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COMMODITY FUTURES TRADING IN INDIA–POTATO SCENARIO

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Derivatives are the financial contracts that derive their value from the value of the underlying asset. The trading in the modern securities involves a mammoth risk and a proficient way of dealing with them are the derivatives. The most prominent four types of derivatives are forwards, futures, options and swaps. Forwards are the customized contracts made between the buyer and seller to exchange an asset, whereas, futures are the standardized contract in which the deals get fixed through exchange mode. Options are the contracts that provide rights to buy and sell an asset but not the obligation of real buying and selling. Swaps are the most complex agreements as they are made privately between the parties and their trading does not takes place in stock exchange but through a middleman of investment banker.

Futures involves number of players and its perspective differs according to the players in the futures market. According to buyers and sellers, futures trading is generally an agreement where the seller is obliged to sell a certain quantity of any asset and buyer is obliged to pay the pre-agreed price in the future date at a pre-agreed place. On the other hand, for speculators and hedgers, futures trading is a tool for profit maximization and loss minimization, respectively (Rana *et al.*, 2008). The types of futures contract are subjected to the types of assets traded such as equity, stock market index, commodity, currency and interest rate futures. The market place where this kind of buying and selling takes place are called as futures markets.

The three major activities that differentiate the conventional markets and futures markets are speculation, hedging and price discovery.

i) **Hedging** is the process of protecting oneself (hedgers) from the price risk like high price for the buyers and low price for the sellers.

ii) **Speculation** is the process of predicting or guessing about the future prices by speculators which is always seen to be the main reason for price fluctuation.

iii) **Price discovery** is the process where the prices determined by supply and demand are discovered.

The main purposes of futures trading are to transfer cash or price risk, discover prices and provide public access to information about the markets.

History of Futures Market

The development of the futures markets over the years across the world and in India is mentioned in the following table.

Year	Major activities
1710	1st modern organized futures exchange (Dojima Rice Exchange) in Osaka, Japan
1750	First ever legal code of futures trading in Ancient Mesopotomia
1848	Chicago Board of Trade (CBOT) – standardized the futures trading
1875	1st futures trading of cotton by Bombay Cotton trade association
1877	London Metal Exchange (LME)
1952	1st organized futures trading in India – Forward Market (Regulation) Act
1953	Forward Market Commission (FMC)
1960s	Ban of futures trade of all commodities except pepper and turmeric in India
1980	Potato futures trading on the recommendation of Khusro committee in India
1999	Futures trading of oil seed complexes in India
2000	Additional 54 commodities were permitted for futures with advent of National Agricultural Policy (NAP)
2001	Inter-Continental Exchange (ICE)
2002	National Multi-Commodity Exchange of India (NMCE)
2003	All agricultural commodities were permitted to trade in futures Multi-Commodity Exchange of India Ltd. (MCX) and National Commodity and Derivatives Exchange of India Ltd. (NCDEX)
2005	African Mercantile Exchange (AME)
2006	New York Stock Exchange
2014	Curbing of potato futures trading in India by MCX
2015	FMC merged with SEBI

Commodity Exchanges

The functioning of futures markets had over run its purpose in past few years increased speculation led to drastic increase in prices and caused inflation in the country. In order to take effective control of functioning of futures markets, the central government handed over its power to Securities and Exchange Board of India (SEBI) and FMC merged with SEBI in 2015. Futures trading are carried out in various commodities in India *viz.*, Edible oilseed complexes including groundnut, mustard seed, cotton seed, sunflower and soy oil, food grains like cereals, pulses and maize, fibers like cotton and jute, spices such as turmeric, pepper and cardamom, metals such as gold, silver, copper, zinc and aluminum, energy like crude oil and natural gas and miscellaneous commodities like sugar, jaggery, castor seeds and rubber.

