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Volume Author/Editor: Anne O. Krueger

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Chapter Author: Anne O. Krueger

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CHAPTER IV

Response to stabilization: Phases III and IV

As indicated in the last chapter, the Stabilization Program had many components, not all of which were effected in August 1958. The response of the Turkish economy to the Stabilization Program is traced in this chapter. An effort is made to analyze the separate effects of the various components of the program and to evaluate its optimality on the basis of that response.

Three factors cloud the analysis. First, there were so many changes undertaken simultaneously that it is difficult to sort out the effects of the separate parts of the Stabilization Program. Second, detailed data, especially on quarterly and monthly changes, are woefully lacking even for key variables. Third, the political events of 1959 to 1962 had strong economic repercussions and must be taken into account in the analysis. It will be useful at the outset to provide the reader with a brief chronology of the period. Thereafter the shifts in monetary policy, fiscal policy, the trade regime and other variables are examined, along with their effects. Next, consideration is given to the relationship of the Stabilization Program to the recession experienced by Turkey. Finally, an effort is made to assess the degree to which the Program was optimal from the viewpoint of Turkish economic growth.

I. Macroeconomic indicators

Figure 2 charts the course of the major macroeconomic variables over the 1959–1961 period, with indicators for the preceding and subsequent years given to enable comparisons. As can be seen, the years 1959 to 1961 were a time of extremely slow growth. The average annual growth of real GNP over the three years was 2 per cent, less than tha rate of population growth. Thereafter the growth rate rose sharply. The proximate cause of the slow growth rate was recession, although the fact that agricultural output grew at even less than its trend rate also contributed. The evidence suggests that there were really two recessions. One started in 1958 and was largely the result of tight money and thus of the Stabilization Program. It appears to have reached a trough in the spring of 1959, after which economic activity began expanding. By the spring of 1960 economic activity appears to have been fairly buoyant with few signs of recession left. The second recession started in the summer of 1960 after the May Revolution and reached a trough sometime during late 1961.

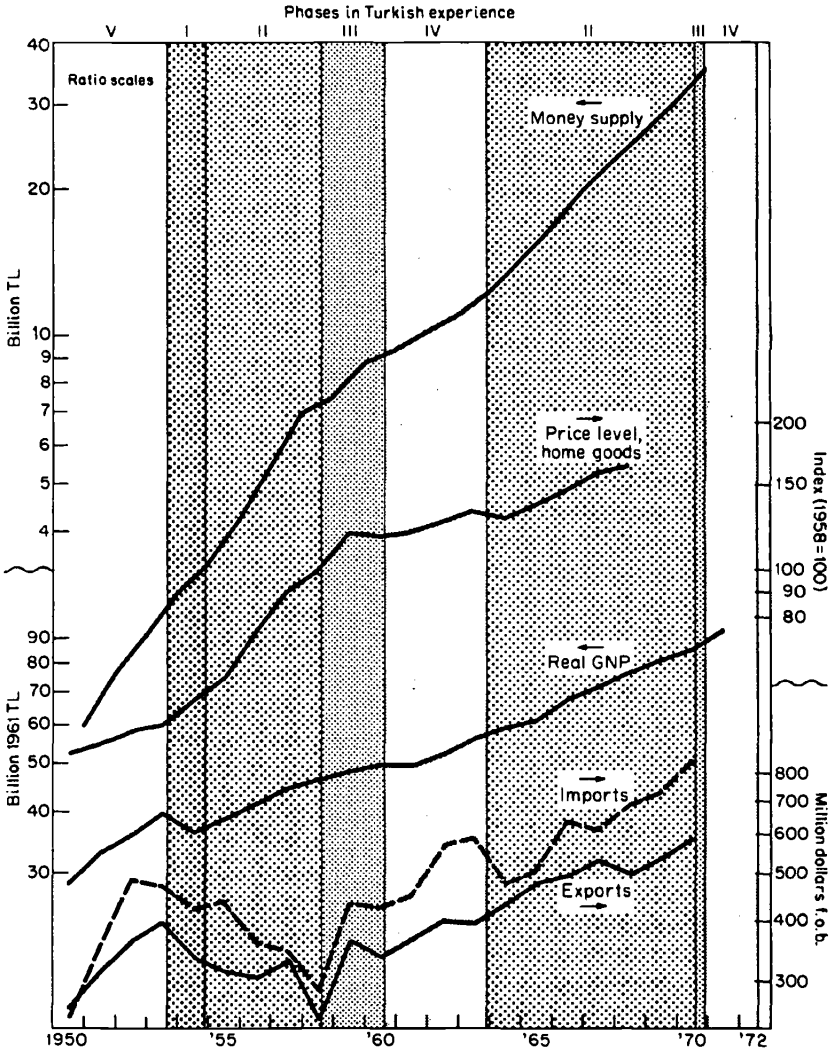

Fig. 2. Selected macroeconomic indicators, 1950 to 1971.

Perhaps the most remarkable fact about the period 1959–1961 is that after the spring of 1959 the Turkish price level remained stable through 1961. Price increases, in fact, were relatively modest throughout the 1960's. Thus the Stabilization Program was a complete success in breaking the inflationary spiral that had existed in Turkey prior to the inauguration of the Program.

This can be seen by the dramatic change in the course of the price level in Fig. 2. Analysis of the factors that led to the change will be undertaken in detail in Section II.

The government appears to have adhered fairly closely to most aspects of the Stabilization Program until the summer of 1959. Thereafter the money supply started to expand more rapidly than had been agreed to. By the winter of 1960 it appeared that the government intended to resume its expansionist policies, as a very expansionary budget was presented to Parliament.[1]

In May 1960 a bloodless revolution occurred when a group of military leaders calling themselves the National Unity Committee (NUC) took over the government. The causes of the revolution lay in discontent over both political repression and economic policy.[2] The NUC quickly reversed some of the expansionist policies of the Menderes government and announced complete adherence to the Stabilization Program. Thus in contrast to Cooper's conclusion that devaluations increase the probability that politicians will lose their jobs,[3] in Turkey it was the failure of the government to adhere to the Stabilization Program that contributed to its fall.

The flow of imports increased markedly after 1958. Premia on import licenses and the active black market of the mid-1950's virtually disappeared. Although exports and other foreign exchange receipts increased, the change was not enough to compensate for the large rise in foreign exchange expenditures. Among other charges made by the NUC against the Menderes government was the fact that almost the entire foreign credit received in 1958 had already been exhausted.[4] Imports nonetheless continued increasing rapidly in the first three years after the revolution and the foreign trade regime became increasingly liberal. Thus the period 1960-to-1963 can be regarded as Phase IV.

II. Components of the Stabilization Program and their effects

Monetary and fiscal changes

As indicated above, the use of official prices (which were controlled by law) in the construction of the price indices of the mid-1950's led to an understatement of the true rate of inflation during that period. The average

1. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 20.
2. Weiker, *op. cit.* (Note 13, Chap. I), Chapters 1 and 2.
3. Richard N. Cooper, "Currency Devaluation in Developing Countries," *Essays in International Finance No. 86*, International Finance Section, Princeton University, June 1971, p. 30.
4. Weiker, *op. cit.* (Note 13, Chap. I), p. 13.

annual rate of increase in average wholesale prices from 1955 to 1958 was 19 per cent, even by official statistics, contrasting with an average annual rate of 1.5 per cent between final quarters from 1959 to 1962.

Four factors were primarily responsible for the change: (1) monetary policy, (2) the increased flow of imports, (3) the exchange-rate changes, and (4) abandonment of the price control law and changes in SEE pricing policy. Fiscal policy changes were of secondary importance. Brief consideration is given in this section to fiscal policy and especially the fiscal impact of the revenue generated by net receipts from the system of exchange taxes and premia. Monetary policy changes are discussed thereafter.

Fiscal policy. Table IV-1 presents data on central government expenditures and receipts as a per cent of national income over the period 1957 to 1963. As pointed out in Chapter II, the government accounts do not include the operations of the SEEs. Thus an incomplete picture of the impact of the government sector on economic activity is provided. However, since the effect of SEE finances was primarily felt through money creation, the impact of SEEs on governmental activity can be more appropriately considered when evaluating monetary policy.

