Appraisal of present commodity markets in Indian agriculture and ways to make markets better for present-day operations

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ABSTRACT

India is predominantly agriculture orient economy more than 70% of people depend on agriculture as a primary occupation it is a major employer and determines the health of economy and development and growth of the economy. this sector is affected with many problems like lack of financial facilities and other infrastructural issues, the structure of Indian agriculture has made it venerable to price challenges, farmers are not able to get better price for their produce vowing to market inefficiencies and regulatory problems and other deficiencies, Hence to strengthen the price discovery mechanism in order to get better price for the agricultural products and to foster development of the sector, to impact the life of people depended on the agriculture in a country which has remained one of the largest producers in world most of the commodities since time immemorial there is an urgent need to safe guard interest of various stake holders by providing them adequate hedging facilities through development of commodity derivatives.

Keywords: Commodity, Commodity market, Agriculture.

1. EVOLUTION OF COMMODITY MARKETS IN INDIA

The history of commodity market can be traced back to the 17th century when cotton producers, buyers, and traders used it for hedging against price fluctuations, non-delivery of physical cotton and low production. The contract specifications were set by the two parties involved and were settled post-expiry. However, this system failed due to counter party risk. Disputes became common as it didn’t involve a party to settle the contract. This led to the establishment of commodity exchange, which guaranteed settlement of derivative contracts. The Chicago Board of Trade (or CBOT) started in 1848. It became the first organized trading exchange in the world.

In India, organized trading in commodities started with the constitution of the Bombay Cotton Trade Association in the year 1875. The commodities futures market discontinued in the mid-1960’s due to war, natural calamities, and the resultant shortages.

The economic liberalization in the early nineties laid the foundation of the Indian commodity trading. By 2002, there were 20 commodity exchanges in India, trading in 42 commodities. In 2002, the Indian Government re-introduced commodity futures. Commodity futures contracts and the exchanges they trade are governed by the Forward Contracts Regulation Act, 1952. The Forward Markets Commission (FMC) approved multi-commodity exchanges. The FMC merged with Securities Exchange Board of India (or SEBI) in 2015. The commodity exchanges set up by the FMC include:

National Commodity & Derivative Exchange (or NCDEX)
This exchange was promoted by National Stock Exchange (NSE), National Bank for Agriculture and Rural Development (NABARD), ICICI Bank, and Life Insurance Corporation of India (LIC). NCDEX is popular for trading in agricultural commodities.

National Multi Commodity Exchange of India (or NMCE)
NMCE was promoted by Kailash Gupta, an Ahmedabad based trader, and the Central Warehousing Corporation (CWC). NMCE is popular for trading in spices and plantation crops.
2. INDIAN AGRICULTURE IN RELATION TO COMMODITY MARKETS

Agriculture provides life to everyone in the form of food and fiber. It provides earning and income to producers, processors, intermediaries, exporters, industries, and government in one way or the other. Agriculture is, in fact, the heart of our economy. The commodity market is linking our agriculture with demand. A thousand years old existence of commodity future and market operation as explained by ’Kautilya’ is one of the oldest commodity markets of the world (Kevin 2010). India is among the top 10 producers in the world for rice, buffalo milk, wheat, cow milk, fresh vegetables, sugarcane, potatoes, groundnut, peppermint and buffalo meat (Nageshwara and Rao, 2009). The liberalization has given a way to challenge the world through the core strength of Indian agrarian economy. The Indian commodity market has witnessed regulation and de-regulation since inception. Even after a number of committees and the respective recommendations the commodity market is struggling to get a practical liberalization. The UNCTAD and the World Bank’s joint Mission Report ’India: Managing Price Risk in India’s Liberalise Agriculture: Can Futures Market Help?’ (1996) highlighted the role of future markets as market-based instruments for managing risks, and suggested the strengthening of the institutional capacity of the regulator and the exchanges for the efficient performance of these markets. Another major policy statement, the National Agricultural Policy, 2000, also expressed support for commodity futures. The Expert Committee on Strengthening and Developing Agricultural marketing (Guru Committee, 2001) emphasized the need for a commodity market 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.

3. SCENARIO OF COMMODITY MARKETS IN INDIAN AGRICULTURAL MARKETS

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 urbanization 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.

4. INITIATIVES OF GOVERNMENT OF INDIA

The Government of India has under taken various activities and assistance programmes to promote our commodities market. During the year 2015-16, the commission conducted 872 awareness programs, out of which 535 programmes were for the benefit of the farmers and 337 programs for other stakeholders. There were 100 capacity programmes conducted with the aim to build capacities of the important take holders in the eco-system of commodity future markets and to sensitize the policy makers about the utility of the futures markets. Out of the total 83 programs were conducted for the general states and 17 were for the NER states. The FMC is an association with the Commodity Exchange initiated a process of dissemination of futures and spot prices of an agricultural commodity by installing Price Ticker board at various locations. This may have helped get a group like farmers in the improving and post-harvest decision making process and hedging their price risks in the market. The officers of the Commission participated in various international conferences and were also deputed for training/symposium organized by international organizations/training institutes. Further, the commission with the National exchange has facilitated the participation of hedgers in various exchange programs, exhibitions, and expos.

5. WORLD COMMODITY MARKET BENCHMARK

In the global perspective, the commodity market is utilized in a broader range to stimulate trade practices in the commodity sector. It has been serving the purposes of market creation, market access, stimulating regional integration, facilitating the provision of finance, price discovery, price transparency, price risk management, reducing counterparty risk, infrastructure enhancement, quality assurance or upgrading, and uplifting export drive commodity economy. This may be through the use of instruments other than futures, options, swaps, spot or cash trade for immediate delivery, forward contracts on warehouse receipts, the trade of farmers repurchase agreements, or ‘reports’. Alternatively, the focus is to evolve a system and process on facilitation activities rather than just providing a trading environment.

