

Dervis, Kemal

**Working Paper**

## Global economic governance and economic policy: A personal perspective

WIDER Working Paper, No. 2015/139

**Provided in Cooperation with:**

United Nations University (UNU), World Institute for Development Economics Research (WIDER)

*Suggested Citation:* Dervis, Kemal (2015) : Global economic governance and economic policy: A personal perspective, WIDER Working Paper, No. 2015/139, ISBN 978-92-9256-028-7, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki, <https://doi.org/10.35188/UNU-WIDER/2015/028-7>

This Version is available at:

<https://hdl.handle.net/10419/129449>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

UNU-WIDER

30 YEARS OF RESEARCH  
FOR DEVELOPMENT

WIDER Working Paper 2015/139

## **Global economic governance and economic policy**

A personal perspective

Kemal Dervis\*

December 2015

**Abstract:** The policy advice given by economists in international institutions is influenced by their prior academic work. In my case, applied general equilibrium work resulted both in a belief in the necessity of decentralized markets and in a distrust of their ability to be stable. A career in international institutions can also create a global outlook that can be a public good when trying to achieve collective action while accommodating legitimate but narrower national interests. Finally, even if an underlying economic strategy is well designed, emphasis on communications with multiple audiences is crucial for both national and international policy success.

**Keywords:** global economic governance, international institutions

**JEL classification:** F00, O1

**Acknowledgements:** Carol Graham, John Page, and Finn Tarp provided excellent comments on a draft version of this paper.

---

\*The Brookings Institution, [kdervis@brookings.edu](mailto:kdervis@brookings.edu).

This study has been prepared within the UNU-WIDER project 'Development Policy and Practices – Competing Paradigms and Approaches'.

Copyright © UNU-WIDER 2015

ISSN 1798-7237 ISBN 978-92-9256-028-7

Typescript prepared by Sophie Richmond for UNU-WIDER.

UNU-WIDER gratefully acknowledges the financial contributions to the research programme from the governments of Denmark, Finland, Sweden, and the United Kingdom.

The World Institute for Development Economics Research (WIDER) was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy-making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

UNU-WIDER, Katajanokanlaituri 6 B, 00160 Helsinki, Finland, [wider.unu.edu](http://wider.unu.edu)

The views expressed in this publication are those of the author(s). Publication does not imply endorsement by the Institute or the United Nations University, nor by the programme/project sponsors, of any of the views expressed.

## 1 Introduction and personal experience

The first job I ever took, aside from being a teaching assistant, was offered to me by the Development Research Center of the World Bank, in the unit then headed by Montek Ahluwalia, while I was writing my PhD thesis at Princeton at age 23. This was my introduction to what was later to become my work with international economic institutions, complemented by periods in academia and by periods as national policy adviser, policy maker in the government, and parliamentarian.

My intellectual and professional life started in academia, as has been the case for so many of us who later joined the international economic institutions. After completing high school with the French Baccalaureate in 1966, I went to the turbulent and exciting London School of Economics (LSE) of the late 1960s, obtaining my Bachelor's and Master's degrees in economics, all the while active in student affairs. After some hesitation about going back to France for the PhD, I ended up at Princeton, with a generous fellowship and far from the 'revolutionary' student turbulence of the Paris and London of those times. Princeton was a peaceful and somewhat unreal 'academic paradise' that made me really focus full time on studies, rather than on student union meetings, demonstrations, and sit-ins as had been the case in London.

While I enjoyed Princeton very much, I was eager to get home to Turkey and impatient to influence policy. Consequently, I rushed to Ankara after completing my PhD, in time to participate in the ideological debates as a young policy adviser to the leader of the Turkish centre-left, while teaching as an assistant professor of economics at the Middle East Technical University. Within the 'left' in Turkey, as well as more generally in Europe, there was a spirited debate between social democrats arguing for a social market economy with indicative planning only, Scandinavian style, and those in favour of a more planned and more statist economy. As deputy editor of the party's monthly magazine (*Ozgur Insan*), I was in the first group. One of the high points of those years was an official visit accompanying Republican People's Party (CHP) leader Bulent Ecevit to Germany, where I was able to have dinner with the iconic leader of western European social democracy, Willy Brandt. A future where a social democratic Turkey would become a full member of a diverse and open Europe was sparkling in front of our eyes.

