

## CHAPTER 7.8

# INTERNAL TRADE

7.8.1 Trading enables mutual exchange of goods and services and is also the foundation of markets comprising diverse goods and services. Goods and services are in turn, an embodiment of the division of labour in a society since they represent diverse kinds of labour and skills.

led to the division of labour on a small scale, national and global trade ensured division of labour on a larger scale. With the expansion of trade beyond the local level, the functions of market increased manifold to take care of the needs of processing, storage, packaging and transportation.

7.8.2 The advent of various modes of transportation and development of diverse means of communication helped expand the scope of trade in goods and services. If local exchange and barter

7.8.3 Monetisation of the economy further facilitated trade in a big way, introducing, in the process, credit and insurance as added characteristics of trading activity. In order to ensure that demand

**Table-7.8.1**  
**Contribution of Internal Trade to Gross Domestic Product (GDP)**

Year	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01 (Q.E)	2001-02 (A.E)
<b>Trade (Rs. crore)</b>												
At current prices	59,845	68,150	79,470	93,206	1,12,058	1,36,950	1,60,840	1,82,091	2,09,905	2,30,555	2,42,807	2,63,954
At constant prices	81,820	82,291	87,242	93,206	1,03,362	1,17,856	1,26,976	1,36,628	1,45,666	1,57,141	1,62,406	1,68,805
<b>Share in GDP(%)</b>												
At current prices	11.7	11.6	11.8	11.9	12.2	12.8	12.9	13.1	13.0	12.9	12.8	12.7
At constant prices	11.8	11.7	11.8	11.9	12.3	13.1	13.1	13.4	13.4	13.6	13.6	13.4
<b>Gross Fixed Capital Formation (GFCF) (Rs. crore)</b>												
At current prices	3,286	3,317	3,684	3,759	5,980	9,134	6,361	5,862	5,613	6,076	-	-
At constant prices	4,276	3,795	3,863	3,759	5,598	7,852	5,239	4,761	4,460	4,759	-	-

**Sources** : 1. National Accounts Statistics, 2001, CSO, M/o Statistics & Programme Implementation, Govt. of India, New Delhi, July, 2001.  
2. National Accounts Statistics- Back series: 1950-51 to 1992-93, CSO, M/o Statistics & Programme Implementation, Government. of India, April, 200.

**Note** : A.E- Advance Estimate; Q.E -Quick Estimate.

and supply matched each other, over time and regions, the distribution system acquired more sophistication with the introduction of 'wholesale trade' and 'retail trade'. The State as an institution has been favourably disposed towards trade as it enabled it to collect taxes.

7.8.4 The share of trade in the Indian economy stood at around 13.4 per cent of gross domestic product (GDP) (Table-1) and employed approximately 36 million people, a majority of whom were self-employed, engaged in the retail and wholesale trade. The growth rate of 'trade' over the period 1990-91 to 1999-2000 was 6.9 per cent. It is the most important sector in the tertiary/service sector with a share twice the share of 'finance and insurance'. Both imports and exports are becoming increasingly important components of internal trade. The sales turnover of imports increased from around 8 per cent of GDP in 1990-91 to 11 per cent of GDP in 2000-01 and that of exports has gone up from around 6 per cent in 1990-91 to 9 per cent of GDP in 2000-01.

## WHOLESALE TRADE

7.8.5 Internal trade is made up of trade in goods and services across the country. The major problems faced by the trading community are the diversity of controls exercised by multiple authorities at different levels, restrictions on inter-state and inter-district movement of goods, lack of uniformity in standards laid down by different authorities and agencies and in taxes. Pricing strategies get affected by differential tax rates and become localised.

7.8.6 All this has led to breaking up the vast Indian market into a large number of smaller regional markets. The paperwork involved in complying with the various controls, regulations and licenses, the cost involved in terms of time and resources and the inevitable corruption and malpractices that this leads to have served as big drag on the efficiency of trading operations in the country. There is a need to look into following impediments that hinder efficient trading.

## Regulatory Impediments

7.8.7 It is imperative for a trader to obtain a licence before undertaking trade. Different classes of goods require licences from different authorities. Once a licence has been obtained, innumerable laws and regulations bind the trader. There are around 400 laws that govern trade. Some of the provisions of these laws have outlived their utility and appear arbitrary.

## The Essential Commodities Act, 1955

7.8.8 Prior to the third amendment to the Constitution in 1955, regulation of trade and finance (barring industrial goods) was the exclusive responsibility of the State Governments. The Constitution (Third) Amendment Act made statutory provision for regulating the production, prices and distribution of essential commodities all under the Government of India. The Essential Commodities Act (ECA), 1955, accordingly, authorises the Central Government to make orders for the following:

- (i) Regulating by licenses, permits, etc. the production, storage, transport, distribution, disposal acquisition, use or consumption of an essential commodity;
- (ii) increasing cultivation of food grains;
- (iii) controlling prices;
- (iv) prohibiting the withholding from sale of any essential commodity;
- (v) requiring a stockholder to sell any essential commodity to the Government;
- (vi) regulating or prohibiting any commercial or financial transactions in food items or cotton textiles which may be detrimental to the public interest;
- (vii) collecting any information;
- (viii) requiring production of books of accounts etc; and
- (ix) any incidental matters.

