

ECONOMIC SURVEY OF INDIA

CHAPTER 5

LECTURE-3

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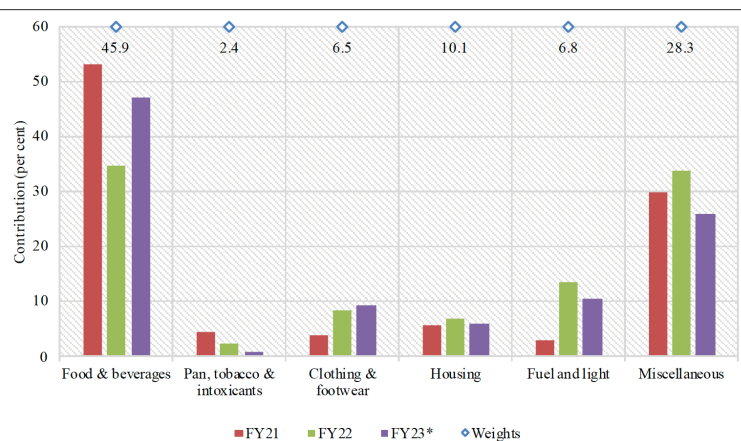
1. C3: PRICES AND INFLATION: SUCCESSFUL TIGHT-ROPE WALKING

- Rising prices are always a cause of concern for policy makers as they hurt common people. Inflation impacts developing countries more because in their consumption basket there are more necessities.
- Between 2017 to 2019 India was able to tame its inflation and it remained below 4%.
 - But in 2020 because of COVID-19 disruptions [supply side disruptions] it went above RBI tolerance limit of 6%.
 - After this, the Russia-Ukraine war in Feb 2022 lead to surging prices of oil and commodities. The result was worldwide inflation.
 - In advanced economies, as per IMF's projection (World Economic Outlook), inflation rose from 3.1% in 2021 to 7.2% in 2022 which was highest since 1982.
 - USA [9.1% in June 2022 – 40 year high]
 - UK [9.2% in Dec 22]
 - Germany [8.6% in Dec 22]
 - In Emerging Markets and Developing Economies, IMF as projected the inflation to have increased from 5.9% in 2021 to 9.9% in 2022.
 - Consequently, central banks all across the world have tightened their monetary policy to fight this inflation.

1) DOMESTIC RETAIL INFLATION

- During FY22, CPI-Combined (CPI-C) based retail inflation remained lower than FY21. But it was still higher than the pre-pandemic years.
 - During FY22 – subgroups such as 'oils & fats', 'Fuel & Light' and 'transport & communication' reported high inflation.
- During FY23, 'Food and Beverages', 'Clothing and footwear', and 'Fuel and Light' were the major contributors to headline inflation.

Figure V.4: Retail Inflation Driven by 'Food and Beverages' Group



A) FOOD INFLATION CAUSED BY VEGETABLE AND CEREALS IN FY23

- **Food inflation** based on Consumer Food Price Index (CFPI) climbed to 7.0% in FY23 from 3.8% in FY22. The the major contributors in food inflation are vegetables, cereals, milk, and spices.
- **Milk prices** are increasing because of increased feed cost.
- **Cereal prices** are mostly increasing because of Russia-Ukraine War.
 - To contain these prices, government has recently put a **ban on export of wheat products under HS Code 1101** (Note: this is the code for Wheat or meslin flour)
 - To **protect vulnerable sections**, government has also launched a new integrated food security scheme, '**Pradhan Mantri Garib Kalyan Ann Yojana**' on 1st Jan 2023 to provide free food grains to more than 80 crore beneficiaries.
- **Vegetable Prices** were primarily high due to rise in tomato prices which was caused by damage and supply disruption due to unseasonal rains in the major producing states of KAR, TN, Andhra and Telangana.

