Food inflation trends and causes

Food Inflation Trends and Causes In our country almost 40% people are living below the poverty line and high inflation makes it extremely difficult for them to maintain the livelihood. Though Inflation hits the poorer the most, it also affects the middle class of our society significantly. For past few months Indian economy has been witnessing consistent spiralling food prices. Country got some respite with the food inflation rate declining to 6. 60 percent for the week ended November 26, from 8. 00 percent in the previous week.

According to the data released by Ministry of Commerce & Industry the 52 – week average inflation has come down to 10. 45 percent. The annual rate of food inflation is measured in wholesale price index or WPI and currently the base year is 2004-05. Food inflation has been the primary driver of general inflation and this downward trend for past weeks is giving hope amidst the difficult economic situation. This improvement can be credited to better monsoons this year and improvement in supply and distribution of certain commodities. And also, as per the latest crop estimates, the food grain production in 2010-11 reached a record level of 241. million tonnes and is expected to touch 245 million tonnes. On examining the food inflation trend for past 3 years India has faced spells of high inflation many times. On a closer look the major factors leading to inflation are different every time. Global scenario had a role to play in the high inflation rates during 2008-09. Along with that the domestic policies related to money supply also accelerated the inflationary trend. But for past one year RBI has been very strict with the monetary policies changing the rate for 13 times since march 2010.

This indicates thatthe roots of food inflation lie in the supply side constraints both from the production and distribution side. In this paper we will first look at the factors driving the recent food inflation and then few measures taken by Government to contain it. Recent food inflation in India can be primarily attributed to the following factors: a)Stronger Inclusive growth: Govt. policies most notably MGNREGS and National Food Security Bill have also contributed to the rising food inflation. MGNREGS, since it was introduced in August 2005, has resulted in a significant growth of rural wages.

This has led to an increase in average per capita expenditure in the rural areas much of which was spent on food items. The National Food Security Bill which aims to ensure subsidized food entitlement to almost 75% of rural population and 50% of urban population has resulted in increased food grain procurement by the government. This has caused a demand pressure for food grains while there has been no significant rise in the supply side of food grains. Both these factors have contributed to increasing food inflation spurred by increasing demand.)Increase in Minimum Support Prices (MSP) for Food Grains: Recent years have seen a steady increase in MSP for major agricultural products. This is consistent with the steady increase in wages which are input costs to various agricultural activities. Increasing MSP for food grains has further increased the food prices and led to rising food inflation. c)Inefficiencies in Supply Chain: Though procurement of food grains has remained fairly steady over the years and our reserves have stayed way over our prescribed buffer limits, we have been unable to meet the demand fluctuations.

This is due to inefficiencies in releasing food grains when required. Also storage and cold chain facilities to store adequate food items like food grains, pulses as well as perishables like vegetables need to be revamped. d)Change in Dietary patterns towards a Protein rich diet: With increasing per-capita Income stemmed by strong growth over the last few years, India has witnessed a change in dietary pattern. The proportion of carbohydrate rich food staples has seen a decline as compared to Protein rich food items like – pulses, milk, eggs, fish and meat.

Inflation in these protein rich food items has largely contributed to the rise in Food Inflation and consequently to overall Inflation. Though the change in dietary pattern was evident, the prices have seen a sharp spike in the recent past. Measures taken by government to combat rising food prices 1. Role of subsidies In an effort to make food grains accessible to the impoverished sections, the government directs subsidies at them. But the system is heavily dependent on the efficiency and integrity of the Public Distribution System(PDS).

Records suggest around 20 percent of the food grains meant for the poor is diverted and sold illegally at higher prices. Approximately 20 percent of the poorest households actually get the essential food grains. The picture is still worse in states like Bihar and UP where the figure is around 2 percent and 6 percent respectively. A possible alternative that the government can consider is that of selling the grains directly to the poor without channelling it through middlemen. Even then there is the risk of part of the food being bought by traders who resell it back to the government at higher prices.

All the above factors lead to an unnecessary increase in the fiscal expenditure resulting in inflation. It’s a system where the government ends up subsidizing both the consumers and the producers. It’s a situation where the farming sector finds itself relying heavily on subsidies and MSP for its survival. Ideally, the government would be better off if it utilizes the amount used up in subsidies for improving the rural infrastructure as well as introducing better technologies to improve the overall productivity of food grains. 2. FDI in Retail Government of India has floated the idea of FDI in retail to curb food inflation.