Inspection of the data in Table IV-1 suggests that there was little change in central government fiscal impact after 1958. The central government budget was if anything somewhat expansionary. Expenditures rose from 14.5 per cent of national income in 1958 to 18.1 per cent in 1961. Tax revenues also rose, but their increase did not keep pace with that of expenditures, and net government borrowing increased substantially in 1960. Thus both the in-

Table IV-1
Central government expenditures and receipts, 1957 to 1963
(per cent of national income)

	1957	1958	1959	1960	1961	1962	1963
Current outlays	11.4	11.0	12.1	12.4	14.3	13.5	14.1
Capital formation	3.5	3.5	3.6	3.9	3.8	3.7	4.2
Total expenditures	14.9	14.5	15.7	16.3	18.1	17.2	18.3
Tax receipts	14.3	13.1	14.2	13.7	15.4	14.6	15.6
Transfers	1.0	1.6	1.7	1.6	2.2	2.1	1.6
Net borrowing	−0.4	−0.2	−0.2	1.0	0.5	0.5	1.2

Note: The government's assumption of the consolidated SEE debt is not included in 1961 central government borrowing.
Source: Same as Table II-4.

Table IV-2
Government net revenues from foreign trade taxes, 1956 to 1962

	1956	1957	1958	1959	1960	1961	1962
Tax revenue (millions of TL)							
Net foreign trade taxes	399	744	873	1565	1507	1553	1918
Total tax receipts	2999	3821	4430	5928	6096	7187	7625
Net foreign trade taxes as percentage of:							
Tax revenue	13.3	19.5	19.7	26.4	24.7	21.6	25.2
Imports c.i.f.	35.0	66.9	99.0	118.9	68.1	33.9	34.3

Sources: Tax data from Land, *op. cit.* (Table I-5).
Import data from *Statistical Yearbook, 1968, Pub. No. 580* (Ankara), 1969, p. 309, State Institute of Statistics.

crease in government expenditures and its financing probably led to mild expansionary pressures upon the Turkish economy.[5]

One interesting aspect of the Stabilization Program was the use of exchange taxes and premia. Their net effect was equivalent to that of imposing export taxes. Since all purchases of foreign exchange were taxed TL 6.20 per dollar while many sales of foreign exchange were accorded smaller premia, the net receipts from the tax were sizeable, especially given the import surplus. Table IV-2 gives the net revenue from foreign trade taxes and premia in relation to total tax revenue and to imports for the period 1956 to 1962. As can be seen, net revenue from foreign trade taxes increased almost five-fold between 1956 and 1959. The large increase between 1956 and 1957 originated in the 40 per cent "Treasury Tax" imposed then on most imports.

Until 1958, export premia accounted for a relatively small drain on import tax receipts, so that net tax receipts were just slightly less than gross receipts. Export premia were sizeable from 1958 until 1960 and the difference between import taxes collected and export premia paid out became significant. After August 1958 gross tax receipts on imports were more than two and one half times imports (recorded at TL 2.80 per dollar), as the tax per TL 2.80 of

5. As indicated above, part of the increase in government expenditures in 1959 was attributable to the adjustment in salaries of government servants. For the government as a whole (including social security institutions and local governments), wages and salaries in relation to current expenditures on goods and services were as follows (millions of TL):

	1958	1959	1960	1961	1962
Current expenditures	3226	4578	4762	5852	6231
Wages and salaries	1592	2424	2560	3276	3483
Per cent wage & salary	49.3	52.3	53.8	56.0	55.9

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

imports c.i.f. was TL 6.20 and import duties were charged over and above that. With an average premium on exports of about TL 2.70 and exports much less than imports, net receipts from foreign trade taxes were greater than the recorded TL value of imports in 1959. The export premia were increased and the exchange rate was finally unified, so that by 1961 import taxes were about the same fraction of imports as in 1956. But since the exchange rate had increased so sharply foreign trade taxes generated about 25 per cent of total tax revenue in 1962, contrasting with only 13 per cent in 1956.

The net revenue from the tax-premium system in 1959 and 1960 was therefore a significant element in keeping the government budget from being even more expansionary than it was. Between 1958 and 1959, 46 per cent of the increase in total tax revenues originated from the changes in net foreign-trade tax receipts, and to some extent the 1958 figures already reflect the incidence of the tax-premium system. While there would have been some increase in foreign-trade tax receipts resulting from the increased flow of imports in 1959, the incremental revenues resulting from the tax-premium system, amounting to 1.6 per cent of 1959 national income, were undoubtedly an anti-inflationary factor of significance.

Monetary policy. Whereas fiscal policy was mildly expansionary in the years 1958 to 1960, monetary policy was extremely tight from August 1958 to mid-1959. It will be recalled that one component of the Stabilization Program was the ceilings imposed on Central Bank and commercial bank credit.

Table IV-3 gives data on the money supply at the end of each quarter as reported by the EIU. The money supply had increased by more than 10 per cent between March and September 1958, with virtually the entire increase coming in the period before August. The money supply then actually contracted about 5 per cent from September to December, with a further 1 per cent decline in the first quarter of 1959.[6] The shift from rapid monetary expansion to monetary contraction was therefore abrupt. After the second quarter of 1959 rapid expansion of the money supply resumed, with an increase of over 16 per cent in the last six months of 1959. After the NUC assumed power in May 1960 the money supply remained virtually stable until the middle of 1961. Thus two distinct tight-money periods can be distinguished: the first lasted from August 1958 until mid-1959; the second started in the second quarter of 1960 and continued well into 1961.

6. The data given in Table IV-3 are based on EIU reports. The OEEC reported a 2 per cent drop in the money supply between June and October 1958 but did not present data for later periods. OEEC, *Turkey, 1959, op. cit.* (Note 32, Chap. 1), p. 23.

Table IV-3
Money supply, quarterly, 1957 to 1962
(billions of TL – at the end of each period indicated)

Year	Quarter			
	I	II	III	IV
1957	4.6	4.9	5.1	5.5
1958	5.6	6.0	6.2	5.9/9.0
1959	8.9	9.0	9.4	10.5
1960	10.8	10.6	10.8	10.9
1961	10.8	10.7	10.9	11.7
1962	11.7	11.6	12.3	13.0

Notes: a) The EIU changed series at the end of 1958, so that figures are not comparable between periods. Until 1958, only currency and demand deposits were included. Thereafter, currency and all commercial bank deposits are included. The figure before the slash for the fourth quarter of 1958 is comparable with earlier data. The TL 9.0 figure is comparable with figures for later quarters.
b) The data are not comparable with those given by the Central Bank or with those given in *International Financial Statistics.* However, issues of the Central Bank's *Monthly Bulletin* for the period 1958 to 1962 were not available to the author, and *International Financial Statistics* does not report quarterly data on the Turkish money supply until the second quarter of 1959.

Source: EIU, *op. cit.* (Note 1, Chap. II), *Nos. 28, 32, 35, 39, 40, 43,* and *47.*

There is ample evidence that the sharp shift in mid-1958 from rapid monetary expansion to a stable money supply had immediate effects on the Turkish economy. As reported by the EIU,

> The authorities certainly appear to be determined ... to maintain the credit squeeze, but the latter, both by stifling demand and making it more difficult to finance essential imports, is undoubtedly hitting industry hard; many factories, particularly in the textile field, have closed down or are working part-time ... At present, the import market is finding credit stringency a less serious handicap than are manufacturers and exporters ... It is already clear that certain of the smaller manufacturing concerns set up speculatively during the import famine of recent years will have to close down permanently. In the end, ... some credit relaxation would appear inevitable; failing this, the continuing slump in demand would nullify the effects of any increase in output arising from a more liberal import policy.[7]

Detailed examination of the effects of tight monetary policy will be undertaken in Section III, below. The important points for present purposes are that: (1) the shift in monetary policy was large and abrupt; (2) the tight money policy was abandoned in the second half of 1959; and (3) tight money was resumed in the summer of 1960. One question of importance for under-

7. EIU, *op. cit.* (Note 1, Chap. II), *No. 31,* August 1959, p. 10.

standing the timing of the response to the Stabilization Program is what led to the abrupt resumption of monetary expansion and the inflationary budget of 1960.

