5. The Fragility of Agricultural Policy Reforms

Bharat Ramaswami

Historical Review

In India, the origins of government intervention lie in the Second World War when the government used its powers to promulgate orders on price control, movement and requisition of foodgrains. In 1942, the Department of Food was established to administer these policies. The principal issue was on the best means by which government should procure foodgrains. The British government instituted a foodgrain policy committee to consider the question whether the government should purchase grain from the market in competition with private traders or whether it should have a monopoly of grain trade and obtain the supplies it needs. The committee rejected either of these extremes and instead opted for a dual market consisting of procurement machinery, fixation of procurement and levy price and a retail network of ration shops. These elements of the foodgrain economy have survived till today. A comprehensive history of government interventions in agricultural markets in India is beyond the scope of this study and the reader is referred to Chopra (1981).
Here we draw on the elements relevant to our purpose.

The initial intervention was motivated by the necessity to procure and supply foodgrains to the cities in times of overall shortage. As shortages persisted after independence, the Second World War interventions were continued and restrictions on private trade were intensified. The Foodgrains Procurement Committee of 1950 recommended doing away with competition altogether and instituting a system of monopoly purchase. The government desisted from such an extreme step and opted for continuing government procurement in parallel with private trade. However, unwilling to pay a competitive price for grain, the government tried procurement through various means: purchases by pre-emption, zoning restrictions, and levy on producers and millers.

Ironically, however, till the mid 1960s, domestic procurement (compared to commercial imports and food aid) was neither an important nor a reliable source of supply to the public distribution system. The lack of success of the procurement machinery is repeatedly acknowledged in government reports of the time and is ascribed to the existence of a free market where traders compete away supplies. The Foodgrains Policy Committee of 1966 stated the desired policy direction as follows:

"In order to achieve the basic objectives of food policy, it is necessary for the Government to acquire a large share of the foodgrains produced in the country. It is in the light of this requirement that systems of procurement and regulations affecting private trade have to be formulated and appraised. Government has to strengthen its own machinery for the procurement, transport and distribution of foodgrains for the surplus as well as deficit areas" (quoted in Chopra, 1986).

These views reached their logical end with the State takeover of wheat trade in 1974. However, the move was unsuccessful and the policy had to be rescinded.

The reshaping of food price policies began in 1965 when the government formed the Food Corporation of India, which became the principal central agency responsible for purchase and storage of foodgrains. The other important event in the same year was the formation of the Agricultural Prices Commission to advise on price policies for wheat, rice, jowar, bajra, maize, gram and other pulses, sugarcane, oilseeds, cotton and jute. One of the objectives of the commission was the need to provide incentives to producers, for technology adoption and maximizing production. The success of the Green Revolution meant that the harsher aspects of the earlier food policy directed at maximizing procurement could be moderated. At the same time, the food surplus states now had a clout in national politics that could be used to lobby for prices favourable to farmers. Even by 1970, B. M. Bhatia noted that

> "The concern of the Government in the matter of agricultural prices for the first twenty years of independence was to keep down the prices of foodgrains through controls, imports and rationing. The beginning of the Green Revolution has coincided with a marked shift in the price policy of the State Governments, from the desire to protect the interests of the urban consumer to promoting the interests of the producer. The new policy solves the procurement problem of the State governments……….Such a policy is necessary to provide the much needed incentives to the farmer to use costly but highly productive inputs, thus increasing food production in the country. Behind these economic arguments, however, lie powerful political considerations and strong agricultural lobbies……….In such a situation prices fixed are bound to be what are politically feasible and not what are economically fair, as determined by an expert body…like the Agricultural Prices Commission."

While these observations ring true even today, the above perspective is both deceptively simple as well as incomplete. It is oversimplified because it is not easy to define what is economically fair. Further, it is not true that food policy has ignored consumer interests. Till India reformed its trade policies to comply with treaty obligations at World Trade Organization, farmer's access to world markets were tightly regulated by the government. Indeed, the situation has not materially changed even in this decade when the government is supposed to have given up on quantitative restrictions on trade. It can be recalled that wheat and rice exports were banned in the latter half of this decade during a period of boom in world commodity prices.

Current Policy Scenario

How different is the current policy scenario? As mentioned before, there is a remarkable continuity of the principal elements that constitute government intervention in foodgrain markets. This should not blind us, however, to the evolution in the policy environment. Two changes that deserve attention are (a) the transformation of the public distribution system (PDS) from an ad-hoc rationing system for the urban population to a food safety net for the poor and (b) a moderation of policies of the Central government towards private trade in agricultural commodities. I discuss each of these and highlight their implications for government intervention in the foodgrains economy.

