

CHAPTER XXV

THE NEED FOR A FUTURES MARKET

Theoretical
basis for
forward mar-
kets.

We have been asked to recommend what steps should be taken to put down malpractices in certain quarters of the jute industry, i.e., attempts to rig up or depress prices, and to ensure that the jute export trade is not affected by such manipulations of interested persons. We have also been asked to survey the problem in the context of the action taken by Government in closing the *Fatka* market in Calcutta in December 1952. Periodically in the past, such punitive action had been taken in respect of futures market in raw jute and jute goods. This has made it necessary for us to obtain the opinion of all sectors interested in jute trade and industry on the question whether a futures market is necessary or desirable for raw jute and jute goods and if so, what would be its best organisational form so that irregularities of the type that have prevailed, can be obviated.

An organised futures market has always been considered in theory as a necessity in certain conditions of trade. Its requisities are thus described in Marshall's *Industry and Trade*-vide Book II.V.3.

“An organised market is one the proceedings of which are formally regulated. As a rule those who deal in it are virtually a corporation: They elect new members and also the executive of their body and appoint the committee by which their own regulations are enforced. In some cases their status is fixed and their actions are superintended by Government. Their regulations generally provide implicitly or explicitly for the completion of a contract to buy or sell a quantity of a definite commodity at a certain price”.....

“The chief conditions needed for rendering any class of products suitable to be handled in an organised market are, (1) that it be not quickly perishable, (2) that the quantity of each thing can be expressed by number, weight or measure, (3) that its quality can be determined by tests

that yield almost identical results when applied by different officials, assumed to be expert and honest, (4) that the class is important enough to occupy large bodies of buyers and sellers. These conditions are sufficient to render organised marketing practicable. But a fifth condition is required to make it attractive; it is that the class of things dealt in should be generally liable to considerable fluctuation in price." (*Vide Marshall Ibid.*)

All these theoretical conditions are fulfilled in the case of market for raw jute and jute goods and not all types of future transactions can be described as speculation. Thus, when a mill which is attracted to sell forward some part of its output buys an equivalent weight of raw jute, or when a dealer in raw jute who has a contract for delivery of jute to a mill buys against a future contract for jute, he hedges. He does not merely gamble or speculate. In so buying for future, he merely throws on the shoulders of the general market the risks and chances of gain that would have otherwise accrued to him through general market movements outside his own business. All such legitimate speculation is in fact a type of market insurance.

The common argument against futures markets is that dealers arrange to keep down prices of jute just after the new season crop begins to come in and raise the prices later on. Where there is a futures market it contended that they are liable to be sold down and prices are thereafter raised later in the season so that neither the grower nor the consumer (the mills) gain from such rise. As in other produce markets, the chief form of manipulative speculation in the jute and jute goods market also is to create false opinions as to the conditions of demand and supply. Pronouncement of speculators as regards the size of the new crop plausibly drawing attention to weather conditions and overseas demands or starting rumours as regards new orders expected from Government or foreign buyers, are typical of the kind. Even in organised markets abuses are possible by the action of unscrupulous men as above if aided by the folly of ill-informed speculators. But these are preventible by proper regulation of the conditions of trading and would not detract from the advantages of having a regulated futures market. These advantages proceed from the fact that "the fundamental effect of speculation is to promote the establishment of

the equilibrium of demand and supply. It tends to make the daily market prices conform to seasonal market price such that the whole seasonal supply is disposed of". (Taussig. Principles of Economics, Chapter XI, Part I.)

Opinion of
Chairman,
Calcutta
Stock Ex-
change.

Supporting the case for starting a futures market for jute goods Shri B. N. Chaturvedi, Chairman of the Calcutta Stock Exchange, has stated :

"Judged by the various criteria which would constitute a proper *raison d etre* for it, a futures market in raw jute may be viewed as neither necessary nor desirable in the present circumstances of the day. These criteria may be stated to be: (i) self-sufficiency, (ii) well-defined standards, and (iii) accurate forecasts.

