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Agricultural pricing and public procurement policies in South Asia

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Female agricultural workers cultivate a potato field in Chitwan, Nepal. Poor smallholders in Nepal need better access to markets and increased market efficiency.
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Many countries in South Asia have achieved remarkable rates of growth, the result of decades of effective economic policies. In the agricultural sector, however, growth rates in many South Asian countries are either declining or stagnating. This briefing explores the impact of pricing and public procurement policies on the huge number of people who are dependent on agriculture for their livelihoods.

Key messages

- Three decades of subsidizing the farmers of South Asia through the policies of public procurement and public food distribution has helped to improve their welfare, but only marginally. Trade liberalization, which many would expect to put everything right, has not eliminated the need for intervention.
- The aim of stabilizing the price of goods has been met with success, substantially insulating both farmers and consumers from the worst of the price fluctuations in the world market, but the price slumps induced domestically during harvest times have not been dealt with equally well.
- Little evidence exists to prove the link between South Asia's impressive output growth in the past three decades and any agricultural price and procurement policies. Technological improvements during these decades have certainly influenced this positive trend, but the role of price risk reduction remains unclear and the costs of government intervention in agriculture are high and have increased over time. In spite of this, current public procurement and food distribution policies are likely to continue in some countries due to the high political priority they receive.
- While there is a case for continued government intervention, there is also a strong need for reform of the private sector. Thus, there is a case for forging a middle path that combines the strengths of both the public and the private sector.

This briefing paper is one of the 10-part Global Development Network (GDN) Agriculture Policy Series for its project, 'Supporting Policy Research to Inform Agricultural Policy in Sub-Saharan Africa and South Asia'. It is based on a longer synthesis paper, ***Agricultural pricing and procurement policies in South Asia***, which draws on extensive published and unpublished research. The full paper can be downloaded at: **www.agripolicyoutreach.org**

It will be of value to policymakers, experts and civil society working to improve agriculture in South Asia.

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Laborers work at a rice mill in Asuganj in Bangladesh's Brahmanbaria district. The Bangladeshi government has successfully reformed its food policies by liberalizing trade and supporting farmers through irrigation and fertilizer provision.
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Following the global food crisis of 2008, agriculture received renewed attention the world over, reigniting debate over the need for continuing government intervention in South Asian agricultural markets. At one end there are arguments that, since the economic conditions which led to government intervention no longer exist, governments should withdraw from the food grain market. At the other extreme, it is being argued that the unfinished reform process in South Asia and the current price volatility in the international markets support a case for continued government intervention. This briefing paper, based on a review of the existing literature and stakeholder interviews, attempts to bring out the various contours of the debate and also proposes possible ways forward.

It analyzes three strands of debate:

- Is there a continuing need for government intervention?
- Are government policies putting a strain on public resources without a real role to play?
- Should existing agricultural systems be reformed?

The review examines four main aspects in relation to price and procurement policies in five countries: Bangladesh, India, Pakistan, Nepal and Sri Lanka:

1
Historical experiences relating to agricultural price and procurement policies.

2
Whether there has been a reversal of the economic conditions that justified government intervention.

3
Critical evaluation of the extent to which government intervention in the agricultural sector has achieved its stated objectives.

4
Documenting case studies that highlight the debate as to whether government intervention should be continued.

Market failure

Most of the literature claims that government intervention in the agricultural market was due to different forms of market failure.

Four commonly agreed justifications for government intervention in food grain markets are:

1
Weak infrastructure and limited flow of price information.

2
Risk mitigation for the diffusion of technology.

3
Thinness and volatility of the international market.

4
The inability to participate in the international market.

Infrastructural, technological and institutional developments in South Asian countries have helped to relieve these market failures over the past three decades. But a total withdrawal of government intervention in agriculture cannot be justified as the conditions have not changed sufficiently and policies have not met all their main objectives.

