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India's Political Economy Responses to Global Food Price Shock of 2007-08:

Learning Some Lessons

By Ashok Gulati and Shweta Saini,
ICRIER

India's policy responses were strong to the food price crisis. Exports of basic staples were banned, domestic support prices of wheat and rice were raised substantially, urea price increases in global markets were absorbed through enhanced fertilizer subsidy, and a National Food Security Mission was launched to raise grain production by 20 MMT over the next five years.

The results: India contained food inflation below 7 percent in 2007-08; grain production increased by 42 MMT; and grains stocks touched 82 MMT. With freeing of exports in September 2011, India became a world leader in rice exports.

The cost of this policy was rising subsidies on food and fertilizers, rising fiscal deficit, leading to double digit food inflation after 2009-10.

Had India quickly reviewed its export ban policy, and opened exports earlier, it could avoid excessive grain stocks, reduced fiscal deficit, and benefited global markets, leading to a win-win situation.

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India's Political Economy Responses to Global Food Price Shock of 2007-08: Learning Some Lessons

Ashok Gulati and Shweta Saini[1]

1. Backdrop:

Despite being one of the fastest growing large economy in the world in recent years, India has the largest mass of poor and malnourished people. India has about 17 percent of global population, but almost one third of global poor. Interestingly, India's share in global poverty (33 percent) in 2010 was higher than in 1981 (22 percent) (World Bank, 2013), primarily because many other countries, especially China, were able to reduce their poverty much faster. One in every three malnourished children in the world is from India (HUNGaMA, 2011).

Going by the international poverty line defined as $1.25/day per capita, India had 41.6 percent of its population below poverty line in 2005, which reduced to 32.7 percent by 2010 (Word Development Indicators, 2014). By Indian definition of poverty line, however, India had roughly 22 percent people below poverty line in 2011, down from 44 percent in 1993 (Planning Commission, Government of India). No matter how one looks at it, almost 250-400 million people in India still struggle to get the basics for their existence.

Further, it may be worth noting that an average Indian household still spends about 45 percent of its expenditure on food (NSSO, 2011), while the poor spend even more, between 55-60 percent of their expenditure on food.

No wonder, therefore, food prices remain critical to Indian policy makers and any sharp increases in their levels invite major political repercussions. Political parties know it well that even spikes in onion prices had shaken the governments in power in earlier years.

Given this backdrop, it was but natural to expect a major political response to the global price shock of 2007-08, when food prices erupted, and even prices of basic staples like wheat and rice shot up

[1] Ashok Gulati is currently Infosys Chair Professor for Agriculture at the Indian Council for Research on International Economic Relations (ICRIER), Delhi, India. He was formerly the Chairman of the Commission for Agricultural Costs and Prices (CACP), Government of India (2011-14); and Director at the International Food Policy Research Institute (IFPRI) (2001-11). Shweta Saini is a Consultant at ICRIER.

by more than 50 percent within a few months. Going by India's Financial Year (FY, April-March), global wheat prices (US Hard Red Winter-2) in 2008-09 were at least 56 percent higher over 2007-08, and rice prices (Thai 25% broken) were 67 percent up compared to 2007-08 levels. This had a strong impact on Indian policy makers, more so because in FY 2006-07, India had imported about six million metric tonnes (MMT) of wheat at prices much higher than they were paying to their own farmers as minimum support prices (MSP).

2. Political Economy Responses to Trade Policy of Staples:

Indian policy makers were keeping a close watch on international prices of staples, especially after having imported large quantities of wheat (6MMTs) in 2006-07, may be the largest wheat import India undertook in more than two decades. Several international agencies such as FAO, IFPRI, among many others, were of the opinion that these high prices of food will stay strong for the next 10 years or so. The era of low food prices seemed to be over. This made Indian policy makers somewhat nervous, particularly because the stocks of wheat and rice with the Central pool (Food Corporation of India (FCI)) fell short of minimum buffer stock norms (Figure-1). At the same time, Indian prices of wheat and rice were way below the unfolding world prices, and therefore were very competitive exports.

