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Inflation

Fight on four fronts needed

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> In the context of assessing whether the government has been put in the appropriate gear, four major issues need to be addressed. These include deficit finance, administered prices, pricing of agricultural products and black money. True there are no magic solutions to this complex phenomenon. But the degree of success on these fronts will give an indication of our preparedness to deal with the problem.

When the National Front government assumed office about a year ago, controlling inflation was on the top of its agenda. Notwithstanding various steps taken in this direction, the disquieting trend continues unabated. This is amply confirmed by the revelation in the RBI report for 1989-90 and the already beleagued consumers continue to reel under the impact of spiralling prices of almost all essential items at the retail level.

A thorough scrutiny of the underlying factors is needed, as any failure to deal with it effectively not only erodes the real content of our development exercises, but also entails serious sociopolitical repercussions. True, there are no magic solutions to this complex phenomenon. Nevertheless, there has to be some indication of a movement in the right direction in order to ensure success within a reasonable period of time, if not in the immediate short-run.

In the context of assessing whether the government machinery has been put in the appropriate gear, four major issues need to be addressed. These include deficit finance, administered prices, pricing of agricultural products and black money. In fact, the degree of success on these fronts will give an indication of our preparedness to deal with the problem.

Budgetary Deficit

The need to contain budgetary deficit and avoid excessive recourse to deficit financing is by now fully embodied in our thinking and needs no reiteration. It has been adequately reflected in the process of policy formulation and even got special thrust in the seventh plan. But still, the quantum of deficit finance particularly during the 80s, has increased at an accelerted pace. Clearly, there have been serious gaps between policy pronouncements and implementation of the required measures.

In its endeavour to improve fiscal management, the last regime sought to establish mechanisms to ensure a greater degree of accountability and transparency in government functioning/transactions. The various administrative ministries/departments were required to review their income-expenditure profiles every month. The finance minister even made a commitment to present the deficit position to the Parliament every quarter.

Whether or not these mechanisms/institutional arrangements were more effective than the earlier dispensation is a debtable poi[illegible]ultimate test, in any case, is the de[illegible]ccess in containing growth in the quantum of deficit finance. A more important element, however, is the sincerity of efforts involved in dealing with some of the fundamental factors contributing to this growing menace.

Defence has been a major burden on the exchequer. Initially, there were positive expectations that substantial reduction in defence expenditure could be brought about without jeopardising our security concerns. This was, perhaps, based on te presumption that efforts on the diplomatic front to improve relations with our neighbours, particularly Pakistan, would yield good results. The scenario is far from encouraging. In fact, any significant cut in defence expenditure at this stage is viewed with great concern. Needless to mention, the overall security environment in the subcontinent has deteriorated and it is unlikely that in the short to medium the situation would improve to an extent as the allow any significant cut.

Subsidies

There is enormous scope for reducing the quantum of subsidies. Potential areas having already been identified but appropriate decisions are hampered by lack of political will and indifferent attitude of the bureaucrats. For instance, farmers continue to pay for fertilisers at the rates prevailing a decade wago which in the face of allround inflation escalating cost of production and distribution, has led to steep increase in fertiliser subsidy to about Rs 4600 crore in 1989-90.

While there is consensus on the need to increase fertiliser price to the farmers, a suitable decision does not seem to be in the offing. Apart from the political dimensions, the Planning Commission's reported disagreement over how to reduce fertiliser subsidy, has contributed to avoidable delay. The Commission seems to prefer denial of the benefit of subsidy to the rich farmers as a better option. Attractive though this may sound, one must not ignore the practical difficulties in implementation, the high cost revolved and even the scope for misuse. In any case, this cannot be allowed to come in the way of a prompt decision on increase in fertiliser price for the farmer. In fact, following three successive years of good monsoon, the farmer is favourably placed to accept some increase in the cost of agricultural inputs, particularly fertilisers.

There is also substantial scope for reducing food subsidy through suitable rationalisation and stremalining of the Public Distribution System (PDS). As an immediate measure, withdrawal of the facility from urban areas particularly the cosmopolitan cities, can yield good results. In this connection, the suggestion in a recent NCAER study to withdraw around four million tonnes of grains meant for the "upper strata" of urban households from the PDS and its release in the open market merits attention. Simultaneously, measures aimed at efficiency improvement in procurement, handling, storage and distribution, rationalisation of manpower and over all cost minimisation through better planning and management, can effect additional savings. In the next stage, efforts are needed to gradually reduce the role of FCI and its outfits by facilitating direct interface between the farmer and the consumer, as recently recommended by the Bhanu Pratap Singh Committee.

The staggering interest burden on outstanding government debt is another important element tending to destabilise the budgetary position. It goes without saying that this has been the consequence of reckless use of borrowings to cover the revenue deficit in the past. The contemplated move to bring borrowings, both internal and external, under the constitutional obligation is no doubt welcome. While this alone is no panacea for the problem of budgetary deficit for which serious efforts are needed, it is rather unfortunate that the debate on this important question is meeting with resistance on trivial grounds.

The soft peddlers have argued that ceiling on borrowings will come in the way of negotiating external assistance and undermine our ability to deal with natural catastrophes etc. It is strange logic that we must not disciplie our routine financial transations because some day we might need resources to deal with other eventualities. While getting bogged down with administrative hitches, we seem to be forgetting the issue from where the resource will come.