(i) So far as self-sufficiency is concerned, the country is now far from it. Yet self-sufficiency is a condition essential for the efficient and healthy working of a futures market. For sizable portion of the requirements of its mills the country depends on supplies from a foreign country. The existence of a futures market in such a circumstance would afford the foreign interests an opportunity to manipulate prices movements in our market in such a way as would enable them to tip the balance in their favour to the grief and mortification of Indian interests.

(ii) A proper grading system is also an essential pre-requisite for healthy working of a futures market. But since the partition of the country there have been no well-defined standards for raw jute. Neither is there a proper test-house for the grading of jute. As a result malpractices have been rampant. So long as these pre-requisites are not brought into being, a futures market will work against the healthy working of the economic system.

(iii) Accurate forecasts are also a basic condition for the healthy working of a futures market. Asservations in regard to crop both in India and Pakistan are unreliable, and this has given long ropes to operators in the futures market to swing the prices widely to the detriment of other interests. Inasmuch as two-thirds of the cost of manufacture of jute goods are represented by the cost of raw material, this aspect of the question cannot possibly be ignored. Inauguration of a system of accurate forecasting of crop is therefore a condition precedent to the establishment of a futures markets.

Vis-a-vis the views expressed on a futures market in raw jute, I do, however, consider a futures market in jute goods to be necessary and desirable in view of the following reasons :

(i) For its very existence and stability the Indian jute mill industry depends to a great extent on orders from overseas. But it often happens that when the mills are eager sellers, there are no foreign orders. Again, when there are lots of foreign orders flowing in, the mills are no sellers at all. To circumvent such a circumstance, there must be intermediary agencies to absorb the mills production and cater to the requirements of our overseas buyers, as and when either of them is in the market. For smooth functioning of such intermediary agencies there must be sufficient holding power or ready availability of hedging facilities. Inasmuch as credit required for the former purpose being of gigantic proportions and the same being dear too nowadays, the necessity for a futures market in jute goods to provide necessary hedging facilities automatically comes in.

(ii) Business in forward delivery is now an integral aspect of trading in the gunny market. Large volume of business in jute goods with forward deliveries takes place every day. As such, the question of its retention cannot be challenged. But what is needed is proper rationalisation of the futures market in jute goods so that it can function in a smooth and healthy manner. For the attainment of this objective the following suggestions can be made:

- (1) The market must be well-regulated and all interests in the trade and industry should be represented on the Board of control for such a market.
- (2) In view of the fact that the standard of jute goods has considerably fallen in recent years and our overseas customers have often times complained about quality, there should be a proper Test House to test the quality and specifications of the goods, so that malpractices may not be resorted to.

However, the main essential for proper functioning of a futures market is co-operation of all the interests involved. This was not present in the past and that, perhaps, was one of the reasons why the futures market in the past did not function properly. Indications at present are that practically all the interests are feeling the necessity of a futures market and to that extent satisfactory conditions for a futures market exist."

In further discussions with us, Shri Chaturvedi has agreed that there are undoubted advantages in a futures market covering both raw jute and jute goods and any factors which favour the growth of adequate resources of raw jute and a degree of price regulation, whether by statute or by agreement in the trade, would render the operation in raw jute markets stabler.

Assessment
of opinions
for and
against it.

Opinion is still somewhat divided on the question whether there should be a futures market for jute and jute goods. The Bengal Jute Dealers Association and the Jute Balers Association have said that a futures market is neither necessary nor desirable either for jute or jute goods. They are unnecessary from the cultivator's point of view as the cultivator in India is not educated nor well-to-do like the American farmer who can realise the advantage and importance of hedging. On the other hand, the great majority of trade associations including the I.J.M.A. who were at one time opposed to futures market have now expressed themselves in favour of it. The I.J.M.A. have stated:

"In the opinion of the Association a well regulated futures market would fulfil a most useful function to those engaged in the jute goods trade, but a futures market which was not well regulated would do more harm than good. In the past a futures market was not essential because shippers and bazar dealers took up the mills production of jute goods. Nowadays the bazar is not taking up goods on the same scale and a well run futures market would therefore be useful to the mills for hedging purposes. In addition to being a convenience to members of the trade such a futures market could also assist in reducing if not eliminating such undesirable gambling operations as are carried on in the *Katni* market. Similarly a futures

market for raw jute would be desirable if it could be well-regulated and confined to those genuinely interested in the raw jute trade as opposed to mere speculators."