7.8.9 The essential commodities, to which the Essential Commodities Act is applied, fall into four broad categories:

- (a) foodstuffs (including edible oilseeds and oil) tea, onion, drugs and textile which are items of mass consumption;
- (b) cattle fodder, seed of food crops, seeds of fruits and vegetables which are of agricultural origin;
- (c) insecticides, fungicides and medicines which are intermediate products; and
- (d) coal, iron and steel, paper, petroleum, cement, textile machinery, electric cables, general lighting service lamps and switches, which are industrial products.

7.8.10 The ambit of items so included becomes pervasive since these items may be generic terms. The actual number of items covered under the Act is, therefore, far more than can be gauged from this list. For example, iron and steel may include all items manufactured from iron and steel and foodstuffs may include food grains as well as products like nutritive foods, pickles and jams.

7.8.11 The Task Force on Employment Opportunities (Planning Commission, 2001), thus, observed, 'The Essential Commodities Act is a Central legislation which provides an umbrella under which states are enabled to impose all kinds of restrictions on the storage, transport and processing of agricultural produce. These controls have been traditionally justified on the grounds that they are necessary to control hoarding and other types of speculative activity, but the fact is that they do not work in times of genuine scarcity and they are not needed in normal times. Besides, they are typically misused by the lower levels of the administration and become an instrument for harassment and corruption.'

7.8.12 The need to relax various controls on agricultural products including on inter-state movement of these products was discussed in the conference of Chief Ministers in May 2001 and later, in the Standing Committee of Union Ministers and Chief Ministers that was set up following the recommendations of the conference. A consensus emerged on allowing the Essential Commodities Act to continue as an umbrella legislation for the Centre

and the States to be used when needed, but the need for a progressive dismantling of controls and restrictions was also recognised.

7.8.13 To do away with the requirements of licensing and controls on the storage and movement of food grains (wheat, paddy/rice, coarse grains), sugar, oilseeds and edible oils, the Central Government issued an order under Section 3 of the Essential Commodities Act in February 2002 which allows dealers to freely buy, stock, sell, transport, etc. any quantity of the specified commodities. It also removed a number of items declared as essential under the Act.

7.8.14 These items are: cement, textiles made from silk, textiles made wholly or in part from man-made cellulosic and non-cellulosic spun fibres, textiles made wholly or in part from man-made cellulosic filament yarn, textiles machinery (namely, knitting machine, spinning machine, lace making machine, power loom and processing machinery), central lighting service lamps, household appliances such as electric irons, heaters and the like, electrical cables and wires, man-made cellulosic and non-cellulosic staple fibres, yarn made wholly or in part from any of the materials (namely, wool, man-made cellulosic spun fibre, man-made non-cellulosic spun fibre, and silk), nylon tire yarn/cord/fabric, and switches for domestic and similar purposes (namely, 2-AMP Switches, 3-pin plugs and socket outlets).

### Weights and Measures Acts

7.8.15 While the establishment of standards of weights and measures is the responsibility of the Central Government, the enforcement of these is placed in the Concurrent List and its implementation rests with the State Governments. Accordingly, the Standards of Weights and Measures Act, 1976 deals with the establishment of standards of weights and measures, while the Standards of Weights and Measures Enforcement Act, 1985 deals with the regulation and enforcement of weights and measures involved in industrial production, trade and commerce.

7.8.16 The Controller of Legal Metrology normally heads the enforcement machinery. The legal

metrology department in the state is normally under the control of the Department of Food and Civil Supplies, though in some states they are attached to other departments like Labour, Industry etc. In most states, Controller is an official from the administrative services, who holds the office for a short period and carries out the functions with the help of Joint Controllers or Deputy Controllers, who hold permanent posts in the Department. Each state is divided into a number of districts and normally two or three districts are placed under the supervision of a Deputy Controller. An Assistant Controller is appointed for almost every district to look after the enforcement in that district. The declaration requirement on packaged commodities with regard to weights and measures are provided under the Act and the Rules framed by the Central Government, and are, therefore, uniform throughout the country. However, the other declaration requirements desired by the enforcement machinery differ from state to state.

### Fiscal Impediments

7.8.17 Domestic trade in India is impeded by highly complex and elaborate sales tax system, comprising State sales tax, Central sales tax, turnover tax, octroi and entry tax. Besides, there may be some taxes specific to some states, such as, tobacco tax in Uttar Pradesh and professional tax in Maharashtra. Moreover, there are inter-state differences in definitions, enforcement and incidence of taxes and each tax may have multiple rates. Traders have thus to keep track of all the returns that have to be submitted, with each return having a number of pages. Problems only get compounded for those with operations in more than one state for different states have different requirements and formats for returns.

7.8.18 The system of both 'Union excise duty' and 'State sales tax', the two principal components of the domestic trade taxes, has given rise to inefficiencies that have cost the economy dearly in the following ways:

- lack of free flow of goods within the country;

- higher transaction cost and lower productivity;
- inter-jurisdictional conflicts and rate wars; and
- hindrance to exports.

7.8.19 A 1994 study by the National Institute of Public Finance and Policy (NIPFP), New Delhi, on *Reform of Domestic Trade Taxes in India: Issues and Options* observed: 'In sheer complexity and irrationality, the sales tax system, as they are structured and implemented at present, surpass the excises even at their worst.' The Report goes on to describe the complexity of the system: 'Even a bare description of the sales tax laws would provide an idea of the complexity of the prevailing structure. The rules and procedures laid down for compliance and enforcement make the systems even more complex than might appear from the primary legislation. In fact, judging by the complexity of the system and frequency with which changes are made, one wonders whether the tax officials themselves can keep abreast of them, or fully comprehend them.'

