



सत्यमेव जयते

Government of India
Planning Commission
New Delhi
2006

Background Paper for the meeting of
the empowered Sub-Committee of NDC on

Removal of Barriers to Internal Trade

**BACKGROUND PAPER
FOR
THE MEETING OF THE
EMPOWERED SUB-COMMITTEE OF NDC
ON
REMOVAL OF BARRIERS TO INTERNAL TRADE**



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*Main
Recommendations*

ESSENTIAL COMMODITIES ACT

1.1 **A total 227 control orders arising from EC Act continue to be in operation, of which 31 are issued by Central Ministries and the remaining 196 are issued by State governments.** These control orders may be removed through deleting all items declared as 'essential commodities' under the extant EC Act as they inhibit trade in goods and services across the country.

1.2 The Act itself may be amended, providing for declaration of any commodity as 'essential' only under the conditions of:

- (a) Emergencies like war and major natural calamities,
- (b) Maintaining supply of items of human consumption, and
- (c) Removing bottlenecks/distribution in trade.

1.3 The Union Government shall, moreover, specify the reasons in the notified orders and lay every notified order made under the said provision before both the Houses of Parliament.

1.4 Any such notification declaring an item as 'essential' should, moreover, be specific to a particular commodity (and not to a group of commodities) and should also have a sun set clause specifying the period.

AGRICULTURAL TRADE

2.1 States that have not amended their extant APMC Acts should amend the same with speed in the light of the Model Act. This will entail reforms in regard to the followings:

- (a) Permission for direct sale (and purchase) of agricultural produce,
- (b) Permission for forward contract in agriculture/contract farming,
- (c) Single point (market) levy within the state,
- (d) Permission to private sector to set up (modern) markets, and
- (e) Public-private-partnership in construction, financing, operation and maintenance of mega/terminal markets.

2.2 *Development of market infrastructure* near towns and cities may be included under the National Urban Renewal Mission (NURM).

2.3 City's Master Plan should earmark zones/land use for the development of mega/terminal markets.

2.4 Agricultural mega/ terminal markets developed through *public-private-partnership* (*private finance initiative*) should qualify for support under the '**Scheme for Support under PPP in the Infrastructure Support**' of Government of India.

FORWARD TRADING

3.1 Since regulated markets/'mandis' are centres of price discovery of 'spot prices', these could be looked at as the starting point for trading in commodity futures. Major mandis may, therefore, be linked to national commodity exchanges. It may be made mandatory for 'mandi' operators to have **electronic price boards** to display prices of *both spot and futures markets transparently**.

* The Multi Commodity Exchange (MCX) in association with NAFED and others have decided to launch an electronic Spot Market Exchange that would disseminate prices of agricultural commodities on real time basis across the country.

3.2 Necessary measures may be taken to improve the functioning of most of the **commodity exchanges** for *efficient clearing, settlement and guarantee systems* as well as to establish new exchanges. **Market regulation** may be further strengthened to ensure the right kind of relationship between ‘**spot price**’ and ‘**future price**’ and to provide greater credibility to commodity exchanges.

3.3 Commodity futures markets function best when efficient storage is possible and trading is supported by well functioning credit system. World over banks are observed to be active members on the clearinghouses (of the exchanges) and for lending money to hedgers/ investors, The Banking Regulation Act (1949), however, does not permit banks to deal in commodities and commodity derivatives. The Banking Regulation Act may, therefore, be suitably amended. Desired amendment in SEBI (Mutual Fund) Regulations, 1996 may also be made to enable mutual funds to invest in commodity markets.

3.4 With a view to provide protection to farmers against fall in futures prices; they may be allowed to participate in options in the commodity exchanges. As such, if the future price of the underlying commodity happens to be lower than Minimum Support Price (MSP), the farmer will not be bound to sell under the option contract in the futures market. However, Section 19 of FC(R) Act prohibits ‘options’. The Act could, therefore, be suitably amended.

3.5 A comprehensive *legislation on warehousing* needs to be introduced on the line of the Indian Multi-modal Transportation of Goods Act (1993) to provide to warehouse *receipts* (WR) attributes similar to bill of lading, namely, *title to the goods, rights and obligations of the holder and the warehouse keeper and (its) negotiability*.

TRANSPORTATION OF GOODS

4.1 Payment of both **road tax** and national **permit fee** on commercial vehicles may be replaced by levy of a **uniform surcharge on petrol and diesel**. This might be extended to non-commercial vehicles as well. This system would be free from administrative hassles and

would be rational since the amount collected would depend upon the extent of use of the vehicle.

4.2 The amount of surcharge collected by the retailers/dealers on petrol and diesel might be transferred to the state in which the tax is collected, in the same manner as that of sales tax/state VAT collection. This would do away with the upfront payment of road tax on purchase of new cars/other vehicles, *reducing in the process the cost of acquisition of these vehicles.*

4.3 With a view to encourage greater use of *multi-axle vehicle* that reduce wear and tear on roads, the Government of India may charge lower rates of CENVAT/excise duty on these vehicles compared to other vehicles.

4.4 The on-going programme of the front-end and backend computerization of RTOs including issuance of Smart Card based documents for DL and RC should be strengthened to reduce detention time for various types of checks on inter-state movement of vehicles.

