

CRISES AND STABILIZATION POLICIES IN THE TURKISH ECONOMY

Doç. Dr. M. Sadık ACAR

It will be useful to run over briefly what has happened in the past, to evaluate the present situation of the Turkish economy, and the effects of the recent precautions on the general balance. Because today's situation and the probable events in the future are casually linked to the past events. In this article, firstly the economic movements which has taken place since 1946 will be considered briefly with the main points and later on, December 1983 decisions will be taken into consideration, and finally, after discussing the probable impacts of these policy decisions on the economy, a conclusion will be tried to reach at.

Turkey has realized an average annual growth-rate about 6 % in the last thirty years prior to 1980 when "24th January decisions" were taken. After this date, economic growth has started again, and has been reached at a rate about 4 %, which was negative in 1979. Economic growth which has been realized in the last thirty-five years, can be regarded obtained by the domestic sources of the economy; because the foreign aids were granted in this period were very unimportant in comparison with the west European countries.

The growth rate has changed from year to year in this thirty five years period. It can be set forth that the Turkish economy has faced several succeeding business cycles in the period in question. Every cycle started with a high rate of growth and ended with a shortage of foreign-exchange and a slowdown in growth. First of these cycles, began with the precautions so called "7th September Decisions" in the economic history. At this date the price of the U.S. dollar was increased from 1.27 TL. to 2.80 TL. By this operation the U.S. dollar appreciated 120.4 % against TL (uncertain rate); and TL. was devaluated 54.6 % against the U.S. dollar (certain-

1983
Türkiye İstatistik Kurumu

rate). Here, the performance of this devaluation will not be scrutinized. Starting from this date, the recovery period of the cycle began which continued to 1950. In this stage, the substitutional investments were performed which were neglected during the Second World War. After 1950, Turkey, as it is well known, tried to achieve a high rate of growth, so the second stage of the cycle began. This new development attempt was mainly based upon private sector, foreign capital, foreign aids and expansionary monetary and fiscal policies. Moreover, infra-structure investments were expanded, and liberation in foreign trade, mechanization in agriculture together with highly subsidized prices for the agricultural goods were brought into application. To perpetuate this new economic policy large-scale industrial establishments were founded through the "State Economic Enterprises", although mainly a liberal economic policy was adapted. Since a high rate of growth was realized, the employment level also increased in the first years of this period.

This new economic policy brought about some economic problems as well, especially after 1954 for example, government expenditures gave rise to inflation because of the increases in investments of the State Economic Enterprises and the subsidized prices of the agricultural goods. On the other hand, application of liberation in foreign trade, deteriorated the deficit in the balance of payments and depleted the foreign-exchange reserves (1). As the result of this process, the liberation policy was abandoned and quotas were adopted for imports. But the quotas caused a commodity shortage in the domestic markets and accelerated the inflation.

Under the pressure of this deterioration, the government increased the price of the U.S. dollar from 2.30 TL. to 9.00 TL. by imposing additional taxes on imports, according to the new "Stabilization Decisions of 4th August 1958". It is clear that this operation is to increase the value of the dollar actually at the rate of 221.4 %, or to devalue the TL. at 68.9 % (certain rate). Thus, a business cycle which started with an intense attempt of development, a high rate of growth and a rise in prices ended with a slowdown, a great embarrassment of foreign-exchange and a high rate of devaluation.

(1) As a matter of fact, while the deficit in the balance of payments was \$ % 22.3 million in 1952, it increased to \$ % 193 million in 1953.

A new cycle began, after this date, and it continued until the "decisions of 10th August 1970". It made possible to prevent inflation, by supporting the decision of devaluation which was taken at the beginning of the cycle with demand decreasing policies and the consolidation of the foreign debts. On the other hand, after this devaluation, the exports of Turkey raised, thus the credits of the country were recovered in the view of the International Financial Institutions and the foreign aids increased. Hence the shortage of foreign exchange mitigated, and Turkey find the chance of increasing imports. But, because of the demand decreasing policies, domestic financial embarrassments arose and a stagnation appeared in the economy. In this beginning stage of the cycle, unemployment has become the main problem of the economy and Turkey has begun to send labour force abroad. Another feature of this period (since 1963), is endeavouring to realize the economic and social development through plans. The refreshing of industrialization efforts, and giving priority to import substitutes, increased the needs of intermediate and investment goods importation of the economy. New investments have stimulated the economy. Thus, the level of employment increased and the unemployment level which was 9 % in 1963 declined to 7 % in the midst of the period.

