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## **UNIT 20 AGRICULTURAL PRICE POLICY AND FOOD INFLATION**

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### **20.0 OBJECTIVES**

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After going through this unit, you will be able to:

- state the importance of proper ‘pricing’ of agricultural products;
- identify/outline how the agricultural prices influence the major sections of the economy;
- explain the factors that are important to be considered while determining the agricultural prices;
- describe the institutional mechanism implicit in the role of the Commission for Agricultural Costs and Prices and the change in its thrust on price policies; and
- discuss the concept of ‘food inflation’ and suggest policy options for management and control of agricultural prices.

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## 20.1 INTRODUCTION

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We are aware that with more than half of India's labour force continuing to be still dependent on agriculture (directly or indirectly), and with the entire agriculture and allied activities contributing less than 15 percent to the national income, productivity in agriculture is low. This means that the income of large number of poor farmers engaged in agriculture is low. Further, as agricultural operations are carried out under conditions of uncertain land tenure, constraints of low technology, credit/marketing services, etc. there is open/disguised unemployment and poverty in the sector. In such a scenario, as noted in unit 19, the role of the government in providing a just and remunerative prices to the farmers assumes critical importance. To recall, remunerative price for agricultural products ensures that the: (a) farmers are not forced to sell their crop at very low prices during post-harvest times; and (b) agricultural prices do not get out of control in a year of crop failure which may result in food price inflation. In other words, pricing of agricultural products is aimed at striking a balance between the interests of: (a) the producers by ensuring a minimum support price; and (b) the consumers by maintaining stable food prices. In order to achieve this, the various mechanisms instituted by the government are: (i) declare a minimum support price (MSP) [or procurement price] for important crops, (ii) procure crops at the MSP through its various agencies like the FCI, (iii) strengthen the agricultural marketing system like market infrastructure and warehousing, (iv) distribute the foodgrains at subsidised prices through the PDS, and (v) monitor regularly the prices through an elaborate arrangement of data collection, processing and dissemination. While we have already studied about these issues in the previous unit on 'food security', in the present unit we shall mainly focus on studying the mechanism of fixing agricultural prices, the factors which determine the policy of agricultural pricing, the major institution in CACP (i.e. the commission for agricultural costs and prices) which is set up to administer this process, the constraints and emerging problems which the CACP faces in discharging its tasks, etc. A major issue on which we especially focus in the unit relates to 'food inflation'. In this, we shall elaborate on the role played by stable agricultural prices in controlling it. We begin by recapitulating the impact of agricultural prices on different sections of the economy.

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## 20.2 IMPACT OF AGRICULTURAL PRICES

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To understand the impact of agricultural prices, we must be clear about which price is being referred to as there are a host of prices for the same product at different stages of its journey from the farmer to the final consumer. In this, the first is the 'farm gate price'. This is the price that the farmer gets from the buyer who in many cases is a local trader. From the local trader, the produce passes through layers of intermediaries to reach the wholesaler. The wholesaler sells at the wholesale price to the retail seller, who in turn, sells at the retail price to the ultimate consumer. Therefore, when one talks of ensuring remunerative price to the farmer, one is referring to the 'farm gate price'. But due to the wide 'price spread' between the farm gate price and the ultimate price paid by the consumer to the retailer (which means there is a profit realised by the various intermediate players), the farmer ends up getting a low share of the consumer price. Thus:

Final price paid by the consumer = farm gate price + margin of the local buyer + margin of the whole seller and other traders + margin of the retail seller + transport and storage cost + taxes.

However, other things remaining optimum, it is only a higher farm gate price which would ensure a higher income to the actual producer/farmer. It is important to note in this context that fixing the prices of farm products as in the case of MSP for foodgrains, or ensuring a better farm gate price for other crops, besides ensuring higher income to the farmers also has other significant repercussions. As we know, close to one-fourth of

our one billion-plus population live below the poverty line spending a sizeable portion of their income on food. Therefore, keeping the food prices under check minimises the negative impact of high food prices on such poor families. On the other hand, better prices for agricultural produce influences the pattern of farming in other regions and could become a determining factor for prosperity as also regional inequality. This is because higher prices of a given crop not only increases the income of those farmers who cultivate that particular crop but also, in turn, encourages other farmers to change their cropping pattern by adopting the use of new technology which such a change entails. There is thus a cyclical effect with wider implications. We elaborate this below.

