

Prices and Food Management

Inflation

The annual point to point inflation rate in terms of WPI declined significantly from 6.5 per cent in 2002-03 to 4.6 per cent in 2003-04. During 2004-05, the inflation rate for the week ending June 12, 2004 stood at 5.89 per cent compared to 4.97 per cent in the corresponding period last year.

5.2 Performance of the Indian economy on the inflation front - with price stability as one of the primary objectives of the reform process initiated in the early 1990s-has been satisfactory, particularly after the mid-1990s (Table 5.1). Domestic deregulation and tariff rationalization have resulted in greater competition, greater cost-efficiency and moderation of upward pressure on prices. The double-digit annual average inflation rate of 10.6 per cent between 1991-92 and 1995-96 came down to 4.2 per cent between 2001-02 and 2003-04. The structural decline in inflation has also narrowed the differential with inflation in developed economies (Box 5.1).

Table 5.1 : Annual average inflation based on Wholesale Price Index (WPI) since 1991-92 (based on 52 week average inflation rates)

	Annual average inflation (%)			
	All Commodities	Primary	Fuel	Manufactured
1991-92 to 1995-96	10.6	11.3	11.3	10.1
1996-97 to 2000-01	5.1	5.4	13.0	3.1
2001-02 to 2003-04	4.2	3.8	6.9	3.4

5.3 The decline in inflation since the beginning of the 1990s has been most pronounced in the manufacturing sector, where the inflation rate declined from around 10 per cent in the first half of the 1990s to 3.4 per cent during 2001-02 to 2003-04. Though global slowdown, subdued demand and low capacity utilization provide some answers to this phenomenon, the bulk of the decline may be attributed to deregulation, removal of trade barriers, reduction of customs tariffs, resulting in increased competition and inducing manufacturers to cut down on costs and profit margins.

5.4 Lower annual average inflation rates for primary products point towards better supply side management. The decline in inflation in the fuel sector is noteworthy in view of the dismantling of the Administered Price Mechanism in the hydrocarbon sector in April 2002, allaying fears that such a dismantling would result in abnormal swings in petroleum product prices. The low inflation in fuel prices also reflected the preponderant public ownership of marketing companies in the petroleum sector.

5.5 In recent years, supply side factors have been more instrumental in determining the direction and magnitude of price rise, while the impact of demand side factors on inflation has been relatively weak. The occurrence of drought, decline in agricultural production, increase in global crude oil prices, supply shortages and increased international prices of imported commodities like crude oil, steel and edible oils are some of the factors that have played a crucial role in fueling inflation in the recent past. Imported inflation has

Box 5.1 : Global Inflation

Global inflation based on the Consumer Price Index averaged 15 per cent in the 1980s and peaked to 30 per cent in the first half of the 1990s due to soaring inflation throughout the developing world. But in recent years, inflation rates in many of the developed as well as emerging economies have maintained a declining trend. Global inflation came down to 8.4 per cent for the period 1995-99 and further to 4.1 during 2000-2003. Not only has global inflation declined, it has also become more firmly anchored and is less sensitive to fluctuations in short-term inflation movements. Increased level of competitiveness and reduction in monopoly pricing power resulting from increased deregulation and globalisation could provide possible answers to this declining trend in inflation. (Table A).

In the most recent period, some economies are even experiencing an unprecedented low inflation with the need to take appropriate steps for boosting economic activity to avoid a further fall in inflation.

Even in India, increased deregulation in the domestic market and a reduction in tariffs have gradually resulted in a structural decline in inflation and the differential between the inflation rates in India vis-a-vis its trading partners has somewhat narrowed down. However, the domestic annual point to point inflation rate based on the Wholesale Price Index currently in the range of 4-5 per cent is still higher than that prevailing in many developed economies.

Table A: Global Inflation rates based on Consumer Prices (%)

	1970-79	1980-89	1990-99	2000-2003
USA	7.1	5.5	3.0	2.5
Japan	9.1	2.5	1.2	-1.8
Euro Area	-	-	-	2.3
Austria	6.1	3.8	2.1	1.9
France	8.9	7.3	1.9	1.9
Germany	4.9	2.9	2.4	1.7
Italy	12.5	11.4	4.2	2.6
Netherlands	7.1	2.8	2.3	3.5
UK	12.4	7.1	3.8	2.3
India	7.4	9.1	9.5	4.0

Source: IMF Paper on "Globalisation and Global Disinflation" by Keneth Rogoff (August 2003).

therefore, a crucial role to play in setting the direction of domestic inflation.

Developments during 2003-04

5.6 After the drought of 2002 and the POL price increases resulting from tension in the Gulf region, the year 2003-04 began with an inflation rate of 6.7 per cent. However, with the ebbing of hostilities in Iraq and the end of the war, the pressure on crude prices gradually eased off, giving temporary relief on the inflation front. The annual point-to-point inflation rate based on the WPI after peaking at a high of 6.9 per cent in the first week of May 2003, decelerated continuously, reaching a low of 3.9 per cent in end-August, 2003.

5.7 The interplay of different factors— increase in energy prices, rise in prices of food

articles- led to a firming of the inflation rate during September-November 2003 and it hovered around the 6 per cent level in December 2003. A further firming of energy and primary product prices resulted in the inflation rate crossing 6 per cent in January 2004. However, inflation rate softened during March 2004 and fell to below 5 per cent. The year 2003-04 ended with an annual point-to-point inflation rate of 4.6 per cent, while the 52 week average inflation rate was 5.5 per cent (Table 5.3). The high point-to-point inflation through much of 2003-04, and its sharp deceleration in March 2004, was partly because of the carry over of the price increase that took place in the last quarter of 2002-03, especially March 2003 (Table 5.2).

