Sound of Money Inflation

By Sundar Sankaran

Decades ago, Henry Youngman gave an excellent twist to inflation. He said "Americans are getting stronger. Twenty years ago, it took two people to carry ten dollars' worth of groceries. Today, a five-year old can do it."

The Government seems to be giving its own twist to inflation in India…

A few years ago, I recall reading an interview with Dr. Rangarajan, former Governor of RBI. He reasoned that the Consumer Price Index (CPI) was a good measure of inflation at the consumer end. Wholesale Price Index (WPI) measures inflation at producer's end. The basket of commodities that form the basis for WPI do not reflect the consumption pattern. But the strength of WPI is that it is quickly calculated and is available every week – unlike CPI which comes with a lag, every month. So, from the point of view of quick policy response, it is useful to work with WPI.

Imagine my surprise therefore, when voices from the government indicate a desire to shift to a monthly WPI. It looks like a student, who does not like the report card being issued by the school so regularly!

Once the inflation animal arrives, it needs to be tamed. How? Unfortunately, the policy response to inflation, in many countries, is not based on ground reality, but the philosophy the policy-maker subscribes to. A widely prevalent economic philosophy is to control money supply / raise interest rates to control inflation. There are two concerns to this approach:

- An aspect that is often ignored is that money supply controls and increases in interest rates might stifle supply and thus exacerbate the inflationary pressures, instead of controlling them.
- Monetary policy takes time to take effect. Political realities of coalitions, and looming elections, mean that the Indian Government might be in a hurry to control inflation. A monetary policy overdrive might lead to the parallel of a sick person taking one aspirin after another to get quick relief from head ache – only to see the cumulative effect of all the aspirins hit her later.

Oil, Metals and Food – all are going up. But food is what hits the common man directly and immediately. This has prompted several economists to call it *agflation* (agriculture + inflation). The global nature of this inflation is borne out by the view espoused by George Bush & Co. (in an otherwise positive context) that food prices are going up because Indians are eating well. The globalisation of inflationary trends is also evident from alternate hypotheses that food prices are up because the US has incentivised cultivation away from food and towards bio-fuels.

Countries are seeking to protect themselves by cutting out exports of inflationary products. These measures may work in the short term. They may also hurt some segments (like farmers, in the case of food), who are deprived of the opportunity to benefit from market prices. In the long run, there is no alternative to increasing the supply level. A few points for the Indian government to ponder over –

1. Oil, metals and food – all bear the brunt of traditionally excessive government controls. In many other sectors, Indian companies are setting the global agenda. Isn't it time for the government to give private enterprise a better chance in these sectors? After the green revolution, what innovation can the Government boast of, in agriculture? Clearly, government control over agriculture is controlling growth instead of promoting it.

2. What use is it to ban futures trading in commodities in India, when commodity inflation is otherwise a global phenomenon? Futures prices may serve the purpose of being an indicater of where inflation is headed. By killing futures prices, the government may only be shooting the messenger in India, while laying a platform for people to explore other markets where the trading is permitted. Instead of exporting products, we may be exporting the market itself out of the country!

3. There is anecdotal evidence that farmers decide their marketing and pricing strategies based on transparent prices in the commodity exchanges. This obviously does not suit the traders, who thrive on information gaps. By killing this flow of price information, is the government inadvertently hurting the politician's sacred cow – agricultural sector?