

Market Integration and Price Transmission Analysis of Onion in Wholesale Markets of India

Abstract

The present study was done in **Seven** (seven) major onion markets in India, namely Pimpalgaon, Lasalgaon, Solapur, Pune, Bangalore, Hyderabad and Indore to explore the interdependence of wholesale prices amongst Indian onion markets. The current study employs co-integration analysis of wholesale monthly onion prices in selected marketplaces to determine the degree of market integration. The Trace and Maximum Eigen-value tests results showed that the onion prices in India moves together in the long run equilibrium. As a result, it may be stated that India's onion markets are well-functioning. The direction of information flow was determined by using Granger Causality test. It was found that in few markets pairs, price transmissions were bi-directional whereas between Bangalore and Pune market, no transmission was found. The study reveals that Lasalgaon market is dominating in terms of price determination. The empirical study also recommends keeping a careful eye on diverse market behavioural patterns, since "news" in one market might have an influence on other markets due to the numerous interdependencies.

Keywords: Granger Causality, Price transmissions, Stationary test, bi-directional.

Introduction

Onion is considered as the most highly volatile crop among the vegetables, showing increasing fluctuation of unexpected price spikes & falls. In recent years, such extreme price movements have attracted the attention of policy makers. Prices in horticultural crops play an important role in distributing the resources efficiently and signalling shortages and surpluses, which help the farmers to respond to dynamic market conditions (Haji and Gelaw, 2011). Onion production in India is concentrated primarily in Maharashtra, which accounts for around 30 % of total onion output (GOI, 2016). As a result, supply shocks in major onion-producing regions triggered by either excessive rainfall or drought are immediately transmitted to the country's other markets (Sendhil, *et al.*, 2014; Singla, 2015). Onion prices are more volatile than non-farm commodities due to inherently unstable production. India is the second largest producer of onion after China & it accounts 40.74 % of the total annual

production of the onion among top five onion producing countries of the world as mentioned in Table 1.

Table 1: Top five onion producing countries of the world (Write in Bold)

Country	Production (Tonnes)	Share %
China	24775344	45.73
India	22071000	40.74
USA	3284420	06.06
Iran	2406718	04.44
Russia	1642106	03.03
Total	54,179,588	100.00

Source: (FAOSTAT 2018).

In India, Maharashtra is the leading producer of onion in terms of area and production which accounts 29.55% share of the total onion production followed by M.P (16.97%), Karnataka (11.63 %), Rajasthan (6.57%) and Gujarat (5.90%) of India in the year 2018-19 as showed in the Table 2.

Table 2: Percentage share of area & production under major onion producing states (2018-19) (Write in Bold)

State	Area	% of All India	Area-000 Hectare	
			Production	% of All India
Maharashtra	501.76	38.15	6522.84	29.55
Madhya Pradesh	151.35	11.51	3745.47	16.97
Karnataka	191.34	14.59	2566.43	11.63
Rajasthan	64.15	4.88	1450.00	6.57
Gujarat	52.13	3.96	1303.07	5.90
Bihar	54.60	4.15	1261.45	5.72
Andhra Pradesh	43.87	3.34	1078.22	4.89
Haryana	29.75	2.26	690.99	3.13
West Bengal	35.20	2.68	633.60	2.87
Uttar Pradesh	26.85	2.04	439.64	1.99
Others	163.75	12.45	2379.43	10.87
All India	1315.24	100.00	22071.24	100.00

Source: Department of Agriculture, Cooperation & Farmers Welfare

Because of the spillover impact to other onion markets, the rapid increase in onion market price affects both producers and consumers, resulting in significant inflation in the economy. One of the most essential responsibilities for market players is to understand the price

transmission mechanism, which allows prices to move instantly from one market to another which helps in price control. The marketing of onions in the country has always been a source of concern for both farmers and consumers due to a lack of market intelligence and uncertainty about future pricing. In this background, an attempt has been made to examine market integration among major Indian onion markets. In literature, Granger (1969), Engle and Granger (1987), Johansen (1991, 1995, and 1996), and others set the basis for co-integration analysis in econometric modelling. Accordingly, Paul *et al.* (2016) studied the effectiveness of integration in price forecasting for onion in selected markets of Delhi. Wani *et al.* (2015a,b,c) described market integration as a measure of the extent to which demand and supply in one location are transmitted to another.

