VIEWS

OF

THE STOCK EXCHANGE, BOMBAY,

ON

THE REPORT OF
DR. P. J. THOMAS

ON

"THE REGULATION OF
THE STOCK MARKET IN INDIA"

AUGUST, 1948

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I—INTRODUCTORY

1. THOMAS REPORT NOT FORWARDED OFFICIALLY ON RELEASE : The Report of Dr. P. J. Thomas on "The Regulation of the Stock Market in India" was released for publication by the Government of India on the 26th of July, 1948. Strangely enough, Government did not consider it necessary to forward a copy officially to the Exchange. A special request had to be made by letter and that had to be followed up by a telegram before a copy was made available. It was received so late as on the 12th of August, 1948. Those most affected were thus officially the last advised.

2. GOVERNMENT AND STOCK EXCHANGES MUST CO-OPERATE : Government frequently appeals for co-operation. In practice what is the regard shown for recognised and well-established institutions ? This distant attitude must be revised. There must be full and fair discussion and exchange of views with the stock markets before legislation is introduced. Neglect on this point will be fatal. No legislation will succeed unless it is inaugurated in consultation and collaboration with the Stock Exchanges. This Exchange is and has always been ready to co-operate. It now remains for Government to co-operate.

II—GENERAL REMARKS

3. **UNWARRANTED ATTACKS ON STANDARDS OF COMMERCIAL MORALITY OF THE STOCK MARKET:** Before expressing itself on the Report, the Exchange must at the outset lodge a protest and record its censure of the baseless accusation that "moral standards in the stock market, never very high, have greatly deteriorated" (Ch. VIII, Para 30, Page 111). It is true that the nepotism, bribery, graft and jobbery that corrupt Government services have been recently denounced by the Prime Minister himself. But the honesty, integrity and credit of the Stock Exchange have never been so impeached even by its worst enemies. Transactions involving lakhs and crores of Rupees passing by mere word of mouth have been always scrupulously honoured. Brokers have met their obligations in full notwithstanding heavy losses suffered either in the market or as has happened much more frequently on account of large scale defaults on the part of their constituents. No member has repudiated his contracts as void or illegal no matter what the resulting advantage. These facts are noted in High Court suits and have been publicly acknowledged. The following quotation from the speech of the President of this Exchange delivered as early as on the 29th of October, 1923, is remarkably apposite:

> "Are the members of the Exchange dishonest? Is there any instance in which even a single bank in Bombay has lost any money in its dealings as agents of the investing public with the members of the Exchange as share brokers? Is there any instance of a member of the Stock Exchange having ever repudiated or evaded his contract with a bank or a customer? On the other hand, there are numerous instances in which the public have repudiated their contracts with their brokers or outside brokers with their

customers. During the period of depression following the Great War, a wave of cancellations swept the commercial world. Bombay did not escape the evil consequences of such a wave. Some of the exchange Banks and several mercantile firms lost heavily on the advances against import of piece-goods, etc., from Europe on behalf of their customers. Our spinning and weaving mills had also to come to terms with the parties who had entered into contracts to purchase the goods from them. Throughout the world there was welching on a trade and the evasion of a contract was sought and allowed. If authentic statistics instead of prejudices were to be consulted, it will be found that even during the worst slump, the Stock Exchange met its liabilities to the public to a pie without any failure of importance, whereas its individual members lost heavily owing to the default of their clients. The wave of cancellations never overtook our Association. No group of businessmen other than members of our Association can boast of such high commercial morality."

This tradition has been maintained. Unfortunately, the Report does not forget its facts and decorum only in one passing instance. Even in matters of judgment where differences are only too natural, it loses its balance of mind and language. Referring to the attitude of this Exchange in regard to the slump in prices in May 1947 — on which two opinions were perhaps possible and in respect of which this Exchange has been proved by subsequent events to be overwhelmingly right and the other side overwhelmingly wrong (See Para 26 below)— the Report descends to unfair vilification. Without making so much as an effort to offer corroboratory proof, it has the temerity to charge that the authorities of this Stock Exchange "found themselves ineffective in going against the self-interest of the great majority of their members, *including themselves*" (Ch. VIII, Para 21, Page 108). Such and similar upstart accusations (*e.g.*, at Page iii ; in Ch. I, Para 26, Page 8 ; Ch. VI, Para 19, Page 72 ; Ch. VII, Para 12, Page 89) having no foundation in fact or substance disfigure the Report. Ignorance of facts — of which there are signs in the Report — can be tolerated, but when such ignorance lapses into slander, it ceases to be pitiable. The Exchange is astonished at this want of propriety and must record its deep regret. The report is a public document and there has been gross abuse of a privileged position. It seems but fair that either the charges be made more definite and proved or the mischievous portions withdrawn and expunged from record.

4. THOMAS REPORT A STARTING POINT BUT NOT A BASIS FOR DISCUSSIONS : The Report of Dr. P. J. Thomas offers a starting point for discussions. It can scarcely be accepted as enunciating a body of settled and indisputable facts and conclusions. It is true that the Inquiry lasted over the better part of two years but the difficulties must have been overwhelming. As observed at page iv in the course of Acknowledgments preparatory to the Report, "the staff consisted of one Research Officer" with the part-time "assistance of one Research Assistant". In the complete absence of any business background combined with an equally striking lack of acquaintance with stock market machinery and technique, armchair improvisation was perhaps unavoidable. One therefore does not feel surprised that the Report should draw its language, accents and inspiration from the plentiful American literature on the subject. But the Report borrows from that source its facts as well. That is unfortunate.

5. AMERICAN ANALOGY DECEPTIVE IN ARGUMENT AND SUBSTANCE : The Report bases its flight on the disarming assumption that "the security market in India today has much in common with the security market in the U. S. A. before the legislation of 1933 and 1934" (Ch. IX, Para 27, Page 118).

The briefest consideration shows that this purely superficial resemblance flatters but to deceive. Even in the 1930's, the economic development of the U. S. A., the progress of its joint stock enterprise, the organisation of its industries, its methods of finance and its stock market machinery, practices and technique stood at a level to which there is little approximation in the position obtaining in this country today. Nor is much critical analysis necessary to understand that apart from their spectacular character there is little in common in general conditions or fundamental causes between the 1928-29 boom and crash on Wall Street and the post-war cheap money inflationary boom and subsequent depression on the Indian Stock Exchanges. On such a palpable misconception of facts and circumstances, the Report has transported the entire American scene to the Indian stage. For instance, with pencil and paper it has fathered a system of margin trading (Ch. IV), set up large over-the-counter markets run by outside brokers (Ch. VI), and established powerful joint stock corporations "suddenly putting thousands of scrips on the market or withdrawing large quantities from it", creating corners, precipitating crises, extorting "much money from members and speculators and *even* investors" and causing "serious embarrassment to institutions like insurance companies, trusts, banks, benevolent societies, etc." (Ch. VI, Paras 46-50, Pages 79-80). Despite painstaking efforts and trimmings, this ready-made jacket does not fit.

6. **RE-APPRAISAL OF POSITION NECESSARY:** An economic phenomenon is seldom cut out to pattern. In this connection the following remarks offered by the President at the last annual General Meeting of the Exchange are appropriate :

> "Assumptions and realities are two things apart. Government officials, frequently lacking practical experience and fired by a zeal for 'reforms', find it hard to understand that it is the assumptions which should conform to basic realities. It is an awkward

> job trying to fit the realities into a framework of preconceived notions and assumptions or into a complex of conditions divergent from that prevailing in other countries."

It is regrettable that this fact has not been more fully realised. The Report is grounded on a fallacious and imperfect understanding of basic facts and conditions. Accordingly, its conclusions and recommendations have no inherent validity. They must stand up to a fresh appraisal and prove their merits under independent questioning and rigorous cross-examination.