Unfortunately, politics took a violent turn in Turkey in the second half of the 1970s. Democratic debate was becoming difficult, with extremists having taken over many campuses and with violence in the streets. I missed the academic research at Princeton. I also realized that almost full-time political activism at that young age would prevent me from ever really becoming a serious academic economist. There were many economic issues I felt confused about and wanted to pursue intellectually. So I accepted Princeton's invitation to join their faculty. As an assistant professor at Princeton, I also wrote what can be referred to as a 'second thesis', required to become an associate professor in the Turkish university system, with the intention of returning to Turkey soon.

It was not meant to be. Hollis Chenery, then chief economist and head of the research vice-presidency at the World Bank, made me an offer that I could not refuse. He asked me to adapt my academic work to make it more relevant to development policy worldwide. Doing that in the supportive and international environment of the World Bank of the late 1970s, where ideas were as important as lending, was very attractive, at least for a while. The 1980 military coup in Turkey, and the suppression of democratic freedoms that ensued, altered my plans. The World Bank became my professional and intellectual home for close to two decades, until I unexpectedly found myself Secretary of the Treasury and Minister for Economic Coordination in my homeland of Turkey, straight after the financial collapse of February 2001, called upon by the

same Bulent Ecevit I had served when I was 24. For close to two years I was Treasury Secretary and Economic Policy Coordinator, appointed from outside Parliament in a coalition government led by my old mentor, Bulent Ecevit, who remained the meticulously honest patriot and social democrat as well as secular pro-European that I had known more than 25 years earlier. He played a critical role in helping us overcome the deep economic crisis by supporting very difficult decisions, despite ill health and old age.

As soon as interest rates fell and the exchange rate and gross domestic product (GDP) recovered, the coalition's cohesion suffered, however, with the far right endangering our achievements. I resigned and soon thereafter was elected Member of Parliament and became economic spokesman for the left-of-centre opposition following the November 2002 general elections. Experiencing politics in opposition was very different from being a policy maker, but allowed me to better understand the inside of the political process.

In the summer of 2005, I moved back to the world of international institutions, this time first nominated by Secretary-General Kofi Annan, and then elected by the General Assembly, to head the United Nations Development Programme (UNDP). After leaving the UNDP, I became Director of the Global Economy and Development Program at the Brookings Institution, returning to policy-oriented economic research.

I would like to concentrate in this paper on some of the lessons I think I learned during this back and forth between academia, international institutions, and national government. Three themes appear to me as being of particular interest:

- 1) the influence of my academic experience and areas of expertise on my policy role;
- (2) the role of a global institution in policy-making at the national level; and
- (3) the interaction between political communication and economic policy.

## **2 Academic work and policy advice: some virtues of gradualism**

As a graduate student and young academic, I had concentrated on capital and growth theory, because my motivation was to understand how developing Turkey could catch up with the advanced world. I have a vivid memory of a lecture by Frank Hahn, one of the foremost mathematical economists of the 1960s at the LSE, which started with a declaration that 'he was a socialist because intertemporal markets were inefficient'. His statement struck a chord, because my concern was much more about long-term progress than about short-term efficiency. I believed in the need for a high investment rate and some form of forward planning that would remedy the intertemporal failures of markets. At the same time, microeconomic theory had convinced me of the importance of prices and incentives to motivate effort. The Soviet system was showing the first signs of serious economic weakness in the late 1960s, and the socialists were trying to implement reforms in order to bring prices into the socialist system, not just to improve allocation efficiency but also increase motivation and effort in getting the most from a given set of resources, a metric sometimes called X-efficiency.

