MINIMUM SUPPORT PRICES FOR FOODGRAINS
GUIDELINES FOR A POLICY AND A PROGRAMME

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1. The demand for a minimum support price for foodgrains comes from the producers of foodgrains. Naturally, in the minds of many, the demand for and the concept of minimum support price are closely associated with the notion of ‘cost of production’ of foodgrains. One of the reasons, possibly a minor one, for the failure to evolve a public policy and a programme in this field in the past has been the difficulty of knowing what the ‘cost of production’ means in this context and an imperfect understanding of how it might be related, in concept and in operation, to a minimum support price. In this paper, we shall argue that ‘cost of production’ is only remotely connected to the notion of a minimum support price and that therefore an operationally meaningful policy and programme in this field can be evolved without an active reference to the notion of ‘cost of production’.

2. We shall begin by distinguishing two rather different sets of circumstances under which the demand for a minimum support price is often made. For convenience we shall refer to them as the short-term and the long-term considerations respectively. In the short-term considerations, the inputs or costs incurred by a producer in the process of production are supposed to be given. Nevertheless, the output is variable due to fortuitous circumstances such as weather. The price which the produce fetches in the market affects immediately the well-being of the producer. In the long-term considerations, the inputs or costs that a producer incurs in the process of production are variable and are determined by conscious production decisions by the the producer in which his price expectation play an important part. The output is significantly related to the inputs. Therefore, the price that the output fetches in any year influences the future production decisions of the producer and hence also the production. Both sets of circumstances lead to a demand for a minimum support price. However, the two are different and need to be kept distinct. We shall first examine the
demand for a minimum support price under the short term considerations.

3. In a free market economy, the prices are determined by the conditions of supply and demand and the function of the market price is to equate the two. In the short-run, which in relation to agricultural commodities is often called the ‘stock period’ that is the period after the harvest has arrived on the market, the supply is given. The market price then is so determined that all the supply is taken up and no more is demanded. Thus during a year, the market price of foodgrains is determined predominantly by the size of the harvest and the price elasticities of consumer demand for foodgrains. Because of generally low price elasticities of demand for foodgrains, it needs a disproportionately large rise in order to restrict the demand to a somewhat smaller harvest; and it needs a disproportionately large fall in price, to expand the demand to a somewhat large harvest. The market price of foodgrains is thus liable to large fluctuations from year to year, firstly because of fluctuations in the size of the harvest and secondly because of the generally low price elasticities of demand for foodgrains.

4. From the standpoint of the producers, the fluctuations in the harvest are entirely fortuitous and given acreage sown under the crops and barring exceptionally bad seasons, the inputs or costs incurred by the producers are more or less independent of the harvest. This means that the cost of production per ton of the foodgrains are low in an year of good harvest and high in an year of bad harvest. Therefore, in the short-term considerations, high prices in an year of bad harvest and low prices in an year of good harvest are not entirely contrary to the interests of the producers.

5. However, on account of the generally low price elasticities of consumer demand for foodgrains, the fluctuations in prices are likely to be more pronounced than warranted by the fluctuations in the harvest. Thus in an year of bad harvest, the rise in prices might more than compensate the fall in yield and the producers might actually reap a higher total revenue. On the other hand, in an year of good harvest,
the prices might fall so low that in spite of the high yields, the producers might end up with a smaller total revenue. The short-term case for minimum support prices rests on this phenomenon and consequent need to support the prices in an year of good harvest.

6. Let us examine the point of view of the consumer on this question. Obviously there is little reason why in an year of good harvest, a consumer should pay a price higher than the one demanded by the market, unless this help him, in an year of bad harvest, to pay a price lower than that demanded by the market. In fact, it does not help the consumer to have a low price and high consumption in an year of good harvest and a high price and low consumption in an year of bad harvest. Therefore, he would prefer the price to be supported in an year of good harvest and thus not be allowed to fall below a certain minimum provided a reserve obligation is accepted and in an year of bad harvest the price is not allowed to rise above a certain maximum. Thus in the view of the consumer, a maximum ceiling price is a necessary corollary to a minimum support price.

