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CHAPTER II

Phase II: 1953 to 1958

The focus of this part is upon the devaluation of 1958 and its effects. Understanding and analysis of that episode requires consideration of the factors leading to payments imbalance in the 1950's. Knowledge of that period is also valuable in understanding many aspects of the exchange control regime in the 1960's.

Consideration is given in the present chapter to the nature of the imbalance in the 1950's and to other aspects of the experience that are relevant for subsequent analysis – subject, of course, to severe limitations of data availability. It is simply not possible to obtain meaningful data on a variety of aspects of the Turkish experience prior to 1958. The lack of data is in part attributable to inadequate data collection in the 1950's. In fact, many of the data used below were developed in the early 1960's by the staff of the State Planning Organization, who found them necessary for planning purposes. Another factor contributing to the lack of information is that the Menderes regime was discredited after the May 1960 Revolution, and as a result many of those who could have provided insights into events of the 1950's have not done so. In addition, the nature of the payments regime and the partially suppressed inflation which resulted precluded reliable information. The economic environment was one in which data *a priori* were subject to wide margins of error. As indicated in Chapter I, even Turkish balance-of-payments statistics are believed to be subject to sizeable error for the latter half of the 1950's. Meaningful price data are impossible to obtain, since price controls were legally in force. Although black markets were prevalent, there are no records of those transactions. Many statistics simply were not collected at all, owing partly to the government's lack of interest in coordination of economic policy.

Subject to data limitations, then, three questions about Phase II of the mid-1950's must be considered: (1) the nature of the trade and payments regime; (2) the factors contributing to the payments imbalance; and (3) the effects of those factors and of the balance of payments on the Turkish economy. Each of these questions is considered, in turn, in this chapter.

I. The trade and payments regime of Phase II in the 1950's

Once exchange controls and multiple exchange rates were imposed in 1953, they were constantly changed in response to continued balance-of-payments difficulties. Thus the exchange rates applicable to various transaction categories, licensing regulations, guarantee deposits and other aspects of the trade and payments regime were in a constant state of flux. The proliferation of detailed, generally *ad hoc*, measures sometimes resulted in a system of internally inconsistent regulations.[1]

In addition to the factors creating continuing payments imbalance discussed in Section II below, another source of difficulty confronted the Turkish government. That factor, already existing in late 1952, was an accumulated short-term indebtedness. Because of its effects on other aspects of the regime and even upon the interpretation of those statistics that are available, we start by considering Turkey's foreign debt and its effects upon the trade and payments regime.

Foreign indebtedness

Nothing better illustrates the lack of coordination in economic policy during the Menderes years mentioned in Chapter I than the management, or more accurately its absence, of Turkey's international indebtedness. From 1952 until 1958 the debt hung over the entire exchange regime and affected everything: even export data and export prices are incomprehensible, except in that light.

Difficulties were already immense by late 1952. Despite the rapid increase in export earnings in the early 1950's, imports rose much more sharply. With a fairly liberal regime many of these imports were financed by suppliers' credits: Turkish importers were able to buy goods on short-term credit. The volume of those obligations was far in excess of the Central Bank's foreign exchange resources. Turkey was the first country to overdraw her IMF quota, and the first to request an extension of time when payment came due.[2]

By 1952 a large volume of overdue debt had already accumulated. The Central Bank always had a negative free-foreign-exchange position, from late 1952 until 1958, and Turkish importers were often unable to buy foreign exchange from the Central Bank to pay their commercial debts, despite their having been issued import licenses at earlier dates.

1. *Three Monthly Economic Reports, Turkey*, Economist Intelligence Unit, *No.21*, March 1957, pp. 3–4. Hereafter, various issues of this publication will be cited as EIU.
2. Keith Horsefield, *The International Monetary Fund 1945–1965*, International Monetary Fund (Washington), 1969, p. 347.

The precise amount of arrears and total debt during the 1952–1958 period has never been known. When debt consolidation was agreed upon by Turkey and the European Payments Union (EPU) governments in 1958, the EPU governments were forced to advertise within their countries in an effort to learn the extent of Turkish indebtedness.

Various estimates have been made about the volume of outstanding overdue and total debt at different dates. Table II-1 provides these estimates. However, the only official figure in Table II-1 is the Central Bank's estimate in early 1958 – at that time long- and short-term debt amounted to TL 3,550 million not counting arrears, which were estimated at TL 644 million.[3] As of early 1958 total indebtedness thus exceeded 10 per cent of GNP. Arrears alone were over 2 per cent of GNP and almost equal to 1958 exports.

Despite its large and growing size during the 1950's there was considerable turnover of the debt. Starting in 1954, Turkey made a series of bilateral agreements with various Western European countries for exporting and debt repayment: first Germany, then Switzerland, Italy, England and others.[4] All of these agreements had a similar format, although they varied in detail. For Turkish exports of specified commodities, a certain fraction of the export earnings was retainable by Turkish creditors. For example, an export-import firm in Germany could, if it imported DM 500,000 of hazelnuts, pay the Turkish exporter DM 250,000 and retain DM 250,000 against overdue Turkish debt. The Turkish debtor then paid the Turkish exporter the TL equivalent of DM 250,000.

These bilateral agreements have certain important consequences for the interpretation of Turkish trade and balance-of-payments statistics in the mid-1950's. First, not all of Turkey's foreign exchange earnings from exports – even those officially recorded – were available as free foreign exchange for the Central Bank. The picture of declining export earnings therefore understates the decline in free foreign exchange. Second, the fact that EPU creditors could receive repayment of their loans only if they imported from Turkey resulted in their willingness to buy Turkish commodities at prices above those in the world market. Failure to do so cost, at a minimum, foregone interest (or profits) for an unknown period and, at a maximum, implied an increased probability that the debt might not be repaid at all.[5] Hence the bilateral-agreement device enabled Turkey to export at a time when, as will be seen below, Turkey's export prices were non-competitive.

3. EIU, *op. cit.* (Note 1), *No. 25,* February 1958, p. 2.
4. Unfortunately there are no official records of the value of exports to Western Europe that moved under these bilateral agreements. In export data for the 1950's, exports to EPU countries include exports under bilateral debt payment agreements.
5. EIU, *op. cit.* (Note 1), *No. 21,* March 1957, p. 6.

Table II-1
Turkey's foreign debt, various dates (millions of TL)

Date	Central Bank Assets and Liabilities				
	Assets		Arrears	Balance	Total Debt
	Gold	Foreign Exchange			
2/54			420		
12/54	402	172	584		
12/55	402	188	799	−209	
12/56	402	242	732	−88	2,800
12/57				−160	4,200
8/58			1120		

Source: EIU, *op. cit.* (Note 1), various issues.

The eventual consolidation of arrears in 1958 amounted to $436 million. It is likely that this figure was below the actually overdue debt at that date. Moreover, by that time many creditors had accepted repayment of part or all of their loans at a discount under the bilateral-agreement arrangements.

Exchange rates[6]

Turkey had in effect a multiple exchange rate system from 1953 to 1960. The official rate, however, remained at TL 2.80 per dollar throughout the period. Multiple rates were achieved by imposing taxes on imports and other foreign exchange purchases, and by paying premia of differing heights for various categories of foreign exchange sales.

Import EERs.[7] When exchange control was instituted in September 1953, a system of surcharges on various categories of import transactions was inaugurated, along with import licensing. Once surcharges were established, commodities were frequently transferred from one category to another and the rates payable were changed frequently. The details of these surcharges and their EER equivalents are given in Appendix A.

Although import licensing was the dominant means of import control in

6. Data in this section, except as otherwise indicated, are drawn from: EIU, *op. cit.* (Note 1), various issues; and *Annual Report Exchange Restrictions,* IMF, 1952 to 1958.

7. For the definition of Effective Exchange Rates (EERs) and Price-Level-Deflated EER: (PLD-EER) mentioned below, see the Definitions and Concepts used in the Project on Foreign Trade Regimes and Economic Development included in this volume (Appendix D-1).

the 1950's, exchange surcharges of 25, 50, and 75 per cent were decreed for various categories of "luxury" imports in September 1953. Within two months, however, import licensing was restricted to permit only imports "essential to development," while the surcharges were extended to cover many of those goods.

The three-tier surcharge system remained in effect until 1958. Turkey switched from specific to *ad valorem* tariffs in 1954, with a general rise in the average rate of duty paid and thus an increase in EERs in that year. In 1957 a 40 per cent "exchange tax" was imposed on all purchases of foreign exchange, this tax lasting until December 1958.

Table II-2 summarizes the resulting import EERs for the 1953-to-1958 period. As can be seen, the EERs for all categories of transactions rose substantially over the period. However, as will be seen below, the price level rose sufficiently rapidly so that the PLD-EERs (see list of Definitions and Concepts used in the Research Project on Foreign Trade Regimes and Economic Development, Appendix D-1) for imports actually decreased (see Table II-3 below). It is noteworthy that as the nominal EERs rose the disparity in rates between import categories fell. Thus despite the initial intention of the government to favor capital goods, the increased use of multiple exchange rates reduced the differential between capital goods and other import categories.

