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1 Turkish Economic Development: An Overview

This monograph is an analysis of the interactions between external debt and internal adjustment in Turkey since the early 1970s. As an oil-importing, middle-income economy, Turkey experienced a series of external shocks after 1973. Correspondingly, it went through a cycle of foreign borrowing and a sequence of sharply altered policy phases. Two important questions arise from Turkey's experience in this period. First, what were the underlying reasons for Turkey's debt debacle in the late 1970s? Our interest here centers on the puzzling fact that Turkey entered its debt crisis considerably earlier than most other middle-income countries. Secondly, how can we interpret the adjustment experience of the Turkish economy in the early 1980s? This question is of obvious comparative interest as it has become commonplace by now to point to Turkey's example as a successful case of "life after debt." In what follows we will attempt to provide synthetic answers to both of these questions. Since this requires a fairly broad view, however, our monograph can also be read as an analytical macroeconomic history of the Turkish economy during the last two and a half decades.

We should stress at the outset that our emphasis is on *macro*economic phenomena. This is the natural consequence of the fact that external debt represents the central focus of our narrative. The accumulation and servicing of foreign debt are both linked tightly to the relation between national output and aggregate expenditures. Consequently we will pay only limited attention to many aspects of the microeconomic and institutional structure which have no doubt played important roles in the performance of the Turkish economy since 1973. This limitation notwithstanding, we hope to make clear in our account that Turkey's relationship with external debt has set the terms for the economy's growth: debt has acted in turn as an opportunity and a constraint for growth.

To provide context and perspective for the assessments undertaken in the remainder of the monograph, we present in this chapter an overview of Turkey's development in the earlier periods with broad references to its political, institutional, and structural characteristics. Some basic background data on the Turkish economy are presented in table 1.1. To the reader unfamiliar with the Turkish economy, a quick glance at this table may be useful prior to the historical discussion to follow.[1] The table brings out the semi-industrial nature of the Turkish economy in 1985 (see the shares of industry in GDP and total employment) and presents the relevant growth rates from 1953 to 1985. We conclude this introductory chapter with an outline of the policy chronology for the post-1973 period and a plan of the monograph.

1.1 Historical Background

1.1.1 Institution-building Prior to the 1950s

The Republic of Turkey was established in 1923, after the War of Independence following the total collapse of the Ottoman Empire in the late 1910s. Although the newly founded state had a claim on the historical heritage of an empire, its leaders immediately turned to contemporary Western methods and institutions in the early phases of political reconstruc-

Table 1.1 **Turkey: Basic Data**

A. Major Indicators, 1985					
Population	49.8	million			
Employment	15.9	million			
Unemployment rate	12.6	percent (excluding labor surplus in agriculture)			
GNP	$ 53.0	billion (current prices)			
GNP per capita	$ 1,064.0	(current prices)			
Gini coefficient	0.51 (1973),	0.50 (1978),	0.525 (1983)		
B. Sectoral Structure, 1985	GDP[a]		Employment		
Agriculture	18.4%		58.9%		
Industry	30.6		22.9		
Services	51.0		28.2		
C. Growth Rate (% per year)	1953/63	63/73	73/77	77/79	79/85
GNP	4.8	6.7	6.8	1.2	3.6
Agriculture	3.2	2.3	6.8	2.8	2.4
Manufacturing	8.5	10.1	7.9	−1.7	5.7
GNP per capita	2.0	4.0	4.7	−0.9	1.2
Prices					
GNP deflator	10.6	9.6	21.6	56.5	47.4
Agriculture deflator	10.2	10.5	23.3	41.8	43.8
Terms of foreign trade			−5.6	−3.7	−4.5

Source: SPO; central bank; Celâsun (1983); and for Gini coefficients, 1978–83, Celâsun (1986b).

[a]GDP at factor cost.

tion. The first fifteen years of the new republican regime, led by the founding president M. Kemal Atatürk, was characterized by deep social and cultural reforms, including, most importantly, the adoption of secular principles in the political life of the country.