### **20.2.1 Income Effect**

If farmers are left to the mercy of free functioning of the market the agrarian economy may become unstable. This is because farmers who own small pieces of land (less than 2 hectares) or farmers who are referred to as 'marginal and small farmers' constitute a sizable majority of Indian farming population (86 percent in 2002-03). When price of output falls, usually the producer reduces the supply so that low price does not affect him adversely. But when the producer is poor he cannot afford to cut or hold back the supply. This is what is referred to as 'distress selling'. As a result, due to higher supply, price falls further depressing the income of the poor farmer. Quite often, they suffer because of the collusive behaviour of traders who by acting in a coordinated manner often manage to influence the price of agricultural products. This collusion may be so strong that the traders extract crop from farmers at low price. Low farm gate price adversely affects the poverty and inequality in the economy.

### **20.2.2 Influence on Cropping Pattern**

The change in the income levels of the farmers can, in turn, change the cropping pattern too. As an example, let us consider two crops: rice and wheat. Let us assume that: (i) price of input used in the production of these two crops is fixed, (ii) the land which is under rice production can be used to produce wheat also, and (iii) technology of enhanced production is available to both the crops. In this case, an increase in price of wheat would imply higher profits for wheat producers. This could induce the rice producers to divert their land and capital to wheat production. Thus the cropping pattern could get affected due to price differences as the production decisions are susceptible to profit or income returns. In other words, price of a particular product can influence the decision on the cropping pattern.

### **20.2.3 Resource Allocation**

As a farmer opts for a more profitable crop in place of a less profitable one, the resources he has is diverted for the production of the more profitable crop. While this is true at the individual farmer level, at a broader level also a similar effect could be there. As many farmers start cultivating a particular crop, the government would be pressurized to divert resources to facilitate the marketing of that crop. For instance, sugarcane farming needs fast transportation of canes to sugar mills. If paddy farmers shift to sugarcane, adequate roads and transportation services would be required in that area. In other words, the resources could get transferred for the servicing of that crop whose prices are more profit generating to the producers than others. This is what happened in the case of Indian agriculture in the last few decades. Before the 1990s, there were many restrictions on export of agricultural products. After the restrictions were lifted, cultivators found that cash crops were more lucrative than coarse grains as they fetched higher price in the international market. As a consequence, a shift in production practices leading to differences in the 'area under crops' took place. For instance, in 1995-96 the gross cropped area under Jowar as a percentage to total area was 6.3 percent

which fell to 4.9 percent by 2007-08. Likewise, area under Bajra fell from 5.5 percent to 4.2 percent. But for cotton, the corresponding percentage rose from 3.8 percent to 4.8 percent. Results of such switching over have not been uniformly positive. As coarse cereals provide fodder and fuel (besides forming a major part of the consumption basket of the poorer sections of the population), with lower production of these crops poorer sections of people had to buy them from the market affecting their expenditure pattern adversely.

#### **20.2.4 Distribution Effect**

Effects of changes in agricultural prices on income distribution work through various channels. A rise in agricultural prices would result in a rise in the income level of farmers. On the other hand, as prices rise, for the buyer it would mean a contraction of his purchasing power i.e. there is a decline in real income. However, food is a commodity which has very low price elasticity of demand. This means that if food prices increase, the demand for food does not decrease much. However, while a rise in agricultural prices would lower the real income level of the poor, the rich would be affected much less as food constitutes a small portion of the consumption expenditure of the rich. Thus, the distributional impact of agricultural prices would differ for rich and poor persons. Such an impact has other dimensions particularly for the poor farmers. Since the poor farmers sell their food crops immediately after harvest and buy their food needs during lean season from the market, increase in food prices has the potential to increase their poverty level. Thus, while the price rise benefits the poor farmers positively, the negative impact of the price rise which they face as buyers is more acute for them. However, rich farmers who produce marketable surplus (additional crop over and above the consumption requirement and having the ability to store foodgrains) are beneficiaries of the rise in food price. In other words, the distributional impact is adverse for poor farmers compared to the rich.

#### **20.2.5 Industrial Output**

Output of the industrial sector is affected through both demand and supply mechanisms as a result of changes in agricultural prices. We have seen above that as a result of the rise in agricultural prices the real income of poor is adversely affected. This also means that there is less demand for industrial goods. With low demand for industrial goods, less industrial goods are produced. This leads to less employment in the industrial sector. The other effect is from the supply side. As agricultural products are used as inputs in the production of many agro-industrial goods, a rise in agricultural prices would raise the cost of production pushing up the prices of such industrial goods. With higher price, the demand for industrial goods would fall in general. Thus on both the demand and supply sides, there is a contraction of industrial output due to rise in agricultural prices.

