Facilitating Efficient Agricultural Markets in India

An Assessment of Competition and Regulatory Reform Requirements

Summary and Recommendations for Discussion and Consideration

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Introduction

This project follows from previous research that was funded in part by the Australian Centre for International Agricultural Research (ACIAR) and which found that India’s ‘border’ reforms need to be complemented by ‘behind-the-border’ domestic reforms in the agricultural sector.

The project was undertaken by collaborators from India, Australia and the UK, with funding support from ACIAR.

Guidance was provided by a High Level Steering Committee, consisting of senior Indian policy makers and eminent public policy academics.

The work involved a review of agricultural policy developments in the emerging economies of Brazil, Russia, India and China (BRICs), followed by detailed analyses of supply chain regulations impacting on the productivity and income earning capacity of India’s farm sector.

Given the significant impacts of the Food Corporation of India’s (FCI) activities on farm level price signals, detailed analysis was also undertaken to support policy reforms that reduce the impacts of the FCI’s operations on competition, while at the same time meeting government food security, poverty alleviation and farm income objectives.

Food supply-chain case studies were also undertaken for wheat, rice and horticultural crops to assess the relative significance of regulations impacting on competition from final markets through to the farm level to help provide strategic focus for government reform efforts.

Agricultural Policy Reforms – Strategic Directions for India

The comparative study of the agricultural experience in the BRICs countries provides significant evidence that a range of market orientated agricultural policy reforms can lead to higher rural incomes, increased agricultural productivity and reduced poverty. Market orientated reforms, however, necessarily involve progressively decoupling agricultural assistance from farm input and output prices and the associated quantities. Significant efforts are required by government, however, to tailor such changes to the specific circumstances of each country.

A clear message from policy developments in both developed and emerging economies is that policy reform and the ‘openness’ of economies hold the key to productivity gains, rather than having governments attempting to ‘drive’ growth through subsidised agricultural input and output prices.

A related concern is the continuing focus of some governments on establishing ‘growth targets’ as the centrepiece of rural policy. This experience highlights the need for governments to also be ensuring that food security and rural income goals are achieved in
the most efficient manner so that national resources and limited government funds can be efficiently utilised. Pursuing output and growth targets, without regard to the economic, social and environmental costs of achieving them, has been demonstrated to be a waste of national resources and ultimately incompatible with the goal of achieving food security and increasing rural incomes in a sustainable manner. Government policies must be redirected toward increasing market efficiency and correcting market failures, such as poverty alleviation.

In the case of India, given the current status of agriculture and the rural sector, the challenge is therefore to make this transition without placing in jeopardy the food and income surety of vulnerable groups including marginal and small farmers. This calls for a well thought out strategy for gradually, but not unduly slowly, transforming Indian agriculture and establishing a policy environment that can provide rural producers with the flexibility to face the challenges of a fast growing modern economy.

More generally, the focus of government needs to shift from effectively acting as a market operative, through efforts aimed at directly influencing farm prices, to one of facilitating the development of more efficient markets, with appropriately targeted safety nets and adjustment assistance.

Various studies find that:

- food security can be addressed more efficiently through direct income support programs directed at the poor, than through large scale government food stockpiling and distribution which goes beyond the maintenance of stocks needed for emergency food security needs. However, where such arrangements are maintained, the potential benefits of commercialisation should be evaluated;

- that farm income support delivered directly through farm input and output prices leads to unintended and inefficient resource use distortions, and by delivering most benefits to better off farmers and processors, it is not only regressive but also ineffective in targeting support to those most in need; and

- once programs are in place that effectively target the poor and disadvantaged, governments need to consider whether their price stabilisation and risk management objectives can be more efficiently addressed at the farm and industry level through strategies such as production diversification, off-farm income and private marketing options such as forward contracts.

