



The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

Papers downloaded from AgEcon Search may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.

No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.

Changing Crop Production Cost in India: Input Prices, Substitution and Technological Effects

S.K. Srivastava*, Ramesh Chand and Jaspal Singh

NITI Aayog, New Delhi-110 001

Abstract

The study has examined economics of crop cultivation at the aggregate level over the past 25 years, identified sources of cost escalation and evaluated the effects of factor prices, substitution and technological effects on the production cost. The results reveal that a disproportionate change in gross return vis-à-vis cost resulted in varying rate of return from crop enterprise during the past 25 years. During 2007-08 to 2014-15, the average cost inflation reached the highest level of 13 per cent, more than half of which was contributed by the rising labour cost alone. Further, at the aggregate level, use of physical inputs increased only marginally and a large share of the increase in the cost of cultivation was attributed to the rising prices of inputs. The estimated negative and inelastic demand of inputs revealed a great scope to reduce the cost by keeping a check on input prices, particularly labour wages. The estimated elasticity of substitution indicated imperfect substitution between labour and machine and the present level of farm mechanization is inadequate to offset the wage-push cost inflation in Indian agriculture. It is therefore necessary to accelerate appropriate farm mechanization through the development of farm machinery suitable and economical at small farms and improvement in its access through the custom hiring. The study has also revealed a slow rate of yield improvement to offset the rising cost.

Key words: Production cost, cost inflation, input price effects, factor substitution, technological effects

JEL Classification: Q12, Q14, Q16

Introduction

The agriculture sector, which engages 64 per cent of the rural workforce, assumes a predominant role in improving the overall welfare of rural society. According to the latest available data in Situation Assessment Survey of Agricultural Households conducted by the National Sample Survey Office (NSS-SAS), nearly half of the farmers' income comes from crop cultivation. The economic viability of crop production sector, therefore, becomes an essential condition to sustain interests of the farming community. In this context, accurate information on the cost of cultivation (COC) is indispensable. It not only helps the farmers to decide on the allocation of limited

resources among alternate crop choices but also enables an assessment of farm profitability, which in turn influences their decision to invest in agriculture.

During the past five decades, Indian agriculture has witnessed a significant change in input-use away from traditional inputs like human labour, bullock labour, farm-grown seeds, manure and traditional methods of irrigation towards modern inputs like improved seeds, chemical fertilizers, farm machine and large-scale use of tubewells for irrigation. It is pertinent to evaluate the effect of such transitions on crop production cost and profitability of crop enterprise. It is also important to ascertain whether the change in COC, if any, is due to the changes in level of input-use or its prices. The changing relative price of the factors of production prompts farmers to partially substitute

* Author for correspondence
Email: shivendraiari@gmail.com

the related factors (e.g., farm labour with machinery) in order to maximize their profits. The evaluation of effect of factor substitution on crop cultivation cost is useful in devising suitable strategies for controlling the cost inflation in the country.

Most of the studies in the present literature have used cost concepts as a supplementary tool to estimate farm profitability or to assess the economic viability of a technology or to evaluate the impact of policy reforms (e.g., subsidy, MSP) on production cost. But barring few (Sen and Bhatia, 2004; Raghavan, 2008), no study in recent years has focussed exclusively on the changing structure of COC in a comprehensive manner. A properly-designed study on economics of crop production assumes a significant importance, particularly in the recent years when Indian agriculture has witnessed a positive turnaround in its performance since the year 2004-05 (Chand, 2014). With this background, the present study examines the changes in average real COC and relative profitability at the aggregate level during the past 25 years and identifies the sources of cost inflation and contribution of different factors in rising COC. The paper also evaluates the effects of factor prices, factor substitution and technological improvements on production cost by estimating price elasticity of input use, elasticity of factor substitution and yield elasticity of cost in selected crops, respectively.

Data and Methodology

The study is based on the state-level aggregate and unit-level data on cost of cultivation collected under the *Comprehensive Scheme on Cost of Cultivation of Principal Crops* of Directorate of Economics and Statistics, Ministry of Agriculture & Farmers Welfare, Government of India. Presently, the COC data are collected for 21 principal crops across major producing states in the country. However, consistent time series data over a long time period is available only for a few crops. The present study uses time series data on COC for ten crops across 19 major producing states for the period 1990-91 to 2014-15. The selected crops are paddy, wheat, maize and jowar from cereals group,

gram and arhar from pulses group, rapeseed & mustard and groundnut from oilseeds group and sugarcane and cotton among the other cash crops. These crops covered 66.11 per cent of gross cropped area (GCA) in the country in the year 2014-15. The state-wise area covered under the selected crops is given in Appendix 1. For evaluating the effects of factor prices and factor substitution, plot- level data were used for the period 2000-01 to 2012-13 for the selected crops. The technological effects on production cost were evaluated using state-level panel data for the period 2000-01 to 2012-13 in the selected crops.

