

Some Issues in the Cash Vs Kind Debate



BHARAT RAMASWAMI
IGW, 2012

Collaboration



- **Ashok Kotwal**
- **Milind Murugkar**

Background



- **National Food Security Bill**
- **Increased coverage (uniformly across states)**
- **PDS or direct transfer? No clear unambiguous message.**
- **No consensus exists within government(s) – Central and State**
- **Allow states to go their own way??**

Issues



- **Fungibility of in-kind transfers**
- **Procurement and cash transfers**

The Paternalistic Argument for in-kind transfer

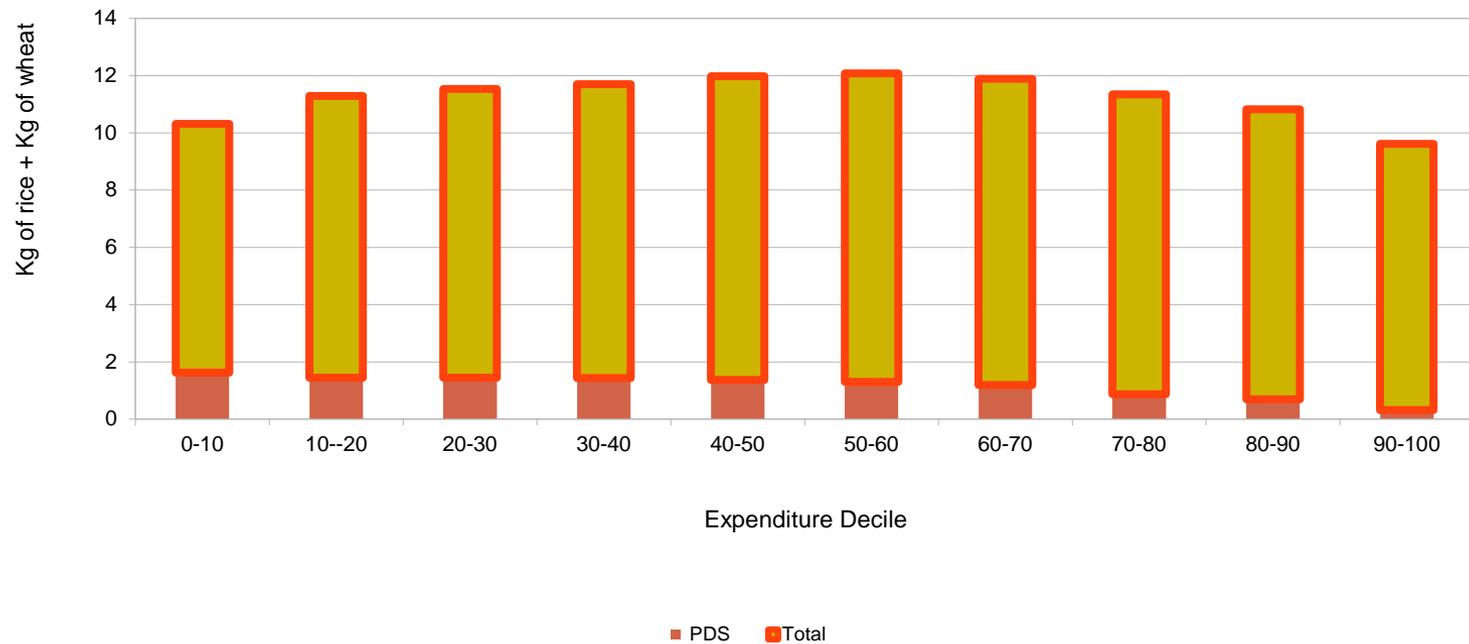


- Goal is to increase food consumption
- Cash transfers will be dissipated away
- Hence in-kind transfers.
- This is valid if (a) in-kind transfers cannot be resold **and** (b) the subsidy is not infra-marginal (i.e., the transfer is larger than what household would consume in its absence).
- Both conditions required; even some economists have considered only (a)!

PDS Subsidy is an infra-marginal transfer



Figure 3: Per capita grain consumption, PDS and total, 2004/05



Implications....



