



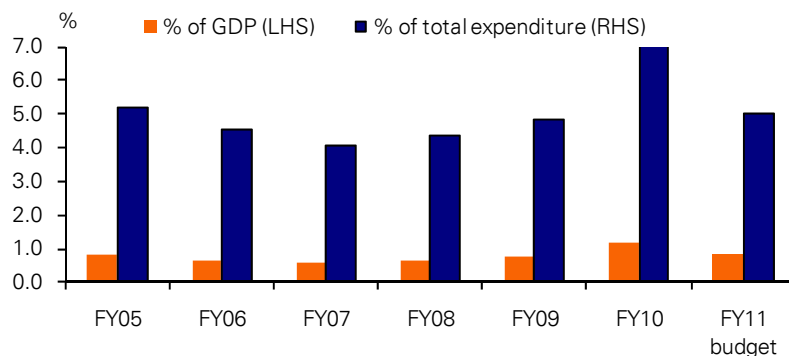
29 April 2010

## Asia Economics Special

# Food subsidies in India: a new fiscal risk

- The government of India pursues a policy of subsidizing food staples for the poor. In recent years food subsidies have averaged ¾ percent of GDP, making up about 5% of total government spending. Recent developments in policy suggest that the subsidy bill would rise in the coming years as the authorities are keen to expand the scope of the subsidy program. The number of households under the subsidy umbrella has been revised up, and the per capita subsidy portion is being raised.
- We estimate that given these developments the total food subsidy bill could amount to about 1.1% of GDP in FY10/11, posing a 0.3% of GDP upside to total spending and the fiscal deficit from the present official projections. Our estimate may be an upper bound as far as risk to the deficit is concerned as procurement cost and quantity could be lower this year due to a better monsoon or declining need to build government food-stock reserves. Still, it appears clear that a non-trivial upside risk to the spending envelope has risen due to the government's intention to expand the scope of its food subsidy program.

### Subsidy cost is rising; significant upside risk to the FY11 estimates



Source: Government of India, Deutsche Bank

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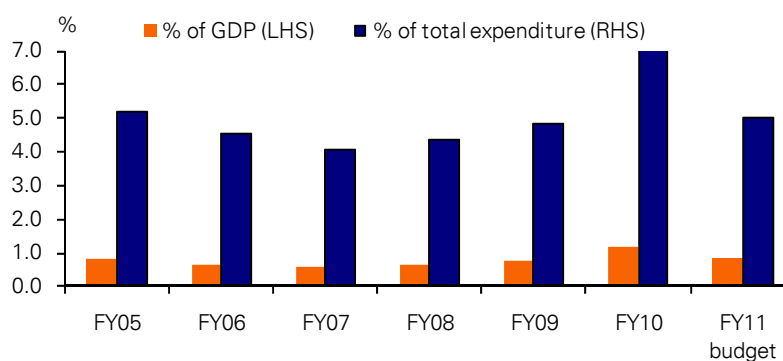
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# Rising food subsidy bill

## Upside risks to food subsidy cost

The government of India pursues a policy of subsidizing food staples for the poor. In recent years food subsidies have averaged around ¾ percent of GDP, making up about 5% of total government spending. Recent developments in policy suggest that the subsidy bill would rise in the coming years as the authorities are keen to expand the scope of the subsidy program. The number of households under the subsidy umbrella has been revised up, and the per capita subsidy portion is being raised. Below we examine these developments:

### Food subsidy bill has been rising



Source: CEIC, Government of India, Deutsche Bank

**Revised poverty estimate:** According to the findings of the Expert Group on the Estimation of Poverty (known as the “Tendulkar Committee report”), India’s overall poverty ratio for 2004-05 is 37.2% (with 41.8% for rural areas and 25.7% for urban areas). This is much higher than the previous working figure of 27.5%. As a result, targeted households for government support have increased from 65mn to 74mn (each household is considered to have 5 people). The findings of the report have been endorsed by the government.

The Expert Group has shifted away from the past practice of calorie-anchored estimates of poverty. The approach used to be whether one meal a day with minimum nutritional needs (2,400 calories per day per capita for rural areas and 2,100 calories for urban areas) could be afforded by families. Instead the Group rationalized the basket of goods and services that are consumed by households at the poverty line. The poverty line basket has now been updated to reflect the expenditures on health and education that are incurred by the poor.

**Food Securities Act:** The government has planned to provide 35kg of rice and wheat per month to each Below the Poverty Line (BPL) family at a rate of INR3/kg versus the present issue price of INR5.65/kg for rice and INR4.15/kg for wheat. The 24.3 million extremely poor families within the BPL set (covered under the Antyodaya Anna Yojna scheme) are however likely to continue receiving food grains at an even cheaper rate (35kg of wheat/month at INR2/kg). Presently the government also provides subsidized food grains (ranging between 10 and 35 kg per month) for Above Poverty Line (APL) families, though at a higher rate than BPL families (see table below). The quantity and prices being made available to these target groups are more generous than what was initially proposed by the government last year. As a result, the overall cost of the initiative will rise on a per capita basis.

