Indian Agriculture and Reform : Concerns, Issues and Agenda*

Professor Parthasarathy garu, Vice Chancellor Radhakrishna, Prof Sathyanarayana and friends.

I am honoured by the fact that you have invited me to deliver the Presidential address. When the organisers first spoke to me about this lecture, I humbly submitted to Professor Parthasarathy that, in the past, many eminent personalities like Governor, Dr. Rangarajan, Professor G.S. Bhalla, Professor Vyas, Dr. K. Subba Rao and Professor Radhakrishna had delivered this address and so we should together explore an appropriate scholar for the purpose. But, Professor Parthasarathy insisted and said that I had no choice. I do realise now that there is some merit in the invitation in the sense that the Reserve Bank of India is perhaps the first central bank in the world to have taken interest in matters relating to agriculture and agricultural finance and it continues to do so. RBI had conducted the first ever Rural Credit Survey in the world, promoted the National Bank for Agriculture and Rural Development (NABARD) and, is financing endowment chairs on the subject in Universities. Apart from this, belonging to Andhra Pradesh and having worked in the Finance and Planning Department in the State of Andhra Pradesh for several years, I have naturally been taking significant interest in matters related to agriculture.

On hearing the annual report on the activities of the Society, one cannot but be impressed with the remarkable enthusiasm and commitment with which the Indian Society of Agricultural Marketing is able to carry on its endeavour. I think the work methods of this Society should be advocated as a role model for other similar academic societies to emulate. There is also a distinguishing feature of the Conference on Agricultural Marketing. Unlike some associations where thousands of people assemble for a gala-conference, the discussions in this Conference seem to be conducted in a focused and purposeful way. Moreover, this must be one of the few societies, which does not restrict membership to only those who have specialized qualifications. The participation is allowed on the basis of the functions that one is performing, be it regulator, regulated or academia. Hence, by way of productivity or contribution to knowledge, the approach of this Society to the conduct of a conference is extremely desirable and I will certainly advocate this model. I am most grateful to the organisers for the honour conferred on me by choosing me as the Conference President for the year 2000.

Now on the subject itself, namely agriculture marketing, I went through the conference papers carefully and I do not think that there would really be much value addition in my commenting on these valuable papers. I would, therefore, place before you some broad perspectives of what we in the RBI have been grappling with, as concerns and issues relating to agriculture.

Concerns

The most important aspect that has been referred to in the Reserve Bank of India Annual Report and in the Report on Currency and Finance of recent years is a serious concern that of late, real Gross Domestic Product (GDP) in agriculture and allied activities recorded absolute declines. The decline is of 1.3 per cent in the third and fourth quarters of 1999-2000. In 2000-01, the first quarter growth of real GDP originating from agriculture and allied activities of 1.7 per cent has increased to 1.9 per cent in the second quarter. In the third quarter, the lower growth of 1.2 per cent can still be considered significant when compared with the absolute decline of 1.1 per cent during the corresponding quarter of 1999-00. The movements in the index of agricultural production suggest that this recent downturn is part of a longer-term trend. The annual trend growth rate of agricultural production has decelerated to 2.2 per cent in the 1990s from 3.1 per cent in the 1980s. The 1990s also witnessed considerable degree of variability of agricultural output with five years in the decade recording absolute declines in output.

Overall, it may be argued by some that the secular decline in output growth is not a matter of serious concern since structural transformation of the economy may imply that growth in agriculture would be less than that in non-agricultural sectors. Although the contribution of agriculture and allied activities to the GDP has declined from 35 per cent in the 1980s to 25 per cent in 1999-2000, more than two-third of the population continues to depend upon agriculture. Growth in sectors other than agriculture is not absorbing work force on a significant scale. Agricultural development has, therefore, rightly come to be regarded as an indicator of the quality of life at the grassroot level making it what may be called peoples sector. The agricultural sector also makes a significant contribution to India’s exports, accounting for a little less than a fifth of total merchandise exports. Also, despite some degree of weatherproofing acquired by the economy in recent years, agriculture continues to play a critical role in determining the macroeconomic balances in our country especially in generating private consumption demand.

It is no surprise therefore, that considerable anxiety is being expressed in some quarters that perhaps the poor performance of agriculture in the ‘nineties indicates that the process of reforms has by-passed the agricultural sector. It is also argued that while there has been emphasis on trade, industry and the financial sector, attention of the reform in some sense has not percolated to the agricultural sector, although as will be explained later, terms of trade improved for agriculture.