Export EERs. At the same time that exchange control and import surcharges were imposed in 1953, premia were started for a few export categories. These were all marginal exports and had accounted for only about 3 per cent of Turkey's export earnings in 1952. The premia were: 50 per cent for exports earning "free" dollars, 40 per cent for proceeds from EPU coun-

Table II-2
Import EERs, 1953 to 1957 (TL per U.S. dollar of c.i.f. value)

	1953	1954	1955	1956	1957
Construction materials	3.58	3.76	4.25	4.55	6.16
Machinery and equipment	3.22	3.48	4.02	4.72	5.97
Intermediate goods and raw materials	3.78	4.14	4.38	4.54	5.35
Consumer goods	5.60	6.09	6.37	6.54	7.47

Sources: Construction Materials and Investment Goods EERs: Table A-10. Intermediate Goods and Raw Materials, and Consumer goods: 1954 and 1957 from Tables A-11 and A-14. 1955 and 1956: the percentage change from 1954 to 1957 was prorated over the intervening years in proportion to the change in construction materials.

Table II-3
Nominal and PLD-EERs, 1953 to 1957

	1953	1954	1955	1956	1957
	A. Nominal EERs (TL per dollar)				
Sales of foreign exchange					
Traditional exports	2.80	2.85	2.89	2.91	2.94
Nontraditional exports	3.92	4.48	4.50	5.00	5.00
Tourists and invisibles	2.80	2.80	2.80	5.75	5.75
Capital account	2.80	2.80	2.80	2.80	2.80
Purchases of foreign exchange					
Capital goods imports	3.22	3.48	4.02	4.72	5.97
Consumer goods imports	5.60	6.09	6.37	6.54	7.47
Tourists and invisibles	2.80	2.80	2.80	5.25	5.25
Capital account	2.80	2.80	2.80	2.80	2.80
	B. PLD-EERs (1958 TL per dollar)				
Sales of foreign exchange					
Traditional exports	5.83	5.28	4.82	3.93	3.26
Nontraditional exports	8.16	8.30	7.50	6.76	5.55
Tourists and invisibles	5.83	5.18	4.66	7.77	6.39
Capital account	5.83	5.18	4.66	3.78	3.11
Purchases of foreign exchange					
Capital goods imports	6.71	6.44	6.70	6.38	6.63
Consumer goods imports	11.67	11.28	10.62	8.84	8.30
Tourists and invisibles	5.83	5.18	4.66	7.09	5.83
Capital account	5.83	5.18	4.66	3.78	3.11

Notes: a) Capital goods import rate taken as the machinery and equipment rate.
b) PLD-EERs were computed by dividing the nominal EER by the home goods wholesale price index (1958 = 100) given in Table I-5..
c) Capital account sales of foreign exchange does not include capital repatriated by Turks after 1956, which was subject to the TL 5.25 = $ 1 exchange rate.
Source: Appendix A.

tries, and 25 per cent for earnings from bilateral-agreement (generally Eastern European) countries.

Premium rates were introduced in subsequent years for additional categories of exports, the number of commodities eligible for the basic premia was increased, and the premium rates themselves were altered periodically. Some premia, such as those for raisins and figs, were specific and were altered frequently. One effect of the premia was to encourage exports to Eastern European countries at relatively high prices, thereby enabling Turkish exporters to earn the premia. The importers in turn resold Turkish commodities in Western European markets at lower prices, recovering their losses through

high prices on the goods exported to Turkey. These transactions, known as "switch deals," were reported to be widespread in the mid-1950's. The government even stopped premia on cotton exports in 1957 (thereby virtually halting the exportation of cotton) to investigate the extent of switch-dealing.[8]

In addition to export premia, exporters of certain commodities were accorded foreign-exchange retention privileges. Chrome and manganese exporters, for example, were allowed to retain and use 100 per cent of export earnings from 1956 to March 1957. Another system, with 1 to 15 per cent retention, was introduced in August 1957 and later rescinded. It was not possible to calculate the value of retention rights in computing export EERs. However, their sporadic and limited use suggests that little bias in estimating export EERs results from their omission. Export EERs are given in Appendix Table A-1 and are summarized in Table II-3.

As can be seen, Turkey's major exports – tobacco, cotton, raisins, figs, hazelnuts, chrome and copper – received virtually the official exchange rate until 1956. Even after that date the premia for most traditional exports were relatively low. Even the marginal export commodities were subject to EERs below those applicable to imports.

Invisible and capital account transactions. Until October 1956 virtually all invisible and capital account transactions were subject to the official rate of exchange. An 87.5 per cent surcharge was imposed in October 1956 on payments for services and purchases of foreign exchange by Turks for foreign travel. The effective rate, TL 5.25 per dollar, thus applied to purchases of foreign exchange on current account except for dividend and interest payments. A premium of 105 per cent was simultaneously extended to foreigners' purchases of Turkish lira for tourist purposes, to repatriation of capital held abroad by Turks, and to some minor exports. The intent of introducing these new rates was apparently the hope of diverting foreign exchange transactions from black-market to official channels (see below, Section III). These rates remained in effect until August 1958.

Spread of EERs. Table II-3 presents the nominal and (price-level-deflated) PLD-EERs on various classes of transactions during the 1953-to-1957 period. As can be seen, the disparity between sales and purchase rates increased over the period. The amount in real terms received by traditional exporters per dollar of sales decreased by 45 per cent, and even that for non-traditional exports fell 32 per cent. The real exchange rates for capital goods imports, by contrast, remained virtually constant over the period, and the consumer

8. EIU, *op. cit.* (Note 1), *No. 22,* May 1957, p. 7.

goods import rate, initially 75 per cent above the capital goods import rate, fell to 25 per cent above it. Thus while the export rate depreciated markedly, that for imports fell by a considerably smaller magnitude and the spread between import rates decreased. As inspection of the detailed tables in Appendix A indicates, the spread within categories of both export and import rates was even greater than that shown in Table II-3.

Quantitative restrictions

Although there were frequent changes in EERs during the 1950's, the basic instrument used to control the balance of payments was quantitative restriction. Both imports and exports were subject to licensing, and the rules governing each were frequently changed. Initially, the intent of import licensing was to limit expenditures upon imported goods, while export licensing was primarily aimed at insuring that foreign exchange earnings would enter official channels. But regulations were rapidly modified in attempts to prevent the evasions of the system which had developed. Moreover, the restrictiveness of the system increased as foreign exchange earnings declined. We consider quantitative restrictions on imports and exports in turn.

Import licensing and price checks. It was decreed in the initial decision to employ exchange control that all imports would be subject to licensing and that machinery, equipment and raw materials would be licensed fairly freely, while other items could be imported only "if needed for development."[9] The regulations governing import licensing increased in complexity and detail thereafter. In 1954 all importers were required to possess "importer's certificates," and their annual imports were limited to their highest annual imports of the years 1948 to 1953.[10] Not more than one-sixth of this amount could be imported in any two-month period. The system was further tightened and modified in mid-1955, but by the end of that year it was decided that the Ministry of Finance and the Minister of Economy and Commerce should determine the import needs of the private and public sectors and decide on their foreign exchange allocations.[11] The government gradually became the sole importer of a variety of raw materials and other goods.

Guarantee deposits against applications for import licenses from the private sector were a part of the control system throughout the 1953-to-1958 period. These requirements were increased at intervals, rising from 4 per cent in 1953 to 20 per cent in 1958.

9. *Sixth Annual Report on Currency Restriction,* IMF, 1954, p. 301.
10. *Seventh Annual Report on Currency Restriction,* IMF, 1955, p. 294.
11. *Eighth Annual Report on Currency Restriction,* IMF, 1956, p. 290.

There were frequent "holidays" on the issuance of import licenses as the government's foreign exchange holdings became smaller. It often happened that applications for licenses, even for those commodities whose importation was supposed to be liberal, were delayed two to eight months before action was taken on them. In the last few weeks prior to August 1958, indeed, no import licenses were issued. Licensing in earlier years had on occasion been suspended for periods of several weeks, and delays were frequent.

As evidence of large premia on imports developed in the mid-1950's, the government placed a number of goods on a "restricted import" list. These goods were to be eligible for importation only if the importer could arrange foreign credit of more than a year's duration to finance the import.[12] The intent of the "restricted import" list was to increase the flow of imports of high-premium goods without worsening Turkey's indebtedness situation in the short run. One result of the regulation was a major increase in imports in this category, apparently financed by foreign credits, but often actually paid for by black-market foreign exchange.[13]

In an effort to stem the growing black market, the government developed a system of import price controls. Price committees were established to verify that import prices were in line with those in world markets. No licenses were issued after 1956 and no goods cleared customs without an official price certificate.[14]

There was also increasing resort to bilateral agreements with Eastern European countries throughout the 1953-to-1958 period in order to step up the flow of imports and to find export markets. As those agreements affected both imports and exports, they are dealt with separately below.

