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Inflation- The Unrevealed Tax

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ABSTRACT

This paper aims to discuss the various aspects which trigger the increase in inflation in the Indian economy and further discusses the inescapable causes of increase in the countries general price level.We have genuinely tried to craft our honest perceptives and assessments regarding addressing inflation as an unrevealed iniquitious tax.There has been a structural change in calculation of Inflation in the economy since 2012 and however we have further tried to discuss the current scenario of increase in general price level at present in the Indian Economy.Nevertheless the paper aims to provide some recommendations to control and further maintain the balance and justify Reserve Bank's most important function 'Price stability in the country'.

INTRODUCTION

Inflation is a continuous increase in the common price level of goods and services in an economy over an era of time. When the price levelincreases, each unit of currency buys rarer goods and services. Inflation tax is a term which states to the financial loss of value grieved by the owners of cash and (if inflation is unexpected) fixed rate bonds. Purchasing power loss is often expressed by the value of financial loss. It may be better written off as a wealth transfer than tax. Since several people with debt, holder of hard assets and several equities instantaneously gain, numerous economists opine that the middle and lower classes are affected more than the rich by inflation, as larger fraction of their income is held by them in cash , they are far less probable to accept the newly generated monies before the market has used to with inflated prices, more frequently have fixed wages, income, or pension and lack the means to escape native inflation by reallocating assets oversees. Some dispute also prevails that inflation is a reverse nonlinear consumption nevertheless, unpredicted inflation directs economic position of people with outstanding fixed interest debt like mortgages and student loans and it can ripen the nation balance of trade inspiring exports with the decreasing imports and less lavish currency. In a country with inflated currency, a large portion of tax also falls on foreign holders of fixed income debt. It is significant to annotation that tax on creditors couples with the instantaneous transfer to debtors reducing the debt liability. An “inflated tax” can more increase real income by transferring wealth to people who are likely to expend it (inflation adjusted) economic growth (beyond its favourable impact on trade)

Lets get to the point from where it all began,the historical event of establishment of RBI (Reserve Bank of India) in 1935.The further significant historical events happened , namely nationalization of RBI in 1949, nationalization of commercial banks in 1991 and introduction of new economic policies in 1991 till date. India's track of inflation is moral in the sense that hyperinflation terror has never occurred.India's practice of inflation has been a mixed bag. There were years at which inflation was as high as 20% annual rate and in other year it was in negative. Giving example of the years starting from 1939-1940, inflation rate was below 6% for 34 years and for rest of the years it was 6%. India is not really an inflation ridden country but inflation has been proven to be both evil and god for our Indian economy.Inflation can be calculated or measure with the help of three basic indexes,viz :Consumers Price Index, Wholesale Price Index and the GDP deflator. Since years India,rather than using a more acceptable index of calculation (consumer price index) which would have included rent and wages, use wholesale pricesas an index to measure inflation.Anyhow presently our mighty nation is using consumer price index which is a more reflective indicator to the increase in price level.The measure that observes the weighted average of price of basket of consumer goods and services such as food, medical care, transportation is consumer price index. It is calculated by compelling price variations for each item in the predertimined basket of goods and averaging them.Refering to recent data, consumers price index has averaged to 7.4% from 2012 to 2016 and showed a peak increase during end of 2013 (11.16%) which was generally pretty high for India,but to our good fortune,inflation rate showed a great deal of improvement and attenuation and reached a remarkable low of 3.6% in mid 2015 respectively.Consumer price in india increased 4.2 percent year on year in October 2016, easing from an upwardly revised 4.39 percent rise in September reaching a new low since august last year

Now here rises the question and the answer would be embedded in the same, "Is inflation an iniquitous tax?"

