Futures Trading in Pulses, Benefits Whom?

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INTRODUCTION

"Forward markets have understandably helped farmers to earn a little bit extra. This should not be curbed,"
-The Forward Markets Commission Chairman, Mr S. Sundareshan talking about futures market and farmers on 28th August 2006 at Kolkata.

"Commodities have emerged as investment and we believe that futures' trading has both direct and indirect economic benefits. Farmers would be in a position to choose their cropping pattern based on the future prices disseminated by the exchange rather than the practice of sowing a particular crop based on current prices,"
- NCDEX managing director & CEO Mr. PH Ravikumar as reported by Economic Times, article titled NCDEX wants to bring farmers in futures play on 21st June 2007

"Forwards trade helps growers to select which crop to plant and when to sell it in the market. The farmers have now started taking notice of price fluctuations in forwards trade before making the sales. It has also allowed them access to rates practiced at various mandis and leverage to negotiate.
- Mr. Narendra Gupta, Strategist at National Commodity and Derivatives Exchange [NCDEX] in a conversation with Mr. Kamal Sharma, Hindu editor.

In light of the views on Government imposing temporary ban on futures trading of agricultural commodities in two phases from the start of the year 2007, in January ban on URAD and TUR DAL and later extending the ban at the end of February on WHEAT and RICE, it is time now to know whether Futures Trading on agricultural commodities in India is as such justifiable are not. As nearly 60% of Indian population depends on agriculture for their livelihood, the least responsibility of the government is that to protect the interests of farmers to allow them to continue earn their living.

In another way, it simply means that the farmer should be in a position to decide which crop should be grown and at what price it should be sold. This should benefit all the consumers, the ultimate user of the produce, the farmer, who sweats his blood to produce and the nation at large. Here, the question arises who is really benefited by the futures trading, is it the consumer, the farmer, or the trader?

OBJECTIVE OF THE STUDY

In light of the arguments for and against futures trading in pulses, a study is intended as to who is befitted through the futures trading finally.

In view of imposing ban on futures trading on certain agricultural commodities, the study is intended to analyze, as to who is benefited by the futures trading in agricultural commodities in India -is it the consumer, the farmer or the investor?

SCOPE OF THE STUDY

The paper looks into the various aspects of what is futures trading, its need, how is trading done, commodities futures in India, the various commodities exchanges in India, the list of commodities traded, trading in pulses futures, its importance in India with regards to demand and supply, category of farmers, yield per hectare and the various problems faced by farmers and that, there is a need to address the problems before them and later think of including them in futures trading.

LIMITATION OF THE STUDY

The study focuses only on the issues relating to the need for banning agricultural commodities from futures trading in India based on various news articles published in newspapers and on the findings of the study by NCDEX on "Role of futures market: Mitigation of Price Risk ".

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WHAT IS FUTURES TRADING?

Futures contracts are firm commitments to make or accept delivery of a specific quantity and quality of a commodity during a specific month in the future at a price agreed upon at the time the commitment is made.

MEANING OF FUTURES TRADING

Futures Contract means a legally binding agreement to buy or sell the underlying security on a future date.

A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. The futures contracts are standardized and exchange traded.

Future contracts are the organized/standardized contracts in terms of quantity, quality (in case of commodities), delivery time and place for settlement on any date in future. The contract expires on a pre-specified date which is called the expiry date of the contract. On expiry, futures can be settled by delivery of the underlying asset or cash. Cash settlement enables the settlement of obligations arising out of the future/option contract in cash.

Contracts that gamble on the future prices of assets--are secondary assets, such as options and futures, which derive their value from primary assets, such as currency, commodities, stocks, and bonds.

COMMODITIES FUTURES TRADING IN INDIA

Commodity trading is nothing but trading in commodity derivatives (futures or options). In other words, anyone keen at taking a buy/sell position based on the future performance of commodities like gold, silver, agricultural commodities, metals, crude etc; could do so by trading in commodity derivatives.

Trading in commodities futures is quite similar to equity futures trading. NCDEX and MCX are the two most popular national level online exchanges offering futures trading in commodities in India.

1. **NCDEX** (National Commodity and Derivative Exchange)
2. **MCX** (Multi-Commodity Exchange).

Gold, Silver, Agri-commodities including grains, pulses, spices, oils and oilseeds, mentha oil, metals and crude are some of the commodities that the exchanges deal in.

NEED FOR COMMODITY TRADING EXCHANGE

Commodity exchange is an association, or a company or any other body corporate organizing futures trading in commodities

Earlier, all the sellers and buyers of a commodity used to come to a common market place for the trade. Buyer could judge the amount of produce that year while the seller could judge the amount of demand of the commodity. Thus they could dictate their terms and hence the counter party was left with no choice. Thus, in order to hedge from this unfavorable price movement, need of the commodity exchange was felt.

