# Foreign Exchange Reserves: Job Well Done, More Remains

**Bhanoji Rao**

When we declared ourselves the Republic, we had a little over $ 2 billion of foreign exchange reserves in the national kitty. While this writer and others of his generation were then too young to comprehend the value of reserves, seniors too perhaps were not aware. It would appear as though the rulers had the authority to allow the reserves to deplete, albeit in the name of development. The level of reserves from 1950-51 (that is, at the end of fiscal) onwards never exceeded $ 2 billion for the next 26 long years. Since March 77, there were periods of growth and decline in the level of reserves, but not much to crow about up until recently.

Those were times of perpetual foreign exchange shortage. Those were the times when some of the best of men had to resort to unheard of practices to shop abroad as the following account illustrates.

A little over three decades ago, an elderly gentleman visited Singapore and called me to meet him. He was a highly placed executive at home. He was religious, and others believed that the divine was very kind to him and bestowed on him comforts others could only dream about. Like most visitors to Singapore those days, he had his modest shopping list. As he was reading parts of the list, I was quick in asking him whether RBI had relaxed its exchange controls. He laughed and laughed, implying how I could ever think that those used to controlling would relax, and took out a pack of cigarettes. As I was about to question since when he started smoking, the pack was already opened and there he was, like a magician, producing a few high denomination dollar notes.

The country's policy environment then was one of living under foreign exchange controls. Increasing the quantum of reserves was not a policy objective or even an unsolicited end result of policies to achieve massive export growth and foreign investment inflows. Even without those policies, reserves could have been at least maintained if not augmented.

Suppose the reserves we had at the end of fiscal 1950-51 fetched an average annual nominal (inflation adjusted) return of 6 per cent. Reserves would have continuously increased and would have reached, for instance in billions of US$, 12.4 by 1980-81 as against 6.8 actual, 22.2 by 1990-91 as against 5.8 actual and so on. It was in 1999-2000, for the first time ever (since 1950-51), the actual exceeded the projected by half a billion dollars. Since then, there was no turning back. Reserves grew from $ 38 billion at the end of fiscal 1999-2000 to 42 by 2000-01, 54 in 2001-02 and $ 75.4 billion in 2002-03. The surge continues.

On June 13, reserves stood at a whopping $ 82.4 billion. Today, one need not struggle to obtain a few dollars, as long as the need is justified – travel, education, medical, for instance. In fact, the Reserve Bank has recently announced that residents who earn foreign exchange could open resident foreign currency accounts, a change that is diametrically opposed to controls and permits.

The country's economic managers have done a great job thus far. Now the challenge is to keep the level of reserves fairly stable, without ever facing unanticipated and substantial withdrawals from confidence crises, leading to a drastic fall in exchange rate and untold serious problems that come along.

Against the foreign currency assets of $ 82 billion, it is the mix of liabilities that the external and internal investors would be carefully watching. The following is the back of the envelope calculation of the principal liabilities: around $ 25 billion of NRI deposits; close to $ 20 billion of net cumulative portfolio investment; and no more than $ 2 to 3 billion of short term debt. These are no threat to the total reserves at our disposal.

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(Note that close to $ 25 billion was cumulative foreign direct investment, which, as one would expect, should stay with us.)

The key issue is whether or not the economic managers should ensure that depletions of reserves would take place in a predictable manner or whether reserves must be maintained at any cost. The best option is the former, rather than the latter.

As for the augmentation of reserves over the medium term, their growth should be more in terms of substantial increase in export earnings and FDI flows and less in terms of providing any extra incentives to NRIs. At the same time, none in future should have the authority to squander the reserves whatever may be the political compulsions of our democracy.

Mr Lee Kuan Yew, the first Prime Minister and present Senior Minister of Singapore, once said that even from his grave he would protect the foreign exchange reserves of the country against misuse (which I would guess will include excessive depletion). The tiny nation had no more than $ 3 billion in reserves in 1970. They are currently running at close to $ 150 billion.

# The gathering storm in the cup that cheers

**C S Venkata Ratnam**

India is world's largest producer of tea. In 1998 an estimated 70 million kgs. was produced in India. It is also home to the world's best teas, accounting for 28 per cent of world's output of (3112 million kg. as of 2001) and 13 per cent of world's exports. Yet, India is not globally competitive in production of tea.