A truism is that market based policy reforms are inevitable in response to changing supply and demand conditions and the need for economies to maintain global competitiveness. Nevertheless, they are often politically sensitive and need to occur in an orderly manner that engages with key stakeholders and the broader community.
Hence there is a strong case, particularly for emerging economies, to introduce public institutions and associated regulatory review processes that enable transparent and ongoing scrutiny of agricultural policy settings, with review processes complemented by:

- the regular monitoring by government of farm incomes and sectoral productivity to assess the impacts of reform; and

- an ongoing program of independent public policy research aimed at enhancing the welfare and productivity dividends of the government’s regulatory portfolio.

A major concern for India is that traditional forms of agricultural policy, such as the FCI, its food grain procurement arrangements, APMC markets, minimum support prices and input subsidies, have created an incentive system throughout India’s food supply chains which maintains certain ‘historical’ production patterns, and in so doing, limits agricultural sector adjustment which would otherwise enhance sectoral incomes, productivity and food security.

The unintended impacts of these arrangements, such as their contribution to food price inflation and decelerating total factor productivity, are also now becoming more evident. They may also be acting as a disincentive to farmer participation in new programs and to private sector and foreign investment in areas such as infrastructure provision.

Importantly, they also incur significant budgetary costs that impede the capacity of government to otherwise assist farm families and communities through the introduction of new government adjustment programs.

In this context, the productivity of India’s agricultural sector needs to be re-considered with a focus on total factor productivity, as defined by the relationship between inputs and outputs, rather than on ‘partial’ productivity measures, such as crop yields.

The current emphasis of government assistance on subsidising prices, needs to shift to focus on those forms of market failure typically associated with farming systems, such as information failure with respect to the development and adoption of new technology, credit markets and the introduction of industry and government partnership arrangements aimed at facilitating more efficient levels of investment in environmental management, food safety, biosecurity and infrastructure provision.

Given the focus of the recently constituted Competition Commission of India on ensuring fair and healthy competition in the economy to achieve efficient resource use and faster and inclusive growth and development, it follows that it has an important role in considering the application of trade practices law to agriculture as part of India’s new ‘agricultural policy program’. This will help ensure that the gains from reform are efficiently and equitably distributed among supply chain participants consistent with national goals. Important areas of focus will be (i) ‘unconscionable conduct’ and ‘market power abuse’, rather than on differences per se in market power between buyers and sellers, and (ii) farm level arrangements that provide for collective bargaining.
Recommendations

Recommendation 1. That the Indian Government, with the Competition Commission of India, move to adopt a ‘market failure’ based policy framework to guide agricultural policy reform.

Recommendation 2. Key components of that framework include:

- a transparent legislation/regulation review process, whereby agricultural regulation that significantly influences competition and food chain prices is subject to an independent, rolling, 5 year review process;
- as part of a broader agricultural policy reform program, government objectives need to increasingly focus on facilitating efficient input and output markets with necessary targeted assistance and safeguards for vulnerable groups;
- regular monitoring and surveying of the farm sector to enable a sound understanding of developments in farm incomes and productivity in response to the government’s policy reform agenda, to be shared with key stakeholders; and
- the strategic application of competition law.

Recommendation 3. Analysis of alternative mechanisms for meeting the current government objectives pursued through FCI operations indicates that current problems with wasteful levels of stocks and denial of food to needy consumers can be minimised by:

- addressing the FCI’s food security objective through the introduction of targeted programs which effectively meet those food security objectives in relation to the rural and urban poor, such as a food stamp program;
- addressing the FCI’s farm income objective through alternative arrangements, such as a guaranteed price deficiency payment scheme;
- requiring the FCI to focus on the management of the buffer stock.

Recommendation 4. Given that much information already exists in relation to the adverse effects of agricultural policy involving the provision of government assistance through input and output prices, early reform priority be placed on:

- improving the ability of rural labour and farm families to adopt more efficient farm practices and to move into other sectors of the economy; and
- implementing an orderly transition program from currently provided input subsidies to new farm programs which focus on more appropriate measures of productivity and the market failure issues typically associated with agricultural production systems.