Thus, this constellation of various factor: deficit in domestic grain stocks compared to their buffer stock norms; India having imported 6 MMT of wheat in 2006-07 after several decades; and Indian wheat and rice being competitive exports in the wake of rising global prices, seemed a perfect storm for Indian policy makers. The first reaction came in terms of restricting exports of rice and wheat. Wheat exports were banned in February 2007, but rice exports were going on. Therefore, first, they imposed a minimum export price (MEP) of $425/MT on common rice in October 2007, which was increased to $500/MT in December 2007 with a view to restrict exports. But when the exports of rice did not stop, finally, the government imposed a complete ban on exports of common rice in March 2008. It is worth noting that India had already exported about 6.5 MMT of rice (common and basmati) in 2007-08 , when complete ban was imposed on non-basmati rice in March 2008.

India was not alone in banning exports of rice. Many other countries followed in quick succession. Vietnam, e.g, started restricting exports of rice in September 2007, followed by India in October 2007 (with complete ban on non-basmati rice exports in March 2008), and China in December 2007. By March 2008, even Cambodia and Egypt had also joined in restricting exports of rice (see

Gulati-Dutta, 2010). This created a little political uproar in net rice importing countries and created a scare globally, throwing rice prices even above $900/MT for some time (Figure-2)

The Government of India (GoI) realized the political fallout of its policy, especially on neighboring countries that were importing rice from India (like Bangladesh and Bhutan), and therefore, very quickly, within about three months after the ban, an export quota was opened for Bangladesh followed by small export quotas of both rice and wheat for a number of other South Asian and African countries honoring the existing commitments of exports to these countries. But there was no doubt that Indian policy maker's primary focus was to contain food inflation at home, especially of staples, with a view to protect poor. These highly restrictive export policies mostly remained in place until early September 2011. The rice export restrictions began to affect physical exports in a major way around March–April 2008. Rice exports fell to 2.5 MMT in FY 2008-09, down from 6.5MMT a year earlier. Exports were now primarily of basmati rice, which was exempt from export ban. The situation remained somewhat same in the next two years too. The government finally lifted the ban on wheat and non-basmati rice exports in September 2011. As a result, while exports of rice in FY 2011-12 crossed 7 MMT, wheat exports remained somewhat subdued due to its lower international prices. The rice exports galloped further and in the next three years, FY 2012-13 to FY 2014-15, India consistently exported more than 10 MMT of rice, touching even 12 MMT in FY 2014-15, becoming the biggest exporter of rice in the world, replacing Thailand (Figure-3).

Not only rice became a wonder export, but these three years (FY 2012-13 to FY 2014-15) have been remarkably different in terms of overall cereal exports in India's history. India exported roughly 20 MMT of cereals, on an average, each year, which was nothing short of a cereal wonder as this level of cereal exports, India had never done in its recorded history (Figure-4)

The question that props up is: how did it happen? From where did so much cereal "surpluses" emerge, especially when India had imported 6 MMT of wheat only in FY 2006-07? The answer to these questions lies in political responses to India's domestic food policy in the wake of 2007-08 global food price shock.

3. Political Economy Responses to Domestic Food Policy:

Having imported 6 MMT of wheat in FY 2006-07 at prices much above the MSPs India was giving to its own farmers, and realizing that global prices may stay high in the coming years, GoI took three major policy decisions to give a boost to grains production at home. First, it increased the

MSPs of wheat and rice (paddy) substantially. Wheat MSP was raised by 21.4 percent in 2007-08 and again by 17.6 percent in 2008-09. Similarly, paddy MSP was raised by about 20 percent in 2007-08, 21 percent in 2008-09, and 17 percent in 2009-10. These were whopping increases in MSP history of wheat and rice. Interestingly, despite these hefty increases in MSPs, they were still below their corresponding global prices. Second, GoI launched a National Food Security Mission (NFSM) in 2007 with a view to increase food grain production by 20 MMT within the next five years (10 MMT of rice, 8 MMT of wheat and 2 MMT of pulses). NFSM focused on delivering good quality seeds, extension, and other inputs, to farmers in selected districts in a number of states. Thirdly, despite a steep increase in fertilizer prices in international markets, GoI kept the urea price almost unchanged for a number of years, absorbing much of the increased costs as fertilizer subsidy, which spiked in 2007-08.

