inaccessible areas. A food coupon system for distribution of rice and kerosene through PDS was introduced in Andhra Pradesh in 1998-99. Particulars regarding the scheme are in Box 3.4.1.

**BOX 3.4.1 :The Andhra Pradesh Experiment**

A food coupon system for distribution of rice and kerosene through the public distribution system (PDS) was introduced in Andhra Pradesh during 1998-1999 in order to improve the delivery system for these two commodities. Under the scheme, mere possession of the card was not enough to draw PDS rice, wheat or kerosene. The cardholder, whose photo was affixed on the card has to be physically present when obtaining the coupons. Coupons are issued once a year and coupon holders are entitled to draw rice and kerosene on a monthly basis. To help the coupon holder draw rice and kerosene in easy instalments in a month, coupons are denominated in smaller quantities like 4 kg, 8 kg etc. The coupon holder/ beneficiary is aware of his entitlement. The State Government feels that this system has largely eliminated the scope of cheating by dealers by giving beneficiaries less than their entitlement. The coupon guarantees the stakeholder his right to draw a specific quantity every month. Rice or kerosene is not released unless the coupon is produced. This facilitates proper accounting of the actual quantity distributed in the month as it is calculated on the basis of 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. Introduction of the coupon system has also reduced the number of bogus cards or those with ineligible families by approximately eight lakh. This system has resulted in saving about 20,000 tonnes of rice and 7,100 kilo litres of kerosene every month. In financial terms, the exchequer has saved Rs. 9 crore per month on rice and Rs. 5.67 crore per month on kerosene as subsidy. The coupon system could be made more effective if the list of beneficiaries is computerised on the basis of FPS 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 counterfeiting of coupons by unscrupulous persons. Regular and staggered distribution of coupons could also prevent mischief and manipulation.

3.4.32 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. The card can have in-built security features that make it difficult, if not impossible, to trade.

3.4.33 A food credit card system could be a superior alternative to the prevalent system of FPS and perhaps even a food stamp system. The customers could use food credit/debit cards to buy subsidised food grains from the market and the retailers can claim the subsidy from the Government. Though the initial cost of issuing a food credit card and setting up a leakage-proof system are likely to be higher than for the existing ration card, the running costs of the system may be lower as the credit/debit card can be used in existing retail shops that accept such cards. Besides, the cost would also be compensated 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 persuaded to set up and run the food credit/debit card system at a cost, in return for advertisement rights to this social service. Specialised credit card companies can also ensure that the food retailers are reimbursed on time, thus giving them an incentive to sell food to the poor.

3.4.34 The food debit/credit card can also have the in-built flexibility of changing over from a food subsidy to an income transfer system if there is a subsequent change in the policy. The card can also be made applicable to all cereals including coarse grains. If desired, a different subsidy rate can be specified for different cereals. As coarse cereals are consumed mainly by the poor, the smart card will allow some self-selecting/self-targeting features to be built into the system.

3.4.35 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 adding the food grain to the food credit of the worker. Once this system is set up, it can also be used to provide social security to the old, infirm, disabled and handicapped citizens. This could be done by programming a higher subsidy proportion for such groups. However, in the rural areas the smart card system may have to be preceded by a food stamp system.

### Decentralisation of Operations

3.4.36 One possibility that could be considered is that based on the net consumer subsidy spent on providing food through the PDS, the Central budget should make a provision for a national food subsidy. This subsidy can be distributed among the states according to a prescribed formula based on the latest available data and updated poverty ratios. It would then be left to individual State Governments to determine the quantum of food subsidy based on the contribution they get from the Centre and their own contribution. The Centre could also agree to enhance the quantum of its contribution to compensate for any increase in prices. The new system will also result in a more equitable distribution of the benefits of food subsidy among different states. *However, it needs to be ensured that the food subsidy distributed by the Centre is utilised for the purpose for which it is meant and not diverted for other purposes.*

3.4.37 The operation of the PDS should be the responsibility of the State Governments. If a State Government feels that its administrative and managerial resources are inadequate to the task, it can sub-contract this job to other State agencies or the private sector. The role of the Centre should be limited to the allocation of food subsidy to the states and the maintenance of buffer stock through the FCI. Procurement, storage and distribution of food grains should be the joint responsibility of the central and state governments. The scheme of decentralised procurement, which is in operation, should be promoted and more states should be encouraged to adopt this scheme.