Tea industry is one of the largest providers of employment – about 1.5 million - in various roles from gardens to the stores in the form of a vast network of tea producers, retailers, distributors, auctioneers, exporters, packers, etc. In recent years the industry is facing the problem of closure of plantations and production units due to mismanagement, financial problems, labour disputes and occasional violence leading to loss of life. Managements typically suggest wage freeze, subsidies and other protective measures while labour's solutions range from government patronage to better management to handing over of closed plantations to workers' cooperatives. There are differences among the respective interest groups on the desired remedies and some of the remedies suggested may well amount to barking up the wrong tree proving the proverb that some of the remedies could be worse than disease itself.

India's consumption of tea is growing faster than its production. Therefore India imports tea. India's tea imports have risen from 9.99 m. kg in 1999 to 16.58 m. kg. The value of the imports per kg, however, fell from RS.57.49 to Rs.55.78 during the period. Though India removed quantitative restrictions on import of tea in 2001 it has raised customs duty from 35 per cent to 70 per cent. Indonesia and Vietnam accounted for over three fourths of our imports in 2001 (12.75 m. kg out of a total of 16.58 m. kg) at a price ranging between Rs.0.92 to Rs.50.69 per kg. which is lower than the Indian cost of production.

The problems of Indian tea industry are manifold:

a) Over supply of tea in the world market. The production in Kenya and Vietnam increased two to three times higher than that of India during 1981-2000 and that in China double that of India

b) Increase in cost of production in India by 38 per cent during the 1998-2001. A recent study by Accenture which was commissioned by Tea Board noted that cost of production in India was US$1.62 per kg against US$ 1.23 in Sri Lanka, US$1.1.16 in Kenya, US$0.96 in Vietnam, US$0.58 in

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Indonesia and US$0.32 in Bangladesh. Labour cost per kg. in India was US$ 0.81 against US$0.74 in Sri Lanka, US$0.55 in Kenya and US$0.16 in Bangladesh. The relevant data was not available for Indonesia and Vietnam.

c) Decrease in price realization by about 20 per cent between 1998 and 2001.

The increase in cost of production and fall in price realization, together with technology can have negative effect on employment, wages and working conditions of plantation workers over the years to come. Significantly, the pressure of social labeling is being extended to tea also. Even though the buyers from western countries are asking for compliance with core labour standards on the assurance that they will pay a premium to subsidize the additional social costs of improved labour standards, in reality what is happening is a steady fall in prices. Forbes and Walker estimated the price of tea has fallen from around US$2.25 per kg in 1970 to almost US$1.25 in 1994.

In the context of free trade environment in the world, the industry players have to implement a variety of regulations and comply with a maze of standards imposed by world bodies in regard to quality of product, value added products like instant tea, flavoured tea, and allied aspects like packaging, etc. Nutritional uptake and residual uptake and its avoidance are additional issues. Unless the industry takes a conscious decision to move up the value chain and add value to the product (for instance, organic, herbal, branded products) with the passage of time, both the industry and the workforce may continue to suffer.

Straight international comparisons can be misleading. Wild fluctuation in exchange rates in some countries make it difficult to properly analyse the real growth in cost of production in local currency vis-à-vis the trends in production cost in dollar terms. The strengthening of rupee by over 3 per cent in the last one year may adversely affect the rupee realization of some of the Indian exporters. It also makes exports costlier (and less competitive) and imports cheaper.

85 per cent of tea exports are from developing countries in South Asia and East Africa. Nearly two thirds of tea imports are by developed countries in the triad countries – North America, Europe and Japan besides Australia, South Africa, former Soviet Union and West Asia. Problems in CIS countries, West Asia and Afghanistan had adverse impact on tea exports from South Asia in recent times. Now, of course, once again, the situation is looking bright for tea exporters to Afghanistan and Iraq.

In future tea exporters from developing countries in South Asia have to face additional problems:

- ☆ Restrictive land ownership laws prevent entrepreneurs from expanding and achieving economies of scale and bargaining power with powerful buyers. 50 per cent of world exports are handled in the UK.
- ☆ Competition from East Africa is making deep inroads in to exports from South Asia.
- ☆ The growing popularity of tea bags and soluble instant tea decreases tea consumption per cup and increases the demand for cheaper tea at the expense of high quality tea. Therefore volumes and value are likely to come down for given levels of consumption.

The sliver lining, however, is in the following trends:

- ☆ Tea as a health drink.
- ☆ Tea as a cold drink
- ☆ Spurt in the use of vending machines.

India mainly exports premium tea and imports low-cost tea. Though Sri Lanka's production costs are nearly as high as India, Sri Lanka privatized tea estates and reporting significant increase in productivity levels. The real competition for India comes from Bangladesh, Indonesia and Vietnam in future where the production costs, including labour costs, are much lower than that of India.