The trends in the real world—showing signs of a slowdown in socialist economies as well as the influence of general equilibrium theory—led me to try and introduce prices and price-elastic supply and demand curves in the rigid fixed-coefficient Leontief input-output models that were the basis of development planning at the time (see, for example, Eckaus 1968; Leontief with

Chenery et al. 1953). So I followed the lead of Norwegian economist Leif Johansen (1960), who had built such a price-sensitive input-output model. The problem at the time was that while *linear* input-output models could be solved by the computer, the introduction of demand and supply curves made them non-linear. To solve such a non-linear model, Johansen had ‘linearized them’ by using first-derivatives of the non-linear demand and supply curves, thereby transforming them into linear models that could be solved by computer programmes. But such solutions were only valid at the ‘neighbourhood’ of a particular general equilibrium, and were only a very imperfect tool to simulate policy experiments or growth paths *over time*. For my thesis at Princeton, working under the supervision of Larry Westphal, Sherman Robinson, and Ray Fair, I used a ‘Walrasian Tâtonnement’ algorithm to solve a non-linear multi-sector growth model *without linearizing it*. After quite a bit of suffering, I succeeded in ‘computing’ growth paths that *equated supply and demand in all markets* and at the same time *equated rates of return including capital gains across all sectors*, the requirement for intertemporal efficiency.<sup>1</sup> The key to my final success in getting the tâtonnement algorithm to converge was to *slow* the speed with which prices adjusted to excess demand in the program. The model behaved like a multi-sector version of the single-market cobweb model: if prices were made to adjust too rapidly they exploded, moving further and further from equilibrium. I developed that work further at the World Bank, culminating in a joint volume with Jaime de Melo and Sherman Robinson (Dervis et al. 1982).

These academic foundations strongly influenced the policy advice I gave for many years at the World Bank. I tried to convince my counterparts that prices and incentives were important. But combined with ‘mainstream’ advice which was routine in the late 1980s and 1990s, I emphasized the need to *retain planning as a tool of public policy* and always added *a note of caution regarding the stability of markets* driven by totally free price adjustment mechanisms. Indicative planning was needed because markets and private actors needed the ‘public good’ of multi-sector simulations of long-term interactions between sectors, as well as interactions between the national economy and the rest of the world. Price fluctuations, particularly in capital markets, could be extreme and lead to a great deal of undesirable ‘cobweb-like’ volatility, causing inter-temporally wasteful investments. The simulations should not be interpreted as a *prescriptive* growth path; instead, they provide illustrations of interactions, which were difficult to internalize at the enterprise or sector level alone. They should inform policy as well as private investors.

This approach of *using markets without trusting them*, relying on private initiative while worrying about the right incentive signals, and looking forward, by trying to simulate alternative growth paths, permeated my policy advice at the World Bank as well as the policies I later implemented in Turkey.

I applied them as division chief of the global Industrial Policy and Trade Division at the World Bank, advising gradual rather than sudden trade liberalization, in order to avoid excessive sudden shifts in immediate prices, while signalling medium-term changes in the incentive structure. I was in favour of announcing the path of a tariff set to decline over, say, five years from 40 per cent to 5 per cent, rather than moving it to 5 per cent right away. And as a general equilibrium practitioner, I was aware that gradualism was needed not only to avoid sudden and destructive disruptions in production, but also for fiscal reasons. The approach of my advice to the Eastern European countries after 1990 was in the same spirit. It was of course important to distinguish the need to overcome hyper-inflation, for example in Poland, which needed a ‘sudden

---

<sup>1</sup> These were the days of punching cards for a personally designed Fortran programmes, before packages became available to do the same job in a much more routine fashion.

macroeconomic shock' as correctly argued by Leszek Balcerowicz,<sup>2</sup> from the speed of privatization and microeconomic price reforms, where I advocated gradualism.