At the outset, the national leadership faced colossal tasks in the reconstruction of a war-torn and long-neglected economy. Throughout the 1920s, the government grappled with difficulties in two sets of economic policy: (1) the renegotiation and servicing of a huge external debt; and (2) the dismantling of the remaining portions of the so-called capitulations inherited from the Ottoman era. As a balancing factor for political favors received in earlier times, the capitulations granted foreign powers the rights to collect tax revenue and fix import tariffs, which effectively limited domestic policy initiatives to redesign the foreign trade and fiscal regimes for an improved management of the national economy.

The externally imposed tax and tariff constraints were largely removed by 1929. To correct the disappointing economic performance in the 1920s and offset the adverse impact of the world economic depression, Turkey instituted a new set of economic policies in the early 1930s, which placed a heavy emphasis on import-substituting industrialization. Turkey's government-led industrial drive in the 1930s was quite successful in resource mobilization, and generated growth and considerable structural change in output. Major investment projects were implemented within the framework of the first industrial plan in the 1934–38 period.

In the mid-thirties, the government (along with the ruling bureaucratic elite) formulated an official ideological position, called etatism (statism). This position sought a middle way between Soviet-style comprehensive planning and a Western-style market economy system. Etatism assigned a leading role to the public sector in savings generation and in carrying out key entrepreneurial functions in industrial development and technological improvement.[2] The political appeal of this ideology eventually led to the evolution of a particular form of a mixed economy system in Turkey, which imparted a considerable antimarket bias in the foreign trade regime and the financial system until the liberalization episode of the 1980s.

The attempts to implement a second industrial plan during 1938–44 were disrupted by national defense concerns connected with World War II. During the war, Turkey's political energies were consumed in maintaining a quasi-neutral stance with a tilt toward the allied powers. Turkey could not escape the devastating economic effects of the external environment and faced severe commodity shortages, black markets, and high inflation in the early 1940s.

In the immediate postwar years, two major factors shaped domestic policy and economic performance. First, Turkey obtained access to Marshall Plan aid to Europe and U.S. bilateral assistance programs, which were partly based on defense considerations. The conditions of these foreign aid programs required, however, a shift in economic priorities away from industrial development and toward primary production, as called for by the newly emerging perceptions of the optimal division of labor in Europe. Second, against the backdrop of rising domestic discontent with one-party rule, the government (under the second head of state, İsmet İnönü) initiated a change toward a multiparty parliamentary system.

Given the intense preoccupation with political changes, a draft five-year plan was aborted and industrialization objectives were pushed aside in the late 1940s.[3] Following a major exchange rate adjustment in 1946, government policies began to favor agricultural expansion and free enterprise. Average annual GNP growth rates have been estimated as 7.4 percent, 1.2 percent, and 7.9 percent for the periods 1923–38, 1938–48, and 1948–53, respectively.[4]

1.1.2 1950–60: Democratic Party Rule

In the context of rising domestic dissatisfaction, Turkey's switch to a multiparty parliamentary framework eventually culminated in the defeat of İnönü's Republican People's Party and a victory for the newly formed Democratic Party (DP) in the May 1950 general elections. The mass basis of the DP was rural conservatives. On economic matters, the DP's plan was not to plan.[5]

The Turkish economy expanded rapidly in the early 1950s with the help of a steep rise in agriculture output (due to favorable weather conditions and the extension of farm land to low-yield areas) and primary exports (partly due to the world trade boom connected with the Korean War). However, after the massive crop failure of 1954, the economy entered into a phase of foreign exchange stringency and reduced GNP growth, averaging around 4 percent per year during 1953–58. External debt management and domestic policy increasingly became ad hoc, with a growing reliance on short-term foreign borrowing and trade arrears (much like the scenario to be observed in 1976–77). The central bank financing of public enterprise deficits and agricultural support purchases resulted in high inflation, which eventually led to the reluctant introduction of an IMF-designed stabilization and devaluation program in mid-1958. This program was supported by a sizable package of external financial assistance and debt consolidation under a multilateral agreement.

To the students of Turkey's recent history, a balanced reassessment of the Democratic Party administrations represents, in our view, a continuing research challenge. On the one hand, DP rule in the 1950s stimulated broader political participation and improved the political status of the rural population. On the other hand, the DP governments became increasingly repressive in the face of mounting economic difficulties and rising political dissent by the urban elite. The end result was a tragic one for the top party leaders and came in the form of a complete military takeover in May 1960.

