

SIMSETT Volume 2

Inflation Targeting: Convergence of Ideas



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Live life king size, live it as it comes !!

**Knowledge is the ultimate powerhouse,
strive to build on it !!**

Economists, industry leaders and common man all seem to be getting increasingly impatient as they beckon for a boost in the economy that has been fragile for over 3 years.

Inflation targeting (IT) has traditionally been a popular monetary framework worldwide. Although the monetary policy in India has been following a multiple-indicator approach since 1998, Reserve Bank of India's reactions in the last two years seem to be following the inflation approach; shifting to the Consumer Price Index as a measure of Inflation and then standing firm on its resolve to bring it down before going for monetary easing. With inflation recently easing considerably and forecasted to be stable in future, there seems to be a convergence in the otherwise alternate ideologies between the economists, industrialists and central banks' current stance.

Some authors have argued that for transition economies undergoing sustained financial liberalization and integration in world financial markets IT is an attractive monetary policy framework. It may however be noted that traditionally, although IT may have been responsible for maintaining a low inflation regime, it has not brought down the inflation rate substantially by itself. Moreover, the volatility of exchange rate and output movements in transition countries adopting IT has been higher than in the developed market economies.

It is important to understand that the Reserve Bank of India was constituted to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage. Implicit in these words are the core purposes of RBI, ***to foster monetary and financial stability conducive to sustainable economic growth, and to ensure the development of an efficient and inclusive financial system.***

Yes price stability becomes crucial in the short term but, it is important to understand that India has had a long standing problem of poverty and its alleviation has to be the cornerstone of success of any policy including the monetary policy. Amongst the emerging markets India's poverty alleviation record has been substantially poor. The country must sustain growth at over 8 % to significantly reduce poverty levels which can further boost the economy. With roughly 300 million people below poverty line any policy measure that curbs growth in the country for a long period becomes critically harmful and would obviously be frowned upon.

Keeping in view the structure of the economy, objectives of RBI and the basic financial infrastructure of the country, it seems that the RBI's current stand of keeping inflation under check over the medium to long term might not be as fruitful as it is expected to be. **Economists, industry leaders and common man all seem to be getting increasingly impatient as they beckon for a boost in the economy that has been fragile for over 3 years.**

Another school of thought develops from increasing evidences over the years that the functioning of the government and its fiscal policies have either been inefficient or insufficient for sustained economic growth or bringing down price levels. We can blame it on corruption, hoarding, scams or disinterested politicians but the fact remains that governance in the country has largely been poor.

India's agricultural yield per square hectare is one of the worst amongst emerging economies and far behind the developed economies, owing to the use of obsolete tools, techniques and technology still in large parts of the country. Poor infrastructure, lack of last mile roads, storage and warehouse facilities leads to immense wastage limiting the supply capacities leading to higher production costs and hence higher prices. In addition Acts like the APMC (Agriculture produce market committee) which has been one of the worst anti-market forces since liberalization literally reduces farmers to pawns in the hands of middlemen. Prices of food items rises due to the commissions these brokers charge and the act of hoarding some of them

indulge in. This means that, while consumers pay sky-high prices for food, farmers get a pittance for that produce.

Realizing such supply side inefficiencies it was imperative for RBI to take a stand against the spiraling inflation which rose close to 11% in the year 2012. The Reserve Bank of India governor Dr. Raghuram Rajan only tries to explain through the policy actions undertaken by RBI of late and through public speeches that, boosting growth in the phase of high inflation would negate the effect of real growth keeping the input costs high for producers, although demand could increase owing to lower interest rates leading to further increase of inflation. He hence urges that lower inflation today becomes quintessential to observe the real economic growth tomorrow when at an appropriate phase of sustained low inflation, the impact of reducing interest rates would become huge.

In my opinion, Rajan through his speeches has leveraged on his rigid stand and an influential personality to rightly convince the people that the government reforms on supply side and operational efficiency are more important to bring price stability in India.

Going forward as the new government has responded to the importance of infrastructural reforms, releasing many policy bottlenecks has made the environment conducive for investments. With retail inflation already easing by 40 % in the last 3 quarters owing to pressure from RBI's stand and of late, global reduction in oil prices which are forecasted to remain low until the next year, I think it's appropriate for RBI to cut interest rates by at least 25 bps to give the much required boost in the economy and cheer the sentiments of the industry.

Can Sports Boost Indian Economy?

