

EXECUTIVE SUMMARY

Background

The emergence of agricultural Price Policy in India was in the backdrop of food scarcity and price fluctuations provoked by drought, floods and international prices for exports and imports. This policy in general was directed towards ensuring reasonable (affordable to consumers') food prices for consumers' by providing food grains through Public Distribution System (PDS) and inducing adoption of the new technology for increasing yield by providing a price support mechanism through Minimum Support Price (MSP) system.

MSP is viewed as a form of market intervention by the central government and as one of the supportive measures (safety nets) to the agricultural producers. This has also a strong linkage to factor market. In this situation, two important aspects deserve attention, viz., (i) insulating the farm producers against the unwarranted fluctuations in prices, which may be provoked by among others, international price variations (ii) creation of an incentive structure for the farm producers in order to direct the allocation of resources towards desired crops and (iii) insulating consumers' against sharp price rise, which may have been created by monsoon failure or even by vested interest by creating artificial scarcity. The focus is to create value addition for the cultivators as well as the consumers'. Therefore, it is necessary to consider some policy alternatives and view effectiveness of MSP as an instrument in this background.

Procurement of food grains at MSP is carried out by Food Corporation of India (FCI). FCI operates however, in only selected states and selected districts which had surplus of food grains initially. In the current situation several other states which have had deficit have started getting surplus. Farmers in these states are deprived of the benefit of MSP. Market prices in some mandies fall below MSP. Thus, there is a need to extend effective procurement operations in other states to ensure MSP to farmers. This has also an advantage that transport cost of operating the PDS would be reduced. In the recent past, agricultural production pattern across states has seen a change; some of the earlier deficit states have started posting surplus of food grains. Besides, it was felt that by encouraging the states to take up procurement operations, the benefits

of MSP can accrue to farmers throughout the country. Under the “extended procurement regime” simulated here the designated states could locally procure, store and distribute food grains as per allotments indicated by the central government under PDS.

Issues Addressed

The present study analyze the impacts of a hypothetically extended procurement system (bringing new states and more districts of existing states under procurement net) of food grains at both macro and micro levels, for example i.e. on the level of procurement, the consequent changes in fiscal outlay, impact on local mandi price (Retail price) and consequently change in producers’ income and consumers’ expenditure on food grains, under ceteris paribus.

Approach

In the present study district wise procurement (rice and wheat) quantity and farm harvest price along with market price are analyzed to see the likely impact of extended procurement system on the volume of procurement and local market price. Unit value (ratio of household monthly consumption expenditure on wheat and rice and their respective quantity consumed) obtained from NSS 55th (FY 1999-00) and 60th (FY 2004) round survey data is taken as proxy for the market prices of wheat and rice. We relate market price as a function of per capita production and farm harvest price. We then work out implication of extended procurement regime. In all districts harvest price will be Maximum of MSP and harvest price. Change in procurement quantity, change in market price, and consequent change in gains or loss to producers (Rice and wheat) and consumers’ are calculated under ceteris paribus. Fiscal outlay in terms of subsidy which is difference between procurement (included operational cost and transport cost) and PDS price is calculated. The analysis is done only for two states Uttar Pradesh and Madhya Pradesh for FY 1999-00 and Year 2004.

Selection of States

For the analysis two sample states were selected based on the criteria like prevalence of MSP (procurement operation should be taking place in the state but at minimal level), sound production and consumption base of rice and wheat, union territories and small states should be

excluded analysis should be generalizable for the country as a whole, for which it is better to take large states as a sample), level of poverty (PDS concerned more with the poor than the rich households due to their low purchasing power) etc.

Results

It is found from the sample data analysis for UP, that the consumers' experience a mix response. The study results show consumer aggregate expenditure on rice consumption (PDS and other source) is decreasing due to increasing proportion of subsidized PDS rice (made available to consumer) in the consumer rice mix. Aggregate consumer expenditure on wheat is increasing by a small margin due to increase in effective price of wheat. This might result in a change in consumption pattern in the favor of wheat as rice will get substituted by wheat. Extension of MSP raises income of both rice and wheat producers, due to high realized effective price (mix of market price and procurement price) by producers. In other words extension of MSP shows a clear positive gain for producers of both rice and wheat. Though producers and consumers' are gaining marginally with this extended procurement system fiscal support required to carry out the procurement operation is increasing by 3 to 4 fold.

The substantial increase in fiscal outlay as a result of extended Procurement system can be attributed to the fact that, most of the districts in Uttar Pradesh have considerable quantities of these food grains left un-procured that can be procured by extending MSP to all districts so far uncovered. Substantial rise in fiscal outlay in percentage term compared to percentage gain posted by producers and consumers' is on account of the benefit of the system under new arrangement which is percolating to the entire state which was limited to few districts.

In Madhya Pradesh, extension of MSP led to an increase in producers' income for both rice and wheat. Consumers' are also getting benefited there as their aggregate consumption expenditure for both rice and wheat are decreasing. Unlike Uttar Pradesh, in Madhya Pradesh both producers and consumers' of both wheat and rice are experiencing positive gain. Like Uttar Pradesh fiscal support required to carry out extended procurement in Madhya Pradesh too is increasing by a substantial margin.

Concluding Remarks

Analysis of this new hypothetical extended procurement system in both the selected states for both the analysis periods are showing by and large same trend that the consumer and producer gains are increasing on the cost of substantially rising fiscal outlays. Substantial increase in fiscal support is accounted to an extensive coverage of procurement by bringing uncovered districts under procurement net. The important fact emerging from the study is that the fiscal support extended to carry out extended procurement is translating into a gain to a large section of poor farmers. Government subsidy which is benefiting only small pockets of farmers residing in the areas covered under procurement operation to the farmers through out the state. Since this is a sample based analysis and the percentage changes are calculated based on the reference period figures. It is still an open ended question by this analysis that whether the rise in fiscal burden is compensated by the aggregate gain to the societies or not. Rice and wheat figures prominently in the food grain basket of the people. One would therefore expect that the gain to people, particularly the poor ones, would offset the impact of higher fiscal outlay. Efforts are needed to achieve lower consumer prices, greater food consumption, and sufficient grain stocks to meet any unforeseen contingencies in future.

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

The agricultural pricing policies and allied institutional mechanisms evolved in India in the context of shortages in the availability and excess demand for food grains during 1960s (Kahlon, 1983). A system of procurement and distribution of major food grains was introduced and statutory minimum prices were set, though not strictly enforced. India's agricultural price policy includes three main types of administered prices: support, procurement, and issue price. The support price is generally announced at sowing time, and the government agrees to buy all grain offered for sale at this price. These prices guarantee to the farmer that, in the event of excessive production leading to over supply in the market, prices of his produce will not fall below the support price. Support prices generally affect farmers' decisions indirectly, regarding land allocation to crops. The areas to be sown, however, depend upon the actual prices farmers realized for the previous crop and their expectations for the coming season.

The quantity to be procured is determined by the government's needs for disbursements under the public distribution system. In recent years, however, the actual quantities procured have depended upon the grain offered for sale by farmers at prices fixed by the government. These prices are generally higher than the support prices but lower than the free market prices in normal years. In a good crop year, in surplus states, free market prices would have been lower but for government purchases; after the surplus is mopped up, market prices tend to run higher than procurement prices. The government recognizes the importance of assuring reasonable prices to farmers to motivate them to adopt improved technology and to promote investment by them in farm enterprises for increasing agricultural production. The basic objective of agricultural pricing policy in India is to evolve a balanced and stable price structure to meet the overall needs of the economy while protecting, in particular, the interests of the producers' and the consumers'. The policy is aimed towards facilitating the desirable path of attaining the objectives of growth and equity in the process of economic development.

Incentive prices in the form of minimum support prices are essential to the success of agricultural production programs based on high-yielding-varieties technology. At the same time, undue reliance cannot be placed on environment of high prices alone as an incentive for increasing production of food grains. Effective implementation of price support policies requires adequate institutional arrangements for the purchase of quantities offered for sale at that price.

