The Poor in India Wonder: Is New Delhi Incapable of Controlling Inflation?

by Ramtanu Maitra

FIGURE 1

Ganga (Ganges) River Valley and Its Main Provinces: Uttar Pradesh, Bihar, and West Bengal

The result of the Assembly elections in the state of Bihar, announced in the third week of November, was a major setback for the leading national political party, the Congress Party, in the United Progressive Alliance (UPA), a mish-mash of alliances that has been in power in New Delhi, since 2004. Out of 243 Assembly seats that were up for grabs, the Congress Party won only four—a performance so abysmal, that Indian analysts have not even tried to figure it out. By contrast, the coalition of a local Janata Dal (United) party and the national Bharatiya Janata Party (BJP) garnered 206 of those seats to form the state government.

But, Bihar may not be an exception; it could very well prove to be a trend, and possibly a statement. The state of West Bengal is expected to go to the polls in early Spring, and various political parties will be contesting for 294 Assembly seats. In this state, the weakling Congress Party is playing a distant second fiddle, and trying to catch up with the Trinamool Congress (TC), which seems to be the party of choice of the state electorates. As of now, it is not clear how many seats TC will allow the Congress to contest, but current projections indicate that the Congress Party may not have more than 30 winners in all.

Next year, in the largest Indian state, Uttar Pradesh, where 403 assembly seats will be contested, the Congress Party is running a poor fourth. How few of these 403 seats the Congress party will be able to win is anyone's guess at this point.

People Reject, But Why?

These three large states, all located in the Ganga (Ganges) Valley, together constitute more than 25% of India's parliamentary seats. Why is the Congress Party doing so badly? The question is a valid one since during the UPA government, led by the Congress Party's Manmohan Singh, India has registered rapid economic growth. The growth rate is expected to accelerate further and reach 9-10% in the coming years, if one goes by what Prime Minister Singh is promising the population.

Why are the people of large states such as Bihar, West Bengal, and Uttar Pradesh, among many other smaller states, reluctant to jump on the Singh bandwagon? Briefly, India's phenomenal growth rate has created an environment where India's overall development does not include everyone, and excludes many. However, despite endorsements from some international free-market-promoting economists, the fact remains that the growth has bypassed a large section of the population. These are the poor, mostly agricultural workers, with little skill for participating in modern industry, and, as a result, they are very low wage-earners.

A 2008 study by Assocham, one of India's major chambers of commerce and industry, pointed out that as of this year, 70% of India's growth will come from the urban areas. There is absolutely nothing wrong with growth in urban areas; however, a mid-2009 study by the Population Division of the United Nations showed that about 410 million of the 1.2 billion Indians live in urban areas, which include mega-cities such as Delhi, Mumbai, and Kolkata, as well as smaller cities with populations ranging from 500,000 to 10 million. That means, about 800 million Indians who live in rural areas will be contributing only about 30% of India's growth of, say, 9% in the best of years.

This disparity in growth, which translates into disparity in earnings, is not difficult to comprehend. Those who venture out of the urban areas in India will notice the slow rate of growth nationwide. In my previous article (*EIR*, Jan. 14, 2011), I pointed out that India has not prepared itself at all to develop infrastructure nationwide. The failure to organize the necessary ingredients, stated in that article, for the power sector alone, has resulted in India's poor power production. What was not documented in that article, is that some of India's growth in industry and the service sector has been achieved through cannibalization of existing available power. The result: More and more people in the smaller towns and villages (where there is electricity) are experiencing longer power outages.

Endless Food Price Rise

But that distortion aside, what the Indians are experiencing is inflation that the Singh government, despite many routine promises, has not been able to bring under control. What is particularly disturbing, is that the sector that the inflation is ravaging the most, is the food sector. India's poor, desperate as they are, do not consume many food items simply because they do not have the income to buy a majority of food items that a well-balanced meal calls for. They depend on the basics, such as cereals, a few vegetables, and a source of protein such as lentils and other pulses (legumes).

While cereal prices have risen significantly during the last two to three years, the prices of poor protein sources, lentils and other pulses, have skyrocketed to a point, that it has become difficult even for middle class Indian families to include them in their daily meal. One analyst pointed out that, with most of India's vast population living close to, or below, the poverty line, inflation acts as a "poor man's tax." This effect is amplified when food prices rise, since food represents more than half of the budget of the poor.

One argument, presented by Subir Gokarn, deputy governor of India's central bank, the Reserve Bank of India (RBI), as to why food prices have skyrocketed, and show no sign of coming under control, is that a 39% rise in income per person, in the previous five years, might have created an extra 220 million regular consumers of milk, eggs, meat, and fish. Supplies have not kept up with this potential demand, Gokarn says. Gokarn's explanation does not make sense. How does he explain why the prices of basic food items consumed by the poor, such as cereal, pulses, and vegetables, have soared? I'll bet he cannot.

