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Managing Inflation: Modi Government's Biggest Economic Challenge

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Controlling inflation, particularly food prices, is one of the biggest challenges facing the Modi Government in India.

Runaway food inflation was a key factor contributing to the electorate's unhappiness with the previous Congress-led government. The new government is expected to deliver decisively in this regard. Its success in taming inflation will be critical in ensuring its long-term sustenance and credibility with the electorate.

How bad is Inflation in India?

The new system of reporting inflation by the Central Statistical Organisation (CSO) reflects monthly price rises in different consumption categories such as food, beverages and tobacco, fuel and light, clothing and footwear, for rural and urban households. This is a distinct improvement over the earlier system of reporting inflation through changes in consumer price indices (CPI) for specific sections of the population e.g. agricultural labourers and industrial workers.² The new system also provides

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² *Consumer Price Index Numbers – Separately for Rural and Urban Areas and also Combined (Rural plus Urban)*, Central Statistics Office, Ministry of Statistics and Programme Implementation, Government of India; http://mospi.nic.in/Mospi_New/upload/brochure_n_cpi18_feb11.pdf Accessed on 2 June 2014.

estimates on inflation for rural and urban population for all states and union territories (UTs) of the country.

According to the latest estimates of CPI released on 12 May 2014, annual inflation in April 2014 was 8.59 per cent. Corresponding inflation rates in rural and urban areas were 8.89 per cent and 7.51 per cent respectively.³

At the above rates, India's inflation was higher than the consumer price inflations (2013) in all emerging markets and developing countries of Asia except Bhutan (8.7 per cent), Mongolia (9.6 per cent), Nepal (9.9 per cent) and Timor-Leste (10.6 per cent). India's inflation was almost double that of the combined inflation of 4.5 per cent for entire group of emerging market and developing economies of Asia.

India's current inflation is also higher than the inflation rates for Latin America and the Caribbean (6.8 per cent) and Sub-Saharan Africa (6.3 per cent) and slightly lower than that in the Middle East and North Africa (10.5 per cent).⁴ There is no doubt that India has one of the highest rates of inflation in the world.

New Government's Anti-Inflation Strategy

Considerable emphasis is expected to be on managing the supply-side contributors to price rise. This would be in contrast to the earlier government, which relied mostly on interest rates and monetary policy tools for tackling demand-side drivers – a policy that hardly produced results.

While the government is yet to announce a formal strategy, the latter is expected to include the measures mentioned in the BJP's election manifesto for checking prices. If it is indeed so, then the recommendations of a report prepared in 2011 on controlling inflation by a committee headed by Modi and comprising the then Chief Ministers of Andhra Pradesh, Maharashtra and Tamil Nadu would be significant.

Various recommendations of the report included creation of a central price stabilisation fund for helping states facing supply shortages procure food items, amendment of the Agriculture Produce and Marketing Committee (APMC) Acts of states for improving movement of farm produce from growers to consumers, stoppage of futures trading in essential commodities for checking speculation, non-grant of bail to offenders under the Essential Commodities Act, addition of agriculture marketing to

³ Press Release; *Consumer Price Index Numbers on Base 2010=100 For Rural, Urban and Combined for the Month of April 2014*; http://mospi.nic.in/Mospi_New/upload/cpi_press_rele_12may14K.pdf Accessed on 2 June 2014.

⁴ *World Economic Outlook*, April 2014; IMF; pages 187-191; <http://www.imf.org/external/pubs/ft/weo/2014/01/pdf/text.pdf> Accessed on 2 June 2014.

sectors and activities eligible for priority lending by commercial banks and the unbundling of operations of the Food Cooperation of India (FCI).⁵

The details of the Central Price Stabilisation Fund were not spelt out in the BJP manifesto. Conceptually this should be a mechanism enabling quick release of food grain from the Central pool of food stocks for disbursement to the states experiencing shortages. This can be useful in stabilising supplies of essential cereals like rice and wheat and other food items that are usually procured by the government. But it might not help in buffering supplies of milk, fruits and vegetables – items that have been experiencing maximum inflations in the food baskets of households.

Amendment of State APMC Acts enabling farmers to sell their produce to all procurers other than only the government-appointed agents is a necessary measure. This would diversify and add depth to procurement. As a proposal though, this is not new. The government's challenge would be to persuade the states to amend the APMC Acts as fast as possible.

The benefits of the amendments, however, might not entirely pass on to consumers given the BJP's reluctance to allow foreign retailers to take advantage of the new Acts. The BJP manifesto proposes a greater role for organised domestic cooperatives in this regard as opposed to foreign retailers. But the cooperatives are unlikely to get the much-needed investments in building cold storages and warehouses for establishing supply chains connecting farmers directly to consumers by removing intermediaries. The refusal to invite foreign suppliers in domestic food retail business might inhibit growth of modern food supply chains and hold back prices from softening in the long-term.

Stopping futures trading in essential food commodities can at best be a temporary measure. Such trading allows farmers to hedge against price losses if open market sales are below expectations. Stricter enforcement of the Essential Commodities Act by not granting bail to offenders would discourage hoarders if states implement the provisions sincerely. Unbundling the operations of the FCI is also a step in the right direction and can make procurements and disbursements more efficient. The effects of these, though, would be felt only in the long-term.

Implementing the measures in the BJP manifesto and the Modi Committee report of 2011 would be only partially successful in tackling prices unless they are sharpened further. The government would also require active cooperation from the state governments.

⁵ For more details see 1) *Election Manifesto 2014*, Bharatiya Janata Party; http://www.bjp.org/images/pdf_2014/full_manifesto_english_07.04.2014.pdf (Accessed on 19 May 2014) and 2) 'Narendra Modi submits 84-point report on food inflation', 2 March 2011; <http://deshgujarat.com/2011/03/02/narendra-modi-to-visit-dr-manmohan-singh-on-wednesday/> (Accessed on 19 May 2014)

Given the government's intention to rationalise subsidies, fuel prices are likely to harden. Food prices need to be brought down substantially for neutralising the effect of higher fuel prices on household consumption. Achieving fiscal discipline and price stability simultaneously is a huge challenge. Should the new government succeed in doing so, that would add a new dimension to inflation management policies in emerging markets.

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