

Management of Stubborn Inflation in India

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Abstract-

Theoretically speaking, inflation can be checked by restricting supply of money in a Country's Economic system. The Reserve Bank of India has been deploying this concept to tame inflation within India by way of credit control measures which included adjustments in repo rate, reverse repo rate, statutory liquidity ratio and cash reserve ratio for Indian banking system. However, in the last few years, these measures have failed to tame inflation in India. During the period 2012-2014, India has been facing average inflation rate of 9.62 with an all time high of 11.16 in Nov. 2013 despite consistent inflation control measures by Reserve bank of India.

The reason as to why Indian Economy is not responding positively to time tested inflation control measures of Reserve bank of India is the fact that some extra-ordinary elements have got built in it which are immune to these measures. These elements have got built due to ill conceived policies of Govt. of India and are immune to inflation control measures of Reserve Bank of India. It is, thus, a clear case of left hand undoing what is done by right hand to control the inflation. Health of Indian Economy can be normalized only through co-ordinated efforts of Government of India and the Reserve Bank of India. This paper discusses details of two such new elements of Indian Economy. It also discusses the measures to be taken by Government of India to restore efficacy of Inflation control measures of Reserve bank of India.

Key words: Inflation, Immune, black money, subsidy, innovated

I. INTRODUCTION

The current phase of continuing high inflation followed the global financial crisis of 2008. Initially, India was somewhat insulated from global developments due to its various internal strengths but was eventually impacted significantly by global shocks.[1] The Reserve Bank of India introduced a comprehensive range of measures and was able to limit the impact of adverse global developments on domestic financial system. To counter the effect of this international turmoil on its poor people, Government of India introduced a few schemes to feed the poor. It introduced schemes of supply of food at highly subsidized rates besides providing some guaranteed employment through a scheme called MGNREGA (Mahatama Gandhi National Rural Employment Guarantee Act).

For last two years, Government of India has been worried about its rising fiscal deficit. In a bid to limit fiscal deficit, Government has been slashing plan expenditure while leaving non-plan expenditures on salaries and subsidies etc largely intact.[5] Subsidies were rather being raised as a part of appeasement policies before general Elections. This management (call mis-management) of fiscal deficit has fueled inflation and has adversely affected growth.

All these years, The Reserve Bank of India has been taking historically tested measures of credit control but the efforts have failed to bring expected cooling effect on inflation. Reserve bank of India appear to be doing what is within its sphere of activity but some recent viral in our Economy appear to be immune to such credit control measures. Some co-ordinated efforts are now needed to tackle this viral in Indian economy.

II. VIRUS IN INDIAN ECONOMY

If we go into details of Inflation dynamics evolving over last few years, we would very clearly hit upon the factors which are beyond normal banking system and which have insulated the inflation from control by time tested conventional measures by Reserve Bank of India. Two such factors are:

- Parallel Economy of Black Money.
- Mahatama Gandhi National Rural Employment Guarantee Act 2005.

Government may call some of these factors as necessary evils but these factors are evidently the villains of stubborn high inflation in India. These factors are briefly discussed below:

Parallel Economy of Black money: According to National institute of public finance and policy 'Black money is that money which is generated by illegal ways and used in non-transparent ways'. It is the aggregate of income which are kept hidden from Government to avoid taxes.[2]

White paper on Black money by Ministry of Finance (Central board of direct taxes) in May 2012[3] indicates different estimates of black money as prepared by different agencies. However, one thing is clear from all the estimates that the black money was more than 20% of G.D.P. during the year 1980-81 and that this ratio of black money to GDP was increasing year after year. We can thus safely conclude that black today may be as high as GDP itself.

This black money is kept stacked at home or in bank lockers but does not pass through normal banking system. For this reason, propensity of holders of this money is not affected by Credit Control measures by RBI and hence remain immune to efforts to control inflation. It is for this reason that efforts by Reserve bank of India to control inflation are not giving expected results and are only partially successful.

Mahtama Gandhi National Rural Employment Guarantee Act 2005 popularly known as ‘MGNREGA’, was enacted by Government of India in September, 2005 and was operationalised in 200 most backward districts of India w.e.f. Feb 2006. The scheme was extended to whole of India w.e.f. April, 2008.