Table 5.2 : Point-to-Point inflation rate based on WPI

(Per cent)

Month	WPI (Base : 1993-94=100)		
	2001-02	2002-03	2003-04
APR	5.5	1.5	6.6
MAY	5.5	1.6	6.5
JUN	5.4	2.4	5.4
JUL	5.3	2.8	4.6
AUG	5.4	3.3	3.9
SEP	4.5	3.5	4.9
OCT	2.9	3.1	5.1
NOV	2.6	3.4	5.4
DEC	2.1	3.3	5.8
JAN	1.5	4.2	6.5
FEB	1.4	5.3	6.1
MAR	1.8	6.0	4.8
Average	3.6	3.4	5.5

Table 5.3 : Annual inflation rate based on Wholesale Price Index (base 1993-94=100)

(Per cent)

	End of year	52 week average
1995-96	4.4	8.0
1996-97	5.4	4.6
1997-98	4.5	4.4
1998-99	5.3	5.9
1999-00	6.5	3.3
2000-01	5.5	7.2
2001-02	1.6	3.6
2002-03	6.5	3.4
2003-04	4.6	5.5

5.8 The manufacturing sector is the major contributor to inflation accounting for nearly 80 per cent of the inflation in 2003-04. While the year end point to point inflation rate for the primary group in 2003-04 remained below 2 per cent, the same for the manufactured and fuel products groups were 6.7 and 2.5 per cent, respectively (Figure 5.1). Non-food articles in the primary products group, including fibres, raw cotton, oilseeds and sugarcane, recorded a high price rise during

the year 2003-04, consequent to the production shortfalls resulting from the drought of 2002. Within the manufacturing sector, food products, edible oils, textiles, leather and leather products, basic metal and alloys and iron and steel were the prime movers.

i. Manufactured products

5.9 Though there were some signs of a revival of the manufacturing sector at the end of 2002-03, the year 2003-04 started with sure signs of a pick up in industrial activity. The annual point-to-point inflation rate for the manufacturing sector remained in the range of 4-7 per cent during the year. The inflation rate in some major products in 2003-04 is given in Table 5.4.

Table 5.4 : Price increase in some major manufactured products

Major groups	Rate of inflation (per cent)	
	52 weeks average 2003-04	End March 2003-04
Manufactured products	5.7	6.7
Sugar	0.7	16.9
Edible oils	14.4	6.6
Textiles	7.7	8.8
Wood & wood products	0.2	0.3
Leather & leather prod	12.9	15.1
Chemicals & chemical prod	1.9	0.1
Urea	0.2	0.0
Cement	1.2	1.3
Basic metals & alloys	15.6	28.5
Iron & steel	26.3	34.6

5.10 The price rise in the manufactured products group witnessed during the first two months of 2004 was largely due to a rise in the prices of steel and sugar. Steel prices were pushed up by demand-supply imbalances and high international prices. Though the custom duty on steel imports was reduced from 25 per cent to 20 per cent in the month of December, and DGFT notification imposing non-tariff barriers on import of hot rolled coils withdrawn, domestic prices remained high. The rise in prices has been attributed to a rise in the prices of raw materials like coke, iron ore, scrap iron, sponge iron and nickel. Iron

and steel have a weight of 3.63 per cent in the WPI, and the steep rise in steel prices had a significant bearing on the overall inflation rate.

5.11 Like steel, sugar too has a large weight of 3.62 per cent in the WPI. Sugar prices rose because of the decline in production during the sugar season in 2003-04 (October-September). The rise in prices during January-February 2004 were reported to be on account of an artificial shortage created by mills not releasing any sugar during the first half of February 2004. Prices of sugar stabilised during March 2004.

5.12 The price rise in the manufactured products group has helped arrest the erosion in the domestic terms of trade of manufactured vis-à-vis agricultural products. Thus, the terms of trade for the manufacturing sector after deteriorating since 2000-01, staged a mild recovery in 2003-04 (Table 5.5).

Table 5.5 : Movement of manufactured prices vis-à-vis agricultural prices	
	Domestic terms of trade manufactured vis-à-vis agricultural price indices
1993-94	100.0
1994-95	96.7
1995-96	96.7
1996-97	91.2
1997-98	91.2
1998-99	85.0
1999-00	86.2
2000-01	86.6
2001-02	85.1
2002-03	84.5
2003-04	85.6

Note: Agricultural Prices Index is computed using the composite index of the sub-groups— Food Articles and Non-food Articles in the Primary Products group of the WPI.

ii. Primary products

5.13 The seasonality in primary product prices - an uptrend during summer months followed by a downtrend during winter months - was observed in 2003-04 as well, with price rise of primary products (on a point-to-point basis) in the range of 5-7 per cent till July 2003.

Thereafter, prices softened and the inflation rate in this group hovered close to 4 per cent till end January 2004. The inflation rate for this group declined further to below 2 per cent by end March 2004 (Table 5.6).

Table 5.6 : Price increase in some major primary products		
Some major groups	Rate of inflation (per cent)	
	52 weeks average 2003-04	End March 2003-04
Primary articles	4.3	1.6
Food articles	1.2	0.2
Rice	1.7	-2.0
Wheat	3.2	6.1
Fruits & vegetables	2.8	-4.9
Pulses	-2.2	-2.6
Non food articles (oilseeds, cotton, jute, sugarcane etc.)	12.6	4.1

5.14 The supply shortfalls for oilseeds, raw cotton and sugarcane, because of the 2002 drought, resulted in large increases in the prices of these commodities during 2003-04. However, despite the drought, prices of major staples - rice and wheat - remained quite stable with output shortfalls made up by releases from the buffer stocks of foodgrains with the Food Corporation of India (FCI). Onion prices firmed up during September-October, 2003 and then again during December, 2003-January, 04.

