PART IV

PRICE POLICY
CHAPTER X

ISSUES FOR PRICE POLICY AND IMPLICATIONS

A. Recapitulation

We may now pick up the main threads of arguments developed in the earlier chapters and then develop certain policy proposals in the light of them. The present concept and practice of price policy can then be examined in the context of the emerging implications for policy.

In Part I, we have observed that as national income increases, food production must increase in accordance with the demand generated by the increase in national income. In the absence of a balance between agricultural and nonagricultural national production, the resulting inflationary process would be of an aggravating or an unstable type.

In Part II, on an analysis of the price behaviour in India, we found that the major contribution to the changes in general price level came from agricultural prices or food article prices. But this has not been accompanied by favourable terms of trade for agriculture or an improvement in relative income from agriculture. We also found that money supply or nonagricultural national domestic product was a more significant factor behind changes in agricultural
prices including foodgrain prices, than production.

But we also found that increasing agricultural prices themselves would adversely affect investment and the growth of nonagricultural national product. Such a behaviour, if widespread and significant, should check the agricultural prices in turn, through a recession or a slump, i.e., through a general slowing down in the economic activity of the nonagricultural sector. However, this need not necessarily happen in an economy where the government is deliberately and continuously trying to step up the rate of development through planned efforts and public expenditure, with a more than necessary emphasis on nonagricultural sector. If there is a respite in such a propped up expenditure, the economy would adjust itself by creating conditions of slow rate of growth of nonagricultural sector. But there may be much wastage and suffering in such a process of adjustment.

We examined in Part III whether an increase in agricultural prices would stimulate agricultural production.

1. A recent study shows that more than production it is the plan outlay and government expenditure which influence prices significantly. See, Economic and Scientific Research Foundation, "Fourth Plan, Inflation without Growth," Occasional Paper Two, New Delhi, 1967.
so that the inflationary process could become stable and could come to an end. We found that even if the rise in agricultural prices reaches the farmer fairly, the response of agriculture is a limited one, though this is not to be attributed to the so-called irrationality, leisure-preference, orthodoxy or what-not of the farmers. An increase in the agricultural prices itself creates a cost-push in the non-agricultural sectors. This, together with the artificial propping up of these sectors by public expenditure can raise nonagricultural prices sufficiently enough to offset the favourable terms of trade for agriculture that could otherwise result. Moreover, however much the agricultural prices may rise, farmers cannot take advantage of them if the essential agricultural inputs are not produced sufficiently. It is the inelasticity of input supply rather than the orthodoxy of the farmer which is the bane of Indian agriculture.

Even in regard to the impact on crop pattern, we find that more than changes in relative prices, it is relative profitability or relative productivity of different crops which is important. The question of relative crop prices and the impact on crop-pattern, however, is secondary to the more important question of improving the production
of all crops. Coming to marketable surplus, we find no evidence of their elastic response to prices either, at least in the short run marked by stagnation in food production.

This would mean that whereas increasing agricultural prices are detrimental to the goal of economic development with stability, they have no significant functional role to play. No great reliance could, therefore, be placed on price mechanism alone to improve agricultural production.

We may now come to the issues facing the agricultural price-policy-maker. His first concern would be to stabilize the agricultural prices in such a way that the impact of inflation on consumers would be softened as much as possible. His second concern (not necessarily in order of importance) would be to ensure that the prices received by farmers would not be disincentive prices.

Any policy aiming at stabilization of prices would have to take note of both sources of instability: one is fluctuations in the production of the commodity in question and the other is the expansion in money supply, nonagricultural output or public expenditure. If it has not been possible

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to check the expansion in purchasing power, the question facing the policy-maker is whether he can soften the impact of such inflation. He has, therefore, to keep in mind both sources of instability.

As far as farmers' interests are concerned, it is not necessary to maintain a historical relationship between agricultural and nonagricultural prices, or between prices paid and prices received by farmers. What is important to ensure is that prices received by farmers do not fall below a certain level which covers the cost of production. Opportunities for preventing a crash in prices do not present themselves frequently or significantly in the context of continuously rising money supply or nonagricultural output. If policy is restricted to only preventing a crash in prices, it is as good as preventing a crash in prices; it is as good as inactive; there is little scope for it to come into operation. If policy is to be more positive, it is necessary to keep agricultural prices above cost of production by means of a minimum support price and at the same time to strive for producing abundant and cheap inputs. If necessary, inputs may be supplied to farmers at a subsidy whenever input prices threaten to rise significantly.

B. Buffer Stock Operations

It would be helpful for us to distinguish between these
two sources of instability and see what measures are called for under each. We shall, therefore, first assume that there are no fluctuations around the trend in purchasing power and that the trend rate of purchasing power and that of production are just such that prices do not increase over time. Thus, only the effects of fluctuations in production are to be countered. This problem is, of course, tackled by buffer-stock operations. Here, the Government has to enter the open market as a buyer and seller, releasing stocks when production is less and building stocks when production is more. Though the principle appears simple, several questions arise.