3.4. 38 The issue of food stamps will be the responsibility of the state governments. The subsidy in each food stamp could be decided by them based on the resources available. The state's own resources could supplement the subsidy provided by the Centre.

3.4.39 As long as the Centre fixes the issue price, changes should be made every time there is a revision in the procurement price of food grains. This will drive home the message to the public that the issue price is being raised because of an increase in the cost of production. There will, then, be less resistance to increase in the issue price. One reason for the burgeoning food subsidy bill is the non-neutralisation of the increase in MSP by a corresponding increase in issue prices. However, any attempt to increase the issue price following an increase in MSP has the undesirable effect of reducing the offtake, leading to further accumulation of excess stocks.

3.4.40 There is a suggestion that the task of fixing the issue price of foodgrains, deciding the quantum of food subsidy per food stamp, amount of food grains to be supplied to beneficiaries etc. may be left to the discretion of state governments, whose decision will be based on their individual capacities. The implications of this suggestion need further examination.

## Operation of Buffer Stocks and FCI

3.4.41 The high level of market prices of wheat now prevailing in India are primarily due to the rise in procurement prices over the past three years and taxes and charges on cereals imposed by state governments. The difference between the economic cost of FCI and the market price also contributes to the higher price. Notwithstanding the criticisms against FCI, it has to be admitted that it does play an important role in the country's food economy. The contribution of the FCI would be enhanced if there were greater competition in food trade from other public, co-operative and private organisations.

3.4.42 While the provision of food subsidy is an important element of the food security system in India, the food procurement and buffer stock operations play an equally important role. Since agricultural production tends to fluctuate due to climatic factors, it is necessary to maintain an adequate level of buffer stock to ensure stability in food grain prices. Based on a study done by Dr Kirit Parikh of the IGIDR, the ERC has recommended that a food security buffer stock of 10 mt – 4 mt of wheat and 6 mt of rice - would be adequate. The present levels of buffer stocks in the country are far in excess of requirements and create more economic instability than stability.

3.4.43 The FCI can maintain a minimum level of buffer stock and then undertake open market operations within a prescribed price band. It can release stocks in the open market when there are shortages and prices increase. It 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. Recognising the fact that a high level of buffer stock can itself contribute to inflationary pressures, the FCI can be instructed to limit its role to more manageable and optimum levels in the future. Presently, the level of food credit is more than Rs. 40,000 crore. Large food credit will have significant macro economic implications since it has a significant impact on money supply.

3.4.44 The FCI could also play a role in the international market for food grains by importing when stocks are low and exporting food grains when there are surplus stocks. The private sector and the farmers must also be allowed a role in the export of food grains, by removing all restrictions on the export of wheat and rice. In fact, there should be no restriction on the export of any agricultural commodity. The lifting of quantitative restrictions on the import of wheat and rice has been accompanied by import duties that are well above the general 'peak' rate of duty of 35 per cent. The relationship between these duties and the 'peak' rate can be defined in the context of the continuing custom duty reform.

3.4.45 The FCI will continue to play a vital role in the maintenance of the buffer stock to insulate the food economy from fluctuations in food grains production. However, its monopoly in food procurement must be ended by allowing State procurement agencies to be set up in all states. Restrictions on private trade must be lifted so that competitive forces can have a free play, thus reducing intermediation costs. Curbs on the entry of modern food procurement, transport, processing and distribution companies must also be removed, so that the agriculture sector can benefit from modern management practices like silo storage, logistics and large-scale processing. This will benefit both farmers and consumers.