4.5 In view of Inland Water Transport (IWT) being *more energy efficient* than other modes of transportation (in the range of one-half to one-fourth of other transportation costs), **all efforts should be made to fully utilize the inland water ways potential in the country.**

RETAIL TRADE

5.1 Enactment of zoning laws/land use norms, providing for adequate space for '**market centres**' in urban settlements should be an essential feature of urban planning. Since urban settlements cannot be 'static', *zoning norms/use of zones should be periodically reviewed.*

5.2 *Markets often come up by the side of roads.* It is observed to be a universal phenomenon. *Recognizing the overriding importance of commercial activity in these markets and the huge investments made in shops and buildings, municipalities in various*

countries have stopped vehicular traffic on these roads. Municipalities in India may also be encouraged to adopt this cost-effective approach for **developing market centres/shopping malls** through providing alternatives routes for vehicular traffic.

5.3 Municipal authorities may be encouraged to simplify rules and provide the facility of **a single window clearance** for registration to aspiring retailers. Use of computers and barcodes by the retailers/shop keepers may also be encouraged.

5.4 Retail sector should have easier and greater access to credit, both long term and short term. The retail traders may be extended the facility of **Credit Cards** on similar lines as the Kisan Credit Cards and the Laghu Udyami Credit Cards.

5.5 Organized retailing is often run on the principle of 'franchising'. A comprehensive '**franchise law**' may be enacted to promote 'organized retailing'.

5.6 A government *programme* for hawkers/*venders and squatters under unorganized retailing, may be launched to help them acquire better transport, equipments and know how.*

TAX ON TRADE

(Sale, Purchase and Transportation of Goods)

6.1 Implementation of state VAT in the remaining states of U.P., Tamil Nadu and Pondichery may be expedited. A **consistent commodity classification** for the items covered under state VAT should be developed *at the earliest* to ensure uniformity in rates.

6.2 The CST on inter-state sale of goods does not provide for tax credit on inputs. It, moreover, raises the price of an item in the consuming state. **Phasing out of Central Sales Tax (CST) may, therefore, be started without further delay.**

6.3 'Entry tax' is stated to be unconstitutional, unless it is imposed to give protection to local manufacturers against discrimination from imported goods due to lower taxes charged in the exporting state. Possibility of discrimination has been removed with the introduction

of *uniform rates* under the state VAT system. A **general consensus must, therefore, be built against imposition of ‘entry tax’ by the states.**

6.4 **Municipalities may be asked to withdraw ‘octroi’ on goods and passengers entering their localities.** All check posts intended to enforce payment of ‘octroi’ should be dismantled. States may compensate the municipalities for the consequent loss of revenue from out of the general increase in their revenue receipts. Places of ‘tourist’ interests may, however, impose a toll tax on incoming taxis/cars/tourist busses for better upkeep of the locality.

Chapter-I
INTRODUCTION

INTRODUCTION

The Constitution of India provides for *free trade and commerce*¹ throughout the territory of India without any discrimination or prejudice². At the same time, *the Parliament and State Legislatures* are authorized to put restrictions on trade and commerce³ if it was in the greater interest of the public. While external trade⁴ and regulation of inter-state trade⁵ (including taxes⁶ on such trade) are covered under the Union List, trade and commerce within a state⁷ is covered under the State List (*with the exception of those items mentioned in Entry 33 of the Concurrent List*). The states are empowered to impose taxes on trade within the state⁸ (e.g., sales tax). The states may also impose taxes *on goods entering*⁹ for sale/ consumption in the state if there is a case of discrimination against local manufacturer, arising from lower taxes charged in the exporting state.

Prior to the amendment of Entry 33 of the Concurrent List in 1955, the Union Government *regulated* trade and commerce (only) of *certain industrial products* as approved by the Parliament. The Third Constitutional Amendment (1955) **modified Entry 33 of the Concurrent List** to include items other than industrial products, such as, foodstuffs, cattle fodder, raw cotton & jute, imported goods, etc. This brought '*regulation of trade and commerce*' in almost all products under the purview of the Union Government. The Parliament, subsequently, passed the **Essential Commodities Act (1955)**, which authorized the Union Government to make orders for regulating *production, transportation (movement), storage, distribution and control of prices* of essential commodities.

¹ Article 301, Part XIII

² Article 303, Part XIII

³ Articles 302, 304, Part XIII

⁴ Entry 41, List I, 7th Schedule

⁵ Entry 42, List I, 7th Schedule

⁶ Entries 92A & 92B, List I, 7th Schedule

⁷ Entries 26 & 27, List II, 7th Schedule

⁸ Entry 60, List II, 7th Schedule

⁹ Entry 52, List II, 7th Schedule

Various 'control orders' issued by the different Ministries of the Union Government and those issued by the State Governments for regulating trade *are derived from the Essential Commodities Act*. Some 'control orders' are, however, reported to have been issued by the state governments *even without the knowledge and permission of the Union Government*. Regulations and controls were introduced primarily to check prices of essential items and to protect the interests of consumers. The decades of the 1950s and 1960s were periods that were witness to large-scale scarcity of essential goods. The Government (both the Union Government and the State Governments) had to keep a constant vigil on traders to ensure that they did not indulge in *hoarding and black marketing*.

The Indian economy today has moved away from conditions of shortages. There is a general consensus to review the *control orders/ regulations* on trade that have outlived their utility. The **Committee on Controls and Subsidies** (Chairman: Vadilal Dagli, 1979) was of the opinion that '*considering the sweeping nature of the powers vesting with the executive authority under the Essential Commodities Act, the coverage should be reviewed from time to time as a regular and automatic feature*'. The various 'control orders' issued by the different Ministries of the Union Government and by the State Governments have been at the root of what has been called the 'inspector raj' by trade and industry.

