DILEMMA OF INFLATION IN PAKISTAN

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Abstract

It is since long that Pakistan is witnessing constant rise in inflation with every regime change. The cost of the ever worsening problem is constantly being paid by the people of Pakistan without any iota of respite. Today the state of inflation has reached at such a level which is causing devastating effects to the country's very survival, integrity and sovereignty. The urgency of the situation calls for an in-depth appraisal of the prevailing dilemma. The paper aims to identify factors adding to the prevalent inflation, highlight the still-existing grey areas and recommend viable options in-order to control the nightmare.

Theoretical Perspective:

Inflation, a highly controversial term, is meant by galloping rise in commodities prices because of excessive increase in quantity of money circulating in the economy (Jhingan, 2003). Conceptually, inflation expresses a situation whereby the aggregate demand of goods and services exceeds the available supply of output (Dewett & Chand, 1997). It affects different classes of the people differently. People with fixed income lose and people with flexible income normally gain from this phenomenon. People with fixed income group are mostly salaried workers such as clerks, teachers, daily wagers and white collar people. South Asia in general and

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Pakistan in particular is hard hit by the phenomenon. According to the World Bank (2009) report; people living below the poverty line (based on $2-a-day criterion) account for more than 80 percent of the population in India, Bangladesh and Nepal, 73.6 percent in Pakistan, and 41.6 percent in Sri Lanka. In a country like Pakistan where nearly 40% people (based on one $ per day income) live below poverty line and per capita income is less then 1000$, the majority of population suffered from inflation because their income level moves upward with very marginal speed than rate of persistent price hike. As inflation rises, every rupee you own buys a smaller percentage of a good or service.

The inflation not only affects the purchasing power of the already down trodden people rather minimizes chancing of recovery towards growth. (Cecchetti, 2000). It is measured as an annual percentage increase. There has always been difference of opinion amongst the economists on its contributing factors. Some blame monetary causes and other attribute its occurrence to maladjustments in the economic system. However, all agree upon three theories of inflations namely; market power theory or cost push theory, demand pull theory and the quantity theory (Dewett & Chand, 1997). Demand-pull-inflation is a result of strong consumer demand. When many individuals are trying to purchase the same good, the price will inevitably increase. When this happens across the entire economy for all goods, it is known as demand-pull-inflation. Whereas, cost push inflation causes substantial increase in the cost of important goods or services where no suitable alternative is available. On the other hand quantity theory assumes that the changes in income arise due to the changes in prices and output is always at its permanent level. Therefore, more money flowing inside the economy- more will be the inflation. If the interest rates are kept high, money supply can be controlled and it can help control the inflation.

Inflation discourages savings if the rate of return on savings is less than the inflation rate because it decreases the purchasing power. Hence, the price level is determined by the money supply via the operation of real balance effect (Allsopp & Vines, 2000). If the central bank does not intervene inflation causes currency devaluation. This is certainly the case with hyperinflation. In fact, in this case, central banks often choose to fix a certain exchange rate in order to overcome inflation: with fixed exchange rates, inflation makes import cheaper in comparison to domestic products, so that domestic firms face more intense competition, and will have to reduce prices. As a result there will be a decrease in inflation.

The dilemma of the inflation is that everyone take it a negative which may not be always so. As it has been discussed above that inflation affects different people in different ways. It depends on whether inflation is anticipated or unanticipated. Problems arise when there is unanticipated inflation. If it is unanticipated there will be uncertainty about future prices which can cause unexpected gains and losses in trade and industry and, thus, discourage long term contracts and investments channeling resources into speculation. Some of the problems are:

- Firms may be reluctant to invest in new plant and equipment as they may be unsure of what the government will do in the future. Both of these factors could reduce the long-term level of economic growth.
- If our prices in our country are increasing faster than those in other countries, then our will become less competitive and the demand of our products decreases. Exports are discouraged and because of that there is a negative effect on the balance of payments

- Many people have to live off fixed incomes, mainly those on pensions. When the inflation increases the worth of their income decreases.
- This is a general term for all the inconvenient costs that businesses and individuals face. As prices increase they have to redo their price lists, change price labels, reprint menus and so on.

If inflation is not controlled, the domestic goods become more expensive in international market, typically with a decrease in exports and increase in imports, which adversely affect the trade balance. Very high levels of inflation as well as very low levels of inflation, both are harmful for an economy. Both extremes effects the growth prospects, impose economic suffering on the population, create uncertainty throughout the economy, badly effects the poor and fixed income groups, and weakens the macroeconomic policies.

