PRICE LEVEL IN INDIA (1981-82 TO 2012-13)

CAUSES AND EFFECTIVENESS OF CONTROLLING MEASURES.

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ABSTRACT.

The purpose of this research paper is to examine the trends in inflation during the post-reforms period beginning from 1991 and ending with 2012. This paper also examines the causes and remedial measures undertaken by the Government of India over more than thirty years.

Given the high level of tolerance of inflation in the entire post-independent India's economic history, the author concludes that both the governments and planners had tacitly accepted high inflation in order to fuel the engine of economic growth. However, with economic reforms and globalization of the Indian economy, the tolerance level has come down and inflation targeting has become a part of the monetary and fiscal policy framework. The RBI was expected to announce a cheap monetary policy in the fall of 2012. Belying all expectations, Dr. Duvvuri Subba Rao, Governor, RBI held a tight leash on the monetary measures. The CRR was tweaked by 25 basis points thereby releasing little more money to the market. However, the Governor cautioned the Government that if the fiscal deficit is not brought down, inflation rate may breach the eight per cent mark in the near future.

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MEANING OF INFLATION.

A sustained rise in the general price level over a period of time is known as inflation. Inflation is measured in terms of a price index. For instance in India, we have the wholesale price index (WPI) and the consumer price index (CPI). The Price Index is based on a basket of goods and

services. Within a given basket, the prices of some goods and services may rise or fall. However, when there is a net increase the price of the basket, it is called inflation.

INFLATION DURING THE PERIOD (1981-82 ONWARDS)

Between 1981-82 and 1991-92, prices rose at an annual rate of 8.1 per cent with 1981-82 as the base year. During the next five years i.e. 1990-91 to 1994-95, the general price level rose at an annual rate of 10.7 per cent. Beginning with 1991-92 and up to 1994-95 in the Post reforms period, India once again experienced Double digit inflation. It is only after 1994-95, that the inflation rate began to moderate and remained around the five per cent average rate. However, between 2006-07 and 2011-12, the average inflation rate once again assumed serious proportions and remained high at an average rate of 7.7 per cent. Inflation rates in India in the entire planning period until the year 2011-12 are given in Tables 1 to 3 below.

Table 1 - Inflation in India (1981-82 to 1994-95)

Year	WPI Rate (per cent)	Remarks
Base Year 1981-82 = 100		
1981-82	9.3	The average inflation rate during the period 1981-82 to 1991-92 was 8.1 per cent
1982-83	4.9	
1983-84	7.5	
1984-85	6.5	
1985-86	4.4	
1986-87	5.8	
1987-88	8.1	
1988-89	7.5	
1989-90	7.5	
1990-91	10.3	
1991-92	13.7	
1992-93	10.1	Beginning with 1991-92 and up to 1994-95 in the Post reforms period, India experienced Double digit inflation.
1993-94	10.4	
1994-95	12.5	
Source: Indian Economic Surveys various issues.		

Table 2 - Inflation in India (1995-96 to 2004-05)

Year	WPI Rate (per cent)	Remarks
Base Year 1993-94 = 100		
1995-96	8.0	The average annual inflation during the period 1995-96 to 2004-05 was 5.5 per cent.
1996-97	4.6	
1997-98	4.4	
1998-99	5.9	
1999-2000	3.3	
2000-01	7.2	
2001-02	3.6	

2002-03	3.4	
2003-04	5.4	
2004-05	5.1	
Source: Indian Economic Surveys various issues.		

Table 3 - Inflation in India (2005-06 to 2011-12)		
Year	WPI Rate (per cent)	Remarks
Base Year 2004-05 = 100		
2005-06	4.4	The average annual inflation rate during the period 2005-06 to 2011-12 is 7.7 per cent.
2006-07	6.6	
2007-08	4.7	
2008-09	8.0	
2009-10	3.8	
2010-11	9.5	
2011-12	6.9	
Source: Indian Economic Surveys various issues.		

CAUSES OF INFLATION AND THEIR RELEVANCE TO INDIA.

The causes of inflation are classified into two categories. They are demand side and supply side factors. These factors are discussed in this section.

