POLICY PAPER

Monetary Policy for All:

Understanding the Social Footprint of Monetary Policy in Pakistan

Sajid Amin Javed

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Sajid Amin Javed

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Author:
Sajid Amin Javed

Responsible:
Dr. Jochen Hippler | Country Director
Abdullah Dayo | Programme Coordinator
Friedrich-Ebert-Stiftung (FES), Pakistan Office

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1st Floor, 66-W, Junaid Plaza, Jinnah Avenue, Blue Area,
P.O Box 1289, Islamabad, Pakistan

Phone: +92 51 2803391-4
Fax: +92 51 2803395
Website: http:/pakistan.fes.de
Facebook: Friedrich-Ebert-Stiftung, Pakistan
Twitter: @FES_PAK

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Abstract:

This policy paper brings to* discussion *the social footprint of monetary policy in Pakistan *for the first time. It argues that central banking in general, and monetary policy in particular, have significant distributional effects. It is thus time, for the State Bank of Pakistan (SBP) to understand that its policies have a wide range of side effects, both positive and negative.* ***Monetary policy affects the day-to-day life of the common man*** *and* ***influences poverty, inequality and other social outcomes. SBP, therefore, needs to assess, consider and communicate the side effects of monetary policy to the public for greater transparency, as well as to the government in order to align fiscal and regulatory policies to counter these unintended consequences****. Against this backdrop, the paper presents the case for* ***monetary policy for all*** *and outlines the agenda for central banking reforms, in the areas of communication, research and designing and implementing monetary policy. The paper maintains that* ***monetary policy actions to achieve price stability must be aligned with the social and development agenda of the country to promote the welfare of the people.*** *Finally, it is important to reiterate, that this paper is the first of its kind to generate a much-needed debate around the social considerations of central banking and monetary policy in Pakistan. In doing so, it hopes a more vibrant and engaging discourse on the topic will soon follow.*

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Acronyms

BI	Bank Indonesia
BoD	Board of Directors
BOE	Bank of England
CPI	Consumer Price Index
DPC	Deposit Protection Corporation
GDP	Gross Domestic Product
IIT	Integrated Inflation Targeting
IMF	International Monetary Fund
IT	Inflation Targeting
MPC	Monetary Policy Committee
MPF	Monetary Policy Framework
MPS	Monetary Policy Statement
NFIS	National Financial Inclusion Strategy
NIBAF	National Institute of Banking and Finance
RBI	Reserve Bank of India
RBNZ	Reserve Bank of New Zealand
SBP	State Bank of Pakistan
SBP-BSC	Banking Services Corporation
SMEs	Small and medium-sized enterprises
TERF	Temporary Economic Relief Financing

Preface

The Social Implications of Monetary Policy

"Economy", as an academic discipline, is full of abstractions. This should be neither surprising nor is anything wrong with it. For a businessman, trader, or worker the economy is a context full of specific and concrete things: The price of cotton, the quality of a required commodity, the price of bread. For the economists the economy looks very different. For them it is a network of abstract relationships, where many factors influence each other and often are interdependent. Somehow, foreign debt, balance of payments, rate of inflation, or technological innovation are logically connected and cannot be analyzed properly in isolation. Each of these terms, and many others, are quite abstract and difficult to grasp for a non-expert. And one of the most abstract concepts of them is called "money". Very few common people will be able to explain, what "money" really is, and how it should be defined. Everybody knows how to use it when shopping. It seems to be connected to the "value" of things, but how does this really work, and how can anyone compare the "value" of an apple to the "value" of a specific piece of textile?

As mentioned before, there is nothing wrong with abstractions, in academic analysis. Just the opposite: Without them we would never be able to grasp the complexities of our societies, and our economies. We desperately need them, if we want to understand the "food requirements" in some province or country, instead of the three tomatoes in front of us on the dinner table. But at the same time, sometimes the abstractions we need can blind us. Sometimes they make us forget that they are just tools of analysis, not realities. Especially in the world of economists there exists a habit of reifying the abstracts concepts they have to deal with, and disconnect them from the realities of societies. The outcome often is that the economy (and its academic discipline) are not longer understood as a tool to serve society and its people, like providing livelihood and comfort, but as their master. Achieving some target in regard to an abstract variable (e.g. balance of payment, foreign debt, exchange rate of the currency) which often has been set arbitrarily or according to some political intention, becomes a goal in itself, instead of the instrument of serving the material needs of society. Then, the economy has lost its way and becomes deified. In such case, society should serve some economic abstractions, instead of the other way around. In developing societies, where many people are poor and the gap between rich and poor is deepest, the effects will be worst. As empirical evidence shows in many countries, the poorer parts of society and sometimes the middle classes are paying the price for such policies.

Monetary policy is not just a case in point, but also a topic which for most people just looks too technical, too abstract to consider. Monetary policy is rarely debated in public, and even less in its consequences for the well-being of people. At the same time, it has a serious and often grave impact, in can influence the degree of poverty, it will benefit some groups of people and hurt others. But the social effects of monetary policy are hidden from the public, and they are rarely considered when decisions are taken. It is not an integral part of an economic policy to strengthen the development of a country – Pakistan – and further the well-being of the majority of its people. But it should be.

The current paper, researched and written by Dr. Sajid Amin Javed of the Sustainable Development Policy Institute (SDPI), is breaking new ground. It is the first one we are aware of that focuses on the social implications and social effects of monetary policy in Pakistan. It fills a surprising gap and links economic, social, and development policy analysis. This paper makes quite clear that monetary policy is not just some technical endeavor undertaken by experts for experts, but can dramatically affect the social development of

Pakistan, in a positive or negative way. And the author convincingly makes the point that monetary policy needs conceptional and institutional reform to fulfil both its legal mandate and social responsibility for the good of the country in a more convincing way. The starting point is not a wholesale or unfair critique of the State Bank of Pakistan, but the attempt to help advise on improvements in regard to its way of operating.

We sincerely hope that the study will be recognized as an important contribution to not just monetary policy formulation, but also to economic policy as a whole, and to the improvement of the economic conditions of the citizens of Pakistan.

Dr. Jochen Hippler
Country Director
Friedrich Ebert Stiftung (FES),
Pakistan

Abdullah Dayo
Programme Coordinator
Friedrich Ebert Stiftung (FES),
Pakistan

Islamabad, December 2021

1. Central banking, particularly monetary policy, has significant distributional effects

There is increasing debate that monetary policy actions and policies affect different groups of society, such as the poor and the rich, differently. It, therefore, has significant distributional effects and impact income, consumption and wealth inequalities (Hansen, et al., 2021). The social footprint of central banking and monetary policy goes well beyond inequality and affect wide range of social outcomes such as climate change, poverty, and employment.

The social implications of monetary policy, particularly its distributional impacts, have garnered a great deal of attention since the Global Financial Crisis of 2008. With the emergence of the COVID-19 pandemic, this discussion has once again resurfaced, challenging policy makers and central banks to re-envision the frontier and role of monetary policy at a more societal level. While monetary policy is certainly among the more complicated and technical of social sciences, its implications for the wellbeing of individuals, and relevance for social relationships of those individuals in larger society, cannot be downplayed.

Discussion on social implications of central banking and monetary policy is largely missing in Pakistan. In fact, monetary policy decisions, research and communication have become greatly distanced from the general public. Both decision-making and communication, are commonly outcome-based, where the ultimate objective is to achieve a particular target - for instance, strong exchange rate for the rupee - at whatever the cost, with little to no consideration for the adverse side effects on different segments of the population.

In light of this, this paper is the first attempt to generate a debate around the social footprint of central banking and monetary policy in Pakistan. It argues that central banking, particularly monetary policy, has distributional effects such as income, consumption and wealth inequalities, as well as climate change (Bank for International Settlements, 2021). Simply put, monetary policy instruments disproportionately affect high- and low-income groups, generating various inequities. The need for central banking, particularly monetary policy, to be considerate of its social imprint is, therefore, increasing.

The International Monetary Fund (IMF) presents a compelling case for central bankers *to take inequality specifically into account when conducting monetary policy.* An IMF working paper, published in September 2020 (Hansen, et al., 2021), clearly recommends that *"tackling inequality should be an explicit target of monetary policy"*. Central banks, therefore, while meeting their formal mandate of price stability, should pay increasing attention to poverty, inequality, climate change, and other issues.

Monetary policy, therefore, cannot be undertaken in isolation from its socio-economic consequences. It is thus time, for the State Bank of Pakistan (SBP) to understand and be considerate of that fact that the implications of its decisions, actions and policies go well beyond simply correcting balance of payments, and also affect poverty, inequality and other social outcomes. SBP actions directly impact the day-to-day lives of the public at large. Alternative types of monetary policy interventions that have the same aggregate effect – for example, higher and increasing inflation – and policies used to achieve price stability, impact different population groups differently.

Take for example, increasing the policy rate to control inflation, i.e. tight monetary policy. While the aggregate impact of such an action would be to bring down inflation, its differentiated impact inadvertently creates certain winners and losers, raising serious welfare concerns in the country. When interest rate increases, the rich gain, while the cost of controlling inflation is actually paid by the poor. The following three channels can used to demonstrate this differentiated impact:

i). Occupational differences: A slowdown in economic activity affects the labour market and the people in it, who face livelihood and employment concerns. Many lose their jobs when the economy shrinks in order to control aggregate demand. On the other hand, people who work in the capital market, as well as those who trade stocks, are seen to make money out of a hike in the interest rate. As do banks, insurance companies and brokerage firms.

ii). Portfolios composition*:* Individuals who hold bonds as major monetary assets (which are almost entirely the wealthy), earn money from a hike in the interest rate, while individuals who hold cash as major monetary assets (which are almost entirely the poor), do not.

iii). Savings vs. borrowers: Households with larger savings and deposits in the formal banking sector, gain from a rise in the interest rate (which, once again, are predominantly the rich), while borrowers lose out as borrowing becomes expensive. Particularly, poor households that borrow to finance routine consumption, are left paying a higher price of borrowing. Around 30% of households in Pakistan borrow for routine household consumption, which includes expenditures on food, clothing, household equipment etc. while subsequently, 12% of households borrow for medical needs (Javed, et al., 2019).

All these factors combined show that, individuals who are already rich benefit from an increase in the policy rate, while the poor further lose out. The gains are highest for the top 1%, 5% or even 10% of income groups that hold bonds and stocks. This creates and widens overall existing inequalities, for example income, wealth, and consumption inequalities.

Recent estimates from a macroeconomic model developed by Beaconhouse National University's Center for Policy research for Pakistan's economy[1], show that an increase in the policy rate by the SBP is associated with the dampening of economic growth (with the objective of controlling the demand), with side effects of inflating inequality and deepening poverty (table 1). However, this is hardly communicated or even discussed when it comes to monetary policy in developing countries, such as Pakistan.

Table 1: Increase in Policy Rate and Inequality in Pakistan:

	Impact on Growth	**Impact on Inequality**	**Impact on Poverty**
An increase in the Nominal Interest Rate	Decrease	Increase	Increase

Source: Key results from Macroeconomic Model by Dr. Hafiz Pasha

While the SBP clearly notes that *'economic policies aim to increase the welfare of the general public, and monetary policy supports this broad objective by focusing its efforts to promote price stability'* (SBP, 2008), it makes no assessment of the impact of its policies on the masses. Monetary policy research and communication starts and ends with the achieved *outcome*, such as correcting the balance of payment crisis, stabilizing and strengthening the rupee rate to the dollar or accumulating foreign reserves etc.

