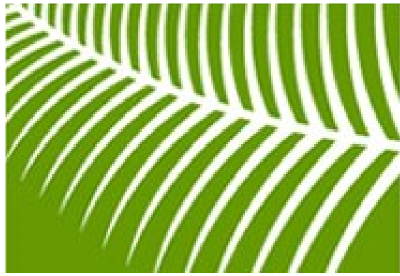

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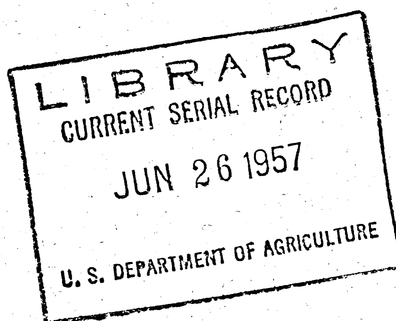

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STABILISATION OF AGRICULTURAL PRICES IN INDIA IN THE CONTEXT OF RAPID ECONOMIC DEVELOPMENT.*

By

Mrs. S. Chowdhry.

Agriculture is many industries rolled into one; it includes several industries such as cereal farming, fruit and vegetable growing and dairy farming etc. It can be further divided according to the kind of products grown or produced. There are many jointly produced commodities in which case decisions regarding price become difficult, because separate costs cannot be shown. The proportions are not variable ; many a time one agricultural commodity is used for several purposes and the farmer finds it difficult to anticipate market demand. Besides, agriculture is mainly dependent upon nature. This phenomenon makes this industry still more unstable. As man's control over nature is limited, it becomes all the more necessary to help the farm community by controlling undue fluctuations in prices and assure them a steady income.

In agriculture there is the backward sloping of supply curve. That is, when prices fall, supply rises, because the farmer tries to get the same real income from the output; as prices fall, marginal utility of the last unit increases for him and the farmer falls into a vicious circle. Therefore, when once the prices start falling, they cannot be checked easily. Land is more or less a permanent asset and does not depreciate like a mine ; therefore the farmer does not give up cultivation as long as variable costs are covered. As variable costs are very low in case of agriculture, the extent to which fall in prices can be allowed is very great. There is a long time lag between the decison to change supply guided by the market price trend and the actual appearance of output in the market. Prices may not be as expected, when the commodity is brought into the market, but the farmer is helpless and has to sell at whatever price he can.

Agriculture has a low income elasticity of demand. Upto a certain point demand for food increases due to a rise in income but thereafter demand for food decreases relatively as income further rises. This is as per the operation of the famous Engel's Law of Consumption and the Fundamental Psychological Law which has been propounded by Keynes. Not only is demand inelastic in agricultural commodities but supply is also less elastic. The Cobweb Theorem tells us that if intensity of inelasticity is the same in case of both supply and demand, there will be continuous fluctuations. Movement will be towards equilibrium, if elasticity of supply is less than elasticity of demand. In fact in agriculture elasticity of supply is greater than elasticity of demand and there is possibility of divergent movement or moving away from equilibrium. This important phenomenon makes agriculture unstable and a depressed industry.

Moreover, what the farmer loses in a period of depression is much more than what he gains in boom period. It is because of the rigid payments he has to make

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e.g., contractual payments, middle men's charges and railway freights etc. This weakens the overall position of the farmer, because fall in prices affects profits and incomes in agriculture and not output and employment as in the case of industry.

Rise and fall of agricultural production and rise and fall of incomes do not synchronise and unevenness in price movements is the fundamental cause of instability in agriculture. Speculation enhances the fluctuations instead of reducing them as in the case of industry ; when prices fall, stocks are released and *vice versa* in case of rise in prices. This is also to keep real incomes stable.

These are the special features of agriculture which must be borne in mind while dealing with the general question of stabilization of agricultural prices. The importance of the question becomes still intense, when we take account of the steps that we are taking to achieve the main goal. Present indications show that the private sector comprising agriculture, cottage industries and some large-scale industries will continue to contribute a very large proportion—probably 75 or 80 per cent—of the national income. Since this sector will be subjected to vagaries of market forces it is quite possible that economic development in this sector may deviate considerably from the planned pattern unless effectively regulated. It is also quite possible that a serious deviation from the planned pattern in private sector may adversely affect the public sector itself in the Mixed Economy of the type, which has been envisaged for the Second Five-Year Plan.