#### **20.2.6 Technology Effect**

Higher profitability of a crop induce producers to raise the production of that crop by introducing better technology. In the Indian context, this is what happened during the period of green revolution in the states where it made a deeper impact. The government also procures a larger quantity of grain for its public distribution system from such regions. Regular procurement and higher assured prices by the government encourages the farmers to adopt improved productive technologies. This is the technology effect of rise in the prices for agricultural products.

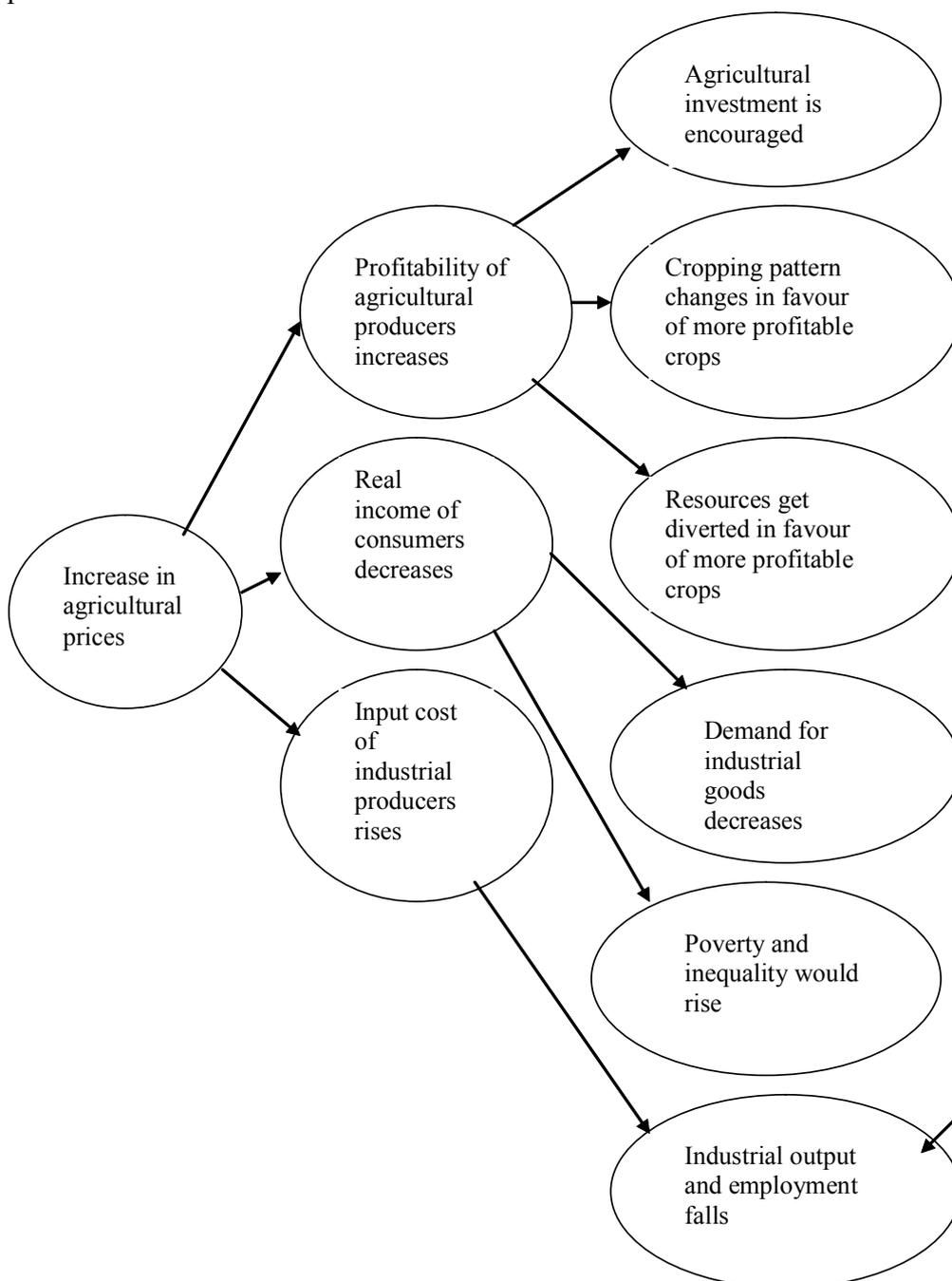
#### **20.2.7 International Competitiveness**

Global market for foodgrains is a different platform than domestic market. Consumers of developed countries which import grain are more quality conscious. In the international market, the Indian agricultural products have to compete with the products of other

countries. Hence, competitive prices are essential to get access to global agricultural market. This is thus a motivating factor for quality conscious agricultural production attributable to international influence.