The trends in average cost and return from crop cultivation were examined by constructing all-India level aggregated time series of selected crops across major producing states using crop area in respective states as weight. The concept of Cost $A_i +$ imputed value of family labour (Cost $A_i + FL$)¹ was used to represent the cost. The cost and return were expressed in real terms using Consumer Price Index for Agricultural Labour (CPI_AL). The relative profitability of a crop enterprise was examined from the ratio of Cost $A_i + FL$ and value of gross output during the period 1990-91 to 2014-15. Based on the structural change in cost-output ratio, the crop performance was examined during three distinct sub-periods, viz. 1990-91 to 2002-03, 2002-03 to 2007-08, and 2007-08 to 2014-15.

To estimate annual cost inflation and identify sources of change in COC over time, cost index (with base 2004-05=100) was constructed. Relative contribution of different factors in cost inflation was estimated using the following formula;

$$Z_{it} = \frac{(w_{it} \times I_{it})}{\sum_{i=1}^n (w_{it} \times I_{it})} \times 100 \quad \dots (1)$$

where,

Z_{it} = Contribution of i^{th} factor in cost inflation in the t^{th} year

w_{it} = Share of i^{th} factor in cost ($A_i + FL$) in the t^{th} year

I_i = Inflation rate of i^{th} factor cost in the t^{th} year over previous year, and

$i = 1, 2, \dots, n$ inputs.

¹ Cost A_i comprises of all paid out cost components such as value of hired human labour, hired bullock labour, maintenance and upkeep charges on owned bullock labour, upkeep charges of owned machines, hired machine charges, seed cost, pesticides cost, manure cost, fertilizer cost, canal irrigation charges, depreciation of implements and farm buildings, land revenue cess and other taxes, interest on working capital and miscellaneous expenses on other inputs. Imputed value of family labour was estimated by multiplying working hours of family labour with prevailing wage rate.

The effect of factor prices and factor substitution on COC was evaluated by estimating the price elasticity of factor demand and elasticity of technical substitution between factors (labour and machine) in the selected crops. The price elasticity of factor demand simulates the response of input used to the changes in its prices, while elasticity of technical substitution explains how changes in relative prices of factors affect the share of factors and income distribution. These elasticities were estimated by fitting the transcendental logarithmic (translog) cost function in selected crops for the period 2000-01 to 2012-2013. The translog functional form captures many of the attributes of a cost function that are implied by the economic theory. Because of this flexibility, it has been widely used for studying production relationships. Before logarithms are taken, the function is:

$$C = a_0 y^{a_{yy}} y^{\frac{1}{2} a_{yy} \ln y} \prod_{i=1}^N w_i^{a_i} \prod_{i=1}^N w_i^{a_{iy} \ln y} \prod_{i=1}^N w_i^{\frac{1}{2} \sum_{j=1}^N a_{ij} \ln w_j} \quad \dots (2)$$

where, w is a vector of prices for the inputs to production and y is a single output. N is the total number of inputs and a 's are the parameters of the function.

One disadvantage of the previous form is that it is not linear in parameters. A standard technique when dealing with power functions like the translog cost function, is to take logarithms. The resulting function is linear in parameters and standard statistical techniques can be used for estimation. After taking logarithms, the function is:

$$\ln C = a_0 + \sum_{i=1}^N a_i \ln w_i + a_y \ln y + \frac{1}{2} \sum_{i=1}^N \sum_{j=1}^N a_{ij} \ln w_i \ln w_j \sum_{i=1}^N a_{iy} \ln w_i \ln y + \frac{1}{2} a_{yy} \ln y \ln y \quad \dots (3)$$

While it is possible to include terms to account for technological progress, the specification used here assumes that cost is independent of time. Using Shepherd's lemma, the derived demand equations are

$$S_i = a_i + a_{iy} \ln y + \sum_{j=1}^N a_{ij} \ln w_j \quad \dots (4)$$

where, $S_i = \frac{w_i x_i}{C}$ is the cost share of the i^{th} input. The cost function is assumed to be continuous, so Young's Theorem concerning symmetry of the second derivatives restricts

$$a_{ij} = a_{ji} \text{ for all } i \neq j.$$

The result of this derivation is a system of N equations consisting of N derived demand equations and one cost function.

Homogeneity of the first degree implies

$$\sum_{i=1}^N a_i = 1, \sum_{j=1}^N a_{ij} = 0, \sum_{i=1}^N a_{iy} = 0$$

for all i and j .

It is also possible to impose constant returns to scale – equivalent to imposing homogeneity in y – and details of this procedure can be found in Diewert and Wales (1987). The global concavity can also be imposed on this specification by forcing the matrix $[a_{ij}]$ to be negative semi definite. A technique for accomplishing this can be found in Jorgenson (1986).

The elasticities of substitution are given by

$$\sigma_{ii} = \frac{a_{ii} + S_i^2 - S_i}{S_i^2} \quad \dots (5)$$

$$\sigma_{ij} = \frac{a_{ij} + S_i S_j}{S_i S_j} \quad i \neq j \quad \dots (5)$$

The price elasticities (own and cross) are given by

$$\eta_{ij} = \sigma_{ij} S_j \quad \dots (6)$$

In the empirical analysis, five production factors — labour, machine, seed, fertilizer and irrigation were taken into consideration. The model consisted of four share equations each for the factors, namely labour, machine, seed and fertilizer. The coefficient of 'irrigation' was estimated using homogeneity constraint in the model.