Observers who compare the performance of India and China feel that in the reform cycle in China, agricultural reforms were started in the early stage, which helped increase China’s rate of growth of this sector and consequently the potential output of the economy as a whole, thereby placing it on a high growth path. In India, while financial sector reforms have been undertaken early in the reform cycle, the commentators feel that reforms in agriculture sector have not been as much in the forefront both in terms of sequencing and overall priority. This issue of appropriate priority for agriculture in our reform process needs to be explored further in view of the fact that the trends in recent years are clearly indicative of a possible long-term deceleration in agriculture.

Some studies have been undertaken in the Reserve Bank of India focussing on some of these issues. The internal research studies seem to indicate that there are two major areas, which are constraining the upward movement of output towards its potential for India. These relate to agricultural sector and physical infrastructure. These preliminary findings, which are yet to be confirmed, add weight to the argument already articulated in the recent Annual Reports that agriculture has to be on the top of the agenda of reforms in India.

In regard to the importance of agriculture in a broader socio-economic sense, all the three basic objectives of economic development of the country, namely, output growth, price stability and poverty alleviation are best served by growth of agriculture sector. It may sound ironic that agriculture is one sector where there is convergence of all the three main objectives of economic policy in India but we seem to have relegated the sector to the background in the process of economic reform. In fact, there is a feeling that the economy may face slowdown if there is inadequate pickup in demand from rural areas and the depressed price conditions in agricultural commodities in the recent past have brought to the fore the criticality of agriculture sector in enabling Indian economy to maintain a respectable growth rate.

Issues

Eminent economists such as Professor Hanumantha Rao, Professor Vaidyanathan, Professor Vyas and Dr. Radhakrishna have been working on the problems of and prospects for agricultural growth and their contributions are well known. Hence only select issues relating to macro balances, public expenditure policies, and credit flow are addressed here.

First issue relates to macro economic balances. In terms of macro balances, the overall saving-investment gap in India in the recent years has been between 1.0 and 1.4 per cent of GDP. This is very low, and it has tended to move down in the second half of 1990s. This is contrary to the general impression that after liberalisation, increased dependence is being placed on foreign flows. It is, however not so, since the role of foreign savings has been reduced in the second half of 1990s.

Further, it may be noted that the public sector investment-saving gap has increased. The objective of reform is that more investible resources should be released to the private sector. But the data, particularly the recent CSO data, indicates that the contrary has occurred. Earlier, government savings used to be negative and the public enterprises savings were positive, and between the government and public enterprises put together, the public sector as a whole showed marginal positive saving. Now, the government and the public sector as a whole are contributing negatively to savings. So, during the reforms, though it is popularly felt that more resources have been released to the private sector to enable them to undertake larger investments, the way the fiscal reform has been managed did result in a situation where the saving-investment gap has moved adverse to the private sector, and public sector (including Government) dissaving has in fact increased in recent years.

It can be observed that out of the gross domestic saving of 22 per cent, 19.8 per cent are household saving, 50-60 per cent of which is financial saving. Furthermore, about 80 per cent of the financial saving of household sector is absorbed by the public sector (i.e. government and public enterprises) in India. Moreover, the continuing revenue deficits of the Centre and States indicate that much of the private financial savings absorbed by public sector is being used up for consumption and not investment.

The share of gross capital formation in agriculture as a proportion of total gross domestic capital formation has declined from 6.8 per cent in 1993-94 to 5.5 per cent in 1998-99. The decline in capital formation has been more pronounced in the public sector, reflecting the persistent and large revenue deficits. The share of agriculture and allied activities in total Plan outlay has declined from 6.1 per cent in the Sixth Plan Period to an estimated 4.4 per cent in the Ninth Plan Period. The share of irrigation and flood control in total outlay has also shrunk from 10.0 per cent to an estimated 6.5 per cent over the Plan periods.

Early correction of overall macro imbalances by improving fiscal management will help to release higher investible resources in the country, which would benefit agriculture also. But, this cannot be an excuse for not increasing public investments in agriculture.

Secondly, while public investment in agriculture is coming down, the subsidy bill accruing towards agriculture is going up though the general impression is that all subsidies have been pruned in recent years. Budgetary subsidies for the agriculture sector have been increasing in nominal terms over the years. The increase is concentrated on input subsidies, though food subsidies are also incurred to maintain high levels of food stocks.