The present study uses Augmented Dicky fuller test, Johnsen cointegration and Granger causality test for estimating the market integration and studying the direction of causality in the long run in the selected markets.

Data and Methodology

Time series data of monthly duration for the prices of onion were collected from the portal of NHRDF from the year January 2004 to December 2020 for the study under consideration. Seven national market from various states of India were selected on the basis of highest tri-annual ending average of onion arrivals in the market for the last three year from 2017 to 2020. Pimpalgaon, Lasalgaon, Solapur, Pune markets from Maharashtra, Bangalore market from Karnataka, Hyderabad market from Telangana & Indore market from Madhya Pradesh were selected as national market respectively for the study. The data collected for the study was analysed using the R, E-views 11 & SAS software, respectively.

Techniques and Tools Used

Unit root test

Stationarity in the data series explains the order of differences & it is utmost important for the markets to be in the same order in order to perform co-integration between market pairs. It is very important to test whether or not the time series is stationary because if a time series is not stationary, its behaviour can only be studied for the time period under consideration, it cannot be generalized to other periods & thus one cannot predict such a time series data. So in order to test the data is stationary or having unit root, the famous test known as Augmented Dickey-Fuller (ADF) (Dickey, 1979) test is used.

The presence of unit root (non-stationary) in the underlying series is tested by performing Augmented Dickey-Fuller test using the following regression:

$$\Delta Y_t = \alpha + \beta_i T + \delta_i Y_{it-1} + b_i \sum_{i=1}^p \Delta Y_{it-1} + e_t \quad (1)$$

Where, Y_{it} = Price of a commodity in a given market 'i' at a time 't'; $\Delta Y_{t-i} = (Y_{t-1} - Y_{t-2})$ (t-i – lagged prices & Δ is Differenced series); e_t is pure white noise error-term, α is the drift parameter, T is the time trend effect, β_i , δ_i & b_i is coefficients. The null hypothesis that $\rho = 0$; signifying presence of unit root, *i.e.*, the time series is non-stationary and the alternative hypothesis is $\rho < 0$ signifying the time series is stationary, therefore, rejecting the null hypothesis.

Johansen Co-integration Test

The ADF test was supplemented by Johansen-Juselius Maximum Likelihood Method. The maximum likelihood (ML) approach of cointegration is used to examine the long-run relationship between wholesale prices of onion in selected markets of India (Johansen and Juselius, 1990).

The Johansen technique examines a Vector Auto Regression (VAR) model of Y_t , an (n x 1) vector of variables that are integrated of the order one - I time series. This VAR can be expressed as equation:

$$Y_t = \mu + \sum_{i=1}^{p-1} \Gamma_i Y_{t-1} + \Pi Y_{t-1} + \varepsilon_t \quad (2)$$

where, Γ & Π are matrices of parameters, p is the number of lags (selected on the basis of Akaike information criterion), ε_t is an (n x 1) vector of innovations. Both Γ and Π are the n*n matrixes of the coefficient conveying the short and long run information respectively and ε_t is the n-dimensional vector of the residuals that is identical and independent distributed. To measure the number of cointegrating vectors, Johansen and Juselius (1990) developed two likelihood ratio test statistics (Trace and Max Eigen test statistics) represented as equations:

$$J_{trace} = -T \sum_{i=r+1}^n \ln (1 - \hat{\lambda}_i) \quad (3)$$

$$J_{max} = -T \ln(1 - \hat{\lambda}_r + 1) \quad (4)$$

where, T is the sample size & $\hat{\lambda}_i$ is the i^{th} largest canonical correlation, r is the number cointegrated vector. r cointegrating vector(s) against the alternative hypothesis of n

cointegrating relations. The Max Eigen statistic tested the null hypothesis ($r = 0$) against the alternative ($r + 1$) (Gujarati, 2010).

