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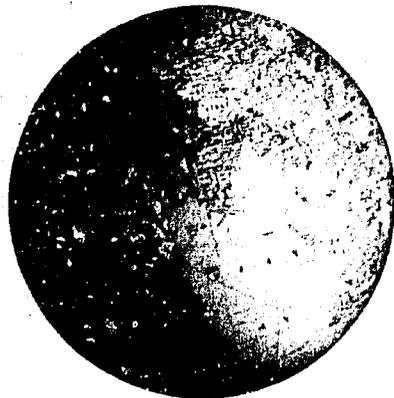
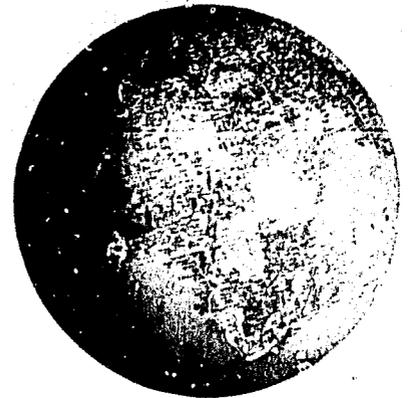
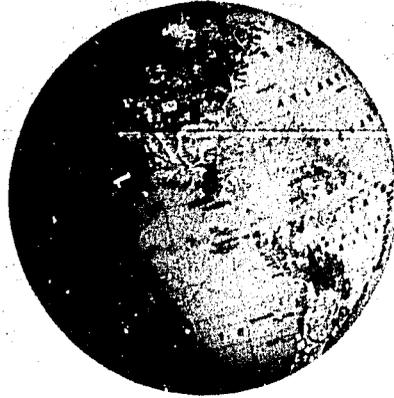
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AGRICULTURAL PRICE POLICY

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Agricultural price policy has remained a controversial issue over the past two decades. It has, over this period, swung from complete restoration of free trade after the Korean War boom, to virtual abolition of free trade in several parts of India by the mid-sixties.

The range of policy measures have often originated in political pressure, popular biases, inadequate knowledge, or simply in developmental zeal. Indeed, more often than not, they were a reaction to a series of unexpected crises than to planned measures that carefully considered the various requirements of a long-range price policy.

The gradual shift to free trade in foodgrains after the Second World War was brought about by the realisation that the "continuing food crisis was likely to perpetuate in an artificial manner as a result of the high commitments undertaken by the Government on one hand and the difficulties of procurement on the other",¹ and that "the real solution is not imports or controls on procurement and distribution, but that it is only a substantial increase of domestic production within the earliest possible time that can solve the Indian food problem".² The failure on the food front, aggravated by a series of poor crops, resulted in resurgence of controls on distribution in the later 1950s and their further intensification in the mid-60s, and was followed by virtual abolition of free trade in several States.

Compulsory procurement of marketed surplus, either partial or complete, at prices that disregarded market forces, has been a failure. Government has failed to procure more than 10 per cent of the total production even with the maximum gearing of its administration to procurement. At the same time, it has increased its commitments by introducing statutory rationing across the board in all large urban centres. It has had to depend heavily on imported food for distribution. And, meanwhile, there has been an extensive black market in foodgrains that handled approximately two-thirds of the marketed surplus during 1965-67. Understandably, therefore, food policy became a centre of debate.³

[The author is indebted to John W. Mellor for his critical comments.]

The popular view in India, as elsewhere, is that markets for agricultural commodities do not operate efficiently in price signalling and that there are large spreads between prices paid by consumers and those received by producers, both over time and space, and that these are caused by monopolistic elements. The view is shared by those in academic circles who support the present price policy. Yet the literature on the food policy debate amply shows the concern of many prominent economists who oppose the present policy on procurement and the consequent reliance on imported supplies for feeding the urban masses.⁴

It is essential to examine the available evidence to ascertain whether the markets are, in fact, inefficient, or whether this popular belief is prompted by political victimisation of a small group of individuals holding little power at the ballot boxes. Academic interest in distributional arrangements is aroused, however, not so much because of the contention of superiority of one economic system over another, but because the choice of the marketing system has become an integral part of the agricultural price policy in India. It is thus not enough to resolve the issue of competitiveness, of the grain markets. For, even if the markets are efficient, they may have certain unacceptable features — such as that they may operate in a manner that lends a great deal of year-to-year instability to the price level,⁵ or that they may provide a price level which adversely affects the growth of the industrial or agricultural sectors.

