CHAPTER XXIV

FUTURES MARKETS

Forward dealings in jute and cotton came into existence in Calcutta and Bombay respectively as they are two of the most important cash crops and the concerned industries are located in Bengal and Bombay. The futures market in cotton was reorganised following a crisis after the Great War. There is thus a difference as between cotton and jute. India is one of the main textiles manufacturing country in the world and an exporter of textiles. She exports indigenous cotton as well as imports certain types of foreign cotton. Hence the need for keeping up with world market trends becomes a necessity. On the other hand, in the case of jute, the trade in which India held a near monopoly, the mill industry was always opposed to organised forward dealings in jute and even in jute manufactures. (*Vide* Mr. Todd's Report 1944). It is only after partition that the I.J.M.A. have accepted in principle the need for a futures market in jute and jute goods.

History of Futures markets in jute.

In 1925 when there was a short crop of jute the *Fatka* market was closed as the working of such a market tends to push up raw jute prices. There was a demand for creating a futures market in jute on a properly organised basis. The East India Jute Association was started for this purpose. A few witnesses who appeared before us have complained that this association was not allowed to function properly owing to the hostility of jute mill interests and European trading interests generally. The State Governments were reluctant to accept the views expressed by the Trade and so invited Prof. J.A. Todd to study and report on the working of a futures market for jute. Mr. Todd's final report was ready in 1944; but due to the intervention of war no action was taken on that report. Owing to the general dwindling of trade activities during the war period as distinct from mill production which was stepped up on account of Government orders, the forward markets remained moribund. In 1945 the East

India Jute Association and the Calcutta Hessian Exchange which controlled the markets for jute and hessian respectively were amalgamated into the East India Jute and Hessian Exchange and dealings were started in hessians and B. Twills. The raw jute section did not become active till about 1947. After the withdrawal of the control on jute and jute manufactures, under the Defence of India Rules in September 1946, business increased. But there was a sharp rise in the price of jute and jute manufactures with the partition of India. Because of the shortage in the supply of raw materials and the apprehended activity of speculators, mill interests began to press for closure of the futures market. Shri H. P. Bagaria of the East India Jute and Hessian Exchange stated that they had done their best to alter the terms of the basis contract and to fix limits within which dealings should be permitted. He averred that the activities of other associations dealing in raw products who had also entered the field of forward trading in jute, was primarily responsible for the stoppage by W. Bengal Government (*vide* Ordinance X of 1948—Act XXV of 1948, Appendix IX) of all forward dealings in raw jute with effect from September 1948. The jute goods section of the market maintained by the East India Jute and Hessian Exchange continued to function, but during 1948 normal forward markets could not work satisfactorily owing to shortage of goods.

