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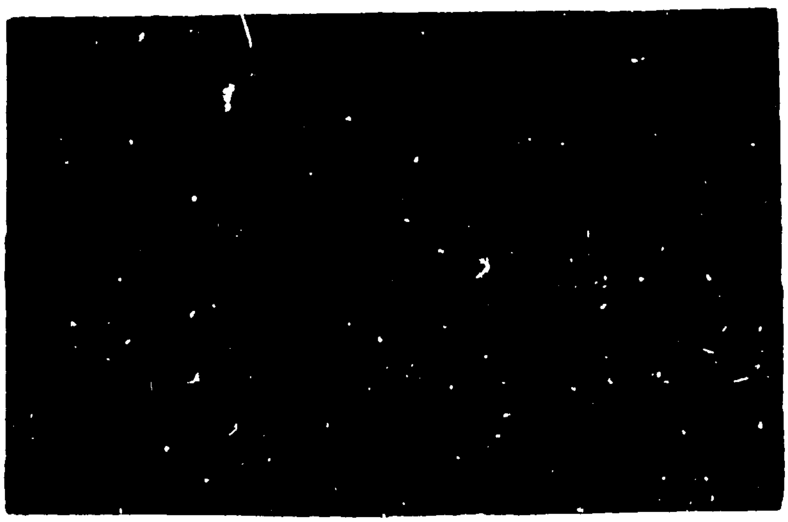

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Discussion Paper No. 5

ECONOMIC ASPECTS OF THE DEVALUATION OF THE TURKISH LIRA OF AUGUST 10, 1970

By

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April, 1972

ERRATA

DISCUSSION PAPER NO. 5

ECONOMIC ASPECTS OF THE DEVALUATION OF THE TURKISH LIRA OF AUGUST 10, 1970

TABLE 7, PAGE 37

Percent Change Over Prior Month

	WRONG	RIGHT
January 1971	-1.0	-1.2
March 1971	-5.9	-5.6
April 1968	-2.0	-3.3
December 1968	-6.9	-6.4
December 1969	-10.3	-9.4

TABLE 9, PAGE 40

Annual Percentage Change 1971

	WRONG	RIGHT
B. To Private Sector	-47.0	-40.0
	-13.7	-12.1
	-36.5	-26.7
	-15.9	-13.7
	-525.1	-84.0
	-15.4	-13.4
	-42.7	-29.4
C. Bank Liq. Fund	-10.2	-9.3

TABLE 15, PAGE 52	WRONG	RIGHT
Column 6, line 10	-293.8	-74.6
Column 7, line 10	-294.5	-74.7

TABLE 27, PAGE 71

	COLUMN	WRONG	RIGHT
1. Cotton	9	-22.4	-18.3
2. Tobacco	9	-16.0	-14.0
3. Hazelnuts	10	-23.6	-19.1
4. Raisins	10	- 8.1	- 7.5
5. Fruits	10	-15.3	-13.2
6. Vegetables	9	-33.3	-25.0
7. Other	9	- 4.1	- 3.9

TABLE 23, PAGE 63

	COLUMN	WRONG	RIGHT
Rice	5	-30.0	-23.1
Eggs	3	- 5.0	- 4.8
Olive Oil	3	-16.3	-14.0
B. Cheese	5	- 5.1	- 4.8
Mutton	3	- 7.3	- 6.8
Woolen Fabric	5	- 6.6	- 6.2
Calico	3	- 3.8	- 2.0

TABLE 23, PAGE 64

	COLUMN	WRONG	RIGHT
Coffee	9	-29.6	-22.9
Tin	7	-13.9	-12.2
Tin	9	-27.4	-21.3
Pig Iron	7	-35.0	-25.9
Pig Iron	9	-28.6	-22.2
Cement	5	- 2.2	-22.0

TABLE 24, PAGE 66

Delete percentage change figures for:

Net balance

Extra Budgetary Sources

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INTRODUCTION

Although the central aims of a devaluation normally are to increase the attractiveness of a country's exports and to decrease the relative attractiveness of imports to competing domestic products, there are often complex price and income interreactions which may offset these desired effects. Accordingly, it is important that effective measures accompany devaluation particularly in a controlled exchange economy which will influence the internal level and structure of demand and supply. In recognition of these facts, the Turkish Government announced a number of tax, monetary and credit mesures along with the official forty percent devaluation of August 10, 1970. Part I of this paper describes these measures briefly and in some cases comments on the limitations to their potential effectiveness. Part II is an examination of the effects of the devaluation and these associated measures as reflected in economic indicators on money and bank activity, prices, the government budget and balance of payments.

Highlights of Pre-Devaluation Period

Open speculation on the possibility of devaluation had begun in early 1969 and was reinforced by the falling external value of the Turkish Lira and the lengthening foreign exchange delays as the result of continuous balance of payments difficulties.

