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SOURCING INSIGHTS

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Corrective measures for inflation control

R P Gupta

As on date, inflation is the biggest source of concern both for the government as well as the general public. Even important issues like trade deficit, current account deficit, investment/GDP ratio, debt/GDP ratio and so on, have taken a back seat. If these macro economic factors are not corrected we may perhaps loose investor confidence. The current inflation monster needs to be tackled by adopting multi-prone strategies, not limited to monetary tools alone. This is all the more needed because high inflation itself is an obstacle to growth.

This article makes an effort to highlight how production of sufficient goods and services are required to meet domestic demand to reduce inflation. It is equally important to produce at an affordable cost to curtail inflation. Supply chain needs to be strengthened and made more cost effective. Once the productive sector including Indian entrepreneurs have demonstrated their capability, it is now the turn of the government and administration to facilitate and perform. The media should also play a supportive role to the decision makers.

Monetary tools for increasing supply; not curtailing demand

It is a commonly known fact that when demand exceeds supply, the price tends to increase, which is popularly known as inflation. The corollary concept states that excess liquidity in the system creates more demand. Hence, as an immediate corrective action, the central bank of a country uses monetary tools to curb liquidity, either through slashing the cash reserve ratio (CRR) / statutory liquidity ratio (SLR) or to increases the interest rate to make funds costlier to curtail the demand. Such action reduces the demand of consumer financed products like automobile, real-estate and related sectors. However, in the long run, such action only hurts the growth of the productive sector by curtailing the production. It also affects new investment vis-à-vis growth. Hence, inflation will continue in the long term in absence of new capacities. High interest also increases the production cost, which further adds to inflation. Temporary fall in demand may slightly ease out inflation, but it will be at the cost of growth which should not be the ultimate aim. True skill and prudence lies in maintaining growth rate with moderate inflation.

Over the last decade, GDP growth has definitely increased public income and purchasing power. The demand spurt in the rural sector is a burning example of the same. We should not curtail such demand, which is otherwise a sign of rural prosperity. Hence, the focus has to be on matching production and supply management. Increase of production and efficient supply chain needs fresh investment. It also requires cheaper capital to attract new investment which requires reduction of interest rate. At present, interest rate in India is at the peak level. This is a deterrent for new investment. The gap between demand and supply is bound to widen in near future leading to high inflationary trend. Hence, it requires reversal of monetary policy as a long term solution. Hence, credit needs to be chanellised to productive sector.

It is to be noted here that government subsidy is also infusing liquidity to the system. This provides cash in few hands without productive work. Similarly, consumption led spending by Government is also infusing liquidity into the system. Utilisation of forex inflow for consumption is also having similar effect of liquidity expansion. In today's context, these are the actual factors really responsible for inflation and not the excess credit flow from the bank. Of course, consumer finance (other than housing and educational loan) has to be decreased under inflationary situation, but through credit restriction instead of a general credit curb or hiking the interest rate ay further. Any consumption which is funded from earning is not a problem. Earning comes from production of some goods or services. Hence, such private consumption will only help the growth without putting inflationary pressure. It is actually borrowed funds and subsidy-backed demand which are the real causes of the present un-manageable inflation. This needs corrective action.

Import is not a permanent answer to inflation

Quite often, import is opted to overcome short supply to tackle inflation. This may be true on a temporary basis, but it should not be a regular practice. As it is, our country is having huge trade deficit of about USD125 Bn. This is the worst indicator than any other macro indicator. It reflects that we consume more than what we produce. Trade deficit is to be obviously funded through forex borrowing or forex inflow. But, funding of trade deficit through borrowing is really suicidal. The right utilisation of forex inflow is in the productive sector or infrastructure which strengthens economy in the long run. We also need to essentially meet the export target to balance the import without creating any trade deficit. The easy option of trade deficit to meet the supply deficit and to manage inflation is not at all a long term solution.

Higher production is the real answer

If we cannot sacrifice to reduce consumption, the only answer is to increase the production and supply. Higher production needs fresh investment in the productive sector and infrastructure sector. Unless there is matching growth of infrastructure, production vis-à-vis GDP will have serious bottlenecks. Fresh investment in these sectors will not come merely from monetary resources and natural resources. What is most important is the need for administrative reforms and favourable investment climate.

What is unfortunate is that over the last decade, liberalisation has taken a back seat. Lot of hurdles are coming in the way of new investment due to tougher and new regulations in the disguise of reforms. Public opinion is also becoming anti-investment as they are often misguided by people with vested interests. The media can play a very important role here to educate the public and remove misconceptions, if any. Even large public utility projects like power plants, road construction and irrigation projects are often opposed on various environmental and other grounds. Land acquisition has become extremely difficult. While environment conservation is important, it needs to be kept in mind that these pulic utility projects will generate more income for the people, apart from fulfilling basic needs of the people.

What needs to be understood here is that industry, agriculture and mining are the prime drivers of growth ensure earning opportunities for the public. Service sector is basically a tertiary sector depending upon the primary sector only. Recent growth in GDP is propelling the service sector which itself cannot sustain, unless otherwise, matching growth in primary sector takes place.

Inflation is bound to stay unless fresh impetus is given to the productive sector. Hence, the need of hour is to re-visit and to bring administrative reforms to facilitate growth. What we need is to generate income through higher production and then to consume out of earnings. Then inflation will be at a moderate level. This will also create a strong economic base for long term sustainable growth.