As noted earlier, the food policy context changed in the 1970s with the technological breakthroughs of the Green Revolution. Earlier concerns about movements in inter-sectoral terms of trade adverse to industry faded away. With the decline of food aid, the growth of domestic food surpluses, declining real prices of foodgrains, and greater political clout of farmers, the emphasis of food distribution shifted to support farmgate prices, stabilization and subsidy for lower income groups. The policies of procurement and buffer stocks dovetailed neatly into the public distribution system. Food subsidy as a major item of government expenditures made its appearance around this time.

Starting in 1997, targeting was introduced in the PDS by which greater subsidies were offered to the below poverty line (BPL) households. Over the years, other foodgrain based anti-poverty programmes such as the Antodaya (for the extremely poor) and the mid-day meal for school children have also become an integral part of food subsidy policies[1]. The PDS and allied programmes need to distribute about 30 million MT of grain annually. It is this necessity that primarily drives the rest of the government interventions - namely procurement prices, procurement operations and the policies towards foodgrain exports and imports. A failure to maintain adequate supplies to the PDS is thought to be politically costly because the PDS is seen as a programme for the poor (notwithstanding its failures) and because it is seen as the foremost instrument by which the government can discipline market prices.

As a result, government actions even today are driven by the need to acquire a large share of the marketed surplus of foodgrains. In this respect, as the review in the previous section demonstrates, there is a historical continuity from the origins of government involvement in foodgrains markets to the present. This is also the reason why the major elements of government intervention have persisted in the same form for so long.

For foodgrain markets, the major implication of the government's commitment to the PDS is that the government will always be tempted to find ways to procure grain cheaply especially in periods of rising prices. One way is to forcibly appropriate grain from producers at low prices like what was done in some periods in Soviet and Chinese history of the 20th century. With the constraints of an electoral democracy, this strategy has not been employed in India although a close relative of it is still employed in the form of levies on rice mills. The principal strategy to procure grain cheaply is to ward off competition from other buyers (namely, private traders).

Along with a commitment to food subsidy policies based on physical distribution of grain, the Central government has in the last decade or so moderated its policies towards private trade in agricultural commodities. These include (i) persuading State governments to remove the monopoly of the notified regulated markets in wholesale trade (ii) removing the long-

[1] There is a huge literature on the impact of PDS and other foodgrain based programs on poverty. In particular, it is well established that the PDS is seriously deficient (for a review, see Ramaswami, 2002)

standing prohibitions on futures trading in various commodities (iii) a promise to keep the Essential Commodities Act inoperative except in emergency situations and (iv) passing of Warehousing (Development and Regulation) Act 2007 to provide the legal and regulatory backbone for a system of negotiable warehouse receipts.

These reforms were meant to transform agricultural marketing - a sector that is seen to serve both producers and consumers poorly. Investments in the value chain are needed to overcome inefficiencies in handling, grading, transportation and storage. The reforms are therefore aimed at facilitating and encouraging the growth of an agri-business sector that would invest in marketing infrastructure, shorten the supply chain and benefit both producers and consumers.

Yet these reforms have not been irreversible. The contingent nature of these policy changes was illustrated in the commodity boom of 2006 to 2008. The run-up in world commodity prices till the first quarter of 2008 led the government to impose bans (official and unannounced) of various kinds - on procurement of grain by private players, on exports of rice and wheat and on futures contracts in many agricultural commodities. The ban on private players and on grain exports bought the government some stability and enabled it to procure grain cheaper than what would have been possible otherwise[2].
The ban on futures market was based on flimsy evidence and achieved nothing.
The point of this account is that reforms in agricultural marketing do not sit well with the necessities of the PDS. In flush periods with low prices and abundant supplies, the competition with private trade is not an issue. But when supplies are tight, PDS management will not allow free activity by private trade. Such backtracking by the government is not without cost. Clearly, private players will be wary of investing in the marketing chain when their activities can be curtailed at will. Progress towards transforming the marketing sector will be slow, to the detriment of producers and consumers.

Reconciling Food Safety Nets with Marketing Reforms

Can India have food safety nets without strangulating the food marketing sector? Yes, perhaps it can be done if government gives up its involvement in the physical distribution of grain. An alternative system of food subsidies is for the government to distribute coupons or stamps to the poor that are used to purchase food. In such a set-up, the government no longer procures, transports and distributes grain. Market players handle the underlying logistics-whether retailers, wholesalers or public agencies. The job of the government is to monitor and guard the value of food subsidies (against inflation).

