Weekly Notes

The Baby and the Bathwater

WHILE explaining the duties of the Forward Market Commission, Shri W R Natu displayed an ethical bias "which is common among our civil servants who are largely drawn from the non-trading classes.

What Shri Natu says about the rationale of forward trading and of the necessity of regulating such trading through the statutory body of which he is the Chairman are unexceptionable. It is only in taking up a very partial attitude towards speculators that he trips. The sole rationale of forward trading is the provision of hedging. This is an important facility for those who have to carry stocks, in so far as it offers an insurance against price fluctuations. By eliminating some of the risks of carrying stocks, forward trading is also believed to help the grower who may not have the means of holding on for a better price. To what extent, in fact, it does so, however, is not so easy to ascertain statistically. But beyond this, it would be difficult to establish any further claim for forward trading such as that it tends to steady prices over time.

Now the role of outside participation in forward markets can be viewed from two stand points, one that of stabilising prices over time and the other of maintaining the liquidity of the market. The speculator unjustly comes in for blame for causing even wider fluctuations in prices than would be the case had he Kept out. But except for over-trading, that is for taking risks beyond his capacity, he cannot very well be blamed for coming forward and shouldering the risk of price fluctuation which is the essence of forward trading and which gives It its sole justification, Without such outside participation, the market would be narrower and its liquidity will be greatly impaired. So by putting the blame on the outside operator, is not Shri Natu throwing out the baby with the bathwater? The organised markets are there with their rules and regulations to prevent over-trading and the Forward Markets Commission is there to see that these regulations are properly devised and implemented. Why then pick on the speculator?

To ascribe price disturbances to the outside operator is to subscribe to the fatuous theory that it is the successful speculator alone who plays a constructive role by correctly foreseeing the future movement of prices and making the transition gradual and steady, while the unsuccessful speculator who loses his own money or rather should, if the markets are properly run abuses the facilities of forward trading in that he only disturbs rather than smoothens price movements. As a criterion of social behaviour or of conduct in the market, this is not particularly helpful. There is, of course, nothing like leather and no harm in flattering the self-esteem of the professional market operators or in propping up their morale by holding up before them a high conception of their constructive role. But it is hardly necessary for the Chairman of the Forward Markets Commission to believe that this fiction is also a fact. Surely, operators do not participate with the sole object of enabling the farmer to get a better price for his crop. If hedge facilities are abused by persons who have no "direct interest except in making quick money'', to quote Shri Natu, what would happen to forward trading if such trading was to be confined exclusively to producers and consumers? A narrower market, less liquidity and no stabler prices! Surely this cannot be Shri Natu's prescription,

Elucidation of a Complex Problem

'THE combined effects of the Electricity (Supply) Act and the taxation measures on the electricity undertakings in the country are so complicated that it needs an expert to bring them out clearly. From this point of view, if not from any other, Mr K G Milne's speech at the annual general meeting of the Ahmedabad Electricity Company Limited last week was a major contribution. Analysing the working of that company last year, Mr Milne roamed over the entire question of price and taxation policy in respect of the electricity supply industry. Despite the fact that expansion of this industry is basic to economic development. Government policy continues to be rigid and unimaginative. It is true that supply of power should be as cheap as can be; but intense preoccupation with the price at which electricity should be sold to help the consumers should not blind one to the fact that the supplying firms, as long as they are in the private sector, ought to be remunerated sufficiently to make them willing and able to expand.

It may not be possible for Government to go the whole way with Mr Milne and give the electricity companies complete freedom to adjust their rates, But something should be done—and right speedily too to remove the anomalies that have persisted so long in the calculation of the Standard Rate of return and the taxation liabilities of electricity supply companies.

Future of Banks Well Assured

IN his speech at the annual General Meeting of the Central Bank of India last week, the Chairman, Sir Homi Mody made, amongst others, two pregnant observations. He viewed increased public expenditure on development as a major contribution to the increase in the demand for bank credit last year, and felt that in the context of the large investment envisaged under the second Plan, the future growth of banking seemed well assured. It is good to see Sir Homi underlining the close connection between the operations of the public sector and the fortunes of banking institutions — though he could not resist the temptation of saying that had Government not chosen to expand their operations in certain spheres, things would have been even better. One might differ from Sir Homi on that; but one must be thankful that he was not, as Is generally the fashion, bitter or complaining about it.

The second of his significant observations is in relation to the margins available to banks. He took the position, though not explicitly, that the growing scramble for deposits at steadily rising rates of interest was an unhealthy development. A scramble of this sort could, through an increase in lending rates, discourage borrowers more than ,\t attracted fresh depositors. One wishes Sir Homi Mody had been more forthright on this and ueprecated the tendency amongst bankers to consider deposits as highly interest-elastic.