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# Reforms in Food Corporation of India

## *Case of Wheat Imports*

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## Background

After many years India is buying wheat in the international market. Indian government's decision to import wheat has emerged as a major politically sensitive issue. But unfortunately the debate surrounding this issue has remained sensational and shallow leaving the issue of urgency of reforms in India's food policy untouched.

The Food Corporation of India (FCI) was set up under the Food Corporation Act 1964, in order to fulfill certain objectives of the food policy. These objectives include effective price support operations for safeguarding the interests of the farmers, distribution of foodgrains all over the country through the Public Distribution System (PDS) and maintaining satisfactory level of operational and buffer stocks of foodgrains to ensure National Food Security.

The issue of wheat imports has given rise to number of controversies and highlights the extreme inefficiency of the FCI. This inefficiency has resulted into a high food subsidy bill. The gross anomalies in the system need to be balanced with certain radical reforms. Introduction of food stamps is a promising alternative in this regard. This has not only great potential of effective transfer of food subsidy to the poor, but also has the potential to benefit the poor local foodgrain producers.

## Sensational discourse missing the point

The issue of export and import of foodgrain has often been debated but the debate has always remained shallow. Different policies of the government have been blamed but the issue has never been deliberated with due seriousness.

*Export of foodgrains*

The Indian government exported huge quantities of food grains a few years back. The export price was lower than the price at which the government sold the food grains to the poorest in the society at subsidised rates through the fair price shops. In other words, the exports were subsidised. The food grain exported was of inferior quality, due to its storage in the government warehouses for long periods. It was used as cattle feed abroad. Thus, while millions of Indians remained hungry due to lack of purchasing power, Indian government subsidised the export.

The subsidised food grain export brought to light contradictions in India's food policy. The asymmetrical increase in support prices of wheat and rice distorted the domestic market for these food grains, driving out private traders. This has resulted in building up of huge stocks of wheat and rice with the state. The granary of the country was overflowing with a record stock of 65 metric tonne of food grains. Part of it had begun to rot. In the year 2001, the total quantity that rotted in the warehouses of the FCI, equaled the total food grain production of the country in 1971. The crisis was 'resolved' by exporting the food grains at subsidised rates.

Unfortunately, the issue was not addressed with due concern then. Some blamed the policies of liberalisation while others held government's export-oriented agricultural policy responsible for it without (strategically of course) looking into the subsidy component. The real culprit was the trade distorting intervention of the state in the domestic market through the FCI.

*Import of wheat*

Now the government has decided to import 3.5 million tonnes of wheat from Australia. It claims that this has been necessitated as the FCI's wheat stock is inadequate to meet the requirements of the PDS. The decision was taken two months ago and the first ship carrying half a million tonne of wheat has already reached a port in south India. This decision is being resisted as expected. It is causing ripples and might emerge as one of the most sensitive political issues. But again the debate has remained shallow. It blames the policies of 'liberalisation and globalisation' for this import, missing the crux of the issue.

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**Box 1: Monopoly and the Wheat Imports**

The debate on wheat imports has missed another important point of Governments monopoly in the wheat imports. Importing food is the right way to deal with domestic scarcity. The manner of intervention is, however, a throw back to the bad old days when agricultural trade flows were dictated by the government. What is striking about the present intervention is that the imports are on government account, canalised through government agencies and tariffs on these imports (only) have been removed (i.e., reduced to zero).

The state trading agencies do not have an inspiring record with respect to efficiency. Why should they receive a monopoly on these purchases?

More fundamentally, the choice to import (rather than to procure domestically) and the follow up decisions on the quantity and source of imports are always open to criticism for poor judgement and alleged favours shown (such as the relaxed quarantine norms for the Australian wheat imports). Indeed the government should not be in the import business at all. As the primary concern is to secure food supplies in the coastal states, the transparent and efficient mechanism would be for the government to float tenders asking for the supply of the required quantities of grain at the desired locations.

The winning contract would be the cheapest. It is immaterial who wins it — whether the FCI or a private player (Indian or foreign). It is irrelevant where they source it — from Indian farmers or from somewhere else. The import tariffs would apply to all imports of grain and not just to those on government account. The mechanism is simple and transparent. Even farmers would recognise that such contracts would not unfairly privilege foreign supplies. Supplies will be procured from the cheaper source.