Administered Prices

All through the 80s, increase in the administered prices of basic goods and services such as coal, petrol, steel and power etc., have contributed to inflation. In fact, these have had a much greater cascading effect than the levy of indirect taxes. Besides, to the extent such increases push up the cost of production in industries such as fertilisers, the exercise is futile even from the angle of resource generation as increased subsidy has to be paid by the government under the scheme of administered pricing. For instance, the recently introduced 25 per cent Gulf surcharge will lead to an additional fertiliser subsidy outgo of about Rs 150 crore to all naphtha and fuel oil based nitrogen producing units. In fact, if one considers the higher value of local taxes (levied as per cent on ex-refinery price) which will also have to be paid under the pricing scheme, the exchequer would lend up incurring a net loss.

Earlier in the year and before the presentation of Union Budget for 1990-91, hopes were aroused that the trend of the past would be contained if not reversed. Not only have these been dashed, the message seems to have gone around that if an undertaking wanted to minimise its losses or generate extra resources for its expansion/diversification programme, it could take recourse to increase in administered prices. A recent example will help drive home the point.

In the oil/gas sector, about four years ago, the price of gas was raised by about 400 per cent in February, 1987. The Kelkar Committee on Gas Pricing recently recommended an increase of Rs 200 per 1000 M^3 per annum over the existing landfall price of Rs 1400 over a three year period. Considering large scale flaring of gas and the need for its optimum utilisation particularly free gas, this price by itself shuld have been suggested at a lower level which would also be consistent with the prices prevailing the world over, besides ensuring efficiency in gas production and transportation.

Ironically, the Department of Petroleum and Natural Gas has rejected even the Kelkar Committee recommendation and, instead, suggested an exorbitant price of Rs 2500 per 1000 M^3 at landfall point and for the unit taking gas from the HBJ pipeline, an additional transportation element of Rs 1219 (against Rs 850/ currently allowed by GAIL). Considering the impact of royalty, central sales tax and the local taxes etc., the user industries along HBJ pipeline will have to pay a price of about Rs 4400 per 1000 M^3 as against the present landed cost of about Rs 2600 per 1000 M^3. Clearly, using the option of increase in the administered prices in this manner is certainly not desirable.

Pricing Foodgrains

The developing approach to pricing of foodgrains also raises serious doubts regarding their likely impact on inflation. First, increase in the procurement prices allowed to the farmers in recent years have become more frequent than in the past. In fact, during the current year itself, prices of major foodgrains items have been increased on two occasions. It is not clear whether these are based on comprehensive calculations with regard to possible increases in cost of inputs and other factors involved in crop cultivation. Further, the fact that there has been virtually no change in the overall scenario with regard to cost of basic inputs such as fertilisers, irrigation, HYV seeds and credit etc., only reinforces the doubts in this regard.

Second, in an ostensible bid to put agriculture on a footing not too different from industry, new elements are sought to be introduced in the mechanics of price fixation. Some of these include allowanc for wages either at minimum statutory level or the actual which ever is higher and some margin towards what is euphemistically described as the "managerial factor." Whereas, these are by themselves subject of intense controversy and call for an objective and detailed scrutiny in the light of comprehensive input cost data, any haste in incorporating these additional features in the pricing mechanism would mean working towrds a high cost scenario.

Third, in the recent past, the issue price of goodgrains has been raised more or less in tandem with increase in the procurement prices allowed to the farmers. Besides being a negation of the avowed policy to protect the poor consumers, particularly those below the poverty line, this may contribute further to the inflationery forces. Let us ot ignore the fact tht the fair prices at ration shops set the bottomline and if these increase more often, the free market prices which in any case stay ahead, will have a tendency to grow much faster.

Black Money

The contribution of black money in exacerbating the forces of inflation has been well recognised. Ironically, even the foodgrains sector has not remained unaffected. But for this, how could one explain continuation of the rising trend in prices of almost all food items despite three successive good cropping seasons, i.e., 1988-89 to 1990-91. The fact that the RBI's credit policy has been implemented with restraint in recent years further reinforces the apprehension that unaccounted money has been used for hoarding thus creating artificial shortages and consequential increase in prices.

In the past, efforts to bring black money in the mainstream of economic development have not succeeded. Perhaps, the incentive orientation of various schemes introduced for the purpose has not been backed up by sufficient confidence-building measures. A piquant situation has indeed developed. Whereas, on the one hand, the tax evaders are reluctant to come forward for fear of prosecution/penalty, on the other, they are not willing to discontinue the pernicious practice either.

An effective policy to combat this menace has to rest on two basic premises. First, to bring black money already in operation, the incentive package in any scheme should be made to work onthe basis of "mutual trust" between the assessee and the tax department. Second, to prevent generation of black money, heavy penalties built into the system must be supported by an effective tax administration/enforcement machinery. Even as the former finance minister talked of the need to channel black money in creation of social infrastructure such as housing, slum development and road construction etc., none of the schemes geared towards this end is likely to succeed unless these two basics are effectively addressed.

The package to deal with inflation has to involve effective action on a wide spectrum. First, efforts to contain growing deficit need to be improved in content to meaningfully incorporate essentials such as subsidies and interest etc. Second, administered prices must not be viewed as a "convenient" option for raising resources which should come primarily through improvement in efficiency/productivity, capacity optimisation and overall better management. Third, the procurement prices of foodgrains and other agricultural products need to be fixed with great circumspection based on the economic criteria alone and must not be allowed to become an instrument of political appeasement. Fourth, effctive steps at the political and administrative level are urgently needed to minimise the influence of black money in the economy. Once these fundamentals are tackled, even steps tailormade for individual commodities such as edible oils, cement, sugar etc...will have a fair chance of success.