On one hand, the cultivators face difficulties in repaying loans taken for production because they do not get the right price for their produce. On the other hand, consumers end up paying huge prices, which are almost four times of that the cultivators get while selling their produce. Thus a chain of corrupted middlemen make substantial profit. The upward spiral in food prices is primarily due to demand-supply dynamics. While allowing FDI in retail, the government insisted that foreign retailers would have to make 50% of the total investment in back-end infrastructure like cold storages.

Perishable goods worth one lakh crore rupees are destroyed annually in India due to poor infrastructure. An estimated forty percent of fruit and vegetables perish due to lack of refrigerated trucking, warehouses, poor roads and corruption. That means lower incomes for farmers and higher prices for customers. If companies like Wal-Mart and Tesco open shops in India, they will have to make investments in improving agricultural techniques and getting produce into stores efficiently. This could effectively reduce food inflation. The benefits of FDI in retail management are as follows: 1. Cultivators will get reasonable price of their produce.

They can sell their crop sitting in the villages or agricultural field. 2. An efficient supply chain in agriculture will help decrease inflation. 3. Advanced technology will result in higher production of crops. 4. Middlemen who create problems by not buying the produce at right time and price will be eliminated. 5. Refrigerated transportation and investment in cold storages will help consumers to get more fresh vegetables at right price. 6. Minimize wastages due of lack of proper storage facilities. 7. FDI in retail will bring in advanced supply-chain management know-how and technology to India. . Organized retail has the ability to drive efficiencies and leverage scale and we can expect that affordability for consumers will increase. 9. The difference in price between producers and consumers will get narrowed due to elimination of middlemen. 10. FDI in retail will bring in the global best practices in sourcing of raw materials and agricultural marketing. Farmers will benefit from profit realizations and better price. Consumers are getting badly affected while purchasing agricultural product from the market due to role of chain of corrupted middlemen.

In India this practice is going on for centuries, hence it cannot be changed overnight. There will be social pressure of this group of middlemen who will be affected. The strategy to allow FDI in retail would be in the larger interest of consumers. This move will create competition, thus resulting in excellent quality and lower prices. In the past twenty years, Indian consumers have experienced the best that sectors like IT and telecom have to offer — thanks to the sectors opening up. That can also be said of the Indian retail sector.

The development of organized retail in India would bringin huge benefits across the value chain — from cultivators to small-scale manufacturers and to consumers. Agrarian states in India would benefit from backward integration and investment in agriculture. The states would be able to move their produce efficiently across the country. FDI in retail will result in substantial investment in backend infrastructure like cold chains, logistics and warehousing. In order to curb food inflation, our political parties have to decide whom they want to favour – cultivators and onsumers or a series of corrupted middle men? 3. Market and trade policy measures to reduce prices for consumers a)Releasing food stock to the market Releasing food stock at a subsidized rate to the market is one of the important reasons to curb food inflation. Countries like India, Pakistan, China, Senegal, Ethiopia etc. release public stocks and offer subsidies for staple food. For example, in 2008, Food Corporation of India had made a record purchase of rice and wheat and thus created an opportunity for Indian government to release sufficient stock into the market to stabilize prices.

Both the government and Reserve Bank had been maintaining that the high inflation is largely due to supply side constraints. As of February 2011, wheat reserve in India is at 19. 4 million tons, rice reserve at 27. 8 million tons. Some release of this ample stock of wheat was announced for public consumption by the food and agriculture dept. of India. b)Reducing Tariffs Reduction in tariffs impacts food inflation. Lesser the tariff lesser will be the price of food materials for the producers and distributors and hence lesser will be the market price of those food materials.

But tariff in developing countries are declining as a result of bilateral and multilateral agreements or deals between regions or nations. A number of countries like Indonesia, Pakistan etc. have to a great extent reduced or eliminated such kinds of food tax to curb food inflation. But in many countries the decline in food price as a result of tariff reduction has not been of significant value. The impact has been significant in few countries for selected food items. c)Restricting Export As the export is restricted, quantity of food materials available in the market increases or in other words supply also increases.

