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TOWARDS LOW COST ECONOMY

Challenges and constraints

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The reorientations during the last 4 years or so, both in the field of overall macro-economic policy as also policies specific to individual industries, give a clear indication of an impending shift towards a free market economy. The latter in fact, is a much sought after concept in a predominantly socialist India against the backdrop of the declared commitment to usher in a competitive low cost economy.

Undoubtedly, the reoriented approach, as reflected in a series of liberalisation measures since 1985-86 in the field of industrial licensing, import-export policy and fiscal sphere, have contributed to a significant step-up in investment and industrial growth. The seventh plan is, in fact, slated to end with an overall GDP growth rate of 5.5 per cent, exceeding the target of 5 per cent.

Apparently, these achievements may seem to vindicate the success of the new approach. However, the problems of burgeoning budgetary deficit, growing pressure on balance of payments, inflation and significant depreciation of the rupee *vis-a-vis* major world currencies, which have indeed aggravated in recent years, clearly show that as yet, we are far from achieving a high-production low-cost scenario. The concern over this is fairly legitimate, particularly keeping in view the fact that bulk of the resorce support for various expansion, modernisation projects and schemes for technological upgradation etc., has been sought to be justified on grounds of achieving productivity improvement, cost competitiveness and quality. In fact, even liberalisation of import policy which has led to a heavy surge in the import of capital goods, raw materials, intermediates and inflow of technological services in recent years can boomrang unless there is commensurate increase in exports based on a low-cost, high-quality and excellent services package.

Clearly, there is need for undertaking reappraisal of the factors leading to high cost economy. Besides enabling identification of appropriate corrective steps, this would also facilitate better understanding of the consequences of the discernible moves towards a free market economy.

Delays in the commissioning of new projects expansion and modernisation schemes leading to time and cost overruns need urgent attention. In this context, recent changes seeking to streamline the procedures and cutting down multiplicity of agencies involved in according approval to project proposals, have generated an air of expectancy in as much as the investors, are now hopeful of commissioning their projects as per the schedule drawn up by the implementing authorities. While this would certainly have a positive effect on the capital cost and consequently, the cost competitiveness of the goods and services, no significant improvement is expected unless adequate attention is paid to the need for timely implementation of projects in the government sector which provides basic inputs, utilities and services such as coal, power, steel, petroleum, etc. In respect of the latter, the situation is far from encouraging as brought out in a recent study conducted by the ministry for programme implementation, covering 297 projects in the central sector. On a total investment outlay of Rs 49,247 crores originally envisaged, the escalation in cost owing to delays in execution, as on January 1, 1989 was Rs 29,300 crores.

While this would inevitably mean a cascading cost-push effect throughout the plant life after commissioning, there is need for clear thinking whether or not the consequential increase in the capital cost could be ignored while fixing the prices for the goods and services if only to prevent the high cost burden on the economy. Undoubtedly, such a course would have serious repercussions on the overall budgetary position even as huge sums are required to be reimbursed as capital subsidy. Nonetheless, this may sound a healthy proposition in the long-run as, on the one hand, project delays would become transparent at the macro-economic level leading to better financial accountability and, on the other, viability of downstream industries could be projected realistically free from the cost-push effect of basic goods industries in the government sector.

While on the issue of pricing for the public sector projects, the reorientation in policy as envisaged in the policy paper on administered pricing some three and a half years ago, is yet to produce the desired results. The concept of long-run marginal cost (LRMC), on which the BICP is ostensibly working to determine the ex-factory prices for a number of core sector commodities, offers a good potential, at least theoretically, for contributing to a low cost economy. The moot question is whether this has really helped in any meaningful way. It does not require much effort to recognise that, given cost escalations arising from delays in project commissioning, currency fluctuations, besides project locations very often decided on non-economic considerations and in turn, entailing heavy cost of infrastructural development, even the most efficient unit of optimum size and incorporating the state-of-art technology, will turn out to be high cost in financial terms. Besides, even for the existing industries, wherein the policy paper sought to achieve lowering of administered prices by insisting on cost reduction through improvement in the productivity, better inventory management and improved labour relation etc., the net result has been steep increases almost across the board.