But the increase in industrialization and in the growth-rate gave rise to a greater deficit in the balance of payments and to problem of inflation, as it was in the previous period. In fact, increases in the workers remittances (employed abroad) made considerable contributions to the foreign exchange inflows. These inflows, however, also became insufficient towards the end of the period. Due to the lack of foreign exchange inflows, investments decreased and a danger of idle capacity and of a rise in unemployment appeared. Moreover, the increase between domestic and foreign prices stagnated the exportation. Then, this business cycle also began to come an end. The expected goals were not achieved. Although tariffs and export subsidies had been increased since 1966. Therefore, this cycle ended with a high rate of devaluation on the 10th August 1970.

The devaluation of 10th August 1970, raised the value of the dollar from 9 TL. to 15 TL. That is, the value of the dollar increased 66.6 % and the TL. was devaluated 40 %. The new cycle which began with the devaluation mentioned above also brought about an acceleration on growth and an increase in exportation as well;

but the rate of unemployment increased. For instance, exportation increased by 300 % during the preceeding three years, workers remittances reached at \$ 1.426 million in 1976 with an unexpected augmentation, whereas it was \$ 141 million in 1969. In fact, these precautions made their effects especially on workers remittances, and the rate of augmentation in 1970 reached at 93 %. Nevertheless, expected increase in the employment level couldn't be reached. While the unemployment level for 1972 had been projected to be 3.67 %, it was realized to 11 %. These precautions aimed to stimulate the economy and to expand new employment opportunities by extending the credits. The increase in the supply of money couldn't raise the level of employment, but accelerated the inflation. For instance, the rate of inflation exceeded 24 % while the average rate of world inflation was only 12 %. Due to the facts that the worker's remittances decreased, that world oil crisis effected the Turkish economy, that U.S.A. put an embargo on Turkey, and that Turkey's import necessities of raw materials and intermediate goods increased, depleted the gold and foreign currency reserves. The embarrassment was felt in 1975 and it turned to a complete crisis in 1977. The inflation rate reached at 52.6 % in 1978. Investments were stagnated, unemployment continued to extend and the black markets began to control the economy. Thus, this cycle which had begun with an intense effort of growth and an increase in exportation, came to an end, too.

As a result of this process a term of succeeding devaluations began in Turkey. In 21th September 1977, the price of the dollar was increased from 17.50 TL. to 19.25 TL., and after nearly six months, it was increased to 25 TL. in 1th March 1978 and to 26.50 TL. in 10th April 1979. However, the actual exchange rate was \$ 1 = 37 TL., regarding the premium which given to the workers' remittances at 40 % and the tax which was applied to the foreign currency purchases of the Turkish citizens, for the touristic purposes. A new arrangement which was performed in June 1979 increased the price of dollar to 47.10 TL., but for some goods it was limited to 35 TL. But these devaluations only accelareted the inflation. These devaluations which were performed within six months caused no advantage and the growth rate fell below zero, because the supply of money was increased permanently. For instance, while the supply of money was 151.5 billion TL. in 1976, it was increased to 210 billion TL.

in 1977 under these circumstances. The Turkish economy came to 24th January 1980.

A high rated new devaluation took place in the 24th January stabilization program. By this operation, the price of the dollar was increased from 47.10 TL to 70 TL. at 48.6 %. In other words, Turkey devaluated its currency at 32.7 %. In addition, exportation has been supported by tax returns, by facilities on currency transfers and by exceptions on tax expenses. By supporting the importation with liberation, reducing the revenue stamp taxes from 25 % to 1 %, decreasing the rate of deposit it was endeavoured to provide the intermediate goods and to increase the capacity use.

Moreover, in 1 th July 1980, the interest rates were liberated for the purpose of increasing the savings and establishing the aggregate supply/aggregate demand (or savings/investments) equality.

Several small-rate devaluations were applied to maintain the increase in exportation by cross-rate adjustments and since 1 May 1981, the method of determining and declaring the exchange-rates daily by the Central Bank has been adapted. Finally, exchange-rate policy has been supported by the demand reducing monetary and fiscal policies to achieve both internal and external equilibrium simultaneously.

