

Inflation: The war is on

These days, everywhere we are reading news about 'inflation', so let's see what this inflation is, is it a matter of concern? ...If yes, then why? So what different measures Government is taking and how can we overcome the problem?

Inflation arises when 'Demand' is greater than 'Supply'. Generically speaking, when supply of a commodity is less and when more people demand it or when people demand it in more quantity, then those who have more purchasing power (money), pay more for the same, hence price of the commodity goes higher than existing price. This is inflation and it actually helps in growth of the market, so it is in fact desired to some extent, say 2% to 3%. But when it goes higher, then it indicates that the supply is significantly short of the demand, which means that many people may not be able to get what they need, as they may not be able to afford it because not all would have enough money hence demand (need + purchasing power). This non-affordability for life's necessities is the main concern for the government and citizens. Today because we are also suffering from the problem of economic disparity, the problems are worsened. So can there be some solution, which might help in following ways not only to avoid problem of inflation but also to take care of it, when forced to us due to global issues in unforeseen circumstances

- Increase affordability of individuals by increasing their purchasing power and by reduction in prices of commodities
- Provide existence allowance to people below affordability line, considering the inflation
- Have abundant capital formation, hence cheap (may be at 2%) and easy access to credit, which can boost production hence supply from long term perspective

Causes:

Inflation can be of 2 kinds

1. Demand pulled inflation – Too much money and limited production case, obviously demand will go up and hence prices also go up, though cost of production may not have increased. Fake currencies increase such problems, as money is poured into economy without any credibility backup and we are witnessing many such cases today.
2. Cost pushed inflation – Cost of producing or supplying goods itself is rising, for instance if we are importing goods then if other countries raise prices or if fuel prices go up then transporting goods become costly

Before 20th July 08, we had inflation in range of 8% - 8.5%, this was before petroleum prices were to be effected, this was effect of both kinds of inflation. However this has been exacerbated by the cost pushed inflation caused by hike in fuel prices, which has taken inflation to 11.05% on 20th July 08.

What steps government is taking to manage the inflation and its ill effects?

- Withdraw money (liquidity) from market,
 - By increasing CRR - This again reduces the capital availability in the market and hence impact on production, so this could be a temporary measure, which in fact could add to the problem, particularly when there is also cost pushed inflation
 - By increasing loan rates – This certainly increases cost of capital hence will add to cost of production

These measures not only hamper growth but also are very ineffective in country like India, where mainly liquidity is in form of currency and bank money is very less, just 20% of narrow money. Where as in other countries with economies are strong the proportion is opposite i.e. bank money is 5 to 6 times of currency money. Thus in India, where access and affordability of credit is already a problem, these measures add to shortage of capital and put us down in

globalized economy. And anyway as more money available as currency, withdrawing credit does not help to curb inflation to that extent.

- Policy tinkering to reduce cost of production or distribution
 - Reduce import duties – Though this makes import cheaper, it proves to be disincentive for local producers
 - Ban exports – This sudden decision again hampers the work done by our internal people, as since some period they might have created export market for themselves and produced considering all those conditions
 - Rationing – Government intervenes by buying lot of food grains from the market (approximately 20% this time) and tries to distribute it in terms of ration. However we all know the ineffectiveness of this public distribution system in India. Also in china though they have a lot more effective public distribution system, they are facing an inflation of more than 8%

You can see easily and think for yourselves about the downsides and ineffectiveness of these measures.

How to solve or mitigate the problem?

1. With simplification and equity in taxation system, as in Arthakranti proposal, **tax burden on individuals would reduce drastically**, at the same time due to reduction in number & amount of taxes, commodity prices would come down. As effect of both these points, **individual's affordability would increase by great extent**.
2. With Arthakranti proposal, **loan rates will come down to about 2% to 3%**, by solving credit formation problem in current banking system. This will result in promotion of production activities, where as today the loan rates are very high.
3. To increase production of life's basic necessities, market will produce those only if population has enough purchasing power (if there is demand in market), where as today more than 78% of our population lives on below daily income of Rs. 20/-. So government needs to provide purchasing power to such population directly in terms of existence allowance i.e. social security allowance.
4. Money not backed by value generation or production causes inflation, so should not be added to the economy. Today government prints/introduces money not backed by credibility, as oil bond etc. Instead **government can have enough and abundant revenue** if we have efficient and effective taxation system as Arthakranti proposal
5. Introduction of money in terms of fake currency should be controlled. For the same, **higher denomination should be Rs. 50/-**, as analyzed and suggested by Arthakranti proposal
6. By taxing crediting transaction, a check will be added to non-value adding transaction as speculative trading etc. This will result in promoting value-adding transactions like production, service industry, long-term investments etc.

And even after all these measures, if we got to face inflation due to global reasons, then we can immediately take care of that by increasing the existence allowance (as mentioned in point '3' above) to compensate for the inflation. And this extra amount can be very easily (without adding much burden to people) and quickly (within a month) rose by the elastic and effective single point tax proposal as Arthakranti.