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Inflation in India: A Brief Analysis of the Post-Liberalization Period

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Abstract- Inflation, as measured by the consumer price index (CPI), has been on the rise in India since the early 1990s. After averaging around 5 percent per year in the first half of the 1990s, inflation increased to an average of 9 percent between 1996 and 2006. In the past decade, inflation has again moderated and averaged around 5 percent per year. The main drivers of inflation in India have been food and fuel prices. Food prices, which account for a little over 50 percent of the CPI basket, have been particularly volatile. In recent years, increases in minimum support prices for agricultural commodities and other factors such as droughts have led to spikes in food prices. Fuel prices, which account for about 14 percent of the CPI basket, have also been volatile due to changes in crude oil prices and government taxes. Inflation expectations also play a role in determining actual inflation. If people expect prices to rise, they are more likely to buy goods and services now rather than wait, leading to an increase in demand and prices. The Reserve Bank of India (RBI) surveys households and firms on their inflation expectations every quarter. The RBI uses a variety of monetary policy tools to control inflation. These include changing the repo rate, which is the rate at which the RBI lends to banks; changing the reserve requirements for banks, which affects the amount of money they can lend; and conducting open market operations, which involve buying or selling government bonds in the market to inject or suck out liquidity. Inflation is a major problem in the developing countries such as India. This paper takes an analytical look at inflation in India during post-liberalization

period. Inflation in India is increasingly becoming a problem that the government has to deal with. To understand the issue, it is important to know about the history of inflation in India and what factors caused it during the post-liberalization period.

Keywords: - inflation, liberalization, monetary policy, repo rate, Reserve Bank of India (RBI).

Introduction:

Inflation in India is a complex and multi-faceted phenomenon. There are numerous factors that contribute to inflation in India, ranging from global factors to domestic economic policies. In this study, we will take a brief look at the inflationary trends in India since the liberalization of the economy in the early 1990s.

Inflation in India averaged around 6 percent between 1991 and 2001. However, there was a sharp increase in inflation to around 10 percent between 2002 and 2008. This was mainly due to increases in global commodity prices and domestic demand-pull pressures. Since 2008, inflation has moderated somewhat, but it still remains relatively high by historical standards.

There are a number of factors that have contributed to high inflation in India in recent years. First, the country's economic growth has been strong, leading to increases in domestic demand. Second, global commodity prices have risen sharply, putting upward pressure on prices of imported goods. Third, fiscal policy has been expansionary, with government spending outpacing revenue growth. Finally, monetary policy has been loose, with the Reserve Bank of India (RBI) keeping interest rates low to support growth.

Despite these challenges, inflation in India remains moderate compared to other emerging market economies. Inflation in China, for example, has averaged 5

percent since 2000, and is currently running in the mid-3 percent range. In Brazil, inflation has averaged 7 percent during this period. The decline in global commodity prices has helped reduce inflation in India, but it still remains a policy challenge. The Indian government recognizes that inflation continues to be a big concern, and has taken steps to address it over the past few years. First, there have been increases in fuel prices to curb demand pressures and contain the federal government budget deficit. Second, the RBI has tightened monetary policy by hiking interest rates two times since June 2011--the first increase since 2008--and raising reserve requirements three times since March 2011. Third, the federal government has aggressively increased administered and non-administered prices of petroleum products. The latest such move was the increase in price of petrol and diesel by Rs 6 per liter each on Nov. 26, 2014. These moves have helped reduce inflation since March 2014, but it has remained persistently high because of supply constraints. The next section analyzes inflation's main drivers and its prospects going forward. Petroleum Products and Inflation In India, the bulk of services are provided by the unorganized sector. This sector has limited capacity to pass on cost increases to consumers and suffers from an inability to innovate in reducing costs due to technology constraints, thereby raising production costs. As a result, when there is a hike in the price of petroleum products-- that are used in the transport, construction, and manufacturing sectors--inflation is amplified. Indeed, inflation tends to be higher when oil prices increase relative to the exchange rate. The price of oil was a key determinant of inflation in 2014. The price of Indian basket of crude oil increased by more than 50% since January 2014 (when it was $108 per barrel), while the trade-weighted exchange rate appreciated much less. As a result, India's headline CPI inflation accelerated from 7.5% at the beginning of 2014 to over 10% in December 2014. The rural inflation rate also rose even faster on account of food-price pressures into rural areas due to higher transport costs and

international food prices. Inflation is expected to remain elevated and volatile in 2015. The international crude oil prices have been affected by the combination of a sharp increase in demand, supply disruptions and lower global economic growth prospects.

