Gallup Pakistan History Project - **Weekend Read 16** **'Inflation: Public Enemy No. 1'**: by Murad Javed (Research Fellow, Gallup Pakistan History Project)

The rate of inflation is a critical variable that determines a range of different economic activities, patterns, and relationships in an economic structure. Inflation is generally defined and understood as the rate at which the general level of prices for goods and services increases in an economy. This increase in prices over time erodes purchasing power from incomes, and therefore in its extreme form, inflation can wreak havoc in an economy. Central Banks around the world attempt to use monetary policy levers to contain severe inflation i.e. excessive increase in prices, as well as deflation i.e. a decrease in price of goods and services (deflation – downward spiral in prices – can also negatively impact economies by depressing demand, less employment, falling incomes, and potential recession). For Central Banks and national economic policymakers, a crucial objective is the maintenance of a stable inflation rate. This stability ensures balanced growth in the economy. Inflation also negatively impacts long-term economic planning and decision-making for economic actors (households and firms) by eroding or rendering worthless earnings and savings, and pushes the cost of borrowing upwards in an economy.

Central Banks around the world rely on Consumer Price Indices (CPIs) that contain a basket of goods and services that adequately capture the standard of living in an economy. A baseline year is established which serves to function as the benchmark against which inflation/deflation are measured and tracked. Changes in the prices of these goods and services – commensurate to the weights assigned to each item in the basket – are regularly tracked by the Central Banks and economic authorities to follow changes in the overall level of inflation in an economy.

For most governments, inflation is in equal measure a political variable that must be dealt with effectively. The level of prices in an economy directly impacts the standard of living in a society. Numerous examples from around the world indicate instances where inflation plays a critical political role in determining the fates of governments. The 1923 hyperinflation episode from Weimar Germany is perhaps the most frequently cited and analyzed instances of inflation running amok. As a consequence of the war reparation pressure on the economy, the German marks quickly lost value and the currency became worthless overnight. This runaway spike in inflation adversely impacted the (re)emerging middle class in Germany, whose savings disappeared overnight, and incomes vanished rapidly. With no material assets or resources to rely on, the German middle class was arguably primed for political manipulation and transformation. The majority of the masses, who suffered as the result of hyperinflation in 1923, turned to the Nazi Party's National Socialist political agenda and policies with devastating consequences for European and global politics. More recently, for many analysts, the Arab Spring was in many ways a direct consequence of persistent inflationary pressures in Arab economies. Many of the dictatorial regimes throughout North Africa and the Middle East that fell or faced insurrection had failed in containing inflation. Inflation reacted with political repression and insularity, acute economic inequalities, and a youthful, unemployed population looking for upward social mobility, to topple regimes that had appeared strong and stable for decades.

