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9. Study of Agricultural and Agribusiness Investment in India

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Abstract

In India there are healthy signs of transformation in agriculture and allied activities. Visible improvement has come about through adoption of management practices through on-farm and off-farm operations in this sector. Agri-business has evolved out of the new input-output matrix. Agriprenuers have come to realise the importance of quality changes and value addition in agriculture. Risk and uncertainty being inevitable parameters of modern business, serving farmers and saving farming has become the need of the hour. This paper examines how under liberalisation and globalisation, agri-business has opened new vistas for growth and development of the rural economy in general and of the agrarian economy in particular. The challenges of the rural economy can be balanced provided there is better management in the economy. We suggest that the right type of managerial skills and entrepreneurial expertise peppered with timely measures by the government would help fulfil the growing needs of agri-business.

Keywords : agri-business, globalisation, transformation, rural economy

Introduction

Economic growth in India has accelerated since the early 1990s, when a package of market-oriented reforms to domestic, trade, and exchange rate policies sparked investment and productivity gains in the industrial and services sectors. But agricultural investment has lagged investment in the rest of the economy since the 1980s(table1). Output growth has slowed since the early 1990s and agreement on reforms to strengthen agricultural performance has proven difficult.1 With rising incomes, urbanization, and youthful demographics boosting demand for an increasingly diverse array of food and agricultural products, slowed growth in farm output is translating into rising real prices for some foods, as well as more agricultural imports. Although agricultural imports remain low compared with the size of the Indian economy, they have grown about 13 percent annually in real terms since the early 1990s, and India has emerged as a major global importer of edible oils, pulses, and, most recently, wheat.

Despite the robust gains elsewhere in the economy, the poor performance of India's agricultural sector—including both production agriculture and marketing—has become a key concern of Indian policy makers. Agriculture accounts for about 21 percent of economic output (2003/04-2005/06 average; Reserve Bank of India, 2007) and is the primary source of employment and income for about 58 percent the population (Government of India,Ministry of Statistics and Program Implementation, 2005), including a large share of Indians living below the poverty line. Lagging performance in such a large segment of the economy jeopardizes the sustainability of the economy's strong overall growth. It has also prompted political resistance to extending market-oriented domestic and trade policy reforms into a farmsector comprised mostly of small farmers and agribusinesses that are seen as vulnerable and unready to compete in international markets.

The lack of substantive yield growth and the inefficiency of markets in Indian agriculture are correlated with low levels of public and private investment in agriculture and agribusiness. In contrast to the dynamism evident in other sectors, investment in Indian agriculture and agribusiness—public and private, domestic and foreign—has been low and, until very recently, has shown little growth. Public investment has been partially constrained by the large and increasing costs of farm subsidies. Private onfarm investment has been hampered by policies that have historically taxed producers by maintaining relatively low domestic farm prices, inefficient markets that dampen market returns, and weak institutional support for growers, especially small and marginal farmers. Private agribusiness investors, in turn, have faced state and central regulatory policies—including marketing, interstate movement, storage, and taxation policies—that create disincentives for investment, particularly in larger, integrated agribusiness enterprises. Although foreign direct investment is permitted in most agribusiness the key exception being retailing—the regulatory policies that impede domestic investors

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Trends in Agricultural Investment

Output and investment in Indian agriculture have not been showing the same robust growth as in the overall economy. For the economy as a whole, real growth in gross domestic product (GDP) and in investment—as captured by gross fixed capital formation (GFCF)—have

Table 1

Growth of real gross domestic product (GDP) and gross fixed capital formation (GFCF) in India

Period	Gross domestic product: Total	Gross domestic product: In agriculture	Gross fixed capital formatior: Total	Gross fixed capital formatior: In agriculture
	Growth rates (percent per year)[1]			
1960s	3.7	2.2	5.9	5.9
1970s	3.2	1.6	4.6	5.1
1980s	5.3	3.4	6.0	0.6
1990-04	5.8	2.9	6.1	2.4
1997-04	5.8	1.8	11.3	3.9

[1]Growth rates between 3-year averages centered on years indicated.
Sources: Government of India, Ministry of Program Planning and Implementation, Central Statistical Organization; Government of India, Ministry of Finance, Economic Survey.

both been strengthening, particularly since the early 1990s (table 1). In agriculture, however, output growth has been slowing, and investment has continued to lag that in the overall economy. The annual share of GDP that is invested in GFCF averaged a robust 27 percent for the overall economy during 2005-07; by contrast, GFCF in agriculture was only about 7 percent of agricultural GDP during the same period. And while the rate of investment in the overall economy has continued to rise, the rate of investment in agriculture generally declined through 2000 before turning up slightly during 2000-07 (fig. 1). Although overall agricultural investment in India is low and growing slowly compared with investment in the rest of the economy, some categories of investment have shown signs of growth. Among these are investments in agriculture-related infrastructure and services, and in investment by the private as opposed to the public sector.