While analysing impact of technological improvement on production cost, it was assumed that technological effects get manifested in crop yield. Therefore, the impact of technological improvement on production cost can be evaluated by estimating the

association between crop yield and production cost. In the present study, yield elasticity of production cost was estimated for the selected crops by fitting log-linear state-level panel cost functions for the period 2000-01 to 2012-13. The general form of the cost function is given by Equation (7).

Production cost = $f(\text{crop yield, seed prices, fertilizer prices, labour wages, machine use prices, irrigation prices, animal use prices, trend})$... (7)

The appropriate models among fixed effects, random effects and pooled data regression were selected by following standard panel data modelling process (Gujarati, 2005).

Results and Discussion

Trends in Cost and Returns

The trends in average real COC and return from the selected crops during the past 25 years are depicted in Figure 1. The average real COC witnessed a steady rise with annual growth rate of 2.14 per cent over the past 25 years. The rising COC is expected as it implies growth in input use through higher investments in crop cultivation. What matters from producers' point of view is whether increase in cost is accompanied by at least a similar increase in the returns?

The ratio of cost to gross return revealed a disproportionate change in the gross return as compared

to the cost during 1990-91 to 2014-15. Based on the trend in the ratio, three distinct phases were delineated. An increase in cost per 100 rupee of output during 1990-91 to 2002-03; a phase of sharp decline in the production cost after 2002-03 till 2007-08, followed by a phase of steep increase in the production cost during 2007-08 to 2014-15.

During 1990-91 to 2002-03, the real COC representing all the selected crops increased by 2.06 per cent per annum, whereas the real gross returns remained stagnant. As a result, cost incurred to produce 100 rupees of crop output increased from ₹ 51 in 1990-91 to ₹ 66 in 2002-03 and the net return declined at the rate of 2.77 per cent per year (Figure 1). The subsequent period till the year 2007-08 witnessed revival in the real output, which witnessed a substantially higher growth rate of 6.56 per cent against a modest increase in real COC. This reduced the cost of producing 100 rupees of output to historically lowest level of¹ 48 by the year 2007-08. The crop profitability witnessed a substantial improvement during this period.

However, the impressive growth in the real crop output could not sustain after 2007-08. The value of crop output deflated by CPI_AL during the year 2014-15 dropped to the 2006-07 level. On the other hand, the real COC increased rapidly by 3.22 per cent a year. These changes led to the reversal in the declining cost of production from ₹ 48 /100 rupee output in year 2007-08 to ₹ 64 by the year 2014-15. Based on these results, it can be concluded that during recent years, the growth

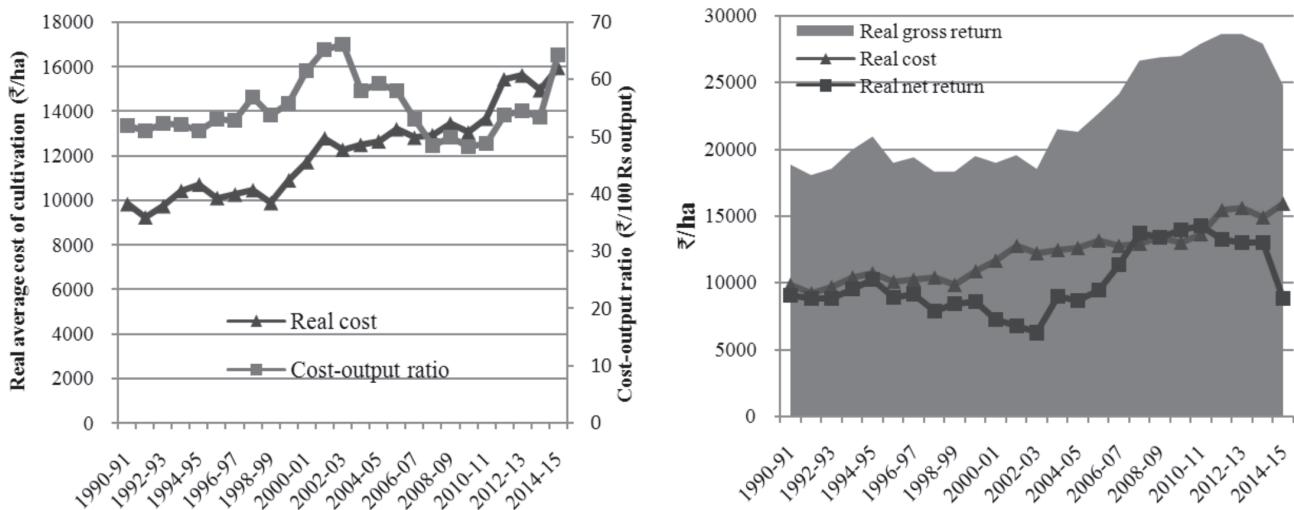


Figure 1. Trends in average cost and return from the crop cultivation in India

Table 1. Cost of production in selected crops across the major producing states in 2014-15