1. NCDEX

NCDEX is a nation-level, technology driven de-mutualised on-line commodity exchange with an independent Board of Directors and professional management NCDEX is the only commodity exchange in the country promoted by national level institutions such as LIC, NABARD etc. This unique parentage enables it to offer a bouquet of benefits, which are currently in short supply in the commodity markets.

NCDEX is a public limited company incorporated on April 23, 2003 under the Companies Act, 1956. It commenced its operations on December 15, 2003. NCDEX is located in Mumbai and offers facilities to its members about 550 centers throughout India.

NCDEX is regulated by Forward Markets Commission. NCDEX is subjected to various laws of the land. NCDEX currently facilitates trading of 57 commodities - in Agriculture, Metals and Energy

2. MCX

Multi Commodity Exchange of India Ltd. (MCX) is an independent and de-mutualised multi commodity exchange. It was inaugurated on November 10, 2003 in the financial capital Mumbai. It has permanent recognition from the Forward Markets Commission, Government of India for facilitating online trading, clearing and settlement operations for commodities futures market across the country. It is a nation-wide commodity exchange having state-of-the-art infrastructure, offering multiple commodities for trading with wide reach and penetration, MCX is well placed to tap the vast potential poised by the commodities market. MCX holds more than 55% market share of the total trading volume of all the domestic commodity exchanges. The exchange has also affected large deliveries in domestic commodities, signifying the efficiency of price discovery.

NCDEX / MCX trading

Established in 2003, and already the largest commodity futures exchange in India provides the premier forum for managing the price risk associated with pulses market. It helps its members in entering into orders, verifying the credit worthiness of clearing members, matching orders on price and time proximity and confirming them for clearing and adjusting accounts of buyers and sellers for positions and margins of the trade.

TRADING IN PULSES FUTURES

The Indian pulses' market importance in the world, and responsiveness to international events makes pulses futures an important risk management tool for commercial interests as well as an exciting potential opportunity for those investors who seek to profit by correctly anticipating price changes.

Importance of Pulses in India

Pulses, such as beans, lentils and chickpeas, are the "meat" of India and the main source of protein for most of its 1 billion people.

- **India's Pulse Varieties & Cropping Seasons for Pulses**

Foreign Name	Local Name	Seasonality/Harvesting
Chickpea	Gram/DesiChana	Rabi (Mar/April)
Pigeon Pea	Arhar/Tur	Kharif (Sept/Oct)
Lentils	Masoor	Rabi
Green Beans	Moong	Kharif
Black Matpe	Urad	Kharif

- **Pulses Markets :** The most important pulses markets in India include Mumbai, Delhi, Chennai, Indore, Kanpur, Bikaner, Hapur, Hyderabad, Jaipur, Jalandhar, Ludiana, and Sangrur.
- **Pulses Production** : The stagnant or declining production due to low investment, imbalance in fertilizer use, low rate of seeds replacement, a distorted incentive system, low post- harvest value addition etc., has led to declining per capita consumption over the past 20 years. The per capita availability has progressively declined from 60 g in 1950-51 to 32 g in 2007-08.
- **Pulses Imports :** India's huge and growing demand for pulses has created an import market of 7, 00,000 tons despite the fact that it remains the world's largest producer.
- **Pulses Demand** : There's every indication that there is huge market for pulses as India's population increases by 18 million each year, but production of pulses has languished as government research and price supports have favored cereal grains over other foodstuffs. As a result, per capita availability of pulses has fallen to just 38 grams per day, one-half the level of the early 1960s.
- **Pulses Consumption :** Interesting in India, consumers chose different types of pulses, based on tastes or cooking practices in the different parts of the country, to mention a few.

  In the North : *Chickpeas* and products are very popular. Chickpea flour is used to prepare various snack foods. *Kidney beans (rajma)* and *black-eyed* beans *(lobia)* also are popular in this region.

  In the South: *Pigeon peas* and *urad (*black *matpe)*, are popular. *Mung bean* flour forms several snack items such as *bari,* spiced balls of ground pulses.

  Throughout India: *Peas* are cooked and eaten as snack foods or used as fillers in traditional snacks such as *samosas.* Split *yellow peas* and pea flour are increasingly being blended in cooking. *Lentils* are generally served along with rice as *dal. Dal,* garnished with onions and spices, is an indispensable entree in roadside *dhabas* (quick, cheap eateries). *Dal* also is found on menus of five-star hotels.