Even within India there is a need to reckon regional differences. For instance, recently Government of India has taken a decision to allow futures trading in different commodities. At a discussion meeting held on the subject a couple of years under the auspices of the Union Ministry of Commerce, the tea industry in North India did not show much interest while the United Planters Association of South India (UPASI) has shown interest.

60 per cent of the pre-tax profits in tea is treated as agriculture which is taxable by states. States levy high tax of around 50 to 7 per cent. The remaining 40 per cent is taxed as corporate income by the centre which is presently around 35 per cent for domestic income. Export income is exempt from taxation. 20 per cent of total profit is exempt from tax if the funds are deposited with National Bank for Agriculture and Rural Development (NABARD) and used for capital expenditure after a year.

India produces a large variety of tea and value realization is not uniform. Labour costs in South India account for 43 per cent of production cost against 32 per cent to 50 per cent in North India.

The industry was able to influence the Union Commerce Ministry to set up a committee headed by Shri L V Saptharishi, Additional Secretary to find ways in which the tea industry can restrict its social costs of housing, health care and subsidized rations.

The Indian Tea Association has recently come out with a novel suggestion. It examined the existing government schemes concerning rural development which mainly target below poverty level population and hence inapplicable to tea estates. However, the numerous schemes for improvement of rural infrastructure – for instance, rural housing, rural water supply programme, rural sanitation programme, The Pradhan Mantri Gam Sadak Yojana, and the extension of Annapurna scheme (free foodgrains upt o 10 kgs/month for persons above 65 years of age and living below poverty line) to aged dependents of workers in tea estate – would go a long way in improving the living conditions of plantation workers without adding to the production costs of tea.

Whether government would agree to bear the social costs to make the industry stay competitive and even if it does, whether international pressures will make it questionable practice remains to be seen. Unfortunately, however, globalization is resulting in a situation in the tea industry where the intermediate players and end consumers in developed countries gain at the expense of industry and labour in developing countries.

# Workshop on "Agenda for Cancun: Indian Perspective" – A Report

The main objectives of the workshop were to discuss the main issues of interest to developing countries in general and India in particular, and make recommendations for an action plan.

The deliberations of the workshop and the recommendations arising therefrom are summarized below.

**Strengths and Weaknesses of WTO**

The WTO has not been able to fulfill the basic objectives for which it has been set up. It did not live up to the expectations of the developing countries, e.g. in implementation issues. However, it has certain basic strengths: (i) In organizations like the ADB, World Bank, and IMF, decisions are taken by a governing body, whose members represent groups of countries. In contrast, in WTO, all decisions are taken by consensus, taking account the views of all the Members. (ii) The WTO's Dispute Settlement Body (DSB) is functioning well, settling disputes brought before it by Members.

Though the Doha Round has been termed the Doha Development Agenda, the developmental concerns of the developing countries have not received adequate attention. The workshop felt that trade does not act as an engine of growth. However, it can help growth. The objectives should be growth with equity and employment generation.

**Negotiating Strategy**

The workshop observed that just as the poor are at a disadvantage in day-to-day negotiations, the developing countries are at a disadvantage in the negotiations under WTO. The developed countries have resources to employ a battery of professionals like lawyers, scientists, etc. to assist in the negotiation process. Most developing countries do not have the same level and kind of resources.

In the past, India's preparation for participation in trade negotiations was not quite satisfactory, though she has experts in most of the areas that are under discussion in WTO. There is some improvement over the years. Some attempt is made to utilize them by bringing in the private sector, government, professionals, academia, civil society organizations, etc. in seminars and workshops, but a true synergy is yet to develop. There should be a concerted collaborative effort for chalking out appropriate negotiating strategies The workshop felt that if we are ready, the wind will blow our way and if not, we fail.

The workshop observed that most developed countries are democratic but they make international organizations like the WTO undemocratic. Thus the question was raised by some academics whether international organizations can be democratic. These organizations tend to be bureaucratic bargaining systems. There is need for democratic control for successful functioning but in fact the control is getting reduced. This is termed the 'democratic deficit'. This deficit is dangerous because democratic control is supplanted by money power in preparing the agenda and in decision making.

**Recommendations**

1. Bringing together different stake-holders in seminars is good, but not enough. There should be collaborative efforts in India where experts from government, private sector, civil society organizations, trade unions, academia, etc. work together to come out with suitable negotiating strategies.
2. Democratic control in international organizations like the WTO is getting reduced giving rise to 'democratic deficit'. India and other developing countries should strive to reduce this deficit.

