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Do farmers gain from high prices?

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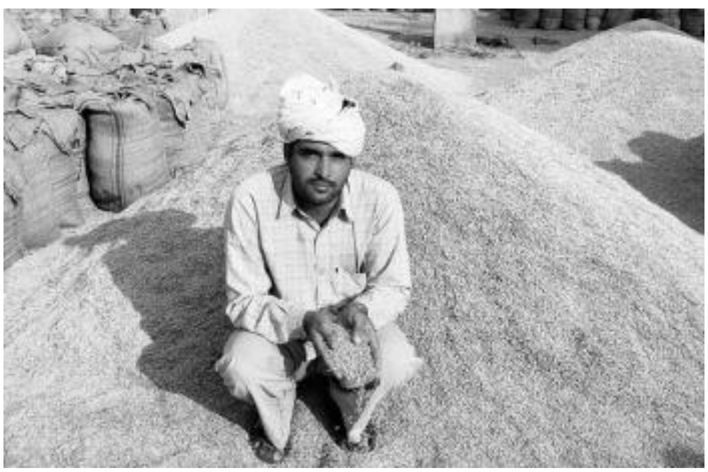
How can the farmer share the gains from higher prices when they rise beyond his markets or much after his harvest time? The solution lies in the futures markets and co-operatives rather than in assured prices, says SHASHANKA BHIDE.



Rarely do higher retail prices for produce translate into more money for the farmer.

The persistence of a high rate of increase in food prices in the last two years has been a distressing aspect of the economy. Although the price rise has happened across several commodities, the rise in food-grain prices has affected consumers the most. The wholesale price index of wheat rose by 20 per cent in December 2009 and the rate of increase dropped to less than 10 per cent only in April 2010. The annual increase for rice was in double digits throughout 2009 and declined to under 10 per cent in March and April this year.

The rise is most prominent in pulses, the price index for which has increased by at least 30 per cent on an annual basis since November 2009. Clearly, the Public Distribution System (PDS) has been critical in supporting consumers holding below the poverty line (BPL) cards by supplying grains at near constant prices. It has been a period of high food-grain stocks and also rising prices. Non-BPL consumers have paid high prices for the grains through these couple of years but have the farmers gained?

It is generally accepted that, for an average agricultural producer, high retail prices for produce often do not translate into more money — unless, of course, the high prices prevail at the time of harvest. As the stocks held by the average farmer are rather insignificant, the rise in prices much after the harvest does not flow back to him. This is not a new problem. The most common remedy to this anomaly in the last six decades has been co-operative marketing.

Futures market

The more sophisticated approaches, such as a futures market which may even out the price variations, have not yet found widespread favour. These markets are perceived to introduce more uncertainty than reduce risk. A lot more experience with these markets seems necessary before they become the main instruments that even out the price variations within a crop year.

In practice, the alternative solution has been awkward: to raise the minimum support prices in the next season which may only benefit those farmers who sell to the agencies buying at these prices. The minimum support prices do eliminate downward risk on prices for the farmers. If the rise in price is because of supply shortages that are not just temporary, the next season will bring higher prices for the farmer, irrespective of the minimum support prices.

If the shocks are a temporary phenomenon, the higher support prices would put more money in some farmers' hands, and place more stocks with the government, and therefore warrant more subsidies. The judgment in fixing MSPs would have to be based on long-term considerations rather than merely what happened the previous year. It cannot bring to the farmers benefits of any price increase that occurs immediately after the harvest season.

Although poor rainfall last year has been a significant behind in the sharp rise in prices, the high food prices of the last two years should not have been a surprise. The minimum support prices of rice and wheat had, in fact, increased by an average of about 16 per cent per year between 2006-07 and 2009-10.

Sharing the gains

In pulses the increases was lower. The farmers did benefit from these higher prices to some extent. But if the price rise in the retail markets was even greater, as has been the case now, the farmers may not have benefited from these higher prices.

Farmers may not have benefited from the higher prices of the other crops such as pulses and sugar either, unless the co-operatives paid them back the benefits of higher prices, especially in sugar. They may have benefited from the higher prices of milk and poultry, either because the output is continuous through the year, rather than all at one time, or due to some effective co-operatives reaching benefits to the members.

The battle between the farmers and the government over minimum support prices and bonuses can be expected to continue. Although the strategies are unclear, it now appears that the food-grain prices have caught up with international prices. The markets, which have been so far been assigned a secondary role, may yet become important, especially with respect to international markets. The international trade is likely to be more active than before as there will be no reason to be excessively protective or repressive. The aggressively higher minimum support prices for select crops also push the other ‘less incentivised' substitute crops to more marginal lands.

Production in such conditions is more vulnerable to supply-side shocks, such as a weak monsoon. And it would still leave the old question alive: Who would let the farmer share the gains when the prices rise either beyond his markets or much after his harvest time? The solution lies in the futures markets and co-operatives rather than in assured prices.

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