Close on the heels of the EC Act, the Union Government introduced the *Central Sales Tax (CST) Act* in 1956. A CST at the rate of 1% was initially imposed on inter-state sale or purchase of goods, which was later on increased to 4%. The proceeds of CST are retained by the originating state and have favoured more the advanced states with stronger manufacturing or raw material base. The importing states, at their end, have often introduced '*entry tax* on various goods entering their territory. The local bodies/municipalities, in turn, are observed to have imposed '*octroi*' on goods and passengers entering their localities. Collection of these taxes, by the different tiers of government has led to establishment of **border check-posts** that have been the cause of much delay, harassment and inefficiency in movement of goods within the economy. In brief, they have fragmented the Indian market into smaller markets.

Trade and commerce have been also faced with a highly complex (state) sales tax regime. It has been witness to multiplicity of rates compounded by differences in rates across the states. While some states adopted the single point sales tax system, the others adopted the multi-point sales tax system. The trading community has been, moreover, faced with uncertainty in tax rates as they have been subject to arbitrary changes. The rate wars amongst states or the *sales tax based incentives* to attract investments into the state have been responsible for uneconomic decisions regarding location of manufacturing and trading establishments within the country.

Trading has, generally, been considered as an activity *where goods are bought on credit and sold in cash*, therefore requiring very little capital. The Indian economy is, however, mute witness to annual losses of fruits and vegetables in magnitudes that is stated to be equal to the total output (of fruits and vegetables) of many countries. *These losses, both in terms of quality and quantity can be minimized if there is commensurate investment in cold storage chains over the length and breadth of the country.* Excess control on trade in agriculture as well as barriers to intra-state and inter-state trade has been inhibiting such investments.

Trade and commerce can gain a great deal through the use of computers (and bar-coding machines) for bookkeeping, inventory management and quality control. Very little seems to be happening in this direction. The demand for capital in trade and commerce is thus bound to go up. The financial sector has, however, been wary of lending capital to “trade and commerce” as majority of such enterprises belong to the unorganized sector. While the share of trade in GDP has moved up from about 12 per cent in 1993-94 to 15 per cent in 2003-04, its share in total advances by the organized banking sector is observed to be as low as 6 per cent. A substantial portion of the capital required for trading purposes thus comes from the informal sector and as supplier’s credit where the cost of credit is much higher.

A great deal of growth in trade can take place through development of *forward and futures* markets, as they provide avenues of hedging risks arising from fluctuation in prices. This is expected to benefit both buyers and sellers, *including the farming community.*

Until recently, futures contract in most commodities was prohibited. Lifting the ban on “futures” in all commodities, however, poses a challenge for the government/regulator to ensure successful trading operation at the various *commodity exchanges*.

There is also a felt need to allocate more space for *market centres* through enactment of appropriate ‘*zoning laws*’/*zoning norms* in all urban settlements across the country. Necessary reforms are also called for vis-à-vis *rent control laws* and *stamp duties* that have been inhibiting the real estate development. Due to the poor ambience of market places, India has failed to attract tourists in larger numbers and sell higher volume of products. The expenditure incurred by foreign tourists (cost of travel and purchases) in India is much lower (20%) compared to other destinations (60%).

I. CONSTITUTION OF THE EMPOWERED SUB-COMMITTEE

In order to introduce the policy reforms vis-à-vis internal trade, it was decided to constitute the **Empowered Sub-Committee of the National Development Council on Removal of Barriers to Internal Trade** under the chairmanship of the Prime Minister. The composition of the reconstituted Committee (September, 2005) is as under :

i) Prime Minister	... Chairman
ii) Minister of Agriculture	... Member
iii) Minister of Commerce & Industry	... Member
iv) Minister of Consumer Affairs, Food & Public Distribution	... Member
v) Minister of Finance	... Member
vi) Minister of Law & Justice	... Member
vii) Deputy Chairman, Planning Commission	... Member
viii) Minister of Shipping, Road Transport & Highways	... Member

ix) Minister of Urban Development & Poverty Alleviation	... Member
x) Chief Minister of Maharashtra	... Member
xi) Chief Minister of Tamil Nadu	... Member
xii) Chief Minister of Uttar Pradesh	... Member
xiii) Chief Minister of West Bengal	... Member
xiv) Member-Secretary, Planning Commission	... Convener
xv) Secretary, Department of Revenue	... Co-Convener

The **Terms of Reference** for this committee are as follows:

- I. To identify and remove all fiscal and other barriers to free movement of goods and services.
- II. To identify and remove unnecessary restrictions/control orders inhibiting trade in agriculture and in retailing.
- III. To examine the scope and context of ECA, 1955.
- IV. To identify and remove all barriers/restrictions on movement of commercial vehicles inter-state, intra-state including those arising from municipal jurisdiction.
- V. To clearly lay down the operational modalities for exercise of their retained role by the police, tax authorities, municipal authorities etc. in regulating the flow of goods and vehicles to ensure that unnecessary impediments and harassment do not arise.
- VI. To consider any other issues relating to internal trade in goods and services.

