Farmer Loan Waiver & Absence of Free Enterprise in Indian Agriculture

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FORUM
OF FREE ENTERPRISE

"Free Enterprise was born with man and shall survive as long as man survives".

- **A. D. Shroff**
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An Overview

The two articles in this booklet on the agricultural scenario in the country are very pertinent at this stage when there is a raging debate.

Despite success and breakthrough achieved in several sectors, the failure has been agriculture. This is largely due to lack of adoption of a strategic policy for enhancing and sustaining growth,ever since the success of the green revolution.

It may be useful to emphasize some of the key issues. This is also to a great extent due to lack of political leadership, as in recent years, no heavy weight political leader at the centre has been assigned the agricultural portfolio. These two articles vividly bring out a major shortcoming. Agriculture is a state subject and the issues involved are not applicable to all states. Farmer's distress may not be a country wide problem at any point of time and crop failure in many parts of the country due to severe draughts may not be applicable to all states.

Agriculture has become a highly unviable occupation. A majority of farmers rely on borrowings. Rising cost of cultivation is a main contributing factor. Substantial increases in minimum support prices for several products until 2013-14 for five successive years tilted term of trade in favour of agriculture.

However, the bulk of retail prices were retained by the middlemen.

Consequently, investments in agriculture remained negligible. It raised retail prices rather than farm investment and did nothing to improve productivity, which is the need of the hour. Farmers' suicides arose as a result of not only crop failure but also market failure. Farmers depend on non-institutional credit in recent years, where the rate of interest is much higher. One of the major deficiencies is lack of storage of perishable products like fruits and vegetables resulting in wastage of 32% to 40%. The Agricultural Products Market Committee, which plays a critical role in the marketing of farm products, results in farmers getting less than one third of the retail price, a large share going to the middlemen. In short, competitive forces do not operate.

Farm loan waiver is not the optimum solution to bail out the farmers in a distressed situation. Marginal farmers and landless labourers are out of the reach of institutional and bank loans, which largely benefit the rich farmers. Besides, they distort control as farmers wilfully withhold repayments. It is observed that poor farmers are generally more regular in the farm loan repayments whereas rich farmers hang on to outstanding farm loans. This leads to distortion of credit culture. The better options are to extend procurement operations to all major crops for which MSP is announced, strengthen forward markets to enable farmers to hedge price risk, widen the coverage of crop insurance which will cover not only crop failure but also market failure, create integrated agricultural market by linking rural supplies to urban demands and increased productivity.

Agrarian distress is deep rooted and loan waivers may provide only a short term solution and relieve political pressure on state governments. Competitive farm loan waiver will only distort credit culture as it does not meet the test of equity.

Another major lacunae is that prices of almost all inputs going to agriculture are distorted through subsidies and government controls. However, farmers are not free to sell their products to whomever they want and at the best price they can negotiate. Procurement price of major products are never mutually agreed but dictated to the farmers. Procurement market only has a single buyer in the form of government. The price is arrived at by bidding between politicians and farm union leaders. The result has been that a majority of what farmers produce is in excess of demand. What is produced is not necessarily what consumers want, not more of cereals but more of vegetables, milk and poultry, which consumers want more and more. This is not corrected as a price signal is not effective.

The booklet is very instructive and readable for all interested in the subject.

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Editorial

In an otherwise positive and promising current Indian economic scenario, what is unfortunately depressing and worrisome is the growing incidence of rural distress, unsustainably burdensome rural indebtedness and farmers suicides. Consequently, the most commonly sought after relief measure by farmers and their representative organizations, and politicians cutting across all political parties, happens to be loan waivers. Doubtless, rural distress is a huge legacy problem, and as many agricultural economists and experts have repeatedly argued that loan waivers offer only a soft option and the short-term relief to the farming community. There are various facets of this issue – and practically all of those have been hitherto discussed and debated intensively and extensively in different forums, be it in the floors of State Legislatures, the Parliament and their concerned committees; professional seminars; academic and official research institutions; media or even at the policy level.

