



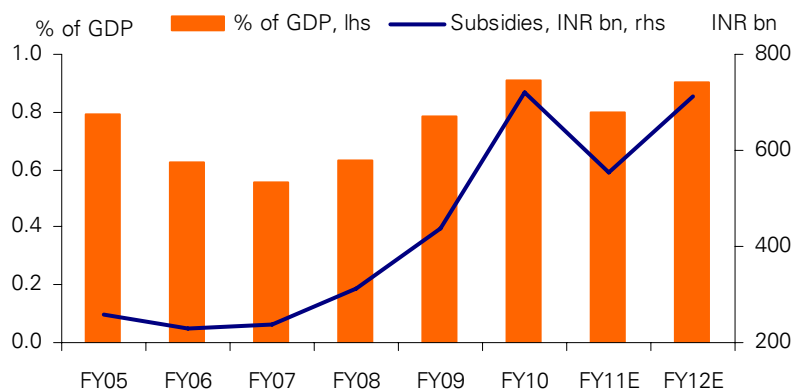
28 October 2010

# Asia Economics Special

## Assessing the fiscal impact of India's Food Security Act

- The National Advisory Council has finalized its recommendations for the Food Security Act. In this piece, we calculate the likely rise in food subsidy cost over the period of the implementation of the program. We estimate that 167mn families will qualify to access subsidized food grains, which will increase the food subsidy bill to INR780bn (1.0% of GDP), about INR225bn (0.3% of GDP) higher than the current subsidy level of INR556bn. On the face of it, funding a food subsidy bill of 1% of GDP in the coming years does not seem such an uphill task; but add to it the possibility of further increases in other subsidy outlays, such as fertilizer and/or fuel items, the cumulative impact could put substantial strain on the fiscal position, especially given the fact that i) revenue generating tax reforms such as Direct Tax Code and GST will not be implemented in the next fiscal year and that ii) one-off windfall gain from non-tax revenue will be absent.

### Food subsidy costs have risen appreciably over the years...



Source: Ministry of Food & Public Distribution, Budget Documents, Deutsche Bank

### Incremental cost of food subsidy under the proposed Food Security Act

	Units	Priority	General	Total
1	Assumed economic cost of food grains	INR	18	18
2	Issue price of food grains	INR	3	6
3	Subsidy per kg of food grains per month (1-2)	INR	15	12
4	Number of kg/ month	kilogram	35	20
5	Subsidy per month per family (3 x 4)	INR	525	240
6	Annual subsidy per family (5 x 12 months)	INR	6,300	2,880
7	No. of families likely to qualify for the programme	million	88	79
8	Annual Subsidy (6 x 7)	INR bn	554	228
9	Current (FY10/11BE) food subsidy outlay	INR bn		556
<b>10</b>	<b>Incremental cost of food subsidy (8-9)</b>	<b>INR bn</b>		<b>226</b>

Source: Various press reports, Budget Documents, Planning Commission, Ministry of Food & Public Distribution, Economic Survey, Deutsche Bank

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#### Key forecasts

Year ending 31 Mar	FY08/09	FY09/10	FY10/11F
Real GDP (YoY %)	6.7	7.4	8.0
Consolidated fiscal deficit, % of GDP	-10.3	-10.1	-8.7
WPI (YoY%) avg	8.1	3.6	8.0
WPI (YoY%) eop	1.5	10.2	6.0
	2008	2009	2010F
Trade balance, % of GDP	-9.9	-9.0	-8.4
Current account balance, % of GDP	-2.5	-2.6	-2.7
INR/USD, eop	48.5	46.7	44.0

Source: CEIC, Deutsche Bank. Forecast changes highlighted

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Publication Title	2010
Rupee and capital controls	21-Oct
India's heterogeneous states	21-Sep
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# Food Security Act

## Assessing the fiscal impact

The National Advisory Council's (NAC) proposals regarding the Food Securities Bill have undergone various changes over the past months, with the final version of recommendations including the key features:

- At least 75% of India's population will be given the right to access subsidized food grain, which will include 90% of rural and 50% of urban households. The NAC was in favor of 'universalizing' the programme, but stopped short of recommending it given fiscal and food supply constraints.
- Instead of categorizing likely beneficiaries as BPL or APL (as is the prevalent norm, see table below), the recipients will be classified into two new categories, "priority" (extremely poor and needy people) and "general" (those who are above the poverty line but cannot be classified as affluent). The priority category will comprise of 46% of rural population and 28% of urban population while the general category will include 44% of rural and 22% of urban households.