Two interpretations are possible. One is that the Menderes government never seriously intended to carry through the Stabilization Program. The other is that the credit stringency and other effects of tight money and the Stabilization Program were sufficiently pronounced to lead the government to abandon the program as politically unpalatable and/or economically undesirable. Okyar and Iren[8] take the former view, while Aktan takes the latter.[9] Which interpretation is correct is closely related to the question raised in Chapter III: whether the government accepted the Stabilization Program because that was a necessary price for obtaining foreign credits or, alternatively, whether it believed that its past policies were in general need of reform. A definitive judgment is impossible in the absence of direct evidence. On either interpretation, however, it is likely that the visible effects of extremely tight money must have made the abandonment of the Program more appealing and perhaps speeded the time at which rapid monetary expansion resumed. We shall return to this question below when evaluating the optimality of the Stabilization Program.

SEE finances and their effects. In August 1958 the prices of many SEE products were raised. However, the initial increase proved to be inadequate to enable the SEEs to cover their expenses, and a second large round of price increases took place in May 1959.[10]

In view of the important role of the SEE deficits in contributing to the money supply increases prior to August 1958, raising SEE prices was essential if rapid expansion of the money supply was to be halted. After 1959 SEE deficits never again became a major drain on Central Bank credits, although financing their investment programs remained something of an issue. As such, the Stabilization Program succeeded in eliminating one source of inflationary pressure.[11]

8. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 20.
9. Aktan, *op. cit.* (Note 16, Chap. I), p. 36.
10. Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 25.
11. There is one interesting sidelight on the period which may be indicative of government intentions. After the Stabilization Program was in effect, the SEEs were still in financial difficulties. The government responded initially by failing to charge the TL 6.20 tax on their imports, and the SEEs did not pay the government tax liabilities they incurred. These practices stopped only after the IMF protested. See Columbia School of Law, *op. cit.* (Note 14, Chap. I), pp. 25 ff.

The inflow of imports

Table IV-4 gives quarterly export and import figures for the years 1957 to 1960. The export response to the Stabilization Program will be evaluated in more detail below. It is sufficient for present purposes to note that the increase in exports in the first half of 1959 was attributable to delays in exporting the 1958 crop and to some reductions in inventory following the Stabilization Program. It will be recalled that new export regulations were not promulgated immediately in August 1958 and that there was therefore a delay before exporting at the new exchange rates could begin. Until the final quarter of 1959 the increase in exports was thus achieved primarily through reductions in inventory rather than through increases in production.

In the absence of estimates of inventory investment, the increased flow of imports which really began in the first quarter of 1959 should therefore be regarded as a net deflationary factor.[12] Thus for the first three quarters of 1959 the increase in imports was $73.7 million. In the final quarter of 1959 the increase in the net inflow (imports minus exports) was $38.4 million. The deflationary effect of the import flow can be placed at $112 million for 1959 as a whole. Converted at the TL 9 per dollar exchange rate, that represented 2.4 per cent of 1959 national income and 3 per cent of 1958 national income. Thus the increased net inflow of imports, allowing for the part of

12. Of course part of the recorded increase in imports may reflect an increase in the fraction of imports entering legally or a reduction in under-invoicing. The data in Table II-9 suggest that that was not a significant factor until 1961, however.

Table IV-4
Imports and exports, quarterly, 1957 to 1960 (millions of U.S. dollars)

Year	Quarter				Total
	I	II	III	IV	
Exports f.o.b.					
1957	90.4	94.6	62.4	97.7	345.2
1958	81.5	50.5	38.6	76.6	247.2
1959	103.4	81.3	49.6	119.5	353.8
1960	98.6	59.0	54.4	108.7	320.7
Imports c.i.f.					
1957	90.5	98.2	101.4	107.0	397.1
1958	86.0	100.8	58.9	69.3	315.1
1959	98.4	105.9	115.1	150.6	469.9
1960	115.9	115.6	129.6	107.3	468.1

Source: *International Financial Statistics*, 1967/68 Supplement.

exports originating from inventory disinvestment, constituted a sizeable deflationary factor.

Net effect on prices

Table IV-5 presents quarterly wholesale and home-goods price indices for the period 1958 to 1962. Data for home-goods prices in 1958 are unfortunately not available on a quarterly basis. It seems clear, however, that both wholesale prices and home-goods prices rose at least until the first quarter of 1959. Some of that rise, of course, resulted from the first increase in SEE prices, and part of it may have been the result of recording procedures.[13] The home-goods price index shows prices falling somewhat after the first quarter of 1959, while the wholesale price index shows increases, albeit at a far slower rate than in earlier periods. On either index, however, it is evident that inflation had ceased by early 1959. The annual figures therefore obscure a great deal about the timing of price changes.

13. As indicated above, the government recorded official prices in the price indices during the inflation years. Thus when prices were decontrolled the prices actually recorded rose more than market prices. See OEEC, *Turkey, 1961, op. cit.* (Note 42, Chap. III), pp. 11–12.

Table IV-5
Quarterly price indices, 1958 to 1962 (1958 average = 100)

Year	Quarter				Annual
	I	II	III	IV	
Wholesale prices					
1958	90	95	104	111	100
1959	116	119	120	124	120
1960	129	128	123	125	126
1961	129	129	129	132	130
1962	140	139	133	137	137
Home-goods prices					
1958	n.a.	n.a.	n.a.	n.a.	100
1959	129	118	117	119	119
1960	122	121	114	116	117
1961	119	117	118	121	119
1962	125	124	122	127	125

Note: There is a discrepancy between the annual figures and the average of the quarterly figures for the 1959 home-goods price index. The reason for the difference is not known.

Source: Same as Table I-5.

Both indices indicate a return to moderate price increases in the final quarter of 1959 and the first quarter of 1960, after which prices declined for the remainder of the year and remained highly stable until the final quarter of 1961. Thus, contrasted with an annual average rate of inflation of over 15 per cent between 1956 and the first half of 1958, prices were either stable or rose only a few per cent annually between 1959 and 1961, even without allowing for bias in the statistics.

To estimate the factors contributing to the change, the same methodology is used as was employed in Chapter II with regard to the inflation of the mid-1950's. The results are reported in Table IV-6.

It is of interest that the predicted rate of price increase for 1959 to 1961 almost equals the actual price increase. But whereas the simple model developed in Chapter II predicts a very low rate of inflation in 1959 followed by rates of 10.6 and 8.4 per cent in 1960 and 1961, the actual rate of price increase was 19 per cent in 1959, negative in 1960, and only 1.7 per cent in 1961.

The difference between predicted and actual timing may have resulted from several factors. As already seen, part of the increase in prices in 1959 was attributable to the "catch-up" in SEE prices, which was a necessary condition for the cessation of additional inflation and which can to a large

Table IV-6
Predicted and actual inflation, 1959 to 1962
(percentage of previous year's real national income)

	Supply Changes				Demand Changes	Inflation	
	Agriculture	Non-Agriculture	Imports	Total	$\frac{\Delta M_{t-1}}{M_{t-2}}$	Estimated	Actual
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1959	0.0	3.0	3.0	6.0	6.9	0.9	19.0
1960	0.6	3.0	−0.2	3.4	14.0	10.6	−1.7
1961	−1.1	3.0	0.6	2.5	10.9	8.4	1.7
1962	2.6	3.0	2.6	8.2	7.6	−0.6	5.0

Sources: Given in Table II-7, except for imports, which had to be adjusted because of the exchange-rate change. The 1961 TL value of imports was linked to national income in 1961 prices. TL values for 1960 and 1962 were then computed by multiplying the 1961 figure by the ratio of the other year's dollar value of imports to the 1961 dollar value of imports. The same linkage procedure was followed for earlier years, except that the 1961 TL value of imports was multiplied by the ratio of 1961 national income at 1948 prices to 1961 national income at 1961 prices to obtain a base figure.

extent be attributed to the pent-up inflation of earlier years rather than to the degree of inflationary pressure in 1959.

Computed 1959 excess demand was virtually zero. Compared with computed excess demands of 21.3, 21.5, and 12.5 per cent in the preceding three years, the magnitude of the shift was truly remarkable and attests to the severity of the Stabilization Program. If time is required before altered underlying conditions are reflected in changed expectations, the virtual price stability of 1960–1961 may have resulted from a downward shift in expectations, which offset excess demand from other sources.