This booklet is a composite of two separate articles: the first is titled as "Farm Loan Waiver in India: A critical Evaluation"; and the second talks about "Indian Agriculture Suffers from an Absence of Free Markets". In the context of recent announcements of various State Governments either granting or considering farm loan waivers and the stance of the Central Government on this issue, the

Forum of Free Enterprise thought it appropriate to analyse and reflect once again on this subject more comprehensively and objectively. We are, therefore, pleased to present in this booklet two independent viewpoints on this issue of great topical interest. Two authors of the first article in this booklet, Dr. C. L. Dadhich and Dr. Barendra Kumar Bhoi – both eminent economists and former senior officials of the RBI with considerable experience in authentic economic research and policy making – are eminently positioned to deal with the complexity of this task. The second article is scripted by Mr. Kumar Anand, a young economic liberal thinker. We strongly endorse their analysis, views and perceptions – all of which will be extremely relevant to the concerned stakeholders of Indian agriculture, and especially to the policy makers.

What stands out in the paper of Dr. Dadhich and Dr. Bhoi, is their very systematic approach to highlighting the underpinnings of agrarian distress and reflecting on economic implications of farm loan waivers as well as on a set of policy options. With the help of relevant official data, they have sought to point out how agriculture has become an unviable proposition thanks to three key factors, namely, (a) small and fragmented size of asset [land] holding; (b) growing dependence on non-institutional sources in financing of agricultural operations; and (c) inefficient value chain. It also observes that inadequacies of marketing infrastructure and multiple layers in the marketing of farm produce deprives the farmers of a substantial share of the final retail price paid by the consumers – and the system favours the middlemen.

Authors have focused on various policy options such as procurement operation in major crops; strengthening of forward markets; composite crop insurance; integration of agricultural markets; and smart farming. But what is most important is their candid proclamation that the *"the farm loan waiver may provide a short-term relief to Indian farmers... There is a need to provide medium term solution to the problem so that a sub-optimal solution like loan waiver can be avoided..."*. From FORUM's perspective, despite the secular decline in the contribution of agricultural sector to the Indian economy, this sector is vital to the stability and sustainability not only of the rural sector, but also for the overall socio-economic equilibrium and dynamics of India.

Turning to a thought-provoking article of Kumar Anand, what comes out loudly is his articulation that the crisis in Indian agriculture has perhaps so much do with the lack of principles, policies and practices of market economy – both at the input and output levels. He sounds justifiably critical about the persistent neglect of agriculture, and raises a crucial issue whether we have really abandoned central planning, although the Planning Commission stands dissolved. His concluding observation offers a very valid message: *"There is nothing about agriculture that necessitates so many interventions ..."*

All in all, there are multiple dimensions to the persistent phenomenon of rural distress and its various manifestations. We believe this booklet would inspire more honest and holistic assessment of challenges confronting India's rural economy in general and agriculture sector in particular, so that we can think beyond the regularity of populist soft option of farm loan waivers, and aspire to build growth-oriented, stable and sustainable rural sector.

Sunil S. Bhandare
Editor

Farmer Loan Waiver
A Critical Evaluation

Dr. C.L Dadhich*
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I. Introduction

Pressure for farm loan waiver is mounting in India to address agrarian distress. Historically, farm loans in India were waived under exceptional circumstances, mostly on occasions of crop failures. Recently, farm loan waivers have been pursued by several state governments when agricultural production is at a record level. In fact, farm loan waiver has emerged as an intricate socio-economic and political problem in India. Abstracting from political dimension of the farm loan waiver, an attempt has been made here to

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critically examine the problem from socio-economic angles and suggest feasible solutions in the medium term.

