BOOK REVIEWS

Inflation Targeting in the World Economy

In the last two decades, the global monetary policy thought has witnessed the rising dominance of price stability as the single most important objective of the central banks around the world. In their quest for price stability, the central banks have tried with various strategies, including monetary and exchange rate targeting, which with the ever-increasing challenges have been unable to deliver. In December 1989 the world was introduced with yet another monetary policy framework by the Reserve Bank of New Zealand, known as ‘inflation targeting.’

Not without its impressive performance in inflation subjugation, inflation targeting strategy has gained a considerable popularity ever since its introduction in both industrial and non-industrial world. The popularity has also resulted in burgeoning literature covering various aspects of this framework. While the literature usually revolves around single country perspective, this book by Edwin M. Truman presents a global view and is indeed an interesting and important addition to the growing body of literature on inflation targeting.

With the assumption that inflation targeting framework is not “a rule, a fixed formula, or a straitjacket,” the book poses four broad questions about its challenges and opportunities for the global economy: (i) Would the adoption of inflation targeting by United States, Euroland, and Japan (the ‘G3 economies’) improve the performance of the world economy? (ii) Given a variety of sizes, vulnerabilities, and capacities of the countries, is inflation targeting broadly applicable in the world? (iii) What are the implications of inflation targeting for the exchange rate stability and regimes? (iv) What are the implications of inflation targeting for the international financial architecture?

The author argues that the performance of the world economy would improve if the ever-influencing G3 economies adopt this strategy. It is primarily because of its inherent flexibility, transparency, and accountability that would lessen the current monetary policy rigidities, secretiveness, and non-accountability of the G3 economies. It would also open an avenue for increased dialogue among the G3 countries and between the G3 and the rest of the world thus leading to less policy uncertainty. Moreover, the framework offers to deal with the emerging menace of deflation in these countries, and its effects on the rest of the world, in the form of “anti-deflation targeting,” which is a great promise.
The author argues for the possibility of world wide implementation of inflation targeting irrespective of the individual countries’ size, vulnerability, state of preparedness, and policy makers’ unnecessary weight on inflation. He notes that little evidence exists to negate its broad applicability and the concerns regarding various countries’ capacity to adopt this strategy are often exaggerated, they are even “arbitrary and arrogant.” Inflation targeting strategy gives substantial weight to other concerns, such as output stabilization, of the policy makers and therefore does not end up with inflation bias.

As far as inflation targeting strategy’s implication for exchange rate regime is concerned, the author notes that any exchange rate regime ranging from pure flexible to the boundaries of hard peg is compatible with the very monetary policy strategy. However, the very strategy does not guarantee exchange rate stability. Nonetheless, the marginal impact of inflation stability, to follow inflation targeting, would positively reflect on exchange rate stability. Moreover, he rejects the apprehensions of ‘fear of floating’ type of reactions as an impediment to this strategy. The author argues that influencing exchange rate movements may only be consistent with good monetary policy and does not necessarily imply ‘fear of floating’ type reactions.

The author cautions that inflation targeting monetary policy strategy is not the pillar that would strengthen the international financial architecture to deal with financial crises. Nonetheless, its features of flexible exchange rates and increased transparency are consistent with the emerging consensus of recent crisis prevention dialogue. In this context, the author suggests a more encouraging role for International Monetary Fund in supporting its member countries to benefit from inflation targeting strategy.

The book is very well-argued and explains its hypothesis with an academic treatment. What is remarkable is its balanced view on the opportunities and challenges offered by inflation targeting to the world. The author repeatedly emphasizes that inflation targeting monetary policy framework is neither a “panacea” nor a “poison pill” and concludes the book by calling himself as inflation targeting “sympathizer” and not a “proselytizer.”

Then, should the G3 countries and emerging economies at large heed to his recommendation? Based on the aforementioned arguments one can nod in an affirmative. Also, at the moment there is no other better alternative equipped enough to deal with deflationary challenges in G3 countries and unabated financial crises in emerging economies than inflation targeting. We would only know best,
as we have known monetary and exchange rate targeting, once we implement this strategy; after all, “the proof of the pudding is in the eating.”

Omar Farooq Saqib
Senior Economist
Research Department