The share of fertilizer subsidies in the total explicit subsidies of the central government steadily increased from 35 per cent in the 1980s to 42 per cent in the first half of the 1990s and further to 49.8 per cent in the second half. Fertilizer subsidy as a ratio to GDP fell from 0.8 per cent in 1990-91 to 0.7 per cent in 1999-00. In absolute terms, it rose from Rs.4,390 crore to Rs.13,463 crore during the same period. Though this subsidy is formally attributed to agriculture, in reality, most of it supports fertiliser manufacturing industry. States' power sector subsidies to agriculture have also undergone steady growth during the 1990s. Power sector subsidies to agriculture account for well over one per cent of GDP. Hidden subsidies provided by the States for agriculture increased from Rs.5,938 crore in 1991-92 to Rs.25,577 crore in 1999-00. In comparison, in 1990-91, the Plan outlay of agriculture sector including irrigation was Rs.12,515 crore, which increased to Rs.33,858 crore during 1999-2000.

Therefore, the issue that arises here is that a conscious choice has to be made given the overall resource constraint, as to what would be good for agriculture at this juncture in our country – increase in subsidies or more investment. Although it is recognized that subsidies can be regarded as production equivalents, the question that has to be raised in the context of overall balance is whether it would be worthwhile shifting the total spending on subsidies to investment, especially in terms of contribution to agricultural employment and poverty alleviation. Thus, the trade-off between investment in agriculture and increase in subsidies should be an important item on the agenda.

The third issue relates to inadequate flow of credit to agriculture. This could be viewed in two different ways. One, the Reserve Bank has been taking a number of initiatives to ensure adequate credit to agriculture sector and recently the Capoor Committee had made a number of recommendations on issues relating to cooperative sector. Two, the issue may also be viewed in the broader perspective of institutional dynamics. There are broadly three categories of institutions which deliver credit to rural areas, i.e., commercial banks, Regional Rural Banks (RRBs) and cooperative banks. Owing to accumulation of losses in public sector banks on account of mounting NPAs, the flow of credit to rural areas by banks in recent years has not been up to the mark. There is also a marked change in the orientation of commercial banks, which are being subjected to greater competition from private and foreign banks. Some of the public sector commercial banks are sometimes adopting their competitors' strategies without recognising that their comparative advantage lies in rural and semi-urban areas. Sooner the public sector banks recognise the importance of rural economies better it is for their long-term commercial sustainability. The RRBs have been in the early years subjected to an interest rate regime that led inexorably to accumulated losses, which are continuing to constrain their operations even now. The rural co-operatives sector has not come upto expectations in large parts of the country and is heavily dependant on flow of finance from NABARD.

The issue, therefore, is what are the ideal instruments that would deliver adequate and timely agricultural credit. It is not necessary that the same institutions that have been responsible for providing agricultural credit for the last twenty years or so should continue to do so as they did in the past. The moment agriculture is accorded high priority, revamping the rural cooperatives also come on top of the agenda, which would require recapitalising them. More attention to the actual revamping process of RRBs would need to be bestowed.

The third item of the agenda will, therefore, be the appropriate institutional changes that are required to ensure necessary credit flow to agriculture. Clearly, there is a need to examine the issue of rural credit and rural credit delivery systems in an objective as well as transparent way and accord them priority in legislative actions and financial allocations.

Fourthly, as a result of reform measures, there are some commercial banks that are not able to reach the prescribed target of lending to agriculture. As per the current prescription, they are required to place funds to the extent of the shortfall with NABARD, which in turn, would place these funds with State Governments for investment in agriculture related activities, mainly rural infrastructure. An issue has been raised that such a process amounts to indirect borrowings from the banks by State Governments and that funds originally meant to be deployed for agriculture are diverted for public investment. Incidentally, it is worth noting that even after accounting for such Rural Infrastructure Development Fund (RIDF) allocations during the reform era, public investment in agriculture has slackened. Furthermore, the risk based rates of return on banks' investments in RIDF are better than similar returns by lending to agriculture, implying incentive incompatibility of RIDF with the main objective. Also, coverage of definition of priority sector lending has been broadened significantly in the recent years, thus overestimating credit flows to actual agricultural operations in recent years. It can, therefore, be argued that the RIDF should be refocused, if possible by diverting such funds to agricultural operations through revamped systems of RRBs and cooperatives. Incidentally, banks have been arguing that a constraint facing them with regard to deployment of agriculture credit is lack of viable credit products, implying lack of demand for credit. On the other hand, there exists an informal sector which provides agricultural credit at high interest rates, which indicates that there is no demand constraint. The dichotomy between the formal and informal sectors could be explained by the lack of banks' capacity to reach potential borrowers, which in turn could be explained by attitudinal, procedural and institutional factors. In fact, the very purpose of deregulation of interest rates for this sector, which was expected to encourage banks to lend higher, does not seem to have served its purpose fully.