It neither outlines nor assesses the *impacts* and *incidence* of the policies implemented to achieve these outcomes on the general public. As discussed above, the costs of a higher interest rate to correct current account balances, are largely paid by the ordinary worker in the labour market, who may likely lose their income or even their job, due to the resulting economic slowdown. Despite this, monetary policy communication does not convey these side effects to the government and public.

1. The details for the model called "'Homegrown Macroeconomic Framework," comprising 46 equations, can be found here https://www.bnu.edu.pk/bnu/Portals/0/FINAL%20'HOMEGROWN'%20%20MACROECONOMIC%20FRAMEWORK%20%202nd%20of%20May%202019%20(1)%20(1)%20(1).pdf

It is important to note here that, we fully recognize that every public policy creates winners and losers. The point here is that monetary policy, like other public policies, should clearly consider, assess and communicate its side effects. Doing so can help to: First, reduce the gap between the SBP and the public at large. Second, help the SBP to expand its vision and calibrate monetary policy accordingly which, in turn, will improve welfare of the people. Third, a clear communication of side effects of the SBP's policies and action to the government, will position fiscal policy to better design compensation policies. All these factors together improve the welfare and wellbeing of the people, which is the ultimate objective of any public policy.

With some exceptions, most of the existing research in Pakistan has largely ignored the scholarship on side effects and possible social implications of monetary policy interventions. To some extent, the available literature explores the aggerate impact of inflation on aggregate wages and employment. But questions such as, how day-to-day monetary policy actions affect the poor, poverty and inequality, remain largely neglected. This paper aims to fill this void. It introduces the discussion around social footprint of monetary policy in Pakistan for the very first time.

2. Scope of the paper and overarching methods

It is important to note that, while the paper touches upon conventional policies of the SBP, its major focus remains on monetary policy, as this is the core policy of the SBP. Monetary policy decisions and actions have far reaching affects, greater so than conventional policies. While conventional policies, such as concessionary financing, financial inclusion and green financing, appear to be directly considerate of their social footprint, they are more so a set of residual policies instead of the SBP's core toolkit. No central bank, including the SBP, can be held accountable for these policies, as they are merely benevolent policies. This is not the case for monetary policy.

Further, these policies are aimed a particular segment of society and their impacts are limited to that target population. In contrast, the impact of monetary policy decisions and actions are spread across the whole of society. This, however, does not undermine the importance of conventional policies of the SBP. It only suggests that the SBP needs to "*select policy mixes that result in more favorable side effects of monetary policy on these dimensions without impairing the transmission of monetary policy to macroeconomic goals" (Honohan, 2019)*.

Most of the discussion presented in this paper benefits from extensive consultations and expert interviews, undertaken to contextualize the issue for Pakistan. In addition to an inception consultation (see footnote for participants)[2] to refine the research agenda, multiple consultation workshops (see foot note for list of participants)[3], and in-depth expert Interviews were conducted with an array of thought leaders.

The SBP, as a custodian of monetary policy, was purposely kept onboard right from the conception of the idea, down to consolidating the discussion[4]. The intent was to capture the needs of stakeholders from the onset, developing the discussion in collaboration with them, rather than in isolation. Further the paper benefits from the content analysis of i) The monetary policy statements (MPS), ii) SBP's minutes of MPC meetings[5] iii) The SBP's monetary policy framework, iv) The SBP Amendment Act 2021 and v) Other relevant documents. Finally, it also benefited from a review of regional and global literature on the issue, to draw some comparisons and identify best practices, which were then contextualized for Pakistan.

2. The inception consultation meeting was attended by Dr. Jochen Hippler (Country Director, FES), Dr. Hafiz A. Pasha (Former Finance Minister, BNU), Dr. Aliya Hashmi Khan (Former Professor of Economics, QAU), Mr. Ali Kemal (Chief SGDs, Ministry of Planning, Development & Special Initiatives), Dr. Hamza Ali Malik (Director Macroeconomic Policy and Financing for Development Division, UNESCAP), Dr. Ahmed Jamal Pirzada (Lecturer in Economics, Bristol University, United Kingdom), Dr. Waseem Shahid Malik (Professor of Economics (University of Peshawar); "Mr Mahbubur Raschid Chair", State Bank of Pakistan), Dr. Waqas Ahmad (Additional Director, SBP), Dr. Syed Kalim Hyder Bukhari (Senoir Joint Director, SBP), Dr. Abid Qaiyum Suleri (Executive Director, SDPI), Dr. Vaqar Ahmed (Joint Executive Director, SDPI), Dr. Sajid Amin Javed (Research Fellow, SDPI)

3. Regional Consultations were attended by Abdullah Dayo (Program Coordinator, FES), Sohaib Jamali (Senior Economist, SBP), Zubair Abbasi (Journalist, Business Recorder), Dr. Aadil Nahoda (Assistant Professor, IBA), Shehryar Aziz (Economic Advisor, FCDO), Dr. Muhammad Nasir (Associate Professor, IBA), Dr. Aqdas Afzal (Assistant Professor, Habib University), Shaista Ayesha (CEO, SEED Ventures), Dr. Usama Ehsan Khan (Senior Researcher, FPCCI), Asher Saeed (Head Corporate & Finance, Shajar Capital Pakistan), Maheen Salman (Vice President, Korangi Association of Trade & Industry (KATI)), Karamat Ali (Executive Director, Pakistan Institute of Labor and Education), Kaiser Bengali (Consultant), Dr. Rabnawaz Lodhi (Assocaite Professor, University of Central Punjab), Yasir Javed Sheikh (Program Manager, PIU P&D), Dr Azmat Hayat (Associate Professor, Punjab University), Arif Masud Mriza (Head, ACCA), Dr. S. M. Naeem Nawaz (Research Fellow, PERI), Kamran Niazi (Economic Growth Specialist, USAID), Javed Afzal (Provincial Chief, SMEDA), Kashif Anwar (President, Friends of Economic +Business Reforms), Sudhir Chaudhry (President, LEJA), Asad Feroze (CA,ICAP), Ali Khizer (Head of Research, Business Recorder), Dr. Zafar Hayat (Senior Economist, IMF)

4. The consultation meeting at SBP was Chaired by Dr. Murtaza Syed, Deputy Governor SBP and attended by Dr. Ali Choudhry (Executive Director/Research Advisor), Mr. Muhammad Mansoor Ali (Corporate Secretary), Dr. Waqas Ahmad (Additional Director), Dr. Syed Kalim Hyder Bukhari (Senior Joint Director), Dr. Abid Qamar (Chief Spokesman)

5. In the case of unavailability of these minutes, we relied on monetary policy statements.

It is also important to highlight that we use inequality as representative of social footprint of monetary policy purposefully for the following reasons: First, the sharp increase in inequality has received serious attention recently. It has emerged as a macro prudent risk, and macroeconomic policies to reduce inequality are gaining popularity. Second, inequality is now being considered as a serious threat to the SDGs agenda. Failure to address inequalities can block or slowdown progress on the global agenda 2030. Third, inequality can be directly measured and incorporated into decisions and actions by central banks.

Recently, IMF suggested using inequality of consumption as "explicit target of monetary policy" (IMF, 2020). Finally, literature on monetary policy and inequality reveal a two-way causality. On one hand, monetary policy can affect inequality. On the other hand, inequality can significantly affect monetary policy effectiveness as well. The impact of monetary policy actions on the distribution of income and wealth is, therefore, central in the recent debate on the ethical consideration of central banking *(Honohan, 2019).*

3. A more autonomous[6] SBP intending to adopt inflation targeting needs fresh thinking on central banking, particularly the conduct of monetary policy, in Pakistan

Clearly, it is high time for the SBP and public policy scholarship in Pakistan at large, including the development sector and academia, to focus on social impacts of monetary policy. Especially so, given that central banking in Pakistan is likely to undergo a fundamental transition; an autonomous SBP intending to adopt inflation targeting. The SBP is pushing for a number of structural changes in the SBP Act 1956, which laid down the foundations for how the SBP functions[7]. The SBP Act 2021 proposes two structural shifts in central banking in Pakistan[8], which are:

i. *Establishing an autonomous and independent central banking authority.*

ii. *Redefining monetary policy objectives and shifting towards an inflation targeting regime.*

The proposed changes may further generate significant consequences for social welfare, poverty and inequality in the country. They present a defining moment for the SBP, to reconceptualize its role as the public sector institute striving to improve the welfare of people in the country. This, in turn, necessitates the need for the SBP to ensure better consideration of the side effects of its policies and actions, and update its policy tool kit, including monetary policy framework, accordingly.

For example, evidence suggests a higher possibility that central bank independence can lead to inequality – independent central banks are seen to constrain fiscal policy and weaken redistribution efforts undertaken by governments, can also generate a boom in the value of assets (which are possessed predominantly by wealthier income groups) by encouraging deregulation of financial markets and may lower the bargaining power of workers, as governments attempt to contain inflationary pressures (Aklin , et al., 2021). If and when this does occur, the SBP cannot act in passivity in minimizing the adverse impacts that arise.

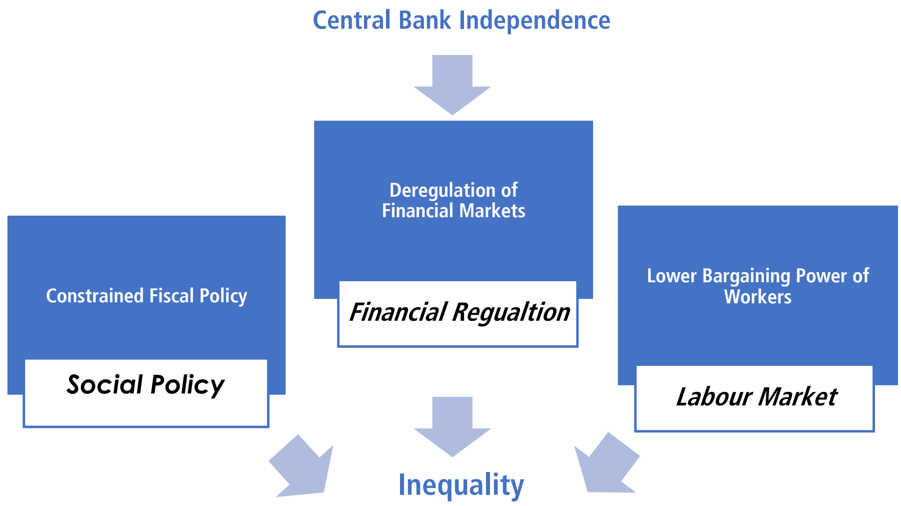
These inequality-increasing channels of central bank independence (Figure 1) are likely to be stronger at the initial phase of independence – as in the case of the SBP, where the institutional capacity, monetary policy framework, monetary instruments and coordination mechanism with fiscal and other regulatory policies, do not match with the newly adopted regime of inflation targeting.

