Impact of Suspension of Agri Commodities on Food Prices and Agri Ecosystem

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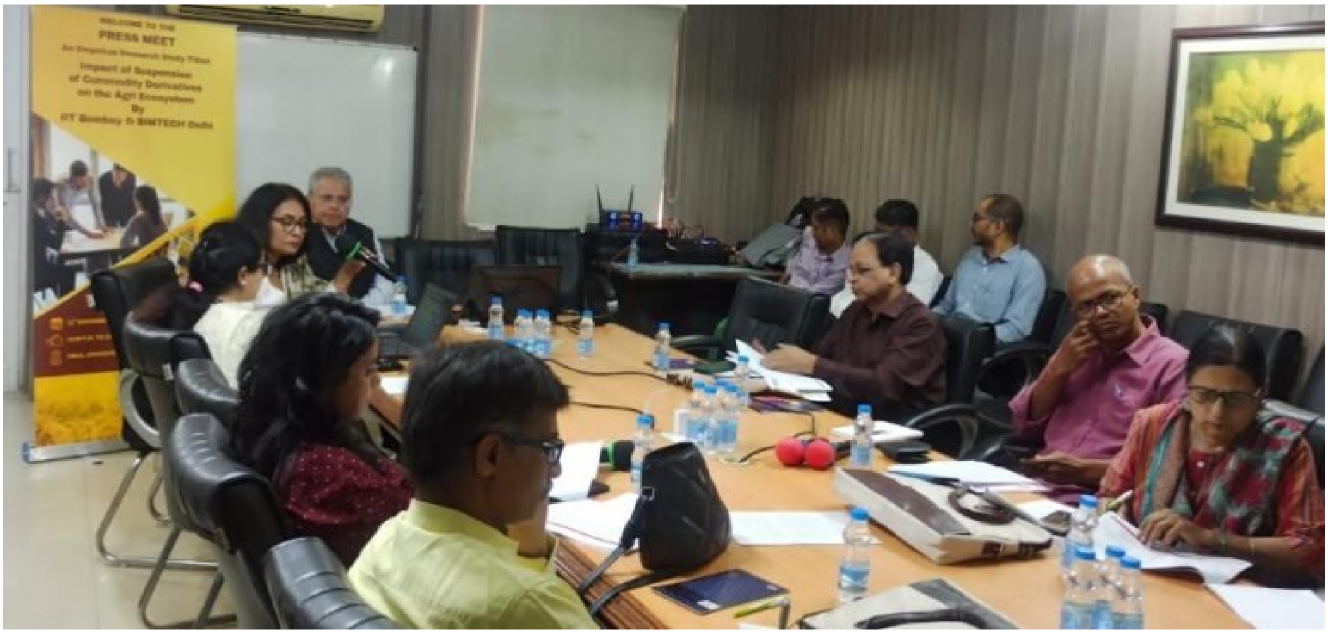

Birla Institute of Management Technology (BIMTECH), Noida, one of the leading B-school in India and the Shailesh J. Mehta School of Management (SJMSOM), IIT Bombay conducted two separate studies investigating the impact of suspension of future derivatives contracts on Exchange Traded Commodities (ETCDs). BIMTECH study titled – **Impact of Commodity Derivatives Suspension on Underlying Commodity Market** is based on empirical data from January 2016 to April 2024 for Mustard Seed, Soybean including Soy Oil, Mustard Oil and Palm oil. It conclusively reports that that suspension of ETCDs (Exchange Traded Commodities) leads to absence of reference price for physical market, and that in turn results in scattered and higher price variance across mandis. SJMSOM, IIT Bombay study titled **– Impact of Suspension of Commodity Derivatives on the Agri Ecosystem** combines primary and secondary research through survey and in-depth interview of physical market participants (including farmers and FPOs) in three states i.e. Maharashtra, Rajasthan, and Madhya Pradesh with focus on Mustard Seed, Soya Oil, Soybean, Chana and Wheat. The study underlines that derivatives contracts serve as an important tool of price discovery and price risk management for farmer/FPOs and other value chain participants in managing the price volatility and inherent risks in the agro economic space.