Current net subsidy per kg of rice and wheat for different categories of household				
(INR/kg)	Economic Cost	Issue price for various categories (fixed since 2002)		
	2010-11E	Above Poverty Level (APL)	Below Poverty Level (BPL)	Extremely poor under BPL
Rice	20.43	8.30	5.65	3.00
Wheat	15.43	6.10	4.15	2.00

Source: Ministry of Food & Public Distribution, Deutsche Bank

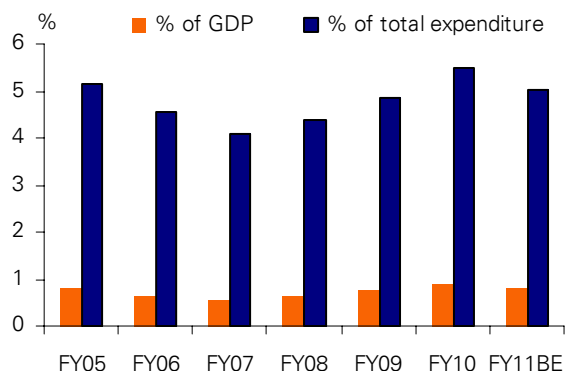
- The priority category will be entitled to 35 kg of grains a month at the following prices: rice at INR 3 per kg, wheat at INR 2 per kg and millets at INR 1 per kg. The general category will be entitled to 20 kg per month at a price which doesn't exceed half of the minimum support price for these grains.
- The NAC has recommended that the programme should cover 85% of the rural population and 40% of the urban population in the first phase, the implementation of which should start from FY11/12. Complete coverage is slated to be achieved by FY13/14.
- Other components of the NAC's Food Security Bill are legal entitlements for child and maternal nutrition, and for community kitchens and programmes for feeding the destitute and vulnerable groups. Suggestions have been made for revitalizing agriculture, diversifying the commodities available under PDS and ensuring universal access to safe water and proper sanitation.
- The Council has also recommended universalizing primary healthcare, extending nutrition and health support to adolescent girls and strengthening the school health program.

In this piece, we calculate the likely rise in food subsidy cost over the period of the implementation of the program (see next page).

## The cost of food subsidy

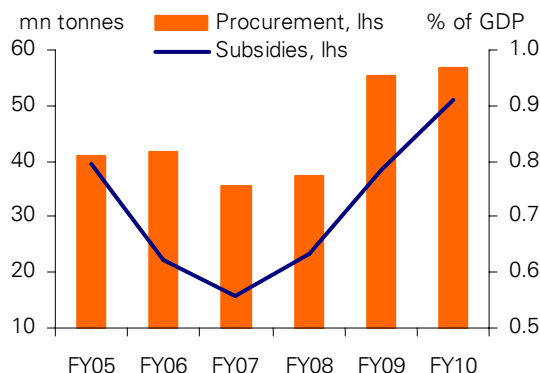
In recent years, India's food subsidy has averaged ¾ percent of the GDP and accounted for roughly 5% of the total expenditure. However, the rise in food subsidy cost has been more pronounced since 2008/09 owing to i) increased divergence between economic price and issue price (administered price) of food grains and, ii) appreciably higher amount of procurement of food grains since 2008/09. Note that the twin impact of the rise in size as well as minimum support prices of procured food grains since 2008/09 have coincided with rising food inflation from around the same time.

### Food subsidy bill has risen appreciably over the years...



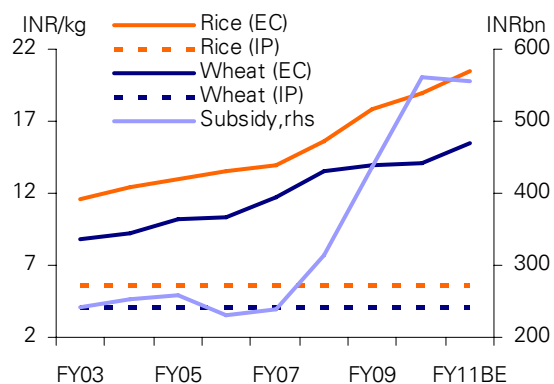
Source: Ministry of Food & Public Distribution, Budget Documents, Deutsche Bank

### ... owing to higher procurement of food grains



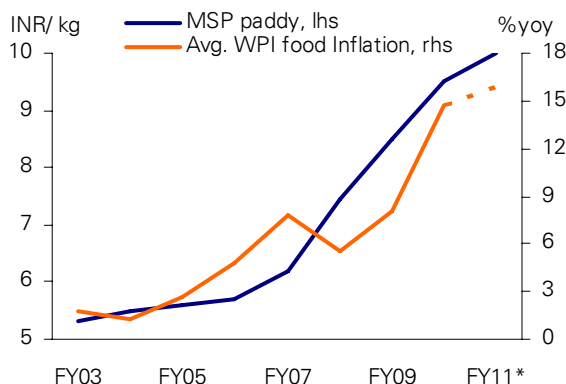
Source: Ministry of Food & Public Distribution, Budget Documents, Deutsche Bank

### ...and increasing gap between EC and IP of food grains



Source: Ministry of Food & Public Distribution, Budget Documents, Deutsche Bank

### Food inflation has also risen with rise in MSP



Source: Ministry of Food & Public Distribution, CEIC, Economic Survey 2009-10, Deutsche Bank. \*FY10/11 average WPI food inflation is DB forecast

Based on the NAC's latest recommendations, we calculate the likely incremental rise in food subsidy cost over the period of the implementation of the program. According to our estimates, around 167mn families (88mn priority and 79mn general) will qualify to access subsidized food grains (assuming average family size of 5.5), which will increase the food subsidy bill to INR782bn, about INR226bn higher than the current subsidy level of INR556bn.