FARMERS AND FUTURES TRADING

The NCDEX study on "Role of Futures Market: Mitigation of Price Risk" reveals (through table 1 and 2) the present state of Indian Farmers with respect to their land holdings, crop yield per hectare and the other issues that

Table 1 - A look at the Indian Farmer and his Respective Land Holdings

Category of farmers	Average Size of Holdings (hectares)	Area operated (as % of total)
Marginal	0.40	17.21
Small	1.42	18.81
Small-Medium	2.73	23.85
Medium	5.83	25.34
Large	17.21	14.79
All Groups	1.41	100

Source NCDEX Oct 19, 2006

Table 2 - Production Situation of Small & Production Situation of Small & Marginal Farmers Today

	Yield/hec	Production / Farmer		
	Tons/hec	Tonnes / Farm		
		Large (17.2 hectares)	Medium (4.2 hectares)	Small/Marginal (1.5 Hectares)
Rice	2.20	37.84	9.24	3.30
Wheat	2.60	44.72	10.92	3.90
Tur	0.70	12.04	2.94	1.05
Chana	0.73	12.56	3.07	1.10
Urad	0.40	6.88	1.68	0.60
Soyabean	1.10	18.92	4.62	1.65
Groundnut	1.14	19.61	4.79	1.71
Mustard	1.10	18.92	4.62	1.65
Pepper	0.30	5.16	1.26	0.45
Jeera	0.30	5.16	1.26	0.45
Turmeric	3.50	60.20	14.70	5.25

Source NCDEX Oct 19 2006

are before them and how futures trading helps in addressing their problems.

The problems and issues before the Indian farmer are many, to cite a few:

- The incidence of hunger and poverty among those farmers whose landholdings are < than 0.5 hectares is 38 percent;
- The likelihood of being affected by hunger or poverty drops to 12 and 13 percent, respectively, for those farmers who cultivate more than 4 hectares of land.
  The other important issues before the Indian farmers (as identified by a recent NCDEX study) that need to be addressed immediately are :-
- Traditional cropping pattern
- Dependency on monsoon
- Income variation due to price fluctuations
- Asymmetric price information
- Irregular flow of credit
- Reliance on money lender, adathiya
- Stocking infrastructure
- Warehouses, grading etc.
- Marketing
- Absence of common economic market

Benefits from futures market as projected by the study:-

- Selection of Crop
- Price risk mitigation
- Sell forward before harvest
- Sell forward after harvest

With over 40% of the farmers holding small and marginal farms (as per NCDEX study), it becomes very crucial to understand whether these farmers with as many basic issues unaddressed before them, are they in a position to receive the benefits of futures trading as expected by the Government of India. And is there a need to continue to include agricultural commodities in futures trading?

FINDINGS AND CONCLUSION

After going through various views and the issues relating to futures trading in pulses and its relations with the rise in prices, the following conclusions are made :-

1. In India, where medium to small farmers are more, the knowledge of the very existence of futures trading among such farmers is assumable low. Thus the question how many farmers are aware of futures trading. Hence, the benefits of futures trading cannot be fully assumed to be reachable to the farmers.

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2. According to Naik`s analysis as the conclusions of a study by IIM Bangalore Professor Gopal Naik (posted online on Aug 11th 2007. After the ban, the facts: Futures didn`t spike wheat, pulses prices by Ravish Tiwari) “the jump in prices , isn't because of futures trading but because of lower production, lower stocks and soaring international prices of certain commodities”, the reason being if futures trading help farmers to decide which crop to grow, it leads to imbalance in production. It makes the farmer grow the crop that is profitable rather than the crop that is desirable for the nation. It leads to low production and high prices.
3. Another observation is, it takes time to sell the produce since farmer waits till he gets a better price for his crop which in turn creates artificial demand with low supplies due to hoarding, hence the rise in prices.
4. In case the farmer gets a better price after 3 to 4 months also, he cannot wait to take advantage of this price as he has to meet many financial obligations post harvest of the crop.
5. Apart from all these, India being basically an agrarian economy should see to that the country is self sufficient, mainly in food grains. Pulses “the common man's meat” cannot be put to future trading. The country should first have sufficient to meet the internal demand for consumption at fair prices. That is what is needed for the country. One can carry out futures trading on metals, energy, etc., which are not basic necessities to live with. But as far as food grains are concerned, the government should help the farmers to get a better price and facilitate the consumers to get it at an affordable price.

It is appreciated that the government banned futures trading on some pulses protecting the farmers and the consumers and not leaving the market open to speculative trade like futures trading. It is still beneficial if the trading on pulses as such is banned which will benefit the farmers to grow crops according to the nature of the soil and the seasons and not as per futures trading demand.

Hence a total ban on futures trading on pulses is advisable.

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