Tomorrow's Affairs
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The Fight Against Inflation Needs Patience

This week's article will explore the common misconceptions about the fight against inflation. These misconceptions are so commonplace that even some mainstream economists often tend to fail to express their theories correctly.

Those who protest interest rate hikes and those who advocate rapid hikes commit the same bigotry.

Economics is the science of alternatives, and it rarely uses the term "impossible" concerning anything. Nevertheless, the same prescription may not always apply to the treatment of the same disease under different circumstances.

When cause-effect relationships are chaotic, it is important to see what is wrong first, not what is right. So, let me tell you about some of the most common misconceptions about the fight against high inflation:

- "Forsaking the fight against inflation for growth". This is utterly wrong. On the contrary, low inflation is required for stable economic growth. Sometimes, governments tend to prefer the easy way over the challenging, yet right, way. This preference often results in growth slowdown and high inflation: that is, the inevitable stagflation.
- "Raising interest rates will help us reduce inflation". This is a very simplistic and reductionist approach that almost never yields results. Argentina and Turkey, for example, will continue to struggle with high inflation for an uncertain period of time since they were late in increasing rates. As the central banks of both countries hike interest rates, demand will naturally slow down and GDP growth will decline. There is even the possibility that both countries might suffer from stagflation at some point during their efforts to bring inflation under control. Although this period of stagflation will not last very long, if governments start seeing it as a threat to their political power, they may abandon the fight at any time.
- "The cause of inflation is excess demand, so let's increase the supply". This is a complete nonsense. Demand and supply constantly slope upward and downward. We know that governments often tend to use this nonsense as a pretext to give up the fight against inflation. There are countries that eventually went into hyperinflation while trying to accelerate growth by stimulating consumption and investment through loans. Therefore, it is best to reduce inflation first and then grow your GDP.
- "If the economy gets too hot, we will take necessary precautions to cool it down". This is neither scientific nor practical. Every economist of sound mind knows that "there is no perfect remedy for a soft landing". Some did try but their efforts have always resulted either in economic contraction or nothing has changed.
- Used by emperors, kings, sultans and all sorts of totalitarian regimes, the method of "intervening in prices and markets" has always failed. Prices have risen again. The right thing to do is to deal with the causes of inflation, not its consequences. Still, this method is being used by governments that look for an easy way out of problems.
- "Let's raise taxes so that people will spend less". This could only make inflation worse, let alone stop it. Though this approach may bring results in advanced economies, in developing ones, where informal employment is widespread, it may even endanger tax revenues due to purchases without invoice, non-declared sales and other black-market activities. Not for nothing do they say too much tax kills tax.
- "Let's keep foreign exchange rates under control to avoid further inflation". This could only lead to a disaster. The cost of living in

developing countries is directly linked to FX rates, and they tend to go up whenever governments start losing people's trust, which inevitably causes inflation. So, what a government must do is to take a minute and think about the wrong decisions and policies that led to this situation in the first place, instead of trying to prevent FX rates from rising further by selling foreign currency from reserves, even limiting the FX transactions of businesses and individuals. Obviously, these misguided efforts remain insufficient to make citizens believe that their government is telling the truth about the real value of their national currency, so they go and buy the foreign money sold by the government to save them as rainy-day funds. Similarly, hurt by circumstances and having no idea what the future holds, businesses do not pay attention to official exchange rates when pricing their goods - they only take into account the one they think would generate profit for them. Goods and services thus begin to be priced differently in all sectors. Inflation rises.

- Every government that raises wages every time inflation goes up deliberately causes the cost of living to rise further and further. These damaging outcomes mostly stem from governments' stubbornness in focusing on consequences, not causes, of inflation. After a while, they start making statements like "psychological reasons lie behind inflation rather than technical ones", which, in fact, is true to some extent. Seeing that wages are constantly increased and people's purchasing power does not decrease, businesses continue to hike their prices. This is because they are afraid that they will incur greater costs when producing the goods they sell or when buying them from suppliers. Accordingly, in this case, "fear" and "worry" are psychological factors playing a certain part in the rise of inflation. However, it is immoral to try to take advantage of people's hardships. It is the government's duty to prevent this.

- "Portraying official inflation figures lower than they actually are" is perhaps the most dangerous among the so-called solutions or methods that governments use. Because data integrity is the integrity of a nation. Under no circumstances should governments falsify data, especially those concerning the national economy. Once you do this, you lose people's trust, maybe forever. And once trust is gone, pricing behaviour deteriorates massively.

Any government that gives its attention solely to the "consequences" of the problem, rather than its "causes", is unfortunately doomed to fail. But what might be the solution? The solution is simple: not to allow inflation to rise, take the right actions at the right time, think twice before increasing taxes, eliminate the factors that reduce people's purchasing power instead of raising wages, deal with unfair competition and breaches of competition law, make efforts to reduce production costs and provide incentives if necessary, etc.

The fundamental duty of a government is to invest in infrastructure to reduce production costs

In other words, an efficient administration must spend money on investments that serve the needs of citizens and businesses, not its own needs and ambitions.