7. As we shall presently see, even operationally, a maximum ceiling price is necessary corollary to a minimum support price. Let us very briefly see how a minimum support price may be made operative in practice. A minimum support price begins to operate when, in an year of good harvest, the market price tends to fall below the support price. It follows that if in such a situation the support price were made effective, all the supplies would not be taken up by the consumers and that there would result an excess of supplies in the market. The support operation consists in buying up these excess supplies and thus prevent them from depressing the market price below the minimum support price.

8. Once supplies are bought and stored in an year of good harvest, their disposal becomes an operational necessity. The most opportune time for their disposal is when, in an year bad harvest, supplies are short and prices are rising. If used purposefully and effectively, the disposal can be so operated as to prevent the market price from rising above a certain maximum. Thus, even operationally, a maximum ceiling price becomes a necessary corollary to a minimum support price.
9. As mentioned above, the producers require only the support price. However, they must recognize that a ceiling price is a necessary corollary both because consumer interest demands it and because it would be impossible operationally to offer support without enforcing a ceiling. The two together reduce the range within which the market price may fluctuate. This is good for the consumer and the smaller the range within which the market price is allowed to fluctuate, the better for him. The relatively stable prices are also in the interests of the producers in the long run. However, in the short-run, it must be recognized that stable prices with fluctuating harvests result in fluctuating incomes for the producers which may lead to wasteful expenditure in year of bad harvest. Therefore, in the interest of the producers, any measures of stabilization of prices such as through operating support and ceiling prices, should be accompanied by measures of income stabilization through appropriate credit and insurance policies.

10. The above describes the nature of the demand for support prices under short-term considerations and also the manner in which such support prices may be operated. Let us now ask the question as to how such support prices may be fixed and in particular whether in fixing the support prices, the “cost of production” can be and need be explicitly taken into account. In the above we have emphasized how a minimum support price and a maximum ceiling price are necessary complements of the proposed operation. In the following, we shall point out that the minimum support price and the maximum ceiling price must stand in a certain mutual relationship. An essential condition of the price support that can be offered on the kind of short-term considerations as we have described above, is that the support operation must not lead to a permanent accumulation of stocks with the agency responsible for the operation and must also not involve the agency into financial losses in its buying and selling operations. The first condition means that over a period of years, the agency must be able to sell the stocks it acquires in good years. This requires a certain relation, pragmatically arrived at, between the buying and the selling prices of the agency. The second condition means, neglecting for the sake of simplicity the costs of transport, storage and handling which the agency must incur, that the selling price of the agency must
not be below its buying price. In fact, it is on this supposition that we call its selling price the 'ceiling' and its buying price the 'support'. The agency agrees to buy all supplies offered to it at the 'support' price. It undertakes to release on the market stocks at the 'ceiling price' whenever the market price crosses the ceiling and as long as it remains above the ceiling. For it to fulfil its second obligation, it must have sufficient stocks which in turn depend upon the support price. It is thus that the support and the ceiling prices at which the agency buys and sells must bear a certain relationship. The higher the support price, the larger will be the stocks that the agency will be obliged to buy and the lower will be the ceiling it will be able to enforce. The support must not be placed so high that the ceiling will have to be below the support. The lower the support, the smaller will be the stocks that the agency may acquire and the higher will be the ceiling it may be able to enforce. The support must not be so low and the consequent ceiling must not be so high that both become meaningless in practice. These considerations provide the broad limits within which the support price may be fixed.

11. While fixing the support price somewhere between these broad limits, the following considerations will appear relevant. The higher the support price the larger will be the stocks that the agency will have to acquire and deal with. This involves buying, transport, storage, rotating and finally selling in a manner that the price for the consumer will remain effectively below the ceiling. This requires knowledge, organization, expertise and competence. All these can be built only through experience. It will therefore be entirely legitimate to begin with a low support price and to raise it gradually.