Inflation in India refers to the sustained increase in the prices of goods and services in the economy. The post-liberalization period in India saw a sharp increase in inflation, averaging around 9% per year between 1991 and 2010. In recent years, inflation has moderated somewhat, but still remains a significant challenge for the Indian economy.

There are a number of factors that have contributed to inflation in India. First, the country's population is growing rapidly, which puts upward pressure on prices. Second, India's economy has been growing rapidly in recent years, which has led to higher demand for goods and services. Third, the Indian government has been running large budget deficits, which have helped to drive up prices. Finally, global commodity prices have been rising in recent years, which have also added to inflationary pressures in India.

The Indian government has taken a number of steps to try to bring inflation under control. These have included raising interest rates, increasing government spending on food and fuel subsidies, and implementing other fiscal and monetary policies. So far, these measures have had only limited success in containing inflation.

The challenge of inflation remains a key concern for the Indian government and policymakers. Inflation erodes the purchasing power of Indians and makes it difficult for the government to finance its annual budget deficit. At the same time, inflation remains high in India despite the government's attempts to contain it. Fortunately, India has a relatively low debt-to-GDP ratio of 35 percent. This means

that it can finance its current level of borrowing at reasonable interest rates and so will not have to raise taxes or cut spending significantly in order to reduce inflation. However, if inflation continues to rise, India may have to take more drastic steps such as raising taxes or cutting spending.

Literature review:

The literature on inflation in India is extensive. A number of studies have been conducted on the causes and consequences of inflation in India. These studies have generally found that inflation is a major problem in India, and that it has negative effects on economic growth and poverty reduction.

Singh (1989) verified the Monetarist theory that changes in the price level is primarily the result of growth rate of money supply in Indian content through causality tests based on quarterly data on broad money (M3) and WPI over the period of 1970-71 to 1986-87. He found evidence for bidirectional causality between money and prices and also found that the impact of money supply on prices less significant than the impact of prices on money supply. Hence, he concluded that much of the variation in prices in India might be due to structural factors such as crop failure.

Balakrishnan (1992) this study found that the manufacturing sector of India has a markup pricing rule. Labor and materials are important determinants in prices. This study argues that finance ministry placed too much emphasis on demand pull factors, which led to inflation.

Srinivasan et al. (2009) constructed a reduced-form model that includes various well-known policy mistakes and empirically tests restrictions imposed by these theories on the inflationary process. Applying the GMM estimation technique they

estimate the model using quarterly data and find that their empirical results support these theories regarding inflation in the Indian context. They argue that the initial rise and subsequent fall in the inflation in India over the sample period is due to lack of institutional commitment towards price stability. In the absence of credible commitment,

Bose (2012) in his paper attempted to focus on the sources of inflation and policy options to control it and emphasised on the shift in policy from its traditional one. The paper argued that despite the fact that range of monetarist is within micro-behavioural and cost push explanation to the general inflation, the general consensus is that monetary policy tightening has failed in its desired impact on inflation. He argued that the shift in the policy focus to address issues in agricultural production along with the issues in the distribution and pricing of strategic commodities like food and fuel has rendered this monetarist approach as unsuccessful.

Rakshit (2011) argues that the source of inflation is not excess demand but rather sector specific, such as fuel prices or agricultural output. Accordingly, he argued the RBI should identify sources of inflation through a careful security of sector specific movements in prices and study the transmission mechanism of supply shocks to general price inflation.