Further, our calculations show that the incremental cost in the next fiscal year (1<sup>st</sup> phase), would be around INR155bn (over and above the current subsidy level INR556bn), raising the total food subsidy bill to INR711bn (0.9% of GDP). Of course, the total food subsidy cost could turn out to be higher in the next fiscal, if the current year's target (INR556bn) is itself breached.

**Incremental cost of food subsidy under the newly proposed Food Security Act**

	Units	Priority	General	Total
1 Assumed economic cost of food grains	INR	18	18	
2 Issue price of food grains	INR	3	6	
3 Subsidy per kg of food grains per month (1-2)	INR	15	12	
4 Number of kg/ month	kilogram	35	20	
5 Subsidy per month per family (3 x 4)	INR	525	240	
6 Annual subsidy per family (5 x 12 months)	INR	6,330	2,880	
7 No. of families likely to qualify for the programme	million	88	79	
8 Annual Subsidy (6 x 7)	INR bn	554	228	782
9 Current (FY10/11BE) food subsidy outlay	INR bn			556
<b>10 Incremental cost of food subsidy (8-9)</b>	<b>INR bn</b>			<b>226</b>

**2011-2012**

		Priority	General	Total
11 No. of families likely to qualify for the programme	million	79	73	
12 Annual Subsidy (6 x 11)	INR bn	499	212	711
13 Current (FY10/11BE) food subsidy outlay	INR bn			556
<b>14 Incremental cost in 2011-12 (12 - 13)</b>	<b>INR bn</b>			<b>155</b>
<b>15 Incremental cost in 2012-14 (10-14)</b>	<b>INR bn</b>			<b>71</b>

Source: Various press reports, Budget Documents, Planning Commission, Ministry of Food & Public Distribution, Economic Survey, Deutsche Bank

The latest recommendations of the proposed Food Security Act leads to an incremental rise in food subsidy bill by around INR171bn as compared to the older version (INR226bn vs. INR55bn), according to which only 74mn below poverty line households (as estimated by the Tendulkar Committee Report) would have qualified for subsidized food grains.

On the face of it, funding a food subsidy bill of 1% of GDP in the coming years does not seem such an uphill task; but add to it the possibility of further increases in other subsidy outlays, such as fertilizer and/or fuel items, the cumulative impact could put substantial strain on the fiscal position, especially given the fact that i) revenue generating tax reforms such as Direct Tax Code and GST will not be implemented in the next fiscal year and that ii) one-off windfall gain from non-tax revenue will be absent.

**Incremental cost of food subsidy in the older version of the Food Security Act**

1 Assumed economic cost of food grains	INR			18
2 Issue price of food grains	INR			3
3 Subsidy per kg of food grains per month (2-1)	INR			15
4 Number of kg/ month	kilogram			35
5 Subsidy per month per family (3 x 4)	INR			525
6 Annual subsidy per family (5 x 12 months)	INR			6,300
7 BPL families (Planning Commission estimate)	million			65
8 BPL families (Tendulkar Committee estimate)	million			74
9 Annual Subsidy (Planning Commission) (6 x 7)	INR bn			411
10 Annual Subsidy (Tendulkar Committee) (6 x 8)	INR bn			466
<b>11 Incremental cost of food subsidy (10-9)</b>	<b>INR bn</b>			<b>55</b>

Source: Various press reports, Budget Documents, Planning Commission, Ministry of Food & Public Distribution, Economic Survey, Tendulkar Committee Report, Deutsche Bank

# Appendix

## Calculation of "no. of families" likely to be covered under the newly proposed Food Security Act

		Rural	Urban
Population	mn	823	353
% of population to be covered over 2011-14	%	90	50
% of population to be covered in 2011-12 (1 <sup>st</sup> phase)	%	85	40
% of population to be covered over 2012-14 (2 <sup>nd</sup> phase)	%	5	10

		Rural			Urban		
		Priority	General	Total	Priority	General	Total
<b>% of population to be covered</b>							
1st phase	%	43	42	85	22	18	40
2nd phase	%	3	2	5	6	4	10
<b>Total</b>	<b>%</b>	<b>46</b>	<b>44</b>	<b>90</b>	<b>28</b>	<b>22</b>	<b>50</b>
<b>No. of people estimated to be covered</b>							
1st phase	mn	357	342	699	79	62	141
2nd phase	mn	25	16	41	21	14	35
<b>Total</b>	<b>mn</b>	<b>382</b>	<b>359</b>	<b>740</b>	<b>100</b>	<b>76</b>	<b>176</b>
<b>Families likely to be covered under the scheme*</b>							
1st phase	mn families	65	62	127	14	11	23
2nd phase	mn families	4	3	7	4	3	7

		Priority	General
1st phase	mn families	79	73
2nd phase	mn families	8	6
<b>Total</b>	<b>mn families</b>	<b>88</b>	<b>79</b>

Source: Various press reports, Budget Documents, Planning Commission, Ministry of Food & Public Distribution, Economic Survey, Tendulkar Committee Report, Deutsche Bank. \* No. of families calculated assuming average family size of 5.5)

# Appendix 1

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