First would be the size of operations. The approach illustrated below is suggested in this respect.

Table 23 below gives in column (2) the absolute figures of cereal production in India in million tonnes, during sixteen years from 1960-61 to 1965-66. Linear trend was fitted to these figures. The following trend equation was obtained:

\[ Y = 49.76 + 1.67 X (r = .8862) \]

\[ (0.25) \]

3. Exponential trend may as well be fitted, depending on which of the two fits the data better.
### Table 25: Fluctuations in General Production

<table>
<thead>
<tr>
<th>Year</th>
<th>Observed Production (1)</th>
<th>Production Estimated from Trend (2)</th>
<th>Fluctuations (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>45.74</td>
<td>49.76</td>
<td>-4.02</td>
</tr>
<tr>
<td>1951-52</td>
<td>46.40</td>
<td>51.33</td>
<td>-4.93</td>
</tr>
<tr>
<td>1952-53</td>
<td>51.33</td>
<td>52.90</td>
<td>-1.55</td>
</tr>
<tr>
<td>1953-54</td>
<td>61.08</td>
<td>54.47</td>
<td>+6.61</td>
</tr>
<tr>
<td>1954-55</td>
<td>58.97</td>
<td>56.04</td>
<td>+2.93</td>
</tr>
<tr>
<td>1955-56</td>
<td>57.53</td>
<td>57.61</td>
<td>-0.08</td>
</tr>
<tr>
<td>1956-57</td>
<td>60.20</td>
<td>59.18</td>
<td>+1.02</td>
</tr>
<tr>
<td>1957-58</td>
<td>56.41</td>
<td>60.75</td>
<td>-4.34</td>
</tr>
<tr>
<td>1958-59</td>
<td>65.49</td>
<td>62.32</td>
<td>+3.17</td>
</tr>
<tr>
<td>1959-60</td>
<td>64.88</td>
<td>65.89</td>
<td>+0.99</td>
</tr>
<tr>
<td>1960-61</td>
<td>69.31</td>
<td>65.46</td>
<td>+3.85</td>
</tr>
<tr>
<td>1961-62</td>
<td>70.95</td>
<td>67.03</td>
<td>+3.92</td>
</tr>
<tr>
<td>1962-63</td>
<td>67.01</td>
<td>66.60</td>
<td>-0.41</td>
</tr>
<tr>
<td>1963-64</td>
<td>70.19</td>
<td>70.17</td>
<td>+0.02</td>
</tr>
<tr>
<td>1964-65</td>
<td>76.56</td>
<td>71.74</td>
<td>+4.82</td>
</tr>
</tbody>
</table>
| 1965-66  | 62.25                   | 73.31                              | -11.06           

Note: Source for Column (2) - Economic Survey 1966-67, Govt. of India, Table 1.5, Column (3) estimated from the trend equation presented in the Text.
where \( Y \) is the estimated value of production in million tonnes and \( X \) is time. The trend co-efficient is highly significant, being over 6 times larger than its standard error shown in brackets below it. The constant 49.76 is the estimated production in the initial year 1950-51. From this equation, the estimated values of production are calculated and they are presented in column (3) of Table 23. Column (4) gives the difference between the observed values and estimated values of production, representing fluctuations from the trend. It is this last column which is of significance to us.

Next step would be to calculate the trend value of production figure from the equation, for the next year (or the year which buffer stock operations would be performed). In this case, the trend value of production would be 74.88 million tonnes for the agricultural year 1966-67. Before the end of this agricultural year, fair estimates of actual production can be made and compared with the trend estimate. Assuming that 1966-67 agricultural year's production becomes available for consumption during the financial year 1967-68 and hence affects the price level during this period, it would be possible to know whether stocks are to be purchased from or released into the open market and how much of them. Thus, supposing that actual production turns out to be only
70 million tonnes, 4.88 million tonnes will have to be released into the open market. If on the other hand, actual production is say, 80 million tonnes, 5.12 million tonnes will have to be purchased from the open market, to be added to the buffer stock.

If the actual production is in excess of trend value, it would present no serious problem; purchasing in the open market would be easy. But if the situation is otherwise, the buffer stock should be big enough to make good the shortfall in production. It may be seen that the maximum shortfall in the production has been of the order of 11.06 million tonnes among the observations Table 25. It may look as if the buffer stock should be at least of this size to start with. But what if the crops of succeeding years are also bad? At the end of a given year, there would not be any buffer stocks if that year proves to be the worst year. In the table above, the maximum period for which there has been a succession of shortfalls in production, is of three years - 1950-51 to 1952-53. The sum of shortfalls for all the three years together is 10.50 million tonnes, and it may look as if it is enough for the Buffer Stock Operations (B.S.O.) authority to start its scheme with an initial stock equal to this figure. But this figure itself is smaller than the maximum shortfall recorded for a single year, which of course, may be an accident or
an abnormality. It appears, therefore, that to be on the safer side, the B.S.O. authority may start its scheme with an initial stock of 15 million tonnes. It is not necessary that at the end of every year, this should be the minimum stock with the authority. But it would be necessary to have this much of stock before a B.S.O. scheme is launched. Adequate storage facilities should be created for this purpose on a priority basis. Taking a period of some 16 years, as here, 15 million tonnes would be the average size of stock with the B.S.O. authority, the shortfalls being compensated by excess, on the whole for the period. Trend equation may be fitted anew once in three years for the previous 15 or 16 years for this purpose. It may be noted here that buffer stock operations done this way do not interfere with secular or long term trends following technological advance.