Military rule was transitional and ended quickly after the adoption of a socially progressive constitution in 1961, which provided more checks and balances in the overall political process.

1.1.3 1963–73: Experience with Economywide Planning

From the standpoint of development policy, a notable feature of the 1961 constitution was the requirement of formal economywide planning through five-year plans and annual programs, the preparation of which was entrusted to the newly established State Planning Organization (SPO). In the formal sense, the planning techniques emphasized the consolidated treatment of government accounts, balanced macroeconomic projections, sector-level consistency studies, and improved methods of project selection. While providing compulsory guidelines for the public sector, the plans have been indicative for the private sector, relying on continually modified mixtures of specific incentives.

With the introduction of economywide planning, the style and effectiveness of development policy improved considerably from 1962 onward, exhibiting a greater concern for noninflationary resource mobilization and industrialization. Despite the sluggish growth of agricultural output, annual GNP growth for 1963–73 averaged around 6.7 percent as compared with 4.8 percent in 1953–63. During the first and second plans (1963–67 and 1968–72), the policy emphasis on domestic savings performance paid off quite well, resulting in economywide marginal savings ratios of 32 and 26, respectively, in these two consecutive plan periods. The share of the public sector in total domestic savings was about 45–50 percent, reflecting the significant role of the government in major development programs.

However, the pursuit of development in a planned fashion did not fundamentally change the restrictive and largely ad hoc character of trade policies, which discriminated against exports. The annual import programs (containing devices such as quotas, licences, import deposits, and tariffs) served as important policy instruments under the successive five-year plans. These instruments were used more for limiting imports to foreign exchange availability than for evolving a selective and increasingly competitive import-substitution pattern in the economy.[6]

Under the prolonged maintenance of an increasingly overvalued fixed exchange rate regime, the strains on the external balance intensified in 1969. To prevent the emergence of a payments crisis, the administration of Süleyman Demirel was persuaded to introduce an IMF-supported stabilization program in August 1970, involving a maxi-devaluation. The liberalization objectives of this program were largely abandoned after the partial intervention of the military in March 1971.

Concerned with the rising political violence on the left, the chiefs of the armed forces intervened in 1971 mainly to avoid a complete takeover by the younger officers. Their proposed policy remedies were the adoption of some restrictive clauses in the 1961 constitution, and legislation of socioeconomic reforms to restore confidence in the future of the nation. The reforms suggested by the military were ill-defined, however, resulting essentially in the passage of the so-called agricultural reform legislation, which sidestepped the basic task of designing an operationally feasible land reform program for the rural sector. Although it was not a complete takeover, the military intervention in 1971 produced a highly destabilized political structure in the post-1971 period.

In the setting of a hospitable world economic environment and a trade boom in the early 1970s, the 1970 devaluation contributed favorably to export and GNP expansion from 1971 to 1973. The most notable development in this period was the surge in remittances from Turkish workers abroad, whose emigration had accelerated in the late 1960s. In light of an unprecedented rise in foreign exchange reserves, an ambitious third plan (1973–77) was adopted with far-reaching objectives of import-substituting industrialization in capital-intensive sectors. The planned growth process was then seen as part of a large national effort to broaden the productive structure of the country for a more effective integration with the European Economic Community (EEC).

1.1.4 Turkey-EEC Relations

Notwithstanding the heavy use of a restrictive trade regime, an important long-term policy choice was made in 1963–73 as regards integration with the EEC. In September 1963, Turkey and the EEC signed the Association Agreement, which envisaged two consecutive stages (preparatory and transitional) before Turkey's eventual accession to a full member status. Upon the completion of the preparatory stage at the end of the 1970s, the Additional Protocol was signed in November 1970, which became effective in January 1973. This protocol specified the ground rules for the transitional stage, which projected the establishment of a customs union before the full membership stage.

In the Additional Protocol, Turkey agreed to remove gradually tariff and nontariff barriers for EEC manufactured exports according to two timetables (over 12- and 22-year periods, as differentiated by products). In turn, the EEC removed tariff barriers for Turkish manufactured exports, except for particular product categories such as cotton yarns, textiles, and processed food items in which Turkey had a comparative advantage. The selective trade advantages granted to Turkish agricultural exports rapidly eroded after the EEC's subsequent agreements with other Mediterranean countries. The EEC also agreed, in principle, to allow free movement for Turkish labor by 1986.

