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# A STUDY OF HISTORICAL BACKGROUND OF INDIAN COMMODITY MARKET

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## ABSTRACT

*The main purpose of this study historical background of commodity market in India. The commodity market provides trading to trade commodities of varied types. This study evaluates the extent to which commodity policies and regulatory framework. With the current pace of growth, India would emerge as a major player in the international market in terms of commodity consumption, production and trade. After gaining the considerable popularity, the major commodity exchanges in India has started the futures contract in various commodities year back, which can serve preferably to manage the risk that can arises due to adversity of expected prices of commodities besides the price discovery tool. The future contracts dealing in major commodity exchanges are standardize in nature. In this study I have included history of commodity market. Than I have included commodity market in India. And after that I have discussed the mechanism of trading, segments and regulatory framework of commodity market in India. In this study I have taken a first look at forward, futures and options contract and other risk management. There are mainly three types of traders: hedgers, speculators and arbitrageurs. I have at the end given the research conclusion. Price discovery which is one of the functions of futures market has been researched from a narrow perspective of quantitative analysis. India now enjoys world ranking with respect to trading volume in certain commodities like Silver, Gold, Copper, Guar Seed etc.*

*This study attempts to discuss the commodity market and its historical developments, types of traded commodities products, regulation and policy developments, trend and growth of commodity market in India.*

**KEYWORDS:** *Commodity Markets, Commodity Exchanges, Commodities Futures.*

# I. INTRODUCTION

Gradual evaluation of commodity markets in India has been of great significance for both the country's general economic distribution and its linkages with financial sector. Being a unique hedging instrument, it provide for efficient portfolio management arising from diversification benefits, which result in improved returns to domestic as well as international investor.

A commodity is a product that has commercial value. It can be produced, bought, solid, and consumed. Commodities are basically the product of primary sector of an economy. The primary sector of an economy is concerned with agriculture and extraction of raw materials such as metals and energy (crude oil, natural gas), which serve as basic inputs for the secondary sector of the economy. Agriculture is backbone of Indian economy. About 70% of Indian population depends directly on agriculture and it account for around 23% of GDP. Trading in derivatives first started to protect farmers from the risk of the value of their crop going below the cost price of their products. Derivative contract were offered on various agricultural products like cotton, rice, wheat, coffee, pepper etc.

A market where commodities are traded is a commodity market. These commodities include bullion (gold, silver), non-ferrous (base) metals (copper, zinc, nickel, lead, aluminum, tin), energy (crude oil, natural gas) and agricultural commodities such as soya oil, palm oil, coffee, pepper, cotton, rice, wheat and cashew. Vibrant, active, liquid, and transparent commodity markets characters developed economies. India is well placed to acquire such a commodity market. The commodity market that is referred to today pertains, to the derivative market in the country for various commodities that are dealt with on exchange. A commodity exchange is place where various commodities and derivatives are bought and sold. Commodities exchange usually trade on commodity future. The commodity exchanges have as part of its own business models had to crate the necessary infrastructure to conduct their operations. Commodity exchanges in India are expected to contribute significantly in strengthening. At present, there are 4 national level commodity exchanges and 22regional commodity exchanges in India. The national level exchanges are MCX, NCDEX, NMCE, & ICEX. There are 26 commodity exchanges operating in India and carrying out futures trading activities in as many as 146 commodities items. The three electronic national exchanges i.e., Multi Commodity Exchange of India Limited (MCX) and National Commodity Derivative Exchange Limited (NCDEX) had shown remarkable growth in the commodity derivative exchanges, gold, Silver and crude oil recorded the highest turnover in MCX while in NCDEX, soy oil, gaur seed and soybean and in NMCE pepper, rubber and raw jute were the most actively traded commodities. The dual, price system under which different prices for same commodities exist in different exchanges leads to inefficiencies in the commodity derivative market in India.

Indian commodity market are regulated India's independence the forward contracts (Regulation) Act 1952, (FCR Act) was passed by the parliament to regulate this market and forward market commission (FMC) was established in 1953 as the Regulation under provision of FCR Act, which comes under the Ministry of Consumer Affairs Food and Public Distribution.

Commodity markets in India have a huge potential since Indian economy is conventionally an agricultural based economy. Commodity market can influence the whole economy of a country through important macroeconomic variable like inflation. India is one of the few countries where the wholesale price index considered as the headline of inflation.

As a developing country like India two third of the one billion population depends on agricultural commodities. Commodity derivative market plays a vital role in the development of the Indian economy. With the introduction of online commodities trading one can carryout their trades all over the world. World over the commodities markets are 10 times bigger than the equity markets. The commodity derivative markets in India had a bright future and it should become an emerging global hub that overtakes the market for stock derivatives.

Commodity market segment has divided into two types like hard and soft commodities. Hard commodities are typically natural resources that must be mined and soft commodities are agricultural products. The investor or speculators can prefer convenient segment to trade the commodities to earn return. This study attempts to discuss the commodity market and its historical developments, types of traded commodities products, regulation and policy developments, trend and growth of commodity market in India.