Farm loan waiver is a fiscal burden and therefore falls in the category of costly public policy decision, particularly when both central and state governments are committed to the fiscal discipline. On the other hand, in the absence of a good social security system in India, distressed farmers need to be supported, at least on a humanitarian ground to reduce farmers' suicide. Farmers' distress may not be a country-wide problem at any point of time unless there is a crop failure in most parts of the country due to severe drought. Agriculture being a state subject, the central government expects state governments to take appropriate actions as and when required although there is precedence of nation-wide farm loan waiver earlier. There are also guidelines from the Reserve Bank of India (RBI) to restructure farm loans under certain circumstances.

Given the complexity of the problem, underlying reasons contributing to the agrarian distress in India are analysed in Section II. Section III reflects on the economic implications of farm loan waiver, evaluates relative merits and demerits of possible solutions and suggests appropriate policy actions. Concluding observations are given in Section IV.

II. Agrarians Distress

a. *Unviable Agriculture*

According to 59th round of National Sample Survey (NSS, 2003), about 40 per cent of farmers wanted to abandon agriculture mainly because it has become a highly unviable occupation. A recent repeat survey (NSS 70th round, 2013) reveals worsening of the situation. In case of about two thirds agricultural households, total consumption expenditure was higher than net income received by them (Table 1). This suggests that large number of farmers have been managing their farming activities essentially by borrowing. This has also adversely affected capital formation in agriculture. Rising cost of cultivation, particularly labour cost and cost of inputs like fertilisers, etc. (Economic Survey, 2015), is the main reason for the non-viability of cultivation.

Until 2013-14, minimum support prices (MSP) for several farm products were hiked significantly for five consecutive years. As a result, the terms of trade tilted in favour of agriculture vis-a-vis industry. However, farmers got a limited share of the improvement in the terms of trade. Bulk of the retail prices was retained by middlemen operating in the agricultural value chain. Despite improvement in the terms of trade, investment in agriculture continued to remain negligible. Large hikes in MSP seem to have raised retail prices

Table 1: Monthly Income and Expenditure of Agricultural Households in 2012

Size class of land possessed (ha)	Income from wages/ salary (Rs.)	Net receipt from cultivation (Rs.)	Net receipt from farming of animals (Rs.)	Net receipt from non-farm business (Rs.)	Total income (Rs.)	Total consumption expenditure (Rs.)	Net investment in productive assets (Rs.)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
< 0.01	2902	30	1181	447	4561	5108	55
0.01 - 0.40	2386	687	621	459	4152	5401	251
0.41 – 1.00	2011	2145	629	462	5247	6020	540
1.01 – 2.00	1728	4209	818	593	7348	6457	422
2.01 – 4.00	1657	7359	1161	554	10730	7786	746
4.01 – 10.00	2031	15243	1501	861	19637	10104	1975
10.00 +	1311	35685	2622	1770	41388	14447	6987
All sizes	2071	3081	763	512	6426	6223	513

Source: NSSO 70th Round, December 2014, Government of India.

rather than pushed up farm investment. Within the limited arable land in the country, year-to-year variations in the cropping pattern indicated that farmers were shuttling between cash crops and food grains depending on market prices of farm products rather than doing something credible to improve productivity.

The agrarian distress, which has been a legacy problem, has further worsened in the recent past. The average CPI and WPI inflation is currently hovering significantly below two per cent. Typically, at a very low rate of inflation, certain sectors of the economy suffer from deflationary pressures. In fact, food and beverage inflation, which was decelerating since 2016, has turned negative since May 2017, led by pulses and vegetables. The phase of demonetisation-related decline in food prices, mostly perishables, is over. In 2016-17, arrival of winter crops was large and pulses production was at a historic high level. Farmers are distressed mainly because prices of several farm products like pulses, oilseeds and vegetables have crashed. As a result, farmers are subjected to distressed sale as their products are priced much below the level of MSP. Despite bumper harvest in 2016-17, farmers' suicide continues to remain elevated. Farmers' unrest this time is not on account of crop failure, but due to market failure. Hence, farmers' agitation is a survival problem in an unviable agriculture.

