The Pulses Conundrum*

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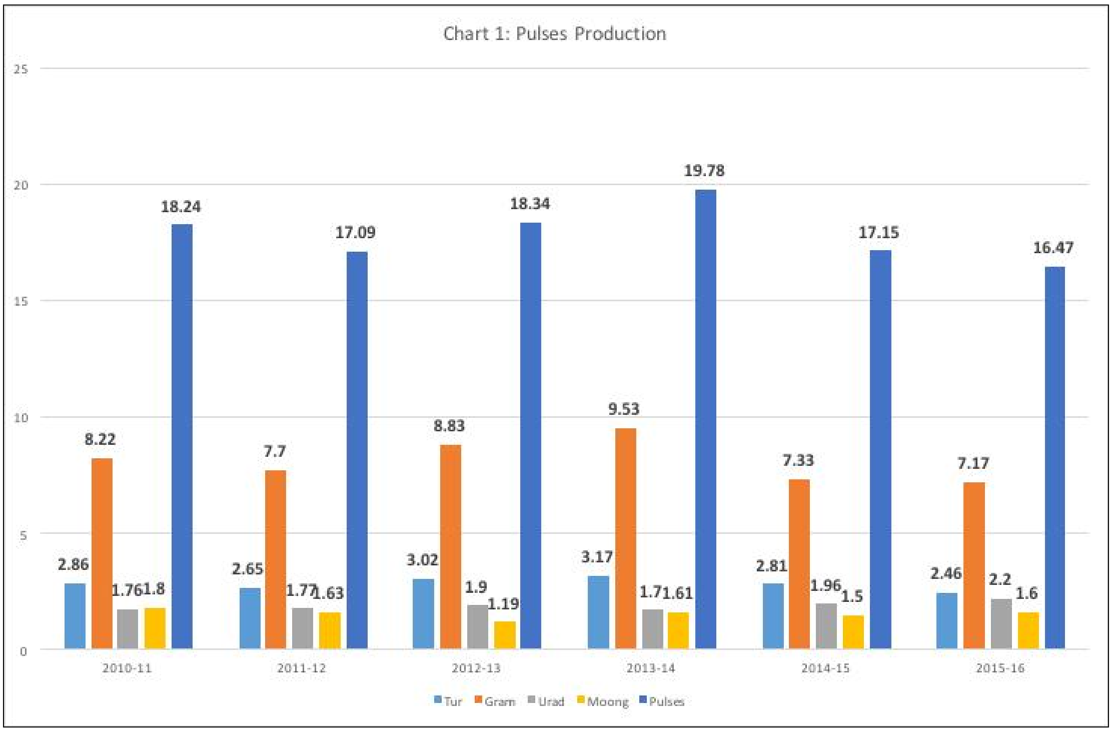
As India prepares for another recovery in the production cycle in pulses, a Finance Ministry appointed committee headed by Chief Economic Adviser Arvind Subramanian has recommended a combination of intervention and market dependence to serve the dual and (not necessarily) conflicting interest of consumer and farmers. This need for a special committee is clearly a consequence of the fact that recent months have been a peculiarly volatile period in the pulses market. Consecutive bad harvests have resulted in sharp falls in production (driven by both acreage and yield declines) and sharp increases in domestic prices. But a good monsoon in the last agricultural year and high prices have triggered a recovery in production that threatens to precipitate to a collapse in prices.

Such cycles in output have meant that pulses production is far more volatile than cereals production. This should not be a cause for surprise, because as compared with a 16 per cent share of irrigated area under pulses cultivation, the irrigated areas under wheat and rice are 93 and 59 per cent respectively. This huge differential in monsoon dependence implies that domestic production swings sharply with variations in seasonal rainfall. Thus two consecutive bad monsoons have resulted in a fall in pulses production from 19.8 million tonnes in 2013-14 to 17.2 million tonnes in 2014-15 and a five-year low of 16.5 million tonnes in 2015-16 (Chart 1). As a result, wholesale prices of gram, the principal pulse, have risen by 65 per cent between August 2015 and August 2016 and 43 per cent between August 2014 and August 2015. This as expected has impacted retail prices that in Delhi (for example) have risen by 49 and 38 per cent respectively during the years ending August 2016 and August 2015 (Chart 2).

