NEW STRAITS TIMES

Food inflation amidst lacklustre growth policy constraints

By Samirul Ariff Othman - September 11, 2023 @ 2:26pm

Malaysia is a small open economy highly integrated into the global economy.

When economic activity in our major trading partners (Hong Kong, Singapore, USA, Japan and Europe) slows down, our exports will take a hit.

For example, the latest reading of the S&P Global Malaysia Manufacturing Purchasing Managers 'Index (indicates that the PMI continues to be in contraction mode. Subdued global demand causes lower production, while the lethargy in local manufacturing activities are in line with the global manufacturing trend.

Amidst a lacklustre global economic landscape, amongst others domestic demand, private consumption and government spending will keep our economy growing. Only when there is growth can the gains be redistributed in the forms of wages and taxes to name few.

Average wages tend to correspond with the productivity levels in an economy.

High value added economic activity and higher productivity levels are necessary to raise average wages and consequently, the share of labour income in an economy. Thus, the need for Malaysia to continue to focus on strategies to increase average wage levels, with the effect of raising the share of labour income.

This could be achieved through the promotion of high value added economic activities and by attracting quality investments, particularly in knowledge intensive industries, which will create more opportunities for high skilled, high paying jobs.

Food Consumption Metric

One metric that is a reflection of a country's living standard is the Engel coefficient.

It is an application of Engel's law, which is an observation in economics stating that as income rises, the proportion of income spent on food falls, even if absolute expenditure on food rises.

Engel's law does not imply that food spending remains unchanged as income increases.

It suggests that consumers increase their expenditure on food products in percentage terms less than their increase in income. In other words, when the Engel coefficient increases, the country is by nature poorer.

Conversely, a low Engel coefficient indicates a higher standard of living.

Conduct of Policy

Price stability implies avoiding both prolonged inflation and deflation.

Inflation is a rise in the general price level of goods and services in an economy over the long run, resulting in a decline in the value of money and purchasing power.

Deflation is a decrease in the general price level of goods and services over the long run.

Price stability is one of the primary goals of central banks. Some central banks monitor core inflation rather than headline inflation. Core inflation is a measure of inflation t hat excludes the rate of increase of prices for certain volatile components in price indexes.

Focusing on core inflation can help prevent a central bank from responding too strongly to transitory movements in inflation as it provides signal about persisten t movements in inflation, which is important for the conduct of monetary policy.

Among the impact of high food prices are increased poverty, possible worsening of malnutrition, depletion of the productive assets of the poor and reduction in the utilisation of education and health services.

The immediate policy responses of the government, aimed at reducing the negative impact of high and volatile food prices on the lives of the poor in a timely manner, could translate into sustainable policies that mitigate the adverse impact of high and volatile food prices on poverty.

In the long run, it would mean supporting broad based growth in productivity and market participation in agriculture to ensure an adequate supply response as part of a sustained improvement in food supply.

One such move is targeted food subsidies and targeting is key, simply because across the board food price subsidies are generally the least desired option. They can be regressive, distort relative prices and functioning of the market, and usually cost more than other options. Politically speaking, once established, they can be very difficult to eliminate.

During boom times, one can expect abnormally high inflation in the absence of subsidies. However, this is not the case as sub sidies act to buffer sudden price spikes and dampen erratic fluctuations.

If one were to look at food items in finer detail, fruits and vegetables, as well as fish, are influenced by weather conditions and market imperfections, to name a few.

Dairy product s, milk and meat are examples of imported items, which in turn, are influenced by the exchange rate, distribution and marketing cost, and so on.

Granular data analysis is the key to explain these volatile prices.

Consumption patterns and share of food in household expenditure, income and substitution effects need to be examined.

In Malaysia, the stabilisation of food prices is achieved via three means: subsidies, control of prices and control of supply.

Subsidies are meant to help the poor and to stabilise prices from price shocks. In addition, subsidising the production of certain goods helps promote domestic industries. However, there is always a lag time for these price adjustments to take effect. In short, the adjustment is neither proportionate nor inst antaneous.

Many believe that subsidies do more harm than good because they act against the functioning of an efficient market. Subsidies raises the important issue of inequity it is the tax paying citizens who have to ultimately foot the bill.

This is the dilemma faced by any government wishing to help its poorest citizens by having affordable goods and services.

This noble objective can only be achieved at the cost of weaker economic growth.

The deployment of subsidies is also accompanied by one unintentional consequence richer citizens who can afford to pay the market price of goods are now able to gain more from these subsidies.

Subsidies also mask the true cost of scarcity as industries tend to overproduce to meet the artificial demand that they create.

This encourages wastage that, along with growing government budget deficits, will impair national competitiveness.

In Malaysia, among the earliest legislation to protect consumers was the old Price Control Act 1946, enacted by the colonial government.

Aimed at controlling prices and inflation, it was later revised in 1973 as Act 121.

More recently in 2011, the Act was repealed and replaced by the new Price Control and Anti Profiteering Act 2011 (Act 723) to include anti profiteering. This Act empowers t he Minister of Domestic Trade and Consumerism to determine prices and charges, and the mechanism to determine if profit is unreasonably high.

Another piece of legislation, the Control of Supplies Act 1961, provides for the control and rationing of supplies of controlled articles.The Act prohibits hoarding and refusal to sell controlled goods.

Goods declared as controlled articles under this ACT include, sugar, milk, salt, wheat flour, chicken and cooking oil as well as fertilisers, pesticides, petrol, diesel and cement and clinker.

This brings us to the question as to how policymakers react to inflation, Should they behave like fire fighters or should they be mroe proactive and less reactive instead? It is noteworthy that even George Soros, the infamous speculator, believes that left to their own devices, markets tend to overcorrect themselves.

In the final analysis, when faced with the spectre of rising cost of living, what are the proactive measures to be observed by policymakers? Or should the question be in the first place, "Are there any real strategies?"

- ends -

Samirul Ariff is a widely quoted Economist & International Relations expert. He was previously a Senior Researcher at the Malaysian Institute of Economic Research (MIER) and has been engaged as a consultant for government agencies and international institutions. He did his graduate studies at Macquarie University, Australia. The opinions expressed in this article are his personal views.