(₹/quintal)

State	Paddy	Wheat	Maize	Jowar	Gram	Arhar	Groundnut	Rapeseed & mustard	Cotton	Sugarcane
Punjab	515	562	934	-	-	-	-	-	2473	-
Uttarakhand	644	934	-	-	-	-	-	-	-	79
Haryana	911	842	-	-	1962	-	-	1686	4156	-
Jharkhand	878	1505	987	-	1299	-	-	-	-	-
Rajasthan	-	1029	1567	2283	2636	-	3033	1923	2948	-
Kerala	1223	-	-	-	-	-	-	-	-	-
Madhya Pradesh	1151	801	1083	2917	1943	2968	-	1276	4624	-
Bihar	875	1036	952	-	-	-	-	1356	-	-
Gujarat	-	993	-	-	-	3578	3195	1423	2827	-
Karnataka	915	2085	1040	1933	1947	-	3639	-	3059	91
Chhattisgarh	938	-	-	-	2176	-	-	-	-	-
Andhra Pradesh	892	-	745	1431	-	-	3424	-	3311	145
Uttar Pradesh	1089	1220	1609	-	4166	2772	-	2512	-	100
Tamil Nadu	1123	-	-	2338	-	-	2917	-	2974	134
Himachal Pradesh	-	1594	1713	-	-	-	-	-	-	-
Maharashtra	-	1527	1811	2376	-	4189	5014	-	3585	146
Odisha	1175	-	1061	-	-	4336	-	-	5228	-
West Bengal	1234	1311	-	-	-	-	-	-	-	-
Assam	1139	-	-	-	-	-	-	3339	-	-
Overall (₹/quintal)	1016	1011	1296	2279	2283	3703	3379	1933	3356	114
Output-cost ratio	1.40	1.74	1.23	1.28	1.70	1.51	1.32	1.82	1.22	2.29

in output of the major field crops has remained inadequate to offset the rising COC leading to a downward trend in the average net returns from the crop cultivation. In real terms, the net returns received by the farmers in 2014-15 were even less than the returns which they received ten years back in 2005-06. The effects of declining returns from the investment in crop enterprises are reflected in the rising resentment among the farmers across the country during the recent years (Narayananamoorthy, 2013). As rising COC is not translating into the improvement in crop output, strategy to raise farmers' income should include both output acceleration and cost reduction measures.

The results presented in Table 1 show that production cost varies substantially across the crops and the producing states. For instance, the cost of producing a quintal of paddy varied from ₹ 515 in Punjab to ₹ 1234 in west Bengal in 2014-15. Similarly, the cost of producing wheat in Karnataka was 3.7-times the production cost in Punjab. The large variation in

the production cost of a crop across the states arises due to difference in production technology (resulting in differential COC), access to irrigation, and the level of productivity. Therefore, in the states with low level of productivity, the production cost can be reduced substantially by improving crop yield.

Sources of Changes in Cost of Cultivation

The sources of changes in COC have been identified by estimating the contribution of different inputs in the average cost inflation during the three sub-periods of the past 25 years. This in turn depends on respective share of inputs in COC (weight) and extent of rise in the COC during the period under consideration. The composition of the average COC during the three sub-periods is presented in Table 2. The evidences showed that during the past 25 years, Indian agriculture witnessed a steady shift from animal labour towards machine-use. The share of human labour in $\text{Cost}_A + \text{FL}$ witnessed a fluctuating trend

Table 2. Changing structure of cost of cultivation: TE 1990-91 to TE 2014-15

(per cent)

Year	Share in cost of cultivation							Cost A ₁ +FL*
	Seed	Fertilizer	Labour	Animal	Machine	Insecticides	Others [#]	
TE 1990-91	10	12	39	14	7	2	16	3737
TE 2002-03	8	11	42	12	10	2	15	9768
TE 2007-08	9	11	41	9	13	2	15	14856
TE 2014-15	8	11	47	5	14	2	13	34232

*₹/ha (at current prices); [#] Others include manure, depreciation of implements and farm buildings, land revenue cess and other taxes, interest on working capital and miscellaneous expenses on other inputs

Table 3. Contribution of factors in average cost inflation in India

(per cent)

Period	Contribution in cost inflation							Cost inflation
	Seed	Fertilizer	Labour	Animal	Machine	Insecticides	Others*	
1990-02	7	11	46	10	11	3	11	10
2002-07	12	8	34	8	21	3	20	6
2007-14	7	9	53	2	16	2	5	13
Overall	9	10	46	5	15	3	12	10

*Others include manure, depreciation of implements and farm buildings, land revenue cess and other taxes, interest on working capital and miscellaneous expenses on other inputs

during the successive periods and attained the highest level of 47 per cent by TE 2014-15. The labour was followed by machine, fertilizer, seed, animal labour and insecticide with their respective shares of 14 per cent, 11 per cent, 8 per cent, 5 per cent and 2 per cent.

