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Food Inflation: Noxious Problem and Policies Cure in India

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For six long years since 2007, we have lived with persistent double-digit food inflation, high consumer price and wholesale inflation. The right policy application in synchronized manner not only controls the persistent inflation but also boosts up the agricultural growth and reduces the rural poverty.

Introduction

Inflation is a persistent increase in the general price level of goods and services in an economy over a period of time. Economically, it has hurt growth. Poor and urban middle-class households have been affected the most. A combination of slowing growth and high inflation has weakened our macro-fundamentals: households fled financial savings, domestic and foreign investors lost confidence, and the rupee plunged. Politically, it has been a disaster. For six long years since 2007, we have lived with persistent double-digit food inflation, and in turn, high consumer price (CPI) and wholesale (WPI) inflation. Food and non-food inflation are linked. Although peak inflation rates may have come down, the pace of reduction was glacial. But the persistent food inflation is the major concern and the problem which has to be eradicated from the system and economic area to make it on the growing track with the positive growth as a whole. The right policies are always mitigating the hurdles in between and make the proper implications of decision accordingly. Policy application in synchronized manner not only controls the persistent inflation but also it boosts up the agricultural growth and reduces the rural poverty.

If we go back to the mid-2000s, India was growing very rapidly and the belief of the middle classes and business was that there was a very talented team running the economy, with an economist prime minister and a decent finance minister. There was faith that the central bank would keep inflation low and all would be well. India did not recognize the fragility of growth. The RBI let inflation get out of control. Inflation in general and food price inflation in particular has been a persistent problem in India over the past few years. Thus, there is an urgent need to understand this problem and to respond with appropriate agricultural policies to keep food prices stable if we are to reduce hunger and poverty in India.

Pessimistic Side of the Inflation

In festive season, a big damper, sharply higher food prices - driven by a 323 per cent jump in onion prices, an 89 per cent rise in vegetable prices and a 20 per cent increase in diesel prices - have pushed

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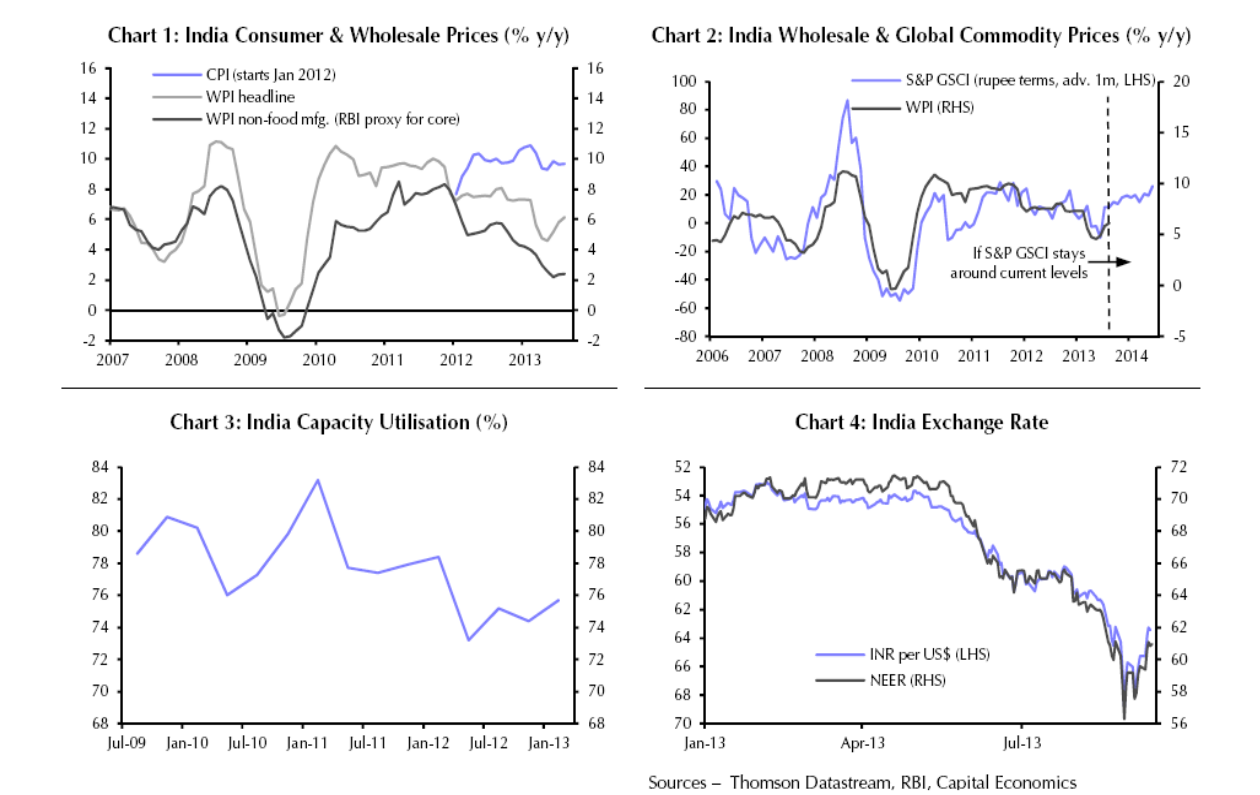