Further, newer forms of global market failure, such as climate change and increased price volatility in international markets, may also call for newer interventions. For governments to respond to the rapidly changing global and local economic conditions, policies will have to change too. The policies of the 1970s demonstrated the power that government intervention has in helping agricultural markets grow at an impressive rate, although some differences of opinion in the literature still exist. Nevertheless, there is now renewed clamor for a second round of reforms, particularly in the wake of trade liberalization. Whether this implies continued government intervention with changes, complete government withdrawal or a public-private partnership, the most important objectives of agricultural policy are farmers' welfare, agricultural price stability and general food security.

Price and procurement policy has been a major instrument used by the governments of South Asia to develop their agricultural sectors, which were affected by weak market infrastructure, the volatility of domestic and international markets and poor adoption of new technology – partly due to inadequate risk mitigation. The stated objectives vary, but these policies were primarily aimed at ensuring a 'reasonably high' and stable price for farmers, thereby boosting production and farmer income. But despite being in practice for the last few decades, there is not much consensus over the effectiveness of this policy approach.

There is also concern about the trade-offs that agricultural subsidies engender by 'crowding-out' resources from other productive uses, such as investment in education, infrastructure or health.

In addition, public food distribution schemes in South Asia have failed to channel enough food to meet the demands of the food subsidy recipients. Yet such schemes continue to exist despite heavy fiscal costs, because food security is such a politically sensitive issue. Poor targeting and leakages appear to be the major drawbacks of the schemes, while general inefficiency and limited resource availability also thwart their smooth execution. This is further compounded by the problem of poor and unplanned buffer stock operations, in which commodities are stored in a bid to stabilize prices.

Background to the research

This briefing paper is based on a longer analysis of published and unpublished literature and websites on the subject, supplemented by interviews with a broad range of stakeholders.

The study reviewed existing literature and interviewed stakeholders relevant to the five focus countries. The bulk of the public funds allocated for public interventions in these countries have been spent on rice and wheat. Consequently, the focus of the present study has been confined to these two commodities. Furthermore, the impact of price and procurement policies is often evaluated alongside border protection and public food distribution policies. As such, it is impossible to assess these components individually. In this briefing paper, 'price policy' refers to all policies that create a price gap for a particular product in a particular country. This might include tariffs at borders and price subsidies in domestic markets. Interventions such as direct payments (which do not affect price) are also included in this study of agricultural market distortions.

Two main ideologies have prevailed in all South Asian economies. Following political independence, most South Asian countries adopted an inward-oriented strategy of import substitution. Governments protected industries through import restrictions, export taxes and overvalued exchange rates. Governments, however, discriminated against agriculture.

After a period of under-achieving polices, and with continuing pressure from international donor agencies and the World Trade Organization, South Asian countries adopted international trade reforms to varying degrees. In the 1990s, the agricultural sector was liberalized. A reduction in net tax reduced the fiscal burden on the producer and consumer and agricultural trade increased. Governments do support the agriculture sector, but overall the contribution of domestic policies to supporting agriculture is minimal. Domestic policies have also been scaled down over the years in all the countries studied.

Policymakers, and researchers' interests have moved towards trade liberalization policies. In the past, both domestic and border measures together had discriminated against the agriculture sector but this has now changed, particularly after 2000. Pricing and procurement policies are closely intertwined with public food distribution policies in all countries and this package appears to be providing positive, or at least non-negative, support to farmers. In some cases, the procurement levels of the price and procurement policies depend more on changes in public food distribution policies than the procurement price itself.

Crop diversification could help South Asian countries in several ways, including export expansion under liberalization. Yet price procurement policies have had a negative impact on crop diversification.

Successful price stabilization

The objective of price stabilization has been met with substantial success. As a result, neither farmers nor consumers have felt the full impact of price fluctuations in the world food grain market. Nevertheless, the domestic price slumps during harvest times cannot always be adequately remedied due to inadequacies and inefficiencies in the procurement systems. Consequently, the role played by price and procurement policy in promoting technological improvements through the reduction of price risk is not clear.