Mere adoption or commitment to competitive pricing or fixation of administered prices in the most cost-effective manner, is not enough. For instance, if the capital cost goes up owing to delay in the commissioning of the project or taxes are levied at various levels, including custom and excise and consequential increase in the cost has to be serviced, there is no escape from a high cost scenario, even within the framework of, say, the LRMC pricing.

A number of projects, particularly in the power sector, have been delayed because of the clearance required from the environmental angle. Nearly 37 per cent of 38,000 MW generation capacity proposed to be added during the 8th Plan is held up on this account. While concern on this account is appreciated and efforts should be pursued vigorously to maintain the ecological balance, need for expeditious clearance by the ministry of environment and forestry cannot be overemphasised.

The contribution of indirect taxes to a high cost economy is well-known. It is also clear that the levy of taxes, customs or excise duty, on capital goods does not constitute a net resource gain to the exchequer by way of additional revenue, as the project cost increases, which in the case of public sector projects has to be financed entirely by the government, and even for projects in the private sector, financial institutions owned by the government have to bear the brunt of the additional cost. In fact, there is a net loss to the extent of financing charges during construction on the duty-induced addition to capital cost. This apart, there is a cascading cost-push effect on the economy generally or increased subsidy payment as in the case of industries like fertilisers which come under administered price control. These implications have been recognised by various committees of the government, including the economic administrative reforms commission (EARC), headed by late Dr L.K. Jha, as also in the finance minister's speech on the Union budget for 1985-86.

The impact of substantial devaluation of rupee *vis-a-vis* major world currencies such as dollar and yen, on the balance of payments situation and the foreign exchange reserves is well-documented. However, what does not come into sharp focus is its debilitating effect on the viability of new projects as also the cost-push that it leads to. While it is customary to dismiss this as an exogenous factor on which the government has little control, the fact cannot be ignored that the value of rupee vs. other currencies reflects the overall weakness of the Indian economy, particularly the aspect of high inflation in turn causing serious imbalance in export — import and consequential weakening of our currency in a fluctuating exchange regime. If only we can improve management of fiscal budget, and contain the cost-push inflation, the same will automatically show up in an improving exchange rate situation.

It is clear that, in an otherwise downward inflexible high cost environment, the move towards a liberalised/competitive free market regime may not produce the desired results. As a logical corollary, even the solution to economic ailments, including those concerning individual industries, cannot be sought in the underlying economic system/philosophy. Nor the existence of such problems be viewed as a reflection of the merits/demerits of any particular system whether complete government regulation, partial decontrol or total decontrol/free market economy.

In the case of cement, after its partial decontrol in 1982, while the market prices fell as a consequence of the sudden spurt in capacity, the increase in cost of production due to a steep escalation in the prices of coal, power and railway freight, etc., threatened the viability of the cement companies. Various concessions offered by way of reduction in levy quota or excise etc., have been of little consequence as brought out in a number of memoranda submitted by the Cement Manufacturers' Association (CMA) from time to time. Obviously, decontrol with effect from March 1, 1989 has not relieved the situation. The cement industry has requested for moratorium on repayment of outstanding loans, consideration of interest subsidy and adequate cash-credit accommodation from the banks etc., as part of a crisis management package.

In the steel sector which comes entirely under the administered pricing system, between 1982 and 1985, there were as many as 6 revisions in the price, ostensibly to accommodate the cascading effect of increasing input costs, such as coal, power and railway freight. Since 1985, however, for almost two years, conscious efforts were made to absorb the impact of increases in input costs through improvement in productivity, better management and rationalisation/streamlining of manpower deployment. While this did prevent any increase in the administered price of steel for two years with consequential relief to the users, the declining profitability of SAIL, which was inevitable in the emerging situation, became a matter of concern. This, together with the declared commitment to finance expansion and modernisation plans predominantly out of internal surpluses, virtually meant a good-bye to the policy of avoiding recourse to increase in prices to accommodate the cost-push effect. Since 1988, as per the recommendations of the joint plant committee, the steel prices have again been raised to adjust for the escalation in the input cost. Though this may take care of the financial health of SAIL, which has already turned corner, the cost-push effect of this on the downstream industries and the consumers remains a matter of concern.

The new approach with its

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