Another feature to be noted is that agricultural production, according to SIS national income estimates, contributed virtually nothing to whatever adjustments occurred following devaluation. Although the 1958 crop was perhaps good,[14] the disagreement over the size of the crop renders analysis difficult. After 1958 all sources appear to be in agreement that increases in agricultural production were relatively small. Thus it cannot be concluded that fortuitous weather conditions were a factor in bringing inflation to a halt. From 1959 to 1961, on the contrary, agricultural production contributed little to growth in aggregate supply.

It should also be noted that the estimates in Table IV-6 contain the implicit assumption that the growth of non-agricultural capacity was invariant with respect to the devaluation and stabilization. Not only is that a questionable assumption, but it will be seen below that there is evidence that it is wrong. On balance, however, it is doubtful if the short-term shifts in supply were sufficient to render the orders of magnitude given in Table IV-6 inappropriate.

The evidence then is mixed. Certainly in 1959 the influx of imports constituted a major anti-inflationary factor. The increased revenue from foreign trade taxes also undoubtedly absorbed a significant amount of purchasing power previously accruing to importers. These factors, as well as any improvement in resource allocation and increase in capacity utilization, led to stronger anti-inflationary pressures than would have taken place from monetary shifts alone. Without the shift in monetary policy, however, inflation would have been temporarily retarded but certainly could not have been stopped. Thus primary responsibility for stopping inflation must go to the shift in monetary policy; other components of the Stabilization Program enhanced the impact of the monetary shift.

14. There is dispute over the 1958 crop. This dispute lies at the basis of the divergence between SIS and SPO national income data. SIS estimates of national income at 1948 prices imply a 17.7 per cent increase in agricultural production between 1957 and 1958 with no increase between 1958 and 1959. SPO estimates imply no increase between 1957 and 1958 and a 6 per cent increase in agricultural output between 1958 and 1959. In recent years a consensus has begun emerging to the effect that the truth lies somewhere between the two estimates.

The role of exchange-rate changes

It has already been seen that the most remarkable result of the Stabilization Program was Turkey's transformation from a rapid-inflation country to one with virtual price stability. A natural question is the role of the EER changes in the Stabilization Program. While the increased flow of imports helped in the transformation, it was Turkey's receipt of foreign credits rather than exchange-rate policy which was the primary factor enabling additional imports. To the extent that imports entered at a higher EER not fully offset by increased government payments of export premia, some purchasing power was absorbed which contributed to the shift to price stability.

The questions therefore arise as to whether: the EER changes had any effects separate from those of the other components of the Stabilization Program and whether the EER changes can be viewed as separate from the Stabilization Program aside from their revenue-generating effects which, in any event, came at least as much from the import surplus as from the differential EERs between imports and exports.

The first question has three separate parts: (1) the behavior of exports after August 1958; (2) the behavior of other components of the balance of payments; and (3) the resource-allocational effects of EER changes. The resource-allocational effects of EER changes are considered in Section III, since they were closely interrelated with the overall determinants of the level of economic activity. It should be noted at this juncture that the primary resource-allocational effects of the EER changes were not immediately felt, and can be better considered as part of a longer-run response to devaluation.[15]

Export behavior. Although exports increased between 1958 and 1959, their expansion was by no means dramatic. A number of factors obscure analysis of reasons for the increase that did occur. First, it has already been seen that export statistics prior to August 1958 were difficult to interpret, reflecting "switch" deals, bilateral debt repayment arrangements and associated artificially high prices for exports, and perhaps some faking of invoices as well as unrecorded export transactions. Second, many of the export transactions undertaken in 1957 and 1958 were carried out by government and quasi-government agencies, often at a loss. Since those transactions were somewhat less closely tied to profitability than were exports undertaken by private traders, one would not necessarily expect the same sort of response as if the profit motive had dominated all exports. Third, as was seen in Chapter III, the export EERs were not fully unified in August 1958, and export premia increased for different commodities at various dates from August 1958 to 1960.

15. See Chapter VII, below.

With these factors in mind, we can examine data on the quarterly behavior of exports given in Table IV-7. The first column gives quarterly exports seasonally adjusted at annual rates for the period 1957 to 1960. The second column gives the quarterly figures for exports of traditional commodities. With the exception of cotton, those commodities did not receive the TL 9 rate until various dates in 1959 and 1960. Many commodities were exported primarily by government agencies. The third column gives the behavior of other "minor" exports, all of which were accorded a TL 6.20 premium in August 1958 and were predominantly the domain of private traders.

Inspection of the second and third columns of Table IV-7 indicates that

Table IV-7
Short-term export response, 1957 to 1960 (millions of U.S. dollars)

Year and Quarter	Total Exports (seasonally adjusted annual rate)	Major Exports (actual quarterly figures)	Minor Exports (actual quarterly figures)
1957			
I	295.7	67.3	23.1
II	487.6	77.0	17.6
III	380.5	42.9	19.5
IV	272.9	78.1	19.6
1958			
I	287.0	74.9	6.6
II	260.3	42.6	7.9
III	235.3	15.7	22.9
IV	214.0	50.1	26.5
1959			
I	364.0	75.7	27.7
II	419.1	57.3	24.0
III	302.4	22.6	27.0
IV	333.8	79.1	40.4
1960			
I	347.2	66.7	31.9
II	346.5	31.9	27.1
III	331.7	19.4	35.0
IV	303.6	70.0	38.7

Notes: a) Seasonal adjustment factors were computed for the period 1948 to 1970. The year was taken from the second quarter of one calendar year to the first quarter of the next, since the crop export season overlaps the calendar year.
b) Major exports are: chrome, cotton, hazelnuts, raisins, tobacco and wheat. Minor exports are the difference between total and major exports.
c) Actual quarterly export totals are the sum of major and minor exports and are given in Table IV-4.

Source: Data from *International Financial Statistics*, various issues.

there were significant differences in the behavior of major and minor exports following August 1958. The exportation of major commodities appears to have been delayed somewhat until new export regulations were issued, so that the third quarter 1958 exports were less than they would otherwise have been and the subsequent three quarters' totals were perhaps slightly higher. Exports of major commodities were still 11 per cent below their 1957 level in 1959. Although they rose 28 per cent over 1958, that was primarily attributable to the spillover in exports from calendar year 1958 to calendar 1959, as exporters awaited higher premia on traditional exports.[16] In all, the response of traditional exports to the changed EERs was very moderate and generally disappointing. It will be seen in Chapter VII that a major reason for this is that price signals from the international market are generally not reflected to producers in Turkey, so that the quantity of exports depends much more upon government policy than upon EERs themselves.

In contrast to major exports, minor exports had declined much more sharply during the mid-1950's and were $77.8 million in 1957 compared to $116 million in 1953. The striking feature is the shrinkage in minor exports in the first half of 1958. Although the decline was steady from 1953 on, much of the drop in the first half of 1958 may have represented speculative inventory accumulation in anticipation of devaluation.[17] This is the more plausible because it seems unlikely that any production response to the altered EERs could have been felt by the end of the third quarter of 1958 and little could have occurred by the end of the year.

Even if the change in minor exports between the first and second halves of 1958 was entirely attributable to offsetting inventory changes, it is noteworthy that the flow of minor exports increased in each subsequent year. Minor exports in 1959 were $109 million, compared to $80 million in 1957. They had thus virtually reattained their 1953 level. By 1960, minor exports were $133 million. Thus minor exports seem to have responded to the altered EERs. Although the relative response appears impressive, the minor exports were too small a component of total exports to have a sizeable effect on total export earnings.

It will be seen in Chapter VII that there is ample evidence of the responsiveness of most minor and some traditional exports to changed real EERs. But in the short-run period from August 1958 to 1961 the export response was not pronounced.

16. Mustafa Renksizbulut, "Analysis of Turkey's Foreign Trade and Some Estimates about Future Developments," *Turkish Economic Review*, May 1962, p. 21.
17. There is little, if anything, in contemporary comments to suggest that devaluation appeared any more likely in 1958 than in earlier years until at least the second quarter. Thus although the data are strongly suggestive of speculative activity, there is no corroborating evidence.

Capital flows. When there are expectations of exchange-rate changes, people attempt to hold the currencies they expect may appreciate. One effect of changes in EERs is that funds previously held in other currencies may be repatriated. Although such repatriation represents a once-and-for-all increase in foreign exchange receipts, it can potentially be used to finance some liberalization of imports. It is of interest to attempt to estimate the magnitude of the speculative flow in Turkey.

