CHAPTER-II

AGRICULTURAL PRICE POLICY - A HISTORICAL REVIEW

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2.1 INTRODUCTION :

During the first five year plan (1951-1956) the prices of many agricultural commodities were rising high. Naturally, the price policy aimed at controlling the continuous rise in foodgrain prices. However, in 1954-55, the agricultural prices started decreasing and as a result the price policy aimed at arresting the declining prices.

The agricultural price policy was consumer oriented in the first two plan periods.[1] The two major aspects of price policy, therefore are (1) to protect producer interests by removing the major uncertainities which afflict the agricultural economy and (2) to safeguard the interests of low income consumers by assuring them minimum supplies of food-grains at reasonable prices.[2]

Agricultural price policy a sensitive and complex issue, is expected to provide an incentive to the farmer which helps him to adopt highly capital intensive modern technology and the improved methods of production and practices associated with it and at the same time safeguard the interests of the consumer by public distribution and issue prices.

Agricultural price policy which relies on relative prices is possible in a situation in which most of the commodities are in balance and shortage or surplus is restricted to one or two commodities.3

The major aim of agricultural price policy should be to correct distortions which are socially or economically harmful and which emerge from time to time from the imperfections of market, mechanism, price regulations becomes necessary to protect the interests of produces as well as consumers when supplies become excess due to bumper harvest and there is a sudden and sharp fall in prices, the Government must intervene through price support operations. On the other hand, when in a general situation of inflation a shortfall in production results in steep rise in prices, particularly of foodgrains, the Government has to protect the consumers.[4]

2.2 IMPORTANCE OF AGRICULTURE IN THE NATIONAL ECONOMY :

India can be described as an agricultural country par excellence. Agriculture is the largest industry in the country. It is the source of livelihood for over 70% of population in the country.

The significance of agriculture in the national economy can be best explained by considering, following aspects :

i) Share of Agriculture in the National Income -

The first and foremost measure of the place of agriculture in the economy is well reflected in the large income that flows out of this section. Two important facts must be emphasised - (i) agriculture contributes a major share of national income in India. (ii) the share of agriculture in national income has been descreasing continously. The share of agriculture in national output was 59 percent in 1950-51, 54 percent in 1960-61, 43% in 1970-71, 40 percent in 1980-81 and 34 percent in 1986-87.

ii) Indian Agriculture and Pattern of Employment in the Country -

In providing employment to the people of India, agriculture gets on to the top position among the avenues of employment. According to an estimate, 68.7% of working population in India was engaged in agriculture in 1985 as compared to 69.7 percent in 1961 and 1971 censues. It is thus clear that agriculture is the largest employer of the people overshadowing any other source of jobs singly or even collectively.

iii) Importance of Agriculture for Industrial Development -

Indian agriculture has been the source of supply of raw materials to our leading industries, cotton and jute, textile industries, sugar, vanaspati and plantations - all these depend on agriculture. There are many other industries which depend on agriculture in an indirect manner. Many of small scale and cottage industries like handloom weaving, oil crushing, rice husking etc. depend upon agriculture for their raw materials. Together they account for 50% of income generated in the manufacturing sector in India.

iv) Role of Agriculture in the field of International Trade -

Importance of Indian agriculture also arises from the role it plays in India's trade. Agricultural products - tea, sugar, oilseeds, tobacco, spices, jute etc. constitute the main items of exports of India. The proportion of agricultural goods which are exported may amount to 50 percent of our exports and manufactures with agricultural content (such goods as manufactured jute, cloth and sugar) contribute another 20% and total comes to 70% of India's exports. This has great significance for economic development.

v) Role of Agricultural Sector in Economic Planning -

Importance of agriculture in the national economy is indicated by many facts. For example, agriculture is the main support for India's transport system. Since railways and roadways secure bulk of their business from the movement of agricultural goods. International trade is mostly in agricultural products. Further good crops implying large purchasing power with the farmers lead to greater demand for manufacturers and therefore, better prices. Generally, it is the failure on the agricultural front that has led to failure of economic planning. Finally finances of the Government, especially of the State Governments depend, to a large extent upon the prosperity of agriculture.[5]

Agriculture has the greater share of productive assets like building machines, irrigation works, livestock agricultural implements, land improvement etc.[6]

From the foregoing it is clear that agriculture contributes in many ways to the sustenance of the economy. Naturally, it becomes of critical importance that prices of agricultural produce are such that they lead to greater productivity and income for the farmers as well adequate.availability to the urban consumers at reasonable prices.