Demand side Factors Causing Inflation.

Inflation is caused by a rise in aggregate demand over aggregate supply. Factors causing in aggregate demand over aggregate supply are as follows.

1. **High Proportion of Non-developmental Expenditure.** Rising government expenditure has been an important cause of inflation in India. In 1990-91, public expenditure was 31 per cent of the GDP. It further rose to 32 per cent in 2010-11. About 71% of the public expenditure in India was on non-developmental activities in 2010-11.

2. **Deficit Financing.** The fiscal deficit during the year 2010-11 was Rs.3, 69,043crores and in the year 2011-012, it was Rs.4, 12,817crores. The fiscal deficit as a percentage of GDP for the period 1990-91 to 2011-12 is given in Table 4 below. In the years 2008-09 and 2009-10 the fiscal deficit have gone up to 6% and 6.5% respectively. The budget for 2010-11 announced going back to fiscal consolidation and the projected fiscal deficit for 2010-11, 2011-12 and 2012-13 is 5.5%, 4.8% and 4.1 % respectively. The actual fiscal deficit figures in the years 2010-11 and 2011-12 were below the projected figures. However, fiscal deficit in 2008-09 and 2009-10, had gone up due to fiscal intervention made by the Government of India in the wake of the Global Financial Crisis.

Table 4 - Trends in the Deficits of the Central Government.				
Year	Revenue Deficit	Primary Deficit	Fiscal Deficit	**Revenue Deficit As per cent of Fiscal Deficit**
	(As per cent of GDP)			
1990-91	3.3	2.8	6.6	**49.4**
1991-92	2.5	0.7	4.7	**52.7**
1992-93	2.5	0.6	4.8	**51.7**
1993-94	3.8	2.2	6.4	**59.2**
1994-95	3.1	0.4	4.7	**64.6**
1995-96	2.5	0.0	4.2	**59.2**
1996-97	2.4	-0.2	4.1	**58.2**
1997-98	3.1	0.5	4.8	**63.5**
1998-99	3.8	0.7	5.1	**74.8**
1999-2000	3.5	0.7	5.4	**64.6**
2000-01	4.1	0.9	5.7	**71.7**
2001-02	4.4	1.5	6.2	**71.1**
2002-03	4.4	1.1	5.9	**74.4**
Enactment of FRBM Act				
2003-04	3.6	0.0	4.5	**79.7**
2004-05	2.5	-0.1	4.0	**62.6**
2005-06	2.7	0.4	4.1	**64.7**
2006-07	1.9	-0.2	3.3	**57.6**
2007-08	1.1	-0.9	2.6	**42.3**
2008-09	4.5	2.6	**6.0**	**12.8**
2009-10	5.2	3.2	**6.5**	**66.6**
2010-11	3.2	1.8	4.8	**66.6**
2011-12	3.4	1.6	4.6	**73.9**
Source: IES 2011-12.				

3. **Increase in Money Supply.** Commenting on the effect of money supply on prices, Dr. C Rangarajan, former Governor of the Reserve Bank of India states that “Money has an impact on both output and price. The process of money creation is a process of credit creation. Money comes into existence because credit is given either to the government or the private sector or the foreign sector. Since credit facilitates the production process, it has favorable impact on output. But at the same time the increased money supply raises the demand with an upward pressure on prices”. **Dr. Rangarajan has therefore accepted the fact in India that price effect of money supply is greater than output effect.**

4. **Corruption and Black Money.** Corruption by public servants and ministers amounts to unearned income and leakages in the system. Any leakage in the flow of production would reduce the total quantity of output and increase in aggregate demand. Further unreported incomes or black money would also cause rise in prices. Although unreported incomes are not entirely unearned incomes, they do contribute to excessive consumption expenditure and therefore cause rise in prices.

   Out of the 180 countries surveyed by Transparency International for corruption, India's rank was 74 with an index of 3.5 in the year 2006. An index of 10 indicates complete freedom from corruption and an index of zero indicates total corruption. Countries with a CPI score of less than five are considered to have serious problem. India is therefore one of the most seriously corrupted countries in the world.

Supply Side Factors Causing Inflation.