Rural Indebtedness

In the post-independence era, there have been massive market interventions to provide adequate credit to agriculture in general and to farmers in particular. Mention may be made about cooperative movement, nationalization of banks, setting up of National Bank for Agriculture and Rural Development (NABARD), Regional Rural Banks (RRBs), priority sector lending, Kisan Credit Cards, interest are subvention by the government in farm lending, micro finance etc. Despite these innovative measures, coverage and flow of institutional credit to rural areas have been far from satisfactory, particularly in the wake of financial sector reforms (Dadhich, 2016). According to NSSO reports, the share of institutional credit declined from a peak of 69.4 per cent in 1991 to 56 per cent in 2012 (Table 2). Farmers' dependence on non-institutional credit has gone up significantly from 30.6 per cent in 1991 to 44 per cent in 2012. According to 70th round of National Sample Survey, among the institutional agencies, the share of commercial banks was

Table 2: Agency-wise Share of Rural Loan Outstanding

(Per cent)

Credit Agency	1981	1991	2002	2012
Institutional	61.2	69.4	61.1	56.0
Non-institutional	38.8	30.6	38.9	44.0
Total	100	100	100	100

Source: NSSO 70th Round, Government of India.

the highest at 25.1 per cent, closely followed by cooperatives at 24.8 per cent in 2012. Self-help groups contributed only 2.2 per cent, Government 1.2 per cent and financial companies 1.1 per cent of the total institutional credit to agriculture.

Table 3: Rural Indebtedness as on June 30, 2012

(Per cent)

Credit Agency	IOI	SRLO	IOI	SRLO	IOI	SRLO
Institutional	33.8	64.0	14.2	52.1	17.2	56.0
Non-institutional	21.5	18.6	18.6	47.9	19.0	44.0
Total	45.9	100	28.9	100	31.4	100

IOI: Incidence of Indebtedness, SRLO: Share in rural loan outstanding
Source: Key indicators of debt and investment in India (2014) NSSO.

Table 4: Asset Holding-Wise Incidence of Rural Indebtedness

(Per cent)

Decile Class of Asset	Rural Indebtedness to		
Holding (hectare)	Institutional	Non-institutional	All
1	7.9	14.0	19.6
2	7.4	17.1	22.3
3	10.8	19.1	27.1
4	12.4	18.2	27.5
5	13.0	21.9	30.9
6	16.9	21.6	33.0
7	19.1	19.3	32.7
8	22.2	21.6	42.6
9	29.3	22.1	42.6
10	32.6	15.3	41.3
All	17.2	19.0	31.4

Source: Key indicators of debt and investment in India (2014), NSSO.

In 2012, 17.2 per cent of rural households were indebted to institutional agencies while such indebtedness to non-institutional sources was higher at 19 per cent (Table 3). Institutional agencies preferred to lend households with higher asset class (Table 4). Non-institutional lenders did not discriminate borrowers biased on asset class. This suggests that while non-institutional agencies were neutral between size of the asset, institutional agencies had a preference for the rich.

Inefficient Value Chain in Agriculture

Farmers typically offload their products in the market soon after harvest except some rich farmers who have means to store farm products and sell those at an opportune time. Small and marginal farmers require cash flow immediately after the harvest to meet their obligations, including repayment of farm loans. Moreover, warehousing facility is grossly inadequate in rural areas forcing even rich farmers to sell their produce after the harvest. The problem is compounded if prices of farm products crash after the harvest, particularly when there is a bumper crop. Central and state governments undertake procurement operations only in case of paddy/rice, wheat and sometimes sugar cane and pulses. Procurement operation is also limited to a few states like Punjab, Haryana, Andhra Pradesh, Odisha, West Bengal etc., which have large share in the production of paddy/wheat.

At the state level, the Agricultural Produce Market Committee (APMC) plays a critical role in the marketing of farm products. Typically, farm products are traded at a price, much below the cost of cultivation when there is a bumper harvest. There are five to six layers of intermediaries between farmers and final consumers. While urban consumers pay a much higher price for the same product, farmers often get less than one-third of the retail price. A large share of retail prices of farm products is cornered by middlemen. Competitive forces do not operate in case of agricultural value chain.