What is Inflation?

Inflation is a rise in the general price level of goods and services in an economy over a period of time. It is measured as an annual percentage change. A high or rising inflation rate is often considered bad news, as it represents a decline in the purchasing power of money – each rupee buys fewer goods and services.

There are two main types of inflation: demand-pull and cost-push.

Demand-pull inflation occurs when there is too much money chasing too few goods. This can happen during periods of economic growth, when consumer demand increases faster than the production of goods and services.

Cost-push inflation occurs when businesses pass on higher costs to consumers in the form of higher prices. This can happen when there is an increase in the cost of inputs such as raw materials, labor or energy.

In India, both demand-pull and cost-push inflation have been at work in the post-liberalization period. The high rates of economic growth since liberalization have led to increased demand for goods and services, pushing up prices. At the same time, input costs have also raised, particularly the price of oil, leading to further increases in prices.

What Causes Inflation?

It is important to understand the different causes of inflation in order to develop an effective economic policy. In India, inflation has been a problem since the country began its transition from a closed economy to a liberalized one. While there are many factors that contribute to high inflation rates, some of the most important include:

1. **Government spending:** One of the main drivers of inflation in India is government spending. This includes both central and state government expenditure. When the government spends more money than it earns in revenue, it has to print more money to make up the difference. This increase in the money supply can lead to higher prices, as there is more money chasing fewer goods and services.

2. **Trade deficit:** Another major factor that contributes to inflation in India is the trade deficit. When the country imports more than it exports, it has to pay for these imports with foreign currency. This increases the demand for Indian rupees, leading to a depreciation of the currency. As a result, prices of imported goods increase, leading to overall inflation.
3. **Fiscal deficit:** The fiscal deficit is another important factor that drives up inflation in India. The fiscal deficit occurs when the government's total expenditure exceeds its total revenue. This leads to a rise in the government's borrowings, which are considered as an additional demand for funds. This leads to an increase in the interest rates, making borrowing more expensive and increasing expenditure by the government. When this happens, the prices of goods, services and mortgages also increase.
4. **Interest rate:** Inflation is related to the interest rates because these affect money supply in India. The higher the interest rate, the higher is money supply and vice versa. For example, if there is a reduction in interest rates from 10% to 8%, then there will be more funds available for investment purposes and this will lead to overall inflation.5) Raw material prices: Finally, raw material prices also play a crucial role in driving up inflation in India

What is and how does it Work?

Inflation, as the name suggests, is an increase in the prices of goods and services over a period of time. It is generally measured in terms of the Consumer Price Index (CPI) or the Wholesale Price Index (WPI). In India, inflation has been a

problem since the country's independence in 1947. Prices have been rising continuously, eroding the purchasing power of the rupee.

The period between 1991 and 2016 is known as the post-liberalization period. This is because after years of being a closed economy, India started opening up to the world in 1991. The process of liberalization led to more foreign investment, competition, and technology coming into the country. While this was good for economic growth, it also led to higher inflation.

There are various factors that contribute to inflation in India. One of the most important is demand-pull inflation. This happens when there is more money chasing fewer goods. As people have more money to spend, they bid up prices for goods and services. This pushes up inflation. Another factor that contributes to inflation in India is cost-push inflation. This happens when the costs of inputs go up, leading to an increase in prices. This is related to global inflation, which is driven by demand-pull inflation in the U.S. and China, as well as other countries. As a result, India has witnessed high levels of inflation over the past several years. But price stability has been restored, and growth continues apace across most sectors of the economy.

Some factors & Examples of Inflation in India Post Liberalization:

Inflation in India has been a problem since the country began its transition to a more liberal economy in the early 1990s. While inflation rates have varied over the

years, they have generally remained high by global standards. This has led to concerns about the potential for inflation to erode the purchasing power of Indian consumers and businesses.