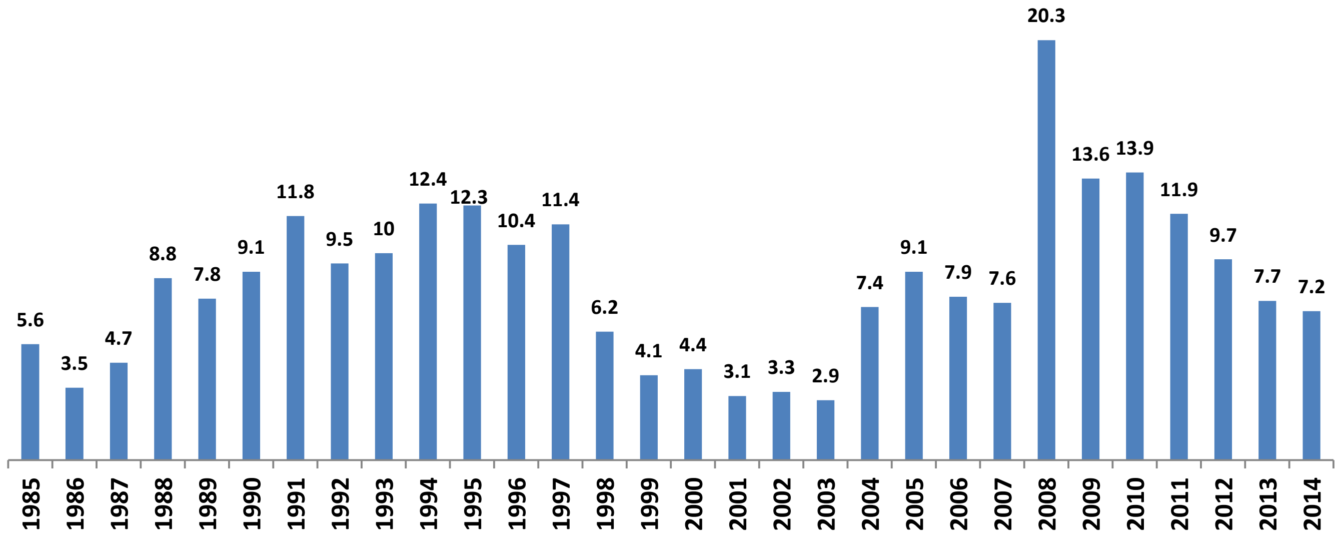
Political governments, authoritarian and democratic governments included, understand well that for the citizens of a state, inflation is an everyday, palpable phenomenon that affects and orchestrates socioeconomic and political decision-making. When incumbent governments fail to control and stabilize inflation in the economy, they are pushed out of the exit door through the ballot or popular insurrection. Parties and political actors that seek to replace the incumbent regime(s), often begin their political and election manifestoes with a commitment to controlling the evil of inflation. In most political systems, inflation is the economic vocabulary most often used in political discourse and dialogue between the voters and political representatives. And Pakistan is not immune to this far-reaching effect of inflation on the economy, society, and politics of the country.

Over the last three decades, the rate of inflation in the country is often the most frequently mentioned, assessed and bemoaned variable in Pakistan's economy and politics. More crucially, inflation rate, often couched in the vocabulary of changing prices of everyday items and food, is often a common subject of conversations between Pakistanis. For Pakistanis in the lower, lower-middle, and middle-classes, inflation is the primary concern that animates and impacts daily decisions, as well as economic planning for the future. The political governments in Pakistan over the last three decades (democratic governments and dictatorships) have fully understood the critical importance of controlling and stabilizing inflation rate as a means to pacifying public opinion and sustaining support. When everyday lives of the citizens are frequently disturbed and disrupted due to inflationary pressures, they are more likely to withdraw support for the incumbent regime, and clamour for change. In short, the political costs of the inability of a government to control inflation are immense.

Gallup Pakistan's repository of public opinion polling data over the last three decades captures the entire spectrum of issues that animate and enliven Pakistani society, culture, politics, and economy. Inflation is frequently captured in this data as a primary concern for the people of Pakistan. Crucially, Gallup has tracked public opinion on Pakistan's most significant challenges and problems since the 1980s. Data gathered at various points in time over this period reflect the trend in people's opinions on the issue of inflation, as well as other critical national problems in the country.

Fortunately, there is ample and reliable data available for the historical rate of inflation in Pakistan over the last three decades. The trends and changes in this data are indicative of and explain the various vicissitudes in Pakistan's domestic circumstances in this time period. The following figure draws data made available by the World Bank on the annualized rate of inflation in Pakistan between 1985 and 2014:

Historical Rate of Inflation in Pakistan (1985-2014)