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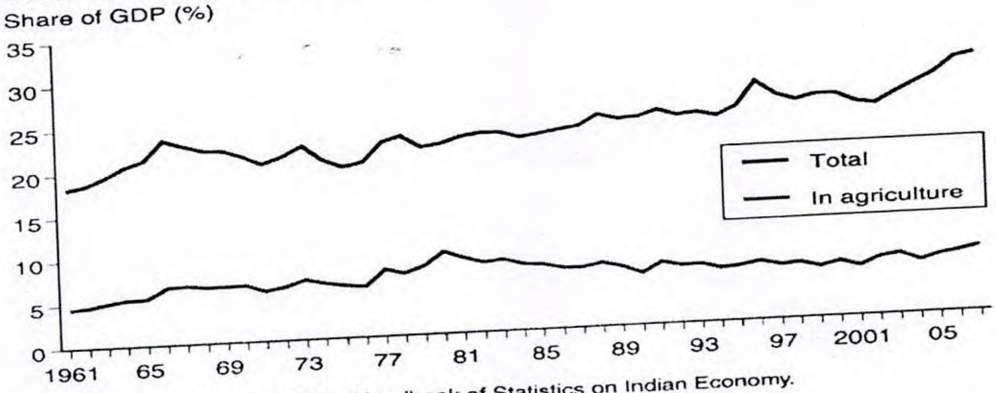
Figure 1
Gross fixed capital formation in India as share of Gross Domestic Product (GDP)



Source: Reserve Bank of India, Handbook of Statistics on Indian Economy.

Investment "In" and "For" Agriculture

The data on capital formation in agriculture (shown in table 1) include primarily onfarm investment in construction, farm equipment, irrigation, and other land improvements. Omitted from these accounts are investments in off-farm agriculture-related infrastructure such as markets, storage facilities, rural roads, and rural electrification. Trends in these off-farm investments termed investments "for" agriculture—are characterized in table 2 (Ministry of Agriculture, 2003). These data, which are available only through 2000, show that investment for agriculture has been growing much faster than investment in agriculture, though it too lags overall investment in the economy. And investments both in and for agriculture, combined, still represent a small share of agricultural GDP—about 15 percent during 1998-2000—compared with the 26-percent share of investment in the overall economy during that period.

Table 2
Growth in public and private gross fixed capital formation in and for agriculture in India

	GFCF in Agriculture			GFCF for Agriculture			GFCF in/for Agriculture		
Period	Public	Private	Total	Public	Private	Total	Public	Private	Total
	Growth rate (percent per year)								
1982-92	-4.3	5.1	1.2	-1.3	5.1	2.0	-2.5	5.2	1.6
1992-99	-0.3	2.4	1.7	1.3	3.0	2.7	0.8	3.5	2.3
1992-97	1.3	2.4	2.0	1.7	3.4	3.2	1.5	4.2	2.8
1997-99	-4.0	2.6	0.7	0.4	2.2	1.3	-1.1	1.8	1.1
	Shares of agricultural GDP (percent)								
1981-83 avg.	4.3	4.0	8.3	6.0	4.7	10.7	10.3	8.6	19.0
1991-93 avg.	2.0	4.8	6.8	3.8	5.7	9.5	5.9	10.4	16.3
1996-98 avg.	1.8	4.5	6.4	3.5	5.9	9.4	5.4	10.4	15.8
1998-00 avg.	1.6	4.5	6.1	3.4	5.8	9.1	5.0	10.3	15.3

Source: Government of India, Ministry of Agriculture, Directorate of Economics and Statistics, 2003.

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Foreign Direct Investment

Prior to 1991, foreign direct investment (FDI) was negligible in the Indian economy because of highly restrictive policies regarding the permissible types of projects and foreign ownership shares, and the repatriation of earnings. In 1991, the Government began to liberalize FDI policies, initially giving automatic approval for up to 51 percent foreign ownership in 34 industries, including food processing, but with continued restrictions on imports and earnings repatriation.FDI began to flow into India immediately following the 1991 reforms, growing about 36 percent annually in real terms between 1990-92 and 2003-05, but with only small amounts flowing into agriculture. Overall FDI growth has been aided by the implementation of additional reforms that have further eased the approval process, increased permissible sectors and foreign ownership shares, and loosened foreign exchange balancing restrictions. Still, FDI continues to make only a small contribution to annual fixed capital formation in India—now averaging about 4 percent (fig.2).

Although many agricultural sectors have been open to FDI since the early 1990s, FDI in Indian agriculture has not been significant. Leading sectors for FDI in India have been electrical equipment (17 percent of total FDI during 1991-2006), telecommunications (11 percent), transport (10 percent), services (9 percent), and power/petroleum refining (8 percent). Of the $38.9 billion in total FDI inflows during 1991-2006, about $1.7 billion—or 4 percent—has been in industries that can be identified as specific to agriculture. Food processing accounted for $1.2 billion of FDI, with agricultural machinery ($166 million), timber products ($107 million), and fertilizers ($78 million) accounting for most of the remainder. Some additional FDI that is classified in general activities, such as trading and services, might also be attributed to the agricultural sector.

