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CHAPTER III

The stabilization program

I. Introduction

On August 8, 1958 the Turkish government announced a series of sweeping changes in virtually every aspect of the foreign trade regime and in many aspects of domestic economic policy. Consideration is given in this chapter to the political and economic factors that led to the decision to change and the nature of the changes. In Chapter IV the effects of the program are analyzed.

Some preliminary background is required on political developments prior to 1958. The economic developments of the mid-1950's, reviewed in the last chapter, had political ramifications long before 1958, and earlier political developments were important in the evolution of the Stabilization Program.

It seems fairly clear that the Menderes government enjoyed strong political support for its policies in the early 1950's. The Democratic Party was returned to power in the election of 1954 with 57.6 per cent of the popular vote, compared to the 52.9 per cent it had received in the 1950 elections. The first signs of unrest came in the fall of 1955. Despite the fact that the Menderes government had earlier appeared fairly strongly entrenched, revolt broke out within Menderes' own party, with ten prominent members of Parliament resigning from the party and joining the opposition. Consequently, the entire cabinet resigned; but the Prime Minister formed a new government, the key change being the appointment of a new Finance Minister. Most contemporary observers cited the government's economic policies as the basic cause of the unrest.[1]

There apparently was considerable discussion within the administration in late 1955 and early 1956 as to the policy changes which should be made. Notwithstanding a speech by the Prime Minister in December 1955 when he declared that "...we shall never consider any change in the value of our money despite all sorts of propaganda to the contrary..."[2] there was evident-

1. Eleanor Bisbee, "About-Face in Turkey," *Foreign Policy Bulletin,* April 15, 1956, pp. 113-4.
2. Cited by Hershlag, *op. cit.* (Note 4, Chap. I), p. 145, taken from *Prime Minister's Speech on Government Programme,* Anatolian Agency (Ankara), December 24, 1955, pp. 13-14.

ly a serious devaluation plan under consideration. Several government officials interviewed in the 1960's recalled that a devaluation plan was prepared and ready for adoption, with a new exchange rate of TL 6 to the dollar, when opposition to the program emerged from within the Cabinet.

A series of changes was finally made in 1956. These included: (1) the special TL 5.25 and 5.75 rates for tourist and other current account transactions; (2) the price control law; (3) increased export premia; (4) ceilings on commercial bank credits; and (5) an increase in the Central Bank discount rate to 6 per cent, contrasted with a rate of inflation well in excess of 10 per cent.

These measures appear to have had some effect during 1956. The black-market rate for the lira declined slightly, the trade balance improved somewhat in the second and third quarters of 1956, and the Central Bank's net foreign exchange deficit was somewhat reduced. The wholesale price index actually declined 6 per cent (part of which was a normal seasonal pattern) between the second and third quarters of 1956, and there is some evidence that the level of economic activity was somewhat depressed during that period. Electricity production declined from a monthly average of 131 million kilowatt hours in the first quarter of 1956 to 123 and 124 million in the second and third quarters, respectively. Even the production of cement, one of the most rapidly growing industries during the 1950's, declined by 10 per cent between the second and third quarters, despite a normal seasonal trend to the contrary.

The effects were short-lived, as evasion of the price-control law by the private sector, increases in the money supply resulting from increased SEE deficits, and abandonment of commercial credit ceilings soon transpired.

Political disaffection was evidently mounting by 1957 and elections were scheduled. Despite increasingly restrictive curbs on opposition political activity[3] and large increases in expenditures designed to woo the electorate,[4] the Democratic Party's share of the popular vote fell to 47.9 per cent. The Party nevertheless won 424 out of 610 seats in Parliament, as changes favoring the Democratic Party had been made in the electoral laws.[5] Once the elections were over the regime continued its *ad hoc* efforts to meet the foreign exchange shortage and inflationary financing of the SEEs continued.

3. Weiker, *op. cit.* (Note 13, Chap. I), p. 11.
4. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 22.
5. Nuri Eren, *Turkey Today and Tomorrow*, Praeger (New York), 1963, p. 37.

II. The devaluation decision

Given inflation, import shortages, retarded economic growth, a flourishing black market, multiple exchange rates and constant arrears in foreign indebtedness, there can be little doubt as to the economic rationale for the Turkish devaluation decision. However, all those phenomena were present from at least 1953 onward. Inflationary pressure grew after 1955, but it is difficult to argue that the underlying economic difficulties caused by inflation and overvaluation were more massive in 1958 than in 1956 except in the sense that those difficulties had continued longer. Then too, the import curtailment of 1957–1958 may have made those difficulties more visible than they were earlier.

It seems clear that Turkey delayed the devaluation decision long past the point where most other governments would have taken action. When devaluation did occur, *The Economist* commented

> ...Few countries have put off inevitable devaluation longer or with greater damage to their economies than Turkey. For at least ten years the Turkish lira has been artificially valued at its parity of TL 2.80 to the dollar. Since 1953 the effects of this overvaluation on the balance of payments have been partly but quite inadequately cushioned by a cumbersome system of differential surcharges on imports and subsidies on exports...[6]

Thus while it is straightforward to analyze the underlying economic reasons for devaluation, it is much less easy to determine the causes of the timing of devaluation or the factors that weighed in the decision. At least three separate factors undoubtedly contributed to it: (1) the apparent disruption of domestic economic activity, (2) domestic political dissatisfaction, and (3) pressure by foreign creditors and donors. We consider each of these in turn.

Disruption of economic activity

Enough was said in Chapter II to indicate that the payments situation and inflation had damaging effects upon the Turkish economy as early as 1954. Import stringency became so severe as time went on that capital goods, imported earlier, were left idle. Eren, for example, reported that:

> Within ten years, the Turks plunged from an unequalled affluence to an unexpected scarcity. Even coffee, rationed but available during the war, disappeared totally... The cement mixer and steel for ferroconcrete were everywhere....The horns of trucks and tractors broke the immemorial silence of the Anatolian plateau. But the sugar plant in Erzurum starved for beets, the cement factory in Sivas was without coal, and the

6. *The Economist*, August 9, 1958, p. 468.