Agricultural surplus is an essential pre-requisite for the process of economic development in any country. In U.S.S.R. marketable surplus in agriculture was found to be the foundation spring for economic development. In an under-developed country there is potential agricultural surplus behind the veil of disguised unemployment, which can be channelized only by thoughtful and rational means. Since there is a fairly large population having its dependence on agriculture, the prime-mover has to be sought in this source. There is no doubt that agricultural production has gone up due to facilities of better irrigation, fertilizers and land reforms but there is still the need for providing incentive to the farm community to create more marketable surplus which will provide the base for industrial development. This incentive can be provided by assuring them a stable price.

One of the most important objectives of price stabilisation is to maintain a reasonable relationship between the prices of agricultural commodities and those of manufactured articles with a view to ensuring that the terms of trade between these two important sectors of the economy do not change too sharply against one another. Any step towards this direction will fill or atleast narrow down the wide gap that exists between industrial and agricultural incomes.

There is no doubt about the fact that general economic stability is essential for the implementation of the Second Five-Year Plan. This can be ensured only if there is stability of general level of prices. Moreover, in a country like ours where 50% of the national income is derived from agriculture, stability of agricultural prices is the key to the stability of general price level. If prices of raw-materials and food-stuffs are stable, prices of industrial products will also be stabilised and thus development or progress will be faster and much more even.

The precipitous fall in agricultural prices in 1954 attracted countrywide attention and caused much alarm in the political circles. Different sections of opinion explained the problem in different ways. That the problem was too urgent to be brushed aside was recognized at the Avadi Session of the Congress party, where a resolution was adopted to assure the agriculturist a fair return for his labour. The Government are, of late, endeavouring to check the fall in prices by building up reserves of food grains and also propose to form a corporation to undertake O. M. O. as a reasonable means of stabilising prices. However, price support policy can only serve as a short term remedy. A substantial unilateral fall in agricultural prices, while industrial prices hold their own, might eventually cause serious dislocations in our economic development. The disparate relationship between industrial and agricultural prices demands establishment of a suitable parity between these two major categories of prices rather than mere farm price support.

The magnitude of the crisis facing the agriculturist is worse than that of the 'thirties in two respects (*i*) it is not matched by a parallel fall of prices in other sectors and in wages (*ii*) whereas in the 'thirties the price of rice fell by nearly 50% over a period of 3 years, the price of foodgrains in some parts of the country fell by 35 to 50% below procurement price in a few months. In the view of the Planning Commission the creation of the "scope for deficit financing at any particular time" rests in "the trends in cost of living indices." The theory is that when the "costs of living are high, increased purchasing power injected into the system is apt to lead to increased demand for basic commodities of consumption and push up costs of living still further" (First Five-Year Plan p. 61). By implication when cost of living indices take a downward turn, this may be looked upon as a signal for deficit financing. It is thought that if deficit financing is appropriately adjusted, increased investment and production will be financed without inflationary consequences and the community will have the advantage of economic and price stability during the period of economic development. There is need for caution in adopting any fiscal or monetary measures to solve the problem of falling agricultural prices because fall in agricultural prices was by no means universal or uniform. It was the heaviest in pulses, cereals and gur among foodgrains, in oilseeds among industrial raw-materials and in black pepper among the miscellaneous group. Some agricultural prices e.g., tea, coffee, raw hides etc., which were export goods and raw jute among import goods have risen almost as high as some other agricultural prices had fallen. In the background of dissimilar movements of prices even among major commodities, it may not be safe to apply simple monetary remedies. The effect of changes in money supply being all pervasive, there may ensue contrary consequences and the net overall price situation, that may result from the monetary measures, that may be adopted, may not be less complex and difficult than the initial price situation. As an upward price movement might disturb the international price relationships of commodities, this may present new export problems.

