Effects of higher farm support prices

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Another good farm harvest is expected this year, although the monsoon rains were not quite well-timed everywhere. There was untimely and excessive rainfall in several places and the impact was felt in the higher prices of fruits and vegetables. Nevertheless, a foodgrain harvest of 240 million tonnes has now been projected.

The year is set to be another procurement and storage challenge for the FCI and other agencies. With the current stock of foodgrain in the central pool at about 50 million tonnes, the task of storage and distribution will require much more innovation and efficiency to ensure that better output simply does not mean more subsidy and wastage.

With the bountiful harvest in sight, will prices oblige and lead to a decline in the inflation rate? If the increase in food prices is essentially a signal of rising demand relative to supply, then maintaining a favourable price environment for farmers is important to increase supplies.

Apart from the bountiful harvest now there is also a favourable price environment for major foodgrains. After all, the minimum support price was raised by 8 per cent for kharif rice, and by 9-10 per cent for pulses. The increase in the case of oilseeds was even greater.

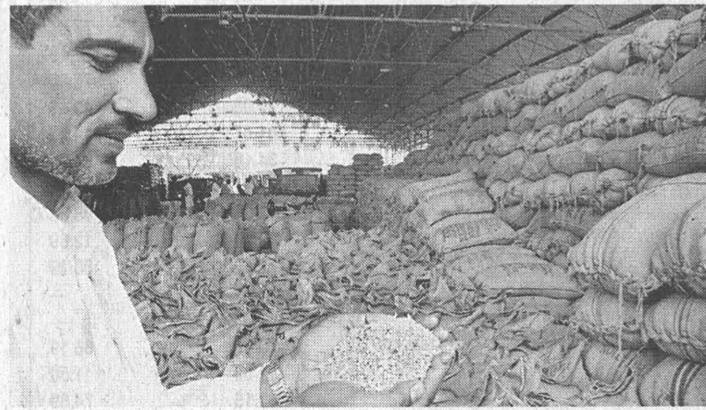
Even in cotton, which has seen a technology revolution, there was an increase in MSP. The MSP for rabi crops has also now been increased significantly. In fact, the turnaround in pulses production in recent years is attributed to the price effect.

UNAVOIDABLE INCREASE

Given the sharp increase in cost of production, the increases in minimum prices were probably unavoidable. Ensuring that the farm sector remains commercially viable is a policy goal for a populous country like ours, given the growing requirements for food.

The minimum prices are actually set subject to a variety of conditions, keeping in view the interests of producers, consumers and the government, which has to manage the financial outlays besides the commercial incentives for farmers. The generally tight international grain markets in recent times and the depreciation of the rupee would also justify favourable prices for domestic producers.

MSP is not the only instrument with which to influence production, although unfavourable prices are unlikely to boost output. The balance between price and other instruments to raise production has always been a tenuous one. If prices favourable to producers also lead to more investments, productivity improvements and therefore output, a period of rising farm prices is worth the effort.



Given the sharp increase in production costs, the hike in minimum prices may have been unavoidable.

Facilitating the subsequent changes is crucial for the success of price as an instrument to achieve output growth. The minimum support price is one instrument but it has several goals to consider. More important, it has to be combined with other policy instruments to achieve the often contradictory goals. A further complication that MSPs must contend with is the international markets. If domestic prices are systematically higher than international prices, domestic consumers are losing out on consumption. If the price scenario is the opposite, producers are losing out on income opportunities.

IMPACT ON MARKET PRICES

To the list of concerns that those setting the MSPs must be watchful of, we must now add inflation. Do the minimum support prices lead to a cost-price spiral, as the wage increases may lead to a wage cost-price spiral? In a sense, any moderation in farm prices is also subject to a moderation in the prices of farm inputs, particularly energy, fertilisers and wages.

If the increases in input prices are persistent there would indeed be stagnation in farm output and higher prices as well. The cost-price linkage can be broken more effectively if the cost-push elements are diffused and there are productivity responses.

Procurement prices are often higher than the MSP. They are more likely to have an impact on market prices and the prices received by the farmers than just the MSP. It is also the case that changes in MSP do not necessarily translate into the same percentage change in actual prices. For instance, the increase in the WPI for rice has remained at about 5 per cent or less in June-September this year.

If market prices are higher than the minimum prices, market forces have some room to operate in times of a bumper harvest. There is also the fact that effective purchase mechanisms may not be available for all farmers, who may end up selling their produce at lower prices.

The MSP is at least a signal that farm income is likely to suffer if there is no price correction. It may act as price protection to farmers where implementation is effective. But its positive impact is limited to the crops where it is available. In this sense, even when MSP does not play a significant role, as in the case of fruits, vegetables, milk, eggs, fish and meat, price increases have to be addressed by improving supplies.

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