FOOD INFLATION WILL UNDERMINE INDIAN ECONOMIC GROWTH

Dr. Devajit Mahanta

Vice President, Benzcom Consulting Pvt. Ltd., Assam
Email: devajitmahanta@gmail.com

ABSTRACT

Food inflation in India is driven by demand side forces or at least enduring weakness in growth in supply relative to demand. This means it is also no transient and calls for monetary policy response. Addressing food inflation requires a good scientific understanding as well as coordinated action at national and state level. However the implications of various initiatives and the allocation of costs, risks and responsibilities are still under debate and negotiation. Rather than resign to a rise in food inflation Indian policy makers have to assess all adaptation options and have to take fresh look at nationally appropriate mitigation actions. Also instead of unseemly spectacle of blame and counter blame between the Union and State governments a more coordinated effort will help to control the inflation.

Keywords: Inflation, Monetary Policy, RBI, Supply Shock

INTRODUCTION

In economies, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. As per the Commerce Ministry release report India's inflation accelerated faster than expected 9.9 percent in February, 2010, adding to pressure on policymakers to continue unwinding stimulus measures. A hike in inflation rate suggests that there will be more rise in the food prices. A correct diagnosis of the factor underlying this inflation is needed to assess whether prevailing policy responses to rising food prices have been adequate and to formulate ongoing suitable responses. If the inflation due to supply shocks then it seems to the general consensus among policy makers which should be ignore. On the other hand is it is due to demand overheating then monetary policy should tighten severely. However, if the food price situation corresponds to neither demand overheating nor supply shocks but to a different set of circumstances then appropriate policies for these circumstances options need to be explored.

Table 1. Inflation in India (Average)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2010	16.22	14.86	14.86	13.3	13.9	13.9	13.73	11.25	9.88	9.82	9.7	NA
2009	10.45	9.63	8.03	8.7	8.63	9.29	11.89	11.72	11.64	11.49	13.51	14.97
2008	5.51	5.47	7.87	7.81	7.75	7.69	8.33	9.02	9.77	9.77	10.45	9.7
2007	6.72	7.56	6.72	6.67	6.61	5.69	6.45	7.26	6.4	6.4	5.50	5.51

Source: RBI, 2010

It is clear from the Table-1 that since January 2010, the inflation is declining. But on the other hand the food commodities inflation increased from 5.64 in 1994-95 to 19.42 in January 2010 (Table-2). The table clearly indicated that since 2006 the price inflation of food commodities compare to non-food commodities increased are much higher. Also if we analyze the item wise (Table-3) as on January 2010 inflation increases in food grains 17.89, cereals 13.69, pulses 45.62, rice 12.02, wheat 14.86 dairy product 12.87, milk group 13.99, egg, fish and meat 30.17, and sugar 58.94 which affects the general people. Increase in food prices become emotive and political issue because it upsets the common man`s family budget.

Table 2. Inflation in Food and Non-Food commodities (During 1994-95 to January-2010)

Item	1994-95 to 2004-05	2005	2006	2007	2008	2009	2010 January	Average 2006-09
All Commodities	5.90	4.74	4.82	4.82	9.12	2.01	8.54	5.19
Non-Food Commodities	6.02	5.37	4.72	4.54	9.55	-1.76	4.53	4.27
Food Commodities	5.64	5.09	5.09	5.60	7.87	12.90	19.42	7.86

Source: Ramesh, 2010

Table 3. Inflation in Food item wise (During 1994-95 to January-2010)

Item	1994-95 to 2004-05	2005	2006	2007	2008	2009	2010 January	Average 2006-09
Food Grains	5.54	3.83	9.71	6.27	6.37	14.14	17.89	9.12
Cereals	5.57	3.68	6.63	6.97	7.20	12.96	13.69	8.44
Pulses	5.46	5.04	32.0	2.14	1.30	21.81	45.62	14.33
Rice	5.00	4.01	2.13	6.05	8.97	15.96	12.02	8.28
Wheat	5.93	1.08	12.99	6.77	5.06	6.83	14.86	7.91
Oilseeds	5.89	-6.11	-3.96	26.58	17.46	0.92	10.05	10.25
Fruits & Vegetables	7.47	7.51	2.24	6.49	5.94	11.77	8.33	6.61
Diary Products	5.20	0.11	4.20	6.08	8.38	6012	12.87	6.19
Milk Group	5.57	0.73	4.48	8.17	7.87	8.93	13.99	7.36
Egg, Fish & Meat	6.46	9.46	6.72	6.38	3.75	14.44	30.71	7.82
Edible Oil	4.85	-7.19	1.23	13.11	12.52	-6.59	-1.17	5.07
Sugar	4.06	15.09	4.83	-14.69	5.62	36.34	58.94	8.02