On January 5, 1970 the Central Bank found it necessary to apply stiffer pre-deposits on letters of credit. Although Prime Minister Demirel's speech of January 24, 1970 predicted a 7 percent rise in GNP with a 12 percent increase in industrial output, there was doubt in many sectors that such would be the case. The Government was having trouble holding down budgetary expenditures and new tax measures were in the offing. Commercial bank credit was continuously being tightened so that a liquidity shortage became noticeable. The Government Opposition maintained that the economic situation had deteriorated "long before." 1/

The defeat of the proposed 1970 TFY budget on February 11, 1970 led to the resignation of the Justice Party Government of Prime Minister Demirel. (This defeat was carried out through a combination of opposition parties with a dissident group of 41 Justice Party deputies.) A temporary budget was passed at the end of February, but at the same time the Government's tax requests were vetoed by the President. The uncertainty of the Government's economic program coupled with the developing political instability were further strong destabilizing factors.

1/ See all newspapers, February, 1970.

PART I

ECONOMIC MEASURES ASSOCIATED WITH THE DEVALUATION

In the sections below, first, the devaluation itself is defined based on the existing de facto exchange rates. Second, the several measures directed toward export promotion are discussed. Third, the new interest rate-subsidy structure is defined and commented upon. Last, special price and tax measures are described.

Attachment 1 describes the special exchange rate for "traditional" agricultural exports. Attachments 2 and 3 describe the new rates on petroleum products and the new taxes associated with the devaluation, respectively.

1. Devaluation Itself.

The single exchange rate of TL 9 = $ 1 established in 1958 was subject to several exceptions in the following years so that a de facto multiple exchange rate system existed at the time of the August 10, 1970 devaluation. These rates distinguished between commodity transactions (TL 9 = $ 1), workers' remittances and tourist purchases (TL 12 = $ 1), and Turkish citizens' purchase rate (TL 13.50 = $ 1). As can be seen in Table 1, the 1970 devaluation essentially eliminated this implicit multiple exchange rate system.

TABLE 1

OFFICIAL DE FACTO EXCHANGE RATES
(TL Equivalent of $ U.S. 1)

	Aug. 9, 1970	Aug. 10,1970	Percentage Changes
Commodity Imports (Purchases)	9.08	15.15	65.0
Commodity Exports (Receipts)	9.00	14.85 1/	65.0
Workers' Remittances (Receipts) 2/	12.00	14.85	23.7
Official Tourist Purchase Rates (Receipts)	12.00	14.85	23.7
Official Turkish Citizens Purchase Rates (Purchases) 3/	13.50	15.15	12.2

The relatively largest effect of the devaluation was on the Turkish Lira prices of commodity transactions (65%). It was hoped that this large increase in prices of imports would curb import demand for luxury goods and make Turkish products of all types more competitive in the domestic market. Concomitantly, Turkish export markets would be more appealing to domestic producers, and the relative decrease in price to the foreigner would increase the quantity demanded to an extent greater than the foreign exchange loss by devaluation. Since workers' remittances and tourists' purchases had already been de facto adjusted nearer to the new rate, their devaluation was not so large (23.7%). Finally, the "penalty" rate for Turkish Citizens purchase was eliminated, even though this de facto rate was raised by 12.2 percent and

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1/ Except for cotton, tobacco, hazelnuts, seedless raisins, dried figs, olive oil, oilcakes, and molasses which became TL 12 = $ 1. (33.3% increase) See attachment 1.

2/ Includes 3 years' interest (33 1/3%) payable in advance by Law 499. Basic rate was 9; after August 10, 11.25.

3/ Includes the 50% Foreign Travel Expenditures Tax by Law 196. Basic rate was 9; after August 10, 10.

a $200 limit was maintained.

2. Export Promotion. 1/

The emphasis on (commodity) export promotion is based on the assumption that development demands imports and foreign aid; therefore large quantities of foreign exchange to pay for imports and interest and to repay principal. In the First Five Year Plan period actual exports exceeded planned exports by about 11 percent for an average annual increase of 6.5 percent. An average annual growth target was set at 7 percent for exports in the Second Plan. A sharp decline in traditional Turkish exports in 1968 set back this plan and "export promotion" became a major topic of conversation and activity.(See 1969, 1970, 1971 SPO Annual Programs.) The 1970 devaluation itself was a measure to stimulate exports.

The post-devaluation measures associated with export promotion were, in general, indirect rather than direct, that is, special credit conditions and tax rebate and exemptions were given to exporters.

a. Credits: Interest Rate Incentives.

