Available online at www.elixirpublishers.com (Elixir International Journal)

Management Arts

Elixir Mgmt. Arts 78 (2015) 29432-29434

ISSN: 2229-712X

Necessity of commodity markets in Indian economy

V.Sreedevi

Department of Management Studies, Ponjesly College of Engineering, Nagercoil, Kanyakumari District.

ARTICLE INFO

Article history:

Received: 20 June 2011;

Received in revised form:

19 December 2014;

Accepted: 29 December 2014;

Keywords

Commodity market,

Spot and futures market,

Derivative market Agriculture,

Essential commodity and mundis.

ABSTRACT

Globalization has brought about a new perspective and fresh challenges and vast opportunities in its train. Indian agriculture is undergoing a fundamental change wherein the technology and inputs are moving out of the hands of farmers to external suppliers. It is agriculture is confronted by a number of challenges as domestic prices of several commodities have gone up and are much higher than international price. This has made imports attractive adversely affecting exports. The price distortion due to long supply chain in farm produce marketing and the resultant low share of farmers in the final price is an important issue in the development of agriculture. Therefore, there is a need to integrate agriculture sector with commercial and industrial sector on the same business principle. The importance of commodity market, in this respect, needs no emphasis.

Introduction

"India's future is in her farms. Agriculture has the potential to accelerate economic growth and social development in India" – Mukesh Ambani.

"India lives in its villages" – Gandhiji

India situated on the Indian subcontinent of Asia, holds the world's largest Peninsula and is the seventh largest country in the world and is the second most heavily populated country. She covers over three million Square Kilometers in area. Fifty-six percent of the area is cultivable land Seventy-three percent of her people are live in rural areas and agriculture is the backbone of their lives.

Agriculture is a way of life, a tradition which for centuries has shaped the thought, outlook, culture and economic life of the people in India. Nearly 61 percent of the workforce depends upon agriculture. It is the very backbone of her economic system and the prosperity of India depends on its agriculture. Agriculture feeds not only the population but also supplies raw materials to the various industries.

It has been estimated that the income from agro based industries all put together is roughly one-half of the total income generated in the manufacturing sector of the country. Apart from these, agriculture has considerable importance in social and political system of the country.

To achieve 7 to 8 percent GDP growth, agriculture sector will have to play an important role, although its contribution in GDP has steadily fallen from 58.9 percent in 2004-'05. The sector offers promising prospects on both demand and supply sides.

Globalization has brought about a new perspective, and hot on its heels fresh challenges and vast opportunities. Indian agriculture is undergoing a fundamental change wherein the technology and inputs are moving out from the hands of farmers to external suppliers.

The studies in the field concerned pointed-out the fact that economic liberalization and reforms process have considerable impact on the agricultural and rural sector very much. Indian agriculture is confronted by a number of challenges as domestic prices of several commodities are higher than international prices. This has made imports attractive adversely affecting exports. The situation calls for improving competitiveness of Indian agriculture which requires improvement in efficiency in agricultural production, marketing, transport etc. The liberalization of agriculture policies paves the way for free entry of vertically integrated multinational agricultural corporations in the country. Hence most of the small farmers are losers and most of them are left with meager assets. [Shrikrishna Singh 2009]

The price distribution due to long supply chain in farm produce marketing and resultant low share of farmers in the final price is an important issue in the development of agriculture.

Therefore, there is a need to integrate agriculture sector with commercial and industrial sector on the same business principle. The importance of commodity market in this respect needs no emphasis. A developed commodity market will help commercial section of agriculture and infuse competitiveness. The strengthening of the commodity spot and future market will help to achieve this end. The commodity derivative market has an important role in price discovery and risk management. The need of the hour is that a significant part of the Indian economy, i.e, agriculture, needs to be strengthened by way of strengthening price discovery and hedge mechanism, which are greatly facilitated by futures mechanism [P.R.Kulkarni 2005-'06]

Evolution of Commodity Markets:

Modern commodity markets have their own roots in the trading of agricultural products. Wheat and corn, cattle and pigs were widely traded using standard instruments in the 19th century.

History places in record that in ancient times trade was conducted in Sumeria by using sheep, goats, pigs, rare seashells or other items as commodity money, have traded. Contracts were in the delivery of such items to render trade itself smoother and more predictable. Chicago Board of Trade was established in 1848 by 82 merchants who were frustrated over unstable price and neglected forward contracts. Commodity futures contracts started being functioned in 1865. Chicago Mercantile Exchange was established in 1919.

The concept of commodity futures is not new to our

Tele:

E-mail addresses: devikittu@yahoo.com

country. India being primarily an agrarian economy with a rich economy and a rich history of trading and speculation, has had a long experience with commodity futures trading. Organised futures trading was started in India with the setting up of the Bombay Trade Association in 1875 and soon exchanges to trade futures in commodities such as oil seeds, bullion, wheat and jute were setup in various centers across the country. However futures and option trading in most commodities was banned in the 1960s.

The era of widespread shortages in many essential commodities resulting in inflationary pressures and tilt towards socialist policy, in which the role of market forces for resource allocation got diminished, saw the decline of this market resulting in virtual dismantling of the commodities futures markets. It is only in the last decade that commodity future exchanges were actively encouraged. However, the markets have been thin with poor liquidity and have not grown up to any significant level.