Matters were brought to a head by devaluation when prices of gunnies rose steeply in non-sterling areas. To meet the threat to production costs by shortage of indigenous raw materials and to avoid excessive competition for indigenous raw jute as well as for the small quantities imported from Pakistan, the West Bengal Government fixed a schedule of maximum prices for raw jute—*vide* Ordinance VII of 1949 (*see* Appendix X). As Indian jute goods were still short of world demand their export was regulated by quotas as there was a risk of prices being pushed up very high due to shortage of raw material. Besides fixation of prices of raw jute, regulation of prices of jute goods also became necessary. The Government of India fixed the maximum prices for jute goods for export—(*vide* Commerce Ministry Notification of 10th October 1949—Appendix XI). During the period as the Central Jute Disposals Section of the I.J.M.A. which was formed to look after the orderly distribution of raw jute, particularly imported supplies, did not succeed in regulating the intake of jute mills, the West Bengal Government set up a statutory board (*vide* Ordinance VII of 1950) to regulate contracts for sale and supply of raw jute. As a complementary measure to check speculative purchases in the market, the forward market in jute goods was also banned (*vide* West Bengal Act V of 1950, Appendix XII). It was in this context that devaluation had taken place with the consequences we have referred to, in the jute goods market. With greater availability of jute goods and raw materials and adjustment of world demands came decontrol of prices of jute and jute goods, and later abolition of destinational quotas took place. With improvements in the situation as regards availability of raw jute and jute goods the ban on futures was also lifted on 26th April 1952. The Indian Chamber of Commerce and the East Indian Jute and Hessian Exchange seem to have made representations on this subject and on the reopening of the futures trading, the latter body started business with a broadening of the basis for its directorate including representatives of the Indian Chamber of Commerce. After the market had been opened for two contract periods August 1952 and November 1952, occurred a period of feverish speculative activity in the closing week of November 1952 which led to the closure of the futures market in jute goods again (*vide* Ordinance XVII of 1952, Appendix XIII). Meanwhile as the original ban in terms of the Ordinance X of 1948 was held to apply on to futures trading in jute in *pucca* bales, the India Futures and Forward Markets Association and certain other bodies started a forward market in loose jute. As this was held to prejudice the effect of the closure of futures market in jute goods and the matter had been referred for advice by this Commission, Government also passed orders banning futures in loose jute also under section 17 of the Forward Contract (Regulation) Act 1952 *vide* Commerce and Industry Ministry Notification No. 2(24) Jute 53 dated 29th October, 1953 (*vide* Appendix XIV).

Katni market.

The stoppage of forward trading does not however appear to have put out of business unrecognised markets carrying on speculation. We have been informed that in the so-called *Katni* market business is often conducted in vacant plots and street corners. The business is not conducted under any definite rules and regulations of an association and the basis of business does not require delivery against contracts. All outstanding transactions are settled at the end of the day at a rate fixed by those in charge of the market. The rates fixed are supposed to be on the basis of price of B. Twills bags as prevails in the gunny trade. The *Katni* market is also reported to have gone in for dealing in hessians and loose jute with similar daily settlements. *Katni* is apparently pure gambling which the arms of the law are yet unable to root out. None of the trade associations who have replied to our questionnaire have been able to assess the extent of the transactions in this illegal market. Others had complained that with the closing of the regular futures market, those who were speculatively minded have turned to *Katni*. Since business its purported to be done on the basis of prevailing market rates, the artificial ups and downs in these *Katni* rates can have a harmful effect on price stabilisation in the regular market, where the possibility of some sections of the industry also operating through *Katni* cannot be ruled out. We are strongly of opinion that every step should be taken by Government to stamp out altogether *Katni* and other irregular markets.

Report of Mr. J. A. Todd.

Mr. J. A. Todd of the Liverpool Cotton Exchange whom the Bengal Government invited to study and report on the conditions of futures trading in jute, made a preliminary study in the autumn of 1940 and gave an interim report on the working of the jute futures and hessian futures markets in February 1941, a report on the same subject covering the period March to December 1941 in 1942 and a further report on the subject in March 1944. Mr. Todd was of the view that conditions of supply and demand in regard to jute, make it peculiarly suitable for a future market. It is a seasonal crop of large volume the bulk of which is sold by primary producers over the latter half of the year and not being perishable, can be stored and be carried over. He has pointed out that "much of the objection to the use of the jute futures market is due to the claims(1) that the trade has never used futures and has done very well without them, (2) that the need of a hedge is met by the present system of forward sales to the bazar, and (3) that the futures market in the past has been so completely dominated by speculation of the worst kind that it has been useless as a hedge". From the point of view of the mills, who generally used to buy a considerable part of their requirements in the autumn, he suggested that even if they were to buy three months' consumption instead of six or nine as was formerly the general practice, they could cover the risk of a later rise in jute price by buying in future months for part of their seasonal requirements. If prices subsequently fell they would be able to buy the actual jute at a lower price to cover the loss on their futures. The advantages would be to reduce the dependence of the mills on the bazars which they have been using as a hedge, reduce their amount of capital requirement to finance raw jute purchases and give them longer time to wait for sale of their output to shippers or genuine merchants. For the mofussil merchants and *kutcha* balers the advantage of hedging over purchase of loose jute by an immediate sale of futures for more or less distant months would cover the risk of a falling market. He has pointed out that only *pucca* balers had so far mainly used the futures market for hedging purposes.