It should be recalled that the many changes in the licensing system and its administration interacted with changes in import EERs discussed above. The brief description of the control mechanism given here fails to convey more than the barest outline of the import controls applied during the 1950's. It will be seen below that the curtailment of imports flowing through official channels was pronounced and had considerable impact on the economy.

Export licensing. Whereas the purposes of import controls were to restrict the flow of imports and to plug loopholes in the system, export licensing was apparently intended primarily as a means of preventing extra-legal flows of exports. In addition to bilateral agreements, to be discussed below, the major instrument used in connection with exports was the system of price controls, or price registrations.

12. EIU, *op. cit.* (Note 1), *No. 10,* July 1954, p. 5.
13. *Ibid., No. 15,* September 1955, p. 3.
14. *Ibid., No. 19,* August 1956, p. 4.

It should be noted first that the pricing policies of the SEEs and other government agencies were and are a major factor influencing exports.[15] During the 1950's the export prices set by government agencies, especially for traditional agricultural exports, were significantly above international prices. Thus even in the absence of export price controls there would have been severe problems associated with exporting those commodities.

Price controls on exports were intended to prevent under-invoicing of exports and the diversion of export proceeds to the black market, but the manner of their administration led to additional difficulties. In general an export price was "registered" applicable to a particular commodity category. Once that price was established, no export licenses were issued for prices lower than the registered price.

A priori, one would expect price registration of this form to have several drawbacks. Firms attempting to develop export markets or penetrate new ones would be hampered in so doing; quantity discounts would be difficult to make; and firms with below-average quality would encounter difficulty in obtaining export orders, since they could not cut price to reflect lower quality. Attempts to get approval of exports at less than the registered price would entail delays, and hence shifts in world market prices would be difficult to adjust to. An exporter with an unusually high-priced order would be reluctant to accept it for fear that the price would become the registered price and hence prejudice future sales (unless of course he resorted to under-invoicing). Bilateral agreement countries would also become increasingly attractive export markets relative to convertible currency markets, since prices paid under those agreements were generally higher.

There can be little doubt that throughout most of the 1950's there was an incentive to under-invoice exports. Despite the legal export premia indicated above, the black-market rate (see below) was considerably in excess of the legal premium rate, generally by a factor of two or more. While this consideration might have warranted some sort of minimum prices for exports, the actual administration of registered prices was done in a way that made their effects even more pronounced than *a priori* arguments would suggest.

Price registration for hazelnuts will illustrate. The minimum export prices for the 1955 crop were $140, $110 and $104 per 100 kilos in 1955, 1956 and 1957, respectively; the 1956 crop had a minimum export price of $130 in 1956 and $110 in 1957, contrasted with world prices in those years of $55–$60.[16] Stocks consequently built up to 40,000 tons by the beginning of 1957, and thereafter declined to 23,000 tons after the government granted special import rights to the exporters. As of November 1, 1957, however, no

15. See Chapter VII for a fuller discussion.
16. EIU, *op. cit.* (Note 1), *No. 23*, November 1957, p. 4.

sales of that year's crop had yet been made, as the minimum export price had not yet been established. When the price was finally set at $100 per 100 kilo, it was well above the international price, but also below the internal price, and the Exporter's Union was expected to take the loss on export sales.[17]

Other export commodities suffered similar fates. Neither tobacco nor figs could be exported at the start of the 1957 export season owing to delays in establishing registered export prices.[18] In general, registered prices for exports appear to have been set well above international prices. Turkey often lost export markets as a consequence, ending up with large stocks of exportable goods. In many instances the government finally exported at a later date, incurring sizeable losses. In other cases excessive stocks were sold at above-world prices under bilateral debt-repayment agreements, in which cases free foreign exchange earned was much smaller than export proceeds.

In examining the decline in export earnings, the price control policies of the government should be borne in mind. Given the decline in the real exchange rate for exports, there would in any event have been a downward shift in export supply. That decline was accentuated by price registration.

Bilateral agreements. As the Turkish foreign exchange position became increasingly stringent, Turkey resorted more and more to bilateral clearing agreements as a means of obtaining some imports, and of finding some export markets at the relatively high prices of her export goods. These agreements were different from the bilateral arrangements referred to above, which focused upon debt repayment. By 1957 there were fifteen such bilateral agreements in effect.[19] Whereas only 7 per cent of Turkey's imports originated from bilateral trading partners in 1952, 29 per cent of all imports originated from those countries by 1955. Similarly, 14 per cent of Turkish exports were destined for clearing-agreement partners in 1952, and 32 per cent in 1955.[20]

With a general shortage of imports, Turkish importers were willing to pay higher prices than those prevailing in Western Europe for imports from bilateral agreement countries, thus offsetting the above-world prices charged for Turkey's exports. The switch-deal phenomenon was one outcome. In effect, some Eastern European countries were involved in an entrepôt trade, buying

17. *Ibid.*, p. 6.
18. *Ibid.*, p. 4.
19. They were with Brazil, Bulgaria, Czechoslovakia, Egypt, Finland, East Germany, Hungary, Iran, Israel, Japan, Poland, Romania, Spain, U.S.S.R., and Yugoslavia.
20. By 1955 Turkey's imports from her bilateral trading partners were 33 per cent greater than her exports to them. The absolute value of imports from clearing agreements countries then fell from TL 404 million in that year to TL 259 million in 1957, contrasted with exports to those countries of TL 285 million in 1955 and TL 238 million in 1957.

Western European goods to sell to Turkey and buying Turkish exports for resale on the Western European market.

There is no hard evidence as to the extent of switch-dealing, although most people interviewed on the question indicated they thought it to be widespread. The large increase in Turkey's traditional exports to Eastern Europe is sometimes cited as presumptive evidence of the argument that Turkey's Eastern European trading partners could not have absorbed so much tobacco, cotton, hazelnuts and dried fruit. A further indication is the fact that the government adopted several measures to attempt to stop switch-dealing. As indicated above, cotton exports were halted at one time while switch-dealing was investigated. On other occasions, the government imposed quantitative regulations on the fraction of exports that could go to Eastern Europe. For example, the government decreed in 1955 that 75 per cent of every cotton exporter's shipments should go to EPU countries,[21] and in 1956 hazelnut exports to non-EPU destinations were limited to 1,000 tons.[22]

II. Sources of inflationary pressure and imbalance

Five interrelated factors must be examined in evaluating the causes of Turkey's inflation and payments difficulties of the mid-1950's. These are: (1) the government's budget policies, (2) agricultural price support policy, (3) the losses of the SEEs, (4) the expansion of the money supply, and (5) exogenous shifts in Turkish agricultural production. Each of these factors is considered in turn in this section, and the combined consequences of all five phenomena are evaluated thereafter.

Government budgets

In Turkey the general government budget is separate from that of public enterprises, except insofar as there are transfers from the general government to the public enterprises. Hence the government revenue and expenditure figures presented here do not include the activities of the SEEs, which will be considered separately below.

Table II-4 provides the basic data on the public finance of the Government of Turkey during the 1950's. As can be seen, real government expenditures rose rapidly, especially in the early 1950's. With an average annual 11 per cent growth rate of real GNP, government expenditures rose from 15.6 per cent of national income in 1950 to 17.4 per cent of national income in 1955. Although tax revenues were less than expenditures, transfers, primarily from

21. EIU, *op. cit.* (Note 1), *No. 16*, December 1955, p. 7.
22. *Ibid.*, *No. 17*, March 1956, p. 7.

Table II-4
Central government expenditures and receipts, 1950 to 1957

	1950	1953	1954	1955	1956	1957
	A. (millions of TL)					
Current outlays	1,236	1,809	2,140	2,635	2,693	3,025
Capital formation	134	339	367	537	762	940
Total expenditures	1,370	2,148	2,507	3,172	3,455	3,965
Tax receipts	1,312	1,971	2,222	2,627	2,999	3,821
Transfers	120	241	230	522	295	264
Net domestic borrowing	−62	−64	55	23	161	−120
	B. (per cent of national income)					
Current outlays	13.9	12.3	14.5	14.5	12.7	11.4
Capital formation	1.7	2.3	2.9	2.9	3.6	3.5
Total expenditures	15.6	14.6	17.0	17.4	16.3	14.9
Tax receipts	14.9	13.4	15.0	14.4	14.1	14.3
Transfers	1.2	1.6	1.6	2.9	1.4	1.0
Net borrowing	−0.5	−0.4	0.4	0.1	0.8	−0.4

Notes: a) Transfers consist predominantly of use of TL counterpart funds.
b) These accounts are on an economic basis, and do not coincide with the Turkish classification of current and capital accounts.
c) Central government budget includes the general and annexed budgets. See Land, *op. cit.*, for details.

Source: Land, *op. cit.* (Table I-5).

abroad, covered most of the disparity until 1954. Thus inflationary pressure from the government budget originated more from the rapid increase in real expenditure than from the financing of that expenditure in the early 1950's.