5.15 The September rains in onion producing areas had delayed both the harvesting of kharif onions as well as the sowing of the late kharif crop. As a result, the late kharif onion crop from Maharashtra, which was scheduled to arrive in the first week of January arrived late and led to a rise in onion prices, feeding into overall inflation.

iii. Fuel group

5.16 The Indian economy's dependence on crude oil imports from West Asia has made it vulnerable to changes in the international price of crude oil. The environment of uncertainty

created by the likelihood of war in the Gulf region had led to a hardening of crude oil prices towards the end of 2002-03. Consequently, the year 2003-04 started with a double-digit inflation of 11.2 per cent for the fuel group. The end of Iraq war and the subsequent softening of crude oil prices led to a moderation of domestic fuel inflation, which dipped to below 5 per cent by June 2003. Inflation started to pick up again after August 2003 to cross 8 per cent in December 2003, but moderated after February 2004 to reach 2.5 per cent in end March, 2004.

5.17 Organisation of Petroleum Exporting Countries' (OPEC) decision to cut crude oil production quota from November 1, 2003 gave a clear direction that crude oil prices would maintain a bullish trend during the winter months. Persistent terrorist activities in the region, non-resumption of normal supplies from Iraq, low commercial inventories of petroleum and increased energy demand in the US and Europe due to the severe winter created an environment of supply uncertainty, and put upward pressure on crude prices after November 2003. In response, domestic energy prices rose twice during December 2003. In spite of hardening of international petroleum prices, public sector oil marketing companies did not raise domestic energy prices after the hike announced on December 31, 2003. The OPEC announced a further cut in the production quota from April 1, 2004. Even though demand in the April-June quarter is expected to decline, the announcement did result in an immediate firming of prices.

Some major groups	Rate of inflation (per cent)	
	52 weeks average 2003-04	End March 2003-04
Fuel group	6.4	2.5
Coal mining	6.9	9.2
Mineral oils	7.7	0.0
Electricity	4.5	4.9

5.18 The inflation rate pertaining to coal and electricity also remained at a fairly high level contributing to the above six per cent average inflation rate for the fuel group in 2003-04 (Table 5.7 and Figure 5.1).

Movement in Consumer Price Index

5.19 Retail price inflation, commonly measured by the Consumer Price Index for Industrial Workers (CPI-IW), after touching a peak of 5.1 per cent in April 2003, decelerated more or less steadily to 3.5 per cent in March 2004 (Table 5.8 and Figure 5.2).

Month	2001-02	2002-03	2003-04
APR	2.3	4.7	5.1
MAY	2.5	4.7	4.7
JUN	3.4	4.2	4.4
JUL	4.0	3.9	4.2
AUG	5.2	3.9	3.1
SEP	4.7	4.3	2.9
OCT	4.2	4.1	3.3
NOV	4.9	3.6	3.1
DEC	5.2	3.2	3.7
JAN	4.9	3.4	4.3
FEB	5.2	3.9	4.1
MAR	5.2	4.1	3.5
Average	4.3	4.0	3.9

5.20 There is a strong case for revising the current series of CPI-IW that has 1982 as the base year. A more recent base year, and a new weighting scheme is needed to make the CPI-IW series capture the changing economic environment in a more realistic manner. The current series is not only outdated in terms of the base year, but also does not adequately reflect the changes that consumption patterns have undergone over the last two decades. For example, food has a weight of 57 per cent, while the fuel group has a weight of only 6 per cent and services (lumped in the miscellaneous group) are not adequately represented in the current CPI-IW series. This weighing pattern may not be appropriate for current times. Keeping in view this need for change, the index is being revised, and

Commodity group	Weight	2002-03				2003-04			
		Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
All commodities	100.00	1.3	2.1	0.5	1.3	2.2	0.5	1.4	1.6
Primary articles	22.03	1.9	2.8	0.5	0.3	3.1	-0.8	1.3	-0.4
Fuel, power, light & lubricants	14.23	0.9	2.9	0.8	2.7	1.0	0.7	1.7	2.7
Manufactured products	63.75	1.2	1.6	0.3	1.1	2.3	1.0	1.3	2.0

Source : Office of Economic Adviser, Ministry of Industry.

Commodity group	Weight	2002-03				2003-04			
		Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4
		Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar
General	100.00	1.1	2.3	0.7	-0.4	2.1	1.0	0.7	0.2
Food	57.00	-0.3	4.6	0.5	-1.7	3.1	1.0	0.7	-0.8
Pan, supari, tobacco & intox.	3.15	-0.6	1.5	0.5	0.7	0.9	1.3	0.8	1.3
Fuel & light	6.28	-3.9	8.1	2.3	1.7	2.1	-0.4	1.6	3.3
Housing	8.67	-7.6	11.3	0.0	2.5	0.0	2.3	0.0	1.5
Clothing, bedding & footwear	8.54	-1.1	2.3	-0.4	1.0	0.8	0.5	-0.5	1.1
Miscellaneous group	16.36	-2.3	5.2	1.4	0.9	0.6	0.7	0.9	1.0

Source : Labour bureau, Shimla/Chandigarh.

preliminary work in this regard has already been completed.

5.21 Quarterly movement of WPI and CPI inflation by major groups in 2002-03 and 2003-04 are presented in Tables 5.9 and 5.10.

Commodity profiles: Sugar and edible oils

i. Sugar

5.22 Not only is the sugar industry one of the largest industries in the Indian economy, but also India is the largest producer of sugar next to Brazil. Maharashtra contributes over a third of the country's sugar output followed by Uttar Pradesh with 25 per cent share. With consistently high production, the industry had large stocks of sugar for the 3 sugar seasons (October – September) ending in September 2003. Production of sugar during 2002-03 season was 201 lakh tonnes as against 183 lakh tonnes in 2001-02. The production in the

current sugar season i.e. 2003-04 is estimated at 140 lakh tonnes. The reduction in sugar production is on account of drought in some of the major sugar producing states and infestation by white woolly aphids in some areas. The closing stock at the end of 2003-04 season is estimated to be around 80 lakh tonnes.

