The Observer of Business and Politics June 22, 1993

Fiscal muddles

Rising administered prices are responsible for almost one-third of the overall rate of inflation, says **Uttam Gupta**

AN internal assessment by the finance ministry reportedly projects the rate of inflation during 1993-94 at about 10-12 per cent, up from an estimated level of 6.7 per cent for 1992-93. Close on the heels of the government slipping the target for fiscal deficit for 1992-93, this should have sounded alarm bells in the official circles. But, that should not be surprising given the strategy mix that was chosen to attack inflation.

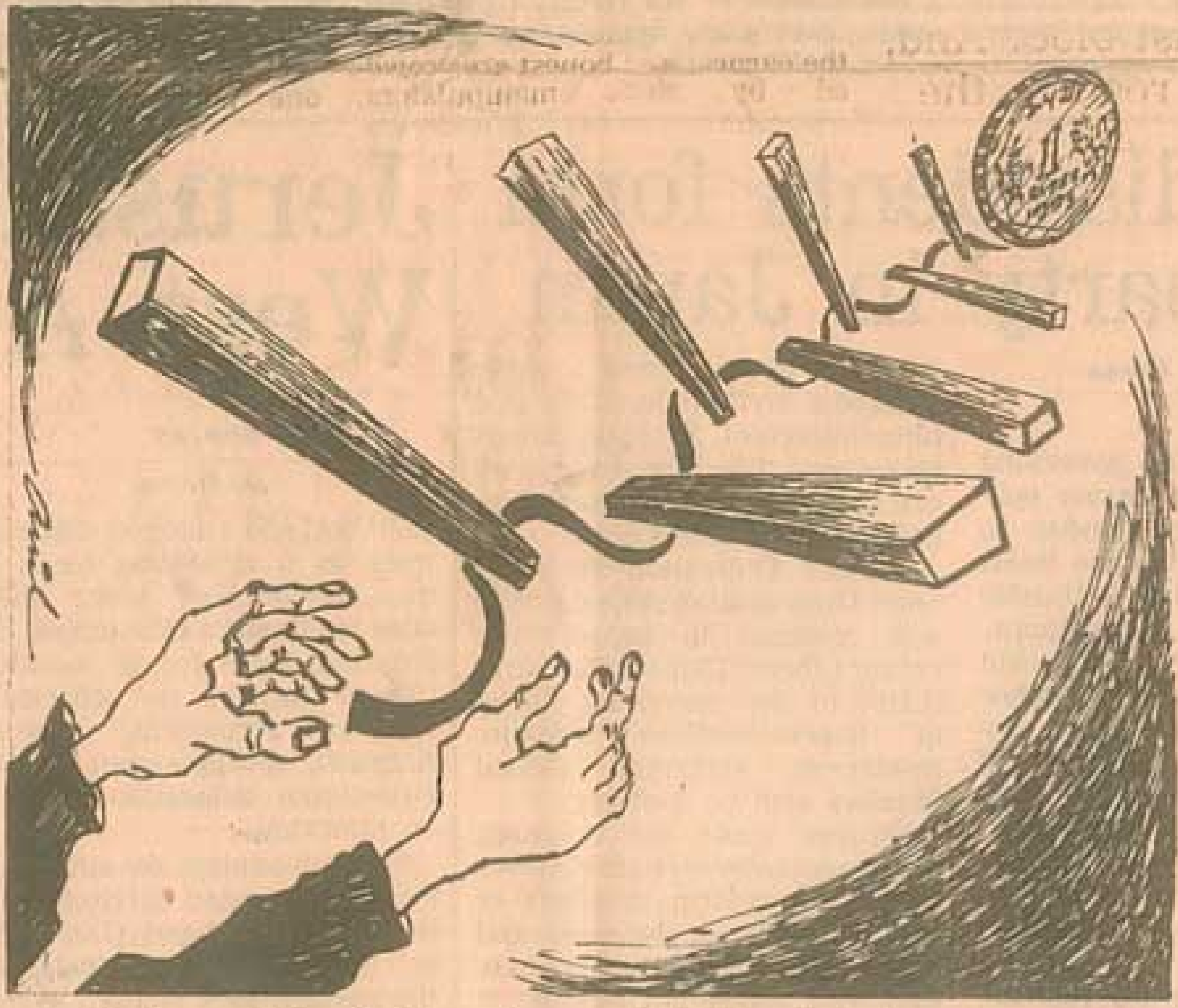
The government's package was essentially two-fold. First, by bringing down the budget deficit, the intention was to check the growth in net government demand and consequently money supply in the economy. Second, by lowering the custom and excise duties across a whole range of industries, the objective was to reduce the cost push. On both the counts, we seem to have faltered miserably.