> thousands of tractor owners in Adana and in Izmir scrambled in the black market for spark plugs and batteries....[7]

Export earnings in the first two quarters of 1958 were 40 per cent below the corresponding level in 1957. By June 1958, with foreign exchange earnings declining, no available sources of credit and mounting arrears, import licensing ceased. It must have been evident that the situation could not continue without some sort of change.

An important question is the diagnosis of ills made by the Turkish leadership. There are two possibilities. These gentlemen may have concluded that import shortages were retarding growth and were the source of the problem. Alternatively they may have become convinced that past economic policies, including expenditure, finance and foreign trade issues, were ill-advised.

If the first interpretation is correct, additional imports were deemed the sole requirement for eliminating difficulties and the government would have adopted the Stabilization Program in order to obtain additional badly needed foreign credits. On the second view, the 1958 Program was adopted in the belief that the entire set of policy changes was necessary for Turkey's future sound development.

The question of which interpretation is correct is important in analyzing the course of events after August 1958. Unfortunately, no clear-cut evidence is available. Dr. Sturc, who was an active participant in the discussion prior to August 1958, clearly believes that the Turkish leaders were convinced of the desirability of both devaluation and stabilization.[8] If they did believe stabilization to be an essential part of the program, the second interpretation is valid. Others,[9] however, take the view that the Prime Minister and his cabinet reluctantly accepted the stabilization components of the program as a necessary cost of receiving foreign credits.

It seems clear that the regime at least recognized that failure to take action would entail further reductions in imports and regarded the probable economic and political costs of such reductions as prohibitive. As such, the economic dislocation and unavailability of additional foreign financing without government action were necessary conditions for the adoption of the Stabilization Program. Whether the government initially believed that the stabilization aspects of the Program were desirable will be considered in Chapter IV.

7. Eren, *op. cit.* (Note 5), p. 50.
8. Ernest Sturc, "Stabilization Policies: Experience of Some European Countries in the 1950's," *International Monetary Fund Staff Papers*, July 1968, p. 207.
9. Edwin J. Cohn, *Turkish Economic, Social, and Political Change*, Praeger (New York), 1970, p. 24.

Political disaffection

There appears to be little doubt that large segments of the Turkish population were adversely affected by inflation and import shortages by 1957–1958, and were unhappy with the Menderes government. Although all commentators agree that political discontent had its origins in the administration's economic policies,[10] they are not unanimous in their diagnosis as to the aspects of those policies upon which criticism focused. The diagnoses are not mutually inconsistent, however. According to Simpson,

> There is considerable political unrest in Turkey today, and most of it is directly traceable to the government's economic policies. Critics of the Democratic party argue that the major evil is "planlessness." This point is in many respects well taken. It is a fact that the government has never published a plan or even an outline giving the impression that an orderly, balanced development of the country and its resources was under way. As a result, there are cases of waste, duplication and the misuses of funds, resources and manpower. Moreover, a sizeable number of Turkish industrial projects have been undertaken, not for their own intrinsic soundness, but for the political advantages to be gained...[11]

Contemporary foreign observers agreed that economic conditions were at the heart of political difficulties, but placed the discontent as originating more from other aspects of the economic situation.

> The biggest practical stick with which the opposition can belabor the government is the serious economic condition in that country...The cost of living is rising and supply shortages are acute...Coffee is nonexistent...[12]

Sturc's analysis is somewhat more subtle, and perhaps more plausible. He argues that

> It was only late in 1957 that increasing resistance to government policy became noticeable. The Government had lost the support of some intellectuals as early as 1954, and it lost more after it had abandoned an abortive stabilization attempt in 1956. The Government believed, however, that the changed attitude of the intellectuals was caused mainly by their dislike of certain noneconomic aspects of its program...The Government overlooked the fact that the intelligentsia came to the conclusion that the sacrifices demanded of it were not yielding the expected benefits to the nation as a whole.... The Government later found that, when the external supply of capital goods on credit also diminished, it could still proceed albeit temporarily, with infrastructure development projects, such as village water wells, irrigation sys-

10. Another factor leading to discontent was the increasingly repressive political measures taken by the government. See Nuri Eren, "Turkey: Problems, Policies, Parties," *Foreign Affairs*, October 1961, p. 97.
11. Dwight Simpson, "Turkey: Problems and Prospects," *Foreign Policy Bulletin*, June 1, 1958, p. 142.
12. *The Economist*, April 19, 1958, p. 223.

> tems, roads, power dams, with the existing machinery. (It used military trucks and bulldozers when civilian equipment wore out.) Construction thus progressed: there were new roads, new dams, and new harbors, but no new vehicles on the roads. Industrial consumer goods, based upon imported raw materials, also disappeared from the market, and prices began to rise sharply. It was only when this stage was reached that the Government came to accept the need for a stabilization policy...[13]

In many regards, Sturc's analysis seems more appropriate than that of those who argue that political disaffection caused the administration's changes in policy. On his interpretation, dissatisfaction with existing economic policies made devaluation appear a viable alternative since there would be little opposition to it. Civil servants' salaries were virtually unchanged between 1954 and 1959. The deterioration in their real income surely led many within the government to react against inflation. But that would not have been sufficient to bring about changes in the thinking of the political leadership. The Menderes government was, after all, reelected in 1957; under the Constitution, it had until 1961 before it would face the electorate again. Moreover, despite the smaller plurality received by the Democratic Party in 1957 than in earlier elections, the regime was firmly in power.

Role of foreign lenders

As evidenced by the amount of foreign assistance forthcoming in August 1958, the major foreign lenders and international organizations clearly supported the Stabilization Program enthusiastically. Devaluation had been urged upon the Turks from at least 1953 onwards, but the

> Government did not heed the advice from successive IMF missions and from OEEC and the International Bank for Reconstruction and Development that, in order to attain its objectives, it must reform internal policies and adjust its trade and payments system so that exports could move again and foreign suppliers would be forced by a more liberal import licensing policy to compete for the Turkish market.[14]

The fact that foreign governments urged devaluation as early as 1953 raises the question of why they should have been successful in 1958 and not in earlier years.