Chapter-II

BARRIERS TO INTERNAL TRADE : AGENDA ITEMS

BARRIERS TO INTERNAL TRADE : AGENDA ITEMS

The paragraphs below mention the *agenda items* that constitute the major barriers to internal trade for the consideration of the Sub-Committee.

2.1.1.0 RESTRICTIONS ARISING FROM ESSENTIAL COMMODITIES ACT

2.1.1.1 ISSUES

Plethora of control orders inhibiting trade that is derived from Essential Commodities Act, 1955.

2.1.2.0 BACKGROUND

2.1.2.1 The Essential Commodities Act 1955 empowers the Union Government to regulate production, distribution/sale, prices and movement of essential commodities. Any item may be notified as 'essential' under the Act either by legislation or by executive authority. While executive authority can remove items as 'essential' (so declared under their authority) *through a Gazette Notification*, items declared as 'essential' through legislation require amendment to the Act.

2.1.2.2 Using the powers under the Act, the various Ministries/Departments have issued control orders for regulating production, sale and prices of items, such as, coal, textile, paper and jute etc. Similarly, utilizing the powers delegated by the Union Government, the State Governments/UT Administrations have issued a variety of control orders in regard to items, such as paddy/rice, edible oils etc. A total of 227 control orders are in operation, of which 31 are issued by Central Ministries and the remaining 196 are issued by the State Governments.

2.1.2.3 These 'control orders' or *licenses and permits* of various kinds may relate to *movement of goods, stock holding limit, sale and purchase or rent on storage* etc. A number of registers have to be maintained and returns filed periodically, which are subject to inspection. The trader (as well as manufacturer and farmer) in the field is thus faced with an 'inspector raj'. The trading class, in general, is a hapless lot and has to operate perforce at high margins that act as dis-incentives to both production and distribution.

2.1.2.4 The Union Government decided in March 1993 to treat the entire country as a single food zone and all restrictions regarding inter-state and intra-state movement of food grains were removed. The list of essential commodities under the Act has been reviewed from time to time in the light of changed economic situation. The number of items declared as essential has come down to 15 at present from 70 in the year 1989. Since out of the 15 remaining essential items, 11 are listed in the Act itself and can be deleted or modified through amendment (of the Act) by the Parliament, the Union Government is contemplating of introducing a Bill to this effect.

2.1.3.0 RECOMMENDATIONS

2.1.3.1 The Essential Commodities Act may be amended leading to *deletion* of all the items listed in clause (a) of section 2 of the said Act (e.g., coal, iron & steel, cotton & woolen textiles and paper etc.). Some items may, however, be retained as *essential commodities* under the Schedule to the amended Act, which are strongly recommended for *regulation* by the concerned ministries (e.g., drugs, foodstuffs including edible oilseeds and oils, fertilizer, petroleum and petroleum products, hank yarn made wholly from cotton, raw jute and jute textile and seeds of food-crops and seeds of fruits and vegetables, seeds of cattle fodder, and jute seeds).

2.1.3.2 The amendment may, furthermore, provide for *declaring a commodity as 'essential' by notification of the Union Government* under the following conditions:

- (i) In case of emergencies like war and major natural calamities;
- (ii) When government intervention becomes imperative for maintaining supply of items of human consumption;
- (iii) To remove distortion/bottleneck in trade of a particular commodity.

2.1.3.3 The Union Government shall, moreover, specify the reasons in the notified orders and lay every *notified order* made under the said provision before both the Houses of Parliament.

2.1.3.4 All notifications should, moreover, be specific *to a particular commodity* (and not to a group of commodities). All notifications should also have *the sunset clause* specifying the period, so that the *control orders* remain in force only as long as they are absolutely necessary.

2.2.1.0 **BOTTLENECKS IN AGRICULTURAL TRADE**

2.2.1.1 **ISSUES**

- Obstacles in direct marketing of agricultural produce.
- Ill equipped markets/yards and congestions causing delay in disposal of agricultural produce.
- Inadequate investment in **marketing infrastructure**, both for agricultural inputs and outputs.
- Levy of market fee at multiple points.

2.2.2.0 **BACKGROUND**

2.2.2.1 While the extant APMC Act has been instrumental in the development of 7161 markets/yards/sub-yards in the country *providing for more reliable weighing, standardized market charges, payment of cash without undue deductions and sequencing of auctions*, regulated market 'mandis' are (to-day) noticed to be often congested and farmers face delays in disposal of their produce. Besides the regulated markets, there are 27,294 rural periodic markets that are undeveloped.

- 2.2.2.2 The area served per (regulated) market yard works out to 459 sq. km. at the national level. It is much higher for states like Assam, H.P., M.P., Rajasthan and Orissa. The *Committee on Strengthening Agricultural Markets, Ministry of Agriculture* (June, 2000) recommended **direct marketing** as one of the alternative marketing structures as it obviates the necessity to haul the produce to the regulated markets.
- 2.2.2.3 Due to poor handling, cleaning, sorting, grading and packaging at the village/farm gate level, about 7% of grains, 30% of fruits and vegetables and 10% of seed species is estimated to be lost before reaching the market. An estimated amount of Rs.50,000 crores are lost annually in the marketing chain due to the *lack of marketing infrastructure* and excess controls across the country. This is one of the important reasons for the wide margins between the farm gate/ wholesale prices and the retail prices.
- 2.2.2.4 The **Model Act** on Agricultural Produce Marketing (Development and Regulation) formulated by the Ministry of Agriculture *provides a comprehensive framework for reforms in agricultural marketing*. Although the model Act was circulated to the States in 2004, only few States (A.P., H.P., M.P., Punjab, Rajasthan, Sikkim and Nagaland) have introduced the necessary amendments in their extant APMC Acts. The **slow pace of legislations in the states** has become a hindrance in inducing the necessary investments in marketing infrastructure. The main areas of reforms arising from the Model Act relate to the following provisions :
- (a) Permission for direct sale (and purchase) of agricultural produce,
 - (b) Permission for forward contract in agriculture/contract farming,
 - (c) Single point (market) levy within the state,
 - (d) Permission to private sector to set up (modern) markets, and
 - (e) Public-private-partnership in construction, financing, operation and maintenance of mega/terminal markets.