The competition between FCI and private players would also ensure that farmer and consumer interests are not held hostage to FCI's costs.

*Source: Monopoly and wheat imports: Milind Murugkar & Bharat Ramswami,The Economic Times,12th May 2006*

*Details of the wheat import*

Imports of food grains, even for an agrarian country like India, need not be considered inherently bad – especially when one considers the miserable state of food security for the poor, who depend mainly on the open market to meet their food demand. For instance, unfavourable weather such as drought or farmers shifting to more profitable crops can be a legitimate justification for imports.

The statement made by the Union Agriculture Minister Sharad Pawar while defending the decision to import leads to the core of the issue. He said that it is cheaper to import wheat from Australia directly to Kerala in south India than to transport it from north India. This might appear strange, but it is a fact. And those opposing the imports do not recognise this.

The price of wheat in the southern states of India is roaring at a high of Rs 1200 (US$26.6) per quintal, while the landed cost of imported wheat from Australia (the first lot of half a million tonnes) is Rs 875 (US$19.4) per quintal. Wheat can be transported from the warehouses of the FCI, which are located in north India but that will be more costly. The economic cost of the FCI is the price at which it can sell its stock of wheat in open market without incurring losses. It is the price at which FCI procures wheat from the farmers plus the procurement incidentals and the cost of storage etc. This price is around Rs 925 (US$20.5) per quintal, which is higher than that of the imported Australian wheat. It is noteworthy that the FCI procures wheat at the Minimum Support Price (MSP) of Rs 650 (US$14.4) per quintal (recently the government announced additional bonus of Rs 50 (US$1.1) per quintal in order to compete with the private traders in procuring the wheat). The disparity between the economic cost and the MSP is indicative of the inefficiency in the FCI's operation. The inefficient FCI more than compensates for the long distance transportation of wheat from Australia to India.

Table 1 compares the MSP and the Economic Cost of the FCI for wheat:

**Table 1: Comparison of MSP and Economic cost of the FCI (Rs./US$)***

| Year | MSP | Economic cost |
|---|---|---|
| 1992-93 | 275/6.11 | 507/11.26 |
| 1993-94 | 330/7.33 | 532/11.82 |
| 1994-95 | 350/7.77 | 551/12.24 |
| 1995-96 | 360/8.00 | 584/12.97 |
| 1996-97 | 380/8.44 | 663/14.73 |
| 1997-98 | 475/10.55 | 798/17.73 |
| 1999-00 | 550/12.22 | 888/19.73 |
| 2000-01 | 580/12.88 | 858/19.06 |
| 2001-02 | 610/13.55 | 871/19.35 |

**Rs. 45= US$1*

*Source: Abhijit Sen Committee report on India's long-term food grain policy.*

## Failure of the FCI

The FCI established with a twin mandate to firstly assure farmers the MSP and, secondly, to ensure the food security of the poorest of the society by supplying subsidised food grains through the fair price shops run under the PDS, failed miserably.

The PDS has virtually collapsed in almost all the states in India due to rampant corruption. There are, however, exceptions like Kerala and Tamilnadu. It is an undisputed truth that most of the poor depend upon the market to meet their food grain requirements. Large portion of the food grains expected to be distributed through the PDS is diverted illegally to the open market. The grains, which reach the consumers through fair price shops, are often of inferior quality as the better quality food grains are diverted to the open market. If this is the state of affairs of the PDS in the cities, one can only imagine the plight of the poor consumers in the villages. The frequent scams in the FCI operations have ceased to be sensational news any more.

The price support, in principle, is for all the food grain producers in the country. The FCI is expected to procure the grains at the pre decided MSP if the market prices fall below MSP. But the effective procurement of the food grains takes place only in the green revolution belt of Punjab, Haryana and western Uttar Pradesh. In majority of the states, FCI's procurement system is highly inadequate or virtually absent. In many parts of India the market prices have remained lower than the MSP. This is obvious from the Abhijit Sen Committee report on Long Term Food Grain Policy of India. This imbalanced state intervention in the market has adversely affected the food grain producers producing locally consumed coarse cereals like *sorghum* and *bajara* in states like Karnataka and Maharashtra. The poor rural population in these states still consumes these food grains.