### Financial Impediments

7.8.20 The organised financial sector has been, for a long time, somewhat wary about lending to the trading community. This has been treated as a high-risk proposition, mainly because the bulk of trading activity is carried out by small and medium traders. A substantial proportion of the financial capital needed for trading purposes, has been provided by the informal sector where the cost of credit is usually higher than in the formal sector. Under the Industrial Development Bank of India (IDBI) Act, 1964, institutional finance can be availed by only those sectors which enjoy industry status. Trade as a sector is thus deprived of benefits arising from institutional finance and raising money from stock exchange. These factors have been inhibiting higher growth and modernisation of trading activities.

7.8.21 According to the Reserve Bank of India (RBI) Annual Report 1998-99, wholesale trade

(other than food procurement) accounted for just 4 per cent of the gross bank credit disbursed during that year. The share of retail trade in the total priority sector advances made by the public sector banks was, similarly, less than 2 per cent during the March 1997 to March 2000 period. The constraint of finance has made it difficult for traders to have optimal inventory holdings. This, in turn, has often created artificial shortages and increased the prices of goods.

## TRADE IN AGRICULTURE

7.8.22 Trade in agricultural products is overshadowed by various restrictions imposed on account of 'food security' considerations under the Essential Commodities Act. These restrictions may encompass sale and purchase of agricultural produce in organised mandis, storage of essential commodities, transportation of food grains, processing and distribution. Storage controls, together with selective credit policies, severely restrict the capacity of private operators to undertake storage thus reducing their capacity to cover price risks through hedging on futures market. Currently, as part of its selective credit control policy, the RBI sets 'minimum margins' on commercial bank advances against a range of 'sensitive commodities' such as, food grains, pulses, oilseed, vegetable oils, sugar, gur, khandhari and kapas/cotton. Some of the restrictive provisions distorting trade in agriculture as well as those laws that are necessary but need to be modernised are discussed below:

### Orders Related to the Essential Commodities Act

#### *State Levy Control Orders*

7.8.23 Under the Essential Commodities Act, various State Levy Control Orders have been introduced, which require private mills to deliver between 7 and 75 per cent of their rice production to the Food Corporation of India (FCI) and to State Governments for the public distribution system (PDS) and buffer stocks. 'For these deliveries, the mills receive a state-prescribed pan-territorial and

pan-seasonal levy price that is based on the minimum support price (MSP) for paddy plus "average" rice milling costs. Only after meeting levy commitments, from which rice hullers and shellers are exempt, can private mills sell their remaining rice output in the open market'.<sup>1</sup> The 'compulsory levy of rice' is prejudicial to rice-millers and puts them at a disadvantage vis-à-vis the hullers and shellers who do not have to make any contribution towards levy.

#### *Sugar (Control) Order, 1966*

7.8.24 Section 3 (3C) of the Essential Commodities Act lays down the guidelines for determining the price payable to the producer for levy sugar supplied by him. Under this sub-section, levy sugar price is required to be fixed by the Central Government having regard to:

- (a) the minimum price fixed for sugarcane by the Central Government;
- (b) the manufacturing cost of sugar;
- (c) the duty or tax payable thereon; and
- (d) the securing of a reasonable return on the capital employed in the business of manufacturing sugar.

7.8.25 The Sugar (Control) Order, 1966, thus empowers the Government to regulate production of sugar, restrict sale etc. of sugar by producers, issue directions to producers and dealers, regulate movement of sugar and quality of sugar, call for information from the producer or recognised dealer, inspection, entry search, sampling and seizure of sugar. On the basis of the monthly free sale decided by the Government, month-to-month release orders for sale of sugar in the open market are also issued under clause 5 of the Order.

#### *Milk & Milk Products Order (MMPO)*

7.8.26 The Department of Animal Husbandry and Dairying, Ministry of Agriculture issued the Milk and Milk Product Order (MMPO) in June 1992 under Section 3 of the Essential Commodities Act. This

order seeks to ensure the supply of liquid milk, an essential commodity, to the consumers by regulating its processing and distribution. The salient features of MMPO are:

- Establishment of a Milk and Milk Product Advisory Board, giving representation to industry (both cooperative as well as private) and consumer organisations.
- Registration of units handling more than 10,000 litres of milk per day or an equivalent amount of milk sold.
- State Governments are authorised to issue registration for capacity up to one lakh litres per day.
- Registration Certificate issued under the MMPO specifies the maximum quantity of milk a unit is allowed to handle and also the range of products it can manufacture.
- Preferential treatment to cooperatives in grant of registration.
- The Certificate also specifies the milk-shed area, which is defined as a geographical area demarcated by the Registering Authority for the collection of milk by the registered unit. Holders of the Registration Certificate are normally required to confine the procurement of milk to the allotted milk-shed.
- Maintenance of specified hygienic conditions in the premises where milk and milk products are handled, processed, controlled, manufactured and stored.
- The Registering Authority has the power to enter, inspect and seize in case of non-compliance with the provisions of MMPO.
- The Registering Authority has the power for suspension or cancellation of registration in case of wilful furnishing of incorrect information or non-compliance with the terms and conditions of the Registration Certificate.
- Appeal to the Controller against the decisions of Registering Authorities and

appeal to Government of India against the decisions of Controller is allowed.

7.8.27 The Central/State Registering Authorities have, till November 2001, granted registration to a total of 675 units with a total processing capacity of 687 lakh litres per day (llpd). Out of these, 212 units with a processing capacity of 284 llpd are in the cooperative sector and 399 units with a processing capacity of 316 llpd are in the private sector, and the remaining 64 with a total processing capacity of 88 llpd fall in other categories. The MMPO is, however, another form of licensing that restricts private sector investment.

