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Over the last two weeks, the Opposition has been blaming high LPG prices and GST on pre-packaged food items as key factors behind the current bout of inflation. However, ask economists and they would dismiss the impact of the two factors as minimal.

From a layman's perspective, inflation occurs when there is a mismatch between demand and supply of output. Managing inflation is to manage demand-side factors, supply-side factors, or a combination of both, affecting availability of output (GDP).

Demand management refers to the use of fiscal and monetary policies when inflation is characterised by a positive output gap (difference between demand and supply). Agricultural output gap, the cause of food price inflation, can happen because of an increase in demand-side factors or a reduction in supply of outputs.

Among the demand-side factors, consumption expenditure is important. In India, it contributes close to 60 per cent of GDP. Since the start of this millennium, there

has been an increase in real income (and hence, consumption) resulting in a shift in preference towards consuming high protein items such as meat, milk and eggs. Advocates of demand-side factors believe that increase in food price is because of higher income resulting from the India growth story.

But consumption of food items cannot move beyond the steady-state level. This is particularly true for basic cereals and vegetables. Moreover, real wage rate data suggest that there has been a marginal increase for non-agricultural workers post-2015. For construction workers, there has been a fall, particularly post-2019.

Also, last fiscal, there has been a reduction in MGNREGA outlay – a 34 per cent fall in FY22 over FY21. The rural economy employs 350 million people (around 54 per cent of the total workforce) and contributes nearly half of India's total GDP. The slow growth in FMCG and two-wheeler sales in rural areas testifies to the lack of demand. Additionally, procurement of foodgrains at Minimum Support Price (MSP) has fallen from ₹2.87 lakh crore in FY21 to ₹2.37 lakh crore in FY22. The factors which may have cranked-up



Weathering the price rise

demand are missing. Clearly, the root cause of inflation is not demand-driven.

On the supply side, there has been a fall in net sown area. As per latest estimates, the net sown area in India is 139.3 million hectares (Annual Report 2021-22, Ministry of Agriculture). Ten years back it was 141.1 million hectares.

Technology is also not coming to the rescue. For long, output per hectare, a common measure of agriculture productivity, remained low in India. For example, in potato farming, the productivity of Indian farmers is less than half that of their counterparts in the US, Germany and the Netherlands.

Over the last one decade, the an-

nual growth of India's agriculture output has been hovering around 3 per cent. With around half of the country's agriculture still rainfall dependent, below-normal or excessive rain affects production. Lower agricultural produce also means higher fodder prices for live-stock, leading to increase in meat, egg and milk prices.

Statistics don't lie

Coming back to the Opposition's grouse, let us see if the rise in prices of LPG and pre-packaged food items is fuelling inflation. Examining the weights of various commodities in the current Consumer Price Index (CPI) series, LPG (belonging to Fuel and Light category) contributes a meagre 6.84 per cent, whereas the Food and Beverages contribute 45.8 per cent of the total weight. So the inflation, as explained by CPI, is driven more by the rise in price of food and beverages and not LPG.

Within the Food and Beverages category, a large chunk (more than 10 per cent) is contributed by fruits and vegetables, whereas the newly added pre-packaged items will have less than 1 per cent weight. In fact, pre-packaged food of more than 25 kg in a single packet would be ex-

empted from GST. So there's a need to focus on factors raising the prices of fruits and vegetables.

In addition to poor agricultural productivity and shrinkage in net sown areas, another factor which is contributing to price rise is climate change. The rise in lemon and tomato prices in June also has to do with heat waves in the northern part of the country. The apple growing orchards in the foothills of Himachal Pradesh are fast vanishing. Unseasonal rains and excessive heat damaged production of lemons, mangoes, and tomatoes. Even wheat output has suffered because of excessive heat.

Capacity constraints in the form of a lack in cold storage facilities and an imperfect market due to lack of reforms in the APMC Act have made matters worse.

As an aside, since May, the RBI has been trying to fight inflation by raising interest rates. Rate hikes cannot curb inflation when it is not driven by demand-side factors. Fiscal initiatives such as reforms in the agriculture, and putting in place climate policies may help.

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