The most pronounced objective of these policies is to subsidize the farmers. Governments provide substantial subsidies, albeit with negligible per capita subsidy levels (with the exception of India and Sri Lanka). This objective has been met, but not to an appreciable degree as of 2012. The next most important objective of policy intervention is to stabilize prices and this has been met with moderate success. For example, prices have been set at farm and consumer levels to protect people from violent fluctuations. However, evidence indicates that while administered prices at the consumers' end can effectively impact prices, placing restrictions on quantity is more effective at the producers' end.

There is little evidence to prove the link between impressive output growth in the past three decades and government pricing and procurement policies. Technological improvements during these decades have certainly influenced this positive trend, but the role of price risk reduction remains unclear. However, domestic prices held artificially high by price procurement policies can safely be assumed to have made the adoption of expensive modern inputs possible.

Reducing costs through information technology: e-Choupal

Farmers in many parts of India face weak infrastructural links, poor transport and numerous intermediaries charging commission for their goods. e-Choupal is the brainchild of the Indian Tobacco Company (ITC), an Indian agribusiness conglomerate. It covers 1,300 choupals (village gathering places) and links almost 700 villages. A series of internet/information points give farmers access to online market prices and information about the weather or soil quality. This also enables farmers to negotiate directly with the end buyer (ITC in this case). A literate farmer is elected from the village to act as the interface between illiterate farmers and the internet/computer. ITC redefined the roles of the former intermediaries, who now help to set up new e-choupals and conduct village surveys. Farmers are now able to align their agricultural output with market demand, and they can also choose to sell their produce to the highest bidder.

This model eliminates the huge leakages that are associated with government pricing and procurement in India. It provides farmers with a viable alternative to either travelling huge distances to government procurement centers or to making distress sales.

The e-Choupal initiative is now recognized as one of the widest internet-based initiatives in India. Almost 1 million farmers participate. The value of agricultural commodities procured from these e-choupals is US$140 million.

Farmers harvest rice in Weweldigiliya, Sri Lanka. They receive seasonal loans for the purchase of seeds, fertilizers and pesticides. Three decades of subsidizing farmers in South Asia has helped to improve their welfare, but only marginally.
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Debating government intervention

It is clear that the initial conditions for government intervention have not been completely altered. Nor have the interventions achieved their major objectives of improving farmer welfare, and achieving agricultural price stability and general food security to the desired extent. Therefore, the debate about the necessity of government intervention is still an open one, contrary to the arguments of the neo-liberal school of economics.

Bangladesh: deregulation and productivity growth

Bangladesh is perhaps the only South Asian economy to have completely dismantled its food procurement and distribution system and still achieve remarkable success in reducing poverty and increasing agricultural productivity. Since 1994, the government proactively reformed its food policy. It privatized food grain distribution, lifted restrictions on international trade, and reduced its presence in food grain markets. This took place through substantial investment in agricultural research, and institutional developments in irrigation and fertilizer markets.

As a result, the cost of government subsidies reduced from taka 3,916 million (US$120 million) in 1989 to taka 1,680 million (US$42 million) in 1994. More resources are now available for investment in new social welfare programs targeted towards poor people. Reduced intervention by the Bangladeshi government has led to efficiency gains and market development. Competition in domestic markets has increased and this has benefited customers. Prices and production are more stable and there is more focus on enhancing social welfare. As a result of increased private sector participation in international trade, government costs have been reduced by US$190 million per year.

A major determinant of procurement volumes under price and procurement programs is the procurement price. Prices are intended to benefit the farmers as they are generally higher than the farm price in a market isolated from the rest of the world. But they are lower than world prices, and consequently the price policy appears to be a tax on farmers for the benefit of consumers in trading economies. Thus, the studies conducted using free trade as a benchmark reveal that overall food policy has subsidized the farmers only marginally and this had been overshadowed by the impact of the protective border policies in the past, making the net effect on farmers an implicit tax. However, following relatively free border policies adopted after trade liberalization in the 2000s, the situation has become less restrictive. Presently, farmer subsidy is non-negative, though not very effective.