12. In principle, one may raise the support price so high that the difference between the ceiling and the support may become very small. In deciding how far one may go in this direction, the following consideration is relevant. The minimum support price and the maximum ceiling price determine the limits within which the normal market is allowed to function. The higher the support price, the lower will have to be the ceiling price and thus smaller will be the margin left for normal market to operate within. Decision in this matter must
therefore be largely governed by considerations of expediency and advisability of how large a field may be left to the normal market.

13. It would be obvious that throughout these several considerations, the "cost of production" of the producer did not appear anywhere explicitly. Therefore it seems that it should be possible to evolve a policy and a programme in this field without any active reference to "cost of production". This should be true of a price support policy at least to the extent demanded by what we have called the short-term considerations.

14. Before we proceed to examine the demand for price support under what we have called the long-term considerations, let us once again emphasize what we have called the essential condition of the price-support under the short-term considerations. Briefly stated, this condition is that the agency responsible for operating the support programme should be able to sell, over a period of years, all the stocks it acquires at the support price, at prices not below the support price. If the condition is satisfied, it indeed means that over a period of years, the programme does not give any price support over and above what the market offers. Its operative purpose is merely to equalize the supplies and consequently also the prices over the years. It creates an agency to undertake the operations necessary to equalize the supplies over the years. The agency may use prices as indicators of quantities coming to the market and withdraw or reimburse the supplies as occasion demands. But the resulting prices on the market are such as the market decides them. It still is a free market and the programme is a part of it. It offers no price support over and above the market price.

15. Let us now examine the long-term considerations of the producers. These are basically different from the short-term considerations. In the short-term considerations, we presumed that the size of the harvest was more or less independent of the inputs or costs incurred by the producers. This is not so in the long run. In the long-run, the size of the production is positively related to the inputs or costs incurred. The producer knows that he can expand production by increased inputs or costs. But he would naturally not do it, unless it paid him to do so. Thus the inputs or the costs that the producer incurs get related to the price that he expects. Under these conditions, the demand for a mini-
mum support price arises on two slightly different grounds. One, is that the producer wants an assured minimum price which he may count upon and which may provide a basis for production decisions regarding inputs and costs to be incurred. The underlying consideration here is closely akin to those we have termed short-term considerations. However, there is a difference. In the short-term considerations, we have supposed that the size of the harvest is more or less independent of the inputs or costs incurred in the sense that it is determined by entirely fortuitous circumstances beyond the control of the producer. In the long-term considerations as we are now examining them, this need not be so. Here we suppose that the size of production depends upon the inputs or costs incurred and that the producer is aware of the possibility of expanding production by means of incurring higher inputs or costs. Under these conditions, production may expand and may bring down the market price below the economic level and thus ruin the producer. The producer needs an assurance against this eventuality. The second consideration is related. In order to continue production at a given level, the producer needs an assured minimum price. In order to expand production beyond the given level, the producer wants a higher minimum. He is willing to and able to incur higher inputs and costs, if and only if a higher minimum is assured.

16. Thus it seems that the minimum support price to be assured has to have some relation to what might be called the "cost of production" or the "supply price" of foodgrains. The two are not quite the same and in view of the fact that "cost of production" is not uniquely defined or understood, it may be more convenient and meaningful to talk in terms of the "supply price". The last mentioned consideration then only means that the supply schedule of foodgrains is of the usual kind with a positive slope and thus requiring a higher supply price for a larger market supply. Nevertheless, certain doubts are often expressed on this point and it may be useful to clarify certain issues involved.