Production cost needs to be curtailed

Even if demand and supply match, inflation is bound to stay to some extent as long as production is not cost effective. Hence, it is equally important that productive sector has to be cost efficient to reduce inflation. Reduction of export deficit will help us in becoming more export competitive.

At present, Indian industry is not getting basic inputs at reasonable cost. Important categories in this regard such as power, energy, transportation cost, interest rate and taxation are directly or indirectly under the control of the government, often being much costlier in comparison to the global market. To add to this, the cost of these inputs is increasing on a year-to-year basis.

Multiple taxes also add to the cost. Although taxation is essential, it needs to be rationalised. As much as 40 to 50 percent tax is being levied in some cases on the production costs of certain basic items, which in turn, is ultimately is passed on to the consumer, thereby adding to inflation. On top of it, cross subsidy in power tariff, railway tariff and petroleum products are the hidden taxes on productive sector which are ultimately passed on to the consumer. Thus, it is obvious that suitable administrative reforms can go a long way in addressing these issues to make the productive sector more cost competitive to reduce inflation.

Regulations need to be replaced by facilitation

The present regulatory system in our country is too restrictive for the productive sector. For instance, there are several hundreds of Acts applicable to the sector. On top of it, there are regulations, rules & guidelines, which are increasing on a month to month basis, implemented both by state and central governments. Sometimes, it becomes virtually impossible to strictly comply with the law, even by large reputed corporates. The compliance cost in terms of time and money is huge. Non-compliance has penal consequences even though it is sometimes unintentional. Ultimately, all these factors add to production cost which is being passed on to the general consumer. These regulatory practises often discourage first generation entrepreneurs as well, thereby promoting monopoly among existing producers. Monopoly will always lead to either inefficiency or to high profiteering and both situations contribute to inflation.

Another effect of such stringent regulations is that it distorts the supply chain, that is, from the production point / farm gate till the actual consumer. Hence, ultimately there is no relief to consumer and the blame is passed on to the seemingly weak link, namely the distribution channel which may be the transporter, trader or retailer.

Administrative reforms should be investment friendly and promote new entries to break monopoly in every sector. Laws and regulations need to stay, but they should be simple, limited in number and easy to comply. If a particular law is violated by the majority, it is better to introspect and amend it instead of adhering to it, thereby promoting non-compliance and corruption. Regulation has to be replaced by facilitation to promote economic activities so that our huge work force can be deployed for productive purpose. Entrepreneurship particularly, should be encouraged.

It is recommended that a special cell in the law ministry be created to repeal obsolete laws and to simplify all the laws applicable on economic activities with the single focus of increasing GDP growth. Media and public has to support this initiative in the long term interest of the country. Once the demand or consumption is met from productive income, inflation will not find any place, except in an intermittent short span, in any particular item.

Food inflation

The country's spiraling food inflation is a point of major concern and ones that needs to be urgently addressed. Unfortunately, agricultural growth is at an all-time low. On top of it, there is huge wastage of agricultural produce due to poor storage facilities and poor connectivity. The basic infrastructure for supply chain is missing. Hence, there is a huge gap between the price at farm gate and retail consumer.

As a first step, the food taxation policy should be reorganised and all taxes on food items should be lessened as far as possible. The procedure of licensing and controls should be amended or even scrapped in some cases, so that it becomes possible for entry of new persons, thereby breaking localised monopoly of a few traders. Once there is intense competition, the situation of local hoarding and profiteering will be automatically eliminated.

Priority is to be given to rural infrastructure spending, particularly for village connectivity, warehouses and cold storages. Entry of private operators should be encouraged through viability gap funding. Credit flow to the sector has to increase at cheaper cost. Logistic cost has to be reduced by modification of MV Act particularly for agricultural produce and 25 percent over loading may be permitted as was done in case of Railways.

Agro based industries may be given highest priority with incentive. Agro produce may be taken out from commodity exchange. Technological input may be provided in aggressive manner to increase productivity per acre of land. The government scheme of 'NGERA' may be primarily focused for land upgradation and small irrigation schemes like check dams and construction of village roads should be put in place.

Besides major structural changes, if these steps are taken, there is bound to be a spurt in production and reduction of wastage, thereby reducing the inflation in food items without affecting the farmer's income.

Outlook

Monetary tools have limited impact, that too, on demand management. We need supply management to increase availability with cost efficiency. This requires fresh investment. Monetary resources can be mobilised, but a series of administrative reforms is essential to re-generate investment-friendly atmosphere. The focus should be on facilitation instead of regulation of the productive sector. Minimum and compliable laws need to be enacted. The present hostile mood of the public towards new investment has to be reversed through proper and effective communication, where media has a role to play. Subsidies should be phased out. Government spending should be investment-led instead of being consumption-led.

If the present situation continues, inflation will be unmanageable and growth cycle may be reversed. Given the current scenario, the country needs a strong foundation of high growth with low inflation. ■

R.P. Gupta, B.Sc.Engg., Vice Chairman – Orissa Assembly of Small & Medium Entrepreneurs, Cuttack; Advisor – OJC (Orissa, Jharkhand,Chhattisgarh) Chamber of Commerce & Industry & Ex-Vice President, All India Mini Cement Plant Association, Hyderabad

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