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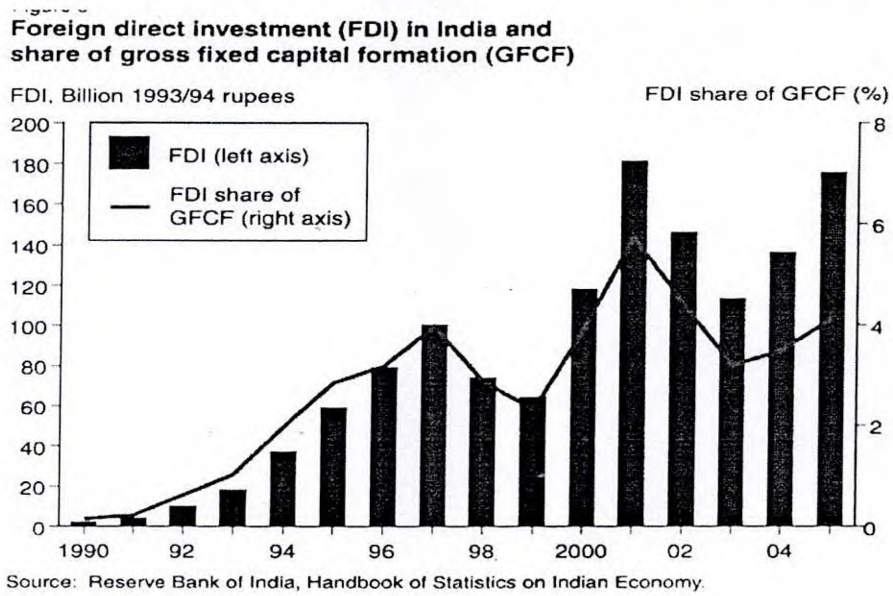

Figure 2

Policy Factors Affecting Investment

India's agricultural sector—including most aspects of agricultural production, marketing, processing, and trade—has traditionally been heavily regulated. Although an earlier study (Chand and Kumar, 2004) identified the importance of credit availability in driving private investment, a broader range of Indian policies and regulatory interventions is at play in shaping the environment for private investment by farmers and agribusiness. To the extent that regulatory and institutional disincentives for investment have resulted in inefficient markets, they can also limit the potential for farmers—including India's many small farmers—to benefit from and respond to signals from India's expanding and diversifying consumer markets.

The primary goals of regulation have been to enhance food security by ensuring adequate supplies of food staples at affordable prices and to support employment growth through labor-intensive import substitution. Historically, regulation of agriculture has included strict controls on foreign trade, domestic marketing and interstate movement of agricultural produce, the scale of agricultural processing firms, and land ownership (in addition to the taxation, labor, and investment measures that applied to all areas of the economy). While regulation has eased since the early 1990s, there has been less reform in agriculture than in the manufacturing or service sectors of the Indian economy. India's Constitution vests the governments of India's 35 States and Union Territories with most of the authority to make and implement regulations and policies affecting the agricultural sector. Central government influence over the regulations and policies promulgated by the States stems largely from the extent to which States are dependent on the central government for funds. Many States tend to have unique regulations and policies, which complicates the regulatory climate facing agribusinesses when operating across State lines. The necessity for obtaining State-by-State legislation and implementation can aiso slow the process of reform.

Overall, the analysis of individual factors below indicates that the regulatory and policy climate is becoming more supportive of new investment by farmers and agribusiness, but it is not clear if the completed reforms will be adequate to stimulate rapid growth in investment, or if the process of implementing reforms will be sustained

Conclusion

Although rising incomes are contributing to expanding and diversifying food demand, investment in Indian agriculture has remained low relative to other sectors and grown slowly since the early 1990s. Lagging private investment in agriculture and agribusiness has corresponded with burdensome regulatory policies, poor infrastructure, and weak institutional support for agricultural markets. Even though India has one of the world's largest agricultural economies, Indian agribusiness is characterized by a multitude of small-scale, nonintegrated processing and marketing firms that use mostly outdated technology and are uncompetitive in global markets. India's numerous domestic policy interventions—along with weak infrastructure and limited institutional support for agricultural markets have been a deterrent to agricultural investment, particularly in large vertically integrated agribusinesses. Interventions have included restrictions on trans porting, storing, and marketing of agricultural commodities, restrictions on the size of agribusiness firms, high taxes on processed products, high-cost credit, and complex food laws. The climate for private investment is also undermined by weak transport and power infrastructure and lack of key services such as market information, risk management tools, and grading/inspection systems

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