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ECONOMIC DEVELOPMENT

AGRICULTURAL SUBSIDIES & MSP



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AGRICULTURAL SUBSIDIES AND MINIMUM SUPPORT PRICE

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1. Introduction

The Indian Government plays a vital role in agriculture sector development. The government's role is diverse and varied including, but not limited to, self-sufficiency, employment creation, support to small-scale producers for adopting modern technologies and inputs, reduction of price instability and improvement of the income of farm households.

This vital role can take a number of forms such as import-export policies and domestic policies like price support programmes, direct payments, and input subsidies to influence the cost and availability of farm inputs like credit, fertilizers, seeds, irrigation water, etc. Of all the domestic support instruments in agriculture, input subsidies and product price support are the most common.

Derived from the Latin word 'subsidium', a subsidy literally implies coming to assistance from behind. A subsidy, often viewed as the converse of a tax, is an instrument of fiscal policy.

Subsidies may be direct or indirect, cash or kind, general or particular, budgetary or non budgetary, etc. However, their impact is practically visible on both the production and distribution. The **economic rationale** of subsidies lies in incentivising the producers to invest in productive activities and increase production leading to high growth in national income and obtaining desirable structure of production. A subsidy is a powerful fiscal instrument, besides taxes and others, by which the objective of growth and social justice may be achieved. It may serve as a necessary production accelerating catalyst for such interventions, which are socially desirable but whose adoption requires huge capital and risk.

Similarly, the social justification of subsidies lies in reducing inter-personal income inequalities and inter- regional development imbalances. Subsidies help manipulate or balance growth rates of production and trade across various sectors and regions, and for equitable distribution of income for protecting the weaker sections of the society. These are essentially negative taxes, skewed towards transfer resources in favour of those who receive them.

2. Agriculture Subsidies

An agriculture subsidy is a governmental financial support paid to farmers and agribusinesses to supplement their income, manage the supply of agricultural commodities, and influence the cost and supply of such commodities.

Agriculture subsidies act as an incentive to promote agricultural development and as an instrument of stimulating agricultural production and attaining self-sufficiency. In order to attain the goal of self-sufficiency in food, government adopts short term policies such as support prices of products and input subsidy to stimulate the products to increase the food production. It is expected that subsidies contribute to better cropping pattern, employment and income of the beneficiaries.

But in most development programmes, subsidies are one among the many developmental inputs being provided. Thus the observable changes in cropping pattern, employment level and overall incomes are because of the joint effect of all the efforts going on. Therefore, these changes cannot be attributed solely to subsidies.

2.1. Types of Agriculture Subsidies in India

2.1.1. Explicit Input Subsidies

Explicit input subsidies are payments made to the farmers to meet a part of the cost of an input. These are explicit payments made to the farmer. For example, subsidy on improved or high yielding variety seeds, plant protection chemicals and equipments, improved agricultural implements and supply of mini-kits containing seeds, fertilizers and plant protection chemicals

for certain crops are the explicit subsidies. These are usually made available to small and marginal farmers and those belonging to scheduled castes and tribes. The objective of such subsidies is to induce the farmers to adopt yield increasing inputs so that they are able to realize the benefits of new technology.

2.1.2. Implicit Input Subsidies

While there is transparency in explicit input subsidies, implicit input subsidies are hidden in nature. Implicit input subsidies emerge from the mechanics of pricing of inputs themselves. If inputs whose prices are administratively determined are priced low as compared to their economic cost, it becomes a case of implicit subsidization. As far as the farmer is concerned, he does not receive any direct payment but somebody in the economy accounts for the difference.

2.1.3. Output Subsidies

If by employing a restrictive trade policy, product prices in the domestic market are maintained at levels higher than those that would have prevailed in the absence of restrictions on trade, it becomes a case of subsidization of agricultural sector through output pricing. Conversely, if trade policies are such that result in lowering of domestic prices than the corresponding border reference price, it can be said that the policies have taxed the agricultural sector. (*The border reference price is the free on board prices in the case of exportables and cost, insurance and freight price in the case of importables.*)

2.1.4. Food Subsidies

The Indian government follows a twin policy of “providing market support to the foodgrain producers and supplying at least a part of the requirement to consumers at reasonable prices”, and a policy of “maintaining a buffer- stock of required quantity for national food security”. This policy paradigm involves a cost in the form of meeting the difference between the economic cost and issue prices of foodgrains. This is what is called the food subsidy and appears explicitly in the Union Budget.

2.2. Types of Agriculture Subsidies on the basis of Mode of Payment

2.2.1. Direct Subsidies

Direct subsidies are money transfers by the government that reach the ultimate beneficiary through a formal predetermined route. In agriculture and allied sectors, subsidies are given for crop husbandry, agricultural implements, minor irrigation, soil conservation, horticulture, animal husbandry, pisciculture, sericulture and also for loss in agriculture during natural calamities like droughts or floods. The various subsidy schemes in agriculture and allied sectors are routed through the departments of Agriculture, Horticulture, Animal Husbandry and Fisheries.

Advantages of deploying Direct Subsidies

- Direct subsidies provide purchasing capacity to the farmer and have a multiplier effect in terms of farmers investing in agriculture and raising their standard of living.
- These subsidies help in proper identification of beneficiaries thereby reducing pilferage and corruption etc.
- These increase efficiency, as well as promote regional balance, and crop diversification.
- These schemes impart a sense of agency to the beneficiaries which was otherwise absent from Indian policymaking. People can decide for themselves which crop they would want to grow, according to the profits and their local requirements. They can also use the amount in value addition, mixed farming and other beneficial activities for their farms/lands.
- Direct subsidies are more likely to control inflation and decrease prices of fertiliser, and other agricultural produce as well. It is because direct subsidies like cash transfer bring in

greater transparency and efficiency. This leads to both demand and supply responding more quickly to price signals, diminishing the distortions that keep inflation high.

- These induce behavioural changes, as farmers will stop using excessive water or fertiliser in their fields.
- These also ensure better nutrition as cereal centric food policy (Calorie based intervention) ignores micro-nutrients requirement of human body.

Disadvantages of Direct Subsidies

- There is a good chance that the cash may get used in some non-priority activities or for some non-productive works e.g. on marriage of girls, alcohol, etc. rather than being used for the right purposes.
- The country may not be able to reach its desired goals such as food grain production may not be enough to support the huge population and create the problem of food security instead.
- This will also open the country to volatility of market mechanisms.
- Widespread illiteracy and lack of awareness may also hamper the prospect of Agriculture in the country.

2.2.2. Indirect Subsidies

Indirect subsidies are provided through price reduction, welfare and other ways but do not include a direct cash payment. They reach the farmers alongside the use of inputs. Therefore, these are highly correlated with the amount of use of inputs by farmers. Generally, those farmers who use more inputs would naturally enjoy higher subsidies. Example cheaper credit, farm loan waivers, reduced tariffs for electricity and irrigation etc.

Advantages of Indirect Subsidies

- In developing economies such subsidies can be deployed to address development concerns of priority sectors.
- Generally, indirect subsidies are better tools at the Government's disposal to fulfill some targets fixed by it or to guide people to move towards required goal.