- 2.2.2.5 Trade volumes in agriculture *vis-à-vis both inputs and outputs* have been increasing enormously over the years. **Mega/ Terminal Markets** with public-private-partnership may be promoted for horticulture products, livestock and agricultural outputs and inputs etc.
- 2.2.2.6 Under the ‘*Scheme for Development/Strengthening of Agricultural Marketing Infrastructure, Grading and Standardization*’ being implemented by the Ministry of Agriculture (November 2004), an **investment subsidy** of 25% of the capital cost up to Rs.50 lakh on each project is allowed for providing ‘direct’ service delivery to producers/farming community in post-harvest management/marketing. This may be expanded to include *development of mega/terminal markets*. Such markets when developed through public-private partnership should also be given the support under the ‘**Scheme for Support under PPP in the Infrastructure Support**’ being implemented by the Ministry of Finance (Government of India).
- 2.2.2.7 Towns and cities serve as markets for agricultural produce and also serve as centres for sale and purchase of inputs of various kinds by people residing in both rural and urban areas. Earmarking of areas for development of mega markets near cities should be an important part of the land use/ ‘zoning norms’ of the City’s Master Plan.

2.2.3.0 RECOMMENDATIONS

- 2.2.3.1 States that have not amended their extant APMC Acts should amend the same with speed in the light of the **Model Act**.
- 2.2.3.2 *Development of market infrastructure* should be included under the National Urban Renewal Mission (NURM).
- 2.2.3.3 Development of mega/terminal markets through *public-private partnership/ private finance initiative* should qualify for support under the ‘**Scheme for Support under PPP in the Infrastructure Support**’ of Government of India.

2.2.3.4 Earmarking areas for development of mega/terminal markets should be an important component of the land use/ 'zoning norms' of the City's Master Plan.

2.3.1.0 **BOTTLENECKS IN FORWARD TRADING**

2.3.1.1 **ISSUES**

- Unsatisfactory (price) risk management in agriculture.
- Underdeveloped commodity exchanges.
- Non-negotiability of warehouse receipts.
- Restrictions on mutual funds/banks to participate in commodity future trading.
- Prohibition on *option trading* in commodity futures.

2.3.2.0 **BACKGROUND**

2.3.2.1 Agricultural *products and minerals* are observed to exhibit big variations in prices as they are subject to wide fluctuations in *supply and demand*. Buyers, therefore, tend to hedge against *high prices* and sellers need to hedge against *lower prices*. **Forward and future contracts provide a way out to hedge risks arising from price fluctuations.**

2.3.2.2 'Forward contract' is an OTC (over-the-counter) agreement between the buyer and the seller and the contract is usually in regard to *both price and quantity*. It is *customized* and is *collateral based*. Neither the buyer nor the seller can transfer the contract to another party. **In the context of agriculture, this may very well include 'contract farming'.**

2.3.2.3 'Future contract' is a standardized tradable contract; the terms and conditions of contract are set in advance by the commodity exchange. Commodity futures in India are traded both on various commodity exchanges as well as on online exchanges, such as, *the Multi-Commodity Exchange (Mumbai), the National*

Commodity and Derivatives Exchange (Mumbai), the National Multi-Commodity Exchange (Ahmedabad) and the National Board of Trade (Indore).

- 2.3.2.4 *Credibility of contract* comes from *the guarantee* provided by the exchange. The commodity exchange in turn makes it binding on the negotiating parties to deposit *margin money* equivalent to a certain percentage of the value of the contract. In case of insolvency, the responsibility of honouring the contract dovetails fully on the commodity exchange. With a view to reduce such (replacement) risks, the exchange have the system of '*daily settlement*' and the *margin money* for the negotiating parties is adjusted on a daily basis based on the current price (of the underlying commodity) prevailing in the futures market.
- 2.3.2.5 Risk arising from fluctuation in prices is hedged by the buyers or sellers either (a) through locking-in *at a particular price* now for delivery in future or (b) through *offsetting the price risk* in the 'spot market' taking an equal and opposite position (buying against selling) in the 'futures market'. Commodity exchanges allow for both kinds of settlement in future contract, that is, settlement both through *physical delivery* and through *settlement in cash*.
- 2.3.2.6 The speculators/ (locals)[□] are not interested in physical delivery; their intention is to earn profit from changes in the prices of the underlying asset. In the case of hedgers (buyers/sellers), as well, it is found more convenient to *close out the future position through cash settlement* and buy or sell a commodity separately.
- 2.3.2.7 Until **recently, futures contract in as many as fifty-four commodities were prohibited**. Now futures trading are allowed in all commodities. While the Forward Markets Commission (FMC) under the **Forward Contracts (Regulation) Act, 1952** regulates *the commodity exchanges*,

□ Locals are brokers who act on their own behalf, rather than on behalf of buyers and sellers.

the elected executives of the commodity exchanges supervise the market participants (brokers, hedgers and speculators).