This twin pronged strategy, of providing monetary incentives to farmers (through MSP hikes and keeping urea prices low) and ensuring timely physical delivery of good quality inputs (seeds, fertilizers, extension, etc), paid rich dividends. Against a target of 20 MMT of extra production by 2011, India increased its foodgrain production by 42 MMT by 2011-12 over 2006-07. Considering that during most of this period, wheat and rice exports were either restricted or banned, it led to massive accumulation of stocks with FCI, which touched 82 MMT by June 1, 2012 (Figure-1), way above the buffer stock norm of about 32 MMT. It was this rising accumulation of stocks, and the cost of carrying these (including wastages in the absence of good infrastructure for stocking), which finally led GoI to open up exports of wheat and rice in September-October 2011. Rest is now history, as India exported massive quantities of rice and wheat in the following years, becoming top most exporter of rice in the world.

Another major political response was for consumers. India already has a large network of public distribution system (PDS) to distribute subsidized food, primarily wheat and rice to consumers. When MSPs of wheat and rice were raised and NFSM launched, and as a consequence, production and procurement increased, GoI kept issue prices of wheat and rice for consumers under PDS more or less unchanged. This was to extend protection to poor consumers. In fact, by 2011, emboldened by rising grain stocks with FCI, GoI introduced a bill in the Parliament to give the 'right to food' to much of Indian population, which was passed in 2013 as an Act. Under this National Food Security Act (NFSA,2013), 67 percent of India's population is supposed to get highly subsidized grains (basically wheat and rice), at Rs 2/kg for wheat and Rs 3/kg for rice, and Rs 1/kg for coarse cereals. Antyodaya Households (poorest of poor) will get 35Kg/family per month, while others (Priority)

Households will get 5Kg/person per month. The NFSA is still being rolled out, and by middle of 2015, only about 11 of the 36 Indian States/UTs have adopted it.

One more significant political response to the 2007-08 price crisis was expansion of employment program, called Mahatma Gandhi National Rural Employment Program (MNREGA), which gave legal assurance for employment to job seekers for at least 100 days in a year. This was basically to protect the landless labor.

4. Consequences and Lessons Learnt:

What were the consequences of India's political responses to 2007-08 global price shock on global prices, especially rice and wheat, and also on India's major economic indicators such as food inflation, fiscal situation, and overall growth and poverty reduction?

As we noted earlier (in Figure-3) that before India put a complete ban on non-basmati rice exports in March 2008, India had exported 6.5 MMT of rice in FY 2007-08, which fell to 2.5 MMT (basically basmati) in FY 2008-09. So, India practically withdrew roughly 4 MMT from the export market when overall global rice market hovered around 28-30 MMT. It may have had an impact in pushing up global rice prices. But India was not the only one: Vietnam, China, Cambodia and even Egypt had also joined. It is very difficult to estimate how much exactly was the impact of Indian export ban, when others also had joined this bandwagon and increased uncertainty in global markets. But it is clear that prices which were hovering below $400/MT in 2007 went above $900/MT within few months in 2008. That must have hurt the poor consumers in net rice importing countries. It depends upon how those countries coped with this situation of rising rice prices to protect their poor consumers. Attempts have been made to capture these effects country by country (Dawe, 2010).

For India, consequences were reasonably clear: India was able to hold down food inflation within 5-7 percent in FY 2007-08. Comparing the FAO's global food price index with Indian wholesale food price index (WPI-Food) and food articles (WPI-FA) index (Figure-5), it is clear that India did not allow the full transmission of global prices into Indian economy, instantaneously. So, in a way, India avoided the global price shock on its millions of consumers that year, and since India has the largest mass of poor, it may also show up in global welfare gains. But as is also clear from the figure, that Indian food price index (WPI-Food) gradually caught up with global prices by March

2013. In fact thereafter Indian food price index has been higher than the FAO food price index with prices falling only in the recent times, indicating probably to a transmission lag between the two dynamic forces.