During the past 25 years, the average annual inflation in CostA₁+FL (2004-05=100) was about 10 per cent per annum (Table 3). The rise in COC was not uniform during the period under consideration. The average annual cost inflation declined from 10 per cent during 1990-91 to 2002-03 to 6 per cent during 2002-03 to 2007-08. But, the post 2007-08 period witnessed a sharp increase in COC at the annual rate of 13 per cent. The decomposition of cost inflation among various factors revealed that labour alone contributed 53 per cent to the increase in COC during 2007-08 to 2014-15. The labour cost was followed by cost on

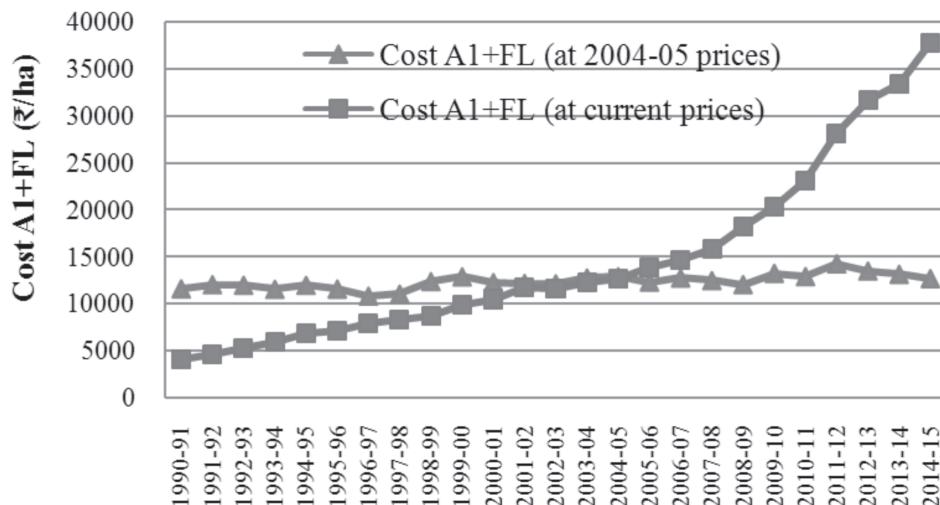
machine, fertilizer, seed, insecticides, and animal labour with their respective contribution of 16 per cent, 9 per cent, 7 per cent, 2 per cent and 2 per cent. Thus, the evidences revealed that labour cost is the predominant source of cost inflation, particularly in the recent years and managing this factor of production alone can substantially reduce the COC.

Effect of Input Prices on Cost of Cultivation

The effects of input prices and input-use on increase in COC were seen from the trend in cost expressed at current and at 2004-05 prices². The trend in CostA₁+FL at the base year prices represents changes in the physical use of inputs. Figure 2 shows that at the aggregate level, physical use of inputs has changed only marginally³, whereas COC at current prices witnessed a sharp increase which turned exponential

² The CostA₁+FL at 2004-05 prices was arrived at by deflating cost of individual inputs with its implicit price deflator and summing over all input costs.

³ The trend in CostA₁+FL at 2004-05 prices does not capture change in the use of individual inputs which might have witnessed differential (increase/decrease) trend in its use

Figure 2. Trend in costA_i+FL at current and 2004-05 prices

after mid-2000. These changes imply that a large share of the increase in cost is attributed to the rising prices of the inputs.

Further, the input prices also exert an indirect effect on the cost by influencing the actual use of the input. Such effects can be predicted from the price elasticity of inputs used in the crop cultivation (Chand, 1986). In the present study, the price elasticities of inputs used in the cultivation of selected crops were estimated by fitting translog cost functions using the SURE estimation technique. The estimated price elasticities for labour, irrigation, seed, fertilizer and machine are given in Table 4. The average estimated price elasticities varied across the inputs used and the crops taken into consideration. The elasticity values were negative and less than one, which imply that the increase in prices of the inputs would lead to less than proportionate decline in their use. Therefore, in a situation of rising input prices, COC will increase.

Thus, inelastic demand of inputs explains a rapid increase in COC, especially during the recent years. At the same time, inelastic demand for inputs reveals a great scope to reduce the COC by controlling input prices because reduction in input prices would lead to a less than proportionate increase in input use which in turn will result in the cost saving for the farmers.

Interestingly, labour, a predominant source of cost inflation, exhibited the lowest price elasticity among all the inputs in most of the crops. This implies that in a situation of falling wage rates, COC will reduce substantially. This fact also strengthens the argument to manage the labour use in agriculture and devise a strong strategy to offset the cost-push effects of wages, which have risen sharply during the recent years (Chand and Srivastava, 2014). On the other hand, cost-reducing effect for the machine, which exhibited the highest price elasticity among all the inputs used in all crops, would be the lowest. Nevertheless, these results

