GOVERNMENT OF INDIA
CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION
LOK SABHA

UNSTARRED QUESTION NO:4525
ANSWERED ON:07.12.2010
OBJECTIVES OF FUTURES TRADING
Pal Shri Jagdambika

Will the Minister of CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION be pleased to state:

(a) the objectives for allowing Futures Trading in commodities alongwith the achievements made therein;

(b) whether Futures Trading has also been permitted in essential commodities;

(c) if so, the details thereof and the reasons therefor alongwith its impact on the price and availability of the said commodities;

(d) whether the Government proposes to allow options in trading; and

(e) if so, the details thereof and the benefits likely to accrue therefrom?

Answer

MINISTER OF THE STATE IN THE MINISTRY OF AGRICULTURE AND MINISTER OF THE STATE IN THE MINISTRY OF CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION (PROF. K. V. THOMAS)

(a): The futures trading in commodities is allowed in accordance with the provisions of the Forward Contracts (Regulation) Act, 1952 for performing two important economic functions, i.e., price discovery and price risk management.

The price discovery role of futures market is extremely valuable to the real sector of the economy in terms of planning business activity and for allocating commodity price risk. The price signals emanating from the market help various stakeholders in the commodities sector, viz., farmers, producers, processors, manufacturers, exporters etc. to plan their business strategies and use the futures markets to mitigate their price risks arising out of potential unfavourable price movements in the future.

The second important function performed by the commodity futures market is that of price risk management. Price Risk management is the process by which commodity market participants from the real sector, viz., producers, processors, exporters, importers etc. protect their businesses from adverse price changes in the future (which could dent the profitability of their business), by hedging their price risks in the commodity futures market. The price risk in the spot market is offset in the commodity futures market by taking an equal but opposite position in the futures market. Hedging benefits all participants like farmers, livestock producers, traders and merchandisers, food processors, feed manufacturers, exporters and importers.

Thus, by performing the two important economic functions of price discovery and price risk management, the commodity futures market serves as an important adjunct to the commodity spot market. It also helps policy makers to realign policies to meet likely shortage or surplus situation in a given commodity in the near future.

(b) & (c): Yes Madam, some of the essential commodities are permitted for futures trading. The presently actively traded essential commodities are wheat, chana, mustard seed, soyabean, soy oil, maize and potato.

Futures trading does not impact the price or availability of any commodities in the shorterm. But in the medium or long-term price discovery process facilitates strategic action by various stake holders including policy planners in government to augment production and imports in shortage situation and export and MSP operations during surplus situation, thereby helping the consumers and producers respectively as well as stabilize the prices. Thus, futures market helps the players in the real economy to plan their economic activities better and balance the demand-supply equation.

(d) & (e): As per the provisions of the Forward Contracts (Regulation) Act, 1952, presently options trading in commodities is not allowed. However, under the proposed amendments to the FC(R) Act, options will be allowed. An options contract provides an option to a producer/stockist/importer to sell or not to sell his commodity if the subsequent price movement is upwards. In other words, if the prices move down, he can exercise his option and sell his goods to the options underwriter (counter party who has transferred the risk to himself) at the agreed (counter party who has transferred his risk) at the agreed price but retains the right not to sell by foregoing the option premium if price movement is favorable to him. In that situation, he can sell his goods in the open market at higher price. Thus, the options contract will help a farmer to protect his down side without foregoing the benefit of the potential upside where as in futures contract, the farmer has to sell the goods at the agreed price. Thus, options contract is a superior instrument for price risk management as far as the farmer is concerned.