Fifthly, one of areas the Reserve Bank has taken a lot of interest in the recent past relates to micro-finance. A Committee was constituted under the leadership of NABARD for this purpose. Lending under micro finance can be formal or informal. In Professor Ram Reddy memorial Lecture delivered by the same author, it has been mentioned that the temptation to bureaucratise and regulate microfinance must be resisted. This aspect is also being carefully looked into by the RBI.

Sixthly, another matter that has been engaging the attention of the policy makers for the past ten years relates to the huge food stocks, but the problem has exacerbated in recent years. There are several aspects that need to be carefully considered. The world food market and the market instruments by which food stocks are imported have changed in recent years. It is possible to buy options so that we can pay now merely for an option to import specific quantities at a price. Another issue relates to types of storage facilities that need improvement in public sector and the compelling requirement of creating private storage facilities. The cost and efficiency of operations of Food Corporation of India have also been a subject of scrutiny more recently by a study conducted in Administrative Staff College of India. The pattern of food consumption, food storage, food production and food trading in the world have changed. Therefore, our policy on what constitutes optimal food stocks would need to be revisited and this was raised in the RBI Annual Report last year. Of direct interest to the RBI is the monetary and fiscal implications of buffer stock operations. The Reserve Bank of India has requested the Administrative Staff College of India to study this issue separately and submit a technical report.

Seventhly, the issue of terms of trade is important. The terms of trade in agriculture in India is not dwelt upon have except to recognise that the terms of trade have on the whole moved somewhat favourably to agriculture in recent years. Recently the global competitiveness of our agriculture sector has gained attention of policy-makers but the aspect of supply elasticities in our economy needs to be looked into. If public investment and market infrastructure in agriculture continue to be inadequate, there could be a serious problem of competitiveness and adequate supply response. No doubt, India is a large producer of several agricultural products. In terms of quantity of production, India is the top producer in the world in milk, and second largest in wheat and rice. We should, therefore, be concerned about improving quality while maintaining the lead in quantity. If the focus is on global agriculture, it is important to think of both quality and quantity of production. The issue is whether it is possible to create an environment where we can compete in terms of quality also.

Quality in global standards has several dimensions. Quality may mean rigid adherence to global environmental and health standards. It may also mean rigid adherence to delivery-schedules, in terms of both quantity and quality, and timeliness. Global orientation would require a complete re-orientation of what may be called 'towards a more aggressive thinking', rather than 'defensive thinking', to create an enabling institutional environment to compete and survive. For example, it is not desirable to have highly segmented markets, although large quantities are available in the country. Certification of quality requires institutional arrangements within the country that carry credibility in both domestic and foreign markets. In this context, the institutional arrangements such as commodity exchange assumes importance and it is an area where we are still rooted in the past. A thorough review of adequacy of institutional arrangements in quality control, certification and trading in agriculture sector should be a national priority to take advantage of global opportunities. Indeed, with liberalisation of imports, even domestic markets would demand such institutional changes if our agriculture sector has to survive competition brought about trade liberalisation.

Eighth, another important aspect relates to the mindset on role of middlemen. In India the general attitude to trade especially in agriculture has been to favour elimination of middlemen or ensure that middlemen's functions are carried out by public sector or cooperatives in name, but public sector in reality. However, experience has shown that public sector as middleman also utilises other middlemen and in any case has not been cost effective. In a modern economy, it is inconceivable that the role of middlemen can be eliminated. This underscores the need to regulate the middlemen in order to make them more efficient, competitive and accountable. It is necessary to move to a situation where an efficient system of market intermediaries is created in agriculture sector. The related issue of mindset relates to futures-trading. There needs to be a mechanism for hedging risks. Again, this should be adequately regulated in a competitive environment so as to ward off unworthy speculation. This raises among others, issues of financing trade, settlement mechanisms, ensuring that futures contracts are honoured, etc. The concept of nationwide multi-commodity exchange has been mooted in the country. A Committee was appointed, of which RBI was a member, to work on these issues. The Report of the Committee is under consideration of the Government of India.

Ninth, farmers face uncertainties with regard to weather as well as price. The issue of uncertainty should be distinguished from the issue of commercial viability. Thus, advocating subsidised credit to tackle the problem of distress among farmers due to weather failure or depressed prices is not enough. The current regime of subsidies does not tackle the major problem of agriculture viz. uncertainty. Uncertainty of weather may be alleviated by insurance-mechanisms but unfortunately the experience so far, with what has essentially been insurance of credit to agriculture, has not been encouraging. Commercialisation of agriculture can progress only when institutional arrangements such as insurance penetrate deep within the agriculture sector.