Foreign governments and international organizations had two related influences on Turkish economic policy in the mid-1950's: (1) some believe that had foreign credits not been forthcoming in the early and mid-1950's the devaluation decision would, of necessity, have been undertaken much earlier; (2) there is some support for the view that the regime finally decided to

13. Sturc, *op. cit.* (Note 8), p. 207.
14. *Ibid.*

adopt the Stabilization Program only when it was realized that no additional foreign credits would be received without such action.

Role of donors in perpetuating overvaluation. Perhaps the most forceful statement of the view that creditor countries were largely to blame for perpetuating the imbalance is that of the authors of the Columbia School of Law study:

> Although it is true that the international development financing has been a crucial factor in making possible the investments of the past decade and the increases in income to which they have given rise, it is also true that the Turkish inflationary crisis could not have been prolonged for a period of almost eight years without any corrective measures being taken, had it not been for the lack of coordination of the lending policies of the Western countries.[15]

While the availability of foreign credits certainly enabled the government to continue its policies at lower cost than would otherwise have been possible, it is difficult to see what action foreign creditors and donor countries could have taken that might have led to an earlier decision. The World Bank Mission to Turkey, for example, tried to discuss the inflation with the government in 1954 and refused to grant credits requested. The government's response was to request the termination of the Mission in Turkey on the grounds that the loan had not been granted and that the Mission had interfered in domestic affairs (by mentioning the inflationary threat).[16] Even if all Western countries and international organizations had withdrawn all support from Turkey it is questionable whether action would have been taken much sooner. First, the Turks could have resorted to bilateral payments agreements and other arrangements with Eastern European countries even more than they did. Second, the administration was certainly not reluctant to accumulate arrears in indebtedness, so it would have required not only cessation of official lending, but the Western governments' imposition of restrictions upon the private transactions of their own firms to prevent the use of suppliers' credits. Even then Turkey might have made fewer payments on arrears had new suppliers' credits been cut off. Third and perhaps most convincing, the regime's demonstrated lack of concern about the consequences of its economic policies is virtually proof that total cessation of foreign credits would not have resulted in a rapid change in outlook and behavior.

Of course the subject of what would have happened had there been no international development financing can only be conjectural. At most, however, continuing foreign credits were one additional factor at the margin en-

15. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 164. The authors of the study were Osman Okyar and Cihat Iren.
16. *Ibid.*, p. 16.

abling Turkish economic policies to continue. The Turkish disregard for the views of creditor countries seems striking, and it is doubtful whether anything short of really extreme measures would have influenced Turkish policy.

Expectations of additional aid and donor pressures. It appears that until some time in 1957 or early 1958 the governing body continued to believe that additional foreign credits would be received if the situation became sufficiently desperate. One factor leading to the adoption of the Stabilization Program in 1958 was probably a reversal of that belief.

From 1955 onward the United States, the source of virtually all aid to Turkey before 1955, became increasingly reluctant to extend additional credits. The Turks sent several delegations to Washington and sought generally to secure a large American loan of $300 million. The American government did not act on repeated requests.[17]

Actual American aid disbursements exclusive of PL 480 shipments were $68 million, $84 million and $39 million, respectively, in the years 1956, 1957 and 1958. Given the lag between authorization and disbursements (and the large American loan of August 1958), these figures suggest that American support was indeed withheld or diminished in 1956 and 1957.

There were undoubtedly political and military factors influencing aid to Turkey. Early in 1958 the Turkish administration sent a delegation to Moscow with the reported purpose of obtaining Soviet aid. Whether or not this was an attempt to obtain aid from the Western powers cannot be judged. It was subsequently announced that the Moscow negotiations had broken down. *The Economist* concluded:

> ...They (the Turks) may be beginning to realize that if they do not put their house in order, they may not get it (aid)...[18]

In July 1958 there was a revolution in Iraq. The pro-Western government was ousted and Iraq withdrew from the Central Treaty Organization. To what extent the resulting increased military and political importance attached to Turkey influenced the aid forthcoming in August 1958 is an open question.[19] Negotiations with respect to the Stabilization Program were undoubtedly proceeding prior to the Iraqi revolution. The fact remains that the Stabilization Program was announced within several weeks of the Baghdad coup.

As explained by the authors of the Columbia School of Law Study,

> ...the situation from the point of view of external financing became desperate after 1954...Short term measures of a stop gap nature were resorted to such as the effort to persuade the United States Government finally to agree to the demand for a large

17. Simpson, *op. cit.* (Note 11), p. 143.
18. Columbia School of Law, *op. cit.* (Note 14, Chap. I), pp. 23-4.
19. *The Economist*, April 19, 1958, p. 152.

> loan; efforts to obtain more bilateral credits from European countries, especially from Germany; effecting imports on credit arrangements; making severe cuts in imports of consumer goods and raw materials; and the piling up of new commercial arrears by delaying payment on current imports. These were essentially stop gap measures intended to make it possible to go along a little bit further with the policies of expansion and inflation while hoping for something to turn up. The Government probably did not lose hope for a large United States loan without conditions until very late, only during 1957–58. Import cuts, severe inflation at home and the price control system introduced in June 1956 and later changed several times were causing severe disruption in the whole economy. Devaluation and an attempt at stabilization had finally to be carried out in August 1958 when the Government realized that it could not continue to meet its most essential commitments and that large scale aid would definitely not be forthcoming without conditions.[20]

The appropriate evaluation is probably that two preconditions had to be met before the regime would consider the adoption of the Stabilization Program: (1) the government could not obtain further credits without conditions; and (2) the high and rising economic costs of import shortages had to have become highly visible and increasingly politically unpopular. It is unlikely that the Stabilization Program would have been adopted even then had it not been for the willingness of foreigners and international agencies to extend credit contingent upon the acceptance of the Stabilization Program. Whether the government believed that the entire program was desirable or only halfheartedly accepted it remains an open question.