Over the last decade, the economies throughout the world have shown much growth, per capita income has increased, rapid industrialization and urbanization has been observed, inflation has also started taking its ugly head in many parts of the world, including Pakistan. Food inflation has emerged as the main contributor to recent global inflation. It has become a threat to macroeconomic stability. The high levels of inflation reflect a volatile economy in which money can't be maintained. Labours will require higher wages to cover the increasing costs, and savings are discouraged. Producers will also raise their selling prices to cover the increasing costs. Many such problems have been, and still are, being faced by Pakistan. For a developing country like Pakistan, inflation needs to be stabilized in order to have a sustainable growth as well as macroeconomic stability. Inflation in

Pakistan over the past two decades had an unpredictable trend, ranging as high as 13.0 percent and as low as 3.1 percent.

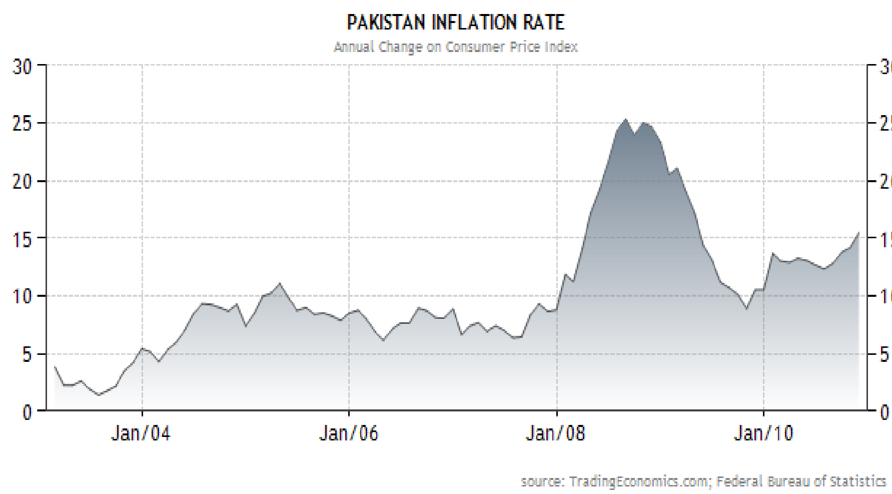
Foregoing in view, there is a dire need for an in-depth analysis of the dilemma of inflation prevailing in Pakistan. Hence, the paper aims to unearth contributing factors, describe government efforts undertaken so far to fight this menace, identify the still-existing grey areas and recommend viable options in-order to control the nightmare. The paper is arranged in to following sequence:

- Inflation: Prevailing environment in Pakistan
- Causes of unending inflation in Pakistan
- Suggested measures to control the dilemma

Prevailing Environment

Over the last few years Pakistan is passing through an acute economic crisis and inflation is the critical indicator of this worst scenario. According to Pakistan, Planning Commission (2009), poverty rate (based on 1$ daily income) has jumped from 23.9 to 37.5 percent in the last three years, which

means 35.5 millions Pakistani living below the poverty line have moved to the figure of 64 millions in 2008. There may be a long list of the causes of such a worsening scenario but the effect is the one – and that is '*inflation*'. And the inflation is likely to go further up, if not checked immediately, because of the rising population, high level corruption, political instability, agriculture backwardness, internal situation unequal income distribution, defence expenditure, increase in utility charges and rise in unproductive activities etc. The following graph can be a eye opener illustration of our growth rate adjusted with inflation:



Source: Trading Economic.Com[4]

[4] http://www.tradingeconomics.com/Economics/GDP-Growth.aspx?symbol=PKR

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2010	13.68	13.04	12.91	13.26	13.07	12.69	12.34	12.79	13.77	14.17	15.48	
2009	20.52	21.07	19.07	17.19	14.39	13.14	11.17	10.69	10.12	8.87	10.51	10.52
2008	11.86	11.25	14.12	17.21	19.27	21.53	24.33	25.33	23.91	25.00	24.68	23.34

* The table above displays the monthly average.

Source: Trading Economic.Com

Consumer Price Index (CPI) is the main measure of price changes at the retail level. It measures changes in the cost of buying a representative fixed basket of goods and services and generally indicates inflation rate in the country. High inflation has changed the daily life of the masses and the people are selling their babies and sons are killing their parents[5] to meet their daily expenses.

