

Farm support prices come with hidden costs

In view of the distortions arising out of excessive price support, direct income transfers to farmers is a better option



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The domestic debate has tended to conclude that the rise in MSP announced in the Budget is an essential part of achieving the government's objective of doubling farm incomes. But MSP stands for minimum support prices and is an instrument designed for reducing income volatility, not for raising incomes. Therefore conceptually it should only cover variable costs — A2 plus FL (variable input cost plus family labour), not the comprehensive cost the Swaminathan committee wanted.

The distortions

Giving prices unrelated to demand leads to distortions such as over-production of foodgrains for which procurement is effective and costly excess stocks with the government. Even so limits on procurement and stocking implying cobweb cycles, of sharp rise and then collapse in market prices, still occur. For example, price incentives given for pulses led to over-production price-collapse and the current farmer distress.

Higher procurement prices were set in the 1970s, with the onset of the green revolution, as incentives for farmers to adopt new techniques. The distinction between the procurement and support price, at which farmers could make assured sales, became closer to the market price.

In the 1990s, support prices overtook the procurement price, although in the 1980s the price in-

crease was kept low to share productivity gains with consumers. As productivity growth slowed in the 1990s, more rapid price increases were given. Double devaluation of the exchange rate contributed to upward pressures by widening the gap between domestic and border prices. The steady increase in government stocks indicated prices were set too high. Average stocks rose from 10.1 million tonnes (mt) in the 1970s to 13.8 mt in the 1980s, 17.4 mt in the 1990s, 29.7 mt in the 2000s and 48.9 mt in the 2010s. This was far in excess of buffer stock norms for smoothing prices.

In 2001-02, stocks peaked at 51 mt then fell as the increase in procurement prices was a modest 2.25 per cent per annum over 2000-05. A new peak of 59.7 mt was reached in 2012-13, after a price rise of 11.9 per cent per annum over 2006-13, following a rise in world prices. Stocks fell again as the rate of MSP increase slowed to 4.44 per cent over 2014-18. But prices were now so high in relation to demand that food stocks remained at 57.8 mt in 2017-18 despite slower price growth.

Ballooning food stocks create inefficiencies, such as high storage costs, leakage and wastage of grain. For example, in 2010 the government emerged as the biggest hoarder, carrying 32 mt of wheat stocks that it was unable to release even as food inflation was in double digits.

The subsidy factor

Food subsidies rose from ₹9,200 crore in 1999-00 to ₹1,36,901 crore in 2017-18. As diets diversify national food security should partly

be based on coupons, not on excessive food stocks.

Input subsidies compound distortions. Free electricity with procurement of water-intensive crops such as rice has led to over-extraction of ground water, flooding,



Farm incomes Relying just on MSP won't help

leaching of arsenic and a high incidence of cancer in Punjab. This is one of many possible cases where well-meaning measures impose enormous indirect human costs.

Farmer distress

Farmer suicides are another enormous human cost. Farmers have agitated for more relief, which is required. But imposing more distortions will not provide sustainable relief. Can this be communicated to them?

A major misunderstanding fueling farmer grievance is that the government is not delivering on the promises made. But doubling farmer incomes is not possible unless the number of farmers reduces even as sources of their incomes diversify and become more shock proof. All this takes time. The government has been working steadily towards this agenda.

Since agriculture is also a State subject States have a major role to play. Granular market-facilitating changes are required. For example, good quality grading and sorting is essential for integrating e-markets; improved land records and tenancy laws for overcoming fragmentation in production. There is substantial

progress in building cold storages, roads, water bodies, enabling diversification to horticulture, aquaculture etc. But the improvements are, however, uneven across States.

Rural roads have been growing steadily since 2001 at an average per annum growth of 1.9 per cent for total roads and 8.5 per cent for surfaced roads. Over 2014-15 States that posted above average growth in surfaced roads were Rajasthan, Chhattisgarh, Goa, Haryana, HP, J&K, Jharkhand, MP, Manipur, Sikkim, TN, UP, and Uttarakhand.

Water bodies showed an average 41 per cent rate of growth between 1997 and 2017; States with a high share of completed water works in 2017-18 were AP, Jharkhand, TN, Telangana, WB, and UP. Above average performing States with completed water works under MGNREGA were Rajasthan, Chhattisgarh, Jharkhand, Tamil Nadu, MP, and UP.

Over 2009-10 to 2016-17 cold storage capacity grew above 50 per cent per annum; with units increasing from 5,381 to 7,645. States with above the average share of 3 per cent were AP, Telangana, Bihar, Gujarat, Haryana, MP, Maharashtra, West Bengal, Punjab, and UP. Orissa,

Rajasthan, and Uttarakhand had a low share but the rates of growth were above average.

The ranking of States has also increased the spirit of competitiveness among them.

Indirect indicators also suggest improvements. It is widely reported that youth do not want to farm, and farmers cannot get hired labour — but then they must turn to income raising mechanisation. Non-agricultural rural employment is providing valuable support for rural incomes, but skills are the constraint here. Although the rural population share is still large, agriculture now accounts for only 64 per cent of rural employment.

Inflation, fiscal deficits

Since food is still accounts for 50 per cent of the consumption basket, low food inflation is essential to stall the second round effects that raise aggregate inflation. Double digit food inflation over 2007-11 coincided with high and rising MSP, which helped make a temporary supply shock persistent. Conversely, moderate MSP increases and stable exchange rates from 2014 contributed to falling inflation.

Excessive deficits from non-productivity raising expenditures can also be inflationary. The fiscal cost of a conservative MSP rise covering only variable costs is likely to be only about 0.25 per cent of GDP. If the aim is to cover most crops it is better to switch to income transfers to small farmers. This could be linked to crops cultivated using satellite data. A Telangana-type Rythu Bandhu transfer needs to be preceded by a cleaning up of land records. Non-price distorting transfers can also be WTO-compatible.

With India approaching middle-income status, it needs to switch to the advanced economy way of subsidising agriculture.

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