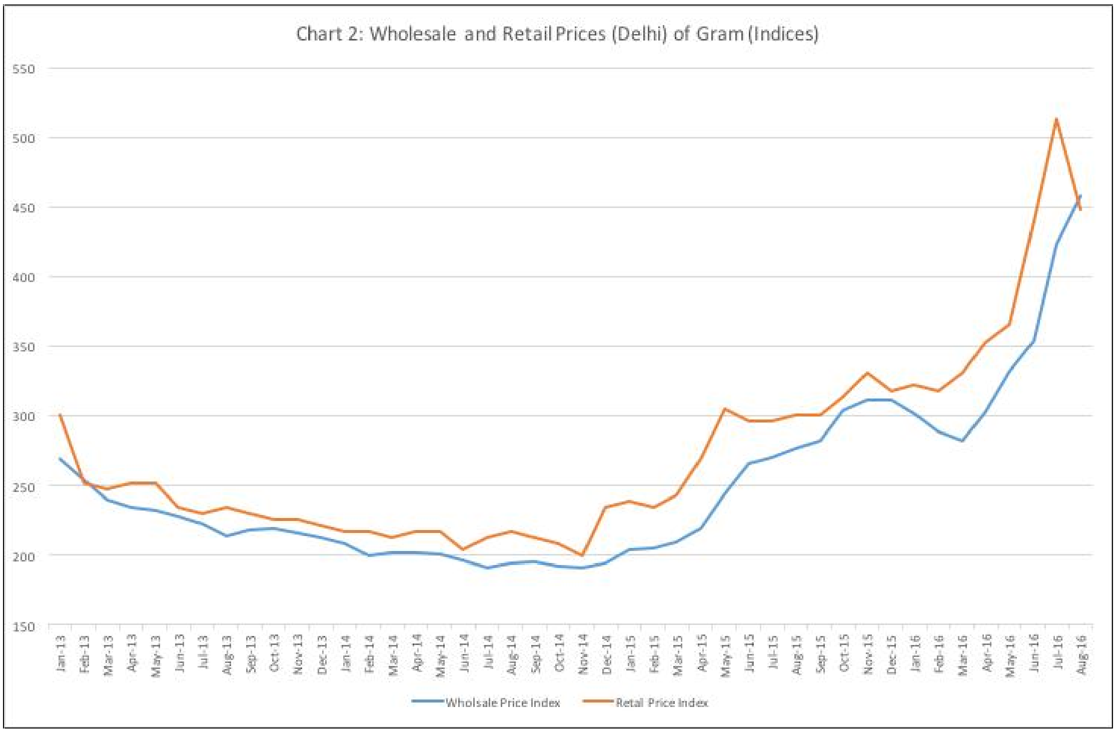
This volatility in prices has to be assessed keeping in mind the facts that: (i) the principal pulses are under the government's support price regime, with minimum support prices (MSPs) being set on a cost plus basis so as to provide a remunerative floor to market prices; and (ii) in bad harvest years the government adopts policies to match supply with demand such as resorting to or encouraging imports, setting limits on stockholding by the private trade and restricting exports. In the context of the sharp fall in domestic production over the last two years the government had responded with similar measures to shore up domestic supply. Imports of pulses rose from 3.7 million tonnes in 2013-14 to 4.6 million tonnes in 2014-15 and 5.8 million tonnes in 2015-16 (Chart 3). Exports fell from 0.34 million tonnes to 0.22 million tonnes between 2013-14 and 2014-15 and stood at 0.26 million tonnes in 2015-16.



The second of these measures is partly aimed at curbing speculation which tends to breed in environments in which supply-demand imbalances drive prices and supply is volatile because of monsoon dependence. Overall, the government's policy is aimed at preventing prices from fluctuating widely, while ensuring that farmers obtain a remunerative price. But there is a contradiction here inasmuch as the MSP encourages speculation. Speculators holding back stocks in the expectation of a price increase know that in case their expectations are not realised they have the option of cutting their losses by handing over their surplus stocks to the government at the minimum cost-plus, support price. On the other hand, the facts that the MSP encourages speculation and the observed tendency is for government to hold back on releasing its own stocks in periods of shortages for strategic reasons (or because of pressure from market participants),ensure that expectations are indeed realised.