### 20.2.8 Food Inflation

Rising price of food affects people in a developing country badly. It is a fact that food prices have a strong influence on the general inflation rate as food items constitute a substantial portion of the items in the ‘basket of goods’ considered for calculating the consumer price index. Food prices and the general price level of all goods taken together, therefore, rise or fall in tandem. In recent years, especially since 2006, food prices in India has risen at a faster rate. For instance, while in February 2004, food price rose by 4.4 percent per annum, in 2006 it rose by 6.1 percent, in 2007 by 9.2 percent, and in 2010 it touched a peak of 20.2 percent. The high growth of food price shows a lack of response to the policy measures pursued. Figure 20.1 presents the impact of agricultural price rise in a nutshell.



**Fig. 20.1: Impact of Agricultural Price**

**Check Your Progress 1** [answer in about 50 words using the space given]

1) State the two objectives sought to be served by the official pricing of agricultural products?

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2) Mention the different mechanisms instituted by the government of India to achieve its objectives of agricultural price policy.

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3) What is meant by ‘farm-gate price’? State two reasons on why it is important to focus on better farm-gate price?

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4) How does low farm-gate price adversely affect poverty and inequality in an agrarian economy like India?

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5) Do you agree that changing income levels of farmers (on account of price differences among crops) can influence the cropping pattern? How?

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6) What influence does the differential profitability level among crops carry on the ‘resource allocation’ at a general level?

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7) Why is the distributional impact of agricultural prices adverse for the poor farmers?

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8) Do you agree that as a result of rise in agricultural prices, industrial output also suffers? How?

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9) What do you understand by the ‘technological effect’ of a rise in prices for agricultural products?

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10) How does ‘international competitiveness’ serve as an important factor for better quality production of agricultural products?

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11) Why do ‘food prices’ make a strong influence on the overall general inflation rate? In which recent year did the food inflation touch its peak in India?

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### **20.3 FACTORS DETERMINING AGRICULTURAL PRICE POLICY**

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The role of the government in monitoring the agricultural prices is clear in the light of the discussion above. Prices should not be so low that they result in losses for producers.

They should rather be conducive to higher agricultural production, investments and growth. These factors are of vital importance particularly in a developing country. On the other hand, prices should not be so high that they erode consumers' purchasing power. Retardation of growth of industries and services may take place if people end up spending a larger chunk of their budget in meeting the essential food requirements. How then must the government go about determining the agricultural prices? In this section, we dwell on the objectives of an appropriate agricultural price policy which must be aligned to the factors that should be kept in view in their formulation.

### 20.3.1 Proper Remuneration

More than 80 percent of Indian farmers fall under the category of small and marginal farmers. Apart from the uncertainty of the monsoon, the other main risk they have to bear is the movement in market prices for their product. Unlike industrial products, agricultural commodities have many features of a perfectly competitive market e.g. (i) the products are homogenous in nature; (ii) there are large number of small buyers and sellers. These factors mean that the producers have negligible control over the prices. Agricultural prices are, therefore, much more volatile than the industrial goods. Low prices for the produce can ruin the farmer. Therefore, price-regulating authorities try to fix the price (or a range of prices) at a level that the agricultural producers are assured of a minimum return. Another important factor to be kept in mind is that the less endowed farmers often borrow large sums to carry out production. In view of this, if they get unremunerative prices it becomes difficult for them to repay the loan. Suicide deaths in recent years by the cotton farmers of Vidarbha region of Maharashtra, and other places such as Punjab, Karnataka, Andhra Pradesh, are examples of what may happen if remunerative prices do not prevail. In many cases, failure of harvest adds to the crisis, but low price is a major reason.

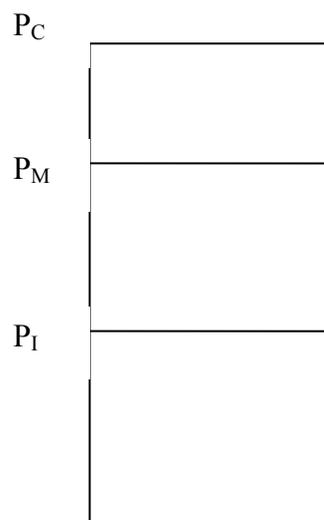
The issue of remunerative price for the producer is interlinked with the price of inputs. A sharp rise in the price of inputs adversely affects the profit of the farmer. Taking this factor into account, the government stressed the importance of subsidized inputs. This was in the decades following independence. In the last two decades after the introduction of the policies of economic reforms, many of the production subsidies (e.g. free electricity or low priced electricity to farmers, subsidized fertilizers, seeds and irrigation ) have been (or are being) withdrawn. This has adversely affected the farmers by increasing their cost of production. As a consequence, growth rate of output, as well as investments in agriculture, have declined in the 1990s compared to the previous decades. This issue is particularly related to the shrinkage of public investment in agricultural infrastructure development. All these factors which contribute to raising the cost of production of the farmer requires to be duly considered while fixing the agricultural prices for procurement.

