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Cap the surging monster

Forex reserves are no great help in undertaking domestic price stabilisation operations, says **Uttam Gupta**

INFLATION is once again showing no signs of let up on its double-digit climb — currently at over 10.5 per cent. With a huge stock of money already in the marketplace due to fiscal profligacy of 1993-94, large budget deficit left uncovered in 1994-95 budget and steep increases in the administered prices of basic items such as wheat, rice, sugar, petrol and diesel immediately preceding the presentation of the budget, the possibility of inflation getting back to the August 1991 figure of 17 per cent or perhaps, even higher is not ruled out.

Clearly, it is a case of too much money chasing too few goods. While on the one hand, recovery in industrial growth during 1993-94 was much below expectations, on the other, money supply in the economy has been allowed to increase at a galloping pace. This is despite oft-repeated claims by the RBI that limits will be place on monetisation of the budget deficit, which is the predominant source of increase in money supply.

In this context, the RBI had initially specified a target of 12 per cent for 1993-94, which was subsequently revised to 14 per cent in September 1993. The actuals during the period March 31, 1993, to February 18, 1994, has been placed at 16.3 per cent as against 13.6 per cent during the corresponding period of 1992-93. For the whole year, the increase in money supply is expected to be about 17 per cent.

Significantly, the composition of money supply has also changed in a manner that would prove to be highly inflationary. During March 31, 1993, to February 18, 1994, the increase in demand deposits was 18.1 per cent in sharp contrast to an increase of only 3.3 per cent during the corresponding period of 1992-93. Similarly, the increase in currency with the public was 18.9 per cent as against 10.9 per cent in 1992-93. The component of money supply which is otherwise not so inflationary i.e. the growth in time deposits has however, declined from 18.8 per cent during March 31, 1992 to February 18, 1993, to 15.3 per cent in the corresponding period of 1993-94.

Having already allowed the situation to drift to a point beyond redemption, there is very little that the RBI could do by way of contributing to effective management of inflation. That would also explain, to some extent, the delay in the announcement of the credit policy for the ensuing season. In the past, the RBI has been seeking to exercise control either by raising the lending rate (during 1991-92, it was increased four times) or restricting the availability of credit to industries or a combination of both. None of these options are presently available.

The government is committed to lowering the interest rate as part of the financial sector reforms. From a peak of almost 21 per cent (without interest tax) the basic lending rate has already been reduced to 15 per cent. The compulsions of Indian industry having to compete in a global environment however, call for further reduction. As regards the quantum of credit, unlike the past when the overall availability of institutional credit was tight in relation to demand, the commercial banks are currently flushed with funds. Curtailment of lending operations could be seriously counterproductive from point of maintaining profitability levels.

While admitting the resurgence of inflationary tendencies, the government has sought to put up a somewhat orthodox defence in terms of its capability to deal with the menace. The argument is essentially two-fold. First, it is made out that we have substantial reserves of foodgrains and that in the event of shortages, these can be drawn upon. Second, the bulging forex reserves of about US$14 billion at the end of 1993-94 could be used for imports. Both these arguments are fallacious.

We have already seen how intervention by government agencies compound the problem rather than easing it. In this context, the recently-attempted price stabilisation by the FCI through auction of the wheat stocks in the central buffer, actually worked to give a further boost to selling prices. Indeed, the auction itself was done at a price that was even higher than the PDS issue price.

Moreover, we have been extremely lucky to have six consecutive good monsoon years that helped in maintaining high levels of foodgrains production. So much so, the former has even helped in overcoming, so far, the potentially devastating effect of recent policy changes including decontrol of phosphatic and potassic fertilisers. That may not happen again and one bad patch of monsoon would be sufficient to not only bring down buffer stocks to a low level, but, may also lead us to depend heavily on imports of foodgrains. This possibility is not ruled out during 1994-95 itself as the meteorological office is expecting a below normal monsoon.

Surfeit of foreign exchange may give some confidence to the government although the fact that much of this is highly volatile. A sudden outflow could have a serious destablising influence and make us extremely vulnerable. That apart, mere availability of foreign exchange does not automatically ensure that the commodity in short supply would be imported well in time and made available to the masses.

Another aspect is the expenditure that the government will incur in making imported food available to the consumer. It may be recalled that the cost of wheat (c&f landed plus handling and distribution expenses) imported in 1991-92 worked out to about Rs 6 per kg as against a PDS issue price of just about Rs 3 per kg. If the selling price is high, it would frustrate the very objective for which import has been done i.e. to stabilise the domestic price situation.

If, however, the government proposed to sell the imported item at a price lower than the domestic selling price or perhaps, even equal, it will have to incur heavy subsidy. That in turn, would increase the budget deficit and consequently add to inflation. It is clear that the forex reserves alone are no great help in undertaking domestic price stabilisation operations. For this, to achieve the desired results, other preconditions are also required which simply do not exist; nor can these be created overnight.

All economic fundamentals are pitched in favour of exacerbating inflation. Short of a magic wand, there is nothing extraordinary that might happen to facilitate improvement either on the demand side or the supply side. Declining investment in agriculture, substantial reduction in fertiliser consumption and the possibility of a below-normal monsoon during 1994-95 do not auger well for increase in foodgrains production. On the industrial front, despite the easy availability of funds, contemplated investments are unlikely to translate into increased production.

The position on the demand side is even more grim as the economy will have to put up with the consequences of further increase in forex reserves to an estimated level of about US $25 billion by the end of 1994-95 (as per the CMIE) even as the government does not intend to allow the rupee to appreciate in order to maintain exports growth.