1.2 Role of FCI (Food Corporation of India)

The broad objective of food policy in India has been to make food available to the people at reasonable prices. Specific objectives include providing remunerative prices to cultivators; supplying food at subsidized prices to the undernourished; controlling inflationary pressures; stabilizing prices for consumers' and producers; reducing fluctuations in food availability and achieving self sufficiency in food grains production.

On behalf of the Central Government, Food Corporation of India (FCI) along with State Governments and their agencies procure a sizeable quantity, of the total grain that is harvested in a season. Since production is concentrated in a few states of India, there is a large regional mismatch between supply and demand of food grains, which is relieved by the transfer of grains from surplus to deficit states.

In order to facilitate the farmers to bring their produce to the procuring agencies, purchase Centers (Mandies) are supposed to be opened in all corners of the country. However procurement of wheat and rice are usually being done in selected states only. The FCI/ Government Agencies purchase all the grains offered at the minimum support price (MSP). The main areas for procurement of wheat and rice are the surplus states like Punjab, Haryana, and some parts of Uttar Pradesh for both crops and Andhra Pradesh for rice.

The Food Corporation of India (FCI) was set up under the Food Corporations Act of 1964 to be the nodal central government agency responsible for the purchase, storage, inter- state movement, transport, distribution and sale of food grain and other food items. In short, the FCI is responsible for implementing central government policies on procurement, storage, and distribution. In certain operations such as the maintenance of national buffer stocks, the FCI has sole responsibility whereas in certain other operations such as procurement, the FCI has to work

with State government organizations (such as State marketing federations) and within the purview of State government policies.

The role of the Food Corporation of India (FCI) has evolved over time, from being an agency to procure food grains and distribute to states for the operation of the public distribution system (PDS), in recent years it has become a device of maintaining the Minimum Support Prices by procuring whatever is offered. FCI's procurement operations are concentrated in only a few states. This has led to problems of two kinds, one, growing buffer stock with FCI as the MSPs have been set above the market clearing price. In the year 2001 buffer stock accumulated in FCI's go-down had toughed to the historical high. There was a huge debate going at that time among policy maker's academician and planners about the proper utilization of this buffer stock. Irony of the situation was that our go-down was reporting overflowing stocks of food grains, but, at the same time some parts of the country reported death due to starvation. This shows inefficiency of distribution system in delivering food grains to needy. This buffer stock situation continues till recent past. But now the situation has changed rather than having overflowing buffer stocks countries has resorted to import of food grains. Second farmers of those states where FCI price support operations are not well organized do not fully get the benefit of the support price.

1.3 Minimum Support Price: An Overview

1.3.1 Minimum Support Price and its Supply Response

Even prior to mid sixties, it was recognized that for the acceleration of agricultural growth, farmers need to be motivated to adopt better technology and to invest more in their farm enterprises. This evidently was difficult without assuring reasonable prices to the farmers. The Government constituted a committee to suggest price policy for food grains for the 1964-65 and to suggest the terms of references for an organization which would be set up to advice the government on price policy on a long term basis. The recommendations of the committee led to the establishment of the Agricultural Price Commission in 1965 which was later renamed as Commission for Agricultural Costs and Prices (CACP) in March 1985. Simultaneously, the development strategy for agricultural sector was also remodeled. Remodeling of strategy

included application of modern inputs like high yielding varieties of seed (HYV), chemical fertilizers and mechanization of certain agricultural operations. Thus, main emphasis in this development was on finding methods of increasing land productivity through the use of modern input and improved methods of production in the potential regions of the country. This development strategy in turn required that price policy should encourage farmers to make greater investments in farm operations so as to enable them to shift on to higher production possibility curves. Thus the minimum support price was aimed to:

- (i) Assure remunerative and relatively stable price environment for the farmers by inducing them to increase production and thereby augment the availability of food grains.
- (ii) Improve economic access of food to people.
- (iii) Evolve a production pattern which is in line with overall needs of the economy.

