

Causes Of Recent Inflation

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The economy of Bangladesh has been suffering from a double-digit inflation. A shortage of oil production or energy crisis world-wide, increase in energy prices and cost-of production in combination with a demand-pull inflation from expansionary economic policies have caused a persistent inflation. Altogether these have created a supply-side problem by decreasing the productivity. The situation of Bangladesh has been aggravated due to political problems and effort of minimizing corruption and a lack of confidence in business and manufacturing. It is hard to assume that we can ever get back to the single digit inflation. It is almost clear that we have to live with this double-digit inflation. We must find out the avenue how to increase output and income, aggregate production and supply of goods and services in an effort to fight the inflation.

The natural rate of inflation from four to five percent is accepted in almost any developing country. But, a double-digit inflation of more than ten percent must have some reasons. Inflation is the persistent and generalized increase in the level of prices of goods and services. Consumers are worried about higher or increasing prices of their consumer goods as their real income, purchasing power and their standard of living is going down. Producers, manufacturers, businessmen and traders are overly concerned about increasing prices of raw materials, energies including electricity, gas and oil and the higher cost of production. Producers would like to maximize their profit by meeting the consumer demand and by keeping their plant, factories and firms/farms in operation at higher prices. Producers and suppliers do not have any other alternative except to charge a higher price directly from the consumer and indirectly from dealers, wholesalers and retailers. The market intermediaries are the last agents to charge higher prices.

Inflation is normally caused by a combined effect of demand-pull, cost-push, and expansionary monetary or fiscal policy. The recent inflation in Bangladesh is relatively more a cost-push inflation than a demand-pull. Rising prices of goods of all kinds including the goods of necessities is mere a reflection of the rising cost of production than

a higher demand for these goods and commodities.

Productivity, or output per labor, is not increasing as much as their wages are increasing. Factors of production and their productivity in our economy of recession including land, labor, capital, technology, innovation and management are not increasing due to land erosion and land fragmentation, lack of training, wear and tear of capital equipment, and their lack of replacement, backwardness of technology and innovation. The lack of skilled manpower, leadership, smart management and productive working environment and discipline is common in Bangladesh. The higher import prices of raw-material, energies, fuel and intermediate goods are also increasing the cost of production.

Wages in the major employment - or the public sector in Bangladesh has been increasing for more than the last two decades due to both strong or moderately strong labor union. Due to political, social and cultural tradition and for a humanitarian reason, the Government cannot make a distinction between productive, un-productive, and moderately productive sector in their attempt to increase the wages. The Government had to increase the wages in all sectors equally. Our private sectors try to follow the wage-increases in the public sector more or less in a different fashion according to the labor productivity and the profitability of the firms/farms. Finally, we have the nationwide increase in wages relative to the productivity or output per labor. Higher wage is easily transferred to higher cost of production and higher prices of consumer goods. Increased wages lead to the rising inflation.

Bangladesh, with its population of 140 million, is one among the few major importing countries. Most of the consumer and intermediate goods for manufacturing and production sectors are imported. Consumption goods, including the goods of necessities, are also imported. These are rice, wheat, fish, cows, lintel, onion, garlic, zinger, red-pepper, and a lot of spices. These are mostly imported from India. Eighty percent of woven fabrics and more than 20 percent of knit fabrics and garments accessories are largely imported to Bangladesh from

different countries. India is the largest market for many women's dresses including three-pieces and saris. These are largely imported. A large quantities of these goods of necessities including women's dresses and fabrics from India are continuously being imported or smuggled into Bangladesh.

Generalized increase in prices worldwide have been persistent. Rising prices of the above mentioned goods and service worldwide and in India has certainly increased the import price and prices of consumption goods and goods of necessities in Bangladesh. Rising import prices of energies and oil in particular and other intermediate goods, consumer goods, including goods of necessities, have clearly caused inflation in Bangladesh.

Iraq has the second largest oil field. Oil production in Iraq has been cut by 5,00,000 barrels per day since the U.S. invasion in Iraq for more than three years. Crude and refined oil is used in all sphere of life including manufacturing and production of consumption - and material goods. Increased oil prices have increased the cost of production worldwide. The firms and suppliers have no other choices except to raise the price of goods and materials and, therefore, have caused a cost-push inflation. As mentioned before, the increased prices have tempted the labor unions or workers to increase their wages to compensate for their loss of purchasing power. Increased prices have led to increased wages. A wage-price spiral has been set.

Recently most of our economists think that devaluation or depreciating exchange rate of Taka is another cause of inflation, with whom the Governor of Bangladesh Bank (BB) disagreed. It matters little how the devaluation is related to inflation rate. We are in an economic stage of recession with lower output and income, higher unemployment and an unacceptably high instability in prices and inflation. We simply cannot afford to have a contractionary monetary policy to increase the exchange rate or value of Taka currency. Contractionary monetary policy will further lower the output and income, increase unemployment and lower purchasing power and further aggravate the situation, and may not be able to

decrease the cost-push inflation.

If we see the reference to D.C. Colander, Macroeconomics, Third Edition, in the late 1970s, OPEC members decided to decrease their production and supply of oil to 1.5 billion barrels. Initially, supplying 2 billion barrels of oil at \$6 per barrel gave the OPEC a revenue of \$12 billion. With restricted supply, the real price of oil per barrel rose to \$16, giving OPEC members a revenue of \$24 billion (= 1.5 billion x \$16). Quantity demanded for oil exceeds the Quantity supplied. The result was a shortage of oil. In the 1970s, people lined up to buy limited supply of gas for their car. Today's situation is not different from the one of late 1970s, as mentioned above. We have a shortage of oil or energy crisis world-wide and in Bangladesh, which has raised the cost of production and prices of goods and materials, even though some non-OPEC members have tried to increase their supply of oil in response to its price increase. During writing this article oil price has been raised to \$92 per barrel from \$6 in 1970, an increase by \$76 per barrel for about the last 37 years.

London based Center For Global Energy Studies said, we would see a oil crisis further and prices will continue to increase to meet the higher demand in America during the next winter of 2007. Further exploration of 5,00,000 barrel per day by OPEC may not help much; oil prices are assumed to be \$85/barrel soon.

IWF does not want to agree about the reverse effect of stagflation due to tight money and higher interest rate of the recent past but would like to blame the recent lack in business confidence. Most economists, including Dr. S. Ahmad and Dr. M.A. Rahman of Uttara University, have agreed that rising energy prices and cost of production in combination with that tight monetary policy and higher interest rate and the recent lack of confidence in business are responsible to decrease in the productivity, create a supply-side problem and to cause a double-digit inflation.

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