3

How to Create Economic Freedom for Agriculture

Can Agriculture be Unshackled from Government Controls?

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On the face of it, Indian agriculture is country's largest private sector enterprise employing more than half the workforce and contributing about 14 per cent to overall GDP of the country. Given that it is in private sector, one would expect that this sector should enjoy full freedom to produce whatever it likes, market its produce the way it deems fit, both at home and abroad and buy its inputs from anyone it prefers. This expectation is particularly strong since the economic reforms of 1991 have freed many controls on industry. But the reality is that agriculture is still a sector that has the most stifling controls, especially on marketing its produce.

In this brief chapter, first we highlight the nature and degree of government interventions in three agricultural products and two basic inputs (land and water) as examples of the overall malaise. Then we try to see whether the government has been able to achieve its stated objectives through these controls. If so, we see at what cost, especially in terms of production and marketing efficiency and also in terms of overall growth of that sector. Finally, we present what could be the way forward to ensure faster and more inclusive growth in agriculture, more efficiency in production and marketing, and more sustainability in environmental and financial terms.

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Sugar: Controls and Consequences

Consider the following. An official in the Directorate of Sugar (Government of India) decides how much sugar each of the 550-plus sugar mills in the country can sell as "non-levy quota" in the free market each month. Sometimes this so-called "release mechanism" is used to control sugar sales every fortnight, or even every week. An overall "export quota" for sugar exports is decided in tranches by an Empowered Group of Ministers (a Cabinet sub-committee), over several meetings. Then another official decides how much of the government's annual "export quota" should be allotted to each sugar mill and how much they can export each month (whether or not they have the international competitiveness or motivation to export). Mills are also subject to a "levy-quota": each mill has to give the government a portion of its output at a below-market price fixed by the government, for distribution at subsidised rates to consumers served by the public distribution system (PDS). The levy quota has varied over time: it was once as high as 65 per cent but is currently 10 per cent. However, it can be raised any time the government feels the need to do so.

The government also decides whether the packing of sugar will be in jute bags or poly-propylene bags (this allows it to provide artificial respiration to a dying, uneconomic jute industry). The by-products of sugar are also controlled. Molasses generally cannot move from one state to another, unless permitted by the state government. Molasses cannot be sold freely: different industrial users (mainly liquor and chemicals) are allotted quotas of molasses by state governments. Whether sugar mills can produce ethanol from sugarcane or molasses has to be decided by the government (and permission has been refused for several mills in Bihar). The price of ethanol too is decided by the government. So too is the price of electricity generated from bagasse (crushed cane). Controls abound at not only the factory level but trade level too. How much sugar or molasses can be held by any wholesale trader or sugar factory at any particular time is decided periodically by some official.

Sugarcane is a starting point for many industries—liquor, ethanol, chemicals, electricity, fibre board. When the marketing and pricing of sugar as well as allied products is subject to government controls (which are sometimes light-years from market rationality), the potential of developing sugarcane is affected. The price of cane to be paid by sugar factories to farmers is announced by the Central government. This is supposed to be a fair and remunerative price (FRP) based on the recommendations of the Commission for Agricultural Costs and Prices (CACP). But then different

states, most notably Uttar Pradesh, announce their own "State Advised Price" (SAP). This can be much higher than the fair price announced by the Central government and this often makes the FRP irrelevant. The state of Maharashtra has its own system of cane pricing, which also is much higher than the FRP announced by the Centre.

The impact of these controls on the growth and efficiency of cane production and the sugar industry is a matter for detailed research. But what is very clear is that despite industrial delicensing of this sector and opening it to foreign direct investment (FDI), it has failed to attract any. Investment has come primarily from the Indian private sector, and that too when packaged with large tax concessions (which can, however, be withdrawn arbitrarily). Sugar production in Maharashtra is done by cooperatives. Once viewed as a model, the Maharashtra regime is under severe strain and fragmenting. It cannot compete with the private sector which has scale economies. Maharashtra has a severe dearth of water, and so is not suitable for a water-guzzling crop like cane. Less than 3 per cent of the state's cropped area is under sugarcane but it uses more than 60 per cent of the irrigation water of the state. Ironically, sugar factories have gone sick in a state like Bihar which has ample water and so used to be the hub of sugarcane cultivation 100 years ago.

Sugar factories often complain of a "political overdose" in the pricing of cane at the state level (through SAPs). This is especially true during election years, when the ruling party woos farmers with sky-high cane prices. Quite often this makes factories unable to pay farmers in full and leads to large payment arrears. In April 2012, the cumulative payment arrears were estimated at ₹ 10,000 crores (around $200 million). Payments disputes drag on in the courts for years.

The ratio of Central government cane prices to market price for sugar was just 46 per cent in the period 2002-03 to 2006-07, way below the international norm of 70 per cent. So if farmers had always been paid the low price fixed by the central government, India's sugar industry would have been much smaller. The SAPs have been closer to international prices. For example, in the state of Uttar Pradesh, the cane-to-sugar price ratio was 69.4 in 2004-05 to 2008-09. In Maharashtra, this percentage was even higher at 74.3 per cent for the same period (because the sugar yield per tonne of cane is much higher in Maharashtra than in Uttar Pradesh). All such pricing is arbitrary and unrelated to market realities. This greatly hampers investment in cane and sugar by farmers and mills.

Rice: Controls and Consequences

Consider the case of India's biggest staple crop, rice. India is the world's second largest producer of rice (after China), growing 103 million tonnes (m.t.) of rice from 44 million hectares in 2011-12. There are many controls. The central government banned exports of rice in the wake of skyrocketing global prices in 2007-08. Some states like Andhra Pradesh have banned the movement of rice out of the state. This has happened even though four of the last five years have witnessed normal rainfall in India, resulting in rice production rising from 96 million tonnes in 2007-08 to 103 million tonnes in 2011-12. High production plus export restrictions have led to accumulation of rice and wheat stocks with the government. These rose from 24 m.t. on July 1st, 2007 to an estimated 75 m.t. by the end of June 2012. The covered capacity to store grain in the country is less than 50 million tonnes, so the rest of the grain is being stacked in the open and covered with plastic sheets, exposing it to potential damage during the rainy season.

In the 2010-11 post-monsoon marketing season, the national export ban on rice, coupled with inter-state restrictions in Andhra Pradesh, created a crisis. The market price of paddy in Andhra Pradesh crashed below the government's own minimum support price (MSP). Angry farmers swore to respond with a "crop holiday". In consequence, the rice area in Andhra Pradesh came down from 4.8 million hectares in 2010-11 to 4 million hectares in 2011-12.

The Commisson on Agricultiural Prices and Costs (CACP) in its 2011-12 Policy Report urged the government to restart exports of rice and wheat. This prompted the government to open up exports of rice in September 2011. It is expected that in 2011-12, India will export more than 6.5 m.t. of rice. This saved Andhra Pradesh farmers from another "price crash"—the maximum exports of rice took place from this state. However, farmers in Assam, Bihar, Jharkhand, Odisha, eastern Uttar Pradesh and West Bengal suffered from market prices way below the government's promised minimum. Clearly, export controls inflict an implicit tax on paddy farmers, who suffer depressed prices.

Paddy has to be sent to mills for rice extraction. In each major rice-growing state, rice mills are obliged to give a certain percentage of rice milled to the government at a fixed price—this is called "levy rice". This provides the government with rice for its subsidised public distribution system (PDS). The levy on rice ranges from 75 per cent of milled common rice in Punjab, Haryana, Andhra Pradesh to 50 per cent in Uttar Pradesh and West Bengal.

State governments decide how much rice wholesale traders can hold at any time. The rice market is also burdened with some other controls. Punjab, for example, imposes local taxes totaling 14.5 per cent of paddy price. In Andhra Pradesh local levies total 12.5 per cent, and in Haryana 11.5 per cent. These amount to taxes on consumers in rice-deficit states. High levies keep much of the private trade away, and this has led to a virtual state take-over of trade in paddy/rice in these states. Chhattisgarh is the latest state entering this category.

A state like Kerala gives paddy farmers an extra bonus of ₹ 500 ($10) per quintal over and above the central government's MSP. Kerala also provides a subsidy of ₹ 10,000 ($200)/hectare to grow paddy, creating a Japan-like island of high cost paddy cultivation within India. This plethora of government interventions seriously distorts the rice market and leads to irrational incentives and disincentives. The problem gets compounded when some states sell rice to the poor at just ₹ 1 per kilogram (as in Andhra Pradesh, Tamil Nadu and Kerala). This can be sold right back to the governments at a huge profit at the next harvest, at the MSP. India needs a unified national market, with rice flowing seamlessly across state borders. Instead we have a highly fragmented rice market, leading to large inefficiencies in production, procurement, stocking and distribution.

Heavy national reliance on Punjab for procuring rice for the PDS has led to serious environmental problems. The state's ground water table has fallen calamitously. The majority of its districts have been declared in danger or in crisis, with water withdrawals vastly exceeding annual recharge by rain. On the other hand Bihar, eastern Uttar Pradesh and West Bengal have ample water and are ideal for paddy cultivation. But the government has not organised procurement from these states at the MSP, as it has in Punjab. So, farmers in the eastern states with ample water end up getting paddy prices 20 to 30 per cent below what Punjab farmers get. This highlights huge inefficiencies in the rice system. Paddy is grown mostly where it should not be (Punjab) and much less where it should be (the eastern states).

Fruits and Vegetables (F&V): Controls and Consequences

Next, consider the case of F&V. These today account for almost one-fifth of the value of total agricultural output and demand for them is growing much faster than for cereals. In most states, F&V have to be sold through regulated markets (*mandis*). These have been set up under the APMC (Agricultural Produce Marketing Committe) Act. The biggest APMC markets for F&V are at Azadpur in Delhi and Vashi in Mumbai. The

APMC commission agents who conduct auctions of produce in Azadpur are officially entitled to charge 6 per cent commission on the value of transaction but field visits by researchers suggest that they charge up to 10 per cent with impunity. In Vashi, the official commission rate is 8 per cent but unofficially field reports suggest that it goes up to 14-15 per cent. An auction takes just five to ten minutes, so the commission agents are making easy monopoly profits without taking any risk of production or marketing.

Very little major investment has been made by state governments in building supply lines with good infrastructure. Cold chains—cold storages and refrigerated vans and trains—are needed for perishable products but are not available.

Produce should be sourced directly from farmers, not routed through commission agents at *mandis*, as mandated by the APMC Act. Unfortunately, organised retail remains at a nascent stage in India and FDI (foreign direct investment) in multibrand retail has not been permitted, despite discussions for almost a decade. This makes India's supply chains expensive with several layers of middlemen, gives lower prices to producers, yet charges high prices to consumers. This is neither efficient nor equitable. The system needs to be changed drastically. But this is resisted by the traders and middlemen, who are politically powerful.

Land and Water: Primary Inputs into Agriculture

The last example we would like to give constitutes the very base of agriculture, namely land and water. In case of land markets, most states do not permit tenancy at all. In those that permit it, the tenancy law is strongly tilted to protect tenant's rights and tenure, making it risky for owners to rent their land. Eviction is very difficult. According to large official surveys of the National Sample Survey Organisation (NSSO), tenancy exists on only 7 per cent of agricultural land. However, unofficial micro-surveys indicate that almost 30 per cent of land is leased in or leased out, mostly informally. Problem: the informal tenants find it difficult to get institutional credit as they have no land records to prove they are farmers. They are obliged to go to money lenders at 3 to 6 times bank rates of interest. This leads to high debt burdens and sometimes to suicides. In some states like Madhya Pradesh, Chhattisgarh and Bihar, tenant-farmers find it hard to sell their produce to government agencies, which also ask for land records. So, they are forced to sell to millers and traders, sometimes at a distress price. Investments in land suffer, as neither the landowner nor the tenant find it worthwhile to put much capital into the land, given uncertainties of sales.

