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Protectionism in the Stock Market

What is the issue?

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- Structural problems within India's stock exchanges are causing trading in Indian derivatives to move offshore.
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- But rather than addressing them, BSE, NSE and MSE recently announced stopping data feed regarding Indian stocks and indices to overseas exchanges.
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What are the aspects that drove the move?

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- While foreign exchanges seem to be doing better at attracting new clients, India's stock exchanges aren't willing to compete.
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- Instead, they've resorted to protectionism to guard the home turf against foreign exchanges by resorting to data feed disruption.
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- They've spelt out their intention to not renew existing agreement with foreign exchanges regarding data-sharing, most of which will expire in 6 months
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- The reason stated is that offshore derivatives could be causing "migration of liquidity from India, which is not in the best interest of Indian markets".
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- But in reality, higher volumes of Indian derivatives are trading in the offshore market than in domestic bourses, which has spooked Indian exchanges.
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- This crackdown on offshore derivatives market is hence more to boost the businesses of Indian exchanges than anything else.
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- This move is also expected to benefit ambitious endeavours such as the "International Financial Services Centre" in Gujarat.
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What are the structural issues in the Indian stock market?

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- Index derivatives such as the SGX Nifty that is linked to stocks that form Nifty, have gained the patronage of large foreign investors for many reasons.
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- These instruments are traded for longer hours in offshore exchanges, including hours when Indian exchanges are closed for business.
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- Contrarily, the proposal to extend trading hours by Indian stock markets has failed to take off.
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- Also, places like Singapore and Dubai, are low-tax jurisdictions that offer investors the chance to lower their transaction costs.
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- In India, in contrast, the securities transaction tax and the capital gains tax discourage foreign investment in financial assets.
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- All of these make the foreign exchanges more investor-friendly, and the fact that offshore derivatives are denominated in dollars adds to their allure.
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What are the challenges?

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- **Sustainability -** Foreign bourses will find other ways to list derivatives linked to Indian stocks and indices without any help from Indian exchanges soon.
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- The present move, thus, is unlikely to rein in the vast offshore market for Indian derivatives.
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- **Addressing Demand -** Singapore Exchange Limited (SGX) had recently decided to introduce futures on individual stocks that are part of Nifty.
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- Incidentally, the SGX's decision to introduce futures was spurred by the

SEBI’s decision last year to restrict foreign investment in domestic futures.
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- While the current protectionism can be seen as a counter to this, it needs to be recognized that offshore markets are simply catering to the unmet demand.
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- **Way Forward -** India’s policymakers should hence address the structural problems that have caused trading in Indian derivatives to move offshore.
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- This would be a far better response than any knee-jerk response favouring domestic exchanges and also boost trading volumes and businesses.
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Source: The Hindu

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