Disadvantages of Indirect Subsidies

- It takes away incentives from other areas, such as Indian agriculture has become cereal centric, regionally biased, and input intensive. Indirect subsidies are one of the main reason towards such a state.
- Farmers do not feel the incentive to save resources such as over exploitation of ground water, indiscriminate use of fertilizers, etc. are resulting due to it.
- Indirect subsidies are not successful in reaching the target beneficiaries because of several lacunae in identification, corruption, lobbying by rich farmers etc.
- It is liable for misuse for gaining political mileage especially during time of elections.

2.3. Issues related to Agriculture Subsidies and their Possible Resolution

1. **Heavy Fiscal Burden:** In 2017-18, the annual central government subsidies to farmers was of the order of Rs. 120,500 crores. In the same period, the annual State government subsidies are almost of an equal amount of Rs. 115,500 crores.

Table 2: Expenditure on Major Agricultural Subsidies (Rs. Crores)

Name	Source	Year	Year
Fertilizer	Union Budget	2017/18	70,000
Power	Dharmadhikari et.al (2018) based on Power Finance Corporation data	2015/16	90,000
Credit	Union Budget	2017/18	20,000
Irrigation	Central Water Commission (2017)	2013/14	17,500
Crop Insurance	Union Budget	2018/19	13,000
Price Support	Author's estimate	2014/15-2016/17	24,000
Total (without inflation to 2017/18 price levels)			2,35,500
Lona waivers	PRS Legislative Research https://www.prsindia.org/policy/discussion-papers/state-state-finances-2018-19	2017/18	1,22,200

Source: Compiled from the sources mentioned in the Table. The price support subsidy are the author's computations.

Table 3: The Division of Agricultural Subsidies Between the Centre and the States (Rs. Crores)

Central Government Subsidies	Amount
Fertilizer	70,000
Credit	20,000
Crop Insurance	6,500
Price Support	24,000
Total	1,20,500
State Government Subsidies	
Power	91,000
Irrigation	17,500
Crop Insurance	6,500
Lone Waivers	1,22,200
Total	2,37,200

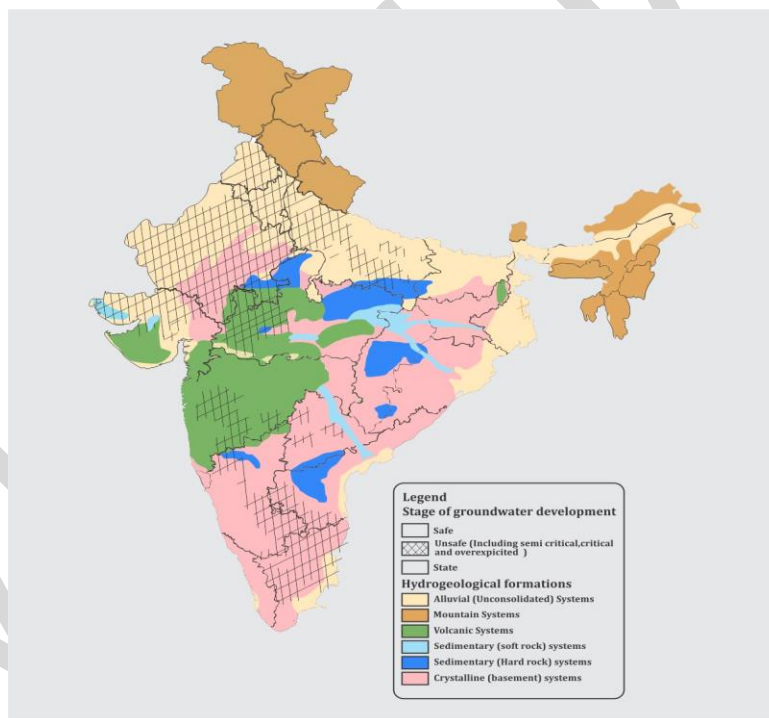
- **Possible Resolution:** A better targeting of subsidies with the usage of JAM (JanDhan – AADHAAR- Mobile Number) trinity can reduce the fiscal burden.
2. **Excessive use of natural resources:** The policy design and implementation is such that it is skewed towards the excessive use of subsidized resources. For instance, power subsidy has led to overuse of ground water which has further resulted into dramatic fall in ground water levels. Electricity consumption in Indian agriculture is far greater than in any comparable large country. Water extracted from deep inside earth has shown contamination of Arsenic and other heavy metals.

International Comparison of Electricity Consumption Across Sectors (Proportions)

Student Notes:



- Possible Resolution:** Separate agriculture feeder network (under Deen Dayal Upadhyay Gram Jyoti Yojna). This separate agriculture feeder will supply electricity only for a few hours a day. The process has shown positive results in arresting decline of ground water levels in Gujarat.



- Environmental Effects and decline in Soil Fertility:** The Parliamentary Standing Committee on Agriculture in their 29th Report (16th Lok Sabha) observed that there is an imbalance in fertilizer use in terms of NPK as it is evidenced by their wider consumption ratio of (6.7) : (2.4) : 1 in the country as against their desirable ratio of 4:2:1. The situation is more grim in agriculturally important States like Punjab and Haryana where NPK use ratio is as high as (31.4) : 8 : 1 and (27.7) : (6.1) : 1, respectively. This harms the soil fertility, biodiversity, and also leads to eutrophication (increased nutrients in water bodies, eventually leading to decreased oxygen concentration in them) and bio-accumulation/bio-magnification (increasing concentration of toxic material in tissues of living organisms at successively higher levels in a food chain).

- **Possible Resolution:** Creating awareness among farmers, increasing penetration of soil health card scheme, promoting organic farming and innovative products like neem-coated urea will go a long way to check the issue.
4. **No benefits to the targeted groups:** Fertilizer subsidies are generally cornered by the manufacturers and the rich farmers of Punjab, Haryana and Western UP.
- **Possible Resolution:** Nutrient based subsidy and Neem-Coated Urea has been introduced by Government. There should be Direct Benefit Transfer of fertiliser subsidy through Aadhaar authentication, organic farming should be encouraged and there should be phased increase in the price of urea.
5. **Cereal Centric, Regionally Biased, and Input Intensive:** Price subsidies has affected Indian agriculture negatively. This has made Indian agriculture cereal centric, and neglectful towards pulses, oil seeds and coarse cereals. This has led to import of these crops and food insecurity in lower strata which depend upon coarse cereals. Also, most of the subsidies go to the rich farmers, and the rich states which are able to grow marketable surplus and have well developed infrastructure.
- **Possible Resolution:** Crop diversification by including more crops under MSP, Mission on Integrated Development of Horticulture, Organic and Cooperative farming, food processing, mixed farming, Direct Benefit Transfer.
6. **Indiscriminate use of Price Subsidies:** Although price subsidies are better targeted, they tend to create inefficiencies since they embed incentives for fraud, diversion, and waste. Such subsidies eventually become entrenched, accumulate and may ultimately pose a threat to the sustainability of subsidies itself.
- **Possible resolution:** Alternatives to price interventions that have similar advantages of targeting beneficiaries must be explored and tried. For instance, Price deficiency payments are a substantial improvement on procurement-based price supports.
7. **Better use of credit or interest subsidies:** There is no strong rationale backing credit and interest subsidies. This is because formal sector interest rates have not been the constraint to increasing access to formal sector institutions.
- **Possible Resolution:** These subsidies would be better spent in strengthening the credit infrastructure and rural banking.