MGNREGA is an attempt to tackle the problem of unemployment in rural areas.[4] The act provides a minimum guaranteed 100 days employment per year at a minimum guaranteed wage to every household in rural areas whose adult members are willing to do unskilled manual work. The scheme also aimed to build a sustainable infrastructure in rural areas.[4]

The act, on the face of it, appears to be an ideal scheme for rural areas. But the implementation of the scheme has remained largely flawed. The main criticism of the scheme has been for following reasons:

- That the scheme is just creating long term dependency among the poor on a largesee of The Government. A large number of work force, who were working on various production activities in the cities, have returned back to their villages where Government was simply pumping money distribution to rural youth.
- The works executed were only of a marginal importance & involved mainly the digging and filling of ground. No worthwhile sustainable infrastructure was being created.
- Production activities in cities got a severe jolt due to consequent shortage of labour. Further they suffered as labour rates in cities increased substantially due to shortage of labour force.

The critics for above flaws include Mr. Jai Ram Ramesh, the then Rural development Minister and Mr. N.C. Saxena, the then member national advisory council. Their criticism of the scheme were abundantly carried by the media.

An Editorial, titled ‘MGNREGA: a tale of wasted efforts’ in a magazine named MINT has made assertion that populist scheme has helped raise wages without raising productivity. It has also asserted that MGNREGA has contributed more to inflation than to rural wealth.

Huge expenses on various Government Schemes to feed the poor including subsidy schemes have led to serious fiscal deficit in India. These schemes, along with Management of this consequent fiscal deficit,, has fueled inflation and has adversely affected growth.

III. CO-ORDINATED EFFORTS CAN MANAGE INFLATION IN INDIA

These new factors in Indian Economy may be beyond the conventional Inflation control measures by Reserve Bank of India. However innovated and co-ordinated efforts on part of Government of India and Reserve Bank of India can put back Indian economy in good health. Some such steps may be as follows:

- a) To-day black money is not with some selected persons only. It is, more or less, universal in India. Every Indian intends to create and possess some black money because of our existing socio-economic system. No Government official or other person with medium salary of even Rs. 40,000/- a month can afford to meet the expenses on education of his children with his salary. He cannot afford the budget required for honourable marriage of their daughters. Honesty carries no value in our social system today. Status of every individual in present materialistic society is measured by the wealth one can demonstrate in the form of flashy cars, good bungalow, & lavish life style etc. Above all, present day politicians need such black money to fight elections. To kill this monster of black money, Government need take strict punitive action against holders of black money. The Government must also create a new social system where a mid-income person can lead an honourable life with his salary. Government must ensure affordable quality education for his children . Government must also take strong action against dowry. Government should also be able to trace the expenditure by individuals as it traces the income of individuals. It is only then, that black money would slowly get killed and Indian Economy would then be manageable by Reserve Bank of India.
- b) Present trends to keep down fiscal deficit by slashing non-plan capital expenditures adversely affects growth of Indian Economy and subsequently adds to inflation. There is need to have a genuine fiscal discipline. Government must avoid pumping unproductive cash into economy through various ill designed subsidy schemes. It must carefully implement social scheme called MNREGA (Mahatama Gandhi National Rural Employment Guarantee Scheme) by ensuring creation of sustainable rural infrastructure through the scheme. There should be District wise accountability of expenses vis-à-vis creation of sustainable rural infra structure.

It is important for the Government to understand that inflation is caused when money supply in an Economy grows faster than the rate of economic growth.

It must follow the common proverb 'Do not give bread to a poor man. Teach him how to earn his bread'.

IV. CONCLUSION

In the last few years, the credibility of conventional Economic wisdom to tame inflation has been largely eroded. Consistent actions by Reserve bank of India based on such wisdom have failed to tame inflation in India. Actually, the fault lies in the virus in our economic system rather than efficacy of conventional economic wisdom. To-day, India is facing syndrome of 'left hand undoing what is done by the right hand'. Reserve Bank of India is trying to tame inflation while ill-conceived policies of Govt. of India are adding to the inflation in India. The Government must review its policies and must take measures to kill the existing parallel economy of black money. Secondly, the Government must review its policies of feeding the poor by pumping excessive cash in the Economy. Government must follow the existing social proverb: 'Do not give bread to the poor to eat. Teach him as to how to earn his bread.'

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