6. INDIAN COMMODITY MARKETS ROLE IN PROVIDING PLATFORM FOR PRICE RISK MANAGEMENT AND PRICE DISCOVERY

Over the last decade or so, when Indian commodity exchanges came into being, they have served a useful purpose on both these counts. There have been, of course, hiccups from time to time, natural to any nascent market, when there were knee-jerk reactions by the policy makers, such as banning futures trade in certain commodities. But on the whole, the commodity risk management mechanism in the country has got institutionalized. During this period, there have been many positive developments in the Indian commodities derivatives market. Indian commodity exchanges are offering contracts on many agri-commodities such as grains, oilseeds, pulses, spices, and plantation commodities. Electronic spot exchanges have started offering spot trading facilities. After commodity exchanges have come into the picture,
warehouse capacity building has got a filip. Many new warehouses are coming up with modern storage, weighing, and grading facilities. Warehouse receipts have also been made negotiable instruments.

On the flip side, although commodity exchanges started functioning about a decade ago, the trading volumes and durations for which commodity futures contracts can be taken are limited. Liquidity exists mostly in near-month or next near-month contracts, thereby providing price directions for at most 2–3 months. In a well-functioning commodity derivatives market, there should be enough liquidity in longer-maturity contracts so that farmers can get a fair idea about future price and decide whether to go ahead with planting a crop or not.

7. SOME PROBLEMS IN COMMODITY MARKETS IN RESPECT OF INDIAN AGRICULTURE

Lack of price transparency

The commodity futures markets also suffer from problems of lack of price transparency. There is no common interface or communications infrastructure using which prices from one market become accessible at another. The collection of price information is done at the initiative of individual traders and dealers. This works in situations where the cost of collecting information is low – for example, using cellphones to get real-time updates on prices from nearby markets – but becomes a bottleneck when the cost is high. The human and telecommunications cost of getting real-time price updates from far-flung markets is prohibitive. This implies markets with relatively high price efficiency among local markets, but poor efficiency across national markets.

Lack of contract and product standardization

The cost that traders are willing to pay to access price and order flow information from the distant market is exacerbated by the lack of product standardization and differences in contract design from one futures market to the next. Fragmented order flow and the lack of economies of scale There are several similarities between the equity markets of the nineties and the commodities futures markets today. But, commodities exchanges suffer from a much higher degree of fragmentation than the equity markets in the late nineties. In the case of the equities markets, the typical structure of markets was to have one exchange per state: this meant that the economic order flow was fragmented at most at the level of the state. In the case of commodities markets (either spot or futures) in India, there are typically multiple exchanges to a single district for commodities

8. SUGGESTIONS TO OVERCOME DEFICIENCIES

First, for SEBI to allow the agri-commodity derivative markets to stay open till 8 pm on weekdays and to remain open on Saturdays as well to match the timings of Mandis. This will enable better integration of Spot market with Futures market thus avoiding the risk of participants resorting to ‘Dabba trading’ and will make markets more efficient in terms of better price discovery, reduction in volatility and lower impact

Second, the Daily Price Limits (DPL) on commodity futures contract must be relaxed. Restricting price movement on daily basis may jeopardize the very purpose of future price discovery and hedging (price risk management), as on the application of DPL, future prices may be delinked from commodity spot market or in some cases, international prices, where DPL are not applied. Hence, it has been suggested that for the markets to function efficiently, the limits should be set at optimum levels.

Third, many market participants have physical market exposure far greater than the allowed hedge limits on the Commodity Exchange thus forcing such participants to either hedge the remaining quantity on overseas markets or remain unhedged. With near month limits being even smaller, hedges are left vulnerable to the price movements and risks involved.

The fourth suggestion is to permit banks to trade on commodity exchanges.

9. SUGGESTION FOR PRODUCT SUB HEADS

The first recommendation under products is to re-launch the Forwards segment which will provide farmers with an alternative tool to get the best price for their produce and manage price risk more efficiently.

Second is to align the contract specifications with the quality traded in physical markets.

The third suggestion is to develop weather derivative indices along with other sectoral indices. Market participants, especially farmers, can use these instruments as a hedging tool against weather risk.

Fourth, it is suggested that continuous contracts should be launched throughout the year. As exports and imports of commodities go on through out the year such a move would greatly benefit the various market participants who could use these contracts to meet their specific requirements.

Fifth, all e-Negotiable Warehouse Receipt (eNWR) based financing provided to farmers should be considered as priority sector lending and banks should be mandated to provide credit to the agriculture sector compulsorily through eNWR. A default guarantee structure under Warehousing Development and Regulatory Authority (WDRA) can give further confidence to banks and boost agri-financing.

Under the sub-head of Participation, it is recommended that in order to increase liquidity and depth in the commodity markets there is a need to allow institutional participation such as banks, insurance companies, mutual funds, portfolio management schemes, AIFs, etc. that can act as risk transfer agents for

10. CONCLUSION
From the paper, it can be concluded that Indian commodity markets from its inception has undergone a plethora of changes and has evolved to meet the changing and dynamic requirements of markets and regulatory frameworks. Though commodity markets for agriculture have been performing well some of the change are required for making it best for agricultural markets. Some of the suggestions given above if integrated with commodity markets with special reference to agriculture it can make the transactions better and markets can graduate to new dimensions by providing good hedging support to farmers and bring in good practices for all the stakeholders associated with commodity market operation in agriculture.

11. REFERENCES