Price Hike in India – Breaking the Waist of the Common, Rural, Poor and Downtrodden Indians

Abstract

The authors would like to draw the attention of the readers that what are the causes for price hike and how to control the same, so that common people can lead a normal life. The annualized inflation rate in India is 6.46% as of September 2014, as per the Indian Ministry of Statistics and Programme Implementation. This represents a modest reduction from the previous annual figure of 9.6% for June 2011. Inflation rates in India are usually quoted as changes in the Wholesale Price Index, for all commodities.

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Introduction

In economics, inflation is a sustained increase in the general price level of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy. A chief measure of price inflation is the inflation rate, the annualized percentage change in a general price index (normally the consumer price index) over time.

Inflation affects an economy in various ways, both positive and negative. Negative effects of inflation include an increase in the opportunity cost of holding money, uncertainty over future inflation which may discourage investment and savings, and if inflation were rapid enough, shortages of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include ensuring that central banks can adjust real interest rates (to mitigate recessions), and encouraging investment in non-monetary capital projects.

Economists generally believe that high rates of inflation and hyperinflation are caused by an excessive growth of the money supply. However, money supply growth does not necessarily cause inflation. Some economists maintain that under the conditions of a liquidity trap, large monetary injections are like "pushing on a string". Views on which factors determine low to moderate rates of inflation are more varied. Low or moderate inflation may be attributed to fluctuations in real demand for goods and services, or changes in available supplies such as during scarcities. However, the consensus view is that a long sustained period of inflation is inflation is caused by money supply growing faster than the rate of economic growth.

Today, most economists favor a low and steady rate of inflation. Low (as opposed to zero or negative) inflation reduces the severity of economic recessions by enabling the labor market to adjust more quickly in a downturn, and reduces the risk that a liquidity trap prevents monetary policy from stabilizing the economy. The task of keeping the rate of inflation low and stable is usually given to monetary authorities. Generally, these monetary authorities are the central banks that control monetary policy through the setting of interest rates, through open market operations, and through the setting of banking reserve requirements.

The challenges in developing economy are many, especially when in context of the monetary policy with the Central Bank, the inflation and price stability phenomenon. There has been a universal argument these days when monetary policy is determined to be a key element in depicting and controlling inflation. The Central Bank works on the objective to control and have a stable price for commodities. A good environment of price stability happens to create saving mobilization and a sustained economic growth. The former Governor of RBI C. Rangarajan points out that there is a long-term trade-off between output and inflation. He adds on that short-term trade-off happens to only introduce uncertainty about the price level in future. There is an agreement that the central banks have aimed to introduce the target of price stability while an argument supports it for what that means in practice.

The Facts Speak

Provisional annual inflation rate based on all India general CPI (Combined) for November 2013 on point to point basis (November 2013 over November 2012) is 11.24% as compared to 10.17% (final) for the previous month of October 2013. The corresponding provisional inflation rates for rural and urban areas for November 2013 are 11.74% and 10.53% respectively. Inflation rates (final) for rural and urban areas for October 2013 are 10.19% and 10.20% respectively.

The WPI measures the price of a representative basket of wholesale goods. In India, this basket is composed of three groups: Primary Articles (20.1% of total weight), Fuel and Power (14.9%) and Manufactured Products (65%). Food Articles from the Primary Articles Group account for 14.3% of the total weight. The most important components of the Manufactured Products Group are Chemicals and Chemical products (12%); Basic Metals, Alloys and Metal Products (10.8%); Machinery and Machine Tools (8.9%); Textiles (7.3%) and Transport, Equipment and Parts (5.2%).

Factors Responsible for the Price Hike

There are several factors which help to determine the inflationary impact in the country and further help in making a comparative analysis of the policies for the same. The major determinant of the inflation in regard to the employment generation and growth is depicted by the Phillips curve.

Demand Factors

It basically occurs in a situation when the aggregate demand in the economy has exceeded the aggregate supply. It could further be described as a situation where too much money chases just few goods. A country has a capacity of producing just 550 units of a commodity but the actual demand in the country is 700 units. Hence, as a result of which due to scarcity in supply the prices of the commodity rises. This has generally been seen in India in context with the agrarian society where due to droughts and floods or inadequate methods for the storage of grains leads to lesser or deteriorated output hence increasing the prices for the commodities as the demand remains the same.

Supply Factors

The supply side inflation is a key ingredient for the rising inflation in India. The agricultural scarcity or the damage in transit creates a scarcity causing high inflationary pressures. Similarly, the high cost of labor eventually increases the production cost and leads to a high price for the commodity. The energies issues regarding the cost of production often increases the value of the final output produced. These supply driven factors have basically have a fiscal tool for regulation and moderation. Further, the global level impacts of price rise often impacts inflation from the supply side of the economy.

Consensus on the prime reason for the sticky and stubbornly high Consumer Price Index, that is retail inflation of India, is due to supply side constraints; and still where interest rate remains the only tool with The Reserve Bank of India. Higher inflation rate also constraints India's manufacturing environment.

Domestic Factors

Developing economies like India have generally a lesser developed financial market which creates a weak bonding between the interest rates and the aggregate demand. This accounts for the real money gap that could be determined as the potential determinant for the price rise and inflation in India. There is a gap in India for both the output and the real money gap. The supply of money grows rapidly while the supply of goods takes due time which causes increased inflation. Similarly Hoarding has been a problem of major concern in India where onions prices have shot high in the sky. There are several other stances for the gold and silver commodities and their price hike.