**Regionalism and Bilateralism**

The workshop noted that negotiating strength lies in economic strength. Reference was made to countries

like the USA that are entering into bilateral agreements with Singapore, Chile, etc. threatening the very raison d'etre of WTO. As some scholars have mentioned, such bilateral treaties conspire with special interests to distort the global system. The workshop felt that regional and bilateral treaties are means to reduce neighbourhood hostilities. They help commitment to openness. However, the efforts at the regional and bilateral levels should not be allowed to outstrip the interests and commitment to multilateralism, besides making them transparent at the WTO forum.

If the bilateral interests are deliberately designed to outstrip multilateral interests, India should not hesitate and lag in its efforts to seek bilateral treaties with such countries where India would benefit more. For instance, India could think in terms of entering into a bilateral agreement with China with a view to reducing the losses India is estimated to suffer (US$3 billion in 1977 prices over the period 2001-2007) due to the entry of China into the WTO. It is a good sign that India and China are coming together to chalk out a joint negotiating strategy in WTO negotiations.

**Recommendation**

India needs to have a clear policy towards regionalism and bilateralism consistent with multilateralism. She should pursue further the current initiative to work with China for joint negotiations in WTO.

**Agriculture**

India's official position on agricultural issues is that her basic interest is in the protection of domestic agricultural production on which farmers depend for their subsistence. Therefore the compulsion to offer minimal market access concessions and commitments outweigh the opportunities for export.

In the context of food security, the workshop noted that international commodity prices are far more volatile than domestic prices, and the main victim of this would be the poor. The phrase, that the 'poor in the poor countries are cursed twice' appears to be quite appropriate here. The economy of the small and marginal farmers is not resilient enough to enable poor farmers to make drastic switch from food crops to non-food crops within a short period. It has been observed in the Indian context that a progressively larger demand for cereals contributed to steep increase in cereal prices affecting the real income of the poor.

The workshop emphasized that India should stick to her stand insisting on the USA and the EU to reduce their production- and export-subsidies and not give in to pressures for reciprocal and deeper tariff cuts in agriculture. The workshop noted that there were some signs of softening on this and stressed that this should not be done.

It was noted that the US Farm Security and Rural Investment Act 2002 has provided $ 82.6 billion of farm subsidies on top of $ 100 billion already committed. The level of subsidies in India is below that allowed under WTO. Therefore there is scope for raising domestic support to farmers. Priority needs to be given to diversification and improved competitiveness through cost-effective technologies and increased public investment in agriculture. The combined expenditure by the Centre and State governments on agricultural research and education stagnated around 0.5 percent of agricultural GDP as against 1 percent proposed by the Indian Council of Agricultural research.

**Recommendations**

1. Since protecting domestic farmers is the primary objective, India should not soften her stand by reducing tariffs in return for reduction in production- and export-subsidies in the US and the EU. The phrase that the 'poor in the poor countries are twice cursed' is quite appropriate in the present context.

2. Efforts should be made to increase productivity in agriculture enabling India to participate more effectively in world trade in agriculture.

**TRIPS and Public Health**

The workshop discussed to what extent the provisions of the TRIPS Agreement and the Doha Declaration on TRIPS Agreement and Public Health are reflected in India's Patents (Amendment) Act 2002. It was noted that the Declaration, while reiterating commit-

ment to the TRIPS Agreement, affirmed that the Agreement can and should be interpreted in a manner supportive of WTO Members' right to protect public health and, in particular, to promote access to medicines for all.

The workshop noted that the developed countries are "endogenous" growth countries where growth is self-sustaining driven by ideas and innovations generating income which in turn stimulates innovation. "Catching-up" economies are those with lower level of technology and income which try to catch up with the endogenous growth countries (many Asian and Pacific Rim countries come into this category). "Resource-based" growth countries rise and fall due to resource boom and busts.

The workshop noted that the flexibility accorded in the TRIPS Agreement and the Declaration has not been fully utilized in the revised Act, e.g. no exceptions were made in the 20-year rule, which could have been made. The workshop, therefore, felt that these issues need to be taken up in the next amendment of the Act.

The Declaration states that each Member has the right to determine what constitutes a national emergency or other circumstances of extreme urgency. The workshop felt that India should utilize this provision for compulsory licensing and should not allow the developed countries to go back on this provision. Also the workshop suggested that compulsory licensing should be applicable not only to drugs used for diseases such as tuberculosis, HIV/AIDS, and malaria, but also to drug that may be invented in future for a disease that may affect the masses which may still be unknown now. For example, HV/AIDS was not known in the 1970s, so we cannot say what diseases may crop up in the future.