7.8.28 Apart from the above there are a plethora of orders such as Meat Food Products Order (1973), Fruit Products Order (1977), Pulses and Edible Oils Order (1977), Cotton Control Order (2000), Jute and Jute Textiles Control Order (2000), which need to be reviewed.

### Other Acts

#### Agricultural Produce Marketing Acts

7.8.29 The National Commission on Agriculture (1976) recommended regulated markets for agricultural produce. States and Union Territories (except for Kerala, Manipur, Andaman and Nicobar Islands, Lakshadweep and Dadar and Nagar Haveli) initiated action for the enactment of legislation for regulation of markets. Regulated markets or organised mandis were set up under the Agricultural Produce Markets Act to help upgrade market yards, storage, grading and packaging and other market services like market information, intelligence and verification of weights and scales. As on March 2001, there were 7,177 regulated markets (2,355 principal markets and 4,822 sub-yards) in the country. In a large number of cases, the already existing wholesale markets were brought under the regulations of the Act.

7.8.30 Various systems of sale are in vogue even in regulated markets. The system of sale followed at present are open auction, mutual agreement between buyer and seller, sale under cover, chit

tender system, forward sales, etc. Among these systems, the open auction system is the most desirable and popular method of sale. The basic objective of market regulations is to regulate the trade practices, increase market efficiency through reduction in market charges, elimination of superfluous intermediaries and protecting the interest of producer-sellers. However, these objectives could not be adequately achieved.

7.8.31 A World Bank report on India's food marketing policy points out that an inspector is employed by the mandi or state government to inspect the grain to determine whether it meet fair average quality (FAQ) standards. However, it notes, 'In practice, inspection is usually manual and visual, even if moisture-measuring instruments and a testing laboratory are available. Grain failing to meet FAQ standards is discounted, but only rarely is it rejected. It is well known that the post of inspector is much sought after everywhere. Inspected grain is then auctioned with bidding organised by a '*kacha arthia*' or commission agent who usually get a two-per cent commission. Once bidding is completed, the grain is loaded into 95 kg. bags for wheat and 65 kg bags for paddy, each weighed individually on a portable scale (a balance) by a licensed weigh man. Each bag is stitched close manually with the required 14 stitches (informally cut to 7-10 during peak periods, resulting in higher losses during transport and handling). The bags are manually loaded into trucks of private traders, FCI or state agencies. The farmer bears the cost of unloading, cleaning, filling and weighing and tips to the weigh man and commission agent. Buyers pay the commission agent's fee, the market fee, purchase tax, stitching, loading and any other associated taxes.'<sup>2</sup> The organised mandis have thus failed to take off, in letter and spirit, and have been abandoned at several places on account of high mandi charges, purchase and sales tax and the consequent reduced trading margins.

### Prevention of Food Adulteration Act, 1955

7.8.32 The Prevention of Food Adulteration Act (PFA), 1955, is the principal instrument to ensure that clean and wholesome articles of human

consumption are sold to the public. While the Act by itself is not a very complicated piece of legislation, the accompanying rules are byzantine in nature. There are a number of procedural problems in the implementation of this law. The law requires food inspectors to pay for the samples that they take and these samples must be taken in the presence of at least two witnesses. In practice, however, no one is willing to go through the hassle of court proceedings and finding a witness is thus an impossible job. People often give a fictitious name and address, which cannot be traced at the time of issue of summons.

### FUTURES AND FORWARD MARKETS

7.8.33 As in the case of competitively produced industrial products, commodity prices are also determined by the forces of supply and demand. Commodity markets (e.g., those of minerals and agriculture products) are, however, faced with greater risks because of price fluctuations. Forward and futures markets enable sellers and buyers to reduce uncertainty and the consequent risk through price discovery ahead of actual production. By aligning their functioning with spot markets, the forward/futures markets can work as a tool to handle complex situations arising from good and bad harvests through stabilising supplies and prices. The prospect of good harvest, internally and globally, enables the buyers/traders to contract their purchases at lower prices. This provides a signal to the farmers for reducing the cultivated area under a particular crop as well as for timely diversion in the cropping pattern. The demand for storage acquires its own dynamics in the light of the risk management benefits and arbitrage possibilities in the futures market, thereby rationalising the sudden flow of agricultural produce in the market during peak seasons.

7.8.34 Forward contract is an agreement between the buyer and the seller in regard to both price and quantity. It is a sale or purchase of a commodity for a deferred delivery, and the contract price supposedly fluctuates less from year to year than the actual or 'spot price'. The future contract, on the other hand, is an obligation to make or take a

delivery of a fixed quantity (and quality) at the market price in the future. It is like taking a bet on where the market price would be in future. Thus, the future contract is fixed only in respect to the quantity, and the negotiating parties win or lose to the extent of the price difference between the bet and the actual price in the market on the future date.