External Factors

The exchange rate determination is an important component for the inflationary pressures that arises in the India. The liberal economic perspective in India affects the domestic markets. As the prices in United States Of America rises it impacts India where the commodities are now imported at a higher price impacting the price rise. Hence, the nominal exchange rate and the import inflation are a measures that depict the competitiveness and challenges for the economy.

Value

The inflation rate in India was recorded at 6.1% (WPI) in August 2013. Historically, from 1969 until 2013, the inflation rate in India averaged 7.7% reaching an all time high of 34.7% in September 1974 and a record low of -11.3% in May 1976.

The inflation rate for Primary Articles is currently at 9.8% (as of 2012). This breaks down into a rate 7.3% for Food, 9.6% for Non-Food Agriculturals, and 26.6% for Mining Products. The inflation rate for Fuel and Power is at 14.0%. Finally, the inflation rate for Manufactured Articles is currently at 7.3%.

Measures to Control Price Hike

A variety of methods and policies have been proposed and used to control inflation.

Monetary policy

Governments and central banks primarily use monetary policy to control inflation. Central banks such as the U.S. Federal Reserve increase the interest rate, slow or stop the growth of the money supply, and reduce the money supply. Some banks have a symmetrical inflation target while others only control inflation when it rises above a target, whether express or implied.

Most central banks are tasked with keeping their inter-bank lending rates at low levels, normally to a target annual rate of about 2% to 3%, and within a targeted annual inflation range of about 2% to 6%. Central bankers target a low inflation rate because they believe deflation endangers the economy.

Higher interest rates reduce the amount of money because fewer people seek loans, and loans are usually made with new money. When banks make loans, they usually first create new money, then lend it. A central bank usually creates money lent to a national government. Therefore, when a person pays back a loan, the bank destroys the money and the quantity of money falls. In the early 1980s, when the federal funds rate exceeded 15 percent, the quantity of Federal Reserve dollars fell 8.1 percent, from $8.6 trillion down to $7.9 trillion.

Monetarists emphasize a steady growth rate of money and use monetary policy to control inflation by increasing interest rates and slowing the rise in the money supply. Keynesians emphasize reducing aggregate demand during economic expansions and increasing demand during recessions to keep inflation stable. Control of aggregate demand can be achieved using both monetary policy and fiscal policy (increased taxation or reduced government spending to reduce demand).

Fixed Exchange Rates

Under a fixed exchange rate currency regime, a country's currency is tied in value to another single currency or to a basket of other currencies (or sometimes to another measure of value, such as gold). A fixed exchange rate is usually used to stabilize the value of a currency, vis-a-vis the currency it is pegged to. It can also be used as a means to control inflation. However, as the value of the reference currency rises and falls, so does the currency pegged to it. This essentially means that the inflation rate in the fixed exchange rate country is determined by the inflation rate of the country the currency is pegged to. In addition, a fixed exchange rate prevents a government from using domestic monetary policy in order to achieve macroeconomic stability.

Under the Bretton Woods agreement, most countries around the world had currencies that were fixed to the US dollar. This limited inflation in those countries, but also exposed them to the danger of speculative attacks. After the Bretton Woods agreement broke down in the early 1970s, countries gradually turned to floating exchange rates. However, in the later part of the 20th century, some countries reverted to a fixed exchange rate as part of an attempt to control inflation. This policy of using a fixed exchange rate to control inflation was used in many countries in South America in the later part of the 20th century (e.g. Argentina (1991–2002), Bolivia, Brazil, and Chile).

Wage and Price Controls

Another method attempted in the past have been wage and price controls ("incomes policies"). Wage and price controls have been successful in wartime environments in combination with rationing. However, their use in other contexts is far more mixed. Notable failures of their use include the 1972 imposition of wage and price controls by Richard Nixon. More successful examples include the Prices and Incomes Accord in Australia and the Wassenaar Agreement in the Netherlands.

In general, wage and price controls are regarded as a temporary and exceptional measure, only effective when coupled with policies designed to reduce the underlying causes of inflation during the wage and price control regime, for example, winning the war being fought. They often have perverse effects, due to the distorted signals they send to the market. Artificially low prices often cause rationing and shortages and discourage future investment, resulting in yet further shortages. The usual economic analysis is that any product or service that is under-priced is over consumed. For example, if the official price of bread is too low, there will be too little bread at official prices, and too little investment in bread making by the market to satisfy future needs, thereby exacerbating the problem in the long term.

Temporary controls may complement a recession as a way to fight inflation: the controls make the recession more efficient as a way to fight inflation (reducing the need to increase unemployment), while the recession prevents the kinds of distortions that controls cause when demand is high. However, in general the advice of economists is not to impose price controls but to liberalize prices by assuming that the economy will adjust and abandon unprofitable economic activity. The lower activity will place fewer demands on whatever commodities were driving inflation, whether labor or resources, and inflation will fall with total economic output. This often produces a severe recession, as productive capacity is reallocated and is thus often very unpopular with the people whose livelihoods are destroyed.

Stimulating Economic Growth

If economic growth matches the growth of the money supply, inflation should not occur when all else is equal. A large variety of factors can affect the rate of both. For example, investment in market production, infrastructure, education, and preventative health care can all grow an economy in greater amounts than the investment spending.

Conclusion

One of the main causes of price hike of commodities is hoarding. It comes out due to the dirty politics, corruption among political leaders, officers. The business men do their business only for their profit. This profit is earned from the common people, rural poor. This problem of price hike is going to break the waist of the poor people, unless and until there is an intervention by the dedicated and committed leaders, educationists, and socialists.

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