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Risk management & price discovery are two key functions of mkt

Commodity exchanges have been often criticised for pushing up prices of many key commodities. **Nilanjan Ghosh**, *Chief Economist, Multi Commodity Exchange of India Limited (MCX), country's leading exchange, spoke to FE's* **Sandip Das** *on growth of commodity derivatives in the country:*

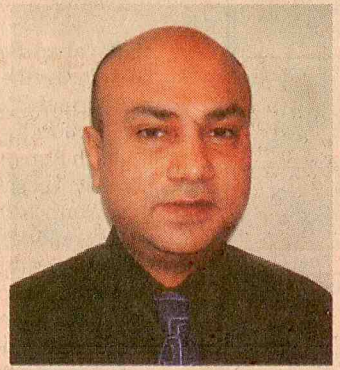
Can you explain about the functioning of the commodity derivatives markets in India?

There is an inherent problem with the way commodity derivative markets have been perceived. Anti-market thinkers, essentially, attack the markets from the perspective of the misconceived notion that speculation in such markets can distort market fundamentals, and can cause inflation. As has been emphasised in many reports (further vindicated by the Abhijit Sen Committee Report), there is no empirical evidence based on the right methodology to prove the validity of such a contention.

This floated myth has further flouted the realities of the commodity derivatives market. The entire energy was expended by pro-market researchers to justify the existence of the markets by trying to prove the hedging efficiency and price discovery functions, with a set of econometric equations. Anti-market thinkers have again used such equations to their own advantage. Both groups somehow remain oblivious of the fact that the market is too big, and too great an institution for its existence to be justified on the basis of the statistical significance and directional causality of a few equations.

Define the risk management aspect of the derivatives market.

There is no doubt that risk management and price discovery



are two fundamental and critical functions of the commodity derivatives market. Yet, the market plays a much bigger role in the socio-economic-institutional backdrop. The role of commodity derivative market needs to be viewed from an integrated social and institutional setting, rather than merely from the perspectives of price discovery and hedging, or from the anti-market perception of being the hotbed of speculation and inflation.

THE ROLE NEEDS TO BE VIEWED FROM AN INTEGRATED SOCIAL AND INSTITUTIONAL SETTING, RATHER THAN MERELY FROM THE PERSPECTIVES OF PRICE DISCOVERY AND HEDGING, OR FROM THE ANTI-MKT PERCEPTION OF BEING THE HOTBED OF SPECULATION & INFLATION

As an institution develops, it brings with itself changes that are social, economic, physical, and philosophical. This has been seen in international experiences of commodity derivatives market development. The evolution of the Chicago Board of Trade (CBOT) from 1848 in the US is a well-documented case in this regard. The development of CBOT needs to be located within several other developments. A combined dynamics of enabling factors include new investment in infrastructure (rail, roads and telegraph), the burgeoning settlement and colonisation of the hinterland of the Great West, the increasing volumes of grain production, and passage through the commercial hubs to find the distant markets.

The evolution of CBOT also needs to be seen in the context of the dynamics of inter-city rivalry, within which Chicago emerged as a preferred city playing a critical role in linking up the broader commercial interests of eastern cities like New York with the hinterland of the west, thereby ensuring the constant flow of commodities over a large geographical expanse.

Is enabling infrastructure for development of derivatives market available in the country?

While development of CBOT led to these demands, the development of enabling infrastructure also helped CBOT emerging as the prime trading forum. The importance of CBOT thus emerges from the changes in the institutional practices not only in the domain of agricultural marketing, but from the impact that it created at the socio-politico-economic stratum of human existence.

This is, indeed, a big lesson for emerging markets like India. It calls for a change in the way the policy makers, economists, market players, and civil society in general need to look at commodity derivative markets in India. Commodities affect every facet of human existence, and the impact of the derivatives markets should be seen from a long-term and integrated perspective, rather than confining it to its minimalist role of short-term hedging efficiency or price discovery.