7. **ANALYSIS UNDER FOUR MAIN HEADS:** Attention may now be turned to the main body of the Report. Temptation notwithstanding, the Exchange does not propose to vet it in any great detail. It seems easier to deal with it broadly under the following four main heads:

A. The descriptive history of the constitution and growth of Stock Exchanges.

B. The market structure, its machinery, mechanism and technique.

C. Analysis and evaluation of market functions.

D. Proposals and recommendations.

III—DESCRIPTIVE HISTORY

8. **HISTORY IN THE MAIN ADEQUATE BUT INACCURATE AND MISLEADING IN PARTS :** There is little of importance that requires to be said about the descriptive history contained in the Report and that little may be briefly expressed :

(a) First, there are gaps here and there. For instance, it has not been understood or recognised that in Bombay the large number of unlisted or what are called "foreign" securities (business in which is almost entirely put through by the Members of this Exchange) adds substantially to the officially quoted list. This omission leads to an underestimate of the total trade (Ch. III, Para 10, Page 27).

(b) Secondly, there are occasional misstatements and contradictions. For example, it is mistakenly explained that this Exchange is an "unincorporated but *registered* non-profit association" (Ch. II, Para 3, Page 13) and that its membership can "be inherited by the legal heir of a deceased member" (Ch. II, Para 4, Page 13), while at one place the Listing Committee of the Exchange is reported to be appointed "by the general body" (Ch. II, Para 30, Page 20) and at another "by the Governing Board" (Ch. II, Para 42, Page 23).

(c) Thirdly, in some respects the account is sadly misleading. To illustrate, after admitting that in the case of the two recognised Exchanges of Bombay and Ahmedabad "the Presidents used to help the Government in getting the stamp duties", it avers that "it is doubtful if this service was rendered fully after the promulgation of D. I. Rule 94-C" (Ch. IV, Para 22, Page 45) or whether the Exchanges "co-operated fully" (Ch. VII, Para 26, Page 94). It may be elucidated that the Stamp Act provided for collection of stamp duty through the Clearing House in respect of forward contracts only and not ready delivery contracts. Against all friendly warnings of the Exchanges to the contrary, Defence Rule 94-C prohibited the Exchanges from offering facilities for forward business. Under the law as it stood, it was *not permissible* to collect stamp duty through the Clearing House in respect of Ready Delivery contracts and thus Government itself banged the door in the face of the cooperation the Presidents were prepared to and did as a matter of fact offer. This piece of folly on the part of Government cost the public exchequer well over Rs. 1¼ crores.

(d) Lastly, in places the account is obscure, as for instance in Para 8 of Ch. II (Page 14), while at times it lapses into plain exaggeration as in its references to the "*serious repercussions* on the Indian Security market" if certain law suits relating to forfeiture of the share capital of members were to be decided against the Calcutta Stock Exchange (Ch. II, Para 9, Page 15).

The Exchange is not concerned overmuch about the deficiencies and anomalies outlined above. They are natural to a new-comer and merely show up the unfamiliarity of a stranger in foreign surroundings.

IV—MARKET STRUCTURE

9. MARKET MACHINERY AND TECHNIQUE MISUNDERSTOOD AND MISINTERPRETED : On the second main head of market machinery and technique, the Exchange must speak with less reserve. There is clear and irresistible evidence that the trading and operational methods of business have entirely baffled the Report. It seems ill at ease when dealing with them The patchwork in Paras 13 and 39 of Ch. IV (Pages 42 and 50) and the *corrigenda* bear mute but eloquent testimony to the hurried last-minute corrections after the printing of the Report. These changes notwithstanding, the analysis of many a method of business, known and unknown, fills the account with troubled confusion. The list is extensive of which the following is a selection :

(a) Apart from the two methods of delivery and payment and of carry-over, transactions outstanding at the end of the settlement are supposed to be settled by the third method of "reversal of the contract and payment of differences in prices based on the make-up price" (Ch. IV, Para 30, Page 48). Such a system of "differencing at the making-up price at the reversal of the contract" (Ch. IV, Paras 18 and 26, Pages 44 and 46) does not exist.

(b) The system of margin trading as elaborately explained in Paras 47-51 of Ch. IV (Pages 54-56) and stated to be "widely prevalent on Indian Stock Exchanges" (Page 156) is largely unknown.

(c) It is imagined that Budla "only postpone(s) and continue(s) upto the next settlement through a new contract" "the obligation to make or take delivery *on the existing terms*" (Ch. IV, Para 37, Page 50) and from that is drawn the erroneous conclusion that "the real defect of Budla consists *in the advance* *of credit without any adequate pledge or security*" (Ch. VI, Para 7, Page 69). Further the "Budli charge" which in fact is determined by the free play of market forces is somehow believed to be "fixed by the Managing Committee of the Exchange" (Ch. IV, Para 30, Page 48). That fixing by the Committee is reported to be done "in proportion to the fluctuations in price" and unfortunately "if the prices remain static, carry-over is done only on even terms, *i.e.*, without payment of a budla charge" (Ch. IV, Para 37, Page 50) — an absurd proposition.

(d) It is revealed that "Put-through" business "gives opportunities for authorised clerks to trade on their own account with the help of other firms without involving their own principals" (Ch. VI, Para 15, Page 71). In some equally mysterious fashion it "is found to foster inordinate speculation, often resulting in defaults and failures, and even crises sometime" (Ch. VI, Para 12, Page 70) and to involve "the failure of many small brokers, leading the market to crisis involving large amounts of credit" (Ch. VI, Para 13, Page 70)—fears which happily have never been so far realised.

(e) It is made out, and altogether incorrectly, that in regard to buying-in and selling-out, the Governing Board of this Exchange "is empowered to extend the time upto 15 days beyond which the right cannot be exercised and the Board is not competent to vary this rule" (Ch. IV, Para 34, Page 49). No such rule exists, nor is there any special limitation on the power of the Board to vary such rule if it did exist.

(f) It is complained that in contracts "between members (or ......) brokerage, an important factor adding to the price, is never separately shown,

> Thus a knowledge of the brokerage added to the price, is denied to the public as well as the authorities of the Exchange" (Ch. IV, Para 22, Page 45). Apparently, the simple fact is not realised that when a member buys from or sells to another, no question of charging a brokerage commission arises.

And so on. The list can be enlarged, for it illustrates but does not exhaust the subject. Instances can be multiplied and they conclusively establish an astonishing lack of acquaintance, if not deluded misunderstanding, of important parts of the market machinery.

10. **REPORT STANDS INVALIDATED:** The question that arises is — Does the foregoing demonstration cut off the ground under the Report? As the Report itself observes, only after a "survey (of) the mechanics of the market" "will it be possible for us to find out whether our security market has any defects, and if so, what they are, and how they arise" (Ch. IV, Para 1, Page 40). In the light of this observation, the Report stands invalidated.

V—EVALUATION OF FUNCTIONS

11. **FALLACIOUS ASSUMPTION THAT POST-WAR PERIOD NORMAL—BOTH WAR AND POST-WAR PERIODS ABNORMAL :** Under the third head, the Report sets out to evaluate the functions performed by the Indian security market. It is a daring venture. However, the basic assumption scarcely augurs well. The basis of a "detailed analysis of the prices" excludes the early years of war on the ground that "India was threatened by the Japanese invasion" and was subject to the influence of "inflation in general prices." It is considered to be "more fair to take the period after the end of hostilities" "when the risks of invasion (had) subsided and when the advance of inflation was kept under check" (Ch. VII, Para 5, Page 87). The Exchange does not share this quaint reading of recent economic history. The assumption makes it necessary to stand first on one's feet and then on one's head. As pointed out repeatedly in the last three annual addresses of the President of this Exchange, the post-war period has been beset in its own way by dangerous problems of inflation and economic dislocation and of internal political upheavals of as serious a character, if not more, as the early years of the war. The fact of the matter is that the entire period following the outbreak of war has been abnormal. The analysis therefore relates to the functioning of the Stock market during an abnormal period, and whatever the conclusions, they are conditioned by this basic limitation.

12. **THREE STATISTICAL TOOLS :** The analysis is developed by three leading arguments each supported by a statistical table. In each case the statistical tool is badly blunted by callous misuse and the attendant conclusion that "the stock market in India has failed to fulfil to any reasonable extent the functions which are expected of it" (Page 159) has to be dismissed as arbitrary and untenable.