2.4. Agriculture Subsidies and WTO

2.4.1. Historical Background

Agriculture sector has historically been subject to government interventions more than any other sector. Although, agriculture was covered by the General Agreement on Tariffs and Trade (1948), there were numerous exemptions related to it. Consequently, agricultural trade remained free of the strict discipline as enforced more generally to trade in industrial products. Resultantly, measures that obstructed imports began to be used widely, for instance, import bans, import quotas, high import duties, variation in import duties rates, minimum import prices, and various impediments not related to tariffs such as regulations and the activities of state trading enterprises. Similarly, richer countries offered huge subsidies, thereby artificially increasing production and exports and driving down world prices. Developing countries' also followed trade distorting practices like taxing exports or requiring purchases at low prices.

As a result, the world embarked on a series of negotiations beginning in 1986 with the launch of the Uruguay Round, to comprehensively look at the sector and suggest, implement and monitor reform measures.

A. Uruguay Round, 1995

- a) It led to the formation of WTO. One of the main objectives of Uruguay round was to reduce agricultural subsidies. The **Agreement on Agriculture (AoA)** was signed by the WTO members.

- b) The agreed long-term objective of the reform process initiated by the Uruguay Round reform programme is **to establish a fair and market-oriented agricultural trading system**.
- c) The reform programme comprises specific commitments **to reduce support and protection** in the areas of domestic support, export subsidies and market access.
- d) The Agreement also takes into account non-trade concerns, including food security and the need to protect the environment, and **provides special and differential treatment for developing countries**, including an improvement in the opportunities and terms of access for agricultural products of particular export interest to these members.
- e) The implementation period for the country-specific commitments was the six-year period commencing in 1995. However, **developing countries had the flexibility to implement their reduction and other specific commitments over a period of up to 10 years**.
- f) **Special Agricultural Safeguard (SSG)** was provided to developing economies under which they can **impose an additional duty** in case of import surge (volume) or fall of import price below a specified reference price.
- g) Uruguay Round created two categories of domestic support
1. **Support with no, or minimal, distortive effect on trade** on the one hand (often referred to as “Green Box” measures). For example, government funded agricultural research or training.
 2. **Trade-distorting support** on the other hand (often referred to as “Amber Box” measures). For example, government buying-in at a guaranteed price (“market price support”) falls into the Amber Box.
 - **Green Box:** These measures are **exempt from reduction commitments** and, indeed, can even be **increased without any financial limitation** under the WTO. The Green Box applies to both developed and developing country members but in the case of developing countries **special treatment** is provided in respect of governmental stockholding programmes for food security purposes and subsidized food prices for urban and rural poor. But, they must not involve **transfers from consumers** and must not have the effect of providing **price support to producers** (India's PDS does not come under Green Box). Following programs come under Green Box:
 - **Government service programs** such as Research Programs, Pest and Disease Control, training, infrastructure etc.
 - **Direct Payment to producers** but it must not influence type or volume of production, also called *Decoupled Payments*.
 - **Amber Box Subsidies:** All domestic support measures considered to distort production and trade (with some exceptions) fall into the amber box. For instance, MSP, Procurement Price, sum total of subsidies on inputs like fertilizer, water, credit, power, etc.
 - **Blue Box:** These are basically Amber Box subsidies but they tend to limit the production. Any support that would normally be in the amber box, is placed in the blue box if the support also **requires farmers to limit their production**. These measures are also **exempt from reduction commitments**. It includes **direct payments under production limiting programs**, made on fixed areas and yield or a fixed number of livestock. Such payments also fit into this category if they are made on 85 per cent or less of production in a defined base period. While the Green Box covers decoupled payments, in the case of the Blue Box measures, production is still required in order to receive the payments, but the actual payments do not relate directly to the current quantity of that production.

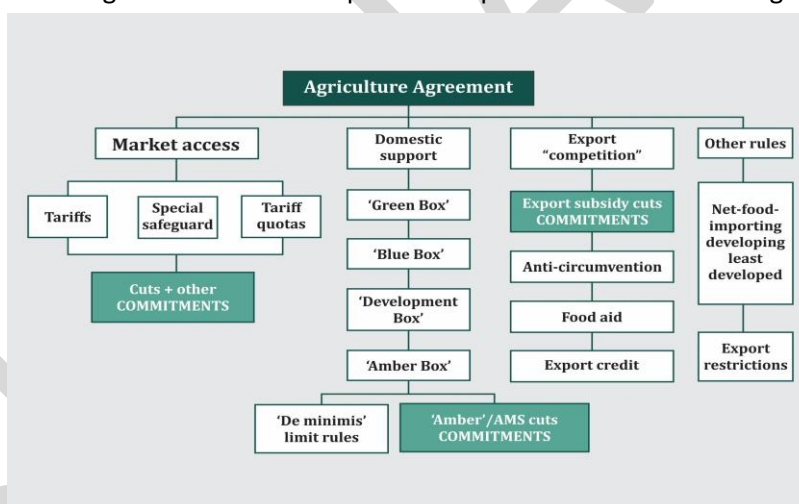
- **Special and Differential Treatment Box:** The S&DT measures generally comprises of
 1. Investment subsidies like tractors and pump sets to farmers
 2. Agricultural input services like fertilizers to farmers. These subsidies should be provided only to low income and resource poor producers (or poor farmers) in developing countries.
 3. Measures for diversification of narcotics crop in order to rehabilitates the farmers.

De Minimis: Minimal amounts of domestic support that are allowed even though they distort trade. Under the de minimis provisions of the agreement:

1. There is no requirement to reduce trade-distorting domestic support in any year in which the aggregate value of the product-specific support does not exceed 5 per cent of the total value of production of the agricultural product in question.
2. Non-product specific support which is less than 5 per cent of the value of total agricultural production is also exempt from reduction.

The 5 per cent threshold applies to developed countries whereas in the case of developing countries the de minimis ceiling is 10 per cent. However, the quantum of subsidy is computed after taking into consideration prices that prevailed two decades ago.

India is well below and within the de minimis level (10 per cent) for all its major crops.



Peace Clause : This clause holds that domestic support measures and export subsidies of a WTO Member that are legal under the provisions of Article 13 of the Agreement

on Agriculture cannot be challenged by other WTO Members on grounds of being illegal under the provisions of another WTO agreement. The Peace Clause **expired on January 1, 2004**. Another **temporary peace clause** was made at the WTO Bali conference in December 2013 for four years until 2017. It stipulated that no country would be legally barred from food security programs for its own people even if the subsidy breached the limits specified in the WTO Agreement on Agriculture.

