

Explainer MSP (Minimum Support Price) and Government Procurement

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Every year we see news of increase in government announced Minimum Support Prices and how the MSP benefits farmers get a reasonable income from their production. We also hear about complains by farmers about how low the MPS is. This document aims to explain how the system of government procurement works and raises some key questions for discussion.

How did it come about?

In 1960s, India faced a food shortage due to multiple years of drought. At the same time, the US made its export of wheat to India contingent to India toeing the American line on international politics. Humiliated, the Indian government decided to institute a collection of policies to achieve food security. These policies and institutions which were established to operationalize them came to later be known as the 'green revolution'

As part of these policies, the government created a system of food grain procurement for multiples reasons:

- Maintaining reserve stocks of food (national food security)
- Providing price support to farmers by declaring, and procuring at, 'minimum support price' for various commodities
- Selling the grain at subsidized rates for those who cannot afford it

How is MSP calculated?

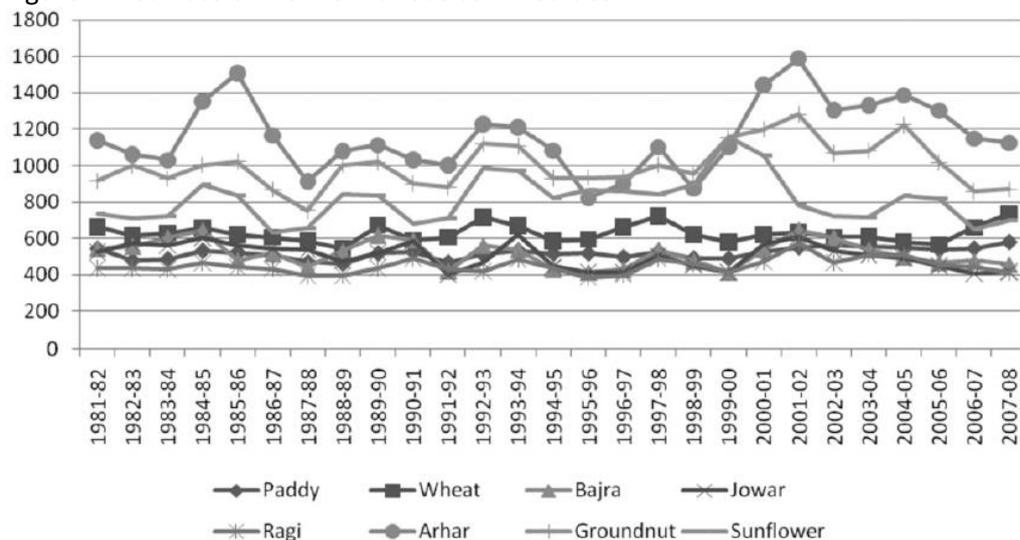
The MSP is calculated each year by the [CACP](#) (Commission for Agricultural Costs and Prices), based on estimate of the average costs of production of each commodity. As India is a vast country with multiple agro-climatic zones, different levels of canal/ groundwater irrigation, different levels of application of inputs such as fertilizers, these estimates are based on detailed survey of production costs from around the country. There is also the question of whether to account for imputed cost of family labour who work on the family farm (as opposed to employed labour) or cost of leasing of land. And the CACP (under the directive of the ministry) has to set the price based on desirable profit margin on top of all the costs. This exercise is carried out every year and the MSP is declared for 24 commodities.

Unlike minimum wage, the MSP is not a legal minimum for markets. The minimum wage is a legal limit which every employer in the country is supposed to adhere to, whether the employer is a public sector unit or a private company. The MSP is simply the price the government pays when procuring the produce. Traders are not required by law to buy and sell at the same price.

Therefore, market prices can be higher or lower than the MSP.

Over the years, the nominal MSP has increased for all produce, but real MSP (inflation adjusted) have varied quite a bit (see Figure 1)

Figure 1: Real rate of MSP for various commodities¹



The procurement and distribution process is as follows:

1. Government declares the price at which it will buy food grains at the beginning of sowing season twice a year (*Kharif* and *Rabi* seasons)
2. Government declares how much it will buy; agencies go to *Mandis* and buy food grains directly from the producers
3. Government agencies stock the food grains in depots
4. Government releases some of the food grains to the state agencies at a pre-fixed price
5. State agencies release that food grain to primary buyers through PDS shops (Fair Price Shops)
6. In some cases, state governments procure additional items for distribution through the PDS

The institutional architecture for this includes Commission for agricultural costs & prices

Central:

- Ministry of Agriculture, including CACP which calculates and recommends the MSP for 24 commodities (rice, wheat, maize, ragi jowar, bajra, arhar/toor, mung, groundnut, soyabean, sesame, cotton, etc.)
- Ministry of Food
- Procurement centres/ agencies
 - Food Corporation of India (buys and stores paddy & wheat)
 - NAFED for pulses, oilseeds, onions/ potatoes (no MSP for vegetables)
 - CCI buys cotton
 - JCI buys jute
- Local Storage
- Distribution Centres
- Depots

¹ Kannan 2015

State:

- State Government
- Department of agriculture
- Department of food
- State procurement agencies
- Local storage

How much does the govt. procure?

Of all the 24 commodities, government procurement is greatest for wheat and rice. GOI procures about 30% of all wheat and rice produced in the country (for market and subsistence) and about 6-7% of other commodities. Wheat and rice procurement has increased over the decades; in 1970s, GOI used to procure only about 10% of grain output, but by 2000s it reached 25% and now it is around 30%.²

Who benefits from MSP – Which regions/ crops?