13. THE FALLACY OF A SUPERFICIAL APPROACH : Consider first the argument "that price fluctuations have been much more violent in India than in other countries in recent years" (Ch. VI, Para 2, Page 68). This is the head and front of the main assault. The proposition is sought to be established by comparing the index numbers of industrial shares of various countries. These Indices are marshalled in Table I and plotted on Chart A contained in Chapter VII (Page 86) and it is deduced therefrom that "any *deep delving* into figures is not necessary for testing the truth of this (charge)" (Ch. VI, Para, 2, Page 68) as "even the most *superficial study* of stock market prices in India" shows that they "have been violently fluctuating, largely by the manipulations of speculators" (Ch. VII, Para 2, Page 85). It is precisely because of a "superficial study" and absence of "deep delving" that the conclusion drawn in the Report is possible.

14. THE INFLUENCE OF INFLATION : The all-powerful phenomenon of inflation and the wide variations in its penetration and range of influence on the economies of different countries are not unknown even to those who lay no pretence to knowledge of economics and statistics. A little thought shows that this major factor distorting comparative analysis of the statistics of different countries must be isolated before drawing any inference from the figures on view. When the Report casually comments that in regard to price fluctuations India "has behaved more like France than the more steady Anglo-Saxon countries", it is almost on the verge of discovery. But it fails to draw the inference and follow it through. The defect must therefore be rectified and the table of comparative Indices reconstructed.

15. THE MEASURE OF INFLATION : The General Price Index of each country offers an exceedingly rough and ready method of measuring the change in the value of its money.

In the accompanying Table No. 1 are set out the General Price Indices of each country from 1939 to 1946. These figures are taken from Table No. 46 for Wages and Prices (January-June 1939 = 100) appearing in March 1947 No. 3 Issue of the Monthly Bulletin of Statistics, Statistical Office of the United Nations. The extraordinary influence of inflation and the manner in which such influence has varied from country to country is apparent from the following Table No. 2 showing the range within which the Index has fluctuated in each case :

TABLE No. 2

Country	General Price Index 1939-46		
	Lowest	Highest	Range in Points
Canada	103	148	45
U. S. A.	101	158	57
France..	101	623	522
U. K.	106	180	74
Australia	100	140	40
India	100	266	166

As can be seen from the accompanying Chart A also, apart from France, India was the worst afflicted of all the other countries ; Canada, U. S. A., U. K. and Australia enjoyed, comparatively speaking, a much greater immunity.

16. "CORRECTED" SHARE PRICE INDEX NUMBERS—FLUCTUATION OVER EIGHT YEARS : The influence of inflation can be neutralised and the "money-price factor" taken out of the Indices of share values by applying the General Price Index to the Share Price Index. This is done in the subjoined Table No. 1 where the "Corrected" Share Price Index represents share value

TABLE No. 1

(See Paras 15 to 19)

COUNTRY		SERIES	Annual Average 1939	1940	1941	1942	1943	1944	1945	1946	1946 Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
CANADA	1.	L. N. Share Price Index	100	81	70	67	86	86	103	119	127	125	122	129	129	128	123	121	107	104	104	109
	2.	U. N. General Price Index ..	103	113	123	130	136	140	141	148.1	143	143	144	148	148	149	149	149	149	151	152	152
	3.	"Corrected" Share Price Index ..	97.1	71.7	56.9	51.5	63.2	61.4	73	80.5	88.8	87.4	84.7	87.2	87.2	85.9	82.6	81.2	71.8	68.9	68.4	71.7
U. S. A.	1.	L. N. Share Price Index	103	95	87	77	102	110	133	155.3	160	158	156	169	172	170	166	163	139	136	134	140
	2.	U. N. General Price In dex ..	101	103	114	129	135	136	138	158.1	140	141	143	144	145	148	163	169	162	175	183	184
	3.	"Corrected" Share Price Index ..	102	92.2	76.3	59.7	75.6	80.9	96.4	99.8	114.3	112.1	109.1	117.4	118.6	114.9	101.8	96.4	85.8	77.7	73.2	76.2
FRANCE	1.	L. N. Share Price Index	100	118	..	431	486	495	405	590.8	389	415	406	403	478	486	512	524	531	589	1105	1251
	2.	U. N. General Price Index ..	101	134	165	194	226	256	362	622.9	462	466	520	539	602	583	551	673	701	793	776	809
	3.	"Corrected" Share Price Index ..	99	88.1	..	222.2	215	193.4	111.9	92.2	84.2	89.1	78.1	74.8	79.4	83.4	92.9	77.9	75.7	74.3	142.4	154.6
AUSTRALIA	1.	L. N. Share Price Index	101	101	104	94	112	114	117	134.1	127	127	128	133	134	134	134	136	139	138	139	140
	2.	U. N. General Price Index ..	100	110	117	131	138	139	140	139.6	139	139	140	140	140	140	140	138	139	139	141	140
	3.	"Corrected" Share Price Index ..	101	91.8	88.9	71.8	81.2	82	83.6	96.1	91.4	91.4	91.4	95	95.7	95.7	95.7	98.6	100	99.4	98.6	100
U. K.	1.	L. N. Share Price Index	96	80	87	103	124	136	147	161.9	153	154	152	160	167	168	166	167	159	163	172	..
	2.	U. N. General Price Index ..	106	140	157	164	167	171	174	180.2	177	177	177	178	178	178	181	182	182	183	184	185
	3.	"Corrected" Share Price Index ..	90.6	57.1	55.4	62.8	74.3	79.5	84.5	90	86.4	87	85.9	89.9	93.8	93.8	91.7	91.8	87.4	89	93.5	..
INDIA	1.	L. N. Share Price Index	100*	126	142	151	197	235	255	337.1	289	287	309	323	345	358	400	399	357	341	320	317
	2.	U. N. General Price Index ..	100	119	129	158	228	241	244	266.3	250	253	253	253	255	264	270	271	271	282	290	284
	3.	"Corrected" Share Price Index ..	100	105.9	110.1	95.6	86.4	97.5	104.5	126.6	115.6	113.4	122.1	127.7	135.3	135.6	148.1	147.2	131.7	120.9	110.3	111.6

NOTE:—1. **L. N. Share Price Index**—Index Numbers of Market Value of Industrial Shares (Base: Jan.-June, 1939=100); Source: Monthly Bulletin of Statistics, League of Nations; appearing in Table No. 1 at Page 86 of the Thomas Report.

2. **U. N. General Price Index**—Source: United Nations Monthly Bulletin of Statistics, March 1947 No. 3 Issue, Table No. 46, for Wages and Prices (Base: January-June 1939=100).

3. **"Corrected" Share Price Index**—L. N. Share Price Index Numbers expressed in terms of General Prices prevailing in each country during the six-monthly period January to June, 1939.

* Assumed.

Chart A

(Pl. see Table No. 1 and Paras 154(b))

[Base : Jan.-June, 1939 = 100]