This leads to the fall in food prices. Other countries like Egypt, India, Pakistan and Vietnam imposed ban or steeply hiked minimum prices on fears of dwindling supplies and rising prices, but later lifted or promised to end the export restrictions. The Govt. of India banned the export of rice since 2008, wheat since 2007. Onion export ban has been lifted but with a minimum price and sugar is exported under quota. This is one of the temporary steps that the government takes to curb food inflation. 4. Minimum support price Minimum support price is a supportive measure on part of the government for the farmers.

It is a price at which the government agrees to purchase crops from the farmers irrespective of the market value. It assumes relevance when after a rich harvest; the prices go down so that the farmer has very little in terms of margins. The MSP level is fixed by the government from year to year by taking various factors into consideration like the rainfall trends in that season, the productivity levels as well as the recommendations of the commissions for agricultural costs and prices, the various state governments and other ministries.

Over the last decade there has been a marked increase in the MSP of various agricultural products which has pushed up food inflation levels (Exhibit1). The cost plus pricing formula adopted by the commission for agricultural costs and prices, rising labour costs as well as rising input costs have resulted in heightened inflation levels (Exhibit 2). The Mahatma Gandhi National Rural Employment Guarantee Scheme enacted in 2005 which assures 100 days of guaranteed wage employment every fiscal year to a household has played a big role in the shooting up of the labour costs.

With a rise in the input costs as well as the labour costs, the government resorted to raising the MSP'S of the food grains i. e. rice (39%), wheat (10%). While the farming community still isn't satisfied, the move worsens the food inflation system pushing it further high. Also the increasing input costs have led to growing apprehensions among the exporters regarding the competitiveness of the nation in the global market. The government should pull a check in the MSP level to control inflation. Instead providing subsidies to the cash-strapped farmers would be a more feasible option. . Measures to curb inflation through agricultural practices Curbing food inflation through agricultural practices is a long term measure. Population increase is inevitable. If the rate of increase of food grain production lags behind rate of increase of population growth, we will face a huge scarcity of an essential commodity-food. As it is an essential commodity, it would be too optimistic to assume a decline in its demand. High demand and less supply will fuel an inflationary cycle that might even lead to hyperinflation.

So, it is essential to take measures to prevent scarcity of food. The following measures could be adopted for that: •Bring more land area under cultivation. •Use more technological practices to offset the effect of farmers shifting to other occupation. •Prevent usage of food crops for fuel purposes. •Make farming a deseasonal activity. This is truer for India where only a good monsoon guarantees a good harvest. Paradox: The producers of food, -farmers cannot take a stand on low or high food inflation. The demand for their produce does not go down with high food prices.

They can fetch higher prices for their produce in case of high food prices. But food inflation is never alone. It is highly correlated with fuel and overall inflation. The inputs for farm produce will also experience increased prices especially fertilizers, thus offsetting the income from increased prices of food grains. So, it’s highly unclear what would be beneficial for farmers. 6. Effect of monetary policies Monetary policies are changed by the RBI to keep a check on the overall rate of inflation. It has a minimal impact on food inflation, if any.

Monetary tightening and increase of interest rates makes credit costly. This impacts businesses directly as their cost of borrowing increases. It impacts them indirectly as customers have to pay a higher price for purchasing goods on credit and that dampens their sales. Banks have separate credit policies for farmers and change in interest rates hardly affects their cost of borrowing as they might be even subsidized by the government. People spend on food primarily and do not rely for it on credit. So, demand for food doesn’t go down. . Infrastructure revamp to improve Storage and Cold chain facilities Government has come up with budgetary plans to improve food items supply chain. As part of the Annual Budget 2011-2012, government has planned to setup additional 15 Mega Food Parks. It also plans to augment the storage capacity and cold chains though private players. In order to expedite the process Rs 300 Crore has been allocated for its promotion. Equipment needed for storage and warehouse facilities on agricultural produce have now been granted Excise exemption.

Cold Storage Facilities are now classified as sub-section of Infrastructure. This would bring in additional benefits to the Cold Storage Facilities including ability to create infrastructure debt funds through tax free bonds. Investment in such Infrastructure bonds is further promoted by Rs 20000 exemption in tax liability in Direct taxes. Improvement in Storage and Cold chain facilities would facilitate lesser wastage and would help even out seasonal and other unforeseen fluctuations in supply. This would greatly help stabilize food prices and help fight food inflation.