The general notion is , an increase in price level leads to decrease in purchasing power of currency and hence the real income of people may decrease even if their nominal income increases giving them a false illusion of exceeded purchasing power exactly putting up a trifling picture of hidden tax .Inflation has a direct impact both positive and negetive on the value of currency of the country and it also affects the global economy.Yes,indeed if we think and analyse few facts about the negetive impact of inflationit generally can be referred to as an iniquitous tax,and high rate of inflation usually affects the quality of life of individuals negatively.If the future rates of inflation are uncertain then it will decrease investments and savings.If the rate of inflation rises rapidly then there can be shortage of goods and services, because of hoardings in concern that prices will rise in future.Inflation reduces the burden of public and private debt.It keeps nominal rate above zero and thus central banks adjust their interest rates on stabilizing the economy.Inflation if is pulled by demand (demand pull inflation) is generally good for the economy.The aggregate demand of the economy increases leading to increase in supply which inturn leads to establishment of the effective demand situation thus boosting the growth of the economy. It also reduces unemployment due to nominal wage rigidity.It increases the opportunity cost of holding money or of cash in hand.The world has seen some epic Instances of countries going through hyperinflation such as Germany and france,which became a global issue and a desperate situation of a country meltdown.

Specifically discussing about our Indian economy, inflation is triggered by various aspects which include increase in national salaries; imbalances in demand and supply and high prices on import. The increase in average salary cost rise in price of goods but it distresses the consumer differently. Because the population of India is so much branched out, large section of the population belongs to below the poverty line and hence they cannot manage to pay for the hike in prices of basic goods of necessity. There are few inescapable causes for increase in inflation giving us representation of hidden tax viz., depraved weather, poor crops and inadequate infrastructure. It generally affects on supply of food on the other hand upsurge in import of affluent goods also raise the price of food and other supply, but this cost can be condensed or avoided by starting manufacture within our country or by initiating domestic products.Inflation affects different people differently. Due to reduction in the value of money some may have gains, other may lose or few stand in between or they are indifferent to the change. The inflation positively affects in a way that manufacturers get their wealth maintained yearly. Also they will invest more in motivation to fetch higher profits. This will ultimately affect the wage based labour to find employment.Though inflation causes a fall in value of the currency it has its own advantages as well. Moderate and predictable inflation discourages hoarding of goods, services and money and it encourages them to invest in production, band, securities etc so that they can get higher returns in future.The main benefit of inflation is to debtors, as the payments they have to make for debts are usually fixed to the number of units of currency and not real value or buying power. The beneficiary of inflation is corporation, banks and government. Moderate inflation enables adjustment of wages.If average wages are rising due to moderate inflation, it is easier to increase the wages of productive workers and wages of the unproductive workers can be freeze. Inflation enables adjustment of relative prices. Inflation helps to

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boost the growth. At times very low rate of inflation may cause the economy stuck in a recession. In a developing country like ours, moderate inflation gives stimulus to fuller utilization of the resources, man and materials and accelerates the economic growth and thus helps to raise the standard of living of all classes of people.

The Current Scenario

For the first time in independent India's history, we are getting a demonstration of what deflation may look like. The current scenario is demonstrating a clear picture of how people react in cash shortage situations. The people who had huge hoardings of cash are in trouble,as well people are trying to conserve currency and spend quite less than they were habituated to.Now that people previously know that cash is a problem, this is the time for a major push by the government towards digital money.The dream of our Prime Minister of cash less economy will soon come true due to these drastic and reasonable steps.As per the global wealth report 2016, India ranked 2nd in wealth disparity. there is only 1% of the people holding 60% of wealth and 10% of the people hold 90% of wealth. As potrayed in the RBI website the year 2015-16, there was circulation of Rs 500 notes & Rs 1000 notes were 47.21% & 38.03% of the total currency circulated in the economy. Such currency is majority used by the rich people and its circulation is very high . It's oversupply in the economy and controlling by few people create panic in the Aam Adami in the form of inflation and become iniquitous tax. Impact of demonetization that has been in effect since November 9 is expected to have a negative impact on inflation. RBI is making changes in the monetary policy and it cuts the repo rate 8% on 14 June 2014 to 6.25% in October 2016.it brought the changes in CRR and from 16 September to 11 November deposits of 3.24 lakh rupees has been observed. CRR will be 100% which will restrict the supply of currency in the market and inflation rate will decline.