In economics we cannot conduct counterfactual experiments. I do believe, however, that the advice on speed of liberalization and privatization given, in particular, to Russia, by other policy advisers (when at the World Bank, I was solely responsible for Central Europe and the Balkans) helped lead to a sizable output loss in the early 1990s that was totally unnecessary. It also led to what has been, without a doubt, the greatest semi-legal 'hold-up' in history. GDP collapsed in Russia by close to 50 per cent between 1991 and 1996. The collapse came about as incentives were changed almost overnight and the strongly protected economy was very suddenly opened to imports without any long-term vision available to guide and encourage existing and new producers. The economy was simply allowed to collapse. At the same time, the all-out privatization process, without any private sector ready to buy and manage huge amounts of valuable private assets, literally handed Russia's industrial and natural resources over to a group of new 'insiders' who became billionaire oligarchs, many while they were still below the age of 40. In the process, substantial capital flight took place, with investments flowing into European and American real estate, rather than into the creation of productive economic assets in Russia. I have no doubt that the current weaknesses of Russian democracy and the force of populism there, are rooted, to some extent at least, in the expropriation of the Russian people that took place under the cover of market reforms and privatization. Much of such excess was fortunately avoided in Central Europe.

In general, I do not believe that there are good economic arguments for large sudden price changes and/or wholesale privatization in a fire-house sale atmosphere, particularly when there is not much of a national private sector. This does *not* mean that the institutional and legal framework should not be rapidly changed in certain circumstances, only that there has to be a long-term perspective and that implementation should proceed cautiously once the direction is set. Financial sector reforms in an acute crisis situation may be an exception, as I will note in the third section of this paper, but even at such a time, one has to be careful that the destructive part of creative destruction is kept under control. These views I held as a policy adviser were strongly grounded in the type of academic work I had done and was doing. The World Bank was a quite decentralized institution. However, de facto, if not by design, the type of policy advice given varied and there was tremendous freedom of action available for those who wanted to use it. I found this almost academic freedom again at the UNDP when I later moved to the United Nations' (UN) headquarters in New York. Many different perspectives thrived at the UNDP, which I found valuable, although it made the job of the UN's Resident Coordinators in the field, whom I 'tried' to manage on behalf of the Secretary-General, even more difficult. In the end these remarkable men and women, sometimes risking their lives trying to accomplish their mission, adapted the many inputs they received to local circumstances, using their own judgment. The best of them were outstanding in their courage and commitment.

### **3 Internationalism and policy-making: some virtues of *international* institutions**

I have a vivid memory of my first mission as a World Bank economist to an African country in the mid 1980s. It was a trade and industrial policy mission, and the country had a tiny, super-protected, and very inefficient manufacturing sector. There were two foreign-owned assembly

---

<sup>2</sup> The Balcerowicz Plan comprised ten acts and was presented to the Polish public in October before being signed by the president in December 1989. It stabilized the Polish economy. I have great respect for Leszek Balcerowicz, but we have ended up disagreeing on the microeconomic and institutional aspects of economic policy.

plants ‘producing’ a very small number of cars and selling them at no less than three times the world price on the domestic market, under huge effective protection. There was very little employment in these assembly plants, no learning by doing that could in the foreseeable future lead to significantly greater domestic content. Large profits per unit assembled were being sent to the home countries of the automobile firms. As part of the structural reform loan conditionality, I insisted that these assembly plants lose their excessive protection quite quickly. The potential virtues of gradualism were absent in this case, as there was no conceivable way productivity could be improved—given the mini-scale of what elsewhere were much larger scale production units—as well as the absence of linkages or skills that could have led to significant learning and linkages to other activities. As soon as the draft loan agreement was communicated to our counterparts, most of them in fact not Africans, but Europeans from the old colonial power detached to the government of the country, I had the two ambassadors of the ‘home countries’ of the foreign firms, in my hotel. At the very time when the executive directors of these two countries on the Board of the World Bank were arguing for quick trade liberalization in developing countries in general, these two ambassadors were arguing vehemently that the lowering of protection for these two assembly plants would lead to the downfall of the whole economy! Fortunately, I felt no compulsion to listen to them and politely reminded them that the World Bank was interested in the development of the country and not in the repatriated profits of the foreign firms.