The big surge in government expenditures came just at the time when agricultural production fell sharply in 1954. Hence whatever inflationary pressures would otherwise have been generated by the rapid increase in expenditures were intensified by exogenous events. After 1955 government expenditures continued to increase, but not as rapidly as GNP. As a means of finance, domestic borrowing assumed some importance in the years 1954 to 1956, but was not large by any absolute standard.

Thus if the government budget was inflationary, it was the very rapid increase in real government expenditures that provided the stimulus. Even so, there is no way in which government fiscal policy (aside from the effects of SEE financing) could have resulted in the amount of inflation actually experienced. While government fiscal policy may have contributed moderately to Turkish inflation, it did not do more than that.

Agricultural price supports

During the early 1950's the government attempted to encourage rapid growth in agriculture through high price supports on major agricultural products, especially cereals, and other measures. The result was rapid output expansion for a few years, which was the major factor in the very rapid GNP growth. The costs of that expansion however were strong inflationary pressures and an uneconomic land utilization pattern.[23]

Government policy toward agriculture had several parts: (1) maintenance of high prices for agricultural commodities through price support programs and purchases by state agencies, (2) the subsidization of inputs and especially of tractors, and (3) the development of roads and infrastructure in agriculture. Of these policies, the first was most important and is of particular concern here. Support prices were announced for a number of agricultural commodities early in the year. Various government agencies then stood ready to buy at those support prices. Those agencies were either SEEs or Agricultural Cooperatives under government control (although membership by farmers is voluntary). Focus for present purposes is upon TMO (Toprak Mahsulleri Ofisi – Soil Products Office) which was organized as a state enterprise in 1938. TMO is responsible for price intervention in wheat and other cereals,[24] and in addition is the sole importer and exporter of cereals for Turkey. Grains account for about 70 per cent of the value of Turkish agricultural output.

Table II-5 gives estimates of acreage, production, yield, and net trade in wheat over the 1950-to-1957 period. As can be seen, the response to high support prices was a rapid increase in acreage devoted to wheat. The area

23. Expansion of cereals output was accomplished primarily through the conversion of pastureland and forests to cropland. The evidence is that almost all the converted land had a higher marginal product in livestock or forests than in cereals production. Not only did yields decline in cereals production, but livestock yields must also have fallen. It is estimated that, by 1956, total livestock output was declining. The decrease in livestock production is not taken into account in the national income statistics. See Eva Hirsch and Abraham Hirsch, "Changes in Agricultural Output Per Capita of Rural Population in Turkey, 1927–60," *Economic Development and Cultural Change*, July 1963.

24. There are also SEEs for livestock and fish (Et ve Balık Kurumu – EBK – Meat and Fish Company), sugar (Şeker Fabrikası Kurumu – Sugar Factories Company), and tobacco (State Monopoly). Other products are handled by sales cooperatives. The EBK has set ceilings on livestock prices, which have been below the prices prevailing in Turkey's southeastern neighbors. This is a major factor accounting for a large smuggling trade in livestock over Turkey's southeastern border as well as very very low rates of capacity utilization in EBK, averaging 7 per cent for sheep and 21 per cent for cattle in 1960. See Olan Forker, *Agricultural Price Intervention by the Government of Turkey*, mimeograph (Ankara), August 1967.

Table II-5
Wheat acreage, yield, production, and net trade, 1950 to 1957

	Acreage (thousands of hectares) (1)	Production (thousands of tons) (2)	Yield (kg. per hectare) (3)	Exports Minus Imports (thousands of tons) (4)	(millions of dollars) (5)
1950	4,477	3,872	864	−189	−122.0
1951	4,789	5,660	1,169	−69	−7.1
1952	5,400	6,447	1,194	462	59.4
1953	6,410	8,000	1,248	601	58.7
1954	6,405	4,900	765	950	67.3
1955	7,060	6,900	977	−63	−4.9
1956	7,335	6,400	872	−9	+1.0
1957	7,157	8,300	1,159	−444	−37.7

Notes: Palmer's data are reworked SIS estimates and do not accord with SIS figures. They are not consistent with balance of payments data.

Sources: Columns (1) to (3). Edgar Z. Palmer *et al., Agriculture in Turkey,* Robert College (Istanbul), 1966, Chapter 8.
Columns (4) and (5). *Yearbook of International Trade Statistics, U.N.,* various issues.

sown increased from 4.5 million hectares in 1950 to 7.0 million hectares in 1955. Production also increased markedly; Turkish wheat production in 1950 was 3.9 million tons, and 189,000 tons were imported. By 1953, a bumper-crop year, production of wheat had more than doubled, resulting in an export surplus of 601,000 tons (adding $58.7 million to Turkey's export earnings in that year) and a sizeable increase in TMO's stocks.

The price at which TMO exported wheat was well below the price at which TMO purchased wheat. Although the government had earlier declared its intention of compensating TMO for its resulting losses, no such compensation was made. Rather, TMO financed its deficits by borrowing from the Central Bank,[25] and did not repay its loans. The outstanding amounts of TMO's credits from the Central Bank were: TL 196 million, 1950; TL 519 million, 1952; TL 708 million, 1954; and TL 1,371 million in 1958. By 1958, 31 per cent of all Central Bank credit was extended to TMO. Of the increase of TL 5,516 million in high-powered money between 1950 and 1958, TL 1,175 million, or 21 per cent, resulted from TMO losses alone. Moreover, for the years 1950 to 1954 the net increase of TL 512 million in TMO's Central Bank

25. TMO had inadequate storage facilities. Some of its losses were caused by the resulting depletion of grain stocks.

credits accounted for over 31 per cent of the increase in high-powered money.

Other agricultural commodities also benefited from high price supports, with consequent losses on export sales (by other agencies not included in the central government budget), although TMO's losses were the largest. That TMO's operations were clearly an important inflationary factor was observed at the time. According to the Chenery report, written in 1953:

> Normally, it is not possible to identify any one factor as inflationary; it is the aggregate excess of investment over intended savings which is significant. In the present situation, however, there is one element of investment which clearly stands out as the marginal factor. This is the accumulation of cereals stocks by Toprak [TMO] and its borrowing from the Central Bank to cover not only the stock accumulation but the difference between the prices which it pays for cereals and their sale price....Toprak's investment in stocks in the past two years has been equal to half of the inflationary gap between investment and total savings.[26]

There can be little doubt that the government's cereals policy was responsible for much of the initial inflationary pressure experienced within the Turkish economy. The large import surpluses in the years 1951 to 1953 and the rapid increases in agricultural output offset much of the inflationary pressure and there were relatively small rates of price increase. With the first crop failure in 1954, however, the effects of TMO policies and their financing were immediately felt.

State economic enterprises

Once inflation was underway, the government attempted to stop it through a variety of direct interventions. One such measure was instructions to the non-agricultural SEEs to keep their sales prices constant. With rising costs, the SEEs were soon unable to cover their expenditures from current revenues and they too borrowed heavily from the Central Bank.[27]

In 1956 a law was passed regulating legal profit margins on private transactions, as well as imposing legal ceilings on SEE prices.[28] Although enforcement was fairly strict over the private sector for a short time, the inevitable black market soon developed. For SEEs, caught with rising input costs and fixed output prices, the magnitude of borrowing simply increased.[29]

As indicated above, SEE budgets are not included in the Turkish govern-

26. Chenery *et al.*, *op. cit.* (Note 14, Chap. I), pp. 40–41. Acquisition of stocks was of course the result of export-pricing policies.
27. Aktan, *op. cit.* (Note 16, Chap. I), p. 336.
28. Law No. 6731 passed June 6, 1956 and published in the *Official Gazette No. 9329*, June 11, 1956.
29. Okyar, *op. cit.* (Note 5, Chap. I), pp. 104–5.

ment accounts. Credits from the Central Bank to the SEEs were of major importance in the latter half of the 1950's. They had much the same inflationary impact that a central government deficit financed by Central Bank borrowing would have had. Credits to SEEs from the Central Bank stood at TL 745 million in 1950. By 1956 they were TL 1,844 million. In 1958 they were TL 3,247 million. Thus, whereas TMO operations had their biggest impact on Central Bank credits in the early 1950's, deficits of other SEEs were huge in the 1956-to-1958 period.

Little or nothing can be inferred from the SEE losses about their efficiency during the 1950's, since it was government policy which forced them to sell below the cost of production. However, insofar as increases in the money supply led to excess demand, which in turn was met by the SEEs with heavier losses and additional borrowing and consequent money creation, the anti-inflation price controls of the government became in fact the chief source of continuing inflationary pressures. Elimination of the SEE deficits and alterations in SEE pricing policies in 1958-1959 were among the important components of Turkey's devaluation package.

Money supply and money income

It is clear that TMO and other SEE borrowings from the Central Bank largely explain the rapid increase in Central Bank credits from 1953 to 1958. It remains only to link up the behavior of money income and the price level with that of the money supply and Central Bank credits.