Canal water and electricity for irrigation are provided to farmers by the government, mostly at very low rates or completely free. Since demand for such subsidised inputs greatly exceeds the supply, the quantity farmers get has to be rationed by government agencies. They limited the number of connections, limit hours of electricity supplied and days on which canal water is released into canals. Where states charge for electricity, it is generally a flat monthly rate per horse-power, with no electricity meters. The marginal cost of pumping becomes zero. This induces farmers to grow inappropriate water-intensive and electricity-intensive crops such as paddy and sugarcane even in low-rainfall areas. For example, paddy in Punjab and Haryana requires roughly 225 centimeters (cms.) of irrigation water per crop. But the annual rainfall is only 60 cms. So, farmers have to pump huge amounts of ground water for thirsty paddy, depleting the water table at an alarming rate (33 cms. per year, according to NASA satellites during 2002-2008). Similarly, sugarcane in Maharashtra demands large quantities of water and hogs the very limited water available from irrigation canals. These are more than environmental disasters in the making: they also ruin the finances of State Electricity Boards (SEBs) and Irrigation Departments.

The underpricing of water and power has led to another perverse outcome. Because competitors abroad have to pay for water and power, Indian producers of water/power guzzling crops appear to have greater export competitiveness. In 2011-12, India has exported more than 6.5 million tonnes of rice and more than 3 million tonnes of sugar. To produce a kilogram of rice, one requires 3,000-5,000 litres of water and the same is true of sugar. By exporting these large quantities of rice and sugar, we are basically exporting huge amounts of water. This is outrageous in a country where water is scarce and state governments fight each other bitterly over sharing river waters. Agricultural exports may look good but we need to ask whether our policies and controls have helped to develop cropping patterns and exports in line with India’s natural endowments. The answer is “no”. In which case, such exports are not sustainable.

The Way Forward: Dismantle the Controls and Free Agriculture

Where do we go from here? What changes in policy agenda will promote efficiency and growth that is widespread and inclusive? How should we promote sustainability, both financially and environmentally?

First, we must free up agriculture from domestic controls to the extent feasible. In case of sugar and sugarcane, controls such as release mechanisms, levy quotas, stocking limits, cane area reservation, minimum distance between sugar mills and several other minor controls all need to

be removed. This will create greater competition, efficiency and growth. Similarly, we must abolish controls such as government levies on rice and paddy, movement restrictions across states, and stocking limits with traders and millers.

Second, physical bans on export/import of agricultural products must end. As a first step, they can be replaced by variable tariffs (import or export duties).

Third, crops like F&V need to be freed from marketing controls ordained by obsolete APMC laws. Indeed, the APMC Act needs to be changed to encourage direct sourcing by retailers from farmers' groups, to compress supply chains by removing unnecessary middlemen, and to invest in back-end infrastructure. For this, organised retailers, both domestic and foreign, need to be encouraged and incentivised.

Fourth, land lease markets needs to be officially freed. Tenancy, including long-term tenancy, should be encouraged in a transparent manner. This will induce agglomeration of small uneconomic holdings into larger economic ones. The pricing of water and power needs to be rationalized. Institutional reforms can help cut costs of generation and distribution of power and water by public utilities.

Such market reforms can go a long way to promote efficiency, growth and sustainability in Indian agriculture. It will improve inclusiveness too, by inducing growth faster than 4 per cent per year in a sector that employs half of all Indians, mostly poor.