As indicated in Chapter II, the reliability of the balance-of-payments statistics in the 1950's left much to be desired. Official data can therefore provide only a rough approximation as to the size of the speculative flow and must be interpreted with care.

Recorded net private capital outflows were $29 million in 1956 and $61 million in 1957. By contrast, inflows of $73 million were recorded in 1958 and an additional $39 million is reported for the next two years (see Table I-6, above). It is probable that most of the 1958-to-1960 private capital inflow reflected the return of speculative funds. Since there were probably net capital outflows in the first eight months of 1958, the capital inflow over the last four months was very likely larger than $73 million, but there are no quarterly data available. Even accepting the $73 million estimate would indicate a reversal of $131 million between 1957 and 1958 in private capital flows, all of which represented a net improvement in the balance of payments.

Errors and omissions in the official balance-of-payments statistics continued to be negative until the end of 1959, although the largest negative figure (minus $97 million) was recorded in 1957. Although negative errors and omissions in 1958 might have been the outcome of a negative balance on unrecorded capital flows for the first eight months and a positive balance for the last four months, the fact that errors and omissions were still negative in 1959 suggests that something more systematic was wrong. Given the unreliability of the data, it is difficult to reach any firm conclusions, but it seems inadvisable to count the change in errors and omissions as part of the speculative reversal following devaluation.

Expectations. With the frequent changes in exchange taxes and export premia in the mid-1950's, it would be surprising had the August 1958 changes removed all expectations of future increases in EERs. There is some evidence that supports the hypothesis that many persons indeed anticipated further exchange-rate adjustments. Uncertainty about future premia probably lasted until *de jure* devaluation in 1960. Thus the EIU reported in early 1959 that:

> In recent weeks, there have been many rumours in Turkish business circles that with the second global import quota, the premium rate for imports, now TL 9.02 = $1,

would be adjusted to an average TL 12 = $1, with separate rates for specific categories of goods..."[18]

This uncertainty may account in part for the fact noted in Chapter III that initial applications for import licenses under the First Import Program totaled almost four times the amount allocated for that period. On the export side, it was reported that exporters continued holding stocks of some commodities in anticipation of further changes in the export premia.[19]

One indicator of expectations about future exchange rates is the price of gold. The price of gold coin, fairly symptomatic of the gold market's behavior, reached a peak of TL 128 per gram in 1958, a level not reattained until the late 1960's. Although expectations of future changes may have persisted, the disparity between prevailing and expected future exchange rates fell after 1958.

Interaction between exchange-rate changes and stabilization. Given the relatively limited short-term response of foreign-exchange receipts to changes in export EERs, it is apparent that the primary impact of the Stabilization Program, at least initially, was the cessation of inflation. An interesting question, therefore, is whether inflation could have been equally effectively stopped had the Stabilization Program not contained provisions for EER changes.

Two separate factors must be considered. First, the large inflow of imports was a sizeable deflationary factor and would have been considerably less so had the 1957 import EERs remained in effect. Second, there is the consideration that exports would almost certainly have stagnated, if not declined further, had export EERs not been altered.

It seems incontrovertible that a sizeable increase in imports was a necessary precondition for substantially halting Turkey's inflation. Those imports were financed primarily by foreign credits and therefore could have taken place at the old EERs (had the creditor countries not insisted upon EER changes as a precondition for receipt of the foreign credits). Had imports increased at 1957 nominal import EERs, a much smaller fraction of the premium on import licenses would have been absorbed by the government. It has already been seen that the net revenues (which were less than the increase in payments for imports by reason of the increased premium payments to exports) from foreign trade taxes in 1959 were 2.4 per cent of national income, and that the additional domestic purchasing power absorbed by the altered import EERs was at least twice that amount.

The effects of tight money would have been substantially reduced had

18. EIU, *op. cit.* (Note 1, Chap. II), *No. 29*, February 1959, p. 5.
19. *Ibid.*, *No. 28*, November 1958, p. 3.

import EERs not been increased. While a contraction of the money supply of sufficient magnitude to reduce demand for imports via deflation might have similarly reduced the premium, the adverse consequences of a contraction of that magnitude would almost certainly have been unacceptable. In the context of inflationary expectations which existed in mid-1958, it seems reasonable to conclude that given the shift in monetary policy which actually occurred, failure to increase import EERs would have impaired if not eliminated Turkey's chances of transition from a high-inflation to a moderate-inflation country. Thus increases in import EERs were in this author's judgment an integral and necessary part of the program to achieve price stability, in that the economic costs of increasing import EERs were far less than would have been the costs of reducing the money supply by enough to absorb the premium on imports at the old EERs.

On the export side, it is not as obvious that altered EERs contributed significantly to reduction in the rate of inflation in the first several years after August 1958. First, there is the fact that the short-term export response was disappointing. Second, there is the obvious consideration that if Turkey (or any other country) could obtain imports without exports, it would be deflationary. Thus if Turkey from 1958 on could have had her actual level of imports with her 1958 level of exports, the net effect would have been deflationary as contrasted with the actual course of events. However, Turkey would have been unable to borrow more without increasing export EERs, as other countries were not willing to finance an import surplus of the implied size. Export-EER alterations were thought necessary to restore prospects of eventual export growth. Even if Turkey had received an initial foreign credit enabling the increase in imports, it would have been a once-and-for-all increase. The import flow would have had to be reduced once the initial credit was exhausted, with attendant inflationary pressures at that time.

Thus it seems reasonable to conclude that: (1) the increased flow of imports was an important factor in enabling the achievement of price stability; (2) altering import EERs, by absorbing domestic purchasing power, was at least as important a deflationary factor as the increased flow of imports; (3) since the imports were financed by foreign credits, altered export EERs were not essential to the attainment of price stability in the short run; but (4) alteration of export EERs was essential if the flow of imports was to be maintained over an extended period of time, which was necessary for continuation of price stability over the longer run.

III. The Stabilization Program and the level of economic activity

The years 1959 to 1962 were slow-growth years for the Turkish economy,

and there is little doubt that recession was experienced over much of the period. In this section, the magnitude, timing and determinants of the level of economic activity over the period are examined.

The magnitude and timing of the recession

Data are woefully lacking for an adequate evaluation of the degree and timing of changes in the level of economic activity over the 1959-to-1962 period. Such data as are available suggest that the rate of growth leveled off in the first six to nine months after the August 1958 devaluation, and then increased rapidly. That was followed, however, by a sharp decline in the level of economic activity in the last half of 1960 and most of 1961.

The SIS estimates of national income at constant prices suggest overall growth rates of 3.8, 2.4, zero, and 6.4 per cent, respectively, for the years 1959 to 1962,[20] with income originating in manufacturing remaining constant over the three years 1959 to 1961. As indicated above, one factor accounting for the relatively slow growth rate over the period was undoubtedly the lackluster performance of the agricultural sector, from which income originating at constant prices actually declined.

There are few if any valid indicators of changes in the level of economic activity between quarters. Data on quarterly electric power and cement production reported by the EIU are given in Table IV-8 and indicate a slackening in the growth rate of power production and sharp fluctuations in cement production. The right-hand side of the Table gives the percentage change from the same quarter in the previous year. The power production data suggest that the two middle quarters of 1959 and the four quarters starting with the third quarter of 1960 were the periods of most pronounced slackening in growth, and also that the slackening was both longer and more pronounced in 1960–1961 than in 1959.

The figures of cement production show rather more marked changes. For cement, an import-substitute during the 1950's, production fell somewhat after the third quarter of 1958, rose rapidly from mid-1959 to mid-1960, and thereafter declined once again. The 1960–1961 decline is both steeper and of longer duration. Insofar as cement and power production can be taken as indicators of short-term changes in the level of economic activity, these data would suggest that the 1960–1961 recession was far more pronounced than that of 1959.

Annual production data tend to confirm this impression. As seen in Chapter I, real national income is estimated to have declined in 1961. Residential construction declined in 1959 and did not reattain its 1958 level until 1962.