2.3 IMPORTANCE OF AGRICULTURAL PRICES :

Prices are as indicators for proper allocation of resources. The prices of agricultural commodities have an added significance in a country like India, because most of the people spend almost two thirds of their expenditure on agricualtural produce.

Agricultural prices also play a prominent role in determining the production pattern not only of agricultural sector but of many manufacturing industries which depend upon agricultural for supply of their raw materials.

Agricultural prices also affect the prices of those consumer goods like textiles, sugar, cigarettes etc. in the production of which agricultural raw materials are used. Agricultural prices have astrong bearing on the general price level in the country.

Agricultural prices can also shape the desired cropping pattern and bring about changes in agricultural production in accordance with the objectives of national economic policy.[7]

Agricultural develolpent to a great extent depends on the price, the farmer receives for his produce. The anxiety about any abnormal increase in foodgrains prices in the Indian context is understandable because expenditure on foodgrains forms te major part of total consumer expenditure. The Report of National Sample Survey (1955) indicated that in the rural sector of our economy food accounts for about two thirds of total expenditure and cloth about onetenth.[8]

Prices also have to play an important role in economic planning; price stability and price incentives are thus important for economic progress, particularly that of agriculture.

Agricultural prices have three important functions : (a) to allocate resources, (b) to distribute incomes and (c) to induce capital formation.

Agricultural prices give signals to both producers and consumers regarding the level of production and consumption. Changes in the relative prices of the various agricultural commodities affect the allocation of resources among agricultural commodities by the producers and allocation of expenditure on consumption of these goods by the consumers If the price of a given commodity increases relatively to all other agricultural commodities, then the producers would be allocating more resources i.e. land and other inputs, for the production of that commodity To the extent substitution is possible, the consumer would try to substitute high priced commodities by cheaper commodities.

Agricultural prices determine the income of the farmers and affect the level of living of the people engaged in the other sectors of the economy, as agricultural commodities form part of wage goods.[9] Agricualtural prices also have to play an important role in foreign trade.

2.4 NATURE OF AGRICULTURAL PRICES :

a) Price Instability -

Agriculture in India is seasonal and supply of agricultural products is subject to serious fluctuations. Naturally agricultural prices may rise faster at times and full rapidly at some other time, due to a temporary imbalance of supply and demand.

The impact of rise and fall in agricultural prices is discussed below.

a.i) Rise in agricultural prices

The income elasticity of demand for foodgrains of the bulk of the population in a developing country like India is high. Therefore, stepping up the rate of investment and increasing money income with the people without adequate measure to increase food supply leads to a distortion of the price structure. Further increasing population and urbanisation are also responsible for increased demand for foodgrains and rise in foodgrains prices. Accoardingly fluctuations in the prices of foodgrains and other agricultural products have serious consequences for the producers and consumers and the both could be exploited easily by the middleman. It is in this context that the problem of stabilization of prices of agricultural products, specially foodgrains becomes significant.

Besides a steep rise in the prices of cereals, pulses, oilseeds and other essential food articles increases the cost of living of the people. Consumers belonging to the lower income groups of the population are hit hard because of the fact that their income does not increase so easily as to cancel the adverse effect of the rise in prices.

a.2) Fall in agricultural prices

As more than 70% of the India's population depends on agriculture for their livelihood, a full in the agricultural prices means distress for a majority of the farmers and decline in Government revenue too.

The farmers have many fixed commitments such as land revenue rent social ceremonies etc. and hence their net income will be considerably reduced when the prices of agricultural products fall. This will adversely affect the capacity of small and marginal farmers to meet their fixed charges. In many cases they may be forced to sell their small holdings to meet their commitments. Besides the farmers loose their interest in increasing production and thus, there may be a fall in production of agricultural commodities.

