



By: **Emre Alkin**

# A Note on the Challenges of the Disinflation Process



I have been dealing with the issue of **inflation** since the early years of my academic career. Looking back, I witnessed what Turkey and other developing countries did in the fight against inflation throughout the 1990s.

Due to my mother's illness, I had to stay in England for more than a few months from 1982 to 1994. Later, due to various responsibilities, I frequently visited Latin America, the MENA region, the Far East, the Turkish Republics, the Caucasus, and Russia.

I realized that every country has an anti-inflationary approach or, as we say today, a disinflation approach according to its political understanding. In a scientific article I wrote 36 years ago, in 1998, I thoroughly analyzed the relationship between political power and the fight against inflation.

I even wrote the following to take the criticisms that "the causes of inflation are clear, yet no intervention is made" a bit further than just casual coffee talk:

## Courage, power, knowledge

"...If the causes of inflation are so clear, why is an effective anti-inflation policy not being implemented? The answers to this question can be listed as follows:

The problem is well analyzed, but the tools used are wrongly chosen;

The problem is not well analyzed, and therefore no remedy is found;

Although the problem is apparent, it is left to the next government;

As often observed, policies (like freezing prices) are artificially used to consolidate power while giving the impression that there is awareness of the problem.

**There is neither the courage, power, nor the knowledge to neutralize or soften the reaction of a society accustomed to living with inflation when radical economic decisions are made**

The most important reason lying behind this is that there is neither the courage, power, nor, most importantly, the knowledge to neutralize or soften the reaction of a society accustomed to living with inflation when radical economic decisions are made.

This examination (which requires scientific rigor and consideration of unseen and even theoretical alternatives) is a discussion regarding the challenges that governments will face in trying to solve the issue of reducing inflation, using a synthesis of sociology and politics..."

## Global leaders are not considering stepping down

Now, let's move on to the analysis of what I wrote. I immediately dismissed number 3 among the four points I emphasized 36 years ago. This is because the current global leaders are not considering stepping down from their positions, and since they work hard to ensure that the next government is still themselves, perhaps it is more appropriate to rephrase the sentence this way:

"Although the problem is clear, it is deemed suitable to keep the ball in the air until the next election." Of course, it has also become customary to blame all political centers outside of the government for this.

Even those who have served two terms as president in the U.S. have made it a habit to blame the previous president and administration. Besides, the validity of points 1, 2, and 4 still holds true.

While the correct analysis of the problem

using the wrong instruments is an issue of merit on its own, the incorrect analysis of the problem and the application of the wrong prescription has emerged as a very current and serious issue.

Of course, the gravity of this is further exemplified by point 4, which involves interventions in currency rates and prices of goods and services that give the impression that there is a fight against inflation.

**Leaders support everything when things are going well but blame the economic management and dismiss them when things go wrong**

Disinflation policy, of course, necessitates the mandatory reduction of effective demand, which is not welcomed by either citizens or businesspeople. Since public spending is also a component of effective demand, we should expect objections and resistance from within the government as well.

Thus, the fight against inflation is not solely an activity to be conducted by economic management, but rather a political issue that the government must embrace.

What we have witnessed so far is a process or habit where leaders support everything when things are going well but blame the economic management and dismiss them when things go wrong. Changes occurring before the end of terms from Central Bank presidents to ministers of economics are often witnessed in developing countries. In fact, the duration of these appointments is increasingly unclear.

## Trust problem

In the article I wrote in 1998, I referenced the opinions of many scientists on this subject. Almost all of them emphasized that the issue involves a healing process that encompasses not just a technical prescription but also many socio-economic, socio-political, and, in some

cases, diplomatic effects.

After presenting all these opinions, my analysis seems to have led me to the "credibility problem" or "trust problem."

"...In the face of inconsistent and unstable behaviors of governments, those with wages, interest, profits, and rent incomes will keep their inflation expectations higher than what is stated in government programs. This is, in a sense, the erosion of trust or "credibility." The transformation of inflation into a social and even psychological issue for society directly pushes it towards deep mistrust of the government and politicians. Therefore, the greatest challenge for any government in Turkey and developing countries that will genuinely implement an anti-inflationary economic policy in the future will be the "credibility problem." Since the state of a country's economy affects not only its internal reputation but also its external reputation, it should be emphasized that the precautions and policies discussed may face application difficulties due to the credibility problem..."

Additionally, I have listed some of the factors creating the credibility problem as follows:

Technological limitations;

Insufficient or incorrect data and methods used in the decision-making process;

Unrealistic goals;

Insufficient knowledge of economic theory;

Political, administrative pressure and limitations;

Political strategic limitations (short-term policies implemented due to the politician's concern for popularity);

Needless to say, number 2 is one of the most relevant reasons today. Indeed, the data that economic managements consider these days is always debatable. They lack complete knowledge not only about inflation rates, growth, or other macroeconomic parameters,

but also do not have tangible experience or knowledge regarding the real causes and sources of developments as stated in point 4.

**The element of “political pressure” has always existed in developing countries and will continue to do so**

Generally, those appointed from a list composed of people educated in a curriculum aligned with U.S. or Anglo-Saxon philosophy are taken out of their positions before they can adapt. In Africa, individuals trained in curricula closely tied to France or the French School are preferred according to their country.

Of course, the element of “political pressure” in point 5 has always existed in developing countries and will continue to do so. Point 6 also remains valid. However, it is necessary to assume that those appointed to these positions possess sufficient life experience. Thus, they choose these roles knowingly.

