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REVVING UP THE INDIAN COMMODITY MARKETS

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ABSTRACT India is one of the largest commodity traders in the world. However, trading volumes through commodity exchanges are ridiculously low. Globally, the size of commodity derivatives market is many times larger than the underlying physical commodity trade. One should appreciate that higher volumes in the derivatives market help minimise the commodity price risks spanning across the markets. With SEBI strengthening exchanges and intermediaries through policy fine-tuning, permitting new entities like mutual funds and portfolio management services (PMS) and permitting new products like options and index trading, the scope of commodity trading in the country is set to improve significantly. However, much more needs to be done to rev up the market. The researcher's interaction with three respondent categories associated with the market, namely hedgers, arbitrageurs and speculators led the researcher to conclude that levies like CTT had placed the domestic market at a disadvantage. Even today, speculators and HNIs alone are conspicuous in the market to the exclusion of other categories and this has to change. The physical market should to be reformed so it could move in perfect lockstep with the derivatives market. The onerous regulatory regime should be replaced by a light-touch regulatory regime. More importantly, the LTCG regime should be reviewed since it comes in the way of long-term investment flowing into the market. The two regulators, namely SEBI and RBI are not on the same page vis-à-vis certain issues like permitting banks to participate in the market . This is unfortunate and has to change.

KEYWORDS : Commodity Transaction; Long-term Capital Gains; Portfolio Management Services

1.1 INTRODUCTION

India is one of the largest commodity traders in the world. However, trading volumes through commodity exchanges are ridiculously low. Globally, the size of commodity derivatives market is many times larger than the underlying physical commodity trade. One should appreciate that higher volumes in the derivatives market help minimise the commodity price risks spread across the markets. With SEBI strengthening exchanges and intermediaries through policy fine-tuning, permitting new entities like mutual funds and portfolio management services (PMS) and permitting new products like options and index trading, the scope of commodity trading in the country is well set to improve significantly. The resultant broad-based market will hopefully render the platform viable for genuine participants. These measures seem to have moved in lockstep with those witnessed in the country's equity market.

1.2 STATEMENT OF THE PROBLEM

The Indian commodity markets are yet to become internationally competitive and their ease of doing business is yet to improve. Issues like long term capital gains tax (LTCG), shrinking trading volumes, toughening regulatory compliance and closure of several brokerage houses, have been hobbling their growth. In fact, the commodity market volumes have shrunk drastically from INR 90,000 crore per day in Sep 2018 on an average basis to INR 35,000 crore per day is Sep 2019. Levies like securities transaction tax (STT), commodity transaction tax (CTT) and goods and services tax (GST) have affected the very financial viability of trading .

1.3 REVIEW OF LITERATURE

1 SEBI, the commodity market watchdog has initiated several steps to raise active trading interest in commodities. Commodity derivative trading in India is set for rapid expansion after recent moves from SEBI (Hareesh, 2019). Steps like strengthening of exchanges and intermediaries through policy changes, adding new entities like mutual funds and Portfolio Management Services (PMS), permitting new products like options and index trading are a few such steps that are likely to increase the scope of commodity trading in the country. These efforts by SEBI have help to broadbase the market by removing obstacles and making the platform viable to reach genuine participants.

2 To deepen the market and counter price risks, promotion of derivatives trading nationally ought to be a priority (Chandrashekhar, 2019). It is fifteen years since the commodity derivatives trade was launched through nationwide exchanges. The exchanges traded multiple commodities online. All the same, there is still a sense of under-achievement in terms of products and trading volumes. Not surprisingly, this feeling is palpable, especially among major stakeholders . The participation in the derivatives market by those with direct exposure to commodities has been rather limited. A large number of primary producers, processors, industrial consumers, exporters and importers of commodities are still not on the exchange platform. In other words, they are still exposed to risks that price volatility can engender.

3 In line with the country's growing economic activities, the commodities trade has increased, although it is not showing in the commodities futures market (The Economic Times, 2019). However, the turnover figures came down gradually amid competition from the better performing equity markets. Some speed-breakers such as regular government interventions and imposition of CTT came in the way and dried up the volumes. Currently, this market is facing some other issues. Despite the lucrative margin in commodities, investors are distancing themselves from this asset class to avoid churning of money on the counter.

1.4 RESEARCH GAP

The learned researchers have brought out clearly some of the factors that have hobbled the growth of the commodity derivatives market in India. A discussion on the current status of the market and the steps needed to rev up the market would have added even more value to their research. It is this gap the preset study proposes to bridge.