STABILISATION OF AGRICULTURAL PRICES :

Meaning -

The Famine Enquiry Commission observed "Given price stability much can be done by linking up credit, agricultural improvement and marketing so as to supply facilities needed for agriculture, whether water or manaure or seed or machinery organisation, without it we are building on sand."*

(*The Famine Enquiry Commission, 1945, p. 285)

Price stabilization is not the same thing as holding the price line. It signifies a policy aiming at prevention of violent fluctuations in the prices, on both sides. Price stabilization consists of measures that the Government might take to prevent a fall or rise in prices if and when it occurs. The Government measures consist of buying all that is offered for sale at the predetermined minimum support prices in a bid to prevent undue fall in prices and selling the reserve stocks at controlled prices to check a rise in prices beyond what is considered a fair level.

Thus price stabilisation of agriculture would stabilize income and wages of not only those engaged in the field of agriculture, but also of the mass of non-agricultural workers. It would also help in raising the level of production and productivity in agriculture.

Need for stabilization of Agricultural Prices

Fixing fair prices for agricultural products is very important because unless the producers get fair money for their marketable surplus, no increments in efficiency and amount of production can successfully raise the standard of living of the masses. The unrestrained rise in agricultural price would affect adversely the level of the economy via increasing costs due to wage rises. With rising incomes during development, the demand for farm products does not rise as fast as that for industrial goods and services because of the low income elasticity for demand for farm products. It is for these reasons that Governments intervention for price stabilization of agricultural produce becomes necessary.

A review of the price policy followed by different countries shows that many of them introduced legislation to regulate agricultural prices so as to prevent undue rise in the cost of living. These decisions initially were made only, hesitatingly under the emergency conditions of the first world war.

The price sub-committee of the policy committe on Agriculture, Forestry and Fisheries appointed by the Government of India in 1946 wrote "when a general expansion of agricultural production is aimed at in the present circumstances of the country a guarantee of minimum price is an effective measure to adopt and, therefore, forms an essential part of the policy of agricultural development." The Cooperative Planning

Committee, 1946 had observed thus, "while the risks are high in lines of production, they are particularly serious in the sphere of agriculture because of the vagaries of the monsoon, the inelasticity of production, the large number of small producers and wide range of price fluctuations. The fluctuations in agricultural prices in particular imbalance the whole economy of the country since they affect the income of more than 70% of the population affecting the demand for all types of commodities. Besides they also influence the prices of industrial goods through their effects on the costs of living and on costs of raw materials. The state must adopt a policy of actively supporting agriculture prices within a range which is fair both to the producer and consumer."[10]

Measures of Stabilization of Agricultural Prices

The sharp cyclical fluctuations require adoption of specific measures for stabilization of agricultural prices.

The price stabilization policies for agricultural products generally tend to have three elements :

i) Appropriate support prices.
ii) Bufferstock operation.
iii) Imports.

i) Appropriate support prices -

It includes statutory fixation of minimum or maximum prices or both. In fixing the prices the interests of the producers and consumers are reconciled. From the producers point of view, the minimum price should cover the cost of production and provide a fair margin or profit. From the consumers' point of view, the maximum price should not be too servere and should generate demand for the whole quantity producec. The minimum and maximum fixation are supposed to be a supplemented by an appropriate policy : storage is an effective means of counteracting cyclical changes in the level of production. In other words, keeping a regular stock of agricultural aproduce throughout the year is important. The minimum and maximum prices should be announced in advance of the crop planning period and simultaneously for products competing for the same resources.

ii) Buffer-stock operation -

Buffer stock operations serve the two purposes. (i) offering support prices during periods excess supply and low prices. (ii) price moderation during years of scarcity. Buffer stock operations are carried on bythe Food Corporation of India (F.C.I.) when prices tend to fall in general or in particularl localaity the F.C.I. starts purchasing at reasonable prices and when prices tend to rise. F.C.I. steps in and sells at reasonable prices.