So, if one were to quantify the transmission of global prices to domestic prices, one must allow a much longer period of adjustment, at least in the Indian case. The catching up of domestic prices to global prices was much gradual, subdued, and through myriad means ranging from raising of MSPs to finally giving up export bans. But the story of domestic inflation in general and food inflation in particular gets more complicated when one brings in an important factor which seemed to have strong impact on prices. This is about 'fiscal stimulus' given as a part of the global fiscal stimulus in the wake of recessionary fears that erupted in 2008 and were feared to be the worst since World War II. As a part of the G-20 summit, India also agreed to give economic stimulus in sync with other global powers, especially US, China and Europe. India was concerned as its overall GDP growth had fallen from 9.3 percent in FY 2007-08 to 6.7 percent in FY 2008-09. So, India let loose its fiscal policy and injected lot of expenditure through various welfare schemes promoting consumption (MNREGA, Loan waivers for farmers, higher subsidies on food and fertilizers, and so on). India's fiscal deficit more than doubled in a single year (FY 2008-09 over 2007-08), which inevitably led to rising money supply (M3) is the economy (Figure 6), putting pressures on prices in subsequent years. Fiscal deficit of the Centre crossed 6 percent of GDP in FY 2008-09 and if one adds to it the fiscal deficit of states, roughly 3 percent, total fiscal deficit hovered around 9 percent of GDP, way above any prudent norm that GoI had specified under Fiscal Responsibility and Budget Management Act (FRBMA) of 2003.

This hefty 'fiscal stimulus' did give India a chance to revive its overall GDP growth from 6.7 percent in 2008-09 to 8.6 percent in 2009-10 and further to 8.9 percent in 2010-11. But it came back to haunt policy makers with higher inflation in general, and food inflation in particular, which hovered around double digits till 2013-14, and became a major factor behind the ouster of the political party (UPA) in power in 2014. The Finance Minister of UPA, Mr Chidambaram, admitted in one of his writings that this loose fiscal policy continued for too long, and cost them heavy politically.

On food management front too, while higher MSPs and NFSM helped boost grain output, export bans resulted in accumulation of grain stocks with FCI, which reached 2.5 times the buffer stock requirement by June 1st, 2012. It has resulted in rising food subsidy bill (approximately $20 billion

in FY2015-16 budget plus unpaid arrears of about $8 billion) on one hand, and also of fertilizer subsidy (approximately $12 billion in FY 2015-16 budget and another $ 6.5 billion in unpaid arrears). This is where massive inefficiencies exist, with leakages in PDS system to the tune of more than 40 percent, and diversion of fertilizers (especially urea) to neighboring countries and for non-agri uses. These have become major challenges not only for fiscal management but also for political masters to wind them down in a calibrated fashion.

From this, at least three major lessons emerge from this India story:

- India could have averted an outright ban on exports of wheat and rice, by raising MEP in a gradual manner. Even if the ban was imposed to protect the poor in India, it should have been reviewed every three months, and exports could have been opened much earlier when domestic stocks were building up. That would have avoided excessive accumulation of stocks (in relation to buffer stocking norms) at home, and also put a little downward pressure on global food prices with win-win situation, globally and locally.

- Loose fiscal policy in the garb of 'fiscal stimulus' continued for too long, and it could have been wound down much earlier. Also, if 'fiscal stimulus' had to be given, it could have been more in building infrastructure that would have given good supply response and also enhanced India's competitive strength. Fiscal stimulus largely for consumption created too much pressure on prices, including food prices, and took a heavy toll politically.

- India could use a direct income policy (direct benefit transfer (DBT)) to help its poor consumers on one hand, and small and marginal farmers on the other. This could be done by putting food and fertilizer subsidies through cash transfer route directly into the accounts of identified beneficiaries. This would reduce "leakages" in food and fertilizers dramatically, and save large resources of the GoI without compromising on the objectives of helping poor consumers and farmers. These savings can be put in as investments in agriculture (irrigation, agri-R&D, marketing infrastructure, etc), which would reduce the distortions and make Indian agriculture more productive, competitive and vibrant, reducing rural poverty much faster.