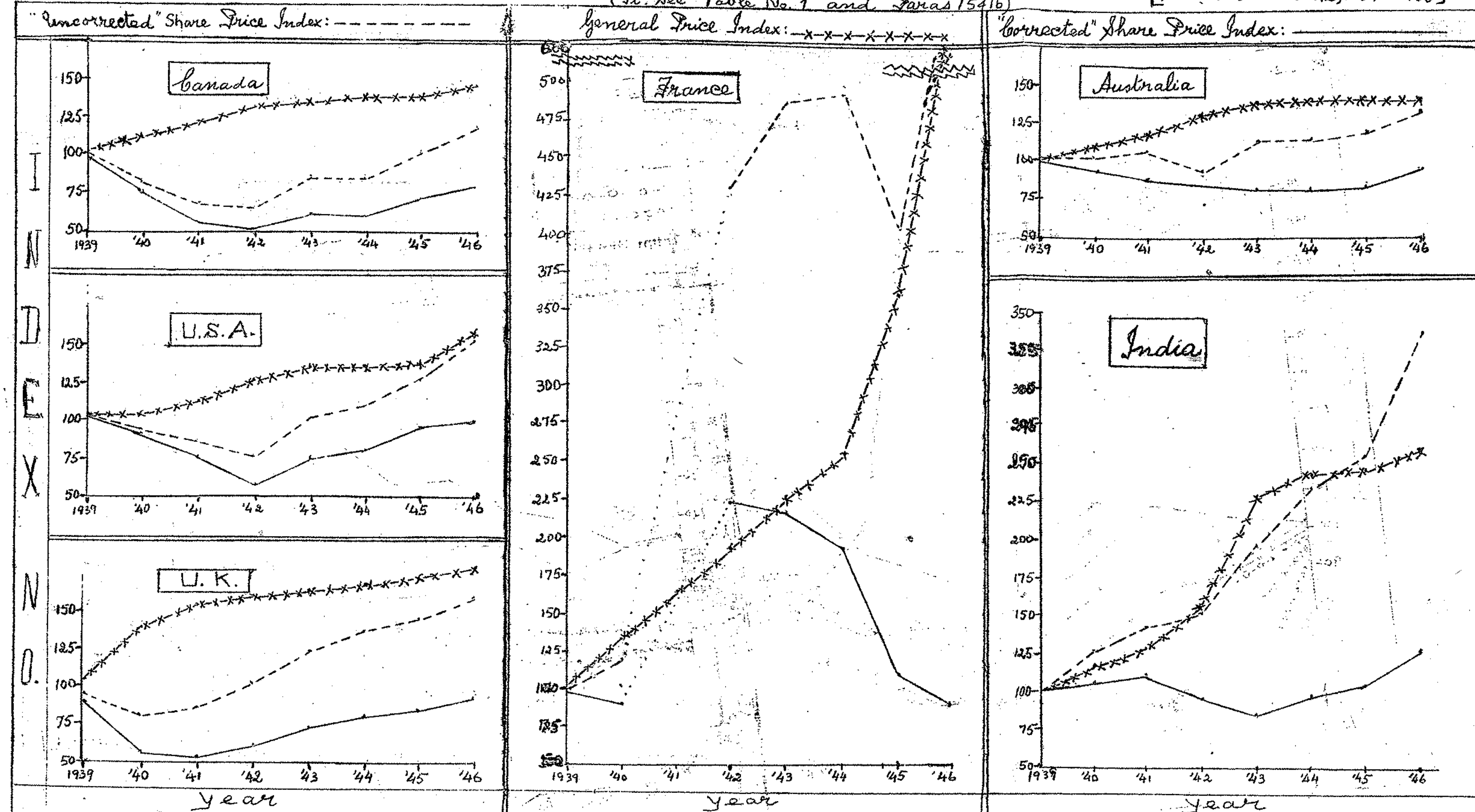
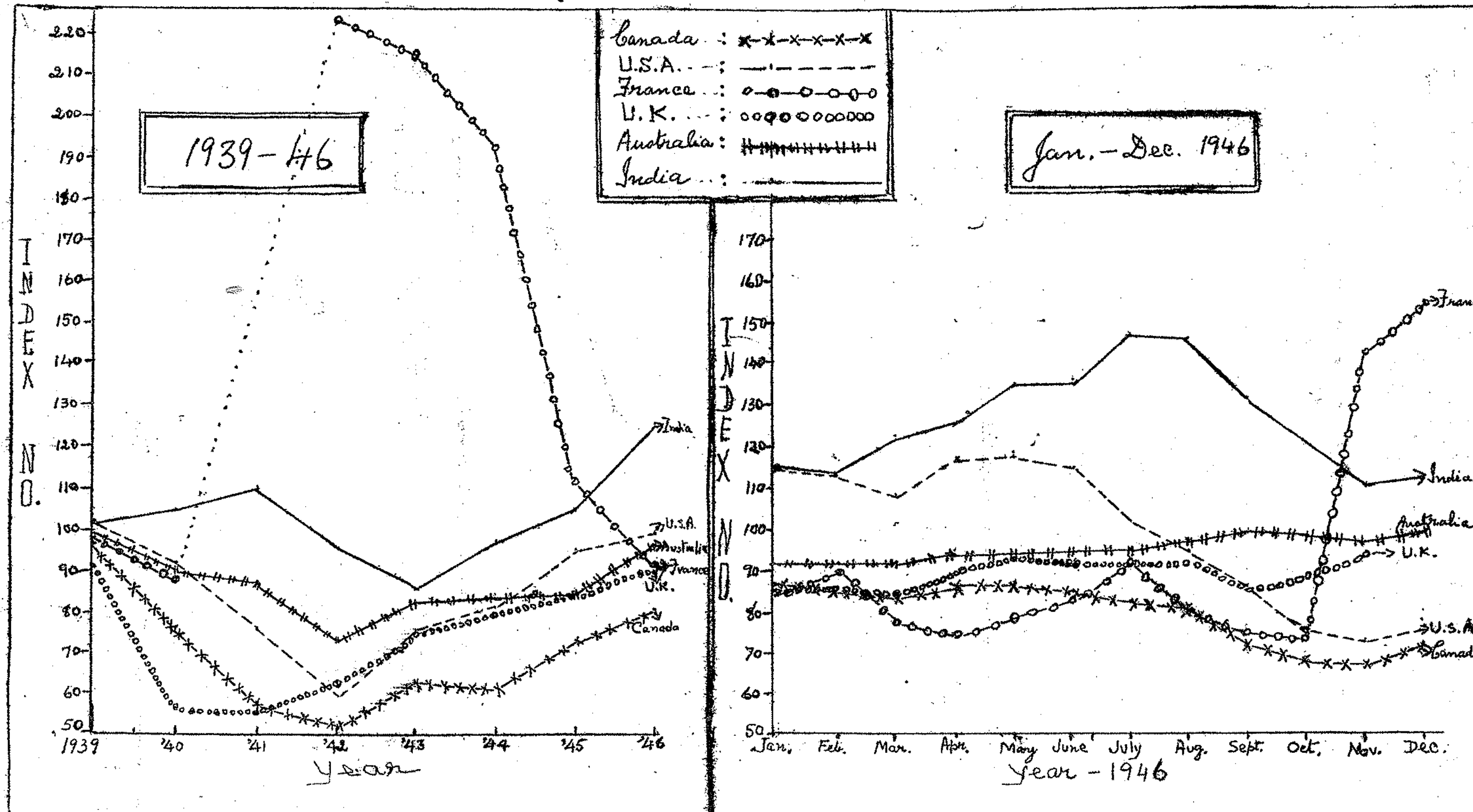


Chart B

"Corrected" Share Price Index [Base: Jan.–June, 1939 = 100]
(Pl. see Table No. 1 and Paras 13 to 19)



Indices in terms of prices prevailing in each country during the six-monthly period January to June 1939. The following Table No. 3 sets out a summary of the range within which the "Corrected" Share Price Index has fluctuated in each country during the years 1939-1946:

TABLE No. 3

Country	"Corrected" Share Price Index 1939-46		
	Lowest	Highest	Range in Points
Canada	51.5	97.1	45.6
U. S. A.	59.7	102	42.3
France..	88.1	222.2	134.1
U. K.	55.4	90.6	35.2
Australia	71.8	101	29.2
India	86.4	126.6	40.2

It is clear from the range within which the "Corrected" Share Price Index has moved during the eight years 1939-1946 that there has been wider fluctuation in prices in France, Canada and U. S. A. than in India. In fact it is interesting to observe that in this matter, Canada, U. S. A., India and U. K. with ranges of 45.6, 42.3, 40.2 and 35.2 points are all clustering round each other and at the two extremes are France with a range of 134.1 showing evidence of the violent impact of the war and at the other end Australia with a range of 29.2 offering proof of a rigidly "controlled" price economy.

17. **"CORRECTED" SHARE PRICE INDEX NUMBERS—FLUCTUATION IN 1946:** The foregoing relates to fluctuations over

the period of eight years. The following Table No. 4 records the range for the twelve months January to December 1946 :

TABLE No. 4

Country	Corrected Share Price Index Jan-Dec. 1946		
	Lowest	Highest	Range in Points
Canada	68.4	88.8	20.4
U. S. A.	73.2	118.6	45.4
France..	74.3	154.6	80.3
U. K.	85.9	93.8	7.9
Australia	91.4	100	8.6
India	110.3	148.1	37.8

The year 1946 was one of exceptional stress and strain for India as a whole and for the Indian Stock markets in particular (See Para 24 below). Even so, the range of fluctuations in India was less than in France and the U. S. A. In fact, India with a range of 37.8 points stood between the U. S. A. and Canada having a range of 45.4 and 20.4 points respectively*. And this was the fluctuation in an abnormal period of hectic trade activity, the like of which has had few parallels in the history of the Indian Stock Exchanges.