Therefore, the provision of Minimum Support Prices (MSP) was initiated during the mid-1960s to create a favorable environment for the producers of major food crops, which were seen to possess vast potential for raising grain production. Presently, 24 major crops are covered under the minimum support price program (paddy rice, wheat, five coarse grains, four pulses, eight oilseeds, cotton, jute, tobacco and sugar cane). With the price support policy favoring food grains, there is very little incentive for the farmer to move away from the food grains to the production of other crop. The price support policy has been a major deterrent to crop diversification. In determining minimum support prices, the CACP has taken into account cost of production as well as domestic and global market conditions. MSP is determined by the principle of full cost of production that includes the rental value of land, an imputed value of family labor and returns to management (indiabudget.nic.in).

This policy has proved to be helpful in several ways. From a situation of massive shortages, India has emerged as a grain surplus country with self reliance in food grains, and this inherent process of self sufficiency subsumed the in built proposition of attaining food security at the national level. A strong base has been created for grain production and for meeting grain demand in the medium term (Tyagi.1990, Acharya, 1999; Connell, Hiram and Jahan, 2004). The policy has had a favorable impact on farm income and has led to an economic

transformation in the well-endowed, mainly irrigated regions. The other purpose of MSP was to maintain price stability in the food grain market.

However, the adverse effects can also be recognized as the food policy has been highly asymmetric and skewed mainly towards the production of rice and wheat at the cost of cultivation of pulses, oilseeds and other crops. This has created serious imbalances in demand and supply of principal crops in the country. Similarly, the country has been facing large shortages of pulses and edible oils and now has to meet about one-tenth of its demand for pulses and close to half of the demand for edible oil from imports. These imports are in turn having an adverse impact on producers in the unfavorable dry-land areas. These changes necessitate a fresh look at the role and relevance of the Minimum Support Price system in the country.

The implementation of Minimum Support Prices (MSP) in the high potential regions of the country has played an important role in meeting the ultimate goal of improving the agricultural production and the welfare of the agricultural community. A study conducted by Deshpande and Naika (2002), examines the impact of MSP on agricultural growth by analyzing its relevance and effectiveness in certain crops. This study indicates that wheat and rice got the best out of price policy through MSP but unintentionally this worked as an externality to discourage coarse cereal and pulses. Therefore, the policy is biased against certain crops which are grown in agriculturally backward regions and mostly by resource poor farmers. There are certain factors influencing the effectiveness of MSP e.g. the manner of implementation of the policy, undue dependence on the state for intervention, lack of required information at appropriate time etc. It was also experienced that there are a number of institutions involved in procurement process and there is inadequate coordination between them.

Another study by Karwasra, Kundu and Jain (2003) observed the impact of domestic price policy on the production of rice and wheat. The study supported the fact that the MSP for wheat and rice, which have been maintained reasonably high, has helped the farmers to increase their production. Similarly, Sidhu and Singh (2003) also found that the provision of MSP for wheat and paddy encouraged the farmers to produce the grains as marketable surplus.

The strategic objectives of agricultural development in India have been changing over time. During the period up to mid sixties, the basic objective was to maintain the prices of food grains at low level; in the mid-sixties to early eighties the objectivity was to maximize food production. In the early eighties to early nineties the objectives changed to go for a demand driven production pattern. Since early nineties, the strategic objective was to reduce inputs of agricultural commodities. When India's import of cereals had reached an alarming stage during the mid of sixties, a new strategy of agricultural development was launched in the country. The strategy included technological package, provision of input delivery and assured remunerative prices for agricultural production. Under this strategy of agricultural development, various institutional instruments were used. These include fixation and announcement of minimum support prices for the selected commodities, provision of marketing facilities, efficient marketing regulations and provision of Public Distribution System (PDS) of certain commodities like wheat and rice at subsidized price to poor households in the country (Acharya, 1999).

The dynamic role of policy prescriptions for agriculture in a country like India has been widely acknowledged. During eighties the import of cereal had come down negligible level. The share of rice and wheat production had increased as much as 94 % while the share of coarse cereal had come down drastically i.e. from 43 % to 18 %. It is found that production of the cereals was more dispersed across the regions. The growth of production of rice was more dispersed as compared to that of wheat. The concentration of production in case of wheat was also limited to certain states like Punjab, Haryana and Uttar Pradesh (Acharya, 1999).