Short-term bank credits from banks' own resources to exporters benefitted from a subsidy of 1.5 percentage points to the lending bank and 3.0 percentage points to the borrower. Thus the interest paid by the borrower was 7.5 percent versus the normal 10.5 percent. If the bank credits were from funds obtained from the Central Bank, there was no subsidy to the bank,

1/ The following sections draw on information found in SPO publication No. SPO: 966-EPD: 304, November, 1970.

but the interest rate paid by the borrower was subsidized by 1.5 percentage points resulting in an 8.5 percent interest rate.

Medium-term bank credit to exporters for either the export itself or investment in export-oriented industry enjoyed a 4.0 percentage point subsidy to the borrower and a 2.0 percentage point subsidy to the lender. The cost of money to the borrower was 8.0 percent as opposed to the normal 12.0 percent medium-term credit interest rate.

Furthermore, export credits were exempted from tax and stamp duties.

b. Credits: Available Funds.

Two funds, connected with each other and, in turn, dependent on the import regime, were set up to provide credit to exporters. The first, the "Special Export Support Fund" was based on the import predeposits collected at the Central Bank previous to transfer of foreign exchange. Fifty percent of the value of these predeposits was eligible to be lent through this fund at between 6 and 9 percent rates. The second fund was based on "interest received" from credit given from the first fund sources. These were given in form of subsidies to enterprises that earn foreign exchange.

The amount available in the first fund for credit purposes was a function of (1) level of programmed imports; (2) level of predeposits required and (3) length of waiting period for foreign exchange transfer. The second fund was furthermore affected by the time period of loans from the first fund and the propensity to pay interest on time. All in all these seem to be very unstable sources of funds.

A third fund the "Foreign Exchange Equalization Fund" is discussed in Attachment 1.

c. Tax Rebate.

The general rule was that exporters were rebated those amounts paid for taxes, duties, etc., up to between 10-40 percent of the total export price (if more than $1 million exports were made) and 10-30 percent if exports were less. As mentioned before, export credits were subject to exemptions from taxes, duties and related charges.

d. Other Incentives.

Exporter-manufacturers were entitled to 25 percent of expected export values as foreign exchange allocation to finance necessary production goods imports. They could export goods on credit in certain cases. Certain incentives were given to Turkish entrepreneurs who wished to undertake work abroad.

3. Interest Rate Reform.

a. Interest on Credits.

The Turkish interest rate structure (within the organized banking system) is one of fixed, differentiated, maximum rates for both credit and deposit transactions. Table 2 gives a historical picture of the official interest rate structure of commercial bank loans since 1931.

An examination of the structure of interest rates prior to the 1970 devaluation is available elsewhere. 1/ It is shown that official interest rate policy since 1954 has been set by the Committee for the Regulation of Bank

1/ Maxwell J. Fry, Finance and Development Planning in Turkey, Ankara, USAID, 1970, Chapter 6.

Credit. Mr. Fry suggests that "if an interest rate policy can be said to exist in Turkey today, it would appear to consist of keeping interest rates below their market equilibrium levels in order that funds may be directed, through a rationing procedure, into investment which might not have been willingly undertaken at higher rates." 1/ However it is further noted that if this is the underlying aim, it has been "impotent" 2/ mainly because banks have not found it profitable to lend from their own resources at given priority rates.

The devaluation-associated interest rate changes coupled with the application of a subsidy system seem to be directed toward a strengthening of the rationing procedure, by means of ensuring profitability of banks in use of their own funds for priority sector loans. Two expected associated effects can be a simplification of the interest rate structure and a better data base for estimating the "cost" of subsidizing priority sectors. On the other hand the reasons underlying the selection of the new rates of interest and subsidy payments are not clear. A second question is why such a complicated system of subsidy payments has been set up whereby the banker and borrowers are given separate subsidies under fourteen different schemes for a total of twenty-eight different types of subsidy payments. Such a system could create tremendous administrative problems.

1/ Maxwell J. Fry, Finance and Development Planning in Turkey. Ankara USAID, 1970, p. 231.

2/ *Ibid*, p. 232.

