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Harvard's Gopinath Helps France Beat Euro Straitjacket

By Rina Chandran - Feb 6, 2013 4:35 PM ET

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Gopinath on Fiscal Devaluation, Women in Economics

When French President Francois Hollande unveiled a plan in November for a business tax credit and higher sales taxes as a way to revive the economy, he was implementing an idea championed by economist Gita Gopinath.

Enlarge image



Gita Gopinath, professor of economics at Harvard University, poses for a portrait in her office on campus in Cambridge, Massachusetts. Photographer: Kelvin Ma/Bloomberg

Enlarge image

Gopinath, 41, a professor at Harvard University in Cambridge, Massachusetts, has pushed for tax intervention as a way forward for euro-area countries that cannot devalue their exchange rates. "Fiscal devaluation" is helping France turn the corner during a period of extreme budget constraints, former Airbus SAS chief Louis Gallois said in a business-competitiveness report Hollande commissioned.

Gopinath's support for the theory took shape through her years teaching at Harvard and the University of Chicago and particularly as a Ph.D. student at Princeton University under the guidance of Kenneth Rogoff, Pierre-Olivier Gourinchas and Ben Bernanke, now chairman of the Federal Reserve. While her earlier work on current accounts and balance of payments garnered praise, it is her recent focus on the 17

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The European Union (EU) flag, left, flies alongside the national flag of France in Paris. Photographer: Balint Pornecki/Bloomberg

euro nations that has national leaders paying action.

"Gita is already a major star, at the top of her cohort in international macroeconomics and still rapidly growing as a scholar," Rogoff said in an e-mail. "Her empirical work on price rigidities is simply stunning and has had everyone going back to the drawing boards. Her theoretical work on international debt and default defines the state of the art in the field," he said, calling her strategies for the euro zone to achieve internal devaluations "very influential."

Parental Advice

Gopinath's path to becoming an economist and the first Indian woman to receive tenure at Harvard began almost by chance in the South Indian city of Mysore where she grew up. Like many Indian high-school students, she sought her parents' advice on what to study at university, and like many Indian parents of the time, they wanted her to land a respectable job as a government official in the Indian Administrative Services.

The best way to achieve that, they were told by some friends in the services, was for Gopinath to get a bachelor's degree in economics from the University of Delhi.

"It was purely accidental," Gopinath said in a telephone interview. "Luckily, I found out fairly quickly that I had more of an academic leaning and little aptitude for administration."

Economics Degree

Her bachelor's degree in economics from the university's [Lady Shri Ram College for Women](#) in 1992 was followed by a first master's at the Delhi School of Economics and a second in the U.S. at the University of Washington in 1996. After receiving her doctorate at Princeton, she taught at the University of Chicago from 2001 to 2005 before moving to Harvard, where she was first invited as a visiting assistant professor for a semester in 2005. At the end of that stint, the university made her an offer to stay.

Her Ph.D. thesis, titled "Three Essays on International Capital Flows: A Search Theoretic Approach," was far ahead of its time, said Rogoff, who has an office a few doors from hers at Harvard and describes her as a "gifted and popular" teacher.

She advocated fiscal devaluation for Europe's currency union in a 2011 paper she co-authored with her colleague Emmanuel Farhi and former student Oleg Itskhoki, an assistant professor at Princeton in New Jersey.

Formal Analysis

"Despite discussions in policy circles, there is little formal analysis of the equivalence between fiscal devaluations and exchange-rate devaluations," they wrote. "This [paper](#) is intended to bridge this gap."

The paper examines a "remarkably simple alternative" that doesn't require countries to abandon the euro and devalue their currencies, Gopinath said. By increasing value-added taxes while cutting payroll taxes, a government can create very similar effects on gross domestic product, consumption, employment and inflation.

The higher VAT raises the price of imported goods as foreign companies pay the levy. The lower payroll tax helps offset the extra sales tax for domestic companies, reducing the need

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for them to raise prices. Since exports are VAT exempt, the payroll-cost saving allows producers to sell goods cheaper overseas, simulating the effect of a weaker currency, according to the paper.

The policy also can help on the fiscal front, as increased competitiveness can lead to higher tax revenue, Gopinath said.

Competitive Edge

Hollande is seeking to revive France's competitive edge by offering companies a 20 billion-euro (\$27 billion) tax cut on some salaries as he attempts to turn around an economy that has barely grown in more than a year. He also will lift the two highest value-added tax rates. The plan was inspired partly by Gopinath's paper, said Harvard professor [Philippe Aghion](#), an informal campaign adviser to Hollande, who was elected president in May.

Aghion, who co-wrote a [column](#) in Le Monde newspaper last October advocating Gopinath's theory, said Gallois proposed to Hollande that it's the right strategy for France. Gallois is slated to become a member of the board at automaker [PSA Peugeot Citroen](#) this year.

"We contributed to the adoption of the policy by Hollande, and Gallois called to thank me," Aghion said in a telephone interview. "There is wider interest in the policy. Italy, [Spain](#), Greece -- they should all be interested. It's an idea that would work."

Provoking Criticism

Gopinath's analysis and Aghion's push for its adoption in France have provoked criticism from some economists, who said her strategy contradicts Keynesian economics.

