

## INFLATION :CAUSES AND CONSEQUENCES

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<sup>1</sup>First of all, let me thank Tariq Ikram and Hassan Tariq for providing me this opportunity to share my thoughts with you this morning and I'm very impressed by the presentations of the panel who are specialists in their own fields. So I won't repeat very much what we heard this morning in the first session and also from my fellow panelists but I would pick up on the point which Atif left at the end.

People don't realize that beginning of the inflation in Pakistan is not solely externally induced through the pandemic, the supply disruptions, the price hikes, the China lock down--all these external factors did contribute to inflation and now Russia-Ukraine war , our own internal imbalances arising from the system of administrative prices, sharp depreciation of currency and rising interest rates have also contributed to inflationary pressures. Price of wheat which is the large component of the food basket of an average household is fixed by the Government both at the producer as well as consumer level . . Who are the beneficiaries of the government procurement of wheat at controlled price--it's the big farmers who are able to capture most of the gains from that subsidized government controlled price as they have marketable surplus. When it comes to the consumers , controlled prices of atta are displayed by the retailers but the ordinary consumer is not able to buy at that price and they are forced to buy at a much higher black market price and that adds to the inflationary pressures. Nowhere in the world 84 per cent of residential consumers of electricity are subsidized .The industrial , commercial and agricultural sectors have to pay much higher prices for electricity as they have to bear the cost of the cross subsidy to the residential consumers. . Nowhere in the world piped natural gas is dissipated on households, and not allocated to the industry which can really be a source of competitive advantage and can increase the domestic supply of goods and reduce the

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inflationary pressures. Nowhere in the world the retail pump prices of petroleum products are regulated by the government and the market forces of supply and demand are not allowed to set the prices. In the field of healthcare it was suggested that DRAP should not have any role in fixing the prices of medicines across the board. Only 99 molecules of essential drugs prescribed by the WHO should be fixed and let the competition decide what the price of other drugs should be. DRAP is under the ministry of health which is always keen to handle prices of drugs while the ministry of commerce and ministry of finance consider that liberalized trade can be a potential source of export earnings. McKinsey has done a study which shows that Pakistan's competitive advantage lies in pharma. We still don't have an FDA certified laboratory in this country because incentive structures for the pharma are so distorted.

Let me reiterate : Administrative prices of food, drugs, petroleum products, energy all together with fiscal , monetary and exchange rate policies contribute towards inflationary pressures in the country. Every Government shifts the blame of inflation on external factors but the fact of the matter is that the forces of distorted markets , weak policies , poor governance and administrative prices have to be neutralized if we wish to tackle this malaise. In contrast to these government interventions let us look at two crops, maize and rice, which are not controlled and the prices are internationally determined . Maize farmers have increased their area and productivity and Pakistan has been able to double its maize production in a short period of time which , in turn , is helping our poultry and livestock industry. Look at rice, we have now become the fourth largest exporter because the government has kept hands off this crop. . Can't we learn from that experience as now the government wants to intervene in the cotton market by announcing minimum support price. The right policy to boost Cotton crop is to bring in high yielding seeds for distribution among the farmers so they are able to increase the productivity and the Government increase spending on R&D in Cotton. That is what the government should be doing rather than asking the assistant commissioners and magistrates to go and check whether the

prices are according to the prescribed schedule creating another source of harassment for the business community and rent seeking .

I won't delve into the role of fiscal and monetary policies especially on the depreciation of exchange rate and the rising interest rates which Inayat has very rightly discussed and I won't therefore repeat those points. I would however, like to dwell on the role of the Government . Its role is that of a facilitator and an enabler of creating educated and skilled labour force, investing in research and development and innovation, in helping with the infrastructure, investing in human capital formation , and digitalizing the whole economy. That is what a strong and capable state should be doing rather than interfering in the working of the markets in the name of protecting the ordinary citizen and consumer. The effect is exactly the opposite. The elites of Pakistan like you and me are benefitting from all these across the board subsidies. We are the main beneficiaries of these government actions. In fact , it is the poor person who deserves to get targeted subsidy . Sania has done a wonderful job in creating an ecosystem and infrastructure where during the covid we used the data and evidence based on the National social economic registry to target 16 million poor households for the covid cash transfers. If that can be done why can't we target all the subsidies to the poor people through this mechanism. This single measure will reduce the budget deficit significantly but it is us the elite classes who sit in the government ,in the parliaments, in the big businesses who are not going to allow this to happen as we lose our privileges and perks. I think we should realize that we keep on blaming the government of the day but we collectively are as much guilty party in preserving this whole paraphernalia of the government intervention. Some people talked this morning about the broadening of the tax net. How can you have 66 per cent of the entire tax collection from the manufacturing industry of this country which has only contribution of 15 per cent to GDP and while exempting 60 per cent of the economy which is agriculture, retail and wholesale trade, private transportation, real estate and construction from paying taxes. Capital formation would take place by increasing domestic savings and reducing public sector dissavings. That's why the Bangladesh and India have taken their investment rates from 15

per cent to 30 per cent and their growth rates are 6 to 7 per cent. Our investment rate is stagnant at 15 per cent and therefore we have to borrow because our savings are not enough. We have to borrow 4 to 5 per cent of GDP every year piling up our debt stock which is now 70 per cent of our GDP. So unless we bring all those who are earning the same amount of income irrespective of the source of their income into tax net our debt problem would keep haunting us. . Let's say Rs 400,000 is the income tax threshold level. Anybody in agriculture , in the real estate or in the wholesale retail trade who earns 400,000 should be paying tax. . Why the burden should be on the salaried class and also on the productive sectors and the manufacturers. We have 60 per cent of our youth below the age of 30. We have to create jobs for them for the future. We have to give them the skill sets, we have to give them the opportunities for productive employment. That is where the government direction should be. So we have to refigure, reconfigure the role of a strong and capable government operating in conjunction with the competitive private sector without any concessions or favoritism and the help of the civil society which is doing a fantastic job as far as access to education and health are concerned. When three sectors of this economy, the government, the private sector and the NGOs and the civil society work in tandem within their specified boundaries I can assure you that the country will be much better off than it is today.