III. Resolution of Agrarian Distress

Is farm loan waiver an optimum solution to bail out farmers in a distressed situation? Apparently not. Farm loan waiver may provide temporary relief to farmers, but it is unlikely to resolve their problem on an enduring basis to the extent they continue to depend on non-institutional agencies to meet their financing requirement to the tune of as high as 44 per cent as referred to above. Borrowers from micro-finance and self-help groups often remained outside the loan waiver scheme due to difficulty in segregating farm loans from total micro loans. Farmers' suicide remained elevated in post-loan waiver period in the past as most vulnerable sections - marginal and small farmers and landless labourers - continued to remain indebted to non-institutional agencies to a great extent (Table 5).

Table 5: Trends in Farmer Suicides in India

Year	Total Suicides	Of which suicides by farmers and agricultural labourers	3 as % of 2
(1)	(2)	(3)	(4)
2010	1,34,599	15,963	11.86
2011	1,35,585	14,207	10.48
2012	1,35,445	13,755	10.16
2013	1,34,739	11,772	8.74
2014	1,31,666	12,360	9.39
2015	1,33,623	12 602	9.43
Source: National Crime Research Bureau, Government of India.			

Does farm loan waiver ensure equity among farming community? This is a debatable issue as rich farmers are eligible for higher farm loans than poor farmers as mentioned above. Marginal farmers and landless labourers, who are poorest of the poor, are mostly out of the reach of bank loans. Hence, loan waiver is likely to benefit rich farmers more than poor ones.

More damaging ramification of farm loan waiver is that it distorts credit culture. In anticipation of the loan waiver, farmers wilfully withhold repayments. While rich farmers have the wherewithal to continue farming activities in the next season without crop loans from banks, poor farmers cannot afford to do so within their means. Hence, it is observed that poor farmers either borrow from non-institutional sources or are generally more regular in farm loan repayments while rich farmers hang on to outstanding farm loans in case of an impending loan waiver. Going by either the quantum of farm loan or by repayment habit of farmers, indiscriminant loan waiver does not pass the test of equity unless rich farmers are excluded from the exercise.

Going forward, distortion in the credit culture may push farmers more towards informal agencies to meet their credit requirement, which is a more serious problem. There is a need to find out ways and means to bail out farmers on an enduring basis so that the issue of loan waiver would not recur in normal circumstances. What are the options available to avoid loan waiver in an era of fiscal discipline? These options are: a) extend procurement operations to all major crops for which MSP is announced; b) strengthen forward markets so that farmers can hedge price risks; c) widen the coverage of crop insurance, which would include not only crop failure but also market failure; d) integrate agricultural markets by linking rural supply to urban demand; and e) promote smart farming to increase productivity.

a. Procurement operation in major crops

Although government announces minimum support prices for 23 commodities before the crop season begins, infrastructure and/or logistics are not available to carry out procurement operations for all such crops. Moreover, public distribution system in India is not efficient (Gulati, 2015). As central government has a commitment to provide food security to the poor people, public distribution system is maintained by procuring only a few commodities like rice/paddy, wheat and of late pulses. Food subsidy continues to be large and threatens fiscal discipline year after year. Fiscal burden may turn out to be prohibitive and enduring if procurement operation is undertaken in all crops for which MSP is announced. Moreover, there is a vast agricultural market for crops that are not covered under the MSP. Farmers may face distress sale in those commodities as well.

b. Strengthen forward markets

Theoretically, forward and/or future trading of farm products provide a market-based solution to hedge market risks and price discovery. Currently, there are forward trading for a few agricultural commodities. Commodity futures are being introduced. Derivatives are cash settled and speculators and/or traders dominant the market. Farmers are conspicuous by their absence in the commodity derivative markets. Forward trading in India has not been very successful in hedging price risks of farm products for various reasons such as lack of deepening and widening of markets leading to speculation, lack of standardisation of products and poor warehousing facilities. As such, forward trading in all farm products may be difficult to introduce. Moreover, Indian farmers are not smart enough to take recourse to forward trading in commodities for the purpose of hedging. This apart, policy relating to forward trading and futures in respect of agricultural commodities is changed from time to time in response to domestic availability and price situation (Economic Survey, 2015). Needless to say, frequent policy charges cause instability in the market.

c. Composite crop insurance

One of the welcome initiatives of the central government in this direction has been to introduce crop insurance under *Pradhan Mantri Fasal Bima Yojana* (PMFBY) to reduce farmers' burden in case of crop failure. Framers bear only a small portion of the premium - 2% for *Kharif*, 1.5% for *Rabi* and 5% for commercial and horticulture crops. It is yet to be fully implemented throughout the country. Moreover, PMFBY does not cover market risks. It is, therefore, suggested that distress sale of farm products below MPS may be covered under a composite crop insurance scheme so that farmers need not seek loan waiver when there is a market failure.

The composite insurance may be extended to non-MSP crops at the earliest. Price stabilisation fund may not be required if this scheme is introduced.

The premium of the composite insurance may be distributed between farmers and the government in the same proportion as in case of the existing PMFBY. The extra burden of insurance premium for the government under the composite insurance scheme may be much less compared to the magnitude of loan waiver. If necessary, state governments may be roped in to bear a portion of the government share in the composite insurance premium.

d. Integration of agricultural markets

In case of milk production in India, roughly about two-third of the retail price paid by the urban consumers goes to producers. This has been possible through linking rural supply to the urban demand through milk co-operatives. If white revolution has been successful through integration of markets, can it be replicated for other farm products?

In order to integrate wholesale markets relating to major farm products, the central government gas set up a pan India electronic portal called e-NAM – electronic National Agriculture Market, which provides a single window for all APMC related information and services. . In April 2017, the Ministry of Agriculture rolled out a model legislation called new Agriculture Produce and Livestock Marketing Act, 2017. Now it is the turn of the state governments to amend state APMC Acts so that farmers can benefit from the new

APMC law. The idea is to allow farmers to sell their produce to ultimate consumers directly bypassing the middlemen. Incidentally, fruits and vegetables have been taken out of APMC control. Unless the value chain of agricultural products is completely revamped and remunerated prices are ensured to farmers through market mechanism and/or insurance coverage, demand for farm loan waiver, which is anyway not an optimal solution, shall be a recurring phenomenon in India.

e. Smart farming

The major problems in Indian agriculture are low productivity, climate risks and unwanted side effects of excess use of chemical fertilizers and pesticides. In some parts of the country, mono crop system has made agriculture a highly risky proposition. Inadequate share of mixed farming has also caused high volatility in agricultural sector (Dalwai, 2017). The diversification of agriculture will go a long way in smoothening and augmenting agricultural income (Chand, 2017).

Per capita water availability in India is one of the lowest in the world. Less than 40 per cent of India's farm land is double cropped due to lack of irrigation. The ultimate solution of the agrarian distress lies in improving farm productivity and reducing the weather/market risks. This requires large investment in agriculture by the government as farmers may not be in position to do so given their financial condition. Central government has an ambitious programme of interlinking rivers in India, which can strengthen water harvesting and improve farm productivity in a big way. Rural infrastructure may also undergo sea change by this project together with Prime Minister's Gram Sadak Yojana.

Smart farming shall contribute significantly to the improvement in farm productivity. Science and technology, particularly use of digital technology will play a bigger role in the efficient use of resources, linking of rural supply to urban demand, forecasting of weather, soil testing, crop planning and marketing of farm products (Dadhich, 2017). Post-harvest technology will be an integral part of smart farming. Excess labour in farm sector shall be engaged in non-farm activities in the rural areas.