With regard to Geographical Indications, the workshop noted the demand by India and some other developing countries for 'extension' of Geographical Indications to other products. India's interest is in products like Darjeeling Tea and Kolhapuri Chappals. It was felt that Kondapalli Toys from Andhra Pradesh could be added to the list. The workshop suggested that in anticipation of the extension, necessary preparatory work may be started now, as India was slow in the past to capture opportunities as they crop up.

**Recommendations**

1. The developed countries are "endogenous" growth countries where innovations generate income and vice versa. This is not the case with 'catching up' countries and 'resource-based' economies. Therefore, it should be ensured that the provisions in the Doha Declaration on TRIPS Agreement and Public Health are honoured by the developed countries.
2. India does not seem to have made full use of the provisions in the TRIPS Agreement and the Doha Declaration on TRIPS Agreement and Public Health for implementing measures, e.g. compulsory licensing in the Patents (Amendment) Act, 2002. India should make all out efforts in negotiations and in future amendments to the Act to safeguard her interests.
3. India should start the required preparatory work now to take advantage of opportunities that arise as and when 'extension' of Geographical Indications takes effect.

**Globalisation and Volatility**

The workshop noted that globalization of the world is not a new phenomenon. It occurred in the 19th century. The only difference is that now, the phenomenon is taking place not only on the merchandise (trade) front, but on the investment and services front also. Especially, the flow of foreign investment is capable of creating greater volatility in the economies of the developing countries against which some safeguards need to be negotiated. If one looks at the numbers relating to inter- and intra-trade of regional blocs, especially NAFTA and EU, the picture seemingly looks like end of globalization rather than height of globalization.

Similarly, foreign investment among and within the blocs has been predominant compared to that outside the blocs. Even that, from the developing countries' viewpoint becomes large enough in comparison with their domestic investment efforts. At the slightest

suspicion of confidence crisis, for whatever reasons, the foreign investment makes a quixotic exit thereby plunging the county into crisis.

**Recommendation**

The developing countries need to develop a mechanism whereby the quixotic exits of foreign investments will not precipitate a serious crisis. For this purpose the developing countries should collectively negotiate seeking:

- Offshore lender of last resort from international financial institutions (both multilateral and bilateral).
- Emergency clauses in loan contracts to the developing countries that stretch maturities to avoid a melt-down or a currency crisis situation.

**Anti-dumping**

The workshop noted that recently India faced a 'steel trap' when the US imposed protective tariffs and sought protection under the anti-dumping laws on steel imports from India. It seems that every one-time surge in imports of steel into the US can reverberate for four years and precipitate 30 bankruptcies at home. To minimize frequent resorting to anti-dumping rules, the US plans to going for restructuring of its steel industry. The issue concerns any industry subject to restructuring.

**Recommendation**

Under the guise of restructuring, it is quite likely that the ailing industry might actually be bailed out via subsidies indirectly. Since India's interests are at stake, it should seek transparency of the rules and procedures under which restructuring takes place of whatever industry and wherever it is.

**Singapore Issues**

The workshop noted that India has taken an appropriate stand on Singapore issues, viz. investment, competition policy, transparency in government procurement, and trade facilitation. India consistently opposed expansion of the WTO agenda to include new issues and laid stress on implementation issues of the existing agreements. However, in view of the interest shown by some trade partners, she participated in the working groups set up on Singapore issues.

With regard to investment, the workshop noted that foreign direct investment (FDI) has been growing much faster than world trade and that FDI has been trade-substituting instead of trade-promoting. Current literature shows that FDI has crowded out domestic investment in several developing countries. These countries need to insist on having policy options for fostering industrialization and development. Since the current proposals of the developed countries do not provide for such policy options, the developing countries need to firm up their stance.

The ambiguity still remains whether it is only a matter of modalities to be decided for negotiation of the Singapore issues or whether a decision is yet to be made on taking up the negotiations. The chairman of the Doha Ministerial Conference gave the clarification that it was his understanding that at the Fifth Session of the Ministerial Conference (i.e. at Cancun) a decision would indeed need to be taken by explicit consensus, before negotiations on trade and investment could proceed. It is not clear how far this clarification would help the developing countries in Cancun.

**Recommendation**

The Singapore issues may crop up in quite unexpected fashion at Cancun. India needs to be ready with a contingency plan.

