INFLATION

1. INTRODUCTION:

The word INFLATION comes from 'inflate', which means to rise artificially. "Inflation is a rise in the general price level in a country," defined by Brooman. According to Shapiro, "Inflation is a persistent rise in the general price level vis-à-vis rise rise in the prices of goods and services." Inflation in economics implies an increase in the supply or money, unaccompanied by a corresponding increase in the supply for output. When output fails to increase in response to an increase in the quantity or supply of money in circulation, inflation takes place. Therefore, it affects the overall economy of a country on one hand and increases the expenditure of a common man on the other. There is no blinking the fact that the living conditions of a common man deteriorate with the increasing prices of the goods and services.

Inflation seemed to be a chronic problem in many parts of the world. There is a wide spread recognition that inflation results in inefficient resource allocation and hence reduces potential economic growth. Inflation imposes high cost on economies and societies; disproportionately hurts the poor and fixed income groups and creates uncertainty throughout the economy and undermines macro economic stability. High inflation has always penalized the poor more than the rich because the poor are less able to protect themselves against the consequences, and less able to hedge against the risks that high inflation poses. Lowering inflation therefore, directly benefits the low and fixed income groups. Pakistan has witnessed a low inflation environment for the last several years but experienced a sharp picked up last year at 9.3 percent.

2. TYPES OF INFLATION:

I. Demand Pull Inflation: When aggregate demand of goods and services exceeds the available supply of output; there is rise in the general price level, which is called demand-pull inflation.

II. Cost Push Inflation: When there is no increase in aggregate demand, prices may rise. This may happen because of costs, particularly the wage cost go on rise.

III. Creeping Inflation: If the general price level in a country is rising less than 3 per cent per annum.

IV. Trotting Inflation: If the general price level arises between 3 to 6 per cent per annum.

V. Running Inflation: The annual rise in inflation of about 10 per cent.

VI. Gallop or Hyper Inflation: When the average general price level increases between 20 to 30 per cent per annum.

3. CAUSES OF INFLATION:

According to Gallop Economic Survey, which was conducted in different countries of the world, there are following causes of inflation:

I. Increase in money supply

II. Increase in community's aggregate spending.

III. A rise in wages.

4. EFFECTS OF INFLATION ON DIFFERENT ECONOMIC GROUPS:

I. On Businessmen: It is of positive sense. When the prices of goods and services increase, they get more profit. They usually try their level best to increase the gap between the cost and prices. When the price increases, the salaries or remunerations don't increase.

II. On Fixed Salary Group: Inflation has negative effect on the fixed salary groups of the country; investors make profits in this context.

III. On Agriculturists: The agriculturists welcome the high prices of the commodities. The reason is simple; they get more profits of their crops.
IV. On Common Man:

5. HISTORICAL REVIEW OF PAKISTAN:

Historically speaking, inflation rate is on continual increase in Pakistan since its independence. From 1961 to 1972, inflation rate was 3.3 per cent per annum. From 1972-74, inflation rate was 30 per cent, which was the highest increase in the history of the country. From 1974-77, inflation rate stood at 17.3 per cent per annum; a little decline from the previous period. From 1977-80, rate of inflation declined to 8.5 per cent per annum. During the years 1980-90, inflation rate on average stood at 11.4 per cent per annum. During the years 1991-97, the rate was increased to 13.9 per cent per annum. During the years 1998-2000, inflation rate declined to 5.7 per cent. Presently, the inflation rate has decreased from 9.3 per cent in 2005 to 8 percent in the mid of 2006.

6. CAUSES OF INFLATION IN PAKISTAN:

I. Increase in the flow of remittances: PPP increases
II. Deficit financing: gap between the revenues and expenditures
III. Rapid monitory expansion:
IV. Foreign economic aid:
V. Investment in real estate:
VI. Lavish spending habits:
VII. Excessive speculation and hoarding:
VIII. Increase in population;

7. ANTI-INFLATORY MEASURES:

I. Incentives to farmers:
II. Check on corruption:
III. Recovery of loans:
IV. Check on non-productive spending:
V. Check on hoarding:
VI. Promotion of Sunday Bazaars:
VII. Supplies by Utility stores:

8. PRESENT SCENARIO:

The flare-up in prices over the past two years had emerged as one of the biggest challenges in macroeconomic management. On the back of the high rate of economic growth generated over the last four years in succession and in combination with negative exogenous shocks, price pressure had built up noticeably in the economy, especially during the preceding fiscal year (2004-05). In terms of generating inflation, the phenomenal rise in aggregate demand in the economy, on the one hand, was compounded by supply shocks on the other. The adverse external developments which impacted the price level for the fiscal year under review included a continuation of the surge in international price of oil to an all-time record of nearly US $ 75 per barrel in April this year, before pulling back somewhat, coupled with an unprecedented rise in world prices of commodities due to demand from fast-growing economies such as China and India. Also impacting price development in Pakistan was the decline in the size of sugarcane crop resulting in relatively lesser production of sugar within the country as well as significant rise in international prices of sugar owing to diversion of large portion of sugarcane into ethanol (a petroleum substitute) by the world's largest producer, Brazil. These factors combined to spark inflationary pressers not just in Pakistan but also in the global economy.

I. Price Developing during 2005-06:

A sharp pickup in the prices of essential commodities and unprecedented rise in international price of oil have led to the re-emergence of inflationary pressure across the globe. After living in a low inflationary environment (4%) for the last five years, Pakistan witnessed higher inflation for a verity of reasons. The higher inflationary trend in Pakistan over the last two years has been the outcome of pressure that emanated from demand and supply sides. Four years of strong economic growth has given rise to the income levels of various segments of the society. The rising level of income have strengthened domestic demand and put upward pressure on prices of essential commodities.

Supply side pressure emanated from a variety of factors, prominent among those are: increase in support price of wheat for three years in row, shortage of wheat owing to less than the targeted production, mismanagement in wheat operation in one of the wheat deficit province, inter-provincial ban on the movement of wheat resulting in sharp increases in prices of wheat and wheat flour. The prices of other food item such as beef, mutton, chicken, milk etc also registered sharp increases owing to "sympathy effect" on the one hand and demand pressure on the other.

Lower production of sugarcane resulting in relatively lower production of sugar on the one hand and a sharp increase in the international prices of sugar owing to significant diversion of sugarcane into ethanol (petroleum substitute) by the largest producer, Brazil, also contributed in building inflationary pressure in Pakistan .In recent months, prices of various kinds of pulses also registered sharp increases owing to a significant decline in domestic production as well as shortages in international markets, keeping the prices of pulses at record high level.

Unprecedented rise in international oil prices also contributed to the build up in inflationary pressure in Pakistan.

9. ECONOMIC SURVEY:

I. Inflation by Income Group:

Price hike affects various sections of the society differently. In most cases, the lower income group of society becomes victim of the severity of inflation on account of their erosion of purchasing power. To assess the impact of inflation across all income classes, the CPI is also computed for four-income group with income limits ranging from Rs. 3000 to Rs. 12,000 per month.

II. Price Stabilization Measures:

In order to keep the prices of essential commodities under control, the government has been taking various measures throughout the year. These measures include liberal import regime for food items including zero rating of imports of these commodities. The government has been expanding the supply of essential items such as sugar and wheat flour through the outlets of the Utility Stores Corporation (USC). Furthermore, in order to provide relief to low and fixed income groups, the government has been selling wheat flour and sugar through the outlets of the USC at much lower prices than the market. In order to augment supplies of essential commodities at shortest time and at lower freight charges, the government has allowed the import of various items through land routes from neighbouring countries.

10. CONCLUSION: