washingtonpost.com

Inflation Rates Fall Worldwide

IMF Official Credits Free-Market Policies

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Friday, September 12, 2003; Page E03

Inflation has dropped to "the moral equivalent of zero" in the United States and other industrial nations and, surprisingly, is headed that way in most of the rest of the world as well, according to the International Monetary Fund's top economist.

"On current trends, by the end of the decade or even earlier, inflation will be tamed if not virtually eradicated throughout most of the developing world," IMF research director Kenneth S. Rogoff said at the recent annual economic conference of the Federal Reserve Bank of Kansas City, Mo.

The worldwide decline in the level of inflation and its variability has had an important role in improving economic growth in many countries.

Rogoff credited "the huge success of monetary authorities around the globe in reducing inflation" to several factors, including more effective actions by central bankers determined to lower inflation. But a favorable global environment with increased competition, less governmental intervention in economies and less debt accumulation has helped, he said.

"Arguably, the most important factor supporting worldwide disinflation has been the mutually reinforcing mix of deregulation and globalization, which has led to a significant reduction in monopoly levels in many countries," Rogoff said. "It is easier to credibly sustain low inflation in a competitive economy than in a highly monopolistic one."

Another key development has been a change in the way economists think about the impact of inflation.

Economists used to think inflation had to approach an annual rate of 40 percent before it damaged growth prospects, Stanley Fischer, vice chairman of Citigroup and a former first deputy managing director of the IMF, told the group. But now, he said, it is clear that tipping point is about 10 percent per year. Thirty or 40 years ago, some economists believed that moderate rates of inflation could enhance growth by allowing unemployment to be lower than it otherwise would have been. In other words, there was a trade-off between employment and inflation that policymakers could exploit. Now there is a broad consensus that is not true.

"I was taught as an undergraduate that inflation was good for growth," said Vittorio Corbo, governor of the Central Bank of Chile. "As a graduate student I was taught that reducing inflation was very costly."

But all that has changed, Corbo said. "Latin America has changed radically. . . . We learned a lesson. We built institutions to control inflation and that has been good for growth," he said.

Guillermo Ortiz, governor of the Bank of Mexico, agreed that there is a much greater consensus for price stability in Latin America. Adoption of floating exchange rates and the use of inflation targets in setting monetary policy have led to "drastic changes in expectations about inflation," he said.

Rogoff, however, sounded a cautionary note: "Can inflation, which has been largely eradicated in the industrialized countries, and is now being tamed if not exterminated in one developing country after another, make a comeback anytime in the next decade or two? Though institutions and understanding are much improved, it is not hard to imagine that the present historical wave of low inflation, like others, will someday end."

Whatever the future might hold, the recent drop in inflation in the developing countries is "remarkable," Rogoff said. He noted that the inflation in those nations worsened in the 1980s and averaged more than 50 percent annually during the first five years of the 1990s. Referring to IMF figures, Rogoff said inflation was greatest from 1990 to 1994 in the "transition economies" -- the former members of the Soviet bloc that dropped central economic planning -- where it soared to an annual rate of 363 percent. For the same period, inflation in Latin America was 233 percent.

Both groups are projected to have inflation rates around 10 percent this year, according to IMF forecasts.

In the United States, where the worst consumer price inflation in modern times was 13.5 percent in 1980, it is hard to comprehend the impact of extremely high inflation for extended periods.

In some nations, "hyperinflation" lasted for decades. For example, Rogoff said, "Argentina's price level has increased 100 trillion times since 1970, Brazil's a thousand trillion."

But now, "of the IMF's 184 member states, only 11 are projected to have inflation over 20 percent in 2003, and six over 30 percent," he said. The two countries with very high rates are expected to be Angola, with inflation at more than a 75 percent rate, and Zimbabwe, with a rate above 400 percent.

Rogoff offered two hypothetical situations that might threaten the progress that has been made around the world in bringing down inflation: more wars or terrorist activities that lead to a prolonged decline in world trade, and soaring public debt that causes governments to use inflationary policies to reduce those burdens.

"If events forced sharp cutbacks in global trade for a sustained period, a likely result would be a partial resurgence of domestic monopoly power for firms and unions in many countries, again leading to greater price inflexibility, and greater pressures on the central bank to inflate," he said.

"Also, while there are few countries today where fiscal policy is an immediate threat to monetary policy, it is not hard to find industrialized or emerging-market countries where debt levels are a looming problem," Rogoff said.