Supply lags in the economy causes aggregate supply to fall short of aggregate demand and cause price rise. These supply side causes are as follows.

1. **Fluctuating Agricultural Growth.** In Indian, population growth rate and the rate of growth of agricultural output has remained the same in the last twenty years. Indian agriculture is dependent on monsoons. Thus bad and poor monsoons mean crop failure and rise in food prices leading to rise in the general price level in the country. In the year 2009-10, food production fell by seven per cent. In the subsequent two years, food production was up but the year 2012-13 appears to be a year of drought and only time will tell the state of food production in the country. The growth in real national income has been much higher than the rise in food production thereby causing the prices to rise.

2. **Hoarding of Essential Goods.** When the agricultural sector fails, food prices begin to rise more rapidly than non-food prices. The problem of food price rise is compounded by hoarding of agricultural goods by traders. In times of food scarcity, hoarding of food grains and other food products only helps the prices to rise further.

3. **Inadequate Rise in Industrial Production.** In India, during the period 1995-96 to 2001-02, the industrial sector registered slow growth. Inadequate increase in industrial production has also been an important cause of inflation in India. For instance, after registering 12.9 and 15.5 per cent growth in the index of industrial production in the years 2006-07 and 2007-08, in the subsequent four years, the index went up only by 2.5, 6.3, 8.2 and 3.6 per cent respectively.

MEASURES TO CONTROL INFLATION W.R.T. INDIA.

From 1981-82 to 1989-90, prices rose at an average rate of 8.5 per cent per annum. In 1990-91, the inflation rate was 10.3 per cent followed by 13.7 per cent in 1991-92. In July 1991, the

Government of India adopted the new economic policy. One of the important tasks of the government was to maintain price stability under the new economic policy. Accordingly, the government undertook various measures to control inflation in the country. These measures were as follows:

1. **Monetary Policy.** In 1981 the bank rate was raised to 10 per cent to control inflation. Between May 1983 and July 1989, the CRR was raised from 7 per cent to a maximum of 15 per cent. Further, the SLR was raised in stages to 38.5 per cent in September, 1990. The bank rate was raised to 12 per cent in October, 1991 to control liquidity in the economy. Monetary expansion due to rising foreign exchange reserves was controlled by sterilization of foreign exchange reserves.

2. **Fiscal Policy.** Fiscal policy refers to the income and expenditure policy of the government. It is an effective tool to control inflation. The Government of India made attempts to remove fiscal imbalance from 1991-92 by bringing down fiscal deficit from 6.6 per cent to 4.7 per cent of GDP. However, in 1993-94 the fiscal deficit rose to 6.4 per cent. It was 5.9 per cent in 2001-02. In 2005-06, the fiscal deficit was brought down to below the five per cent mark. During the decade 1995-2005, the government has been able to keep the average inflation rate below the five per cent level. However, between 2005-06 and 2011-12, the government had failed to control inflation rate and fiscal once again went up to 6.0 and 6.5 % in the years 2008-09 and 2009-10.

3. **Public Distribution System.** The Public Distribution System was established in the country to provide essential consumer goods particularly to the poor people at low prices. The entire country is covered by this system. However, one cannot say that the system has been able to control price rise. The agricultural price support policy of the government has worked against the objective of price stability. As a result of faulty agricultural policy, food production in India had failed to keep pace with rising demand for food.

4. **Supply Side Measures.** In order to improve the supply of essential commodities, the government of India had allowed food imports. During 1995-96, imports of edible oils, palmolein, sugar and pulses were allowed. The Food Corporation of India sold rice and wheat in the open market to control market prices of these food grains. Excise duties on a number of industrial products were reduced to improve the supply of manufactured goods.

CAUSES OF INFLATION IN THE YEARS 2010-11 AND 2011-12 AND REMEDIAL MEASURES UNDERTAKEN BY THE GOVENRMENT OF INDIA.

