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THE CABLE POWER

INFLATION & ECONOMIC GROWTH

R.P. Gupta

After independence, for the first time India witnessed a consistent GDP growth of 8-9 percent for past 5 years. Such growth phase was relatively new and hence, we are yet to develop expertise to manage the growth, which was not equitable. Agricultural growth was 2-4 percent only while service grew by double digit.

Sectors like automobile and telecom are growing at a rate of more than 20 percent, but sectors like mining, power, coal were growing at rates below 5 percent. Infrastructure spending has been far below the need to sustain the growth. Rural and semi-urban sector has been growing at lesser rate than the urban sector. Eastern states have been growing slower than western and southern states. Such disparities in the initial growth phase are normal and hence, bound to result into some "side affect". High inflation rate is one of the side affect. Global inflation, particularly in food items, has further increased the woe of decision makers.

But one thing is sure that, to control inflation, GDP growth should not be sacrificed. Short term measure taken by government to control inflation, was perhaps due to compelling reasons, but it requires a revisit. Few harsh decisions are sending wrong signals. It may affect investment and growth. Inflation is definitely a cause of worry but a balance has to be struck between inflation and growth in the long term interest of the nation.

Moderate Inflation as Growth Incentive

For a developing country like India, an inflation rate of 5-6 percent is natural. To some extent, inflation acts as an incentive to the producers. Though agricultural growth was limited to 2-4 percent, still I am sure that we will witness higher growth because price of commodities are rising and it is an incentive for growers. Same theory applies to industrial production.

The present inflation rate of 8 percent is high by 2.5 percentage points than the desired level. In developed economies, where the growth rate is below 5 percent, the inflation can be brought down to 2-3 percent. India, which is in a growth phase, low inflation could become disincentive. So, a right balance between growth and inflation is necessary.

Monetary Measures

Liquidity Curb

To control inflation, the natural step is to curb liquidity at the first instance. But it may not be applicable for growing economy like India. The curb on liquidity will first hit the investment growth, then GDP growth, public income and lastly consumption. It means liquidity curb may control inflation at the cost of investment and GDP growth only. The logical step could have been to impose certain restriction on expenditure funding of luxury items through personal loans (except house and educational loans). But the liquidity for the investment i productive sector should not be curbed.

Interest Rates

Increase in interest rate may simply add to production cost shal only push inflation up. However this option of increasing interes rate is acceptable, provided savings are not growing and bein diverted to consumption. But savings rate has been growing So, increasing interest rate could be counter productive.

Rupee-Dollar

The cost of US dollar has climbed almost 20 percent from Rs 36 to Rs 43. This has increased import cost, particularly crud oil. Choice of cheaper import to control the inflation is also no available. Huge subsidy to petroleum sector could have bee avoided if the rupee could have been stronger at Rs 35-36.

Stronger rupee will affect exports of few sectors but expo subsidy is a better option than import subsidy as it can b partly compensated through tax on domestic productio Hence, new monetary measures should be considered.

Cheaper funds are essential for investment in core sector Government has already reviewed and relaxed the EC norms. It should be further relaxed at least to core sector an infrastructure spending. The restriction on FII investment ma be further relaxed as they are key drivers to capital market.

How to tackle Inflation

It is difficult to control the inflation without sacrificin growth. Public expects immediate results. Hence, both sho term and long term action plan has to be prepared focusing o higher capacity utilisation of productive assets, new capacit additions and on reducing consumer price.

Higher Capacity Utilisation

All administrative and regulatory hurdles should be remove for highest capacity utilisation of the existing productiv assets which will enhance the availability of commodities t give immediate results. Several regulations prescribe closu of plant and mines for non compliance. Recently, 32 mi steel plants were closed down in a state due to environme problems. I think, time and opportunities should be given f compliance instead of closures.

Similarly, some mines have been closed down for pendin forest clearance which may be restarted by giving time f compliance. Some of the mines are not allowed to produ more than their capacity as declared in the mining plan. L the production go and the capacity and mining plan be revise in due course. In transport sector, trucks are not allowed t carry more than their rated capacity. I think, 25-30 perce additional load may be permitted. Several power plants are operating at low plant load factor. They should be asked to increase plant load factor.

In a nutshell, the productive assets and existing infrastructure should have optimum utilisation to enhance production. On the contrary, some fiscal incentives should be provided for higher capacity utilisation. It will not only control the inflation but shall generate additional revenue.

Capacity Addition

For fresh investment, investible surplus is essential besides, low cost debt and healthy capital market. But unfortunately, capital market is in a poor shape. The restriction on ECB and increase in interest rate is a dampener. Investor's confidence is essential. Hence, the recent decisions may be reviewed to bring growth and investments to original track so that future capacity addition is not affected as it is a long term solution to inflation.

Cost control for minimizing Consumer Price

Cost efficiency has been totally over looked in India. Whenever cost efficiency is discussed the total burden is shifted on production. A combined role between the producer and government is needed to achieve cost efficiency to minimize consumer price. This can be partly achieved in short term and fully in the long term.

Short term measures

Capacities cannot be built up overnight. So, short term focus should be on cost reduction and the important components are raw material, transportation cost, tax and levies, capital cost, power and fuel.