B) MEASURES TO CONTROL INFLATION IN ESSENTIAL FOOD COMMODITIES

Box V.1: Measures to Contain Inflation in Essential Food Commodities

The government keeps a close watch on the production and availability of essential commodities through regular reviews by the Inter-Ministerial Committee and Committee of Secretaries. The following fiscal measures are taken to bring down the prices of essential commodities:

Cereals

- On 13 May 2022, wheat flour exports were prohibited in order to prevent a domestic surge in prices.
- From 12 July 2022 wheat flour exports were permitted but were subjected to restrictions as recommended by an inter-ministerial panel.
- With effect from 14 August 2022 the export of maida and suji was allowed only after the approval of the inter-ministerial panel.
- Notification dated 27 August 2022 prohibited export of wheat or meslin flour (atta), maida, samolina (rava/sirgi), wholemeal atta and resultant atta (HS Code 1101). This amendment in the policy aimed to ensure food security and put a check on the mounting prices of wheat flour in the country.
- The Central Government, w.e.f. 9 September 2022, imposed an export duty of 20 per cent on rice, brown rice, and semi-milled as well as wholly milled rice, except parboiled rice.

Pulses

- A buffer stock of pulses has been maintained for price stabilisation in 2020-21, 2021-22 and 2022-23. Calibrated release of pulses from the buffer stock will moderate the prices in the market.
- The import duty on masur was brought down to zero per cent with effect from 26 July 2021. Further, the Agriculture Infrastructure and Development Cess (AIDC) on masur was brought down to zero per cent with effect from 12 February 2022. The nil rate of AIDC has been extended up to 31 March 2023.
- On 30 March 2022, the import of tur and urad under the Free Category was extended until 31 March 2023.
- The Central Government, on 1 September 2022 decided to provide 1.5 million tonnes of chana to States and UTs at a discounted rate for distribution under various welfare schemes. The states will be able to procure chana at a discount of ₹8 per kg over their respective issue prices.

Edible Oils

- The Central government, on 24 May 2022, exempted customs duty and AIDC on yearly import of 20 lakh metric tonne each of crude soya bean and sunflower oil for the years 2022-23 and 2023-24.
- The basic duty on refined palm oil was reduced from 17.5 per cent to 12.5 per cent w.e.f 21 December 2021 until 31 March, 2022 and the basic duty on crude palm oil was reduced from 7.5 per cent to 5 per cent w.e.f 13 February 2022 until 30 September 2022. The Central Government has allowed free import of refined palm oil until 31 December 2022.
- The Central Government, in November 2021, cut the basic duty on crude palm oil, crude soyabean oil and crude sunflower oil from 2.5 per cent to Nil. The Agri-cess on these oils has been brought down to 5 per cent.
- *Vide* notification dated 14 October 2021, the basic import duty on refined soyabean oil and refined sunflower oil has been slashed to 17.5 per cent from 32.5 per cent.
- In a bid to cool down the domestic prices of soya meal, Central Government has notified an order under the Essential Commodities Act to declare 'Soya Meal' as an Essential Commodity up to 30 June 2022, by amending the Schedule of the Essential Commodities Act, 1955. Stock limit on soya meal had been imposed for a period from 23 December 2021 to 30 June 2022.
- Stock limits imposed on all edible oils and oilseeds, *vide* order dated 3 February 2022, were extended up to 31 December 2022, by amending the Removal of Licensing Requirements, Stock Limits and Movement Restrictions on Specified Foodstuffs Order, 2016. This measure is to curtail any unfair practices like hoarding, black marketing etc. in the market and to control the prices of edible oils.
- In July 2022, the Central Government directed leading Edible Oil Associations to ensure a reduction in the maximum retail price of edible oils by ₹15 per litre with immediate effect. Mother Dairy has slashed prices of rice bran and soybean oil by up to ₹14 per litre after the Centre directed edible oil companies to pass on the benefits of a fall in global edible oil prices to consumers.

Note: AIDC ~ Agriculture, Infrastructure and Development Cess

2) DOMESTIC WHOLESALE PRICE INFLATION

WPI remained low during pandemic period and started gaining momentum in the post-pandemic period as economic activities resumed.

The Russia-Ukraine war exacerbated the burden by worsening the supply chain along with free movement of essential commodity.