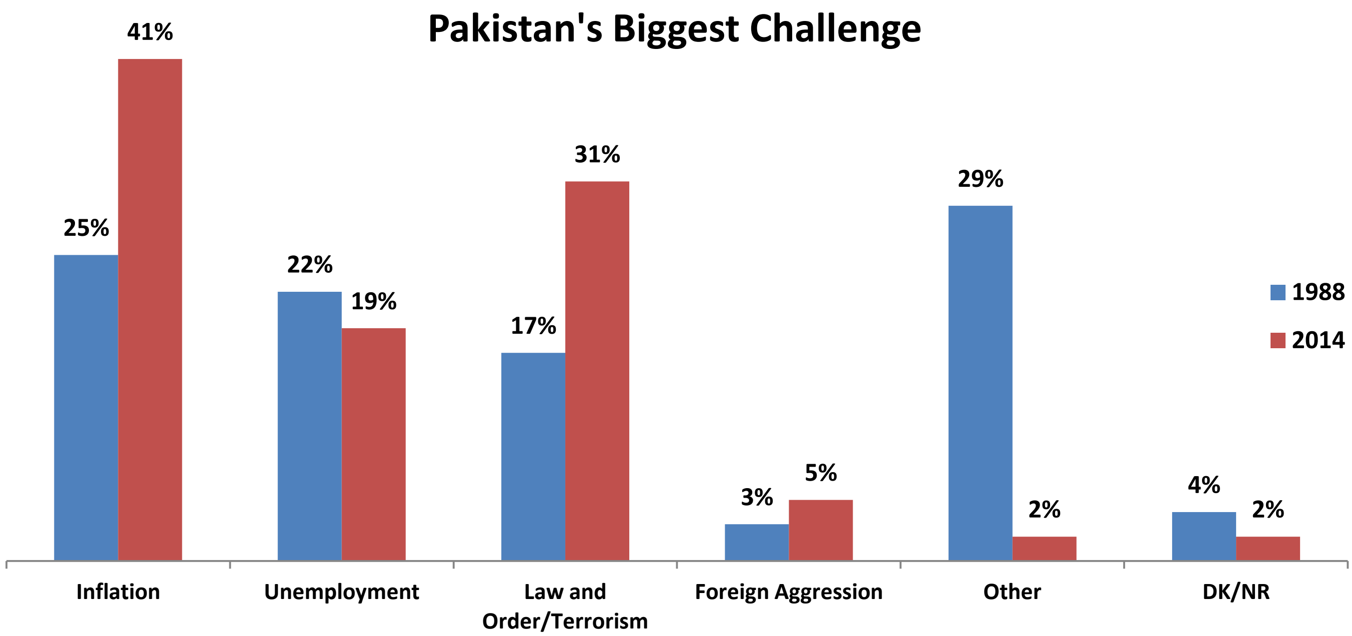


This historical trend shows that the inflation rate in Pakistan over the last thirty years has remained mostly on the higher side. The average inflation rate over this thirty year period is 8.5% per annum. Most economic analysts, governments, and Central Banks aim to contain inflation rates within a reasonable range of 2-5% year-on-year. This policy, known as inflation targeting allows for a stable benchmark for long-term growth in the economy for economic policymakers and governments. For instance, the Reserve Bank of India guides its monetary policy by targeting inflation at 4% per annum,[1] while the Central Bank of Canada aims to keep inflation rate at 2% midpoint of an inflation control target range of 1-3%.[2] While inflation targeting is an oft-debated issue, persistent and tenacious inflation rates above this globally accepted range are often considered a matter of concern, and indicate overheating in the economy. In Pakistan, the average historical inflation rate over the last thirty years (8.5%) has remained well-above and beyond the range that is seen by most monetary policy specialists as conducive to stable economic growth or expansion. The State Bank of Pakistan began debating and using inflation targeting as a monetary policy tool in 2007,[3] while earlier this year, the Bank targeted inflation between 4.5 to 5.5% for the fiscal year 2014-15.

The peaks and troughs in the historical rates of inflation provide an interesting vantage point for discussing and analyzing the transformations and changes inflation might have induced in Pakistani politics and society over the last thirty years. But what of the effect of inflation on the everyday lives of ordinary Pakistanis? And how have Pakistanis perceived inflation as a national challenge? Gallup Pakistan provides us with answers to these questions. The following figure

[1] http://www.forbes.com/sites/timworstall/2015/03/05/indias-rbi-adopts-inflation-targeting-in-positive-move/
[2] http://www.bankofcanada.ca/core-functions/monetary-policy/inflation/
[3] http://www.sbp.org.pk/research/bulletin/2009/vol5/PakistanInflationTargeting.pdf

shows data on the question first asked in 1988, and then repeated in 2014: In your opinion, which one of the following is the biggest problem faced by Pakistan?



