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CHALLENGES OF MEASURING INFLATION IN INDIA

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ABSTRACT

Inflation is a rate of increase in the general-price index known as the wholesale price index (WPI) which is a weighted average-price index of a basket of six hundred and seventy-six critical items (earlier it was four hundred and thirty-five), which impacts the overall economy. It will have prices of steel, cement, food grains, etc. It is computed in Indian on a weekly basis in comparison to the corresponding week last year with reference to a base year (now 2004-2005 earlier it was 1993-1994) known as 'headline inflation' measured on an annual basis. Once rate of increase in price rise is more than the increase in income it begins to hurt, especially the poor who are hit the hardest. Essential items of consumption get out of reach of a majority of people. To maintain the same standards, living people have to spend more in inflationary period, very often they have to dip into their savings, Protracted periods of continuous inflation can damage the fabric of the economy and experience in the past has shown that inflation has led to the downfall of many governments in different countries. It is simply because demand is more than what is being supplied and accordingly could be demand-driven as demand-pull inflation or driven from the supply side as either as cost push inflation. However, in inflationary period both reinforce each other, difficult to distinguish which is the cause and which is the effect.

It can thus be seen that inflation is multi-dimentional and cannot be tackled through one policy tool but through a combination of strategies aimed at the supply side especially in the agricultural sector. Therein, is the challenge for the government that once inflation sets in, all efforts at taming inflation will always fall short of expectations.

KEYWORDS: *Inflation- High Prices – CRR, SLR, OMO and NREGA.*

INTRODUCTION:-

Right in the first chapter, a reference was made to output of an economy has always to be adjusted for inflation. That is the monetary value of output tends to increase in periods of inflation-rising prices. In simple terms inflation refers to situation when prices in an economy tend to increase.

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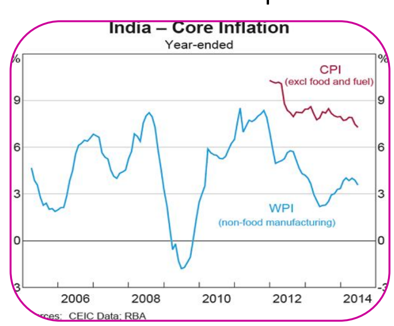

The government also publishes the consumer prices index (CPI) separate for agricultural workers and industrial workers. This index has those good which are sensitive to the consumer. The commodities covered under CPI are different besides also having different weights in the indices. While inflation is measured at WPI, all compensation to consumers is at CPI (popularly known as 'dearness allowance' which is part neutralization for inflation).

Some other measures of inflation are the 'core inflation' which refers to price increase excluding that of volatile fluctuation in prices of food and energy. The measure can also be known as 'structural inflation'. The other is 'food inflation' which is increase in food prices presently being faced since 2009 which is in double digits for the last nine months.

Yet another measure is 'imported inflation' wherein prices of imports contribute to inflation like increase in crude petroleum prices leading to increased fuel prices and it results in overall increase in prices.

Besides these, various economists have coined different kinds of inflation based on the degree of rate of increase in prices like:-

- Hyper or runaway inflation (averaging 100 per cent in three years).
- Galloping inflation (inflation increasing in arithmetic or geometric progression).
- Creeping inflation (gradual increase in price are seen as good for economies).
- Dis-inflation (reduced rates of increase in prices).
- Deflation (inflation turning negative and prices falling).

FALL OUT OF INFLATION

It is said that a mild dose of price is good for an economy like creeping inflation as it provides incentive to producers in an economy to produce more, thereby more output and income in an economy. The increased income enables the people to bear the modest increase in prices.

However, once rate of increase in price rise is more than the increase in income it begins to hurt, especially the poor who are hit the hardest. Essential items of consumption get out of reach of a majority of people. To maintain the same standards, living people have to spend more in inflationary period, very often they have to dip into their savings, Protracted periods of continuous inflation can damage the fabric of the economy and experience in the past has shown that inflation has led to the downfall of many governments in different countries.

WHY PRICES INCREASE?

It is simply because demand is more than what is being supplied and accordingly could be demand-driven as demand-pull inflation or driven from the supply side as either as cost push inflation. However, in inflationary period both reinforce each other, difficult to distinguish which is the cause and which is the effect. Demand-[pull inflation can occur because of the following reasons:

(1) Increasing population and a natural incrase in demands of goods in an economy.
(2) Increase in income levels leads to increasing purchasing power of people to purchase more goods.
(3) Consumerism in the economy when people believe in spending money rather than saving.
(4) Increase in money supply and liquidity in the economy.

A demand in the economy is said to be good provided there are no supply constraints because if supply is not able to adjust by expansion it will lead to demand-pull inflation.

Some of the major aspects on the supply side in India are as follows:

(1) Food grains production has virtually become stagnant creating a severe demand supply mismatch and similarly for other agricultural products. It may not be out of place to say that rising food prices is essentially a supply issue. In the past the problem of inflation was on account of shortage of food grains, but in recent times it is essentially on account daily consumables of fruits, vegetables etc.
(2) Excessive monsoon dependence of the agricultural sector and the weather has a large role in augmenting supply.

(3) India also has problems in the supply chain and involvement of too many middlemen disrupting supply and creating an artificial shortage in the agricultural sector.
(4) Supply of key industrial goods such as electricity, steel, cement hampers adjustment of supply to the increased demand.
(5) Despite the policy of liberalization and the freedom given to the private sector it is not relatively easy to make the supply flexible enough in the short-term which would potentially become inflationary.
(6) Increased prices of raw materials, labour, etc., increase the cost of production giving rise to cost-push inflation.

Traditionally measures of inflationary control are seen from three angles as explained below:

One, as a monetary phenomenon of increased liquidity with the banks, increasing money supply, leading to 'too much money chasing too few goods' results in a price rise of commodities or inflation. Controlling such liquidity is within the domain of |RBI through policy tools such as CRR, SLR, OMO, Repo auctions.

Secondly, being seen as fiscal, through expenditure and tax measures and from the supply side which is essentially in respect of agricultural products, which may arise due to genuine production bottlenecks or distribution bottlenecks or speculation and hoardings. It is simple to segregate as above but once inflation sets in all the above, it is difficult to say which is the cause and all get interrelated.

It can thus be seen that inflation is multi-dimentional and cannot be tackled through one policy tool but through a combination of strategies aimed at the supply side especially in the agricultural sector. Therein, is the challenge for the government that once inflation sets in, all efforts at taming inflation will always fall short of expectations.

At a still broader level, inflation is also about the perception which people in general hold in the ability of the government to maintain price stability. As if one is unsure of the prices tomorrow, one will stock up today. And if one's apprehensions come out true it will lead to more stoking. Imagine this situation if everyone in the economy starts to behave similarly. No matter what the government does it will not be able to prevent rising prices for the goods and this invariably happens in periods of inflation.

It often said that no government would not like to lift the lid of inflation, as containing it, is always a stiff challenge for the government and inflation leaves a scar in the minds of people which are difficult to remove.

CONCLUSION:-

There are structural problems like rising income of the poor through the NREGA and other such income, generation activities for the poor which is bound to increase demand for food items and given the near stagnancy in agricultural production build inflationary pressures again. It is solely a matter of time when inflation would resurface and continue to haunt the government unless serious measures are taken to address the stagnancy issue in the agricultural sector.

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