Table II-6 presents data on the amount of high-powered money (currency plus Central Bank credits) for the years 1950 to 1958. The top part of the table gives the amount of high-powered money at the end of each year. As can be seen, the amount of high-powered money almost quadrupled in the eight-year period 1950 to 1958, with the biggest increase in the years 1956 and 1957. The role of SEE credits from the Central Bank in the total increase in high-powered money stands out clearly. Part B of Table II-6 gives the year-to-year changes in high-powered money.

Fry has extensively investigated the relationship between high-powered money, money stocks and money income in Turkey.[30] In evaluating the relationship of high-powered money to the money supply, his results were that:

> It is clear that long-run movements in all definitions of money have been primarily determined by changes in high-powered money. Over the period 1950–1968, the contribution of high-powered money to the change in all definitions of the money supply exceeded 90 per cent.[31]

30. Maxwell J. Fry, *Finance and Development Planning in Turkey*, E.J. Brill (Leiden), 1972.
31. *Ibid.*, p. 85.

Table II-6
High-powered money expansion and its origins, 1950 to 1958 (millions of TL)

	Currency	Central Bank Credits: SEEs	Central Bank Credits: Government	Central Bank Credits: Other	Central Bank Credits: Total	Total High-Powered Money	Per cent SEE Credits of High-Powered Money
	A. Absolute Amount						
1950	900	745	263	63	1071	1971	37.8
1951	1048	933	298	88	1319	2367	39.4
1952	1146	1145	263	131	1539	2685	42.6
1953	1333	1444	242	126	1812	3145	45.9
1954	1397	1562	439	227	2228	3625	43.1
1955	1805	1643	616	193	2452	4257	38.5
1956	2322	1844	892	119	2855	5177	35.6
1957	2936	2566	1021	153	3740	6676	38.4
1958	3052	3247	1000	188	4435	7487	43.3
	B. Change from Previous Year						
1951	148	188	35	25	248	396	–
1952	98	212	−35	43	220	618	–
1953	187	299	−21	−5	273	160	–
1954	64	118	197	101	416	480	–
1955	408	81	177	−34	224	632	–
1956	517	201	276	−74	403	920	–
1957	614	722	129	34	885	1499	–
1958	116	681	−21	35	695	811	–

Note: Much of TMO's borrowing was reflected in expansion of currency in circulation, as TMO bought up crops. Thus, the column of "SEE credits" fails to reflect the combined effect of TMO and other economic enterprises.

Source: *Aylık Bülten*, Central Bank, June–September 1971.

Fry concluded that for the period 1950 to 1961, with the annual average increase in money stocks of 14.5 per cent, 14.1 per cent was accounted for by changes in high-powered money.[32]

Thus the mechanism of credit creation to finance the government agricultural policies and SEE deficits contributed directly to increases in the money supply during the 1950's.

Fry found a strong link between the money supply and money income in Turkey. In view of the fact that government price policy and weather conditions are the chief determinants of agricultural money income, it is not surprising that Fry found the best fits for money supply and money income

32. *Ibid.*, p. 84.

excluding agricultural income. Fry attempted to estimate the lag between money stock and non-agricultural money income for all definitions of the money supply. With only annual data at hand, he found that the lag between money supply and non-agricultural money income was about two years. The constant term in his estimating equation was insignificant, and for the period 1950 to 1969 Fry's estimates are:

$$\Delta \log Y_t = 0.91\, \Delta \log M_{t-2} + 0.03\, \Delta \log i_t \qquad (1)$$

where Y_t is non-agricultural income in year t, and M_{t-2} is the money supply (defined as currency in circulation, commercial sight deposits, sight deposits at the Central Bank, savings time deposits,[33] and commercial time deposits) lagged two years. The symbol i_t stands for the rate of inflation in year t – a proxy for the cost of holding money – and was insignificant. Of the variance in the rate of change of money income, 62 per cent is explained by eq. (1).[34] These results imply that a one per cent increase in high-powered money in year $t-2$ gives rise to a 0.91 per cent increase in money income with a two-year lag.

Fry also attempted to test the link between money supply and real income. All tests were insignificant, lending strong support to the view that the Turkish inflation of the 1950's was induced, proximately, by the behavior of the money supply. That behavior in turn was largely the result of Central Bank creation of high-powered money, much of which was forced upon the Central Bank by the agricultural and SEE pricing policies of the government.

Exogenous shifts in agriculture

Given Fry's results, the increases in high-powered money in the early 1950's would have led to inflationary pressures within Turkey even if supply conditions had been stable. However, at the same time that monetary policy was resulting in strong inflationary pressures, after increases in the money supply of 21, 12, and 19 per cent in the years 1951 to 1953, respectively (see Table I-5 above), agricultural production dropped sharply.

The year 1954 was an extremely poor one for Turkish agriculture and 1955 was little better. Judged by the national income accounts, agricultural production fell by 20 per cent between 1953 and 1954; wheat production fell 38 per cent; output of other cereals declined by 25 per cent; and tobacco output fell 13 per cent.[35] Agricultural production in 1955 was still 12 per

33. *Ibid.*, p. 87. Savings time deposits can normally be withdrawn on demand in Turkey.
34. *Ibid.*, p. 101.
35. Data are from Palmer, *op. cit.* (Table II-5), p. 52.

cent below the 1953 level. Cereals production did not reattain the 1953 level until 1957.

Available data indicate that food prices did not rise more than the general price level in 1954 and 1955. The Istanbul Chamber of Commerce and Industry price index gives the following estimates, by components, on a 1948 base:[36]

	Food Prices	Overall Prices	Ratio
1953	113	109	104
1954	120	119	101
1955	129	134	96

The International Labor Organization, which derived its estimates independently by direct sampling, indicates the same movements in the domestic terms of trade.[37] Hence stock sales of TMO and other agricultural organizations prevented an increase in the relative price of food. The fact that agricultural production declined so sharply must nonetheless have accentuated the inflationary pressure generated by money supply increases.

The net inflationary impact

We are now in a position to estimate the contribution of each of the above-mentioned factors to excess demand and inflationary pressures in Turkey during the 1950's. Any such estimates must necessarily be somewhat heroic, but they nonetheless serve to give an idea of the separate contribution of various factors to excess demand.

The model chosen is exceedingly simple: changes in the money supply are assumed to have been determined, in accordance with Fry's results, by changes in high-powered money. Changes in the money supply are in turn assumed to determine later changes in money income, which is assumed equal to aggregate demand. Supply shifts are taken to be exogenously determined. Thus the increase in real agricultural output, in constant prices, is taken as a fraction of the previous year's real income. The non-agricultural sector's capacity is assumed to have grown at a constant rate, equal to 3 per cent of the previous year's national income over the period (this implies a 10 per cent annual increase in manufacturing capacity and a 5 per cent average increase in capacity in all other nonagricultural sectors). Given inflationary pressures, it is reasonable to assume that capacity was generally fully utilized. The change in imports was determined by the foreign trade regime, and is also linked to the previous year's national income.

36. *Monthly Bulletin,* Central Bank, July–December 1960.
37. *International Labour Review, Statistical Supplement,* International Labour Organization, various issues.

Formally,

$$\frac{Y_t - Y_{t-1}}{Y_{t-1}} = \frac{M_{t-1} - M_{t-2}}{M_{t-2}} \tag{2}$$

$$\frac{Y_t - Y_{t-1}}{Y_{t-1}} = \frac{Q_t - Q_{t-1}}{Q_{t-1}} + \frac{P_t - P_{t-1}}{P_{t-1}} \tag{3}$$

$$\frac{Q_t - Q_{t-1}}{Q_{t-1}} = \frac{A_t - A_{t-1}}{Q_{t-1}} + \frac{N_t - N_{t-1}}{Q_{t-1}} + \frac{I_t - I_{t-1}}{Q_{t-1}} \tag{4}$$

where Y is money income, M is the money supply, Q is the physical quantity of output evaluated at the previous year's prices, P is the price level, A is agricultural output in previous-year prices, N is non-agricultural output (equal to capacity) at previous-year prices, and I is imports. Changes in the money supply and in the three right-hand variables of eq. (4) are taken as exogenous.

Table II-7 presents the results of the computation. As can be seen, fluctuations in agricultural output would have been very important in the early 1950's had their influence not been damped by TMO operations. In 1954 the reduction in agricultural output was equal to over 10 per cent of 1953 national income. Sales from TMO stocks in 1954 undoubtedly led to the smaller-than-predicted (26.9 per cent) increase in prices and the relatively small (8.9 per cent) increase in the money supply, which served to damp inflationary pressures in 1955. It is interesting to note, however, that the combined 1954 and 1955 predicted price increases were very close to the actuals: TMO operations evidently delayed inflation but did not suppress it for long. By and large, inflation was less than predicted in the period 1952–1954, and about equal to the predicted amount after 1955. Given the crude nature of the estimates, however, inferences must be drawn with care.[38]

The role of SEE credits in the period 1955 to 1958 stands out clearly via its influence on the money supply, and therefore on aggregate demand. Even if agricultural output had increased steadily at 5 per cent of national income – a very high rate of increase – there would have been considerable inflationary pressure: only in 1954 and 1957 would the situation have significantly improved on the assumptions underlying the model.