"In fact, the first person to put forward the idea was Keynes himself in 1931," Aghion said. "Because of the gold standard at the time, it was not possible to devalue the pound. So he proposed fiscal devaluation as a way to achieve the same goals."

Concerns that such a plan "will conflict with euro rules can be met by simply pointing out that [Germany's](#) government carried one out in 2007, though by another name, when it raised VAT from 16 percent to 19 percent and cut employers' contribution to social insurance from 6.5 percent to 4.2 percent," Gopinath, Farhi and Itskhoki wrote in a Mar. 1, 2012, [commentary](#).

Among central bankers, Gopinath singles out Bernanke and the European Central Bank's [Mario Draghi](#) as those who "stepped up to the task of responding in a timely and aggressive manner" to the challenges facing their nations and the global economy.

Less Praise

She has less praise for policy makers in her country of birth. India's current-account deficit, at 5.4 percent of gross domestic product, is "worrying," Gopinath said, because it's driven by lower savings rates.

The shortfall has triggered memories of India's fiscal crisis in 1990-1991, when an overvalued currency led to a massive [current-account deficit](#) and a sharp decline in foreign reserves. More than two decades after the country airlifted gold reserves to pledge as collateral for a loan from the International Monetary Fund, India is grappling with its [widest- ever](#) shortfall, which has led to warnings of a downgrade to junk by ratings companies.

"The reason I'm an international economist now is partly because of the exposure I had back then," said Gopinath, who was in college in New Delhi at the time. "That was when I really got

into the subject, and it stuck with me.”

Policy Overhaul

After months of impasse, Prime Minister [Manmohan Singh](#) in September began a policy overhaul to limit subsidies, lure foreign investment and speed up infrastructure projects as the [economy](#) looks set to expand the least in a decade. Still, India needs “consistent, ongoing reform of its economic and political institutions and not just in response to a crisis,” Gopinath said.

She said she doesn't expect to be tapped by the Indian government like [Raghuram Rajan](#), chief economic adviser to the finance ministry and former chief economist at the IMF. Still, the success of Gopinath, and India-born [Amartya Sen](#), who won the Nobel Prize for economics in 1998, belies India's low literacy rate and university enrollment.

Only 63 percent of people older than 15 could read in 2006, compared with 94 percent in China in 2010, the most recent United Nations [data](#) for each country show. The South Asian nation's 13 percent college-enrollment ratio is half the global average, according to KPMG.

Career Guidance

Gopinath has served on committees at Harvard's economics department to provide women students with career guidance.

In the U.S., female MBA graduates are paid less than their male peers, a Bloomberg Businessweek [survey](#) shows, and only one- third of Ph.D. economists are women, a ratio that has changed little since 1995, the American Economic Association has said. At universities, 44 percent of women faculty had tenure in 2011-12, compared with 62 percent of men, [according](#) to the American Association of University Professors.

“You need a pipeline,” Gopinath said. “You need to encourage women early on. It can't be fixed by requiring more women to be hired.”

She and her husband, director of policy at the Massachusetts Institute of Technology's Abdul Latif Jameel Poverty Action Lab in Cambridge, have a son who's nearly 10 years old and is “very wired to world events,” said Gopinath, who likes biographies and Indian movies. She's currently reading [Mohandas K. Gandhi](#)'s autobiography, “The Story of My Experiments with Truth.”

While women academics still lag behind men when it comes to mentoring and networking, Gopinath said she hasn't felt any bias. “It has been a very difficult path for women in the past,” she said. “That's changing.”

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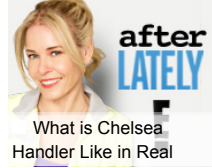
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Sam Kar 3 weeks ago

Yep, Europe would love the idea of high import taxes, VAT, to offset low export taxes and payroll taxes. Might work for Europe, never worked for most emerging economies. The U.S and China outbid themselves to devaluing their respective currencies to stay competitive... Europe? What are you thinking?

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Durand Dupont 3 weeks ago

The difference with fiscal devaluation and currency devaluation is that the former is never as clean as the latter as we have seen in the French case. In fiscal devaluations government and politicians always meddle in and as a result distort the essence of what the fiscal devaluation should be and consequently they significantly reduce the benefit thereof. In France, payroll taxes cut have been combined among other purposes with the intent to reduce temporary jobs and foster permanent employment. As a result, beneficiaries of this reform will be sectors who do not necessarily export and are not in competition with international alternatives, the hairdressers and the like or the fast food, cleaning companies etc...

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Moshe 4 weeks ago

No amount of tricks can save France' from an economic Waterloo. This charming Indian economist's theory will only contribute to stagflation. The Euro is grossly overvalued by speculators Forex manipulation, aided by an incomprehensibly one-sided, stubborn and myopic policy sponsored by Berlin. The Euro at \$1,25 would be still 20% overvalued, but would at least give Europe a fighting chance to recover competitiveness.. How are you going to tax people who have no income, corporations in bankruptcy? Who will pay increased VAT on what? This can only be called 'Disconnected Economics', - disconnected from reality.

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