The defects of the working of the futures market as observed by Mr. Todd were that the *pucca* bale contract (L.J.A. first marks) was too narrow and therefore enabled the market to be cornered. This basis was useless for producers or purchasers of *kutcha* bales, that the system of tendering was practically non-existent and that the great bulk of the business transacted was speculation of the worst kind and not genuine hedging business (*Gadri* and *Katni* markets were the worst sinners). The remedies proposed therefore included the following recommendations:—

(1) The establishment of an Indian Jute Federation representing every interest in trade and industry as well as of growers and State Governments which would have the exclusive control of the jute exchange which will actually operate as the futures market both for jute and gunnies;

(2) Membership of the exchange should be open to every individual or firm actually engaged in the jute trade, a substantial deposit of Rs. 50,000 being required from each member and brokers to be similarly admitted and licensed on payment of a deposit. The existing Indian Jute Association should be permitted to do business on the above basis.

(3) The contracts to be dealt with should include a loose jute contract of, say, one thousand maunds as well as the existing pucca bale contract for 250 bales. The

grade deliverable under each should be clearly defined. For the former, the basis should be Indian Jat middles and for the latter L.J.A. first marks, with other varieties and grades tenderable at points on or off the basic price. All types and grades tenderable against the two contracts must be represented by standard boxes exhibited in the exchange and used by arbitrators. There should be four monthly contracts always current for each contract, *e.g.* September, December, March, and June, with possibility of double monthly contracts such as August-September, November-December etc.,

(4) To check undue speculation, limits should be imposed on the interest of each broker or of each client, a deposit of, say 10 per cent., on the contract value being obligatory; limits should also be set on daily price fluctuations permitted say 3 per cent.;

(5) Settlement of margins should be weekly instead of fortnightly;

(6) Futures trading to be confined to business hours and to the business premises of the exchange cnly.

(7) All contracts between members or between members and non members should be in writing and registered with the exchange authorities;

(8) A limit to be imposed on the daily price fluctuations as a percentage of value, say, one anna in the rupee;

(9) Brokerage should be fixed on a compulsory and percentage basis;

(10) A new standard for loose jute to be established by the Federation with suitable price differentials for these grades as distinct from the basic grade to which the contract price applies.

In regard to the hessian futures market, Mr. Todd ruled out the argument that the futures market in a manufactured article is self-condemned. He noted with approval that the fact that probably 75 per cent. of the output of mills in India is sold ahead under to merchants or dealers in the bazar, and the circumstance that the *pucca* delivery orders issued by mills circulated in the bazar like negotiable documents of title if no shipping instructions had been given for the goods on the due contract date, were convincing grounds for requiring a hessian futures market for hedging. Having studied the working of the Calcutta Hessian Exchange his criticism was that though the regulations provided the necessary structure for an organised market, their working was not satisfactory, that of the four contracts for hessians 40″×8 oz., 40″×10 oz. B.T. will 44×26½ and Australian corn sacks all but the first had gone out of use and the operation of a single basis was undesirable, that there should be at least two contracts, one for hessian and the other for heavies, each with the necessary options, and that the hessian future market should also be brought under the same control as the raw jute futures market, *i.e.*, the Indian Jute Federation, and carried on in the same premises and same conditions as to membership, contracts, tender, arbitration and restrictions on daily fluctuations. While it was contended at that time that the monopolistic position of the mills was a factor exposing the futures market to dangers, the conditions have changed substantially by the growth of competition in the overseas market where 80 per cent. of the Indian mill output has now to be sold.