III. Components of the program

On August 3, 1958 a decree was issued declaring that: (1) the foreign trade regime would be changed; and (2) no international transactions would be permitted until new regulations were promulgated. Hence except for a few tourist transactions all international financial dealings between Turkey and the rest of the world ceased. Import licenses were not again issued until the announcement of the First Import Program at the end of September; and new export regulations were not issued until early October. The initial impact of the change, therefore, was virtually a complete suspension of foreign trade.

The components of the program emerged over the next several months. There were essentially seven parts: (1) the *de facto* exchange rates were altered and largely unified; (2) Turkish external debt was consolidated and rescheduled and Turkey agreed not to use suppliers'-credit financing; (3) Turkey received massive credits from international lenders; (4) a ceiling was imposed upon Central Bank and commercial bank credits and upon govern-

20. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 20.

ment budgets; (5) the import regime was substantially liberalized; (6) the export regime was altered; and (7) SEE prices were raised and price controls were removed.

The first five parts of the package were announced in August 1958, although debt consolidation and rescheduling was not completed for some time. The export and import regimes were gradually liberalized over the succeeding two years; and SEE prices were finally raised in May 1959. We discuss each of these measures in turn.

(1) *The* de facto *exchange rate*

Turkey did not alter the official parity in August 1958. Records of international transactions were kept on the basis of the TL 2.80-per-dollar exchange rate until August 1960.[21] As of August 1958, however, an exchange tax of TL 6.22 per dollar was imposed on all imports, invisible expenditures, and capital transactions.[22] Tariffs were applied on the basis of the TL 9.02 rate, thus making the devaluation complete, *de facto*, on the purchase of foreign exchange. For foreign exchange earnings, a premium of TL 6.20 per dollar was set for all invisibles, capital transactions, and exports other than those indicated below.

Chrome, copper, tobacco and opium exports, which were subject to the TL 2.80 exchange rate until the moment of devaluation, were granted an exchange premium of TL 2.10 per dollar, thus making the EER for those exports – almost half the total value of exports in earlier years – TL 4.90. Dried fruits (figs, hazelnuts and raisins), which had received premia varying from TL 0.70 to TL 2.38 per dollar, were accorded a uniform premium of TL 2.80 per dollar. Thus while the exchange rate was unified completely for foreign exchange expenditures, the structure of premia on the foreign exchange earnings side was simplified considerably but was not immediately unified.

Over the next eighteen months the premia on exports initially receiving less than TL 9 per dollar were gradually raised: chrome was accorded the TL 9 rate in May 1959. The premia on exports of copper, raisins, figs and hazelnuts were subsequently increased, so that by November 1959 only tobacco and opium were subject to a lower rate. The EER for these commodities was increased to TL 5.60. Thus by the fall of 1959 only two export rates

21. Thus recorded imports, c.i.f., for 1959 were TL 1,315 million and $470 million, implying a TL 2.80 = $1 exchange rate even though no imports (except a few for SEEs, see below) entered at that rate.

22. The one exception involved the earnings of foreign oil companies. Under the Petroleum Law foreign oil companies were assured that they could repatriate their profits at the rate of TL 2.80 per dollar, regardless of the exchange rate, up to a certain percentage of their invested capital.

were in effect and all commodities except opium and tobacco were subject to the TL 9 = $1 rate. The tobacco rate was increased to TL 9 in February 1960. Finally, in August 1960 the exchange rate was altered *de jure*. At that time the diagnosis was:

> ...Altogether, the main effect of the formal devaluation will be to relieve the banks of a great deal of paper work which the premia system entailed...[23]

Paperwork had resulted, of course, from the payment and recording for the premia and for the foreign exchange transactions by different government agencies.

Thus one can regard the 1958 EER changes, covering as they did invisible and capital transactions, as a *de facto* devaluation accompanied, in effect, by the imposition of export taxes on several commodities. Although devaluation is generally thought to occur when the *de jure* parity is changed, the Turkish case represents an instance when the *de jure* alteration was simply recognition of a *fait accompli.* Thus we shall speak of the Turkish devaluation as having occurred in 1958; the 1960 parity devaluation will be referred to as the *de jure* change.

Three interesting questions arise with respect to the method by which devaluation was effected. (1) Was there any advantage in doing it *de facto* rather than announcing a *de jure* devaluation and imposing export taxes?[24] (2) What was the motive for imposition of export taxes, or, more accurately, failure to accord some exports the otherwise-uniform premium? (3) On economic grounds, what can be said about the imposition of export taxes?

De facto *versus* de jure *devaluation.* The answer to the first question appears to be that on balance there were disadvantages to the *de facto* approach, although as events actually transpired, it made little difference. Ignoring for the moment the taxation of exports, the effects on buyers and sellers of foreign exchange of imposing uniform premia and taxes were identical to the effects that would have been experienced under *de jure* devaluation. The only conceivable defense of the method actually used is that it reserved for the administration the option of increasing premia and surcharges at a later date. The difficulty with that defense is that if the government was uncertain as to what the new exchange rate should be it should have allowed the rate to float. For the very act of imposing premia and taxes without formal devaluation could have fueled (and probably to a small extent did fuel) speculation

23. EIU, *op. cit.* (Note 1, Chap. II), *No. 36*, November 1960, p. 6.

24. In 1970 the *de jure* devaluation was accompanied by declaring different exchange rates for some export commodities; again, this was equivalent to the imposition of export taxes. See Appendix C, below.

that there would be further *de facto* exchange-rate changes and thus slowed reaction to the altered exchange rate. Since exchange premia and taxes had been increased repeatedly since 1953, anticipation of further rate adjustments was a reasonable expectation, and could only end with *de jure* devaluation. By fixing the premia and surcharges the government gave one-sided certainty to private traders and thus increased the likelihood of speculation on further changes in the exchange rate.

The government's actual motive was probably not associated with uncertainty as to the proper exchange rate. Although no evidence is available on the point, the motive for the *de facto* approach probably lay simply in the government's unwillingness to use the word "devaluation," especially after past pronouncements on the subject.[25] It is doubtful whether in the actual course of events *de jure* devaluation would have altered the short-term response to the Stabilization Program very much. In the longer run of course the rate was altered *de jure*.