Until the emergence of a severe foreign exchange stringency in 1977–78. Turkey carried out tariff reductions as scheduled in the Additional Protocol. Following the 1978–86 period of somewhat cold and strained relations (partly due to Turkey's internal political difficulties), Turkey formally applied for full membership in the European Community in mid-1987.

1.2 Structural Peculiarities and the Mixed Economy System

Before we embark upon the analysis of the post-1973 phases in detail, it would also be useful to draw attention to some of the peculiar structural properties of Turkey's growth and the major characteristics of its mixed economy system.

1.2.1 Structural Transition: A Cross-Country Comparison

Turkey's historical growth process produced a considerable change in its economic structure. However, in some ways, this structural change lagged behind the norms (or standards) predicted for countries at Turkey's population size and income level. The leads and lags in structural transition are helpful in identifying the areas where special policy and nonpolicy factors were at work in the growth process. A convenient analytical framework for such a comparative analysis of structural trends is the cross-country regressions of Chenery and Syrquin (1975), which bring out the average (or normal) patterns of development over time. Chenery and Syrquin examine the observed shifts in development characteristics as functions of per capita income for various country groupings differentiated by population sizes and/or net resource inflows.

By making use of Chenery and Syrquin's regressions (for large countries), an earlier study by Celâsun (1983) compared Turkey's actual structural change with that of an average country with size (measured by population) and per capita income similar to Turkey for the benchmark years 1953, 1963, 1973, and 1978. Table 1.2 presents a selective summary of the results of this study.[7] The data shown in this table point to a number of peculiarities in the form of notable deviations of actual values from predicted cross-country norms during the 1953–78 period. Turkey performed substantially below the predicted norms in the accumulation of capital and restructuring of domestic demand and production in the 1950s and early 1960s. However, unlike the preceding ten years, the 1963–73 decade saw (under economywide planning) a considerable catching up in the accumulation and industrialization processes.

In turn, external trade ratios were far below the cross-country norms throughout 1953–78. This clearly indicates the inward-orientation of Turkey's past development strategy. This finding is supported by a further analysis of the sources of growth, carried out for the manufacturing sector and summarized in table 1.3. Compared with other industrializing countries, the demand side effects of external trade have been very small in the expansion of Turkish manufacturing in comparison with domestic demand.

Table 1.2 Resource Accumulation and Allocational Processes, 1953–78[a]

	Actual				Predicted[b]			
	1953	1963	1973	1978	1953	1963	1973	1978
A. Accumulation (% of GDP)								
1. Investment								
a. Savings	11.5	12.0	14.8	17.8	16.3	18.0	19.6	20.5
b. Gross investment	14.8	15.6	18.3	21.6	18.0	19.6	21.0	21.8
c. Capital inflow[c]	3.3	3.6	3.5	3.8	2.8	1.6	1.4	1.3
2. Government Revenue								
a. Government[d]	16.0	16.6	21.1	24.4	15.6	16.8	18.7	19.7
b. Tax[d]	12.6	13.9	18.5	20.2	15.0	15.8	17.8	18.6
B. Allocation (% of GDP)								
1. Domestic demand								
a. Gross investment	14.8	15.6	18.3	21.6	18.0	19.6	21.0	21.8
b. Public consumption	11.0	11.5	14.1	12.7	12.2	13.6	13.7	13.8
c. Private consumption	77.6	76.6	71.2	69.4	71.5	70.1	68.9	68.2
d. Food consumption	41.4	38.9	28.9	27.4	33.9	30.4	26.7	25.1
2. Production (value added at factor cost)								
a. Primary	45.9	40.1	29.7	26.9	34.4	30.2	24.5	22.0
b. Industry[e]	12.8	19.2	22.9	25.0	22.6	23.5	26.8	28.4
c. Utilities	5.7	8.8	10.7	11.0	6.2	7.1	7.5	7.8
d. Services	35.6	31.8	25.7	37.1	36.2	38.8	40.5	41.2
3. Trade								
a. Imports	11.3	9.6	11.4	9.9	17.0	16.2	15.6	15.3
b. Exports	8.0	6.0	7.9	6.1	17.3	15.2	14.8	14.6
c. Primary exports	7.4	4.0	4.1	3.3	10.8	9.7	8.3	7.6
d. Manufacturing exports	0.6	1.0	1.8	1.2	4.4	4.8	6.0	6.6
e. Service exports	—	1.0	2.0	1.6				
C. Labor allocation								
1. % Share of:								
a. Primary labor	79.2	77.6	64.8	60.9	56.9	53.8	47.2	44.9
b. Industry labor	7.4	10.1	13.6	15.3	15.8	17.9	21.7	22.9
c. Utilities & service labor	13.4	12.3	21.6	23.8	17.4	28.2	30.8	31.9

Source: Celâsun (1983).