In case of oilseeds, oil and cotton, the fall in prices was related to the international price trends. An artificial price rise in India may add to the export difficulties of these commodities especially under a rigid exchange rate, which needs to be adjusted for past inflation. In the case of some other commodities principally cereals, pulses and gur, the fall in prices may be due to the output

exceeding the capacity of the domestic market either because of favourable seasonal factors or as reflecting the various measures of agricultural improvements. In case of some foodgrains, this presented a complicated problem, both immediate and long run, and a solution may be in permitting exports of the surplus over home needs. In case of some commodities their special situation may call for a policy of price support.

This does not mean that deficit financing has no part to play towards a solution of price problem, when agricultural output increases, even as output in other sectors of the economy may increase, the total real income of the community will increase. If there was no relative overproduction, the increased output would be marketed at current prices either in the home or foreign markets. Part of the increase in real income will be consumed, part will be saved and invested and a part will be held in the form of larger cash balances than hitherto. The increased output corresponding to the larger cash balances (or equivalent real resources obtained from the home or foreign markets in exchange for the output) may be matched by deficit financing or by credit creation. This would prevent a general fall in prices, which may otherwise ensue from an increase in total output. But deficit financing for economic development is no solution to price problems resulting from overproduction of individual commondities, export difficulties or exchange over-valuation. It may aggravate the difficulties confronting these commodities. A price decline in one sector of economy is no indication that the flow of savings is being accelerated. It provides no excuse for speeding up of the programme of economic development. Therefore, it should be seen that major economic variables are harmoniously related to one another and the remedy should cut at the main roots ; that is, the main causes of the particular price fluctuations should be taken full care of.

The operation of buffer stock is indeed the key to the problem of stablisation of agricultural prices. In fact it would go a long way to protect both the producer and the consumer against violent fluctuations in prices, if managed with wisdom and flexibility. Buffer stock agency ensures future supply of commodities while having the motive of stabilising prices. This agency builds up stocks, when prices are falling to release them when prices are rising. In this way supply is kept in balance with demand and prices are stabilised. For the success of buffer stock agency, it is necessary that it should be prepared to buy and sell in unlimited quantities so that no one can speculate on its stocks. Therefore, reserves of both commodity and money should be large to bear the cost of storage also. There should be a basic price to guide its actions and minimum and maximum limits of fluctuation can be derived from this. These limits may be the same as indicated by the Krishnamachari Committee on Agricultural prices *i.e.*, $12\frac{1}{2}\%$ either way of the fair or basic price. Fair price should cover fully the cost of production and provide a fair margin of profit and at the same time should meet demand for the whole quantity produced. This requires data on cost and fair standard of living. An idea of the latter can be had by the index of the standard of living of industrial sector.

The purpose of the basic price set by the buffer stock agency is to even out short term fluctuations along the long term trend. Basic price, therefore, should not be rigid; if more commodity is purchased, when price falls, than which can

be sold during the upswing, that should be regarded as signal, that the basic price has departed from the long term trend and it should be changed. Moreover, it need not ultimately involve Government in heavy financial losses. Government will, on most occasions, be able to purchase at comparatively low rates from the low price areas when prices are falling and sell the stock at comparatively high rates when the prices are rising. The risk of loss would be further reduced, if Government concentrates on purchasing immediately after harvest of a particular commodity and selling a part of its stocks at the lean season of the year thus taking advantage of a small seasonal rise in prices. Moreover, Government should try to spread the risk over a number of commodities and over a number of seasons and give up the principle of no profit no loss. It should be prepared to make small profits, when opportunity arises, so as to build up a "buffer fund" which can be utilised to meet the loss, which may have to be incurred, when prices fall.

According to some people, buffer stock scheme or price support policies for agricultural commodities would be too costly for a country like India, where 50% of National Income comes from Agriculture. But the argument that nothing can be done to give support to agricultural prices cannot be accepted especially in a planned economy. If purchasing power in agriculture is allowed to go down, it is sure to bring about a slump in the market for manufactured goods and unemployment in its wake, thus starting a vicious circle, which would upset the plan completely. Since the object is not to peg the price at too high a level, but only to prevent if from falling to an uneconomic level, there is no reason why the proposal should prove unduly burdensome. Moreover, the time when it may be necessary for the buffer stock administration to make heavy purchases will precisely be the occasion, when deficit financing will be feasible. Therefore, the losses, which the buffer stock agency may have to incur, should not cause undue concern. Although in times of development the best way of pumping purchasing power into the economy may be through public works, yet the planning and execution of public works will take very often a long time and will not be adequate to cope with sharp decline in prices. In such a case buffer stock purchases will be the quickest way of injecting additional purchasing power into the economy and speed up the programme of overall economic development.