3.4.46 It has also to be noted that when procurement prices for food grains are fixed, these should not be pegged at such a high level that it leads to accumulation of surplus stocks in FCI godowns. In this connection, there is a need to strictly adhere to the recommendations of the CACP and not resort to fixation of procurement prices much in excess of the estimated costs of production.

3.4.47 The high market prices of wheat now prevailing in India are due to primarily 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 FCI and the market price also contributes to the higher price.

3.4.48 A study by the Indian Statistical Institute researchers using NSS data for 1993-4 along with other data for Andhra Pradesh and 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 per cent to 58.5 per cent of the total food subsidy (i.e. Centre and State) reaches the PDS consumers. A major part of the subsidy is lost in the process of administering it. While leakages (grains shown as issued by the PDS system minus grains actually received by households from PDS) can range from 15 per cent to 28 per cent of the subsidy, another 16 per cent to 26.5 per cent of the subsidy is eaten up by the inefficiency of the Government procurement and distribution system (FCI plus State level) relative to the market.

3.4.49 The contribution of FCI would be enhanced if there were greater competition in food trade from other public, co-operative and private organisations. Most of FCI's storage godowns 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. The quality of the FCI's food stocks is also questionable. As noted in the approach paper to the Tenth Plan, a June 2000 research report found that half of FCI's grain stocks is at least two years' old, 30 per cent between two and four years old, and some grain as old as 16 years[1]. Immediate disposal of all the stocks that are more than three years old should be undertaken. A credible physical audit of the FCI stocks is necessary.

3.4.50 The main objective of the food procurement policy should be the stabilisation of food prices rather than subsidising producers. Currently, even though food subsidies are provided to the BPL population, the PDS meets only a limited part of their food requirements. They depend on private traders to meet the rest of their requirements. This makes the objective of stabilisation of foodgrain prices even more important. Such stabilisation has to be achieved by appropriate buffer stock operations and market interventions by the FCI.

### Private Trade in Foodgrains

3.4.51 The FCI should gradually hand over its role of MSP-related procurement to private trade. This requires a comprehensive reform of policies, rules and procedures to strengthen the role of the modern private sector in the matter of storage, distribution and processing of foodgrains. Various restrictions that inhibit private initiatives in this regard need to be removed so that the private sector has an incentive to make huge investment in grain handling operations and food processing. There is urgent need to upgrade market infrastructure, cold storage facilities, mandi facilities and roads, areas in which the private sector should be encouraged to make productive investment.

3.4.52 While the National Policy on Handling, Storage and Transportation of Food Grains 2000 is timely, its success is largely dependent upon highly regulated and controlled sectors of the economy. Under the policy, integrated bulk handling facilities with silos of large capacity for wheat along with testing facilities for quality control would be created for the storage of foodgrains procured by the FCI at about 20 locations in producing and consuming areas as well as a few port towns. These facilities, including the infrastructure for bulk transportation

[1] By the World Bank.

to these centres, will be created and maintained by the private sector under the overall supervision of the FCI. Private sector participation in this sector will be encouraged through measures such as Build-Own-Operate-Transfer (BOOT), Build-Own-Lease-Transfer (BOLT), Build-Own-Operate (BOO), Lease-Develop-Operate (LDO), joint ventures etc. It is proposed to provide several fiscal incentives to make the scheme a success.

3.4.53 However, the success of the proposed public-private partnerships will be limited unless the existing controls on storage and movement of foodgrains and other essential commodities is suitably relaxed. Many of these controls have outlived their utility since the country has achieved self-sufficiency in food and their continuance hampers the market from performing its productive and commercial role. There is an urgent need to withdraw them, and legislative and administrative measures to ensure this need to be accorded top priority.