6. The SBP presently holds on paper, full authority to 'regulate the banking sector, to conduct an independent monetary policy and to set limit on government borrowings' (SBP, 2021). Through the SBP Act 2021, it is seeking to increase its functional and administrative autonomy. The study agrees with this definition of autonomy. The SBP should indeed remain free of any political pressure in its design and conduct of monetary policy, undertaken to meet its formal mandate. However, the author acknowledges the need to balance greater accountability, with enhanced accountability, transparency and oversight – for which there must be clear mechanisms in place. For more details, please refer to: Javed, S. A., (2021). First Response to the SBP Amendment Act 2021. Sustainable Development Policy Institute, Policy Review.

7. The SBP Act of 1956 has been previously amended in 1994, 1997, 2012 and 2015.

8. For more details, refer to: Ministry of Finance (2021). SBP Amendment Act 2021 - Salient Proposed Changes in the State Bank of Pakistan Act, 1956. Available at: http://www.finance.gov.pk/SBP_Amendment_Act_2021.pdf

Figure 1: Inequality-increasing Channels of Central Bank Independence



Source: Based on (Aklin , et al., 2021) and Author's elaborations.

However, this proposition in no way suggests that central bank independence is bad. Rather, it advises that a more independent central bank has a larger role to play in fighting inequality and other social outcomes. And that the existing monetary framework, policy actions, and instruments should be considerate of their social implications. In fact, a more independent, yet also more accountable SBP, is necessary to ensure price stability.

Therefore, given the economy-wide reach and impact of SBP's actions, autonomy must be balanced with greater accountability, transparency and oversight (Javed, 2021a). In a democratic world, every institution has to be accountable, transparent and credible. Accountability of the SBP can be ensured by setting clear inflation and financial stability targets. Additionally, the parliament needs to continue mediating by introducing legislation to separate and clearly define the regulatory power of the SBP and government, without any external influences (Ibid).

Unfortunately, despite the significance of the matter, debate and evidence on the social welfare consequences of monetary policy in the country, are presently still in their infancy. To a large extent, the bulk of existing literature in the country has overlooked the social welfare consequences of monetary policy interventions entirely, particularly in regard to how these policies impact the everyday lives of vulnerable and poorer segments of the population (Javed, 2021b).

In fact, a systematic search of the titles of the SBP's 107 working papers, published over the past 20 years (2001-2021)[9], found none included terms such as 'inequality' or 'poverty' etc., (Ibid). This points to the complete absence of research on the social footprint of the SBP and its monetary policy. This significant research gap has worked to create a sense of unrelatedness between monetary policy choices and the general public, which must be rectified.

To begin with, it is imperative that the SBP expands its research agenda to explore how its decisions and actions can affect social outcomes such as poverty and inequality. It can then, work towards minimizing these adverse impacts. It should convey the impact of its actions to the general public through a non-technical communication, which touches upon issues of public policy. At a later stage, the SBP should work towards calibrating decision-making processes and refine monetary policy actions and instruments accordingly.

9. For more details, please visit: https://www.sbp.org.pk/publications/wpapers/index2.asp

In light of this, this study, aims to foster a debate on how monetary policy decisions can affect the poor and rich differently, contributing to designing an optimal monetary policy with improved welfare considerations. It is important to note that, incorporating social consideration into the SBP's policies, particularly monetary policy, is not an end goal for us. It is rather a tool to improve welfare of the people.

The integration of monetary policy into developmental policy is in itself a crucial step towards greater community engagement in monetary policy and enhancing the SBP's understanding of how policy decisions impact the daily lives and livelihoods of the very citizens they intend to benefit, rich and poor. It is also indispensable in supplementing development and social policy, and through it, improving the wellbeing of the general public at large.

Central Banking and monetary policy, which is considerate of their social implications, can improve Pakistan's progress towards social and economic development. Such a monetary policy can also strengthen the effectiveness of other public policies, such as its counterpart the fiscal policy, to deliver on social, environmental and economic development *(Honohan, 2019)*[10].

10. Patrick Honohan (2019), Should Monetary Policy Take Inequality and Climate Change into Account? https://www.piie.com/sites/default/files/documents/wp19-18.pdf

4. Clearing some confusions surrounding the role and frontier of monetary policy in Pakistan

Undoubtedly, monetary policy remains an exceedingly puzzling and technical matter for the average citizen, believed best to be left to the experts. However, some serious confusions were observed to emerge from discussions even with students of economy and public policy, including academics, practitioners and people working closely with central banking and monetary policy.

We are fully aware that this may also be an outcome of some errors and emissions in contextualizing the present discussion. It is, therefore, worth clearing some of these major confusions for greater benefit and clarity. For the sake of brevity, I have picked a few of the main misconceptions that arose from the consultations and interviews undertaken for the purpose of this study, and which were related to the matter at hand; the social footprint of central banking and monetary policy.

First, a large majority of individuals believe that inequality and other social outcomes are the exclusive domain of fiscal policy, and that monetary policy has nothing to do with such notions. Most importantly, many representatives from the business sector, academia and development sector, shared the belief that monetary policy has nothing to do with the day to day lives of the masses. They would say "monetary policy is not a problem of the common man." But when you would ask them what the number one problem of Pakistan is, they would answer "inflation."

Majority of participants did not understand why the SBP and monetary policy were being brought into discussions about the welfare and wellbeing of people. For them, monetary policy has nothing to do with such things. This perceived disconnect between monetary policy and the welfare of people needs to be addressed. As the preceding discussion demonstrates, monetary policy has substantial impacts on the day-to-day life of people through inflation, inequality, poverty and environmental impacts.

Second, contrary to what it may seem, suggestions to conduct monetary policy in a manner which is considerate of its social footprint, such as inequality, neither means replacing the formal mandate of the SBP - which is, price stability - with inequality or any other measures, nor is it to expand the purview of the SBP. It simply recommends these formal mandates are met through a policy mix which minimizes the side effects of the SBP's decisions and actions. In other words, it simply suggests that monetary policy, like any other public policy, must be considerate of the broader socio-economic and welfare implications of its actions (Javed, 2021b).

As noted above, the application of monetary policy on the economy creates many winners and losers. The purpose of this study, therefore, is to highlight that the SBP can identify a mix of policies which can reduce the number of people who lose out. Likewise, while the SBP certainly has access to a limited number of instruments, it would do well to ensure there is greater consideration for the socio-economic implication of those few instruments, rather than try to bring even more under its belt.

In many ways, doing this is unquestionably vital, as inequality is seen to distort the effectiveness and transmission of monetary policy itself, and therefore should be factored into SBP's policy decisions (Ibid). In other words, while monetary policy matters for inequality, inequality in turn also matters for monetary policy.

Third, another prevalent misconception that appears to exist is that the discussions and debates surrounding monetary policy tend to conflate the *effectiveness* of monetary policy, with its *effect* on the general public. In actuality, however, the two are quite different. The effectiveness of monetary policy is dependent upon the nature of the economy in question. In developing countries such as Pakistan for instance, where a substantial portion of the population remains unbanked, the effectiveness of monetary policy may dampen. On the other hand, in one way or another, monetary policy *affects* each and every individual in the country, irrespective of whether they access to bank accounts or not. The side effects may be even more adverse for those who are unbanked. Therefore, the two notion cannot be used interchangeably, nor should they be confused with one another.

Fourth, there is also widespread skepticism (albeit, misinformed) regarding the role of the SBP, and its ability to contain inflation, which in Pakistan is considered to be entirely a supply-side phenomenon (Kardar, 2021). Once again, the study is not endorsing the SBP tackles inflationary pressures that arise from supply shocks, rather it recommends that:

- The SBP improves the social footprint of its monetary policy for the demand-driven component of inflation – however minimal it may be.
- There is greater research undertaken to map out the composition or structure of inflation in the country. Accurately decomposing inflation into its supply and demand side components is crucial to understanding the developmental impact of inflationary pressures. Presently, there is a lack of relevant data and indicators for the assessment of aggregate demand in the country, which impedes the SBP's effectiveness in containing inflation (Ibid).
- Side effects and incidence thereof, should be clearly conveyed to members of the public. However, effects which are likely to create panic or fear can be communicated to the government without getting them out to the public.

Fifth, it is important to emphasize that, although controlling inflation is in itself significantly advantageous to maximizing the social welfare of individuals, *how* inflation is controlled can generate substantial consequences for different segments of the population. As a result, while inflation control should remain the SBP's highest priority, the manner in which this is conducted and the instruments and policy actions utilized in achieving this, cannot be disregarded. Therefore, monetary policy needs to go beyond aggregate outcomes and should concern itself with the impact of its policy actions – which will, in turn, aid in reducing inequality in the country.

Doing this will require a critical analysis of a number of important emerging questions such as: how and to what extent does money supply growth and/or a hike in interest rates affect the poor or those with large cash holdings and restricted access to financial services, how interest rates impact the prices of goods and services consumed inherently by lower-income groups etc. Such concerns, and more, must navigate the research agenda of the SBP moving forward.

Sixth, there is strong (mis)perception that social footprint is only a matter of conventional policies of a central bank – such as, financial inclusion, concessionary finance to businesses, green financing etc. - and should not be considered in the context of monetary policy, even for the sake of discussion. While we agree and appreciate that the SBP's use of conventional policies were invaluable to leading the response to the COVID-19 pandemic and helped maintain liquidity in the market. Schemes such as, concessionary finance for avoiding layoffs, were good initiatives. So is the current scheme of Temporary Economic Relief Financing (TERF). However, in this regard, at least four points are worth highlighting.

One, the main policy through which any central bank affects economic and social outcomes is monetary policy. It is monetary policy which delivers on price and economic stability. The evidence clearly suggests that the policy mix used to achieve these objectives have much wider, larger and intergenerational social impacts. So, the primary mode for any central bank to deliver on social outcomes is its monetary policy. Same is the case for the SBP. Second, conventional policies fall outside the periphery of a central bank's traditional and core mandate, and therefore it cannot be held accountable for any policies not in its formal mandate.

Third, as mentioned, the impact and reach of conventional policies, by design, is limited to a particular selected audience, and cannot be employed for the benefit all citizens. These policies are mainly residual policies. Fourth, and most importantly, while good in intent, these policies can actually inflate inequalities in the presence of structural barriers. This seems to be the case for Pakistan. Take for example, SMEs financing. Despite all the good intentions, only 6-8% of total credit to the private sector goes to SMEs. TERF has, as experts believe, actually inflated inequalities in access to credit. Only larger firms were able to get the loans under concessionary finance of the SBP.

The SME sector contributes to 40% of the GDP in Pakistan, contains 90% of agriculture employment, and contributes 25% to the manufacturing export sector. Under the National Financial Inclusion Strategy (NFIS), SBP considers the SME sector to be a significant priority area. Therefore, the SBP announced in 2017, to increase the share of SMEs in total private sector credit from 8% to 17% by 2020 (Policy for Promotion of SME Finance, SBP, 2017). However, at the end of fiscal year 2020, the share of SME to private sector credit was just 8.5 %, while at the end of fiscal year 2021, it was 8.23% (Annual Performance Review SBP, 2020-2021).

It should be noted that, discussions unravelling in this study, do not intend to undermine the developmental role of conventional policies of the SBP. Instead, as mentioned, it suggests that the SBP, like any other central bank, is better positioned to deliver on social welfare of the people, if it calibrates its monetary policy to be better aware of its side effects. In this way, both monetary and conventional policies will reinforce each other in maximizing the gains from SBP's policies for the public at large.

