

Should the Government be in the Business of Fixing Agricultural Prices? If Yes, then How?

By

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- Mr. Secretary , VC PIDE, Distinguished Colleagues
AOA
- Having spent most part of professional life, 24 years in the APCOM; witness to various stages of its life cycle - from infancy to maturity as a first rate policy analysis outfit and then giving way passing into stage of atrophy, my answer to the today's question is obvious.

- But let me hasten to add that my answer is neither for nostalgia nor for any dogmatic reasons but based on cogent economic reasons, supported by empirical analysis and ground realities of the situation.
- Let us start first with common sense and then with economics

Commonsense

- It is also a qualified and conditional support of the proposition.
- Agri. Produces a vast number of commodities and no govt. no matter how powerful and strong can fix the prices of all these products.
- Be selective and confine it to some of the most important commodities
- The second and more important condition is that govt. should be in the business of setting prices only and only if it has the will and institutional wherewithal to effectively intervene if need for such an intervention arises. There is no point in setting prices if the same are not to be assured.
- Another important dimension of the issue is conceptual clarity about the policy objectives and instruments being employed in this context.

Economics: Rationale for Fixing (Setting) Prices

- Prices of farm Commodities are characterized by wide fluctuations [inter as well intra year], both in domestic and world markets.
- Domestic market prices of farm products low at harvest time but rising later on especially in off season.
- Recall the prices of wheat, rice, and of sugarcane in the recent past

Why Fluctuations? And Consequences

- *Low income/price elasticity of demand for most of the primary commodities. Thus, marginal rise in production leads to disproportionate fall in prices and vice- a – versa.*
- Inelastic nature of supply and demand compounded by many institutional and other fixities/ rigidities cause severe fluctuations in prices, more so in developing parts of the world.

Why Fluctuations? And Consequences

- Biological and seasonal nature of production; agri. Production cannot be adjusted rapidly as may be the case in industry . Time lag in adjusting production capacity makes matching supply with demand more difficult.
- Vagaries of weather also play their role via yield effects on fluctuations in production and prices.
- seasonal nature- output becomes available at particular time(s) in a year and at that time market is glutted.

Why Fluctuations? And Consequences

- This uneven distribution of supplies while consumption spreading through the year, inter alia, adds to fluctuations.
- Prices normally low at harvest time and peaking in off season. However following factors accentuate this situation to the disadvantage of small and marginal farmers.
- Small farmers (> 12.5 acres) account for 50-55 % of the crop area of important crops: wheat, rice, sugarcane, cotton and maize.

Why Fluctuations? And Consequences

- Inadequate storage facilities at farm/ household level and insufficient financial capacity to hold on to their produce in the hope of better prices later on.
- As majority of farmers tend to off load their marketable surplus immediately after its harvest, market glutted with surplus putting further downward pressure on prices.
- Seasonal market glut puts tremendous pressure on the market infrastructure and pricing mechanism; resulting in its break down and market failure especially in years of good harvest.

Why Fluctuations? And Consequences

- Creditors both , formal and informal, launch their recovery campaigns in the harvest season, putting further pressure on the farmers for selling the produce at harvest low prices.
- Good crop years often accompanied by low prices, bringing low returns to farmers; followed by reduced production and tight supplies in the next crop year. Result obvious -- a Cob Web cycle phenomena well known to students of economics.
- The current sugar crisis, has had its roots in the record crop of 2006-07 and farmers suffering at the hands of mill management bear ample testimony to this.
- Sugarcane situation may repeat itself next harvest.

Key to Development of Agriculture: Technology

- Technology holds the key to the development of agriculture and the efforts aimed at improving its productivity.
- However, relationship between output and input prices (terms of trade) extremely important for the adoption and use level of technology.
- Economic text books mention agriculture to provide a perfect model of Perfect competition.
- But only in production of commodities.

Farms, Farm Area and Farm Households by Province

| | Farms Million | Total farm area Million acres | Associated Households Million |
|---|------------------|----------------------------------|-------------------------------------|
| Pakistan | 6.62 | 50.43 | 6.66 |
| NWFP | 1.356 | 5.59 | 1.37 |
| Punjab | 3.864 | 27.76 | 3.88 |
| Sindh | 1.0699 | 10.69 | 1.07 |
| Balochistan | 0.3299 | 6.39 | 0.33 |
| Source : Table 1.7 Pakistan Agricultural Census 2000 | | | |

Imperfect Competition in Marketing

- But do the conditions of perfect competition also apply to the suppliers of inputs, marketing and processors of farm commodities? Unfortunately here answer is no?
- Farmers' bargaining position against manufacturers and suppliers of farm inputs (fertilizers, pesticides, hybrid seed) and machinery (tractors, threshers, etc) weak.
- Look at the price jumps in fertilizers and farm machinery and their exorbitant profits in the last few years.
- Farmers especially vulnerable to price manipulations by the processors of farm commodities in general and in good harvest years in particular.

Imperfect Competition in Marketing

- The processors and buyers of wheat, paddy, seed cotton, sugarcane, maize have their cartels/ association : Flour Mills Association, Rice Millers and Exporters, APTMA, PSMA . All powerful lobbies, enjoying economic and political clout in the corridors of power.
- Farmers are unorganized, weak and really voiceless when and pitted against powerful and articulate groups.
- This is in spite of many Honorable Members of Parliament with rural background.