3.4.54 The Essential Commodities Act, 1955 is one legislation that is the source of stifling controls. A large number of permits and licences are required to be obtained from the authorities under the Act, periodic returns have to be submitted and regular inspections are carried out, all of which add to transaction costs. Some notifications under the Act restrict the movement of goods from the surplus states to deficit states. These controls and restrictions, and the constant threat of arrest in case of violations, discourage private companies from producing and distributing essential commodities, thus denying the food sector the benefits of economies of scale and modernisation.

3.4.55 In order to facilitate the free trade and movement of foodgrains, the Government issued a Control Order tilted, 'Removal of (Licensing Requirements, Stock Limits and Movement Restrictions) on Specified Foodstuffs Order, 2002' on 15 February 2002. The Order allows any dealer to 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, without a licence or permit. State governments would require the Centre's prior permission before issuing any order for regulating, by licences or permits, the storage, transport and distribution of the specified commodities.

3.4.56 According to the Expenditure Reforms Commission, the induction of the private sector in procurement operations will indirectly lead to a reduction in the cost of procurement to FCI. The report points out that even though the MSP for wheat in 1999-00 was only Rs. 550 per quintal, the costs by way of statutory and non-statutory charges paid to agencies in Punjab and Haryana totalled up to an additional Rs. 60 per quintal. Of these, mandi charges were Rs. 28.46 per quintal and the purchase tax was Rs. 17.12 per quintal. Some of these charges are in the nature of economic costs and unavoidable like mandi labour costs, local transport costs, forwarding charges etc. However, the remaining items clearly reflect an attempt by the State Government and various other agencies involved in the process to maximise the returns to themselves on these transactions.

3.4.57 The following combination of policy reforms can benefit both farmers and food consumers:

- **Single Market**
  - ☐ Amend the Essential Commodities Act to make it an emergency provision that will have to be formally invoked by a notification for a limited period.
  - ☐ Enact a Central Act to ban controls on movement within and between States.
  - ☐ Abolish octroi and all sorts of taxes/levies on food articles.
- **Competitive Grain Procurement**
  - ☐ Phase out all forms of monopoly purchase.
  - ☐ State Food Corporations should be allowed and encouraged to operate in all States.
  - ☐ The role of private agencies in food procurement activities should be gradually enhanced.

- **De-Licensing**
  - ☐ Remove licensing controls and de-reserve all agro-based and food-processing industries in a time-bound manner.
  - ☐ Phase out controls on sugar and its by-products and also remove sugar from the PDS.
  - ☐ Remove the present restrictions on establishing new milk processing capacity under the Milk and Milk Products Order, (MMPO).
  - ☐ De-reserve roller flour mills.
  - ☐ Remove rapeseed and groundnut processing units from the small-scale industries (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 shortages should be met by imports, not by imposing export controls.
  - ☐ Remove all restrictions (e.g. canalisation) 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 the Agricultural Produce Marketing Acts of states to allow direct purchase of grain and other produce from farmers by agro-produce trading, storage and processing companies.
- Support and promote provision of all types of insurance (health and hospitalisation, crop and weather) to farmers and other rural inhabitants.
  - ☐ Give income tax incentives to insurance companies for a specified promotional period (five years).
  - ☐ Allow 100 per cent foreign direct investment (FDI) in insurance for agriculture and rural areas.
- Modernise the information and extension system for farmers.
- Overhaul the agricultural research and development system so as to replace the bureaucratic financial/administrative system with a modern system of professional management and accountability under the Societies Act and provide for academic autonomy and peer review.
- Remove all central and state taxes on production and marketing of cereals and other food products.
- Allow 26 per cent FDI in food retailing. Food retailers would also be free to sell other agro-based and rural industrial products.