It may now be asked what the machinery should be for the buffer stocks operations. It is obvious that whatever be the organisation to which B.S.O. are entrusted, it should function within the framework of a free market, because its very purpose is to stabilise free market prices by evening out market supplies. Procuring grains through a levy or through compulsion at less than market prices cannot simply come under the functions and concept of B.S.O. By this we
do not mean that there should be no compulsory procurement at less than market prices. As will be argued below in Section D, such a procurement will be quite necessary to feed fair price shops meant to soften the impact of inflation on vulnerable classes of population, and this system will be in operation simultaneously with buffer stock operations. The point that needs appreciation, however, is that any idea of making compulsory procurement an instrument of B.S.O. rests upon a confusion about the role of the two instruments. The role of the former is to secure a fair distribution of a given shortage during a given year, but the role of the latter is to prevent sharp shortages or gluts by evening out supplies over a period of years and thereby to prevent fluctuations in market prices. The two instruments are designed to meet two different sources of instability mentioned above in section A.

It may also be mentioned that the act of building initial buffer stocks (15 million tonnes as proposed above) is different from the act of buffer stock operations in subsequent years. The former, however, may need compulsory procurement in a crop like rice, where it may be difficult to secure large imports. If all the required initial stock is built during a single year only through compulsory procurement, the economy will have to face a significant rise in open market prices. But if vulnerable population is not already covered through fair price shops, such a price
rise will not be welcome. In case it is so covered, made possible by already existing compulsory procurement, the new compulsory procurement to build initial buffer stocks, would be an additional burden which may be very much resented. For building initial stocks, dependence on open market purchases alone will also be unwelcome, because purchases in a single year will cause a very sharp spurt in market prices. A careful and balanced combination of all the three methods - imports, compulsory procurement and open market purchases - may be necessary to build initial stocks.

Just as buffer stock operations as such (once the initial stocks are built) do not need levies on farmers or traders, they do not also need restrictions on movements of foodgrains between regions. On the other hand, absence of restrictions on inter-state movements would be helpful and the whole country should, for that purpose, be made into one market. To quote Dandekar, "The total production of all the foodgrains for the country as a whole is much less variable than the production of a single crop in a small region. .... if we are able to bring about an effective integration of the whole country into a single market, that in itself may help to achieve a considerable degree of stability in the prices of foodgrains."  

on movements, and improvement in transport and communication
help this process. Later, we shall have more to comment on
the necessity of zones in other respects also.

Purchases should, therefore, be made by the B.S.O.
authority without interfering in any way with the free market
mechanism. Fears may be expressed that, if the purpose and
nature of this authority is known to traders, they may easily
infer that the year in which the authority steps into the
market as a purchaser must be a good year and may anticipate
a price fall. Similarly they may anticipate a price-rise,
if the B.S.O. authority steps in as a seller. Such antici­
pations may make them withhold purchases or sell hurriedly in
the first case and withhold sales or purchase hurriedly in the
second case. Once, however, traders begin to have faith in
adequacy and efficacy of B.S.O., such psychological reper­
cussions would become less and less significant. Moreover,
it is not as if only during the year of shortfall sales
will be made, and only during the year of excess purchases
will be made. There needs to be turnover of stocks with the
B.S.O. authority and during any given year both purchases
and sales will be made. The only requirement would be that
purchases will be more than sales during a bumper year and
sales will be more than purchases during a lean year, by the
amount of excess and shortfall respectively. If it is
feared that in anticipation of better prices wholesalers may sit tight over buffer stocks released in the open market instead of selling them to retailers, the stocks may be released directly to retailers at market prices. Moreover, the B.S.O. authority can release more stocks in places of acute shortage and purchase more stocks in places of relative abundance.

It does not seem necessary that government or B.S.O. officials should themselves make direct purchases and sales in the market. The B.S.O. authority can conduct its operations through licensed traders by paying them commission for their deals, just as principal traders pay commission to smaller traders. Method of pre-emption can also be tried for making purchases, especially where regulated markets are developed well.

