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EVOLUTION AND IMPACT OF AGRICULTURAL COMMODITY FUTURES TRADING IN INDIA: HISTORY, STRUCTURE, AND FARMER OUTCOMES

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Abstract

Agricultural commodity futures markets are essential for farmers to control risk and set prices. The expansion of futures trading in India has been facilitated by notable institutional reforms, policy changes, and structural advancements. Due to low awareness, infrastructural issues, and a lack of trust, farmer participation is currently restricted despite their potential advantages in stabilizing agricultural incomes and lowering price unpredictability. The institutional and regulatory framework, the historical evolution of agricultural futures in India, and their function in risk mitigation and market efficiency are all examined in this article. The report also examines the barriers to farmers' adoption of futures trading and proposes legislative remedies to boost their involvement and rewards.

Key words: Agricultural futures, Price discovery, Risk management, Farmer participation.

Introduction

A good or service that has complete physical, temporal, and spatial specifications is called a commodity (P. Nicola, 1994). Gold, oil, copper, wheat, coffee, and other key agricultural products are examples of raw materials that can be bought and sold. Usually, these products are standardized and interchangeable with similar products. In India, commodities are divided into two categories

1. Hard Commodities: These are tangible items or natural resources that are extracted or exploited. Gold, silver, oil, natural gas, copper and other metals and minerals are a few examples.

2. Soft Commodities: These are produced goods or agricultural products. Wheat, corn, soybeans, coffee, chocolate, cotton, and animals are a few examples. Weather, agricultural yields, and geopolitical events are some of the variables that frequently affect soft commodities.

What is Future Trading?

The purchasing and selling of standardized contracts, referred to as futures contracts, for the future delivery of agricultural commodities at a fixed price is known as futures trading in agriculture. These trades take place on organized futures markets, giving market players a way to speculate, find future commodity prices, and hedge against price swings.

History/Progress of Agriculture Commodity futures trading in India

- The first organized market for cotton derivatives was founded in Bombay in 1875, marking the beginning of commodity futures markets in India (Dhole, 2014; Bhagwat et al., 2015).
- Oilseeds, jute, wheat, and bullion were among the commodities that futures trading expanded to encompass in later years. However, worries about shortages during the Great Depression and World

War II caused futures trading to be virtually outlawed (Srivastava, 2012).

- Following independence, a legislative framework for commodity exchanges was established under the Forward Contracts (Regulation) Act, 1952.
- Future trade in all main commodities is banned or suspended until the late 1990s.

Reopening of market

- As process of liberalization of economy started in 90s the Futures trading permitted in an increasing number of commodities after 1991 (Coffee, Jute, Sugar, Edible Oilseed complex).
- The "National Agricultural Policy" announced in July 2000 emphasized the need for allowing futures trading in agricultural commodities for risk management and price discovery.
- Futures trading permitted in all the commodities (April 2003).

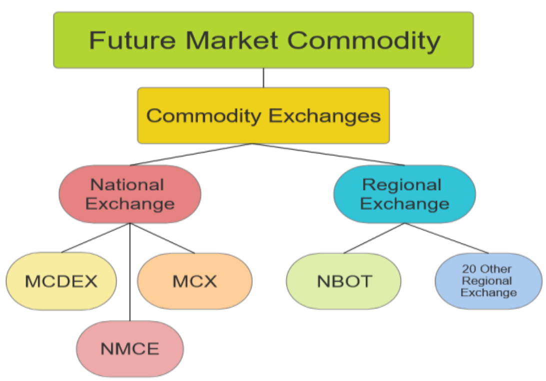


Figure 1: Structure of Indian Commodity Future Exchange

- Understanding the structure of futures is essential in the future market. In India, there are two levels of commodity exchanges: regional and national. Only a certain number of contracts with local membership are allowed on regional exchanges. The national exchanges have a demutualized ownership structure and are multi-commodity electronic exchanges.

Currently, there are three such exchanges:

i. MCX (Multi Commodity Exchange)

ii. NMCE (National Multi Commodity Exchange)

iii. NCDEX (National Commodities and Derivatives Exchange).

iv. The trading activity in India's commodity derivatives market increased somewhat in 2021–2022. MCX, which holds the majority of the pan-Indian turnover in the commodity derivatives category (88% in 2021–2022) (Source: SEBI).

v. The National Commodities and Derivatives Exchange (NCDEX) is a public limited company that was founded in 2003 under the Companies Act of 1956. It started operating in 2003. The NCDEX is governed by the Securities and Exchange Board of India (SEBI). On March 31, 2018, the exchange started to provide trading in 23 commodity futures, including 19 contracts for agricultural commodities.

vi. A collection of Indian commodity-based businesses and government organizations established the NMCE (National Multi Commodity Exchange) in 2002 as the country's first online, demutualized commodity exchange. The exchange listed its initial contracts on 24 commodities in 2002. Future contracts on 13 different commodities, including oils and oilseeds, rubber, sacking, raw jute, coffee, isabgoll seed, chana, pepper, and cardamom, were listed by the NMCE starting in 2016.