Such situations arose dozens of times during my professional life at the World Bank. On another occasion, for example, I argued, against the position of major shareholder governments, for the maintenance of a small across-the-board import tariff in a North African country, which badly needed the fiscal revenue from the tax that was not very distortive. It was interesting and rewarding that I was always able to maintain my policy advice, even when powerful national interests disagreed. I may not always have been right—it would be presumptuous to claim that—but I never had to give in and change my position because of the interest of even the largest shareholder government. There were times when my department could not *lend* to a particular country, because of lack of political support at the board, but I never had my professional *advice* constrained by political power. I consider this, when it is the case, a hugely positive aspect of the role of international financial institutions (IFIs).

There is another illustration of the same point that I can share from my time as Minister of Economic Affairs in Turkey, this time not *in*, but *negotiating with* the IFIs. Turkey in 2001-02 needed large amounts of bridge financing to overcome an acute liquidity crisis which some, at the beginning, saw as a solvency crisis. The private lenders were withdrawing and the exchange rate had collapsed in early 2001. There was some debate in the government on whether or not we should ask key allies in the G7 for bi-lateral loans, in lieu of, or in addition to International Monetary Fund (IMF) (and World Bank) financing. This was a time when the chronic Cyprus problem was at a critical stage, when negotiations for membership of the European Union (EU) could potentially take a positive turn, and, perhaps most importantly, when the second Iraq war was looming. I knew very well that the amount of lending the IMF might eventually agree to provide would indeed depend on the position of the major shareholders, not just on the recommendation of IMF staff. It was very important, therefore, to explain Turkey’s reform programme to these shareholders directly, in the context of their friendly relations with Turkey. My first visit was to Rome, to visit Mario Draghi, then director of the Treasury in Italy, which was chairing the G7 at the time, who offered support at the IMF board and gave me good policy advice. Still, although I absolutely did not want to mix up the economic and financial negotiation process with foreign policy and military matters, these were in the background. I could not avoid that. However, I did not want them, directly or indirectly, as part of loan conditionality. I did of course meet with non-economic officials in some countries, I stressed our countries’ friendship,

but when non-economic matters came up, I said simply that these were not within my remit. I opted, therefore, for not asking for any parallel *bi-lateral financing*. Practically all of the financing we obtained came from the IMF (a little from the World Bank), and no foreign policy topic ever became part of our programme of negotiations with the IMF. Importantly for this paper, neither IMF staff nor management ever brought up the topic either: we were, on both sides, entirely focused on the merits of the economic programme. We agreed on a lot easily, we disagreed on key matters, but finally resolved them by compromise,<sup>3</sup> everything remaining in the realm of economic policy and institutions.

These examples, among many, reflect the fact that economists in international institutions acquire a certain impartiality and loyalty to multilateralism, which is a ‘global public good’ for the international community. Of course they retain their nationality, their loyalty to their home country, and of course they may at times want to please powerful shareholder governments. Nonetheless, a good number of these international economists and civil servants acquire an identity which makes them, to some extent, international citizens. It is never an all-or-nothing affair, there is a continuum and identities are often conflicted. But if there is a global public good argument for international co-operation on such matters as climate, financial stability, trade, macroeconomic spillovers, as well as the transfer of knowledge and experience, the staff of international institutions are very much part of providing these global public goods. My professional life, both as a national policy maker, and as economist/manager at the World Bank and later at the UNDP, has allowed me to witness innumerable examples of how the internationalism of global institutions can help individual nations as well as the global public interest.

