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New agriculture infrastructure fund is a major step forward. Policymakers must have stable policies for them

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Ashok Gulati | August 17, 2020

On August 9, Prime Minister Narendra Modi launched the Rs 1 lakh crore Agriculture Infrastructure Fund (AIF) to be used over the next four years. This fund will be used to build post-harvest storage and processing facilities, largely anchored at the Farmer Producer Organisations (FPOs), but can also be availed by individual entrepreneurs. The fund will also be used to provide loans, at concessional rates, to FPOs and other entrepreneurs through primary agriculture credit societies (PACs). NABARD will steer this initiative in association with the Ministry of Agriculture and Farmers Welfare. The implication of this for the Central government budget is not going to be more than Rs 5,000 crore over four years in terms of interest subvention subsidy. The creation of the AIF presumes that there is already large demand for storage facilities and other post harvest infrastructure.

The fund is a major step towards getting agri-markets right. The Narendra Modi government had earlier issued three ordinances related to the legal framework of agri-markets with a view to bringing about some degree of liberalisation. These ordinances relate to amendments in the Essential Commodities Act, allowing farmers to sell their produce outside the APMC mandis and encouraging farming contracts between farmers, processors, exporters and retailers. Changes in the legal framework are a necessary condition, though not a sufficient one, for getting agri-markets right. Creating post-harvest physical infrastructure is as important as the changes in the legal framework. The AIF will help fill this gap. Its positive impact will be evident in due course, depending upon how fast, and how earnestly, the states, FPOs, and individual entrepreneurs implement the reforms initiated by the Centre.

Since NABARD is also responsible for the creation of 10,000 more FPOs, it can create a package that will help these outfits realise better prices. Here are a few missing elements of the puzzle. There is no doubt that more and better storage facilities can help farmers avoid distress selling immediately after the harvest, when prices are generally at their lowest. But small farmers cannot hold stocks for long as they have urgent cash needs to meet family expenditures. Therefore, the value of the storage facilities at the FPO level could be enhanced by a negotiable warehouse receipt system: FPOs can give an advance to farmers, say 75-80 per cent of the value of their produce at the current market price. But FPOs will need large working capital to give advances to farmers against their produce as collateral. Unless NABARD ensures that FPOs get their working capital at interest rates of 4 to 7 per cent — like farmers get for crop loans — the mere creation of storage facilities will not be enough to benefit farmers. Currently, most FPOs get a large chunk of their loans for working capital from microfinance institutions at rates ranging from 18-22 per cent per annum. At such rates, stocking is not economically viable unless the off-season prices are substantially higher than the prices at harvest time.

This brings me to the second missing item in the getting agri-markets right puzzle: The future of the agri-futures markets. A vibrant futures market is a standard way of hedging risks in a market economy. Several countries — be it China or the US — have agri-futures markets that are multiple times the size of those in India. The value of traded contracts on agri-futures in the NCDEX, the largest agri-commodities derivatives exchange in India, was Rs 18.3 lakh crore in 2012. It fell to Rs 4.5 lakh crore in 2019, and by July 2020 it had plummeted to Rs 1.5 lakh crore (see graphic). In terms of volume, the number of contracts fell from about 44 million in 2012 to 12.5 million in 2019. In contrast, in China, the volume of contracts traded on agri-futures was more than 1,000 million in 2015; in the US, it was more than 300 million (in the US, the value of each contract is normally much higher than in China and India.)

How do we fix this puzzle to have a full set of right instruments for farmers to minimise their market risk and have better price realisation? First, as NABARD forms 10,000 FPOs and creates basic storage facilities through the AIF, it should devise a compulsory module that trains FPOs to use the negotiable warehouse receipt system and navigate the realm of agri-futures to hedge their market risks.

Second, government agencies dabbling in commodity markets — the Food Corporation of India (FCI), National Agricultural Cooperative Marketing Federation of India (NAFED), State Trading Corporation (STC) — should increase their participation in agri-futures. That is how China deepened its agri-futures markets.

Third, the banks that give loans to FPOs and traders should also participate in commodity futures as "re-insurers" of sorts for the healthy growth of agri-markets. Finally, government policy has to be more stable and market friendly. In the past, it has been too restrictive and unpredictable. A rise in agri-prices would often result in the banning of agri-futures. Most Indian policymakers look at agri-future markets as dens of speculators. These markets are blamed for any abnormal price rise or fall. Sadly, our policymakers don't realise that these are important tools of price discovery. By banning/suspending agri-futures at the drop of a hat, they kill the price messenger. Thereafter, their policy actions on the price front are akin to shooting in the dark — several times they shoot at their own feet.

The bottom line is that India needs to not only spatially integrate its agri-markets (one nation, one market) but also integrate them temporally — spot and futures markets have to converge. Only then will Indian farmers realise the best price for their produce and hedge market risks.

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