Building efficient commodities markets: How can warehousing help?

NIPFP

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Warehousing and Food Prices

Decision:
Land for
p1 vs. p2

June
October
(Harvest)
March
(Peak price)

Decision:
Storage for
p1 vs. p2
Warehousing and Food Prices

- High intra-year price fluctuations:
  - Max/Min ratio for average monthly wholesale price of onion in 2013: Onion - 4
  - Vegetable component of price index most volatile
- 70% agricultural land to produce wheat and rice (25% of value of food produce)
- High quality, abundant warehousing can help farmers
  - Store to sell at the optimal time
  - Access loans with commodities as collateral, for consumption during the holding period

1. High quality, abundant warehousing could help
   - *reduce intra-year price fluctuations for non-traded food commodities*, and
   - *encourage more efficient allocation of farming resources.*
Compare: Equity Market

- Issuance of shares
- Depository
- Equity market

Creation → Storage → Trading
Compare: Warehouses as "Depositories"

- **Creation**
  - Production of agricultural commodities

- **Storage**
  - Warehouse

- **Trading**
  - Commodities futures market

- **Depository**

- **Equity market**

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2. High quality storage is essential to connect primary markets with secondary market in agriculture commodities.

- Unreliable storage leads to
  - high transaction costs for trading, especially over long distances
  - difficulties in settlement of trade
  - poor development of negotiable receipts
  - low trust in commodities markets -> low participation

- Uncertainty in storage reduces depth and liquidity of markets
Will a “depository-type” solution work?

- Commodities markets are different
  - Dispersed storage: not feasible to store commodities centrally in one place
  - Diversity: high level of diversity in characteristics of commodities coming from different places

- Solutions have to be different.
The objective

- The objective should not be to improve the quality of warehousing *at any cost*
  - Quality should be market-determined
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- Quality should be market-determined

Modest objective: people should get what they pay for.
- Low uncertainty about what one will get when the commodities are received from the warehouse.
Warehousing market in India

- Weak systems of producing and making available information on quality of warehouses
- Thriving business of collateral management services
- Regulation
  - WDRA gives registration to warehousing, and regulates accreditation agencies
  - Weak penalties for poor performance
Solutions

- Solutions should generate incentives for warehouses to fulfil contracts, instead of prescribing expensive standards

Market-driven
- How can the information infrastructure around warehouses be improved?
  - Information repository on warehouse performance?
- How can users know more about the quality of warehouses?

Regulator-driven
- Strengthening penalties for violations?