**Many countries in past have improved their economy with the help of sports,
for instance Japan in 1964 & Britain in 2012**



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(I am passionate about Lawn Tennis)

From Kashmir to Kanyakumari , if something rises about all diversity in India , it's cricket! At one time Indians loved Cricket to the exclusion of other games and cricket appeared to be as if in the genes of Indians. Not anymore. From the past 2-3 years, other games through Kabaddi league, Hockey league, Badminton league & Football league have started appearing on the radar of youngsters, children, parents & most importantly sponsors & media.

There should always be a two way process. If economy has helped sports then sports can also help economy to come out of the present lull. Keynes half-jokingly suggested governments to pay people to dig ditches & fill them up! Britain hoped to get out of recession through the huge private expenditure made for the royal baby's birth and a second baby is said to be on its way now! Point is whether government or private companies, or individual's incremental expenditure has the multiplier & accelerator effect of generating investments, incomes & demand, completing the cycle.

How about additional spending on Cricket, non-cricket, & hitherto neglected sports by government, thereby encouraging backward & forward linkages stimulating private investment expenditure & consumption expenditure by individuals which can have the spin-offs in physically & mentally healthier citizens & probably even falling crime rate?

We have our own deshi example (IPL) of how sports can help boost the economy. IPL has helped economy in numerous ways like, it has created temporary & permanent employment opportunities, it has helped various advertising & marketing agencies in increasing their turnovers to new heights, it has encouraged tourism & city branding in India & the very important things which IPL has done is, it has encouraged the Indian middle class, known for their conservative spending nature to spend on non-essential things. Same things have been done by other leagues as well in sports like kabaddi, in which an investment of Rs. 20,000 crore (the amount refers to the investments the companies had made in purchasing broadcast rights and creating sporting league) resulted in registration of 3944 Kabaddi clubs in India & witnessing of kabaddi league finals by more than 50,000 people

Many countries in past have improved their economy with the help of sports, for instance Japan in 1964 & Britain in 2012.

Japan being a defeated nation in World War II, their economy was in a bad situation in 1950's. Therefore, they urgently needed to grow their post-World War economy. Fortunately, Tokyo 1964 games came to their rescue. 1964 games didn't just resurrect their economy, but it propelled it to a new height. Their GDP growth rate touched the staggering 20% mark in 1960s, GDP contributed from service was 45.2%, highest among all industries. In addition construction, transportation, communication & manufacturing were 21%, 19.4% & 14.4% respectively. The Olympic Games brought about employment of 650 thousand workers. The increased employment from manufacturing amounted to 210 thousand, the most of all the industries. Also, employment from construction & transportation with communication was 180 thousand, while that of service was 80 thousand.

And as far as Britain is concerned, their economy has seen a trade and industry boost in excess of £14 billion following the London 2012 Olympic and Paralympic Games, beating the 4 year target of £11 billion in half the time.

So, sports have a lot to contribute to a country's economy but subject to government's willingness & proactiveness. So, in India if government really wants to make Indian sports contribute to Indian economy they must do the following:

- Government has to make sports an integral part of Indian academic curriculum, by which more & more children will be attracted towards sports & will start dreaming about becoming a sportsmen along with Doctors & Engineers.
- Government can take FDI approach in sports sector as well, by which foreign companies will be attracted to India & bring newer technologies besides capital.
- Through budgetary sport we can assure more lasting impact on economy. We can give best of the facilities to our athletes & other players, we can develop more indigenous sports-related technologies, high class stadiums & infrastructure, which can grab the attention of world sporting bodies & can hand us the opportunity to host the biggest games & through which the opportunity to boost economy.
- Government has to address factors that affect participation in sports, such as cost. This includes both the monetary cost of accessing sports facilities & also the costs in terms of minimum time which required for participating in sports. For example, the longer the distances that people need to travel to access sports facilities or the longer the waiting period to access facilities of adequate quality, the less inclined will be people to take part in sport. Other factors affecting participation include lack of familiarity with sport, self-confidence and language issues. Here, building the group of people, who will be involved in the organization of sport or in the delivery of coaching / training, is very important.

So, investment in sports routed appropriately would raise the physical fitness of people thereby reducing the healthcare cost. This would also increase the productivity & production & eventually may improve the GDP.

By laying down the foundation correctly right now, instead of the usual chatter, people will be talking about India's remarkable hosting 10 years from now at the 2024 Olympic Games.