## Regulatory Framework

7.8.35 The Ministry of Consumer Affairs, Food and Public Distribution regulates commodity forward and futures trade through the Forward Contracts (Regulation) Act, 1952. The Act differentiates and classifies the following type of contracts:

- Spot or 'ready delivery' contracts: Contracts which provide for the delivery of goods and the full payment of the value of the goods at the price settled when the contract was entered into either immediately or within a period of eleven days after signature of the contract.
- Forward contracts: These are contracts for the delivery of goods and which are not 'ready delivery' contracts.
- Non-transferable specific delivery (NTSD) contracts: These are forward contracts between two parties in which a commodity of a specific grade has to be delivered to a specified location during a predetermined time frame at a predetermined price. Neither the buyer nor the seller can transfer the contract to another party, and financial settlement is not allowed. Grade, location and delivery dates cannot be renegotiated after the contract has been signed.
- Transferable specific delivery contracts: These specify the (basis) grade, quantity and delivery location of a commodity, just like NTSD contracts do. However, the buyer can transfer the contract to others, often up to a pre-determined number of times, for instance, six times in the case of oilseed. Contracts can, in principle, even be transferred back to the original seller

implying the financial closing out of the contract.

- Hedge contracts: These specify the basis and tenderable delivery grades, and a range of delivery centres. Both buyers and sellers can close out their positions, and delivery is not obligatory. Hedge contracts are not defined in the Act, but can be considered as delivery contracts that are both transferable and non-specific until entered into.
- Option contracts: Option contracts give the right, but not the obligation, to make or take delivery of a commodity (or a futures contract) at a given price and one pays a premium for this right. Options can thus be likened to insurance, but they can also be used for speculation; the premium paid can be quite low in relation to the possible profits if prices move in the anticipated manner. These contracts, widespread earlier, were banned for all commodities under the Act because of the speculative features.

## Commodity Exchanges

7.8.36 The Forward Market Commission (FMC) under the Ministry of Consumer Affairs, Food and Public Distribution is the statutory body responsible for regulating and supervising the commodity exchanges. Normally only one trade/association is recognised in a city or region for forward/futures contracts in any single commodity. While commodities like cotton, gur, potatoes, groundnut, castor seed are traded at several centres, some commodities are traded by only one exchange in the country: pepper and copra in Kochi (Kerala), turmeric in Sangli (Maharashtra), jute and jute goods in Kolkata (West Bengal) and mustard in Jaipur (Rajasthan). Futures trading has recently been permitted in sugar (in May 2001) and in tea (in November 2001), although they have still to take off. The FMC's recommendations on permitting futures trading in rubber, onion, gram and chilies etc. are being examined by the Government.



7.8.37 Under Section 17 of the Forward Contracts Act, forward contracts are prohibited in metals like gold and silver, and several food grains, including rice, wheat and maize. While the underlying conditions like presence of a reasonably large number of market players and sufficient marketable surplus may not hold good in the case of most of these items, favourable conditions do exist in the case of rice and wheat. There is a need, therefore, to bring rice and wheat under the regulated list in Section 15, with the approval of the Cabinet. Section 14 of the Act covers the 'free list' of residual commodities in regard to which the FMC is empowered to give a certificate for commencing futures trading. Recognised associations are responsible for the day-to-day operations of the futures markets. They set the standards and rules of trade, register prices; work as clearing houses, including the collection of margin money and settlement of closed transactions; distribute delivery notices etc. All associations have their trading bye-laws, memorandum and articles of association generally modeled after British and American commodity exchanges.

7.8.38 There are apprehensions that futures markets would prevent the Government from pursuing its own price stability and production objectives.<sup>3</sup> In practice, however, a commodity futures markets does not prevent a Government from subsidising producers or consumers, or from controlling the external trade of products. In the United States, two raw sugar futures contracts are traded. One reflects world market conditions while the other reflects domestic conditions. The latter, therefore, trades at a considerably higher price, reflecting the government's objective of stimulating sugar production.

7.8.39 The relationship between storage, access to credit and futures market has also been very well documented. Commodity futures markets function best when efficient storage is possible and supported by a well-functioning credit system. Storage charges will keep in check the price differentials between spot and futures prices. If spot market prices are considered low in relation to

futures market prices, operators will arbitrage: buy commodity now, pushing up spot prices, sell futures contracts, pushing futures prices down; after a period of storage, commodities will be sold, pushing down spot prices, and buy back futures contracts. Arbitrage contributes to greater seasonal price stability. Such arbitrage strategies freeze working capital, but because the hedging futures market provide, it should not be difficult to obtain bank finance'.<sup>4</sup>

## RETAIL TRADE

7.8.40 A typical trading system of a manufactured item has the following servicing channel: (a) carry and forward (C&F) agent of the company, (b) the stockiest, (c) the wholesale trader, zone-wise and (d) the retailers, area-wise. The large manufacturers have painstakingly built their brand names and massive distribution networks. They attempt to increase their penetration into the widely-dispersed retail trade through advertisements. Some such large manufacturers have a reach of over a million retail outlets, making wholesale trade a lucrative and thriving business. In a seller's market, the wholesale trader may reap abnormal profits.

7.8.41 The retail trade in India is the biggest of all the trading channels, both in terms of number of operators and the value added. According to the Federation of Indian Chambers and Commerce (FICCI), there are as many as 120 lakh retail outlets in the country and the sector gainfully employs nearly 21 million people. The retail structure is dominated by a conglomeration of many unorganised independent stores. The average size of a retail unit is less than 500 sq. ft. and not more than 4 per cent of the retail outlets occupied a space larger than 500 sq.ft. While India has one of the highest numbers of outlets per capita in the world, the per capita retail space is the lowest. It has also been observed that while retail shops typically need a 14 feet high ceiling, the builders build ceiling heights of 9 feet. Several factors like lack of finance and know-how, lower profit margins, poor infrastructure and obstacles in real estate development have been inhibiting the growth of the retail sector.