1.5 SCOPE OF THE PRESENT STUDY

The study confines itself to hedgers, arbitrageurs and speculators based in and around Bangalore and partic

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ipating in commodity markets.

1.6 OBJECTIVES OF THE STUDY

The objectives of the study are to:

1. Assess the current status of the commodities market
2. Identify the measures needed to rev up the commodities market

1.7 HYPOTHESIS PROPOSED TO BE TESTED

The study proposes to test the following hypotheses:
"The LTCG regime should be reviewed to channel long-term investment into the market"

1.8 RESEARCH DESIGN

1.8.1 RESEARCH METHODOLOGY

The study is descriptive in nature and has used the 'fact-finding' survey method

1.8.2 SOURCES OF DATA

Primary data has been collected from the respondents, viz., 30 hedgers, 30 arbitrageurs and 30 speculators.

Secondary data has been collected from reputed finance journals, magazines and newspapers, in hard version and soft version.

1.8.3 SAMPLING PLAN

Hedgers: Given the rather limited number of hedgers (producer hedgers or consumer hedgers) operating in the vicinity where the researcher lives and the time constraint, purposive or judgement sampling under the non-probability method has been deployed. Applying a minimum exposure of five years to hedging as the criterion, the researcher selected 30 such hedgers. This criterion, according to the researcher, is the most appropriate one for the present study. What is important is the typicality and the relevance of the sampling units to the study and not their overall representativeness to the population. Thus it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

Arbitrageurs: Given the rather limited number of arbitrageurs operating in the vicinity where the researcher lives and the time constraint, purposive or judgement sampling under the non-probability method has been deployed. Applying a minimum exposure of five years to arbitrage activity as the criterion, the researcher selected 30 such arbitrageurs. This criterion, according to the researcher, is the most appropriate one for the present study. What is important is the typicality and the relevance of the sampling units to the study and not their overall representativeness to the population. Thus it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

Speculators: Given the rather limited number of speculators operating in the vicinity where the researcher lives and the time constraint, purposive or judgement sampling under the non-probability method has been deployed. Applying a minimum exposure of five years to speculation as the criterion, the researcher selected 30 such speculators. This criterion, according to the researcher, is the most appropriate one for the present study. What is important is the typicality and the relevance of the sampling units to the study and not their overall representativeness to the population. Thus it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

1.8.4 DATA COLLECTION INSTRUMENTS

Interview schedules, specially designed for the purpose, were administered to the respondents for collection of primary data.

1.8.5 DATA PROCESSING AND ANALYSIS PLAN

Non-parametric statistical units were used to test the association between some qualitative characters and conclusions were drawn on the basis of formation of H_o and H_1.

1.8.6 LIMITATIONS OF THE STUDY

Primary data has sometimes been deduced through constant topic-oriented discussions with the respondents. It is possible that a certain degree of subjectivity, even if negligible, has influenced their views.

1.9 HEDGERS

In the following paragraphs, the primary data collected from hedgers, producer hedgers as well as consumer hedgers, is analysed.

1.9.1 THE CURRENT STATUS OF THE COUNTRY'S COMMODITIES MARKET

Several changes have been witnessed in the country's commodities market particularly after Sebi took over as its regulator. Hence the researcher requested the respondents to comment on the current status of the country's commodities market. Their replies to the query appear in the following Table.

Table-1 The current status of the country's commodities market

Current status	Number of respondents
CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX	27
Commodity trading still limited to speculators and HNIs for a variety of reasons	25
Sebi allowing mutual funds to participate in commodity futures along with PMS will improve the liquidity and depth of the market.	24
The sensitivity associated with commodity prices and the high levels of government intervention affect the market	22

CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX , aver 27 respondents. Commodity trading still limited to speculators and HNIs, state 25 respondents. Sebi allowing mutual funds to participate in commodity futures along with PMS will improve the liquidity and depth of the market, declare 24 respondents. The sensitivity associated with commodity prices and the high levels of government intervention affect the market, assert 22 respondents.

1.9.2 REVVING UP THE COMMODITIES MARKET

With the commodities market clocking lower volumes for some time, the researcher sought to know from the respondents how the market can be revved up . Their replies to the query appear in the following Table .

