

Financial and Distributional Implications of the Food Security Law

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The financial implications of the National Food Security Bill, which has now become law, are going to be huge. This analysis points out that one needs to take into account not only the cost of the food subsidy but also the costs of setting up or running new institutions and bureaucracies, and the costs that are likely to arise if there are political pressures to protect the existing beneficiaries. There are still more imponderables, and the final cost could add up to much more than what is now estimated.

The National Food Security Bill (NFSB) which in mid-September was gazetted as the National Food Security Act (NFSA) is an important effort to ensure that the majority of India's population has access to an adequate quantity of food at affordable prices. This note examines the financial consequences of the revised NFSB, which has been passed by Parliament. Our analysis suggests that the NFSB needs to be carefully evaluated to take into account not only the cost of food subsidy but also the additional costs of setting up or running new institutions and bureaucracies, and the additional costs that are likely to arise if there are political pressures to protect the existing beneficiaries, many of whom are not grandfathered in the bill. When these are taken into account, the NFSA may entail significantly higher burdens than currently envisaged.

The food subsidy cost of implementing the amended NFSB is estimated at Rs 1,24,502 crore for 2013-14. It is calculated as [economic cost-issue price] × [foodgrain requirement]. The "economic" cost computed by the Food Corporation of India (FCI) includes in addition to the minimum support price (MSP), handling, storage, and distribution costs. The calculation assumes a total coverage of 75% of the rural population and 50% of the urban population. The individuals identified as "covered" or "included" are entitled to 5 kg/person/month of foodgrains (wheat and rice combined), with an issue price of Rs 2 and Rs 3 per kg for wheat and rice, respectively. The state-wise inclusion ratios are determined by the Planning Commission based on a national-level cut-off for per capita consumption to cover 75% and 67% of the

rural and urban populations, respectively. The Antyodaya Anna Yojana (AAY) households are entitled to an additional 10 kg of foodgrains per household. An additional allocation of foodgrains of 6.5 million tonnes for other welfare schemes (owss) is also included in the revised bill. This includes the provision of an additional 5 kg of grain per month to pregnant women and new mothers, and free mid-day meals in schools for children in the age group of 2-16 years. The total foodgrain requirement is estimated at 61.2 million tonnes, and this includes an additional 2.9 million tonnes to protect the allocation to states under the existing targeted public distribution system (TPDS). These estimates are in line with those of the department of food and public distribution (DOFPD).

The cost is estimated to increase to Rs 1,40,192 crore and Rs 1,57,701 crore in 2014-15 and 2015-16, respectively. This is assuming a 10% increase in MSPs and economic costs, and a 1.7% annual increase in total population (2.8% increase in urban, and 1.16% increase in rural, based on the average annual increase over 2001-11), with the other parameters remaining unchanged.

The "incremental" food subsidy over and above the existing TPDS is estimated at Rs 23,951 crore. This is equivalent to 0.2% of the gross domestic product (GDP). The incremental subsidy is the difference between the estimated cost of the NFSB and the cost of the existing TPDS at Rs 1,00,551 crore (based on 2000 population and 1993-94 poverty definition).

Other Expenditures

A commonly ignored fact is that even the revised NFSB entails significant new financial implications in addition to the food subsidy. These include, for example, the setting up or running of state food commissions and district grievance redressal offices (DGROs); expenditures on intra-state transportation of foodgrains; and cash benefits to pregnant and lactating women. Most of these expenditures would be incremental and is estimated with inputs from the DOFPD at roughly Rs 20,760

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crore annually (Table 1). The states would incur Rs 8,760 crore, and the remaining cost would be shared between the centre and states (based on a sharing arrangement to be determined). A one-time assistance may also be provided by the centre to the states to enable them set up the state food commissions and DGROs. The setting up of a national food commission is done away with in the revised bill. The states are allowed to rejig the existing infrastructure to run state food commissions and DGROs, but it is reasonable to assume that even if they decide not to create new infrastructure, they would still need to incur additional expenditures to beef up their existing facilities to implement the NFSA.

Table 1: Additional Annual Expenditures under NFSA (Rs crore)

	State	Shared b/w Centre and State	Total
District grievance redressal office	320		
State food commission	140		
Expenditure on intra-state transportation and handling of foodgrains	8,300		
Maternity benefit		12,000	
Total	8,760	12,000	20,760

Source: DOPFD.

These costs may still be an underestimate since they do not include many other expenditures stated in the bill. For example, the costs to be incurred for a new system for identification of beneficiaries, for strengthening the capacity of food and civil supplies corporations, for establishing institutionalised licensing for fair price shops (FPS), for setting up vigilance committees to monitor the implementation, for periodic audits of FPS, for food security allowances to be paid in the case of non-supply to entitled persons, and for funds to be provided by the central government to state governments if there is short supply of foodgrains. Whether or how much of these additional expenditures would be incremental needs to be carefully assessed.