## II. OBJECTIVES OF THE STUDY

- To study the historical background of Indian commodity market
- To evaluate the segment of commodity market in India
- To analyze the regulatory framework of commodity market in India

## III. REVIEW OF LITERATURE

The present studies outline theoretical literature the commodity market in India. The review of the earlier studies here is attempted chronologically in order to get a comprehensive picture. Abundance literature on commodity market in general gives theoretical explanation for the emergence of commodity market. There are several studies examine the market efficiency and price forecasting, especially in developed countries. However, relatively very studies exist on commodity market efficiency in underdeveloped and agriculturally dominant countries like India.

**Dr. Anurag Agnihotri** and **Dr. Anand Sharma (2011)** in "Study of Convergence of Spot and Future Price in Commodity Market (with Reference to Zeera, Channa, Zink and Natural Gas for 2005-2010)" investigated the commodity spot prices have converged with future market with a view to measure this convergence. And to find out arbitrage opportunity in MCX, and NCDEX, the correlation, regression, and standard deviation is used. The result indicate that correlation coefficients themselves are not capable of detecting convergence and that the regression- linear tests is more powerful detecting any convergence between the future and spot prices of Zeera, Zink, Channa, and Natural gas.

**Dharmbeer** and **Mr. Barinder Singh (2011)** "Indian Commodity Market: Growth and Prospects" summarizes theoretical and empirical research on the growth and prospects of emerging commodity markets and the resulting implication on policy and regulation. They found from the previous studies that derivatives markets have supported the hedging role of emerging derivatives markets. All commodities are globally traded and the global demand-supply situation is widely known and available to anyone who reaches out for it. The commodity markets are nowhere as volatile as stock futures. Since commodity exchanges promote price transparency, he refuses to buy the story that commodity exchange fuel inflation. **Dr. Anurag Agnihotri** and **Dr. Anand Sharma (2011)** in "Study of Convergence of Spot and Future Price in Commodity Market (with Reference to Zeera, Channa, Zink and Natural Gas for 2005-2010)" investigated the commodity spot prices have converged with future market with a view to measure this convergence. And to find out arbitrage opportunity in MCX, and NCDEX, the correlation, regression, and standard deviation is used. The result indicate that correlation coefficients themselves are not capable of detecting convergence and that the regression- linear tests is more powerful detecting any convergence between the future and spot prices of Zeera, Zink, Channa, and Natural gas.

**Sunil Kumari (2011)** in his research paper "An Insight into Derivative Market: Indian Perspective" attempted to study is the genesis of derivatives trading by tracing its historical developments, types of traded derivatives products, regulation and policy developments, trend and growth, futures prospects and challenges of derivative market in India. Derivatives market should be developed in order to keep it at part with other derivative markets in the world. They found RBI should play a greater role in supporting derivatives and SEBI should conduct seminars regarding the use of derivatives to educate individual investor. So, SEBI should take necessary steps for improvement in Derivative Market so that more investors can invest in Derivative market.

**Meenakshi Malhotra (2012)** in his research paper "Commodities Derivatives Market in India: The Road Traveled and Challenges Ahead" examine that the commodity price very critical for the existence and growth of any industry and for the economy as a whole. Our government has brought about sweeping reforms in the commodities markets so that industry can efficiently manage the price risk they are faced with. They found the commodity price will continue to behave unpredictably. Risk management through commodity derivatives will give stability to the economic activities of the country.

**k. Logasakthi** and **Dr. S. Asokkumar (2012)** in his study titled "A Study on Investors' Awareness of Commodity Market with reference to KIFS Securities Private Limited at Salem" investigated the made to find out the investors knowledge towards commodity market. The study reveals that commodity market is a market stage in Salem. They found the investment avenues of individual investors depend mainly on annual income and risk taking capacity.

**Dr. G. Malyadri** and **B. Sudheer Kumar (2012)** "A Study on Commodity Market" recalls that commodity derivatives arrived in India as early as 1875, barely about decade after they arrived in Chicago. The commodity market in India has experience an unprecedented boom in terms of the number of modern exchanges, the number of commodities allowed for derivative trading as well as the values of futures trading in commodities. However, there are several impediments to be overcome and issues to be settled for a sustained development of the market.

**Dr. (MRS.) Kamlesh Gakhar** and **Ms. Meetu (2013)** in "Derivatives Market in India: Evaluation, Trading Mechanism and Future Prospects" investigated the Indian derivative market has achieved tremendous growth over the years, and also has a long history of trading in various derivatives products. The derivatives market has seen ups and downs. The new and innovative derivative products have emerged over the time to meet the various needs of the different types of investors. Though, the derivative market is burgeoning with its divergent products, yet there are many issues. Solution of these issues will definitely lead to boost the investors' confidence in the Indian derivative market and bring an overall development in all the segments of this market.