Indian policy makers have traditionally coped with the uncertainty and risks associated with price volatility by resorting to policy instruments which attempted to minimize or eliminate price volatility – a virtually closed external trade regime, price control, pervasive government controls on private sector activities extensive market intervention and crop insurance.

Liberalization of Indian economy since 1991 has recognised the role of market and private initative for the development of the economy. The much maligned market instruments such as futures trading is also given due recognition. [Tushar Kulkarni 'Commodity Markets in India]. With the liberalization of economy in the 1990s, the government started giving serious thought to the development of a future markets in commodities. A government notification permitted futures trading in all commodities in 2003 under the regulation of the Forwarded Market Commission (FMC)

Evolution of Commodity Futures:

Commodity Markets – Commodity markets are markets where raw or primary products are exchanged. It covers only physical product like food, metals, electricity markets. The ways that services including those of governments or investment or debt cannot be seen as a commodity.

Commodity Markets are organized traders exchange in which standardized graded products are bought and sold. Commodities are raw materials such as tea, rubber, tin or copper which generally need processing to reach their final state. The actual commodities are seldom present and what is traded in their ownership.

Commodity – Any product that can be used for commerce or an article of commerce which is traded on an authorized commodity exchange is known as commodity.

Commodity includes all kinds of goods, Forward Contracts (Regulation) Act (FCRA) 1952 defines goods as every kind of moveable property other than auctionable claims, money and securities.

A commodity future is a contract to buy and sell a fixed quantity of commodity for a fixed price at a future date. A future is a contract that allows investor (trader) to 'lock in' today the price at which trader will buy or sell commodity in the future. Business can use such contracts to avoid various forms of risk. For example an edible oil company can buy Soya bean for future delivery, thus fixing the cost of its raw material. Alternatively, it can fix the price at which it sells its finished product even before it is produced by selling a Soya oil future. A bilateral contract between the buyer and the seller also provides the same benefits for the two parties. However, a future contract has some very specific advantage. First it is traded on and guaranteed by an exchange. Thus allows the speculators to place their bets, thus, enhancing liquidity and price discovery.

Commodity Futures – Commodity futures is an essential component of commodity exchanges. It can be broadly classified in to precious metal, agriculture energy and other metals. Futures trading perform two important functions: price discovery and price risk management with reference to a given commodity. It is beneficial to all segments of the economy. It is useful to the producer because he can get an idea of the price likely to prevail at a future point of time and therefore, can select the best cultivation that suits futures market. Thus helps the farmers to take decision about acreage, investment and timing of bringing the product to the market. Moreover this reduces the seasonal fluctuations and contains the occurrence of glut (over supply) shortages in the long run. The futures market, thus, has a significant role of price risk management in agriculture, enabling it to move up in the value chain. It enables the traders to get an idea of the price at which the commodity would be available at a future point of time.

He can also do proper costing and also cover his purchases by making forward contracts. Future trading is very useful to the exporters as it provides an advance indication of the price. He is also able to secure export contract in a competitive market. Trading is taking place in 91 commodities through 25 Exchanges/Associations. The spot commodity markets are still opaque (dull) and futures include the absence of scientific grading of goods, scientific quality parameters and testing, system of warehouse receipts being tenderd, as a proof of delivery of underlying needs and commodities, emergence of storage and independent quality testing assurance agencies. These are the areas where spot market needs to address them [P.R. Kulkarni 2005-'06]

Recent Developments

Based on the recommendations of various commodities and initiatives of various forwarded Market Commissions, The Government of India has taken the following decisions to improve the functions of commodity futures trading in India:

- Futures trading was permitted in various edible oil and seed complexes
- Futures trading in sugar was permitted
- Relaxation on prohibition of futures trading in 54 commodities
- Steps were taken to develop institutional capabilities of commodity markets
- National level seminars and workshops were conducted to make the public aware of commodity futures
- New exchanges were given recognition

Constraints:

- Absence of bank participation
- Absence of option on futures in commodity market
- Absence of effective warehouse receipt system
- Lack of support infrastructure
- Lack of awareness and information dissemination
- Lack of unorganized physical markets
- Lack of adoption of standardization and grading practices while selling agricultural commodities
- Lack of price transparency in Mandis
- Lack of interface between spot and commodity exchange
- Lack of awareness among traders, poor accessibility of grass root level/producer level
- Lack of integration and grouping at producer's level

Conclusion:

Owing to privatization policy of the Government and the gradual withdrawal of the government from various sectors in the post-liberalisation era, there is an urgent need for the commodity market operators to be provided with a mechanism to hedge and transfer their risks. It is the obligation of the Government of India to open agriculture sector to world trade and that would require futures in a wide variety of primary commodities and their products to enable diverse market functionaries to cope with the price volatility prevailing in the world markets.

India is rich in agricultural resources which need use of futures and derivatives as price risk management system. This will help the economic development and improvement in the standard of living of small and marginal farmers.

References:

[1]Chandra Sekhar et.al., (2008) "Constraints of Commodities Futures Trading in India", Southern Economist, Vol.47(6) pp45

[2]Kulkarni P.R. (2005-'06) "Commodity Futures Market in India: Issues and Suggestions" Vinimaya Vol. xxvi(4) pp15-27

[3]RBI Report on Features and Commodity Futures 2005

[4]Shrikrishna Singh (2009) "Globalisation and Traditional Economy"; Southern Economist Vol. 44(3)

Websites: www.bseindia.com