20. See Table I-3, above.

Table IV-8
Quarterly power and cement production, 1956 to 1962

	Level of Production					Percentage Change from Previous Year				
	I	II	III	IV	Year	I	II	III	IV	Year
Power (million kwh)										
1956	524	494	496	536	2050	14	8	5	−2	6
1957	617	602	623	702	2544	18	22	26	31	24
1958	686	663	716	823	2888	11	10	15	17	14
1959	780	722	784	946	3232	14	9	9	15	12
1960	890	833	847	1011	3581	14	15	8	7	11
1961	947	863	940	1142	3892	6	4	11	13	9
1962	1095	1051	1108	1297	4551	16	22	18	13	17
Cement (thousands of metric tons)										
1956	188	356	320	396	1260	−18	19	16	41	19
1957	340	420	452	452	1664	81	18	41	14	32
1958	396	556	584	480	2016	16	32	29	6	21
1959	272	604	708	728	2312	−31	9	21	52	15
1960	452	768	748	752	2720	66	27	6	3	18
1961	352	760	848	748	2708	−22	−1	13	−1	−1
1962	504	848	888	848	3088	43	12	5	13	14

Sources: EIU, *op. cit.* (Note 1, Chap. II): *No. 18*, May 1956, p. 14; *No. 23*, August 1957, p. 13; *No. 27*, August 1958, p. 11; *No. 31*, August 1959, p. 11; *No. 35*, August 1960, p. 11; *No. 39*, August 1961, p. 10; *No. 43*, August 1962, p. 11; *No. 47*, September 1963, p. 14.

Other construction declined continuously from 1958 to 1961 and was well below its 1958 level in 1962. The textile industry apparently was also stagnant over the four-year period. Other industries generally show an increase in output in 1959, with stagnation or decline between 1960 and 1961.[21] The OECD interpretation was

> Manufacturing production was practically stagnant in 1958 but, under the impetus of renewed imports of raw materials and spare parts, made possible by the credits received in the framework of the 1958 Stabilization Programme, output rose by nearly 5 per cent in 1959. In 1960, the events leading up to, and immediately following, the revolution in May 1960 led to some hesitation on the part of producers and consumers which had a depressing effect on economic activity.[22]

It seems a reasonable conclusion that there were two separate recessions in Turkey. The first started with the devaluation and reached its nadir in the second quarter of 1959. Thereafter economic expansion resumed, especially in the last half of 1959 and the first few months of 1960. The second recession began in the summer of 1960, and reached its trough late in 1961. Since there was probably some slack in the economy in early 1960, the second recession was undoubtedly the more severe of the two, reflecting both a bigger downswing and a lower level of economic activity at the start of the decline. The greater magnitude of the downswing is evidenced both by the sharper and more widespread declines in production in different sectors of the economy and by the national income estimates for the period. The absence of quarterly data of course renders more precise measurement impossible.

Factors contributing to recession

Causes of the 1958–1959 slowdown. In the absence of data upon which more scientific tests could be based, any interpretation of the determinants of the level of economic activity within Turkey over the 1958-to-1962 period must of necessity be based on personal judgement. The 1958–1959 recession will be first considered.

It has already been seen (Table IV-3, above) that the shift in monetary policy was sharp and abrupt. Given its magnitude, the surprising thing is not that there was a recession but rather how mild the recession appears to have been. In this author's judgment the shift in monetary policy was responsible for the recession that did occur, and had it not been for some mitigating circumstances the monetary shift would have led to a deeper recession than was in fact realized. The increase in economic activity late in 1959 was

21. OECD, *Turkey, 1963,* p. 58; and OECD, *Turkey, 1961, op. cit.* (Note 42, Chap. III), p. 9.
22. *Ibid.*

attributable primarily to the abandonment of monetary stringency and the resulting change in expectations.

This view is consistent with Fry's estimates of the money supply-money income relationship and also with the apparent slowdown in construction activity. The really significant question is why the recession was so mild. Again, no quantitative answer can be given although several factors undoubtedly contributed. First, fiscal policy was expansionary: part of the reduction in investment (as reflected in the construction data) was probably offset by changes in government expenditures. Second, the shortage of imports prior to the second quarter of 1959 had retarded economic activity to some extent. In particular, a large influx of capital goods imports in 1959 and 1960 suggests that replacement demand for capital goods may have been relatively high. This demand probably offset part of the downward shift in private investment which would otherwise have occurred. Insofar as imports of capital goods required complementary domestic resources to complete the investment, the influx of imports was probably less depression-inducing than would otherwise have been the case.

Some observers have suggested in interviews that an additional factor contributing to the mildness of the first recession was the degree of wage and price flexibility in Turkey in the late 1950's and early 1960's. That is a difficult argument to assess. It is true that Turkish labor law at that time forbade strikes. However, there are no reliable data on either employment or wages with which to evaluate this argument. Of the 14 components of the price index which are available on a quarterly basis for the 1961-to-1962 period, eleven declined at least once, and many more frequently during the two-year interval,[23] which would suggest considerable flexibility.

Causes of the 1960–1962 recession. It is far more difficult to evaluate the factors contributing to the 1960–1962 recession than those for 1958–1959. As shown above, the available evidence indicates that the 1960–1962 recession was substantially more severe and protracted than its earlier counterpart. Yet as seen in Table IV-6 the simple model used to estimate aggregate excess demand shows that there was more expansionary stimulus to the Turkish economy in 1960 and 1961 than there had been in 1959.

Contemporary accounts attributed the recession to uncertainties following the May 1960 Revolution. Hoarding on the part of the peasants was particularly blamed for much of the difficulty:

> The economy at the moment is in the doldrums, and it looks as if the recovery will be both slow and painful. The root of the present trouble seems to be that the peasants are simply refraining from spending, with the result that business in the

23. Data from OECD, *Turkey, 1963, op. cit.* (Note 21), p. 59.

> consumer goods sector has slackened off to such a degree that many of the big firms are living off their capital and cannot meet their wage bills, while the smaller firms are being forced to close down...[24]

The OECD view was similar:

> The signs of a renewal of inflationary pressures and speculation, particularly after the vote in February 1960 on the 1960-61 budget at a greatly increased level of expenditure, were counteracted from the spring onwards by government policy to restrict the growth of public expenditure and by the spread of sales resistance and currency hoarding among the population, particularly the peasants. Consequently, demand for consumer goods, such as textiles, declined during part of the year...Hoarding of banknotes and, to a lesser extent, gold coins was a feature of 1960 and was the counterpart of the reluctance of consumers, particularly peasants, to buy...[25]

The available evidence on this hypothesis is mixed, however. The ratio of current GNP to the money supply, a crude indicator of the velocity of circulation, declined from an average of 8.84 in 1950–1954 to 7.59 in 1955–1957, rose to 8.85 in 1958 and 9.62 in 1959. Thereafter it fell to 9.27 in 1960 and 9.07 in 1961, rising to a peak of 10.16 in 1963. Then it gradually declined to 8.65 in 1969. One would expect a gradual decline in the income-money ratio as the Turkish economy becomes increasingly monetized. However, the data for the 1960-to-1962 period suggest a higher-than-average velocity of circulation, the opposite of that implied by the hoarding hypothesis.

If one inspects real consumption behavior over the period, there is a suggestion that consumption expenditures were somewhat below normal. If the percentage of consumption in GNP as given by SPO (Table I-1) is multiplied by real GNP, the resulting estimates of real consumption for the years 1958 to 1962 are:

Year	Consumption as a Per cent of GNP	Real GNP	Estimated Real Consumption
		(billions of TL at 1961 prices)	
1958	77	46.3	35.7
1959	77	48.1	37.0
1960	75	49.9	37.4
1961	74	49.1	36.3
1962	75	52.1	39.1

While these estimates are necessarily crude, they suggest that real consumption declined more than real income, which is consistent with the view that the recession resulted from the response to the political changes.