The Bharat Chamber of Commerce, the Indian Chamber of Commerce and the Calcutta Jute Fabric Shippers Association support this view. Prominent industrialists like Shri M. P. Birla and Shri K. D. Jalan have suggested that though a future market in jute goods is necessary, in the present situation when indigenous raw jute supplies are not adequate, there is no need for a market in raw jute. The Calcutta Jute Exchange have detailed the advantages to the grower, the middlemen and the ultimate buyer (the mills) in having a proper futures market. As the mills are the only buyer there is no intense competition for raw jute and a futures market will enable higher prices to prevail, taking a view of the season's requirements and the grower will benefit. It provides a livelihood for a large number of middlemen (an argument with which we are not impressed). It provides a hedge to the middlemen who buys jute in anticipation and sells to the mills. It also enables mills to hedge against future orders for jute goods so that fluctuations in costs due to fluctuations in price of the raw material are evened out. Quite a large section of opinion (e.g. the Gunny Trades Association) feel that the existence of a proper futures market would outweigh the various illegal markets which human ingenuity to get round laws have set afoot and prohibitory action by Government has not been able to eliminate them completely.

We have also received from a large number of witnesses a critical appreciation of the way in which futures market in jute and jute goods have so far functioned and how defects to which our attention had been pointedly drawn, could be remedied. The main defects noticed have been the lack of a comprehensive organisation, representing different sectional interests and adequately patronised by the trade and having a standing in the jute market, like the East India Cotton Association in the raw cotton market. There have been a few organisations, e.g., the Calcutta Jute Exchange, the East India Jute and Hessian Exchange, the Indian Futures and Forward Markets Association and the Calcutta Seed and Wheat Association, functioning with a single basis contract and doing only a relatively small business since the war. The

Recom-
mendations.

East India Jute and Hessian Exchange have pointed out that a cardinal requirement for futures business is that only one organised association should be able to function. They have urged that a broad-based association on the lines of the East India Cotton Association, Bombay, should be started and all sections of the trade and industry, e.g., I.J.M.A., Calcutta Jute Fabric Shippers Association, Gunny Trades Association, should be given representation on the controlling body in due proportion to their own importance. Since they have suitable operative regulations this exchange have offered to expand their constitution in this direction. The Indian Chamber of Commerce and the Bengal National Chamber of Commerce have supported this idea.

Both the I.J.M.A. and the Gunny Trades Association have drawn attention to over-trading as being even a more serious defect in these markets, than their unrepresentative character. Various opinions have been received on checking excessive speculation. The Gunny Trades Association and the Indian Chamber of Commerce have suggested that over-trading can be controlled by fixing limits on the business by members and calling up of substantial margin deposits for every additional commitment if the limit is exceeded. As cornering attempts by speculators had proved detrimental to genuine trade, to prevent cornering, they have suggested as a further step, inclusion of a provision in the futures contract for delivery of optional goods at a reasonable discount or premium. It has been stated that in the past it was noticed that certain mills issued P.D.Os. which although not backed up with goods were still tendered against futures transactions and payments were realised. To ensure that D.P.Os. tendered in the futures market are duly backed up with goods they must bear on it the mill stamp of inspection clause or must be accompanied with mill's letter that goods against P.D.Os. are open to inspection at all reasonable time. Without exception all sections of the trade who favour a futures market are inclined to impose these regulating conditions.

The West Bengal Government however have stated that if in terms of the Forward Contracts (Regulation) Act, 1952, a futures market in both raw jute and jute goods is allowed to function under suitable regulations, it will provide hedging facilities to all functionaries in the jute trade,

namely dealers, balers, mills and shippers. They have suggested that such a market would be particularly necessary as recently a futures market in burlap has been set up in New York and as that market will be dominated by buyers, the sentiment is likely to be bearish as far as Indian jute goods and raw jute required for its production are concerned. They have further observed—

“At present there exists a ‘futures’ market in jute goods, viz., the East India Jute and Hessian Exchange Ltd. This institution is, however, not actually functioning these days, due to the ban imposed on futures trading in raw jute and jute goods. This market has its rules and regulations for the conduct of business, and has all the appearance of a regulated ‘futures’ market. But it is not possible for the Government to say whether these rules and regulations are scrupulously observed or if any evasion takes place. This much can however be stated that all sections of the trade and industry, particularly the mills, do not use this market.