It can be said that the precautions mentioned above were mainly successful. As it is known, the exportation increased from \$ 2.9 billion to \$ 4.7 billion, by 61.6 % in a year. Next year, it increased by 22 %, in other words to \$ 5.7 billion. But, in 1983 it increased only by 5 %, because of the decrease in incomes of the Middle Eastern countries, attitudes of EEC, effects of bankers' crises and partly giving up the policies mentioned above, Workers' remittances, however brought up unexpected facilities for the economy. Meanwhile, the economic activities were also recovered by the fact that foreign debts were deferred and new credits were provided.

These precautions which were put in use, made it possible to control the inflation and increase the level of employment and capacity use. 78 % of the importation was for intermediate goods and 20 % of it was for investment goods in 1980. Whereas these figures were 48 % for the intermediate goods and 47 % for the investment goods in 1968. These rates were nearly the same prior to 1980 s.

When the improvements recorded in the economy till December 1983 are considered, it is seen that Turkey has a dependent structure in respect of employment, production, stabilization of prices and economic growth with the rest of the world. Turkish industry, therefore, had an import substituting character and didn't aim to produce export oriented goods. TL. was overvalued artificially by the fixed exchange rates to establish such an industry. In other words, foreign exchange purchases were subsidized at cheaper prices. Thus, while importation has been increasing, foreign exchange inflows have not been improving, and importation has been more attractive than exportation. These policies although have succeeded industrialization to some extent and have given new employment facilities for the growing population, also have given rise to some cyclical fluctuations with the problems which they have caused. Thus, these policies which decreased unemployment for a time, have also been the cause of the spreading unemployment occasionally. In this course, comprehensive stabilization precautions have been applied containing high rate of devaluations at the beginning of every cycle.

Since 1980, however, by implementing export oriented policies, it has been endeavoured to increase the foreign currency inflows. Priority have been given to high-rated devaluations and daily cross-rate arrangements for maintaining the increase in exportation. For this reason, demand decreasing monetary and fiscal policies were applied to support these main policies; and these policies have also been brought about the problems of finance, wage and subsidized prices.

Because inflation re-accelerated in 1983, and the increase in exportation were stayed under the plans' targets, a serial of new precautions were taken. The features of the economic media which these precautions were applied may be summarized as below.

GNP of Turkey was about TL 11.214 billion (With current prices) in 1983; and the national income per capital was TL 237.000 or \$ 1100. The growth rate was 3.2 %, while it was 4.6 % in 1982 and 4.2 % in 1981. This means, a significant decrease is observed in the growth-rate in comparison with the previous years. The main cause of this recession was the contraction in the agricultural production. The industrial sector grew 6.3 % in the last two years. While total expenditures increased by 3.4 %, investments rose only by 0,7 % and the consumption rose by 4.3 % in 1983. In other words,

there was a serious stagnation in investments while the consumption expenditures increased. As a matter of fact, the fall in the average propensity to save from 18.7 % to 17.7 % indicates this deterioration. And, while the share of the fixed capital investment expenditures in GNP was 18.9 % in 1982, it fall to 18.5 % in 1983.

Decreases in investments effected the production activities negatively. For example, weighted capacity utilization in the first quarter of 1983 was 69.9 %, and in the second quarter it fall to 68.8 % and also in the third quarter it became 69.1 %. Idle capacity in some of the small business were nearly 50 %.

Naturally, all these improvements effected the level of employment negatively. Statistics indicate that only 134 thousand people could find new employment chance in 1983.

Whereas, the increase of population continued at the same rate. Thus, the unemployment rate rose from 18.2 % to 19.3 %. Today there are 3.5 million unemployed in Turkey. As far as the families of the unemployed people are concerned, it can be said that 10-12 million people are effected by unemployment. Where as unemployment rates in some other countries are as follows.