Increased domestic price stability should have contributed to the income stability of farmers. The domestic prices of food grains kept artificially high by such policies could have made it possible for farmers to adopt expensive modern inputs. However the contribution of price risk reduction through price procurement policies to technological improvements is not clear. There has also been a negative impact of crop diversification, diversification which could help South Asian agriculture.

Youths working as day laborers in Sindhuwa, Dhankuta district in Nepal, carry vegetables to a local market on behalf of a rich landlord. New markets have emerged in Asia for high-value commodities such as fruits and vegetables but poor infrastructure makes it hard for smallholder farmers to access markets.
MICHAEL OSTERGAARD | PANOS PICTURES

In view of the fact that price procurement policy and national food distribution programs are generally inefficient but receive high political priority in South Asian countries, the only logical way forward is to modify them to suit the rapidly changing global and local economic conditions, particularly following trade liberalization.

The case studies presented bear evidence to the fact that reforms of this nature are possible, but that specific strategies need to be context-specific.

Chhattisgarh, India: people empowerment and improved governance

From the 1960s, the Indian government ran the Public Distribution Scheme (PDS), which was criticized for widespread corruption. In Chhattisgarh state nearly 50 per cent of the subsidized rice did not reach poor people. One reason for this was that private businessmen owned the PDS shops and had little incentive to keep them open for long hours. The businessmen were not accountable to the villagers and there was no way to control them.

In 2003, the newly elected state government decided to tackle the problem. Local community groups such as co-operatives, gram panchayats and women's self-help groups took over the running of the PDS shops.

Previously, PDS shop owners cheated and sold the grain and rice to millers who sold it back to the government at market rates. This was stopped.

Bogus identity cards that allowed people to claim the grain were in circulation, so fresh cards were issued and the security net was widened so that more families were allowed to claim.

The Civil Supplies Corporation took charge of transporting the subsidized grains and was held accountable. A web-based application allowed real-time tracking of the amount procured, disbursed and transported. People received rations in the presence of government and vigilance officials and locally elected representatives.

Chhattisgarh is considered a model for successful intervention.

- **Regionalize procurement prices**

  Instead of uniform prices, regional differences in production costs and quality should be taken into account in setting procurement prices.

- **Minimize risk to farmers**

  Procurement mechanisms should entail minimum risk to the farmers. This should be ensured by providing a network of procurement points adequately covering all production areas and by improving general efficiency of the procurement system.

- **Avoid excessive buffer stocks**

  Buffer stock maintenance should be modified to eliminate conflicts between the twin objectives of stabilizing farm prices and ensuring consumers' easy access to food. The policy goal should be to acquire food grains when there is a surplus and release it when there is a shortage. Maintaining a minimum buffer stock at all times is unnecessary and imports and/or exports of food grain should be harmonized with domestic procurement to avoid excess stock build up. Further, the disbursement of procured grains should be in small quantities, to avoid price slumps in the retail market. The management of procurement, stocking and distribution of food grains should be done by a central body with adequate information about private traders' behavior, even though procurement and disbursement operations are decentralized.

- **Widen availability of subsidized food**

  Subsidized food grain should be available through a system of ration coupons granted to the targeted households. Recipients should be able to use coupons to buy food from any store, thereby eliminating any 'intermediary' ration shop owners.

- **Research individual policies**

  Finally, to fill the information requirement of a scheme of this nature, more research should be undertaken at individual policy level to complement the available studies conducted at a highly aggregate level.

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The full paper *Agricultural pricing and procurement policies in South Asia* is available for download at **www.agripolicyoutreach.org**

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