Prof Prabina Rajib, BIMTECH and Mr. Sanjay Rawal, National President, CPAI

- Two separate studies bust the prevalent market myth ‘Commodity Derivatives trading leads to inflation

In 2021, SEBI suspended derivatives trading in seven agricultural commodity/commodity groups, in what can be termed as largest ever clampdown on Indian commodity derivatives market since the modern electronic versions of commodity exchanges came into existence in 2003. Though a specific reason wasn’t attributed to suspension, however, it is widely believed that the decision was taken with the objective of taming the rising prices due to underlying belief that derivatives trading contributes to price rise. In this context, the two esteemed institutes of India undertook a comprehensive study , evaluating the impact of suspension of commodity derivatives on the commodity ecosystem.

The BIMTECH study, conducted by **Dr Prabina Rajib**, **Dr. Ruchi Arora from BIMTECH & Dr Parama Barai from IIT, Kharagpur** focused on three perspectives

- Impact of unavailability of price anchors for local mandis
- Impact on edible oil prices at wholesale and retail level
- Hedging efficiency in the international markets for the suspended commodities

Commenting on the study **Prof Prabina Rajib** said, "*Periodic suspension of commodity derivative contracts has been a recurring theme in India that is not only hampering the growth of the derivative sector but also the growth of the overall commodity ecosystem. Though, world over commodity exchanges have continued to offer uninterrupted commodity derivatives contracts even in the face of supply-demand mismatch and variations in price. Hence, it was intriguing to deep-dive into the underlying prevalent belief system behind suspensions in India via empirical research and understand its impact on the foremost entity – our farmers and value chain participants. Our study articulates that the belief about derivatives futures trading leads to price inflation may be misplaced. Our analysis of retail and wholesale price determines that specifically for edible oils, not only have prices increased across categories during the post-suspension period, retail consumers are paying even higher prices*."

The IIT Bombay Shailesh J Mehta School of Management study conducted by **Associate Professor (Economics) Sarthak Gaurav** and **Assistant Professor Piyush Pandey (Finance)** focused on four specific objectives.

- To examine how price discovery and risk hedging were affected following the suspension of five ETCDs
- To examine the relationship between futures and spot prices, volume, and volatility and to present commodity-specific price variation associated with the suspension
- To understand if speculation in specific suspended commodities is actually even a matter of concern.
- To gain insights pertaining to futures trading for physical market participants including the farming community whose experiences in the context of futures trading remain understudied.

Speaking about their research **Profs. Sarthak Gaurav** commented, "*Our research finds that there is no evidence of a positive relationship between Commodity Futures trading and spot market prices for five suspended commodities, suggesting that relationship between futures trading and food inflation for the commodities and time period of analysis is misplaced. In fact, the study based on statistical analysis of commodity futures and spot prices data and surveys in three states – Maharashtra, Madhya Pradesh, and Gujarat – firmly establishes that prices of both suspended and non-suspended commodities remained high after the suspension and that both domestic and international demand and supply factors influence retail prices of commodities.*" He further states that, "*Commodity derivative contracts play an important role in price discovery and risk hedging, which is apparent from the analysis. The suspension of futures commodities trading has negatively impacted better price realization because of the absence of reference pricing mechanism and thus also disrupted price risk management practices of participants in the commodity value* *chain. Consequently, the agri-ecosystem in whole has been affected due to hurdles in market access, participation and securing fair prices*."

Adding to viewpoint brought forth by the two studies, **Mr. Sanjay Rawal, President of the Commodity Participants Association of India (CPAI)** said, "*Suspensions of commodities and derivatives trading not only negatively impacts the agri value chain, it breaks the inherent trust in the mechanism in the long term. Hence, it is pertinent to note that such decisions have long lasting consequences for our commodity market both physical & financial. Such actions should be evaluated in the light of potential fundamental price influencing factors like international markets, geo-political environment, weather anomalies, supply chain disruptions etc. on the domestic retail prices.*" He further elaborated that, "*Derivatives trading offers an anchor price for the futures market for price discovery and price risk management. Even Indian Economic Survey 2023-24 has emphasized the important role played by the agriculture derivatives market. I sincerely believe that the commodity futures market can effectively contribute to price discovery only when many consumers, producers, traders, and aggregators use these markets to hedge their risk*."

Dr. Rakesh Arrawatia, Professor, and Coordinator, Center of Excellence in Commodity Markets at the Institute of Rural Management Anand (IRMA) opined, "*Commodity derivatives are market driven tools, that serve as shields during volatile times – safeguarding the interest of value chain participants and bringing sustainability to the commodity markets. Since these are relatively new tools, there is understandably a certain level of trepidation about them. However, the Government should utilize these tools to help the farmers manage their price risk even in the face of price volatility, encouraging them to actively participate, thereby boosting* *volumes and bolstering market confidence*.”