B. Doha Round

Doha round or Doha Development Agenda is the trade negotiation round of WTO which started in 2001. For agricultural negotiations, Bali Ministerial Conference (2013) and Nairobi Ministerial Conference (2015) has been important.

a) **2013 Bali Ministerial Conference:** At the Ninth Ministerial Conference in Bali (2013), members agreed on a package of issues. In agriculture, these included four decisions and one declaration:

- An agreement to negotiate a permanent solution to **Public Stockholding for food security purposes** and to refrain from legally challenging breaches of domestic support commitments resulting from developing countries' public stockholding programmes for food security provided certain conditions are met.

- Another agreement was reached to **expand the Green Box list of “general services”**. This list added the following: spending on for land use, land reform, water management, rural livelihood security and other purposes related to development and reducing poverty.
 - A declaration to reduce all forms of export subsidies and to enhance transparency and monitoring. This declaration covers a wide range of issues generally known as **“export competition”**. This includes measures, like international food aid, export credits, export credit guarantees, insurance programmes etc, whose effects may be equivalent to export subsidies.
 - **A temporary peace clause** was added in Bali. It stated that no country would be legally barred from food security programmes even if the subsidy breached the limits specified in the WTO agreement on agriculture. This clause will remain in force for four years until 2017, by which time the members will find a permanent solution to the problem. However, the permanent solution remained elusive after the 11th Ministerial Conference.
- b) **2015 Nairobi Package:**
- WTO members adopted a historic decision to **eliminate agricultural export subsidies** and set disciplines on export measures with equivalent effect. According to the decision, members shall eliminate export subsidies according to different timelines. Developed countries to eliminate immediately, except for a limited number of agriculture products, while developing countries to end it by 2018. This step has been taken to fulfill the key target of **Sustainable Development Goal on Zero Hunger by 2030**.
 - Member nations also agreed to **discipline in food aid** i.e. ensuring that food aid does not negatively affect domestic producers and local or regional markets.
 - WTO members **agreed to engage constructively** in finding a permanent solution to developing countries' use of public stockholding programmes for food security purposes.
 - Ministers also agreed to continue negotiations on a **special safeguard mechanism (SSM)** that would allow developing countries to temporarily raise tariffs on agriculture products in cases of import surges or price falls.

The adoption of the Nairobi Ministerial Declaration signaled the strong commitment of member nations to advance negotiations on the remaining Doha Round issues, including advancing work in all three pillars of agriculture i.e. domestic support, market access and export competition.

2.4.2. Indian Agriculture Subsidies and WTO

India had signed Agreement on Agriculture of WTO expecting that it would:

- reduce the domestic support given by OECD countries to their respective agricultural sectors
- increase the prices of agricultural products in international markets
- improve export prospects for India.

But, to its surprise, the agricultural prices went down, putting agricultural countries like India at disadvantage. India has the following contentions with respect to the AoA and the WTO.



IMPACT FOR INDIA ■ NEGATIVE ■ POSITIVE ■ NEUTRAL

1. FARM GOODS EXPORTS ✂

Of 5 elements, 2 to impact India adversely.

■ EXPORT SUBSIDIES: Immediate elimination by developed countries. ■ STATE-TRADING ENTERPRISES: State agencies to stop support.

■ MARKETING & TRANSPORT ASSISTANCE: Sugar producers in south, Maharashtra & UP hit.

2. SAFEGUARDS AGAINST IMPORT SURGES 🇮🇳

■ India only got statement of intent with no timeframe. Developed nations, Brazil prevailed.

3. PUBLIC STOCKHOLDING FOR FOOD SECURITY 🏠

■ India wanted a reworked formula but failed.

4. DOHA ROUND 🇮🇳

■ No commitment from WTO members to pursue. No guarantee EU & US will lower agri subsidies or make visa rules easier.

Permanent & Workable solution to food security at WTO:

- India insists that member countries of the WTO agree to a permanent solution to the dispute over public stockholding of foodgrains, even though developing nations have been granted an indefinite interim reprieve. The issue of public stockholding of food revolves around the **procurement of foodgrains from farmers at prices fixed by governments in order to promote the food security of poor countries**. As these prices involve a degree of government subsidy, there is a cap on these subsidies as they could otherwise end up distorting global prices. However, developing countries insist that they should not be penalized for breaching any limits, arguing that such stockholdings are crucial for food security.
- At the Bali meetings of the WTO in Dec 2013, India, along with other developing countries, was able to negotiate a “peace clause” that allowed it to go beyond the 10 % cap for its MSP with immunity from legal challenge from other WTO member countries for the next four years, within which time period a permanent solution would be devised. However, India is **not satisfied with the peace clause for perpetuity**.
- Even at the Nairobi declaration, India failed in its objectives to secure credible outcomes on its demands for a permanent solution for public stockholding programmes for food security and the reaffirmation to continue the Doha Development Agenda negotiations.
- Furthermore even at the eleventh Ministerial Conference (MC11) in Buenos Aires, there was no outcome on public stockholding for food security purposes or on other agriculture issues.

High farm subsidies provided by developed countries:

- Under Agreement on Agriculture (AoA), developing countries can give agricultural subsidies or aggregate measurement support (AMS) up to 10% of the value of agricultural production and developed countries give up to 5%.
- AMS has two components:
 - ‘product-specific’ or the excess of price paid to farmers over international price or ERP (external reference price) multiplied by quantum of produce. This is frozen at 1986-88 levels which makes entitlements of developed countries much higher than developing countries

- 'non-product specific' or money spent on schemes to supply inputs such as fertilisers, seed, irrigation, electricity at subsidised rates.
- Developed members provide subsidies, which, at times, exceed 200 per cent of the production value, despite the 5 per cent de minimis. The WTO rules make it possible for rich countries to get away with such high subsidies as their historical bound AMS levels are high.
- The discrepancies had crept in when the Agreement on Agriculture was being negotiated. Developed countries exercised an option of either accepting a product specific ceiling of 5 percent, or an overall cap.
- The developed world, by having an overall ceiling for all farm products, can manipulate the subsidies for individual products. For example - US has continued to provide product-specific support to the tune of 10% of the value of product for 30 products for at least one year during the period 1995-2014. It provided subsidies exceeding 50% of value of production for dry peas (57%), rice (82%), canola (61%), flaxseed (69%), sunflower (65%), sugar (66%), cotton (74%), mohair (141%), and wool (215%).
- In 2017, developed countries have more than 90% of global AMS entitlements amounting to nearly \$160 billion while India and China do not have any AMS entitlements.
- Developed countries label most of the sops as non-trade distorting (green-box subsidy at the WTO) which, supposedly, have minimal effect on world trade. The highest green box support to agriculture is provided by USA which spends more than third of its GDP from agriculture on this support, while India provides support of only 2.34% of its GDP from agriculture in 1995. Investment in agriculture has been between 8% to 12% of agri-GDP.
- The developed countries are not ready to admit that there exists variation in capacity and structural composition of the economies of developed and developing countries. A developed country might need only 1-2% of its GDP to subsidise 50% of its agriculture. Hence, **distortions arising out of Green Box subsidies are significant but are inadequately addressed.**

Use of Sanitary & Phytosanitary Measures & Technical Barriers to Trade by Developed Countries:

- The developed countries also make use of Non-tariff measures like **Agreement on Sanitary and Phytosanitary Measure (SPS)** and **Agreement on Technical Barriers to Trade (TBT)** to selectively ward off imports from developing countries by imposing higher standards than those imposed by international bodies. According to recently published "The Asia-Pacific Trade and Investment Report 2019" by UNCTAD, use of non-tariff measures (NTMs) has increased in the past two decades.
 - **Agreement on Sanitary and Phytosanitary (SPS) Measures 1995, Uruguay Round:** It sets out the basic rules for food safety and animal and plant health standards. It **allows countries to set their own standards**. But it also says regulations must be based on science. They should be applied only to the extent necessary to protect human, animal or plant life or health. And they should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail.
 - **Agreement on Technical Barriers to Trade 1995, Uruguay Round:** It aims to ensure that technical regulations, standards, and conformity assessment procedures are non-discriminatory and do not create unnecessary obstacles to trade. At the same time, it recognises WTO members' right to implement measures to achieve legitimate policy objectives, such as the protection of human health and safety, or protection of the environment. The TBT Agreement strongly encourages members to base their measures on international standards as a means to facilitate trade. Through its transparency provisions, it also aims to create a predictable trading environment.

3. Agriculture Pricing Policies

The agricultural pricing policies and allied institutional mechanisms evolved in India in the context of shortages in the availability and excess demand for food grains during 1960s. A system of procurement and distribution of major food grains was introduced and statutory minimum prices were set, though not strictly enforced. India's agricultural price policy includes three main types of administered prices: **support, procurement, and issue price**.

The support price is generally announced at sowing time, and the government agrees to buy all grain offered for sale at this price. These prices guarantee to the farmer that, in the event of excessive production leading to oversupply in the market, prices of his produce will not fall below the support price. Support prices generally affect farmers' decisions indirectly, regarding land allocation to crops. The areas to be sown, however, depend upon the actual prices farmers realized from the previous crop and their expectations for the coming season.

The quantity to be procured is determined by the government's needs for disbursements under the public distribution system. In recent years, however, the actual quantities procured have depended upon the grain offered for sale by farmers at prices fixed by the government. These prices are generally higher than the support prices but lower than the free market prices in normal years. In a good crop year, in surplus states, free market prices would have been lower but for government purchases; after the surplus is mopped up, market prices tend to run higher than procurement prices. The government recognizes the importance of assuring reasonable prices to farmers to motivate them to adopt improved technology and to promote investment by them in farm enterprises for increasing agricultural production.

Minimum Support Prices	These provide a long term guarantee to the producers, that in case of glut, prices will not fall below these announced minimum prices. The Government started large scale procurement of food grains at the MSP to ensure its intent.
Procurement Prices	These are higher than MSP and are meant essentially for the purchase of quantities needed by the Government to maintain its PDS and for building up the Buffer Stock.
Issue Prices	These indicate prices at which the Government supplies food grains through Fair Price shops and ration depots.

The basic objective of agricultural pricing policy in India is to evolve a balanced and stable price structure to meet the overall needs of the economy while protecting, in particular, the interests of the producers' and the consumers'. The policy is aimed towards facilitating the desirable path of attaining the objectives of growth and equity in the process of economic development.

Incentive prices in the form of minimum support prices are essential for the success of agricultural production programs based on high-yielding-varieties technology. At the same time, undue reliance cannot be placed on high prices alone as an incentive for increasing production of food grains. Effective implementation of price support policies requires adequate institutional arrangements for the purchase of quantities offered for sale at that price.

3.1. Minimum Support Price

Even prior to the mid 1960's, it was recognized that farmers need to be motivated to adopt better technology and to invest more in their farm enterprises, for the acceleration of agricultural growth. This objective, however, was difficult to achieve without assuring reasonable prices to the farmers. Consequently, the Government constituted a committee in 1964-65 to suggest a price policy for food grains and to suggest the terms of references for an organization which would be set up to advice the government on price policy on a long term basis.

The recommendations of the committee led to the establishment of the **Agricultural Price Commission** in 1965 which was later renamed as **Commission for Agricultural Costs and Prices (CACP)** in March 1985. Simultaneously, the development strategy for agricultural sector was

also remodeled. Such remodeling of strategy included application of modern inputs like high yielding varieties of seed (HYV), chemical fertilizers and mechanization of certain agricultural operations. The main emphasis was on finding methods of increasing land productivity through the use of modern input and improved methods of production in the potential regions of the country.

This development strategy, in turn, required that the price policy should encourage farmers to make greater investments in farm operations so as to enable them to shift on to higher production possibility curves. The minimum support price was aimed at:

- Assuring **remunerative and relatively stable price environment** for the farmers by inducing them to increase production and thereby augment the availability of food grains.
- Improving economic **access of food** to people.
- Evolving a **production pattern** which is in line with overall needs of the economy.

Therefore, the provision of Minimum Support Prices (MSP) was initiated during the mid-1960s to create a favorable environment for the producers of major food crops, which were seen to possess a vast potential for raising foodgrain production.

Commission for Agricultural Costs and Prices (CACP)

The Commission for Agricultural Costs & Prices (CACP) is an attached office of the Ministry of Agriculture and Farmers Welfare, Government of India. It came into existence in January 1965. Currently, the Commission comprises a Chairman, Member Secretary, one Member (Official) and two Members (Non-Official). The non-official members are representatives of the farming community and usually have an active association with the farming community.

It is mandated to recommend minimum support prices (MSPs) to incentivize the cultivators to adopt modern technology, and raise productivity and overall grain production in line with the emerging demand patterns in the country

MSP for major agricultural products are fixed by the government, each year, after taking into account the recommendations of the Commission.

As of now, CACP recommends MSPs of 23 commodities, which comprise

- 7 cereals (paddy, wheat, maize, sorghum, pearl millet, barley and ragi)
- 5 pulses (gram, tur, moong, urad, lentil/Masur)
- 7 oilseeds (groundnut, rapeseed/mustard, soyabean, seasmum, sunflower, safflower, nigerseed)
- 4 commercial crops (copra, sugarcane, cotton and raw jute).

CACP submits its recommendations to the government in the form of Price Policy Reports every year, separately for six groups of commodities namely Kharif crops, Rabi crops, Sugarcane, Raw Jute and Copra.

3.1.1. Need of MSP Policy

The prices of agricultural commodities are inherently unstable, primarily due to the variation in their **supply**, lack of **market integration** and **information asymmetry**. It is to counter such variation that the Union Government fixes a Minimum Support Price (MSP) for major agricultural products each year. The MSP is hence a tool which guarantees the farmers, prior to the sowing season, that a fair amount of price is fixed for their upcoming crop to encourage higher investment and production of agricultural commodities.

Rapid and violent fluctuations in agricultural prices can have negative consequences on the economy of a country, such as:

- a) Significant harvest in a year can result in a sharp fall in the price of that commodity during that year. This, in turn, has an adverse impact on the future supply since farmers may withdraw from sowing that crop in the following years. This contraction of supply in the following year may lead to subsequent major price increase for consumers.

b) In case, the price of a particular crop declines steeply: growers will be left with little income and no incentive to grow the same crop next year. If this happens to a staple food item, the reduced supply next year will force the government to import that food item to fulfill the demand of people. This will create a fiscal burden over economy.

c) In case, there is steep rise in price of a commodity: consumers will suffer. If this happens to a necessary item of consumption, consumers will not have enough income left to spend on some of the other items. This will have a disastrous effect on other sectors of the economy.