**Major Conclusions**

- The overall thrust of the workshop was that India and other developing countries would be at a disadvantage so long as they negotiate from a weak standpoint.
- In agricultural negotiations, the workshop endorsed the stand taken by India. This gains significance since the phrase, that the 'poor in the poor countries are twice cursed' appears to be quite appropriate in the present context.
- In TRIPS and Public Health, it should be noted that the developed countries are 'endogenous growth countries', where growth is driven by ideas and innovations generating income and vice

versa. This is not the case with 'catching-up' countries and 'resource-based economies'. Therefore it should be ensured that the provisions in the Doha Declaration on TRIPS Agreement and Public Health are honoured by the developed countries.

- Democratic control is necessary for the successful functioning of the WTO. But this is getting reduced leading to what is termed the 'democratic deficit'. The workshop recommended that we should strive to reduce this deficit.
- The workshop noted that it is good that different stake-holders are brought together in seminars on this subject, but this is not enough. A concerted effort needs to be made for collaborative effort among experts in government, private sector, civil society, academia, etc.
- The workshop stressed that we should be prepared for surprise developments in the negotiations, e.g. on Singapore issues. If we are ready, the wind will blow our way, the workshop concluded.

The workshop was chaired by Professor C P Thakur, formely Dean, Faculty of Management Studies, University of Delhi, former Member of Rajya Sabha, and presently President of the Indian Industrial Relations Association. Inauguration was done by Shri Moheb Ali M., Chief Commissioner of Customs and Central Excise, Hyderabad. Welcome address was given by Professor C S Venkata Ratnam, Director, GIFT. Professor V L Rao, GIFT, coordinated the programme and edited the present report.

The following papers were presented at the workshop:

- "Cancun and Beyond" by Professor V L Rao, GIFT.
- "Road to Cancun – An Indian Viewpoint" by Professor K C Reddy, Department of Economics, Andhra University, Visakhapatnam, and Hony. Director, Centre for SAARC Studies, Andhra University.

The following presented their observations at the workshop:

- Professor Ganti Subrahmanyam, GIFT
- Professor K Sreeramamurthy, Department of Economics, Andhra University
- Dr. U N Moorthy, Department of Economics, Andhra University
- Shri Steven L D'Souza, Additional Commissioner, Customs and Central Excise, Visakhapatnam
- Dr. J Vijaya Ratna, Department of Pharmaceutical Sciences, Andhra University.

The other participants in the workshop included officers of the central excise and customs; faculty members of the Department of Law and Department of Economics, and Director, School of Distance Education, Andhra University; faculty members and final year students of Masters Programme in International Business, GIFT; and others interested in the subject.

# A Report on the National Seminars on COMMODITY FUTURES

### International Commodity Risk Management

Many developing countries in the world are agrarian in sectoral dominance. Therefore, commodities provide livelihood to millions of households. Exports earnings of these countries also depend largely on a few commodities. In 1995, it seemed some sixty countries depended for 50-90 percent of their export earnings on just three commodities. Given that commodity prices are notoriously volatile in nature, this instability permeates the producers' incomes and their livelihoods. It also adversely affects the government revenues, traders' profits, storers' rents and the return on lending by the financial institutions. International Commodity Agreements were devised to deal with commodity price volatility. Buffer stocks, commodity stabilizations funds and compensatory financing schemes through government intervention were some of the instruments deployed to combat the commodity price volatility. All these proved either costly or overall ineffective over the years. It was realized that for commodity risk management what was needed to be done was to reduce commodity price uncertainity but not stabilise commodity prices, as the latter militated against the commodity price cycles. Hence, the rise of market-based commodity risk management instruments.

### The Rise of Market-Based risk management

Privitisation, market liberalization and globalization have all made the market-based risk management instruments popular. Starting 1990's, farmers traders, companies and government in developing countries have been employing commodity derivatives for hedging commodity price risks. Their participation has been increasing in terms of both accessing the international commodity houses, and creating the commodity exchanges at home.

### The Indian Scenario

Single commodity stock exchanges have been actively trading since the Bombay Cotton Exchange in 1921. Till today, India's pepper futures market is the only of its kind surviving in the world. With the lifting of ban on 54 commodities since February 19, 2003, Government of India has virtually thrown open the entire farm sector and gold and silver (in all 94 commodities) for futures trading. The growing incidence of contract and corporate farming has strengthened the case for futures trading in India.

