International Trade and Domestic Reforms: The Case of Food Subsidies in India

Raghbendra Jha, Australia South Asia Research Centre, Australian National University

All correspondence to:
Prof. Raghbendra Jha,
Australia South Asia Research Centre,
Arndt-Corden Department of Economics,
College of Asia and the Pacific,
H.C. Coombs Building (09)
Australian National University,
Canberra, ACT 0200, Australia
Phone: + 61 2 6125 2683; Fax: + 61 2 6125 0443; Email: r.jha@anu.edu.au

Background

The ninth ministerial conference of the WTO held in Bali has been projected in the Indian media as a triumph of India's food security policy.

But this view could be misplaced on two counts. First, there's what India actually negotiated at Bali: an interim 'peace clause' (with no guarantee of successful closure after December 2017) that bars the WTO member-states from raising disputes with India vis-à-vis its food subsidies, in return for a legally binding agreement on trade facilitation.

Second, any subsequent agreement may put at risk India's ability to regulate its minimum support prices (MSP) for major crops such as rice, wheat and maize.

Why does India need Food Subsidies?

Two reasons: 1. Welfare and 2. Strategic

Welfare:

Although rapid economic growth in India has led to steady progress in reducing poverty, malnutrition remains widespread, and ensuring food access for the poor remains a priority. In fact calorie intake has actually declined between 1993-94 and 2009-10.

Till 1992 the Public Distribution Scheme (PDS) was a general entitlement scheme for all consumers without any specific target. Although the food subsidy under the PDS was large, its effects on the poor were minimal.

In response to the growing fiscal deficit and concerns for reducing subsidies and increased expenditures, the government redesigned the PDS in 1997.

The new program, TPDS (Targeted PDS), aimed to reduce subsidies to the non-poor and enhance those to the poor.

TPDS distinguishes between households that fall below the poverty line (BPL households) and those above the official state-specific poverty lines (APL). State governments are responsible for identifying the poor households, using multiple criteria including indicators such as land operated/owned, ownership of TVs, motorcycles and other durables, among others.

Strategic

PDS was used as a rationing device by the colonial government during WWII.

Following widespread crop failures in the mid 1960s India needed to import grain (particularly wheat) from the US under a program called Public Law 480 (PL 480).

There was widespread resentment in India against this particularly from 1968 when President Lyndon Johnson held off PL 480 food shipments off Mumbai harbor until India voted with it at the UN and triggered India's desire to achieve food self-sufficiency. India reacted to this by not only expanding the PDS but also setting up an elaborate system of grain procurement and buffer stocks at the Food Corporation of India.

That desire to not allow any outside power to interfere with its food security played itself out in the recently concluded WTO discussions in Bali, where India opposed a push by the US and others to limit the size of its food subsidy.

Policy Imperatives

But having won that battle, India must now try and modernize its food security system — for its own sake, rather than under pressure from the WTO.

Why?

Subsidy Burden and Inefficiency of operation

India's food subsidy bill has risen considerably in the last few years because of open-ended grain purchases at high minimum support prices, large and costly stock holdings and a food distribution system riddled with inefficiencies and leakages. The government now buys a major share of the marketed grain — 50 per cent in the case of wheat and 40 per cent in the case of rice.

It is now holding almost 80 million tonnes of grain, more than twice the strategic buffer stock needed. The new food security act will expand the scope and coverage of the TPDS.

According to the Wall Street Journal (2 September 2013) this Right to Food Act will increase India's annual food subsidy bill by US$ 4 billion to US$ 20 billion.

Planning Commission reports that 58 per cent of subsidized foodgrain does not reach BPL families because of identification errors, non- transparent operations and unethical practices in the implementation of TDPS. Add to it the high cost of handling foodgrains, and the government ends up spending Rs 8.5 to transfer one rupee to the poor (our estimates for AP, Maharashtra and Rajasthan for 2007-08 based on Jha et. al. 2013).

At the national level implementation of the PDS is plagued by large errors of exclusion and inclusion and ghost cards. The economic costs of grains are higher than the market prices in most states. Only 23 per cent of sample fair price shops (FPSs) are viable. The rest survive on leakages and diversions of subsidized grains.

Policy Options

In the intermediate run India can successfully defend its food subsidy program only if it can be convincingly demonstrated that the TPDS is having a significant impact on under-nutrition. Jha et. al. 2011 demonstrate that real income transfers through the PDS can have a very significant impact on nutritional intake.

Hence, it is even more important to get the TPDS story right.

Policy options:

1. Universal TPDS not an option since the poor will be disadvantaged.
2. Right to Food not an option since, among other reasons, it will very significantly increase the fiscal deficit and disrupt grain markets.
3. It is important to increase the margins for FPS sellers. Currently (2007-08 data) the shopkeeper gets a paltry margin of 7 paise per kg of wheat sold to a BPL household, as compared with a margin of Rs 1.97 for selling this amount in the open market.
4. TPDS performance varies considerably across the nation. Southern states, particularly Tamil Nadu, do very well. Chattisgarh and some other states are improving their performance whereas the Northern and Eastern states continue to underperform.
5. Hence it is imperative to disseminate best governance practices with respect to TPDS throughout the country.
6. Only a short window of less than four years to get all this right.

References:

Jha, R., Bhattacharyya, S. and R. Gaiha (2011) “Social safety nets and nutrient deprivation: An analysis of the National Rural Employment Guarantee Program and the Public Distribution
System in India” *Journal of Asian Economics*, vol. 22, pp. 189-201.

Jha, R., Gaiha, R., Pandey, M. and N. Kaicker (2013) “Food subsidy, income transfer and the poor: A comparative analysis of the public distribution system in India’s states” *Journal of Policy Modeling*, vol. 35, pp. 887-908.