Table 4. Prices elasticity of inputs used in crop production

Inputs	Paddy	Wheat	Maize	Jowar	Gram	Arhar	Groundnut	Rapeseed & mustard	Cotton	Sugarcane
Labour	-0.21	-0.27	-0.21	-0.17	-0.14	-0.21	-0.16	-0.25	-0.20	-0.23
Irrigation	-0.25	-0.47	-0.10	-0.40	-0.30	-0.29	-0.04	-0.49	-0.38	-0.46
Seed	-0.29	-0.26	-0.34	-0.36	-0.21	-0.28	-0.28	-0.18	-0.60	-0.44
Fertilizer	-0.46	-0.38	-0.38	-0.39	-0.38	-0.34	-0.46	-0.44	-0.42	-0.29
Machine	-0.62	-0.53	-0.58	-0.55	-0.55	-0.59	-0.64	-0.54	-0.65	-0.69

Note: The estimated parameters of the models are not given due to paucity of space and can be obtained from the authors

Table 5. Elasticity of substitution between labour and machine use in different crops

EoS	Paddy	Wheat	Maize	Jowar	Gram	Arhar	Groundnut	Rapeseed & mustard	Cotton	Sugarcane
Value	0.73	0.60	0.72	0.68	0.54	0.78	0.47	0.61	0.68	0.62

reveal an ample scope to reduce COC by controlling the input prices.

Effect of Factor Substitution on Cost of Cultivation

Apart from controlling input prices, crop budget can also be managed to some extent by substituting the dearer inputs with technically feasible relatively cheaper inputs. For instance, farmers can substitute human labour with machine for several farm operations if relative labour wages (to machine-use prices) rises. It was observed that average labour-use in crop cultivation witnessed a 13 per cent reduction during 2000-01 to 2014-15. Farm mechanization has played a major role in reducing labour use in agriculture (Reddy *et al.*, 2014). However, inspite of declining labour-use, its share in CostA₁+FL has increased during the recent years (Table 2). Therefore, it is pertinent to evaluate the effect of substitution between labour and machine use on crop budget. This was examined by estimating elasticity of technical substitution between labour and machine (EoS) in cultivation of selected crops.

The EoS between human labour and machine hour varied from 0.47 for groundnut to 0.78 for arhar (Table 5). The positive but less than one value of elasticity implies that labour and machine are inelastic substitutes to each other. A 10 per cent increase in the ratio of wages-machine use price would result in 6.4 per cent (smaller) increase in ratio of machine use –labour use in crop production. Therefore, in the situation of increase in labour wages relative to machine-use prices, labour is not completely substituted by the machine and the share of labour in cost increases. The empirical evidences showed increase in labour wages-machine use prices ratio from 0.82 in 2001-02 to 1.03 in 2012-13 and this was accompanied by the increase in ratio of the share of labour and machine in crop outlay from 2.6 to 3.5 during the same period. Thus, inelastic substitution between labour and machine along with inelastic demand for labour appropriately explains why the share of labour in COC is increasing in the recent

years despite reduction in the use of human labour in farm operations.

The imperfect substitution between human labour and machine use in agriculture also signifies the fact that it is technically not feasible to replace all manual farm operations with machine. Other reasons for the smaller (inelastic) value of EoS might be the slow progress in the development of efficient labour-saving farm machinery as well as its suitability and accessibility to the predominantly small and marginal farmers in the country. Based on these results it can be concluded that at present level of farm mechanization, substitution between labour and machine is not sufficient to offset the rising labour cost in Indian agriculture. Greater efforts, therefore, are warranted to accelerate the development of suitable farm machinery and to improve its economic access to the farmers through the institutional innovations like custom hiring centres.

Effect of Technological Improvement on Production Cost

While evaluating impact of technological improvement on production cost, it was assumed that technological improvement is manifested in the yield of the crops. In a log-linear cost function, estimated coefficient of crop yield represents cost elasticity of yield which explains per cent change in production cost due to one per cent change in crop yield. The estimates of state –level panel cost functions for different crops are given in Table 6. It is to be noted that cross-section (state) effects were fixed to account for state-specific differences in production environment and climatic conditions. Further, inclusion of ‘time’ variable in the regression captured the temporal changes in production cost due to the factors other than those included in the model.

The estimated coefficient of yield was negative for all the selected crops indicating an inverse relationship between yield and cost of production. These results