As a result, in **FY22** – WPI inflation climbed to 13%. Key contributors were (Crude Petroleum & Natural gas, Fuel and Power, Edible oil)

In **FY23**: WPI inflation so far has been 11%. Key causes were Cereals, Crude Petroleum and Natural Gas.

Note: Part of WPI inflation is imported inflation. This is because of high import dependency on edible oil, Crude oil and natural gas.

Table V.2: Average Annual Wholesale Inflation Based on WPI (per cent) (Base: 2011-12=100)

Groups/Subgroups	Weight	FY20	FY21	FY22	FY23*
Primary Articles	22.6	6.8	1.7	10.3	12.3
Food articles	15.3	8.4	3.1	4.1	8.3
Cereals	2.8	7.5	-2.6	1.6	10.7
Pulses	0.6	15.9	11.6	6.9	0.0
Vegetables	1.9	31.2	3.4	0.4	13.2
Fruits	1.6	3.2	1.4	11.3	10.4
Non-Food Articles	4.1	4.5	1.4	21.1	12.0
Minerals	0.8	13.2	6.7	19.6	6.2
Crude Petroleum & Natural Gas	2.4	-7.7	-17.5	56.7	57.7
Fuel & power	13.2	-1.8	-8.0	32.6	33.8
LPG	0.6	-8.3	-2.7	43.3	16.9
Petrol	1.6	-3.2	-11.8	62.9	41.9
High Speed Diesel	3.1	-3.5	-14.4	59.9	60.8
Manufactured Products	64.2	0.3	2.7	11.1	7.1
Food products	9.1	4.1	5.6	11.7	6.0
Edible oils	2.6	1.4	20.3	30.5	1.4
Food Inflation (Food articles + Food products)	24.4	6.9	3.9	6.8	7.5
Core Inflation (Manufactured Products-Food products)	55.1	-0.4	2.2	11.0	9.2
Headline Inflation	100	1.7	1.3	13.0	11.5

A) MEASURES TO CONTAIN INFLATION IN INPUT PRICES

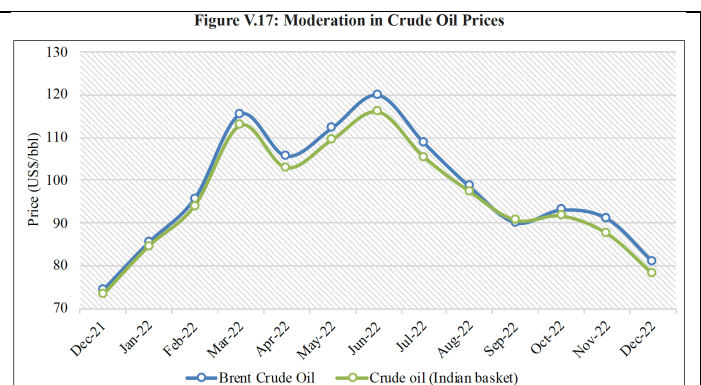
- **Fuel: Reduction in Excise Duty:** First Phase in Nov 2021 (Rs 5 for Petrol and Rs 10 on diesel), Second Phase in May 2022 (Rs 8 for Diesel and Rs 6 on diesel)
- **Plastic Products: Reduction in import duty:** The duties on naphtha, propylene oxide and polymers of vinyl chloride have been reduced from 2.5 per cent to 1 per cent, 5 per cent to 2.5 per cent and from 10 per cent to 7.5 per cent, respectively on 21 May 2022.
- **Steel:**
 - **Reduction in Import Duty (May 2022):**

- **Import duties on major inputs** – ferronickel, cooking oil, PCI coal: Reduced from 2.5% to zero
- **Import Duties on Coke and Semi-Coke** – has been slashed from 5% to zero.
- **Tax on Export:**
 - Tax on export of iron ores and concentrates has increased from 30% to 50%, while that on iron pellets has been raised to 45%.
- **Cotton:**
 - **Waiving off of custom** duty on cotton imports wef from 14th April 2022 – 30th Sep 2022 -> to benefit textile industry and lower prices for consumers.
 - Note: Cotton imports attracted 5% BCD and 5% AIDC.
- **Diamonds and Gemstones:**
 - In Budget 2022-23, customs duty on cut and polished diamonds and gemstones was reduced to 5% and duty on the simply sawn diamond was reduced to nil.
- **Chemical Products:** Custom duties on certain critical chemicals namely methanol, acetic acid and heavy feedstocks for petroleum refining was reduced in Budget 2022-23.