5. Contrary to common belief, the need for monetary policy to be considerate of its social footprint is high for developing countries, such as Pakistan

The global financial crisis of 2008 is considered to be the first shock in recent history to have triggered a shift in monetary policy thinking. Prior to this, a general policy rate for the economy was set to meet the exclusive target of controlling inflation. This allowed central banks to steer *"clear of debates concerning the impact of monetary policy on different groups in the economy"* (*Honohan, 2019).* However, activism around the need to minimize the adverse impacts of the global financial crisis and most recently that of the COVID-19 pandemic, has raised concerns over the side effects of central banking and monetary policy.

The widening differences in portfolio composition of different groups of society has raised concerns about the distributional impact of central banks and monetary policy. The rich own an overwhelming share of monetary assets, such as long-term bonds, which let them make money from policy rate hikes. The poor, on the other hand, face a two-way loss. First, they do not own monetary assets, depriving them of a chance to benefit from policy rate and bond price gains. Second, they suffer in the labour market when policy rate hikes, as aims to achieve stabilization in turn slows down economic activity. Job losses are common and most prevalent among low earning elementary occupation workers.

This was the case in 2018-19, when in order to manage the widening current account deficit and balance of payment crisis, the SBP increased the interest rate from 6% to 13.2% in less than a year. While many earned attractive yields through portfolio investments, many others lost even their basic earnings. Economic activity slowed down; GDP growth rate dropped from 4.8% to 1.9%; large scale manufacturing witnessed a sharp dip. Industries were closed down. Millions fell into poverty. The balance of payment was corrected at the cost of millions losing their jobs and livelihoods.

Such distributional issues can have long term intergenerational effects. This could have been avoided if the SBP was, in the words of the IMF (2020) *"setting lower interest rates that stimulate growth and wages and thereby reducing consumption inequality"* instead of exclusively focusing on keeping the rupee strong (Javed, et al., 2016) by attracting hot money (Javed, 2019).

An opposition to this agenda can also be found. This camp mainly argues that the social agenda of monetary policies, such as inequality, is not suitable for developing countries. They argue this is because monetary policy already has weak transmission mechanisms, therefore asking central banks to focus on social outcomes such as inequality, may not be pertinent.

However, in many ways, the case is even stronger for developing countries. Developing countries like Pakistan have lower financial inclusion, poor social spending, an overwhelming informal economy and higher intergenerational immobility. Together, these characteristics can convert otherwise short-term distributional impacts into long-term structural inequalities. Monetary policy induced inequalities, therefore, can create long-term structural inequalities in access to education, health and skills development.

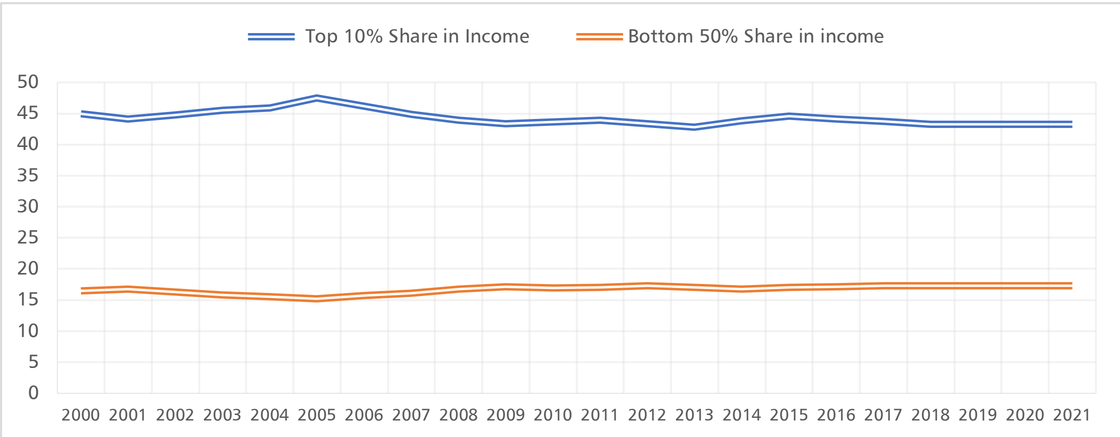
The neglect of big distributional and intergenerational issues can have profound consequences for a society. Monetary policy, like any other public policy, therefore, should be considerate of social outcomes of its decisions and actions. Systemic issues, like climate change and inequality, warrant the attention of central banks worldwide, and in the case of Pakistan, the SBP.

Most importantly, monetary policy in developing countries tends to follow randomly set inflation targets, which keep changing every year. Keeping in line with historical trends, the target rate of inflation is higher than the preceding year. This has two implications for the distributional effects of monetary policy. First, monetary policy is diverted towards delivering on inflation targets set by the government and not on price stability. It delivers a higher inflation target but at the expense of eroded purchasing power for members of the public. Second, and most importantly, the likelihood of random and unpredictable changes in short term policy rate is increased in developing countries, which generally face higher inflation and no policy rule.

Both situations generate serious social consequences. The former leads to monetary policy adversely affecting social welfare continuously. The latter has strong distributional impacts. Unanticipated movements in the policy rate, to correct fluctuations in the economy, can have statistically significant and fairly noticeable effects on various measures of income and expenditure inequality (Coibion, et al., 2017). Chances of unanticipated movements further increase, when monetary policy responds, through changes in the policy rate, to exchange rate movements (which experts believe to be the general case in Pakistan).

Higher level of inequality is a monetary policy concern for two reasons. First, higher income inequality leads to higher inflation (Dolmas, et al., 2000). This suggests that monetary policy in high-income inequality ridden countries, like Pakistan, must be considerate of inequality, even in order to progress on its formal mandate of price stability. Data for Pakistan shows that, the share of the top 10% in terms of income, stood at 43.3% in 2020, compared to 17% of the bottom 50% (Figure 2). In other words, top 10% of the richest people possess 12.53 times more income than the poorest 50% population combined[11].

Figure 2: Income share of top 10% and bottom 50% population (Pakistan, 2000-2021)



Source: World Inequality Data

The strong case for integrating inequality into monetary policy also comes from inequitable impacts of inflation. The literature on a new form of inequality, the **inflation inequality,** is growing. The term refers to the situation where *"differences in spending patterns across households and differences in price increases across goods and services lead to unequal levels of inflation for different households."* Take for example, the relative changes in components of Consumer Price Index (CPI) in Pakistan. The highest inflation is observed for food items, peaking to an all-time high of 23.70% in January 2020. This has been critical in creating further inequalities.

11. Estimated using online tool of World Inequality Database, available at: https://wid.world/country/pakistan/

Higher food inflation disturbs household expenditure patterns of low-income households significantly, as they spend a major share of their income on food. Poor households spend more than half (57%) of their income on food (Malik, et al., 2015). Rising food prices therefore result in a higher share of income going to food, leaving limited space for other necessary expenditures. Overall, high food prices significantly increase poverty in Pakistan (Haq, et al., 2008). Most importantly, the impact of an increase in food prices on Pakistan's poverty levels is substantially greater than the impact of an increase in energy price. Furthermore, the former affects rural population even harder (Chaudhry & Chaudhry , 2008).

Higher food prices also have other long-lasting severe side effects, which go almost unnoticed in Pakistan. Take example of household borrowing. Households may have to borrow to meet other needs, such as health spending and education of children. A recent study from the SDPI suggests that half of all poor households in Pakistan are in debt. Most importantly, about 80% of these households have defaulted on repaying their loans (Javed & Imran, 2021). Higher food inflation can increase borrowing on the one hand, while further weakening the capacity to repay debt.

On the other hand, income and economic inequalities further strengthen inflation inequality. A recent study from Jaravel (2017) on unequal gains from product innovation, suggests that innovations benefit the already wealthy and increase inflation inequality. The firms, adopting most innovative solutions, produce low cost products for rich segments of society.

Inequalities in income, skewed in favor of the rich, result in a relatively higher demand for products consumed by high-income households. Responding to the market, firms introduce products for rich households on priority. This leads to competition, which results in lower pricing. As a result, annual inflation in the United States of America, during 2003-2014, for households earning above $100,000 a year, was 0.65 percentage points lower compared to the households earning $30,000 a year or less. It distorts the income distribution further. The poor households face the highest burden of inflation and costs to control inflation simply because they are poor.

Finally, the activism of central banks to minimize the impacts of the COVID-19 pandemic, going beyond their formal agenda of controlling inflation, also prompted questions regarding the side effects of its actions. In response to the COVID-19 crisis, expansionary monetary policies, particularly during lockdowns, became the "the only game in town". Policy rates were immediately slashed. Quantitative easing was practiced as if there was no tomorrow. While these policy innovations helped navigate the country through the pandemic, they also had novel effects for the distribution of income and wealth, that were more noticeable than those of traditional interest rate policies.

6. Price stability is an unfinished agenda as SBP is busy chasing annual rolling inflation targets set by the government.

Pakistan's monetary policy objectives were first laid down by the SBP Act of 1956, which detailed the various roles and responsibilities of the SBP, in order to '*secure monetary stability and soundness of the financial systems*'[12]. On the basis of the 1956 Act, the SBP was given the mandate to achieve government set annual targets of inflation and growth. Since then, the Act has undergone several amendments: first in 1994, then 1997, 2012, 2015 and the most recent amendment proposed in 2021 this year[13].

As mentioned, the SBP has two overriding monetary policy objectives: stability of prices and growth. However, it has, by and large, been unsuccessful in achieving these, with prices continuing to rise and growth persistently dropping in the country. The economy remains extremely volatile, experiencing unstable macroeconomic conditions and frequent booms and busts. Nor has inflation been effectively contained, with Pakistan pushed into stagflation since 2005 and double-digit inflation prevailing (Shah, et al., 2018). This failure of the SBP, in achieving monetary and financial stability in the country, can be attributed to a number of things.

First, according to the SBP's Monetary Policy Framework, in order to maintain monetary stability, it is mandated to control '*inflation close to its annual and medium-term targets set by the government*' – which has proven a daunting task. Government stipulated inflation targets are provided annually and are generally based on recent price trends. However, these targets change frequently and erratically, often so by wide margins (Figure 3), making it challenging to anchor inflation expectations (Hussain & Rehman, 2020).