Trade Facilitation Agreement.... India's opposition justified?

The developing nations such as India and South Africa are demanding that before passing TFA, the WTO should work on alleviating the concern on food subsidy which is a lifeline for the millions of starving people.



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**(I eat, sleep and breathe
economics)**

“There is no ideological opposition on the issue. Even without a commitment to WTO, India would unilaterally support moves to facilitate trade. However, a solution is required to the dispute regarding holding of food stocks by India. The peace clause should not be phased out till this dispute is settled.” **Arun Jaitely**

With a view to reduce the ‘**Red Tape**’ barriers and excessive regulations on international trade and business, The **WTO** (World Trade Organization) members concluded the agreement on Trade Facilitation or more famously known as the **Trade Facilitation Agreement** (TFA) at the 9th ministerial conference of the WTO held in Bali on 7th December 2013.

The governing body of the TFA, i.e. the WTO was established in **1995** through the **Marrakesh** agreement after serious changes were required in its predecessor i.e. **GATT** (General Agreement on Trade and Tariffs) so as to extend trade liberalization in several areas notably, services and intellectual property.

The TFA became an integral part of the WTO negotiations during the **Doha round** (launched in 2001) as negotiations began on the agreement in order to:

- Provide more clarity on certain GATT articles with a view to further **expedite movement** and clearance of goods across national boundaries

- **Increase cooperation** among customs and other agencies related to trade

Trade Facilitation aims to boost trade by cost reduction and reduce delays through measures which provide more simplicity, transparency and uniformity in cross border trade. The **OECD** has estimated that the TFA has the potential to cut trade costs by up to 14.5% in low income countries and by 10% in high income countries. The agreement will increase **customs efficiency** and **effective revenue collection** which in turn will help small entrepreneurs access new export opportunities through measures like transparency in custom practices and efficient processing of documents.

Mr. Roberto Azevedo (Director General WTO) has stated that it is of prime importance to impart technical assistance to poorer nations and, with the help of TFA the **LDCs** or Least Developed Nations will be helped in building up their capacities.

The deadline to adopt the agreement by all 159 members of the WTO was 31st July 2014. However, because of stiff opposition (with India leading the charge) from many developing nations a consensus could not be reached and the deal fell through. The developing nations such as India and South Africa are demanding that before passing TFA, the WTO should work on alleviating the concern on food subsidy which is a lifeline for the millions of starving people.

India's Concern

- India has been very rigid in its stance in accepting the agreement mainly because of 2 reasons i.e. **Food Subsidy** and **Stockpiling of Food grains**.
- A clause in the TFA limits the **maximum food subsidy** that a nation can provide is **10%** of its total production.
- With the reference year being considered as **1986** (when food prices were relatively low) India's food subsidy looks unnecessarily bigger and objectionable.
- The adoption of the **Food Security** has also not helped matters as the government also provides **Minimum Support Price** to the farmers to make sure the food reaches every part of the country and no one is left hungry.

Where India is right

- (a) India is in some way justified in its stand as food security is a major concern in most developing nations and the WTO should address the issue of food subsidy and security first hand.
- (b) India has also raised concerns mentioning that developed nations like the USA provide almost **120 Billion \$** of agricultural subsidy every year, which is around **10 times more** than what India provides to its own farmers, thus feeling hard done by the agreement in the process.
- (c) It should also be noted that India's food program is largely **domestic based** and it does not distort global trade. The implementation of the TFA in the current state will see a change to that which may not be positive.

Where India is adamant

- (a) The TFA is a trade protocol that is aiming to do away with any hindrances and **stumbling blocks** that come in the way of free movement of goods and services across borders.
- (b) The agreement is beneficial as it will definitely increase **customs efficiency** through measures such as **custom transparency** and reduction in red tapism, which India would lose out on.
- (c) The proponents of the agreement believe that TFA will help add an estimate of **1 trillion \$** to the global Gross Domestic Product (GDP) and create 21 million jobs worldwide and India is missing the bigger picture.

Overall, it is a case of comparing oranges with apples. The Food Subsidy issue and The Trade Facilitation Agreement should be treated *separately* and the two should not be mixed with each other. The WTO should address the demands of the developing nations and make sure that their resources are **not exploited** by the more powerful and wealthier nations.

Whereas nations like India should also be more flexible towards the TFA as it offers an **ease in trade regulations** and guarantees to build stronger relations among member nations leading to **global growth** and **harmony**.