2.3.2.8 Forward trading in futures, however, suffers from a number of limitations like *closed nature of membership of the commodity exchanges, inadequacy of standardization (and grading) system, absence of reliable storages for ensuring quality, lack of negotiable warehouse receipt system and lack of adequate credit.*

2.3.2.9 Lifting the ban on ‘futures’ *in all commodities* poses a real challenge for the government/regulator to ensure successful operation of commodity exchanges.

2.3.3.0 RECOMMENDATIONS

2.3.3.1 Since ‘mandis’ are centres of price discovery of ‘spot prices’, these could be looked at as the starting point for trading in commodity futures. Major mandis could be linked to national commodity exchanges. It may, therefore, be made mandatory for ‘mandi’ operators to have **electronic price boards** to display prices of *both spot and futures markets transparently**.

2.3.3.2 Necessary measures may be taken to improve the functioning of most of the **commodity exchanges** for *efficient clearing, settlement and guarantee systems* as well as to establish new exchanges. **Market regulation** may be further strengthened to ensure the right kind of relationship between ‘**spot price**’ and ‘**future price**’ and to provide greater credibility to commodity exchanges.

2.3.3.3 Commodity futures markets function best when efficient storage is possible and trading is supported by well functioning credit system. World over banks are observed to be active members on the clearinghouses (of the exchanges) and for

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lending money to hedgers/investors, The Banking Regulation Act (1949), however, does not permit banks to deal in commodities and commodity derivatives. The Banking Regulation Act, therefore, needs to be suitably amended. Desired amendment in SEBI (Mutual Fund) Regulations, 1996 may also be made to enable mutual funds to invest in commodity markets.

2.3.3.4 With a view to provide protection to farmers against fall in futures prices, they could be allowed to participate in options in the commodity exchanges. As such, if the future price of the underlying commodity happens to be lower than Minimum Support Price (MSP), the farmer will not be bound to sell under the option contract in the futures market. **However, Section 19 of FC(R) Act prohibits 'options'. The Act could, therefore, be suitably amended.**

2.3.3.5 A comprehensive *legislation on warehousing* needs to be introduced on the line of the Indian Multi-modal Transportation of Goods Act (1993) to provide to warehouse *receipts* (WR) attributes similar to bill of lading, namely, *title to the goods, rights and liabilities of the holder and the warehouse keeper and (its) negotiability.*

2.4.1.0 BOTTLENECKS IN TRANSPORTATION OF GOODS

2.4.1.1 ISSUES

- Multiplicity of controls & checks in movement across state borders.
- Lack of uniformity in rates of road tax amongst states;
- Cumbersome procedure for granting 'permits' to commercial vehicles.

2.4.2.0 BACKGROUND

2.4.2.1 Commercial vehicles moving across state borders face *multiplicity of checks* at the hands of *different authorities* relating to payment of central sales tax, *road tax and permit fee* as well as on account of various other restrictions arising from forest conservation and security etc.

- 2.4.2.2 Movement of motor vehicles is regulated under the Motor Vehicles Act, 1988 and the Central Motor Vehicles Rule, 1989. Currently, the motor vehicles regulations *distinguish between commercial and non-commercial vehicles*. While the latter can move unhindered through the length and breadth of the country and are required to get their registration renewed generally only after 15 years, the transport vehicles are required to pay for the **road tax** and obtain 'fitness certificate' *on an annual basis*.
- 2.4.2.3 Under the Constitution of India, both 'road tax' and 'permit fee' are to be levied and collected by State Governments. There is, however, a great deal of disparity in these rates amongst states. The commercial vehicles can, moreover, move only within the state as mentioned in the 'permit' *or else obtain a new permit for movement to another state*.
- 2.4.2.4 The Motor Vehicles Act (1988) provides for **National Permit** for movement across state borders under which the applicant has to apply for permit for at least 4 states. The transport operator thus pays the '**road tax**' and '**fee for permit**' for all the concerned states in the registering state and the (fee & tax) collecting state issues receipt in respect of the payments received for each state separately. *The registering state is responsible for remittance to the concerned states*. The Central Government has been encouraging states to set up (zonal) **clearing houses** to reconcile their claims against each other and not to demand payments for tax and fee in the form of 'drafts' from truck drivers at the border check posts.
- 2.4.2.5 The **Transport Development Council**, which is the apex body on road transport sector in India deliberated on the issue of bringing about uniformity in the rates of road tax and permit fee amongst states during its last meeting. No consensus could, however, be reached as some states apprehended loss of revenue.
- 2.4.2.6 Inland Water Transport (IWT) is one of the *cheaper and more energy efficient* modes of transportation. Cost of transportation under inland water transport is

observed to be 25-50 per cent less than other modes of transport. This has provided an edge in competitiveness to countries as far away as U.K., China, Germany and USA. While transportation of goods through inland water transport is as high as 42 per cent in Germany and about 15 per cent in USA and China, it is as low as 1 per cent in India.