5.23 In order to avert a fall in prices resulting from excess supply, the Central Government controls the sale of sugar by sugar mills in the open market. The Sugar Directorate assigns the quantity of free sale sugar that may be sold by each sugar mill in each month of the year. A 'release mechanism' is followed for free sale and levy sugar uniformly. Under the policy of partial price control, a specified percentage (currently 10 per cent) of total production of each sugar factory is procured as levy sugar at notified prices for distribution through the

Box 5.2 : Steps taken by the Government during 2003-04 to help sugar industry

- To encourage exports, neutralization of ocean freight disadvantage at the rate of Rs. 350 per tonne on account of export shipments of sugar were permitted with effect from February 14, 2003.
- With effect from 3rd October, 2003, handling and marketing charges have been allowed @ Rs. 500 per M.T.
- The Essential Commodities Act, 1955 was amended to restore the Government's authority to regulate free sale releases, ensure that the sugar mills do not sell sugar in excess of the quota released by the Government, and Courts do not intervene in the regulated "release mechanism".
- Following the Finance Minister's Budget 2003-04 announcement, an inter-ministerial group constituted with Ministry of Food and Ministry of Finance representatives jointly addressed the problems of the sugar industry, and submitted its report to the Government in July 2003.
- In August, 2003, the Central Government approved a one-time assistance of Rs.678 crore to the States of Uttar Pradesh, Uttaranchal, Punjab, Haryana, and Bihar to clear sugar cane arrears of private sugar factories to farmers. The assistance was in respect of the difference between the State Advised Price (SAP) and Statutory Minimum Price (SMP) of 2002-03 sugar season, and was in the form of a soft loan to the relevant State Governments at a concessional rate of interest of 4 per cent per year, with a maturity of six years and an initial moratorium of three years.
- The State Governments where the practice of SAP was not in vogue represented to the Central Government for similar assistance. The Cabinet on October 3, 2003 acceded to the request and also approved further assistance to the SAP States. The SAP and Non-SAP States were allowed additional market borrowings of about Rs. 1,885 crore. Taking into account the Central Assistance of Rs.678 crores already allowed to SAP States, the total Central Assistance to the SAP and Non-SAP States to clear cane arrears of 2002-03 sugar season works out to about Rs. 2,563 crore.
- For financing the development activities of the sugar sector, a cess of Rs.14 per quintal is levied. The proceeds from the cess are credited to the Sugar Development Fund to fund development activities of the sugar sector. The Cabinet has given an in-principle approval for an increase in the rate of the cess on output of sugar to Rs.20 per quintal. The additional duty of customs (countervailing duty) on import of sugar, which is equivalent to the basic excise duty plus additional excise duty and cess, would also be increased from Rs. 85 per quintal to Rs. 91 per quintal.

PDS. Government decided to retain both the levy provision as well as the release mechanism till October 2005. A host of other steps were also taken during 2003-04 to mitigate the difficulties of sugarcane growers (Box 5.2).

ii. Edible oils

5.24 Demand for edible oils in the country has been increasing, widening the gap between domestic requirement and production, which is filled through imports. With the price support policy favouring foodgrains, there is very little incentive for the farmers to move away from the production of foodgrains to oilseeds. The support price policy for foodgrains has been a major deterrent to crop diversification.

5.25 In the absence of any likelihood of an immediate major technological breakthrough in the production of oilseeds in the short run, an incentive regime for producers of oilseeds

and edible oils has to be put in place through the instruments of a supporting price policy and an effective tariff framework. Due caution, however, will have to be exercised to reconcile the interests of the producers with that of the consumers. A freeze of the Minimum Support Prices (MSP) of rice and wheat may be an economically sounder option for maintaining inter-crop price parity instead of increasing the MSPs of oilseeds. Increasing the MSP of oilseeds, besides imposing a fiscal burden, will also exert an upward pressure on the market price of this essential commodity. There are limits to the extent that tariffs can be used as an instrument of crop diversification. Import duty on edible oils is already high. A further increase in duty will lead to further hardening of domestic prices.

5.26 Edible oil prices rose by 6.6 per cent in 2003-04, after a hefty rise of 27 per cent in 2002-03. Domestic prices of edible oils have been on the rise for the last two years in

succession mainly because of a hardening of international prices and drought in 2002 affecting adversely domestic products of oilseeds. To counter the bullish trend, the excise duty of 8 per cent on refined edible oils imposed in the Union Budget for 2003-04 was replaced in April 2003 by a specific duty of Re.1 per kg on refined edible oils and Rs.1.25 per kg on vanaspati. Import tariff on refined palm oil was reduced from 92.2 per cent to 70 per cent with exemption from 4 per cent SAD. These measures had a salutary effect on the prices of edible oils and the rising trend was arrested. Nevertheless, wholesale and retail prices in 2003-04 continued to rule above the 2002-03 levels. Revised tariff values — the assessable values on which the customs duty is payable — were announced twice during October 2003, and for the third time, in November 2003, in line with hardening international prices.

Services Price Index

5.27 In pursuance of the recommendations of the Working Group on the revision of the WPI, work on the development of the Services Price Index covering key services sectors has been initiated by the Government (Box 5.3).

II

Food management

Production of foodgrains

5.28 Rice production, as per the third advance estimates issued by the Directorate of Economics and Statistics for 2003-04, is expected to be 86.4 million tonnes as against 72.66 million tonnes in 2002-03. In the case of wheat, the third advance estimate for the 2003-04 season is 72.7 million tonnes, up from 65.10 million tonnes in 2002-03.

Procurement of foodgrains

5.29 Wheat procurement during 2003-04 was 15.8 million tonnes as against 19.05 million tonnes in 2002-03. Fresh procurement for the 2004-05 season (April-March) has reached 16.4 million tonnes.