The total incremental fiscal cost of implementing the NFSA over and above the existing TPDS (including the quantifiable expenditures in addition to the food subsidy) is thus estimated for 2013-14 at Rs 44,711 crore. The estimated total incremental fiscal cost for 2014-15 and

2015-16 are estimated at Rs 47,392 crore and Rs 50,591 crore, respectively.

Procurement and Its Effect

These estimates should be considered to be lower bounds for the actual expenditures to implement the bill. As discussed, there are various additional expenditure items stated in the bill, the incremental costs of which cannot easily be quantified ex ante. Further, the open-ended procurement policies of the government have implied that procurement has typically been much higher than the required quantity of foodgrains. For example, on average over the last 10 years between 2002-03 and 2011-12, procurement has been 40% higher than the offtake. If we add costs of 40% additional procurement to the incremental foodgrain requirement in the baseline NFSB, the estimated fiscal cost in 2013-14 can increase by Rs 4,925 crore. In addition, the estimated incremental food subsidy costs in the next two years could also be higher if the procurement of additional grains requires an increase in MSP of more than the 10% assumed in the baseline calculations. For example, if we assume a 20% increase in MSP (and economic cost) over 2013-14, the estimated incremental fiscal cost would increase substantially from the baseline by Rs 14,111 crore and Rs 15,720 crore in 2014-15 and 2015-16, respectively.

In addition to the aggregate fiscal costs of implementing the bill, there will be distributional implications as well – while some individuals may gain, some may lose, and others may have unchanged food expenditures. Although the procedure for identification of beneficiaries

will be left to the states and is not specified in the bill, if we assume a natural ordering, we can conduct some simple simulation exercises to see how the current TPDS in a typical state will map into the new regime (Table 2).¹

- All AAYs can be relabelled as “covered”. They will be as well off as under the current TPDS. Their entitlement will be unchanged at 7 kg per person per month, and they will pay the same issue price – Rs 2 and Rs 3 per kg for wheat and rice, respectively.
- The remaining below the poverty line (BPL) individuals (62%) will obtain 5 kg of foodgrains at a lower issue price than under the TPDS, but their entitlement will fall by 2 kg. Assuming current prices of wheat and rice (in the north zone at Rs 19 and Rs 27 per kg for wheat and rice, respectively) and assuming they will demand at least as much as under the TPDS, they will be strictly worse off (the loss on the 2 kg entitlement will outweigh the gain on the 5 kg).
- Seventy-one per cent of the above the poverty line (APL) group will move into the “covered” category. They will obtain 2 kg of additional foodgrains at a lower issue price relative to the TPDS, and will be strictly better off.
- The remaining APLs will move into “uncovered” and will be strictly worse off.
- Overall, out of the current population covered under the existing TPDS, 46% will be strictly better off, 14% will be equally better off, and 40% will be strictly worse off.

Cost of Including Everyone

If the implementation of the NFSA includes grandfathering of existing beneficiaries, the estimated fiscal cost could be higher

Table 2: Distributional Implications: Current TPDS vs NFSA

		Difference in Issue Price (TPDS-NFSA) (Rs/tonne)		Difference in Quantity (NFSA-TPDS) (Kg)
		Wheat	Rice	
AAY	→ Covered			
1,37,495	Unchanged expenditure	0	0	0
Other BPL persons in '000	→ Covered			
2,21,122	62% Increased expenditure	2,150	2,650	-2
APL persons	→ Covered			
4,52,151	71% Reduced expenditure	4,100	2,650	2
Remaining APL	→ No coverage			
1,81,312	29% Increased expenditure			

The estimates for TPDS are based on how it is currently operated (1993-94 poverty ratio and 2000 population). The non-AAY BPL persons who move to covered: they were getting 7 kg before at a higher issue price; they get 5 kg now at the lower issue price, but the gain on 5 kg outweighs the loss of entitlement of 2 kg, which they have to acquire now at the market price, accounting for a potential increase in the expenditures. APL persons moving out of coverage under NFSB have to obtain the grains through the market, and hence a potential increase in their expenditures.

than under the baseline scenario. As discussed, the existing APL beneficiaries who move out of coverage would be worse off, and the BPL individuals whose entitlement is reduced by 2 kg would also lose. If there is a political necessity to ensure no existing beneficiary is worse off, the estimated incremental food subsidy cost could increase by Rs 20,074 crore from Rs 23,951 crore to Rs 44,425 crore in 2013-14 (Table 3). In that case, the overall coverage of the NFSA to include the left-out APLs would increase from 67% to 82% of the total population.