In view of the fact that there is always a seasonal rise in prices and that in a cycle of five years there are usually two years of short crop, when prices are usually much higher than those, which rule in the other three years of good or normal crops, a wise handling of the "buffer fund" should save Government from incurring undue loss over a number of years. Some of the surplus stock of foodstuff, in particular, may be used with advantage in labour intensive development projects. If necessary the buffer stock administration may also export some of its stocks after making sure of a minimum reserve for meeting unexpected crop failure.

It is however doubtful, if Government are in a position to afford vast expenditure, that would be necessary on account of building adequate storage space and purchasing the commodity, if offered for sale at the minimum price. Moreover, even this is a time consuming affair, whereas we need still rapid economic development. Such a plan can be more effective if accompanied by another

scheme at the lower level *i.e.*, there should also be local storage in the villages under the supervision and management of local Panchayats, who would also perform the task of distribution. This could be done immediately and would not require much expenditure.

Developmental works of the Second Five-Year Plan should be carefully classified into schemes of production and schemes of economic and social overheads. Production schemes should be divided into 'early maturing' and 'late maturing' schemes. In times of inflation 'early maturing production schemes' should be stepped up. At the time of deflation expenditure on 'economic and social overheads' should be increased. This will enable the planning authority to effect a more appropriate employment of resources, according as the general trend is inflationary or deflationary than would be otherwise possible. In this way, along with general price level, price level of agricultural commodities will also be stabilised and quick completion of the 'early maturing production schemes' along with giving employment to surplus agricultural labour, will help in rapid economic development.

According to some, inflation will continue to be the main problem during the Second Five-Year Plan period. To avoid this possibility, development in the various sectors of the economy should be so balanced that the additional production in one sector may be readily absorbed by the additional purchasing power generated in the other. For instance, dangers of disequilibrium in the economy will be much less, if surplus agricultural production leading to fall in the prices of agricultural commodities is directed to the industrial sector to balance with the increase in purchasing power, which will result due to various production schemes and other developmental works.

Another important consideration is that a recession developing in the world market may completely upset the price structure and development programme within the country. Export-import quotas, subsidies and duties may help to a certain extent, but may not be enough. In this context we can think of Inter-Governmental Commodity Agreements. As each agricultural commodity is produced under different conditions, *e. g.*, fruits and coffee, no common solution can be effective. In that case agreement has to be regulatory such as the International Wheat Agreement. The purpose of the Commodity Agreement is defined in chapter 6 of the Hawana Charter as "to prevent or moderate fluctuations in primary commodities, to make them fair to consumers and producers, provide reasonable return to producer having regard to desirability of security and long term equilibrium between forces of demand and supply, to maintain and develop natural resources of the world, expand production of primary goods and distribution of basic food-stuffs at special prices to assure equitable distribution of primary commodities in short supply." Such agreement will help to remove surplus, which leads to fall in prices and shortages, which lead to rise in prices and in this way help in smooth and rapid economic development.

All the measures, indicated above, would be of little help, if prices of manufactured goods remain sticky or at any rate continue to rise when agricultural prices are falling. The truth is that structure of relative prices in the country has undergone a thorough change, which has distorted the cost-price relationship