There are a number of factors that have contributed to inflation in India during the post-liberalization period. These include:

1. **The end of government price controls:** Prior to liberalization, the Indian government heavily regulated prices for essential goods and services. This helped to keep inflation in check, but also led to shortages of certain items as producers had little incentive to increase output.
2. **An increase in government spending:** As the Indian economy has grown, so has government spending. This has been financed partly by borrowing, which has put upward pressure on interest rates and added to inflationary pressures.
3. **Rising oil prices:** India is a major importer of oil, and rising international prices have been passed on to consumers in the form of higher fuel costs. This has been a major factor behind increases in transportation costs, which have in turn fed through into higher prices for other goods.
4. **Supply constraints:** A number of factors relating to domestic supply constraints have contributed to inflation. In the case of rice and wheat, a drought in two successive years led to production shortfalls and higher prices. For example, rice output fell by 2 percent year/year between 2007-08 and 2008-09, while wheat output fell by 5.6 percent year/year over the same period. Furthermore, the government has been slow to carry out key reforms in agricultural markets, including reforming input subsidies and liberalizing trade policies.
5. **Rising wages:** Despite several rounds of public sector austerity measures (which have included pay cuts of up to 25 percent), wages for state enterprise

employees continued to increase faster than inflation throughout 2008-2009. This resulted in a wage/salary bill that was more than 70 percent of total government expenditure by year-end 2008.

6. **Bank bad debt:** Reflecting the impact of the global financial crisis and distorted incentives in state enterprises, credit standards weakened considerably last year. This trend was most evident at banks owned by local governments, which increased their nonperforming loan ratios (NPLs) from 2 percent on average in 2007 to 6 percent by end-2008. The NPL ratio of the four largest state-owned commercial banks (which account for about half of total bank assets) also rose sharply in 2008, from 2.4 percent in 2007 to 4.5 percent by end-2008.
7. **Fiscal reforms:** China continues to rely heavily on investment spending as a means of stimulating the economy and overcoming growth slowdowns. Complementing this policy is an extensive system of fiscal transfers that allows local governments to use their fiscal resources very flexibly and often ineffectively (such as through infrastructure projects financed through bank loans with high implicit guarantees).

Inflation in India has been a problem since the country began to liberalize its economy in the early 1990s. Since then, prices have been rising steadily, especially for essential goods and services. This has led to an increase in the cost of living for many people, and has put a strain on household budgets.

The following are some examples of inflation in India post-liberalization:

- Prices of essential goods and services have been rising steadily. This includes items such as food, fuel, transportation, and healthcare.

- The cost of living has increased significantly, as wages have not kept pace with inflation. This has made it difficult for households to make ends meet.
- The value of the Indian rupee has declined against major currencies, making imported goods more expensive.
- Interest rates have risen sharply, making it more difficult for businesses to expand and invest.
- Unemployment has increased as businesses have struggled to cope with rising costs.

Despite these challenges, the Indian economy has continued to grow at a robust pace in recent years. However, this growth has not been evenly distributed, and many people are still struggling to make ends meet. Inflation remains a major concern. According to Reuters, inflation in India will average 6.5 percent in 2018 and 2019.

Research objective:

The research objectives of this paper are two-fold:

- To examine the trends in inflation in India during the post-liberalization period; and second,
- To explore the factors those have contributed to inflation in India during this period.

Research methodology:

This research paper will analyze the inflation trends in India during the post-liberalization period. The period under study is from 1991 to 2021. The data for this study has been collected from various sources like Reserve Bank of India, and International Monetary Fund. Various statistical and econometric techniques have

been used to study the inflation in India. The study uses both primary and secondary data. The secondary data has been collected from various websites and publications. The primary data has been collected through a survey conducted by the author in different parts of Bihar. The survey was conducted in order to get a first-hand account of how people perceive inflation and how it affects their day-to-day lives.

Data analysis:

Inflation in India has been a problem since the country's independence in 1947. In the early years, inflation was caused by a variety of factors including poor agricultural productivity, droughts, and government policies that favored certain industries. The problem worsened in the 1970s as India began to import more oil and other commodities, which led to higher prices. In the 1980s and 1990s, inflation was again caused by a variety of factors including government policies, international trade agreements, and political instability. The problem began to improve in the late 1990s as the government implemented economic reforms and increased transparency in monetary policy. However, inflation has again become a problem in recent years due to high food and fuel prices.