Export taxes. Quite aside from the manner of devaluation, there is the question of the motive for imposing export taxes and of their economic effects. Sturc, the only participant in the negotiations to write on the subject, says that the main motive was to provide the country with "substantial noninflationary revenue" since a sizeable trade deficit financed by foreign credits was planned.[26] It will be seen below that there was indeed a fiscal impact from the premium system. Although the imposition of export taxes for revenue purposes *per se* is ideally no better than a second or third best policy, an economic and political rationale for some export taxes, imposed at the time of devaluation and gradually reduced and eliminated, can be provided.

We note that as seen above the domestic wholesale prices of most agricultural exports were generally well above their international levels before devaluation. Thus some exchange-rate adjustment for those commodities was called for to provide an incentive to private traders to export at all. The question is whether an exchange-rate adjustment of a magnitude sufficient to raise the export price only to the level of the domestic price was warranted, or whether all exports should have been accorded the new rate, thereby increasing the domestic prices of those commodities. Since the exchange-rate adjustments actually made were sufficient to raise the domestic receipts from

25. In the absence of evidence, it is difficult to reach any judgment on the subject, but there is the consideration that the imposition of exchange taxes and premia is a purely domestic matter. The government could have rescinded or increased the rates unilaterally, and thus it did retain its future options. Whether this consideration had any bearing on the manner of devaluation is unknown.

26. Sturc, *op. cit.* (Note 8), p. 208.

export to their level in the domestic market, focus in this discussion is upon failure to raise the rate fully to the new *de facto* exchange rate.

By August 1958 crops were already planted and harvest was approaching. It was impossible that the 1958 production of agricultural commodities could be significantly affected by changes in domestic prices. Thus in the short run there was likely to be little if any supply response to domestic price increases. There is also an institutional income-distributional argument. That is, for the taxed agricultural export commodities, opium, tobacco, figs, raisins and hazelnuts, small growers sell their crops to wholesalers against cash advances well before the harvest. An immediate move to the TL 9 = $1 rate would not have been reflected in prices received by those producers during 1958. It would have resulted in large windfall gains to wholesalers who had already purchased the crop at lower prices and to the larger, presumably wealthier, producers who had not yet entered into sales contracts. For the agricultural commodities which were effectively taxed, moreover, it can be plausibly argued that Turkey had some degree of short-run monopoly power, given her share of the world market in those commodities (see Chapter VII, below). Thus the export taxes on agricultural commodities could be defended on optimal tariff grounds.

Despite these arguments there was one adverse side effect of the lower premia accorded to traditional exports of agricultural commodities: given that all other exchange rates were adjusted, there was speculation that the premia for the traditional exports would be increased. Indeed, as will be seen below, it was precisely such speculation that forced fairly rapid adjustment of the premia.

As to chrome and copper, it is difficult to find a satisfactory rationale for maintaining the lower EER. Turkey's share of both the copper and chrome markets was relatively smaller than her share for the major crop commodities, and both minerals have close substitutes even in the short run. Exports of both commodities had eroded over the preceding decade as domestic costs had risen with a declining real EER. There could be no doubt that the erosion was largely supply-induced, and that the short-run supply response to an increase in the real EER for the minerals was likely to be considerably greater than that for agricultural commodities. In fact, the government recognized its mistake fairly early, as the EER for chrome was the first to be adjusted after August 1958.

Thus whereas the imposition of export taxes on agricultural commodities could at least in principle be defended as a sensible part of the devaluation package, those on minerals were almost certainly a mistake. The effects of the taxes on the short-run behavior of exports is examined in Chapter IV, below.

(2) *Consolidation and rescheduling of Turkish debt*

It was agreed as part of the devaluation package that Turkey would negotiate multilaterally for a consolidation of outstanding commercial debt. As of August 1958 Turkey had cleared debts with United Kingdom creditors only up to March 1953. Debts had been cleared up with other OEEC countries until 1956 and 1957.[27]

By the spring of 1959 a debt repayment schedule had been agreed upon in principle with the OEEC countries. The agreement covered all amounts due to OEEC creditors prior to August 5, 1958, and payments due before December 1963 against previous capital goods imports. The total consolidated debt was put at $422 million. Payments were scheduled to begin with $14 million in 1959, rising $5 million per year until 1963, with the balance paid in equal installments through 1970.[28] Interest was set at 3 per cent per year.

Table III-1 gives the scheduled repayments of consolidated debts and interest.[29] Since the prevailing market rate of interest on international borrowing was considerably in excess of 3 per cent, debt consolidation contained a large element of foreign aid. If one assumes that Turkey could otherwise have borrowed at 6 per cent (unlikely in view of her past performance) the present value of the debt consolidation to Turkey was about $65 million, according to the repayment schedule given in Table III-1.

Official debt at the end of 1961, including consolidated debt, was estimated by the Turks to be $690 million. This figure included indebtedness and arrears not covered by the consolidation, additional credits received during the 1959-to-1961 period and payments due the OEEC not covered by the consolidation agreement. Thus it would appear that about half of Turkey's 1958 foreign debt and arrears was covered by the agreement.[30]

In a sense, however, the chief value to Turkey of the consolidation agreement lay in its permissive aspect: without consolidation it is unlikely that Turkey would have been able to meet her international obligations and the chaotic debt management of previous years would likely have been resumed. A large part of the reform in the Stabilization Program was predicated upon the Turks' ability to manage their foreign exchange expenditures and receipts

27. EIU, *op. cit.* (Note 1, Chap. II), *No. 27*, August 1958, p. 3.
28. The figures do not accord with those given in Table II-1 because: (1) only arrears to OEEC countries are covered; (2) indebtedness to the OEEC not in arrears but payable before 1963 was included; and (3) Table II-1 is in TL and the OEEC agreement in U.S. dollars.
29. Debt rescheduling took place in the mid-1960's, so the data in Table III-1 do not reflect actual repayments. See Chapter V, below.
30. With $14 million paid in 1959, $19 million in 1960, and $24 million in 1961, the balance of consolidated debt in 1961 would have been $365 million.