#### **4 On political economy, communications strategy, and economic reforms**

On 25 February 2001, when the phone rang with Prime Minister Bulent Ecevit directly on the line, asking me to come back to Turkey to help his government manage the very serious financial crisis that had resulted in the collapse of the exchange rate and in the soaring of overnight interest rates to above 1,000 per cent, I was, in very short order, enthusiastic, worried, and then panicked. I felt enthusiastic, because this could be a once-in-a-lifetime chance to help my home country in a very substantial way. This time I would be a policy maker, not just an adviser. I quickly became worried, however, when he asked me to come *immediately* and when I realized that this would mean dropping everything, retiring early from the World Bank, and beginning a new life. In addition, I felt panicked when I also realized that I had to take full responsibility for trying to manage the crisis: this was not about advising, but about leading the charge in the middle of the worst crisis the country had experienced since the late 1950s.

After arranging for my flight to Ankara, I called four or five friends who had actually been in the position of managing a financial crisis in their home country. In retrospect, the best advice came from Guillermo Ortiz, who had been Treasury Secretary of Mexico during the devastating 1994

---

<sup>3</sup> There were two important disagreements: first, about the target rate of inflation for 2002, with the IMF arguing for 20 per cent while we were arguing for 40 per cent (compared to 68 per cent in 2001). Final agreement was reached on 35 per cent (with actual inflation later turning out to be close to 30 per cent), and, second, about an explicit ceiling for the increase in public sector unionized workers pay, which we could not accept since salaries would have to be the outcome of a free collective bargaining process. This disagreement threatened the whole programme. The compromise which I personally worked out with then First Deputy Managing Director Stanley Fischer over several phone calls, was to accept on both sides a gradual convergence target between the ratio of the average (very low) civil servant salary, to the average (higher) salary of unionized workers, without a ceiling as such.

‘Tequila’ crisis. I had come to know him very well when he had become an executive director of the IMF in Washington. ‘Kemal’, Guillermo said, in words I remember well:

you will be tempted to spend a lot of time in your office, going in depth over the figures and trying to fine-tune the economic analysis. While you have to do some of that, you should never forget that being a minister responsible for crisis management and a reform programme is above all a ‘political’ job. You must be out there, convincing public opinion that the programme is well designed and will work. You must be on TV, in the press, talking to unions, students, business, academics, government and opposition politicians all the time, and all over the country.

Guillermo’s was crucial advice, which I heeded, and I believe the activism with regard to public opinion was crucial to the success of the Turkish programme of 2001-02 (Dervis 2005). Contrary to many other cases, I had public opinion support of well over 50 per cent in the polls during the most difficult months, and this helped generate a remarkable increase in confidence after the official approval of IMF financing. This was combined with falling interest rates, a recovery of the exchange rate, and then, at the beginning of 2002, positive growth, ending up averaging 7.6 per cent for 2002 as a whole, compared to minus 7.4 per cent in 2001. This personal experience about the importance of communicating while reforming brings up a controversial policy issue around this point, which has recently been brought into focus by the debate about austerity in Europe. There are those who argue that positive expectations about future stability triggered by a fiscal adjustment programme *can more than compensate for the contractionary effects of fiscal retrenchment* and actually lead to almost simultaneous macroeconomic expansion brought about by a return of confidence, leading to lower interest rates and improved ‘animal spirits’ of investors and consumers. In opposition to this argument, there are those who argue that such ‘confidence effects’ always remain marginal when compared to the ‘real’ impact of fiscal austerity. The IMF has recently done quantitative work that tends to support this latter position, contrary to the earlier work of Alesina and others supporting the thesis of ‘expansionary austerity’ via confidence effects (see Alesina and Ardagna 1998; Blanchard and Leigh 2013; Guajardo et al. 2011).

