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Final Report I

**RE-EQUILIBRATING  
BANGLADESH'S PUBLIC FOOD DISTRIBUTION SYSTEM (PFDS)**

**by**

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Bangladesh Food Policy Project**

**Funded by USAID under Contract No. 388-0027-C-00-9026-00**

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The author accepts full responsibility for the views expressed in this report as well as for any errors or omissions. The contents do not necessarily reflect the position of USAID or the Ministry of Food, Government of Bangladesh.

RE-EQUILIBRATING  
BANGLADESH'S PUBLIC FOOD DISTRIBUTION SYSTEM (PFDS)

I. Recent Reforms

The Public Food Distribution System (PFDS) is a complex organism. Adjustments in one part of the system knock another out of alignment. So any major change requires subsequent adjustment elsewhere in the system.

Recently, two important government decisions have knocked the PFDS out of balance. First, for very sound reasons, they abolished Rural Rationing, a leaky channel operated at high cost and with minimal impact on its intended poor beneficiaries. Second, the extraordinarily high procurement price of 245 taka per maund of paddy led to heavy procurement through millgate contracts. Since Rural Rationing provided the outlet for half of all government rice stocks, its abolition during a year of heavy procurement provoked a heavy buildup of stocks with no obvious outlet.

So abolition of Rural Rationing requires two subsequent actions. In the short run, government must find an alternate outlet for 400,000 tons of rapidly deteriorating rice. In the medium term, they must re-equilibrate the system. Either they must lower procurement quantities, and therefore procurement price, or they must increase offtake through other channels.

This brief review summarizes issues and options for structural adjustment over the medium term.

II. Key Medium-Run Issues in Food Policy

Public food management centers around the Public Food Distribution System (PFDS). Conceptually, it is easiest to think of the PFDS as a large box in which government stores its foodgrain stocks (Figure 1). The key issues in public food policy boil down to how the box should be filled, how big it should be, and how to empty the box.

1. Procurement. Government fills its PFDS godowns from two principal sources: imports, primarily of wheat, and local procurement, primarily of rice.

In international procurement, key current issues involve the private sector and how much of foodgrain imports can simply be devolved to flour millers, large employers and other large traders. Government has recently moved strongly to encourage private import. If this succeeds, the millers, large employers and others will be able to import directly on their own bypassing the PFDS and making the box smaller.

For domestic procurement, key issues include procurement price and method. The current move to open tendering addresses both at a single stroke. In doing so, it avoids the complex annual debate about where to set the procurement prices. Under tendering, government simply procures the quantities it needs at the market price. The price they pay floats up during the season as market price rises. Tendering offers enormous cost savings as well as obviating the need for complex, imprecise forecasts of future prices.

2. Optimal Public Stock Levels. How big should the box be? This is in many ways the central question in food policy. In part, the size of the box depends on the effectiveness of private traders in marketing and storing grain.

It also depends on what objectives the PFDS is meant to address. Three are commonly cited: a) provide security stocks; b) price support; and c) targeted relief to the poor. Future adjustment will require decisions on which of these objectives hold priority.

a. Security stock levels. Few observers doubt the critical importance of this objective given Bangladesh's vulnerability to cyclones and floods. If a security stock is required, how big should public stocks be? Clearly this depends in part on the size of privately held stocks. Recent evidence indicates that private stocks, mostly on-farm stocks, have tripled over the past few decades. This very rapid increase in privately held on-farm stocks suggests that required public stock levels may be less now than before. Although this question merits more careful scrutiny, the numbers commonly advanced for public security stocks range from 5 to 6 lakh tons of foodgrains.

b. Price stabilization. Does price stabilization matter? Given rapid change in price seasonality and greatly dampened price fluctuations (Figure 2), it will be important to review the price stabilization objective.

Doing so requires recognition that price stabilization has two contradictory components. One focuses on dampening consumer price rises during the lean season. The other aims to artificially prop up farm prices immediately after harvest.

For consumers, the case for intervention to dampen lean season prices is much weaker today than it was 20 years ago. Seasonal trough-to-peak price increases have dropped in half with the appearance of a major boro season rice crop (Figure 2). IFPRI's ongoing consumption studies will, over the next four to six months, allow us to clearly measure the nutritional impact of the current diminished price seasonality. It will also allow a comparison of the costs and benefits of price stabilization as opposed to income targeting as a means of addressing the needs of vulnerable groups.

For farmers, steadily lower costs of production and continued high profitability of rice production (see IFPRI/BIDS forthcoming Agricultural Diversification study) suggest that input availability, rather than output pricing, may carry much of the burden of maintaining farmer incentives. In sum, the case for price stabilization is much weaker than it was 20 years ago and now requires careful review.

If government does persist in pursuing this objective, how much public stocks are required to manage a continued dual price stabilization effort? Recent work by IFPRI suggests that stocks in the range of 7.5 lakh tons would suffice, if managed properly.

c. Targeted relief. How much targeted relief can government afford? This is purely a political and budgeting question. As an order of magnitude, in the recent years relief channels have absorbed 7 to 10 lakh tons per year, primarily financed by food aid. In light of declining aid levels and continued fiscal stress, this level is subject to review.

3. Outflows and balancing the box. How to empty the box is a complex question closely tied to the choice of food policy objectives government chooses to pursue. Security stocks require an outlet for rotating stocks. Price stabilization requires an offtake channel that simply introduces extra supply into the system at critical times. Targeted relief requires direct delivery to the poor, or monetization and delivery of cash.