3) FUEL PRICE INFLATION

In FY22 and FY23, the inflation in ‘fuel and power’ was mostly driven by high international crude oil prices.

- **Increase in demand** after COVID-19 lockdown
- **Cuts in supply** by Organization of the Petroleum Exporting Countries (OPEC)+ countries
- **Supply disruption** (Russia-Ukraine war)



The prices went upto US\$116/bbl. in June 2022.

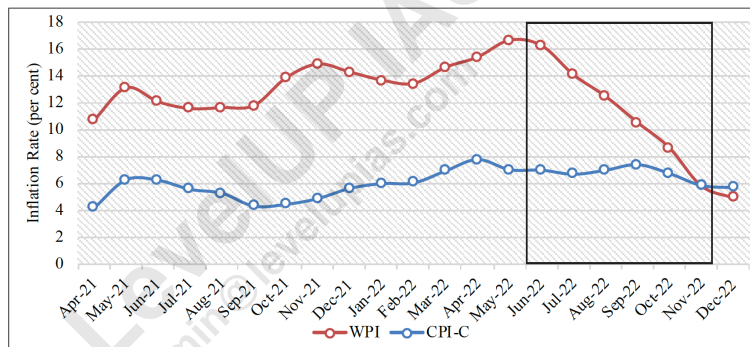
But it has now subsided to US\$78/bbl.

Further, reduction in excise duty by central government and reduction of VAT by state governments have also reduced prices.

4) CONVERGENCE OF WPI AND CPI

- **Why divergence happen between CPI and WPI?**
 - **Passthrough of international** prices to wholesale is faster and it takes some time for it to reach retail
 - **Difference in the basket** (for e.g., WPI doesn't have services and weight of primary products is much lesser)
 - **Less competition** at retail level

Figure V.18: Convergence of Headline WPI Inflation with Headline CPI-C Inflation



Source: MoSPI and Office of Economic Adviser, DPIIT

- **Divergence started in March 2021**
 - WPI became high due to unfavorable base effect. Later, Russia Ukraine war led to high WPI.
- **Convergence by Nov 2022: Two factors**
 - **Cooling in inflation of commodities** such as crude oil, iron, aluminium, and cotton to lower WPI. These commodities have large weight in WPI when compared to CPI.

- **CPI Inflation** rose due to increase in price of services. Services form part of core component of CPI but is not included in WPI.

5) MONETARY POLICY MEASURE FOR PRICE STABILITY

- **RBI's Monetary Policy Committee** (MPC) increased the policy repo rate under the LAF by **2.25%** from **4% to 6.25%** between May and Dec 2022.

6) HOW IS CURRENT INFLATION DIFFERENT FROM 1970s

- **Recent oil price** rises are proportionately smaller than the 1970s crisis, which had taken the oil prices to historic high.
- The **1970 price rise** was confined to oil prices, whereas the current price increase is affecting broader range of commodities (agri goods, fertilizers, and metals).
- **Commodity supply disruption** have played a smaller role in recent price increase than in 1970s.
 - Rise in commodity price is accompanied with modest increase in production of these products.
 - Further, commodity supply chain is more effective now when compared to 1970s.
- **The current inflation** was preceded by several years of low inflation. Whereas in the 1973 oil shock – there was a backdrop of several years of steady rising inflation.
- **Central Banks** today have much more robust policies. They have clearer and more robust institutional framework. This has prevented the inflation expectations of the public from becoming unanchored despite a sharp rise in inflation during the year 2022.
 - The 1973 crisis closely followed the collapse of the Bretton Woods managed exchange rate regime as the goals and even instruments of monetary policy were poorly defined.