In these days of globalization when commodity markets are constantly monitored through the provisions of WTO agreements, the necessity to review various modalities to strengthen the commodity sector cannot be overemphasized. Gitam Institute of Foreign Trade, Visakhapatnam, Indian Institute of Plantation Management, Bangalore and Indian Institute of Foreign Trade, New Delhi, have jointly organized a series of two-day National Seminars on Commodity Futures at Bangalore (July 10th 11th) and at New Delhi (July 15th and 16th). These Seminars were organized at the most opportune time, as the Government of India has expanded the scope of futures trading by allowing futures trading in 39 additional commodities and through Forward Markets Commission (FMC) granting permission for four national level multi commodity exchanges. A debate is also on with respect to the integration of financial and commodity markets by allowing the broking community of the financial markets to participate in commodity futures as well as possible stronger alliance between SEBI and FMC. In all more than 60 members participated in these Seminars representing the commodity interests, trading enterprises including large public enterprises, export houses, trading members of the commodity exchanges, financial institutions like banks, warehousing corporations, single and multi commodity exchanges, online trading systems, academia as well as executives from regulators such as SEBI and FMC and the officials of Government of India.

The Seminar at Bangalore was inaugurated by Shri Ravi Ramu, CFO Mphasis BFL Solutions, Bangalore. Panel discussion was chaired by Ms. K. Kamala, Executive Director, Bangalore Stock Exchange and the

valedictory address was delivered by Dr. Subhash Sharma, Director, Indian Institute of Plantation Management.

The Seminar at Delhi was inaugurated by Shri Prabir Sengupta, Director General, Indian Institute of Foreign Trade and also Chairman, Indian Institute of Plantation Management. The panel discussion was chaired by Dr. Aravind Pandalai, Chairman and Managing Director, State Trading Corporation of Inida, and the valedictory address was delivered by Dr.Kalyan Raipuria, Senior Economic Advisor, Ministry of Food and Consumer Affairs, Government of India.

The Seminar aimed at developing a vision for the commodity futures in India. It raised the issues of immediate concern as well as of long term perspective. The Seminar programme started with a review of international commodity scenario covering the what, why and how of the impact of the various commodity agreements. This discussion stressed on the need for commodity risk management covering both evolutionary as well as devolutionary types of risks with respect to commodities. While highlighting the failure of commodity agreements, the hope and scope of a good future for commodities as the next frontier of risk management was discussed. The next theme focused on the commodity risk management in the Indian scene. Under this scheme the need to have a holistic view of the commodity value chain was emphasized. While reviewing the commodity management in India using the Public Distribution System, administered price mechanism and other public policies, the need to review the policies to accommodate commodity futures with a view to strengthening the commodity value chain was discussed. The issue of special practices such as Pooled Coffee marketing system, and Tea marketing control order was explained. Various tools and techniques of commodity risk management like futures, options and swaps were illustratively discussed using simple examples as well as cases. The Seminar, then extended an opportunity for the various Commodity Exchanges to share their experiences, and discuss various issues concerning clearing, warehousing and settlements, design of contracts, trading fees, membership taboos etc. National Commodity Exchange of India, Ahmedabad, Coffee Futures Exchange of India, Bangalore, SGI Commex Ltd., Mumbai, had made elaborate presentations followed by detailed discussions of the problems and pitfalls.

The need to strengthen the forces for reducing price volatility with a view to hedging producer's incomes by participating in futures as well as the need to attract other parties in the periphery of commodity value chain for gainful risk management have been critically discussed. The Seminar highlighted the need to change the mindset and adopt a better proactive attitude by one and all in redefining the constituency (who else could be the participants, besides the growers and traders?) of the commodity futures and how these markets could solve some of their problems. The Seminar emphasized the need for reviewing the existing regulatory policies with a view to making them more proactive for price discovery, transparency and efficient futures market functioning in view of the economic discontinuities extant in the commodity markets of the Indian economy.

**Issues Discussed**

1. The failure of International Commodity Agreements and the forces that contributed to it.
2. International Commodity Cycles and global commodity price prospects.
3. Indian Commodity Markets, their fragmented nature and Inefficient local commodity markets.
4. Small farmers access to markets.
5. Absence of (or perverse) incentives for commodity risk management.
6. How commodity futures (includes Options) provide a proper risk management tool ?
7. Policy hurdles relating to entry of new commodities into the exchanges.
8. Constraints on brokerage for efficient functioning of the commodity bourses.
9. Policy inaction for membership diversification.
10. Economies of scale and scope with single and multicommodity exchanges.
11. Inadequate support of financial and certified warehousing services.

12. Hurdles in the convention of warehousing receipts into a negotiable financial instrument.
13. Incomplete legal and regulatory infrastructure.
14. Presence of a 'Commodity Lag' in the awareness of risk management in comparison to treasury management.
15. Popularity of government support price systems impeding the emergence of efficient commodity futures.
16. MOU System.
17. Demutualisation.