**Mr. Sharma KRS (2013)** "A Study of Commodity Futures in India" perception towards commodities futures trading in India with special reference to commodity futures exchanges. The growth of commodity derivative market in the country has been impressive. With institutional players prevented from participating in the commodity futures market, the retail investors, as a group, have emerged as major players in the said market. They also add that commodity futures are positively correlated with inflation, unexpected inflation and change in expected inflation.

**Harvindaer pal Kaur** and **Dr. Bimal Anjum (2013)** in his study titled "Commodity Derivatives Market in India "examined that the India is among the apex producers of a number of commodities and has a long history of trading in commodity derivatives. Commodity market has occupied imperative position in Indian economy since the establishment of Forward Market Commission in April 2003. There are 5 national and 21 regional commodity exchanges recognized and regulated by this commission. They found commodity futures reform two vital functions of the economy i. e. price discovery and management. Futures markets provide liquidity and facilities to hedge against future price risk. It helps buyers and sellers of agricultural products to quickly manage their trade at a fair price. Commodity trading also offers a chance for financial leverage to hedgers, speculators and other traders.

**Dr. Sunitha Ravi (2013)** in his research paper "Price Discovery and Volatility Spillover in Indian Commodity Futures Markets Using Selected Commodities "investigated the results of the research study indicate that the future market of the commodities is more efficient as compared to spot market. The future market also helps spot market in the process of Price Discovery. They found the derivative instruments are available for the underlying commodities significantly influence the volatility.

**Sagar Suresh Dhole (2014)** in his research paper "Commodity Futures Market in India: The Legal Aspect and its Rationale" investigated the antiquity of commodity futures market in India epoch back to the ancient times citied in Kautialya's 'Arthasastra', and have been commodity heard in Indian markets for centuries, seems to be coined in 320 BC, referred in Forward Contracts (Regulation) Act, 1952. They found the markets have made enormous advancement in terms of technology, transparency and the trading activity. Interestingly, this has happened only after the Government protection was removed from a number of commodities, and market forces were allowed to play their role. Rational Government policies and the plinth of effective laws have benefited in many ways like Credit accessibility, improved product quality, predictable pricing, Import-export competitiveness, and price risk management and price discovery.

**Dr. S. Rajamohan, G. Hudson Arul Vethamanikam** and **C. Vijaykumar (2014)** in his study titled "Commodity Futures Market in India" examined that the commodity trading has a long history and it has been modernized in the market. The commodities trading are occupied an important place in the economy it depends on the international trade A structural system has been created for commodity trades. It is creating awareness and the more opportunity to the investors and public. They found the market volatility is based on these commodities performance. However the commodity market has provided huge support to the Indian economy. **Rohit Bansl, Varsha Dadhich** and **Naveed Ahmad (2014)** in his study titled "Indian Commodity Market-A Performance Review "investigated the Indian commodity markets have recently thrown open a new avenue for retail investor and traders to participate commodity derivatives. The study discusses the evolution and performance of the market, its present status and the future prospect. They found the different commodities (agriculture, metals, bullion, energy and other) show a positive trend in their volume and value of trade. The percentage share of agriculture commodity in total commodity market has been declined in the year 2011-11 but bullion shows an increasing trend along with metal and energy. It all shows that the market has strong growth potential.

**Dr. G. Selvalakshmi** and **Dr. A. Arumugam (2014)** "Impact of Price Level Change in Indian Commodity Market" asserts that since its reintroduction, the commodity derivatives market is thriving and the current trend shows the strong growth potential of the market, although, the actual growth trajectory will depend upon the attitude of the policy makers and the efficiency of the regulatory mechanism.

## IV. RESEARCH METHODOLOGY

The present study is conducted on commodity market in India. The study is descriptive in nature. The literature and data are mainly based on secondary a source, which has been collected from commodity market and their various publications, text books related topics, magazines, reputed journals, research paper & various internet sources likewww.mcxindia.com,www.ncdexindias.com www.nmceindia.com. www.fmce.gov.in and other publications. The various reports and records issues and maintained by the Government of India (GOI) are also used in the study. This study is based on historical background of commodity market in India & its policies and designed to gather descriptive information's. There is no tool applied to values and volumes fluctuations of commodity market.

## V. HISTORICAL BACKGROUND OF COMMODITY MARKETS

India is one of the top producers of agricultural commodities and a major consumer of bullion and energy products. Given the importance of commodity production and consumption in India, it is necessary to develop the commodity markets with proper regulatory mechanism for efficiency and optimal resource allocation.

India has long and rich history of futures trading in commodities. Commodity derivatives markets in India are as old as those of UK and USA. The history of organized commodity derivatives in India goes back to the nineteenth century when the Cotton Trade Association started futures trading in 1875, about a decade after the started in Chicago. But the concept became popular only after the establishment of Chicago Board of Trade in Chicago, USA in the middle of 19th Century. Histories of Commodity Futures Trading in India There are strong grounds to believe that Commodity futures could have existed in India for thousands of years. References to such markets in India appear in Kautialya,s 'Arthasastra' . The words, "Teji", "Mandi", "Gali", and "Phatak" have been commonly heard in Indian markets for centuries which seem to be coined in 320 BC. The Arthasastra is an ancient Indian treatise on statecraft, economic policy and military strategy, written in Sanskrit whereby it is found that Commodity Futures did existed in ancient times related to agricultural produce, Precious metals and Animals. India has an elongated history of trading commodities and considered the pioneer in some forms of derivatives trading. In fact, commodity trading in India started much before it started in many other countries.