It may be objected that one should use the change in the export surplus as an indicator of the foreign trade sector's contribution to excess demand. The reason for not doing so was that there is considerable evidence that the volume of exports was a result of demand pressures rather than a cause. That

38. The same estimates were made with alternate lags in the money supply, but the results were essentially unaffected.

Table II-7
Predicted and actual inflation, 1952 to 1958
(percentage of previous year's real national income)

	Supply Changes				Demand Changes	Inflation	
	Agriculture (1)	Non-Agriculture (2)	Imports (3)	Total (4)	$\frac{\Delta M_{t-1}}{M_{t-2}}$ (5)	Estimated (6)	Actual (7)
1952	2.8	3.0	3.4	9.2	21.2	12.0	6.8
1953	5.3	3.0	−4.6	3.7	11.7	8.0	2.2
1954	−10.2	3.0	−0.9	−8.1	18.8	26.9	12.5
1955	4.3	3.0	0.3	7.6	8.9	1.3	11.1
1956	4.9	3.0	−1.2	6.7	28.0	21.3	23.3
1957	0.8	3.0	−0.1	3.7	25.2	21.5	21.6
1958	7.8	3.0	−0.7	10.1	22.6	12.5	11.1

Sources: Agricultural output: from national income accounts, at constant prices, as given in Table I-3.
Non-agricultural output: estimated capacity growth as a per cent of national income.
Imports: Lira value of imports (as recorded at a constant exchange rate) as a per cent of previous year's national income.
Money income: the change in the money supply as given in Table I-5 between $t-1$ and $t-2$ as a per cent of the money supply in $t-2$.
Estimated $\Delta P/P$: column (5) minus column (4).
Actual price increase: percentage increase in Istanbul Chamber of Commerce home goods price index, given in Table I-5.

is, exports appear to have been determined largely as a residual: given the level of domestic production, exports were the part of that production remaining after domestic demand was satisfied.[39]

We therefore conclude that fluctuations in agricultural production were themselves a fairly minor factor in leading to inflation. However, agricultural price supports and the ensuing credit creation were the major factors leading to increases in the money supply and initiating inflation. Inflation was thereafter fed through SEE deficits, which led to further money supply increases. Hence the proximate cause of the Turkish inflation in the 1950's was the behavior of the money supply.

39. See Chapter VII, below.

III. Effects on trade and growth

Interaction of foreign trade and the domestic economy

If the Turkish economy had been autarkic during the 1950's the Turkish inflation would still have resulted in some domestic economic dislocations. Conversely, if Turkey had not experienced inflationary pressures in the 1950's she might nonetheless have had some balance-of-payments difficulties at the existing exchange rates even in the absence of foreign indebtedness.

In fact, Turkey was dependent upon foreign trade for a wide variety of goods, and the misallocative effects of inflation were proximately felt through balance-of-payments difficulties and the consequent shrinkage of imports. While other factors might have led to some payments imbalance, their effects were completely swamped by the pressures of excess demand and inflation on the payments situation.

Thus the domestic inflation had its most distortive effects via the associated decline in foreign trade. In this section, consideration is first given to the behavior of foreign exchange earnings and receipts, and the reasons for it. The effects on the domestic economy will be examined thereafter.

Export earnings

As seen in Table I-6, Turkey's export earnings rose from $262 million in 1950 to a peak of $396 million in 1953. Thereafter they declined until 1958, with a minor interruption in 1957, when they were $249 million. Virtually every export category except tobacco shared in the decline, although there were sizeable year-to-year fluctuations in agricultural exports. As indicated above, the recorded decline in export earnings understates the decline in official foreign exchange receipts, since many exports were made under bilateral debt repayment agreements, where part of the receipts were retained in the importing country for debt-repayment purposes.

The first task is to separate the decline in export earnings into that part attributable to changes in international prices and the part attributable to volume changes. With peak export earnings coming in 1953, many have naturally blamed the fall in export earnings on terms-of-trade changes.[40] To quantify the relative importance of terms-of-trade and volume changes, detailed commodity trade statistics for the period 1953-to-1958 were examined and three alternative computations were made. (1) If unit prices had remained at their 1953 levels, what would the value of exports have been given actual export volumes? (2) Given unit prices prevailing in each year, what

40. Hershlag, *op. cit.* (Note 4, Chap. I), p. 180.

value would exports have had if Turkey's commodity-specific export volumes had remained at their 1953 levels? (3) If Turkey had retained her share of each commodity-export market, what would the value of exports have been? The first computation enables one to infer the degree to which changes in export earnings were attributable to volume changes. The second computation permits an inference about the degree to which export prices declined.[41] Those two computations, contrasted with the actual level of exports, indicate the relative importance of price and quantum changes over the 1953-to-1958 period. The share calculations make it possible to estimate the way in which export earnings might have increased had Turkish trade and exchange rate policy allowed Turkey to maintain her share of each of her export markets.[42]

Details of the computations are given in Appendix B. Table II-8 summarizes the results. The decline in export earnings for recorded exports is more than accounted for by a reduction in export volumes. Some have claimed that the reduction in wheat exports accounts for this. However, inspection of the detailed commodity figures in Table B-3 indicates that reduced volumes of exports were the rule rather than the exception. Between 1953 and 1958 cotton exports fell 66 per cent in quantity terms, chrome 24 per cent, copper 29 per cent, wool 29 per cent, and so on. When it is recalled that the dollar prices of minor exports – not included in the computations – were more probably rising than falling, there was undoubtedly a significant decline in the volume of minor exports whose quanta were not individually reported.[43] Had Turkey maintained her share of export markets her export earnings would have increased 26 per cent, contrasted with an actual decline of 45 per cent.

Thus there can be little doubt that the sharp reduction in export earnings

Table II-8
Decomposition of export earnings decline, 1953 to 1958 (millions of TL)

	1953	1954	1955	1956	1957	1958
Actual exports	945	827	738	642	721	519
Exports at 1953 prices	945	854	629	605	658	517
Exports at 1953 volumes	945	1013	1112	979	972	945
Exports at constant share	945	939	907	1070	1197	1192

Source: Appendix B.

41. The fact that export prices were high due to bilateral debt-repayment agreements does not alter the validity of the tests, since focus is upon the reasons for the decline in recorded export earnings.
42. Turkey's share of the world market is relatively low for most of her exported commodities. See Chapter VII, below.
43. See Chapter VII for estimates of the determinants of minor exports.

was attributable to reduced export volumes, and we must now consider the reasons for this. Several factors must be considered. First, the deteriorating real EER for exports was undoubtedly an important factor, since the profitability of exporting was declining. Even beyond that, however, domestic prices were well above international prices, a phenomenon which had two effects: (1) there was little incentive to export out of given volumes of production, since the domestic market was attractive, and (2) foreign purchasers were often unwilling to pay Turkish prices, especially when the registered export prices were set above those prevailing in other countries, even when Turks would have been willing to export at those prices. In addition, however, it is likely that there was a considerable volume of unrecorded or underrecorded exports, since foreign exchange earnings could then profitably be sold on the black market at a higher EER.

It has already been shown (Table II-3) that the PLD-EERs declined sharply for exports during the 1953–1958 period. By 1958, the most favorable import-exchange rate was virtually double that of traditional exports. Evidence on the responsiveness of exports to changes in the real exchange rate is given in Chapter VII.

The sharp declines in export PLD-EERs would by themselves have resulted in some diminution in export volumes. However, the domestic prices of exportable goods were generally well above the prices received for exports, even taking export premia into account. Price quotations for selected commodities in 1957 are revealing. Prices received in the domestic wholesale and export markets in Kuruş/kilogram were as follows:[44]

	Domestic Wholesale	Export	Ratio
Wheat	44.0	23.8	1.85
Beans	205.2	47.2	4.34
Hazelnuts	445.8	263.0	1.69
Figs	98.7	92.8	1.06
Raisins	172.9	105.5	1.64
Cotton	433.3	182.0	2.38

Although the commodities may not be entirely homogeneous between domestic sales and exports, the price discrepancies are much larger than can be accounted for by nonhomogeneity or quality variation.

Thus there was little incentive for private traders to export at the premium-inclusive exchange rates. Most exports that did occur were undertaken by government agencies, usually with sizeable losses. In addition, the higher prices received under both kinds of bilateral agreements may have made some exports privately profitable. In general, however, legal exportation was not

44. *Monthly Bulletin of Statistics*, Ministry of Finance, January 1967.

profitable, and that factor undoubtedly explains the decline in recorded export earnings.

