Inflation: The Worrying Trend

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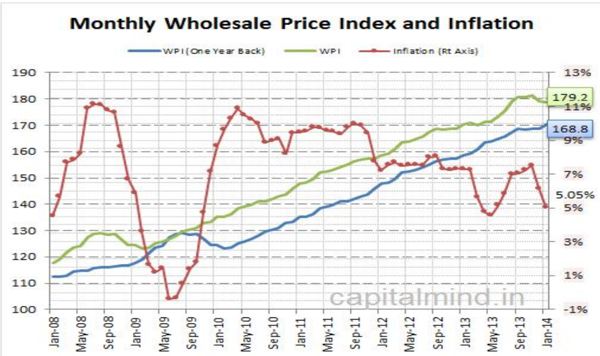
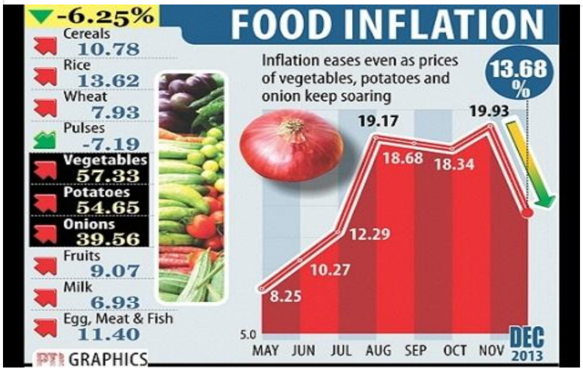
I INTRODUCTION

Persistently high inflation in past few years coupled with economic slow-down has been one of the key challenges for India. And the most dangerous aspect is that the major element in this rise in inflation is food inflation. The trend of rise in food prices is not only witnessed in India but is all across the Indian peninsula including Bangladesh, Nepal, Pakistan etc. This has dampened the regions' efforts to eradicate abject poverty and deal with hunger. As per a report India is among the most affected countries that suffers rising food inflation.





The food inflation has shown further decline in January 2014 and has stood at about 8.8 % as against 13.68% in the preceding month. In a country like India where about 65% of the people are considered to be poor, as per the Government figures, it is very callous to say that because people in India have started to demand more food items and due to growth in prosperity there has been a shift in their dietary habits, the food prices have increased. Rather, the administration needs to accept that there has been a serious policy setback in supply side of the agricultural products. Had the agricultural sector improved its productivity with more timely technological diffusion the scenario would not have been this murky. For example for last many years the decisions on raising Minimum Support Prices (MSPs) were been inspired politically and economically correct decisions have become the talks of the times of yore.

It is no rocket science to know or understand that food prices should be determined by the market and minimum support prices should be used only to provide a lower level support to the producers so that production decisions do not get distorted. But in last ten years the MSPs of wheat and rice have been increased by more than 100%!

It is further dreadful to find that consumer price inflation is rising at a faster rate in rural India as compared to urban India. In November and December 2013 inflation measured by the consumer price index in rural India was 11.66% and 10.49% respectively where as in urban India over the same period consumer price inflation accelerated 10.53% and 9.11% respectively. Theoretically, this means that the money supply in rural areas in the form of wages (in NREGA schemes) or public spending on health, education etc. should be reduced to control inflation! Looking at the present human index in rural India this seems to be quite ridiculous.

Clearly, supply side policies would be critical in managing food inflation. However, finding immediate answers is difficult as this situation has been a result of flawed policies and a long-lasting solution would lie in increasing yields and domestic output for oilseeds, pulses, rice or wheat on one hand and improving agro-based production of sugar, edible oils etc. on the other. There is immense scope for increasing yield through technology diffusion. Further there is an urgent need to understand the potential contradiction between a "remunerative" price for the farmer and a "fair" price for the consumer in the short run. A similar disagreement arises in pricing the petroleum products. The reconciliation of these contradictions and disagreements ought not to be in terms of an expensive compromise of fiscal correctness.

II THE POOR ARE HURT DISPROPORTIONATELY

Persistent rise in food inflation for more than a year and a half is hurting the producers and the consumers alike and is pulling down the economic growth as well. It is not surprising that these trends have hit the poor the most as the basket of lower income family's consumption is full of food articles. Therefore with rise in food inflation the poorer families' living standards are depressed without affecting the higher income groups much.

The policy responses to counter the rising food prices should include only mild monetary tightening by the Central bank along with lowering tax and tariff rates, freeing imports and maintaining larger food stocks to absorb the adverse impact of temporary supply shocks.

Other critical measures include better implementation of the food safety nets and food vouchers with real vigor to protect the poor and vulnerable and developing regional pooling of the buffer stocks of food.

There is no long-term trade-off between inflation and growth. In our view, low and steady inflation is the best way for monetary policy to support robust and inclusive growth in the medium-term. In line with a RBI study, our analysis also suggests that inflation above 5–6% hurts economic growth and the very objective of welfare state.

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