18. ERRONEOUS CONCLUSIONS DRAWN IN THE REPORT: Attention may now be focussed on the "Corrected" Index Numbers of Industrial share prices which offer a basis for comparative evaluation. The series of various countries as running in the Table No. 1 are plotted on the accompanying Chart B. These two together with the inferences drawn from Tables Nos. 3 and 4 give the lie direct to the outstanding

* For a more accurate view, please see Para 19

conclusions reached in the Report on the strength of the Uncorrected Series—

(*a*) First, that "the one dominant feature of the whole of this period is the *wild* fluctuations in (Indian) stock prices" (Ch. VII, Para 5, Page 87) ;

(*b*) Secondly, that "price fluctuations have been much more violent in India than in (other) countries" (Ch. VII, Para 4, Page 87) as illustrated in the contrast between "the frequent and wide fluctuations in Indian stock prices" and "the fairly even tenor of prices in the U. K. and U. S. A. (Ch. VII, Para 6, Page 87) ; and therefore

(*c*) Thirdly, that "prices of stock (in India) have been violently fluctuating, largely by the manipulations of speculators" (Ch. VII, Para 2, Page 85).

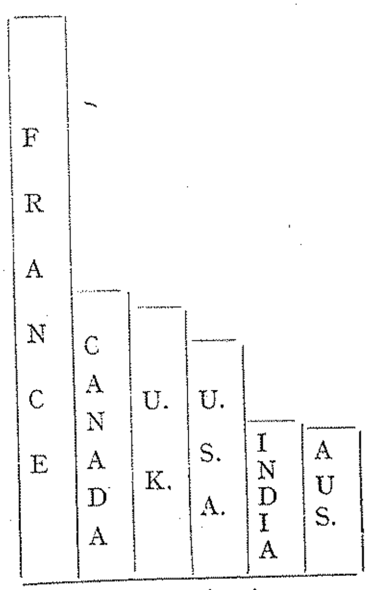
These conclusions can be appropriately condemned in the words of the eminent statistician Prof. A. L. Bowley : "To argue *hastily* from effect to cause" is an error "most often fathered on to statistics" (Elements of Statistics, Ch. I).

19. CONCLUSIONS EMERGING FROM THE "CORRECTED" SHARE PRICE INDEX NUMBERS : The "Corrected" series of Index Numbers of industrial share prices not only demonstrate the falsity of the conclusions reached in the Report ; they establish the point that the Stock Exchanges have functioned reasonably well even during an abnormal period. The Range method, while easily understood, is not a satisfactory tool for measuring dispersion which is apt to be affected by the extremes of a series. A more reliable method is the Co-efficient of Deviation ($= \frac{100 \times \text{S. D.}}{\text{a}}$). These co-efficients measure the extent of fluctuation within a series in terms of percentages and are comparable. Witness the following Table No. 5 giving the results of this simple statistical analysis :

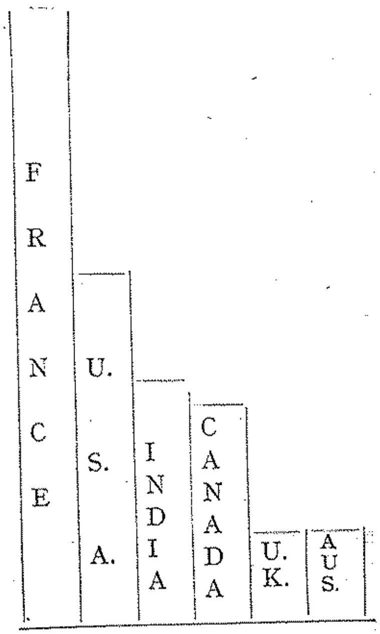
TABLE No. 5

Country	% Co-efficient of Deviation of "Corrected" Share Price Indices for the period	
	1939-1946	Jan. to Dec. 1946
Canada	7.0	2.7
U. S. A.	5.7	4.8
France	14.6	8.1
U. K.	6.4	1.0
Australia..	3.5	1.0
India	3.8	2.9

The percentage fluctuations recorded in Table No. 5 are illustrated in the following simple Bar Diagrams :



Fluctuation in "Corrected" Share Price Index 1939-46



Fluctuation in "Corrected" Share Price Index Jan.—Dec. 1946

From the foregoing it is sufficiently clear that India stands on a par with Canada, U. S. A., U. K. and Australia in the matter of extremes of price fluctuations. Therefore once again the results point in the same direction and confirm the deductions drawn from the previous analysis. The movement of the figures in respect of India as compared with other countries as shown in Table No. 1, the flow of the curves as plotted on Charts A and B and the statistical methods of dispersion measuring the amount of fluctuation in prices over a period of eight years (1939-46) as well as within the period of a single year (1946) (Tables Nos. 3, 4 and 5) prove as emphatically as is possible within the limits of the data available and its accuracy and reliability that **the trend of share values recorded in the Indian share market was the right trend and that the apparent fluctuations were not the artificial fluctuations caused by erratic market manipulations but the true fluctuations inherent in the economic conditions of the country which it was the duty and the prime function of the stock market to reflect and to record.**

20. THE MORAL: What is the moral to be drawn from these conclusions? In the Presidential address at the last Annual General Meeting of the Exchange it was observed: "There have been (some) who have 'as in a glass darkly' caught glimpses of a veiled conspiracy to sabotage the efforts of a progressive Government. Some have muttered deeply in the council halls about the dread disease of cancer and its dangerous contagion. And there have been not a few fire-eaters who have cursed the Exchanges by the bell, book and the candle and consigned them to a perdition worse than all hells." The foregoing facts speak to them and the facts must be chewed, swallowed and digested. Those who take the view held out with such singular lack of perception in the Report that the Indian Stock market is arbitrary, wayward and irresponsible in the trends it makes effective must shed their bias and drastically revise their notions of market utility. It is clear that in the main it does not function as a sounding-board for irresponsible speculators; it has been a barometer of the economic conditions as they have existed in the country over a period of time.

21. THE SECOND STATISTICAL TOOL—ITS LIMITATIONS: The second argument which the Report calls to its aid in arraigning the Indian Stock market is in the Table setting out aggregate share prices of ten securities against the corresponding total dividend amount (Ch. VII, Table 2, Page 87). The statistical material that has gone into the making of the Table is of doubtful validity. There is no indication of the basis on which the total value of the securities is calculated, nor is any explanation offered why the prices for a particular month March or August, as it suits, are taken when the annual average price for each year is easily available. Likewise, it is not explained how the aggregate dividend amount has been arrived at, particularly when 'right' or bonus shares have been issued, as when, for example, they were issued by the Century Mills (1941) and Bombay Dyeing (1946). Apparently, the value of the 'right' or bonus has been left out of account, thus seriously impairing the accuracy of the Table. Again the difference between the earnings or net profits of corporations and the dividends they declare does not appear to have been realised, though no doubt dividends largely depend upon profits. Nor does it seem to have been appreciated that in the very nature of things there must have been a time lead or lag between the two series.

22. MISINTERPRETATION OF THE TABLE OF AGGREGATE SHARE VALUES AND TOTAL DIVIDEND: In view of the many qualifications set out above, how should the figures be interpreted? All that one may expect from the Table is a positive correlationship of fair significance. The annual average aggregate price series and aggregate dividend series appear in the sub-joined Table No. 6 on the lines of Table 2 of Ch. VII (Page 87) and r, the Coefficient of Correlationship, works out at $+.7$. The Coefficient of Correlationship varies from 0 to ± 1. Correlation is said to be perfect if r is equal to $+1$ or -1 and no correlationship exists if r is equal to or tends to zero. In the present case r is equal to $+.7$ and this indicates a high degree of direct correlationship. But the Report seems to contend

TABLE No. 6

(in lakhs of Rs.)

