

## Share Market Gyration: Thwarting National Policy Making

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The share market has been giving the investors the jitters. Few know which way it would go next. Recently, after touching a peak of 19,198.66, the BSE index came down to 17,559.98 and more such fluctuations are in store. This was not unexpected given the rapid rise of the index in the preceding 2 months and especially in the preceding 2 weeks. Investors were getting used to hearing that the index had climbed by 1,000 points in 6 or in 4 trading sessions. It was a bullish market which seemed to have no stops. The media and specially the pink papers with screaming headlines were egging the investors on with stories of investor wealth going up by lakhs of crores and how Indian businessmen were becoming the wealthiest individuals in the world – and all this in a space of a few months. Heady stuff for a country which is still one of the poorest country in the world and 50th from the bottom in HDI ranking. Greed had been raised to a new high pedestal.

The news has been that foreign funds were investing heavily in the Indian markets. They are supposed to be attracted by the rising value of the rupee vis-à-vis the dollar and the high returns being offered by the Indian companies. There are several components of this flow from foreign shores. Rising oil prices have resulted in growing surpluses with the oil exporting countries and they have been looking for avenues to invest. Since the dollar has been declining, they are wary of parking all their funds in the US and in dollar securities so they have been looking for alternatives. The Indian markets which have been rising because its corporate sector has seen a massive surge of profits seem to provide a safe haven of high returns. What could be better than this?

The second component of this flow is the NRI funds which is also looking for diversification of portfolios for much the same reason. Till recently, they brought only little of their savings back to the country but now they are doing so in bigger amounts. According to the just released World Bank report, India is now the largest recipient of non resident transfers in the World. The third component is the flows from the high export earners like China who are also looking for safer havens and diversification to park their surpluses and reserves. China and Japan have over a trillion dollars of reserves which till recently were mostly in dollar related securities. The fourth component is the movements of funds by terrorist organizations, money launderers and smugglers, etc. Apart from continuing their political/business agendas in the country, they are also seeking diversification of their financial operations.

In the Indian context, the Participatory Note (PN) route which is a financial instrument operated by the FIIs has provided a new way of investing in the Indian markets in which the investors identity remains a secret. The secrecy is required since there is illegality and possibly criminality associated with these funds. About 50% of the FII funds now belong to this category. India's National Security Advisor has expressed worry over the operations of illegal money and terrorists through the bourses, to channel funds not only for their own use but also perhaps to destabilize the economy at some point. RBI has expressed worry about this phenomenon and now the SEBI has followed suit.

This route has also been useful for the Indian politicians, businessmen and other corrupt people to bring back their black savings stocked abroad over the last many decades. They can whiten their money through this device. That is why the Indian establishment has not touched this route in spite of the ill effects it is having on the Indian economy in recent times. The Indian businesses have had another important reason to bring back their money, namely, to invest in their own businesses given the need to protect themselves from hostile takeovers. Further, as for others, of late, dollar havens are not all that safe or lucrative as compared to the home market.

Finally, the real estate boom in the last three years has peaked and some funds are being withdrawn from there to be parked in the rising share markets. In other words, quite a conjuncture of factors have fuelled the boom.

The Indian stock markets have been known for severe manipulations by the owners of companies, financiers and brokers who indulge in insider trading and fixing of prices (For an account of this, see this author's book, *The Black Economy in India* published in 1999 by Penguin India). It is suspected that the recent boom has come in handy for such unscrupulous elements to take advantage and raise prices further. Often, owners of companies that are not doing well use this device to manipulate the price of their stocks and make huge sums of monies at the expense of the gullible small investors. Media is cynically used to plant stories. All this has been noticed in the past three stock market booms in the last 16 years. Something similar seems to be happening again.

Why do prices not shoot up like this in the mature economies? The reason is that the Indian markets are rather narrow. The organized sector of the Indian economy is less than 50% of the economy and employs only about 6% of the work force. If government is taken out of this, the rest would be the corporate sector which is broadly represented in the stock markets. Thus, the private corporate sector is not more than 30% of the national output and employs only 2% of the work force.

Further, the ownership of this sector rests with less than 0.1% of the population. The public owns only about 10% of the shares of the corporate sector. The vast bulk being held by promoters, FIIs, financial institutions and the like. In fact, a large part of the FII holding also belongs to the friends of the promoters so that no threat of takeover emerges. In companies like WIPRO or Infosys, the number of stock holders is less than a few thousand and the owners and FIIs own around 90% of the equity stock.

The result is small floating stock of shares (especially of the good companies) in the Indian markets and little relationship with the larger economy so that small infusion of funds can cause large price changes. This along with the above mentioned manipulations make the Indian markets volatile. This is compounded by the fact that the return on stocks is largely made up of capital gains and not dividend. Thus, if the market stops rising the expected return becomes very small and then it is not worth investing. In other words, when prices change rapidly, there is no stable resting point for the stock markets. A rapid rise invariably leads to an equally rapid opposite movement. Fluctuating markets do not move with the fundamentals. In fact, most of the time, they are not in sync.

The increase in wealth associated with the stock market boom is notional. It is based on small amount of trades and does not correspond to any real increase in wealth. This causes imbalances in the economy because it is concentrated in the hands of less than 0.1% of the economy and spells danger for the country with vast sections getting marginalized and instability in society rising. It results in devaluation of work and weakening of democracy.

In brief, the PN story and the market gyrations suggest that the Indian markets are substantially driven by government policies as manipulated by vested interests. Today, they exercise their influence as members of Parliament, Ministers and member of advisory boards of legislative and governmental bodies. These interests have become accustomed to having things their way so even a slight disturbance comes as a rude shock, like, the news that PN story may be coming to an end because it is not good for the vast majority of Indians. Under the circumstances, can good policy or national policy making other than what suits these vested interests make sense?