

PRESENT SCENARIO OF FARMERS AND TRADERS WITH REGARD TO COMMODITY DERIVATIVE MARKET

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ABSTRACT : Commodity derivatives market in India seems like old wine in new bottle. In reality, forward trading in commodities existed in India from ancient times (period of Kautilya's Arthashastra) and the first modern futures market was established in 1875 for cotton contracts by the Bombay Cotton Trade Association, just a decade after CBOT entered the focus and traded its first future. The separate association Bombay Cotton Exchange Ltd was established over widespread discontent amongst leading cotton mill owners and merchants over the functioning of the Bombay Cotton Trade Association. The movement continued by setting up "Gujarath Vyapar Mandali" in 1900 for futures trading in oil seeds, ground nut, castor seed and cotton seeds etc. The chamber of commerce at Harpur established the futures exchange for wheat trading in 1913, the first futures exchange for bullion futures in Mumbai in 1920 and similar exchanges come up in Rajkot, Jamnagar, Kanpur, Delhi and Calcutta. In Calcutta Hessain Exchange Ltd in 1919 and East Indian Jute Association Ltd in 1927 were established further and these two exchanges merged in 1945 as East India Jute and Hessin Ltd to conduct the organized trading of futures contracts in raw jute and related goods, meanwhile, many other exchanges started in country to trade in diversified commodities.

INTRODUCTION :

After independence, Government of India commissioned a committee headed by A D Shroff in 1950 to introduce Forward Contract bill in Parliament, under the regulation of Ministry of Consumer Affairs and Public Distribution. The FMC was powered to regulate, licensing and control of trading of forward and option contracts all over India. The smooth functioning of market continued till 1966, but due to various regulations, the market lost its vivacious and finally the forward trading was completely banned. The Government of India reintroduced forward trading in select commodities like Cotton, Jute, Potato, etc., as per the recommendation of Khusro committee in 1980. Subsequently, the liberalization of Indian economy in 1991 gave a new lease of life for commodity trading. The Government setup a new committee under the chairmanship of Prof. K. N. Kabra in 1993, the committee recommended to start the futures trading in agriculture commodities in basmati rice, cotton seed, oilseeds, etc. Further in 1996, the World Bank in association with United Nations Conference on Trade and Development (UNTCAD) conducted a feasibility study and found that there is tremendous scope in revitalizing futures trading. In 2000, National Agricultural policy envisioned the reforms in agricultural commodities trading, that has brought a new wave in trading of commodity futures and paved the path for hedging and risk management by removal of control and regulation in agricultural market. In the aftermath of the second generation reforms, based on the recommendations of Kabra committee, World Bank Report and Guru Committee (2001) brought a dimension futures trading in Indian commodity market.

Indian commodity derivatives market has been rationalized in 2003 and futures contracts trading has seen upturn in terms of volume and value surge with very swift growth during that decade. It raised itself to compete in the global market with international giants, such as NYMEX, CBOT, LME, etc., and became the top fifth exchange in terms of number of contracts in gold, second in silver, copper and natural gas. It is found that the trading in commodity derivatives is about three times more than in physical market, whereas, it is more than ten times in advanced economies. In spite of reaching global standards, the market is facing the challenges due to lack of infrastructure, warehousing, inadequate risk mitigating instruments, etc. If the regulators take cognizance of these issues, Indian commodity derivatives market will become definitely an icon among the world commodity derivatives market.

The story of the Indian agricultural commodity market is totally different and deviated from the global standards. India is among the world's five largest producers of meat and livestock with one of the fastest growth rate. India was ranked among the world's largest producers of most of the agricultural items including some cash crops such as tobacco, coffee and cotton in 2012 (Singh at el., 2013). The challenges of irrigation, roads, storage, cultivation land, poor electricity, finance and transportation, etc., are culminating poverty, suicide and urbanisation among the agriculture population. The solution lies in developing agriculture to generate value for the global population, and linking it with the markets. The commodity exchange of India, which ranks among the top 10 in the global commodity bourses has the capacity to do it.