Year	Share price in March of each year (aggregate of 10 securities).	Annual average share price (aggregate of 10 securities).	Dividend
1934	11,42	12,12	52.3
1935	15,56	15,05	37.0
1936	12,12	14,19	40.0
1937	33,84	27,95	94.7
1938	20,08	21,54	162.2
1939	21,07	23,44	117.9
1940	28,29	26,78	157.6
1941	28,27	28,50	190.9
1942	23,95	25,78	199.8
1943	32,51	32,94	175.8
1944	36,47	36,97	171.9
1945	36,69	39,04	168.4
1946	49,95	52,34	156.2

that this is not enough. The relationship apparently has to be directly proportionate from year to year with a ratio governed by the rule of three if the stock market is to escape the charge of grossly distorting share values. And that charge is not based on representative annual averages but forced on the basis of figures for particular months (March or August as it suits) in the face of the fact that such figures vary substantially from month to month as is evident from the Table in Appendix B to Ch. VII (Page 100). Witness the comment that "between 1934 and 1937, the aggregate value of the ten stocks actually trebled (in reality, as Table No. 6 above shows, on the basis of the annual average 1934 and 1937 prices it was not treble but only a little over double) although the dividends did not even double during the same period"; or that "in war time, dividends continued to mount up, but stock prices lagged behind"; or that "in 1946, the prices of securities went up to high levels, although dividends remained stationary or falling" (Ch. VII, Para 7, Page 88), where at least it should have been realised that the change in the rate of interest on Government Paper from $3\frac{1}{2}\%$ to 3% was bound to change the basis of capitalization and automatically push up share values by about 17 per cent. without any dividend changes.

23. **CLOSE CORRELATIONSHIP BETWEEN AGGREGATE SHARE PRICE AND DIVIDEND SERIES:** It is obvious even on a preliminary consideration that there is always a time lead or lag in economic series, that strictly proportionate relationship rarely exists, that the price is not solely a function of the profit, still less of the dividend, curve. This is not peculiar to India but is true of all countries alike. As Dice and Eiteman conclude in a survey of American Stock markets—

> "In the long run the market prices of stocks depend upon the *earnings* of corporations, and a rise in the latter will be accompanied by a rise in the former. There exist in this relation, however, *a lead and a lag* which cause the level of *price earning ratios to vary at different phases* of the business cycle. Thus the trend of prices is fundamentally based upon the trend of earnings but there exists *a tendency of prices to lead or lag behind earnings* as a result of psychological and economic conditions." (The Stock Market, Ch. XXIX).

In such conditions the true test of market efficiency lies in the existence of a significant correlationship between the aggregate price and dividend series. As calculated above, the coefficient of correlationship in the case of the Table No. 6 under discussion is $+.7$, and it is a recognised principle of statistics that "if r is above 0.50, there is *decided* correlation" (Connor's "Statistics", Ch. XV). In the light of this result, there is no foundation for the conclusion that "the wild fluctuations in stock prices in India are due largely to mischief of speculators and syndicates of them operating in their self-interest" (Ch. VII, Para 7, Page 88). On the contrary, the proposition is once again established that the stock market has behaved reasonably well even in a most abnormal period.

24. **THE THIRD STATISTICAL TOOL—ITS DEFECT :** The third argument falls as heavily as the second. It highlights the heavy fluctuation in price recorded in some six active scrips during the period September 1945 to May 1947 and condemns the stock market for its speculative orgies which produce such extreme swings in prices (Ch. VII, Paras 10 and 11, Pages 88-89). The following Table No. 7 summarises Table 3 of Ch. VII (Page 88) and the figures are interesting :

TABLE No. 7

Security	% Rise in Price between September 1945 and August 1946	% Fall in Price between August 1946 and May 1947
Bombay Dyeing	61	65
Tata Defd.	51	51
Imperial Bank (Fully Paid) ..	42	25
Indian Iron	67	57
Burrakur Coal	81	44
Howrah Jute	47	37

The Table shows a maximum fall of 65% in Bombay Dyeing which made during the period a bonus issue in the ratio of one bonus for every one old share reducing the value per share by half. The actual fall was only 23%, but in rushing to demonstrate the collapse in price from Rs. 2,865 in September 1946 to Rs. 1,110 in May 1947, this simple fact has been forgotten. More interesting is the inclusion in the Table of Imperial Bank Fully Paid shares showing the rise of 42% from September 1945 to August 1946, and the subsequent fall of 25% by May 1947. Their admission to the Table is like the introduction of the Trojan horse which betrays the citadel. The merest tyro is aware that Imperials are well held investment shares in which there is no speculation at all. The fact that their prices had fluctuated so heavily should have warned that the make-mischief cause did not lie in rabid speculation but elsewhere. The sharp rise in 1946 shown in Table No. 7 above derived its inspiration directly from an unwise cheap money policy as illustrated by the following :

May 1946 ..	Conversion of 3½% Govt. Paper to 3%
July 1946 ..	Issue of 2½% 15-year Loan
Nov. 1946 ..	Issue of 2¾% 8-year Loan

This injudicious monetary policy set up a chain of unhealthy reactions. The equally sharp fall was precipitated by doubts about the policy of ever cheaper money and disastrous budgetary indiscretions, and accelerated by explosive economic and political developments surcharged with industrial crisis, social unrest and overwhelming economic uncertainties. The position is summed up in the following quotation from the President's speech at the last Annual General Meeting of this Exchange—

> "I have referred to the artificial cheap money policy which distorted the country's economy. These lower interest rates offered a basis for higher capitalization of equity values and in their earlier phase combined with other inflationary factors to provoke an unprecedented boom. The break in gilt-edged during the period under review reversed the basis of capitalization. Simultaneously, crushing taxa-

tion in the form of Business Profits Tax, Corporation Tax, Capital Gains Tax and steeply graded Super-tax cut deep into the margin of profits. On the other hand, confidence that profitability of industry could be maintained was destroyed. The severe economic dislocation, ... the alarming growth in the inefficiency of labour, the deterioration of worker morale, increased absenteeism, ca'canny, the friction of endless strikes and stoppages of work : these reacted disastrously on output and precipitated a crisis of production unparalleled in magnitude. The estimated number of man-days lost constituting a statistical expression of the extent to which maximum production possible was prevented skyrocketed to 5.2 million for only four months from January to April 1947 compared with a loss of 2.3 million for the entire year in 1943, 3.5 million in 1944 and 4 million in 1945. The estimated production of cotton textiles in 1947 fell from a peak capacity of 4,800 million yards to 3,800 million yards ; of steel from 1,264,000 tons to 875,000 tons ; of cement from 2,076,000 tons to 1,344,000 tons ; of paper from 110,000 tons to 86,000 tons ; and a similar shortfall was estimated for a long list of thirty other commodities considered vital to the country's progress. This briefly was the state of industry on which the stock market based itself and settled its future course."

The Report seems oblivious of the importance of this radical transformation that changed the economic and political scene and labours under the delusion that "most of these price changes were unconnected with the dividends, profits, or general prospects of the Companies concerned . . . (and) largely due to certain extraneous factors and the mischievous use of them by groups of speculators" (Ch. VII, Para. 11, Page 89). A reference to the annual addresses of the President of the Exchange over the last quinquennium would have offered a corrective antidote to many of the sweeping generalizations. But in its haste to show how in "a few individual scrips both the boom and slump will appear more glaring" (Ch. VII, Para 10, Page 88) and to gain its point that "in India, Stock Exchanges exist for their members' benefit and (that) even those exchange authorities who profess concern for public interest quail from taking firm action when such action injures the private interest of themselves and their members'' (Ch. VII, Para 12, Page 89), the Report maligns and strays on dangerous ground. As Prof. A. L. Bowley trenchantly remarks, "Some of the common ways of producing a false statistical argument are to quote figures without their context, . . . to enumerate the events favourable to an argument, omitting the other side". These constitute evidence of nothing but "elementary mistakes in logic" (Elements of Statistics, Ch. I), if not of a deluded fancy or an erring faith.