Granger Causality Test

Granger causality is a statistical concept of causality that is based on prediction. According to Granger causality, if a signal X "Granger causes" (or "G-causes") a signal Y, then present & past values of X may contain information that helps predict future Y (Granger, 1969). At the same time, it is important to note that Granger causality measures precedence & information content but does not by itself indicate causality. The causality test was attempted by the equation given below:

$$\Delta Y_{it} = \beta_0 + \beta_1 Y_{i(t-1)} + \beta_2 Y_{j(t-1)} + \sum_{k=1}^m \delta_k \Delta y_{i(t-k)} + \sum_{h=1}^n \alpha_h \Delta y_{j(t-h)} + \varepsilon_{it} \quad (5)$$

Where, Y_{it} = market 'i' at time 't', Y_{jt} = market 'j' at time 't' and m & n = number of lags determined by AIC.

The null hypothesis is that X does not Granger cause Y. Rejection of the null hypothesis that $\alpha_h = 0$ where $h = 1, 2, 3, \dots, n$ indicates that prices in market "j" Granger-cause prices in market 'I'. If prices in market 'I' also Granger-cause prices in market 'j', then prices are determined by a simultaneous feed-back mechanism (SFM). This is the phenomenon of bi-directional causality. If the Granger causality runs one way, it is called unidirectional Granger-causality & the market which Granger causes the other is tagged the exogenous market (Gujarati, 2010).

Results and Discussions

The descriptive statistics of the selected markets prices are reported in Table 3. High instability/ volatility of prices has been remained in case of Pimpalgaon market (87.17%) followed by Lasalgaon (83.72%) and Bangalore (82.55%) market while comparatively stable volatility found in case of Hyderabad (75.13%) market. The skewness value for all the markets show presence of asymmetric behaviour in them and also the coefficient of kurtosis is very high in Bangalore market followed by Pimpalgaon and Pune market which reflect the leptokurtic distribution and high degree of extreme values.

Table 3: Descriptive statistics of onion prices in selected national markets (Write in Bold)

Markets	Pimpal.	Lasal.	Solapur	Pune	Bangalore	Hydera.	Indore
Mean	1070.44	1085.91	750.86	1063.50	1203.69	1126.49	902.22
Max	5934.00	5105.00	3520.00	5008.00	9200.00	5159.05	3950.00

Min	163.00	151.00	122.00	223.00	320.00	238.00	158.00
Variance	870597	826540	370485	733302	987389	716260	540357
St. D.	933.06	909.14	608.67	856.33	993.67	846.32	735.09
C.V %	87.17	83.72	81.06	80.52	82.55	75.13	81.48
Skewness	2.378	2.052	2.020	2.171	3.780	2.129	1.892
Kurtosis	6.484	4.377	4.352	5.243	22.728	5.193	3.536

Note: Pimpal.-Pimpalgaon, Lasal.-Lasalgaon, Hydera.-Hyderabad, St. Deviation- Standard Deviation

Unit root test

Typically, the Johansen's procedure necessitated that the time series should be integrated at order one, *i.e.*, I (1). The time series data of onion prices in the selected markets were tested using the Augmented Dickey-Fuller (ADF) test to see whether they are stationary at their current levels, followed by their differences. The null hypothesis of both the tests is accepted or rejected based on the critical value and corresponding probability value. The lag length was selected using the Akaike Information Criterion (AIC). Results from the analysis mentioned in Table 4 revealed that prices were found to be non-stationary at their level for all the selected national markets of onion but become stationary after first differencing. Hence, the value of d was taken as 1 *i.e.*, I(1) for all the markets.

Table 4: ADF test results of onion prices for selected national markets (Write in Bold)

Markets	ADF	
	Level	First Difference
Pimpalgaon	-3.96	-5.42*
Lasalgaon	-3.76	-5.30*
Solapur	-3.81	-5.05*
Pune	-3.56	-5.38*
Bangalore	-3.71	-5.27*
Hyderabad	-3.94	-5.21*
Indore	-3.85	-5.40*

Null Hypothesis: Series has a unit root

Statistical critical value of 1%=-3.4625, 5 per cent = -2.8756

** indicates of significance of values at 5 per cent level*

Johansen's Co-integration Analysis

Co-integration between the stationary price series was then evaluated using Johansen's Trace and Maximum Eigen-value tests as the following step. The Johansen procedure for the onion markets of India was applied by following the three steps firstly appropriate lag length was chosen as suggested by the various lag length criterion. Secondly, the order of integration was confirmed by using the ADF and In the third step, two tests, *i.e.*, trace and max Eigen statistics of Johansen's approach based on the vector autoregressive model (VAR) were put into the application to analyze the co-integrating vectors between the selected onion markets. Table 5 and Table 6 shows the results of Johansen's maximum likelihood tests (trace test and maximum eigen-value). The trace test and maximum eigen-value pits no cointegration ($r = 0$) against the alternative hypothesis ($r \geq 1$) that at least one co-integrated equation predominated in the VAR system.