6. Minimum Support Prices

It is evident that if the approach illustrated above is adopted for the buffer stock operations, the price level that develops through market mechanism would be such that fluctuations in prices are swamped out, following the removal of fluctuations in market supplies, and it is not necessary

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5. Such a fear was expressed, for example, by Prof. Dandekar. Cf. V.M. Dandekar, 'Stabilisation of Foodgrains Prices,' E.W. Annual, Jan. 1958, p.175.
to announce or determine before hand some minimum and maximum prices. It is usual to recommend that a B.S.O. authority should release its stocks when market prices reach a ceiling, and purchase and build stocks when market prices tend to fall below a floor. The snag here is how to fix the floor and ceiling level of prices, which would be both feasible and meaningful for stabilisation. A high ceiling and a low floor would be easy to implement and hence feasible; but it would achieve little stabilisation. On the other hand, if a relatively high floor and a low ceiling are announced, more significant degree of stabilisation is aimed at; but it may not be feasible. When market prices are determined more significantly by expansion in purchasing power, it would be easy to protect the floor but difficult to preserve the ceiling. If a low ceiling is aimed at, the B.S.O. authority would always be hard-pressed for stocks. It would find it difficult to determine just that level of prices which would enable the authority to maintain balance between purchases and sales over a period. The approach illustrated above would obviate the problem of determining such price levels.

It may, therefore seem that even the announcement of minimum support prices need not be necessary if the operations work well and farmers develop confidence in their working. The latter condition, however, may not obtain.
What the farmers are most interested in is that prices do not fall below the cost of production. For this purpose, they would like to know in advance the minimum price they can expect to get. It may be necessary, therefore, to announce prices based on reasonable cost of producing the particular crops. Bulk line costs, rather than the costs of marginal farmer, may be taken as the basis, so as to avoid insuring inefficiency — whether of the farmer or his land. If the announcement of minimum support prices is to serve as an incentive to adopt high-yielding varieties of grains, costs of producing such grains may be taken as the basis. In the adoption of such varieties, however, the farmers are as much concerned with the failure of crops as with price risks. Thorough testing, demonstrations, adequate provision of inputs and crop insurance — these are necessary, even when prices are assured. In fact, P.C. Bansil in a recent paper threw doubts on the efficacy of guaranteed price scheme in stimulating agricultural


development, drawing from the experience of Ceylon. G.
Parthasarathy, however, suggests that this could well be due 9
to lack of supplementary measures needed. He draws atten­
tion to Ponseka's study of Ceylon's experience itself.

Ponseka showed that the scheme did not succeed when allied
measures were not taken up. In the final stage, when such
measures were adopted the scheme proved to be more rewarding
and fruitful. This could well be the case in India if
price support is not accompanied by other measures.

We may also observe that though there should be a
national policy in the fixation of minimum guaranteed prices
(i.e., principle governing the fixation should be the same
for the country in different states), the level of prices
need not be the same in all regions.

Now, the minimum support or guarantee price need not
be the same (even allowing for traders' margin) as the one
that would be secured under buffer stock operations of the

8. P.O.Benasil, “Impact of Food Policy on Agricultural
p. 245.


type described above. As a result, stocks purchased and built under the guarantee scheme may be more or less than are required under the buffer stock operations scheme. If more stocks are purchased under the guarantee scheme, then the difference between this and the stocks needed under the buffer stock scheme, will have to be released into the market at market prices. If stocks purchased under the guarantee scheme are less, then the difference will have to be made good by additional purchases in the market. It is possible that at times, there may be a loss involved, if the guarantee prices are higher than the market prices. Such occasions need not be frequent, and the loss can be minimised if the buffer stock authority is judicious - i.e. releasing stocks in the market in the lean season, when prices are high. Moreover, if the allied or supplementary measures are taken to bring down the costs of production (e.g., providing cheap credit, better seeds and cheap fertilisers) the minimum guarantee prices themselves could be reduced.

It is necessary to mention that in the announcement of minimum support prices, a rigid adherence to any given formula is not practicable. A FAO Report stresses that a frequent check on the costs and methods of production is needed so that the formula does not get out of touch with
reality. The Report in fact shows how there is a major reliance on adhoc methods in many countries adopting support measures. No single formula could be considered adequate and complete. New Zealand has in fact, evolved a multiple-factor-formula, taking note of demand trends, future prospects, costs of production and the general level of costs, wages and prices in New Zealand. Balancing between flexibility and certainty or security of a given formula is a necessary - though a difficult - task for the policy maker here.

D. Other Policies

It should be recalled now, that buffer stock operations on the above lines would stabilise prices only to the extent that instability resulted from fluctuations in production. If the trend of production is itself inadequate compared with the trend of purchasing power, the instability or inflation resulting thereby is not at all touched by these operations. Another limitation of these operations is that it can stabilise prices but not incomes of farmers. It would be necessary, for this reason, to supplement these operations with measures like crop insurance in any scheme of stabilisation. It is, however, the first limitation which is most bothersome.

