ELITE QUALITY INDEX
EQx2022

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ELITE QUALITY REPORT 2022

Inflation control needs responsible and inclusive elites

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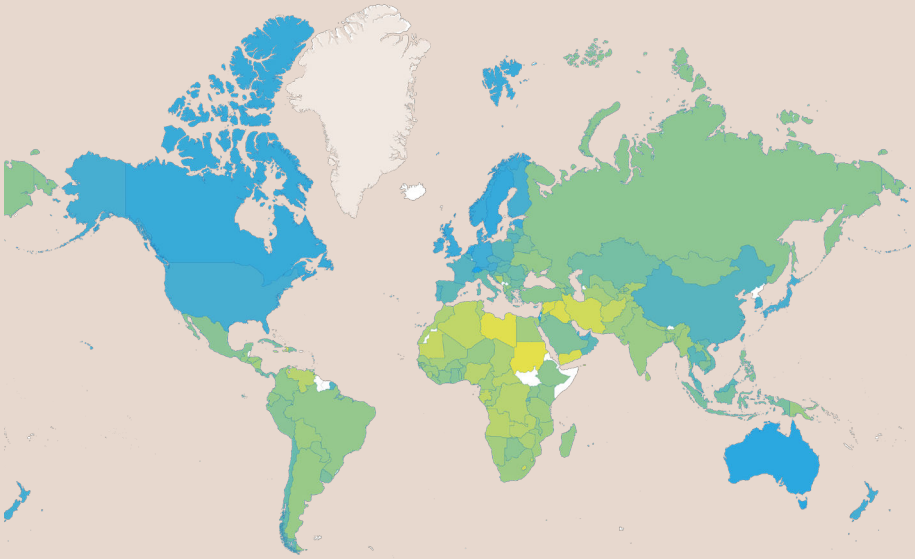

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1.3 Inflation control needs responsible and inclusive elites

When governments force central banks to pursue overly expansionary monetary policies, inflation will take off. A notable example of this has happened in Turkey, where the president has fired three central bankers in the last two years because they saw the need to apply conventional economics; to increase interest rates to tame inflation and stop capital flight. As a result, the Turkish lira depreciated by more than 40% in just twelve months, while consumer and producer price inflation had reached 61% and 115% respectively by March 2022. The EQx *Inflation* Indicator (DOI, iv.11) identifies countries suffering similar hyperinflationary fates.

The EQx2022 shows a positive correlation between lower inflation and a lower *Government debt to GDP ratio* (DBT, iii.9). Low debt levels are the best deterrent to overly expansionary central bank policies: when debt is high, any increase in the interest rate translates into higher government costs. Hence, governments pressure their central banks for monetary expansion, which then leads to inflation. A prominent example of this is the US, which pursued a dangerous mix of ultra-expansionary fiscal and monetary policy in 2021. Moreover, due to excess demand fueled by a 2021 fiscal deficit of 12.4% of GDP, the US government has lit the fuse for an inflationary time bomb to explode in 2022.

Fiscal discipline helps control inflation, as evidenced by the negative correlation between *Inflation* control (DOI, iv. 11) and tax moderation (DTR, iii.8). This means that inflation is under better control in countries that finance their extra spending through taxation rather than through increasing their deficit. If a political elite wants to subsidize the poor and troubled small firms, they should tax the rich rather than future generations.

For a successful example, see China, whose small 3.1% fiscal deficit has set the basis for a much lower vulnerability to inflationary pressures.

Moreover, despite terrible social and economic conditions, even some of the poorest countries, such as Afghanistan, have not yet fallen into the inflationary trap (DOI, iv.11, rank # 1). We consider countries with inflation rates between 0.5% and 2.5% as being in the optimal inflation range and hence all of these countries (39 out of a total of 151) are assigned rank # 1.

In advanced countries, such as Switzerland (DOI, iv.11, also in the optimal range and thus rank # 1), we find that several factors guarantee healthy monetary and fiscal policy, making the country less vulnerable to inflation. Our control of inflation score positively correlates with *Regulatory quality* (REQ, i.2), *Digital institutional quality* (EDB, i.2), *Regulatory enforcement* (REN, i.3), *Health efficiency* (HEI, iv.10), and *Property rights* (PRI, i.2) scores.

In general, the control of inflation score also positively correlates with other relevant Indicators, most notably, the *Global Food Security Index - availability, quality & safety* (FSQ, iii.7) and the *Global Food Security Index - affordability* (FSA, iv.10). Therefore, countries with elites that are more able to guarantee secure food sources to their populations will prevent inflation from rising too quickly.

Not surprisingly, trade barriers dramatically impact inflation because they reduce foreign competition and input varieties. Consistently, Indicators such as *Trade freedom* (TRF, iv.10) and openness in service and network sectors (BSN, ii.4) minimize inflation. In addition, having more women entrepreneurs (IWE, ii.6) implies more competition, and therefore lower inflation.

Interestingly, more *Collective bargaining coverage* (CBC, ii.4) and a higher *Unionization rate* (UNI, ii.4) negatively correlated with inflation in 2021. This suggests that trade unions coordinated towards more disciplined policies to help their countries out of the pandemic crisis. One must not forget that inflation is a transfer away from ordinary citizens and workers relying on nominal wages to wealthy asset-owning elites.

What might be even more surprising is that our analysis shows countries with concentrated business elites, as measured by *Top 3/Top 30 firm revenues as % of GDP* (FRR, ii.5 and FRB, ii.5), were better at resisting inflationary pressures. All of this suggests that powerful coalitions of workers and firms used their power to restrain the extractive value transfers associated with inflationary wage-price spirals. This result casts some optimism on how to escape the destructive effects of inflation. During the pandemic, and despite all the associated pressures, the political and business elites of certain countries proved that it is possible to manage elite business models responsibly without resorting to narrow, non-inclusive policies that lead to inflation.

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