Managing Food Inflation

Speaking Notes

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The topic that I am supposed to speak on today is a very complex one. '<u>Managing food Inflation</u>' has been a tricky business for our policy makers. But before I share my thoughts on the subject, I want to express a slight discomfort with the choice of the words in the topic allotted to me.

As long as we would continue to focus on '<u>managing</u>' anything, I am afraid we are not attacking the status quo and therefore there will always be continuous threats of crisis like 'spiralling food inflation', which if you ask me, is not only an economic issue but also an issue which has significant social dimension.

Food inflation excludes millions from basics of life and reinforces poverty. It is also <u>anti –consumer</u> and <u>anti-producer</u> at the same time. Thus, it would have been better if the topic was '<u>preventing food inflation</u>' rather than '<u>managing food inflation'.</u>

Therefore, at the outset, I would urge and recommend to not only Government of India but also State Governments – under whose exclusive domain comes the subject of agriculture' - to realign their focus from <u>managing to preventing.</u>

I am sure, if accompanied by political will this realignment will ignite fresh imagination in the thinking of policy makers.

One of the reasons for food inflation is the presence of long chain of intermediaries between farmers and consumers. Thus it would be quite logical to say that farmers selling directly to consumers would prevent inflation. For instance, in an ideal situation, farmer producers' organisations selling directly to consumer cooperatives would not only keep inflation in control, but also significantly contribute towards doubling of farmers' income.

This being the broader paradigm let me now delve into some specifics which could prevent food inflation.

Food inflation can be caused due to interplay of number of factors such as state monopoly in agriculture marketing, anachronistic legislative frameworks like Essential Commodities Act, poor storage facilities, inadequate transport infrastructure, inefficiencies in FCI operations, issues with MSP regime, ambivalence on futures trading of agriculture commodities etc.

And of course, all of this needs to be seen in the context of changing consumer palate which is being redefined by the young millennials, their purchasing power and rapidly changing life styles. On the other hand, at the bottom of the pyramid there is an urgent need to see nutritional security as an important component of food security.

All these causes that I have just mentioned have a universe of their own. For instance, The Agricultural Produce Market Committee (APMC) Act mandates the purchase and sale of agricultural commodities in government-regulated *mandi*s. The journey of a commodity from farm to fork involves multiple levels of transportation and handling expenses, agents' commission

and *mandi* taxes — all jacking up the final price of the farm produce considerably.

With regards to Essential Commodities Act, the Act made sense at a time when the transport infrastructure was poor and markets were not integrated. So supply shock in one part of the country could lead to hoarding and black marketing. Today, shortages in one part of the country can be tackled if there is ample supply somewhere else. Initiatives like one National Agriculture Market can aid this process effectively.

The MSP regime also creates distortions. Currently, MSPs are announced for 23 commodities, but effectively price support operates primarily in wheat and rice and that too in selected states. This creates highly skewed incentive structures in favour of wheat and rice as well as also adversely affects realistic price determination in the rest of the commodities.

The inefficiencies of FCI are also well known with regards to procurement, storage and distribution. Shanta Kumar Committee has already looked into it in detail and has recommended that major functions of FCI be outsourced to states and other agencies.

The moot point here is that challenges in each one of the above areas are so immense that it requires a detailed analysis to identify the exact areas of reforms under each of those categories.

Let's take an example of marketing under APMC regime. We know that many states have carried out reforms in their Marketing Acts on the lines of Centre's Model APMC Act of 2003. But it must be noted that the Model Act itself contains restrictive and troublesome provisions and is no longer relevant.

The very concept of determination of <u>"market area"</u> for the purpose of regulation is restrictive by design and is a hindrance towards single agriculture market for India.

The definitions <u>of 'agriculture produce' and the 'marketing'</u> are very broad and include almost every conceivable commodity and post-harvest activity, thereby imposing regulatory restrictions across the gamut. In other words, almost every activity after harvest of agriculture produce comes within the purview of regulation. For instance, technically even 'grading' done by a farmer at his farm comes under the definition of "marketing" and hence can be a subject matter of regulation.

On the other hand, the definition of '<u>agriculturist"</u> is very narrow. Thus, it discourages the farmer from engaging in additional income generating activities such as grading, processing, trading etc. This goes against the spirit of direct marketing system.

Further the Model Act allows setting up of 'private markets' however, the provision is only half hearted as the restrictive conditions for licensing still exist. For instance, Rajasthan APMC Rules require, *amongst other requirements,* five hectare of land for setting up of a private market yard. Other states also propose license fee and high costs threshold for setting up of private markets. Most importantly, there is a *conflict of interest* relating to licensing and operation of private players under the APMC regime. In short licensors are also de facto competitors.

Therefore, the design of regulation under the Model Act does not seem relevant for the present day market dynamics, including e-commerce.

The Model Act also fails to insulate regulation from political capture - leading to political interests making their way into regulatory system. This has maintained and promoted *status quo*.

The Sahni Committee that drafted the Model Act in September 2003, had aimed that it will enable: (1) nationwide integration of agricultural markets, (2) facilitate emergence of competitive agriculture markets in private and cooperative sectors, (3) create environment conducive to massive investments in marketing related infrastructure, and (4) lead to modernisation and strengthening of existing markets.

I think that we have largely failed to achieve those aims because of the factors mentioned above. What was needed was an overhaul but even the Model Act presented very little improvement over existing APMC regimes.

It is good to note that the NITI Aayog is considering a new model APMC law and also the idea of a separate model law on contract farming as mentioned by Shri Arun Jaitly in his budget speech. We can comment on these model laws only when they are formulated and published.

We, however, hope that the concerns such as I just highlighted are addressed in the new draft.

From what is coming in the media reports, there are encouraging signs. For instance, we welcome that the proposed comprehensive contract farming model law would be delinked from APMC law and would delve into all matters from distribution of seeds to marketing of produce and would cover all the agriculture commodities.

We further understand that the new model APMC Act is also in the advance stage of formulation, which will incorporate changes that will be more relevant to current market conditions.

The real challenge, however, would lie in convincing state governments for these reforms. In this context, what could be useful is the methodology that CUTS has developed in its work in four countries including India. It is called - Framework for Competition Reforms– and has been acknowledged by the OECD and Competition Authorities across the globe.

Simply put, it basically entails – preliminary market assessment, data collection/analysis and linking data to competition reforms and indicators of consumer and producer welfare.

We applied this in Rajasthan in 2014 in the wheat sector and found that there is a need for bringing harmony across the multiple policy verticals (both legislative as well as administrative). For example, no farmer-consumer market was operative in the state and only 2 licenses had been issued for private markets despite adherence to the model APMC Act, ostensibly due to factors such as

- ✓ **Heavy security deposit requirement**
- ✓ **Problems in land availability/acquisition or changing usage pattern**
- ✓ **Minimum distance required from existing APMC markets**
- ✓ **Logistical issues, like assured water, electricity availability and/or road/rail connectivity and**
- ✓ **Large investment with low incentives**

You would agree with me that some of these things can be amended without much fuss and to my mind this is the way to move forward if deeply entrenched state monopoly has to be dismantled.

This will go a long way in reining in food inflation and creating necessary conditions for investment and competition in agriculture marketing chain.

Therefore, I would say there is a need to take such granular approach to the state level and conduct a detailed analysis - perhaps starting with APMC and thereafter moving to other areas such as transportation and the others, which have inevitable linkage to food inflation.