And according to the studies of CPI, the inflation rate during the fiscal year 2000-2001 was 4.41, during the fiscal year 2001-2002 it dropped down to 3.54, further dropped to 3.10 during the fiscal year 2002-2003 (the lowest in the last three decades). This low level of inflation was because of strict fiscal discipline, the lower monetization of the budget deficit, a reduction in duties and taxes, and appreciation of exchange rate. During this time period, the country had very low levels of food inflation, as domestic supply was plentiful. Inflation started rising in the second quarter of FY2004 because of wheat shortage. Inflation rate reached 4.57% in FY2004. Inflation touched a highest level by June 2005 since 1997. State Bank warned the trend to continue this fiscal year. Two important factors for this increase in inflation

[5]. The recent case (January 2011) of Mr Naveed Iqbal from Lahore who murdered his parents for money.

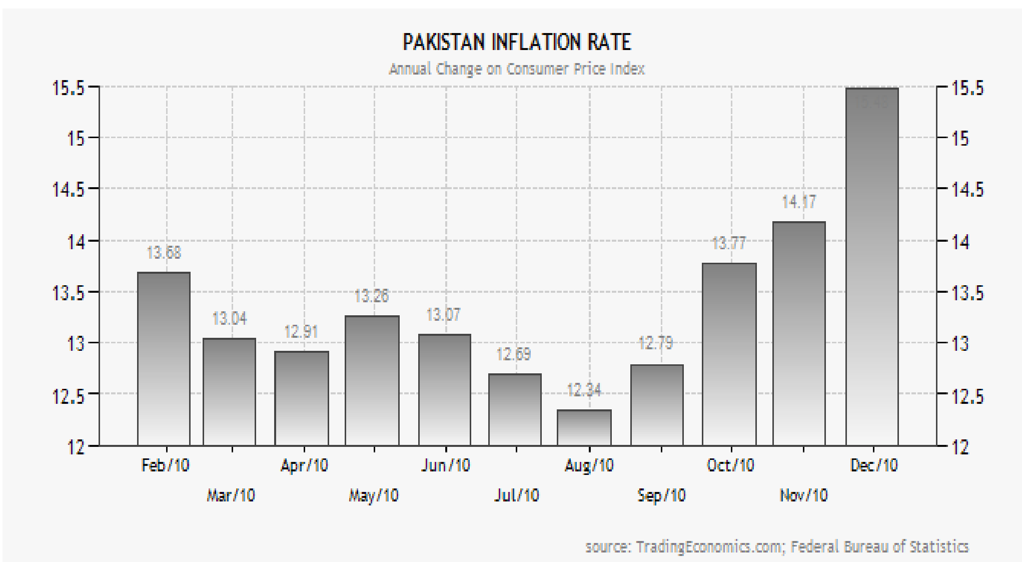
were government sector borrowing and support price of wheat, contributing 17.6 per cent and 11.8 per cent respectively.

Inflation picked up to an average of 8.6 percent per annum during 2005 and 2006 for a variety of reasons. One of the main reasons was rise in international price of oil which more than doubled during the last two years, reaching an all time high of $78/bbl. The rise in international oil prices therefore contributed to the pick up in inflation during the last two years. Second factor was the increase in demand because of the strong economic growth in the last four years income levels were increased which gave rise to domestic demand and put upward pressure on prices of essential commodities.

Inflation in FY2006 was 7.9%. Government had taken several steps to control inflation during 2005-06, which included the tightening of monetary policy as well as increasing the supply of essential commodities through liberalizing the imports. As a result the overall inflation declined from 9.3 percent in 2004-05 to 7.9 percent in 2005-06. Pakistan’s inflation in 2007 stood at 7.8%. Inflationary pressures remained strong in the economy principally due to high international commodity prices (both food and energy) and continued strength of domestic demand.

Inflation rate in the year 2007-2008 was 10.3%. It reached a historical high of 25.33 percent in August 2008. This was because of the impact of strong global inflationary pressures on domestic inflation. It has also compounded by the adjustments of administered prices of key fuels and wheat. All price indices had moved up significantly in FY08 and were significantly higher than the annual averages of the preceding five years. Other reason for this exceptionally high trend was mainly a cause of increasing food inflation. Inflation during 2008 indicates that prices of a few essential food items registered sharp increase particularly during the second half of the fiscal year 2008.

A sharp spike in global commodity prices, mainly relating to food and energy, which has persisted since the beginning of 2009, has exerted strong upward pressure on the domestic price level. Inflationary pressures eased during FY2010 resurged January 2010 onwards. The inflation rate was reported at 15.48 percent in November 2010. From 2003 until 2010, the average inflation rate in Pakistan was 10.15 percent reaching an historical high of 25.33 percent in August of 2008 and a record low of 1.41 percent in July of 2003.