[a] Definitions and measurements follow Chenery and Syrquin (1975, 180–87).

[b] Predicted shares may not add to appropriate totals; from basic regressions in Chenery and Syrquin (1975).

[c] Capital inflow is net imports of goods and nonfactor services.

[d] Central plus local government revenue, excluding savings bonds and public factor income. Tax revenue includes SEE corporate taxes.

[e] Includes manufacturing and construction.

Another structural peculiarity pertains to the pattern of sectoral allocation of labor in the Turkish economy. Despite the rapid growth of manufacturing, the share of industry (including construction, as in table 1.2) in total employment has remained significantly below cross-country standards. The counterpart of this development has been the very slow pace of reduction in the share of primary labor in total employment. In the Turkish setting, where mining has a negligible share in employment, primary labor largely corresponds to agricultural employment. This structural peculiarity, com-

Table 1.3 **Sources of Manufacturing Gross Output Increase Over Time: An Intercountry Comparison[a] (in percentages)**

	Avereage Manufacturing Output Growth Rate (% per year)	Domestic Demand Expansion	Export Expansion	Import Substitution	Change in I-O Coefficients
Japan					
1914–35	5.5	69.9	33.6	4.7	−8.2
1935–55	2.8	70.9	−7.1	15.5	20.7
1955–60	12.6	76.6	11.9	−3.4	15.2
1960–65	10.8	82.3	21.7	−0.3	−3.7
1965–70	16.5	74.2	17.6	−1.4	9.6
Israel					
1958–65	13.6	58.9	26.2	9.8	5.2
1965–68	9.4	68.7	54.8	−27.7	4.2
Korea					
1955–63	10.4	57.3	11.5	42.2	−11.0
1963–70	18.9	70.1	30.4	−0.6	0.1
1970–73	23.8	39.0	61.6	−2.5	1.8
Mexico					
1950–60	7.0	71.8	3.0	10.9	14.4
1960–70	8.6	86.1	4.0	11.0	−1.0
1970–75	7.2	81.5	7.7	2.6	8.2
Norway					
1953–61	5.1	64.3	37.3	−15.9	14.4
1961–69	5.3	50.6	58.8	−19.4	10.0
Taiwan					
1956–61	11.2	34.8	27.5	25.4	12.3
1961–66	16.6	49.2	44.5	1.7	4.6
1966–71	21.1	34.9	57.0	3.8	4.3
Turkey					
1953–63	6.4	81.0	2.2	9.1	7.7
1963–68	9.9	75.2	4.5	10.4	9.9
1968–73	9.4	76.2	10.7	−1.5	14.6
1973–77[b]	8.0	100.4	−1.0	0.6	0.0
1978–81	−3.0	−36.7	81.5	−143.9	−1.0

Source: Kubo and Robinson (1979); Lewis and Urata (1983) for Turkey, 1973–81.

[a]The sources of growth contributions (based on share-total method) in columns 2–5 are measured as percentages of the increment in manufacturing gross output during the indicated periods, and add up to 100 percent.

[b]All sectors.

bined with more normal patterns of sectoral production, leads to large income differentials among sectors and widens the overall income inequality (as elaborated further in chap. 5).[8]

Our review of Turkey's structural trends suggests that a basic concern of development policy in the 1970s should have been the attainment of a more normal trade orientation in the growth process, even in the absence of the external shocks of the mid-1970s. With a more vigorous exploitation of Turkey's comparative advantage, such a policy shift would have generated a larger labor absorption in nonprimary sectors. Furthermore, the prolonged maintenance of inward-orientation produced rigidities in the output structure, which would require large real devaluations and wage cuts to accommodate the trade-liberalization objectives of the post-1980 adjustment program.

