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Commentary

Minimum Support Price: All that Glitters is not Gold

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Though MSP is supposed to be lower than the market prices, it has been consistently higher than market and international prices. While the government keeps hiking the MSP, the farmers argue that MSP is not enough.

INTRODUCTION

Prime Minister Narendra Modi announced the repeal of the contentious farm laws on 19 November 2021 and urged the protesting farmers to return home. These three bills, namely, the Farmers' Produce Trade and Commerce (Promotion and Facilitation) Bill 2020, the Farmers (Empowerment and Protection) Agreement on Price Assurance and Farm Services Bill 2020, and the Essential Commodities (Amendment) Bill 2020, arrived with India's agrarian distress as their backdrop.

Indian agriculture is plagued with high price volatility, lack of access to inputs, poor price realisation, rising costs, inaccessibility to formal credit, and poor bargaining power. In the backdrop of this agrarian distress, farmers have been protesting for over a year against the new Farm Bills passed in the parliament. One of the leading causes of worry for the protesting farmers was that the new farm laws would adversely affect the Minimum Support Price [MSP] regime that has been in place since the 1960s. While PM Modi mentioned

in his speech that a committee would make MSP more effective and transparent, it remains unclear whether the government will agree to farmers' other significant demands of making MSP a legal right.

UNDERSTANDING MSP

MSP is the minimum price that the Indian government pays the farmers at the time of procurement. It is a form of market intervention by the government of India. The original idea behind the introduction of MSP was to provide the farmers with some kind of insurance against any sharp fall in market prices.

Though MSP is supposed to be lower than the market prices, it has been consistently higher than the market and international prices. While the government keeps hiking the MSP, the farmers argue that MSP is not enough. At the same time, there have also been demands to legalise MSP. Since MSP keeps increasing yearly, it costs the government both financially and logistically.

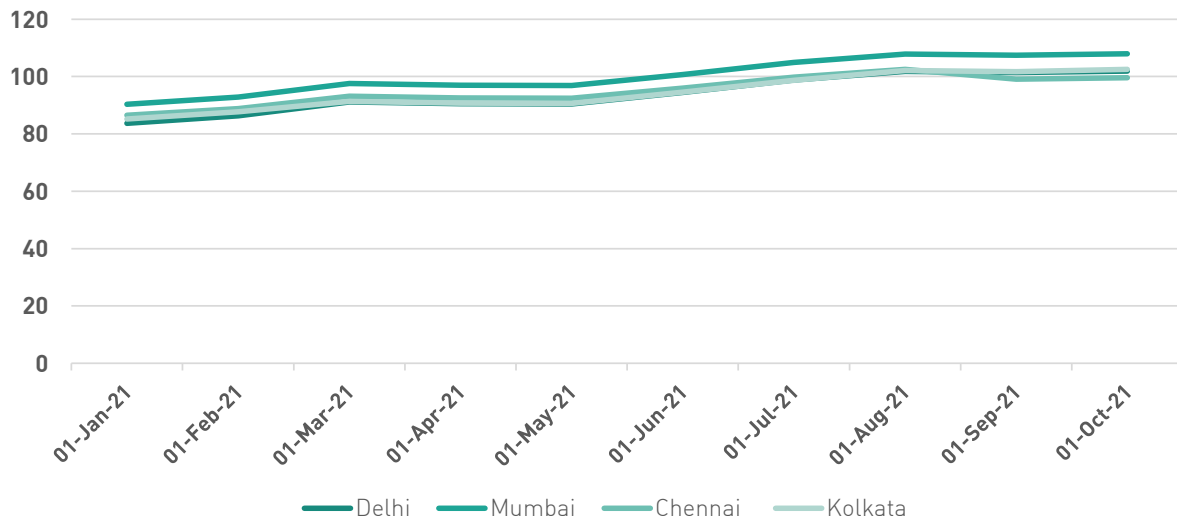
In this context, the paper seeks to analyse some key questions about MSP. The first section looks at the reasons behind the continuous increase in the MSP. The second section discusses whether the current MSP regime is benefitting the intended beneficiaries. Based on these observations, the final section attempts to provide a way forward for the policymakers.

WHY DOES THE MSP KEEP RISING?