2.4.3.0 RECOMMENDATIONS

- 2.4.3.1 Payment of both road tax and national permit fee on commercial vehicles may be replaced by levy of a uniform surcharge on petrol and diesel. This might be extended to non-commercial vehicles as well. This system would be free from administrative hassles and would be rational since the amount collected would depend upon the extent of use of the vehicle.
- 2.4.3.2 The amount of surcharge collected by the retailers/dealers on petrol and diesel might be transferred to the state in which the tax is collected, in the manner of sales tax/state VAT collection. This would also do away with the upfront payment of road tax on purchase of new cars/other vehicles, *reducing in the process the cost of acquisition of these vehicles.*
- 2.4.3.3 With a view to encourage greater use of multi-axle vehicle that reduce wear and tear on roads, the Government of India may charge lower rates of CENVAT/excise duty on these vehicles compared to other vehicles.
- 2.4.3.4 The on-going programme of the front-end and backend computerization of RTOs including issuance of Smart Card based documents for DL and RC should be strengthened to reduce detention time for various types of checks on inter-state movement of vehicles.
- 2.4.3.5 In view of the Inland Water Transport (IWT) being *more energy efficient* than other modes of transportation (in the range of one-half to one-fourth of other transportation costs), all efforts should be made to fully utilize the inland water ways potential in the country.

2.5.1.0 **BOTTLENECKS IN RETAIL TRADE**

2.5.1.1 ISSUES

- Inadequate Credit Availability.
- Absence of Zoning Laws.
- Lack of Market Centres.
- Multiplicity of License/Registrations
- Predominance of Unorganized Trade.
- Absence of Franchise Law.

2.5.2.0 **BACKGROUND**

2.5.2.1 Retail trade is the major segment of the trade sector in India. Most of the *retail trade* (96-98%) comes under the *unorganized sector that comprise own account enterprises that do not maintain regular accounts and whose activity are not covered under the provisions of labour laws.*

2.5.2.2 A typical trading system of a *manufactured item* has the following distribution channel: (a) carry and forward (C&F) agent, (b) the stockiest, (c) the wholesale traders, zone-wise and (d) the retailers, area-wise. Trading in agricultural *produce* may, however, differ significantly from this system as the produce has to be first collected from a large number of small producers and only then brought in the distribution channel.

2.5.2.3 While *wholesale trading* involves business-to-business dealing, *retailing* involves a transaction between a seller and a consumer. 'Wholesale trade' as a category is, however, much smaller to 'retail trade' in India. According to the NSSO-CSO Survey (1996), the '*Own Account Enterprises*', that is, units owned and operated without the help of any regularly employed or hired worker constituted **ninety percent** of all retail trade. The *Non-Directory Establishments*

employing five workers or fewer constituted nine **per cent** and the balance **1-2 per cent** of the retail trade belonged to the category of *Directory Establishments* employing 6 or more workers.

2.5.2.4 Most of the problems faced by retailing in India stem from it being largely in the unorganized sector. While the share of trade in GDP is as high as 13 per cent, *its share in total advances by the organized banking sector is as low as 6 per cent. Loans allowed by commercial banks/financial institutions* to retail traders usually extend to a short period of 3-5 years. An interest rate of 11 per cent has to be paid on loans upto Rs.2 lakh, without any collateral. For loans that exceed Rs.2 lakhs and have no collateral, the interest charged is higher. So far, there is no long-term facility for retail traders from commercial banks/FIs.

2.5.2.5 There is a need to allocate more space for *market centres* through enactment of appropriate '*zoning laws*'/*zoning norms* in all urban settlements across the country. Necessary reforms are also called for vis-à-vis *rent control laws* and *stamp duties* that have been inhibiting the real estate development. **Out of the total 5161 urban settlements in the country during 2001, hardly 1200 of these were observed to have urban planning/ Master Plans.**

2.5.2.6 While India has one of the highest number of retail outlets per capita in the world, the per capita retail space is the lowest (<500 sq.ft.). Similarly, while the standard ceiling of retail a shop globally is 14 feet high, it is usually 9 feet high in cities and towns of India. Due to poor ambience of our market places, we have failed to attract tourists in larger numbers. The expenditure incurred by foreign tourists, out of the total amount spent, is much lower in India (20%) in comparison to other destinations (60%).

2.5.2.7 Hardly 2-4 per cent of retail trade comes under 'organized retailing'. 'Organized retailing' has multiple formats like *supermarkets, hypermarkets, discounters, convenience stores, small outlets and warehouse clubs*. 'Organized 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 names and methods as a joint venture. *There is, however, absence of a 'franchise law' in India for dispute settlement.*

2.5.2.8 Development of '**organized retailing**' leads to value migration from wholesale trade to retail trade *through better management of backend activities such as sourcing and inventory management and strengthening the frontend functions of merchandising, storages (refrigeration), promotions and customer services.* Organized retailing may benefit the small sector through *placing orders with them (entering into forward contract)* and providing brand name to these products.

2.5.3.0 RECOMMENDATIONS

2.5.3.1 It should be made mandatory for the municipal administration in all townships and cities to introduce urban planning. Zoning laws/land use norms in urban settlements should be an essential feature of urban planning. Since urban settlements cannot be 'static, *zoning norms/use of zones should, moreover, be periodically reviewed.*

2.5.3.2 *Markets often come up by the side of roads.* It appears to be a universal phenomenon. *Recognizing the overriding importance of commercial activity in these markets and the huge investments made in shops and buildings,* municipalities in various countries have stopped vehicular traffic on these roads. Municipalities in India may also be encouraged to adopt this cost-effective approach of **developing market centres/shopping malls** through providing alternatives routes.