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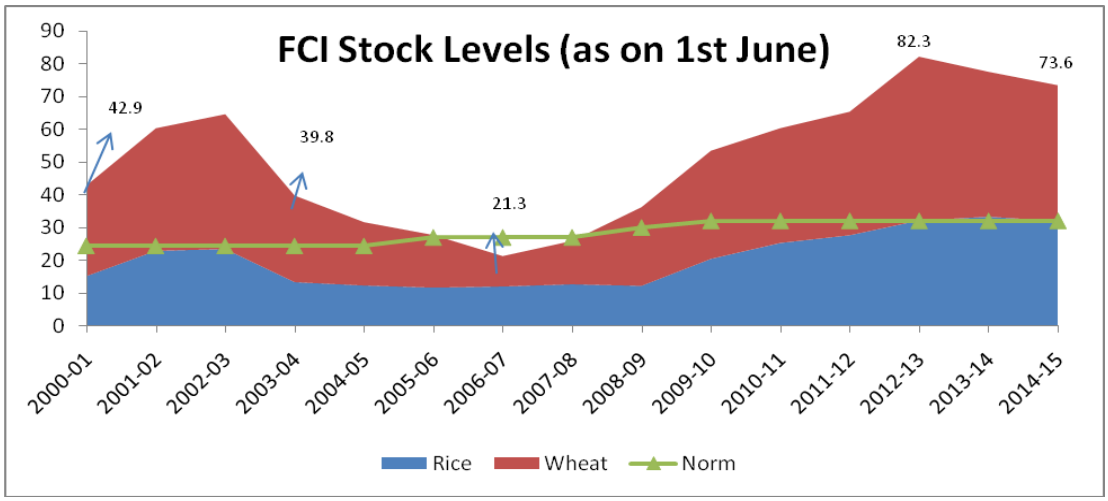
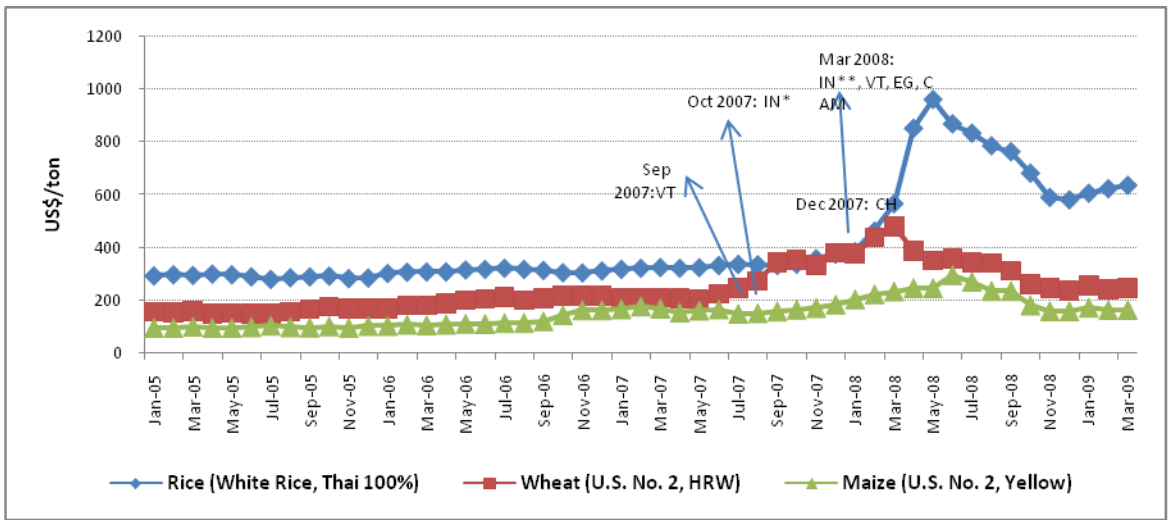
Figure-1: Buffer Stocks Norms and Actual Stocks in the Central Pool