1.2.2 Turkey's Mixed Economy System Prior to 1980

An analysis of macroeconomic adjustment and debt in the post-1973 period also requires an awareness of the scope and structure of the public sector and the financial system in Turkey's mixed economy framework. In section 1.1.1 we noted the emergence of etatism as Turkey's systemic response to the developmental challenges of the interwar period. Under the political conditions of the time, an overriding concern with self-sufficiency led to the establishment of government-owned and operated public enterprises, not only in social overhead and services sectors, but also in mining and practically all branches of the manufacturing sector.

Although they were established as a temporary vehicle for industry-led growth, public enterprises have nevertheless become firmly entrenched in the national economy. After the switch to a multiparty political system in 1950, they served as institutional tools for job creation, regional development, and other extra-market interventions on social grounds. During 1963–77, the share of the public sector in the value added of large manufacturing (including firms with more than ten workers) was around 45 percent. Similarly, from 1963 to 1977, the public sector accounted for about 45 percent of total fixed investment in manufacturing and 50–55 percent of total investment in the economy. In the post-1970 period, however, the economy started to witness an increasingly more vigorous involvement of the private sector in industrial activity.

The entrenched position of the public sector in the growth process created strains in the financial system. Public enterprises often required large budgetary transfers, funding from the social security institutions, and deficit financing from the central bank. In such a milieu, the financial system exhibited a highly segmented pattern of growth, requiring financial resources to flow through administered channels. Because of strict controls over interest rates, the financial sector expanded mainly through the rapid growth of its monetary component (including central bank and deposit banks) on the basis of an unusually large credit usage by public administration and public enterprises.[9]

Table 1.4 provides data on the structural properties of Turkey's financial system for the benchmark years 1970, 1975, and 1980.[10] Besides showing the predominant share of the monetary system within the overall financial sector, the data also bring out the relatively small volumes of the equity and bond issues by the real sectors, reflecting the virtual absence of a capital market in Turkey in the pre-1980 period. With the limited scope for equity and bond financing, private firms relied on deposit banks and their own resources for capital formation. This situation led to the evolution of sellers' markets for bank credits, large spreads in interest rates, and strong

Table 1.4 **Turkey's Financial System, 1970–80**

	1970	1975	1980
A. Total assets of financial institutions (% of GNP)	76.7	80.1	66.6
B. Distribution of assets			
1. Monetary system (Central bank and deposit banks)	68.4	73.3	84.7
2. Investment banks	12.4	11.5	6.3
3. Social insurance institutions	14.4	11.8	6.4
4. Other institutions	4.8	3.4	2.6
Total	100.0	100.0	100.0
C. Net issues of domestic nonfinancial (real sectors)			
1. Total (% of GNP)	59.7	57.8	47.8
2. By sector (%)			
a. Public sector	48.2	42.9	55.1
Administration	27.3	23.6	31.8
Enterprises	20.9	19.3	23.3
b. Private firms	37.3	47.6	37.3
c. Households and others[a]	14.5	9.5	7.6
Total	100.0	100.0	100.0
3. By type (%)			
a. Equities	8.9	11.2	6.9
b. Debt issue			
Bonds	11.3	8.6	8.6
Nonbonds[b]	79.8	80.2	86.6
Total	100.0	100.0	100.0
4. Held by (%)			
a. Financial system	87.1	83.9	85.8
b. Monetary system	57.0	59.7	71.1

Source: Akyuz and Ersel (1984, annex 2) for financial assets; Akyuz (1984, tables 4.1 and 4.4) for other data.

[a] Includes agricultural producers and nonprofit organizations.

[b] Credits, advances, etc.

preference for a restrictive trade regime to sustain high-cost industries established for home markets.

Thus, the simultaneous use of three major institutional instruments, namely (1) public enterprises, (2) a restrictive trade regime, and (3) financial repression, produced a highly compartmentalized mixed economy system. Prior to 1980, the domestic policy debate centered on the relative sizes of the public and private sectors, rather than on the improvement of the integrative price and planning mechanisms within the Turkish economy.

