How policy is the key driver of inflation

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The initial euphoria of above-normal rainfall during the first three weeks of June gave way to despair following a notable rainfall deficiency in the subsequent month. There are rising concerns about the impact of deficient rainfall on food and, hence, headline inflation. In fact, a rainfall deficit of 42% during the first half of September and an overall deficiency of 16% till date is indeed a cause for alarm, especially given that this is the second consecutive year of deficient monsoon.

The fact, however, is that monsoon playing truant does not necessarily translate into high average headline inflation. Food inflation in India is more a result of sub-optimal policy choices than of the vagaries of rainfall. Hence, while monsoon failure does lead to a fairly short-term spurt in food prices, sustenance at elevated levels is more due to structural impediments.

Sample this: If we were to leave aside the flood year of 1994, India's inflation was high between 1996 and 1998, even when monsoon was normal or slightly above average. On the other hand, between 1999 and 2005, average headline inflation remained contained despite a sustained period of below-normal rains, including the drought in 2002 and the hugely deficient monsoon in 2004.

Inadequate buffer stock policy

Although headline inflation may not necessarily react as much to monsoon failure, food production does. However, India has a policy of maintaining a buffer stock, which is expected to act as a shock absorber should crops fail. India's buffer stock policy essentially focuses on foodgrains, notably cereals but not pulses. Since 2008, the government has been aggressive in procuring foodgrains, and the actual buffer stock has consistently been above the specified norm. Unfortunately, foodgrain prices remained high as the government failed to bring the stock to the market during periods of shortage, thereby allowing speculative stocking up and even black market activity. Of late, however, the government has been proactive enough in bringing stocks of foodgrain to the market, which has helped keep inflation under check.

Unfortunately, the government does not maintain a buffer stock of pulses. Unlike foodgrains, pulses are mostly grown in areas that do not have irrigation facilities. In India, roughly half of the land for cultivation is not covered by irrigation. Hence, pulse production is more dependent on adequate monsoon, unlike cereals, which are mostly grown in well-irrigated areas. Also, pulse production, like most of India's other agricultural crops, suffers from low productivity. And not surprisingly, pulse prices remain high.

Minimum support price

Minimum support price (MSP) was announced by the government for the first time in 1966-67 for wheat in the wake of the Green Revolution and consequent bumper harvest, to save farmers from falling profits. Since then, the MSP regime has been expanded to many crops. This is the price at which the government is supposed to purchase crops from farmers if prices drop below the MSP. At present, the government procures cereals from farmers at the MSP to build up the country's buffer stock, while its agency Nafed (National Agricultural Cooperative Marketing Federation of India Ltd) buys other crops from farmers when prices drop below MSP, though not with the intention of building up a buffer.

There was a sharp increase in MSP, especially during 2008-14, and it is no surprise that food inflation remained at double-digit levels during this period. Thankfully, the MSP hike has been kept to the bare minimum over the past two years and this is reflected in the generally easing food inflation.

High food inflation does not benefit farmers

Thanks in large measure to middlemen, there is a substantial mark-up in the agriculture supply chain. So far, agricultural produce marketing committees (APMCs) remain the biggest challenge. These centres thrive under political patronage and restrictive regulations, leading to collusion among traders, even as farmers and consumers remain the worse off. Recently, the government announced the creation of a national market for farm produce—an electronically unified agriculture market that will help introduce transparency and reduce farmers' intermediation costs. Successful implementation of this policy will ensure that the government gets a better handle on inflation and farmers get better remuneration.

Agriculture sector neglect

Years of continued neglect has been one of the biggest banes of this sector. Over the years, a lot of money has been spent in various ill-targeted programmes even at the cost of capital investment. Overall government expenditure in agriculture as a percentage of total expenditure remained small and has been falling dangerously over the years. Even more worrying is the fall in capital expenditure in agriculture as a percentage of total capital expenditure, leading to grossly inadequate pre- and post-harvest infrastructure. The problem is further exacerbated by the fact that save for a few years, actual capital expenditure on agriculture has always been lower than what had been budgeted for, as the government is forced to curtail expenditure (rather than reduce subsidies) to ensure that the fiscal deficit does not get out of hand.

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