OF COWS GOATS and HENS

Looking at the current hue and cry in India over food inflation, I guess many of us appear to have missed out the key points made by RBI Deputy Governor Subir Gokarn in his inaugural address at a special conference at the premier Indira Gandhi Institute for Development Research on 26 October 2010.

The protein factor….

Dr. Gokarn revealed that he and his colleagues at the central bank had been making efforts to understand the dynamics of food prices in the country. Their efforts brought forth some startling revelations. First and foremost was the discovery that protein-rich foods accounted for a significant part of the rising food price index. The researchers further centered down upon some specific foods like pulses, milk, eggs, meat and fish that had shown a tendency to rise in the past few years beginning 2004-05. Second was the conclusion that these proteins were becoming costlier due to a steep increase in demand – an increase far higher than the continuous boost in supplies. Last was the inescapable hypothesis that such demand was a result of an increase in incomes in the economy. To quote, "***as levels of affluence increase, the demand for proteins is bound to increase overall..***" . Thereafter, the RBI Deputy Governor continued to present detailed data to support this hypothesis.

Dynamics of food inflation in India…..

One of the good doctor's big worries was the dilemma in selecting central bank's policy responses to this development. How should the monetary regulator bank respond to this urge of the common man to consume better quality of food in line with his crossover from his carbohydrate existence? While we all understand that ultimately a free market economy will ensure increased supplies, yet we also know that it is not simply a case of farmers producing more milk, meat, eggs and pulses. Firstly, farming in India is more of the individual type and the switch to more lucrative alternates does not take place swiftly. Farmers take time to absorb the fact that the price rise is structural and not a temporary phenomenon. After all, the possible supply gluts arising out of sudden changes in crop patterns and other farm activities can cause quite heavy losses to farm houses. Secondly, while pulse production can be increased within a season or two, increase in milk, eggs and meat production cannot be that fast. This has to be preceded by an increase in the number of animals and birds besides, of course, the decision by millions of farmers to produce more of such foods. Imports beyond a point are not feasible as the cost of transportation is high and also because demand from developing countries is also leading to price increases in the surplus nations themselves.

Coming back to Dr. Gokarn's troubles, many of us were really intrigued at that time and wished to know in what light the central bank would take this report as the above address was made just a few days before a scheduled RBI policy announcement. Would it, for instance, accept the affluence theory and avoid the monetary hammer? The answer came shortly thereafter on 2 November 2010, when RBI imposed yet another increase in policy rates (repo and reverse repo). The Governor D. Subbarao did acknowledge the efforts put in by his junior colleague but was apprehensive that the food inflation would result in higher wages and consequently give rise to industrial as well as overall inflationary pressures. Now again, it has increased policy rates in its Rate Review on 25 January 2011. Once again, the Governor has blamed "supply constraints" in the food chain for much of the pressure on prices.

the problem….

This brings us back to our main concern of this article. After years and years of being an “underdeveloped” country (which entailed low incomes, penury and other difficulties), the Indian economy entered a phase of rapid economic growth from 2004 onwards. This growth rate was only partially hampered by the global developments of 2007-08. However, for the past two years, prices of food items have developed their own peculiar dynamics driving the planners into despair. Even Governor Subbarao has lamented that “food inflation has remained at elevated levels for more than two years now.” He appears to be further disappointed that, unlike in the past, even a good monsoon and a record production of foodgrains has failed to drive down prices. And, finally, he has rightly pointed out that higher food inflation is plaguing a number of other countries too.

Thus, the country is finding it increasingly difficult to reap the fruit borne after years of following a particular economic model. Food prices, in their present weird dynamics, threaten to kill the growth story as the strong monetary steps taken by Reserve Bank will sooner or later stifle production, incomes and growth. The central bank has been tightening markets for over a year now and many sectors are feeling the pinch of higher borrowing costs. Food prices, however, continue their merry journey northwards. Economists are quite distressed that food of all things (Remember India is a surplus food nation) may spoil the show for rapid economic development.

the dilemma….

This then is the dilemma that much of the developing world today faces. As higher incomes for the marginal population results in shifts in food preferences, the demand for such food outstrips the supplies. And such shifts are happening in many parts of the world. Since the countries involved (India, China, Brazil etc) having larger populations, the income shifts are benefitting scores of millions of people. The demand for particular kind of food is also increasing manifold. The challenge before the developing (and the developed world) is to meet this demand timely.

And India, of course, has to find a way out of this impasse. Firstly, of course, the Government, the people and the central bank have to acknowledge and accept that a significant part of the price rise in proteins is structural and, hence, no policy response is called for. Every few years, such shifts in price levels take place in many commodities including food. Moreover, the current weightage given to some food items (and to food itself) in the inflation index needs to be reconsidered as this has become the cause of unnecessary panic and knee jerk policy responses. The supply issues have to be dealt with by economic planners and not the central bank.

and the opportunity….

Finally, this problem has its own positive ramifications. Most of the recession hit countries in the West have been focusing only on industrial growth to fight their way out of the slow down. Many of these countries can also, however, exploit their superior technological knowhow by increasing production of milk and milk products, meat, pulses and fruit. They may well consider this increased demand for food as a new window of opportunity.

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