### 20.3.2 Equitable Income Distribution

We mentioned earlier that agricultural prices influence both the general income distribution as also the level of employment (vide 20.2.4 & 20.2.5). So what should the regulatory authorities do? In the post-independent India, the official approach was to fix a Minimum Support Price (MSP) as procurement price. The foodgrains so procured is subsequently distributed through the Public Distribution System (PDS) at controlled cheap rates, called the *issue price*. Since the procurement price is often higher than the issue price, the deficit is borne by the government as subsidy. The subsidy compensates: (i) the consumers, since the issue price at the PDS outlets is lower than the open market price; and (ii) the producers, since the procurement price would be higher than the market price. Figure 20.2 explains this diagrammatically. Here  $P_M$  is the open market price, which is too low for the producers to earn a reasonable profit and too high for the

consumers to satisfy their food requirements. Therefore, the government intervenes in the market and purchases grains from the farmers at price  $P_C$  which is greater than  $P_M$ . Therefore,

$(P_C - P_M)$  is the subsidy given to the producers. Subsequently, the grains are sold at price  $P_I$  through the fair price shops. Since  $P_I$  is also less than  $P_M$ ,  $(P_M - P_I)$  is the subsidy given to the consumers. The total subsidy given per unit of crop is thus the difference between the procurement price ( $P_C$ ) and issue price ( $P_I$ ) i.e.  $(P_C - P_I)$ . The situation depicted in the figure is, however, an ideal one which need not always prevail. At times, the issue price  $P_I$  could be higher than the open market price  $P_M$ . This has become common after targeted public distribution system has been introduced. In the targeted PDS, the issue price for the above poverty line section is set at a high level.



**Fig. 20.2: Market Price, Procurement Price and Issue Price**

Government intervention in the prices of agricultural products is not limited to foodgrains alone. Cotton, jute etc. also are protected through the Minimum Support Price. For products which are of non-food nature, various agencies like the CCI (Cotton Corporation of India), JCI (Jute Corporation of India) and Tobacco Board ensures that the prices play a balancing role. Apart from the effect on producer and consumer, agricultural pricing policy should also consider the distribution of gains between the producers of various regions. You have studied about this in detail in ‘unit 12’ of this course. Setting a high price for a crop produced in some regions makes the producers of those regions and crop better-off than the rest. Therefore, the producers of other crops may shift to the production of that particularly remunerative crop. This causes grievance among the producers of other regions. The regulatory authorities needs to keep this also in mind while fixing the procurement price.

### **20.3.3 Stable Prices for Inflation Control**

We have noted above that small farmers are adversely affected if there is uncertainty regarding prices that they are going to receive. If the prices are higher than what is necessary to earn a minimum profit level, they are better motivated. If, on the other hand, prices fall below this level the farmers in general, and the small farmers in particular, are affected badly. Since the small farmers are often dependent on loans to carry out their production, such depression in the prices might leave them bankrupt. Therefore, the pricing authorities should not only aim at providing a remunerative price to the producers but the price should be stable. Stability in the procurement prices has a stabilizing influence on open market price. Stability of prices reduces the uncertainty of

the producers regarding investment, employment, etc. Unstable prices has the potential of triggering food inflation. As we noted before, high food inflation causes the general inflation rate also to shoot up. The objective of price fixation from the point of view of maintaining stability through controlling inflation is thus underscored.

**Check Your Progress 2** [answer in about 50 words using the space given]

- 1) What are the detrimental consequences of very low and very high agricultural prices?

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- 2) Do you think agricultural markets are perfectly competitive? In what way does it affect the producers?

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- 3) How is the issue of remunerative price for the producers inter-linked with the price of inputs? In what way the recent policy trends in this respect have affected agricultural output and investment?

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- 4) What is 'issue price'? How is the deficit between the procurement price and issue price bridged?

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- 5) Can the 'issue price' be higher than the 'open market price'? When?

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6) Do you think the regional concerns play a role in the fixation of procurement price? When and why?

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7) Do you agree that high food prices influence the general price level too? How?