The first milestone in the 125 years rich history of organized trading in commodities in India was the constitution of the Bombay Cotton Trade Association in the year 1875. Over time the derivatives market developed in several commodities in India. Following cotton (Bombay Cotton Trade Association) 1875, widespread discontent among leading cotton mill owners and merchants over the functioning of the Bombay Cotton Trade Association, a separate association, Bombay Cotton Exchange Ltd., was constituted in 1893. This was followed by establishment of futures markets in edible oilseeds complex, raw jute and jute goods and bullion. This becomes an active industry with volumes reported to be large. The Gujarati Vyapari Mandli was set up in 1900 to carry out futures trading in groundnut, castor seed and cotton. In 1939, cotton derivatives banned by Government. Before the Second World War broke out in 1939 several futures markets in oilseeds were functioning in Gujrat and Punjab. Futures' trading in wheat was existent at several places in Punjab and Utter Pradesh. The most notable amongst them was the Chamber of Commerce at Hapur, which was established in 1913. Other markets were located at Amritsar, Monga, Ludhiana, Jalandhar, Fazilka, Dhuri, Barnala and Bhatinda in Punjab and Muzaffarnagar, Chandausi, Meerut, Saharanpur, Hathras, Gaziabad, Sikenderabad and Berielly in U.P. Calcutta Hessian Exchange Ltd. was established in 1919 for futures trading in raw jute and jute goods.

But organized futures trading in raw jute began only in 1927 with the establishment of East Indian Jute Association Ltd. These two associations amalgamated in 1945 to form the East Indian Jute & Hessian Ltd. To conduct organized trading in both Raw Jute and Jute goods. Futures trading in Raw Jute suspended in 1964 reportedly on the insistence of the then State Government (WB Govt.). Futures market in bullion began in Mumbai in 1920, and later, similar markets were established in Rajkot, Jaipur, Jamnagar, Kanpur, Delhi, and Calcutta. In due course several other exchanges were also creatrd in the country to trade in such diverse commodities as pepper, turmeric, potato, sugar and gur (jaggory). The derivatives trading in India however did not have uninterrupted legal approval. By the Second World War, i.e., between the 1920's and 1940's futures trading in organized from had commenced in a number of commodities such as – cotton, groundnut, groundnut oil, raw jute jute goods, castor seed, wheat, rice, sugar, precious metals like gold and silver. During the Second World War futures trading was prohibited under Defence of India Rules. In 1921, futures in cotton were organized in Mumbai under the auspices of East India Cotton Association (EICA). The Bombay Commodity Exchange Ltd. Was registered on October 12, 1938 for trading oilsed complex. Before the Second World War broke out in 1939, several futures markets in oilseeds were functioning in the states of Gujarat and Punjab. Further, forward trading was prohibited in oilseed and some other commodities including food-grains, spices, vegetable oils, sugar and cloth in 1943. T he commodity market in India underwent rapid growth between the period of First and Second World Wars. Under the Defence Act of India, commodity trading came too prohibited during the Second World War. After India's independence, in the early 1960s the commodity derivative trading again picked up. In mid 1960s most of the commodities were banned and future trading continued only in the minor commodities, viz., pepper and turmeric. Future trading in potato, caster seed and gur (jiggery) was permitted in 1980s. In 1992, a future trading in hessian was permitted. In April 1999 future trading in various edible oilseed complexes was allowed and in May 2001 future trading in sugar was permitted. Since April 2003, future trading was permissible in all the commodities by Government of India as National Agricultural Policy announced the positive role of commodity market.

However, in 1935 a law was passed allowing the government to in part restrict and directly control food production (Defence of India Act, 1935). This included the ability to restrict or ban the trading in derivatives on those food commodities. Rajkot Commodity Exchange Limited was registered on April, 1951 for tading in castorseed, groundnut, oil and cotton. The Ahmedabad Commodity Exchange Ltd. Was established in 1952 for trading in castor eseed, cottonseed its oil and oil cake.

Post-independence, the Indian constitution listed the subject of –Stock Exchanges and Futures Markets under the union list. As a result, the regulation and development of the commodities futures markets were defined solely as the responsibility of central government. A bill on forward contract was referred to an expert committee headed by Prof. A.D. Shroff and selected committees of two successive parliaments and finally, in December1952, the Forward Contract (Regulation) Act was enacted and the Forward Markets Commission (FMC) was established in 1953 under the Ministry of Consumer Affairs and Public Distribution. The Forward Contract (Regulation) rules were notified by the central government in July 1954.The Act prohibited options trading in Goods along with cash settlement of forward trades, rending a crushing blow to the commodity derivatives market. Under the Act only those Associations/Exchanges, which are granted reorganization from the Government, are allowed to organize forward trading in regulated commodities. The envisages three tire regulations:

(i)The Central Government- Department of consumer Affairs, Ministry of Consumer Affairs Food and Public Distribution- is the ultimate regulatory authority.