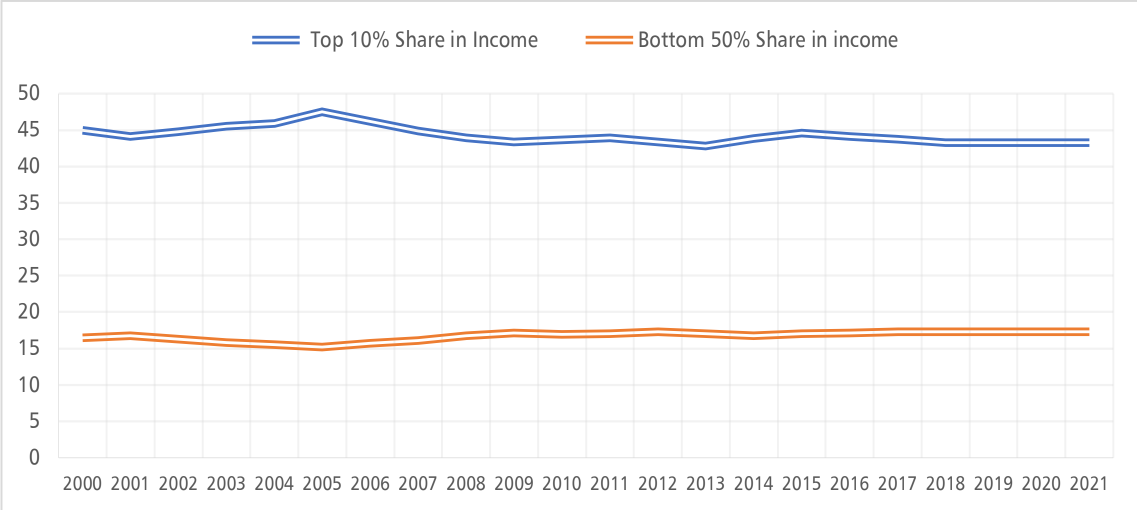
As a result, as the SBP busies itself with rolling inflation targets, it has over the years compromised on price stability, distorting the conduct of monetary policy and generating serious consequences for economic activity in the country. Moving towards the monetary policy framework of targeting inflation, as proposed in SBP Amendment Act 2021, can help overcome this problem.

12. For more details, refer to: The State Bank of Pakistan Act 1956, Available at: https://www.sbp.org.pk/about/sbpact/sbpact56/sbpact4.htm

13. While the IMF has released no official statement as to why it continues to ask for Pakistan's government to provide the SBP its independence – a pre-condition to the resumption of the IMF programme –two reasons may be speculated: 1) Central bank independence is considered a pillar of modern monetary policy, with central banks expected to be able to operate and fulfil their mandates independent from all political pressures, and 2) If history is any guide, Pakistan has a tendency not to undertake significant reforms without external pressure. The IMF, therefore, may be interested in getting the new SBP amendments passed while the country is still in its programme.

    There are, however, downsides to this approach by the IMF. The SBP amendment act2021 is already under heavy criticism as it was not widely published and discussed before sending to cabinet for approval. Any amendment passed in hasty manner, without a detailed discussion on it in the parliament, would hold less public credibility than that passed through regular democratic processes. Strong public credibility in the country's central bank is crucial for the effectiveness of monetary policy.

Figure 3: Government's Inflation Target and CPI Inflation



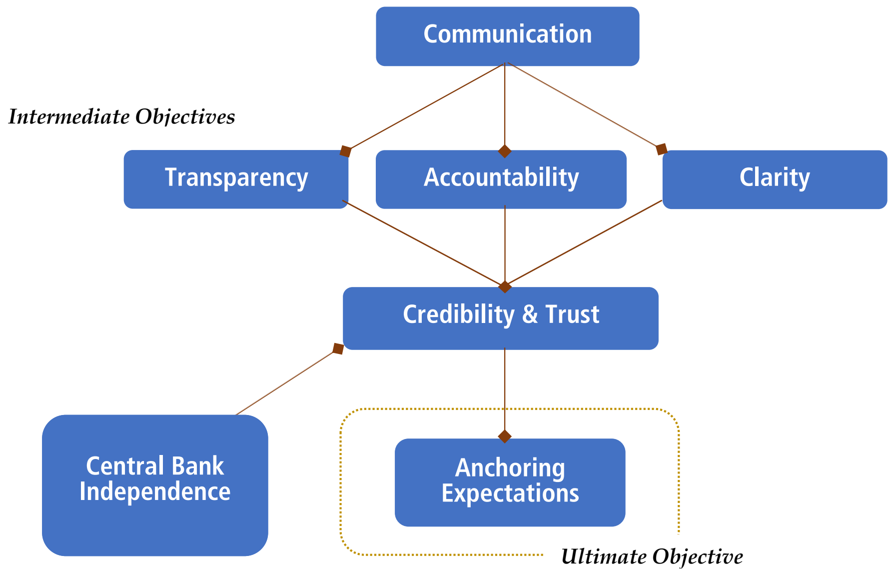
Source: (Hussain & Rehman, 2020).

This issue has been further complicated by the poor coordination between policy-making processes of fiscal and monetary policy. Contention between the two policies makes achieving the objectives of monetary policy that much more strenuous. For example, although there is ample evidence that fiscal policy shocks created through government spending, borrowing and revenue collection have repercussions for inflation, the country's budget-making process is conducted in isolation from its monetary needs. Persistent deficits and government borrowing, as well as overall poor fiscal discipline, has inhibited the independent formulation and execution of monetary policy in the country. Better coordination between the SBP and treasury can support monetary policy effectiveness (Shahid, et al., 2016).

Second, fiscal dominance over monetary policy has prevented the SBP from asserting its macro prudent policies. For example, Pakistan's longstanding policy of artificially overvaluing its exchange rate. Persistent exchange rate overvaluation not only erodes international competitiveness by increasing the cost of production, but is also associated with lower GDP per capita growth, investment and savings – hurting the economy (Javed, et al., 2016). In Pakistan, it has been the cause of a severe balance of payment crisis. In remedying this, greater autonomy in the managing and monitoring of its policies can help the SBP formulate more prudent exchange rate and overall monetary policies (Ibid).

Finally, the SBP has been unsuccessful in communicating its monetary policy stance to the general public effectively. Economies are far from being mechanistic, rather they function on the economic decisions and expectations of households and firms. As a result, the success of monetary policy is greatly contingent upon the ability of central banks to mould market expectations about the evolution of key monetary variables, so to reduce uncertainty faced by economic agents regarding their future decisions (Woodford, 2003). For the purpose of which, transparent and clear communication of central bank actions to the general public remain a strategic tool (Figure 4).

Figure 4: Communication Objectives of Central Banks



Source: (Kibadhi & Pinshi, 2020), with Author's elaborations

In the case of the SBP, it has not, till date, been able to effectively relay the country's macroeconomic outlook, nor explain its actions to a wider audience. This has left households, businesses and many members of the general public, unable to grasp or even accept economic measures undertaken, which thereby decreases the odds of policy success. Part of this undoubtedly stems from the fact that for the average citizen, monetary policy is far too technical and complex, and as a result is thought best to be left to the experts.

The SBP's failure to engage with different communities and economic groups has resulted in the common man not accounting for monetary policy decisions in their day-to-day financial and economic activities, and viewing them relevant only for matters of government, not their daily lives. However, the SBP's failure to effectively communicate with the public is also in part due to the lack of credibility it holds among the people of the country.

Unfortunately, all these factors have created a serious trust deficit between the SBP and the public. The SBP is largely seen as a figurative appendage to the International Monetary Fund (IMF), unable to make suitable and independent monetary decisions for the country. In many ways, the absence of original monetary thought in the country has in fact resulted in the delegation of monetary policy strategies to foreign financial institutions.

This, coupled with poor transparency, limited accountability and poor communication, has further fueled the narrative of the SBP conducting 'foreign agenda', resulting in greater public distrust and serving to further distance the public from SBP's decisions and policies. As a result of these factors, among others, the SBP has not been successful in fulfilling its mandate of price stability.

7. To keep in line with modern practices in central banking, SBP has much work to do on communication, research, decision-making and monetary policy implementation fronts

We clearly understand the constrains of directly including inequality and other social impacts of monetary policy into the decision-making processes and development of SBP's instruments accordingly. This will understandably take time. But this does not mean that the SBP does nothing and wait. There are opportunities that the SBP can build on, in the short run, and gradually move towards a monetary policy which incorporates social impacts in its framework, in the long run.

The SBP can immediately make a big contribution to developing an understanding of the dynamics of distributional inequalities in the country. It can assess how its policies affect income, consumption and wealth inequality in the country. With its impeccable access to data and research expertise, needed to deliver on their primary mandate, the SBP is exceptionally well placed to improve its understanding of these issues. It is also in a good position to advise on the design and scale of potential measures required to deliver societal goals along these dimensions. The SBP is mandated, under its wider goal of supporting economic policy, to ensure goals of price, financial, and macroeconomic stability.

First, it is crucial that the SBP lays out a research agenda, one which is both public, as well as formulated based on a 3 to 5-year strategic plan. This research agenda of the SBP and debates around it, should be guided by the achievable objectives of the SBP. It should also tackle questions such as, what can have a more equalizing effect; a booster to asset prices or a booster to housing prices, higher policy rate to maintain currencies stable or relatively lower rate promoting wage growth in labour market, and which of these are more effective in reducing consumption inequality compared to the other.

Second, the SBP could do more to ensure that it has communicated adequately with the public about side effects of monetary policy. Communication should, however, follow a clear theory of change. The public should be clearly and regularly briefed on why certain monetary decisions and actions are chosen and effective over others, as well as how selected monetary actions aim to deliver intended outcomes. Currently, monetary policy communications seem to be "outcome" based, limited to discussions of macroeconomic indicators, such as current account deficit, balance of payment, trade account and so on. The SBP needs to expand communications, to include the non-monetary impact of the policies adopted to achieve these outcomes.

The SBP should also clearly and regularly communicate to government the side effects of their policy choices, including impacts on income and wealth distribution. This would help the government align its policies to offset these adverse impacts. Together, all this can help the government, as a fiscal and regulatory authority, to minimize the dimensions on which monetary policy can have side effects. Overall, it enables public policy in the country to better deliver on social, environmental and economic development agenda. Specifically, the study recommends the following key actions and strategic policy directions:

i) It is imperative for the SBP to deliver on price stability

Historically, the SBP has not been successful in fulfilling its mandate of price stability. This, in part, has been due to the SBP occupying itself in delivering on ever changing inflation targets set by the government. As mentioned, the SBP considers controlling inflation in line with government stipulated targets as its mandate. This has been illustrated in its Monetary Policy Framework. However, achieving this has been easier said than done, and in the process of doing so, the SBP has greatly eroded the purchasing power of people.

Arguably, monetary policy in Pakistan was not designed to deliver on price stability and the purchasing power of the people. Moreover, targets provided by the government are difficult to follow, changing often and by wide margins, which makes anchoring inflation expectation a more difficult task. A working paper from the SBP shows that the target level of inflation was increased to 12% in 2012 from 5% in 2004. Even if the SBP were successful in delivering this target, doing so would be significantly eroded the purchasing power of the people.

The race to meet inflation targets has overtime led to volatile and unpredictable movements in the interest rates. Sudden shifts in monetary policy directions, from tight monetary policy to ease monetary policy and vice versa, has flooded the market with uncertainty. Most importantly, the formation of people's expectations has been distorted. Higher average levels of inflation have become a norm.