Despite the ruthless attack of the fiscal exercise on investment demand, the budget deficit now estimated at about Rs 13,000 crore for 1992-93 seems to be totally out of control. The growth in money supply (M3) at about 14.7 per cent during 1992-93 was substantially higher than the target of 10.4 per cent agreed upon with the IMF. The surge in foreign exchange reserves from US$5.6 billion at the end of 1991-92 to US$6.4 billion as on March 31, 1993, too has contributed to growth in money supply.

In the 1993-94 Budget, the custom and excise concessions were announced with tremendous fanfare. The Rs 4,000-crore dole was unprecedented particularly when the government maintained that despite this, it would be possible to maintain the fiscal deficit at five per cent of GDP. Equally remarkable were a series of advertisements by most of the big names in the automobile and electronics sectors, white good industry and agro-based products that these concessions will be passed on to the consumers.

Three months after the finance minister announced the reliefs in Parliament, it now appears that the entire exercise was an eyewash. Not only have there been no reductions, the prices on the contrary have been increased substantially across a wide range of goods. One important brand of tea whose selling price was lowered by a meagre Rs 1 per kg immediately after the budget, is now selling at Rs 20 per kg more.

The reasons for the failure of the package are not difficult to seek. On the demand management side, it is not an unknown fact that fiscal profligacy continues unabated. During the first year of reform i.e. 1991-92, at least there was a talk of viewing control of non-development expenditure as the *sine qua non* of the success of fiscal reforms. Now, the powers that be do not even consider this as worthy of even being mentioned in various official pronouncements touching upon the macro-economic issues. Perhaps, with display of extravaganza having acquired the dimensions of a national status symbol, well-meaning thoughts imbibing economic discipline seem to have got bulldozed.



On the cost side too, we have taken a very myopic view of the inflation management exercise. Customs and excise are only one of the several important elements in the total cost of manufacturing operations. Other significant factors are the administered prices of basic inputs and utilities, interest rates besides a plethora of local taxes and duties. It is in these areas that we have allowed the cost pressures to build up at an accelerated pace. The case of petroleum products will amply demonstrate this.

Barely eight months after the Gulf surcharge was levied in October 1990, the prices of all petroleum products were raised by 10 per cent in July 1991. Then came the gas price hike on January 1, 1992. The real onslaught was inflicted in September 1992 when there was a further steep increase in the prices of all petroleum products e.g., 36 per cent in the case of naphtha, 54 per cent in fuel oil and LSHS. The gas prices were increased again in January 1993.

That rising administered prices are a matter of serious concern is buttressed by the government's own admission that these are responsible for almost one-third of the overall rate of inflation in the economy. And yet, these are being used as a handy tool for garnering resources to support the budget. In this connection, the figures for 1993-94 are mind-boggling. Of the total plan outlay of Rs 63,936 crore, the PSUs are expected to mobilise Rs 40,695 crore on their own. Going by the highly disappointing experience of 1991-92 and 1992-93, the contribution of market borrowings could at best be only marginal. The inevitable signal is that administered prices are being increased steeply during the current year as well.

In regard to interest rates, much euphoria has been generated over the reduction of one per cent in the basic lending rate during the current year. But, no one seems to be talking about the horrifying experience of 1991 when the rate was increased on as many as four occasions raising the minimum lending rate to a high of 21.75 per cent on both short-term and long-term finance. Even now, the prevailing rate though somewhat lower, is still substantially higher than the overall rate of inflation.

State level taxes are catching up like wild fire. Apart from the well known sales tax/surcharge/additional sales tax some states have invented new varieties such as turnover tax or purchase tax etc. Although the implied intention of such taxes is to collect the money from the industry, ultimately it is the beleaguered consumer who ends up paying in an overall market environment that is far from being competitive. Some state governments even made attempts to collect tax on subsidy given by the central government under the administered pricing scheme for fertilisers. The irony is that despite the major role these taxes play in the making of inflation, they do not find commensurate mention in the national debate on the subject.

Government's policy towards agriculture also need to be considered. In this context, we should not get carried away by the relative stability of the prices of food and allied items. That was purely coincidental being the result of record production consequent to good monsoon during 1992-93 and fairly satisfactory procurement of wheat and rice. The monsoon may help us again in 1993-94 i.e. the sixth year in succession. But, it would be imprudent to bank on it indefinitely. Not very long from now, the policies with regard to fertilisers, credit, seeds and pricing of food will play the decisive role. That is where removal of pricing and distribution control on fertilisers, contemplated increase in the cost of credit for agriculture and the ramifications of the Dunkel proposals on seed are matters of serious concern.

The underlying fundamentals of the economy clearly do not warrant any optimism in regard to the possibility of containing inflation. Unfortunately, we still do not intend to come out of the state of derisive delusion that a good food crop aided by the monsoon will once again come to our rescue.