As seen in Table IV-3, the increase in the money supply was very small during 1960 and 1961. The behavior of the money supply undoubtedly contributed to the length and severity of the second recession. Indeed, the phe-

24. EIU, *op. cit.* (Note 1, Chap. II), *No. 37,* February 1961, p. 2.
25. OECD, *Turkey, 1961, op. cit.* (Note 42, Chap. III), p. 14.

nomenon from which it is tempting to draw conclusions is that the timing of the first and second recessions coincided almost exactly with changes in the rate of monetary expansion. The conclusion is highly plausible, and the behavior of the money supply was unquestionably important. What is not known, however, is whether during the 1960–1962 period the money supply remained stable as a matter of deliberate government policy or whether it remained stable in the absence of increasing demand for credit.[26]

There is no doubt that the Revolutionary government was committed to make the Stabilization Program work. Indeed, one of the reasons given for the takeover was that the NUC government could better carry out the Stabilization Program than had the Menderes government. The NUC substantially pared the budget submitted by the Menderes government. Rapid expansion of the money supply would not have been countenanced. Expectations based upon the commitment of the new government may well have contributed to recession. However, whether the actual behavior of the money supply was the result of passive adaptation to demand or of deliberate government policy is unknown.

The important question for present purposes is the degree to which the two recessions were related to the Stabilization Program. The picture in regard to the first recession is fairly clear: the abrupt shift in monetary policy and other deflationary pressures emanating from the Stabilization Program were the major factors in leading to it. That recession was very mild in relation to the sharp reversal in monetary policy. The rapid expansion in economic activity in the last part of 1959 and early 1960 is largely explained by the government's abandonment of the major monetary and fiscal elements of the program.

It is more difficult to say to what degree the second recession was linked to the Stabilization Program. Once expansionist policies had been resumed in 1959–1960, the shift back to the Stabilization Program undoubtedly led to a renewal of the recession. It is doubtful, however, whether the severity and intensity of the recession can be laid solely at the door of the resumption of the Stabilization Program. While the behavior of the money supply played a key role in prolonging and intensifying the second recession, that behavior may have been largely a passive response to money demand. Moreover, since the government could have expanded the money supply somewhat without imperiling price stability, part of the blame for the second recession must be attributed to the failure of the money supply to expand.

We conclude therefore that insofar as Turkey had to pay a cost in the form

26. The OECD declared that the commercial banks were in general highly liquid and that the demand for loans was "sluggish." OECD, *Turkey, 1961, op. cit.* (Note 42, Chap. III), p. 21.

of foregone output for the Stabilization Program, that cost lay primarily in the lower-than-average rate of growth in 1959 and 1960. The decline in real national income between 1960 and 1961 was neither necessary for the achievement of price stability nor a result of the Stabilization Program.

Short-run resource-allocational effects of the Stabilization Program. It has already been seen that the behavior of export earnings immediately after 1958 was disappointing. The longer-run results were much more satisfactory and are analyzed in Chapter VII. Here, focus is upon the short-run resource-allocational effects of the Stabilization Program. In the absence of detailed data, there are only three effects which deserve attention: (1) the composition of investment; (2) the behavior of construction; and (3) the productivity of factors of production.

The sharpest shift observable from annual data was that in the composition of investment. Table IV-9 gives the data.[27] By 1957 construction investment had increased to 76 per cent of total investment, with machinery and equipment down to 24 per cent. By 1960 construction investment (which fell in real terms) was 65 per cent of the total, while machinery and equipment had increased to 35 per cent. Real machinery and equipment investment increased fairly sharply. Imports of machinery and equipment virtually doubled between 1958 and 1959.

Simultaneously, the import content of machinery and equipment investment rose sharply after the Stabilization Program, while that of construction investment merely reattained its 1957 level. It was seen above that the machinery-and-equipment component of investment was hit much harder by import shortages in the mid-1950's than was construction. One effect of the Stabilization Program was to reverse the trend toward the increasing importance of construction investment.

The decline in relative importance of construction was, as just noted, accompanied by an absolute drop in construction activity in real terms. During the mid-1950's the increased share of construction had been accompanied by a drop in real machinery and equipment investment. A natural interpretation of this reversal is that the earlier import stringency had led to a non-optimal expansion in construction, which was counteracted with a reverse resource-allocational shift after the Stabilization Program. If there were bottlenecks limiting production in other sectors in the mid-1950's, the construction sector, relatively independent of imports, could have been the market into which resources flowed. If so, the easing of bottlenecks would have reversed the shift, thus leading to the downturn which actually occurred.

27. The data are not carried beyond 1960 because: (1) Gürtan's estimates terminate with that date, and (2) the TL value of imports changed after 1960, so that the import figures (in TL) are noncomparable. See, however, Table VIII-5, below.

Table IV-9
Investment composition and import composition of investment, 1957 to 1960

	1957	1958	1959	1960
A. (millions of TL, current prices)				
Construction investment				
Construction materials imports, c.i.f.	112	94	282	262
Domestic value of imports	324	261	528	505
Domestic materials	800	1289	1927	2043
Domestic value added	1800	2074	2159	2372
Total construction investment	2923	3624	4614	4921
Machinery and equipment investment				
Imports, c.i.f.	249	369	1061	1339
Domestic value of imports	628	894	1727	2115
Domestic goods	276	441	567	584
Total machinery and equipment	903	1335	2294	2699
Total Investment	3827	4960	6908	7620
B. (percentages)				
Composition of total investment				
Construction	76	73	67	65
Machinery and equipment	24	27	33	35
Imports (domestic value) to investment in:				
Construction	11	7	11	10
Machinery and equipment	70	67	75	78

Source: Same as Table II-10.

There is no way of testing this hypothesis with available data. The implicit deflators, calculated in the manner described in Table II-11, indicate a 14 per cent increase in the price of machinery and equipment from 1958 to 1960 compared with a 35 per cent increase in construction prices, thus reversing the increase in the relative domestic price of machinery and equipment of earlier years. To the extent that import liberalization accounted for the decrease in the relative domestic price of machinery and equipment, this would suggest that liberalization accounted for the change in investment composition.

The final resource-allocational effect is that on the productivity of resources. On this subject little evidence is available. Whatever changes did occur are obscured in the available annual data by the effects of recession. Contemporary observers however believed increased productivity to have been an important outcome of the Stabilization Program. The Industrial Development Bank of Turkey observed in its 1959 Annual Report:

> Before application of the stabilization policy the limits of the industrial production of Turkey were determined by the existing industrial production capacity and especially by the possibility of supplying the need for raw materials, auxiliary materials and spare parts. During the year under review, however, the deciding factors in determining the volume of industrial production were especially the volume of demand and the ability of the industrial and commercial community to finance inventory formation...The fact that the sellers' market, which was evident before the inflation turned into a buyers' market and especially the competition of imported goods brought the question of quality improvement and lower cost of production to the foreground.[28]

The OECD placed more emphasis upon the facts that "the serious underutilization of productive capacity that had developed during the previous eighteen months was thereby corrected," and that imports of spare parts and raw materials enabled increases in output from existing capacity.[29]

All these resource-allocational effects undoubtedly emanated from the Stabilization Program and the increased flow of imports. But it is impossible to quantify even approximately the degree to which the productivity of resources was thereby increased.

IV. The optimality of the Stabilization Program

Although the costs in the form of recession of the Stabilization Program have been discussed above, the benefits in the form of an altered long-run growth path have not been. It is nonetheless still possible at this stage to ask the question: if Turkey was going to undergo such a program, could the package have been improved upon?

Evaluation is difficult because there were three separate goals of the program: (1) achieving internal price stability; (2) eliminating some undesirable effects of government policies upon the domestic economy; and (3) altering the nature of the foreign trade regime. Imposition of bank credit and government budgetary ceilings and the raising of SEE prices were primarily aimed at achievement of the first goal. Removal of the government's price control regulations was designed to undo some of the damage inflicted by government policy upon the domestic economy.[30] Altered EERs, debt rescheduling and the import liberalization financed primarily by foreign credits were in-

28. *Annual Statement*, Industrial Development Bank of Turkey, 1959, pp. 27–8.
29. OECD, *Turkey, 1961, op. cit.* (Note 42, Chap. III), p. 6.
30. Removal of the price control laws and price ceilings could have been undertaken at any date independent of the Stabilization Program. While their removal was highly desirable, it was not an integral part of the Stabilization Program, although failure to remove them at that date would have resulted in continued domestic black markets and other difficulties. They are therefore not considered further within this section.

tended to affect the nature of the foreign trade regime. An additional complication to analysis of the optimality of the program is the fact that the monetary-fiscal components of the Stabilization Program were abandoned in 1959 and resumed in 1960 along with other policy changes undertaken by the NUC government.