In the financial world, it is recognised that there are certain uncertainties and hence financial participants are encouraged to devise mechanisms for hedging. Similarly, modern agriculture too will have to have a mechanism by which farmers are able to hedge risks. This is possible only if there are proper institutional mechanisms and incentives to hedge. The traditional approach of handling demand or supply side problems or problems of uncertainty directly and essentially by Government in an *ad hoc* manner, can no longer serve the purpose.

Finally, Reserve Bank of India recognises Self Regulatory Organisations (SROs) in the financial sector. The RBI encourages them to produce standard documentation for trading in repo market. However, genuine self regulatory organisations do not seem to have been nurtured in agriculture sector and in any case interaction between regulatory agencies and SROs has not taken roots in agriculture sector, though it has achieved some progress in the financial sector.

Agenda : Redefine Role of Government

It is clear that improving the growth rate and competitiveness of agriculture is very critical at this juncture for a variety of reasons, including the lacklustre performance of agriculture in the recent past and specially the impact of liberalised trade-regime being announced. There is some merit in the argument that the reform process has bypassed agriculture so far and that this is best illustrated by the co-existence of segmented and overregulated domestic markets with liberalised export–import regime in agricultural commodities.

Briefly stated, those relevant are overall fiscal imbalances, declining and inadequate public-investments in agriculture accompanied by increasing share of patently unproductive and distortionary subsidies. Serious deficiencies relate to the legal and institutional framework for flow of credit to agriculture, maintenance of huge food stocks with considerable fiscal and monetary implications, virtual non-existence of institutional mechanisms to promote assurance of quality and assured delivery in a nation-wide market, outdated attitudes to the role of so-called middlemen, insurance, hedging and finally overarching bureaucratisation with little attention to promotion of Self-Regulatory Organisations. In this background, the agenda for reform virtually encompasses a thorough change in mindset and overhaul of legal and institutional mechanisms to enable a growing, healthy and efficient agriculture sector. In brief, the role of Government in agriculture needs to be comprehensively and urgently redefined, perhaps somewhat on the following lines.

First, there is a need to define the parameters of an optional pattern of utilisation of fiscal resources in agriculture and a medium term time-bound plan to transform the existing system of subsidies in favour of a few to a more desirable well spreadout public investments. In other words, incrementalism in policy-change should not be mistaken for a sequenced reform in deployment of public funds in agriculture.

Second, the distortions and outdated policy approaches to the deployment of credit to agriculture must be recognised and the institutional as well as instrument changes urgently needed should be spelt out, but this would need governmental intervention. In a deregulated financial sector, enabling environment and incentives are infinitely superior to directions or moral suasion.

Third, uncertainty in agricultural activities is admittedly more than in other activities and the institutional arrangements, whether in public domain or private initiative are non-existent. Commercialisation of agriculture and competition warrant mechanisms to meet uncertainties while enhancing productivity. Meeting uncertainty is different from subsidising non-viable operations, and putting in place an institutional framework for insurance, hedging and public resources to make such mechanisms initially viable are necessary as part of refocusing the mindset and resources of government to the emerging challenges of current slowdown and future threat of global competition.

Fourth, public policy should turn immediate attention to trading and marketing aspects, with a clear admission of need to change mindset. For example, middlemen are inevitable and the issue is how to foster competition and assure regulation of such middlemen keeping in view the interests of producers as well as consumers. Certification and credible regulation of trade to ensure competition quality and transparency protects both producer and consumer far better than price and distribution controls, provided public distributing systems are oriented to be more focussed, selective and efficient. A national commodity exchange is but one element of reform. More but a different type of governmental intervention is needed in marketing and trade while genuine co-operatives like in diary sector need to be considered afresh.

Fifth, genuine self-regulatory organisations need to be founded and nurtured and experiences in other countries may not be irrelevant though our needs and cultural milieu are unique. A major challenge is to devise nationwide formats that can cater to nationally integrated markets while allowing for local variations and initiatives particularly at the state level.

To sum up, inadequate finance and outdated as well as inappropriate institutional framework are the twin problems and, of the two, institutional reforms are needed immediately requiring changes in mindset and redefining the role of government.

---

* Address by Dr. Y.V. Reddy, Deputy Governor, Reserve Bank of India at Conference of Indian Society of Agriculture Marketing at Vizag on February 3, 2001. Dr. Reddy is thankful to Dr. Michael Patra and Dr. . Prasad for their assistance.