THE VARIABLES IN THE EQUATION				
CROP	A2+FLCOST	C2 COST	MSP 2017-18	MSP 2018-19
Paddy	1,166	1,560	1,550-1590	1,750-1,770
Jowar	1,619	2,183	1,700-1725	2,430-2,450
Bajra	990	1,324	1,425	1,950
Ragi	1,931	2,370	1,900	2,897
Maize	1,131	1,480	1,425	1,700
Tur	3,432	4,981	5,450	5,675
Moong	4,650	6,161	5,575	6,975
Urad	3,438	4,989	5,400	5,600
Groundnut	3,260	4,186	4,450	4,890
Sunflower	3,592	4,501	4,100	5,388
Soyabean	2,266	2,972	3,050	3,399
Sesasum	4,166	6,053	5,300	6,249
Nigerseed	3,918	5,135	4,050	5,877
Cotton	3,433	4,514	4,020-4,320	5,150-5,450

All Figures in Rs/quintal. A2+FL and C2 costs based CACP projection for 2018-19; price ranges of paddy for 'Common' and 'Grade A' varieties; of jowar for Hybrid and Maldandi varieties; of cotton for Medium-Staple and Long-Staple varieties

Determination of MSP

- MSP's of 23 crops is recommended by Commission for Agricultural Costs and Prices (CACP). The CACP is supposed to consider various factors while recommending the MSP for a commodity, including cost of cultivation. It also takes into account the supply and demand situation for the commodity; market price trends (domestic and global) and parity vis-à-vis other crops; and implications for consumers (inflation), environment (soil and water use) and terms of trade between agriculture and non-agriculture sectors.
- The CACP further projects three kinds of production cost for every crop, both at state and all-India average levels. These include:
 - Cost A₂**: Includes the actual costs paid by farmer for purchase of various inputs like seeds, fertilisers, pesticides, hired labour, rent of land & machinery, if hired.
 - Cost A₂ +FL**: FL refers to Family Labour. When the unaccounted family labour cost is accounted and added to cost A₂, it becomes A₂+FL.
 - Cost C₂**: C₂ stands for Comprehensive Cost. It includes notional costs of family labour, notional rent of owned land and notional interest on owned capital.
- The CACP does not do any field-based cost estimates itself. It's projections are based on the state-wise, crop-specific production cost estimates provided by the Directorate of Economics & Statistics in the Agriculture Ministry.
- These projections take into account likely changes in input costs based on the latest price data from other sources such as the Labour Bureau and Office of the Economic Adviser.

Recent changes to MSP calculation by the Union Government

- In 2014 the union government has promised to offer 50 per cent margin over cost C₂ but this was never implemented in letter and spirit.
- The Budget for 2018-19 announced that MSPs would henceforth be fixed at 1½ times of the production costs for crops as a "pre-determined principle". Simply put, the CACP's job will be only to estimate production costs for a season and recommend the MSPs by applying the 1.5-times formula.
- The Budget speech did not specify the cost on which the 1.5-times formula was to be computed. However, the CACP's 'Price Policy for Kharif Crops: The Marketing Season 2018-19' report states that its MSP recommendation is based on 1.5 times the A₂+FL costs.
- Farm activists, however, insist upon the application of the 1.5-times MSP formula, originally recommended by the National Commission for Farmers headed by agricultural scientist M S Swaminathan, on the C₂ costs.

In addition to the MSP announced by the Central Government, the State Governments also declare a bonus, over and above the already declared MSP so as to promote agriculture practices in their respective States. The quantum of this bonus varies from state to state and from crop to crop.

Constraints in hiking MSP

- Some of the government officials are of the opinion that it is impractical to give 50 per cent margin over cost C_2 in all crops.
 - The estimated cost of C_2 components is about 35-40 per cent higher than cost A_2+FL . This would require a significant rise in MSPs. For example paddy MSP might go up by 46 per cent.
 - Calculating the MSPs based on cost of input components ignores the demand side of crops which might compromise the demand-supply principle for determining the cost.

3.1.2. Critical Evaluation of Minimum Support Price

India's price support policy has proved to be helpful in several ways. From a situation of massive shortages, India has emerged as a grain surplus country with self-reliance in food grains, and this inherent process of self-sufficiency subsumed the inbuilt proposition of attaining food security at the national level. A strong base has been created for grain production and for meeting grain demand in the medium term. The policy has had a favorable impact on farm income and has led to an economic transformation in the well-endowed, mainly irrigated regions. Although price support policy through advance announcement of MSP and procurement prices by CACP (Commission for Agricultural Costs and Prices) provides an assurance to the farmers to confidently invest in the crops, there are several fallouts from this regime that deserve attention:

- a) **Contributes to inflationary trend:** There has been continuous hike in MSP and Procurement prices due to the rich farmers' lobby and it has pushed up the carrying cost of buffer stocks of FCI considerably. This has pushed up the food subsidy bill to a very high level.
- b) **Bias in favour of surplus states:** Almost all states produce wheat, but 95% procurement is from Punjab, Haryana and Western UP. Similarly, around 20 states produce rice, while 90% is procured from Punjab, Andhra Pradesh, Haryana, UP and Tamil Nadu. Other states do not get much benefit from it.
- c) **Adverse impact on investment:** Due to extra expenditure in food procurement, the other sectors loses out on new investments. It has been observed that a 10% increase in MSP of wheat and rice leads to a decline in investment by 1.9% and in overall GDP by 0.33%.
- d) **Distortion in cropping pattern:** MSP of wheat and rice has generally been higher than the cost of production and that of cereals and pulses has been less than the cost of production. So farmers get incentivised for growing profitable crops and hence cropping pattern gets distorted.
- e) **Faulty criterion being used for calculating MSP:** Since cost of production is the major criterion to decide MSP by CACP, inefficiency gets built up, land unsuitable for cultivation of particular crop is being used e.g. rice cultivation is being done in semi-arid regions of Punjab & Haryana which is creating environment and natural resources problem.
- f) **Bias in favour of large farmers:** It has been estimated that in each state, the average income transfer to large farmers is approximately ten or more times greater than those received by marginal farmers.
- g) **Deterrent to crop diversification:** The price support policy has been a major deterrent to crop diversification. It is highly asymmetric and skewed mainly towards the production of rice and wheat at the cost of cultivation of pulses, oilseeds and other crops. This has created serious imbalances in demand and supply of principal crops in the country. Similarly, the country has been facing large shortages of pulses and edible oils and now has to meet about one-tenth of its demand for pulses and close to half of the demand for

edible oil through imports. These imports are in turn having an adverse impact on producers in the unfavorable dry-land areas

- h) **Flaws in PDS:** It is restricted mainly to wheat and rice only, while inferior grains which are main food of the poor have been neglected, PDS coverage in rural areas have been lesser than that in urban areas, high cost of running, and benefits not reaching the targeted beneficiary are the major flaws in PDS.
- i) **Impact on rural poor:** Rise in price of cereals (due to higher MSP) leads to significant burden of high cost for the buyers.
- j) **Price incentives and fiscal squeeze:** Because of the price incentives, there is an agricultural price rise. Since wages are linked to the agricultural price, it will end up in raising wage cost in non-agriculture sector and hence fall in private profits. This will lead to less tax collection by Government. Also, fall in purchasing power of people due to price rise will compress effective demand and hence will affect the economy negatively.

