

**Peterson Perspectives
Interviews on Current Issues**

Edited Transcript

Episode 2: The Food Crisis and Inflation: Asian Policy Responses

India and other Asian countries now face growing inflation pressures and new demands on their food trade policies. Arvind Subramanian discusses the pros and cons of Asian policy responses so far for the short, medium and long term.

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Sherman Katz: Welcome to the second in the Peterson Perspective Series of Interviews of our scholars. Today, we are delighted to have with us Arvind Subramanian. He is going to talk with us about the growing concern on inflation in Asia, in India, and in other emerging markets in the region. Arvind is a joint Fellow at the Peterson Institute of International Economics and The Center for Global Development. He's also a research professor at Johns Hopkins University. He worked at the International Monetary Fund from 1992 thru 2007, and he became assistant director in the research department. He also worked at the World Bank and he's taught at Harvard University, Kennedy School of Government. Arvind, thanks so much for joining us this morning.

Arvind Subramanian: Delighted to be here.

Sherman Katz: Tell us what are the facts, basically, about inflation right now in Asia?

Arvind Subramanian: Well, over the last couple of months, I think it's fair to say that rising inflation has become the overriding or the predominant policy concern in almost all of emerging Asia. Just a few numbers: for example, in India, the inflation rate is close to 8 percent--the headline inflation rate—you have similarly high inflation in China, Singapore, Indonesia, Philippines—you know, right across the world—Vietnam... So, inflation has been creeping up and is now at substantially elevated levels in almost all these countries.

Sherman Katz: And so far, what's been the principal policy response in India and other countries?

Arvind Subramanian: Well, exactly...that's a good question, Sherm. What you would think that countries would do in response to this is actually to tighten macroeconomic policy, but what countries, in fact, have done is rely

much more on trade measures to contain inflation. For example, almost across the developing world, tariff barriers on food products have come tumbling down to the extent that would have been unimaginable even six months ago. So, tariffs on food stocks, for example, are almost close to zero in India, and similarly, Korea took a number of items off the restrictions list. Thus, tariff barriers have come down—so that's on the import side. But in response to growing food shortages and concerns about food security, the flip side of allowing freer imports has been that some countries have slapped on export restrictions. For example, Vietnam, India, the Philippines, and then the countries in other parts of the world, Russia and China as well, Argentina, have all slapped on export restrictions in order to increase the availability of food domestically. So, we have a kind of competitive reverse mercantilism. In mercantilism, normally you're trying to export more at the expense of your trading partner, but in this case, countries are deciding to export less and keep the food stocks domestically. So, of course, what this is doing is aggravating world food price increases because there's just less food to go around globally, so prices go up even further. And that's been the principal way in which many countries have responded to the food crisis.

Sherman Katz: Is this a potential source of litigation at the WTO?

Arvind Subramanian: Well, I suspect not because WTO rules in fact allow export restrictions to be imposed for food on food security grounds, and I think that's interpreted pretty permissively. It would be very difficult to say countries, you know, shouldn't keep food stocks for their own population at the time when there's scarcity. The problem is that from any one country's point of view, it's not something that you would criticize governments for doing. The problem is that when everyone does it, there's a problem. So, if you think about...what you need is collective action so that everyone can desist from doing so and so that everyone can benefit from that.

Sherman Katz: And indeed, if I understand correctly, it's something like 40 countries, not only in Asia but elsewhere, who've begun to impose these export restrictions.

Arvind Subramanian: Yes, I think the World Bank did a survey of about 50 developing countries. I think it was about close to 20 countries that had imposed some kind of restrictions on exports.

Sherman Katz: Are there better tools...Typically in the United States when we have inflation, we tighten interest rates, for example?

Arvind Subramanian: Right.

Sherman Katz: Would that be a more useful technique in India in particular?

Arvind Subramanian: Yeah, I think when you have an aggregate supply shock, like a food shock, what countries, normally would do in terms of their macroeconomic policy response is to tighten either interest rates or fiscal policy, so that the second round effects of the food price increases don't get entrenched into inflationary expectations because even though you may be willing to accommodate a one-off increase in prices, you don't want, then, wages to go up, and then prices go up and set off an inflationary spiral. So, I think that's what you'd like to do. The problem, of course, is that in developing countries, food comprises a much bigger part of the consumption basket. So, merely using macroeconomic policy tools will be seen as insufficient. So, I think the first best response has to be better targeting of whatever assistance that you want to provide; for example, to low-income households or those who are particularly vulnerable to food price increases. So targeting...providing financial assistance to low-income households so that they can buy food or even providing food directly in some way or the other to low-income households. Some kind of social assistance and targeting has to be part of a first best response to the coming food crisis.

Sherman Katz: Do you think these policies to deal with inflation will slow down growth in the region?

Arvind Subramanian: Yes. I think there's no question that...for one thing we're in a situation where not just food prices are going up, but oil prices are going up as well, fuel prices. So, that's a big negative supply shock. So, the impact on growth is going to be, I think, via two channels. First, as oil prices go up profitability of lots of things goes down and that's going to affect supply and output. But the other way in which this is likely to have an effect is that in response to the global downturn, as a result of what's happening in the U.S. and elsewhere I think the whole point is that emerging market countries could shore up demand as a way of cushioning the impact of the growth slowdown. But that room for maneuver of shoring up demand has been taken away by the inflationary scare. So it's going to be less likely or going to be less winning to either maintain or raise aggregate demand in a context where there are inflationary pressures. So that room for fiscal and macro maneuver that countries have to cushion against, you know, real shocks has been, to some extent, taken away.