Singh, Rangi and Kalra (2004) concluded that productivity of wheat in Punjab increased by more than 5 times in five decades (1950 to 2000), area by three times and production by more than 15 times. The increase in MSP during a period of more than two decades, 1977-78 to 2000, was more than five times. The minimum support price policy played a crucial role in bringing India out from deficit to surplus position in food grains. However, the experience suggests that price intervention distorted output crop-mix. During the decade, area under wheat had increased by 0.53 million ha. in Haryana, Punjab and Uttar Pradesh. The area under paddy

in Punjab increased from 2 million to 2.6 million hectares, presumably in response to high procurement price (Chand, 2003; Word Bank, 2003)

There were six and four states for rice and wheat respectively where MSP was implemented (Table1.1). Besides, it emerged (Acharya, 2001) that there were also state procurement agencies contributing their share in the procurement stock of both rice and wheat.

Table.1.1: Major states Procuring Rice and Wheat

Rice	Wheat
West Bengal	Punjab
Tamil Nadu	Haryana
Orissa	Uttar Pradesh
Madhya Pradesh	Rajasthan
Karnataka	Madhya Pradesh

Source: www.agricoop.nic.in

Out of the incremental marketed surplus of rice and wheat, share of other agencies including private traders has been considerably more than that of public agencies (FCI and state procurement agencies). Because of the limited presence of public agencies and implementation of MSP, the farmers who had marketable surplus do not fully benefit from the MSP regime.

Similarly, Chand (2006) also noted that MSPs have been very effectively implemented for some crops and in some regions through procurement of produce by official agencies. These include procurement of paddy and wheat by FCI and other official agencies in the states/regions like Punjab, Haryana, Western Uttar Pradesh and Tamil Nadu, which were early adopters of green revolution and offer sizeable marketed surplus.

In most of the surplus producing regions, the state Governments and their agencies remain active for implementation of the policy of adopting minimum support prices. Areas where, the need for price support arises only once in two or three years, the public agencies were not able to provide effective support to the farmers when the price falls below MSP as they couldn't tie up with central nodal agencies for making necessary purchase arrangement in time. Such failures on the part of states lead to a setback to the production programs. Most of the upcoming cereal producing state like eastern Uttar Pradesh, Madhya Pradesh, West Bengal, Orissa, Bihar and parts of some states are likely to experience this frequently. These are the areas where there is considerable scope for increasing the yield. It is in this context that for

accelerating the production of food grains not only the market infrastructure needs to be strengthened but the price support policy needs to be effectively implemented in all the regions of the country (Acharya 1998; 2001).

1.3.2 Minimum Support Prices & gains/loss to producer and consumer

The procurement of rice and wheat is also undertaken to maintain a buffer stock for dealing with price fluctuations and maintaining an operational stock for the public distribution system. While wheat is directly procured by FCI and other state agencies, part of rice is procured through the system of levy, under which rice millers are required to provide a certain percent of rice from the paddy purchased by them to the government agencies at a levy price derived from MSP. The state maintains a buffer stock of rice and wheat as a safeguard against the adverse impact of fluctuations in price and production of agricultural produce. These interventions have served the purpose of improving food security, maintaining price stability and the creation of favorable pricing environment. However, these interventions have also come under severe criticism. In this regard, some scholars have raised certain issues in their studies.

The provision of minimum support prices was found to have served only a small number of crops in a particular region; most of the crops and states could not benefit from them (Chand, 2003). It was also noted that the price policy favored the selected crops that resulted in substantial decrease in area and production of some coarse cereal, which were preferred by poor across the region. Deshpande and Naika (2002) found in their micro level verifications that that MSP does not bear any consistent and significant relationship with either the wholesale price or farm harvest price. Cropping pattern is largely influenced by market price and MSP plays a role only when MSP is either equal or above the market price. The study also observed that a hike in MSP ignored the demand-side factors that caused adverse impacts on food security for poor (Chand, 2003). Similarly, through the FCI's procurement, distribution and buffer stocking program Government of India repressed private food grain marketing, hindering their potential contribution to long term food security (World Bank, 1999).