	<u>%</u>
U.S.A.	8.3
France	8
U.K.	11.7
F. Germany	7
Italy	8.8
Japan	2

Source: O.E.C.D. Publications

In the same year, because of the interest difference between the demand deposits (current accounts) and the time deposits (deposit accounts) were lessened (respectively % 16 and % 32), the first increased by 104.7 % while the second increased by 12.6 %. It can be said that this fact took an important role on the reacceleration of inflation. Total deposits reached at TL. 3.3 trillion, by increasing 30 %. The increasing rate of inflation was effected by rising amount of the demand deposits. Moreover, the volume of deposits increased

from 13.8 % to 28.3 %. This was also another cause of acceleration of inflation.

In spite of the fact that interest rates decreased and volume of the credits expanded, investments and growth-rate didn't increase and unemployment became more wide-spread. It is seen that, increase in growth and decrease in unemployment is not possible only by increasing the domestic demand. An increase in domestic demand gave rise to increase in consumption expenditures. It is clear that in order to diminish unemployment, increase in exportation and importation is required. But, the exportation didn't increase by a satisfactory rate in 1983. It became nearly \$ 5.7 billion, while importation was \$ 9.2 billion.

Under these circumstances, a serial of decisions were taken to increase domestic savings, to change the structure of the deposits in favour of the time deposits and to rise the inflows of foreign currency in December 1983.

The most important one of these decisions is the re-determining the interest rates. Terms of the time deposits have been re-arranged as three months, six months and 12 months. Afterwards, starting from 1th March, 1 month terms have also been established. Interest-rate of the demand deposits have been determined at a low level annual (5 %), while interest-rate of time deposits have been raised to 52 %, according to compound interest. Moreover, procedures of importation and exportation have been facilitated and more important then that the value of TL. has been left to a partial and a controlled fluctuation in a band of \mp 6 %. At the same time, bureaucratic limitations on currency control have been weakened for easing currency transactions. Bringing TL. from abroad have been liberated, demand deposit accounts in foreign currency has been permitted, currency amount that might be transferred abroad has been raised.

Meanwhile, in the program of 1984, inflation-rate was planned as 25 %, growth-rate as 5 %, exportation as \$ 6.850 billion, importation as \$ 9.550 billion; workers remittances as \$ 1.875 billion and tourism incomes as \$ 325 million. In addition, the rate of fixed capital investments was expected as 33 %, and saving/GNP as 19.5 %. Finally, the unemployment rate was expected to increase to 19.7 % and the number of unemployed from 3.5 million to 3.7 million.

According to the data available, it is seen that growth rate became 5.7 %, total exportation reached at \$ 7.1 billion and importation exceeded \$ 11 billion. But, the inflation rate stayed at 50 % and the unemployment rate increased to 20 %.

In the bunch of these decisions, interest and foreign exchange-rate policies are the basic instruments.

It is generally accepted that in order to pull the inflation down, and to achieve aggregate supply and demand equilibrium, savings ought to be increased. But it is a matter of discussion among the economists whether savings are the function of interest or income. Some of the economists assert that interest rate provides saving/investment equilibrium. According to these economists the higher the interest rates, the higher are the savings. Furthermore, international funds are elastic against the interest rates. If domestic interest rates rise, foreign exchange inflows increase and the outflows decrease. Some other economists assert that savings depend upon the income level. The higher the income level, and thus the higher the saving. And these economists say that interest rates don't play a significant role on the savings.

What is the case in Turkey? Which factor is more effective on the savings? Interest rates or the level of income? This is very important for policy making. The features of the Turkish economy mentioned above gives the idea that the deficiency of savings results from the people can only afford their necessities in minimum subsistence level. They are not able to increase savings whatever the interest rate may be. As a matter of fact, after the decisions significantly. Therefore, it can be said that high-interest-rate policy hasn't been so efficient to increase the savings. But, since the interest rate of the time deposits have been determined much higher than the interest rate of the demand deposits, it has changed the structure of the deposits and the savings alike. Since the liquidity of time deposits is weaker, the aggregate demand have partly been taken under control. But it will be beneficial to mention that while the high interest-rate policy may be able to control the inflation in the short-run, it may be the cause of the inflation in the long-run in two ways. Firstly it increases the total costs of production by increasing the credit costs. It also causes to a cost-push inflation and a low level of employment with idle capacity. Secondly, contrast to the short-term, by increasing the total demand it causes to a demand-pull inflation. Because the

interest incomes will be an important increment of the purchasing power. But this effect might be considered less important, because according to the magnitude of marginal propensity to consume, some of the interest incomes will be saved.