5.30 Rice procurement during kharif season 2003-04 was at a high of 21.49 million tonnes as against 15.66 million tonnes in the kharif season 2002-03. With rabi rice coming to the market, some more procurement may be expected in the coming months (Table 5.11).

Box 5.3 : Progress on development of the Services Price Index

The Working Group on the WPI recommended that a separate Services Price Index Numbers should be developed which would initially incorporate the following services:

- i. Financial services (such as banking and insurance),
- ii. Transport services (road and rail),
- iii. Communication (Postal and telecommunications),
- iv. Water supply, and
- v. Construction activities.

The Group has suggested that the Index be integrated with the WPI once the series gets stabilised.

The work relating to the Services Price Index is being carried out by the Office of the Economic Adviser, Ministry of Industry. The Office has got approved a Plan Scheme "Business Service Price Index" in the Tenth Five Year Plan. The practices adopted by the developed countries, particularly USA, UK, Japan and Australia, in compilation of the services price indices, with particular reference to concepts, scope and coverage, methodology for identification of representative services and index calculation have been reviewed.

Consultation meetings have been held with concerned Organisations/ Departments/sector specific experts, on issues involved in developing sector-specific service price indices. Consultations have been initiated with regard to road transport, air transport, railways, ports, postal services, telecom services, banking and insurance. Technical assistance as part of India's Statistical Strengthening Project from the World Bank for conducting sector-specific surveys to collect data on key services has also started. Sector-specific surveys/studies are proposed to be conducted during 2004-05 and 2005-06, in consultation with the CSO and other Departments and experts.

Table 5.11 : Procurement of wheat and rice (Central Pool)				
<i>(Million tonnes)</i>				
Marketing Year	Wheat (April - March)		Rice (Oct - Sept)	
	Qty	change (per cent)	Qty	change (per cent)
1995-96	12.33	3.9	9.95	-25.7
1996-97	8.16	-33.8	12.22	22.8
1997-98	9.30	14.0	14.33	17.3
1998-99	12.65	36.0	11.84	-17.4
1999-00	14.14	11.8	17.27	45.9
2000-01	16.35	15.7	19.10	10.6
2001-02	20.63	26.1	21.28	11.4
2002-03	19.05	-7.7	16.41	-22.9
2003-04	15.80	-17.1	21.49*	
2004-05	16.40*			

* As on May 9, 2004
Source : Department of Food and Public Distribution.

5.31 Andhra Pradesh, Punjab and Haryana account for over 65 per cent of the rice procurement, while only Punjab and Haryana account for nearly 90 per cent of the wheat procured. There has been significant procurement of rice in 2003-04 from the non-traditional states as well. Over 2 million tonnes of rice was procured from Chattisgarh, which is higher than the 1.3 million tonnes procured from Haryana.

Minimum Support Price

5.32 Keeping in view the interests of the farmers as also the need for self reliance, Government has been announcing Minimum Support Prices (MSP) for 24 major crops including paddy, wheat, jowar, bajra, maize, ragi, pulses, oilseeds, copra, cotton, jute, sugarcane and tobacco. Keeping in view the hardships suffered by the farmers in the drought last year, MSP of wheat for the 2003-04 season was raised to Rs.630/quintal while that of paddy was raised to Rs. 550 per quintal for common variety and to Rs.580 per quintal for Grade A variety (Table 5.12). The special drought relief of Rs.20 per quintal for paddy

and Rs.10 per quintal for wheat announced for the 2002-03 season were absorbed in the MSP for 2003-04 season.

Buffer stocks

5.33 In addition to the requirements of wheat and rice under the Targeted Public Distribution System (TPDS), the Central Pool is required to have sufficient stocks in order to meet emergencies like drought/failure of crops, and undertake open market sale in case of a sharp rise in market prices. The minimum buffer stock norms as well as actual stocks in the Central Pool at the beginning of the four quarters for 2001-2004(April) are given in Table 5.13. The stocks currently with the FCI are over and above the minimum requirements and the foodgrains situation is comfortable. Foodgrain stocks as on April 1, 2004 were 20 million tonnes (Rice stocks of 13.1 million tonnes and wheat stocks of 6.9 million tonnes) as against 32.8 million tonnes on April 1, 2003.

5.34 Buffer stocks have to reconcile the conflicting needs of ensuring a comfortable availability position with the need to economise on wastage, storage costs and interest on credit availed for food procurement and storage. Thus, there is merit in sticking close to the buffer stock norms. Manageable levels of stocks facilitate better grain management, lesser wastage, reduced carrying cost, lower food credit requirement and a lower food subsidy bill.

Offtake

5.35 Total offtake of foodgrains from the Central Pool during 2003-04 (up to March 2004) was 47.93 million tonnes as against 49.64 million tonnes during 2002-03. Export of foodgrains accounted for 21.5 per cent (10.3 million tonnes) of the total offtake, while welfare schemes absorbed another 28.2 per cent (13.5 million tonnes).

5.36 Encouraging output of rice and wheat in 2003-04 ensured robust procurement at the ruling MSP and stock replenishment. WPI-based average inflation rates were low or modest at 1.8 per cent for rice and at 3.10 per cent for wheat. Off-take for the public distribution system in 2003-04 remained more

Table 5.12 : Minimum Support/Procurement Price of wheat and paddy

(Rs/quintal)

Crop Year	Wheat		Paddy				Grade 'A'
	MSP	change (per cent)	Common	change (per cent)	Fine	Super fine	
1992-93	330	20.0	270	17.4	280	290	-
1993-94	350	6.1	310	14.8	330	350	-
1994-95	360	2.9	340	9.7	360	380	-
1995-96	380	5.6	360	5.9	375	395	-
1996-97	475	25.0	380	5.6	395	415	-
1997-98*	510	7.4	415	9.2	-	-	455
1998-99	550	7.8	440	6.0	-	-	470
1999-00	580	5.5	490	11.4	-	-	520
2000-01	610	5.2	510	4.1	-	-	540
2001-02	620	1.6	530	3.9	-	-	560
2002-03	620 \$		530\$	0.0	-	-	560\$
2003-04	630	1.6	550	3.8			580

For MSP of other crops, see Appendix-5.5.