The main advantage of maintaining buffer stocks are :

i) stabilization of prices by counteracting the effects of the activities of speculators and hoarders.

ii) safeguarding the producers against low prices, specially during the surplus production years.

iii) giving stability to the country's food economy.

The buffer stock operations ensure and guarantee a minimum price to the cultivations. In recent years, India has been using the policy of buffer stock operations in foodgrains. The policy appears to be simple and easy but it is not so. Major problems of buffer stock opeations relate to pricing, finance, warehousing, administration etc.

iii) Importsd -

Imports of foodgrains and of other agricultural commodities also enhance domestic supplies and stabilise agricultural prices. In 1956, tne Government of India formulated a long-term food policy based on heavy imports of foodgrains from U.S.A. under P.L. 480. This policy nad following advantages :

i) There was no foreign exchange burden on the Indian Government.

ii) The weaker sections of the community were provided with foodgrains at low prices.

iii) Low foodgrains prices had a favourable stabilizing influence on the general price level and the cost of living.

The Government of India formulated a new integrated food policy in 1966. In this period India's food policy was based on buffer stocks rather than on imports of foodgrains.[5]

2.5 GOVERNMENT POLICY :

a) Before 1965 -

In the beginning of the first five year plan two committees were appointed by the Government of India which indicated the desired price policy. In 1947 Foodgrains Policy Committee was formed which recommended a policy of progressive decontrol, reduction of dependence on imports of foodgrains and substantial increase in domestic production within the earliest possible time. Another Committee (1950) recommended the continuation and extension of the system of rationing in the country.

In the first five year plan period, the easy situation on food front enabled the Government to adopt a policy of complete decontrol. The prices of agricultural products started showing a rising trend again in the last leg of the first plan forcing the Government to introduce again partial controls.

Because of the rising prices the Government appointed foodgrains Enquiry Committee in 1957. The Committee strongly recommended the setting up a foodgrains stabilization, organisation to stabilise the food prices. It recommended building up of a buffer stock, licensing of whole sale traders and fixation of minimum and maximum prices.

Till 1964 the agricultural price policy was more concerned with the stabilisation of consumer prices and not much attention was paid to providing any incentive to the producers.[7]

During 1964, the Government started thinking about a price policy which would ensure incentive prices to the farmers.

b) Establishment of Agricualtural Prices Commission

The Agricultural Price Commission was establisned in January, 1965 to advise Government on price policy for agricultural commodities, with a view to evolving a balanced and integrated price-structure in the perspective of the over-all need of the economy and with due to regard to the interest of producers and consumers.

The foodgrains prices committee was appointed by the Minister for Food and Agricualture, in August, 1964 under the Chairmanship of Sri L.K. Jha. The Committee recommended minimum and maximum prices of rice and wheat for 1964-65 season.

The views expressed by this Committee in its report submitted on 24th December, 1964 areas follows :

i) The Committee recommended that the price policy for all agricultural commodities should come lunder the purview of A.P.C., which may evolve a balanced and integrated price-structure and the claims of the competing crops on limited resources can be resolved in the perspective of the overall needs of the economy.

ii) The Committee suggested that the Commission should study and ascertain the current situation in India and if convinced it should suggest some monetary incentives to attract the cultivators to adopt the improved technology. The Commission should also consider whether the incentives should be provided through schemes which reduce input costs or through increase in output prices.

iii) The Committee recommended that the aim of price policy should be to encourage optimum utilization of land vis-a-vis climatic and soil variations in different regions.

iv) A.P.C. should evolve an appropriate relative price structure among the different crops.

v) In recommending relative price-structure for different agricultural commodities, the conditions prevailing in international markets were to be taken into account. In accessing the impact on domestic markets, the possibilities of imports and exports of agricultural commodities also become relevant.

vi) The Committee recommended that the Commission should see that the benefits of the price policy accrue to the producers on the one hand and to the consumers on the other. For these purposes it was necessary to ensure proper marketing services at reasonable costs. The Commission should recommend the issue prices of the imported foodgrains.

