Will a legally binding MSP deliver?

Reliance on Minimum Support Price won't ensure food security or improve farm income. Fair & competitive markets are needed

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The discussion over agricultural price policies has now been very extensive and the pressures for arriving at a key framework for such a policy has been intensified by the withdrawal of the three Farm Bills that sought to provide a framework for price policies as part of a policy for the management of the entire supply system of the markets for agricultural produce.

One of the issues that has come up in this debate is the possibility of a Minimum Support Price with legal/legislative backing. A legally binding MSP will mean that no one can buy from the farmers at a price below MSP. Any violation can become a punishable offence. There is of course a reason for such a demand.

Prices that farmers receive tend to get depressed when there is abundant production and may fall even to levels at which farmers would not recover the cash expenses incurred by them. One reason for the weakness in agricultural prices in the face of abundant production is the lumpy nature of agricultural produce that arrives in the markets and the demand being not necessarily so lumpy.

The need for transportation and storage to manage such situations and the costs involved affect the returns to farmers. Production level well beyond the market demand cannot be sustained, unless there is a compensation beyond the market price to the producers.

In the absence of such a mechanism, production may not reach the desired level. It must be accepted that MSP is only a mechanism to reduce the inherent market risks in farming but cannot be the mechanism to manage the transitions needed to address medium-term issues such as the changes in farming practices or changes in cropping pattern. Transition from one type of cropping pattern to another does involve costs to the producers.

Procurement operations

The role of MSP in an environment in which procurement operations are undertaken to meet the needs of foodgrain under the Public Distribution System is different from a situation when it is used as a price stabilisation mechanism. The distinction between a procurement price and MSP needs to be understood. MSP is a price stabilisation tool, assuring farmers a minimum support. Procurement price can have multiple goals and can be fixed taking into account many other considerations.

We had argued earlier (*BusinessLine*, November 29, 2017) that when market prices go below the MSP, what needs to be procured in such situations is the additional output over what is normally absorbed by the market. It is not necessary to procure all the output.

Any procurement by the government would also need to have a disposal strategy. Selling the excess stocks back in the market subsequently would affect the prices to the farmers. The longer term concern regarding the demand for the specific farm produce — within the country and exports — is an issue that requires to be dealt with separately. The present system of procurement has come to mean the so-called MSP is essentially the procurement price, although additional payments such as the bonus by State governments, may further increase the price received by the farmers.

Low returns At times, farmers do not recover even the cash expenses incurred

The present recommendations on the MSP consider a wide range of expenses incurred by the producers, including a provision of a margin (which is substantial at 50 per cent under the Swaminathan Committee recommendations) for the farmers in addition to the cash expenses and other imputed expenditures.

Its origin lies in the need to provide an 'incentive price' to farmers to produce the crop, and in the times when there were supply shortages. Fixing an MSP at a level where the government alone becomes the dominant or only buyer would distort the markets and render it fiscally unsustainable, given the fact that even when the government is buying about a third of rice and wheat produced, the food subsidies are seen to be unsustainable. Again, the issue is not one of a one-time intervention but one where such interventions may recur frequently unless the supply system adjusts to the emerging demand conditions.

Rising rates

The MSP announced by the Central government for paddy (rice) and wheat have increased by 5.9 per cent and 5.3 per cent, respectively, average per year, in the period from 2016-17 to 2020-21. During this period, the government procured 35-49 per cent of production of rice and 25-35 per cent of production of wheat. The upper end of the procurement rates occurred in the more recent years.

Thus, in substance, we argue that we should not blur the distinction between MSP and procurement price. In the case of wheat and rice, the system of procurement has a long history.

MSP in the case of these agricultural products has been elevated to the level of procurement price. It may be difficult to change the situation as there is also a commitment to a public distribution system.

Other food crops

In the case of other food commodities, a legally binding MSP can be introduced. In such a situation, MSP must strictly cover only costs and, if necessary, a small margin. That should limit the price uncertainty induced by the markets. As mentioned earlier, a very high margin over costs will result in the government becoming the only procurer and such a situation would become unsustainable.

Reliance on MSP alone would not be appropriate for ensuring either food security or improving farm income. The institutional arrangements to ensure fair and competitive markets are also essential for the MSP to play its role in providing a protective price environment for the farmers.

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