The FCI supplies only wheat and rice procured in the green revolution belt through the PDS. From the point of view of the producers of local food grains like *sorghum* and *bajara* this is nothing short of 'dumping'. The fact that large portion of the grain supplied through the PDS gets diverted illegally to the open markets would not change the argument of 'dumping' as it still distorts the open market prices. The poor producers of *sorghum*, *bajra* etc involved in rain-fed agriculture, are paying a heavy price for this 'state sponsored dumping'.

Unfortunately no political party or non-government organisation (NGO) has protested against this dumping in the country. This has shifted the tastes and demands away from locally produced grain varieties. Despite this impact, these food grains still form a major component of the food basket of the rural poor. Ideally, any food security system should cover these locally produced food grains. This would benefit the poor producers. Instead, the present state policy is biased against these food grains/poor producers.

In short, the FCI with its corrupt and inefficient operation has virtually destroyed the food security system of the poor while simultaneously discriminating against producers of food grain other than wheat and rice with its imbalanced intervention in the food grain market.

As long as large-scale involvement of the state in the food grain market remains essential, the corruption and inefficiency of the beauracracy will be inevitable. Only naive optimists or those safeguarding the vested interests of the bureaucracy will opine otherwise. But those concerned with the poor consumers and farmers should support an alternative system, which involves minimum state intervention in the market. Fortunately, such an alternative does exist and has been implemented successfully in many parts of the world. Implementation of this alternative requires concern for the poor and the political will to take on the vested interests of the bureaucracy.

## Reforming FCI

PDS and provisions of support prices have not proved to function effectively. The food subsidy bill of the country is also shooting up. Certain measures are to be introduced urgently to tackle this problem.

The issue here is not so much of curtailing the food subsidy bill but devising an alternative system to direct a large part of the food subsidy to the poor consumers. This is one of the major challenges facing India today. Such an alternative system should make use of the intrinsically linked economic interests of the poorest consumer and the food grain producer. The poorest section of the society spends most of its income on food. The average income being paltry, most of it is spent to meet basic survival needs. With the increase in income levels, the proportion spent on food as compared to non-food items decreases. The share of expenditure on grains out of the total food expenditure also changes with economic development. Increased income level makes it possible to replace food grains by milk, vegetable and fruits. Keeping this in mind, a comparison between the food grain consumption of a consumer from the topmost strata of the society with that of one on the lowest is revealing. In the state of Maharashtra, for example, the gap in grain consumption between the richest and poorest sections of society is at least three kilograms per person per month (i. e. the poor consumes 3 kgs less than the well off despite the fact that the later's cereal consumption is party substituted by consumption of milk, fruits, vegetables and such products). In many poorer states of the country this figure is likely to be much more. It shows that a large section of the population of our society is going to bed hungry.

This disturbing fact also drives home another important point. Increase in the purchasing power of this poorest section would necessarily translate into increased demand for food grains, which would benefit the food grain producers. Herein lies the intrinsic linkage of welfare interests of the poor consumers and farmers.

**Box 2: Food Subsidy Bill**

While the PDS of the country is eroding fast, the food subsidy bill is skyrocketing. The glaring inefficiency of the FCI becomes obvious even by glancing at the food subsidy bill of the country. How does one calculate the food subsidy bill? Roughly speaking if we deduct the selling price of the food grain from its economic cost we arrive at the figure of the food subsidy bill of the country. The economic cost comprises the price at which FCI procures the food grain from the farmers plus the cost of procurement, storage cost etc. Thus, food subsidy does not give us the exact figure of the subsidy given to the poor consumers as it appears. A large part of it is the expenditure on running this system.

The food subsidy bill of the country in 1990-91 was around Rs 2450 crores (US$544.4mn) and has now surpassed Rs 26000 crores (US$5.77bn) a significant portion of which is accounted for by the unproductive expenditure of the FCI. In order to transfer one rupee of subsidy to the poor the government has to spend Rs 6-8.

*Food Stamps: A promising alternative*

One effective way to directly increase the purchasing power of the poor is through the use of Food Stamps. A Food Stamp system is running effectively in the US. Of the total food consumed there, nearly 20 percent is consumed through the Food Stamp system. The farmers' lobbies in the US are keen on increasing the food subsidy on the Food Stamps and effective implementation of this system, as it creates a demand for the food produced by them as well as processed food.

