# *MicroSave* India Focus Note #117

## Setting Public Distribution System Right: Touchstone Case for Direct Benefit Transfers - Part II

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### Introduction

In the previous Note "Setting the Public Distribution System Right The Case for 'Direct Benefit Transfers' - Part 1" of this two-part series, we discussed what ails the Public Distribution System (PDS) in India. In addition to quick fixes, other alternatives have been tested.

In this Note, we compare the three of these alternative distribution models: 1) Biometric authentication through Point of Sale (PoS) devices; 2) Food coupons; and 3) Direct Benefit Transfer (DBT). These models have been piloted in different geographic locations with different commodities.

Biometric authentication of beneficiaries seems to be working well in Andhra Pradesh. Coupon-based distribution and direct benefit transfers were tested in Bihar (Nalanda district) and Rajasthan (in Alwar district), respectively. Though these have now been discontinued, the Government of India plans to re-introduce them in a modified form soon.

### How Do These Models Work?

We analyse each of these models and assess the processes, as well as the possible impact they could have on food subsidy distribution.

#### 1. Biometric Authentication

Under the first model, inventory management is digitised. Rations are distributed at the fair price shops (FPS) after biometric authentication of the beneficiary through a PoS device. It ensures that only those beneficiaries whose names are in the database, can avail the benefit.

Unfortunately, it is limited to authentication. It does not address the other, more important, issues in the current system. While the receipt will always note that the full 35 kg ration was allotted to a customer, in reality he/she will continue to receive a few kilos less. Similarly, the limited choice and poor quality of food grains distributed remains unaffected in this model.

The largest challenge for implementing this will be infrastructure. Rural areas continue to struggle with connectivity for PoS devices. Indeed, a PoS-based model may even hinder distribution if the connectivity is poor.

#### 2. Food Coupon

Under this model, food subsidy is provided using food coupons. On a monthly basis, local bodies (the *Panchayat*) issue these coupons to beneficiaries. The coupons bear the quantity of the entitled commodity, and are valid only for the month they are issued.

The beneficiary exchanges coupons for food grains from the designated FPS. These coupons are later submitted by the FPS to the FCI (Food Corporation of India) officials for reconciliation, on the basis of which the FCI will replenish the FSP dealer's stock.

The biggest challenge with this model is that it also fails to address the issues of choice and quality of food grains or indeed access (see previous Note). Also it is dependent on equitable distribution of coupons. Coupons may fail to reach the intended beneficiaries. Furthermore, beneficiaries have to keep these coupons safe as they are effectively currency.

#### 3. Direct Benefit Transfer

Under this model, the Government transfers the subsidy directly into the beneficiary's bank account. Beneficiaries can then buy their rations on the open market.

Under the DBT model, the customer's access and choice improve considerably as the FPS gives way to the competitive open market. Beneficiaries withdraw cash from their bank accounts and can then use it to purchase food items anytime, anywhere according to their choice.

The DBT model, thus, solves four major issues in the existing PDS – leakage, choice, access and quality of ration. However, the model is not without challenges – most of which lie in the financial ecosystem. If beneficiaries have to travel large distances or withdraw funds from already choked branches, this will be non-starter. One of long term challenges could also be inflation/cartelisation by traders in markets to increase grain prices.

### Comparison of alternatives

On the basis of front end challenges faced by PDS beneficiaries following table presents the comparison.

| Parameters | Biometric Authenti-cation | Coupon Distribut-ion | DBT |
|---|---|---|---|
| Access | X | X | ✓ |
| Quality | X | X | ✓ |
| Diversion | X | X | ✓ |
| Choice | X | X | ✓ |
| Ease of Use | High | Moderate | Moderate |

*Table 1: Impact of the three models on the major challenges faced in the existing PDS*

### Way Forward

The table highlights DBT as a more beneficiary-centric model than the other two. However, government will have to ensure following few factors to ensure its success.

#### 1. Accessible and reliable withdrawal points

Success of DBT is largely dependent on ease of withdrawals. A thriving and accessible network of Bank Mitrs can overcome this challenge. Indeed the monetisation of PDS may be an important key to making Banking Mitrs sustainable.[1]

#### 2. On-time credit of subsidy

Timely and full payment of the subsidy amount is a prerequisite for the success of the DBT model of food distribution. Customers cannot afford to wait or run from pillar to post to get their monthly subsidy for purchase of ration.

#### 3. Inflation-adjusted subsidy

In our research into this, beneficiaries expressed concern that the subsidy paid might not suffice to buy the full amount of ration that they are currently receiving. To address this issue, the government must conduct careful analysis to set the subsidy amount, and then revise it at regular intervals to ensure that it is inflation-protected.

#### 4. Customer awareness and support

Our research reveals that customers, especially in villages, are largely unaware of their entitlements and have even less understanding of grievance mechanisms. For DBT in PDS to be successful, the customer needs to be empowered by investing in awareness programmes complemented by an effective support system.

### Conclusion

We believe that DBT is the way forward for PDS. However, much remains to be done to ensure its successful implementation. As this may take time, in the short term, implementing a mix of "Biometric Authenticated PDS" and "Food Coupons" in various geographies seems to be a great idea.

[1] See *MicroSave* Policy Brief # 12 "How a 1% DBT Commission Could Undermine India's Financial Inclusion Efforts"