## Organised Retailing

7.8.42 Only 4 per cent of the retail trade in India belonged to organised retail. It covered items such as apparel, grocery, music, electronics, automobiles and financial services. This is inconsequential compared to 20 per cent in China, 40 per cent in Thailand and 80 per cent in the United States. The emergence of organised retail in India is, moreover, so far restricted to the top 15 cities. The strength of organised retailing lies in the ability to source directly from the manufacturers due to increased bargaining power achieved through large-scale operation. Organised retail chains can get bulk discounts on large purchases and reduce cost by eliminating middlemen and by reducing the supply chain. However, the potential benefits of lower prices is not evident in the early stages because modern retailing tends to concentrate on the upper segment of the market where consumers are willing to pay higher prices for convenience and a superior shopping environment.

7.8.43 Organised retailing is often run on the principle of 'franchising'. The franchiser allows a local businessman, a franchisee, to set up a retail outlet using its name and methods as a joint venture on a 50:50 paid up capital basis. The franchiser also provides training, equipment, quality control and national advertising. In exchange, it receives fees and a share of profits. Organised retailing, moreover, has multiple formats like discounters, hypermarkets, convenience stores, small outlets and warehouse clubs. The special advantage of organised retailing are:

- (a) enhancing quality through skilled processing, grading and delivery of goods;
- (b) lower price through better expertise in managing back-end activities such as sourcing and inventory management as well as the ability to strengthen the front-end functions of merchandising, promotions and customer services;
- (c) creating a level playing field for small and medium enterprises vis-à-vis the large manufacturers; and

- (d) higher productivity per worker and better job opportunities.

The growth of organised retailing is thus expected to lead to value migration from wholesale trade to retail trade.

7.8.44 Groceries are one of the major product lines to which organised retailing can contribute significantly. Groceries can be classified under two groups: dry grocery and fresh grocery. Organised retailing has made a mark under the category of fresh grocery, comprising vegetables, fruits and meat. According to rating agency, ICRA, New Delhi, 'Worldwide, it is estimated that the grocery market is worth about \$ 400 billion of which 65-70 per cent is catered to by the organised sector. In the developed countries, these grocery stores are big in size and reap high economies of scale, resulting in cheaper prices to the end-consumer'.

7.8.45 According to the Task Force on Employment Opportunities (ibid), 'Concern is sometimes expressed that the modernisation of retail trade and the growth of larger scale department stores may displace self-employment in the more traditional retail segment since productivity per worker in modern retailing is typically much higher. This leads to the fear that there may be a net reduction in total employment potential. However, it is important to emphasise that expansion of modern retailing is extremely important for several reasons. It will certainly improve the quality of employment provided in this sector. Improvement of quality of employment must be an important objective over the next ten years'. It may also influence the unorganised retail trade through 'demonstration effect' and help them introduce new techniques and new methods of organising their businesses. Organised retailing, moreover, helps develop real estate and also promotes tourism through better shopping experience.

## CONSUMER PROTECTION

7.8.46 The United Nations adopted the UN Guidelines for Consumer Protection on April 9, 1985. The guidelines call upon governments to

develop, strengthen or maintain a strong consumer policy, and provide for enhanced protection of consumers (Box).

consumers' interests. In order to provide speedy, simple and inexpensive redress to consumer disputes through summary trials, a three-tier quasi-

### Box 7.8.1

#### UN GUIDELINES FOR CONSUMER PROTECTION, 1986- GENERAL PRINCIPLES

- Governments should develop, strengthen or maintain a strong consumer protection policy, taking into account the guidelines set out below. In so doing, each Government must set its own priorities for the protection of consumers in accordance with the economic and social circumstances of the country, and the needs of its population, and bearing in mind the costs and benefits of proposed measures.
- The legitimate needs, which the guidelines are intended to meet, are the following:
  - (a) The protection of consumers from hazards to their health and safety;
  - (b) The promotion and protection of the economic interests of consumers;
  - (c) Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs;
  - (d) Consumer Education;
  - (e) Availability of effective consumer redress;
  - (f) Freedom to form consumer and other relevant groups or organizations and the opportunity of such organizations to present their views in decision-making processes affecting them.
- Governments should provide or maintain adequate infrastructure to develop, implement and monitor consumer protection policies. Special care should be taken to ensure that measures for consumer protection are implemented for the benefit of all sections of the population, particularly the rural population.
- All enterprises should obey the relevant laws and regulations of the countries in which they do business. They should also conform to the appropriate provisions of international standards for consumer protection to which the competent authorities of the country in question have agreed.
- The potential positive role of universities and public and private enterprises in research should be considered when developing consumer protection policies.

Source: Department of International Economic and Social Affairs

**UNITED NATIONS**

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### Consumer Protection Act, 1986

7.8.47 Some of these issues, especially those relating to “consumer’s economic interests”, have been covered ‘under unfair trade practices’ in Section 36A of the Monopolies and Restrictive Trade Practices (MRTP) Act 1969 (modified from time to time). The Consumer Protection Act, 1986 was enacted to provide for better protection of

judicial machinery (i.e. one National Commission, 35 State Commissions and 570 District Forums) was introduced under the Act. The Consumer Redressal Forums are required to dispose of cases, as far as possible, within 90-150 days. Apart from these forums, consumers can also approach the civil courts and other legal forums. The Consumer Protection Act has been amended twice – in 1991 and in 1993. It now provides for a Central

Consumer Protection Council (CCPC) as the apex body for safeguarding consumer interests. The Council is supposed to meet once a year to review the progress in regard to consumer awareness and consumer protection.

