Promises and wheat procurement

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Last year the wheat procurement policy led to a pretty significant fiasco. The government had promised a procurement price of Rs. 300 per 40 kg, but had, under the guidance of the Asian Development Bank and other multilateral agencies, imposed a ceiling on how much the government could spend on procurement of wheat. There was a bumper crop and the imposed ceiling was very inadequate for ensuring a floor. This led to a situation where the government had more wheat than it could store and/or handle, as well as need for reserves, while the farmer could not sell the crop at Rs. 300 to the government. Market prices fell to the point where in some areas the farmers could not find anybody to buy their crop, or had to sell it for as low as Rs. 180 per 40 kg.

When farmers have been promised a price of Rs. 300, and they end up getting a price of Rs. 180, there is surely a problem here. And more importantly, it would, for sure, have effects on the production of wheat and other crops in the future. Farmers look at the various rates of return from competing crops to decide which crop to sow. If the rates of return were expected to be low for a crop, one would expect farmers to substitute away from that crop. Wheat is an important crop for Pakistan. It is the staple diet, and it is what keeps most Pakistanis away from malnutrition and starvation. We need large quantities of wheat every year, and at reasonable prices. But if the farmer cannot get a decent return on wheat, he will move out of it. This would be bad for Pakistan as a whole. To ensure 'fair and decent' returns to farmers in this market, the guaranteed floor that the procurement prices offer is essential to remove uncertainty regarding returns from wheat. But it is this 'guaranteeing' factor of a floor that is removed if the government puts a limit on how much it can spend on procurement.

Agricultural commodities are different from producing toothpaste or other consumer items in significant ways. They are necessities unlike a lot of consumer items (though I hope toothpaste is too). Their production is time bound so that from crop to crop the supply curve is almost vertical. In other words once a crop has been reaped the supply remains more or less fixed till the next crop is reaped. We are ignoring the possibility of imports at the moment. Or if one wants to allow imports, just think of world-supply, as a whole, from crop to crop and it will have the same pattern as domestic supply from crop to crop. Hence the production decision of farmers has to be taken in advance and there is no way of altering it once the relevant sowing time has passed. Farmers thus face an inherently uncertain condition regarding returns. Contrast this to producing paper or toothpaste. The producer can always alter production at fairly short notice. The uncertainty due to changes in market conditions is thus likely to be much less for these producers due to higher controls over the production process.

Due to lack of control over the production process agricultural commodities have another peculiarity as well. It makes sense for a farmer to have a higher output than a lower one, as long as it is profitable to produce at all. So the farmer tries to get the optimal output from each plot of cultivated land. In a good year when all or most farmers manage to do this, this implies a very large supply (bumper crop). With this large supply and given demand, prices have to fall to clear the market. So commodities have this peculiarity that if there is a bumper crop, which is wonderful for the GDP and the country in general, individual farmer can lose due to the drop in prices that could happen if demand and this larger supply interact. Again this can be contrasted with other products where individual manufacturers can always condition their production on what other producers are doing. But if farmers lose out in good years, this will surely induce crop diversification at the individual level. There is no necessity that this diversification need of the individual should also be optimal for the country as a whole. Maybe a higher production, with government guaranteed floors, are a better outcome for the country as a whole. I have not seen any analysis by the Asian Development Bank, which is very keen in winding up the role of the government from procurement, that says that ultimately individual responses lead to higher welfare for the country than state coordinated responses.

Small farmers tend to borrow heavily for the sowing season, and need to pay their creditors as soon as the crop comes in. These loans can be in the form of advances from input sellers or landlords and crop traders, loans from the family, or even loans from the commercial or informal credit markets. Whatever the source, these loans tend to have high interest rates, and need to be paid back as soon as the crop is available. If the government promises a particular procurement price at the time of sowing, which determines how much wheat is sown, then the farmers make their input decisions predicated on that particular price. They expect to get that price. If they do not, many are likely to go bankrupt or at the least have significant problems in paying back their loans. This is not only bad because it is tantamount to breaking a promise, it is also bad because it limits how much wheat and other crops can one have in the future. It is also likely to worsen the income distribution in the rural areas and increase poverty. All of the above are definitely contrary to the avowed aims of the government.

Last year, though the announced procurement price was Rs. 300, since there was a ceiling on how much the government was willing or able to purchase, the procurement price became ineffective. The small farmer was the main victim. He is the one who has fewer contacts, has lower saving and ability to store, and hence is obliged to sell quickly. The larger farmers can always contact the procurement agents directly and have nice 'arrangements' with them. The larger farmers and traders can also benefit by intermediating: they buy che from the smaller farmers, hold the crop for somet and then sell in the market, or use their contacts to to the government at the official procurement price

If the government promises to buy wheat at Rs. and then even one farmer willing to sell at this pric unable to get this price, this is a violation of contrac might not be enforceable through the courts, bu reflects very poorly on a government that claims to h the interests of the people as their first priority. Furt more, the government, or the multilateral agenc cannot sweep last years error under the carpet by cla ing that this was just a result of the transition from market structure to another. This is ridiculous to say least about it. If markets are to be transformed government needs to ensure that even more mone available to facilitate the transition. It should not h been the other way round.

The government is hoping that private sector soluti can be worked out for this issue. There is a very sim theoretically that is, market solution to the problen the farmers can have access to market rate credit does not force them to sell quickly, if they can h access to credit for storage costs, and if private se funds were available for building storage capacity commercial basis, the problem of the small farm could be addressed. The farmer would not need to his crop when there is a glut situation, and would wai prices to come back before bringing his crop to market. The government, and the multilateral agen advising the government, want to reach this point.

But this is exactly the problem. Our capital mark are atrociously bad, even taking into account all eff of Agricultural Development Bank and other sim agencies. There is no way a small farmer can get acc to reasonably efficient capital markets in Pakistan. Th is no reason for private investment to enter into build storage capacity at this point in time. Investment been extremely low in Pakistan in the last few years, for good reason. Few investors have confidence in business conditions prevailing to make investment wo while. Why should private money come into stor capacity development? So this 'solution', though a go reference point, is not attainable for Pakistan in the n future.

It is bad strategy on the part of government to ind the movement towards the above 'ideal' by remov the efficacy of the floor. The government should go other way. Keeping the floor, the government sho improve other markets so that investments start co ing in and reliance on the floor is less and less, a eventually the floor becomes non-binding. Or that is achieved, then the floor can be removed. W this point be reached in Pakistan when no suchdevelo ments are present in other comparable credit a other markets? It is very unlikely. But the gover ment might still want to aim for it. Though one observ tion should be kept in mind: how many countries can o think of where there is no government intervention agricultural markets? Probably none. This, one can sure, is not coincidence.

Promises should be honoured. Especially if one wa to build trust and establish goodwill. The governme surely wants to do that. Last year the wheat fias eroded government credibility due to its inability keep its promise to the wheat farmers. It is not ju credibility that is hurt, it is also the growth prospects th are hurt. Broken promises, in agricultural markets, c significantly hamper our ability to generate food, a address issues of rural poverty and income distributio The importance of keeping this promise cannot thus overemphasized. One hopes that the government doe better job this year.

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