It may be essential then to improve the existing distributional arrangements or to replace them altogether. Any such change needs careful consideration because of the impact it can have on several important factors affecting long-run economic development. Mobilisation of market supplies for urban consumption, stability of prices, long-run distributional efficiency, optimum utilisation of financial resources both private and public, balance between prices of food and non-food crops, and balance between prices of agricultural and non-agricultural commodities, are just a few of the more important factors influencing long-run growth rates.

Only some of these issues have received careful consideration in the recent food policy debate. The present food policy has not only failed to mobilise market supplies, it has as a consequence also failed to provide stability to the domestic grain market. This is evident in the fact that a large portion of the domestic marketed surplus is exchanged at prices other than those fixed by the Government. Critics of the policy have argued that prices of domestic foodgrains show a great deal of regional and seasonal variation, which is caused not only by movement and stocking restrictions imposed by Government but also by the fact that the market does not really follow the rules of the open market.

However, what has escaped the opponents of the present policy is the effect of such restrictions on the distribution efficiency both in the short and long run. The black market has, in the short run, resulted in a dispersal of quantities that would be mass-handled in open trade and increased costs of marketing because of small-scale handling and introduction of illegitimate charges in regular market costs. This has resulted in an emergence of a class of profiteering intermediaries who receive a major share of the consumer's rupee and distorted price signals thus further affecting resource allocation.

Continuation of such a policy also has harmful long-run effects which have never received the attention they deserve. The long-run aim of the distribution system in a developing economy, such as India, should be not only to bring about more efficient processing of food, where at present antiquated methods result in heavy losses (such as in rice milling), but also to encourage increased processing and packaging of food where none exists. A black market or, even a chronic fear of its existence, will only discourage such modernisation of the distributional system. Even under the present distributional arrangements, a great deal needs to be done to bring about better crop forecasting and dissemination of stock and crop information in the existing market structure. This would be difficult to bring about when the very existence of the market structure is constantly threatened.

Another feature which has received little attention in policy debates is the question of allocation of scarce capital to the public and private sectors. Two distinct but related issues need careful consideration. First, whether replacement of the traditional market structure by a Governmental organisation will bring about a more efficient distributional system — and here the cooperative sector should be treated as part of Governmental organisation since it is mostly superimposed, at least in food marketing, by a Governmental policy. To resolve this issue it is essential to examine the available evidence to ascertain the inefficiency of the existing market structure. The second issue that needs consideration is whether private capital can be reallocated in the manner desired or whether public resources (financial and administrative) should be reserved for investment in areas where private capital will not flow very easily. Here we should consider reallocation of both financial as well as human capital since trading involves considerable skill — a realisation that dawned on co-operative marketing agencies after much hard competition. It is necessary to weigh the benefits accruing to reallocation at both ends, private capital out of trading and public capital into trading, before introducing any hasty policy measures. If the existing market structure seems sufficiently competitive to begin with, such an evaluation may, however, not be necessary.

An additional feature of the present food policy has escaped attention of its critics. Governmental interference through such policies as

zoning, distribution, procurement, ceiling prices, etc., has been directed mainly at keeping down prices only of cereals, and not of other crops such as pulses, oilseeds, cotton, jute etc. Consequently, prices of these crops have been oscillating more or less with the free market forces, whereas those of cereals have remained controlled.⁶

There is sufficient evidence that individual crops show an elastic supply response to changing prices.⁷ There is also considerable evidence that commercial crops (as distinguished from subsistence crops) such as cotton, jute, etc., show a higher elasticity of supply.⁸ In these circumstances it is likely that, if prices of commercial crops are allowed to increase much more rapidly than those of food crops, there would be a shift of inputs from food crops to non-food crops. It would be worse if scarce agricultural inputs such as water, fertiliser and pesticides, which are provided for the very purpose of bringing about technological change in foodgrain production, are used in the cultivation of commercial crops because of the relatively higher prices of the latter.

Other factors which may lead to a shift to commercial crops are (1) uncertainty regarding prices of foodgrains, and (2) relative ease in the marketing of commercial crops. Not only has price policy been aimed at lower cereal prices, but the nature of controls has changed so frequently as to create a great deal of unpredictability.