25. STOCK MARKET SPECULATION A POTENT FACTOR IN INFLATION—THE CART BEFORE THE HORSE : Having exhausted its heavy statistical artillery in pressing forward three leading arguments for putting the market in the wrong, the Report turns its attention to the engaging task of putting the cart before the horse. It concludes with satisfaction that "speculation in the stock market has been potent factor in the inflationary situation in India in war-time and after" (Page 159), because the steep rise in stock prices put in the hands of the holders "a large increase in purchasing power and, although some of the holders may not have realised these extra values, many must have done so and in any case this made a large addition to the total purchasing power, which when pitched against goods in short supply was bound to aggravate inflation" (Ch. VII, Para 19, Page 91). Realisation of sale proceeds would merely involve a transfer of funds from the purchaser to the seller. Accordingly, the total purchasing power could not have increased unless funds had been borrowed by the purchasers for taking delivery. The Report itself supplies the information that advances on shares by scheduled banks amounted to Rs. 31 crores in November 1945 and to Rs. 49 crores in May 1946 (Ch. III, Para 22, Page 37). Since "on the bulk of the advances the margin allowed was between 30 and 50 per cent." (Ch. VII, Para 22, Page 92) the expansion of credit based on the steep rise in share prices could not have exceeded even on the most generous estimate Rs. 10 to Rs. 15 crores. This comparatively small amount must have been indeed a "potent factor in the inflationary situation". Similarly, the evasion of Share Transfer Stamp Duty amounting to a few crores, if that, is said to have "contributed *extensively* to the inflationary position of war time" (Ch. VII, Para 27, Page 94). The suggestions are incredible. But such were the heavy sins of commission and omission and "it was legitimately believed", according to the Report, that speculation in "share markets had much to do with the growing inflation" (Ch. I, Para 20, Page 6). Travesty of facts could go no further.

26. **SELF-CONTRADICTION AND PARTISANSHIP :** The Report reaches its last stage of evaluation determined to have the worst of both the worlds. After asserting in the Introduction that "at the start it was the Stock Exchanges that attracted sole attention, but it soon became clear that *much of the trouble came from outside markets and from powerful outside operators*" (Page i), the Report throws its discretion to the winds and makes the discovery "that nearly all our Stock Exchange transactions are *initiated and whipped up by the members themselves*" (Ch. VI, Para 4, Pages 68-69). No attempt is made to reconcile this self-contradiction. Then follow the tilts at the windmills. Quite unable to fathom the fundamental trend of the downward movement of stock prices consistently in operation during the last two years, the Report maligns the stock market and lets fly at the "wicked bears" in a dozen different places (*e.g.*, Ch. I, Para 26, Page 8 ; Ch. VI, Para 19, Page 72 ; Ch. VII, Para 12, Page 89), as if swallows are not a sign but the cause of summer. Blaming "the powerful speculative gangs of the Bombay market" for the slump in prices in May 1947, the Report launches into a diatribe with the unfounded allegation that the stock exchange authorities "found themselves ineffective in going against the self-interest of the great majority of their members, including themselves" and then its morbid imagination

runs riot as it exclaims—"One wonders it these individuals ("wicked speculators") are any better than the vultures that gorge human carcass, when, in times of cholera or plague, streets are strewn with dead bodies" (Ch. VIII, Para 21, Page 108). Such abusive expressions expose the complete subservience of the Report to that ebullient section of the financial press which in its jingoism constantly fights a battle now for the bulls and then for the bears. It is not the function of the administration of the Stock Exchange, nor is it the function of a Government Report, to participate actively in these perpetual tussles by pretending to an omniscient knowledge of the movement of prices. In the main, price-determination is the function of the market and not of its administrative authority. The Presidential address at the last Annual General Meeting of the Exchange gives the following effective reply to the pretensions of the Report in this direction :

> "The conclusion is inevitable that except in cases of grave and unforeseen emergencies the only fair price that can be evolved is the price reflected from time to time in the stock market. The history of Stock Exchange prices is littered with examples of "fair price" determined by financial publicists, supported by Government officials and approved of by economic Pundits, which have disappeared into thin smoke at the first puff of unfolding events. But there are some people who would tamper with the market mechanism in order that it might be made to reflect a "fair price" of their own imagining. They would even advocate total destruction of vital parts of the market machinery and urge, for instance, ban on short sales, prohibition of continuations, abolition of account trading and so forth, if the market fails to live up to their divine expectations. It is against such rash and uncritical proposals that I here sound a note of warning.

> The path of stock market reforms lies in other and different directions."

In the context of this conclusion, such remarks and observations of the Report as the one cited above or as the one which clouds Para 25 of Ch. VIII (Pages 109-110) carry little meaning and less conviction.

27. RESULTS OF THE EVALUATION ANALYSIS—A SUMMING-UP : The thunder and lightning of the Report notwithstanding, four firm conclusions emerge from the foregoing analysis. It is established that—

(a) Indian Stock Exchange prices have by and large faithfully reflected the fundamental trends (including inflation) underlying the economic situation.

(b) They have reflected the change in the dividend and profit-earning capacity and measured the progress of corporate enterprise.

(c) They have responded to the changes in monetary policy and the alterations in the basic rate of interest.

(d) They have recorded the right trend and the apparent fluctuations have not been the artificial fluctuations caused by erratic market manipulations but the true fluctuations inherent in the economic conditions of the country which it was the duty and the prime function of the stock market to reflect and to record.

In performing these functions during an abnormal period, "the Stock Exchange has acted as a sensitive barometer reflecting faithfully the fundamental tendencies underlying national progress, measuring broadly its material achievements and failures in the economic field", as pointed out by the President of this Exchange in his last annual address. But this is not a claim to stock market perfection. The Stock Exchange is a human institution, and like all human institutions it has its full share of faults and weaknesses. The following further observations of the President elucidate the point :

> "Speculation, because of its volatile nature, has been prone to get out of hand at certain times, sometimes at the top and sometimes at the bottom of long business cycles ; and at certain points it has proved susceptible to manipulative pressure by disturbing agents with a strong dash of financial jugglery, rumour-mongering — and much else — in their make-up. In such cases market emotion has been exploited and the delusion produced that share prices are possessed of some mystical self-raising and self-depressing properties. It is in the correction of these unhealthy tendencies that there lies the central problem of Stock Exchange reform."

Unfortunately, in its obvious anxiety to prove its misconceptions, the Report has missed the wood for the trees and has perpetrated economic and statistical fallacies fit for a jest, were not the jest so cruelly unjust in its reflections on the workings of the Indian Stock markets.

28. EVALUATION ANALYSIS OF THE REPORT—ITS FAILURE : This concludes the examination of that part of the Report which deals with the analysis and evaluation of market functions. The question may be repeated : Does it cut off the ground under the Report ? Once again the Report answers that only after an enquiry "into the allteged defects of the stock market as it now functions (and seeing) how they affect the interests of the public and of the national economy as a whole" "can we be in a position to judge if the demand lately made for Government regulation is justified" (Ch. V, Para. 1, Page 59). It is clear that the Report furnishes no basis for such a judgment.

VI—PROPOSALS

29. THE REMEDIES FOR THE "PATIENT": It now remains to deal with the fourth head of the Report. An omnibus effort, if it lacks in the essential qualities of discrimination and critical analysis, has one merit: it makes up for its deficiencies by bringing all the material, the good and the bad, together. Witness the full-dress parade of all the proposals, recommendations and "reforms" from the time of the Atlay Committee *via* the Morison Committee right down to the present day. Each remedy, when discussed in its place in the Report, is given the major emphasis and held out to be the most important. But obviously, if all these specifics were to be administered together, even a patient with the strongest constitution would fail to survive. The cure must be related to the patient's state of health.

30. THE STOCK MARKET—ITS PRESENT STATE OF HEALTH: What is the present state of health of the stock market? The colourful journalistic account of the Report deals with a stormy period of history, abnormal in all its characteristics and abnormal in its repercussions on all institutions, not the least affected of which were the Stock Exchanges. That period is over and unlikely to recur, at any rate as far as one can see. The Stock Exchanges are now discouraged, depressed and deflated, struggling on the fringe of survival. The post-script added to the Report that "important changes have come over the Indian Stock market" since it was drafted is illuminating. If there has to be legislation, it must not be to prescribe for a past that is over and which admittedly was abnormal in all its conditions, but for the living present and on the assumption of a normal future. What might have been meat at one time would be poison at another. Care and judgment must therefore be exercised in framing a simple and flexible piece of legislation providing for normal times and for conditions as they exist if the investment market is not to suffer irreparable harm.