Jha and Srinivasan (2006) studied the welfare effects of procurement prices of rice and wheat across the states using model simulation. Welfare implications of alternative scenarios, defined as decentralized PDS/Procurement policies (State agencies will carry out procurement at the

going market price which is assumed to be higher than MSP price) policies and centralized PDS/Procurement policies (FCI will procure on behalf of central government at MSP announced by government) are obtained. Further two more scenarios are constructed by assuming a gradual reduction of 10% and 20% in MSP. Domestic trade of grains restrictions are not accounted in the simulation. Changes in consumption are calculated by assuming constant price elasticity.

It was found that a switch from a centralized procurement system to a decentralized procurement system leads to a reduction in rice consumption by a slight margin in states that face high market prices, but the rise in consumption in other states (having low market price) outweighs the decline in consumption of all states put together. In case of wheat, the changes in consumption are negligible as market price remains unchanged. Further, it was estimated that in addition to procurement, the reduction in MSP by 10 % or 20 % results in to fall of market price at the national level by 11 % and 16 % in case of rice and wheat respectively. This causes an increase in consumption of 10.7 million tones of rice and 6.7 million tones of wheat but reduces the production by 0.62 and 1 million tones for rice and wheat respectively. Therefore, they find that if MSP is reduced, it is no longer attractive to the producers of rice and wheat to sell their produce to the procurement agencies.

In recent years, it was found that increase in minimum support price caused an adverse impact on welfare of the consumer. Parikh, Kumar and Dharbha (2003) conducted a study to examine the welfare impact of minimum support price (MSP) of wheat and rice. In their study, which simulated with a general equilibrium model it was found that when prices of rice and wheat are raised by 10%, the production of these cereals increase by 1.6 % and 2.6 % respectively, in the year immediately following the price hike. This hike could not be sustained because of fall in agricultural investments and addition to consequent fall in irrigation area. The hike in procurement prices caused an increase in both producers as well as consumer prices. This in turn, led to a significant decline in total private consumption of these two commodities by around 3% to 3.5 %. Indeed self consumption of both commodities was higher while the ration and the market consumption were lower in response to increase in prices. The increase in output along with a decline in consumption resulted in a built up of stock of these two

commodities. The effects of increase in prices of rice and wheat on output, consumption and stock of other agricultural commodities were quantitatively marginal. Increase in MSP resulted in welfare loss.

Acharya (2000) observed that the percentage share of average per capita income required to buy a quintal of wheat, rice and coarse cereal went down substantially during two decades as the rate of increase in prices of rice and wheat has been lower than that of the rate of increase in average per capita income. Prices of rice, wheat and coarse cereal in real terms have been declining during the last two decades. As consequences of improved availability of rice, wheat and coarse cereals at declining real prices, the farmers in several regions diverted their resources from less profitable crops to other more profitable commercial crops. Deshpande and Naika (2002) found that for the farmers this practice of resource transfer is confined to the regions which are not predominantly succumb to commercial crops only. Similarly, Reddy and Reddy (2003) also note that MSP primarily covers major crops especially wheat and rice. In case of some other crops MSP failed to cover up the cost of cultivation, harming the interest of the farmers further along with regional imbalances and disparities in the policy persuasion, its implementation and coverage of commodities under MSP. Thus, the MSP scheme can have a significant impact on responsible the cropping pattern.

1.4 Extension of MSP & Fiscal Burden

As already mentioned, the Food Corporation of India along with the State Governments and their agencies procure a sizeable quantity of the total grain that is harvested in a season on behalf of the Central Government. Since production is concentrated in a few states, there is a large regional imbalance between supply and demand of food grains, which necessitates movement of grains from surplus to deficit states.

However, agricultural production has undergone significant changes in the past few years. Surpluses of several agricultural commodities have started appearing in several states and this trend is expected to continue in the coming years as well. Former deficit states like Bihar, Assam and Eastern UP have started generating surpluses of certain cereals. Besides there are

also pockets of surplus emerging in states which otherwise have an overall deficit. (Planning Commission, 2001).