Table-2 Measures to rev up the commodities market

Measures	Number of respondents
The CTT and GST issues should be addressed	27
The LTCG regime should be reviewed to channel long-term investment into the market	27
The physical market has to be reformed too since the cash market and derivatives market feed on each other	26

The burden imposed by regulatory compliance has to be eased	25
RBI should be on the same page as SEBI when it comes to promotion of domestic exchanges	25
RBI should allow banks to participate in the commodities market	24

The CTT and GST issues should be addressed, aver 27 respondents. The LTCG regime should be reviewed to channel long-term investment into the market, assert 27 respondents. The physical market has to be reformed too since the cash market and derivatives market feed on each other, according to 26 respondents. The burden imposed by regulatory compliance has to be eased, according to 25 respondents. RBI should be on the same page as SEBI when it comes to promotion of domestic exchanges, believe 25 respondents. RBI should allow banks to participate in the commodities market, state 24 respondents.

1.10 ARBITRAGEURS

In the following paragraphs, the primary data collected from the arbitrageurs is analysed.

1.10.1 THE CURRENT STATUS OF THE COUNTRY'S COMMODITIES MARKET

Several changes have been witnessed in the country's commodities market particularly after Sebi took over as its regulator. Hence the researcher requested the respondents to comment on the current status of the country's commodities market. Their replies to the query appear in the following Table.

Table-3 The current status of the country's commodities market

Current status	Number of respondents
CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX	27
Commodity trading still limited to speculators and HNIs for a variety of reasons	26
Competition from better performing equity markets has placed the commodity markets at a disadvantage	26
With NSE and BSE entering the fray and Sebi mandating consistency in contract specifications for commodities across exchanges, arbitrage opportunities have been cropping up.	25
Price-sensitive commodities and the high levels of government intervention affect the market	22

CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX , aver 27 respondents. Commodity trading still limited to speculators and HNIs, state 26 respondents. Competition from better performing equity markets has placed the commodity markets at a disadvantage, according to 26 respondents. With NSE and BSE entering the fray and Sebi mandating consistency in contract specifications for commodities across exchanges, arbitrage opportunities have been cropping up, admit 25 respondents. Price-sensitive commodities and the high levels of government intervention affect the market, believe 22 respondents.

1.10.2 REVVING UP THE COMMODITIES MARKET

With the commodities market clocking lower volumes for some time, the researcher sought to know from the respondents how the market can be revved up . Their replies to the query appear in the following Table .

Table-4 Measures to rev up the commodities market

Measures	Number of respondents
The LTCG regime should be reviewed to channel long-term investment into the market	27
RBI should allow banks to participate in the commodities market	26
The CTT and GST issues should be addressed	25
The physical market has to be reformed too since the cash market and derivatives market feed on each other	25

The LTCG regime should be reviewed to channel long-term investment into the market, assert 27 respondents. RBI should allow banks to participate in the commodities market, state 26 respondents. The CTT and GST issues should be addressed, aver 25 respondents. The LTCG regime should be reviewed to channel long-term investment into the market, assert 27 respondents. The physical market has to be reformed too since the cash market and derivatives market feed on each other, according to 25 respondents.

1.11 SPECULATORS

In the following paragraphs, the primary data collected from the speculators is analysed.

1.11.1 THE CURRENT STATUS OF THE COUNTRY'S COMMODITIES MARKET

Several changes have been witnessed in the country's commodities market particularly after Sebi took over as its regulator. Hence the researcher requested the respondents to comment on the current status of the country's commodities market. Their replies to the query appear in the following Table.

Table-5 The current status of the country's commodities market

Current status	Number of respondents
CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX	27
Competition from better performing equity markets has placed the commodity markets at a disadvantage	27
Sebi allowing mutual funds and PMS to participate in commodity futures will improve the liquidity and depth of the market.	26
Sebi permitting participation by Category-III alternative investment funds and foreign companies with exposure to Indian commodities but not having a presence in India will improve the liquidity and depth of the market	26

Sebi permitting options trading in commodities like gold, crude, copper and guar will help raise the market turnover	24

CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX , aver 27 respondents. Competition from better performing equity markets has placed the commodity markets at a disadvantage, assert 27 respondents. Sebi allowing mutual funds to participate in commodity futures along with PMS will improve the liquidity and depth of the market, declare 26 respondents. Sebi permitting participation by Category-III alternative investment funds and foreign companies with exposure to Indian commodities but not having a presence in India will improve the liquidity and depth of the market, believe 26 respondents. Sebi permitting options trading in commodities like gold, crude, copper and guar will help raise the market turnover, assert 24 respondents.