**Box 3: Food Stamp System**

Food Stamps are cash vouchers to be exchanged forx food grains. The identified beneficiaries of the rationing system are issued these Food Stamps of value equal to the food subsidy to be transferred to them. The beneficiaries exchange food stamps for food grains. For example, a consumer who holds Rs 45 worth of Food Stamps buys Rs 90 worth of food. He would use the stock of Food Stamps and pay Rs 45 in cash. The exchange facility can be made available at regular commercial outlets – *kirana* stores (retail stores in neighbourhoods). The shop owner redeems the Food Stamps at a designated bank or post office. Food Stamp system does not need separate fair price (ration) shops. The stamps are issued by an agency, like the one which issues ration cards today.

Advantages of Food Stamps:

- Uses efficiency of existing marketing system.
- The shopkeeper is interested in attracting more consumers unlike the ration shop owner. Competitive pressures at retail level (from consumers) choice ensure better service for consumers.
- Illegal diversion of subsidised foods to open market is avoided.
- Food grain is available at regular stores – location, timings are more advantageous compared to fair price shops under PDS.
- No liquidity problems – the poor can buy food grains according to their cash flow unlike PDS where rations have to be bought in a single purchase. As the poor do not have sufficient savings, they either buy less than their quota or do not use the PDS at all.
- Viability of fair price shops is not an issue as there is no separate marketing channel for subsidised food. In the PDS, the problem is endemic and leads to illegal diversion of grains and limited shop timings.

*Source : Prepared by Prof. Bharat Ramswami and Milind Murugkar*

If the system of Food Stamps is implemented in a state like Maharashtra, it would roughly translate into increased food grain demand of half a million tonnes per year. A large part of this demand would be for locally produced coarse cereals like *sorghum* and *bajra*. This would benefit poor farmers undertaking rain-fed cultivation. The implementation of food security system through food stamps at national level will create food grain demand of roughly five million tonnes. We should also consider the positive spin offs of an effective food-grain security system on demand for milk and vegetable and on nutrition levels. Once the consumer is satiated with his/her demand of food grain, the additional purchasing power translates into demand for milk and vegetables. Once an efficient food security is brought in place, it is possible to include pregnant and lactating women as its beneficiaries by issuing additional Food Stamps for nutritional products like milk and pulses. This would be possible, as the new system would have saved the funds wasted on inefficiency and corruption in the present one. In the US, milk-stamps are an important component of nutritional security for poor children.

With the Food Stamps system in place, the government need not maintain huge stocks of food grains. The local producers will not be discriminated against, as they will no longer be subject to the adverse effects of FCI dumping via PDS. On the contrary, an efficient system of Food Stamps will increase the demand for locally produced food grains.

In his budget speech in 2004, Finance Minister P. Chidambaram promised to bear the entire expenditure of any pilot projects for Food Stamps. Unfortunately no state government has responded to the Finance Minister's appeal so far. The NGO sector in India needs to strongly advocate for undertaking such pilot projects to demonstrate the viability of Food Stamps.

## Conclusions

Reforming FCI essentially means removal of trade distorting intervention of the state in the domestic market while creating an efficient food security system for the poor. The state policy and intentions should align with the interest of the poor and the deprived of the country.

Some believe that switching over to Food Stamps will lead to exclusion of a part of the poor from the food security system. This belief is unfounded. Identification of the poor deserving food subsidy is an independent issue not intrinsically linked with Food Stamps. It is also true for the amount of food subsidy to be transferred. Hence, the fear that introduction of Food Stamps will reduce the quantum of food subsidy is also equally absurd. Such apprehensions stem either from ignorance or are part of strategies devised to resist Food Stamps by those interested in safeguarding the vested interests in the present system.

Implementation of the pilot projects of Food Stamps in different parts of the country might appear a small step but it has a big pro-poor political implications. But there will still be certain issues that need to be addressed. What will be the role of the state in protecting the farmers from the vagaries of the market? The answer to this would be decentralised procurement system, which will maintain a price floor. This system will naturally remove the present bias against locally produced cereals and coarse grains. FCI will still remain but it would have been trimmed down considerably only to carry minimum level of food stocks for emergency situations. It will also compete with private players in the market like the Cotton Corporation of India does today.

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