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Pensions, Economic Growth, Agflation and Inflation

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The year 2020 will be marked in world history with the coronavirus pandemic and the global economic crisis which it sparked.

A new term, "Coronomics" [1], has been coined in order to underline the economic difficulties generated by the coronavirus pandemic. It was precisely this "coronomic crisis" [2] that has gripped most of the states around the world with their leaders having been dragged into combatting this crisis to try and formulate and implement anti-crisis measures [3] in order to ease the social situation for their populations as well as reducing the potential losses to their economies.

At the end of April 2020, the Government of Georgia presented its anti-crisis plan [4], stating that "pensions will rise annually at a rate no less than that of inflation." The plan also specified [5] that an increase in pensions for people above the age of 70 years will be adjusted based on 80% of economic growth as well as the inflation rate.

Despite the fact that this issue has already been analyzed [6] in a rather detailed manner, there remain several points that require clarification.

The idea of pensions being linked with the economic growth of the country is, at a glance, not at all problematic for economists given the fact that a growing economy, *ceteris paribus*, generates more revenues and sets a non-inflationary basis for increasing the amounts of pensions. However, if economic growth is negative, which is to say if a recession takes place, "tying" pensions to economic growth must logically mean their reduction. If we also take into account that given the forecasts made by the International Monetary Fund [7], the coronomic crisis will cause an economic recession in the absolute majority of states around the world, connecting the amount of pensions to economic growth, especially during the coronomic crisis, cannot be justified as a matter of principle.

Irrespective of whether or not the economic growth rate is positive or negative, the reduction of the amounts of pensions is unacceptable.

As for the indexation of pensions with regard to growing inflation, which means that the growth of pensions must not fall behind the growth of the inflation rate [8], this, in itself, requires being familiar with certain issues all the more.

Taking into account that inflation reduces the purchasing power of pensions, it is obligatory to analyze how beneficial the indexation of pensions or retirement incomes with regard to inflation will be for pensioners.

As of March 2020, the amount of old age pension in Georgia exceeded the subsistence minimum of a working age male only slightly – 1.07 times. Given such a situation, the lion's share of a pension is spent on essential products, especially food.

Due to this, the growth of pensions causes the growth of the demand on essential products, especially food, which, other conditions being equal, will have an influence on the growth of the prices of these products.

Economists refer to agricultural inflation, or the growth of the average prices of agricultural products, as *agflation* [9]. This indicator is usually highly noted in both developing as well as developed states [10].

The growth of the average prices of essential products (nutrition, utilities and medication) is called *munflation* [11].

Given the fact that pensions in Georgia are only slightly higher than the subsistence minimum, the growth of pensions will directly lead to the growth of agflation. The special importance of the latter is also confirmed by official statistics [12] as during the coronomic crisis, the level of agflation in Georgia grew faster than the level of inflation. More specifically, in April 2020 the prices of fruit grew by 45%, of dairy products by 23%, of meat products by 15% and of bread products by 8.4% while the annual level of inflation grew by just 6.9% as compared to the same period last year.

As for munflation, the components that reflect the growth of prices on utilities and medication/treatment are less susceptible to change during the coronomic crisis which is mostly due to the special support of the government vis-à-vis these fields.

If we consider all of this logically, the growth of pensions in accordance with the growth of inflation will directly affect the growth of the rate of agflation which will ultimately cause the inflation rate to go up. Here, we naturally have a question about how much the growth of the level of agflation will affect the growth of inflation in Georgia.

In order to answer this question, one must necessarily take into account the share of the food basket in the overall consumer basket as the former is used in calculating agflation while the latter is essential for determining the inflation rate.

According to the official methodology of Georgia for calculating inflation [13], the share of food products in the consumer basket is just 28%. It is worth noting that the share of food products in the consumer basket in post-Communist states that are more-or-less similar to Georgia in terms of their economic situation is much higher [14]. Namely, it is 1.8 times higher in Azerbaijan, Russia and Armenia, double in Tajikistan and 2.1 times higher in Uzbekistan.

It is a fact that the share of food products in the consumer basket has been artificially reduced in Georgia. Therefore, the influence of agflation on the growth of inflation is also artificially reduced. Such a situation leads us to the following conclusions:

First – tying the amounts of pensions to the level of inflation cannot guarantee that the growing level of agflation caused by the growth of pensions will actually be compensated.

Second - the indexation of the pension in accordance with the grouwth of level of inflation cannot have a serious influence on the level of inflation itself.

Hence, the growth of the amounts of pensions in accordance with the growth of the level of inflation will not significantly improve the quality of life of pensioners nor will it have any serious effect on the growth of the inflation rate.

At the same time, the indexation of pensions in accordance with the level of inflation will create the undesired precedent of indexing not only pensions but also putting the indexing of wages with regard to inflation on the agenda. This, on the other hand, will doubtlessly put the economy of our country in the “inflationary spiral” so familiar to economists.

The mechanism of the inflationary spiral is rather simple. More specifically, the growth of wages in accordance with inflation causes the growth of demand which makes the prices of products and services in the consumer basket increase. Given the fact that inflation is calculated precisely on the basis of the growth of the average prices of products and services in the consumer basket, the growing price of the consumer basket means that the level of inflation will also rise which, in the case of the indexation of wages with regard to inflation, also requires wages to increase. The latter, as already pointed out above, causes the level of inflation to increase which will again require the growth of wages and so forth.

Consequently, as we have already stated, the indexation of the amounts of pensions in Georgia will fail to ease the social situation of pensioners while also increasing the threat that the country will be dragged into an inflationary spiral.

In conclusion, it is necessary to say that we consider formally tying the amounts of pensions to economic growth to be unjustified and especially so when pensions are tied to the level of inflation. The pension policy must be complex and flexible when the growth of the amounts of pensions will always be one of the priorities for the government and every decision will take all economic factors (including the levels of economic growth and inflation) into account in a complex manner.

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