I have thought a lot about this issue in light of my own experience in Turkey as well as the European austerity debate in which I have been closer to the ‘southern view’. I think that Germany, the IMF, and the EU institutions imposed an unnecessarily restrictive fiscal framework, not only on the crisis countries, but also on the eurozone as a whole, and Germany on itself! As is so often the case, however, in matters of economic policy, there is neither certainty nor a ‘one-size-fits-all’ prescription.

It is true that in Turkey we set and achieved a very large primary surplus of 5.5 per cent of GDP for the crucial immediate post-crisis year of 2002—and achieved a 7.6 per cent growth rate for that same year! Restoration of confidence was essential to this success. But confidence was restored and indeed newly established, not by *fiscal policy alone*, but by a set of very important *structural reforms*, ranging from a thorough clean-up of the banking system to a new public procurement law, a new competition authority as well as new energy, telecommunications, civil aviation and agricultural policies.

All these policies aimed at a gradual but clear and determined effort to change the nature of the Turkish economy from a rent-seeking crony capitalist system to a truly competitive social market economy. The fact that, at that time, Turkey was becoming a serious candidate to join the EU

helped enormously, for it reinforced the sense of direction for all economic actors.<sup>4</sup> Moreover, Turkey did need to bring down its inflation rate from around 50-60 per cent to 10 per cent or less, to function as a modern European economy. We therefore did need a ‘fiscal shock’ in 2001-02. The continuation of inflation above 50 per cent was incompatible with the restoration of macroeconomic stability and long-term investment. The policies of fiscal retrenchment, initial large devaluation, large IMF bridge financing, a bond swap (where we successfully bet on a recovery of the exchange rate and therefore swapped extremely high yield Turkish lira denominated treasury bonds for US dollar or euro denominated bonds, an admittedly risky move), and a transformational set of structural reforms were a *package*. One piece of that package *would not have worked without the others*. What the very activist communications policy *added* was *early* political support for what was a sound and carefully designed and balanced package. That early support created a virtuous circle where a relatively early return of confidence prevented social unrest and allowed the structural reforms to be enacted and then gradually implemented almost without disruption or serious opposition. This happened in a democratic atmosphere with free collective bargaining determining wage rates, rather than undemocratic conditionality imposed from outside. It is entirely possible, I would say even likely, that without the early emphasis on communications and explanation of the programme, as well as the particular close relationship with the labour unions and the medium-scale business sector that I managed to establish by spending a lot of time with them, the whole reform package, including the fiscal targets, would have collapsed at the very start, leading to massive social unrest and an even deeper, and certainly longer lasting, crisis.

It is also true that, as a newcomer, nobody held me responsible for the onset of the crisis. And, as a veteran of the IFIs, I had a network of friends in these institutions and in other countries, whom I could call, early in the morning if necessary, to ask for quick advice on technical or tactical points, and with whom I had long-established relationships of trust. Finally I must add that Turkey has strong bureaucrats and I had superbly qualified collaborators. I was able to propose the appointment of my closest allies to the prime minister personally, including those of the Central Bank governor, the under-secretary of the Treasury, and the head of the Banking Supervision Agency.

There is absolutely no doubt in my mind that confidence-building is crucial for an economic crisis management programme, particularly where there is a functioning democracy. It can greatly accelerate and magnify success. It should, of course, include confidence-building with foreign creditors and the Bretton Woods Institutions. Confidence-building is not a magic trick, however, that one can pull out of a hat, when a programme itself is ill-designed. To take the original programme designed for Greece in 2009-10 as an example, no amount of good communication could have made it succeed. There was no radical strengthening of the capital of banks, there was an inadequate initial amount of foreign financing, and there was an inappropriate single-minded focus on wage and pension cuts rather than an emphasis on the oligopolistic nature of many product markets. There was an excessive emphasis on fiscal retrenchment as compared to real structural reforms and fairness in the distribution of the adjustment burden. In that context, no communications strategy could have worked, particularly as it was the old political establishment that had led Greece into the huge mess. At the time of writing these lines, in December 2015, Greece, having lost more than a quarter of its GDP in six years, is still trying to overcome the terrible consequences of the crisis that started in 2009. At the start of 2016, a new leader is facing the huge challenge of repairing the mistakes of the past. He has superb

