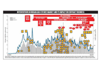
From Plate to Plough: Agri-futures, like China

In November, prices of most major kharif crops crashed below their respective minimum support prices (MSPs), triggering farm distress. One of the many reasons behind this situation is that planting decisions of our farmers are based on last year’s prices, rather than the prices expected at the time of harvest. Signals indicating future prices are largely absent as agri-futures have been decimated by excessive controls and regulation. It is time to think afresh and resurrect agri-futures in India.

In 2003, the Atal Bihari Vajpayee government’s decisions to allow futures markets in India — after a long gap — was hailed as a big and bold step towards better price discovery for farmers. This, in turn, was supposed to help farmers take informed planting decisions. In the initial years — 2003-2007 — agri-futures did show promising growth. But around 2007-2008, they were hit by the global food price crisis. Agri-futures picked up momentum again and peaked in 2011-2012. However, since then, there has been heavy government intervention in agri-futures with higher margin requirements as well as absolute suspensions, resulting in their near collapse.

Chinese agri-futures have had a contrasting trajectory. The agri-futures market was introduced in the early 1990s in China. It struggled for a decade, but thereafter Chinese agri-futures had such a robust growth that by 2016, it was at the top of global chart, crossing the 1,000 million mark, dwarfing India’s 20 million contracts in the process.

What lessons can India learn from China in order to promote its agri-futures and help its farmers in better price discovery? Very briefly, China experimented with several things, including inviting experts from the Chicago Board of Trade in the US, rationalising commodities and exchanges by closing down trade in many items and focusing on a few farm products, especially the less sensitive ones. However, to understand India’s story better, we need to look at the perceptions and actions of three key stakeholders: Policy-makers, regulators (FMC/SEBI), and commodity exchanges. A pre-requisite for the development of a agri-futures market is to have a stable policy environment.



The government, including the regulator, should provide a favourable environment for the futures trade to flourish. Commodity exchanges have to invest in designing appropriate contracts for business development. Abrupt interventions, with frequent changes in stocking restrictions on private trade, have reduced the prospects of agri-futures in India. We collated information about various interventions related to margins and suspensions since 2003 and found that suspensions of agri-futures, as well as high margins, have been targeted more towards commodities that are perceived as sensitive in the common man's food basket (See graph). For example, tur, urad, rice have been suspended for more than a decade now. High margins for sensitive commodities, for example, 100 per cent for potato (August 2014), 95 per cent for chana (June 2016) and 70 per cent for sugar (September 2016) reflect the government's intention of blocking their futures trade.

So, if one has to develop agri-futures in India, the first lesson is to stay away from sensitive commodities (for example, common rice, wheat, most pulses, and even sugar), at least for some time, till futures gain momentum and some depth. It would be prudent to focus on less sensitive commodities like oilseed complex (oilseeds, meals, and oils), feed (maize), cotton, basmati rice and spices. Once markets are developed and the regulator has a higher degree of comfort, the country can diversify to other commodities in the agri-futures portfolio. This is what China also seems to have done. The largest volumes in agri-futures have come from oilseeds. This points to the significance of the regulator's role: Giving a clear direction in terms of the choice of commodities, and then staying the course by adopting a stable policy with minimal interventions.

Second, for the government to be assured that speculators are not rigging markets, the regulator should allow only delivery-based contracts, at least till markets deepen. This is another lesson from the Chinese experience: All agri-commodities traded at the Dalian Commodity Exchange are physical-delivery based.

Third, like its Chinese counterpart, the government of India should encourage state trading enterprises (STEs) to trade on the agri-futures platform. This will boost the government's confidence in agri-futures as it will have ample information from its STEs. In China, STEs, the China National Cereals, Oils and Foodstuffs Corporation (COFCO) for example, have a major presence in the agri-futures' markets. COFCO is directly administered by China's State Council and is the largest food processor, manufacturer and largest exporter and importer in the country. It trades in agri-commodities like soybean oil and meal, palm oil, cotton and sugar in the futures market. India's STEs like the MMTC, STC, PEC or even the FCI can participate on the agri-futures platform in a similar manner, helping it to deepen.

Lastly, it has to be recognised that developing agri-futures is as much the responsibility of the regulator as that of commodity exchanges, and both need to work in harmony for the benefit of various stakeholders, especially farmers who need useful information about future prices for their products while they are planting those crops. Can the Narendra Modi government take bold decisions to revive the legacy of the Vajpayee government and scale new heights in agri-futures, say 200 million contracts by 2022? Remember, China crossed the billion mark in 2015.

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