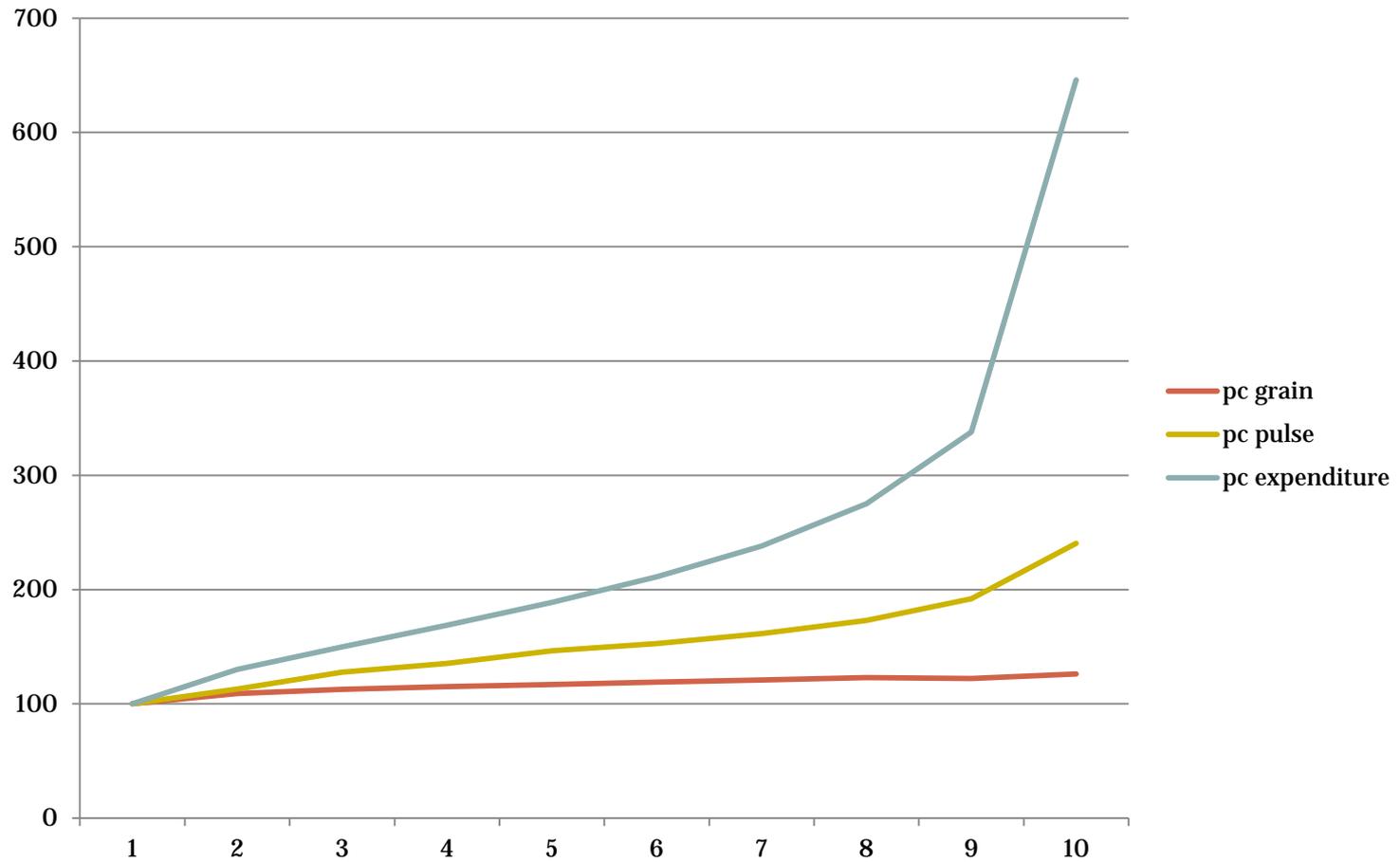
- In principle, the effect of PDS transfer ought to be exactly like that of an income transfer.
- If that is so, why not consider just the best means of transferring income? In particular, why not look at direct cash transfers?
- But are consumers like what economic theory predicts them to be?
- Not easy to check with NSS data because participation in PDS is not random – usual omitted variable bias.

