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 \textbf{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
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

Graph showing the relationship between expenditure deciles and grain, pulse, and expenditure. The graph includes lines for pcgrain, pc pulse, and pc expenditure.
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.