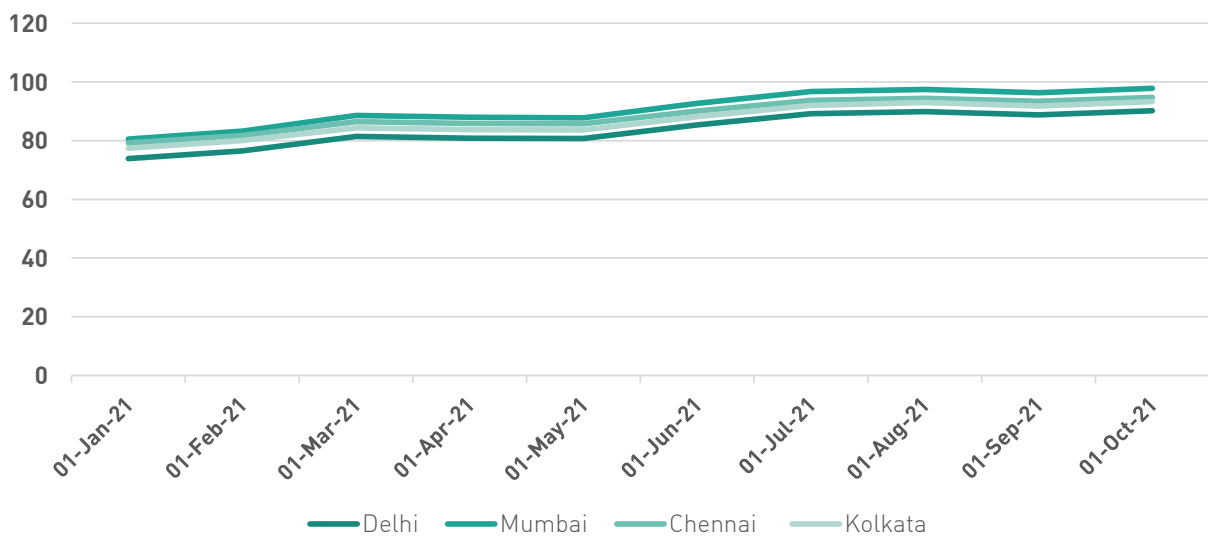
The reason why MSP has risen over the years is because of the rising input costs. The report of the Committee on Doubling Farmers' Income (2017) points out a substantial rise in the cost of material inputs which has ultimately led to a fall in the net income from the crops over the years. On the basis of the comparison between the trends in the wholesale price index [WPI]¹ of food articles such as rice and wheat and that of purchased agricultural inputs like fertilisers and diesel, the committee observed that the WPI of food articles was lower than that of agricultural inputs for most years (ibid.). This observation reflected that the farmers received lower market prices for agricultural commodities than the prices paid for the purchase of inputs.

The consistently rising fuel prices in India also contribute to a hike in input costs (See Figure 1 and Figure 2). Since 2015, the fall in international crude oil prices has been compensated by raising taxes (Powell 2021). This ultimately keeps the retail price of petrol and diesel high. Therefore, even when the benchmark crude oil prices fall, the central and state governments continue to maintain high fuel prices. Therefore, the benefit of falling crude prices are not passed on to the consumers.

¹ Wholesale Price Index is an index that tracks the movement of wholesale prices of goods and is often used as a measure of inflation.

Figure 1: Retail Selling Price of Petrol

Source: Petroleum Planning and Analysis Cell (2021)

Figure 2: Retail Selling Price of Diesel

Source: Petroleum Planning and Analysis Cell (2021)

The rising fuel prices add to the burden of the farmers. Diesel is an important input in the agricultural sector. A rise in diesel prices leads to an increase in cultivation, irrigation, and transportation costs. Increase in input cost squeezes farmers' already low-profit margins.

Furthermore, the country's flawed fertiliser policy has led to an increase in the input cost for the farmers and fertiliser subsidy for the government. The government introduced the Nutrient-based subsidy [NBS] scheme in 2010. Under this scheme, the subsidy on non-urea fertilisers was deregulated to reduce the subsidy burden. The appropriate Nitrogen, Phosphorus, and Potassium [NPK] ratio under Indian soil conditions is 4:2:1. However the ratio was 6.7:2.4:1 in 2015-16, revealing a pattern of distorted fertiliser use in India (Standing Committee on Agriculture 2016). In states

like Punjab and Haryana, this ratio was 31.4:8.0:1 and 27.7:6.1:1 respectively. The fertiliser subsidy has increased over the years and the budget estimate for fertiliser subsidy stands close to INR 80,000 crores in the recent years (Ministry of Finance 2020). Therefore, the NBS scheme has not led to a reduction in farm subsidies. Instead, it has worsened the fertiliser mix, and consequently the soil quality due to overuse of urea.