The SBP needs to now deliver on price stability to prevent the purchasing power of the people from being eroded (Javed, 2021a). However, given the socioeconomic structure of Pakistan: lower and volatile economic growth, high degree of informality, higher inequalities of income, consumption, wealth and employment, and fiscal policy importance, an Integrated Inflation targeting (IIT) regime should be employed, instead of a standard model of Inflation Targeting (IT) (Agénor & Pereira da Silva, 2019). Delivering on price stability, however, will require:

a) **Clear definition of price stability**: SBP Amendment Act 2021, does not provide a clear definition of price stability. In this regard, secondary legislation should be introduced to clearly identify the following:

   i. What does price stability exactly mean? A clear definition must be included in black and white.

   ii. What level of inflation target satisfies the above defined conditions of price stability? In this regard, inflation of 3% may be considered for Pakistan. A higher inflation target, such as 7%, 8% or 9%, as many of the estimates suggest, does not commensurate with the welfare aspect. It is likely to inflate inequalities, even if it supports economic growth. Further, these number were estimated using models calibrated for achieving "economic growth" without considering the distributional effects[14]. Interestingly, these targets, more or less, equal to the average long-term inflation of 8.12% during 1980-2019[15]. It will be meaningless to target such a higher level of inflation in the new regime. SBP, therefore should target a welfare enhancing inflation level. While it may think to start with targeting 5% inflation in the first three to five years, it should move towards targeting average inflation of 3% with deviations of -1 and +1[16]. This level of inflation targeting can:

14. A recent SBP working paper notes that "Regarding Pakistan, a simple data analysis suggests that inflation rate in the range of 5 to 7 percent appears to be beneficial for economic growth. Specifically, using annual data on inflation and economic growth from 1976 to 2016, we computed average growth rates against different bands of inflation. Maximum economic growth corresponds to the period when inflation remained in the band of 5 to 7 percent" ((Hussain & Rehman, 2020).

15. Calculated based on annual average inflation data provided by online portal World development indicators

16. The argument that average inflation in Pakistan ranges between 7-9% so how can SBP target 3% inflation and if it does it will have to raise interest rate to extremely high level are misplaced. Currently, inflation expectations are formed around higher average inflation, as people know there is no specific target. This leads to higher average inflation. SBP, then, starts chasing higher inflation with a higher interest rate. In Inflation target regime, with a stable and lower medium term inflation target, people revise their expectations towards a lower average inflation. Most importantly, central banks operate through credibility more than through the interest rate, and anchor lower inflation expectations.

a. Improve purchasing power of the people, particularly of the poor working in elementary sector, which have a lower nominal wage growth[17].

b. Substantially reduce the income and consumption inequality imposed by higher inflation. At least, it will not deteriorate inequality.

c. Help reduce poverty through greater job opportunities, increased income and purchasing power on account of higher economic growth and lower inflation.

d. Minimize adverse effects of monetary policy that arise from a very volatile change in policy rate. Why would a central bank raise the interest rate when prices are stable?

e. Improves real wage growth through lower inflation in the short run, and productivity growth in the medium to long run. Lower and stable inflation clears the uncertainty present in the market, helping facilitate investment decisions which lead to enhanced economic activity and productivity growth.

iii. Which inflation indicator will be targeted: core inflation or headline inflation? The indicator(s) of core inflation, which increases the command and control of the SBP, should be selected. Is it going to be non-food, non-energy or the average core inflation? This is also necessary to do away with the "inflation was supply side" mantra and improve the SBP's accountability mechanisms. In this regard, targeting core inflation may help. The secondary legislation should, however, clearly indicate which indicator of core inflation will be targeted.

b) Quantifiable monetary policy targets: Targets under each objective of the SBP need to be directly quantifiable and penned down in black and white. Take for example, the tertiary target of *"Support[ing] Government's economic policies to foster development and fuller utilization of resources,"* as proposed in the SBP Amendment Act 2021. This is absolutely vague. It should be replaced with a clear target, such as "maximum and sustainable employment," like Reserve Bank of New Zealand (RBNZ) has done. This is important for at least three reasons:

i. First, sustainable and maximum employment reduces inequalities of income.

ii. Second, it can guide the SBP to consider a policy mix which has favorable side effects.

iii. Third, it is directly quantifiable, hence provides a stronger base for accountability.

c) Strong internal (within the SBP) and external (parliamentary) accountability mechanisms: Once the inflation target, with well-defined specifications is agreed upon, there must be a clear accountability system put in place. The SBP Amendment Act 2021, appears to be inconsistent in this regard. It asks for exemplary independence, with almost no accountability. The two cannot go together, for at least two reasons: First, monetary policy has serious bearings on social and economic indicators, as well as for the lives of people, therefore cannot be left unchecked. Second, even if full independence is given to the SBP, monetary policy has to deliver its mandate and needs to be held accountable if it does not. There should be, therefore, secondary legislation introduced, to put accountability mechanisms in place, which address the following questions:

i. What will be process of accountability?

ii. Who will be responsible for any deviations?

iii. What will be the penalties against unexplained deviations from the target?

17. Average real wage mask up unequal distribution of wages across occupations, gender, region and education. Wage inequality, measured by the Gini index, has increased by 6 percentage points, from 35% in 1991 to 41% in 2018. Between the same period, the share of the top 1%, 5% and 10% of workers has increased by 167%, 53% and 33%, respectively (Burki, et al., 2020). Furthermore, a worker employed in elementary occupations earned in a month, 40.93% of the corresponding earnings of a professional individual and managers in 1990-91. Owing to slow growth in nominal wages, the same worker earned only 21.23% of the earnings of professionals and mangers in 2006-07. See Irfan (2008) for details.

ii) The SBP should improve communications and invest in its communication capacity

Effective communication will decide the fate of SBP's inflation targeting regime. Currently, as mentioned, inflation expectations in Pakistan are aligned with higher average inflation. Targeting a lower inflation rate, such as 3-5%, will require breaking "high inflation expectations". This is not possible without effective and efficient communication. The SBP cannot achieve such a low level of inflation through conventional approach of tightening monetary policy and jacking up the interest rate. Communication, therefore, must take priority, even over the interest rate instrument when moving towards an inflation targeting regime.

Although there exists no fixed rule for what is considered the *optimal* strategy of communication for central banks, nevertheless, in the context of the challenges faced by the SBP (highlighted in the previous section), the following guidelines may be employed to refine the SBP's communication policies and raise its odds of anchoring expectations:

i. First, the SBP should have a clear communication strategy in place for all communications, from Monetary Policy Statements to communications of SBP staff, management and members of different forums. These should include:

    a. The format and frequency of each communication type.

    b. The mention of the office responsible for the communication

    c. The maximum and minimum time taken to circulate the decisions of different forums.

ii. The format of communication should be standard and consistent over the time, though allowing for any modification which can help improve communications. Take for example, the monetary policy statement. It cannot be left to random changes in content and size. There ought to be a clear format for it, which should be followed in letter and spirit. Keeping in line with modern central banking practices, MPS may have the following key sections:

    a. The facts (inflation during the period; other relevant indicators)

    b. The deviation from the target and major reasons for such deviations

    c. The impacts of deviations on economy and day to day life of the people. The latter is an integral part of central banking which is considerate of its social footprint.

    d. How the SBP plans to minimize these deviations and adverse impacts on economy and general. It needs to provide a brief road map for the exact steps needed to achieve this.

    e. Decisions of MPC meetings, as well as the rationale behind all decisions.

iii. In line with international practices of renowned central banks, the SBP may choose to raise transparency in its decisions, by also issuing the voting history of each member of the MPC. There needs to be a clear record available to the public, as to which member voted for or against the decisions. This is now a standard practice not only in developed countries, but also in many developing ones too. The Reserve Bank of India for instance, provides voting history. Doing so can help at least on four fronts:

    a. Encouraging more responsible decision-making.

    b. Promoting transparency in central banking.

    c. Can aid in increasing accountability of MPC members

    d. Can aid in fixing the responsibility of deviations from targets.

iv. Communication needs to go beyond policy rate decisions. The people need to know how decisions to buy and sell government bonds, corporate bond purchase and asset purchase are made and who made these decisions. The Bank of England (BOE) for example, provides all this information, as well as the voting history on all these decisions. The SBP may build an online excel sheet-based repository, which is available online to the public, as the BOE does[18]. The SBP should provide a note on the possible implications for the economy and public at large.

v. The language should be as though the SBP is speaking to the public at large; non-technical language, talking in terms of issues that concern the general public. This will require communication coming out of the SBP to address the economic and social concerns of the common man, and how these are impacted by monetary policy decisions. To begin with, the SBP can add one paragraph of a non-technical summary, which communicates the impact and incidence of SBP's policies and actions. The use of easy-to-understand vocabulary and visuals, to help people be aware of why its policies can and do matter to the wider public (ECB, 2021), can help simplify complex monetary matters to the public at large.

vi. In addition to improving the content of their communication, the SBP has much to gain from adapting to the digital age by exploring non-traditional channels of communication to reach new audiences. For instance, the central bank of Indonesia, Bank Indonesia (BI), boosts a strong social media presence and a large following – BI has more twitter followers than most central banks, even those of the Federal Reserve and Bank of England. BI's decision to pursue social media as a dominant form of communication arose from its need to attract its rapidly growing millennial and Gen Z population. It is good see a more active SBP's twitter handle. But it needs to go beyond just routine announcements of dollar rupee rate, foreign reserve updates, and remittances inflows highlights. It ought to be used to engage the general public, in order to create monetary policy and financial market awareness.

vii. In addition to regular updates on monetary decisions and the macroeconomic outlook, BI makes use of prize giveaways and jovial music videos to educate citizens about different monetary concepts and issues (Salna & Ellis, 2018). SBP too can take a similar course of action, creating engaging and edgy content, which has a high chance of going viral and being widely shared, in order to reach a wider audience.

viii. SBP needs to also publish its detailed criteria and reasons for selecting and nominating members for different decision-making boards. This should be accompanied by a complete profile of members, both external and from the SBP. Doing this will help transparency of decision-making forums. Additionally, it will promote a more merit-based selection of members.

iii) The SBP needs to expand its research agenda

This will require the SBP to shift towards actionable research on issues of public policy and their inter-relation with monetary policy. There is a need to design an agenda for research on social implications of monetary policy, which will result in the creation of evidence with a political economy lens for effective and evidence-based design of future monetary policies and similar discussions. Going beyond its limited focus, the SBP needs to expand its research agenda to explore how its undertaken decisions and actions can generate good and bad side effects and what policy mix is required to achieve favorable side effects (Javed, 2021b). This will in turn require:

i. A more inclusive research agenda: the SBP should set its research agenda to cater to issues of public policy, in relation to monetary policy. While technical research is particularly important, SBP needs to expand agenda for a more actionable research particularly on how monetary policy can generate favorable side effects for broader socioeconomic development of the country.