Source: Trading Economics.Com

Current Scenario: Inflation in Pakistan remained relatively high at 15.48 per cent. Inflation is expected to remain high because of increase in electricity charges and petroleum product prices, effect on prices due to floods and the expected implementation of Reformed General Sales Tax (RGST) regime. Exports have increased by 19 per cent while the rise in imports is 16 per cent during the first four months (July-October) of fiscal year 2011, widening the trade deficit by 12 per cent to $5.08 billion against the previous year's $4.54 billion, Crude oil prices have increased by almost 11 per cent on average. Outstanding borrowings of the government from the SBP are in excess of Rs 1500 billion today compared to only Rs 53 billion at end-June 2003.

Remittances continued to grow and registered a record high level of $3.5 billion during the first four months of fiscal year 2011 compared with $3.09 billion in the same period last year. Foreign direct investment decreased by 28 per cent during the period, foreign investors have lack of confidence and are discouraged mainly because of security and political issues in the country.

Heavily subsidized commodity prices including that of petroleum products, gas and electricity has resulted in heavy government borrowing from the central bank, which consequently had a negative impact on inflation. Repayments of the International Monetary Fund loan will start from fiscal year 2012, pressuring foreign reserves and the current account deficit. Inflation and government borrowings are rising while the economic managers are struggling to keep the fiscal deficit low.

Causes at a Glance

Besides, the non seriousness, bad governance, and massive corruption and plundering at the part of government, there are some of the other glaring and irrefutable reasons for this rising inflation in Pakistan as well e.g.:

Disequilibrium in Supply & Demand: According to law of supply and demand, the shortage of supply or increase of demand will cause price hike. Pakistan is providing both of the causes by decreasing level of supplies (because of decreasing level of agricultural as well as industrial production) and increasing level of demand because of rise in population growth. Today there is a shortage of food (wheat, rice, edible cooking oil, sugar etc), energy shortage (acute deficiency of electricity and gas supply) which has ultimately decreased our agricultural as well as industrial production on one hand and kicked up the unemployment graph on the other. Frequent and long instances of load shedding of gas & electricity has resulted I to closures of many business especially in Punjab and Karachi. These closures of small and medium enterprises have added in to already alarming ratios of unemployment and hence to the poverty that has jumped to nearly 40%.

Squeezing Down the Social sector Budget: Slashing down of current year developmental budget, on the pretext of meeting budgetary deficit, rehabilitation cost of IDPs and flood affected people, was another measure that considerable added up in rising inflation. The immediate casualities of this economic cut were education, health and infra-structure development. Today Pakistan occupies the 136th position among 177 countries listed in the human development index (UNDP Report) and lags behind even India, Bhutan and the Maldives in South Asia.

Corruption: Corruption in Pakistan is a well established phenomenon and it has been consistently amongst the most corrupt countries since the publishing of corruption perception index (CPI) by Transparency International. The 2010 CPI report reveals that corruption in Pakistan is increasing, while it is decreasing in Bangladesh, which ranked as the most corrupt country in 2001, 2002 and 2003. Bangladesh ranking in 2010 has dropped to 39 in the list of most corrupt countries whereas, Pakistan occupies 143 positions. Corruption and corrupt practices are eating up a big chunk of public exchequer nearly to the tune of over 1000 billion rupees. The social sector and human development has been the main victim of this corruption. Because, Petty corruption in the form of bribery, law enforcement, procurement and the provision of public services, weak judiciary, poor record of accountability –all have added in to corruption. Inflation and price hike of food commodities has been the worst effect of this corruption. Daily Times[6] (2010) of October 27 while quoting Federal Bureau of Statistics Pakistan, recorded up to 120 percent increase in the last one year – sugar increasing from Rs 54 to Rs 80 per kg, pulses from Rs 50 to Rs 110 per kg, and eggs from Rs 35 to Rs 60 per dozen. Foreign direct investment for 2009-2010 dropped to $2.21 billion from $3.71 billion in 2008-2009, and in July-Sept 2010 it further dropped to $387.4 million.

Increasing Cost of Production: Rise in production cost is also another common reason which ends up to high price when reaches to its final consumer. Rise in raw material cost, labor cost, high energy cost, high taxes, high interest rates and rising minimum level of pay and government policy supplemented by heavy profit margin by the companies takes the prices sky rocketed. Since all of such increases in cost of production are mostly passed down to the consumer by the businesses therefore, this kind of inflation is call cost-push inflation or wage-push inflation.

