



By: Emre Alkin

# How to Combat Inflation?



Sometimes knowing what not to do rather than trying to find out "what to do" makes a remedy stronger. Since fuelling the economy, on the grounds of the public's rightful reproach of "we consume more than we produce", would make inflation even worse, the Government needs to take more precise steps to try to eliminate inflation.

Turkey is currently experiencing one of the highest inflation rates in the world. As people working at the IMF and International Financial Institutions do not know the dynamics of this country, they tend to recommend wrong prescriptions, or those that have been tried before but failed.

My intention is, if they are reading this column, to humbly offer them some pieces of advice on this particular matter.

Let's shape the recipe for reducing inflation, starting with the most obvious mistake Turkey has made:

## Taxes

- Since 2106, the Government has been increasing taxes on essential goods and services, consequently leading to exponential inflation. Although tax rates were reduced later, the effect was minor. This mistake, which should not be done in countries like ours, is called by the Government "budget discipline". Budget discipline does not mean creating resources for excessive government spending.

Lesson 1: It would be better to reduce the public deficit through domestic borrowing instead of hiking taxes on essential goods and services in order to collect more taxes.

## Mega projects

- The Government has been outrageously focused on mega projects for the last two decades. Unfortunately, it is not easy to manage and maintain numerous government

buildings and facilities. What the Government should do is stop building new ones, cut down on personnel, and reduce the number of state-owned enterprises. Otherwise, the Central Bank will continue to increase the money supply by indirectly financing the government.

Lesson 2: There is no need for extraordinarily large buildings to provide quality service. Besides there are not enough personnel to work in those buildings. So, what the Government needs to do is put an end to spending money on bridge, highway and airport construction unless it is genuinely necessary.

## Supermarket chains

- Supermarket chains and discount stores operate inefficiently, with twice as many operational costs as there should be. Almost half of the shelf life of meat and food products expires long before they are put on market shelves. One third of agricultural products are damaged during freight. All these problems cause extreme rises in prices. In a climate of high inflation, the supermarket market concept adopted from western countries, where inflation rate is low, makes prices resistant to change despite changes in cost or demand. Slotting fees that manufacturers pay retailers to guarantee that their products are placed on store shelves, discounts they request and long-term payments increase costs even further.

Lesson 3: The way supermarket chains operate, especially transport of agricultural products from farms to markets, and the collection/payment process should be rethought. A detailed study would help the Government to see the problematic areas that need intervention. Instead of pressuring the retailers to reduce selling prices, the Government should assign teams to report on what exactly happens in each stage from production to final sale.

## Exchange rates

- Turkey has been adjusting exchange rates by means of a consistent crawling peg for years now. Under this adjustment system, sellers and suppliers have been using the exchange rate in their minds, not the official exchange rate, to price their goods. Because inflation keeps soaring, while exchange rates remain stable for months. When the price of the US dollar increased from TRY 19 to TRY 30, as it had done after the last year's election, prices went up drastically.

Lesson 4: Turkey has been using crawling since 2018 to adjust exchange rates, whereas this system is actually intended to function only for a short time. Since it is prohibited to short sell Turkish lira abroad, no one knows the real value of US Dollar or Euro against Turkish lira. The Government needs to stop intervening in the free market so that if it wants to regain public confidence. The reason why the Government cannot stop intervening in the market could be due to the FX-protected deposit scheme, or guaranteed exchange rate, especially offered to contractors. Obviously, Turkey has not learned its lessons from the 2001 financial crisis. Restrictions on exchange rates must be lifted, sooner rather than later. Also, the Government should stop "confiscating" the foreign currency income earned by exporters since this practice increases costs even further. The bottom line is, in an economy affected by dollarisation, it is imperative to strengthen the public's trust in national currency, instead of constantly intervening in exchange rates.

## Raw material

- Producers of raw material and intermediate goods have been pressuring the Government since 2014 to implement protectionist trade policies by means of tariffs and other restrictions on the imports of foreign competitors. This needs to stop! Additional tariffs are placed on almost every single imported product. This practice absolutely does not contribute to Turkish exporting industry. The inflation alone caused by protectionism is a major problem. Local election results clearly show that the

Government made a mistake by embracing protectionist policies. I think the Government should call those who demand protectionism to account.

Lesson 5: Yes, it was necessary to make Turkish companies strong in foreign competition. However, protectionism was absolutely not the way to do it. This policy had serious inflationary effects on economy. There are still additional tariffs on trainers and it is unclear whom these tariffs serve. Because Turkey is obviously not capable of manufacturing strong and durable trainers for athletes. Many Turkish footwear brands have been declaring bankruptcy recently. So, apparently additional tariffs placed on imports do not protect the Turkish sectors. The Ministry of Trade should definitely reduce and simplify these tariffs and run an economic impact analysis to eliminate "nuisance" ones.

## Roadmap

- The Government has no roadmap whatsoever, guiding them through essential problems that desperately need intervention. The absence of a solid plan constantly disrupts the relative price balance. Rents, agricultural product prices, foreign exchange rates, interest rates and petrol prices are rising in an inconsistent manner. If these rises were due to the free market economy, I would say that it was normal, but there is constant intervention. The mistake that the Government is making is that it intervenes in some and disregards others, which consequently leads to exorbitant prices. Therefore, they should either give free rein or control all production and pricing, which would be quite difficult to handle. "Force majeure measures would not last for years. They are short-term and an urgent return to free market principles is a must." In summary, do not suggest such things to anyone.

Lesson 6: If there is non-conformity to the law or to rules in pricing process, the Government can or should intervene. However, if prices are rising due to economic drivers, then the Government should investigate the reason or

reasons behind the increasing costs, instead repeatedly and unfairly punishing sellers and suppliers. If costs do not decline, prices would not decline either. This never-ending increase in costs is mostly caused by wrong Government policies, especially the ones governing imports, budget, exchange rates and taxation. And the people who are entrusted with the task of solving these problems do not have enough experience to do so. The only logical thing to do here is to study the process costs in detail and eliminate all practices causing specific harm to the economy, as long as the Government itself avoids doing things that could lead to further inflation.

## Overwhelming ambition

In fact, problems started to spiral out of control when the Government said, "We will balance the budget through taxes, not through borrowing".

This overwhelming ambition, which is driven by a desire to show that Turkey is complying with the Maastricht convergence criterion saying, "government debt should not exceed 60% of GDP", made most people in this country miserable.



*Problems started to spiral out of control when the Government said, "We will balance the budget through taxes, not through borrowing" - Emre Alkin*

Instead of spending rationally, the Government embraced the philosophy of "spending excessively and making the people pay for it".

The Government should have reduced its spending much earlier and borrow

domestically to finance its expenditures, instead of burdening the people with exorbitant taxes. This would have also helped the tight monetary policy.

Let me say that this article is not intended for the officials who manage the economy. Because I know that they won't change their ways.

Hopefully, my intended audience is the analysts working for international institutions who suggest absurd prescriptions to Turkey and similar countries and who think they have it all figured out just by looking at some numbers on a computer screen.

I am urging them to take the time to listen to experience of others before making random and irrelevant comments. Because their lack of reliability would inevitably affect the reliability of the institutions they work for.