in the economy. The question is how could industrial costs and prices be brought down and at what level should a parity between agricultural and industrial prices be established, so as to ensure a rapid and even economic development in the country. This requires reorganisation of industrial price-cost structure. This parity between agricultural and industrial prices is necessary because otherwise, industries will have to face the problem of off-take leading to piling of stocks and disinvestment of capital. Aggregate population is as intimately connected with level and structure of prices as employment and output. Disparate variations in prices of agricultural and industrial products will manifest themselves in falling proportion of population and income in agricultural sector and rising unemployment in industrial sector because our industries are not in a position to absorb all the surplus labour in agriculture at present. This will still further intensify the tendency towards disequilibrium in the economy. Example of all advanced countries shows that there has been migration from agricultural to industrial sector during the period of development. If the planners try to fill the gap which exists between agricultural and industrial incomes to check the trend of migration from agricultural to industrial sector through various price policies, this might mean checking of development; therefore the State should not aim to fill the gap between incomes in the two sectors but a reasonable difference should be there, so that only the required proportion of population migrates from agriculture. Another solution to the problem is to provide a third alley for employment, say, in developemental schemes. Falling agricultural prices is only a symptom of the deep seated disease. Farm price support is not the sole remedy, for that may artificially perpetuate a lopsided economy. Both agriculture and industry have to be put on an even level and proper parity has to be established between the two categories of prices. Only *then*, could we maintain the real income of the masses.

It has been said while discussing the complexities of agricultural production, that agricultural prices show much greater tendency of fluctuations than other prices. This fact is more true in case of mono-agriculture or when there is only cereal or raw-material cultivation. Price fluctuation can be moderated to a greater extent, if farming is diversified and when it is properly linked with industry. If there are strong co-operatives as in Denmark which control production as well as marketing of all the products, diversified farming can yield much better results, because in case of specialised cereal farming, there is inelastic demand but in case of animal products, demand is fairly elastic. Cost and availability of raw materials are changing the course and localization of industries. This means that economic activity is proceeding on the lines of "Agriculturalization of Industry." Processing industries established in agricultural regions by the farmers themselves can go a long way to moderate the wide fluctuation in prices of primary production. Agriculture does not include cereal farming only. It includes stock farming as well. Stock farming can develop and compete with industries. When economic development takes place, there is the tendency for stock farming to have greater share, as is shown by the developments expected in the Second Five-Year Plan. Therefore there are prospects of prosperous agriculture and stability of agricultural prices, which will help in speedy economic development of the country by providing a sound base for industrial expansion. This is specially true of "Agro-Industrial concerns" of today who control the marketing of the produce as well.

Another step towards stabilisation of agricultural prices would be to have permanent arrangements for movements of commodities through proper transport facilities. This is another important short term measure to remove scarcities. Lack of transport facilities has been the cause of decline in agricultural prices in many a market in India, as shown in the Survey by the Agricultural Research Section of the Delhi School of Economics.

It is expected that if these various measures are taken, it will not be necessary to resort to direct physical control to any great extent. If, however, ,all these measures fail, the planning authorities should be prepared to take recourse to "restrictionalism" in times of acute depression and to rationing and procurement in times of acute inflation and should have plans ready for the same. But such direct physical controls are not only irksome but also have harmful effect in the long run and should not, therefore, be resorted to except in great emergency.

Moderating the gap between industrial and agricultural incomes and stabilising them through price support measures is a "politically possible" means of diminishing fluctuations in money incomes and prices and therefore real incomes. Restrictions on production and granting of subsidies from general revenue may evoke resistance from producers in the former case and taxpayers in the latter. Moreover, these can only be short term measures, while to have rapid economic development,we need more reliable tools than physical controls.

There are many indirect ways of stabilising agricultural prices to ensure to the farmer good return for his labour. The reason why farmer is forced to sell at very low prices is that he has to dispose of the product immediately after harvest. In many cases he is forced to sell the produce to the village money lender to whom he owes amounts. Farmer's waiting power can be increased by providing him with proper credit facilities either through branches of Commercial Banks or through co-operative credit societies backed by the State Bank. Such a step has been taken in India and it is hoped to go a long way in helping to stabilise agricultural prices. Such a step will save the farmers from the clutches of the cruel middlemen, who always try to flourish at the cost of the poor and ignorant farm community.

This review of the problem shows that any step taken towards stabilisation of agricultural prices must start from the village level, where the root cause of the whole trouble exists. Strong and widely spread co-operatives and Panchayats should be established to help the Government to carry on price support and other plans. This will lead to rapid economic development without curbing the individualistic spirit of the people, which is so very prominent in countries like India and China.