Finally, two remarks on our data presentation are in order. First, the public sector concept in our macroeconomic discussions is a broad one, covering institutional components such as the central government, local government, state economic enterprises, and various adjunct entities. In this context, the public sector deficit refers to a wider aggregate than the deficit in the so-called consolidated budget of the central government. Second, it should be noted that the interchangeable use of the terms "public enterprises" and "state economic enterprises (SEEs)" is not strictly correct under Turkey's legal arrangements.[11] The SEEs constitute the largest subset of public enterprises and are supposed to function under commercial business principles. The non-SEE enterprises are viewed more as public agencies involved in the production of public goods in the conventional sense. In turn, the SEEs have nonfinancial (operational) and financial subcategories. Since our overall concern in the present study is the aggregative analysis of debt and adjustment, we often eschew these institutional distinctions and crudely use the terms SEEs and public enterprises interchangeably, unless noted otherwise.

1.3 Policy Chronology and A Road Map

It is possible to delineate in retrospect three major policy phases subsequent to the first oil shock of 1973. These phases correspond roughly to 1973–77, 1978–79, and post-1980. By way of introduction, we present a brief overview of these three phases.

1.3.1 Phase 1 (1973–77): Debt Accumulation and Postponed Adjustment

The perceived need to accelerate and deepen the industrialization effort formed the background to the official planning process throughout much of the 1970s. Thus, Turkey's response to the external shocks of the mid-1970s became one of postponed internal adjustment, which turned out to be feasible through reserve decumulation initially, and heavy short-term borrowing subsequently, up until mid-1977. The largely unnoticed buildup of price distortions in Phase 1 caused not only a stagnation in exports but also a rapid rise in the import-intensity of domestic production. Moreover, the government's external debt "strategy" promoted overborrowing on the part of the private sector. The latter precipitated a severe payments crisis by mid-1977, when practically all reserves became depleted and available bank lines were terminated.

1.3.2 Phase 2 (1978–79): Foreign Exchange Crisis and Inflationary Response

During this phase, Turkey secured important debt reschedulings but lacked adequate flows of fresh foreign credits to halt a rapidly worsening position in the balance of payments. With insufficient domestic policy remedies and uncurbed monetary expansion, the real sector adjusted to import compression via an inflationary process of output contraction.

1.3.3 Phase 3 (from 1980 on): Stabilization and Outward-Oriented Adjustment

With the introduction of a mix of stabilization and liberalization policies in January 1980 and thereafter, the economy embarked upon a new adjustment path with a greater reliance on export expansion and market forces. Turkey received sizable volumes of new lending and debt relief in 1980–84. The new policy stance produced an export-led recovery and acceptable degree of creditworthiness by 1982–83, just as most of the LDC debtors were entering a deep crisis phase in their development process. After the termination of debt relief in 1984, Turkey began to face an increase in its external debt service. This strained the fiscal position and required a large rise in domestic borrowing at high real rates of interest.

1.4 Plan of the Monograph

Our monograph is organized in two parts. Following the broad retrospective provided on Turkish economic development in this chapter, in part 1 (chapters 2 to 5) we examine the aggregate performance and adjustment patterns from 1973 to 1986. These chapters constitute an analytical chronology of the policy phases outlined above. In part 2 (chapters 6 to 10) we focus on selected aspects of internal adjustment and external debt. Chapter 6 presents the principal findings of a multisector general equilibrium analysis and evaluates the interactions among external borrowing, trade liberalization, and exchange rate policy. Chapter 7 explores in greater detail the sources of Turkey's export boom in the post-1980 period. In chapters 8 and 9 we assess public finance and external debt management, respectively. In chapter 10, we recapitulate our conclusions and discuss the prospects for the future of debt management in Turkey. An appendix contains a political chronology, as well as supplementary tables on subjects covered in the main text of the monograph.

2 Economic Boom and Debt Crisis, 1973–77

For the Turkish economy, the 1970s were the best of times and the worst of times. The decade witnessed an unprecedented spurt of investment and growth until about 1977, accompanied by what looked like a steady improvement in income distribution. That was followed by a crash which was equally unprecedented. From mid-1977 on, Turkey found itself in a monumental debt crisis which took several years of intricate negotiations with creditors and a long series of rescheduling agreements to resolve. Growth suffered heavily, with two years of real contraction at the end of the decade, and income distribution turned sharply against urban workers and the peasantry.