(ii)The Forward Markets Commission provides regulatory oversight under the powers delegated to it by the Central Government.

(iii)The Exchange which organizes forward trading in commodities can regulate trading on day-to-day basis.

In 1955, Gold and Silver futures trading banned. The FCRA, 1955 gives powers to control production, supply, distribution, etc. of essential commodities for maintaining or increasing supplies and for securing their equitable distribution and availability at fair prices. Using the powers under the ECA, 1955 various Ministers/Departments of the Central Government have issued control orders for regulating production/distribution/quality aspects/

movement etc. pertaining to the commodities which are essential and administered by them. In 1956, commencement of futures trading in Castor seed at Mumbai. Commencement of futures trading in Turmeric at Sangli.

The futures trade in spices was first organized by the India Pepper and Spices Trade Association (IPSTA) in Cochin in 1957. Commencement of Futures Trading in Jute at Calcutta, In 1958 and, the Kanpur Commodity Exchange Ltd. Was registered in 1958 for trading in rapeseed/mustardseed and its iol. As a result, after independence, commodity option trading and cash settlement of commodity future were banned in 1952. A further blow come in 1960's when following several years of several droughts has forced many farmers to default on forward contract and even caused some suicides, forward trading was banned in many commodities considered primary or essential. Consequently, the commodities derivatives market dismantled and remained dormant for about four decades. After independence, the parliament passed Forward Contract (Regulation) Act, 1952 which is regulating forward contracts in commodities all over India. The Act applies to goods, which are defined as any moveable property other than security, currency and actionable claims. The Act prohibited options trading in goods along with cash settlements of forward trades, rendering a crushing blow to the commodity derivatives market. The Central India Commercial Exchange Limited has started in 1960, in Gwaliar for futures trading in gur and mustardseed. In 1963,Futures trading in Commodities Banned. Futures trading in Raw Jute suspended in 1964 reportedly on the insistence of the then State Government (WB Government). The Surendranagar Cotton Oil & Oilseeds Association Ltd., surendranagar was incorporated on 18 November 1964 for trading in cotton cottonseed and kapas. In 1966, suspension of futures trading in cotton and most of the commodities-Dantawala Committee Report. However, in order to monitor the price movements of several agricultural and essential commodities, futures trade was completely banned by the government in 1966.Subsequent to the ban of futures trade many traders resorted to unofficial and informal trade in futures. In 1974, setting up of the commodity futures trading Commission-the futures market regulator of the USA. In 1977, Futures trading in Castor Seed and Linseed were also suspended. However, in India's liberalization epoch as per the June 1980 Khusro committee's recommendations, the government reintroduced futures. futures trading in most of the major commodities, including cotton, kapas, raw jute and jute goods and suggested that steps may be taken for introducing futures trading in commodities, like potatoes, onions, etc. at appropriate time. The government, accordingly initiated futures trading in Potato during the latter half of 1980 in quite a few markets in Punjab and Utter Pradesh. The Meerut Agro commodities Exchange company Limited, Meerut was established in 1983 for trading gur.

Following the introduction of economic reforms in 1991, the Government of India appointed an expert committee on forward markets under the chairmanship of Prof. K.N. Kabra in June 1993. The committee submitted its report in September 1994, championing the reintroduction of futures, which were banned in 1966, and expanding its coverage to agricultural commodities, along with silver. By 1996 there was almost a complete ban on Futures Trading. Steps taken towards revival of Futures Trading by Government of India. The Government of India during the period 1950 to 1993 constituted many expert Commodity futures can be looked upon as an option for those who want to diversify their portfolio beyond equities, interest bearing securities or investments and real estate. For traders & Exporters, it is an efficient mechanism to protect themselves against price fluctuations. Last but definitely not the least, for the farmers, commodity futures is a very efficient price discovery as well as price recovery mechanism. Futures trading in Raw Jute and Jute Goods began Calcutta with the establishment of the Calcutta Hessian Exchange Limited., Committees to study the various aspects of futures trading. These were (1) The Shroff Committee (1952) ;( 2) Dantwalla Committee (1966); (3) Khusro Committee (1980) and (4) Kabra Committee (1994). The reports of these commodities helped to lay down the framework for the revival of Futures Trading in commodities in India.