It is almost like a career ambition or plan. Those who manage to hold onto these positions can be assigned to other roles in the government or ministerial posts. Holding a public office in developing countries has always been an important prestige and undoubtedly a source of power. Unfortunately, where there is no equality or justice, there is always a search for “privilege.”

## Fighting inflation according to politics

Now, there will be those who read these lines and take offense, of course, but I wrote these when it was 1998. The Prime Minister of Turkey was Mesut Yılmaz, and there was a coalition government.

In Germany, Helmut Kohl and then Gerhard Schröder had been prime ministers. Bill Clinton was President in the U.S. Hosni Mubarak in Egypt, Carlos Menem in Argentina, Margaret Thatcher in the UK, Fernando

Cardoso in Brazil, and Li Xiannian in China were in power.

In short, the approach of “fighting inflation according to politics” has continued unchanged since then. It wouldn't be far-fetched to predict that the fight against inflation will loosen with Trump's second term.



*It wouldn't be far-fetched to predict that the fight against inflation will loosen with Trump's second term*

Returning to the article: Back then, I carefully followed the works of Prof. Dr. **Erdal Türkkan** because of his scientific research and his analysis of politics and economics together. In an article published in 1996, he claimed that the economy in developing countries like Turkey is not managed according to democratic rules. I say the same today.

We cannot speak of liberal economics or markets where there is no liberal democracy. There is no longer liberal democracy in the world; humanity is now caught between “elective democracy” and “elective autocracy.”

According to Türkkan, political powers display three types of economic understanding in terms of their compliance with political and economic institutions and rules:

An economic understanding oriented toward the maximization of power and political dominance or a voluntarist economic management understanding;

An economic management understanding oriented toward the maximization of votes and economic dominance or a populist economic management understanding;



An economic management understanding oriented toward the maximization of welfare or an optimalist economic understanding.

Therefore, these three types of economic management understanding give rise to three types of state structures:

A strictly authoritative state with unlimited powers and responsibilities;

A one-sided flexible state with unlimited responsibilities and limited powers;

A two-sided flexible state with limited responsibilities and limited powers.

## Politicians forget their goodwill

Thus, today, while fighting inflation in Turkey or developing countries, or while implementing a “disinflation policy,” another issue arises for economic managements that wish to turn populist understanding into optimalist understanding:

The structure of the state is more inclined and conducive to increasing the functions and areas of intervention of the state. This situation is such that even politicians or policymakers elected with good intentions forget their goodwill.

Moreover, such a political hegemony environment is open to the phenomenon of “negative selection” in the evaluation of human capital, meaning that the bad is preferred over the good.

“One of the most significant indicators of distancing from democracy reflected in economic life is inflation” – Dr. Erdal Türkkan

Dr. Türkkan argues that this situation signifies a departure from democracy in economic and political life, to which I completely agree. I am sharing his words to strengthen this emphasis:

“One of the most significant indicators of distancing from democracy reflected in economic life is inflation... Inflation is a phenomenon that destructively impacts both the economy and democracy in multiple ways... For the phenomenon of inflation to emerge and sustain its existence in an economy, it must exceed a certain proportion of the share of public deficits in national income. In an inflationary environment, the financing of public deficits inevitably leads to monetary expansion, which means that the Central Bank prints money, resulting in a transfer of resources from individuals to the state, known as the inflation tax, which is a non-reciprocal, free, and unregulated transfer by law. This transfer constitutes a violation of one of the fundamental rules of democracy, perhaps the most important one. Because in democracies, tax collection is not possible without the direct approval of the representatives of the people.”

## The side effects

Certainly, one of the obstacles that governments implementing disinflation processes will face is the side effects that cause those on fixed incomes and with the lowest bargaining power to suffer the greatest loss of income.

Therefore, policies aimed at reducing inflation will be met with discontent from these segments, which make up a large part of society, and will inevitably lead to a loss of popularity for politicians. For this reason, economic managements always find themselves operating on shaky ground.



*If individuals and institutions within the country have become pessimistic due to prolonged inflation, any policy to be applied will face a credibility problem - Emre Alkin*

The politician in power must convince the public that the implementation is necessarily short-term and that long-term lasting solutions will be found, and most importantly, that the policies in question are being implemented to stop the unjust flow of resources to the segments with high bargaining power benefiting from inflation.

However, as seen in the example of Turkey, high interest and low exchange rate policies are making the poor poorer and the rich richer. For this reason, citizens have lost their faith in economic management.

If individuals and institutions within the country have become pessimistic due to prolonged inflation, any policy to be applied (whether heterodox or orthodox) will face a credibility problem. This truth must be acknowledged.

## The problem cannot be solved without societal consensus

Thus, regardless of the name of the policy to be implemented to reduce inflation, the problem cannot be solved without societal consensus. The greatest obstacle that will emerge in addition to political and social factors in the disinflation process is the public's pressure on the economy.

The government causes deficits through both its expenditures and investments, attempting

to close these deficits through internal borrowing and increased taxes, while interventions in prices lead to numerous imbalances in the markets.

In conclusion, I will write the last paragraph of the article I wrote in 1998:

“...Inflation must be adopted as the number one social and political issue for the state and society. Otherwise, people will continue to live by getting accustomed to inflation, and inflation will become as natural and indispensable a part of life as breathing...”

Friends in developed countries who read these lines may be surprised because they do not fully understand what we are going through. However, I see a light shining in the minds of friends in developing countries. I wish that those in positions of economic management would also see this light.

Note: Together with Prof. Dr. Berrin Ceylan and Prof. Dr. Ercan Gegez from Topkapi University, we will soon complete and share a scientific article on the effects of the disinflation process on wages, profitability, and macroeconomic parameters.