Chart 1-4. Consumer and wholesale prices pattern

the wholesale price index, the most widely-watched indicator of inflation in India, to a seven-month high of 6.46 per cent in September 2013 from a year earlier. Onions are a staple ingredient in many Indian dishes and rising prices of the vegetable anger voters and can quickly become a political issue. In September, food articles inflation surged 18.4 percent while fuel price inflation jumped 10.08 percent. Supply disruptions following heavy rainfall in some parts of the country have driven up food prices, particularly vegetable prices, in recent months. A weak rupee, along with increase in fuel prices, has kept upward

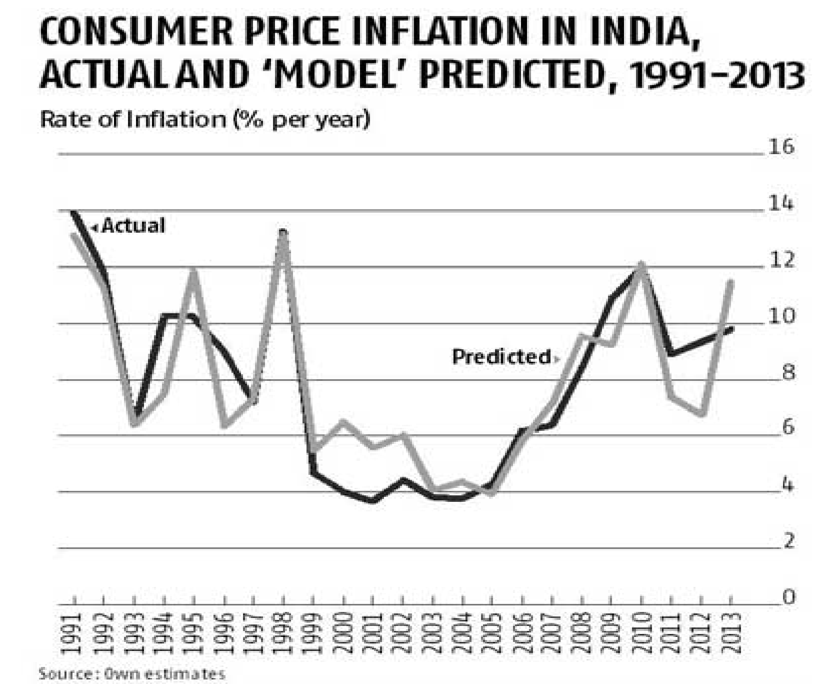

Chart 5. Actual and predicted model of CPI

pressure on inflation. The July wholesale price index was upwards revised to 5.85 percent v/s earlier estimate of 5.79 percent.