Smuggling and faked invoicing

Virtually all commentators on Turkish economic conditions during the 1950's cite the prevalence of a black market (in both internal and external transactions) as a characteristic of the period.[45] Many government actions were undertaken in an effort to control or reduce evasions of the regime. Those actions themselves attest to the incidence of extra-legal activities. Efforts to halt "switch" deals and to verify import prices have already been discussed. The declared purpose of the special tourist rate, introduced in 1956, was to shift funds back into legal channels.[46] Some quotations of black-market rates are given by the Economist Intelligence Unit. These, and their respective dates, were:[47]

September 1955	TL 12 = $ 1
March 1956	TL 9.6 = $ 1
October 1956	TL 11 = $ 1
August 1957	TL 12.5 = $ 1
May 1958	TL 17 = $ 1

In interviews conducted in July 1971 businessmen were asked about conditions prior to the 1970 devaluation. Many cited 1969–1970 black-market exchange rates, but volunteered that they were far below the levels of the 1950's, when the rate reached TL 25 to TL 30. The fact that memories of the 1950's dwarfed those of a much more recent episode attests to the magnitude and extent of the black market in the mid-1950's. Whether a TL 25–30 rate was reached or not, a black-market rate of even TL 17 was six times the official rate and more than three times the highest EER.

One measure of the extent of evasion, both for exports and for imports, is to compare Turkish trade statistics with those of her major trading partners. Such a procedure does not pick up those transactions unrecorded by both parties, such as the large livestock trade over Turkey's southeastern border. Moreover, it can at best provide only a partial insight into the possible order

45. Aktan, *op. cit.* (Note 16, Chap. I), p. 36; Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 22; Hershlag, *op. cit.* (Note 4, Chap. I), p. 147; FFYP, p. 19.
46. EIU, *op. cit.* (Note 1, Chap. II), *No. 20,* December 1956, p. 2.
47. *Ibid., No. 15,* Sept. 1955, p. 2; *ibid., No. 17,* March 1956, p. 1; *ibid., No. 20,* Dec. 1956, p. 2; *ibid., No. 23,* August 1957, p. 1; *ibid., No. 26,* May 1958, p. 4.

Table II-9
Comparison of Turkey's trade statistics with those of her largest trading partners (millions of dollars)

	Exports Reported by:			Imports Reported by:		
	Turkey	Trading Partners	Ratio	Turkey	Trading Partners	Ratio
1954	244.2	312.0	0.783	338.2	355.4	0.952
1955	214.7	247.0	0.869	337.1	400.8	0.841
1956	220.7	246.3	0.896	268.8	347.5	0.773
1957	265.7	270.2	0.983	304.2	369.5	0.823
1958	182.0	201.3	0.904	238.7	330.1	0.723
1959	252.2	290.4	0.868	313.4	385.1	0.816
1960	208.7	247.3	0.843	346.9	399.8	0.867
1961	225.6	262.1	0.860	379.0	409.7	0.925
1962	259.6	308.4	0.841	444.7	431.5	1.032

Note: Turkey's eight largest trading partners, in decreasing order of trade size, were: United States, United Kingdom, France, West Germany, East Germany, Italy, Czechoslovakia and Israel.

Source: Data from *Direction of International Trade,* International Monetary Fund (Washington), various issues.

of the magnitude of evasions, so that the results must be interpreted with care.[48]

To estimate the extent of false recording of merchandise trade, Turkey's recorded transactions with her eight largest trading partners (as reported by Turkey over the 1954–1962 period) were cross-tabulated against the transactions recorded by those trading partners. These eight accounted for over 75 per cent of Turkish recorded merchandise trade, and it is probable that most invoice faking took place in transactions with those countries.[49]

Table II-9 presents the computations. Turkish records of Turkey's exports f.o.b. are compared with her trading partners' records of imports c.i.f. from Turkey. Since there is normally a 10 per cent discrepancy between the f.o.b. value of exports and the c.i.f. value of imports, it is to be expected that

48. See Jagdish Bhagwati, "Fiscal Policies, the Faking of Foreign Trade Declarations, and the Balance of Payments," reprinted in his *Trade, Tariffs and Growth,* Weidenfeld and Nicolson (London), 1969 for a full discussion of the merits and shortcomings of the procedure. Bhagwati used Turkish data for 1960 and 1961 to estimate underrecording of trade.

49. It is likely, however, that smuggling activities may have been sizeable with other countries.

Turkey's estimate of exports will be less than the partner countries' recorded imports. The same procedure was followed with regard to Turkish import records. In that case Turkey's import statistics were compared with those of her trading partners' exports. The *a priori* expectation is that Turkish imports would exceed recorded partner exports by about 10 per cent.

On the export side, exports reported by Turkey f.o.b. were less in every year than the c.i.f. imports from Turkey reported by her eight largest trading partners. But the ratio is too high, especially in 1957 and 1958. This result may reflect the influence of "switch deals" or the incentive to over-invoice exports which were legally undertaken in order to obtain export premia. However, in view of the fact that most exports were effected by government agencies, it is difficult to interpret the results.[50]

The picture is strikingly different on the import side. Whereas Turkish records of imports should exceed the trading partners' exports by 10 per cent or more, imports recorded by Turkey were less than 85 per cent of the trading partners' reports in each year from 1955 to 1958. The fact that the ratio falls off sharply in 1956–1958, the years of greatest foreign exchange shortage, increases the likelihood that the disparity in statistics reflects under-invoicing, since those were the years when black-market activities and premia were greatest, and licenses were issued in value terms.

An important question is how under-invoicing of the magnitude implied by the data in Table II-9 was financed. Some Turks indicated in interviews that proceeds from smuggled exports were used. Another possibility, somewhat less likely in view of Turkey's debt arrears, is that some under-invoiced imports were financed with suppliers' credits. Whatever financing was used, it seems clear that under-invoicing and/or illegal entry of imports assumed sizeable importance in the mid-1950's. Although no hard evidence is available, it is probable that a high fraction of non-recorded imports were consumer goods whose legal importation had virtually ceased and upon which premia were enormous. This factor should be borne in mind when evaluating the decline in recorded imports discussed below.

Effects upon the domestic economy

With declining export earnings and huge arrears in foreign indebtedness, the Turkish government sharply curtailed imports from 1953 onward. As seen in Table I-6, Turkey's recorded imports increased from $252 million in 1950 to $489 million in 1952 and then fell steadily to $284 million in 1958, representing a change from 9.5 to 2.5 per cent of current GNP in six years. Although import-substitution was taking place, partly as a matter of govern-

50. Separate data for government and private exports are not available.

ment policy and partly as a result of the rising domestic prices of imported goods, such a sharp drop in imports must, *prima facie*, have caused severe domestic economic dislocations.

In reviewing the events of the 1950's, the SPO declared that:

> ...because money declined in value while the exchange rate was nevertheless maintained artificially at a high level, exports fell, imports increased, and the resulting shortage of foreign exchange led to the imposition of physical controls on all foreign trade. This situation gave rise to capital flight in addition to the instability and arbitrariness it introduced.
>
> Perhaps the worst consequence of inflation and controls was the disruption of the price mechanism and the disappearance of normal markets. As a result, the economy was strangled by a very unproductive regulatory system on the one hand, while, on the other, there developed a misallocation of resources whose harmful effects are felt even today... Production was interrupted as a result of bottlenecks and, what was worse, investments were channelled to fields which were unproductive for the economy as a whole.[51]

Virtually all commentators describe the economic situation in the 1955-to-1958 period as one of "very severe economic and social disruptions,"[52] "permanent crisis,"[53] and "grave internal and external difficulties."[54] Little hard evidence is available with which to quantify the degree of dislocation in the domestic economy. Moreover, it is difficult if not impossible to disentangle the direct effects of inflation from the indirect effects associated with the declining flow of imports.

It is clear that GNP growth declined markedly from the rate of the early 1950's (see Table I-1). However, the high early-fifties growth rate was at least partially attributable to the once-and-for-all opportunity to increase agricultural output through extensive investment. Growth in agriculture based on conversion of additional land to crops could not have been sustained even under ideal economic policies and was undesirable in any event.[55]

The years of slowest growth were from 1959 to 1961. It is tempting to conclude that the slow growth of those years was part of the cost of inflation and balance-of-payments difficulties earlier in the 1950's, and there is undoubtedly an element of truth in that conclusion. But the recession of 1960–1962 was in large part attributable to other factors, as will be seen in Chapter IV.

51. FFYP, *op. cit.* (Note 20, Chap. I), p. 22.
52. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 28.
53. *Ibid.*, p. 18.
54. OEEC, *Turkey, 1959, op. cit.* (Note 32, Chap. I), p. 5.
55. Hirsch and Hirsch, *op. cit.* (Note 23), believe that the conversion of pastureland to selected cropland was followed immediately by a sharp reduction in livestock output, a computation not included in the national income accounts. If that is so, official figures overstate the real rates of growth for the period 1950 to 1956.

Even if the poor performance of the Turkish economy in the 1958-to-1962 period could be blamed on earlier economic policies, there are many Turks who believe that the excess demand conditions of the mid-1950's, coupled with import shortages, provided an atmosphere in which domestic entrepreneurship could develop. They point to the establishment of many small firms in a variety of import-substitution lines, some of which survived the ensuing Stabilization Program. Evidence is not available to evaluate the overall costs and benefits of the economic policies of the mid-1950's. Several side effects of the payments regime and consequent import shortage can be mentioned, however.