Source: Ramesh, 2010

Forces behind Rising of Inflation

There are many reasons why food prices have risen at such a rapid rate. Moorthy, 2009; Reddy, 2007; and Mohanty, 2010; pointed that the current price rise is not even supply side constraint, as the Government is holding huge stock of food grains, which is sufficient to feed the nation. The basic issue is that of proper planning, effective coordination, efficient management and distribution of food. In 2009 India exported around 65 lakh tonne of Sugar. The government even granted subsidy for export of sugar, while in 2010 sugar inflation raises 58.94 and facing sugar crisis.

Economists warn that the oil prices being the single most influential factor that has impacted severely on the countries economy. If the uptrend seen in fuel continues, inflation could enter the double-digit range in the coming months, possibly resulting in sterner monetary action (Kolhar, 2010). Indian truckers, who carry about sixty five percent of the goods in the country, increased transportation rates by fifteen percent immediately after Finance Minister Pranab Mukherjee on February 26, 2010 imposed excise tax on gasoline and diesel as a part of a plan to withdrawing fiscal stimulus and cut the budget deficit (PTI, 2010).

Another key reason cited for the spiraling food inflation is the bad monsoon in India. According to the Indian Metrological Department, in the year 2010 the Indian monsoon was late by more than two weeks and steadily decreasing rainfall estimate for the rest of the season have raised the specter of drought in India for the first time since 2002. Agriculture will be adversely affected by an increase or decrease in the overall amounts of rainfall also by shifts of the timing of the rainfall. In this regard Vinkitaramanan (2009) pointed that bad monsoon affects the Indian food production system in two ways. One is direct changes through temperature, water balance and atmospheric composition as well as extreme weather events and another is indirect through in the distribution, frequently and severity of pest and disease outbreak, incidence of fire and in soil properties. The studies conducted by scientists Sahany and Mishra (2011) at IIT, Delhi have shown that the surface air temperature in India is going up at the rate of 0.4 degrees Celsius per hundred years, particularly during the post monsoon and winter season which will reduce the total duration of a crop cycle by inducing early flowering and shortening the grain fill period, The shorter the crop cycle the lower the yield per unit area.

Addressing climate change due to monsoon requires a good scientific understanding as well as coordinated action at national and state level. However the implications of various initiatives and the allocation of costs, risks and responsibilities are still under debate and negotiation. With nearly 700 million rural populations directly depending on monsoon for their subsistence and livelihoods food inflation in India is now widely regarded as one of the most serious challenge the Indian Government facing.

So far lot of reasons have been cited for the steep hike of essential commodities during the past few months like vagaries of weather, depreciating Indian money against the dollar, public private distribution, loss of agricultural food items due to lack of post harvesting infrastructure, costly agricultural finance, old method of production etc. But Joshi (2008) in his study mentioned that recently, another reason cited is commodity derivative trading where commodities including oil are traded. Some economist pointed that due to global financial crisis large bank and financial companies use commodity speculation as an alternative investment market which fuelled unnecessary speculation in essential commodities. The bulk of inflation which is substantially caused by commodities, especially fruits and vegetables, are not traded on our commodity exchanges. Thus futures trading cannot be held responsible for inflation. In the case of oil a small proportion of oil production is traded in the futures market. Global oil sales at current price levels amount to about $4.3 trillion. The futures market accounts for only $260 billion.

Another point is that majority of the Indians prefer to invest in fixed deposit which are currently yielding only around 8 to 10 percent annually against the inflation for an average household 12 to 15 percent rather than equity. As a result large sections of the population are losing out on their purchasing power without realizing about it.

Policy Initiative

Food price inflation is one of the most critical economic problems in the country today, and the ability to control prices of food articles quickly and effectively is one of the main bases on which people will judge the performance of this Government. With food inflation at eleven years high the government should review the working of the farm debt waiver scheme and rationalize fertilizer subsidy. The country has to double the storage capacity in public-private partnership.