* Effective 1997-98, MSP is fixed for only two varieties of paddy, common and grade-A.

\$ One Time Special Drought Relief of Rs. 20/- per quintal was given in the case of paddy over and above the existing MSP and for wheat the Special Drought Relief was Rs. 10/- per quintal.

Source : Ministry of Agriculture.

Table 5.13 : Central foodgrain stocks and minimum buffer stock norms

(Million tonnes)

Beginning of the month	Wheat		Rice		Total (wheat and rice)	
	Min. norm	Actual stock	Min. norm	Actual stock	Min. norm	Actual stock
January-2001	8.4	25.0	8.4	20.7	16.8	45.7
April	4.0	21.5	11.8	23.2	15.8	44.7
July	14.3	38.9	10.0	22.8	24.3	61.7
October	11.6	36.8	6.5	21.5	18.1	58.3
January-2002(P)	8.4	32.4	8.4	25.6	16.8	58.0
April	4.0	26.0	11.8	24.9	15.8	50.9
July	14.3	41.1	10.0	21.9	24.3	63.0
October	11.6	35.6	6.5	15.8	18.1	51.4
January-2003 (P)	8.4	28.8	8.4	19.4	16.8	48.2
April	4.0	15.6	11.8	17.2	15.8	32.8
July	14.3	24.2	10.0	11.0	24.3	35.2
October	11.6	18.4	6.5	5.2	18.1	23.6
January- 2004(P)	8.4	12.7	8.4	11.7	16.8	24.4
April	4.0	6.9	11.8	13.1	15.8	20.0

(P) Provisional

Source : Department of Food and Public Distribution.

Table 5.14 : Foodgrains allocation and offtake under Public Distribution System
(Million tonnes)

Year	Wheat		Rice	
	Allocation	Offtake	Allocation	Offtake
1992-93	9.25	7.47	11.48	9.55
1993-94	9.56	5.91	12.41	8.87
1994-95	10.80	4.83	13.32	8.03
1995-96	11.31	5.81	14.62	9.75
1996-97	10.71	8.52	15.10	11.14
1997-98	10.11	7.08	12.83	9.90
1998-99	10.11	7.95	12.93	10.74
1999-00	10.37	5.76	13.89	11.31
2000-01*	11.57	4.07	16.26	7.97
2001-02*	13.14	5.68	17.23	8.16
2002-03*	38.66	9.78	36.02	10.35
2003-04*	37.11	10.71	34.46	12.08

* including Antyodaya
Source : Department of Food and Public Distribution.

or less constant at the higher level observed in 2002-03 (Table 5.14). Availability of rice and wheat is likely to remain comfortable in the coming months.

Policy concerns

i. Food subsidy

5.37 The food subsidy bill, which was Rs.2,450 crore in 1990-91, increased to Rs.27,746 crore in 2004-05 (Table 5.15). The reasons for this increase are not far to find. The increases in MSP every year (Table 5.12), resulted in surpluses replacing shortages. Consequently, despite the recent deceleration in the growth of food-grains output, procurement has increased significantly over the years (Table 5.11). Attractive MSPs and Government's policy of open-ended procurement encouraged farmers to sell their produce to the Government rather than in the open market. During 2000-01 and 2001-02, there was an excessive build-up of public stocks much above the minimum buffer stock norm (Table 5.13). Large volumes of unsold public stocks pushed up the carrying cost, and raised the subsidy burden.

5.38 The enhanced MSP every year, with the associated increase in economic cost (Table 5.17), was not passed on to issue prices under PDS (Table 5.16). But even when the issue price was increased, the misalignment of the MSP – hence the economic costs– with what the market could bear demonstrated the fundamental problem of too high an MSP. Required adjustment of the MSP and realignment of the issue price in line with economic cost can bring about a durable solution to the food subsidy problem.

5.39 Costs incurred by the FCI in carrying out the procurement operations are fully reimbursed by the Government. Over the years, the costs incurred by the FCI have been rising. Further, high statutory levies (including mandi charges, cesses and fees to commission agents) on grain purchase at the State and local levels not only discourage private trade but also increase the FCI's cost, thus putting a pressure on the food subsidy bill. The levies imposed by the State Governments differ from State to State and are the highest in the case of Punjab, Haryana and Andhra Pradesh. A possible resolution of the problem can be through the Government announcing only the procurement price (MSP plus 4 per cent) and leaving it to the States to notify how the procurement price will be shared between the farmers and the State/local Governments.

Table 5.15 : Food subsidy

(Rs. crore)

Year	Food subsidy (Other than sugar)
1996-97	6,066
1997-98	7,500
1998-99	8,700
1999-00	9,200
2000-01	12,010
2001-02	17,494
2002-03	24,176
2003-04	25,160
2004-05 (BE)	27,746

Source : Budget documents

Table 5.16 : PDS issue price of wheat and rice				
(Rs/quintal)				
Year	Wheat	Change (per cent)	Rice	Change (per cent)
1990-91	234	-	289	-
1991-92	280	19.7	377	30.4
1992-93	280	0.0	377	0.0
1993-94	330	17.9	437	15.9
1994-95	402	21.8	537	22.9
1995-96	402	0.0	537	0.0
1996-97	402	0.0	537	0.0
1997-98				
BPL	250	-	350	-
APL	450	-	700	-
1998-99				
BPL	250	0.0	350	0.0
APL	650	44.4	905	29.3
1999-2000				
BPL	250	0.0	350	0.0
APL	682	4.9	905	0.0
2000-01				
BPL	415	66.0	565	61.4
APL	830	21.7	1130	24.9
2001-02				
BPL	415	0.0	565	0.0
APL	610	-26.5	830	-26.5
2002-03				
April				
BPL	415	0.0	565	0.0
APL	510	-16.4	730	-12.0
July				
BPL	415	0.0	565	0.0
APL	610	19.6	830	13.7

5.40 The policy of providing price support by raising the MSP continuously has distorted domestic prices and eroded export competitiveness. India is now an exporter of grains and an exporting country cannot have its domestic grain prices greatly out of sync with free-on-board export prices.