The most difficult question of all is how to balance the overall system, how to match inflows and outflows. The key will be to find a mechanism with clear, predictable rules that will rotate government stock and balance inflows and outflows, without disrupting signals to private traders.

Consider four potential balancing mechanisms.

- **Exports** allow an important safety valve for offloading both public and private stocks in years of surplus production. Imports augment supplies when domestic prices are high. Recent liberalization of foodgrain trade offer a crucially important tool for flexible public food management.

- **Domestic auctions** of government foodgrains offer another potentially interesting option for disposal of public stocks. But timing and operational mechanisms will need require careful review. This or some other sort of flexible open market operation will be essential for rotating security stocks and dampening seasonal price spikes, if that objective is retained. An open market outlet allows government to operate as a large trader and even make money while at the same time moderating fluctuations in domestic food markets.

- **Relief channels** offer advantageous outlets for government foodgrains given that they may not depress market prices as much as open market auctions or sales. But these outlets are much costlier than exports and domestic sales, since the relief channels involve large public financial subsidy.

- **Livestock industries** offer a standard shock-absorber in wealthy foodgrain economies. When grain prices fall, livestock production increases, thus helping to lift slumping grain prices. When grain prices rise, livestock feed becomes more expensive, livestock production falls and this eases upward pressure on grain prices. Although not widespread in Bangladesh, future development of the livestock industry will offer important suppleness and flexibility to Bangladesh's foodgrain economy.

### III. Broad Options for the Future

#### A. A Minimalist Plan

The least cost, least interventionist strategy for public intervention would involve adopting only Objective 1, the security stock objective, and rotating the stocks through export or domestic open market sales. Government would act as a trader and could even make money while maintaining and rotating security stocks.

#### B. More Ambitious Programs of Public Intervention

If government wishes to add on a price stabilization objective, Objective 2, it will raise public stock requirements to about 7.5 lakh tons and increase costs commensurately. To rotate stocks and balance the system, they could use exports or domestic market sales.

The still costlier version of this approach would involve adding Objective 3, that of providing target relief. This may or may not raise stock requirements, depending on the level of relief offtake desired. It would lessen price interference in the market but raise costs because of the 100% cost in the relief channels.

C. Long-term investments in a Safety Valves and Built-in Balancing Mechanisms.

In the long run, Bangladesh should promote development of market-operated balancing mechanisms.

First is trade liberalization. Free import and export of foodgrains is an essential tool allowing access to world markets as a release outlet and as a supply source for supplementing production shortfalls. World prices, likewise, serve as price buffers. Free trade furnishes a price band, between import and export parity prices, within which domestic prices will range, without any government intervention. Thus open trade offers price stabilization at essentially zero cost.

Second is investment in a domestic livestock industry. This proves to be a remarkably supple shock-absorber in wealthy foodgrain economies. In setting investment incentives, government should consider the important food price support afforded by a modern livestock industry. In the long run, this too would provide price stabilization without costly government intervention.

With these two additional private sector supports, it will be possible for government to monitor food markets and maintain fundamental food policy objectives with a greatly reduced government presence and cost.

Figure 1. FOOD POLICY IN BANGLADESH

	FLWS	ISSUES	GOVT. DECISIONS	IFPRI INPUT
Procurement	<p>Other Imports 300</p> <p>Food aid 1,200</p> <p>Domestic Procurement 900</p>	<ul style="list-style-type: none"> <li>Procurement method</li> <li>Procurement price</li> <li>Private vs. Govt. import</li> </ul>	<ul style="list-style-type: none"> <li>Expand tendering</li> <li>Suspend millgate contracting</li> <li>Lower procurement price</li> <li>Allow private import</li> </ul>	<ul style="list-style-type: none"> <li>Tendering reviews (PB1-2, M12,21 &amp;25)</li> <li>1992 Boro Season review (M38)</li> <li>Procurement pricing paper (WP6), training (T2,T7) and briefings</li> </ul>
Stocks	<p>Public Food Distribution System (PFDS)</p>	<ul style="list-style-type: none"> <li>Optimal stock level                             <ul style="list-style-type: none"> <li>Security stock</li> <li>Price support</li> <li>Targeted relief</li> </ul> </li> <li>Mgt. procedure &amp; cost</li> </ul>		<ul style="list-style-type: none"> <li>Optimal stock model (WP4)</li> <li>Studies of private foodgrain markets, private stocks &amp; implications for public stockholding (M22,M37,M39,M40,M44)</li> </ul>
Distribution	<p>FM EP OP VGD FFW RR</p> <p>CONSUMERS</p>	<ul style="list-style-type: none"> <li>Effectiveness of existing channels</li> <li>Balancing the system</li> </ul>	<ul style="list-style-type: none"> <li>Abolish rural rationing</li> <li>Review statutory rationing</li> <li>Introduce Food for Education</li> </ul>	<ul style="list-style-type: none"> <li>Nutritional impact of PFDS (M36,M43,M45)</li> <li>Rural rationing study (WPs)</li> <li>Statutory rationing study (M42)</li> <li>Working group on Targeted Food Intervention (M28)</li> </ul>

Notes: WP= Working Paper; PB=Policy Brief; M=Manuscript; see Table 6 for references.

Figure 2--Index of Coarse Rice Price (Detrended)