Table 5: Unrestricted co-integration rank test (Trace) between onion markets (Write in Bold)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	p-value
None *	0.63	830.38*	239.23	0.0001
At most 1 *	0.31	266.85*	95.75	0.0000
At most 2 *	0.23	191.86*	69.81	0.0000
At most 3 *	0.22	136.95*	47.85	0.0000
At most 4 *	0.17	85.51*	29.79	0.0000
At most 5 *	0.12	47.21*	15.49	0.0000
At most 6 *	0.09	20.90*	3.841	0.0000

Note: Trace test indicates at least 7 co-integrating eq.(s) at the 5 per cent level

** denotes rejection of hypothesis at 5 per cent level of significance*

Table 6: Unrestricted co-integration rank test (Maximum-Eigen value) between onion markets (Write in Bold)

Hypothesized No. of CE(s)	Eigen value	Max-Eigen Statistic	0.05 Critical Value	p-value
None *	0.638	205.41*	64.50	0.0001
At most 1 *	0.310	74.99*	40.07	0.0000
At most 2 *	0.238	54.91*	33.87	0.0000
At most 3 *	0.224	51.43*	27.58	0.0000
At most 4 *	0.172	38.29*	21.13	0.0001
At most 5 *	0.122	26.31*	14.26	0.0004
At most 6 *	0.098	20.90*	3.841	0.0000

Note: Max-Eigen statistics indicates at least 7 co-integrating eq.(s) at the 5% level,

** denotes rejection of hypothesis at 5 per cent level of significance*

The result clearly indicates the existence of at least seven co-integration equation. The Trace and Maximum Eigen-value tests results showed that the onion prices in India moves together in the long run equilibrium. As a result, it may be stated that India's onion markets are well-functioning. Additionally, the Johansen's Trace and Maximum Eigen-value tests indicate that in these onion markets pairs, wholesale prices are competitive. The findings are consistent with the majority of regional studies, which indicated that the domestic onion markets are well-functioning and that prices are well-transmitted and cointegrated (Reddy *et al.*, 2012; Sendhil *et al.*, 2014; Rajendran, 2015).

Granger causality test

After confirming the integration of prices series, in the next step, pair-wise Granger causality test was performed for seven onion markets to comprehend causal relation between them.

Table 7: Results of pair wise Granger causality test of onion prices for selected national markets (Write in Bold)

Null Hypothesis	Obs.	F-Statistic	Prob.	Dir.
LASALGAON does not Granger Cause PIMPALGAON	203	26.44*	6.E-07	Uni
PIMPALGAON does not Granger Cause LASALGAON		0.19	0.65	
SOLAPUR does not Granger Cause PIMPALGAON	203	29.40*	2.E-07	Uni
PIMPALGAON does not Granger Cause SOLAPUR		0.63	0.42	
PUNE does not Granger Cause PIMPALGAON	203	1.84	0.17	Uni
PIMPALGAON does not Granger Cause PUNE		8.68*	0.03	
BANGALORE does not Granger Cause PIMPALGAON	203	0.09	0.97	Uni
PIMPALGAON does not Granger Cause BANGALORE		16.42*	7.E-05	
HYDERABAD does not Granger Cause PIMPALGAON	203	4.82*	0.02	Bi
PIMPALGAON does not Granger Cause HYDERABAD		22.98*	3.E-06	
INDORE does not Granger Cause PIMPALGAON	203	1.21	0.27	Uni
PIMPALGAON does not Granger Cause INDORE		34.97*	1.E-08	
SOLAPUR does not Granger Cause LASALGAON	203	24.05*	2.E-06	Uni
LASALGAON does not Granger Cause SOLAPUR		0.29	0.59	
PUNE does not Granger Cause LASALGAON	203	0.08	0.76	Uni
LASALGAON does not Granger Cause PUNE		28.15*	3.E-07	
BANGALORE does not Granger Cause LASALGAON	203	0.20	0.65	Uni
LASALGAON does not Granger Cause BANGALORE		42.64*	5.E-10	
HYDERABAD does not Granger Cause LASALGAON	203	0.88	0.34	Uni
LASALGAON does not Granger Cause HYDERABAD		21.93*	5.E-06	
INDORE does not Granger Cause LASALGAON	203	0.19	0.66	