It is interesting to observe that high inflation in India has resulted in another peculiar problem. With many people seeing their savings in cash getting eroded due to high inflation, they have started buying more gold as a hedging instrument against inflation. As a result, imports of gold have increased tremendously; in financial year 2012-13 they are expected to cross US$ 50 billion, almost becoming the second largest import item after crude oil imports. This has contributed to the straining of current account deficit and is putting pressures on domestic currency, with rupee depreciating against the US dollar. The biggest culprit behind high food inflation is abnormally high fiscal deficit. This is followed by rising farm wages and global food prices.

As it happens, inflation would not, in any case, be an easy target for the RBI. Central bankers the world over know they cannot control the prices of food and fuel. But food accounts for half of India's consumer price index. Food inflation is also institutionalized since the government raises the support price for several crops every year. Food-led inflation cannot be checked by monetary policy alone: higher interest rates tend to hurt industry more than they reduce inflation. If inflation is very high, people turn away from money. They stop saving through the financial system and turn to gold.

What to Do

So what can we do? We need to restore credibility to policy. We need big measures, and political courage. We need to be able to stand up and say that the Food Security Bill is great but we cannot afford it right now. We need to be able to say, "We learned a lesson - when you have excellent growth, you don't spend all the money."

The trouble is that our policy dinosaurs don't view inflation as a problem or growth as fragile. The result is that investors, both domestic and foreign, who have to deal with the real economy, have lost confidence. Most of us do not seem to grasp the seriousness of the situation. Food price inflation was ignored under the pretext that the benefits of growth needed to spread to rural India. Gorged with high inflows of foreign funds, the government threw money around like a drunkard at a casino. Indians felt they had an inalienable right to grow rapidly, that India was finally getting the growth it deserved. The goal of "spreading" the riches to the mythical aam aadmi (common people) became a moral and not an economic issue.

Thus, from every angle, persistent food inflation and bringing it down to comfortable levels (below 5 percent) needs to be accorded high priority in policy making.

Policies Cure

RBI considers changes in the wholesale price index (WPI), as the headline inflation, which is the most relevant variable representing overall picture of inflation in the country as well as useful for policy articulation.

Lately, RBI's reluctance to reduce interest rates against an overwhelming demand for it from the industry, has juxtaposed a trade-off between growth and inflation. RBI has indicated time and again that government needs to rein-in fiscal deficit before it can reduce interest rates, else, too much money in the system will be putting further pressures on prices in general and food prices in particular.

The art of policy making will be tested in bringing down fiscal deficit in a calibrated manner, without abruptly and adversely hitting the growth rates in the economy. This can be done by pruning revenue deficit- particularly subsidies and non-investment expenditures. The big components of fiscal deficit at the Centre are the subsidies on fuel, food, and fertilizers. And at the state level, it is power subsidy. The pricing of these four commodities need to be rationalized for their efficient usage and also to contain the subsidy bills within manageable limits. The calculations at CACP suggest that food and fertilizer subsidies can be pruned by almost Rs 60,000 crores in FY 2013-14 itself, if one moves through direct cash transfer route using Aadhaar in case of food and fertilizers to direct beneficiaries.

Therefore, rationalization and proper implication of agricultural policies for high value products, and overhauling of the food grain management system, building efficient supply lines for agricultural-products, especially the perishable ones like fruits and vegetables, milk and milk products, eggs, meat and fish, etc, where the pressure of food inflation is much more than on cereals, deserves priority, together with a winding down of fiscal deficits by restructuring and rationalizing food and fertilizer subsidies, promoting appropriate farm mechanization, a special mission on food processing and FDI in organized retailing are steps in the right direction and dovetailing of MNREGA with agricultural-operations, and predictable and stable trade policy for agriculture, will surely go a long way in taming Indian food inflation.

Conclusion

Hence, food inflation is a noxious problem in India and persistent occurring of it is a major cause of pulling back the economy as well as reduction of the growth of agricultural sector and poverty alleviation. Proper implication and rationalization of the policies will check the food inflation and will make sure the desired growth and welfare of society.

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