An important question is whether the dual objectives of price stability and an altered trade regime should have been sought in the same package. Obsiously, unless the rate of inflation had been substantially reduced, no long-run alteration in the trade regime could have been anticipated on the basis of a fixed exchange rate. Thus if price stability had not been sought, some form of flexible exchange rate would have been the only means whereby lasting changes in the trade regime could have been effected. Speculation about the pros and cons of continued inflation, with a constant real EER, seems futile because the political consensus in Turkey seems to have been that the evils of inflation far outweighed its benefits. The price-stability goal of the program seems to have been more important politically than trade-regime alterations.

However, even though price stability was achieved, by setting a fixed exchange rate Turkey left herself vulnerable to renewed foreign-exchange shortages and overvaluation, as indeed occurred in the 1960's. Although inflation was mild contrasted with that in the 1950's, the adoption of a fixed exchange rate precluded use of the exchange rate as a means of attaining continuous external balance. It can be argued that the costs of such preclusion might have been acceptably low had Turkey devalued again in the mid-1960's. But the very fact of a fixed exchange rate created political pressures making that difficult to do. Thus the effects of exchange-rate overvaluation in the late 1960's can in a sense be blamed partly on the non-optimality of the 1958 Stabilization Program as it failed to include a mechanism for continued exchange-rate adjustment.

Although such a mechanism would have been preferable, the Stabilization Program did include a fixed exchange rate. To evaluate the program, therefore, the goals of price stability and an altered trade regime at a fixed-exchange rate are accepted as the basis for evaluation for the remainder of this section. We consider the optimality of each component of the package in turn.

Little comment is required on the adjustment of SEE prices. Of course SEE prices could have been increased without the remaining components of the Stabilization Program, and one inflationary pressure in the situation would have been reduced. However, given that SEE prices had not previously been increased, a source of finance for the SEEs other than Central Bank credits had to be found if inflation was to be reduced or eliminated at the time the Stabilization Program was adopted. Given the situation of the SEEs in August 1958, raising SEE prices was essential for the attainment of price stability.

The other anti-inflation components of the Stabilization Program, budgetary and credit ceilings, require slightly more evaluation. There can be no doubt that the ceilings were stringent enough to bring inflation to a halt and to that extent, were eminently successful. If the ceilings were nonoptimal, it was in the other direction: the reversal of inflationary forces may have been too strong. Not only did monetary expansion cease, but other factors were deflationary: the doubling of import EERs led to a sizeable absorption of purchasing power and the requirement that funds be deposited at the time of import-license applications enhanced the effect. Thus with a constant money supply the demand for money to finance imports shifted upward and the volume of imports increased sharply without an off-setting increase in exports.

The best argument for the necessity of the zero-increase ceilings – which implied constancy of the money supply – is that any permitted rate of expansion might have led the administration to evade the ceilings, or at least to carry out whatever expansion was permitted at the earliest possible date. Then too there is the consideration that some readjustment, accompanied by recession, may have been essential after the near-runaway inflation of the preceding years.

On the opposite side, some permitted expansion in the money supply might have made the effects of the Stabilization Program less unpalatable to the government. If that had happened the renewed inflationary impetus of late 1959 might either have been smaller or nonexistent, thus rendering the recession of 1960–1962 less prolonged and severe or even reversing it.[31] Whether a smaller rate of increase in ceilings in 1958–1959 would have been sufficient to induce the government to maintain the Stabilization Program is integrally related to the question raised above as to the intentions of the government when it accepted the Stabilization Program, and no definitive answer is possible.

The Menderes government probably did not fully accept the goals of the Stabilization Program. If that is so, zero-increase ceilings were probably necessary if the Stabilization Program was to be imposed by foreign creditors and to achieve price stability. However, had there been a government in Turkey which fully accepted the goals of the program, it would probably have been preferable to expand the money supply by 1 or 2 per cent per quarter during the year after the adoption of the Stabilization Program. In view of

31. In view of the developments in 1960–1962, it is evident *ex-post* that monetary and fiscal policy ought to have been more expansionist. But insofar as the reasons for that recession lay in the downward shift in the consumption function and other phenomena associated with the change in government, the problem was one of general monetary-fiscal policy and did not have its origins in the Stabilization Program.

the deflationary effects of imports and their financing and the potential growth rate of the Turkish economy (as well as its increasing monetization), such an increase would still have represented a major shift from past monetary behavior and enabled the cessation of inflation with a smaller impact on the level of economic activity. That conclusion is highly debatable, however, and other interpretations are equally valid.

Turning now to the components of the Stabilization Program aimed at altering the trade regime, there can be little doubt about debt rescheduling. It really was necessary years before it occurred. It is virtually impossible to perform the mental experiment of rationalizing the trade regime in any way in 1958 without debt rescheduling.

The desirability of the foreign credits received by Turkey is another matter about which it would appear that conclusions can be reached. As seen above, it is doubtful if the reversal of speculative capital flows exceeded $100 million. Even though that response by itself would have enabled a temporary increase in the volume of imports, the increase would have been relatively minor in view of the level to which imports had fallen. Moreover, if import liberalization was to be achieved, credits were probably necessary to provide confidence that the liberalization could be continued for more than a very short period.

In the economic conditions of 1958 the marginal product of additional imports far exceeded the interest rate on foreign credits. Some of the credits, especially in late 1959 and early 1960, were probably unwisely used when the government renewed its expansionist policies, and under ideal management the credits would not have been fully expended by mid-1960. However, the large increase in imports which the credits permitted was important in several ways: (1) it virtually wiped out the premia associated with import licenses; (2) it was a significant factor in contributing to the deflationary pressure; and (3) insofar as it enabled increased capacity utilization and other ways of better utilizing existing resources, the direct productivity of the imports was very high.

The final component of the program, alteration of EERs, raises two questions. (1) To what extent were the new EERs optimal? (2) Could the way they were altered have been improved upon? The first question is the more difficult. As seen above, the nominal devaluation was 220 per cent. But even the effective devaluation (the change in the average PLD-EER) was 75 per cent, which is large by any standard. Certainly a smaller effective devaluation would have been less desirable: (1) as seen above, for many export commodities the new EER simply raised the lira equivalent of the international price to the domestic price; (2) available evidence suggests that a change of smaller magnitude would have left premia on import licenses for many commodities; and (3) given that the exchange rate was to be fixed, some allowance had to

be made for the increase in the domestic price level that would follow the raising of SEE prices and other adjustments.

A larger effective devaluation might have been more desirable. A maximum would have been about TL 12 = $1.[32] We have seen that the actual alteration in EERs did not substantially affect the degree of discrimination against exports, as the ratio of the import EER to the export EER in late 1959 was almost the same as in the pre-1958 years. Partly, however, that was attributable to the implicit taxes on traditional exports and any larger effective devaluation would probably have necessitated higher export taxes on some of those commodities. Given the responsiveness of non-traditional exports and minerals to increases in real export EERs (see Chapter VII below), a somewhat greater devaluation could have increased the export response, perhaps sizeably. On balance, the actual EER changes were probably on the lower bound of the right order of magnitude, being sufficient to wipe out premia but not enough to offset discrimination against exports.

The manner in which the exchange rates were altered is another question. Exchange premia were altered so that the devaluation was *de facto* rather than *de jure*, and if Turkey was committed to a fixed exchange rate, the technique used to alter the rates led to a greater likelihood of one-sided speculation about future EERs than *de jure* devaluation would have. Moreover, while taxes on traditional agricultural exports are defensible on a variety of grounds, their use was certainly unwarranted for minerals, and even for other commodities their use led to speculative inventory withholding. Part of the disappointing performance of exports in the first years after 1958 was the result of the manner in which export EERs were changed.

The Stabilization Program must be judged on balance to have been a successful one. Its objectives and achievements were in a sense negative, in that the black markets, inflation, dislocations and import premia of the mid-1950's were largely wiped out. Whether from the situation of 1958 it would have been desirable to attempt more, i.e., to alter incentives drastically in favor of exports, is a matter of judgment. But evaluated in terms of its own goals, the Stabilization Program accomplished a great deal and the costs, in terms of domestic recession, appear to have been held within reasonable bounds.

32. This is the rate suggested by Okyar and Iren in Columbia School of Law, *op. cit.* (Note 14, Chap. I), p. 406.