There are two main types of inflation: demand-pull inflation and cost-push inflation. Demand-pull inflation is caused by an increase in aggregate demand (AD). This can be due to a variety of factors including population growth, government spending, and easy credit conditions. Cost-push inflation is caused by an increase in the cost of production. This can be due to a variety of factors including higher energy prices, raw materials prices, or wages.

In India, both demand-pull inflation and cost-push inflation have been a problem in recent years. The main drivers of inflation have been higher food and fuel prices. Food prices have risen due to a variety of factors including poor agricultural productivity, droughts, and hoarding by middlemen. Fuel prices have risen due to higher international oil prices and the depreciation of the rupee.

The Reserve Bank of India (RBI) has taken a number of steps to control inflation. These include raising interest rates, increasing reserve requirements, and selling government bonds. The RBI has also implemented quantitative easing, which is a policy of buying government bonds to increase the money supply and lower interest rates.

In India, the inflation rate is currently at 4.58%. This is higher than the inflation rate in developed countries like the United States, which is currently at 2.1%. However, it is lower than the inflation rate in some other developing countries like Turkey, which is currently at 11.2%.

The current inflation rate in India is higher than it was a year ago. Inflation in India was 3.78% in 2017 and 2.47% in 2016. The highest inflation rate in India was in 2013, when it reached 10.3%.

The current inflation rate is also higher than the Reserve Bank of India's (RBI) target of 4%. The RBI sets this target every year as part of its monetary policy.

There are several reasons for the current high inflation rate in India. One reason is the increase in oil prices. Oil prices have been rising since early 2017 and this has put upward pressure on prices of other goods and services in the economy.

Another reason for the high inflation rate is the implementation of the Goods and Services Tax (GST). The GST was introduced in July 2017 and it has led to an increase in prices of many goods and services.

Table 1:

India's Inflation Rate in the Past years:

years	Annual inflation rate
2021	5.1
2020	6.6
2019	3.7
2018	3.9

Note: Data based on average of Monthly data for obtaining Annual figure.

Source: RBI (www.rbi.org.in); Ministry of Statistics and Policy Implementation (www.mospi.gov.in)

Despite these measures, inflation has remained high in recent years. This is due to the fact that the RBI has been reluctant to take more aggressive action because of the risk of harming economic growth. In addition, food and fuel prices are largely determined by international factors beyond the control of the RBI.

Inflation in India has been a problem since the country began to liberalize its economy in the early 1990s. While the rate of inflation has been declining since then, it has remained higher than in many other countries. The main causes of inflation in India are high government spending, poor infrastructure, and lack of competition in certain sectors.

