Agriculture and the Free Market*

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In the context of the on-going country-wide kisan movement for repealing Modi's three Agriculture Bills, while an overwhelming majority of commentators have stood with the position taken by the kisans, a few, though not necessarily agreeing with Modi, have raised the question: why shouldn't agriculture operate within a free market? It is worth recapitulating here the answer to this question which is well-known but can bear repetition.

The free market solution is of course patently sub-optimal for the economy as a whole as Keynes had shown; but let us forget the Keynesian argument for the moment. Even so, the market solution is suboptimal in the case of agriculture for two distinct reasons. The prices that would rule for agricultural goods in a free market, far from being socially optimal, are likely to be socially disastrous; and the quantities that would be produced of various agricultural goods, or, what comes to the same thing, the land-use that would result if agriculture is left to the free market, is likely to be socially disastrous too.

To keep these two issues separate for analytical clarity, let us assume to start with, that agriculture produces only one good, foodgrains. Now, the demand for foodgrains is price-inelastic, while output is subject to large fluctuations due inter alia to weather-induced shocks. (These characteristics are true of agricultural goods in general). Hence there are wide price fluctuations around the level at which demand and supply would get equalized under normal circumstances. If prices fall to extremely low levels then the peasants get into debt which they are then saddled with for ever; and if prices rise too high then several consumers get edged out of the market, which in the case of a commodity like foodgrains can be quite disastrous.

Two examples of such extremes are the price-fall during the Great Depression which saddled peasants with enormous debts, and the Great Bengal famine of 1943 that left 3 million people dead. Neither of these events was caused by a supply-side shock, a bumper harvest or a crop failure; but I cite them just to illustrate the disasters that sharp food price movements can cause. Incidentally, it is not as if food consumers benefited during the 1930s price drop or food producers benefited during the Bengal famine; they were simply and unambiguously social catastrophes.

The mainstream theory of the functioning of the free market does not even visualize such possibilities. The standard theory assumes for the existence of a meaningful free market equilibrium that all commodities are "gross substitutes", that is, if the price of any commodity rises while the prices of all other commodities remain unchanged, then the demand for all other commodities will rise or remain unchanged. This assumption rules out the very existence of a commodity like foodgrains, in whose case a rise in price will lower the demand for other commodities, as consumers economise on their other purchases to buy foodgrains. Other commodities in short cannot act as a substitute for foodgrains, as should be the case for a meaningful free market equilibrium.

It becomes essential therefore to ensure that foodgrain prices dot rise or fall too much, that government intervention does not allow the free market equilibrium to prevail.

So, the argument advanced by some commentators that free markets should prevail over a regime of intervention is totally invalid.

Let us now move to the quantity aspect, namely the land-use that the free market will produce. For any scarce resource, the way it is used under the free market system depends upon the relative amounts of purchasing power in the hands of its various potential users. An inevitable consequence of leaving agriculture to the operation of the free market will be a shift of land area away from foodgrain production towards the production of crops that are demanded in the West, or towards some other use of land to satisfy the demand of more affluent sections of society. In other words the superior purchasing power of the affluent consumers located abroad and at home will snatch land away from foodgrain production. Even if this does not raise foodgrain prices because of imports from the advanced countries, it will certainly do two things: one is to destroy such self-sufficiency that the country has developed over the years and make us food-import dependent; the second is to increase mass hunger.

Let us take the second issue first. If a plot of land used for foodgrain production earlier employed 10 persons, while the same plot now used for some other crop, say fruits, employs 5 persons, then the shift of land-use from foodgrains to fruits makes 5 persons unemployed. These 5 have no purchasing power in their hands to demand foodgrains, so that even if imports are available in unlimited quantities at the going international price, and even if the country has the foreign exchange to import foodgrains, there will still be an increase in hunger because people will not have the required purchasing power to buy food.

Of course this argument presumed that the shift of acreage was from foodgrains to some other crop with lesser employment per unit area. But the type of crops whose production will be encouraged by metropolitan demand, or the demand of the affluent sections within the country, will on average be less employment-intensive. And of course to the extent that land-use shifts completely away from crop production towards real estate or Golf Courses, the employment per unit area will be even less, which will create unemployment and mass hunger. Mainstream economics does not recognize this simple fact because it assumes that there is always full employment, and also that at this free market full employment equilibrium, everybody can survive.

Coming now to the first issue, namely the destruction of self-sufficiency in foodgrains, the fact that the country now would not produce the foodgrains it requires but has to depend on imports, creates two obvious problems. The first is that adequate foodgrains may not always be available in the world market when the country needs it; this is particularly important in the case of a large country whose import requirement can also be correspondingly large. A variation of this problem is that the world price itself shoots up when a large country, the size of say India, approaches the world market for larger imports.

The second problem is that the real-life world market is vastly different from the text book picture of a market. In the textbook market there are large numbers of buyers and sellers who have a totally impersonal relationship. In the world food market however whether a country gets the supplies it needs depends upon the goodwill of the American and the European governments. They may impose sanctions, they may arm-twist the importing country into toeing their line in foreign policy, or they may demand a quid pro quo by way of some concessions for their companies. So, even if the country has the required foreign exchange to buy foodgrains, and the world market has enough of it, the country may still have to pay an additional non-money price to be able to access it.

For all these reasons if a large country has to make sure that it is food-secure, then it will have to grow this food itself. The decision on what to grow, that is, the pattern of land-use, cannot be left to the free market. Social rationality demands that there must be government intervention to determine what is produced. And one obvious way to achieve this would be to have a set of government-determined prices ruling in the market as opposed to market-determined prices.

In India, after much effort, an entire arrangement had been put in place, involving minimum support prices, procurement prices, issue prices for foodgrains and subsidies, to achieve an outcome different from the market outcome and closer to something that is socially rational. This had been opposed tooth and nail by the advanced countries who wanted countries like India eating literally out of their hands. And it was also opposed by the domestic corporates whose rationality centres around their self-interest and who did not want the government preventing its fulfilment. What the Modi government is trying to do with its legislation is to destroy that arrangement at the behest of the corporates and imperialism.

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