Table 6. Estimated coefficients of log-linear cost function for different crops

Variable	Paddy	Wheat	Maize	Jowar	Gram	Arhar	Groundnut	Rapeseed	Cotton	Sugarcane
Dependent variable: Cost of production (₹/qtl) in logarithmic form										
Explanatory variables :										
Intercept	7.402*** (0.323)	6.593*** (0.395)	7.440*** (0.455)	5.327*** (0.810)	4.578*** (0.495)	7.552*** (0.891)	4.832*** (0.476)	6.099*** (0.528)	6.722*** (0.510)	4.971*** (0.958)
In(Yield)	-0.758*** (0.061)	-0.933*** (0.049)	-0.812*** (0.054)	-0.251*** (0.065)	-0.251*** (0.053)	-0.638*** (0.131)	-0.651*** (0.060)	-0.962*** (0.088)	-0.621*** (0.053)	-0.428*** (0.122)
In(Seed prices)	- 0.146* (0.083)	0.094** (0.041)	0.005 (0.075)	0.287** (0.134)	-0.040 (0.137)	0.413*** (0.150)	-0.064 (0.150)	0.042* (0.073)	-0.064 (0.073)	0.059 (0.024)
In(Fertiliser prices)	0.065 (0.086)	0.310*** (0.102)	-0.179 (0.165)	0.159 (0.303)	0.025 (0.146)	-0.321 (0.216)	0.037 (0.069)	0.304** (0.164)	0.304** (0.143)	-0.202 (0.221)
In(Labour wages)	0.238*** (0.055)	0.332*** (0.074)	0.453*** (0.080)	0.326** (0.139)	0.392*** (0.073)	0.585*** (0.238)	0.386*** (0.080)	0.529*** (0.123)	0.412*** (0.089)	-0.247 (0.249)
In(Machin-use prices)	0.082** (0.033)	0.067* (0.037)	0.023 (0.035)	-0.052 (0.094)	0.133** (0.055)	0.005 (0.100)	0.179*** (0.063)	0.125* (0.073)	-0.055*** (0.073)	0.521*** (0.129)
In(Irrigation machine- use prices)	0.052*** (0.017)	0.121*** (0.024)	-0.014*** (0.021)	0.012 (0.046)	0.021 (0.037)	0.035 (0.067)	-0.004 (0.028)	0.078 (0.057)	0.036 (0.029)	-0.124 (0.192)
In(Animal-use prices)	-0.001 (0.032)	0.004 (0.026)	0.120 (0.039)	0.255** (0.099)	0.066 (0.052)	0.046 (0.114)	0.209*** (0.058)	0.122** (0.054)	0.125** (0.055)	-0.002 (0.066)
Trend	0.002 (0.003)	-0.011*** (0.003)	-0.006 (0.005)	-0.014* (0.008)	-0.012* (0.007)	0.030** (0.012)	0.004 (0.006)	-0.012 (0.008)	-0.012 (0.007)	0.027*** (0.006)
Model (Fixed/Random/Pooled)	F F	F Y	F N	F N	P Y	P N	F N	P N	R Y	P N
Cross-section effect	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N	Y N
Period effect										
R ²	0.87	0.92	0.93	0.71	0.69	0.73	0.72	0.91	0.727	0.681
Hausman test	14.53** (7)	15.550** (8)	-	-	-	-	-	-	11.390 (8)	-
LR test: Cross section F	-	16.880*** (10,124)	10.506*** (6,76)	2.912** (4,52)	-	8.556*** (4, 52)	-	17.069*** (5,64)	-	-
LR test: Cross section: Chai square	-	122.870*** (13*11)143	54.966*** (13*11)143	(6)13.140** (13*5)65	-	32.871*** (13*6)78	(4)	-	66.097*** (5)	-
Observations	(13*11)143	(13*11)143	(13*7)91	(13*5)65	(13*6)78	(13*5)65	(13*5)65	(13*6)78	(13*9)117	(13*6)78

***, **, * denote significance at 1, 5 and 10 per cent levels, respectively

show that yield improvement through technological interventions offers an opportunity to absorb the rising cost of production of crops. It is worth mentioning that yield elasticities of production cost were less than one for all the crops which implies that increase in yield resulted in less than the proportionate increase in cost of production during the past decade in the country. This draws attention to the nature of technological change in Indian agriculture. A one per cent increase in yield resulted in 0.25 to 0.96 per cent reduction in COC of different crops. The yield effect on reducing cost was quite strong in the case of wheat and rapeseed & mustard but quite weak in the case of gram and jowar.

Conclusions and Policy Implications

The aggregate cost of production and output of ten major crops grown in India showed three distinct patterns during 1990-91 to 2014-15. The period 1990-91 to 2002-03 witnessed a steady rise in the real cost of cultivation (COC) accompanied by a relatively slower increase in the crop output. This mismatch resulted into a decline in profitability and net returns in real terms from crop production during this sub-period. The subsequent period till the year 2007-08 witnessed a significant acceleration in growth of output of the selected crops and the real cost of production reached a historically low level. The crop profitability registered a high growth during this period. However, this could not sustain and growth in the crop output remained inadequate to absorb the rising COC after 2007-08 till 2014-15. Over the 25 year period since 1990-91, the aggregate cost of cultivation of the selected crops increased at a faster rate than the increase in output during 1990-91 to 2014-15.

The average annual inflation in COC reached the highest level of 13 per cent during 2007-08 to 2014-15. More than half of the cost inflation during this period was contributed by the rising labour cost. Therefore, managing human labour alone would bring a substantial reduction in the crop budget of the farmers. Further, the results revealed that at the aggregate level physical use of inputs increased at a smaller rate and a large share of the increase in the COC was attributed to the rising prices of inputs. The negative and inelastic demand for farm inputs explains the sharp increase in the COC due to rising prices of inputs in the recent years. At the same time, keeping a check on input prices offers a great scope to reduce cost as it would lead to a

less than proportionate increase in its use and the net effect will be lower COC.