Table III-1
Consolidated debt repayment schedule, December 1960 (millions of U.S. dollars)

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971
Principal	24.5	29.3	34.4	32.5	32.9	32.9	32.9	32.9	32.9	32.9	8.7
Interest	8.5	8.3	7.6	6.6	5.7	4.7	3.7	2.8	1.8	0.3	
Total	32.9	37.6	32.1	39.2	38.5	37.6	36.6	35.6	34.7	33.2	8.7

Note: Principal and interest do not add to totals due to rounding.
Source: *Mali Yılı Bütçe Tasarısı Gerekçesi,* 1962, p. 61.

in a way which the chaotic arrears of the 1950's had made impossible. To the very considerable extent that the Turks succeeded, debt rescheduling was a necessary prerequisite and had a value in excess of the $65 million interest subsidy.

(3) *Foreign credits*

In addition to debt consolidation, Turkey received sizeable foreign credits at the time of devaluation. These totaled $359 million and included a $75 million credit from the OEEC countries and $25 million from the International Monetary Fund. The remainder came almost entirely from the United States.

An important question is the economic rationale for these foreign credits or, stated alternatively, whether large loans were a desirable part of the Stabilization Program. For loans received at the time of devaluation are typically used to finance increases in the current flow of imports, which was the case in Turkey. The question is whether increasing the current flow of imports over a one- or two-year period has a sufficiently high marginal product to justify the cost of the loan.

Although no answer can be given in general, it is the author's judgment that the foreign credits received by Turkey in 1958 did have a marginal product in excess of their cost. There are several considerations. (1) The increased flow of imports was an important factor in eliminating inflation.[31] Part of the productivity of the imports, therefore, was in the improved resource allocation resulting from generally stable prices. (2) Given the reports of bottlenecks and idle capital due to shortages of spare parts, the marginal product of some of the increased import flow must have been extremely high as idle and underutilized resources were available as complementary inputs. This consideration is all the more important when it is recognized that even

31. See Table IV-6, below.

after debt consolidation, Turkey had virtually no free foreign exchange and the import bill would have had to be reduced from its early-1958 level, at least until mid-1959 when additional export earnings were received. (3) After four or more years of import shortages there were inevitably once-and-for-all demands for imports for restocking and catching-up purposes. Unless this demand was satisfied liberalization of the import regime would have been virtually impossible, and in the absence of the foreign credits the initial spurt in demand could not have been met. (4) A large increase in imports was needed to eliminate the premia on import licenses, even at the new import EERs. Elimination of the premia probably had a large social product, as entrepreneurs shifted their energies from seeking premia to other economic activities.

None of these arguments is quantitative, and thus conclusive evidence on the cost-benefit ratio for foreign credits cannot be given. What is clear is that imports would have had to be much smaller in the eighteen months after devaluation had foreign credits not been available. As such, the actual course of events after devaluation would have been very different, and the large increase in imports actually recorded was an integral part of the Stabilization Program.

(4) *Limitations on monetary and fiscal policy*

A key component of the Stabilization Program was a series of limitations accepted by the Turks on monetary and fiscal policy and the financing of foreign transactions. One provision that requires little comment was that no external borrowing could be undertaken except by the administration and that all imports had to be financed by letters of credit. These provisions were designed essentially to preclude the resort to suppliers' credit financing and "thus gradually restore the country's shattered creditworthiness."[32] Suppliers' credits did not again become an issue in Turkey's management of her foreign exchange regime during the period under review in this study.

On the domestic monetary and fiscal side the Stabilization Program was far more complex. Ceilings, to be periodically negotiated with the IMF, were imposed on the issuance of Central Bank credit, the magnitude of commercial bank credit, the amount of government expenditure, the amount the government could borrow from the Central Bank and the financing of SEEs' current and investment expenditures.

For 1958 (1) commercial bank credit was not to exceed its June 1958 level; (2) the central government budget was to be balanced, with a ceiling (not publicly announced) on government expenditures; (3) agricultural sub-

32. Sturc, *op. cit.* (Note 8), pp. 208–9.

sidies were to be included in the government budget; (4) SEE prices were to be raised so that they covered current expenses out of current receipts, and SEEs were to finance their investments only from their own resources or other "non-inflationary sources"[33]; and (5) the interest rate payable to bank depositors was increased.[34]

These restrictions were wide-sweeping and were generally well observed during 1958, although the initial increase in SEE prices turned out in the event to be inadequate to meet the provisions of the agreement, and SEE prices were increased again in 1959.[35] The restrictions amounted to a complete reversal of government policy of earlier years. As will be seen in Chapter IV, the effects, particularly of tight money, were quickly felt within the economy. As evidence of the effects of the monetary restrictions mounted in 1959, the government weakened its adherence to various parts of the program. In analyzing the effects of the Stabilization Program in the year immediately following devaluation, however, the sweeping changes introduced in monetary and fiscal policy must be borne in mind.

(5) *Import liberalization*

The August 3 announcement that all import licensing was to cease pending the preparation of new import regulations caused all foreign exchange purchases, with only minor exceptions, to remain suspended for several months. For although the First Import Program was announced at the end of August and went into effect in September, no import licenses were issued under it until November. Since orders could not be placed until licenses were received, and given the lag between orders and delivery, it was not until late in the winter of 1959 that the flow of imports to Turkey began increasing. For that reason alone no effect, except possibly anticipatory, could be felt from import liberalization until the spring of 1959.[36]

33. In 1961 the government assumed the debt of certain SEEs, issuing 100-year Treasury bonds as obligations against the General Budget. SEE debt figures are therefore not comparable between the 1950's and 1960's.
34. *Annual Statement*, Türk Sınai Kalkınma Bankası, 1958, p. 28.
35. Columbia School of Law, *op. cit.* (Note 14, Chap. I), pp. 25 ff.
36. When deliveries did start in the winter of 1959, the Istanbul port very quickly became unusually congested, which further delayed the delivery of imports to final users. Two factors accounted for the delays: 1) the port's ability to handle cargo was basically limited, with the port ordinarily somewhat congested; 2) the severe financial stringency resulted in some importers' inability to raise funds for customs duties and other charges before they could land the goods. Those importers therefore left their goods in the ports until the time they could raise funds to clear customs. In some cases goods were left in warehouses until they were sold, whereupon the seller used part of the proceeds to pay customs clearing charges. This practice continued throughout the 1960's.