Following the launch of economic reforms in early 1990s and especially after India signed the General Agreement on Trade and Tariffs (GATT) to enter the World Trade Organization (WTO), The World Bank and United Nations Conference on Trade and Development (UNCTAD) submitted a joint report to the Government of India recommending revival of futures trading in farm commodities and their products to render trade in such commodities competitive in the world markets after the envisaged removal of trade and non-trade barriers. Also, Government of India set up Kabra Committee in 1993 to review the futures trading for other commodities which were hitherto prohibited. As a result, a future trading was revived, after a lapse of nearly three and half decades, towards the close of the 20th century. In the early 1990s the Forex Crisis and liberalization of the economy lead to policy changes in India. After the introduction of economic reforms since June 1991 and the consequent gradual trade and industry liberalization in both the domestic and external sector, the Government of India appointed in June 1993 one more committee on Forward Markets under Chairmanship of Prof. K. N. Kabra. The Kabra Committee (1994), the earliest post-1991, recommended opening up futures trading in 17 selected commodities, although it was not unanimous regarding some of these. Importantly, this committee was unanimous in recommending that futures trading not be resumed in case of cotton and kapas, raw jute and raw goods, groundnut, rapeseed/mustard seed, cottonseed, copra and soybean, castor oil and its oilcake, linseed, silver, onions, wheat, pulses, non-basmati rice, tea, coffee, dry chilli, maize, vanaspati and sugar. The committee also recommended that some of the existing commodity exchanges particularly the ones in pepper and castor seed may be upgraded to the level of international futures markets. In 1992, Futures trading in Hessian permitted. Rajdhani Oil and Oilseeds Exchange Limited (ROOL) was established, Delhi for trading Gur. The Coffee Futures Exchange India Ltd. Bangalore was set up.In 1997 for trading coffee and , permission for international futures contract in black pepper. In 1998, permission for hedging in offshore exchange for actual users of non-oil commodities.

National Board of Trade (NBOT) was set up in 1999 by Soyabean Processors Association of India (Sopa) to offer trading in soya oil to edible oil industry stakeholders. Futures Trading in various edible oilseeds complexes permitted and permission for International futures contract in Castor Oil In 1999, revival of the derivatives trading in some oilseeds. In 1999, approval for futures trading in edible oil block and coffee and permission for international futures contract in castor oil. The First Commodity Exchange of India Limited (FCEI), Kochi was promoted in 2000 for trading in copra/coconut its oil and oil cake.

In order to boost the agricultural sector, the National Agricultural Policy 2000 envisaged external and domestic market reforms and demanding of all controls and regulations in the agricultural commodity markets. It also proposed an expansion of the coverage of futures markets to minimize the wide fluctuations in commodity prices and for hedging the risk arising from extreme price volatilities. The Expert committee on Strengthening and Developing Agricultural Marketing (Guru Committee: 2001) emphasized the need for and role of futures trading in price risk management and in marketing of agricultural produce. This Committee's Group on Forward and Futures Markets recommended that it should be left to interested exchanges to decide the appropriateness/usefulness of commencing futures trading in products (not necessarily of just commodities) based on concrete studies of feasibility on a case-to-case basis.

The liberalized policy being followed by the Government of India and the gradual withdrawal of the procurement and distribution channel necessitated setting in place a market mechanism to perform the economic functions of price discovery and risk management. The National Agriculture Policy announced in July 2000 and the announcements of Finance Minister in the Budget Speech for 2002-2003 were indicative of the Government's resolve to put in place a mechanism of futures trade/market. As a follow up the Government issued notifications on 1.4.2003 permitting futures trading in the commodities, with the issue of these notifications futures trading is not prohibited in any commodity. Options trading in commodity are, however, presently prohibited. From 2013 September 09, the commission is overseen by the Ministry of Finance. Since futures traded in India are traditionally on food commodities, earlier it was overseen by Ministry of Consumer Affairs, Food and Public Distribution (India). In 2001, more commodities opened for futures. In 2001, permission for hedging in petro-products in offshore exchanges and permission for futures trading in Sugar and Tea. In 2002-03, permission for National Level Multi Commodity Exchanges. The Bikaner Commodity Exchange Limited (BCEL) established at Bikaner, Rajasthan in 2002 for futures trading in mustard seed and mustard oil.

Presently, in India, there are 26 commodity exchanges, of which the three national-level electronic commodity exchanges are: **National Multi-Commodity Exchange of India Ltd.(NMCE),** India's first demutualised, electronic, multi-commodity exchange ,which have been working since 26th November 2002, **Multi Commodity Exchange of India Limited (MCX), & National Commodity**

**and Derivatives Exchange Limited (NCDEX),** demutualised online multi- commodity exchange started since 10th November 2003, and 15th December 2003 respectively. The Haryana Commodities Limited was registered in 2004 .

The announcement to reintroduce it was made in February 2003 after the Union Government had pressed for its return. Through Online Futures trading with demutualised set up, which has more transparency, we can hope that proper futures trading will take place in Raw Jute and in India now. Futures trading in most Multi Commodity Exchange of India Limited (MCX) are a leading Exchange for Bullion and Energy sector. National Commodity and Derivatives Exchange Limited (NCDEX) currently facilities trading in 57 commodities. National Multi Commodity Exchange of India Limited (NMCE) commenced futures trading in 24 commo0dities ON 26TH November 2002 on a national scale. Currently (August 2007) 62 commodities are being traded in NMCE.