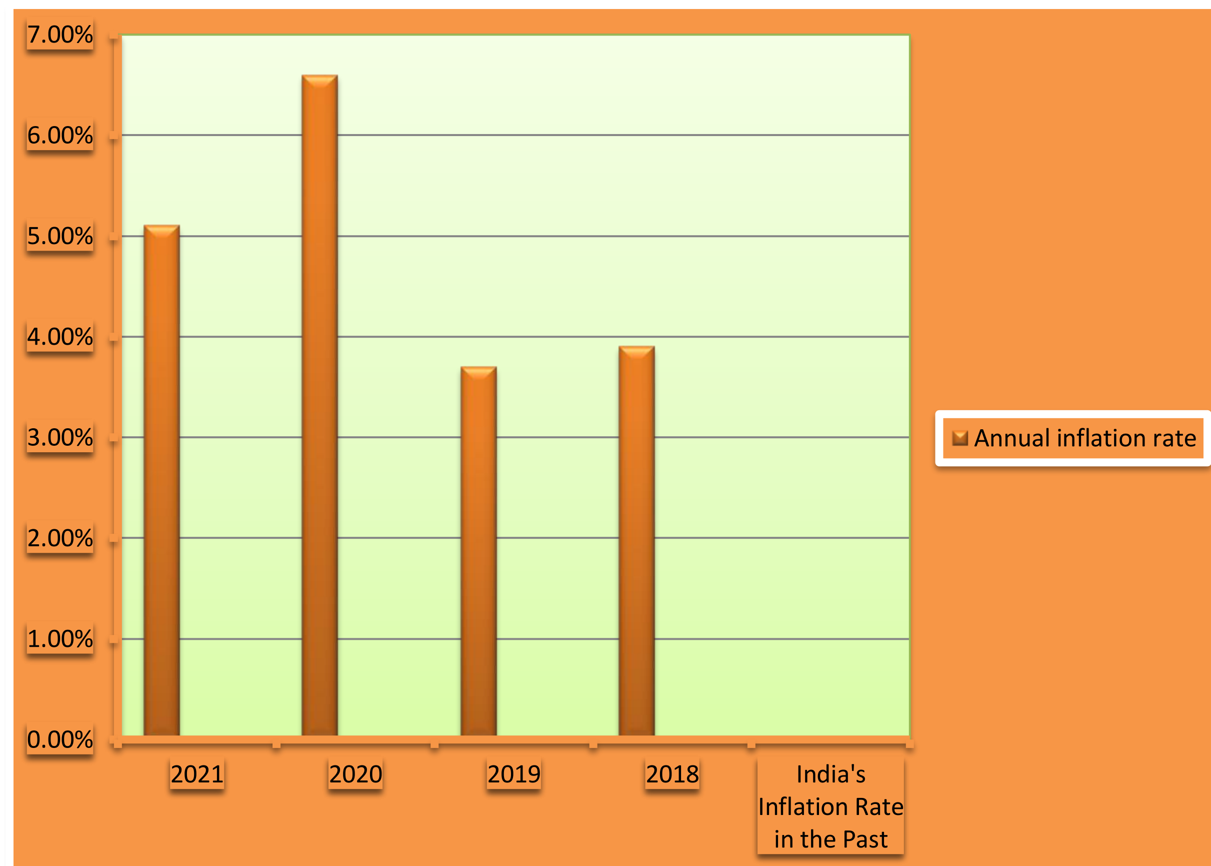

Figure 1: India's Inflation Rate in the Past years:

The government has also taken steps to control inflation. These include increasing import duties on food and fuel, providing subsidies for essential commodities, and increasing public sector wages. However, these measures have not been very effective in controlling inflation. This is because they tend to be offset by other factors such as higher government spending or an increase in the money supply.

Findings:

- Since the liberalization of the Indian economy in 1991, inflation has been a major concern for policymakers. In the post-liberalization period, inflation has

averaged around 5 percent, but has been as high as 11 percent in certain years. In recent years, inflation has been on the decline, averaging around 4 to 5 percent in the last few years.

- ❖ There are a number of factors that have contributed to inflation in India in the post-liberalization period. First, there has been an increase in the money supply due to the inflow of foreign capital and expansion of credit by commercial banks. Second, economic growth has led to an increase in demand for goods and services, which has put pressure on prices. Third, structural factors such as high taxes and subsidies have also contributed to inflation.
- ❖ The Reserve Bank of India (RBI) has taken a number of measures to control inflation in India. These include raising interest rates, restricting credit growth and intervening in the foreign exchange market. However, these measures have not always been successful in curbing inflation. For example, despite RBI's efforts, inflation reached a high of 11 percent in 2008.
- ❖ Overall, inflation has been a major challenge for policymakers in India in the post -reform period

Conclusion:

Inflation in India is a complex issue with many factors at play. While the liberalization of the economy has contributed to higher inflation in recent years, it is not the only factor responsible. Other factors such as population growth, government spending and global economic conditions also play a role. However, by understanding the causes of inflation in India, policymakers can take steps to mitigate its impact and help keep prices stable. Despite these challenges, the Indian economy has continued to grow at a fast pace, and inflation has been kept under control for the most part.

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