Perhaps most important is the fact that real investment declined and that investment in plant and equipment suffered relative to construction investment. There is also some evidence that many firms were unable to operate near full capacity due to a shortage of imported intermediate goods. We consider each of these effects in turn.

Import behavior and real investment. All categories of goods shared in the decline in imports from 1953 to 1958, although consumption goods and construction materials imports declined proportionately more than the other two categories.[56] In the case of consumer goods, it is probable that a large part if not all of the decline was offset by increased smuggling and perhaps some under-invoicing of imports. Smuggling of consumer goods is generally easier than that of other categories because (1) they can be brought in as personal property, (2) they are generally relatively small, high-value items, and (3) resale of small quantities is comparatively easy.

The decline in raw material imports undoubtedly affected capacity utilization, as will be seen below. But declining imports of investment goods had a pronounced impact on the level and composition of real investment. Table II-10 provides estimates of gross domestic capital formation and its composition for the 1953–1958 period. The first row gives the c.i.f. value of construction materials in each year and the second row gives the landed cost of those imports. The increase in EERs for imports can be seen by inspection of the ratio of c.i.f. costs to domestic value of imports.[57] Although imports

56. The dollar value of imports in each end-use category was (millions of dollars):

	1953	1958
Construction materials	85	27
Machinery and equipment	192	109
Consumption goods	105	38
Raw materials	150	140

Source: *Aylık Bülten*, Central Bank, various issues.

57. Landed cost includes the TL paid to the Central Bank to finance the import, duties and surcharges, and costs of unloading the goods. Domestic value is equal to landed cost plus wholesalers' mark-up on the goods.

Table II-10
Investment composition and import content of investment, 1953 to 1958

	1953	1954	1955	1956	1957	1958
A. (millions of TL – current prices)						
Construction investment						
Construction materials imports, c.i.f.	210	180	223	134	112	94
Domestic value of imports	336	310	456	268	324	261
Domestic materials	355	369	456	633	800	1289
Domestic value added	796	1019	1258	1412	1800	2074
Total construction investment	1487	1698	2170	2312	2923	3624
Machinery and equipment investment						
Imports, c.i.f.	425	390	420	376	249	369
Domestic value of imports	569	560	696	721	628	894
Domestic goods	86	100	115	193	276	441
Total machinery and equipment investment	655	660	811	914	903	1335
Total investment:	2142	2358	2982	3226	3827	4960
B. (percentages)						
Composition of total investment						
Construction	69	72	73	72	76	73
Machinery and equipment	31	28	27	28	24	27
Imports (domestic value) to investment in						
Construction	23	18	21	12	11	7
Machinery and equipment	87	85	86	79	70	67

Source: Kenan Gürtan, *Yatırım Hesaplarının Tevhit ve Tashihine Müteallik Proje Çalışmaları Hakkında Rapor*, State Planning Organization (mimeograph), 1962.

of construction materials declined sharply, the value of domestic materials used in construction tripled between 1953 and 1958. The data are in current prices, but imports represented 22.6 per cent of the value of construction investment in 1953 and fell to 7.2 per cent in 1958. The construction materials industry was already well established in Turkey in 1953, and large increases in output of cement, bricks and other building materials enabled the continued growth of construction in the 1953–1958 period.

Imports of machinery and equipment, by contrast, represented 86.8 per cent of the value of machinery and equipment investment in 1953. Turkey was virtually entirely dependent upon imported machinery, as the domestic goods could not have accounted for much more than transport and installation. Despite the sharp decline in imports, the imported component of machinery and equipment fell only to 67 per cent in 1958.

No official data are available providing a breakdown of investment in

Table II-11
Estimates of real investment, 1953 to 1958 (millions of TL)

	1953	1954	1955	1956	1957	1958
Construction investment	655	660	811	914	903	1335
Implicit deflator	0.698	0.595	0.538	0.433	0.360	0.297
Construction investment at constant prices	457	393	436	396	325	397
Machinery investment	1487	1698	2170	2312	2923	3624
Implicit deflator	0.853	0.768	0.648	0.564	0.516	0.454
Machinery investment at constant prices	1268	1304	1406	1304	1508	1645
Total investment (1948 prices)	1725	1697	1842	1700	1833	2042

Notes: a) For the construction investment deflator, the implicit deflator for the construction sector of the national income accounts was used.
b) For the machinery and investment deflator, the domestic component was deflated by the implicit deflator for manufacturing in the national income accounts. The imported component was deflated by the implicit EERs given in Gürtan's data for machinery and equipment, reported in Appendix A.

Sources: Current price investment data, Table II-10. Implicit deflators, *National Income Total Expenditure and Investment of Turkey, 1938, 1948–1969, Pub. No. 607*, SIS (Ankara), 1970, Table 1.

constant prices. To estimate the effects of the decline in imports, the machinery and construction investment data given in Table II-10 were deflated by components by the author, using methods indicated in the notes to Table II-11. According to those estimates, real investment in construction increased by 30 per cent between 1953 and 1958, while real investment in machinery and equipment fell by 13 per cent, and total real investment increased as the share of construction in total investment rose.

It may be argued that real investment fell from 1953 to 1958 and that declining imports were a result of that decline. The contrary conclusion is suggested by the following considerations: (1) real construction investment rose; (2) there was considerable excess demand and investment was extremely profitable; (3) the absolute level – not just the share – of real investment in machinery and equipment declined; (4) the domestic price of machinery and equipment rose 135 per cent while that of new construction rose 85 per cent; and (5) after the Stabilization Program the share of imports in machinery and equipment rose again to 78 per cent in 1960, whereas the share of imports in construction never again rose above 11 per cent. These facts are all consistent with the interpretation that import-substituting production was much more difficult to achieve in machinery and equipment than in construction materials, so that the lack of imports led to a decline in real investment in plant and equipment.

Excess capacity. Excess capacity due to a shortage of imports was reported to be widespread as early as 1954.[58] As the decline in imports continued, various types of dislocation of economic activity undoubtedly resulted. As described by the Economist Intelligence Unit,

> ...There has been no rise in the monthly import bill and shortages are now very serious. Stocks of many raw materials are non-existent and many concerns work short-time, with periodic complete shutdowns. Very few plants are working at full capacity – a fact which helps to set the factory expansion programme in its true perspective...[59]

It is impossible to estimate the degree to which productive capacity was underutilized. As indicated above, price-control laws were in effect, and the consequent black-market evasions led to failure to report actual production levels in the private sector. A few concrete examples of underutilization can be cited, but there is no indication as to how representative these examples are.

It seems fairly clear that the mining sector was particularly affected by a lack of spare parts and transport. As reported by the EIU,

> Chrome ore production, particularly by the private mines, which in recent years were responsible for about three-quarters of total output, is being checked by insufficient mining equipment and inadequate transport facilities...
>
> This is in line with the proposal put forward earlier this year by U.S. firms, which offered to buy 800,000 tons of chrome ore over a five-year period. It was reported that these firms were prepared to pay for part of the ore deliveries in advance and to provide lorries and tyres, which are in very short supply to move them to the ports. This proposal was rejected by the Turkish authorities because they feared that it might encourage black-market transactions...[60]

Earlier, deliveries under existing contracts had not been met "because shortages of spares and tyres for transport trucks meant that supplies of ore could not be moved to the ports."[61]

The number of trucks in use rose only 5 per cent between 1955 and 1958.[62] With a 28 per cent increase in the level of economic activity over the period, an increasing average age of the vehicles and some strains in the transport sector undoubtedly resulted. The volume of imported tires reported in the official trade statistics certainly declined drastically – from 10.14 thousand metric tons in 1954 to 7.79 thousand metric tons in 1957 and 5.37 thousand metric tons in 1958.[63] Since Turkey had no domestic production

58. EIU, *op. cit.* (Note 1, Chap. II), *No. 12,* January 1955, p. 10.
59. *Ibid., No. 24,* November 1957, p. 7.
60. *Ibid., No. 19,* August 1956, p. 8.
61. *Ibid., No. 18,* May 1958, pp. 11–12.
62. *Economic Developments in the Middle East 1958-1959,* United Nations, Department of Economic and Social Affairs (New York), 1960, p. 87.
63. *Yearbook of International Trade Statistics,* United Nations, various issues.

capacity at that time, the shrinkage in imports in the face of increasing demand undoubtedly did cause difficulties.

Beyond this scattered and impressionistic evidence, it is difficult to estimate the extent to which excess and underutilized capacity resulted from import shrinkage during the 1955-to-1958 period. Two things however seem certain: (1) by mid-1958 government authorities believed that import shortages were seriously impairing both the level of economic activity and their ability to continue their investment programs; and (2) further cuts in imports would have been necessary (given the government's inability to borrow further) had action not been taken. Additional reductions in imports, or even continuing imports at the 1958 level, would undoubtedly have had a pronounced negative effect on the level of economic activity. Thus we turn to consideration of the Stabilization Program introduced in August 1958.