The establishment of Exchange accredited Warehouses, which issue Warehouse Receipts, which can be traded, added impetus to the growth of Futures Trading. Introduction of 'scrip' less Trading (in Dematerialized or DMAT form) in Capital Markets paved the way for introduction of Demat-holdings of Commodities. Commodities futures can be looked upon as an option for those who want to diversify their portfolio beyond equities, interest bearing securities or investments and real estate. For traders and Exporters, it is an efficient important milestone in Commodity Futures Trading in India.

At present, there are 26 Exchanges operating in India and carrying out futures trading activities in as many as 146 commodity items. As compared to 59 commodities in January 2005, 94 commodities were traded in December 2006 in the commodity futures market. Those commodities included major agricultural commodities such as rice, wheat, jute, cotton, coffee, major pulses (such as urad, arahar and chana), edible oilseeds (such as mustard seed, coconut oil, groundnut oil and sunflower), spices (pepper, chillies, cumin seed and turmeric), metals (aluminium, tin, nickel and copper), bullion (gold and silver), crude oil, natural gas and polymers, among others. Gold accounted for the largest share of trade in terms of value. A temporary ban was imposed on futures trading in urad and tur dal in January 2007 to ensure orderly market conditions. An efficient and well- organized commodities futures market is generally acknowledged to be helpful in price discovery for traded commodities.

Futures trading in commodities particularly, cotton, oilseeds and bullion, was at its peak during this period. However following the scarcity in various commodities, a future trading in most commodities was prohibited in mid-sixties. There was a time when trading was permitted only two minor commodities, viz., pepper and turmeric. The long spell of prohibition had stunted growth and modernization of the surviving traditional commodity exchanges. Therefore, along with liberalization of commodity futures, the Government initiated steps to cajole and incentives the existing Exchanges to modernize their systems and structure. Faced with the grudging reluctance to modernize and slow pace of introduction of fair and transparent structures by the existing Exchanges, Government allowed setting up of new modern, demutualised Nation-wide Multi-commodity Exchanges with investment support by public and private institutions. National Multi Commodity Exchange of India Limited (NMCE) was the first such exchange to be granted permanent recognition by the Government Deregulation and liberalization following the forex crisis in early 1990s, also triggered policy changes leading to re-introduction of futures trading in commodities in India. The growing realization of imminent globalization under the WTO regime and non-sustainability of the Government support to commodity sector led the Government to explore the alternative of market-based mechanism, viz., futures markets, to protect the commodity sector from price-volatility. In April, 1999 the Government took a landmark decision to remove all the commodities from the restrictive list. Food-grains, pulses and bullion were not exception.

Commodity derivatives have witnessed growth since 2003; nevertheless fingers were still being pointed accusing futures trading for rising inflation in agricultural commodities. Four essential commodities- wheat, urad, tur and rice faced futures trading ban toward the end of 2006-07. An Expert Committee was set up under the Chairmanship of Prof. Abhijit Sen to examine the extent to which futures trading had contributed to price rise in agricultural commodities. The Committee was unable to find any causal relationship between price rise and futures trading in view of the short time period during which the futures market have functioned and the complexities that arise because of a large number of variables that impact spot prices.

National Spot Exchange Limited (NSPOT) is an electronic spot exchange in India set up by NCDEX on October 18, 2006. NSPOT offers an electronic trading platform for trading in a host of commodities, both agricultural and non-agricultural, to various market participants, primary producers, including farmers, traders, processors, etc. In 2007, wheat and rice futures banned. MCX has also set up the National Spot Exchange Limited (NSEL) in October 2008. The mission of NSEL is to develop a common Indian market, by setting up a national level electronic spot market and providing state-of art trading, delivery and settlement facilities in various commodities, which can be accessed from across the country. The exchange started with trading in pre-certified cotton bales for Mumbai delivery and imported gold bar and silver bar for Ahmedabad delivery, and has gone on to add a number of commodities, both agricultural and non-agricultural, for spot trading. In 2009, wheat futures reintroduced.

Indian Commodity Exchange Limited (ICEX) as nation-wide multi-commodity exchanges, which commencement in 2009. ACE Derivatives and Commodity Exchange Ltd., was set up in 2010 as 5th National Commodity Exchange of India .It has registered office at Ahmadabad and corporate office at Mumbai. Universal Commodity Exchange Limited, Mumbai, was set up in 2012. UCX is the India's 6th National Commodity Exchange.

## VI. SEGMENTS IN COMMODITIES MARKET

The commodities market exists in two distinct forms namely the **Over the Counter (OTC) market** and the **exchange based market.** Also, as in equities, there exists the spot and the derivatives segment. The spot markets are essentially over the counter markets and the participation is restricted to people who are involved with that commodity say the farmer, processor, wholesaler etc. Derivative trading takes place through exchange-based markets with standardized contracts, settlements etc. In the spot trade one pays cash and carries the goods. Whereas in future market a person can buy or sale a commodity future on an exchange based on his expectation of where the price will go, wherein the buyer or seller either closes (square off) his account or give/take delivery of the commodity. The broker maintains an account of all dealing parties in which the daily profit or loss due to changes in the futures price is recorded.