This question was gone into in detail in 1941 by Professor Todd who was invited by the late Government of Bengal for conducting an enquiry into the working of the jute futures and hessian futures markets in Calcutta. Professor Todd duly submitted his report and the Commission might consider the recommendations made by him in this context.”

We have carefully considered the above views and the reports of Mr. J. A. Todd and recommend that the establishment of a futures market in jute and jute goods is necessary and for the functioning of such a market a single well knit and regulated association like the East India Cotton Association, Bombay, should be set up. We endorse generally the recommendations of Mr. Todd for the setting up of such a market. We also consider that for the balanced operation of the futures market, dealings in both raw jute and jute goods should be started simultaneously. We have not gone into details regarding the constitution of any associations to run such a market. In the past the East India Jute and Hessian Exchange has functioned to some extent as a futures market. But we suggest that a body with a more broad-based construction representing all interests and with wider bases for business and necessary checks against speculation can be formed by the voluntary co-operation of those in the trade whc

are interested in forward business. Further, as under the Forward Contract (Regulation) Act, 1952 recognition for such association functioning in a forward market has to be accorded by the Forward Markets Commission, it is for those who desire to promote or revive such an association to frame a suitable construction and submit the same for approval of the Commission.

No better
alternative
to check
speculation.

In question 60 we have tried to obtain views on how to eliminate speculative tendencies in the market and with the abolition of a futures market what alternative measures can be considered. The I.J.M.A. have pointed out that the jute trade has always been affected by market manipulations of speculators, and is most affected under abnormal conditions resulting from temporary factors such as the Korean War, variations in the rate of export duties or the existence of controls. The Bengal National Chamber of Commerce even say that speculation in a commodity like jute is both necessary and inevitable. All chambers of Commerce and gunny trade associations are agreed in the view that a price agreement among manufacturers would be impracticable in a buyers market like the present when India has no monopoly for jute goods and has to face keen overseas competition. They also consider that direct export by manufacturers would upset the established channels of the jute trade which were developed over a long period of years. The I.J.M.A. have stated as under:—

“The Indian Export trade in jute manufactures is conducted through an extremely intricate network which has been built up by the regular jute fabric shippers over the past fifty years. If the manufacturers were now to export direct, the overseas contacts which have been built up by the shippers and which are vital to the maintenance of the export markets would be irretrievably lost. From the practical point of view too, direct export by manufacturers would be impossible because individual mills have not the necessary finance and any system of joint export would immediately antagonise overseas buyers and particularly those in the U.S.A. where any form of cartel is anathema. The result would almost certainly be the establishment of central buying organisations as a means of retaliation and the consequence of this in a buyers’ market would be disastrous.”

Trade Associations have also uniformly reacted adversely to any suggestion of State regulation and control of the export trade. The I.J.M.A. point out that in addition to the objections levelled against Mills monopolising the export trade, "bureaucratic methods of business would be quite inappropriate to the trade in jute goods, which above all requires an extremely flexible organisation to deal with overseas markets and to cope with rapid changes in the market situation." In this connection the views of the Committee on State Trading, 1950 (under the Chairmanship of Dr. Panjabrao Deshmukh), may also be referred to: "In view of the fact that 84 per cent. of the output of the jute mill industry is exported, nationalisation of export trade in jute manufactures would virtually carry with it the direct responsibility for the prosperity and well being of the entire industry and of the other interests dependent on it. The demand for jute manufactures though fairly stable in the long run has in the past shown a tendency to fluctuate violently according to the state of economic activity in consuming countries and such fluctuations may call for drastic adjustments in internal prices and production. State intervention at the export stage may hamper such adjustments by shifting responsibility for them from the industry to the State." In view of the above pronouncements and the general hostility of the trade to such suggestions, these alternatives to check speculation have to be ruled out. In a free economy, therefore, we are left with no alternative to allowing the establishment of proper futures markets operating under regulations and conditions approved by Government.