12. Ibid. see pp.32-34.
Of course, the obvious remedy would be to step up production in line with the expansion of purchasing power or check the latter to bring it in line with the former. This is not only the obvious remedy, but the most effective remedy especially in view of our findings that the most significant factor behind increases in agricultural prices is indiscriminate expansion in money supply or nonagricultural output. Regression equations in Chapter V show what rate of growth in the production of agricultural commodities would go with a given rate of growth in money supply or nonagricultural output. It would be helpful if in the nonagricultural sector, agriculture-oriented industries are started and given the first priority, so that supply of agricultural inputs are available at reasonable prices. In this field, a programme of industrialisation and emphasis on agriculture would go hand in hand. This apart, it is also evident that a certain degree of monetary discipline on the part of the government would be most essential for achieving price stability. If not, even the most efficient agricultural price policy may fail to achieve its objective.

But the important question is that if it has not been possible to increase production adequately and to achieve the needed monetary discipline, how best the inflationary impact can be softened.
Three alternatives suggest themselves to us in this respect: (1) Be content with buffer stock operations, checking fluctuations in prices arising out of fluctuations in production and leave every thing to free market forces; (2) Eliminate free market and resort to complete rationing and control; (3) Procure part of the marketable surplus and distribute it in such a way that low income people and/or vulnerable classes (industrial and agricultural labour) would be protected from inflation. We may discuss these one by one.

The usefulness of the first alternative depends upon whether either of the two following circumstances prevail in practice: (1) Major source of instability results from fluctuations in production and not from the expansion in purchasing power. (2) Elasticities of response are fairly high and reliable, so that once the prices of agricultural commodities increase, essential inputs could be available and be utilised, and agricultural production would be stepped up in a reasonably short period.

We have found that the first situation does not obtain in India. As to the second, we have already seen that if the necessary inputs and know-how are not available in the country, no amount of price rise could increase output automatically. On the other hand, if such inputs and know-how
are readily available, it appears enough to provide for a minimum price support and to ensure that the risks of innovation are kept low for the farmer, so that output can be increased. Price stability, rather than price rise would be most needed. A mere price rise has a dubious effect on output, but a deleterious effect on the welfare of the large masses of population, not to speak of the effects on savings and capital formation.

Nevertheless, the alternative of monopoly procurement, eliminating free market and imposition of statutory rationing and control is hazardous, especially if it is restricted to a few agricultural commodities leaving the rest to the free market forces. Production of those commodities on which full controls are imposed will be severely depressed (assuming the controls are effective) and the prices of uncontrolled commodities will rise out of all proportion. The administration faces the task of including more and more commodities within its scope. Its task, already unmanageable even when restricted to one or two principal commodities, becomes more and more so, as new commodities are included. Any way this alternative has to be ruled out as a solution to any long term developmental problems, whatever be its feasibility during wartime when people would be psychologically prepared for the task. It is for this reason that the more
feasible third alternative can be tried, namely, procuring a part of marketable surplus to distribute it to vulnerable classes at less than market prices, through a system of fair price shops.

We believe that once it is decided to allow the free market to function and only to soften the impact of inflation on certain selected classes of population, it will be necessary to have this system not in substitution to the buffer stock operations, but in addition to them. The objective of the former is different one from that of the latter. The former can be called a welfare objective or a political objective, though it has the economic effect in so far as industrial peace is secured and the cost push is checked. The objective of buffer stock operations is to counter the effect of fluctuations in production. It is not an anti-inflationary objective in the context of the type of inflation faced here. The two means are, therefore, totally different and the requirements of the fair price shops are to be met separately and in addition to the needs of the B.S.O. authority. Unfortunately, this distinction is often lost sight of.

It is obvious that it will be extremely difficult to cover the entire population unless full scale statutory rationing is imposed all over the country. What may be aimed
at here is to reach certain selected class of people by issuing them ration cards and permitting them to purchase grains in fair price shops. The rest of the population can purchase only in the open market. The card holders may or may not purchase in the open market. This in fact is the informal rationing which has been the dominant feature of Indian food policy. In cities where open markets are allowed, it is not necessary to issue ration cards to all. The richer classes can be safely excluded. Thus, those who pay income tax can be excluded at one stroke. The people who need to be reached most are industrial labour earning less than ₹200 p.m. and landless agricultural labour. If procured quantities are more than sufficient to meet their requirements, other people can also be reached.