Rationale for Price Intervention

- Widely fluctuating prices result in an inefficient use of resources, in production as well processing.
- If producers induced to over expand when prices are high and then forced to liquidate assets when prices fall to unprofitable level.
- In such situation govt intervention by leading stable pricing can make a positive contribution to the efficiency in resources use.

Rationale for Price Intervention

- To protect farmers against low harvest prices, regulate consumer supplies and provide a conducive environment for farm investments, it is imperative to have a system/ mechanism which ensures adequate prices and competitive returns to farmers for their efforts, and investments in an otherwise uncertain and hostile environment.

How Should the Prices be Established?

Potential Determinants

- A host of factors as potential candidates.
- Objectives and goals, set by the govt, for pricing policy, if any, will determine the likely factors and determinants/ candidates for setting the prices farm products:
- Most likely considerations in the selection of various economic factors in the determination of farm prices are:
 - Cost of production,
 - International prices,
 - General price level / rate of inflation in the economy,

How Should the Prices be Established?

Potential Determinants

- Terms of trade consideration
- Macroeconomic factors: price stability, exchange rate, inflation etc
- Production / development targets
- Market prices , demand supply situation- domestic and international
- Consultative mechanism – inputs from various stake holders.

Decision Making and Implementation

- Forum for decision making- Finance should not have a veto.
- All govt. policies entail costs in their implementation and pricing policy cannot be any exception.
- Timeliness in decision making
- Credibility of govt policy rests on steps for its effective implementation

Cost of Production

- Cost of Production (COP) – Easier said but its empirical estimation fraught with a host of conceptual issues and practical problems and data difficulties: which, inter alia, include :
 - ✓ Whose COP?
 - ✓ COP of progressive or traditional farmers
 - ✓ Marginal cost vs average cost?
- How to determine COP? Based on parameters from research stations or on survey data

Cost of Production (cont'd)

- What factors to include- with or without land rent, and many other imponderables.
- Need for realistic and representative estimates of cost of production - a challenging and difficult but not impossible task.

International prices

- Issues in analysis of the subject, inter alia, include What is an international price?
- Quoted price vs actual prices;
- Prices for Imports/ Exports?
- Spot price, futures prices or long term trend? ;
- Questions about the comparability of the imported and domestic produce in terms of quality;

International Prices (contd)

- Use of exchange rate official or effective equilibrium in estimations of Import / or export parities;
- Selection of the border point for price comparison :
At what place port city? Consumption centre? Farm level?
- Availability of authentic data on technical coefficients, costs, recoveries and prices of principal and by products.
- All these issues need to be addressed in the analysis and need training and experience in handling these issues

Prices of Inputs

- Many times input prices(fertilizers, energy) have increased substantially during the crop season and after the announcement of support prices, eroding the meager margin allowed
- Need for monitoring and checking such tendencies
- In most of the cases tradable inputs sold to farmers at International and + prices

Political Economy, Institutional set up and Miscellaneous Issues

- Commodity coverage – crops of marginal area like gram
- Implementation
- Addressing quality concerns: FAQ and quality parameters- moisture level , admixtures
- Relating prices to quality in sugarcane when quality tends to improve with time
- Funding

Political Economy, Institutional set up and Miscellaneous Issues

- Processing
- Professional leadership to guide analysis
- Voluntary sale by farmers vs administrative measures to achieve procurement targets, restrictions on commodity movements
- Addressing concerns of processors - what about sugar price if mills pay the prices of sugarcane fixed by the govt.

Political Economy, Institutional set up and Miscellaneous Issues

- Prices of commodity and those of the processed produce case of seed cotton and rice paddy
- Conceptual clarity and uniformity- support and indicative price confusion.
- Participation of private sector in marketing, processing, trade and development activities

Political Economy, Institutional set up and Miscellaneous Issues

- The option of agriculture policy tools depends on a country's financial space, ability and institutional capacity for implementation and agricultural information system. The policy options also related to the value system of the society and the country's development stage.
- Developed countries in a better position and can realize or are realizing the transmission from price support tool to income subsidy tool,
- Most developing countries in current developing stage only can apply reasonable price support and small subsidy policy.

Political Economy, Institutional set up and Miscellaneous Issues

- No doubt political and social considerations would influence the policy decision but economists can play a useful role by highlighting the economic costs and the likely beneficiaries and losers.
- Govt intervention invariably predicated on one or more of the following: support farm income, protect small farms, achieve self sufficiency in food grains or promote certain crops to reduce imports, reduce price and income stability, hold down consumers costs and ensure regular supplies, stabilize prices or reduce amplitude of price fluctuations

Political Economy, Institutional set up and Miscellaneous Issues

- Need for realistic expectations from pricing policy
- Achievement of policy objectives predicated on judicious formulation , consistency and effective implementation.
- Need for understanding the necessary and sufficient conditions in the context of pricing policy.
- Not meant to replace the market mechanism but to correct for its short comings and failures.

- **Thanks for your attention**