This data provides a clear indication of what Pakistanis see as the country's greatest contemporary challenge at two points, spaced nearly quarter of a century apart. This list provides a clear understanding of the perceptions of Pakistanis regarding national challenges. Some of the key takeaways are apparent in this data. For example, and predictably, deteriorating law and order situation, and rising terrorism in the country has emerged as the second biggest problem identified by the people of Pakistan in 2014 (31%). In 1988, 17% of the respondents in this nationally representative sample thought that this issue was Pakistan's major challenge. Unemployment also remains a key challenge for the state. Pakistan's rising population and its stop-start economic growth over the last few decades have combined to keep unemployment rates on the higher side. While 22% of all Pakistanis saw unemployment as a major national challenge in 1988, this proportion dropped slightly to 19% in 2014. Crucially, 1988 was a point of social and political turmoil in the country. The Afghan war was winding down with the Soviet pull-out, while General Zia-ul-Haq's military dictatorship ended with his death in air-crash. 1988 saw another democratic election in the country, which is reflected in the panoply of "other" issues and problems identified by Pakistanis in 1988 as critical national issues (29%).

However, and most interesting, inflation has remained the most frequently cited issue by Pakistanis as a critical national challenge. In 1988, 25% of all Pakistanis – the highest proportion of Pakistanis that identified a single issue – reported that inflation was Pakistan's biggest problem. However, in 2014, a substantial 41% of all Pakistanis now think that inflation is single most important national challenge in the country. This finding has several crucial implications.

When read in juxtaposition to the historical rate of inflation shown in Figure 1, this data shows important aspects of the national consciousness. In 1988, the annual rate of inflation in the country was recorded at 8.8%, which was significantly higher than previous years. The country transitioned from a military dictatorship to a democratic government, and the economy felt the effects of this transitional pain. For the people of Pakistan, inflation was clearly a major emergent challenge for the country in that year. Fast forward 26 years to 2014, and the annual rate of inflation was recorded at 7.2%. While this inflation rate is towards the higher side, it represents a decline from double digit inflation recorded between 2008 and 2011. Quite naturally, inflation has been identified as a major national challenge by most Pakistanis last year. The economic costs and effects of high inflation adverse impact the people of Pakistan and their economic fortunes on a day-to-day basis. A high inflation rate erodes earnings and savings, and exacerbating inequalities in the society.

Another crucial understanding that emerges from this data is that notwithstanding the obvious turmoil and mayhem in national politics and events, the people of Pakistanis are most adversely affected and concerned by high rates of inflation in the country. In 1988, the country transitioned from a decade-long dictatorship to a democratic government. But for the people of Pakistan, the most important challenge remained the high prices of everyday items that determine their survival and standard of living. In 2014, Pakistan faced a grave internal challenge to its national sovereignty and stability from terrorism and militancy. Despite the obvious bloodshed and cost of this phenomenon, for most Pakistanis the cost of food and everyday items is the most pressing concern. It could be argued that critical political and national security events and challenges induce increases in inflation – as recorded in the historical data on inflation in Pakistan in the last thirty years. However, for the people of Pakistan, the most cognizable pain, and most visible challenge is the impact of prices on their everyday lives.

This data also provides a key lesson for political stakeholders attempting to stake a governance stake in the country at this point in time. While Pakistan faces many existential and institutional challenges, for the ordinary people of Pakistan, inflation is public enemy no. 1. Strategic political planners amongst political parties that find themselves in Government, or retain the ambition of forming the Government, ought to recognize that what hurts ordinary Pakistanis most adversely is the cost of living and survival. Lofty political commitments and reforms are a critical requirement in Pakistan. However, instant political support and mileage can be gained by focusing exclusively on inflation, and targeting inflation to allay public concerns, pacify public opinion, and find political space for undertaking and implementing ambitions political agendas. Without recognizing this foundational reality of Pakistani political landscape, and the opinions of its voters, political parties and their reform agendas would find public support lacking or absent.