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## **20.4 THE COMMISSION FOR AGRICULTURAL COSTS AND PRICES**

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In 1965, the government of India constituted the Agricultural Prices Commission (APC). The commission was to advise the government on the price policy of agricultural commodities with a view to evolving a ‘balanced’ and ‘integrated’ price structure. In this, the perspective of the overall needs of the economy in general, and the interests of the producers and the consumers in particular, was to be kept in view. While recommending the price policy and relative price structure, the commission was enjoined to keep in view the: (i) need to provide incentive to the producer for adopting improved technology for maximizing production and (ii) the likely effect of the price policy on the rest of the economy, particularly on the cost of living, wages, impact on industry, etc. You may note from this that there is an emphasis that the concern for consumer interests should not be allowed to override the farmer’s incentive to adopt improved technology by making necessary investments for the purpose.

While the above has been the policy on paper, operationally, there has been failure on several counts particularly with regard to controlling inflationary tendencies. This is mainly because the procurement operation by the government have quite often led to price rise in open market. Many state governments felt that the pricing policy of the government has been more in favour of the producers than the consumers. They, therefore, sought to protect the consumers by setting an upper limit to the price level fixed under the procurement policy. The increasing trend in agricultural procurement prices nevertheless continued due to reasons of both rise in costs of production as also to keep up the interest or spirits of the producers. In 1985, the government renamed the APC as the Commission for Agricultural Costs and Prices (CACPC). With this, the emphasis was explicitly brought on costs. The Sixth Plan (1980-85) document drew the emphasis on stable agricultural performance and prices by observing that: (i) prices of agricultural commodities exercise a dominant influence on the behaviour of the overall or general price level; (ii) past experience suggests that relative stability in general price level has often coincided with years of good harvest; and (iii) the general overall inflationary pressure have often been triggered by a fall in agricultural output and consequent rise in agricultural prices. In light of this, the Plan reiterated that agricultural production strategies in the Sixth Plan should be based on the need for increasing the production of commodities in short supply thereby helping to maintain price stability.

The Seventh Plan (1985-90) observed that: (i) the use of high yielding varieties aided by incentive prices and public procurement have contributed to a break-through in the output of certain crops, notably wheat; (ii) this has led to the creation of surpluses which cannot be readily absorbed while shortages persist in respect of certain other commodities; (iii) agricultural price policy needs to be increasingly concerned with the maintenance of a scale appropriate to the relative prices of crops so that the supplies of different commodities are in line with the respective demands; and (iv) procurement operations must be strengthened for crops like rice, oilseeds and pulses in areas inadequately served with marketing infrastructure so as to ensure that the producers are able to sell at prices fixed by the government. All this, led to the evolving of a list of factors to be taken into account by the CACP while recommending agricultural prices. The factors include: (i) cost of production; (ii) changes in input prices; (iii) input-output price parity; (iv) trends in market prices; (v) inter-crop price parity; (vi) demand and supply situation; (vii) effect on industrial cost structure; (viii) effect on general price level; (ix) effect on cost of living; (ix) international market price situation; and (x) parity between prices paid and prices received by farmers (terms of trade).

#### **20.4.1 Political Economy of Procurement Prices**

The issue of fixing procurement/minimum support prices is not simple in reality. Since procurement price influences distribution of income, different pressure groups influence the process of fixing the official procurement prices. This, in turn, affects the magnitude of grain procurement. A high price induces the farmers to sell high quantity of their harvest to the government. However, this is not always helpful as there are costs of transportation and warehousing. In recent years, India has experienced stock piling of foodgrains in FCI godowns. At present, the food stock is twice the recommended buffer stock norm. This has led to pilferage and wastage of grains. The Supreme Court has ruled that the government must distribute free foodgrain to the poor rather than letting them rot. The practice of government resorting to the export of grains to cut losses in such situations is criticised as it amounts to neglecting the domestic food problem. The clout of the regionally concentrated rich farmers lobby have often succeeded to ensure that a major part of procurement of grains takes place from the traditional green revolution regions. The rich producers have thus influenced the pricing policy of the government in their favour.

#### **20.4.2 Emerging Trends: Efforts at Rationalisation**

Since the early 1990s, the government has adopted a new policy package which includes cutting down subsidies and budget deficit. Recall that the price differential between the procurement price and the issue price is the subsidy that the government provides. One way to cut this subsidy is to lower the procurement price. The other way is to raise the issue price under the PDS. Because of pressure of farmer lobbies, lowering of procurement prices or curtailing the procurement operations has not worked. A way out was to reduce the scale of PDS so that there is a decline in the total subsidies. Recall from your study of the previous unit that as an alternative, the government has adopted the policy of two issue prices: one for people above Poverty Line (APL) and another for people below Poverty Line (BPL). This has ensured that the BPL population is the chief beneficiary of PDS since the price for the APL population is often at par with the market price.