Empirical Evidence on Fungibility

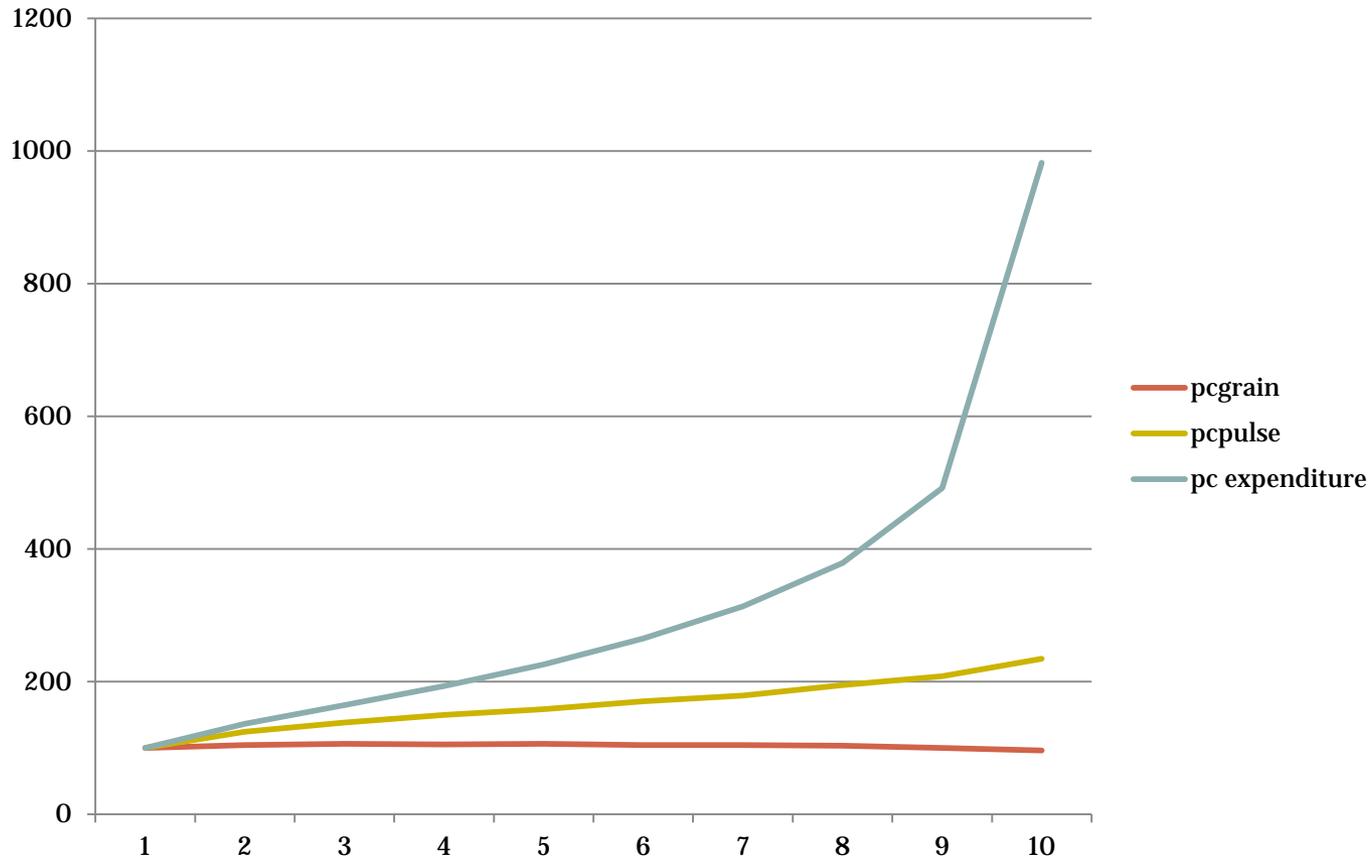


- **Delhi cash transfer study (Newspaper report):**
 - Cash or kind made no difference to wheat, rice and sugar consumption
 - Only differences were in consumption of some foods and medical expenditures
- **China study of Jensen and Miller (2011)**
- **Conjecture: Even if in-kind transfers are not fully fungible, the differences (in terms of impact on grain consumption) are likely to be small. Why?**

Food Consumption Index (Rural): Cross section over expenditure deciles



Food Consumption Index (Urban): Cross-section over Expenditure Deciles, 2004/5



Higher Incomes lead to Diet Diversification



- Staples consumption is not responsive to income.
- Inequality in staple consumption is low and negligible relative to inequality in income
- Inequality in non-staple food consumption is higher.
- Income elasticity of demand for foodgrains is low – that of other foods is higher