The Future trading helps in price discovery and hedging of price.

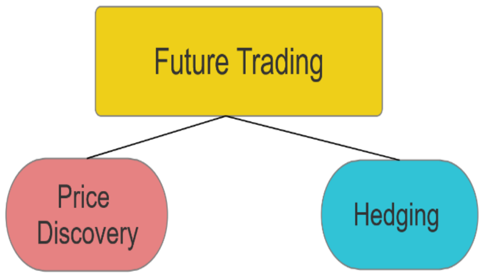


Figure 2: Future Trading

What is Hedging?

Hedging is the practice of buying and selling futures to offset an equal and opposite position in the cash market and thus avoiding the risk of uncertain changes in prices.

Hedging is based on two assumptions:

1. The futures and cash prices are move up and down together same
2. The Mechanics of hedging includes the making of simultaneoustransactions, but of opposite side, in the futures and cash market.

Benefits of Hedging

- **Price Stability:** Hedging helps in stabilizing the prices of assets or commodities, reducing the impact of price fluctuations on the overall portfolio or business operations.
- **Downside Protection:** Hedging protects against the downside risk by providing a financial cushion in case of adverse price movements, ensuring that losses are minimized.
- **Budgeting and Planning:** Businesses can use hedging to lock in prices for future transactions, allowing for better budgeting and financial planning.
- **Reduced Margin Requirements:** In financial markets, hedging can allow traders to reduce margin requirements, freeing up capital for other investment opportunities.
- **Enhanced Financial Stability:** Companies that actively manage their risks through hedging may be viewed more favorably by creditors and investors due to increased financial stability.

What is Speculation?

Speculation is the practice of conducting financial transactions with the primary goal of profiting from brief fluctuations in the price of an item. Speculators, also known as traders, speculate on the future price movements of financial assets like stocks, commodities, currencies, or derivatives in order to profit from price variations.

Key characteristics of speculation include:

1. Short-Term Focus
2. Risk and Uncertainty
3. Leverage
4. Market Timing
5. Varied Instruments
6. Liquidity
7. Profit motive

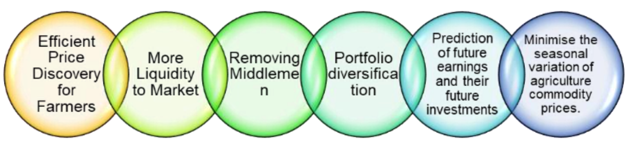
How the futures trading helps to the farmers

- Futures contracts give farmers the possibility to 'lock in' a certain harvest price for (a part of) their agricultural production, thus excluding the possibility that their selling price will fall in the future.
- Farmers can plan their cropping pattern by seeing the future prices of agriculture commodities.
- Price discovery of their produce will happen through futures trading.

Reasons for farmers not active in futures trading.

1. Due to Illiteracy.
2. Lack of proper knowledge on futures trading
3. Small land holdings
4. Futures market is viewed with suspicion and termed as gambling
5. A farmer can sell the crop in advance at a known price on the exchange but if the price on the day of sale is higher, he cannot go back on the contract.
6. Due to large sized futures contracts.

Benefits/Advantages of futures trading in agricultural commodities



Conclusion

- Because traders and investors actively participated in the commodity futures market, agricultural commodity futures trading grew between 2003 and 2012.
- The global commodity and equities markets' correction between 2012 and 2014 resulted in a decline in the value and volume of agriculture futures traded.
- The global commodity and equities markets' rebound from 2014 to 2018 led to an increase in the value and volumes of agriculture futures traded.
- After 2018, the agriculture futures traded value and volumes decreased due to FMC merged with SEBI, the regulator adopted more stringent rules on futures trading i.e., Increased margin & strict KYC norms.
- Due to their ignorance of futures trading, farmers do not actively participate in it. The State Agriculture Department and the Extension division of State Agriculture Universities should educate farmers about the benefits of agricultural futures trading.
- Using this knowledge, farmers will be able to set future pricing for their agricultural products and decide which crops should be planted in the next season based on those values.

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