31. THE PROPOSALS—A STATEMENT OF STOCK EXCHANGE VIEWS : For purposes of framing suitable Stock Exchange legislation, the Report is of little assistance. Its assumptions resting principally on a misconceived American analogy are invalid, its conclusions are vitiated by the abnormal conditions prevailing in the war and post-war years and its understanding of the stock market machinery and evaluation of the functions the market has performed are swamped in doubt. Therefore its assessment of the various proposals relating to stock markets that have been canvassed from time to time is basically unsound. Nor does the Report throw light on any new fact or circumstance of sufficient import to oblige the Exchange to revise the views it has from time to time expressed in the fullest detail on these proposals. In the circumstances, a categorical statement of the views of the Exchange is all that is necessary :

(a) *All-India Legislation :* The Exchange favours all-India legislation. It has urged this point, not "lately", or because another Exchange has recently been registered in Bombay (Ch. VIII). It is an old demand, and had Government acted as advised by the Exchange, there would have been a check on kerb trading and *katni* markets and the extravagant speculation of the war period would have been more restrained.

(b) *Unitary Control :* The guiding principle of regulation should be unitary control — only one recognised exchange in each centre and no licensing of outside brokers or agents — in order to enforce discipline and maintain control.

(c) *Legal Contracts :* All transactions in shares and securities other than through, with or between members of recognised stock exchanges should be illegal.

(d) *Ready and Forward Delivery:* The distinction between "Ready" and "Forward" business is in practice largely a legal fiction. No such distinction should be drawn and all dealings should be properly regulated.

(e) *Fortnightly Clearings:* The existing system of Fortnightly Clearings should be maintained. The hectic speculation that flourished when there were weekly settlements under Defence of India Rule 94-C clearly proves that the length of the period — whether a week, a fortnight or a month — is not very material.

(f) *Budla:* It is impracticable and undesirable to put restrictions on Budla as it is an integral part of the trading system. Besides, no legislation can be devised which could not be easily evaded.

(g) *Margins:* A system of margins would protect brokers but no practical system administratively enforceable can be devised. Such a system would also reach down to the question of credit at its very root. This would have serious repercussions on accepted methods of trade, commerce and finance. Whatever the claims on paper, margins would not check speculation to any appreciable extent. According to the Report, "between February 1945 and January 1946, the margin requirements in the U. S. A. were raised from 40% to 100%. Yet speculation went on all the same" (Ch. XI, Para 38, Page 143). In Indian conditions where "funds employed on the stock market are largely derived from private sources" (Ch. VII, Para 22, Page 92), the system would, while handicapping *bona fide* business, fail in its chief objective. That has been the experience of the East India Cotton Association, where the system was recently given a fairly long trial and finally abandoned with the consent and approval of the Government of Bombay as it proved to be administratively top-heavy and unworkable and in practice a total failure.

(h) *Blank Transfers:* Restriction on blank transfers would be inadvisable and undesirable. It would not dampen down speculation. On the contrary, it would stimulate unhealthy business for differences because it would be more advantageous to reverse before the end of the Clearing contracts that are outstanding and so avoid taking delivery rather than take delivery and lose on transfer stamp duty and registration charges. It would not only accentuate unhealthy speculation in differences through reversal of contracts; such reversal of contracts would also mean fewer deliveries and correspondingly fewer transfers entailing a substantial reduction in the total amount of revenue accruing to Government. Further, as the Report observes, compulsory registration "involves not only expenditure, but it reduces the negotiability of the securities" (Ch. IV, Para. 45, Page 53). It is for this reason that blank transfers have not been abolished by law in any country. Bearer securities are "largely in use on the continent and the U. S. A." (Ch. IV, Para 7, Page 41). India is a country of huge distances and companies take an unduly long time, "usually a month" and sometimes "several months" (Ch. IV, Para 45, Page 53), before registering a transfer. The investment habit would be retarded if restrictions were placed on a system which the Report acknowledges "imparts a high degree of negotiability to securities along with safety for dealings" (Ch. IV, Para 46, Page 54) — two prime pre-requisites for effective functioning of trade in the stock market. Blank transfers render the same useful assistance to business in shares as promissory notes and bearer bonds do in the gilt-edged market and both are equally indispensable for efficient investment service.

(i) *Trading Rules :* A uniform code of rules of business should be adopted by all recognised exchanges.

(j) *Listing Regulations :* A uniform set of listing regulations should be prescribed for all recognised Stock Exchanges.

(k) *Company Promotions, New Issues and Underwriting:* Company promotions, underwriting and new issues should be regulated on the lines indicated in the Report which follows in this respect the communications addressed by this Exchange to Sir Alan Lloyd, till lately Examiner of Capital Issues with the Government of India.

(l) *Companies Act :* The Act should be thoroughly overhauled, particularly in the matter of stock market dealings by Directors, Managing Agents and other officers as well as in regard to publication of periodical progress reports, financial statements and similar other information.

(m) *National Investment Commission:* Such a Commission (Ch. X) would be cumbersome and top heavy looking to the needs of the times. A senior Government officer with expert knowledge and appropriate qualifications and experience should be appointed to co-ordinate and administer the legislation relating to stock exchanges, joint stock companies and new capital issues. The officer should be *ex officio* a Director of the Reserve Bank and of the Government Industrial Finance Corporation. There should be no question of empowering such officer to regulate stock market prices. That would be to invite disaster (See Para 26 above).

(n) *Sales Tax :* It would be suicidal to levy "a sales tax on share transactions . . .every time a scrip is sold " (Ch. XI, Para 70, Page 151). The present Stamp Duty in Bombay on contracts relating to purchase and sale of shares and securities is in fact nothing but a turnover tax not only on sales but also on purchases. Even the present stamp duty imposes a crushing burden as demonstrated in the letter addressed by the President of the Exchange to the Finance Minister, Bombay, on the 29th of April, 1948, and since published for general information. The urgent question is one of a substantial reduction in that duty and not of levying increased taxes. As pointed out by "Commerce" in its issue dated the 31st July, 1948, an additional levy would "if enforced, doubtless prove to be the last straw on the camel's back in so far as investments in shares is concerned."

VII—THE CORRECT PERSPECTIVE

32. It remains for the Exchange to acknowledge that the task confronting Dr. P. J. Thomas was exceptionally difficult. The technical staff at his disposal was entirely inadequate. He himself did not have the advantage of familiarity with the stock market or practical training and experience of its methods and machinery. The survey no doubt was spread over two years during which period he took the opportunity of making some visits to the Exchange but perhaps his other pre-occupations must have left him with little time to give as much thought to the problem of Stock Exchange reform as its complex nature obviously requires. It may be recalled that the two previous Inquiries into Stock Exchange affairs, both carried out in Bombay, were by specially appointed Committees. Their Chairmen were experts and commanded a wide range of practical experience. Their Reports were therefore set in a different perspective. As in the case of those Reports, so in the present case, the Exchange has expressed its views in candid and forthright terms. They refer to matters of importance which affect the Stock Exchange vitally and on which therefore it has a right to be heard. The issue at stake is no less than the survival of the stock market as an efficient and integral part of the economy of the country. The Report emphatically declares that "it is for the people to say what function they want the stock market to perform and in what manner it should be performed" (Ch. VIII, Para 9, Page 104). In this its democratic zeal obviously outruns its economic discretion. What function an individual unit should perform will be largely determined by its place in the economic system that is in force at any given time. The stock market will not turn out silk yarn or steel bars however peremptory the orders of the people. But the people are the masters and within the limits of the natural functions of the individual unit in relation to the structural whole they have a right to see and say whether the work is done

well or ill and to devise measures for better and more effective performance, if that be possible. It is for this reason that the legislators must be well-informed and it is for this reason also that a case must be presented as a whole in all its aspects and not in parts. In technical matters particularly, where much misconception is possible and where much harm may be done by apparently small trifles, there must be full and fair discussion and agreement at an expert level in framing legislation : the approach must be practical and scientific and the appeal must be to the head and not to emotional prejudices and predilections Even in democracy there is *this* perennial danger to guard against and it is best always to take wise counsel and co-operate in friendliness in the general interest of the country at large.