Table 3: Cost of Grandfathering

Number of other BPLs moving into covered	2,21,122
Additional foodgrain per person (kg)	2
Total foodgrain (mn tonne)	5.31
Wheat	2.41
Rice	2.89
Subsidy (Rs/tonne)	
Wheat	15,952
Rice	20,786
Total subsidy bill (Rs crore)	
Wheat	3,852
Rice	6,012
Total	9,864
Number of APLs moving out of coverage	1,81,312
Additional foodgrain per persons (kg)	3
Total foodgrain (mn tonne)	6.53
Wheat	2.97
Rice	3.56
Subsidy to be borne by govt (Rs per tonne)	
Wheat	14,002
Rice	18,136
Total cost (Rs crore)	10,610
Total cost of grandfathering (Rs crore)	20,474
Incremental cost over TPDS (Rs crore)	23,951
Total including grandfathering (Rs crore)	44,425

Similarly, if implementation requires merging the current classification under the TPDS with new and more careful identification schemes, we should also consider the consequences of misclassification. Suppose everyone classified as BPL under the current scheme is automatically given “covered” status. However, everyone who currently holds a BPL card may not be truly poor. Even if a more rigorous identification scheme unearths the poorest 75% and 50% in rural and urban areas, respectively, there may still be political pressure to expand the size of those classified as covered to include those misclassified under the

current BPL system. Assuming the BPL classification has misclassified 25% of individuals when they are truly well off, and the misclassified are entrants into the NFSA (they were not a part of the TPDS offtake, but the NFSA entitlement at much lower issue prices is attractive enough for them), then the cost of subsidising them can be substantial and is estimated at Rs 11,301 crore (Table 4). The overall coverage would increase in the misclassification scenario to 74% of the total population (from 67% in the NFSA). The total incremental food subsidy cost in the baseline would increase from Rs 23,951 crore to Rs 35,252 crore.

Table 4: Misclassification in BPL: Fiscal Costs

	25% Leakage
Additional individuals ('000)	89,654
Total foodgrain per person (kg)	5
Total foodgrain req (mn tonne)	5
Wheat	2.4
Rice	2.9
Additional cost to govt (Rs per tonne)	
Wheat	18,102
Rice	23,436
Total subsidy bill (Rs crore)	
Wheat	4,431
Rice	6,871
Total	11,301
Baseline incremental cost of NFSA (Table 3) Rs crore	23,951
Baseline incremental cost + misclassification cost (Rs crore)	35,252
Baseline incremental cost + grandfathering + misclassification cost (Rs crore)	55,726
Baseline incremental cost + grandfathering + misclassification cost + additional misc expenditure (Rs crore)	76,486

Combining the grandfathering and misclassification scenarios could increase the incremental food subsidy cost of implementing the NFSA in 2013-14 to Rs 55,726 crore. If we include the additional expenditures to be incurred in setting up and running new bureaucracies, the estimated incremental expenditure attributable to the NFSA under the baseline could escalate to Rs 76,486 crore.

To summarise, the total incremental costs of implementing the NFSA over and above the TPDS could range from Rs 44,711 to Rs 76,486 crore in 2013-14. The smaller estimate is the baseline incremental costs, while the larger estimate includes the costs of grandfathering the existing beneficiaries and subsidising the BPLs who are currently misclassified. If we add to it the cost of procuring additional

grains according to historical norms, this would take the incremental costs of the NFSA to Rs 81,411 crore (0.7% of GDP). Table 5 provides a summary, which incorporates all the costs discussed so far.

Table 5: Summary Table: Incremental Cost of NFSA and NFSA-2 Relative to TPDS: 2013-14 (Rs crore)

	NFSA-2
1/ Baseline	23,951
Additional costs relative to baseline	
2/ Grandfathering	20,474
3/ Misclassification	11,301
4/ Miscellaneous expenditures	20,760
1+2/+3/+4/	76,486
% of GDP	0.67
5/40% additional procurement	4,925
1/+2+3/+4/+5/	81,411
% of GDP	0.72

Importantly, all these estimates should be seen as tentative and subject to revision because the precise costs of the current TPDS (and additional welfare) schemes are not easy to obtain. Given the experience that offtake increases when grain is offered at very low prices, and our estimates do not include various additional expenditures stated in the bill that are difficult to quantify, the rough estimates in this note are likely to be underestimates.

NOTE

- 1 We recognise that there is considerable variation across states in the implementation of the TPDS (with near universal PDS in many states). The exercise here simulates the distributional implications of moving into the NFSA assuming allocations and issue prices for BPL and APL as assumed by the central government. This exercise can be repeated in principle for different states taking into account the differences in implementation. The political necessity to protect existing beneficiaries is likely to have different implications for different states.

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