LASALGAON does not Granger Cause INDORE		41.48*	9.E-10	Uni
PUNE does not Granger Cause SOLAPUR	203	0.99	0.32	Uni
SOLAPUR does not Granger Cause PUNE		23.82*	2.E-06	
BANGALORE does not Granger Cause SOLAPUR	203	1.61	0.20	Uni
SOLAPUR does not Granger Cause BANGALORE		26.34*	7.E-07	
HYDERABAD does not Granger Cause SOLAPUR	203	0.11	0.73	Uni
SOLAPUR does not Granger Cause HYDERABAD		26.43*	6.E-07	
INDORE does not Granger Cause SOLAPUR	203	5.46*	0.02	Bi
SOLAPUR does not Granger Cause INDORE		74.96*	2.E-15	
BANGALORE does not Granger Cause PUNE	203	1.37	0.24	-
PUNE does not Granger Cause BANGALORE		0.94	0.33	
HYDERABAD does not Granger Cause PUNE	203	15.19*	0.01	Bi
PUNE does not Granger Cause HYDERABAD		9.40*	0.02	
INDORE does not Granger Cause PUNE	203	11.40*	0.09	Bi
PUNE does not Granger Cause INDORE		16.44*	7.E-05	
HYDERABAD does not Granger Cause BANGALORE	203	14.96*	0.01	Bi
BANGALORE does not Granger Cause HYDERABAD		15.13*	0.01	
INDORE does not Granger Cause BANGALORE	203	35.44*	1.E-08	Bi
BANGALORE does not Granger Cause INDORE		27.97*	3.E-07	
INDORE does not Granger Cause HYDERABAD	203	13.38*	0.03	Bi
HYDERABAD does not Granger Cause INDORE		20.68*	9.E-06	

*indicate rejection of hypothesis at 5 per cent level of significance

The results presented in Table 7 explicates that the few market pairs such as Hyderabad-Pimpalgaon, Indore- Solapur, Hyderabad-Pune, Indore-Pune, Hyderabad-Bangalore, Indore-Bangalore, Indore-Hyderabad showed Bi-directional causality. In these situations, the former market in each pair granger causes the latter market's wholesale price formation, which then gives feedback to the former market. The rest of the market pairs have unidirectional causality. No causal relationship was found between Bangalore and Pune market and *vice versa*.

Summary and Policy Implications

The co-integration and price transmission of wholesale onion prices in seven major Indian marketplaces namely Pimpalgaon, Lasalgaon, Solapur, Pune, Bangalore, Hyderabad and Indore, were investigated in this study. All of the price series in the study state were found to be stationary, indicating that some onion markets were highly integrated and had a long-run price relationship. It is seen that, Lasalgaon market causes the prices of majority of the markets under study in uni-directional manner whereas bi-directional causality has been

found between few markets pairs. It indicates that Lasalgaon market is the dominating market in the price channel. The main reason behind the domination of Lasalgaon market is because Nashik district of Maharashtra is the main production hub in comparison to other.

As a result, onion markets in India are highly cointegrated, implying that the government should continue to encourage the private sector's freedom to operate. The findings of this study might be beneficial in the development of a wholesale market network across the state to improve market integration and price transmission. Market integration is an important tool and prerequisite for effective marketing. This will assist to promote market integration in the long run by establishing marketing infrastructure, pricing information channels, road networks, and transportation facilities, which will help to lower transportation costs and boost inter-regional commerce. These modifications will prevent inefficient onion crop area allocation in India and increase the efficiency of the existing inefficient onion markets. Because the major onion markets in India have a strong long-run price transmission relationship, data on onion prices must be collected and disseminated to both consuming and producing markets. In addition, establishing a real-time Market Information Cell in Major onion producing marketplaces can aid merchants and farmers in analyzing pricing information in other markets throughout the state and country. Farmers can reallocate resources and improve production using this knowledge, and merchants can transfer commodity supply to other markets where there is a local scarcity, perhaps resulting in higher pricing.

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