Apart from input price effect, elasticity of substitution (EoS) between labour and machine is quite important in influencing COC. The EoS between labour and machine use was positive and less than one in all the crops under study indicating imperfect substitution between labour and machine. One consequence of this has been increase in the share of labour in COC in the recent years, despite declining labour-use for farm operations. The evidences revealed that the present level of farm mechanization is inadequate to offset the wage-push cost inflation in Indian agriculture. It is therefore necessary to promote efficient and appropriate farm mechanization suitable for small farm situation. Institutional innovations like custom hiring centres and online taxi type model for machinery services to the farmers seems to hold scope to reduce COC. Nevertheless, the possibility of a perfect substitution between labour and machine in Indian agriculture is remote and therefore efforts should be made to improve crop productivity to absorb rising COC.

The cost elasticity of yield has indicated an inverse association between yield and cost of production in all the crops. However, the elasticity coefficient in most crops barring wheat and rapeseed & mustard was low which revealed that the pace of improvement in the crop yield was less than the increase in COC during the past decade in the country. Such evidences indicate the slow pace of technological improvement in Indian agriculture and underline the need to accelerate efforts to raise yield at a faster rate to offset the effects of rising COC and maintain a fair profit margin in crop cultivation.

Acknowledgements

The paper is partly drawn from the institute project on *Changing Structure of Crop Production Cost and Technological Effects in India* undertaken at ICAR-National Institute of Agricultural Economics and Policy Research.

References

- Chand, R. (1986) Estimating effects of input - output prices on input demand in Punjab agriculture-A profit function approach. *Artha Vijnana*, **28**(2):181-192.
- Chand, R. (2014) *From Slow Down to Fast Track: Indian Agriculture since 1995*. Working Paper 01/2014. ICAR-

National Centre for Agricultural Economics and Policy Research, New Delhi.

Chand, R. and Srivastava, S.K. (2014) Changes in rural labour market and its implications for Indian Agriculture. *Economic and Political Weekly*, **49**(10): 47-54.

Diewert, W.E. and Wales, T.J. (1987) Flexible functional forms and global curvature conditions. *Econometrica*, **55**:43–68.

Gujarati, D.N. (2005) *Basic Econometric (4th Edition)*. Tata McGraw-Hill Publishing Company Limited, New Delhi.

Jorgenson, D. (1986) Econometric methods for modeling producer behavior. In: *Handbook of Econometrics*, Eds: Z. Griliches and M.D. Intriligator. Elsevier. Amsterdam.

Narayananamoorthy, A. (2013) Profitability in crops cultivation in India: Some evidence from cost of cultivation survey data. *Indian Journal of Agricultural Economics*, **68**(1): 104-121.

Raghavan, M. (2008) Changing pattern of input use and cost of cultivation. *Economic and Political Weekly*, **43**(26-27): 123-129.

Reddy, A., Rani, C.R. and Reddy, G.P. (2014) Labour scarcity and farm mechanization: A cross state comparison. *Indian Journal of Agricultural Economics*, **69**(3): 347-358.

Sen, A. and Bhatia, M. S. (2004) *Cost of Cultivation and Farm Income*. State of the Indian Farmer: A Millennium Study, Vol. No. 14, Government of India, Academic Foundation, New Delhi.

Appendix

Appendix 1. Area under selected crops across major producing states in 2014-15

State	Paddy	Wheat	Maize	Jowar	Gram	Arhar	Groundnut	Rapeseed & mustard	Cotton	Sugarcane	Selected crops(a)	GCA (b)	Per cent (a/b)*100	(000, ha)
Andhra Pradesh	2394	303	141			874		281	821	253	4787	7690	62.24	
Assam	2495										2776	4083	68.00	
Bihar	3263	2154	707	60							6184	7673	80.60	
Chhattisgarh	4036	103	125	293		214	1846	185	2773	258	4557	5728	79.57	
Gujarat		1253									6529	12773	51.12	
Haryana	1278	2628		65				482	647		5100	6536	78.04	
Himachal Pradesh		330	293								623	918	67.84	
Jharkhand	993	64									1056	1554	67.99	
Karnataka	1327	1311	1045			650			875	691	5899	12247	48.17	
Kerala	198										198	2625	7.55	
Madhya Pradesh	2058	6351	885	231	2446	375		620	551		13517	23810	56.77	
Maharashtra			3288		1210		327		4190	1030	10045	23474	42.79	
Odisha	4166					141					4307	5173	83.26	
Punjab	2895	3505							421		6821	7857	86.80	
Rajasthan		3318	904		1256		505	2434	487		8904	24235	36.74	
Tamil Nadu	1795			415					187	263	2660	5995	44.37	
Uttar Pradesh	6136	10047	691		534	274		584		2216	20483	26147	78.34	
Uttarakhand	260	344								101	705	1097	64.25	
West Bengal	5527										5527	9690	57.03	
Total	38820	30099	5219	5120	4654	2214	4202	4586	10952	4811	110677	189303	58.47	
India	44238	32078	8797	6242	7652	3398	5104	5405	12660	5565	131139	198360	66.11	
Per cent	87.75	93.83	59.33	82.04	60.82	65.15	82.32	84.84	86.50	86.45		84.40		

Data source: Directorate of Economics and Statistics, Ministry of Agriculture & Farmers Welfare, Government of India