The marginalization of the Congress Party, which began years ago, despite high economic growth rates, can be directly attributed to the food price rise, the inability of the Manmohan Singh government to rapidly develop basic infrastructure, and the growing income disparity between the vast majority of people who are poor, and the much smaller number who are benefitting from the lopsided growth.

India has the highest food inflation of any major Asian economy, and it has continued now for more than two years. And, yet, the Indian government has failed to announce a policy to tackle the problem. After months and months of promising the people that the food prices would come down once nature provides a good monsoon, food prices rose almost 17% in 2010. India did receive a very good monsoon last season, but it was not reflected in food prices. That means talk about the importance of a good monsoon is largely a ruse to avoid taking real measures. Instead of dealing with what is of utmost importance to the hundreds of millions of poor and middle-income Indians, the government announced a review of the import and export of essential commodities, dashing expectations that it would ban the export of wheat products or futures trading in such commodities.

Moreover, India's method for calculating inflation, the Wholesale Price Index (WPI), is different from the way the rest of the world calculates. Each week, the wholesale price of a set of 435 goods is evaluated by the Indian government. Since these are wholesale prices, the actual prices paid by the consumers are significantly higher.

On Jan. 13, the government announced it had contracted for the import of 1,000 tons of onions, and would step up purchases of other essential commodities, such as edible oils and lentils, and create a panel to recommend ways to fight inflation. "Looking at these measures, the government appears helpless. It literally has thrown up its hands. For the past one year, officials have been saying prices will come down," said Paranjoy Guha Thakurta, a political economist. Others point out that adoption of these minor measures showed once more the inability of the Singh government to take the necessary steps.

U.S. Defense Department

India's Green Revolution, under Prime Minister Indira Gandhi (1966-77/1980-84), was aimed at ensuring that India would become food secure. Her agricultural policy allowed India to withstand its virtual isolation during the Cold War, and helped the nation to develop its scienctific and technological capabilities. Shown: a rice farmer, near Hawpi Village, July 2008.

Unwillingness To Invest in Agriculture

A large part of the inflation is due to the failure of New Delhi to expedite infrastructure growth and rejuvenate the agricultural sector. India's agricultural sector, with which the vast majority of the population is associated, has been growing at a rate of only 2.2%. While India needs to sustain its economic growth rate of 9% in the coming years, the agriculture sector growth rate needs to be pushed to around the 4-5% level. That task seems difficult, but it can be achieved through proper planning.

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A number of things afflict India's agriculture sector. Irrigation and water management are perhaps the most important issues on which growth of the agriculture sector depends. India's agro-production, and the 1.2 billion people that depend on agro-products, largely depends on the monsoon. The irrigation potential of the agriculture sector is 140 million hectares, of which only 70% is being exploited.

In addition, the agriculture sector is in dire need of investment to meet the expenses of irrigation, research and development, rural infrastructure, and electricity to further increase productivity and generate 4-5% growth in that sector alone.

Agriculture, in general, has not been modernized to adopt advanced technology, while productivity has remained stagnant for decades. Irrigation systems, and supply of new and productive seeds, are still a distant dream for common farmers. In addition, in recent years, the availability of electric power to irrigate the land has even declined. Moreover, no proper transport and storage system is available. This is exactly where FDI (foreign direct investment) in retail could have played a significant role. One recent study shows that India has suffered an estimated food grain and agriculture production loss of about $10 billion annually, due to the lack of adequate post-harvest infrastructure and inefficient supply-chain management by the country's farmers.

The neglect of the agriculture sector by the Singh government stems from the fact that New Delhi's World Bank-trained economists, now ruling the roost, came to the conclusion that large investment in this sector would not produce the "instant high growth rate" that they have adopted as their mantra. The truth is, that broad-based development of the agriculture sector would not only lay the foundation of a well-balanced development of rural India where hundreds of millions of poor live, but will also make India much stronger than it is today.

Not one Indian leader, with the sole exception of the late-Prime Minister Indira Gandhi, understood this, in-depth. Her undertaking of the Green Revolution of 1967-78 was not aimed at impressing outsiders with "economic growth, but to ensure that India would become food secure. It was her clear understanding of the Indian situation, expressed in her agriculture policy, that allowed India to withstand its virtual isolation during the Cold War days, and helped the nation to develop its science and technology capabilities. Without successful implementation of the Green Revolution during that time, it is arguable whether India could have continued to exist as one nation.

The term "Green Revolution" is a general one, applied to successful agricultural experiments in many Third World countries. It is not specific to India, but it was most successful there. There were three basic elements in the method of the Green Revolution: 1) continued expansion of farming areas; 2) double-cropping of existing farmland; and 3) using seeds with improved genetics. During the last three decades, furthering of these vital elements of what should have been an ongoing green revolution, became of secondary interest to the Indian leaders.

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"Real estate is where most of the cash generated in the economy flows," a Finance Ministry official admitted. In some cities, like Delhi, prices have gone up by 25-30% since the peak of the market in 2007. Shown: high-rise buildings in Delhi; beggars on a Delhi street.