### MRP and Consumer Protection

7.8.48 Manufacturers are required to mention the maximum retail price (MRP) on the packaging of their goods. MRP was made mandatory to protect the consumers against overcharging by the retailer. However, this appears to have lost its relevance since goods are being sold at half the MRP. This indicates that the ceiling price of MRP is not based on cost price, allowing for a reasonable mark up, but has been kept higher by the manufacturers, perhaps to appease the retailer. So the consumer's interest remains unprotected. However, in spite of these shortcomings, the MRP declaration on pre-packed commodities still provides some protection to consumers. Subsequent to the revision of Excise Laws, excise duty collections are linked to MRP in specified cases, which act as a counter to high MRP marking.

### Consumer as Investor

7.8.49 The Indian retail investor has suffered a great deal in recent years. Fly-by-night finance companies have lured the gullible public with promises of high returns into investing their money into these companies. The consumer needs to be educated that high returns and high risk are two sides of the same coin. Regulatory gaps have led to consumers being cheated. Besides, poor law enforcement emboldens white-collar criminals. The regulatory laws have been strengthened to close the gaps and this process must continue.

7.8.50 In the case of investment in housing, too, the consumer faces problems in the timely completion of projects, the cost as well as the quality of dwelling. Housing constitutes the single largest item of expenditure for an average consumer and most consumers take loans to build their houses. Rating systems and self-regulatory organisations need to be created and strengthened.

### Utilities and Consumer Protection

7.8.51 Many public utilities like the railways, the postal system and telecommunications continue to operate under outdated and anti-consumer rules and regulations. The right to information vis-à-vis the cause of accidents, loss etc. is also not readily provided and the rules framed are not transparent. These may be reviewed in the light of the best practices prevalent in other countries.

### POLICY REFORMS

7.8.52 The current development of India's trade sector is far behind its potential. With its size, India can provide economies of scale to its industry and agriculture. However, many regulations which have outlived their utility continue to harm internal trade. While these hindrances need to be removed, the country also needs to introduce modern practices in forward, futures markets and organised retailing.

7.8.53 In view of the falling tariff rates and increasing competition, there is immediate need to provide a level playing field to domestic industry through removing all possible impediments on internal trade, while, at the same time, strengthening transport and communication infrastructure. Some of the policy reforms needed are:

### Laws and Rules

7.8.54 Legal reforms may be initiated in order to evolve a simple, transparent, business-friendly system. States should consider a single procedure for granting licences, irrespective of the goods/services to be traded. There should be a comprehensive legislation relating to consumer's rights, which will protect them from adulteration, malpractices relating to weight and wrong information regarding contents and ingredients etc. Punishment must, however, be commensurate with the misdemeanor. Thus, the use of poisonous substances in food and spurious 'life saving drugs' should attract arrest and imprisonment while incorrect labeling and weights should be treated as civil offences with only monetary penalties. This Act should be uniformly accepted and implemented all over the country.

7.8.55 The Essential Commodities Act is an anachronism for a modern competitive economy. It should be repealed and replaced by an emergency Act that can be applied by notification for a limited period of time to a specified commodity in a specified region. There should be no delegation of authority, to issue notifications, from the Centre to the States.

7.8.56 The different acts applicable to food such as the Prevention of Food Adulteration Act and the Weights and Measures Act should be integrated into a single unified and modern Food Act. This should provide for a single food regulatory authority for the entire food sector, including food processing. While, in the earlier system, the food inspector was almost the judge, under the new dispensation he would be merely carrying out the orders decided by a quasi-judicial forum.

7.8.57 Consideration should be given to enacting a single Food and Drug act that covers both food and drugs, as the central issue in both cases is preserving the health of the consumer. Such an integrated Act should have a provision for two separate regulators for food and drugs. Ideally, drug price control should come under the purview of the proposed Competition Law, so that the modern principles of competition and abuse of monopoly can be applied to drugs.

## Fiscal Issues

7.8.58 Fiscal reforms are important in facilitating the growth of efficient trade. The complex tax structure and multiplicity of state-level taxes distort the process of trade. International experience shows that simpler tax laws not only lower costs of compliance and administration, but also lead to higher revenues and contribute to the fairness of the tax system. Inter-state and Centre-State harmonisation of tax laws and administrative procedures can facilitate the simplification of the tax system. Octroi on transport of goods may also be dispensed with as far as possible.

7.8.59 Since the current tax statutes are cluttered with ad-hoc and outdated rules and procedures, the ideal solution is to gradually move to a uniform,

nation-wide value added tax (VAT). VAT is universally accepted as the most efficient form of indirect taxation. It is a multi-stage tax like the turnover tax but is levied on the value added at each stage and not on the gross turnover of the dealer. As each input going into a final product is taxed only once, this tax avoids cascading and multiple incidences, and is easy to monitor and implement.

7.8.60 A unified system of taxing domestic trade in the form of national VAT levied and administered by the Union Government would, in one stroke, bring about harmonisation and help in removing the tax on inter-state trade. The Government set up the Empowered Committee of State Finance Ministers to Monitor Sales Tax Reforms in November 1991. This Committee is still working on the rationalisation of state taxes. On the recommendations of the Committee, the Government has introduced, as a first step, minimum floor rates for different categories of products from January 2000 so as to discourage rate wars between states. It was to be followed by the introduction of VAT by April, 2001 but this has been deferred.

