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Inertia over inflation

Relatively less spending on food in households could be one reason why food inflation is less of a political issue today

Cafe Economics | Niranjana Rajadhyaksha

Manmohan Singh was chief economic adviser to the Indira Gandhi government between 1972 and 1976, when high inflation led to street protests and added to the political turmoil that eventually led to the imposition of emergency on 25 June 1975. So he should be well aware of the political risks that his government faces if inflation continues to eat into the real incomes of voters. The scattered political opposition now seems to be homing in on the issue of galloping prices of food and other goods, despite unusual inertia from the middle class and the working class.

Elections have been won and lost on the price of onions, making the political class very responsive to the dangers posed by escalating prices. That is perhaps one reason why the Indian inflation record over the past century has been remarkably benign, compared not just with the hyperinflations that wrecked Asian countries such as Japan (568% in 1945) and China (1,579% in 1947) in the aftermath of political collapse, but also compared with the inflation record of most other developing countries in more normal times.

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The highest inflation we have experienced was in the famine year of 1943, when prices shot up at an annualized rate of 53.8%, according to data provided by economists Carmen Reinhart and Kenneth Rogoff in their pathbreaking research on financial crises over the past 800 years. "India has spent about one out of every eight years with inflation about 20%. The likes of China, Indonesia, Korea, Myanmar and even Japan have done worse. But Asian economies such as Hong Kong, Malaysia and Singapore spent far less time struggling with 20%-plus inflation," this column had noted a year ago.

Several commentators have quite rightly asked why the current round of double-digit inflation has not sparked off the sort of political backlash that has been so common in India till now. There have been many sociological and political explanations on offer— from the political withdrawal of the middle class to the collapse of trade unions representing the working class. However, there could be some more humdrum factors at work as well. Middle-class incomes have grown dramatically during the past 10 years, and households are spending a relatively smaller slice of their annual income on basics such as food. These changing consumption patterns could at least partly explain why the sensitivity to inflation has been more muted than we have come to expect.

The average Indian spent around Rs7 out of every Rs10 he earned on food in the 1970s. But incomes have grown since then and food has become a far less important part of the family budget, accounting for around Rs4 out of every Rs10 spent today. It is a well-established fact that spending on food goes into relative decline as incomes increase while spending on other items such as clothing, education, health and transport increases.

Data provided by the National Council of Applied Economic Research's Centre for Macro Consumer Research (NCAER-CMR) shows that "administrative, executive and managerial workers" spent only a little more than one-fifth of their annual income on food in 2004-05, the latest year for such data in NCAER's National Survey of Household Income and Expenditure. The annual household income of this category of workers is estimated at

Rs169,317—an indication that this category is not just restricted to senior corporate executives, but is a fairly large pool of people.

To be sure, food prices are still an emotional issue in India, perhaps because daily purchases remind us more about the ravages of inflation than occasional buys such as television sets or cars do. But the decline in the relative importance of food in household budgets in India could be one reason why food inflation is less of a political issue today: It no longer pinches as hard as it used to. We talk about high food prices, but prefer not to openly protest against them.

While high inflation hurts the poor the most because their earnings are not protected against rising prices, it is the Indian middle class that has been at the forefront of agitations against high prices. The collapse of trade unions has anyway taken the sting out of worker protests. The question is how long this calm can last.

The prospects of a good monsoon should temper food prices while global deflationary pressures could take the pressure off industrial commodities and manufactured goods. So the cyclical tailwinds are in favour of the government. But there is also a structural component to the Indian inflation story, with demand for food growing faster than supply. The solution to such structural inflation cannot be outsourced to the rain gods. It requires a comprehensive policy package to raise food production and availability—if the current social calm is not to be shattered and high food prices are not to fuel demands for higher wages.

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