---

<sup>4</sup> The decision, in principle, to start membership negotiations with Turkey was taken by the European Council in December 2002, a date for the beginning of the negotiations was set in December 2004, and the negotiations started in 2005.

communications skills. I do hope that he will be able to deploy them, with European support, to back a realistic growth and reform programme that can succeed. Structural reforms—including the radical transformation of the ‘clientelist’ public administration—are needed, just as in the case of Turkey in 2001. This is more important than a one or two percentage point difference in the primary surplus target promised for the future. It is also better for confidence-building to set realistic targets and achieve them, than to set very ambitious targets and miss them.

## 5 Conclusion

Economic policy advice and strategies for adjustment and reform are derived from the academic training and the concrete life experiences of those involved. Recent experience has shown that economics remains far from an exact science. The best minds have made huge policy advice or policy design mistakes. Modesty and caution is clearly required.<sup>5</sup>

Nonetheless, in the real world, actual decisions have to be made in real time. Moreover, they always have to be made in a political setting and with many interest groups competing to obtain results favourable to them. There is no doubt in my mind that the international economic institutions can provide an invaluable public good, complementing the legitimate political contexts at national levels, with both global experience and an internationalist spirit that can help solve the prisoner’s dilemma type challenges often embedded in issues of economic co-operation such as macroeconomic spillovers or climate protection. When the opinions of those with international experience and a degree of ‘global civics’ can be considered alongside those of purely national decision makers, within the inevitable and legitimate framework of national democratic political competition, better informed outcomes can be expected. Dani Rodrik’s (2012) twenty-first-century trilemma between democracy, globalization, and the nation-state is not easy to resolve. To the extent that the global organization of economic activity is desirable and irreversible, however, global institutions and a spirit of global civics must complement both private markets and purely national decision-making.

## References

- Alesina, A., and S. Ardagna (1998). ‘Tales of Fiscal Adjustment’. *Economic Policy*, 13(27): 489-585.
- Blanchard, O., and D. Leigh (2013). ‘Growth Forecast Errors and Fiscal Multipliers’. IMF Working Paper, January. Washington, DC: IMF.
- Dervis, K. (2005). ‘Turkey: Return from the Brink, Attempt at Systemic Change and Comprehensive Structural Reform’. In T. Besley and R. Zaghera (eds), *Development Challenges in the 1990s: Leading Policy-makers Speak from Experience*. Washington, DC: World Bank and Oxford University Press.
- Dervis, K., J. de Melo, and S. Robinson (1982). *General Equilibrium Models for Development Policy*. Cambridge: Cambridge University Press.
- Eckaus, R. (1968). *Planning for Growth: Multisectoral, Intertemporal Models Applied to India*. Cambridge, MA: MIT Press.

---

<sup>5</sup> A good example of excessive confidence is the often quoted Robert Lucas claim, in his inaugural address to the American Economic Association in March 2003, that the business cycle has essentially been conquered by modern economics.

- Guajardo, J., D. Leigh, and A. Pescatori (2011). 'Expansionary Austerity: New International Evidence'. IMF Working Paper, July. Washington, DC: IMF.
- Johansen, L. (1960). *A Multi-sector Study of Economic Growth*. Amsterdam: North-Holland.
- Leontief, W.W., H.B. Chenery, P.G. Clark et al. (1953). *Studies in the Structure of the American Economy*. New York, NY: Oxford University Press.
- Rodrik, D. (2012). *The Globalization Paradox: Democracy and the Future of the World Economy*. London: W.W. Norton.