Regarding the effects of the high rate interest policy on the external balance. It is generally accepted that high interest rates play a significant role to achieve the external balance. But this is up to some conditions. Firstly, it is necessary that the interest elasticity of the international funds ought to be high. For instance in some developed countries like the U.K. the U.S.A. and Canada, only a few points of change in interest rates may cause large amounts of capital inflows. In this respect, such countries are able to utilize the interest policy to achieve equilibrium in the external balance. But in the developing countries like Turkey, supply of and demand for foreign exchange is not very sensitive against the interest rates. For this reason, in Turkey higher interest rates are required to set the external balance equilibrium. Moreover the important factor for the external balance is the real interest, not the nominal rates.

The real interest rate in Turkey declines in the view of the foreigners, for two reasons. The first one is the high rate of inflation which is important also in respect of the domestic savings. The second one is more important. This is so-called the coefficient of the risk of exchange rate. This coefficient grows according to the expectations of the depreciation of the value of the currency of the country in question. Because the investors make their decisions according to their expectations. For this reason, expectations are important even if they are unrealistic. While the value of the currency has been devaluated permanently in Turkey, this coefficient is considerably high. Since, the average annual interest rate is 50 %, the rate of inflation is planned to be 20 % but it is about 25 % in reality and the expectation about the currency depreciation is nearly 25 %, then the real interest rate will be 0 % in the view of the foreigners. So, it is necessary to pull this coefficient down. A reliable exchange rate policy which will stabilize the value of the currency, is required to diminish this coefficient.

On the other hand, devaluating the value of the currency permanently, will make it hard to keep the inflation rate on 20 % by

(1) Source: Prime Ministry Undersecretariat of Treasury and Foreign Trade Business Research and Publication Department, 1983—1984.

increasing the cost of the imports and consequently the cost of the domestic production. As a matter of fact, the whole sale price index (about 50 %) was higher than the retail price index (45.5 %). In 1983 and 1984. These indicate that there was a cost-push inflation in Turkey. Since the real wages haven't been increased, the main cause of this inflation is the higher cost of the imported inputs and the high cost of credits because of the interest policy.

Today's, free interest policy is a matter of discussion among those who make the main policies of Turkey. If this policy is accepted, without taking the necessary steps such as anti-trayf regulations and increasing the tax burden ratio, Turkey might have a cost-push inflation again. In 1986 wholesale price index was 25,8 % and retail price index was 32,5 %. In 1987, the wholesale price index is planned to be % 20, but it has still exceeded this figure as mentioned above.

Briefly, it is obvious that the high rate interest policy haven't been able to increase the domestic savings and the inflows of foreign currency in considerable amounts. On the contrary it may be said that this policy has a limited effect to curb the inflation by decreasing the amount of the demand deposits on behalf of the time deposits.

There is a rule in the theory of economic policy: The number of policy instruments used, must be equal to the number of policy goals; otherwise some of the targets cannot be fulfilled. Mainly tight-money policy is used in Turkey. Such a policy rises the interest rates while reducing the demand. Another policy to achieve both the internal and external equilibrium simultaneously. This might be demand reducing fiscal policy which pulls down the interest rates when it is controlling the demand. This policy should increase the tax receipts of the government: Tax receipts/ GNP ratio is 15.27 % in Turkey. This ratio indicates that there are some increments of income which are not taxed. Whereas the optimum ratio is accepted as nearly 20-25 %. If the tax burden comes nearer to this optimum ratio, the interest rates will get down by itself. Both a low burden as 15.27 % and a lower interest rates are not possible to be achieved at the same time. If we are complaining from the high rates of interest we have to pay larger amount of tax. And if we don't want to pay more taxes we should consent to the high rates of interest.

Although, Turkey has accepted tight money policy, the supply of money increases beyond the inflation rate. Emission increased at 43,3 % in 1985. This figure declined to 36.9 % in 1986 and as a result of it inflation rate also declined. But in 1987 the emission has increased at 52.3 % in January and at 50.9 % in February. That means, Turkey has no enough policy tools.

Briefly, present economic policy of Turkey should be fortified by complementary policies, such as fiscal policy, and demand shifting policies besides succeeding small devaluations.