5.41 In order to minimize the burden on the budget, as well as the interest cost of funding the buffer stock operations of the FCI, from April 1, 2004, FCI has been permitted to

borrow directly from the market through bonds backed by a Government guarantee. This will enable the FCI to fund its requirements at a cheaper rate, which is closer to the rate that the Government pays for its borrowed funds. This is likely to contribute to a reduction in the revenue expenditure of the Central Government, on account of food subsidy, by a minimum of Rs. 2,000 crore per annum.

ii. Food credit

5.42 Food credit by banks includes credit to the FCI, State Governments and State Co-operative agencies for purposes of food procurement. It accounts for about 5-6 per cent of the total bank credit. Food credit for FCI's procurement operations is provided by a consortium of 50 commercial banks led by the State Bank of India, and equals the amount required to finance procurement, stocking and distribution operations during any cropping season. Credit is secured against the FCI inventory and partially guaranteed (25 per cent) by the Central Government. Food credit is backed by fully paid-up stocks valued at the issue price. The closing stocks of foodgrains are valued at acquisition cost or the issue price whichever is lower. Open-ended procurement requires open-ended bank credit. Food credit is in the nature of an extended running account, with no deadline for repayment. The outstanding food credit is repaid as and when there is a drawdown in stocks through off-take.

5.43 Increase in procurement results in an increase in stocks as well as in the outstanding food credit, while increased off-take results in decline in stocks and in the outstanding credit. During the last one year, the increase in off-take has been much higher than the increase in procurement resulting in a decline in both stocks and outstanding food credit. However, the decline in food stocks has been higher than the decline in credit reflecting the particular method of stock valuation.

iii. Food security

5.44 The fiscal unsustainability of providing food security through buffer stock operations is becoming increasingly evident. The carrying cost of the buffer stocks have been rising substantially in recent years, currently

Table 5.17 : Economic cost of rice and wheat						
<i>(Rupees per quintal)</i>						
	1999-00	2000-01	2001-02(P)	2002-03(P)	2003-04(RE)	2004-05 (BE)
Rice						
A. Acquisition Cost	887.30	1014.04	1052.66	1015.18	1045.58	1069.60
(i) Pooled cost of grain	831.24	930.41	961.16	944.27	970.68	993.23
(ii) Procurement incidentals	56.06	83.63	91.50	70.91	74.90	76.37
B. Distribution Cost	187.50	166.43	151.61	168.49	207.46	192.91
Economic Cost (A+B)	1074.80	1180.47	1195.55	1183.67	1253.04	1262.51
Wheat						
A. Acquisition Cost	685.51	716.60	739.13	754.55	778.04	784.54
(i) Pooled cost of grain	518.08	580.66	571.93	601.33	621.74	627.78
(ii) Procurement incidentals	117.06	135.94	167.20	153.22	156.30	156.76
(iii) Carry over charges to State Governments	50.37	-	-	-	-	-
B. Distribution Cost	202.00	141.66	132.17	160.16	174.47	140.28
Economic Cost (A+B)	887.51	858.26	859.20	914.71	952.51	924.82

accounting for about 25 per cent of the food subsidy bill : Storage losses are high. The procurement incidentals, distribution and administrative cost, together with the carrying cost form a very high proportion of the actual purchase cost of the grain. A redesign of the food security framework is an imperative need for maintaining fiscal sustainability.

5.45 In the last two years, food stocks have been used as a principal resource for poverty alleviation programmes under the various welfare schemes. The Mid Day Meal scheme, Sampoorna Gramin Rozgar Yojana are the two major welfare schemes that absorbed a substantial off-take of food-grains. In the longer run, with resources currently being spent on holding stocks, it should be possible to eliminate hunger, make a significant dent on the current appalling levels of malnutrition among India's children, and augment the quality of our human resources.

5.46 From April 1, 2004, coverage of the Antyodaya scheme was raised by another 50 lakh by the Interim Budget 2004-05, thus raising the number of beneficiaries to 2 crore of the poorest of the poor families.

iv. Decentralisation

5.47 The proposal to decentralise procurement of foodgrains is intended to benefit both the farmers and the consumers, while reducing the fiscal burden of the Government. Under the decentralisation scheme, instead of the FCI procuring the grains, the States carry out the procurement operations locally, and are paid the difference between the economic cost and the Central Issue Price as subsidy. FCI would continue to procure foodgrains for maintaining food security reserves and for such State Governments who would assign it this task on their behalf. Decentralised procurement has already been initiated in a limited way in Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh.

5.48 Despite its merits, decentralised procurement has not gained much ground as States feel that they do not have the necessary infrastructure and financial resources to undertake procurement operations on the required scale and for a long period. Further, additional storage capacity would have to be created before decentralised procurement

could be initiated. States also feel that decentralised procurement should be preceded by a proper network of roads and market places in rural regions, or farmers would suffer from distress sales and only traders would benefit.