Policy makers have been making various statements about the inflation over the years. In this regard however RBI (2010) stated in the Annual Report of 2009-2010 that “the identification of the source of inflation is important for the conduct of monetary policy … When the inflationary pressure is dominated by adverse supply shocks, monetary policy could be less effective in containing price pressures”

Expressing concern over rising food prices Prime Minister Manmohan Singh on April 1, 2010 asked RBI to formulate policies that control inflation and pave the way for nine percent or more economic growth. To tackle the recession RBI eased the interest rates from nine percent to three percent in 2009. Now to suck out the excess liquidity government indicated that RBI will be raising the cash reserve ratio in future. Tightening rates would mean slowing down growth and slowing the recovery during the ‘beginning of the end of recession’. So rather than raising the interest rate to curtailing food inflation government must provide substantially more funds to enable a proper and affect public food distribution system.

Climate change due to bad monsoon now is a key economic issue and needs to be dealt with accordingly. Though the need for action in response to climate change issues is clearly appreciated by the business leaders at various level the leadership role is bringing about change is largely left on the government. In this context the Prime Minister’s Council on climate change was constituted in June 2007 to develop India’s first ever national action plan on climate change. The policy was published on 30 June 2008, which seeks to promote sustainable development through use of clean technologies. Experts pointed that there seems to be a significant gap between good intentions and appropriate actions to back up the intentions among the top government officials. Some of them expect to contribute to mitigating their impact on climate change; few seem to be approaching this in a structured, measurable manner. The credibility of achievements may therefore remain under question. Finally, Instead of unseemly spectacle of blame and counter blame between the Union and

State governments a more coordinated effort is required to release of stocks through the public distribution system, open market sales of public stocks, precautionary arrangements for importing some food grains and attention to ensuring a strong ravi harvest which will help to control the inflation.

CONCLUSION

India's food inflation now is a major structural and policy issue. The decline in agriculture sector has been happening over decades and the impact on prices is being felt because common man losing their purchasing power. The solutions are to increase investments and productivity across the entire agriculture. The impact of supply shocks should be investigated by carefully examining the link between abnormal rainfall and weather and output and prices on commodity by commodity basis. To ease the prices to a large extent the Government should allow the private sector to import and store the primary agricultural commodities at zero import duty which will increase the food supply rather than money supply control. Government can eased the food price inflation by ensuring adequate supplies from its buffer stocks and removing bottlenecks in distribution, crack down on hoarders and black marketers, in response to inflation and to protect their own people imposed restrictions on food item exports, easy agricultural finance, adequate agricultural research and training specially for proper use of ground water, cropping patterns which will generate of soil quality and productivity of land and other inputs.

REFERENCES

1. Joshi, S. (2008) 'Ban on Futures Trading: Anti-farmer, not anti-inflation'. *Business Line*, May 21, 2008.
2. Kolhar, S. (2010), 'Occasionally Unchanging CPI: Some Methodological Issues', *Indian Economic Journal,* **57**(4), pp. 100-117.
3. Mohanty, Deepak (2010a), 'Inflation Dynamics in India: Issues and Concerns', *RBI Bulletin*, April 2010.
4. Moorthy, V. (2009), "It is time to Downgrade WPI", mint, November 18, 2009.
5. PTI, (2010) Relief to tax-payers in budget; petrol, diesel prices up. [Online] Avilable:http://www.thehindu.com/business/Economy/article113940.ece [accessed 16 September 2012]
6. Ramesh, C. (2010) 'Understanding the nature and causes of food inflation', *International Organization of Scientific Research,* Vol-1, Issue 4, April 2004, pp. 100-117.
7. Reddy, Y. V. (2007), 'Monetary Policy Developments in India: An Overview', RBI Bulletin, October 2007.
8. Reserve Bank of India (2010), *Annual Report 2009-2010*, Reserve Bank of India, Mumbai.
9. Sahany, S. and S.K.Mishra, 2011: Effects of convective scale downdrafts on the rainfall simulation in NCAR-CAM3.
10. Venkitaramanan, S. (2009) 'How not to tackle food inflation' *Business Line,* 28 December, 2009.