18. For more details on the Bank of England's historical MPC Voting, please visit: https://www.bankofengland.co.uk/

ii. *More participatory research collaboration:* presently, collaborative research with stakeholders from academia, policy think tanks and the private sector, is almost entirely missing when it comes to the SBP. One of the key reasons for this, may be a difference in operational priorities, which has led to a mismatch in research priorities. The SBP needs to greater engage stakeholders from these sectors for the purpose of collaborative research

iii. *Building collaboration:* Actionable research on issues of public policy will necessitate setting the research agenda and undertaking the research through joint collaborations with both the academic and civil society. This also includes cross departmental research collaborations within the SBP. The SBP's core research group can and should work very closely with other research groups.

iv. *Upgrading the database:* SBP needs to accordingly upgrade and diversify its data collection and reporting strategy. Data on the labour market and other sectors, which can help debunk the differentiated impact, must be collected and reported. Most importantly, the SBP needs a serious rethinking on its data policy when it comes to data sharing with the public.

v. *Wider dissemination of research:* Research undertaken by the SBP, by its very scope and nature, has been limited in its usability and dissemination. Interestingly, no monetary policy conference is held in Pakistan. The SBP should ensure a wider dissemination of its research through public seminars, webinars and conferences. It can engage with academia, policy think tanks and the private sector in this regard to benefit from comparative advantage of these partners. For example, think tanks are specialized in converting technical outputs into a non-technical language and taking the key messages to the policy makers and the common man. In this regard, the SBP may consider:

   a. Conducting an annual Monetary Policy Conference in Pakistan, in addition to regional seminars.

   b. Clear divisions of labour for SBP's initiatives to promote research and awareness on central banking and monetary policy. For example, faculty on SBP's Chairs should be mandated to produce research, through papers and theses, on cross cutting issues such as poverty, inequality in relation to central banking and monetary policy[19]. Most importantly, the research needs to go beyond technical modelling and should come with actionable policies recommendations.

   c. SBP fellowships in policy think tanks to promote research and literacy of monetary policy in Pakistan.

iv) The SBP should enhance its interaction with civil society, think tanks, and academia

SBP is considered to be the least engaging public office in Pakistan and tends to set its research agenda in isolation from the public at large, as well as from issues of public policy. This perception needs to go, which will require strong engagement and communication with the public, civil society and academic. This will, in turn, help to inform monetary policy of issues faced by the public, as well as devise possible policy solutions for them. Even if the SBP is reluctant at initial stages, development partners should collaborate with academia and think tanks on initiatives. The SBP can engage with policy think tanks to establish:

SBP Chairs and Fellowships for collaborative research and dissemination

i. SBP internship programs for students, with key focus on training students for actionable research
ii. SBP Central Banking and Monetary Policy Dialogues
iii. Memorial lectures

19. A more detailed set of proposal on SBP chairs and other initiatives is provided in following set of recommendations.

iv. Joint research agenda

v. Orientation workshops for academia, civil society and journalist covering economy.

vi. Public Private dialogues, for instance, through the National Network for Economic Think Tanks (NNETT)[20].

There are many examples available in this regard. The Bank of England for instance, has launched a wide range of outreach initiatives aimed at generating constructive dialogue with the public, such as public forums, panels and town halls etc. The Bank's citizen's panels, which took place from late 2018 to July 2021, gave the public a platform to shed light on their day-to-day experiences with the economy. It also gave the Bank the opportunity to improve their economy-related information and decisions.

Such panels "*play an important part in the Bank of England's engagement with the public. These human stories complement and inform the Bank's economic analysis, intelligence gathering by the Agents, and the policymaking process*," and have been on the whole helpful in aiding the Bank *'to reach beyond the economic data and media headlines to refine (its) understanding of the economic landscape."*

In fact, one of the overarching concerns of the public that was uncovered through these panels, was how policies impacted inequality. Panelists expressed concerns that the Bank of England's policies were benefiting those who were already well-off (Bank of England, 2020).

v) Decision-making in the SBP needs to be more participatory and gender balanced

Greater diversity is needed in the composition of the decisions making forums of SBP, including Monetary Policy Committee (MPC). For instance, without horizontal linkages to other social sectors, the SBP's conduct of monetary policy will remain confined to the framework of pure economic policy. This can be remedied by appointing at least one member of the MPC from the development or social sector. The SBP should therefore augment the number of members on the Committee. Additionally, instead of the proposed two terms for MPC members in SBP's Amendment Act 2021, the appointment should be once, with no renewals (Javed, 2021a).

Furthermore, there needs to be greater representation in the SBP from vulnerable and disadvantaged communities and areas, for instance, appointing members from economically weaker provinces such as Balochistan. Similarly, this would include greater gender representation on the MPC. There is currently a vast gender imbalance at the SBP's governance structure (Table 2). Since 2019, there have been no women on the MPC. An almost similar situation is seen for other decision-making forums of the SBP, such as the central board of directors.

20. NNETT is platform for think tanks working on economic issues in Pakistan. The forum is "the part of an interactive and structured Public-Private Dialogue (PPD) model being used by CIPE-SDPI to reform economic issues through positive debate. In order to ensure sustainability of the PPD model, this year SDPI is also forming a stakeholders' network comprising think-tanks, business associations, academia, independent economists, and researchers." For details, visit the web page https://sdpi.org/national-network-of-economic-think-tanks/project_detail

Table 2 A: MPC Composition, SBP.

2011	2012	2013	2014	2015
Advisory Committee on MPC 9 members 9 men No women	Advisory Committee on MPC 9 members 9 men No women	Advisory Committee on MPC 9 members 9 men No women	Advisory Committee on MPC 9 members 9 men No women	Advisory Committee on MPC 9 members 9 men No women
2016	**2017**	**2018**	**2019**	**2020**
MPC 10 members 9 men One woman	MPC 10 members 9 men One woman	MPC 10 members 9 men One woman	MPC 10 members 10 men NO woman	MPC 10 members 10 men NO woman
2021				
MPC 9 members 8 men One woman				

Table 2 B: SBP Central Board of Directors

2001	2002	2003	2004	2005	2006	2007
9 members 9 men No women	9 members 9 men No women	6 members 6 men No women	8 members 8 men No women	9 members 9 men No women	9 members 8 men One woman	9 members 8 men One woman
2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
9 members 8 men One woman	9 members 9 men No women	9 members 9 men No women	6 members 6 men No women	5 members 5 men No women	10 members 10 men No women	10 members 10 men No women
2015	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
8 members 8 men No women	10 members 10 men No women	9 members 9 men No women	9 members 9 men No women	7 members 7 men No women	9 members 9 men No women	9 members 9 men No women

***Source**: Authors elaboration based on review of documents*

vi) The SBP can make use of its existing infrastructure and organisation structure

In helping the SBP conducting its functions, it holds a number of subsidiaries and field offices, with varying objectives, roles and responsibilities. These include[21]: 1) the Banking Services Corporation (SBP-BSC), which consists of 16 field offices across the country, responsible for currency and credit management, 2) the National Institute of Banking and Finance (NIBAF), which provides training to both new hires and existing employees, and 3) the Deposit Protection Corporation (DPC), given the task of protecting deposits of member financial institutions in the country. The SBP's existing infrastructure and organisation structure can be recalibrated and geared towards greater sensitivity to social considerations, in a number of ways:
Rethinking the role and the purpose of the SBP's Memorial Chairs in Economics

21. For more details on the organisational structure of the SBP, please visit: https://www.sbp.org.pk/

The SBP establishes memorial chairs in universities to promote research on monetary policy. As SBP states22 "As a part of its endeavor to enhance the standard of teaching and research in economics, especially in the fields of monetary policy, exchange rate management, capital flows, financial sector stability, and economic growth, SBP has established Chairs in the honour of its former Governors in various public sector universities."

Currently SBP chairs seems to have two important concerns. First, they are mainly limited to teaching, with a lesser focus on research. Second, in addition to a limited focus on research, the nature of research undertaken by SBP chairs is more or less a duplication of research produced by the research department of the SBP. Both have limited scope and ignore research on impact and incidence of monetary policy actions on day to day life of the people.

One of the key reasons for this duplication may be due to setting-up all chairs thus far exclusively in universities, where their role remains limited to teaching. Instead, it may be of far greater benefit to the SBP to establish more chairs among think-tanks (for instance, in SDPI) and the civil society at large. These chairs can be used to promote assessment of impacts of monetary policy on social outcomes such as inequality, poverty and labour market. It can supplement the research of SBP staff.

Doing so will aid in expanding the SBP's research agenda, by inspiring more creative, innovative and thought-provoking research and encouraging an exploration of monetary policy's social footprint in Pakistan. Additionally, the policy think tanks may be asked to mainly focus on social footprint of monetary policy. The SBP may consider establishing these chairs in different disciplines of social sciences, instead of exclusively focus on economics. This diversity can help promote debate and research on social dimensions of monetary policy.

Most importantly, the SBP needs to have clear measurable ToRs for the memorial chairs. The assessment should be based on impact (policy contribution, innovative thinking) in addition to outcome (papers, articles). Engaging with public at large, speaking at public forums should be mandatory for the faculty on these chairs. There can be annual meetings for the faculties and universities that have SBP memorial chairs. The progress should be assessed each year of tenure against well-defined agreed indicators.

a) *Revamping the role, content and agenda of NIBAF*.

While NIBAF has been crucial for the professional development and training of SBP employees, there remains much room for improvement. For example, NIBAF's existing curriculum fails to add value to the learning and capacity building of employees and is rather a revision of academic courses and information employees previous taught. Instead, NIBAF can and should be graduated towards becoming an institution which provides opportunities for diversity in thinking about central banking and monetary policy; instills a foundational understanding and appreciation of social impacts of monetary policy in all employees, thereby ensuring an inherent rewiring of the SBP's functioning in this regard. For example, training courses can be used to improve the knowledge of employees on:

i. How central banking and monetary policy's frontier and role is changing over the time?
ii. How monetary policy impacts the lives of all individuals, banked or unbanked,
iii. How and which winners and loser are created with the conduct of monetary policy,

Going beyond its SBP-only mandate, NIBAF can be scaled up and graduated to a center of excellence promoting management and leadership skills in the banking sector. It should function as an autonomous apex institute of the SBP. A greater focus on e-learning will also be required. National Institute of Bank Management of the Reserve Bank of India[23] may present a good model.

22. For more details on SBP Memorial Chairs in Economics, please visit: https://www.sbp.org.pk/Careers/2008/SBP-Memoria-Chairs.pdf

23. For more details on The RBI's National Institute of Bank Management, please visit: https://www.nibmindia.org/#

c) Transforming local and regional SBP-BSC offices into mini SBPs. Presently, the 16 offices located across the country remain occupied solely with the management of cash and credit, which is a waste of both potential and resources. Instead, these offices represent untapped potential for the SBP, which can be unlocked by expanding the activities and objectives of these branches. For example, field offices can be streamlined to include research and advisory facilities and services.