It is, therefore, necessary to define the goals of agricultural price policy. A policy of controlled food prices and of a free market for commercial crops may result in an increase in the production of commercial crops at the cost of an increase in production of foodgrains. This would be contrary to the goal of self-sufficiency in foodgrains so highly cherished by the policymakers. Conclusions from the preceding discussion are obvious. If the goal is to reach self-sufficiency in food production it is necessary to allow foodgrains prices to remain on par with prices of other agricultural crops. This would stimulate allocation of resources to food crops. And if this is achieved through a free market, increases in demand for food would be checked through the effect of high price elasticity.

The last issue concerns the terms of trade between agriculture and industry. Historical evidence from developed countries is overbearing in favour of turning the terms of trade against the agricultural sector.⁹ Even in India, the question of using high agricultural prices for increasing agricultural production was dismissed as unimportant by the British administrators.¹⁰ Although little work has been done on the aggregate supply response to relative changes in sectoral prices, the available evidence of response of individual crops, their marketed surplus, and the use of inputs, suggests that though terms of trade may not by themselves be sufficient to bring about an agricultural revolution, they may accelerate or retard the growth rate initiated by a technological change.¹¹

The choice of the distributional process is therefore of immense interest not only because of its efficiency but because of its impact on factors crucial in economic development. It is in this light that one must evaluate the performance of the traditional trading sector with regard to 1) efficiency of the structure and 2) causes of inefficiencies if any.

An extensive study of the Indian grain trade has been recently completed that extends to 30 major primary, secondary, and terminal markets of jowar, wheat and rice in the States of Maharashtra, Punjab, West Bengal and Tamil Nadu. The study covers weekly price movements over the period 1955-56 to 1964-65¹² and analyses intramarket and intermarket price movements of the three major cereals. The findings of the study are of considerable interest in view of the current price policy debate in India.

Statistical analysis of price variations over time and regions was preceded by first-hand observation of the market structure and collection of information through informal interviews of traders, market officials and cultivators. The statistical information is not by itself adequate to arrive at specific conclusions unless it is coupled with direct observation. Traders and market officials were, therefore, interviewed extensively through informal discussions regarding trading practices, availability of transport, factors influencing storage decisions, market intelligence available to traders, degree to which entry is free in the trade of agricultural commodities, capital as a factor leading to monopoly, problems of co-operatives, transport facilities, role of caste in entry, extent of partnerships, and other matters. These discussions proved useful for a number of reasons. It was possible to make judgments about trade that were independent of text-books or official reports on marketing in India. Second, the informal discussions helped to generate hypotheses for statistical testing and to interpret results obtained from the statistical study where data proved inadequate. Interviewing primary reporting agencies was also, therefore, essential to be able to use the existing data effectively.

The information collected through such informal interviews provides a number of hypotheses quite contrary to the prevailing views on the subject. First, the number of intermediaries seems much too large to permit monopolistic practices in trade. Due to intramarket and intermarket competition among a large number of intermediaries, profits tend to be small, despite the powerful bargaining position enjoyed by a few traders vis-a-vis the producer and the fellow trader. There is reason to believe that by and large collusion, either tacit or overt, is unlikely to be successful in agricultural trade. High profits earned by a few traders are not monopolistic returns but can be attributed to their large volume of operation resulting from their command of capital, a scarce resource in Indian trade. The high profits of the few large traders can also be explained in terms of the skill of these traders in judging market trends rightly and in their speculation in short-term inventories. The unstable

market conditions in India provide a number of opportunities for a skilful trader to make profits. Traders on the whole appear to be relatively well-informed on prices and demand conditions. The market intelligence available to them is mostly through private agencies and through their contacts in various market centres. Due to the lack of a well-organised agency for disseminating market information, the traders' view of stocks and of overall supply position is, of necessity, poor.

To study regional price variations, prices of comparable varieties of jowar, wheat and rice were each compared in a number of producing and consuming market centres. The degree of relationship between prices in different market centres was taken as an indicator of market integration. Price differences were considered in relation to the costs of transportation. Where differences were found to be greater than transport costs, an attempt was made to examine factors underlying such excessive price differences. Relations between rice and paddy prices were also examined in relation to processing costs.