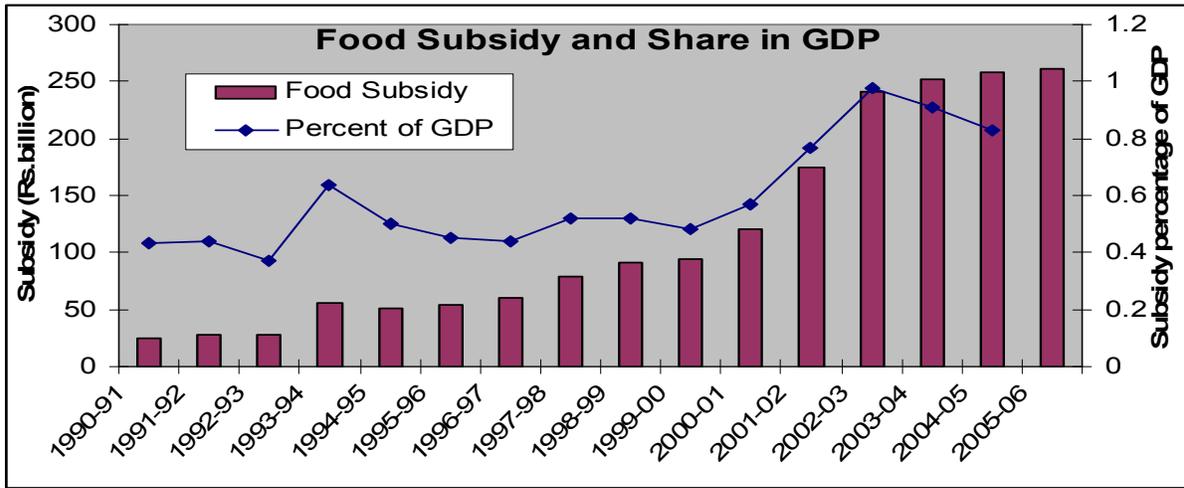
Table1. 2: *State Governments undertaking decentralized procurement scheme.*

No	Name of the State	Procurement of items
1	West Bengal	Rice
2	Uttar Pradesh	Rice/Wheat
3	Madhya Pradesh	Wheat
4	Chhattisgarh	Rice/Wheat
5	Uttaranchal	Rice/Wheat
6	Andaman & Nicobar Islands	Rice
7	Orissa	Rice
8	Tamil Nadu	Rice
9	Gujarat	Wheat
10	Karnataka	Rice
11	Kerala	Rice

Source: *www.agricoop.nic.in*

The emergence of these new surplus states and the issue of growing fiscal outlay necessitated the introduction of extended procurement scheme of the Government of India. It has been noted by several committees, e.g., GOI (1991, 2002), that the operations of FCI tended to become costly due to certain inefficiencies (e.g. transport, administrative). The proposal of extended procurement is mainly aimed at providing a greater role for state governments and private traders enhancing efficiency gains. This scheme proposed that transport and handling costs can be reduced and a more decentralized and distributed support for MSP can be provided to farmers in all states. Accordingly the trend in the food subsidies which showed an annual increase of above 27 per cent during each of the three years namely 2000-01, 2001-02 and 2002-03., came down to 4.1 per cent during 2003-04 and is expected to further decelerate to 2.54 per cent in 2004-05. It would be interesting to analyze how much of this deceleration could be attributed to the schemes.

Figure1.1: Growth of Food Subsidies



Source: Budget documents various issues and CSO

Note: 1999-00 onwards subsidy does not include sugar. 2004-05 figure is RE and 2005-06 figure is BE.

It was felt that by encouraging the states to take up procurement operations the benefits of MSP can accrue to farmers throughout the country. Under “extended procurement” scheme the designated states will locally procure, store and distribute food grains as per allotments indicated by the central government under PDS. The GOI will compensate the states for the difference between the economic cost of procurement and Central Issue Price (CIP) in the form of a subsidy. The states however cannot claim any arbitrary amount as economic cost. It would be fixed by the centre based on some norms. This has a built in incentive for individual states to be efficient. In effect the states purchase grains for the PDS at market price. In the surplus states this market price is, however, likely to be at the level of MSP. This policy allows private trade to play a greater role in agriculture marketing.