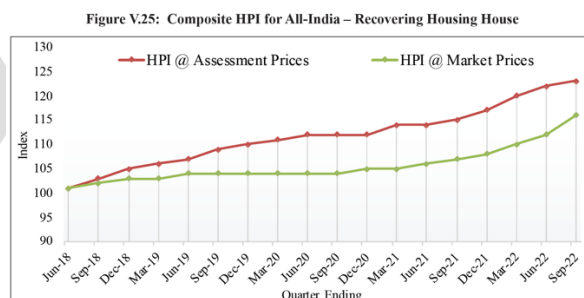
7) HOUSING PRICES: RECOVERING HOUSING SECTOR AFTER THE PANDEMIC

- The **National Housing Bank (NHB)** publishes **two housing price indices** with FY18 as the base year.
 - i) HPI Assessment Price
 - ii) HPI Market Price Quarterly
- **HPI Assessment Price** is based on the valuation of prices of residential units collected from primary lending institutions.
- **HPI Market Price** is based on the market prices for **unsold inventories** collected from developers.
- A **composite index** is calculated for 50 cities across India using the population of the cities as weight.

HPI Market price have shown a general increasing trend in most cities.

COVID-19 crisis had significantly impacted the residential real estate market. The real estate industry started gaining momentum from Sep 2020 onwards and peaked at the end of March 2021. But, the second wave again impacted it. However, timely policy intervention by the government coupled with low home loan interest rates propped up demand and attracted buyers more readily in the affordable segment in FY23.

The **overall increase** in composite HPI assessment and HPI market prices indicate a revival in the housing finance



Source: RESIDEX, NHB

sector. A stable to moderate increase in HPI also offers confidence to homeowners and home loan financiers in terms of the retained value of the asset.

8) KEEPING CHECK ON PHARMACEUTICAL PRICES

A) NATIONAL PHARMACEUTICAL PRICING POLICY, 2012

- The principles for the regulation of the prices of drugs are based on the **National Pharmaceuticals Pricing Policy, 2012**, administered by the Department of Pharmaceuticals. The key principles of the policy are the essentiality of drugs, control of formulation prices and market-based pricing.
- **NLEM 2022** was promulgated by Ministry of Health and Family Welfare in September 2022 and **revised Schedule I of Drugs (Prices Control) Order (DPCO) was notified on 11 November 2022** by Department of Pharmaceuticals incorporating NLEM, 2022. **Ceiling prices of 119 formulations under NLEM, 2022 have been fixed until 31 December 2022.** In addition, retail prices for **2,196 formulations have been fixed under the DPCO, 2013.**

B) JAN AUSHADHI SCHEME (NOW KNOWN AS PRADHAN MANTRI JAN AUSHADHI YOJNA (PMJAY))

- **Intro:**
 - » **Pradhan Mantri Bhartiya Janaushadhi Pariyojna (PMBJP)** was launched by Department of Pharmaceuticals, Ministry of Chemical and Fertilizers, Government of India as a direct market intervention scheme in 2008.
- It aims to make quality generic medicines available to all at affordable prices through Jan Aushadhi Stores (JAS) opened in each district of the states.

- » First Jan Aushadhi Store (JAS) was opened at Amritsar Civil Hospital in 2008.
- Other key focus of the scheme is to create awareness and demand for generic medicine
- **Incentives given:**
 - » The scheme provides an excellent opportunity of self-employment with suitable and regular earnings.
 - » An incentive of Rs 5,00,000 is provided to the Jan Aushadhi Kendras as financial assistance and one-time additional incentive of Rs 1 lakh (as reimbursement for IT and infra expenditure) is provided to Jan Aushadhi Kendra opened in North-Eastern India, Himalayan state, island territories, and backward areas identified by NITI Aayog as aspirational districts or if opened by women entrepreneurship, Ex-Serviceman, Divyangs, SCs and STs.
- As of Jan 2023, 9,000 Jan Aushadhi Kendras are functional across the country.
 - » The government has set up a target to increase the number of Jan Aushadhi Kendras to 10,000 by March 2024.
 - It offers 1759 medicines, and 280 surgical devices covering all major therapeutic groups.