The Import Programs were the major regulatory tool for controlling imports after 1958. Their characteristics are discussed in Chapter VI, below. We concentrate at this juncture only on those aspects of the first few Import Programs relevant for understanding the adjustment to devaluation and its timing.

The total amount of the first three month program was $150 million which was over 40 per cent of 1957 total imports, thus implying a 60 per cent increase in imports. The quotas were heavily weighted toward producers' intermediate goods and raw materials. Of the $150 million total allocation, more than two-thirds were for major items required by producers, including allocations in excess of $10 million each, for vehicle spare parts, tires and tubes, chemicals, iron and steel intermediates and petroleum products.[37] It is clear that producers' demands for spare parts, intermediate goods and raw materials were deemed by the authors of the Import Program to be the most pressing needs.

The First Import Program decreed that all import-license applicants would be required to put up a 100 per cent deposit with the Central Bank against the value of the license within a week of its issuance. Despite tight credit ceilings, applications in the amount of $588 million were placed for $108 million of licenses to be allocated to the private sector. At that point it was announced that 20 per cent of the value of licenses applied for must be deposited at the time of application, subject to forfeit in the event the remaining 80 per cent were not deposited within a week of the receipt of license. Applications against the $108 million allocation thereupon fell to $116 million.[38] While the former figure, $588 million, gives some idea of the degree of speculative activity following devaluation, the fact that $116 million of applications were made within a very short time period, despite credit stringency, is indicative of the degree to which Turkey was import-starved by September 1958.[39]

Subsequent Import Programs continued to emphasize producers' goods and the increased flow of imports. Imports in the first and second halves of 1959 were $204 and $266 million, compared to $128 million in the last half of 1958.

Other features of the import regime also changed. Import price controls under the first few Import Programs were relaxed for some commodities and abandoned for others. Import price checks were virtually a dead letter by the time of *de jure* devaluation in 1960 (although some remained on the books), and little use of them was made during the 1960's.

37. EIU, *op. cit.* (Note 1, Chap. II), *No. 28*, November 1958, pp. 1–2.
38. *Ibid.*,
39. The figure is all the more noteworthy in that the 40 per cent surcharge on imports remained in effect until December 1958. See Table III-2, below.

In the 1956-to-1958 period state organizations had been given exclusive rights to import certain "essential" commodities, which they then resold to end-users. With the initiation of the Import Programs, private firms were allocated many import licenses directly, thus representing a shift toward "actual user" licensing. This shift undoubtedly offset the impact of increased import prices to many private firms, as the prices they had previously paid for imported commodities were probably at least equal to if not greater than the post-devaluation cost of direct importation.

(6) *Export liberalization*

It has already been seen that the exchange rates for major export commodities were gradually moved to the new exchange rate over the two-year period starting in August 1958. Exports during that same period were gradually liberalized in several important regards. Most significant, many minimum export prices were further adjusted to somewhat more realistic levels or abandoned during the 1958-to-1960 period. By mid-1959 the system of export price control was fundamentally altered, in that exporters registered the prices at which they were exporting, and the price checks for most commodities became *ex-post* rather than *ex-ante*. This change entailed considerable relaxation of the export regime as it reduced delays and uncertainties prior to exporting, and frequently gave Turkish exporters latitude to enter into firm export contracts without awaiting approval of the contract before signing it.[40]

Even for those commodities where minimum export prices remained in effect, most observers believed that the prices set after 1958 were considerably closer to realistic international prices than the prices decreed prior to devaluation.[41] Thus even where the formal machinery was not abandoned, the manner in which it was employed was considerably relaxed subsequent to devaluation.

(7) *SEE prices and price controls*

In Chapter II it was shown that one of the major contributing causes of the inflation of the mid-1950's was the failure to raise prices of SEE products in the face of rapid inflation with financing of the resulting deficits by Central Bank credits. Civil servants (including SEE white collar and managerial

40. The practice of prior price checks on exports was reinstituted in the spring of 1971. Delays at port became so great that the regime announced as one of its goals for 1972 a target of 3 weeks rather than 3 months as the average delay in the approval of an export price.
41. EIU, *op. cit.* (Note 1, Chap. II), *No. 30*, May 1959, pp. 5–6.

personnel) had received negligible increases in salaries since 1954, despite the rapidity of the inflation.

Among the measures taken as part of the Stabilization Program was an increase in the prices of SEE products, effected in the hope that the SEEs would be able to finance their investments from their own resources rather than with Central Bank credits. It was simultaneously judged desirable to increase civil servants' salaries substantially. Thus increases in SEE prices had to be sufficient to cover not only the existing costs of SEE products but also the increase in the wage-and-salary bill.

Some price increases were effected shortly after devaluation, in August 1958, but these were insufficient to accomplish the goal. The major adjustments in SEE prices and civil servants' salaries were effected in May 1959. SEE prices were raised an average of 20 per cent at that time, while civil servants' salary levels were raised an average of 41 per cent.[42]

Price controls over the private sector relaxed as SEE prices were increased. Although the basic legislation enabling government controls over prices and profits in the private sector was not repealed until 1960, price controls were in fact lifted in 1958 and 1959 for all commodities except wheat, coal and electric power.

It will be important to bear in mind these institutional changes and their timing when evaluating the degree of inflationary pressure set off by the devaluation and the short-term response to the Stabilization Program. Two things in particular will be noted. The SEEs were sufficiently dominant in enough commodity markets for the increase in their prices alone to be sufficient to give a major fillip to all price indices in the second quarter of 1959. Furthermore, the removal of price controls, even though they could not have been completely effective, undoubtedly resulted in increases in at least a few commodity prices. The official price indices, moreover, drew their observations heavily from controlled prices and ignored the existence of black markets in many commodities. Thus increases in controlled prices had a larger impact on price indices than they did on the actual increase in the price level. Secondly, the increase in the government budget in 1959 can be interpreted only in light of the huge salary increases negotiated as a part of the devaluation package. Ignoring the salary increases, the real expenditures of the Turkish government in 1959 probably did decline from their 1958 level, so that part of the increase in government expenditures can be interpreted primarily as a "catch-up" in wages and salaries from prior inflationary pressure, and was offset in large part by increased SEE prices and government tax revenues.