3.4.58 These reforms will set the stage for large-scale entry of the private sector into agricultural procurement. While these reforms are being introduced in a phased manner, the following steps can be considered to start the process of replacing the FCI operations by private trade:

- Public-private partnerships in setting up modern food procurement, handling, storage and transport systems.
- The Government should operate a market intervention scheme with the support of private trade – purchasing from the farmers when prices are low and offloading in the market when prices are high.
- The number of commodities covered under the procurement scheme should be reduced till finally the scheme is restricted to only rice and wheat. The procurement policy must not be extended to cover more and more commodities.

3.4.59 State governments should be asked to immediately do away with all taxes on foodgrains. This is an unnecessary addition to the price of the essential food items, which, in turn, adds to the burden of subsidy. This should be accompanied by ending the compulsory routing of agro-commodities through regulated grain markets/*mandis*. Farmers must be allowed to borrow working capital from the banks against hypothecation of their stocks, a step that is long overdue. All banks and financial institutions must be instructed to grant this facility. The same facility must be provided to traders as well.

### PDS Plan Schemes

3.4.60 While the provision for food subsidy is made in the non-Plan budget of the Central Government, the Planning Commission provides funds under its Plan programmes for the following schemes to strengthen the operational machinery of the PDS: construction of Godowns; purchase of mobile vans/trucks; and training, research and monitoring. The godowns scheme was intended to assist State Governments and Union Territories in the construction of small godowns of up to 2,000-tonnes capacity. The mobile vans scheme provided financial assistance for the purchase of mobile vans/trucks for distributing essential commodities in rural/hilly/remote and other disadvantaged areas where it is not feasible or viable to set up regular FPS. The training scheme aims at strengthening and upgrading the skills of personnel managing the PDS and to improve the management of supplies. The efforts of the State Governments/Union Territory administrations and Civil Supplies Corporations etc. are supplemented by providing financial assistance for organising training programmes on PDS. Evaluation studies and research studies on various aspects of PDS are also sponsored under the scheme. The Plan outlay and expenditure under the schemes are shown in Table 3.4.3.

**Table-3.4.3**
**PDS Schemes - Plan Outlay/Expenditure (Rs crore)**

| Scheme | 1999-00 Actual | 2000-01 Actual | 2001-02 (R.E) |
|---|---|---|---|
| 1. Construction of Godowns | 22.29 | 8 | 11.5 |
| 2. Purchase of Vans/Trucks | 1.06 | 0.23 | 0.3 |
| 3. Training, Research and Monitoring | 0.36 | 0.16 | 0.5 |
| **TOTAL** | **23.71** | **8.39** | **12.3** |

3.4.61 According to a report of the Comptroller and Auditor General (CAG) between 1983 and 1999, the Government of India released Rs. 58.73 crore and Rs. 62.96 crore for the construction of godowns and purchase of mobile vans respectively. However, the response of State Governments was lukewarm, at best. A large number of godowns for which the Central Government provided funds were not constructed and many were not put to the intended use. Many state governments did not purchase mobile vans. A large number of vans were out of order or used for purposes other than the doorstep delivery of foodgrains.

3.4.62 A decision has, therefore, been taken to abolish the schemes for construction of godowns and purchase of vans during the Tenth Plan. The funds under the training, research and monitoring scheme need to be diverted towards sponsoring studies on the operation and viability of the food security system. A pilot project for the introduction of smart cards in the PDS is proposed to be taken up for implementation during the Tenth Plan. The schemewise break up of Tenth Plan outlay of Department of Food and Public Distribution is given in the Appendix.

### Grain Bank Scheme

3.4.63 As a part of the Government's efforts to prevent deaths of children in remote and backward tribal areas due to malnutrition, a Village Grain Banks scheme was launched in 1996-97. A one-time grant is provided by the Ministry of Tribal Affairs towards the purchase of grains, at the rate of one quintal per family, storage facilities for the grains and purchase of weights and scales. The funds are provided through TRIFED, which acts as the canalising agency. The bank is managed by the village committee, which is elected by the beneficiaries themselves who are also members of the bank. They can borrow grains from the grain banks during times of scarcity.