These changes necessitate a fresh look at the role and relevance of the Minimum Support Price system in the country. Announcing procurement prices has become one of the primary tools of intervention in agriculture while other crucial issues like fall in capital formation, developing irrigation facilities, need of changing land holding pattern etc. have been ignored.

4. Farm Acts 2020 and their impact on Pricing Policy of the Government:

The Union Government introduced three Acts on agriculture reforms in the Parliament to replace ordinances issued during the lockdown. These three acts are:

- a) The Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act, 2020
- b) The Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Act, 2020
- c) The Essential Commodities (Amendment) Act, 2020

The Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act, 2020 contains the following key provisions:

- It opens up agricultural sale and marketing outside the notified APMC Mandis for farmers.
- Further it removes barriers to inter-state trade.
- It also provides a framework for electronic trading of agricultural produce
- It prohibits State Governments from collecting market fee, cess or levy for trade outside the APMC markets.

The Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Act, 2020 is related to Contract Farming and enlists the following key provisions:

- It provides a framework on trade agreements for the sale and purchase of farm produce.
- The mutually agreed remunerative price framework envisaged in the legislation has been conceived to would protect and empower farmers
- The written farming agreement, entered into prior to the production or rearing of any farm produce, lists the terms and conditions for supply, quality, grade, standards and price of farm produce and services.

Similarly, the key provisions of the Essential Commodities (Amendment) Act include:

- Removal of cereals, pulses, oilseeds, edible oils, onion and potatoes from the list of essential commodities. The amendment seeks to deregulate the production, storage, movement and distribution of these food commodities.
- The central government is allowed regulation of supply during war, famine, extraordinary price rise and natural calamity, while providing exemptions for exporters and processors at such times as well.

- Imposition of any stock limit on agricultural produce must be based on price rise. A stock limit may be imposed only if there is a 100% increase in retail price of horticultural produce; and a 50% increase in the retail price of non-perishable agricultural food items

It is argued that the phased dismantling of the monopoly of the APMCs indicates the end of assured procurement of food grains at minimum support prices (MSP). Farmers and rights activists suggest that instead of dismantling the monopoly of APMC's, the centre should focus on getting a larger number of farmers for their produce and addressing weakness in the APMCs.

However, there is no such provision in the Act that indicates the end of the current system of minimum support price (MSP)-based procurement of foodgrains (essentially wheat and paddy) by government agencies. The Centre has assured the continuance of the purchases in state-regulated APMC mandis. Also, the APMCs wouldn't stop functioning. The Act only adds an alternative platform for farmers to sell their produce.

5. Previous Years' UPSC Questions

1. What are the different types of agriculture subsidies given to farmers at the national and at state levels? Critically analyse the agricultural subsidy regime with reference to the distortions created by it. (2013)
2. How do subsidies affect the cropping pattern, crop diversity and economy of farmers? What is the significance of crop insurance, minimum support price and food processing for small and marginal farmers? (2017)
3. What do you mean by Minimum Support Price (MSP)? How will MSP rescue the farmers from the low income trap? (2018)

6. Vision IAS GS Mains Test Series Questions

1. ***With reference to Bali decision clearly stating that Peace clause under Agreement on Agriculture (AoA) would remain in force, until permanent solution is found, can we say that India was at least partially successful in placing 'Food Security Box' and 'Development Box' alongside 'Green Box'? Analyze. Also, suggest some remedies to counter the adverse effects of huge Green Box subsidies offered by developed nations to their farmers.***

Approach:

- Briefly write about the Agreement on agriculture and the need for food security box and developmental box alongside Green box.
- Then explain about the Bali decision to include peace clause until permanent solution is found and its significance for India.
- Write briefly about the adverse effects of huge Green Box subsidies offered by developed nations to their farmers and suggest some remedies to counter them.

Answer:

There has been a demand for 'Development Box' and 'Food Security Box' along with 'Green Box' in agreement on agriculture (AoA) in order to cater to the needs of food security, rural development, and poverty reduction in developing countries. The basic aim is to ensure that developing countries have the policy flexibility to support domestic agricultural production and ensure the food security of their population.

With the recent rise in global food prices, many countries have begun giving higher subsidies to farmers to promote agriculture, putting them in danger of breaching the 10 per cent cap under the de minimis levels.

During the 9th ministerial conference held in Bali a 'peace clause' was agreed between developed and developing countries. The 'peace clause' said that no country would be

legally barred from food security programmes even if the subsidy breached the limits specified in the WTO agreement on agriculture. This 'peace clause' is expected to be in force for four years until 2017, by which time a permanent solution to the problem will be found.

With reference to this outcome, one can correlate to the provisions of Green Box subsidies allowed under AoA which includes items like decoupled income support, research expenditures, pest control measures, training & extension expenses and promotion expenses and infrastructure expenses. However some of the direct payments are also listed in this category. There is ambiguity in head and expense classification, which makes this subsidy highly contentious as many developed nations misuse the loopholes under this category to support their farmers, USA being at the top with 1/3rd of GDP support.

So we can definitely say that with the Bali statement regarding peace clause, India was at least partially successful in placing the 'Food Security Box' and 'Development Box' alongside the 'Green Box'. However India and other developing countries should be cautious of following issues.

- Accepting a temporary peace clause should not be amounted to admitting that the subsidy programmes in India and other developing nations violate global trade norms.
- If the clause expires before a permanent solution is in place, food security programmes and policies to protect farmers, such as Minimum Support Prices, would come under siege.
- The peace clause requires full disclosure of MSPs and annual procurement for food security programmes, which might leave India open to questioning by other countries on domestic matters.

Hence there is a need for permanent solution in this regard to ensure food security programme in developing countries.

The WTO agreement with its complex structure provides enough room for maneuvering subsidies to provide protection to domestic produce under the Green Box subsidies. Level of subsidies is so high in developed countries that level playing field in agriculture trade is a far cry. To counter adverse effect of such support and subsidies following suggestions are made:

- Developing countries should seek clubbing of all kinds of support to agriculture in one category and seek some parity among developed and developing countries.
- Other member countries should have the freedom to impose protective tariff linked to differences in domestic support.
- In order to counter the adverse impact of GBS in other countries on domestic produce, we need to pay serious attention to infrastructure development, which has been deteriorating for quite some time.

2. *Agricultural subsidies are hotly contested at the WTO negotiations. What are the concerns of developing countries, especially India, vis-a-vis the attitude of developed countries on the issue? What is Special Safeguard Mechanism (SSM)? In this context, what are the reasons underlying India's keenness on a permanent solution on public stockholding for food security?*

Approach:

- Describe the reservations of developing countries in respect of agricultural subsidies at WTO negotiations. It should be a comparative outlook vis-a-vis developed countries.