17. For instance, it is asked whether, with expansion of production, we should expect the unit cost of production to fall or rise. The argument runs as follows: Expansion of production will come about through adoption of improved technology. By definition,
improved technology must be cost-saving. Hence, with expansion of production, unit cost of production and hence also the supply price should fall. Evidently, the argument suffers from over-simplification. In the first instance, it is not true that at every stage, a certain expansion of production will come about only through the adoption of a new technology. It is quite conceivable that at each stage, a certain expansion of production may take place within a given technology through increased inputs even beyond the point where diminishing returns and increased average costs set in. Secondly, it is not necessary that an improved technology must be cost reducing. A technology is an improved technology because it enables larger volume of foodgrains to be produced out of the same area of land; it is an improved technology because it converts something which was not available for human consumption into something that is available for human consumption. It does not have to be necessarily cost-reducing. Whether or not it will be adopted in practice will of course depend upon considerations of costs. However, even then it is not necessary that an improved technology would be accepted only if it were cost-reducing. It would be perfectly legitimate to accept an improved technology if it made possible a higher production, though at higher unit cost, simply because there was no other method of securing a higher production. Thirdly, it may be readily concluded that many technological innovations may be cost-reducing. However, it is in the nature of an innovation that its adoption requires higher incentives and higher profit margins. There are considerable costs of research and experimentation even at the individual farmer level and there is need for compensating the risk associated with an innovation until a farmer finally adopts it. It seems that the progress in agriculture will come about mainly through increased inputs within a given technology even beyond the point of diminishing returns, punctuated by adoption of innovations which may be cost-reducing but the acceptance of which nevertheless requires higher incentives and profit-margins. Finally, human labour, both of the farmer’s family and of hired workers, constitutes and will continue to constitute for quite some time, an important input in the production of foodgrains. Hired labour is valued naturally at the existing wage rates and labour of the farmer’s family is often not counted at all in certain definitions of ‘costs of production’. With agricultural development, leading among other things, to increased
production of foodgrains, there is no reason to suppose that the wages of hired labour in agriculture will remain the same or that expectations of the farmer and his family will remain the same. Whether or not one includes such increased expectations of human labour engaged in the process of production as an element in the “cost of production”, they certainly enter the supply price. Therefore, broadly speaking, one must conclude that the supply schedule of foodgrains will be of the usual kind with a positive slope and that the producer will ask for a higher unit price for a larger market supply.

18. Let us now examine the nature of price supports under such long-term considerations. In the first instance, we should be clear that the basic mechanism of offering the support would remain the same, namely, an agency which would buy whatever supplies are offered at the minimum support price. Secondly, the support price required to meet the long-term considerations will have to be higher than the one needed under the short-term considerations. The critical difference between the two is the following: Under the short-term considerations, we said that the support price must not be so high that, over a period of years, it becomes impossible to dispose of the stocks acquired at the support price, except at prices below the support price. The long-term considerations demand that the support price will be at least as high. It means that stocks acquired at the support price will accumulate with the agency concerned. Long-term price support consists in buying up all supplies offered at a support price with full knowledge that over a period of years, it will be impossible to dispose of the stocks except at prices below the price at which they were purchased. One of the principal problems of operating price supports at such a level is how to dispose of the stocks acquired at that price.

19. There is another and a closely related problem. As mentioned above, with high support prices offering long-term support, stocks accumulate which cannot be disposed of except at below the support price. The reasons are two-fold. In the first instance, because of high support prices, the production and market supplies expand. Secondly, because of high prices, consumption is restricted; a class of consumers is unable to buy all its foodgrains requirements at the support price. Thus, accumulated stocks in the hands of the public
marketing agency and unsatisfied demand of a class of consumers are found side by side. An obvious solution therefore is to distribute the acquired stocks at subsidized prices that is at prices below the support price but taking due care that such subsidized distribution does not depress the market price below the support price.

20. We shall not discuss here the problems of subsidized distribution but shall emphasize two relevant points. The first is that subsidized distribution is a necessary corollary of a long-term price support. The higher price provides a necessary condition for expanding production. This price has to be supported because the market fails to provide the support for want of necessary purchasing power. This means that while conditions are being created for expanding production, steps must be taken simultaneously to promote consumption to the same extent as the production may expand. This is the purpose of subsidized distribution. While discussing a minimum support price under short term considerations, we had observed that a maximum ceiling is a necessary corollary to a minimum support price. In the same manner it must be emphasized that subsidized distribution is a necessary corollary to a price support under long-term considerations.