Transportation

The component of transportation cost in the ultimate consumer price is substantial. In case of primary articles it is about 20-25 percent. It has a multiplier affect too. Transportation cost in India is too high compared to China or any other developed country. Particularly, the road transportation cost is prohibitive.

Railways

Indian Railways have increased good's freight indirectly by changing classifications and levying surcharge and other charges. Efficiency of Indian Railways has improved but it will have to invest to expand capacity. In short term, it can afford to reduce freights (inclusive of surcharge and other charges) for primary articles. The loss of revenue can be partly compensated with additional traffic from road. In due course, it can be brought back to original level. It will give an instant result on inflation.

Road Transport

The road transportation cost has gone up by 50 percent in last 3-4 years. It is mainly on account of stricter implementation of MV Act pertaining to "Over Loading". To my opinion, the MV Act relating to over loading has become obsolete in view of improvement in road conditions. It requires amendment permitting 25-30 percent overloading. In fact, Railways has also permitted some overloading to make optimum utilisation of the capacity. The provision of the Act requires a fresh technical study. Pending such study, if the provision of the law is relaxed on trial for a period of six months it will bring visible impact on the inflation control.

Taxation

Total burden of taxes for the consumer on any manufactured product is to the order of 40-45 percent on the basic ex-works production cost. No doubt, government needs revenue. My suggestion is to temporarily reduce the tax on primary articles and then, gradually bring it back to original level in phases. Primary articles having maximum weightage on the inflation should be categorized under "declared goods" so that VAT is not more than 4 percent.

Rupee Dollar conversion

Suitable monetary measures will make the rupee stronger. Cheaper imports of essential goods could create pressure on domestic producer for price control. Though imports are not a long term solution, still it could temporarily be used to control the high inflation. Strong rupee shall also reduce fixed debt service cost for government and private sector.

Power And Fuel

Coal

Cost of coal in India is too high. All hurdles should be removed to increase the production so that at least there are no market premiums. Productivity and cost efficiency targets are to be fixed with individual coal mines. In the long run, government may consider private merchandising to bring competition. Benefit of captive coal block is limited to few large consumers and not to general consumer.

Electricity

Electricity is the basic input for all sectors. Distribution companies are to maintain the viability by reducing commercial loss and not by hiking tariff. Average cost of power in India is high. The burden of cross subsidy on the industrial consumer has to be gradually phased out as it adds to production cost. Tariff should not be hiked for at least one year. The plant load factor has to be increased beyond 80 percent as it will reduce cost of generation. Surplus and idle capacities are available with captive power plants which have to be utilised by removing hurdles. Excess power may be taken to the Grid.

Petroleum

Production of Indian crude oil has to be maximized. An action plan is to be prepared for reducing fuel consumption. Custom duty reduction is not desirable to promote domestic production. The left out gap has to be divided among oil companies, general public and government. Some increase in the price is unavoidable. A reasonable burden should be passed on to oil companies for a period of one year. Then there should be reduction of excise and VAT. At the first instance, VAT should be made uniform in all the states. Reduction of taxes may be brought to original level in phases.

Medium & Long term measures

Besides short term measures, medium and long term action plan is to be prepared in areas like infrastructures, complicated laws, excess regulation and multiplicity of taxes.

Infrastructure

Unless matching infrastructure is created, the addition of capacities cannot be sustained. Either it will create road blockade for growth or it will result in high cost of production. In fact, one of the principal causes of the present inflation is non-matching infrastructure. The priority has to be laid on power generation and distribution, transportation and irrigation.

Price of essential goods is sky-rocketing at consuming centres but at the production points it is low. Same is the case with minerals and cement. The cost difference is due to infrastructure bottlenecks. Infrastructure growth requires massive investment. Such huge spending cannot be done by government alone. So, private participation has to be encouraged with fiscal incentive. Part of forex reserves can be used too.

Intangibles of government such as surplus land, advertising rights, town development rights and others can be utilized for raising funds. Highest importance is to be given on the village roads. It will develop the rural economy and shall also provide cheap agricultural produce to urban population.

Excess Regulation

There are several complicated laws which hinder fresh investment. These laws also add to the transaction cost and affects productivity. Every year, new laws and regulations are enacted but obsolete laws are hardly repealed. I think, simplification of laws is necessary.

Multiplicity of Taxation

Multiplicity of taxes has to be removed by merging. It will result in saving of collection cost and reduce administration cost. The tax rate also needs to be reviewed specially related to primary basic articles having major weightage on the inflation index or WPI, particularly the essential items. Loss of revenue may be compensated through reduction of agricultural subsidies. This will give boost to rural economy besides cheap food articles. The tax rates on other primary articles such as cement, steel, coal needs review.

Conclusion

Continuous GDP growth is the only answer to eradicate poverty and hence, it should not be sacrificed at any cost. Inflation control is equally important. Multi direction actions have to be taken. Total dependency on the monetary measures alone may not yield the result. The action plan has to be short term and long term. There is scope of immediate reduction in consumer price through reform of transport sector and temporary reduction of taxes. Strong rupee will also give immediate benefits. Fiscal support will not only give immediate result, but will give a solid foundation for future growth without adverse affect. ■

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