The major function of the Reserve Bank is to restore price stability in the country and maintain a reasonably moderate level of inflation,the inflation which promotes growth and investment.The major concern of the government is to make the nation able enough to sustain all shocks and crisis and to enhance growth and development in the country.In order to achieve that, the country needs to have reasonable amount of inflation which in turn promotes investment and hence growth in the country.India during her recent past in 2012 has further underwent a phase of high inflation.The decision of structural shift of considering consumer's price index as the major index for calculation rather than the wholesale price index was definitely the key.The rate of inflation since then was beautifully controlled by the reserve bank by altering monetary policies conveniently. Today inflation is approximately 3%which is remarkable for the economy and beneficial as well.Now talking about the micro aspect, the macro concern is goodness for the whole but what about the individual people facing increase in the price level and being unable to detach themselves from the constant concern of increased prices of goods and services. Looking at the broader picture some people still dwell in the illusion that increases is in their money income is hike in real terms as well whereas they forget to analyze the nominal aspect. Sometimes they are overburdened with the increasing prices which inturn definitely acts like a hidden or iniquitous tax in their lives.

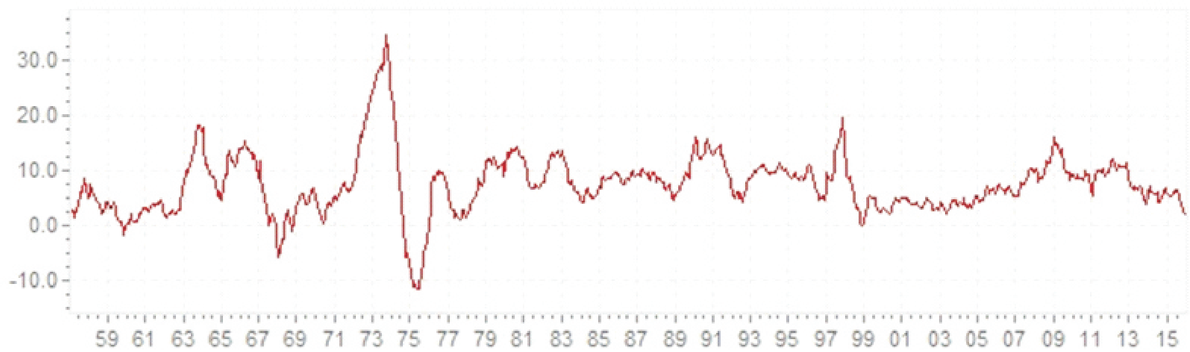

Fig:1 Image Source, World Inflation Data ,March 2017.

India has achieved a historic rate of inflation 3.1% (CPI) represented in the December versus December data in RBI and world Inflation data statistics.

CONCLUSION AND RECOMMENDATIONS

The major recommendations we would like to provide here is changing tax slabs according to growing inflation. Indian tax structure is progressive and that readily helps our country to progress and reduce income gap among classes and enhance development. The earnings of people soaring from the 10% to 20% slab bracket should be once considered in order to the rising inflationary pressures as well in order to reduce the burden of excessive inflation in the nation.Acknowledging the set limit of inflation, ranging from 2 % to 6% and an ideal 4%, is a great target to follow and maintain for the best concern of our economy.Inflation targeting have been embraced in developed countries like Canada and U.K, but developing countries like India has opted for inflation targeting too with a higher upper limit.To avoid inflation being an iniquitous tax, the RBI should control and minimally maintain the lower level inflation rate never letting it go beyond the upper control limit. Demonetization currently upheld deflation in the economywhich will in the long run prove to be beneficial. Tax doesn't sound like a tax when it is hidden. The finest mix of tax subsidy scheme would also help to avoid the costpush inflation in the economy to dwell.India now is in a juncture of implementation of a very important fundamental tax structure of the economy – The Goods and Service Tax (GST) and a stable rate is required as far as to keep inflation in check."Our assessment shows that the industry can live with GST benchmark rate of a band of 17-20 per cent. Anything above that will be counterproductive and lead to inflation, especially on the side of services," Assocham Secretary General DS Rawat said. RBI's core policies remain intact yet liquidity control is the major focus now for the economy (Liquidity stands for over 4 and a half lakh crore rupees in India now).A forecast of bad monsoon has made the RBI governer wary about food inflation and a concern of bad loans is still present.RBI now is going to specially take care of the Non Performing Assests (NPA's) of different banks and give them significant ideas to get rid of the same.The dent on the note ban is impacting the liquidity in the economy and hence RBI is slowly implimnting fruitful policies to maintain the balance in the economy.Many people are still aloof from the idea of its existence. Hoping that god would keep it that way by never letting the common man know and face its disasters, and here by god we mean the most superior enriched and the best central Bank of the world and the country…The Reserve Bank of India.

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