Price policy , farm profitability and food security

Part 3

<u>Economic reform and its effect on working of price policy</u>

Course instructor – Ashwani Kumar , Economics Department

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Working of price policy

- Agricultural price policy plays an important role in achieving growth and equity in the Indian economy in general, and the agriculture sector in particular.
- The major underlying objective of the Indian government’s price policy is to protect both producers and consumers. Achieving food security at both the national and household levels is one of the major challenges in India today.
- Currently, the food security system and price policy basically consist of three instruments: procurement prices/minimum support prices (MSPs), buffer stocks and public distribution system (PDS).
- Agricultural price policy is one of the important instruments in achieving food security by improving production, employment and incomes of the farmers. There is a need to provide remunerative prices for farmers in order to maintain food security and increase the incomes of farmers.

View held regarding reforms

- In the post-reform period, it was viewed that reforms in nonagricultural would shift the terms of trade (ToT) in favour of agriculture and lead to enhancement of private sector investment, which, in turn, would raise growth in agriculture (Singh 1995).
- The favorable ToT in agriculture have had some impact on agriculture in the post-reform period as the periods of improving ToT like in the early 1990s and more recently after 2004 onwards, witnessed a robust growth in agricultural production in general, and in food grains in particular (Dev 2009

- However, the slackening of the efforts in non-price factors has affected the growth of production in the recent period (GOI 2008).

- There has been a debate on price versus non-price factors in the literature. However, a review of literature shows that they are complements rather than substitutes (Dev and Ranade 1998; Rao 2004, 2006; Schiff and Montenegro 1997).

Food inflation of 2009

- Food inflation of around 18%-19% in 2009 is a concern for the poor and vulnerable.
- Several factors such as shortages in domestic supplies due to a poor monsoon in 2009, the rise in international prices, shortages in global supplies mainly due to diversion of significant food grains to biofuels, increase in demand due to higher growth, implementation of the National Rural Employment Guarantee Act and the loan waiver scheme, inefficiencies in the marketing system, speculation, etc., have been responsible for the price rise in cereals, pulses, sugar, fruits and vegetables, milk, etc

Role of price policy : Before reforms

- Agricultural price policy was earlier meant to mitigate the impact of any undue rises in prices on the vulnerable sections of the population.
- After the formation of the Agricultural Price Commission, it has always tried to maintain a balance between the interests of consumers and producers.
- Nevertheless, the limits of price policy in achieving these goals are recognized by the government and other non-price interventions are used

- While a large network of the PDS ensures cheap food to the needy with appropriate levels of subsidy from time to time, many policy initiatives have been put in place to make farming profitable enough for farmers to invest sufficiently in technology for improving productivity per unit of land so that food security is not threatened.
- The policy aimed at encouraging higher production and that the resultant food produce should be available at lower prices. Both higher production and cheap food are considered necessary for food security.
- Thus, price policy remained subservient to the overall societal goal of poverty reduction on the whole until the new economic policies were introduced.

After reforms

- The higher emphasis and reliance on price policy in the 1990s altered the situation drastically, as price interventions to the relative exclusion of non-price interventions marked the new regime as pointed out by Sen (2001).
- As a consequence, the earlier policy of “low-input and low-output” prices shifted to “high-input and high-output” prices (Acharya 1997).
- On the other hand, public investments on irrigation, research, extension and other related infrastructure went down from 3.4% of agricultural gross domestic product in the early 1980s to 1.9% in 2001-03.
- Though private investments increased initially, it later stopped flowing due to the operation of complementarity between public and private investments, by the late 1990s. Technology development, dissemination and adoption received a major setback due to this.

Role of this policy shift on yields and profitability

- As a result of this policy shift, growth rates in yields have gone down and eventually the CoP started rising. These rising costs necessitated higher support prices to sustain the long-run margin of 20% over total costs.
- The analysis in the paper brings out this phenomenon clearly. The MSPs in real terms declined in the 1980s and still returns to farming did continue to. be sufficient for the farming community.
- It is important to note here that these higher support prices are meant to compensate the slowdown in yield growth and the consequent increase in CoP that is the result of dwindling non-price interventions through public investments. In this situation, if the MSPs are not hiked sufficiently as in case of rice in the late 1990s and early years of the new millennium, margins would have gone down and distress would have spread.

- The analysis in the paper shows that farm business income in real terms declined by 1.15% per annum for rice farmers. To sum up, the farming community is not necessarily better off as a result of higher support prices, as these prices are meant to compensate for the rising CoP in the absence of yield increasing public investments.

Second factor – operation of market forces in open trade regime

- Price policy faces different challenges in such a scenario. For example, low production can coincide with low prices with liberalised imports and exports.
- When the international market prices are higher and rising as a result of a supply shock, domestic prices of the respective commodity shoot up and procurement of sufficient quantities to the required levels to ensure food security becomes difficult.
- Therefore, the government will have to offer higher prices as happened in 1997 and 2007 and 2008 in the case of wheat, making the gross margin more than 50%.

- The pulls and pressures of democracy and farmer lobbies make it impossible to roll back these prices without very high political costs, even if global prices recede considerably.
- The forced unidirectional movement of support prices also has an advantage in that assured prices and continuity in price structure can only stimulate supply response for agricultural commodities.

- The result of these higher support prices is that it hurts the consumers and has an adverse impact on poverty reduction. It was estimated by Parikh et al (2003) that a 10% increase in MSPs of wheat and rice leads to a decline in overall GDP by 0.33%, increase in aggregate price index by 1.5%, reduction in investments by 1.9% and has a minuscule impact on agricultural GDP. They also conclude that the bottom 80% of the rural and all of urban population is worse off.

Concluding observations

- Agricultural price policy has been largely successful in playing a major role in regard to providing reasonable level of margins of around 20% over total costs to the farmers of both rice and wheat.
- In turn, it seems to have encouraged farmers' investments in yield increasing technology and in increasing production and enabling sufficient procurement for buffer stocks and providing physical access to food by achieving and maintaining self-sufficiency.
- Nevertheless, agricultural price policy does face some new challenges in the current period with reduced non-price interventions in the form of public investments and also the percolation of some of the global price volatility through open trade. In fact, the analysis in this paper shows these two are mainly responsible for higher support prices.