Decades of neglect of the agricultural sector by India's leaders, and their muddle-headed pursuit of "a high rate of economic growth," have, once again, made India food insecure, and has left hundreds of millions far behind, steeped in utter poverty and hopelessness.

Overall Inflation Threatens Growth

While the food price rise is steeper than overall inflation and is hitting the poor hardest, India is now in a spiral of growing inflation. There are number of reasons for this: To begin with, due to the U.S. Federal Reserve's monetary policy, excessive money has been created over the years, fueling one asset bubble after another. Some of this excess money has gone over to India, and India's inability to channel this excess money toward real development has brought about a part of the inflation. The Mumbai stock market has become a speculator's paradise, giving rise to yet more inflation. For the same reason, inflation is also showing up in China, Brazil, Russia, and other fast-growing nations.

In the early 2000s, economist Arun Kumar estimated that about half of India's wealth was stashed away as black-market money. In a trillion-dollar economy, that's about $500 billion. Some of this money is salted away overseas. A few years ago, a Ford Foundation-sponsored study by the think-tank Global Financial Integrity (GFI) found that Indians had stashed away $23 to $31 billion overseas in 2006.

Analysts point out that India's economy has grown since then, and so has the volume of funds deposited overseas. But even if the outflows doubled, to $50 billion, there is still another $450 billion sloshing around the country. Where is this money parked? Analysts say in bullion, of course, but real estate is actually right at the top of the list.

"Real estate is where most of the cash generated in the economy flows," a Finance Ministry official, who didn't want to be identified, told the Indian news media. No doubt, the real estate industry is now in a bubble. The market value of under-construction projects increased from $70 billion at end-2006, to $102 billion by end-June 2010, which is equal to 8.2% of India's nominal GDP for 2009, one analyst pointed out. Prices have crossed the earlier peak of 2007, in cities like Delhi, Mumbai, Bangalore (now, renamed Bangaluru), Chennai, Kolkata, Hyderabad, Gurgaon, Chandigarh, and Pune. In Mumbai, Delhi, Gurgaon, and Noida, prices have gone up 25-30% higher than the peak of the market in 2007.

In order to deal with the uncontrollable inflation, the central bank is continuing with interest rate hikes. In early November, the RBI raised rates for a sixth time that year, but said it sees little need for additional hikes in the near term, as its tighter monetary policy is acting to bring down the inflation that has plagued Asia's third-biggest economy. "Based purely on current growth and inflation trends, the Bank believes that the likelihood of further rate actions in the immediate future is relatively low," it said in its policy review for the fiscal second quarter ended Sept. 30.

Solution: Faster Building of Infrastructure

However, analysts point out that the RBI is soon going to put that statement in the freezer, and before long, will go for another interest rate hike. This is is evident from RBI's announcement on Jan. 13, expressing concern that inflation remains significantly above its comfort level. It noted that rising domestic input costs for the manufacturing sector, combined with aggregate demand pressures, could weigh on domestic inflation. The chairman of one of India's leading banks, Deepak Parekh, said that, while higher rates are not the favored option at this point, the RBI's hands are tied, given the inflation scenario.

In an interview to CNBC-TV 18 on Jan. 14, Parekh said he expects the RBI to hike rates by 25-50 basis points in its Jan. 25 credit policy review. However, Parekh feels that further hikes in rates will impact growth. "There is a limited number of tools the government has to contain inflation. The interest rate is a tool, but I personally feel that interest rates are already high, and will impact growth. The RBI has a duty to perform, and the RBI has this interest rate tool, so the RBI may be looking at an increase of 25-50 basis points on Jan. 25," he said. Parekh added that since liquidity is very tight, there is a demand from bankers that the cash reserve ratio should come down marginally.

Why is Parekh concerned? An Indian website, mailtoday.in, on Jan. 13, reported on the slowing of India's industrial output, which grew by just 2.7% in November, sparking fears that a softening demand would flatten the economy's growth curve, and pose fresh headaches for monetary authorities battling to bring runaway inflation under control.

The 2.7% increase in the Index of Industrial Production (IIP) is the lowest in 18 months, and marks a sharp plunge from the robust 11.3% increase logged in October 2010. As many as 9 out of 17 industry groups registered negative growth in November 2010. Official figures released Jan. 12 show that the growth rate of the manufacturing sector, which constitutes 80% of the overall IIP, plummeted to 2.3%, compared to a healthy 12.3% in November 2009. With the automobile sector—one of the powerhouses of the manufacturing sector in 2010—also predicting a slower year ahead, there are concerns that consumer demand is being dragged down by rising prices and interest rates.

Finance Minister Pranab Mukherjee is worried that the weak growth figures, coming at a time of high inflation, could have an adverse impact on the economy. "If [the] IIP goes down and inflation goes up, it will have an adverse impact, but I am not coming to any premature conclusion," he said. "If you have noticed that in November last year the IIP index was very high, so base effect is also there, but that is no consolation," he added.