Next question is about the method of procurement. Three alternatives can be thought of here. One option is that of purchasing in the open market either directly or by pre-emption and then selling in the fair price shops at subsidised prices, the subsidy being charged against general revenues. The second alternative is to make the farmers bear the complete burden of this subsidy either through specific taxes or through compulsory procurement at less than market prices. The third alternative is a combination of the first two, so that the cost is borne both general revenues and by the farmers.
The cost of subsidy involved under the first alternative would, however, be enormous. Shah and Shukla have made an attempt at estimating the costs of such subsidy. To quote them: "The cost of subsidy to the Government might have amounted to as low as Rs. 122 crores or as high as Rs. 551 crores for the period 1958-59 to 1963-64 depending on different assumptions. If it is assumed that Government were required to handle one-half of the marketable surplus and to meet the entire cost of marketing i.e. the difference between the harvest price and retail price and that the consumer price will be held in check from 1958-59 to 1963-64 at 1958-59 level, the total amount of subsidy to the Government would have been about Rs. 551 crores. If the Government had decided to handle only 1/3 instead of 1/2 of the marketable surplus then the cost of the subsidy to the Government would have been Rs. 366 crores. If the government had handled one-half of the marketable surplus but used the imported grains to meet the consumer demand at constant prices (implying that the foreign government would be willing to enter into agreement to supply grain at constant prices for a period of five years) then the cost of subsidy would have been Rs. 138 crores, and if imported grains were distributed to consumers at the levels of prices received by farmers then the cost of the subsidy would have been reduced to Rs. 122 crores for 5 years from 1958-59 to 1963-64. This would include (1) rise
in money prices during the 5 years (2) cost of marketing and
(3) addition to cost due to increase in marketed surplus."
The crops considered here are all cereals excluding barley.

We have not made any attempt to estimate the cost of
such subsidies needed at present, but it would be signifi-
cantly greater than the above figures in view of the phe-
nomenal rise in the prices that took place after 1963-64.
The problem is how this enormous subsidy is going to be
financed with minimum adverse effect on savings, production
and economic welfare, both in the rural and urban sectors.
Deficit financing is ruled out because of its inflationary
implications. The scope for financing this subsidy through
general revenues without additional taxation may be limited.
Increasing the tax rates or imposing new taxes on nonagri-
cultural sector has also limited scope, especially if the
idea is to finance the entire subsidy through these means.
Agriculture, however, can provide more scope. Subsidising
the food consumption of industrial (or urban) labour (in
addition to that of agricultural labour) by taxing agri-
cultural surplus, is one way in which agriculture can be
made to provide the savings needed for economic development.
Japan’s example is before us to show that agricultural

15. O.H. Shah and Sara Shukla, "A Proposal for Dual Price
taxation plays this useful role in the initial stages of the
development of a predominantly agricultural country.

This taxation could be of the open or undisguised form, by way of stepping up the revenue from land revenue and agricultural income taxes. State governments in India, however, have shown great reluctance to tap this source adequately even to bridge the gap in their general revenues, let alone using this source for subsidizing urban consumption on a significant scale. It has been suggested at times that agricultural taxes should be levied in the form of foodgrains. The Asok Mehta Committee considered this proposal but did not favour it on the ground that most of the payments will be small and the cost of collection will be very large. It will be cumbersome, task, and not feasible.

What is favoured and practised in India at present, is making direct purchases of part of the marketable surplus of farmers at compulsarily imposed procurement prices which are lower than market prices. This in fact is not a 'purchase',


but more correctly a levy or a tax on farmers growing foodgrains, the amount of tax being the difference between the price that the foodgrain producer would have obtained in the open market and the price at which he has to sell. The discrimination against foodgrains and consequent disincentive to produce them would not arise, if a similar tax is imposed on producers of other crops or if the profitability of producing foodgrains is already so high (either due to higher prices or higher productivity) that it is not materially reduced by such procurement. Of course, the post 1963-64 position has been favourable to foodgrains both in respect of market prices and high-yield varieties of crops being evolved. This, however, cannot permit an indiscriminate reliance on procurement. Even to adopt high-yielding varieties, price incentives will be necessary and if a large portion of marketable surplus is to be parted with at low prices, the position may be discouraging for farmers. Procurement price will, therefore, have to be not less than the cost of producing improved varieties of grains for the bulk of farmers in a given region, and have to be higher than the minimum guaranteed prices. Care may also have to be taken that the disparity between market prices and procurement prices is not very high. The ratio between the two may have to be decided by estimating what is likely to be the weighted average of open market price and procurement
price for bulk of the farmers, and this average must be attractive enough for them. The procurement prices will also have to be fixed for the whole year and should not be changed within the course of a given year. This would make procurement easy and farmers who sell at an early date will not be discriminated against.

It has to be admitted that there is a great resentment against compulsory procurement, on the part of farmers. Inequity present in the levy could be met if procurement takes the form of a per-acre, compulsory levy for all producers, irrespective of whether they produce foodgrains or other crops. In the case of foodgrains produced, the levy would be in kind; in the case of others, the difference between open market price and procurement price in respect of the nearest alternative food crop that can be grown on the holding, can be imposed. Allowance can be made in the rate of levy for differences in fertility. Also, small holdings below certain acres, where entire food output is consumed by the farm family itself and no surplus is left, may have to be exempted.