- Define Special Safeguard Mechanism, and mention its ad-hoc nature.
- Finally, mention why India is keen on a permanent solution on public stockholding.

Answer:

Agriculture occupies crucial space at the WTO negotiations and the issue of subsidies therein is a bone of contention between the developing countries such as India and developed countries such as the United States and those from Europe. The Agreement on Agriculture has been criticised for reducing tariff protections for small farmers in developing countries while simultaneously allowing rich countries to continue subsidizing agriculture at home.

The concern of developing countries regarding the attitude of the developed countries can be summed up thus:

- Whereas the developed countries want subsidies to be removed, the developing countries view agricultural subsidies as crucial for their farm livelihood and food security.
- The box-shifting practices and use of green box as well as amber box subsidies by rich countries such as US cause concern in developing countries. For example under a 2006 ministerial agreement, agriculture subsidies in rich countries were to be eliminated by 2013 to spur export competition in global agriculture, but this did not happen. In fact, new policies, such as the US Farm Bill of 2014 have ensured that there will be no cut in their export subsidies.
- The insistence of countries such as US for Countries like India to limit Amber box subsidies to 1986 production (not adjusted to inflation) is a major bone of contention.
- While developed countries including the US, Australia, the EU oppose public stockholding of food crops, it is crucial for India's food security programme.
- The developing countries are concerned about the issue of import surges and tariffs to be imposed in case of livelihood threatening. This is perhaps most visible in the differences over the structure of the Special Safeguard Mechanism (SSM).

Special Safeguard Mechanism (SSM) is a trade remedy that allows developing countries to impose additional safeguard duties in the event of an abnormal surge in imports or the entry of unusually cheap imports.

India argued for higher level of tariff and lower import surge for making the SSM. On the other hand, the US and allies argued for lower tariffs and higher imports. India and the G33 insist that the SSM mechanism can come into play if imports rise by about 10%, while developed countries want it as 40%.

For a permanent solution, India had proposed either amending the formula to calculate the food subsidy cap of 10 per cent, which is based on the reference price of 1986-88, or allowing such schemes outside the purview of subsidy caps of the AOA. This would enable India to continue with its policy of public stockholding for food security without violating any of the extant provisions.

3. What are the twin objectives of government food procurement policy in India? Discuss the instruments of this policy. Do you think there is an urgent need for rationalization of MSP policy in India?

Approach:

- The introduction should enumerate the twin objectives of food procurement policy.
- Then discuss the instruments of the policy.
- Finally, critically examine the present MSP policy.

Answer:

Student Notes:

The food procurement policy of the Indian government is geared to achieve the twin objectives of

- serving consumers through price subsidy; and
- supporting the price for producer.

In this context, the price instruments used are Minimum Support Price (MSP) and Central Issue Price (CIP). These can be understood thus:

- Grain procurement at MSP, maintenance of buffer stocks and distribution at subsidized rates through PDS.
- Allocation of grains to states at Central Issue Price (CIP) for distribution to consumers.

The Food Corporation of India is the agency of GoI that handles procurement, storage and transportation of grains to states. The States in turn distribute these grains through Fair Price Shops.

In recent times the MSP policy has come under criticism for:

- increasing fiscal burden.
- administrative inefficiency and creating market distortion.

The Commission for Agricultural Costs and Prices (CACP) recommends MSPs at national level for twenty three crops, but effectively price support operates primarily in wheat and rice and that too in selected states. This creates incentive structures highly skewed in favour of wheat and rice. While the country is dependent on imports for pulses and oilseeds (edible oils), their prices often fall below the MSP as there is no effective price support.

High MSPs induce distortions, some of which ultimately hurt the poor. Here are two examples:

- High MSPs result in farmers over-cultivating rice and wheat, which the Food Corporation of India then purchases and houses at great cost. High MSPs also encourage under-cultivation of non-MSP supported crops. The resultant supply-demand mismatch raises prices of non-MSP supported crops and makes them more volatile. This contributes to food price inflation that disproportionately hurts poor households who tend to have uncertain income streams and lack the assets to weather economic shocks.
- High MSPs and price subsidies for water together lead to water-intensive cultivation that causes water tables to drop, which hurts farmers, especially those without irrigation.

Thus, there is a need to rationalize MSP in order to correct the present distortions.

4. *Minimum Support Price (MSP) of crops is a short term solution for agricultural distress which creates long term problems. Examine. Suggest measures to overcome the limitations of the MSP regime.*

Approach:

- Briefly explain the concept of MSP and its importance.
- Examine the long-term problems associated with present MSP mechanism.
- Suggest measures and alternatives to overcome the limitations of the MSP regime.

Answer:

Student Notes:

Minimum Support Price (MSP) is a market intervention by the Government to insure agricultural producers against any sharp fall in farm prices. The idea behind MSP is to give guaranteed price and assured market to the farmers and protect them from the price fluctuations and market imperfections.

However, MSP is associated with various issues such as:

- **Distortion of cropping pattern** - There has been an excess focus on the procurement of wheat, rice and sugarcane at the expense of other crops such as pulses, oilseed and coarse grains.
- **Degradation of agricultural ecosystem** – Crops which are not aligned with the agro-climatic region lead to depletion of water table, soil degradation and deterioration in water quality. For example, rice despite being unsuitable for growth in Punjab and Haryana (semi-arid regions), is widely grown there. This has led to deterioration of groundwater table.
- **Regional imbalance** – Procurement infrastructure is virtually non-existent in eastern states and as such, farmers from these states are not able to reap the monetary benefits of MSP and an assured procurement by government. The Shanta Kumar report on agriculture estimates that just around 4% of the country's farmers benefit from the MSP system.
- **Insurance not remuneration** – MSP is just an insurance and not a remunerative price - M.S. Swaminathan committee recommends fixing MSP at one-and-a-half times the cost of production.
- **Debt obligations** - Resource-poor, marginal and small landholders have to sell a substantial proportion of crops to local private traders and input dealers due to tie-up with credit.

Measures to overcome the limitations of the MSP regime

- Increase the scope of procurement under MSP regime. It should not be restricted to particular region or particular crops.
- Overcoming the state-wise differences in awareness levels and lacunae in MSP announcements.
- Meaningful consultation with the State Government on the methodology of computation of MSP as well as on the implementation mechanism.
- Swift payment should be ensured.
- MSP should be announced well in advance of the sowing season so as to enable the farmers to plan their crops.

The following alternatives to MSP must be considered:

- **Price Deficiency Payment:** Under this arrangement the difference between the MSP and the selling price can be compensated through direct transfer to bank accounts. This would address the problem of most of the stock being sold to the government.
- **Area planning/restrictions:** For example, in the UK, all farms above 5 hectares have to get approval for use of land for growing crops. It can check price crash due to over-production by restricting the area under a particular crop.
- **Direct Income Support:** A direct income support on the basis of cultivated acreage, as done recently in Telangana and Karnataka, also has the advantage of being less distortionary than MSP.

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