The study of regional price disparities suggested that the markets under study are closely related with one another, that prices in the major consuming centres have considerable influence on prices in the producing centres and on prices in other consuming centres. The price differences for comparable varieties are most of the time not greater than costs of shipment. When-ever the difference is positive it does not remain so for any considerable period of time. Prices of different varieties seem to differ considerably and are likely to give a misleading view of high regional price differences as the price data, in many cases, do not specify the variety to which they relate. The positive margins (ie, difference above the cost of shipment) for comparable varieties did not show either an increasing or a decreasing trend during the period under study. The margin between the price in the primary market and the parity price in the whole-sale market, in some cases, indicated marked seasonality. The margin tends to be high in the immediate post-harvest period and declines substantially in the off season. This seasonality can be explained, first, in terms of the consuming centres' time-lag in adjusting to new seasonal prices in the producing centres. The rather high margins in the post-harvest period can also be explained by the difficulties of transport encountered in that period due to pressure on the limited transport facilities. The periods of high margins thus generally seem to be closely related to the shortages of transport facilities in those periods. They also appear to be a result of lack of shipments between markets resulting from official movement restrictions imposed frequently during the period under study. Restrictions caused accumulation of grain in the producing markets which was not completely absorbed by the rest of the markets. The failure of grain flows to shift from out of state to internal markets appears to be a result partly of shortage of facilities for shipment of grain and partly of the failure of demand from the consuming centres to shift to the new supply in the producing centre. This results from preferences of consumers for particular varieties of grain.

The study of market integration suggests that a reasonably well organised and competitive system of private trade exists in India. The existing price differences over regions at present are mainly due to lack of adequate transportation facilities and due to the hindrances to perfect mobility imposed from outside the trading sector (such as transport bottlenecks or official restrictions), and are therefore best regarded as consequences of imperfections in mobility rather than of monopolistic elements.

A study of the extent of seasonal price fluctuations and storage costs of rice, wheat and jowar during 1955-56 to 1964-65 was made, in order to examine profitability of storage. The analysis indicated substantial year to year variation in seasonal price patterns. These price movements when considered in relation to costs of storing grain, from the harvest until the off-seasonal peak, suggested that storage is not always profitable because the off-seasonal price rise does not always cover storage costs. Heavy losses in some years are balanced by gains in others. The hypothetical returns, on the average seem low. Thus the assumption that traders make excessive profits does not seem justified. The analysis of stockbooks and profit and loss statements of traders suggested rapid turnover of stocks. Traders, in actual practice, did not store as long as was presumed in the analysis of hypothetical margins. Their actual margin was on an average lower and showed lower year-to-year variability compared to the hypothetical estimates. Profit rates earned by various traders in a single market and quantities handled by them show considerable variation from year to year and from trader to trader.

An attempt was made to analyse variations in the seasonal pattern in terms of changes in arrivals (where arrival data were available) and in production at various levels. The relationship between arrivals and production was also examined. Wheat marketings in Punjab showed a highly significant relationship with changes in wheat production in the surrounding areas. This result seems of interest in view of the fact that, in Punjab, almost all the marketed surplus passes through primary wholesale markets. No such systematic relation could be established between arrivals of jowar and rice and their production in the primary markets of Maharashtra and Tamil Nadu. This was partly due to the greater prevalence of village sales in these areas as compared to that in Punjab and may have been partly due to imperfect recording of market arrivals. Harvest prices, and off-seasonal prices, arrivals, and production, all showed a statistically significant increasing trend between 1955-56 and 1964-65. Except in Tamil Nadu, the year to year variation in the seasonal price pattern could not be explained by changes in production and/or in arrivals. In other words, increase in production in a year over the previous year did not necessarily result in less off-seasonal price increase and *vice versa*. This seems to be due to the influence of various other factors on cereal prices. Overall demand for each of the cereals was to a considerable extent determined by changes in the production of the other two cereals. Demand for these cereals was also influenced during

the period under study by various official policies such as imports and distribution of cereals, inter-district, inter-State and inter-zonal movement restrictions, occasional procurement, and also changes in money supply. All these factors had varying influences on prices depending on the timing of their adoption and on the length and effectiveness of their implementation. In some cases prices were also influenced by the fixation of ceiling and floor prices.