vii) It was suggested that A.P.C. should make appropriate suggestions to Government for mitigating the stress and strains which might develop.

viii) The Committee also suggested that the Commission should keep in touch with other bodies set up by Government connection with matters having a bearing on prices and production of agricultural goods. In the hight of these consideration the Government of India set up the Agricultural Price Commission under the Chairmanship of Prof.M.L. Dantwala, Head of the Department of Economics, University of Bombay to advise on the price policy of agricultural commodities particularly paddy, rice, wheat, jowar, bajra, maize gram and other pulses, sugarcane, oil-seeds, cotton and jute.[1]

In recommending the policy and the price structure for agricultural produce the Commission considers :

i) The need to provide incentive to the producer for adopting improved technology and for maximising production.

ii) Theneed to ensure national utilization of land and other production resources.

iii) The need to achieve as near a balance as possible between the expected supply and demand conditions of different crops.

iv) Import and export possibilities.

v) The likely effect of the price policy on the rest of the economy. On the cost of living, level of wages, industrial cost structure etc.

The Commission put forward measures, outside the range of price fixation necessary to facilitate the achievement of these objectives.

The Commission could keep under review studies relating to the price policy and arrangements and developing price situation and make appropriate and timely recommendations within the framework of the overall price policy, examine whenever necessary, the prevailing methods and cost of marketing agricultural commodities in different regions, suggest measures to reduce the cost of marketing recommending fair price margins for different markets. It is also the responsibility of the Commission tomake the price policy effective in respect of different commodities.

2.6 THE WORKING AND METHOD OF PRICING ADOPTED BY AGRICULTURAL PRICE COMMISSION :

The A.P.C. recommended the minimum support prices of cereals for 1965 season. The Commission submitted its First Report on 31st May, 1965 and a subsequent report on 13th July, 1965 recommending the guaranteed minimum support price for kharif cereals. Since then the A.P.C. has been submitting its recommendations to the Government on the minimum support prices and other issues related to agricultural prices policy.

The fundamental objective of the agricultural price policy is to safeguard the interests of the producers on the one hand and of the consumers on the other hand.

The income of the farmer from year to year is determined by actual realized price in a free or controlled market, his long term interest is to be served through the policy of guaranteed minimum or support prices. In the latter case the purchase price also becomes the support price but as maximum atleast so far as Government purchase operations are concerned. Therefore, what becomes necessarily significant is the distinction between the guaranteed minimum prices and the official purchase prices in effect.

The objective of the minimum price, as universally understood, is to remove the uncertainities of a sudden fall in prices of agricultural commodities. This should assure the farmers that any temporary glut in the market caused by either the supply or demand will not be allowed to depress their income and enable them to continue their production efforts. In other words, the objective of minimum granteed prices is to assure the progressive farmer that his efforts to augment production through adoption of improved practices and technology will not become unremunerative because of the price factor.[1]

2.7 CRITERIA AND METHOD OF FIXING MINIMUM SUPPORT PRICES :

The level of support prices will depend largely on the objectives of support price policy. In the developed countries the main object of support prices is to sustain farm income at a particular level or to raise them to the level of non-farm income. The methods for determining the level are of different types - (i) farm income formula and (ii) parity formula.

Farm income formula is so constructed as to assure and ascertain net income to the farming community as a whole. In the parity formula the support price level is related to a historical average price received for the community and an index of prices paid by farmer so that the purchasing power of a unit of the community remains more or less, constant. Some countries have evolved multiple factor formula.

In the developing countries like India the main objective of the price support policy is to augment agricultural production by providing an insurance against a sudden and sharp fall in prices and against the risks involved in the adoption of improved technology.