According to the Ministry of Finance's (2015) economic survey, 41% of the subsidised urea is either diverted to non-agricultural uses or smuggled across borders. The survey also estimated that because of these leakages, only 35% of the total urea subsidy actually reaches the small and marginal farmers. As a result, many farmers have to resort to buying urea from black markets at a higher price. According to the survey, nearly 51% of the Indian farmers purchased urea at a rate higher than the MRP. The survey further pointed out that 100% of the farmers had to purchase urea above MRP in the black market in Assam, Bihar, Odisha, West Bengal, and Karnataka. Therefore, neither the government is benefitting from this scheme, nor the farmers.

IS THE IMPORTANCE THAT MSP RECEIVES IN THE POLICY DISCUSSIONS JUSTIFIED?

MSP is announced for 23 crops at the beginning of the sowing season and is fixed twice a year based on the recommendations of the Commission for Agricultural Costs and Prices [CACP]. In 2018, then Finance Minister Arun Jaitley announced that MSP would henceforth be fixed at 1.5 times of the production costs for crops as a predetermined principle. This was recommended by the National Commission on Farmers, chaired by professor M.S. Swaminathan. The commission was constituted in 2004 to look into farmer distress and recommend policies to address this. Arun Jaitley, however, did not clarify which cost would be used to arrive at the MSP for different crops.

The government considers the $A2 + FL$ principle/ formula for ascertaining the cost of production. $A2$ is the cost of inputs that are paid for. These inputs include seeds, fertilisers, hired labour, rent for hired machinery, interest on working capital, operating cost of own machinery, and rent paid on leased land. FL includes estimated value of unpaid family labour².

Swaminathan has clarified that the commission's recommendations were based on "complete costs", which are given by $C2$ (Haq 2018). $C2$ includes all these aforementioned costs, plus the estimated rent and interest forgone on owned land and fixed capital assets³. Evidently, $C2$ is greater than $A2 + FL$. Therefore, the announced MSPs are not enough to cover the costs borne by the farmers.

² Farmers do not pay money to their family members for the work that they do on their farm. However, that does not mean that family labour is not an important input. Therefore, in order to calculate the costs incurred by the farmers, CACP does a rough estimate of this variable and considers it for recommending MSP.

³ Similar to how FL was calculated, $C2$ includes estimation of costs which are not actually paid for by the farmers. These costs are hidden costs and since the assets would have been used for some other reason, if not for farming purposes, the rent and interest on them are estimated and included to arrive at $C2$.

Additionally, apart from wheat and paddy, there is no systematic procurement for other crops by the government. Even the limited procurement is concentrated in a few regions. According to the Food Corporation of India (2015), only 6% of farmers are actually able to sell their crops at MSP. Meaning that an overwhelming percentage of farmers remain outside the ambit of MSP.

When procurement rises, private traders conclude that there is surplus grain with the government. They fear that if this grain is released in the market, the prices will crash. The government of India has been continuously reporting excess foodgrain stocks⁴. To tackle this, CACP (2021) has recommended disposing excess food grains stocks to save the carrying costs and deal with storage space constraint. As a result, it economically makes sense for the private traders to keep their prices low. Therefore, accumulation of stock pushes prices down in states where procurement does not happen.

The existing MSP regime is neither adequate nor impartial. Therefore, excessive focus on this policy is detrimental to the cause of farmers. It diverts attention from other important issues that require addressing.

WHAT NEEDS TO BE DONE

Need for crop diversification and geographical diversification

The procurement at MSP is mainly limited to rice and wheat. This procurement is also confined to a few states such as Punjab, Haryana, and Madhya Pradesh. Though the concentration of attainment in these states has helped farmers prosper, it has had some harmful impacts too. The over reliance on MSP has led to overproduction of rice and wheat in said states. Additionally, since both crops are water-intensive, the soil and water table in these areas is negatively impacted. Furthermore, there is an urgent need for crop diversification (Singh et al., 2021). Policy-makers across the world recognise the importance of a diversified diet. In this context, it is important to diversify the commodities distributed under the Public Distribution System. For this to happen, crops other than wheat and rice must be bought at MSP from the farmers.