India have totally 24 recognized exchanges out of which three are national exchanges and other 21 are product-specific. The national exchanges are the trading platforms for various agricultural as well as non-agricultural commodities in the country. Multi-Commodity Exchange of India Ltd. (MCX) is the most popular and widely reached futures trading platform established in 2003, headquartered at Mumbai focusing more on non-agricultural commodities like energy, petrochemicals and metals but also trade in agricultural commodities like spices, fibers, cereals, plantations, pulses, oil and oilseeds. National Commodity and Derivatives Exchange of India Ltd. (NCDEX) is the only exchange promoted by national institutions like NABARD, NSE, LIC and ICICI, that is famous for its online trading in agricultural commodities like barley, wheat, soybean, coriander, cotton, palm oil and guar. National Multi-Commodity Exchange of India (NMCE) started futures trading in November 2002 but merged with Indian Commodity Exchange (ICEX) in 2017. ICEX is an online trading platform that was recognized as an exchange in October 2004. Spices, oil, oilseeds, plantation, cereals, diamond and steel are the commodities traded by ICEX (Dummu, 2009).

Potato Futures Trading

The price of any commodity is generally determined by two major forces *i.e.*, demand and supply. In view of the agricultural commodities, the supply shows a great variability due to their seasonality, while the demand for agricultural commodities are said to be less elastic or inelastic. This disparity in demand and supply grounds for the wide fluctuations in prices and mainly paves the way to inflation. One of the measures to tap the positive and expedient side of these price fluctuations is the futures trading. However, the current state of commodity futures trading has been much debated by the policy makers which is attributed to the speculative trading of commodities. This led to the increased prices of commodities, followed by inflation over the past few years in the country. Accordingly, Forward Market Commission (FMC) has imposed bans and restrictions on trading agricultural commodities through futures contracts.

Potato (*Solanum tuberosum)* is a semi-perishable and bulky commodity. It is the highest produced vegetable in the country with 56173 million tonnes for the year 2021 (GoI, 2021). Moreover, potatoes were traded successfully through futures contract over MCX and NCDEX exchange platforms until the introduction of potato bonds in 2012. But in 2014, MCX sought after SEBI to discontinue its futures contracts on potato. The curbing in trading potato futures were mainly due to the increased investment in potato bonds rather than potato as a physical commodity and it led to the raise in spot prices of potato. In addition, lack of liquidity, broad-based participation and adequate stock of potatoes in the warehouses accredited to MCX also contributed to the ban in potato futures trading. However, the impact of COVID pandemic had led to the drastic decline in the prices of crude, palm oil, corn, wheat along with potatoes leading to huge volatility and causing loss to farmers as well as Fast Moving Consumer Goods (FMCG) companies. The importance of hedging platforms in managing price risks of any commodities were realized and highlighted as a result of the pandemic. This intrigued MCX in re-launching futures trading of potato which can check and stabilize the prices of the commodity. Consequently, in the year of 2020, MCX had sought approval from SEBI to kick start the futures trading of potato as it would benefit the players in the futures market.

Conclusion

India is a country where 54.6 per cent of the population are dependent on agriculture and about 18.8 per cent of GDP is contributed by the agricultural sector (GoI, 2022). In the era of globalization, it becomes necessary for the country with vast scope for producing large number of commodities to compete in the competitive markets to develop its economy and improve the livelihood of majority of its population. Hence, there arises a need to strengthen the marketing pattern of agricultural commodities considering their seasonality to avoid wastages and losses in terms of quality and profits. The role of futures as a derivative comes into play in this situation which would help in stabilizing the prices of commodity without causing any economic imbalances. Speculation is considered to be the biggest problem of futures trading not only in India but also all over the world. A clear-cut idea about the factors that are causing price risk is a pre-requisite to implement measures in accordance with the problem rather than banning the whole trade. Otherwise, futures trading is one of the best platforms in aiding farmers with remunerative returns provided that the complete regulation and control are taken up by the Forward Markets Commission.

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