**Policy Imperatives or What needs to be done further?**

1. Create commodity awareness in risk management.
2. Disseminate market information and improve access to commodity markets for price discovery.
3. Strengthen the financial support services and encourage standardization of warehouse receipts into new financial instruments.
4. Strengthen the storage and warehousing facilities by encouraging common regulations applicable to both public and private warehouse receipts.
5. Ensure delivery and settlement without risk.
6. Reduce policy-based hurdles for commodity participation.
7. Induce commodity-based instruments to be part of investor portfolios.
8. Outsource risk management functions.
9. Create the necessary technical know-how and the infrastructural support for administration.
10. Support the risk management function with independent audit and inspection.
11. Improve regulatory oversight and supervisory capacity.
12. Remove multiple regulations through merger of the regulatory agencies.
13. Let government also access the commodity futures markets for hedging the budgetary risk wherever necessary or providing price support to farmers etc.
14. Plug the loopholes that create "agency" problems (including insider trading) and corruption.
15. Let the single commodity exchanges act as extensions of national multiple commodity exchanges.
16. Encourage on-line trading with all the security and protection from hackers.
17. Let all the stakeholders have equal rights.
18. Integrate the stock and commodity exchanges in the years to come.
19. Encourage research into developing of and training in appropriate commodity price index futures.
20. Encourage research into adapting the modern risk management tools like the value at risk (VaR) applicable for evaluating the commodity risk exposures.

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GIFT brings out this quarterly publication GLOBAL VISTAS to provide analytical articles and commentaries on issues relating to international trade developments, and WTO and related trade issues. We at Global Vistas invite contributions with a word limit of 2000 words from academics, trade and industry that are of contemporary relevance.

GIFT is an offshoot of Gandhi Institute of Technology and Management (GITAM) located in the port city of Visakhapatnam on the east coast of the country, a city that hosts several large industrial organizations – Visakhapatnam Port Trust, RINL, LG Polymers, HPCL, Marine Products Export Development Authority (MPEDA), Visakhapatnam Special Economic Zone (VSEZ), Office of the Joint Director General of Foreign Trade (JDGFT) and Customs Authorities. Established in 1997 in academic collaboration with the Indian Institute of Foreign Trade, Ministry of Commerce & Industry, Government of India, GIFT offers a two year Masters in International Business (MIB), the flagship programme of the Institute. An integrated business school with teaching, training, consulting and research as the four pillars of its activity base, GIFT has serviced a host of organizations related to foreign trade like APEDA, SIDBI, FAPCCI, Tobacco Board, Horticulture Board, CONCOR , various chambers of commerce, SMEs and prospective entrepreneurs in the fields of export marketing, export finance, foreign exchange risk management, commodity futures; logistics and supply chain management, entrepreneurship development; and WTO agreements and implications for business. The Centre for Entrepreneurship is a new initiative of the Institute. As part of its social responsibility, GIFT has taken up sponsored research and brought out the Visakhapatnam Development Report 2003.

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# Workshop On INTERNATIONAL MARKETING MANAGEMENT

**GITAM Institute of Foreign Trade**
**In association with**
University Of Hyderabad, Jawaharlal Nehru Technological University, PHDCCI-KAF Cooperation and Konrad Adenauer Stiftung

## OBJECTIVE

Internationalization has become a chief engine for growth and competitiveness for corporate organizations as well as SMEs. The workshop familiarizes the participants with identification of marketing opportunities and developing marketing strategies to effectively serve the overseas customers.

- Differences between domestic and international marketing, motives for internationalization
- Evaluation of markets – assessment of market opportunities
- Market selection, clustering and prioritization, Modes of Entry
- Medium term export strategy 2002-2007 – India's Focus Products and Markets
- International Marketing Research - Information sources and data collection methods
- Product strategy - Adapting / developing products for overseas Markets
- Pricing and negotiations
- Promoting the products in the overseas markets and Brand Building
- Preparation for participation in Trade Fairs
- Distribution – identification of agents, drawing up agency contract

## HOW TO REGISTER

Send your nominations along with registration fee drawn in favour of *GITAM Institute of Foreign Trade* payable at V*isakhapatnam*
Email : giftedp@gift-india.org

## FOR WHOM

The workshop is for practicing and prospective professionals engaged in International Business.

| Dates | Venue | Fee | Last date for nominations |
|---|---|---|---|
| August 11-12, 2003 | Hotel Green Park, Hyderabad | Rs. 4000/- Non-Residential | August4, 2003 |
| Fee for SMEs and Academicians: Rs.1500 and for Students Rs.1000 | | | |