Farmers and Support Prices



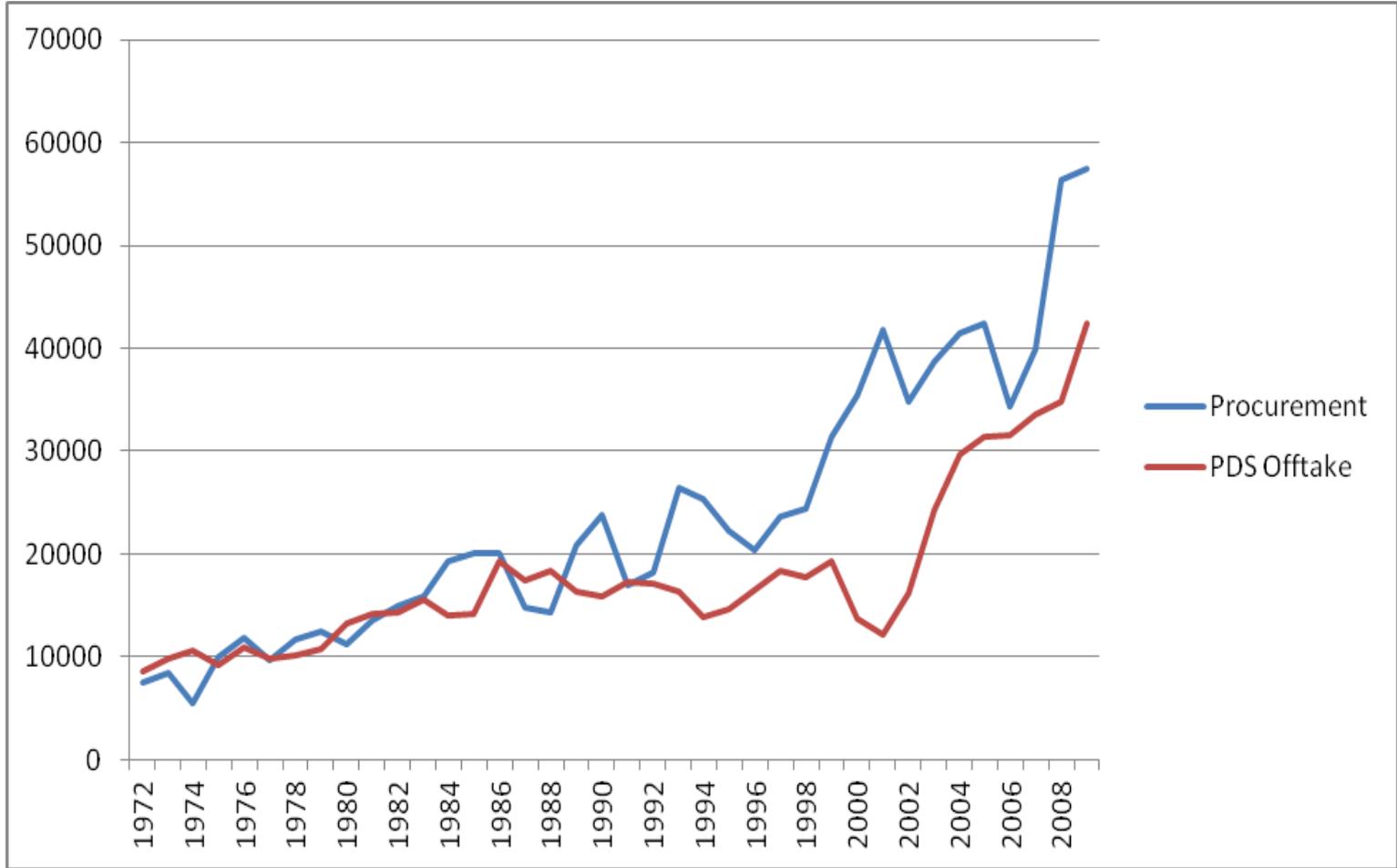
- **What do we do with procurement?**
 - “What else is the government to do with the grains it procures from the farmers? PDS is the only answer to MSP,” (NC Saxena, member, National Advisory Council)
- **How will the grain surplus states be mollified?**
- **Although there is no reason for aggregate demand to fall (under cash transfers), it is not likely that a politician can abandon procurement.**
- **So is this a binding constraint?**

How much is needed to procure?



- How much does the government need to buy to support farm prices?
- Till 15 years ago, procurement was only 25 million tons.
- In the late 2000s, it is about 55 million tons. In the same period, rice+wheat output also increased by 30 million tons.
- Is this because the goal of supporting farm prices now requires greater procurement?

Procurement larger than PDS sales



Why excess procurement?



- Procurement larger than PDS sales
- No stabilization
- Why?
- Farm lobby and coalition politics??
- Other reasons: The central government's problem: what is the right procurement price that elicits the required quantity?
- Politicians and bureaucrats feel the costs of not having enough for the PDS but receive no penalty for excess stocks and high prices. Works to strengthen the farm price lobby.
- Bias in favour of higher than necessary procurement prices and therefore large procurement.

Mistakes endure...



- Once stocks are large, private traders withdraw and procurement continues to be high in successive years (even without high procurement prices)
- This cycle has only been broken by droughts, exports (often subsidised), and ad-hoc sales through the PDS and the market.

If you accept this story...



- While there is a political constraint of doing away with procurement, there is no political constraint of restraining procurement.
- A system of combining PDS and cash transfers is not infeasible politically.
- A near-universal PDS will amplify the tendency to carry excess stocks and market prices will be higher.
- Cash transfers will limit excess stocks and the damage due to it.

To finish...



- Paternalistic argument for in-kind transfer is weak.
- The procurement constraint to a cash transfer system is real; however, the constraint does not apply to individual states or to a combination of in-kind and cash.
- The greater political constraint is the PDS dealer lobby within a state.
- We do not know enough about how a cash transfer system will operate on the ground. Systems can be sketched but no alternative to working it out in the field.