Sherman Katz: I gather from your own writing on the subject—I think you had an article in Business Standard—that there's a special role of inflation in Indian politics. Can you tell us a little about that?

Arvind Subramanian: Yes. It's certainly very, very interesting because if you think about it inflation is like a tax on the poor because they are the least able to hedge themselves against the inflation rate. So, inflation hurts the poor and the vulnerable disproportionately. Now, India has not had a very good record in terms of being able to provide essential services to the poor. If you look at health or education or water or power, it shows deficiencies in these services. However, containing inflation, which is like a public good for the poor and essential service for the poor, is something on which India has had a pretty good record. It's never had very high inflation, and its inflation track record has been much better than countries in Latin America or Africa or even elsewhere in Asia. So the question is why.

Now, the way to capture this is in relation to a kind of iron law of electoral politics in India: when inflation starts to go above 5 percent, politicians panic because they think they're going to lose in the next election, because people care a lot about inflation. So, because the poor are very populous and inflation affects them—they seem to have a lot of political power which they tend to express by voting against governments that don't provide low inflation. So, there's something very interesting and peculiar about the fact that high inflation is a sure electoral loser in India. In some ways, you could say that India has the mother of all inflation targeting regimes: you don't need an independent central bank to provide low inflation because there's a consensus of society demanding low inflation. So, it's very easy for central banks and governments and politicians to actually provide it.

Sherman Katz: But do I recall correctly that you had some concerns about the relative importance of inflation targeting on the one hand and flexible exchange rates on the other?

Arvind Subramanian: Yes.

Sherman Katz: Help us understand that.

Arvind Subramanian: So, there is a debate in India now about whether the central bank should be given a mandate like in many European banks to make inflation the overriding and the top, almost exclusive objective of monetary policy. So, that's the big debate in India. And my own view on this has been that it's both not necessary, for the reasons I just spelled out, namely a natural consensus of society which will always ensure that inflation is low. But also it's a little bit inappropriate in the Indian context because I don't think external competitiveness is something that policy makers have been mindful of. A Maintaining a competitive exchange rate should be another target for the monetary

authorities because if you think that growth relies a lot on exports, and for exports you should have a competitive exchange rate, then making inflation the exclusive target can come in the way of that other objective. And to me, my reading of the empirical evidence is that countries that have managed to maintain a competitive exchange rate have on balance managed to boost their exports and have done much better in the long run. So, why rule that out as a legitimate target for policy?

Sherman Katz: You're describing some of these concepts in a political context. When is the next election likely to be in India?

Arvind Subramanian: Exactly. In fact, that's a very good question, Sherm. The next election is going to be no later than early next year because it's a five-year term and five years end next year. So it's because of the prospect of looming elections that the recent inflation scare has been taken so seriously by the government and has prompted such quick and expeditious reactions on the part of policy makers. The looming elections are a big factor in this.

Sherman Katz: Just to conclude, coming back to your first concerns about export restrictions, clearly in a world in which feeding people is so terribly important, I wonder if you have any final thoughts you'd like to share with us about that problem?

Arvind Subramanian: Yes I'm going to be testifying in Congress tomorrow on this, and the way I think about the food problem is that in terms of the international response, there needs to be a short-term, a medium-term and a long-term response. The reason is that I think we're in this food supply shortage situation for the long going because some of the underlying factors are of a durable nature, such as the rise of China and India and the increased demand for food, and climate change-induced effects on agricultural supply. So, we need to have a consistent sustained response all the time. So, in the short run the food-aid policies need to be revisited. For example, the United States still ties its aid, and some estimates suggest that adds up to 50 percent extra cost. That seems to be a huge cost to pay for a humanitarian objective. That's one thing. In the medium term, I think it's terribly important to fix the incentives for agriculture and agricultural trade around the world. That means revisiting the whole biofuels policy around the world, which I think in retrospect, it's fair to say, has turned out to be not very good food policy and also not very good environmental policy. I think that needs to be changed.

And then because of what I said about the export problem, I think the global trade compact around agriculture needs to be revisited. I think

we need to look at both import and export restrictions together so that we have a trading system that can level the playing field in terms of both excess and inadequate supplies. At the moment, we have the worst of all possible worlds because when we have plentiful food, we have barriers for exporting, and when food is in short supply, we have barriers to exporting it so, we need to fix that. And I think in the very long run there's one positive fallout from this food crisis; it's to refocus the world's attention on agriculture in developing countries. It's been neglected. I saw really surprising statistics that total external assistance to agriculture is just 4 percent of total assistance. The World Bank's share of agricultural lending dropped from something like 30 percent to 10 percent over 20 years. So, the world needs to refocus on agriculture, and I think what the oil exporting and the rich countries, need to do is to think about how to revitalize the research that's devoted to agriculture, especially agriculture in Africa. That's a big agenda there.

Sherman Katz: Thank you so much for that. Just in case any of our listeners would like to come back to your congressional testimony, it will be Wednesday, May 14, before the House Financial Services Committee.

Arvind Subramanian: Thank you very much, Sherman.