[6] . http://www.dailytimes.com.pk/default.asp?page=2010%5C10%5C27%5Cstory_27-10-2010_pg1_2

Unchecked Printing of Currency: Excessive printing of money as a easy way to meet the immediate need is one of the worst causes. It is a most easy way of enhancing buying power potential that has grave nature of effects. It causes unending price rise in at an extremely unprecedented high speed because to much currency starts following too less goods and services thereby creating acute disequilibrium between the money supply and the country output. The situation generates state of demand-pull inflation, in which prices are forced upwards because of a high demand, and excessive monetary growth. The unabated lending of the fund starved government from the State Bank of Pakistan has rose Rs 203.324 billion during first half of the current financial year to Rs 261.337 billion as compared to July-Dec 2009-10. The current money supply that roughly amounts to Rs 1.53 trillion is colossal and is not proportionate to the GDP growth and is likely to lead the country to fiscal bankruptcy or hyper inflation. According to State Bank of Pakistan, the currency supply in the country up to December 2010 stood at Rs 1.595 trillion, compared to Rs 1.368 trillion at the end of same month last year (2009). Some unconfirmed reports have shown that the SBP is currently printing at least Rs 2.0 billion daily to cater government's borrowing demands.

Other Causes: There is a long list of other causes that keep supplementing or reinforcing the factors cited above. Some of these miscellaneous reasons of inflation in Pakistan:

Frequent adjustments in the administered prices of gas, electricity, & POL

- Higher duties and taxes
- Depreciating Pak Rupee
- Socio-Political instability and declining trends in FDI
- Frequent adjustments in support price of wheat

Recommendations

Inflation is one of the major obstacles for the development of Pakistan economy. It cannot be controlled by taking a single step. However, if monetary and fiscal measures are wisely coordinated, it can greatly help in controlling the continuous process of rising prices. The main anti inflationary measures are:

- Problems like inflation and poverty need strategic planning. Selling basic food items at Utility Stores Corporation (USC) is not an achievement. Privileged groups have taken the major part of goods from these USCs, and the poor couldn‘t have access over these basic goods even then. Government should invite foreign investment for the production of basic goods. Agriculture sector should be given sufficient subsidies.
- We know the capitalists regularly hoard essential items in an attempt to artificially affect supply and demand in order to push up prices. Steps should be taken by the government to prevent such practice.
- Investment should be given preference in consumer goods instead of luxuries. Government should give special attention to the production of cottons, wheat, vegetables, edible oil etc.
- Domestic production should be encouraged instead of imports. Domestic productions at less cost of production will not only make the availability of goods much easier but Aggregate Supply will also increase, and domestic industry will get developed.
- The government should launch a massive effort for job creation and employment generation in order to reduce the high levels of poverty. Infrastructure development would be a effective tool to curb the rising

ratios of poverty. It should be country-wide strategy and small and mega projects of infrastructure development should be initiated at the earliest. Housing is another sector which needs to be promoted and encouraged through a well planned incentives package. Huge housing will not only give a boost to all related industries but will go a long way to meet the acute housing shortage in the country. Transportation sector should also be reactivated. Different public welfare schemes should be started at gross-rout levels. Small and extensive vendor units in the textile, engineering and other export-oriented industries should be settled

- Government Luxury Expenses (both Federal and Provincial) should be reduced. Austerity from the top shall be adopted. Current slash down of the cabinet is a welcome step in this regards. The 10 points agenda put forth by the Pakistan Muslim League (N) and 9 points from MQM are likely to serve positive stressor for government to control its lavish spending and live in its means.
- Corrupt practices and the corrupt figures, irrespective of their status and influence, shall be dealt severely and even handedly.
- The budgetary deficit should be kept at a low level and preference should be given to commodity producing.
- Demand management is an essential component of the overall policy mix to avoid an entrenchment of inflationary expectations.
- A strong monitoring system should be established on different levels in order to have a sound evaluation at every stage.
- Restoration of investor confidence is must because investment would automatically create more jobs, reduce poverty level and promote economic growth.
- Better law and order situation would be helpful in the restoration of business activities and to reduce rising poverty.

CONCLUSION

Inflation affects the distribution of both income and wealth. Nominal incomes of some individuals tend to increase with inflation, while those of others remain constant thus causing a change in the distribution of income in favour of the former group. Inflation breeds poverty. Poverty discourages human talent and dignity, decreases patience and tolerance and promotes corruption and terrorism. It gives ways to disintegration and social alienation in the society. Sincere and coordinated efforts should be started to reduce the high ratios of poverty. And this could be done by adopting well thought out monetary, fiscal and other measures. Government has to show its seriousness in controlling inflation by adopting all necessary measures simultaneously with iron hands. Inflation is like a hydra-headed monster which should be fought by using all the weapons. It needs to be controlled by strategic planning.

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