There has been a debate on how to reduce the leakages in the PDS and increase the efficiency of price control measures. You are aware that due to errors in survey and official mismanagement, food earmarked for BPL population often does not reach the

intended target group. Also, identification of BPL population is fraught with corruption and mismanagement as quite often the rich and the influential get themselves recorded in BPL list to corner the subsidies. It has been estimated that half of the population who should have got the BPL cards, are not there in the BPL list of the government. In light of this, the government is considering doing away with the PDS. An alternative proposed is to provide the BPL consumers with food coupons (or direct cash) which can be used to buy food from the market.

**Check Your Progress 3** [answer in about 50 words using the space given]

1) At the time of the constitution of the APC in 1965, what are the two factors on which maximum focus was laid? What was an additional emphasis laid in this context?

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2) What were the three observations of the Sixth Plan to emphasise on stable agricultural performance and prices? What was its particular suggestion for achieving this?

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3) State the observations of the Seventh Plan to emphasise on the reorientation needed in the agricultural price policy of the government.

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4) By the end of 1980s, what factors were identified as necessary to be taken into account by the CACP while recommending the agricultural prices?

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5) Mention the problems that arise due to high procurement prices and the ways in which such situations are tackled. In this context, what is the political economy dimension behind high buffer stock storage?

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- 6) In the context of price differential between the issue and market prices, what strategy is adopted by the government to minimise the subsidy bill?

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## 20.5 FOOD INFLATION: POLICY OPTIONS

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Food prices are the major contributor to CPI-inflation [i.e. consumer price index inflation: recall your study on this in ‘unit 8’ (section 8.2 on prices and price indices) of the course BECE 002)] reflective of the price effect on the consumption pattern of people over time. This is different from ‘core inflation’ calculated after removing food and energy prices. With rising incomes, consumption pattern generally accelerates with the pattern of consumption differing between food items and non-food items. Further, within food items there will be shift towards higher protein food articles. The recent trends in India in food inflation reflect a growing demand for protein rich food articles consisting of fruits and vegetables, eggs, meat and dairy products. This shift in higher protein rich food is noticeable across regions/classes. In particular, for rural Indian households, the proportion of food budgets on cereals has fallen from 40 percent in 1987-88 to 30 percent in 2007-08. The demand pressure on cereals thus tend to be lower with increase in income levels. The trends further reveal that while consumption of food in general is increasing by around 3 percent per year, between food items the increase is higher at 4 percent for protein rich articles and lower at 1.5 percent for cereals.

**Problem of Plenty:** The MSP is notified for 24 food articles on the basis of costs for procurement by the FCI. The FCI transports grains from surplus to deficit states for releasing them at subsidized rates through the FPS. An open procurement policy is followed in which the FCI buys any quantity delivered at the procurement centres within a specified time period. In particular, it procures about one-third of overall production of wheat and rice. The amount of procurement depends upon the attractiveness of the MSPs relative to the open market prices. This sometimes results in large accumulation of stocks many times more than the storage capacity. Large accumulation in bumper crop years creates ‘problem of plenty’ leading to high wastage. However, such high supply cannot bring down the open market prices as the procurement prices themselves are high. Besides normal factors like transportation costs, wholesaler/retailer margin, etc. supply disturbances for reasons of failed monsoon, destroyed harvest, practice of hoarding, etc. adds to the open market prices being high. This is the reason for the situation of high prices coexisting with excessive stock obtaining in India. The increase in procurement leads to a significant increase in the fiscal costs. In India, subsidy on account of ‘food and fertiliser’ has increased from around 1 percent of GDP in the mid-1990s to about 1.5 percent of GDP in 2009. Fiscal consolidation must therefore be a priority both for demand management and building fiscal space to cope with shocks. One argument made is that food subsidies should be substituted by public investment in agriculture and outlays on extension services as these could increase agricultural production leading to lowered prices. Another argument made is that since the private

sector's handling and storage costs are far lower than that of the FCI's, the role of private sector in procurement and distribution management should be considered.

**Policy Options:** The discussion above brings forth the importance of '*foodgrain stock management*' underscored as the first policy option. The second is '*increasing agricultural output and productivity*' by a *comprehensive strategy* with a focus on technology, improved water management, rural infrastructural development, agricultural diversification, food security, private sector investment in marketing and agro-industry development, etc. In this context, the success of Gujarat is offered as a salutary example of how such a comprehensive approach could work. A third policy option suggested is to '*delink the safety net from direct public procurement of wheat and rice*' by increasing the role of the private sector in foodgrain marketing. This option is not meant to be an end to subsidized distribution of food but only aimed at increasing the efficiency in management by minimizing losses. A fourth option is to focus on '*development of market based tools for management of risks*'. Due to volatility in exchange/interest rates, commodity prices has reached unprecedented peaks. This is not likely to ease owing to uncertain political and economic conditions which has become common to contend with. This has generated renewed interest among borrowers and policy planners in market based tools for assistance in management of risks.