5.49 There is no alternative to decentralisation in the long term. Decentralised procurement operations will help save transport cost, and reduce the overall economic cost of procurement. State Governments and private trade need to be induced to enter into food-grains trade covering procurement, storage and exports, and all barriers to private trade, economic as well as legal, should be removed.

v. Crop diversification & food processing

5.50 Given the changing dietary patterns, crop diversification is critical at the current stage of India's agricultural development. One consequence of the recent MSP policy has been to disturb inter-crop price parities, leading to a shift of area towards cereals — even as there are huge stocks — often from crops such as oilseeds, when there are huge edible oils imports.

5.51 Food processing industry is of enormous significance for India's development because of the vital linkages and synergies that it promotes between the two pillars of the economy, namely industry and agriculture. Economic liberalization and rising consumer prosperity are opening up new opportunities in the food processing sector. Liberalization of world trade will open up new vistas for growth. Presently India's share in the world trade of processed fruits and vegetables is still less than one per cent. Abundant investment opportunities exist in the expanding domestic and international markets. The comparative advantage that the country has in the production of non-cereals and horticultural crops, like fruits and vegetables, need to be harnessed, and efforts directed at expanding their markets. With trade barriers gone, the country can look to the global market for export of processed agro-products. To compete, what is needed is not only cost-efficiency, but also appropriate product and quality standards.

What is required is an investment strategy on the same lines and vigour, as was adopted to usher in the green revolution in cereal crops.

vi. Exports

5.52 In view of the surplus position of foodgrains much above the norms stipulated for the Ninth Plan, a series of measures were taken to liquidate the stocks. From a peak level of 648.3 lakh tonnes in June 2002, stocks in August 2003 fell below the minimum requirement. Reflecting the effort to liquidate the surplus stocks of foodgrains, off-take from the Central Pool for exports picked up considerably during the last two years. India, exported over 20 million tonnes of foodgrains during the last two and half years, and emerged as one of the leading exporters of foodgrains (second in case of rice and seventh in case of wheat) in the world grain market. The subsidy incurred on exports is estimated to be much lower than the expenditure that would have been incurred on carrying these foodgrains had they not been exported. There is need for a more pro-active policy in respect of export of foodgrains, rather than using exports simply as an adjustment mechanism to dispose of surplus food grains, if any. There is need for establishing India as a reliable exporter of foodgrains to get a profitable outlet for channelising the country's surplus foodgrains.

Outlook

Inflation

5.53 The falling inflation rate starting mid-February 2004, induced mainly by the falling prices of primary articles and subdued inflation in the fuel group, has continued in the new fiscal. The point-to-point inflation rate which was 4.40 per cent in the beginning of 2004-05 declined to 4.20 per cent in mid-May 2004, before crossing the 5 per cent mark marginally, mainly because of the seasonal increase in prices of fruits and vegetables during this part of the year.

5.54 Comfortable stock position of foodgrains (foodgrain stock as on May 1, 2004 was 33.7 million tonnes as against the buffer norm of 15.8 million tonnes), and Met

Department's projection of a normal monsoon (the early indication of which is the advancement of Monsoon, 2004 by a fortnight resulting in widespread rainfall in the drought affected southern peninsula) augur well for the country. The conditions at present which look to be more favourable for the primary sector, which had to suffer during 2003-04 from the carry-over effect of a bad monsoon, are expected to keep the inflation rate of the primary sector in 2004-05 at a level lower than the average inflation rate of 4.2 per cent during 2003-04.

5.55 The inflation rate for the manufacturing sector, which remained above five per cent for most of the period in 2003-04, averaging 5.7 per cent for the year, has shown signs of softening beginning with the fiscal 2004-05. The rising inflation rates in sub-groups, food products (edible oils and sugar), basic metals (iron & steel), textiles, and cement, the prime movers in 2003-04, have been arrested during the fiscal 2004-05. The year 2004-05 is, therefore, likely to witness a relatively lower inflation rate in the manufacturing group as compared to the annual average of 5.7 per cent in 2003-04.

5.56 Barring the uncertainties of movement of international prices of petro-products, there is reason to believe that the inflation rate during 2004-05 would remain around 5 per cent as projected by the RBI.

Food management

5.57 The comfortable supply situation and remarkable price stability in respect of foodgrains in different parts of the country, despite 2002 poor monsoon, have demonstrated the relevance of our food security system, notwithstanding the recent debate about its utility in the context of ongoing liberalisation of trade in foodgrains and the comfortable foreign exchange reserves position. However, the fiscal implications of the mounting food subsidy, which has grown over

10 times since the early nineties to reach the massive level at Rs 25,160 crore in 2003-04, is a serious threat to the sustainability of the country's food security system in its present form. There is need to address the issues adversely affecting the efficacy of the food security system. The fixation of the MSP of foodgrains has to bear distinct relationship to the cost of production. High MSP apart, factors such as high level of state levies on procurement, high cost of borrowing to FCI, highly centralised system of procurement and distribution, and management inefficiency, which have been adversely affecting the economic cost of foodgrains to FCI, have to be addressed expeditiously.

5.58 It is a matter of some satisfaction that the year 2003-04 has seen progress in some of these areas. There has been no hike in the MSP of both paddy and wheat during the year (with the absorption of special drought relief, the MSP of paddy and wheat remains in effect at the last year's level). The Government has permitted FCI to float its own bond to mobilise its finances at a much cheaper rate as compared to its current cost of borrowing from the banks. The States/UT such as Assam, Tripura, Orissa and A&N Islands, who are not currently covered under the scheme of decentralised procurement, have evinced an interest to participate in the scheme.

5.59 There is need for carrying forward these good initiatives. Thus there has to be restraint in hiking the MSP of foodgrains till it equals the C2 cost of production of the least cost State. The reservation of the States for adoption of decentralised procurement has to be addressed to persuade more States to go for this cost-effective system. There has to be rationalisation of the existing high level of State levies in foodgrains. The proposal to announce a procurement price inclusive of 4 per cent State levies in lieu of the MSP, which is under the consideration of the Government, needs to be pursued.