Each branch can develop a comprehensive research agenda, specific to their region, which may be geared towards: better understanding the impact of monetary policies in their region, conducting research into local socio-economic, financial and monetary concerns, engaging with local communities and businesses, and communicating the SBP's role in enhancing public welfare to them etc. Likewise, social responsibility, financial inclusion or climate and sustainability units (among others) can be built into these branches (Durrani, et al., 2020).

vii) It is necessary for the SBP to address its public trust deficit

Maintaining the trust of the people is an enormous responsibility of any central bank, crucial to preserving its legitimacy and credibility as a country's chief monetary authority. Unfortunately for the SBP, however, this has not been an easy task. The SBP lacks popular support for its policies and decisions, which as mentioned, are often seen as 'foreign agenda.' If it wishes to boost the public's trust of its policies, the SBP should:

i. Reframe the narrative by allowing policies to stand on their merits. This will necessitate: improving the public's knowledge of monetary policy decisions and the role of the SBP. And engaging with experts, commentators and the civil society, to spark thought-provoking and constructive debates on the virtues of the selected monetary policy decisions – compelling people to evaluate polices on their potential contribution and outcomes, not *whom they were suggested by*.

ii. The SBP should operate at arm's length from all political processes - keeping politics out of monetary policy decisions.

iii. Most citizens have little faith in the SBP's desire and ability to protect their interests and hold itself accountable. In remedying this, the SBP should enhance transparency on decisions and use of instruments, as well as ensure greater accountability, which will require (Javed, 2021a):

    - A more balanced Board of Directors (BoD) structure, one which represents the interests of the SBP, the GOP, the non-banking sector and the people of Pakistan equally.
    - A more transparent BoD and Monetary Policy Committee (MPC) selection process, with appointments open to scrutiny. Selections should also remain non-renewable, as second-term appointments are seen to create moral dilemmas.
    - Statutory requirements for reporting the disclosure of decisions, MPC minutes, individual voting records, quarterly inflation reports and appearances before parliament committees.
    - More transparent audits, which allow the SBP to review external audits.

viii) There is need for the SBP to prioritize digitization and financial inclusion

According to the Global Future Council on the New Agenda for Fiscal and Monetary Policy, "while current monetary policy tools might be effective at maintaining liquidity, they might not encourage the structural transformation towards fairer, more equitable and sustainable economies." This is particularly true for economies which experience a high level of financial exclusion, informality and low social spending, where the distributional impacts generated by the conduct of monetary policy are seen to create long-term structural inequalities in access to education, health and skill development (Javed, 2021b).

Pakistan is characterised by low financial inclusion, with a large proportion of the population currently being underserved by the country's the financial system. In fact, over 100 million individuals, out the country's 220 million population, remain unbanked (Demirgüç-Kunt, et al., 2017), particularly women, who are 3 times less likely to have access to financial services than men (World Bank, 2021). The SBP's role as regulatory agency in this regard has been flawed.

SBP should ensure transitions towards mass scale digital payments. Digital payments can help not only to reduce the cost of transaction and enhance the documentation of the economy, but can also reduce the adverse side effects of monetary policy in multiple dimensions which include:

i. **Enhancing Financial Inclusion:** Monetary policy transmission largely depends upon the financial inclusion of the population. Digital inclusion can increase financial inclusion, thereby increasing the effectiveness of monetary policy. Furthermore, poor households generally keep their savings at their houses. These households do not benefit from any increase from monetary policy decisions. In contrast, the rich households make money out of an increase in policy rate as they hold bonds and save money in banks and other financial institutions. This adversely affects income inequality. Digitalization, through promoting financial inclusion for the poor, can reduce this differentiated impact.

ii. **Reducing cash in circulation within the economy:** Cash in circulation is the primary transmission channel of differentiated impact of monetary policy actions, such as growth in money supply, policy rate hikes. Cash in circulation in Pakistan, constitutes 42% of currency in circulation. This is one of the highest ratios in world (Table 3). Cash is major monetary asset of poor households. Rich has less share of cash at hold bonds and make transactions through credit cards.

A mass scale system of digital payments acceptable across the country can reduce inflation inequality. In Pakistan, the poor hold cash as monetary assets and spend around 57%[24] of their income on food products. Mass scale digitalization can significantly cut down cash holdings, reducing the exposure to risks associated with share of cash in portfolio, such as inflation inequality.

Table 3: Currency in circulation as ratio to broad money

	Currency in Circulation			Broad Money			Currency in circulation/Broad Money		
	May 2021	June 2021	Jul 2021	May 2021	June 2021	Jul 2021	May 2021	June 2021	Jul 2021
Pakistan (Million PKR)	7,366,894	7,278,860	7,665,403	22,616,859	24,284,095	23,880,548	32.57%	29.97%	32.09%
Bangladesh (Million Taka)	2,012,077	2,095,177	2,270,429	15,262,754	15,608,953	15,780,460	13.18%	13.42%	14.38%
Sri Lanka (Million Rs)	711,870	692,032	722,925	9,016,772	9,136,220	9,269,581	07.89%	07.57%	07.79%
USA (Million USD)	2,169,500	2,179,000	2186300	20,284,600	20,460,300	20,596,900	10.69%	10.64%	10.61
Canada (Million CAD)	108,163	109,481	110469	2,224,533	2,240,811	2,265,219	04.86%	04.88%	04.87

***Source**: SBP Data*

24. Malik, et al., 2015

iii. **Documentation of economy:** One of the key reasons behind these cash holdings, is the high level of informality in Pakistan's economy. Businesses and SMEs, particularly those working in informal sector, have extremely limited access to finance. Further, for fear of being taxed and forcefully formalization, they avoid any documentation drives. This pushes them to keep larger amounts of cash to ensure liquidity. Mass scale digitalization, without forced formalization of these businesses and SMEs, can significantly reduce payment and receipts in cash, which in turn, reduces the differentiated impact of monetary policy.

Reducing the reluctancy of businesses and SMEs in being documented, would require the cooperation of all revenue authorities in the country, for example the Federal Board of Revenue (FBR), the National Database & Registration Authority (NADRA), as well as the SBP (Ahmed & Qadir, 2018). Documentation of the overall economy may also be further improved by: moving towards a more comprehensive value added tax, the integration of all revenue authorities in the country, and the use of one single tax return, collected by one single collection entity etc., (Ibid).

8. Conclusion:

The paper broadly concludes that welfare of the people could be improved if central banks take the side effects of its policies and action into account when conducting monetary policy. It argues that monetary policy interventions, under different circumstances, affect the poor and the rich differently – which should be accounted for. The SBP can effectively advance the social welfare of citizens by paying attention to the social consequences of its policies and decisions, which are undertaken to achieve its formal mandate of price stability.

In order to deliver on ***monetary policy for all***, the SBP needs to undertake serious reforms to its agenda, which mainly include;

i. delivering on price stability instead of chasing moving inflation targets. This is because, while the latter erodes the purchasing power of people, the former will promote the welfare of the public at large. For this, given Pakistan's structure, an Integrated Inflation targeting (IIT) regime should be employed, instead of a standard model of Inflation Targeting (IT).

ii. Balancing greater autonomy with greater accountability, transparency and oversight***.*** Accountability of the SBP can be ensured by setting clear inflation and financial stability targets, as well as through legislation separating and clearly defining the regulatory power of the SBP and government, without any external influences.

iii. taking the public into confidence, by clearly and transparently communicating to them the policy decisions undertaken, along with their possible side effects and associated impacts on the different segments of society, particularly on the poor. This needs to be carried out in an easy to understand manner and language. It should convey the impact of its actions to the general public by adding one paragraph of a non-technical summary, which communicates the impact and incidence of SBP's policies and actions.

iv. Undertaking and supporting actionable research agenda on broad based interactions of monetary policy with issues of the country, including, but not limited to, inequality, poverty and social exclusion etc. Research agenda on the whole, needs to be inclusive, participatory and widely disseminated.

v. taking steps to integrate monetary policy into the broader development agenda and discourse of the country, while delivering on its formal mandate of price stability.

vi. Enhancing SBP interactions with civil society, think tanks, and academia to expand the central banking and monetary policy audience. Similarly, raising public literacy on the subject, through joint research programs, wider dissemination of research and public forums with different segments of society.

vii. developing and implementing a policy mix that results in more favorable side effects of the central banking and monetary policy, while minimizing the adverse side effects on the poor and marginalized segments of society.

viii. better coordination between policy-making processes of fiscal and monetary policy, e.g. the SBP and treasury.

In addition to these reforms, the SBP should also do more to ensure it has a more inclusive decision-making process, particularly by appointing more members from the development or social sector, vulnerable and disadvantaged communities, as well as more women. Moreover, the SBP can utilize its existing infrastructure and organisation structure to gear itself towards greater sensitivity to social considerations. This would include: revamping the role, content and agenda of NIBAF, streamlining local and regional SBP-BSC offices into mini SBPs, to move beyond simple cash and credit management, and towards including research and advisory facilities and services etc.

The SBP would also greatly benefit from addressing its public trust deficit, by improving the public's knowledge of monetary policy decisions and the role of the SBP, so that SBP policies are able to stand on their own merits, and by keeping politics out of monetary policy decisions. Increasing transparency in its administrative and operational functions will so aid in this. This can be done by issuing the voting history of each member of the MPC, and by publishing its detailed criteria and reasons for selecting and nominating members for different decision-making boards etc.

Furthermore, the SBP ought to adopt non-traditional channels of communication, and create engaging and edgy content, which has a high chance of going viral and being widely shared, in order to reach a wider audience. It should also prioritise the introduction and use of mass scale systems of digital payments. It should improve documentation of the overall economy, in order to enhance financial inclusion and reduce cash in circulation – both of which will greatly contribute to reducing the differentiated impact of monetary policy.

Academia, civil society and other development partners can help the SBP make the transition towards a socially considerate central banking and monetary policy. They can do this by expanding both public and expert thought on monetary policy, and producing actionable research on the different dimensions of monetary policy's social footprint. Academia in general, and SBP's memorial chair in economics established in universities in particular, provide a brilliant resource for supplementing the SBP's research.

Similarly, policy think tanks can contribute to reducing the gap between the SBP and the public at large, by aiding it to convey otherwise technical and complex issues into layman's terms. They can also become the medium through which the SBP and the public communicate with one another: taking voices of the public to SBP and communication from SBP back to the public at large. In this regard, the SBP, as well as other development partners, can facilitate collaborations and initiatives for capacity building, to promote independent and broad-based inquiries into central banking and monetary policy in the country, with particular focus on social footprint of monetary policy.

Overall, Pakistan needs a central bank and monetary policy which, while delivering its formal mandate of price stability, is considerate of the pressing challenges faced by the country today – extreme poverty, widespread joblessness, precarious employment and burgeoning inequality. This drive to include the social considerations of macroeconomic policies and to minimize the adverse side-effects of monetary policy on the poor and marginalized, can help the SBP to contribute to the welfare of its ultimate stakeholder: the common man.

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About the author

Dr. Sajid Amin Javed is macroeconomist with focus on social content in macroeconomic policies. With a clear focus on drawing lessons to reform public policy, he research and write about how design and conduct of macroeconomic policies shape and influence socioeconomic outcomes. Particularly, he studies implications of fiscal and monetary policies for structural inequalities and vice versa. Currently, Dr. Sajid is Research Fellow and Founding head of Policy Solutions Lab at Sustainable Development Policy Institute (SDPI) Pakistan. Before joining SPDI, he was Senior Research Fellow & Assistant Professor at Pakistan Institute of Development Economics (PIDE).

Dr. Sajid has been consultant to United Nations Economic and Social Commission for Asia & the Pacific (UNESCAP), Asian Development Bank (ADB), United Nations Development Programme (UNDP), Department for International Development (DFID), United Nations Population Fund (UNFPA), Islamic Development Bank (IDB), Jeddah, Saudi Arabia, and Overseas Development Institute (ODI), UK.

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Pakistan Office
1st Floor, 66-W, Junaid Plaza, Jinnah Avenue,
Blue Area, P.O Box 1289, Islamabad, Pakistan

Responsible:
Dr. Jochen Hippler | Country Director
Abdullah Dayo | Programme Coordinator

Phone: +92 51 2803391-4
Fax: +92 51 2803395
Website: http://pakistan.fes.de
Facebook: Friedrich-Ebert-Stiftung, Pakistan
Twitter: @FES_PAK

To order publication:
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