21. The second point to be emphasized in this connection is the requirement that the subsidized distribution must not depress the market below the support price. This is obvious, otherwise the subsidized distribution would defeat its purpose. This means that the subsidized distribution must be arranged outside the free market and must be effectively sealed off from the free market. This is in sharp contrast to the situation obtaining in the context of price support under short-term considerations. There, as we have earlier observed, the operation does not indeed offer any support over and above that given by the market and hence the operations of the agency responsible for operating the support prices, together with the ceiling prices as a necessary corollary, may all fall within the framework of a free market. This is no longer so if the price support is to be given under long-term considerations. Here the intention is to offer support over and above what the market gives. This cannot be done by operating within the limits of a free market. Therefore the agency responsible for operating such price supports has to engage in extra-market activities. Subsidized distribution sealed off from the free market is one such activity.
22. Let us now ask the question as to how does one decide upon the level of support prices under such conditions and in particular whether "cost of production" of the producer offers any explicit guidance in the matter. We may begin with an important consideration which is obvious. The higher the support price, the larger will be the stocks that may have to be acquired at that price and later distributed at below the purchase price. This means that the higher the support price, the larger will be the subsidy that will have to be provided to promote consumption. Hence, financial resources available for the purpose clearly set a limit to how high to set the support price.

23. Though the decisions in this matter will be ultimately governed by financial considerations, it is worthwhile being clear about the basic issues involved. As pointed out above, higher support prices lead to larger stocks on account of two reasons: (a) expanded production and (b) restricted consumption. The second is obvious. As long as the first is also assured, namely that as long as it is reasonably certain and as long as continued evidence becomes available to the effect, that higher support prices lead to higher production and larger supplies, there is no reason why the support prices should not be kept so high as would lead to production and supplies large enough to satisfy the physical needs of all the people. That all the supplies which may be forthcoming at high support may not be taken up by the consumers, even when they are needed, is an irony of the way the incomes are distributed. It is possible that the process of economic development of which agricultural development and expansion of food production are a part, may bring about a levelling up of incomes in the lowest income class of consumers partly through increased national income and partly through a better distribution of the same, so that the market itself may support the high minimum necessary to enable the producers to produce enough for every-body. However, until that happens, a better distribution of the incomes at the lowest level must be brought about through subsidized distribution of food. As explained above, subsidized distribution of food operated as a necessary corollary of long-term support price helps to achieve simultaneously a higher production of food and a better distribution of the same. These are evidently the most primary aims of economic deve-
lopment. How much financial resources may be devoted for the purpose, depends upon the strategy and the path of development that one chooses.

24. To return to our question, as to how high to set the support price, one obvious answer then is to set it as high as financial resources permit. It is difficult to see that there can be any other consideration or that in particular the "cost of production" of the producer may offer any explicit guidance in this matter.

25. Let us then sum up the main guidelines that emerge from the above discussion for evolving a policy and a programme for a minimum price support to foodgrains. They are as under:

(a) Make a beginning.

(b) Begin with establishing a programme of minimum support prices under short-term considerations, namely a programme of support prices to be operated in conjunction with ceiling prices in such a manner that it does not lead to any net accumulation of stocks over a period of years. Set up the necessary agencies and the organization.

(c) Begin with a low price support and a high ceiling. Gradually, as experience gathers, raise the support and lower the ceiling, until the difference between the two is just enough to cover the operational expenses of the programme.

(d) The stage will then be reached where the price support may assume the long-term character. Gradually raise the support and simultaneously organize subsidized distribution of all stocks that cannot be disposed of on the market above the support price.

(e) As long as there is continuing evidence to suppose that further raising of the support price may help further expansion of production, continue to raise the support and continue the subsidized distribution until there are enough staple foodgrains for everybody and every one gets them in adequate quantities.

(f) Finally, MAKE A BEGINNING.