

Instant cures

How not to attack the bull's eye

UTTAM GUPTA

THE tight and restrictive monetary policy recently announced by the RBI is targeted at what is euphemistically described as the "only single bull's eye" by the governor. There is nothing new about the phenomenon of inflation. It has been with us for quite some time now and during the last year itself entered double digit figures. Against this backdrop, the monetary policy for the season ending September, 1991 was formulated.

Amongst others, the relevant RBI directives proposed restricting availability of credit to the average peak level utilisation during the preceding three years ending 1990-91, increase in the minimum lending rate e.g. 18.5 per cent in respect of corporate borrowers and requirement of cash margin at the rate of 200 per cent in respect of imports other than capital goods.

Inflation has necessarily to be addressed in a macro-economic framework. All important policy planks — fiscal, industrial, trade and monetary — must work in "unison".

In terms of demand management, the results of the first half of 1991-92 are far from encouraging. The expansion in M-3 at Rs 18.194 crore was about 27 per cent higher than the the previous year.

A significant reason was increase in the net RBI credit to the central government which until September 20, 1991, at Rs 8,891 crore, was nearly 22 per cent higher than the expansion in the corresponding period last year. Clearly, the credit dispensation was tight in terms of providing funds to the industry while being liberal towards support to increasing government expenditure.

The tight credit policy has had a significant adverse effect on the supply side. Although it was stated even at the time of announcing the policy that productive activity will not be allowed to suffer for want of credit, the facts speaks otherwise.

The RBI directive has put a virtual financial squeeze on the industry. Together with increase in lending rate to a minimum of 18.5 per cent, this has affected production operations and increased cost of production. Some banks have even been charging 25-30 per cent on incremental credit.

The requirement of margin money at 200 per cent for the value of imports has affected even the core industries. For instance, in fertilisers, because

of control on the selling prices, the industry cannot afford the higher cost of credit needed to meet the margin money requirement. This cannot come through higher subsidy either. Consequential denial of imported machine parts has adversely affected production.

It is not at all surprising that industrial growth slowed down during the first half of the current year apart from the acceleration in the rate of inflation. The wholesale price index on a point to point basis rose to 8.9 per cent during the current financial year up to September 21, 1991 as against an increase of 5.7 per cent during the corresponding period last year. On a year to year basis, this works out to 15.5 per cent as against 7.7 per cent in the previous year.

The huge stock of unaccounted

The question remains whether the role of the parallel economy can be minimised? The approach announced in the Union Budget seems to be to give a "clean chit" to those whose actions have brought the economy to this pass. Be it the scheme relating to foreign remittances, or the National Housing Bank, the sops are not likely to work unless the tax evader is made to feel that he will pay heavily for concealing unaccounted income.

Oblivious of the underlying trends, the same credit policy dispensation continues even for the current season, perhaps with greater force. The minimum lending rate to corporate borrowers has been further increased to 20 per cent.

The quantitative restrictions on credit availability continue, barring exports where the re-

out. It has sought to deal with the former by resorting to increase in the lending rate in the recent past. But, have we succeeded this way?

The fact that we have not clearly shows that the impact has, in fact, been negative. Perhaps the positive expectations were based on the text-book logic that following the hike in the rate, the demand for funds will decrease. In turn, that would mean reduced money supply and consequent lower demand for goods and services.

In the RBI's line of thought what is being completely ignored is that increase in the lending rate adversely affects production and consequently the supply. Financing cost being a major element in the total cost of production, increase in the lending rate gives a significant cost push.

Denial of funds because certain industries cannot afford high cost will also result in reduced production and consequently, supply constraint. The irony of the underlying social-economic forces is that whenever there is a credit squeeze, the axe falls on the productive sector, while unproductive activities manage to get away.

Combating inflation calls for a multi-pronged strategy. It cannot be tackled through monetary policy alone. Such an un-coordinated view may even produce just the opposite results as seen in the recent past. The package is well-known and has been reiterated time and again even by those who matter, both in the government and outside.

It has to cover the questions of the galloping budgetary deficit, unabated and steep increases in administered prices of basic inputs, high rates of taxes and duties and, above all, the menace of black money. A frontal attack on all these maladies afflicting our system is needed more than ever before. What is needed foremost is seriousness in doing things and gearing institutions and administration to implement the required measures.

Indeed, if only the RBI in its own way can succeed in refusing to be a party to the fiscal profligacy of the government, a major success in attacking the bull's eye would have been made. Perhaps, in that situation, its own condition for lowering of the interest rates would have been met. This is urgently required if we are to avert a major recession.

If, however, the present state of dithering continues, we may soon have to face a frightening situation wherein we are saddled with both inflation and recession. □



currency in circulation, perhaps, has the greatest impact on the prices of mass consumption items, in particular, agro-based commodities. Clearly, the overall supply situation does not warrant the spiralling prices of major agricultural items. In fact, after three successive good agricultural years, we have a fairly comfortable buffer stock of foodgrains, and this year production is expected to touch 180 million tonne.

One cannot escape the conclusion that the so-called "parallel economy" sustains hoarding on a large scale which is unthinkable through credit from the banks. The higher prices in the shortage situation are, in turn, sustained to a considerable extent by consumers having unaccounted incomes.

Whenever there is a credit squeeze, the axe falls on the productive sector while the unproductive activities can bear higher costs because of their higher profit margins

finance norms have been liberalised. Although the cash margin on OGL imports has been reduced to 150 per cent, the level continues to be high.

The RBI has maintained that until inflation is controlled, reduction in interest rate is ruled