7.8.61 Many State Governments have already notified their revised sales-tax rates. A review of these notifications, however, indicates that there is no uniformity in revised rates or the categorisation of products. In some states, 'essential commodities' are clubbed with the 'prohibited items categories', for rate purposes, and the highest rate of 20 per cent is levied on items of mass consumption along with liquor and narcotics. It appears that the decision to implement a minimum floor rate has been used as an excuse to increase the sales tax rates without rationalising the tax structure.

7.8.62 It is heartening to note that the Central Government has made a beginning in the direction of VAT by introducing CENVAT from the current year. But till such times as it is able to introduce a more comprehensive national VAT, each state should be persuaded to have its own VAT the rates of which could be determined to make the tax revenue neutral. For inter-state sales, there should be a zero-rate in the originating state and destination VAT should be

applied at the point of final sale. The state VAT, with a harmonised rate structure across states should replace all other sales taxes and other taxes like the turnover tax, octroi and entry tax.

### Financial Issues

7.8.63 The financial needs of the trading community should be recognised as genuine concerns and sustained efforts must be made to ensure that the sector is not dependent largely on the informal markets using unaccounted money, money laundering and costly credit. Commercial banks must be allowed to be more liberal in their attitude towards lending to traders. However, banks generally fulfill the needs of only bigger traders. The Union Budget (2001) increased the credit limit of the composite loan scheme of the Small Industries Development Bank of India (SIDBI) and commercial banks designed to help small borrowers by providing term loan and working capital through a single window to Rs. 25 lakh. Since small and medium traders account for the bulk of trade, the remit of SIDBI should be expanded to include the service sector, including trade. SIDBI can play a multiple role of providing finances, sensitising traders about laws and regulations as well as the importance of consumers' rights and privileges.

### Futures and Forwards

7.8.64 Both large and small traders are the main users of future contracts in India. The percentage share of trade they hedge through the futures market, however, remains small. The success of most futures contracts depend on (a) sufficiently large supply and demand of the commodity; (b) determination of price by market forces without too much of government intervention; (c) well-developed exchange infrastructure facilities; and (d) conducive legal and regulatory framework. The following policy reforms should be introduced for enhancing greater vitality into the futures market:

- The ban on future contracts in wheat and rice may be lifted. Rice and wheat are a critical sector of the Indian economy

accounting for approximately 26 per cent of agricultural GDP.

- The existing policy of pan-seasonal pricing of wheat and rice under the PDS provides a disincentive for future trading. This needs to be modified to encourage private storage.
- Existing tax rules do not allow hedgers to deduct hedging losses from their ordinary income, unlike investors in financial derivatives. Hedging losses are treated as speculative capital losses, which can only be deducted from speculative gains and can be deferred up to eight years. This regulation creates taxation asymmetry. Unrealised profits on a hedge contract should be allowed to be deferred until the underlying physical transaction has been realised.
- Trading procedures could be improved by introducing a time stamping obligation and the monitoring of prices by an exchange official on a minute-to-minute basis. These prices should be disseminated widely on a real-time basis with the help of information technology. These two measures would make it easier to determine whether a transaction indeed took place at a competitive price and prevent fraudulent behaviour on the part of traders. The length of the trading day needs to be carefully considered since a long day dilutes liquidity over too many hours and also makes it more difficult to monitor the proper functioning of exchange trading.
- The weakness of India's unique delivery system needs to be corrected. A simple solution would be to adopt international practices by giving up the settlement options: positions remaining open at maturity date would have to go to delivery. A less drastic solution, however, would be to set out clear and transparent formula for determining the close-out price, on the basis of spot prices at and near the

maturity date. The formula would be worked out by the Pricing Committee of the exchange in which all the participants in the trade would be represented in order to ensure its fair and transparent operation.

- Greater effort should be directed at enforcing and educating members about the rules and regulations of the exchange. Internal auditing departments should be strengthened in order to consistently monitor the trading behaviour of brokers and to ensure an honest and fair relationship with their customers.

tion be classified as 'industry' getting 'industry' status.

- (b) Earmarking a certain percentage of residential/township area for market centres must be made mandatory and local governments must enact appropriate zoning laws. The absence of such a directive has only led to encroachments on municipal land and the weekly markets in colonies.
- (c) The local bodies/governments may be encouraged to invest in public goods like roads, footpaths, street lighting, public water and toilet facilities.

## Retail Reforms

7.8.65 The efficiency of retail trade can be increased by the following reforms:

- (a) The restrictive clause Section 2(c) of IDBI Act, 1964 providing for grant of term loan, subscription to equity capital, underwriting or guarantee to only industrial concerns needs to be modified to include sectors such as trade, education and entertainment etc. This would also remove the present anomaly of defining sectors that can by no stretch of imagina-

## THE PATH AHEAD

7.8.66 The traditional bias in favour of manufacturing and against trade needs to be jettisoned. Trade generates employment with very little capital investment. In other words, it has a low incremental capital output ratio. Even though modern trade has higher capital requirements, it can generate good quality productive jobs with reasonable capital investment. In a competitive market economy there is no need to either favour or discriminate against trade. In fact efficient trade is one of the key ingredients for attaining a competitive market economy.

1 Food Marketing Policy: India, World Bank, September, 1998

2 Food Marketing Policy: India, World Bank, September., 1998.

3 *Report on 'Managing Price Risks in India's Liberalised Agriculture: Can Futures Markets Help,'* World Bank, 1997.

4 *Report on Managing Price Risks in India's Liberalized Agriculture: Can "Commodity Futures Markets Help?"* World Bank, 1999.