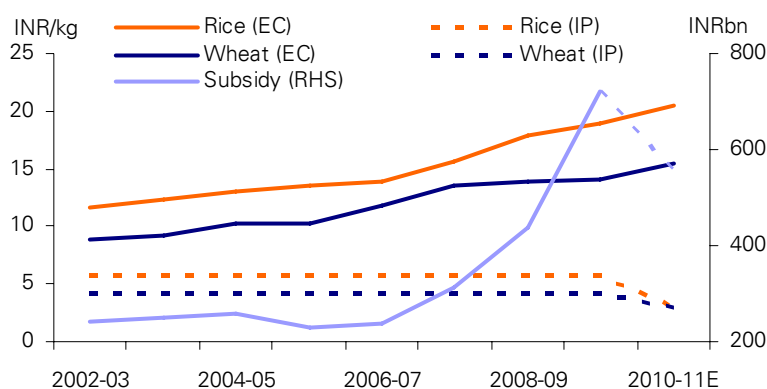
**Current net subsidy per kg of rice and wheat for different categories of household**

(INR/kg)	Economic Cost	Issue price for various categories (fixed since 2002)		
		2010-2011E	Above Poverty Level	Below Poverty Level
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

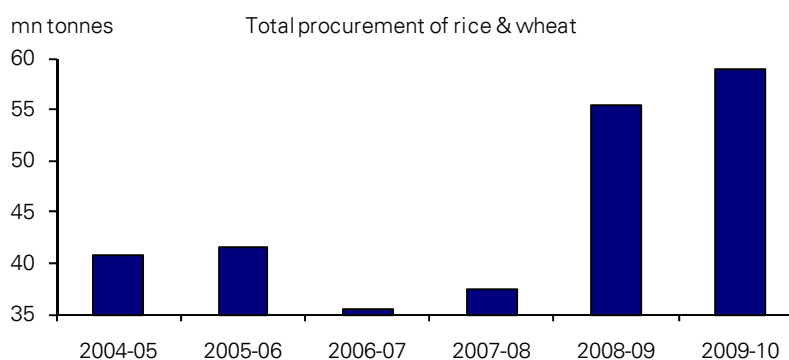
**How much will the food subsidy bill increase?**

Food subsidy cost (the difference between economic cost and issue price of food grains) has already trebled from 2002-03 levels as the former (which includes purchase price, taxes, transport, handling and storage charges) has increased persistently over the last few years while the latter has remained unchanged since 2002.

**Subsidy cost on the rise due to widening gap between economic cost and issue price**

Source: Ministry of Food & Public Distribution, Deutsche Bank. EC = Economic Cost, IP = Issue Price

Moreover, the government's procurement of food grains (at higher economic cost) has also increased substantially in the last three years, adding to the subsidy burden.

**Procurement of food grains has gone up sharply since 2007-08**

Source: Ministry of Food & Public Distribution, Deutsche Bank

The increase in the BPL family headcount as well as the wider scope for per capita subsidy will clearly raise the food subsidy bill going forward.

According to the FY10/11 budget, the food subsidy is estimated to be about INR556bn, slightly lower compared to the spending in FY09/10 of INR560bn. However, the FY09/10 figure, in all likelihood, would be revised upward. Recent reports suggest that higher

procurement and rising economic cost of food grains caused the actual budgetary outlays in this category to have reached INR722bn in FY09/10 (about 30% higher than the estimate mentioned during the presentation of the FY10/11 budget). This is a 65% rise over the subsidy cost of FY08/09 (INR437bn). Note that this rise in the food subsidy bill took place despite a lower BPL family headcount and excluding the provision of the food securities act.

Our calculations show that the incremental cost of food subsidy (see table below), after incorporating the above two conditions is about INR60bn, in line with the Planning Commission's latest estimates.

#### Incremental cost of food subsidy with FSB provision and new poverty estimates for below poverty line families

1	Assumed economic cost of food grains		INR	20
2	Issue price of food grains		INR	3
3	Subsidy per kg of food grains per month	(2-1)	INR	17
4	Number of kg/ month		kilogram	35
5	Subsidy per month per family	(3 x 4)	INR	595
6	Annual subsidy per family	(5 x 12 months)	INR	7140
7	BPL families (Planning Commission estimate)		million	65.2
8	BPL families (Tendulkar Committee estimate)		million	74.0
9	Annual Subsidy(Planning Commission)	(6 x 7)	INRbn	466
10	Annual Subsidy(Tendulkar Committee)	(6 x 8)	INRbn	528
11	Incremental cost of food subsidy	(10 - 9)	INRbn	63

Source: Ministry of Food & Public Distribution, Tendulkar Committee Report, Planning Commission, Deutsche Bank. Note that our food subsidy cost under both the poverty estimates is lower than the FY10/11BE of INR556bn; this is because our calculation does not incorporate 1) the subsidy given to APL families and 2) the cost of running other welfare schemes such as Mid Day Meal Scheme, Nutritional Programme for Adolescent Girls (NPAG), Annapurna Scheme, etc.

The question however is whether this additional INR60bn should be added to last year's official estimate (preliminary) of INR560bn or the recently reported INR722bn. If one were to take the latter figure and add the above estimated INR60bn, total food subsidy would again amount to about 1.1% of GDP in FY10/11, posing a 0.3% of GDP upside to total spending and the fiscal deficit.

Our estimate may be an upper bound as far as risk to the deficit is concerned as procurement cost and quantity could be lower this year due to a better monsoon or less need to build government food-stock reserves. Still, the discussion above clearly illustrates that a non-trivial upside risk to the spending envelope has risen due to the government's intention to expand the scope of its food subsidy program.

# Appendix 1

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