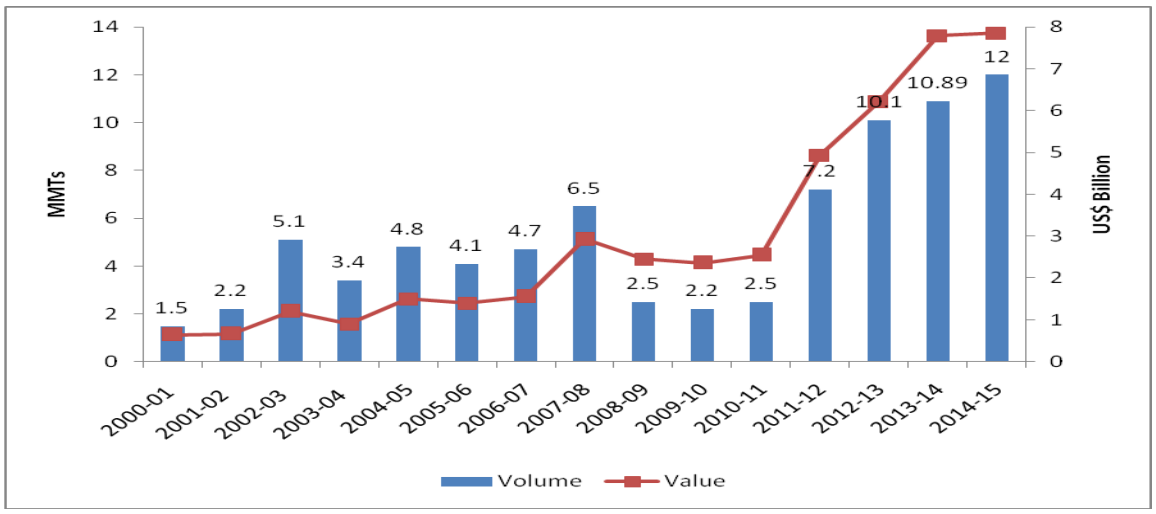
Source: Authors' calculations using data from Food Corporation of India(FCI)

Figure-2: How bans on rice exports by various countries stoked fire in rice prices



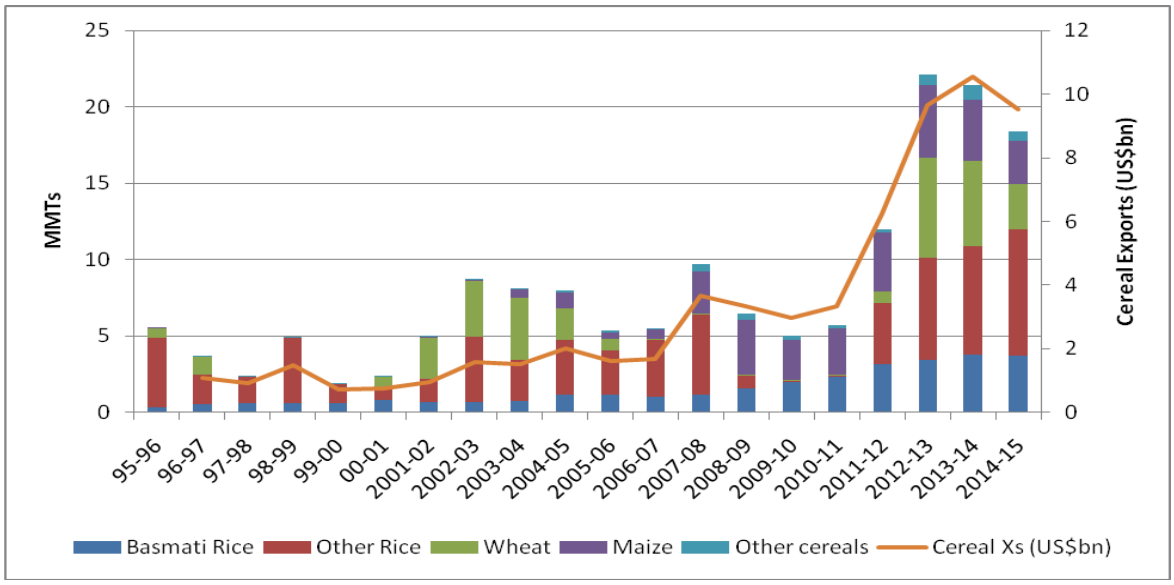
Source: Authors' calculations using data from World Bank

Figure-3: Rice exports from India (Volume in MMT and Value in US $ billion)