1.11.2 REVVING UP THE COMMODITIES MARKET

With the commodities market clocking lower volumes for some time, the researcher sought to know from the respondents how the market can be revved up . Their replies to the query appear in the following Table .

Table-6 Measures to rev up the commodities market

Measures	Number of respondents
The CTT and GST issues should be addressed	27
The physical market has to be reformed too since the cash market and derivatives market feed on each other	27
RBI should allow banks to participate in the commodities market	27
The burden imposed by regulatory compliance has to be eased	26
RBI should be on the same page as SEBI when it comes to promotion of domestic exchanges	26
The LTCG regime should be reviewed to channel long-term investment into the market	25

The CTT and GST issues should be addressed, aver 27 respondents. The physical market has to be reformed too since the cash market and derivatives market feed on each other, according to 27 respondents. RBI should allow banks to participate in the commodities market, state 27 respondents. The burden imposed by regulatory compliance has to be eased, according to 26 respondents. RBI should be on the same page as SEBI when it comes to promotion of domestic exchanges, believe 26 respondents. The LTCG regime should be reviewed to channel long-term investment into the market, assert 25 respondents.

1.12 SUMMARY OF FINDINGS

In the following paragraphs, a summarised version of the findings arrived at in respect of the three categories of respondents is furnished.

1.12.1 HEDGERS

1. CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX , aver 27 respondents. Commodity trading still limited to speculators and HNIs, state 25 respondents. Sebi allowing mutual funds to participate in commodity futures along with PMS will improve the liquidity and depth of the market, declare 24 respondents. The sensitivity associated with commodity prices and the high levels of government intervention affect the market, assert 22 respondents.
2. The CTT and GST issues should be addressed, aver 27 respondents. The LTCG regime should be reviewed to channel long-term investment into the market, assert 27 respondents. The physical market has to be reformed too since the cash market and derivatives market feed on each other, according to 26 respondents. The burden imposed by regulatory compliance has to be eased, according to 25 respondents. RBI should be on the same page as SEBI when it comes to promotion of domestic exchanges, believe 25 respondents. RBI should allow banks to participate in the commodities market, state 24 respondents.

1.12.2 ARBITRAGEURS

3. CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX , aver 27 respondents. Commodity trading still limited to speculators and HNIs, state 26 respondents. Competition from better performing equity markets has placed the commodity markets at a disadvantage, according to 26 respondents. With NSE and BSE entering the fray and Sebi mandating consistency in contract specifications for commodities across exchanges, arbitrage opportunities have been cropping up, admit 25 respondents. Price-sensitive commodities and the high levels of government intervention affect the market, believe 22 respondents.
4. The LTCG regime should be reviewed to channel long-term investment into the market, assert 27 respondents. RBI should allow banks to participate in the commodities market, state 26 respondents. The CTT and GST issues should be addressed, aver 25 respondents. The LTCG regime should be reviewed to channel long-term investment into the market, assert 27 respondents. The physical market has to be reformed too since the cash market and derivatives market feed on each other, according to 25 respondents.

1.12.3 SPECULATORS

5. CTT has placed the Indian commodity futures market at a disadvantage vis-a-vis international markets like COMEX, LME and NYMEX , aver 27 respondents. Competition from better performing equity markets has placed the commodity markets at a disadvantage, assert 27 respondents. Sebi allowing mutual funds to participate in commodity futures along with PMS will improve the liquidity and depth of the market, declare 26 respondents. Sebi permitting participation by Category-III alternative investment funds and foreign companies with exposure to Indian commodities but not having a presence in India will improve the liquidity and depth of the market, believe 26 respondents. Sebi permitting options trading in commodities like gold, crude, copper and guar will help raise the market turnover, assert 24 respondents.
6. The CTT and GST issues should be addressed, aver 27 respondents. The physical market has to be reformed too since the cash market and derivatives market feed on each other, according to 27 respondents. RBI should allow banks to participate in the commodities market, state 27 respondents. The burden imposed by regulatory compliance has to be eased, according to 26 respondents. RBI sh ould be on the same page as SEBI when it comes to promotion of domestic exchanges, believe 26 respondents. The LTCG regime should be reviewed to channel long-term investment into the market, assert 25 respondents.

1.13 CONCLUSIONS

Conclusions relate to the hypotheses. They are answers to the research questions.

1.13.1 HYPOTHESIS TESTING

HYPOTHESIS

As explained, the following is the first hypothesis proposed to be tested:

"The LTCG regime should be reviewed to channel long-term investment into the market".