Such a system has much to offer. Cash transfers or food coupons promote consumer choice between retail outlets, help cash-strapped consumers by eliminating the need to buy all rations in one transaction, end illegal grain diversions (the endemic problem of fraud in PDS), increase volumes facilitating viability of retailers and widen the scope of food subsidies by enabling easy inclusion of coarse cereals, pulses and milk. Scams in cash disbursal (or in the form of food coupons) will certainly be tempting to fraudsters - but which is easier to audit: sacks of

[2] The government did incur the displeasure of farmers and pressure by farm lobby states and threats of procurement boycott led to substantial hikes in procurement prices in the 2008 season.

grain or number-tagged coupons? It should be noted that cash transfers are now the most prevalent form of social protection in many developing countries especially in Latin America.

Besides its inherent advantages, a system of food coupons makes the parallel marketing system from public procurement to fair price shops redundant. At one stroke, this removes the distortions and rent seeking that is generated by the government orders that do not permit the free marketing of food produce[3]. Such a food subsidy scheme will not be in opposition to the agricultural marketing reforms and there would be no reason therefore to backtrack on these policies.

As food coupons would be indexed to food prices, the cost to the exchequer would, of course, be greater when prices rise. So even with food coupons, the government has reason to favour cheap food policies. However, without its own procurement and distribution operation, the government's presence cannot be as heavy-handed as it often is presently. The government will still control the external trade sector whether through tariffs and quantitative restrictions (which continue to be used despite their outlaw status under WTO agreements). This is the policy tool that is used for non-food commodities and foodgrains will therefore be treated similarly.

Time-inconsistency of Reforms

While the economic case for food coupons is strong, there are formidable political difficulties. The PDS may not work well but economic interests have grown around it. Both the central and state governments have market intervention agencies that employ many people. While an agency such as the Food Corporation of India (FCI) would have still have a role in stockpiling emergency reserves, any new role would not be as commanding as its existing function. Secondly, the system generates enormous rents through the illegal diversion of subsidised grain to the open market. The beneficiaries would have the resources to lobby against a move that jeopardises their interest. Thirdly, the farm lobby states will hardly be pleased with policies that downscale procurement. However, the fear that farmgate prices will be negatively impacted is unjustified. This is because food coupons will create equivalent or indeed possibly greater demand for food. Fourthly, in a food coupon type of subsidy regime, the cost of subsidised food is borne by the government alone unlike the present case where levies, movement restrictions and export bans can transfer the burden primarily to farmers and to a lesser extent to traders. Fifthly, there can be genuine political difficulties. It is common lore that the Indian electorate is not tolerant of inflation and, in particular, rising food prices. The politicians understand this and therefore would be loathe giving up the coercive powers (that are endowed by the various laws that govern agricultural marketing) that give them a chance to stamp out speculation and price spirals. Even if these measures are truly counter-productive, what matters to the politicians is their public perception. A less lofty reason is that the agricultural marketing laws are conducive to local level political patronage networks.

[3] Mooij (1999) offers a detailed account of how state regulations such as levy procurement and the Essential Commodities Act play out at the ground level.

Against these difficulties, there is an opportunity as well. Traditionally, the role of state governments has been to implement the PDS rather than to participate in policy making and design. This is changing and the first step towards a genuinely federal structure was the targeted PDS (TPDS). The principal innovation, i.e, the implementation of targeting does not involve the central government at all. In fact, for the central government, the major consequence of TPDS is that it ties the central government subsidy to the BPL population within a state thereby providing a formula for the transfer of food subsidy funds to the states. Although the transfer is still in terms of grain allocations, it is now a very short step to financial transfers. When this happens, the states will not just be implementing agencies but will also have their say in the design of food subsidy schemes.

The government is not a monolithic entity that has an obligation to be consistent at all times. While the government would like to attract private investment in agricultural marketing, it has little incentive to protect the rights of these investors if it involves going against the immediate interests of millions of poor voters. The government is sensitive to high food prices because our food safety net is full of holes. Unless we have an effective food safety net for the poor, the politics of food prices will never allow agricultural markets to work unhindered. Without a functional food safety net that the poor can reliably access, agricultural reforms will always be reversible, stalling the gains that farmers can get from expanding domestic and foreign markets.

References

Bhatia, B. M. (1970), India's Food Problem and Policy since Independence, Somaiya: Bombay.

Chopra, R. N. (1981), Evolution of Food Policy in India, Macmillan India, Delhi

Mooij, J. (1999), Food Policy and the Indian State: The Public Distribution System in South India, Oxford University Press, Delhi.

Ramaswami, B. (2002), Efficiency and Equity of Food Market Interventions, Special Article, Economic and Political Weekly, 37 (12): 1129-1135.