The basis of price fixation must, therefore, be such as would encourage the producers to take decisions for the expansion of production. Therefore, it is necessary to consider norms of price fixation which are given below :

a) Market prices

b) Inter-crop price parities

c) Cost of production.

a) Market prices -

The market price criteria requires the support price to be linked to the moving average of market prices in the recent past period. The main advantage of this method is that it allows both demand and supply changes to be reflected in price fixation. But the Commission did not adopt this method as it suffers from some demerits.

b) Inter-crop price parities

According to this criterion the support price of different commodities should be fixed on the basis of their market price ratios. The theoretical basis of inter-crop price parity is that in a multi-crop economy the allocation of land and other resources between different products depends on the movements of inter-crop price ratios. Hence changes in support prices of some products without coordinating them with those of other products will lead to undesirable product substitutions and accentuations of market imbalances.

c) Cost of Production -

The main advantage of this method is that it is founded on the basic relation between price and cost. In other words, the price should cover the cost of production, otherwise the producer will sooner or later give up producing if the support price does not cover the cost of producing a particular agricultural produce.

Cost of production approach is quite fair and simple but there are some practical difficulties which need to be sorted out.

The main difficulties revolve around following questions :

a) Which costs to consider ?

b) Whose costs to consider ?

a) One problem is whether the price should be fixed on the basis of costs of production with traditional technology or improved technology. It is clear that since the objective is to increase production, the cost of cultivation with improved technology would be the relevant consideration. It further gives rise to another problem, how to arrive at reliable and representative estimates of the cost of cultivation.[2]

Another problem is whether the support price should be fixed on the basis of complete average cost of cultivation, which includes the value of family labour ~~of~~ or only the paid out costs which exclude family labour and other implicit costs.

b) <u>Whose cost to consider</u> ?

The cost of production is affected by a number of factors like (i) size of farms, (ii) quality of soil, (iii) cropping pattern, (v) level of technology, (v) farm-investment, (vi) qualify of inputs. As all these fa~~s~~ctors are not likely to be uniform, costs of producing the same commodity differ between different farms and regions. It is, therefore, necessary to consider whose cost should be the basis of price fixation. The cost of production per unit of output is the minimum in a representative sample of farms which may be considered as efficient farmers. But the support price based on the average cost of efficient farmers will not solve the problem as the costof inefficient farmers (who are likely to be in big majority) will not be covered by this support price.

The Agricultural Price Commission preferred to use the estimated cost of cultivation as a guiding criterion for determining the minimum support prices.[1]

The A.P.C. considers cost of production to be the most appropriate basis for fixing minimum support prices but owing to serious gaps in the available cost data, it has been fixing the support prices, more or less on an ad-hoc basis. While fixing the prices for 1967-68 kharif season the Commission did make an attempt to relate these prices to cost of production. It made use of the past data on the average cost of the best and the least efficient holdings for the relevant crops in the different regions as well as of holdings which cover roughly 85% of the output in each case.[11]

Procurement Prices

Another major instrument of price policy is the procurement of a part of marketable surplus of major foodgrains by Government agencies at procurement prices announced at the beginning of the kharif and rabi marketing seasons.

The minimum support prices are meant to provide an insurance cover to the paroducer against a glut in production and consequent fall in market prices. The contingency of fixing procurement prices arises from the Government's acute need to appropriate a part of the available supplies in the market and making these available, through the public distribution system to the low income consumers who cannot afford to pay the high prices prevailing in the market in periods of scarcity.

Operationally, the procurement prices have greater significance than the minimum support prices.

The procurement prices are used by the Government for making purchases for feeding the public distribution system. It stands to reason that the procurement prices should be higher than the minimum support prices.

In the actual fixation of procurement prices from year to year the A.C.P.C. seems to have generally accepted the principal minimum support prices, but no fixed formula has been used for determining the level of procurement prices.[2]

"The Commission would be in favour of the procurement prices for wheat for the 1968-69 reason being set at levels which would reflect in general the trends in the open market prices. In the fixation of procurement prices anotner guiding principle is the disirability of narrowing the inter-state disparities."[12]

The procurement prices are fixed by the Agricultural Costs of Prices Commission on the basis of cost of cultivation but there is no clear methodology for calculating it. The Commission has no clear directive as to which cost of cultivation (paid out cost or comprehensive cost) and whose cost of cultivation (the marginal farmers or that of the efficient farmer) it is to consider.

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