1. Global Commodity Prices.

Primary articles contributed relatively less to inflation in 2011-12 as compared to the previous year. However, manufactured articles contributed more to inflation. Global commodity inflation also contributed significantly to inflation in the last few years. International prices of silver (up by 75%), coconut and copra by 54%, cotton by 45%, fertilizers by 43%, groundnut oil by 41 %, coffee by 38%, Gold by 28% and Iron by 15%. **Consequently, domestic manufacturing inflation went up by 5.5 % in 2010-11 and 7.6% in 2011-12.** International

food inflation was also higher than domestic food inflation and was 42% in June 2011. The Food Price Index (2002-04 = 100) of the FAO was 238 in February 2011 and it declined to 214 in January 2012. Fall in global demand for food and increase in supplies contributed to this decline. However, food inflation remains a concern due to increased incomes, diversification of dietary patterns, attraction of bio-fuels and weather disturbances. Due to the poor growth projections of the world economy and improved supply prospects, global commodity prices are expected to decline in 2012.

2. **Fuel Prices.**

Oil and Petroleum prices rose sharply from USD 75 per barrel to USD 114 per barrel in June 2011 (up by 52%). **The average price of the Indian basket of crude oil went up from USD 69.76 per barrel in 2009-10 to USD 109.97 in 2011-12.** As a result, the prices of non-administered mineral oil consisting of aviation turbine fuel, bitumen, furnace oil and naphtha went up by **41 %** and administered mineral oil prices consisting of LPG, Kerosene and Diesel went up by **11 per cent.** With petrol price decontrol, prices of petrol went up by 12.46% in 2011-12. The prices of PDS kerosene was up by 16.5 %, diesel by 8.49% and LPG by 15.53%. Hence, domestic fuel inflation was 14.21% in January, 2012.

The international impact of fuel price inflation was reduced by **fiscal policy** measures. Custom duty of five per cent on crude oil was removed, import duty on petrol and diesel was brought down by 5% and excise duty on diesel was reduced by Rs.2.6 per litre.

Food Inflation.

The Food Price Index consists of primary food articles and manufactured food products. The weight of food articles in the WPI is 24.31% (primary food articles 14.34 % and manufactured food products 9.97). Primary food inflation assumed serious proportions during 2009-11 and it was 16.75% in 2010-11 and 15.27 % in 2009-10. In 2011-12, primary food article inflation has come down to 7.15%. Inflation for 31 essential commodities declined from 24% in January 2010 to 5 % in December 2011.

In order to moderate the impact of food inflation, the government continued to lay emphasis on the PDS, imports, distribution of essential commodities at below market prices, anti-hoarding operations and strengthening supply chain efficiency. Good monsoon in the previous two years and government efforts brought down food inflation from 20.22% in February 2010 to 8.95% in April 2011 and 1.58% in January, 2012.

EPILOGUE.

Given the high level of tolerance of inflation in the entire post-independent India's economic history, the author concludes that both the governments and planners had tacitly accepted high inflation in order to fuel the engine of economic growth in the first forty years (1951-1991). However, with economic reforms and globalization of the Indian economy, the tolerance level

has come down and inflation targeting has become a part of the monetary and fiscal policy framework.

In the financial year 2012-13, on 14th September 2012, the Government announced a further rise of 12% in diesel prices. It also announced that families will receive only six LPG cylinders at subsidized rates per annum. LPG cylinders over six per annum will be priced at market rates. These measures will spike inflation rate.

However, there appears to be a silver lining behind the dark clouds of inflation and poor economic growth. Fuel price hikes and disinvestment proceeds from the sale of Government stake in Hindustan Copper, Oil India, MMTC and NALCO will bring down the fiscal deficit. This measure will reduce the inflationary pressure. Further, the Government has also announced 51% FDI in multi-brand retail, 49% in the Airline and Power trading industries. This will boost foreign capital flows. The RBI was expected to come out with a cheap winter session monetary policy so that interest rate would fall and the Rupee-Dollar exchange rate would also fall. With rupee strengthening, fuel prices may come down in the immediate future and bring down the price level in the country. However, expectation regarding monetary easing was belied by the announcement of 2012 winter session monetary policy. The Governor, RBI Dr. Subba Rao kept all other rates constant with a 25 basis point reduction in the CRR. The Governor expects the inflation rate to breach the 8 % mark in the near future if the Government does not reduce the fiscal deficit.

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