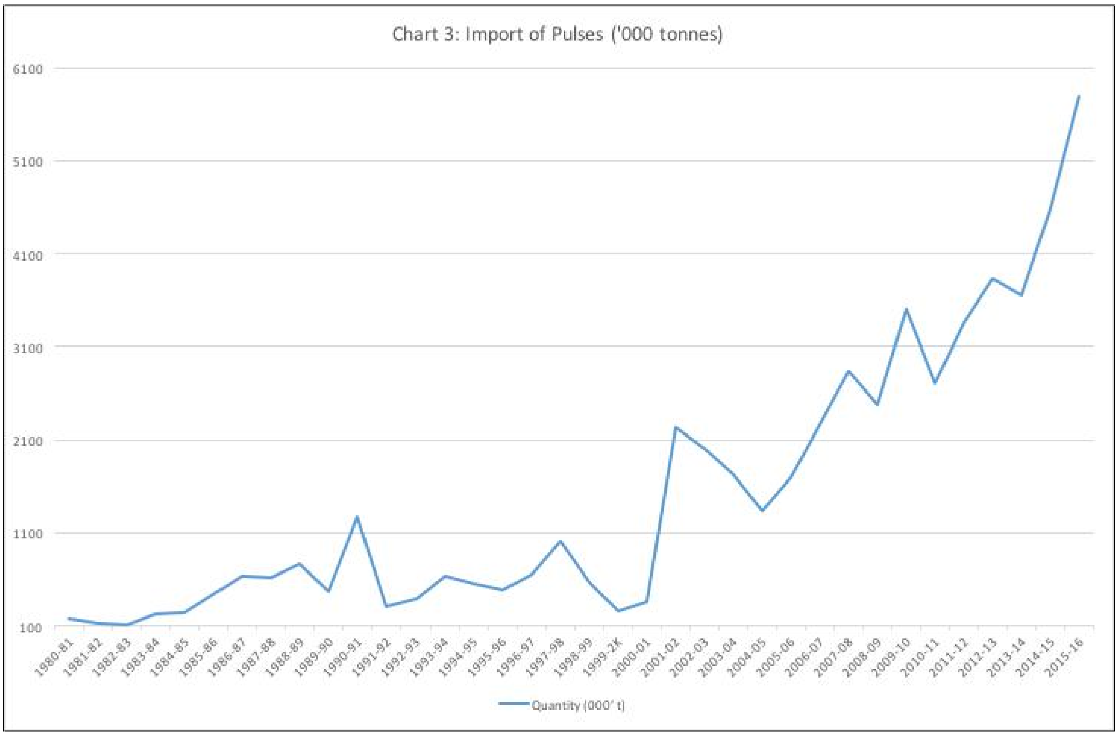
Moreover, India is a dominant buyer of pulses in world markets. This implies that world prices tend to be influenced by how much India imports. If international prices are lower than domestic prices when domestic production falls, India's imports rise, forcing up international prices and bring them close to the domestic price influenced by domestic production and speculation.Meanwhile, given the significant decline in domestic production, government stocks begin to get depleted, which forces it to hold back on stock releases. The net result is that price increases driven by demand-supply imbalances tend to be amplified, resulting in a deviation of policy outcomes from declared intentions.

This is a serious problem in the Indian context, given the crucial role of pulses as a source of protein. Shortfall in availability is common because the government has for long ignored the means of restoring balance between demand and supply, which it could have done by: investing in irrigation, R&D and extension services; not discriminating against pulses in favour of cereals; building stocks with procurement at remunerative MSPs; using those stocks to stabilise prices; and clamping down on speculation.



Despite this, the Subramanian Committee and a host of "experts" and journalists have been critical of "emergency measures" aimed at enhancing domestic supply such as setting limits exports and enhancing imports to curb speculative stockholding. The spurious claim is that these prevent the operation of market forces at a time when the operation of such forces helps the farmer with higher prices. The evidence used to support this view is the sharp fall in acreage, yield and production that accompanies a bad monsoon or a set of consecutive bad monsoons leading to price increases. However, these price increases are inevitably followed by production increases that reverse the price decline. The amplitude of these fluctuations is large, resulting in price volatility that adversely affect consumers when prices rise, though they benefit when prices fall. So any positive effect of market forces in the current environment depends on the extent that the increase in prices in bad monsoon years benefits the actual cultivator as opposed to the trade, and the extent to which the decline in prices in good harvest years hits the cultivator, since the trader can withdraw but the cultivator cannot. The evidence is overwhelming that it is the trade that gets much of the benefit.

Curbs on exports and private stockholding in bad monsoon years are, therefore, needed to restrain speculative trade and protect the consumer, and procurement at remunerative prices and regulation of the trade are crucial in good monsoon years to protect the cultivator. Thus, intervention to stabilise prices through government intervention in the pulses market and curbs on speculative trading are crucial in the short run, not just to reduce volatility but also to allow cultivators to appropriate a reasonable share of the benefits of any price that prevails. In the long run, efforts to raise productivity and ensure a reduction in monsoon dependence are crucial. To call on the government to resort to higher MSPs and lower regulation of the private trade, in the hope that the latter would behave, is naïve to say the least. The issue is not one of morality, but of recognition that markets have failed and only the government can serve the interest of both cultivators and consumers.



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