3.4.64 A grain bank scheme is also being run under the aegis of the Department of Rural Development in the Jhabua district of Madhya Pradesh. The scheme was launched in 1995 on a pilot basis in 18 villages. The performance of the scheme in the last two years encouraged DRDA to adopt the strategy in all villages under the Integrated Watershed Development Programme. Presently, there are 184 grain banks functioning in watershed areas and these are managed by the community itself. In the last season, 12,363 families took loans from the grain bank.

3.4.65 The Madhya Pradesh government has proposed the evolution of community-based support systems to substitute/supplement PDS operations in areas where PDS does not exist. Self-help groups of BPL families will be formed and charged a membership fee of Rs. 50. These groups will be eligible to receive supplies of foodgrains and other infrastructure-based assistance from the government. They will organise activities, under the grain bank scheme, to develop degraded lands on the periphery of forests with significant Adivasi population through food for work programmes. The grain banks will be managed by committees of women beneficiaries to be called *anaj samitis*. The government will give a one-time supply of 100 kg of wheat or rice to each grain bank. The grain will be stored by the traditional method in earthen *kothas* constructed with local material and free family labour.

3.4.66 Grain banks can be set up in remote and isolated areas beyond the reach of PDS and in regions where there is inadequate employment generation such as in tribal and forest areas. In order to be successful, the grain bank scheme has to be combined with a food for work programme, so as to ensure generation of income, which is necessary in order to ensure repayment of borrowed grain by the beneficiaries.

3.4.67 A grain bank scheme should function with minimum interference on the part of the government. It should be run under the supervision of self-help groups headed by women. The moment beneficiaries realise that grain under the scheme is being supplied by the government, there will be a tendency not to repay. However, the government may provide the initial supply of grain and the storage capacity may be created under the food for work programmes. The scheme may work well during times of surplus. Besides, a system of food distribution running parallel with the current PDS could result in lack of accountability on the part of both. In the long-run, therefore, there should be only one system.

## THE PATH AHEAD

3.4.68 Despite the huge stock of food grains available in FCI godowns, stray cases of hunger deaths are still being reported. The food distribution system, therefore, needs to be reformed and made more efficient. The present system could be replaced by a system of food stamps and eventually by a food credit card system. The excess stocks of food grains that have accumulated with the Government is partly a result of the high MSP which often exceeded the levels recommended by the CACP. There is, therefore, a need to adhere to the recommendations of the CACP in this regard. The MSP should encourage diversification of agricultural production.

3.4.69 Surveys by the National Sample Survey Organisation (NSSO) show that consumers today prefer to consume less of cereals and more of fruits, vegetables and animal products than before. This changing food consumption pattern may also have contributed to the accumulation of surplus food grain stocks.

3.4.70 Studies show that a buffer stock of 10 mt is adequate to meet food security needs. The FCI could intervene in the market by timely sales and purchases to maintain stability in food grain prices. The buffer stocking agency could also take resort to exports and imports of food grains as per requirements. The scheme for decentralised procurement of food grains should be encouraged and more states could be brought under its fold. Similarly, the operation of the PDS could be decentralised with the states taking their own decisions regarding issue prices, quantum of food grains to be supplied etc. The national food subsidy could be distributed among the states according to a prescribed formula.

3.4.71 The private sector should play an enhanced role in the food distribution system. The Essential Commodities Act should be amended to make it an emergency provision that will have to be formally invoked by notification for a limited period for specific commodities. All restrictions on inter-state movement of food grains should be removed. Octroi and all sorts of taxes/levies on food articles should be eliminated. The ban on futures trading in all agricultural commodities should be lifted. Twenty-six per cent FDI should be allowed in food retailing along with 100 per cent FDI in insurance for agriculture and rural areas. These and other policy recommendations outlined in the chapter would make the food distribution system in the country more vibrant and efficient and capable of meeting the requirements of a liberalised economy.