One of the most popular arguments against compulsory procurement of this form is that it serves as a disincentive to the farmer, who ought to get the market price. We agree with Dantwala when he asks, ".... is it reasonable to suggest
that anything less than the market price - whatever the state of scarcity, hoarding and speculative manipulation - necessarily constitutes a disincentive to the farmer? Is such absolute reliance on the 'reincarnated dogma of the market' necessary, or desirable? What seems reasonable to posit is that as long as prices are well above the cost of production (inclusive of the risk margin), the farmer will spare no effort to increase his income through the largest possible production, within the constraint of his own and national resources. So long as the farmer has access to the free market, it is open to him to increase output much above what is payable in the form of this fixed levy, and sell more and more in the free market. If care is taken that the weighted average of the open market price and the procurement price is kept attractive enough, compulsory procurement by itself, need not be disincentive.

If, however, the procurement price is not to be much lower than the market price and has to be higher than the minimum price, it is just likely that such a price plus handling charges will turn out to be higher than the price at which the procured quantities are distributed to consumers. If the policy itself is to fix the distribution prices

equal to procurement prices plus handling charges, no additional subsidy is called for. What is important is not to have a decision to shift the entire burden of distribution scheme to farmers, whatever be the level of procurement price. Once a satisfactory level of procurement price is fixed, the policy should either be to fix the distribution prices at a corresponding level, or, if the latter are considered high, to finance the required additional subsidy from general revenues. A balance between considerations of how much farmers can be made to contribute, how much general revenues can contribute and the extent to which distribution prices are to be lower than market prices, has to be always kept in view. While recognizing the need for agriculture to bear certain pressures of economic development, it is also necessary to see that it is not crippled under such a need. For this purpose, it may be necessary to supplement compulsory procurement with open market purchases and also with a levy on traders and millers, with the care that such a levy does not disrupt normal trade.

We have now to see whether procurement for restricted distribution necessarily requires the zonal system, whereby surplus areas are bottled up and no movement of foodgrains are permissible except by or on behalf of government. The most important argument advanced in favour of this system is
that it would facilitate procurement by making the prices in surplus areas lower. However, it appears that if procurement is by purchase at open market prices, zonal restrictions are of dubious value; if it is in the form of a compulsory levy, they become unnecessary. We should remember that procurement is not restricted to surplus states alone. The unwarranted rise in the prices in deficit states following restrictions, would make procurement there very difficult; but what is more, even the prices in surplus areas need not be lower than in the absence of zonal restrictions. The system "may lead to the scarcity conditions and rising prices in the deficit states being transmitted to surplus areas through adverse anticipations. Hoarding and speculation may create artificial scarcity in the surplus areas." Raj Krishna shows that "the single-state zone system has a built-in mechanism which tends to increase the demand (for government supplies) more than it increases the supply. ... the responsibility of meeting the entire deficits of deficit states falls on the central government. The surplus state governments release smaller surpluses than the market would carry out. And the deficit states demand progressively larger

supplies from the centre, because they are compelled to distribute increasing quantities through their own machinery."

Even supposing that such psychological repercussions are ruled out, and granting that sonic by itself would lower prices in the surplus states, can it help matters? Once procurement is done through the open market, prices would start rising again in the surplus areas. If the procurement authority purchases exactly the same amount of grain as would be purchased by traders for transferring to other states, the price level would be the same as the one that would prevail in the absence of zones. It is not to be forgotten that under the social system, the objective of procurement authority is not restricted to supplying grain to the selected classes of population. It has to take on the additional role of compensating the shortage in the deficit states, a role which is unnecessary because it can be left to the care of private trade. The procurement authority should in fact be able to procure much more than what would be transferred by private trade to deficit states; otherwise, it cannot adequately perform both the roles.

We agree with Khmoro when he says: "If the government purchases grain in surplus areas and transfers to the deficit

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regions exactly the amount which private trade would have done, its activity is unnecessary or redundant. If it transfers less or more, it is to be blamed squarely. In actual fact, attempts by the governments of surplus states to procure at less than market prices have led... to the boycott of established markets and to an increase in farm consumption. Governments have thus procured and transferred much less than the market would have done in its attempt to equalise the profit of trade, and transport."

The objections to the zonal system would apply even where procurement is in the form of a compulsory levy. The contention that compulsory procurement is easy under the zonal restrictions rests on the assumption that prices in surplus states would be lower than in the absence of zones and hence the resentment against procurement would also be less. The contention is wrong to the extent that the assumption of prices being lower is falsified. If, however, prices are so low as to equal procurement prices, procurement could be through purchases in open market; it need not be compulsory. If procurement through open market purchases cannot succeed under the zoning system, there is absolutely no reason why it should succeed when procurement is through

a compulsory levy. If the latter does succeed, it is rather due to the efficiency of administration and the reasonableness of the procurement price, i.e. whether the price leaves a satisfactory margin to the farmer over and above the cost of production. But its success cannot be attributed to the zonal systems as such.