Concluding Observations

Agrarian distress in India is deep rooted. The farm loan waiver may provide a short-term relief to Indian farmers. The adverse impacts of farm loan waivers are far-reaching. Competitive farm loan waiver by states distorts credit culture. Disruption in credit flow to agriculture encourages farmers to depend more on informal sources to meet their credit requirements. This may aggravate the agrarian distress going forward as farmers will be under debt trap due to high interest rate prevailing in the informal sector. Farm loan waiver does not pass the test of equity as it benefits rich farmers more than the poor ones besides fiscal burden on the exchequer, both at the centre and state levels.

There is a need to provide medium term solution to the problem so that a sub-optimal solution like loan waiver can be avoided. Among available solutions, government procurement operation covering all major crops is not feasible, while price-hedging mechanism through derivative instruments like forward/future trading in farm products is yet to be popular among farmers. There is a great potential to protect farmers from distress sale through a composite insurance scheme, which can cover risks arising out of both crop failure and market failure. Ultimate solution of the agrarian distress lies in improving farm productivity and revamping agricultural value chain by a series of measures like inter-linking of rivers, integration of rural supply with urban demand, and smart farming by using latest technology.

In short, it is important to address agrarian distress in totality (NABARD, 2015) rather than looking for a short-term solution like farm loan waiver. A holistic approach should be taken up for an enduring solution by involving all stakeholders - central govt., state governments, banks, co-operatives and farmers through concerted efforts, which can invigorate agriculture on a medium farm basis.

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Indian Agriculture Suffer from an Absence of Free Enterprise

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Indian agriculture suffers from an absence of free markets, both in terms of inputs and produce.

A market economy is characterised by voluntary exchange, where prices provide the information that buyers and sellers need to know if a trade is worth it. The exchange takes place only when both parties stand to gain from it. Thinking in terms of profit and loss is just a way of keeping score of whether the proceeds from the sale are higher or lower than the input costs.

Does such a market exist for Indian farmers? Let's take a look.

The prices of almost all the inputs that go into agriculture – labour, water, seeds, fertiliser,

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electricity, credit – are distorted through subsidies and other government controls. The only thing that varies is the level of distortion, which may be different for different states. It is believed that in the absence of such subsidies and controls, farmers won't be able to operate and thrive — as if they are thriving now.

What about the produce? Are farmers free to sell their product to whoever they want, at the best price they can negotiate? The procurement prices of major farm produce are never mutually agreed, but dictated to the farmers. The agriculture market almost has a single buyer, in the form of the government. This is what economists call a 'monopsony' — as opposed to a monopoly in which case there is a single seller. The price in such a market is not arrived at by bidding and haggling through 'an invisible hand', but through negotiations between politicians and farm union leaders. The negotiation power of the farm union leaders comes from whether the elections are near or far away. Such a price fixed by the government is called 'minimum support price.' It is believed that in the absence of such a support price, farmers won't be able to find buyers for their produce, or get a 'reasonable' price.

Farmers have an assured buyer in the government for their produce even though the price may not be mutually agreed. On the face of it, this looks like a good idea as it help protect farmers against the vagaries of nature. The unseen effect of this is that a majority of farmers produce food grain in excess of the demand, and less of vegetables, milk and poultry, which the consumers may well want more. This misallocation is not easily corrected as the price signal has been distorted.

When businesses fail, entrepreneurs have the option to shut it down or to sell it to someone else who can run the business better than she can. This helps protect them from incurring further losses. Farmers can't afford such a luxury, for they are not allowed to sell their land for non-agricultural purposes. This restriction to do with their property as they choose severely depresses its value, thus tying them to their farm.

Clearly, India does not have a marketplace in agriculture. For farmers neither get a fair price for their produce, nor are their input costs determined in the market. They don't even have the option of getting out without taking a definite big loss.

This was not always the case. How did we get here? Let's take a look at how and where the foundations for this crisis were laid.

Historical foundations of the crisis

At the time of India's independence, we were free to decide our own future — or so we thought. In the discovery process for the path that would lead

India towards rapid development, Indian leaders settled for a centralised planning model.

The four stated goals of central planning in India were a) abolition of poverty, b) liquidation of unemployment, c) reduction of income inequalities, and d) industrialisation.