GOI undertakes the procurement of food grains, oilseeds and fibres through its procurement agencies. However, the procurement operations concentrate on a few crops and a few states. For paddy, about 50% of the total paddy procured for the central pool came from three states: Punjab, Andhra Pradesh and Telangana. For wheat, about 60-65% is procured just from Punjab and Haryana.³ Even within these states, procurement takes place only in a small number of districts.

Strong lobbies (e.g. wheat and rice in Punjab and sugarcane farmers in Maharashtra) also influence where and how much procurement takes place.

In the case of oilseeds and pulses, in principle the government is supposed to procure these commodities when market prices crash. However, the quantity procured as a percentage of the marketed surplus is usually negligible. "In dryland regions where these crops are predominantly grown, the government procurement system is almost non-existent".⁴

Who benefits from MSP – Which class of farmers?

As the govt. procurement is concentrated at a few centres, it requires farmers to have transport facilities to reach the procurement centres, usually located far away from villages. Therefore, small it wouldn't make sense for farmers with limited amounts of produce to take their produce to these markets. Furthermore, a high proportion of farmers are not aware of the MSP and whether it is higher/lower than the prevailing market prices⁵.

Therefore only the larger farmers are able to benefit from the MSP and government procurement. However, in districts where a large proportion of production is procured by the government, the

² Rearden and Minten 2011 "The Quiet Revolution in India's Food Supply Chains"; Agriculture at a Glance 2015, Table 9.1(a)

³ Pocketbook of Agricultural Statistics 2016, Table 9.2

⁴ Rearden and Minten 2011

⁵ Kannan 2015

MSP can also affect the overall market prices at which the traders buy produce, due to competition from govt. agencies.

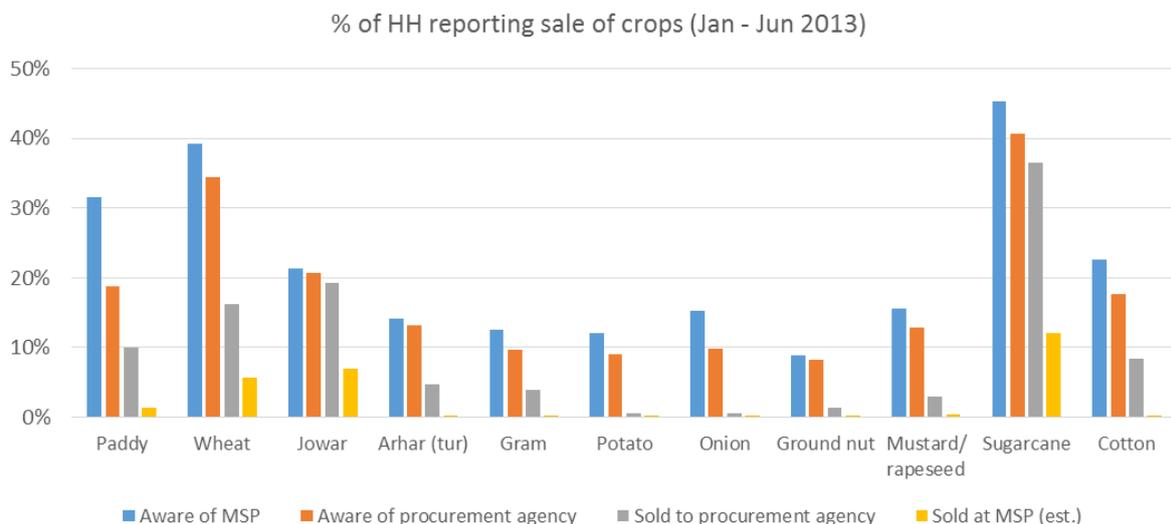
The timing of procurement and payment for the procurement is also an issue. Delays in govt. procurement usually mean that only the larger farmers, who are able to wait before selling their crop, are able to benefit.

So direct procurement benefits only a small percentage of farmers because

- a) govt. procurement is concentrated in some states and districts, e.g. Punjab, Haryana, AP,
- b) while MSP is set for 24 commodities, the government procures mostly wheat and rice
- c) most of the MSP procurement by the govt. happens from medium to large farmers.

In fact, a recent High Level Committee estimated that only about 6% of farmers benefit from the MSP.⁶

Figure 2: Percent of agricultural households aware of and selling at MSP⁷



Larger questions for consideration

Directly related to MSP and govt. procurement:

- How can we ensure that small and marginal farmers benefit from MSP?
- How to ensure that all costs of production are included in the MSP calculation?
- How can (should) we create a similar system of MPS + govt. procurement for vegetables which are perishable (e.g. carrots, capsicum, spinach)?
- How much commodity should we store? How to avoid spoilage during storage?

⁶ Report of the High Level Committee on Reorienting the Role and Restructuring of Food Corporation of India ("Shanta Kumar Committee Report"). January 2015. pp 12-13

⁷ Source: NSS 473 Statement 3.12b

Overall:

- Given the high levels of malnutrition in the country, how do we align our food/nutrition security objectives with the govt. procurement and food distribution system? For example, how much grains vs. vegetables should be procured and distributed? Which commodities should we focus more on?
- How do we avoid incentivizing greater production of rice/wheat simply because govt. will procure these?
- How much food subsidy should we give and for what foods? (gap between price at Fair Price Shops and cost of procurement, transport, storage, distribution, etc.)