Hence H_0 and H_1 are as follows:

H_0: The LTCG regime need not be reviewed to channel long-term investment into the market

H_1: The LTCG regime should be reviewed to channel long-term investment into the market

On the basis of the primary data collected from the respondents, vide Tables: 2,4 and 6, a chi-square test was applied to ascertain the association, if any, between the two variables. The following Table reveals the computation made using MS-Excel:

	Category	**Observed Values**		
		Yes	*No*	*Total*
	Hedgers	27	3	30
	Arbitrageurs	27	3	30
	Speculators	25	5	30
	Total	*79*	*11*	*90*
	Expected Values			
	Category	*Yes*	*No*	*Total*
	Hedgers	26.33333	3.666667	30
	Arbitrageurs	26.33333	3.666667	30
	Speculators	26.33333	3.666667	30
	Total	*79*	*11*	*90*
		Yes	*No*	
2	o-e	0.6667	-0.6667	
		0.6667	-0.6667	
		-1.3333	1.3333	
	(o-e) ^ 2	0.4444	0.4444	
		0.4444	0.4444	
		1.7778	1.7778	
	((o-e) ^ 2)/e	0.0169	0.1212	
		0.0169	0.1212	
		0.0675	0.4848	
	CV	*0.1013*	*0.7273*	*0.8285*
	TV			*5.991465*

The calculated value of 2χ is *0.8285*, lower than the table value of *5.991464547* for an alpha of 0.05 at two degrees of freedom. Hence the null hypothesis is not rejected, and the alternate hypothesis is rejected.

1.14 RESEARCHER'S RECOMMENDATIONS

1. It is time the CTT issue was reviewed. India is one of the largest growers / producers of commodities and metals in the world. Yet its commodity derivatives markets do not rule anywhere near their potential. The physical markets often do, though. Despite the lucrative margins in commodities, investors are keeping the commodity derivatives at arm's length because it is a low-margin game. Imposition of CTT in the circumstances is eminently avoidable if the commodity markets are to regain momentum. Leading global markets like COMEX, LME and NYMEX do not levy CTT.
2. At a time when long-term investment in the commodities exchanges is badly needed, it is regressive to resurrect the LTCG regime. The researcher strongly recommends that the LTCG tax be withdrawn.
3. A healthy and transparent cash market alone can engender a buoyant derivatives market. The physical market, especially of agricultural commodities, badly needs reforms. Reforms in the administration of marketing yards (APMC mandis), upgraded rural connectivity and scaled-up investment in infrastructure will strengthen the physical markets for farm goods. After all, the cash and derivatives markets feed on each other.
4. The regulatory burden has to be eased by replacing the existing regime with a light-touch regulatory regime.
5. RBI should be on the same page as SEBI when it comes to promotion of domestic exchanges. Unfortunately, it is not the case on the ground. For instance, the Reserve Bank of India (RBI) permits business entities with 'direct' and 'indirect' exposure to commodity price risks to hedge in international exchanges. This conflicts with SEBI's move to promote domestic exchanges.
6. RBI should allow commercial banks to trade commodities. This would deepen and widen the derivatives market and promote a superior and scientific price discovery. Here too, the RBI is not on the same page as SEBI.
7. India is one of the largest commodity traders in the world but trading volumes through commodity exchanges are ridiculously low. Globally, the size of the commodity derivatives markets is many times larger than the underlying physical commodity trade. Higher volumes in the derivative markets can help minimise the commodity price risks spread across the markets.

CHI SQUARE TEST

	Observed Values		
Category	*Yes*	*No*	*Total*
Hedgers	27	3	30
Arbitrageurs	27	3	30
Speculators	25	5	30
Total	*79*	*11*	*90*
Expected Values			
Category	*Yes*	*No*	*Total*
Hedgers	26.33333	3.666667	30
Arbitrageurs	26.33333	3.666667	30
Speculators	26.33333	3.666667	30
Total	*79*	*11*	*90*
	Yes	*No*	
o-e	0.6667	-0.6667	
	0.6667	-0.6667	
	-1.3333	1.3333	
(o-e) ^ 2	0.4444	0.4444	
	0.4444	0.4444	
	1.7778	1.7778	
((o-e) ^ 2)/e	0.0169	0.1212	
	0.0169	0.1212	
	0.0675	0.4848	
CV	*0.1013*	*0.7273*	*0.8285*
TV			*5.991465*
P			*0.93*

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