Present Status of Derivative Market There are six national and eleven regional exchanges in India participating in commodity trade (FMC, 2014). There are 113 commodities notified for trade under Section 15 of the Forward Contracts (Regulation) Act [FC (R) Act] 1952. The numbers of traded commodities are 45 in all the exchanges during 2013–14. The total number of agricultural commodities in the approved list is approximately 90 which includes food grains and pulses, oil seeds and oil, spices, fibers and manufactures, and other commodities. There were not more than 34 agricultural commodities traded on the exchange platform during 2013–14. The total traded value of these agricultural commodities is less than 15 per cent of the total commodity traded during 2013–14 even after a huge decline in commodity volume. The actual contribution of agricultural commodities' trade was just 11 per cent last year. The average daily traded value of agricultural commodities is less than Rs. 5,000 crore as against Rs. 29,000 crore for non-agricultural commodities

Commodity derivative trading in India had been in existence since the late nineteenth century when Bombay Cotton Association Limited undertook organized derivative trading in cotton. Over a period of time other commodities were also inducted into commodity derivative markets. However the development of the commodity derivative market was constrained by many hurdles. State intervention was one of the major causes of the unsteady growth of this market.

One of the most debated aspects of the commodity derivative market is that it promotes excessive speculation resulting in price inflation of essential commodities. On this ground this market has been subjected to various restrictions and in an extreme reaction the Indian government banned commodity derivative trading in 1952.

CHALLENGES AND OPPORTUNITIES OF INDIAN COMMODITY DERIVATIVE MARKET:

The history of organized commodity derivatives in India goes back to the nineteenth century when the Cotton Trade Association started futures trading in 1875, barely about a decade after the commodity derivatives started in Chicago. Over time the derivatives market developed in several other commodities in India. After Independence, the Parliament passed the Forward Contracts (Regulation) Act, 1952 (Department of Consumer Affairs, 1952) which regulates future contracts in commodities all over India. The Act applies to goods, which are defined as any movable property other than security, currency and actionable claims. Under the Act, only those associations/exchanges, which are granted recognition by the Government, are allowed to organize future trading in regulated commodities.

However, many feared that derivatives fuelled unnecessary speculation in essential commodities, and were 'detrimental to the healthy functioning of the markets for the underlying commodities, and hence to the farmers' (Jagadharani & Putran, 2006). With a view to restricting speculative activity in cotton market, the Government of Bombay prohibited futures trading in cotton in 1939. Later in 1943, futures trading were prohibited in oilseeds and some other commodities including food-grains, spices, vegetable oils, sugar and cloth. By mid-1960s, the government went on to impose a blanket ban on future trading of the commodities.

Nair (2004) observed that the extended period of the ban resulted in driving a part of the trade underground, whereas a large number of participants shifted to other professions, including securities market, which was functioning without restrictive state intervention. Commodity futures trading in India remained in a state of hibernation for nearly four decades, from 1950 to 1990 mainly due to doubts about the benefits of derivatives (Chitale & Rajendra, 2003).

Prominent economists like Keynes (1930) and John Hicks (1939) pointed out that the future price and spot price moves in the same direction. If hedgers tend to hold short positions and speculators tend to hold long positions, it implies that the futures price of the commodity is expected to be below the spot price. The price difference constitutes the compensation for the risks borne by the speculators when they hold long positions. Potential reduction in income is acceptable for the risk adverse hedgers, as the futures contract eliminates the risk. Conversely, if hedgers tend to hold long positions while speculators hold short positions, the futures price will be above the expected spot price under the same rationale. Convergence of future and spot prices in commodity derivative market lead to better price discovery and also maintenance of buffer stock as a strategy to control price volatility (Asche, 2002). By taking a position in the derivative market, the producer can potentially offset losses in the spot market. However a study by Gilbert (1985) has indicated that as anti-price volatility instrument maintenance of buffer stock appears to be more efficient than future commodity market.

A FMC commissioned study report by the Indian Institute of Management, Bangalore (2008) pointed out that futures markets efficiency is contingent on the efficiency of spot markets. Efficient spot markets reduce the cost of future-spot arbitrage. Efficient spot markets in commodities would require integration of markets across geographical regions and quality. This reduces the basis risk in the use of futures contracts. Integration of the spot markets requires development of rural communication, transport and storage infrastructure. The study report is of the view that in order to expedite this, collections from transaction tax etc of future market should be earmarked exclusively for development of the required physical market infrastructure and any other steps necessary to increase farmer participation.

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