The benefits of procurement operations are also highly skewed in the favour of a few states. Madhya Pradesh, Haryana, and Punjab account for almost 85% of wheat procurement in the country. On the other hand, Punjab, Telangana, Andhra Pradesh, Chhattisgarh, Odisha, and Haryana account for almost 75% of rice procurement (Tiwari 2020). Therefore, there is a need for geographical diversification of the procurement process as well.

Shift the focus away from prices

The government is making efforts to increase the prices that farmers receive in order to make agriculture more profitable for them. At the same time, every year, demands are made to increase the MSP. However, there is a need to analyse whether these demands actually help the intended beneficiaries.

⁴ The data of procurement and distribution has shown this trend over the years.

As discussed, raising the MSP is not good news for farmers of states where procurement is not actively done.

Agricultural commodities constitute a major part of the consumption basket. Moreover, the government wants to attract foreign capital with low inflation rates⁵. Therefore, it is in the government's interest to not let the prices of agricultural commodities rise. Econometric analysis by Gaiha and Kulkarni (2005) shows a positive correlation between the combined MSP of wheat and rice, WPI, and the latter in turn raises the Consumer Price Index for Agricultural Labourers.

An increase in prices of agricultural commodities is not good for farmers either. According to the 10th Agriculture Census of India, the number of small and marginal farmers with less than two hectares of land has been rising. They now account for around 86% of all farmers (Agriculture Census Division 2019). Additionally, the average landholdings of such farmers were reported to be less than 1 hectare each. This means that in most cases, the marketable surplus, that is the production minus consumption, produced by these farmers is very small, and sometimes even negative. As a result, most of these farmers are net buyers of food and not net sellers of food. Therefore, if prices rise, it will negatively impact their ability to afford food, thereby making them food insecure.

On one hand, there is a need to make farming more remunerative. On the other hand, high prices of food and agricultural commodities are not necessarily desirable, since they can end up hurting poor farmers. The only way out from such a paradoxical situation is to shift the focus away from prices and towards costs. If the costs incurred by the farmers are reduced, farming will automatically become profitable for them.

Reduce the cost of production

Soil management is important for small and marginal farmers. Improvement in soil management leads to an improvement in marketable surplus through an improvement in overall resource efficiency (Committee on Doubling Farmers' Income 2018). The government has tried to address this problem by launching the Soil Health Card [SHC] scheme in 2015. Under this scheme, soil health cards are issued to the farmers. These cards contain the soil nutrient status of farm holdings as well as recommendations on nutrients and fertilisers required to improve the quality of the soil. However, such a scheme is unlikely to improve the soil quality as long as the government's other policies continue to send contradictory signals. For instance, as long as schemes like NBS, which negatively impacts soil health, other policies such as SHC will not have any major positive impact. The government needs to take steps to change the pattern of fertiliser use. This involves changing the NBS scheme and giving equal priority to NPK fertilisers. Increased economic investment in fertiliser research is also important to improve efficiency and minimise damage to soil quality.

For small landholdings, it is not profitable to invest in capital-intensive machinery. Therefore, cooperative farming must be promoted to pool in resources and invest

⁵ Inflation rates are one of the major factors that govern the flow of foreign investments. High inflation rates in the host country act as a signal for an unstable economy.

