Ranga roots for monetary action

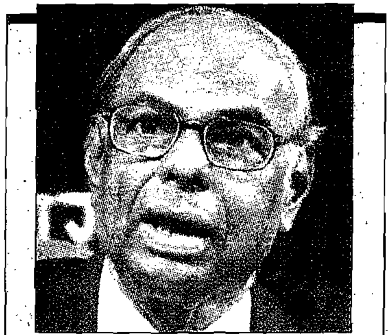
Says growth will still hit 8.5%

THE Prime Minister's Economic Advisory Council has called for monetary measures to tackle inflation but said these would not affect growth and raised its GDP forecast to 8.5% for the current fiscal from 8.2%. EAC chairman **C Rangarajan** *spoke to* **ET** *after releasing the Economic Outlook for 2010-11 on why inflation is a concern and the need for concrete steps to address it. Excerpts:*

Do you think that further monetary tightening will affect the economic recovery?
I do not think so. Maintaining growth and containing inflation are the two objectives of monetary policy. But at the moment, inflation situation calls for action on the part of monetary authorities and, therefore, I would say that the emphasis on controlling inflation might be stronger at this particular point.

There is a view in some sections of the government current inflation is more on account of supply side constraints and that monetary tightening will not help...
I think inflation at the present is not purely because of supply side factors. In fact, foodgrain prices have fallen from the high levels since January 2010. But overall inflation remains at a high level. The non-food manufactured inflation is now around 7%. So what started out as pure food price inflation has now become generalised. So some action on the demand side is called for and some tightening of the monetary policy is called for. Our view is that even with the tightening of the monetary policy the economy will grow at 8.5%.

The EAC has called for rationalising food and fertiliser subsidies in context of fiscal consolidation. Some measures have already been taken on fertiliser subsidy. What else needs to be done?
The nutrient-based subsidy has an impact more on the mix of use of fertilisers rather than the overall level of the fertiliser subsidy. Some action in terms of modulating prices of fertilisers is also called for. There are number of suggestions on this. One is to give to everybody a certain quantity at a subsidised price and then allow the people to buy more at market price. So some such thing will have to be worked out. It may be difficult to reduce the food subsidy, particularly at a time when we are talking of universalisation of the public distribution system.



"Inflation at present is not purely because of supply side factors. In fact, foodgrain prices have fallen from the high levels since January 2010. But overall inflation remains at a high level. What started as pure food inflation has now become generalised. Some action on the demand side is called for and tightening of the monetary policy is also called for.

C RANGARAJAN
EAC CHAIRMAN

What is your opinion on decontrolling diesel prices?
We have taken an in principle decision to decontrol diesel also. We will decide on the timing depending on the overall inflation. It is likely to be done only when there is a perceptible decline in inflation.

What are the other areas where expenditure can be trimmed to reduce the fiscal deficit?
On the expenditure side, what is required is to trim subsidies. Also interest payments can come down if the overall debt-to-GDP ratio is maintained at a lower level. The other thing is to ensure that revenue buoyancy is maintained and revenues go up.

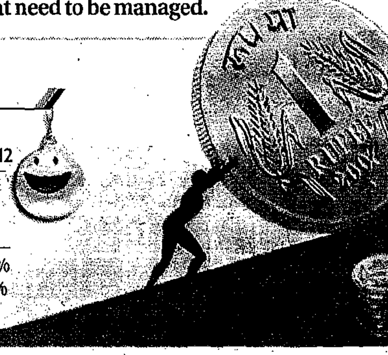
The EAC has said that agriculture productivity needs to be improved. The Department of Industrial Policy and Promotion has recently suggested opening of the retail sector to foreign investment, which in turn will lead to investment in backend infrastructure and fuel investment in agriculture...
In relation to agriculture, action is called on several fronts. For increasing the productivity of agriculture, one of the most important things is to increase the yield per acre. For many crops, productivity is not only very low compared to other countries, but there is considerable difference in productivity even within the country. So even if we just adopt the best practices within the country, we should be able to reach higher level of productivity.

Why has the EAC marginally scaled down its projection for farm output to 4.5% from your earlier forecast of 5%?
It can be 5% but we have been a little conservative, as we don't know what will happen to the monsoon. Once this becomes clearer, we should be in a stronger position to make our forecast on agriculture.

The EAC has suggested maintaining zero import duties on wheat and rice. Do you see a scenario for cutting import duties on manufactured items is cut to tackle inflation?
For containing inflation, we need to impose zero duty for improving the availability of essential commodities. That is why we emphasised on continuing with zero duty on wheat, rice and sugar. The decision on other items should be taken based on the general direction we want to move.

TRUE TO SCRIPT

The Prime Minister's Economic Advisory Council is optimistic of India achieving a sustainable 9% growth soon, but has flagged certain issues that need to be managed.



Strong recovery, towards 9% growth...

- **Indian economy** to grow 8.5% in the current year, 9% in 2011-12
- **Strong rebound** in agriculture output; farm sector to grow 4.5% in 2010-11
- **Industrial growth** at about 9.7% in 2010-11, services to grow 9.6%

As there are many facilitators of high growth...

- **Private expenditure** to increase in the current fiscal and next
- **Investments in** fixed assets expected to recover strongly
- **EAC thinks** these rates can enable the economy to grow at sustained 9%
- **Domestic savings** rate to go up to 34.3% in 2010-11 and further to 35.5% in 2011-12
- **Investments rate** at 37% in current year, rising to 38.4% in 2011-12
- **Domestic savings** sufficient to finance the high investment rate
- **Comfortable external** payments situation despite a likely near 3% current account deficit as capital flows to remain strong
- **A likely** normal monsoon despite hiccups
- **Fisc in** good shape – buoyant tax revenues, bonanza from 3G auction
- **Exchange rate** variations to remain in acceptable range

But many risks that need to be managed...

GLOBAL

- **Strong recovery** in advanced economies unlikely in 2010 or even in 2011
- **Fresh uncertainties** regarding global economic outlook and demand
- **Large fiscal** deficits, high debt ratios and slow economic growth in developed markets
- **Unsettled conditions** for business & potential for great volatility in financial markets
- **A 15%** increase in crude prices

DOMESTIC

- **Budgeted levels** of deficits still beyond acceptable limits
- **Inflation** a major concern, can undermine longer-term prospects of economic growth
- **High merchandise** trade deficit, likely at 9% of GDP
- **Large deficit** in physical infrastructure, especially power
- **Low farm** sector productivity