42. Civil servants' salaries were increased by 20 per cent again in 1961. See OEEC, *Turkey, 1961, op. cit.*, p. 13.

IV. Changes in effective exchange rates

The nominal devaluation of the Turkish lira, from TL 2.80 to TL 9 per dollar, was undoubtedly one of the largest nominal devaluations effected by any country since World War II. As already seen, however, many circumstances contrived to make the relevant magnitude of the change in the effective rate far less than the inspection of official rates would indicate. First, the change was accomplished over a two-year period. Second, the multiple exchange rates which had developed prior to 1958 meant that the *de jure* price of foreign exchange was considerably below the actual price, even on the export side.

Table III-2
EER changes, 1957 to 1959 (TL per dollar)

	December 1957	August 1958	December 1958	December 1959
Exports				
Minerals	2.80	4.90	4.90	9.00
Traditional crops	2.94	5.14	5.14	6.77
Cotton	3.78	9.00	9.00	9.00
Marginal exports	5.00	9.00	9.00	9.00
Weighted export rate	3.17	5.87	5.87	7.76
Imports				
Consumer goods	7.47	22.26	18.66	18.66
Intermediates and raw materials	5.35	16.35	12.75	12.75
Capital goods	5.38	16.15	12.55	12.55
Imports with domestic substitutes	8.29	24.82	21.22	21.22
Weighted import rate	5.94	17.90	14.31	14.31
Tourism	5.25–5.75	9.00	9.00	9.00
Other invisibles	2.80	9.00	9.00	9.00
Capital transactions	2.80	9.00	9.00	9.00

Notes: a) The weighted import rate was derived by using the percentages of total imports in each category. For imports competing with domestic production, however, judgment was used in deriving the weight. Weights used were: consumer goods, 0.106; raw materials, 0.291; capital goods, 0.482; and imports competing with domestic production, 0.121.

b) Data for capital goods imports are based on Table A-13 and do *not* agree with Gürtan's estimates used in Table II-10. Gürtan's data give an average figure for 1958 as a whole, and therefore could not be used to estimate the post-devaluation changes.

Source: Appendix A.

Table III-2 summarizes the estimates of the change in nominal EERs. One should recall that the nominal devaluation rate was 220 per cent. The weighted export EER rose from TL 3.17 at the end of 1957 to TL 5.87 in August 1958 and to TL 7.76 in 1959. Thus the export EER depreciated by only 85 per cent in August 1958. And the weighted import rate was TL 5.94 in 1957, jumping to TL 17.90 in August 1958, and falling to TL 14.31 by the end of 1958 when the 40 per cent tax on imports was lifted. Thus there was effective depreciation on the import side of only 140 per cent between the end of 1957 and the end of 1958. Neither of these percentage rates come close to the nominal devaluation rate of 220 per cent, although both are sizeable.

An important feature of the changes in EERs is that the weighted import EER was 1.87 times the export rate in 1957, three times the export EER in August 1958, and 1.84 times the export EER in December 1959. Thus devaluation did not result, at least prior to 1960, in any narrowing of the

Table III-3
Price-level-deflated EERs, 1957 to 1960 (Dec. 1958 TL per dollar)

	December 1957	August 1958	December 1958	December 1959
Exports				
Minerals	3.74	5.62	4.90	8.70
Traditional crops	3.93	5.89	5.14	6.54
Cotton	5.05	10.32	9.00	8.69
Marginal exports	6.67	10.32	9.00	8.69
Weighted export rate	4.23	6.73	5.87	7.50
Imports				
Consumer goods	9.97	25.53	18.66	18.03
Intermediates	7.14	18.75	12.75	12.32
Capital goods	7.18	18.52	12.55	12.13
Imports with domestic substitutes	11.07	28.46	21.22	20.50
Weighted import rate	7.93	20.53	14.31	13.83
Tourism	7.34	10.32	9.00	8.70
Other invisibles	3.74	10.32	9.00	8.70
Capital transactions	3.74	10.32	9.00	8.70

Note: The home goods price index for the first quarter of 1958 was set equal to 100, and the fourth quarter 1957, third quarter 1958 and fourth quarter 1959 indices were computed from that base.

Sources: EERs from Table III-2. Deflators from home goods price index, quarterly data given in *International Financial Statistics.*

differential between export and import EERs. It should be borne in mind that the import EERs are the prices paid if the import licenses could be obtained, and therefore do not take into account the premia. Even so, the fact that the Stabilization Program did not alter the differential against exports is remarkable. If data on the size of the premia were available, the premium-inclusive EER differential would undoubtedly have been reduced somewhat, although as will be seen below, it remained large in the 1960's.

Table III-3 presents estimates of the PLD-EERs over the devaluation period. December 1958 was used as a base period from which to make the estimates. As can be seen, when price-level changes are taken into account, the magnitude of the devaluation on both the import and the export side was far smaller than even computation of the nominal EER suggests. Thus the real export rate depreciated from TL 4.23 in December 1957 to TL 7.50 in December 1959, an overall depreciation of 77 per cent in a two-year period. On the import side there was a 74 per cent depreciation in the PLD-EER between the end of 1957 and the end of 1959.

We therefore conclude that the "true" order of magnitude of the real devaluation was probably about 80 per cent. While the basis of the estimates is necessarily somewhat rough, the 80 per cent figure much more closely approximates the magnitude of the devaluation than does the nominal exchange rate change.

Of course an 80 per cent devaluation in real terms is large by any standard and is indicative of the severe dislocation of the Turkish economy in 1958. Moreover the devaluation, large as it was, was only one component of the Stabilization Program. Other components also represented major shifts in the Turkish economy in 1958, and one would expect sizeable responses to them on *a priori* grounds. In the next chapter, analysis of the short-term response to the program is undertaken.