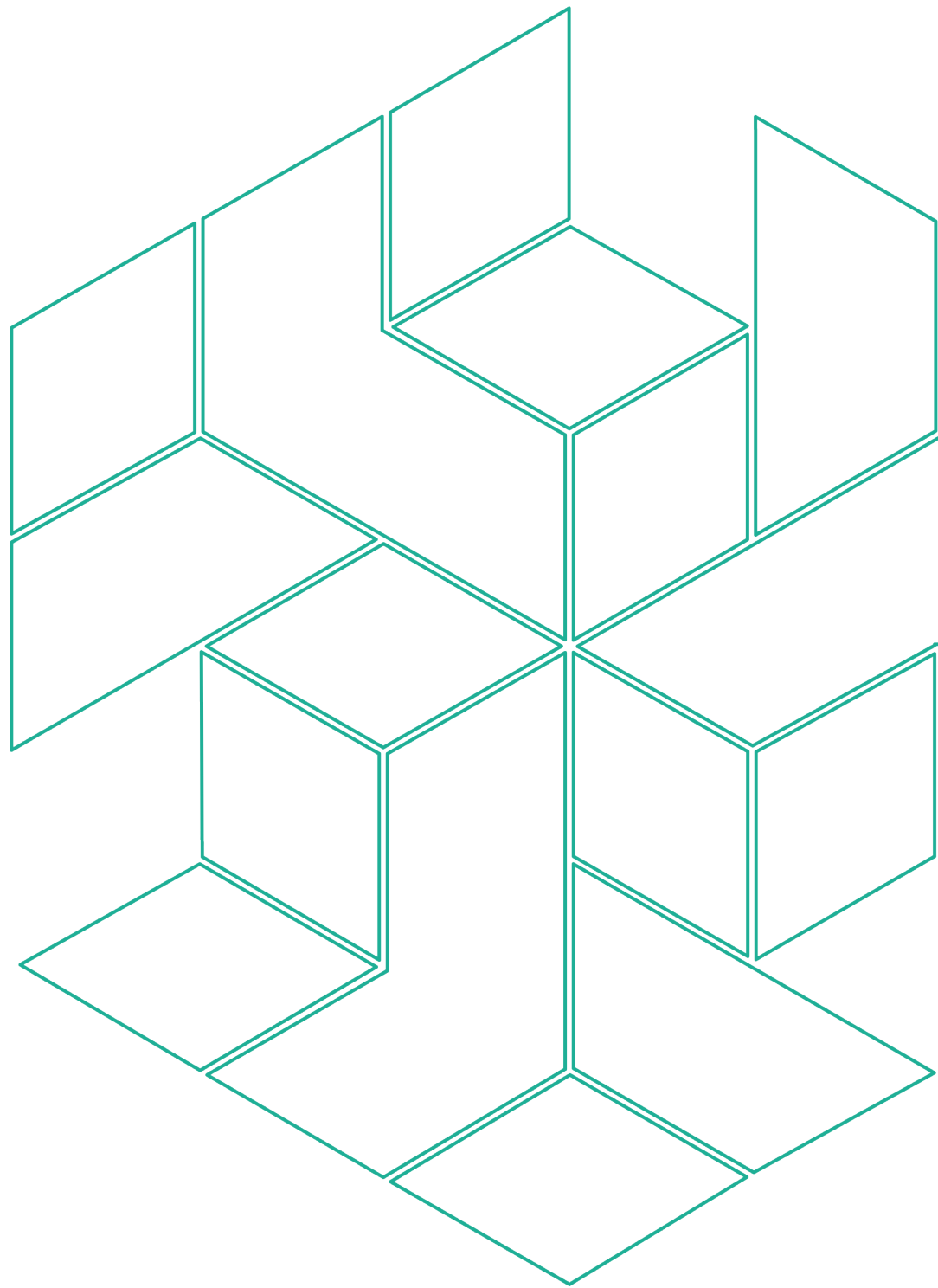
in the capital required. This can substantially bring down the cost of production for the farmers. The central government recently launched a scheme called Formation and Promotion of 10,000 Farmer Producer Organizations [FPOs]. Through this scheme, the government aims to pool small, marginal, and landless farmers into FPOs, so that they can get the benefit of better prices, access to markets, credit, etc., through collective action. FPOs have the potential to improve the incomes of farmers. However, executives of the existing FPOs have expressed the need for more awareness amongst farmers on how the FPOs are supposed to function. Apart from this, these FPOs also lack funds. Shareholders and banks are apprehensive about lending to these FPOs. As a result, these FPO groups find it difficult to expand or even survive in some cases (Paliath 2020). Therefore, the government must step in to provide financial support to FPO groups for an extended period of time. Steps must also be taken to improve access to formal credit. FPOs are also in need of continuous guidance and professional advice.

Ultimately, the focus of the green revolution was on wheat and rice. These crops received extensive research, inputs, and market support. In order to promote crop diversification, the government needs to give a similar degree of support to other crops. These crops would also have the potential to significantly increase farmers' incomes. This can be done by facilitating collaboration and links between agriculture universities, experts, and states and centre's agriculture departments.

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