Granting that prices in the surplus states would be lower under the zones, can this fact be necessarily helpful for procurement and for increasing production in the surplus states? The prices that farmers would get in the market for a part of their marketable surplus will be lower. If procurement price is also kept low in surplus states, the weighted average of procurement and market prices for the farmers may not be attractive enough either in relation to the cost of production of the concerned food crops, or in relation to the price level of other crops on which there are no zonal restrictions.

Whatever the form of procurement, zonal restrictions, therefore appear unnecessary and even harmful.

It may seem that our proposals above have ignored the role of traders in aggravating the price rise and the necessity to control their activities. It is worth remembering that in an inflationary situation, this role could be played by
consumers and also by big farmers in addition to traders. We believe that measures suggested above could, to a large extent, create conditions which offer little or limited incentive for such activities. Buffer stock operations by evening out temporal fluctuations in supplies and prices, do not give much scope for speculative anticipations of spurts in the price level following a bad harvest. The important condition for this, however, is that the magnitude of buffer stock operations should be adequate enough as discussed above, and people concerned - traders and consumers alike - develop faith in the efficacy of the operations as a result. The problem of spatial disparities in prices or checking the 'epicentres' of price rise can also be tackled in a scarcity year by releasing buffer stocks in scarcity areas and pressure pockets (mainly big cities) to the extent that price disparities are reduced. Removing imperfections in markets and removing transport bottlenecks would also help. If it is feared that private traders are not moving the supplies adequately enough, the government can even supplement their activities by purchasing in low price areas and selling in high price areas. It will have to be vigilant about price developments in all major markets, for which the government has all the facilities. Having greater resources at command than private traders, the government can also move supplies more speedily. This
task could as well be entrusted to the B.S.O., itself, pro-
vided it keeps an eye on the total net increase or decline in buffer stocks for the country as a whole, so that temporal price stabilisation for the country is not sacrificed at the alter of spatial price equalisation. Of course, the B.S.O. need not strive for perfect spatial price equality; transport and other costs have to be taken into account. The objective should only be to avert undue distress in any area.

It is quite tempting to suggest that the government should introduce strict licensing of traders, require them to submit frequent returns on their purchases and sales, and have powers to requisition their stocks without notice and at less than market prices. Such legislation may be useful in a real and grave emergency. Even here, the powers have to be exercised sparingly and judiciously. Once such caution is thrown to winds and government interference becomes a normal or regular feature, no normal and open trading can exist. Regular markets will be avoided and the government may find it very difficult to control anything at all.

Let us now summarise our policy proposals. (1) A system of buffer stock operations should be evolved as soon as possible in such a way that fluctuations around the trend
are evened out, but the trend itself is not interfered with. The operations are meaningful only in the context of a free market. (2) Though buffer stock operations, as per the method suggested, do not necessarily require announcement of ceiling and floor prices, it is necessary to announce in advance minimum support or guarantee prices based on bulk-line cost of production. If the stocks purchased under this scheme are more or less than required under the buffer stock operations scheme, the difference can be made good by sale or purchases respectively in the open market. (3) Vulnerable classes of population need to be protected against high food prices. Buffer stock operations do not meet their interests. Grains for these classes can be secured either by procurement through open market purchases which are then to be sold at a subsidy financed by general revenues or, by compulsory procurement of part of marketable surplus from farmers at less than market prices. The latter amounts to a disguised taxation on food producers, the inequality of which could be met by an equal tax on farmers growing other crops. The weighted average of the open market price and procurement price should be attractive enough for farmers. (4) Zonal restrictions are unnecessary and may even be harmful for the success of both buffer stock operations and procurement.
These measures (1) would eliminate fluctuations in prices arising from fluctuations in production, (2) would not deny the incentive of free market prices to farmers; (3) would soften the impact of inflation on vulnerable consumers; and (4) would not disrupt normal trade and would not lead to black marketing and hoarding.

As regards policy implications for other crops, it is usual to state that price policies should be such as to achieve a desirable crop-pattern. The problem of relative crop-prices and crop-pattern, however, is not so acute in the face of the problem of achieving increase in the production of all crops. The emphasis should be to increase productivity, rather than to shift acreage under cultivation. In the case of crops other than foodgrains, the necessity of a public distribution system through fair price shops becomes less marked because, they are less basic than foodgrains in consumption pattern.

It may be recalled that it is the purchasing power or the demand side which has a greater impact on the prices of these crops than fluctuations in production. This would mean that though buffer stock operations may be set up to meet extreme situations, measures restraining demand will be essential, if price-rise is to be checked. But it is precisely this task which is most difficult and many of such
demand restraining measures may not be feasible or effective. Speculative elements also play their part and the role of forward trading also needs to be studied in this respect.

A system of minimum support prices will be necessary for these crops as well, the criterion being the bulk-line cost of production. As it is the market prices which determine the crop pattern, the prices of competing crops need not enter the fixation of support prices.

All these problems are discussed in detail in the next chapter together with the actual measures taken for different crops.

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