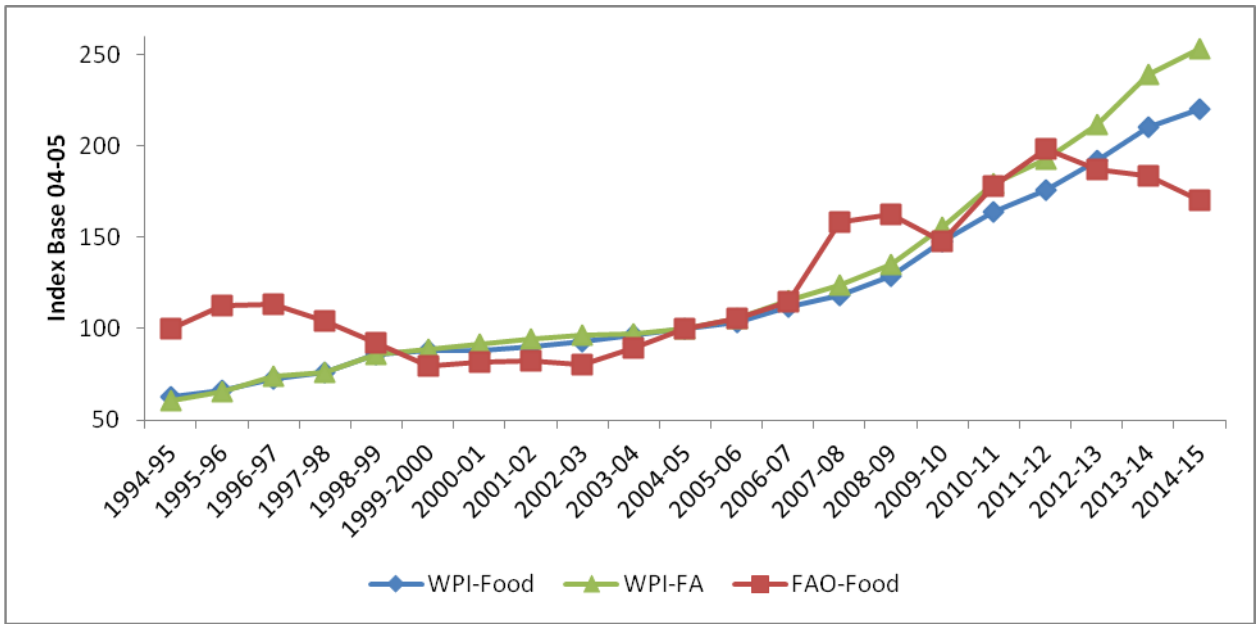
Source: Authors' calculations using data from Ministry of Commerce, GoI

Figure-4: The Cereal Wonder: India's cereal exports



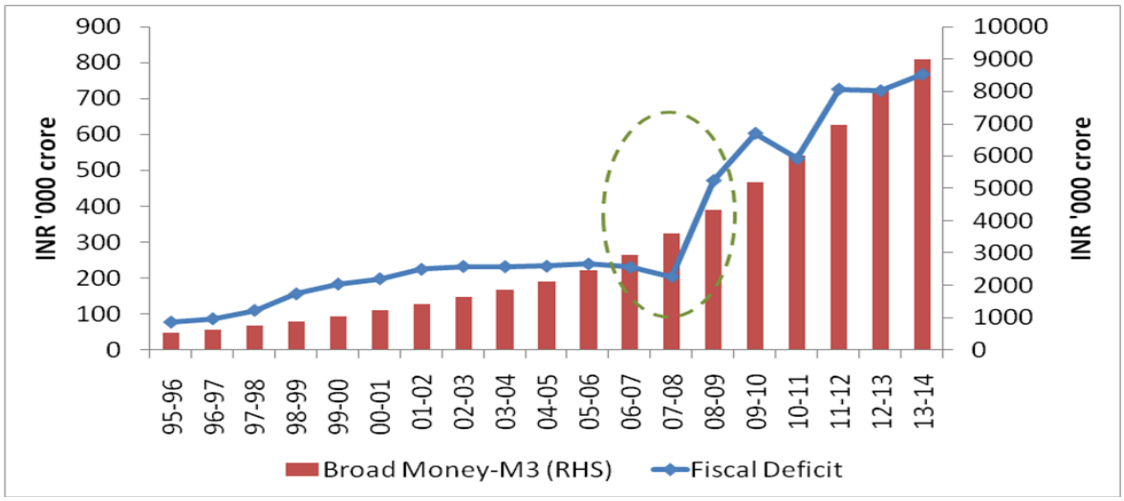
Source: Authors' calculations using data from Ministry of Commerce, GoI

Figure-5: Wholesale Price Indices of Food: Domestic and Global



Source: The Ministry of Statistics and Programme Implementation(MOSPI)

Figure-6: Fiscal Deficit and Money Supply (M3)



Source: Reserve Bank of India and Planning Commission