2.5.3.3 Municipal authorities may be encouraged to simplify rules and provide the facility of a **single window clearance** for registration to aspiring retailers. Use of computers, barcodes and better storage facility may also be encouraged.

2.5.3.4 There is an urgent need to improve availability of credit to the retail sector, both long term and short term. Favourable credit policy may be formulated that reduced the interest burden on retailers. The retail traders may also be extended the facility of **Credit Cards** on similar lines as the Kisan Credit Cards and the Laghu Udyami Credit Cards.

2.5.3.5 A comprehensive '**franchise law**' may be enacted at the earliest to promote 'Organized Retailing'.

2.5.3.6 A Government programme for *hawkers/vendors and squatters* under unorganized retailing, may be launched to help them acquire *better transport, other equipments and know-how*.

2.6.1.0 FISCAL BOTTLENECKS

2.6.1.1 ISSUES

- Introduction of state VAT in all states.
- Phasing out/withdrawal of Central Sales Tax.
- General ban on imposition of 'entry tax'.
- General ban on imposition of 'octroi'.

2.6.2.0 BACKGROUND

2.6.2.1 Trade and commerce *within a state* comes under the State List of the Constitution of India. The state sales tax is, therefore, a state subject. It is also the main source of revenue of the states. The state sales tax system has, however, been beset with multiplicity of rates, lack of simplicity and differences across states in rates. All these have had adverse impact on trade and industry.

2.6.2.2 With a view to facilitate reforms in the state sales tax, the Government of India set up an Empowered Committee of State Finance Ministers (ECSFM) in November

1999 to monitor sales tax reforms. Breakthrough was achieved in January 2000 when a system of *uniform floor rates of sales tax* on most of the items important for inter-state trade was introduced. This reduced considerably the rate war amongst states.

- 2.6.2.3 The ECSFM has since then been meeting as often as possible. It was subsequently decided to implement *state VAT* in all the states from April 2005. State VAT was finally introduced in all the states from December 2005, *barring U.P., Tamil Nadu and Pondichery*. Under the state VAT system covering 550 goods, there are two basic rates of 4% (about 270 goods) and 12.5% (for the remaining goods).
- 2.6.2.4 While filing of tax returns would be **compulsory for registered dealers** (*with turnover above a threshold*), it would be **optional for small dealers and retailers** who may pay (sales) tax under the composition scheme (that is, as a percentage of their gross turnover). According to some estimates, 75% of the dealers would thus be out of the system of state VAT.
- 2.6.2.5 The value added tax (VAT) is a multi-point tax imposed on '*value addition*' at each stage, which is calculated as the difference between the purchase price and the sale price. VAT has to be paid on the sale price; **allowing for the "set off" on the tax paid earlier**. The '*invoice*' of the input purchased earlier provides the *claim on tax credit*, which may be deducted from the tax liability on the sale price.
- 2.6.2.6 Since the prevalent multiple rates of sales taxes would be replaced by uniform rates, it involves **reduction as well as increase in rates on different items**. In view of the apprehensions expressed by a large number of states about possible **revenue loss** in the initial years of introduction of VAT, the Central Government had agreed to compensate 100 per cent of the loss in the first year, 75 per cent of the loss in the second year and 50 per cent of the loss in the third year of introduction of VAT (Budget Speech of the Finance Minister, February 28, 2003).

The data on tax receipts for (all) states put together, interestingly, shows an increase in sales tax collection by 27 per cent in 2004-05 over 2003-04 (Annexure).

2.6.2.7 Under the Additional Excise Duties Act 1957 (Goods of Special Importance), it is the Union Government that imposes Additional Excise Duties *on sugar, textiles and tobacco* in lieu of *sales tax by the states*. This is to be reviewed to bring these items under the state VAT.

2.6.2.8 Consequent to the enactment of the Central Sales Tax (CST) Act in 1956, central sales tax (CST) was imposed at the rate of 1 per cent on *inter-state sale of goods*. The CST was progressively increased to 4 per cent. The CST raises the sale price of an item in the consuming state, in comparison, to that in the manufacturing state. The CST under the new situation has become anarchic as it does not provide for tax credit on inputs; it is considered an output tax when the item concerned may be used as an input in the state. The CST is proposed to be phased out in stages and brought down from 4 per cent to 0 per cent over a period of three to four years.

2.6.3.0 RECOMMENDATIONS

2.6.3.1 Implementation of state VAT in the remaining states of U.P., Tamil Nadu and Pondichery may be expedited. A *consistent commodity classification* for the items covered under state VAT should be developed *at the earliest* to ensure uniformity in rates.

2.6.3.2 Phasing out of Central Sales Tax (CST) may be started without further delay.

2.6.3.3 'Entry tax' is stated to be unconstitutional, unless it is imposed to give protection to local manufacturers against discrimination from imported goods due to lower taxes charged in the exporting state. Possibility of discrimination has been removed with the introduction of *uniform rates* under the state VAT system. A general consensus must therefore be built against imposition of 'entry tax' by the states.

2.6.3.4 Municipalities may be asked to withdraw 'octroi' on goods and passengers entering their localities. All border check posts intended to enforce payment of 'octroi' should be dismantled. States may compensate the municipalities for the consequent loss of revenue from out of the general increase in their revenue receipts. Places of 'tourist' interests may, however, impose a toll tax on incoming taxis/cars/tourist busses for better upkeep of the locality.