Agriculture needs a reforms package

With rural economic anxieties acquiring a political voice, the expectation is that the Budget will focus on agriculture. For some time, the country has been in denial over the extent of the mess in the sector.

Farm incomes are unattractive for a variety of reasons; the absurdity of policies features among them. The overriding objective of price stability, over time, has tilted farm policy in favour of the consumer, the numerically larger vote bank. Trade and price controls are highly restrictive, and mostly anti-farmer. Protection afforded to the inefficient fertilizer industry ensures that input costs are high. The farmer is forced to sell in the domestic market where prices tend to be lower than global agricultural prices. Research papers have quantified the degree of anti-agriculture bias in the system. Farmers' economic viability is rarely the primary consideration, although political rhetoric would suggest otherwise. Increasingly though, incompetence and politics have ensured that policies are failing to serve even consumers.

Agri-markets are not free. Governments seek to influence prices, to smoothen them out. In the absence of state intervention, prices soar in bad weather years and plunge in good weather years, hurting consumers and farmers. The levers in governments' hands are import and export controls, buffer stocks management and minimum support prices (MSPs).

Prime Minister Narendra Modi is under pressure to deliver on the 2014 poll promise of higher MSPs. The centrality of MSPs in vote-bank politics is well-known, but the economics of it is not sufficiently appreciated. The MSP, the price at which the government offers to procure from farmers, is an economic policy tool which requires technical acumen.

A sensible policy would be to buy from farmers when market prices are depressed and sell stocks in the open market when prices are elevated. In the first scenario, if the MSP is pegged higher than the market price, the procurement will raise the market price, boosting farm incomes. In the latter, by offloading its stocks at a price lower than the market price, government can cushion consumers against excessive inflation. The buyers of the subsidised sales (an efficient Public Distribution System) are directly benefitted, but as the sales also lead to lower prices in the open market, all consumers gain.

Procurement works effectively only if trade controls and stocks management are aligned with it. How these tools tend to be deployed in a counterproductive manner was evident in the example of pulses in 2016-17. Despite a bumper harvest, after a steep MSP hike and good rains, export controls and stocking limits for private traders were retained and a record volume of imports allowed to be shipped in. The resulting glut sent the market price down, below the MSPs, rendering it pointless. The looming losses set off farmer protests seeking even higher MSPs.

The United Progressive Alliance government's MSP policy was blamed for the food prices inflation, from 2009 to 2013. The culprit, though, was poor management of food stocks. The government had been raising MSPs to reduce the gap between low domestic and high global agricultural prices. The launch of the National Food Security Mission and a global food prices crisis necessitated hikes more aggressive than were originally planned. The high MSP ensured that the increase in food grain production in the four-year period, 42 million metric tonnes, was more than double of what had been targeted. But the high MSP also edged out private traders, forcing a scale-up in procurement. Wheat and rice stocks surged but were not used to dampen market prices.

Former Chief Economic Adviser Kaushik Basu has written about the mindset behind the reluctance to release stocks to cool rising prices. The argument was that selling at a price lower than the purchase price (MSP plus carrying costs) would inflict losses on the exchequer and add to the fiscal deficit. Since procurement spending is a sunk cost, not selling implied even higher fiscal losses. International wheat prices were 30% lower than in India, yet consumers were forced to pay more.

Agricultural economist Ashok Gulati’s calculations show that even after four years of systematically aggressive hikes, Indian MSPs of rice and wheat are less than support prices in China and other Asian countries, betraying India’s bias in favour of consumers.

This bias explains the deepening economic divide between the farm-dependent and the rest of the population, reflected in insecurities of even traditionally land-owning people.

The narrative is that the bulk of agriculture is not sufficiently productive to be able to gainfully engage young rural Indians and so policy attention must be on building industry. China’s experience challenges such notions. The Chinese economic reforms were kicked off in 1978 with an overhaul of agriculture. As farm prices were decontrolled, real per capita incomes began rising and, in just six years Chinese poverty levels halved, from 33% in 1978 to 15% in 1984. In contrast, India’s 1991 reforms bypassed agriculture altogether and instead focussed completely on industrial liberalisation. Indian poverty halved in 18 years from 45% in 1993 to 22% in 2011.

The Budget presents an opportunity to revisit strategic choices. Nothing short of an overhaul of agriculture, resembling the industrial liberalisation of 1991, will work.

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