## VII. STRUCTURE OF COMMODITY MARKETS IN INDIA

Trading in commodity market takes place in two distinct forms such as the Over-The-Counter (OTC), which are basically spot market and the exchange-based market. Further, as in equities, there exists the spot and the derivatives segments. Spot markets are essentially OTC markets and participation is restricted to people who are involved with that commodity, such as the farmer, processor, wholesaler, etc. A majority of the derivatives trading takes place through the exchange-based markets with standardized contracts, settlements, etc. The exchange-based markets are essentially derivative markets and are similar to equity derivatives in their working, that is, everything is standardized and person can purchase a contract by paying only a percentage of the contact value. A person can also go short on these exchanges. Moreover, even though there is a provision for delivery, most contracts are squared-off before expiry and are settled in cash. As a result, one can see an active participation by people who are not associated with the commodity. At present, in India, there is three-tier regulatory framework for trading in commodity market in India, with the Government being on top (represented by the Ministry of Consumer Affairs, Food and Public Distribution) followed by the Forward Markets Commission (FMC) which is the regulatory arm of the Ministry and then the commodity exchanges through whom the regulation are framed and enforced. Trading in commodity derivatives in India is governed by the Forward Contracts (Regulation) Act, 1952; Section 15 of the FCRA notifies the commodities in which futures trading are permitted. Once notified any forward (futures) trading in these commodities can be done only on recognized commodity exchanges. The list of these notified commodities as well as the recognized exchanges are available freely on the FMC.

At present, there are 26 exchanges operating in India and carrying out futures trading activities in as many as 146 commodity items. As per the recommendation of the FMC, the Government of India recognized the National Multi Commodity Exchange (NMCE), Ahmadabad; Multi Commodity Exchange (MCX), National Commodity and Derivative Exchange (NCDEX), Mumbai and Indian Commodity Exchange ( ICEX) as nation-wide multi-commodity exchanges.

## VIII. LEADING COMMODITY MARKETS OF INDIA

The government has now allowed national commodity exchanges, similar to the BSE & NSE, to come up and let them deal in commodity derivatives in an electronic trading environment. These exchanges are expected to offer a nation-wide anonymous, order driven screen based system for trading. The Forward Market Commission (FMC) regulates these exchanges. Major commodity exchanges in India are namely:

MCX (Multi Commodity Exchange) located at Mumbai.
NCDEX (National Commodity and Derivatives Exchange Ltd.) located at Mumbai.
NMCE (National Multi Commodity Exchange Ltd.) located at Ahmadabad.
NBOT (National Board of Trade) located at Indore and,
ICEX (Indian Commodity Exchange Ltd.).
ACE (Ace Derivatives and Commodity Exchange Ltd.) lactated at Ahmedabad.
UCX (Universal Commodity Exchange Ltd.) located at Mumbai.

## IX. PARTICIPATIONS IN COMMODITY MARKETS

While participants can be banks, FIs, Corporate, Brokers, Individuals, etc., all of these can be classified into three categories:

**Hedgers:** They use the derivatives for the purpose of either plummeting or eliminating the risk associated with the price of an asset.

**Speculators:** They use derivatives to get extra leverage by laying a bet on the future movements in the price of an asset. These types of people voluntarily accept what hedgers want to avoid.

**Arbitrageurs:** They use the derivatives primarily for the purpose of taking the advantage of inconsistency between the prices of an asset prevailing in two markets, by taking the opposite positions.

## X. CONCLUSION

India is one of the top producers of a large number of commodities, and also has a long history of trading in commodities and related derivatives. The commodities derivatives market has seen ups and downs, but seems to have finally arrived now. The market has made enormous progress in terms of technology, transparency and the trading activity. Interestingly, this has happened only after the Government protection was removed from a number of commodities, and market forces were allowed to play their role. This should act as a major lesson for the policy markets in developing countries, that pricing and price risk management should be left to the market forces rather than trying to achieve these through administered price mechanism. The management of price risk is going to assume even greater importance in future with the promotion of free trade and removal of trade barriers in the world. The growth of commodity market is remarkable during last decade. Prices of all commodities are heading northwards due to rapid increase in demand for commodities. Developing countries like China are voraciously consuming the commodities. That's why globally commodity market is bigger than the stock market. It is the market where a wide range of products, viz., precious metals, base metals, crude oil, energy and soft commodities like palm oil, coffee etc. are being traded. It is important to develop a vibrant, active and liquid commodity market. This would help investors hedge their commodity risk, take speculative positions in commodities and exploit arbitrage opportunities in the market. Value of contracts traded in commodity market represents the demand for trading and the people awareness regarding market. To sum up, keeping in view the fact of past baggage being carried by the existing Exchanges, the objective of catching up with the developed countries can be achieved by continuing with the policy liberalization, initiating new development policies and coupled with regulatory pressure exerted not directly by the regulator but indirectly by the competitive market-friendly policies. All this augurs well for the commodity derivatives markets.

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