

Essential Commodities Act: Essential?

In one of their first actions, the newly elected governments in Delhi and Uttar Pradesh announced the decision to suspend the implementation of the Essential Commodities Act. Observers in the media have interpreted the action as a concession to the interests of grain dealers and traders, no doubt, in return for valuable political support during the recent elections. The provisions of the Essential Commodities Act (ECA) that have attracted most attention are those regulating hoarding and commodity stocks. The decision not to implement these provisions have led to fears that it would encourage hoarding and speculative price rises causing hardship to consumers.

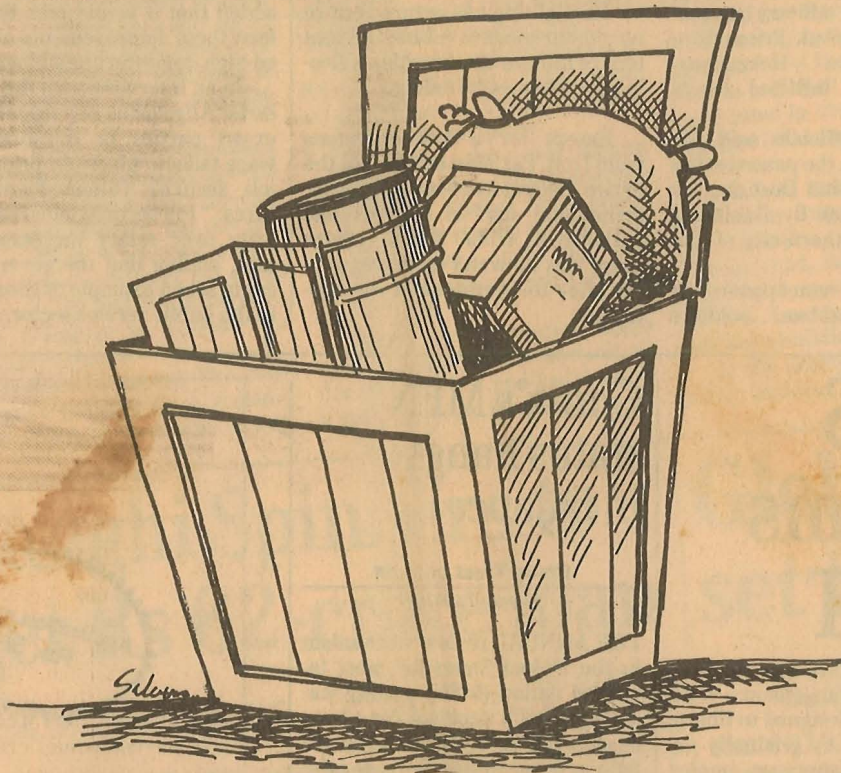
In official policy, control of traders and trading activity has been considered very desirable. Hoarding is after all a pejorative term and conjures up rather unwholesome images from popular cinema. On the other hand, some hoarding is clearly desirable. Since food and vegetable crops are produced only at certain times of the year, some part of the output must be stored to enable consumption at other times of the year. Nobody (in his right mind) would regard such storage as criminal activity. Of course, the really difficult issue is how consumption should be spread across months till the next crop comes by.

The rationale of the Essential Commodities Act is that the decisions about the amount of storage should not be left to speculators alone; rather their storage should conform to government guidelines. The issue whether regulations on stocks are essential really revolves on the question whether speculators make wrong choices? In particular, do they store "too much" or "too little" relative to a desired norm?

Clearly, hoarding is not an end in itself. Commodities are not stored for eternity. The act of storage while it reduces current supplies, also simultaneously augments supplies at a future date. It is wrong to say therefore, as is often asserted, that hoarding raises prices at all times. It is more correct to say that hoarding raises current prices and reduces prices at some future date. But what if the future is very distant? In grains, commodities are very rarely stored from one crop year to next. Stocks are usually liquidated in anticipation of the new crop.

For example, in the case of wheat, stocks are never carried over from March to April when the new harvest is due. This suggests that the wheat that is purchased and stored in the immediate post-harvest months of April, May and June, is actually sold in the lean season, as it should be. Therefore, while "too much" wheat storage increases prices in

The ECA is badly designed and must be replaced by more sensible legislation, says Bharat Ramaswami



the immediate post-harvest months, it also reduces prices in the succeeding months. This is exactly what happened in 1992-93 when a considerable portion of the wheat crop was held back by farmers in expectation of higher prices in the future. Prices, later in the year, remained sluggish as the hoarded supplies found their way to the market.

Official policy, however, ignores the connection between storage today and consumption tomorrow. The single minded emphasis in official policy is on limiting private storage. This is questionable as it amounts to maximising present consumption at the expense of future. It may be argued that the ECA provisions are surely justified in times of scarcity when prices need to be maintained. But if the government has no plans to augment future supplies, such actions, if effective would only tend to ease the pressure on current prices but at the cost of lower supplies and higher prices in the lean season. It is important therefore, for official policy and law to take account of the trade-offs between the present and the future.

Markets for every major agricultural commodity as well as most minor ones are subject to many different government regulations on marketing and trade. In commodities such as wheat, rice, cotton and sugar the government is itself a trader, usually the most important one. The profitability of private hoarding is naturally affected by government policies and actions in agricultural markets. Since government regulations change from time to time, speculators base their decisions in anticipation of government policy. Indeed, a large part of short term price changes are probably due to trading activity sparked off by unanticipated changes in government actions. This would not be unfamiliar to observers of grain markets in India.

For instance, consider some recent market reports in this paper. On December 9, it was reported that "despite circulation of a rumour in the market by speculators that import of gram from Burma had been banned, gram (Rajasthan) eased by Rs 15 per quintal". Two days later it was reported that the "ru-

mour floated by some speculators that import from Burma had been banned further aided the bullish sentiment". On December 8, it was reported that "on expectation of export of wheat desi, offerings from Rajasthan and HP in the local market decreased considerably. As a result, wheat desi flared up by Rs 20/35 quintal". An opposite price movement had occurred earlier when the government announced the sale of wheat from public stocks to flour mills.

The point of all this is that the government is itself a major player in agricultural markets. Although some aspects of government intervention are fairly predictable (e.g., the yearly amount of grain releases through the public distribution system), other actions are less consistent (e.g., export quotas, minimum export prices, monthly sugar releases, timing of imports) making them difficult to predict. It may happen therefore that private storage decision get based on incomplete and inaccurate information leading them to be wrong. However, this calls for greater transparency in government actions.

The anti-hoarding laws of the ECA are badly designed because they ignore the effect of storage on future consumption. Official policy should not be as simple minded as to have the goal of reducing private storage activity at all times. The practical effect of the anti-hoarding provisions of the ECA has been to discourage open reporting and observation of trades and trading practices. Besides discouraging investment in modern methods of storage and in market intelligence, the lack of information on trades makes it harder for market participants to make accurate forecasts of the future. Government policy should be directed at making agricultural markets efficient so that private storage decisions are as right as possible. Since the government is itself a major trader, it must take care that speculative expectations of its actions are not seriously misled due to lack of information.

Instead of laws like the ECA, the government should come up with a regulation which brings trading practices into the open and regulates them for competitiveness. This is exactly the spirit of reforms taking place in the capital market where the Securities and Exchange Board of India (SEBI) has replaced the Controller of Capital Issues. A hopeful sign of a rethink in official policy is the recently appointed committee to consider the establishment of futures markets. Properly regulated, futures markets provide an excellent means of discovering market expectations of future prices which can provide a better basis for private storage decisions.

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