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## 20.6 LET US SUM UP

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Agricultural prices play a major role in a developing country where majority of the population is dependent on agriculture. It affects the overall economy through two channels. First, if the prices are un-remunerative, it affects profits of farmers which influences area under different crops and thereby the cropping pattern. It also, by the same logic, affects the resource allocation both at the individual and aggregate levels. Adoption of technology and its related investment decisions are also affected by changes in prices. Second, it affects the real income of the purchasers. If the agricultural prices increase rapidly it adversely impacts the already poor and thereby the poverty level in general. As a spiralling effect, it also reduces demand for industrial products. As a consequence, the prices of industrial goods, industrial output and employment suffer.

Pricing of farm products, therefore, has to be given due attention to maintain a degree of stability. However, in the Indian context we find that pricing policy has been tilted more in favour of the producers than consumers. Subsidies are granted to make up for the gap in procurement price and issue price. To reduce subsidies, issue prices at PDS outlets needs to be raised. In the context of economic reforms pursued after the 1990s, these issues are attracting renewed interest. While the government is forced to cut down on subsidies, the procurement policies could not be changed due to political pressure. All these have led to falling cereal consumption, higher demand for protein rich food items and wasteful accumulation of PDS stock in basic foodgrains i.e. wheat and rice.

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## 20.7 KEY WORDS

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### Price Spread

- : The difference between the farm gate price and the retail price of food items is referred to as the price spread. It reflects charges for processing, transporting, profit margins of various intermediaries like wholesalers and retailers, taxations margin, etc.

- International Competitiveness :** This determines whether the goods or services are capable of getting sold in the global market. It depends upon factors such as the price at which the good in question is offered for sale at the international market, its quality and trading terms and condition at the global market.
- Issue Price :** The price at which goods are sold through the PDS outlets. This price is decided by taking into consideration the purchasing power of the poor, market price level and the subsidy effect on the fiscal position of the government.
- Open Market Price :** The price prevailing in the market as determined by the interaction of demand for and supply of goods without any external intervention.
- Price Elasticity of Demand :** This measures the responsiveness of demand for a good to change in its unit price. Generally, food has low price elasticity of demand especially for the poor people. This is because food being a necessity, the effect of price rise on reduction in quantity demanded is low.
- Procurement Price :** The price fixed by the government for different crops at which it buys crops from the farmers.
- Terms of Trade :** It is the ratio of prices prevailing in two sectors. For example, if agricultural price is  $P_A$  and industrial price is  $P_B$  then the terms of trade between the sectors would be  $P_A/P_B$ .

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## 20.8 SUGGESTED BOOKS/REFERENCES FOR FURTHER READING

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Kapila, U. (ed.), 2009, *Indian Economy Since Independence 2008-09*, Academic Foundation, New Delhi.

Misra, S. K. and V. K. Puri, 2010, *Indian Economy*, Himalaya Publishing House, New Delhi.

Patnaik, U., 1999, *The Long Transition*, Tulika Publications, New Delhi.

Raj, K. N., 1990, *Organizational Issues in Indian Agriculture*, Oxford University Press, New Delhi.

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## 20.9 ANSWERS/HINTS FOR CYP EXERCISES

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### Check Your Progress 1

- 1) See section 20.1 and answer.
- 2) See section 20.1 and answer.
- 3) See section 20.2 and answer.

- 4) See section 20.2.1 and answer.
- 5) See section 20.2.2 and answer.
- 6) See section 20.2.3 and answer.
- 7) See section 20.2.4 and answer.
- 8) See section 20.2.5 and answer.
- 9) See section 20.2.6 and answer.
- 10) See section 20.2.7 and answer.
- 11) See section 20.2.8 and answer.

**Check Your Progress 2**

- 1) See section 20.3 and answer.
- 2) See section 20.3.1 and answer.
- 3) See section 20.3.1 and answer.
- 4) See section 20.3.2 and answer.
- 5) See section 20.3.2 and answer.
- 6) See section 20.3.2 and answer.
- 7) See section 20.3.3 and answer.

**Check Your Progress 3**

- 1) See section 20.4 and answer.
- 2) See section 20.4 and answer.
- 3) See section 20.4 and answer.
- 4) See section 20.4 and answer.
- 5) See section 20.4.1 and answer.
- 6) See section 20.4.2 and answer.