It should be noted that among the four goals, the last one, industrialisation, is inconspicuous by its presence in the list of goals as, at best, a 'means' and not an 'end'. However, policymakers at the time thought that these objectives were best achieved by focusing on 'industrialisation'. To get this centralised planning model in place, India relied on centralised allocation of limited investible resources.

The majority of the resources of the country were directed towards achieving these objectives. Whenever and wherever necessary, private enterprises in banking, insurance, transport, mining, etc were nationalised towards achieving these objectives. Heavy industry was reserved exclusively for government investment.

Now this necessarily led to an almost total neglect of agriculture.

Highlighting the importance of agriculture in achieving these goals, especially in tackling poverty and unemployment, Professor BR Shenoy, the lone dissenting voice among the panel of eminent Indian economists that was to submit a memorandum on the second five-year plan, said[i]:

Expert studies have shown that, in India, an investment of Rs 1 crore of capital in agriculture adds to output Rs 57 to Rs 69 lakhs annually, in iron and steel Rs 19 lakhs and in textiles Rs 36 lakhs. The inference is that Indian economic development would take place several times faster than has been the case, if only we reversed order of priorities in our investment policies; i.e. gave high preference to agriculture in place of a wholly uneconomic accent on industry, at the expense of agriculture.

He went on:

Nor is it a matter of production alone, Agriculture would liquidate unemployment at a much faster pace than the same investment anywhere else in the economy. It has been estimated that an investment of Rs 1 crore in heavy industry – i.e. industries producing machines – would provide employment for 500 persons; for 1150 persons in large-scale industries producing consumer goods; and for 4000 persons if invested in agriculture.

That India suffered low per capita income and high unemployment through the planning period is no surprise.

As a recently independent underdeveloped country with a large uneducated population and huge arable land, Indians clearly had a comparative advantage in agriculture. It should have been the focus of Indian policymakers, but wasn't.

Economic historian Sudha Shenoy quotes Michael Lipton to help explain the paradox facing Indian agriculture in her research monograph studying Indian central planning[ii]:

...the share of total Plan resources devoted to agriculture has declined over all four plans, yet planners insist on its importance; they persist in setting high targets for it while providing insufficient inputs to attain them. The explanation of the paradox lies in the urban bias of Indian planning and of the Indian socio-economic system. The urban elite of industrial employers and unionised employees, together with their rural allies, the urban-oriented big farmers, exert a major influence on planners and policy makers, and policy is largely conducted in the interests of the 'grand alliance'. The vast mass of unorganiseable and illiterate small farmers are unable to be heard.

But haven't we dissolved the Planning Commission and abandoned the practice of five-year plans already? Yes, we have.

We may have dissolved the Planning Commission and abandoned five-year plans, but we have not abandoned central planning, at least not for agriculture, as evidenced by numerous controls facing it.

In an **earlier essay in Brainstorm**, my fellow participant Nitin Pai called for the setting up of National Agricultural Goals (NAGs) with associated timelines in the next national agricultural policy. I humbly disagree with Nitin.

Just as Indian IT or banking or finance or manufacturing doesn't have any national goals, Indian agriculture doesn't need one either. Just as participants in all other sectors can (and do) coordinate through the market mechanisms of prices and profit and loss, so could every farmer – if only we let them be.

There is no reason why agriculture should be treated differently. There is nothing about agriculture that necessitates so many interventions, except possibly that it involves a large number of adult Indians who are eligible to vote.

References

[i] Page 192, "Planned Progress or Planned Chaos: Selected Prophetic Writings of Prof. B. R. Shenoy", Editors Prof. Mahesh P. Bhatt and Prof. S. B. Mehta, 1996

[ii] Page 58, "India: Progress or Poverty? A Review of the Outcome of Central Planning in India 1951-69", Sudha R. Shenoy, Institute of Economic Affairs, 1971

The views expressed in this booklet are not necessarily those of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

- Eugene Black
Former President,
World Bank

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