It cannot be said what seasonal pattern prices would exhibit if the grain market were left to free interplay of market forces. It is likely that prices would still show an erratic seasonal behaviour due to erratic changes in production, and due to mis-estimates of production and of storage stocks by the trade. Given the nature of the market intelligence available to the traders, it seems unlikely that they would be able to predict the crop size accurately and plan storage operations accordingly. The seasonal price pattern may also depend on the carry-over stocks of grain on farms and on the pace and pattern of market arrivals.

In view of these findings, it would seem that an open market in grain would reduce regional price disparities provided the basic competitive conditions of entry, knowledge and mobility are met. Various steps could be taken to foster intramarket and intermarket competitiveness. Those which flow directly out of this study are discussed below.

Availability of transport needs to be increased in major exporting markets that have a tendency to glut during the harvest season. In the short run, this can be done by assigning more railway wagons to the major assembly centres. In the long run, improved network of transport will be reflected in increased market efficiency. A continuous flow of grain between primary and terminal markets will reduce intermarket and intramarket price disparities both of which appear because of the depressed prices in producing centres in the peak marketing season.

Market information available to the trading sector regarding crop outlook and stock position needs to be improved. Intelligence currently available to traders is inadequate and is not likely to improve unless the nature of the intelligence agency is changed. There has been a general recognition among official circles of the value of improved forecasts, but much has been done in the past few years to increase accuracy and promptness of crop forecasts. However, there is no awareness of the need to make such information available to the trading sector. Also, the size of stocks in various important surplus and deficit regions, both at the farm and the market levels, could be estimated by a central market intelligence agency through frequent surveys.

Improved market intelligence will have to be coupled with a policy of open market operations and buffer stocks. The advantages of such a policy need hardly be emphasised. Purchase operations undertaken in

years of bumper crops would keep prices from falling excessively in those years and would provide stocks in years of scarcity for distribution to industrial labour and to vulnerable sections of the population. Building of buffer stocks is often dismissed by several economists as too much of a luxury that a poor nation cannot afford. It should be kept in mind, however, that Government has already committed itself to a procurement policy that tries to handle large portions of the marketed surplus without providing a sense of permanence to the policy. Yet a buffer stock policy would create a degree of certainty regarding Governmental role in grain trade.

The current dependence on imports (mostly under PL480) has created a great deal of unpredictability as to the size and timing of the distribution, since Governmental agencies themselves have no control on the stocks available to them. However, as there has been little systematic planning of the distribution programme one does not know to what extent the blame could be passed on to the aiding nations. In the future, advanced knowledge of the size of stocks should be an absolute prerequisite for any perspective planning on distribution. Aiding nations could go a long way in stabilising domestic food prices in the aid receiving nations by providing some certainty to their aid programmes.

The unpredictability of Governmental action has not been restricted, unfortunately, to its distribution programme but has been extended to the whole realm of food policy. The movement restrictions, zones, levy, ceiling prices, stocking restrictions, etc., were not part of a carefully thought out policy to prevent instability, but were more a reaction to a series of unexpected crises. Such interference accentuated the instability by leading to a great deal of uncertainty in private trading operations.

The requirements of stocks built up by traders changed from time to time with changes in the area of their trading operations, thus causing sudden excesses and shortages in markets and leading to panicky actions on the part of traders. Fixation of ceiling and floor prices which disregarded market forces resulted in the withholding of stocks by cultivators on a scale unprecedented in the past. The aim of Government policy in the future should be to create stability rather than panic and uncertainty.

Competition can be enhanced by extending the system of market regulation where it has not made any major strides. The purpose of market regulation should be to create favourable marketing conditions through such measures as standardisation of weights, measures and market charges, grading of the produce, dissemination of market information, open bidding of prices, better storage facilities in market centres, etc. Such a policy has been already considerably effective in areas where market regulation has been in operation and in the long run has shifted marketings from small village markets to primary markets where competition is more active.

The overcrowded nature of the grain markets adequately illustrates the ease of entry into trade. Certain Government regulations may, however, discourage such a phenomenon. The restrictions on milling licences are a case in point. This policy has prevented installation of technologically and economically more efficient plants, thus leading to high market margins. Much could be done to regulate new entry into trade so as to foster rather than discourage competition.