The extension of procurement scheme of the Government of India was introduced in 1997 to broaden the production base and hence food grains distribution with more effective and spontaneous participation of local people thus by encouraging the states to acquire the ability of procurement operations. Following this concept in practice, the resultant benefits of MSP could accrue to the farmers throughout the country. Under “extended procurement” scheme the designated states will locally procure, store and distribute food grains as per allotments indicated by the central government under PDS (S. Jha and P.V. Srinivasan, 2006).

The compensation in the form of subsidy will be provided by the central government to the states for the economic cost of procurement, i.e. difference between procurement price and Central Issue Price CIP (price at which grain is sold through PDS) in the form of a subsidy. The states however cannot claim any arbitrary amount as economic cost that would be fixed by the centre based on certain defined norms ensuring efficiency on the part of states. In effect the states purchase grains for the PDS at market price. In the surplus states this market price is, however, likely to be at the level of MSP, the support price. This policy allows private trade a greater role in agriculture marketing.

Recognizing the variation in prices from village to village that are captured through Mandi prices, we propose to analyze and will estimate the impact of the state level procurement at village level prices and household consumption and calorie intake of the poor. The study is carried out for the two states using NSS 55th round data.

If the states are empowered to procure food grains in their own state at the MSP and the Centre promises to reimburse them for it. Transport and handling costs can be reduced and a more decentralized and distributed support for MSP can be provided to farmers in all states. It can, however, create a number of problems. Firstly, it may be difficult to verify what the states actually do. Secondly, it may lead to much higher procurement in the aggregate imposing a larger fiscal outlay and larger political pressure to increase MSPs even more. Thirdly, once a state starts procuring at MSP in all its Mandies, we can expect that the prices of cereals may increase for many rural and urban consumers' having a profound impact on consumer expenditure on food grains and its distribution. Thus it appears that if not handled adequately, the policy may not only lead to a staggering rise in subsidy burden but may even lead to increase in prices that can hurt poor people in rural and urban area . This study will highlight the problems by case studies of two states.

The extended system of procurement is expected to help cover more farmers under the MSP program of the Central Government and economize transport and administrative costs involved in procurement and distribution operations. Further, it helps in minimizing the dependence of

State Governments on the FCI for PDS requirements and reducing the complaints about quality, as consuming States themselves are the custodians of the procured food grains.

However, the scheme has evoked limited response from the State Governments. Out of the State Agencies' share of nearly 58 percent of total rice and 80 percent of total wheat procured by the FCI, only 33 percent rice and 13 percent wheat are contributed by the States with decentralized procurement. At present, the State Governments of West Bengal, Madhya Pradesh, Uttar Pradesh, Chhattisgarh, Uttaranchal and Tamilnadu are implementing this scheme in a limited way. The States of Assam and Nagaland and the Union Territory of Andaman & Nicobar Islands have also evinced interest in the scheme.

The concerns of the State Governments broadly relate to financing of operations (RBI valuation norms for stocks of food grains) and reimbursement of expenses and release of subsidy by the Central Government. The concerns relating to the reimbursement of expenses and release of subsidy have been largely addressed through a process of consultation of all the stakeholders concerned.

1.5 Similar Studies:

No research study has been carried out that relates to the proposed study namely, what happens if the MSP is extended to more states. However, a related paper is there by Deaton, Parikh and Subramanian (1994). They have analyzed food demand pattern and pricing policy in Maharashtra using household level survey data (NSSO 38th round) to see the variation of prices across villages, districts and households. Deaton et al (1988) studied the quality, quantity and spatial variation of prices. Subramanian et al (1991) studied the gender effects in Indian consumption patterns.

A recent study by Jha and Srinivasan (2006) analyzed some of the recent reforms proposed in the operation of government buffer stocks and provision of price support to wheat and rice farmers in India. Based on the Indian grain market scenario and the recent policy initiatives this study estimates the potential impacts of reforms in India's farm support policies on producers, consumers' and traders in various regions of the country. The results are based on a multi-commodity partial equilibrium simulation model of regional supplies and demands of grains by different economic classes. In particular, the study focuses on the extension of procurement of