NOTES

- 1 Foodgrains Policy Committee, Interim Report, Government of India, 1947, p 11.
- 2 Ibid, p 12.
- 3 For a debate on the agricultural price policy in India, see: Report of the Agricultural Prices Commission on Price Policy for Kharif Cereals for 1965-66 Season, Ministry of Food and Agriculture, Government of India, 1965. Raj Krishna's three articles in Economic Times, October 27, 28, and 31, 1964. Also see his "Government Operations in Foodgrains," Economic and Political Weekly, Volume II, Number 37, September 16, 1967, pp 1695-1706.
K. N. Raj in Times of India, January 20, 1966, M. L. Dantwala, Times of India, February 10, 1966, K. N. Raj, Times of India, February 16, 1966, Dantwala in Times of India, February 19, 1966, M. L. Dantwala: "Incentives and Disincentives in Indian Agriculture," Indian Journal of Agricultural Economics, April-June 1967. V. M. Dandekar: "Agricultural Price Policy: A Critique of Dantwala," and Dantwala: "Agricultural Price Policy - Reply," Economic and Political Weekly, Volume III, Number 11, March 16, 1968, pp 454-459. Also, Edward Mason: "Economic Development in India and Pakistan," Occasional Papers in International Affairs, Number 13, Cambridge, The Centre for International Affairs, Harvard University, 1966. T. W. Schultz: "Economic Crisis in World Agriculture," Ann Arbor, University of Michigan Press, 1967. John W. Mellor: "Functions of Agricultural Prices in Economic Development," Indian Journal of Agricultural Economics, Volume XXIII, Number 1, January-March, 1968. Also, Raj Krishna: "Agricultural Price Policy and Economic Development" in Agricultural Development and Economic Growth, Herman M. Southworth and Bruce E. Johnston (editors), Cornell University Press, Ithaca, New York 1968, pp 497-540.
- 4 Although concern was expressed in the context of food shortages in the sixties, the problem is still likely to remain with us as long as production fluctuates with vagaries of weather and is just adequate to make India self-sufficient.

- 5 This may simply be due to fluctuations in supplies, but may nevertheless necessitate interference. Such a problem of year-to-year instability is likely to remain with us for several years despite the recent strides in food production.
- 6 Some may challenge the effectiveness of the policy. However, even they will not dispute that cereal prices received by farmers have been at least somewhat lower than what they would have been in the absence of Governmental intervention at least because of resultant inefficiency in marketing if not directly due to Governmental action.
- 7 See Raj Krishna's excellent article on "Agricultural Price Policy and Economic Development," in Southworth and Johnston. op cit pp 49-548, for review of literature in this area.
- 8 This is partly due to greater use of purchased inputs, partly due to the market oriented attitude of the cultivators who grow them and partly due to the fact that individually, the crops constitute small portions of the total cultivated land and, therefore, can make proportionately larger inroads into the rest of the cultivated land as compared to foodgrains that occupy a major portion of the cultivated land.
 "It is conceivable that a crop taking up 10 per cent of the total acreage in an area could have a much more elastic supply response than the aggregate, but it is not conceivable for a crop taking up 95 per cent of the acreage. The lesser crop after all can double in acreage at the expense of the major one, but the major one can not similarly double at the expense of the minor one." John W. Mellor: "The Functions of Agricultural Prices in Economic Development," The Indian Journal of Agricultural Economics, Volume XXIII, Number 1, January-March 1968.
- 9 Raj Krishna, terms this a 'negative price policy.' See his article in Johnston and Southworth for review of the evidence.
- 10 Regarding the demand for higher procurement prices from the provincial governments in 1946 Henry Knight states, "the real question in India was not whether the black market prices were higher, but whether higher procurement prices would cause more grain to be grown in the country, and there is no reason to believe that this would have happened." Henry Knight: "Food Administration in India," Stanford University Press, Stanford, California, 1954, p 216.
- 11 Raj Krishna in Southworth and Johnston, op cit, V. M. Dandekar, op cit.
- 12 See Uma Lele: "Working of Grain Markets in Selected States, India, 1955-56 to 1964-65." Occasional Paper Number 12, Department of Agricultural Economics, Cornell University, December 1968.