TABLE 2

OFFICIAL INTEREST RATES OF COMMERCIAL BANK LOANS
1931 1971

Type of Credit	June 1933	May 1938	Aug. 1951	Aug. 1960	July 1961	Mar. 1964	Apr. 1969	Sept. 1970
	Dates of Change							
1. General interest rate	12.00	8.50	7.00	12.00	10.50	10.50	10.50	11.50
2. Specified interest rate								
a. Open book credit rate 1/	12.00	12.00	9.00	12.00	10.50	10.50	10.50	11.50
b. Agricultural credits rate	12.00	8.50	7.00	-	-	-	-	-
i. General rate	12.00	8.50	7.00	10.00	9.00	9.00	9.00	10.50
ii. Medium & long term rate	12.00	8.50	7.00	7.00	7.00	7.00	7.00	10.50
iii. Credit rate from bond revenues of Agricultural Bank under Law 5389	-	-	-	5.00	3.00	3.00	3.00	3.00
c. Export Credit rate	12.00	8.50	7.00	10.00	9.00	9.00	-	-
i. Prior sales arrangements made	12.00	8.50	7.00	10.00	9.00	9.00	9.00	10.50
ii. Goods on the tax rebate list	12.00	8.50	7.00	10.00	9.00	9.00	9.00	10.50
iii. Financed from Central Bank rediscounts	12.00	8.50	7.00	10.00	9.00	9.00	8.00	9.00
d. Preferential industry credits	12.00	8.50	7.00	12.00	10.50	9.00 2/	9.00	10.50
e. Peoples' Bank credit to small business, artisans and craftsmen	12.00	8.50	7.00	12.00	9.00	9.00	9.00	10.50
3. Medium Term interest rate	-	-	-	-	-	-	-	12.00 3/
4. Medium Term credit financed through Central Bank rediscounts	-	-	-	-	-	-	-	10.50 3/

1/ Open-book credit represents credit given without a specific collateral. From 1933-1960, there was only a distinction between "open-book" credit and "other" credit. In 1960, 3 types of agricultural credit and export credit rates were distinguished. In 1961, People's Bank credit rates were distinguished. In 1964, a so-called preferential industry rate was established. In 1969 the export credit rate was divided as to the rate for export credit "financed from Central Bank rediscounts" and "other export" credit. In 1970, the banks were authorized to give medium term credit therefore a medium term rate was set up.

2/ As of November 1, 1964

3/ As of November 1, 1970

Source: Central Bank 1970 Annual Report

With these comments in mind, let us look at the new system of interest rates and subsidies implemented as of September, 1970 (suspended in March, 1971 and again implemented after September, 1971.)

There are basically three lending rates: the ordinary short-term credit rate, 11.5%; the priority short-term credit rate 10.5% 1/; and the medium term credit rate, 12.0% 2/. However, there is considerable variation in the ultimate cost of money to the borrower, from 7.0% to 11.0%, and interest received on the loan by the bank, from 9.0% to 14.0%. This variation is a result of the different rates of subsidy paid on various categories of priority loans. Table 3 gives an indication of the nominal cost of credit to the borrower and rate of interest received by the lender under this new scheme.

Several points can be made about this system as it relates to the desired rationing procedure.

(1) Agricultural sector credit. All credit either short, medium or long-term 3/ which is extended directly to farmers has the same nominal interest rate, 10.5%; actually costs the farmer 8.0%, but provides the bank with a 11.8% return in three cases and 13.0% in one case. Therefore even within the agriculture credit priority rate there is variation as to "ultimate" priority. Credits given to agriculture cooperatives are further differentiated in that the borrower pays 8.5%. Most agricultural credit is

1/ One exception is short-term export credit ultimately from Central Bank resources, at 9.0%.

2/ One exception is specified agricultural credits, at 10.5%.

3/ Note that "long-term" credit is given by the banks to agriculture. Another special factor is that credits based on bond revenues of the State owned Agriculture Bank under Law 5389 are lent out at 3.0%.

TABLE 3

BASIC INTEREST RATES, SUBSIDIES a/
AND COST OF CREDIT IN TURKEY BY PURPOSE OF CREDIT
September 7, 1970

Type of Credit	Nominal Rate of Interest	Subsidy		Effective Rate	
		Bank	Borrower	Bank	Borrower
1. General interest rate	11.5			-	-
2. Specified interest rate					
a. Open-book credit rate	11.5			-	-
b. Agricultural credit b/					
i. General rate					
Direct	10.5	1.3	1.5	11.8	9.0
Through Cooperatives	10.5	1.3	2.0	11.8	8.5
ii. Medium and long-term					
Normal	10.5	1.3	1.5	11.8	9.0
Preferential	10.5	2.5	1.5	13.0	9.0
iii. Bond revenues	3.0	-	-	-	-
c. Export credit rate b/					
1-2 From banks' own sources	10.5	1.7	3.0	12.2	7.5
2 From Central Bank resources	9.0	-	1.5	9.0	8.5
d. Preferential industry credits	10.5	1.3	1.0	11.8	9.5
e. Peoples Bank credit to small business, etc. b/	10.5	1.3	1.5	11.8	9.0
3. Medium Term Credit					
Export credits b/	12.0	2.0	4.0	14.0	8.0
Tourism investment	12.0	2.0	4.0	14.0	8.0
Shipbuilding, shipyards	12.0	2.0	5.0	14.0	7.0
Preferential industry	12.0	1.3	2.0	13.3	10.0
Other investment & equipment	12.0	1.0	1.0	13.0	11.0
Operating capital to industry and tourism	12.0	1.0	1.0	13.0	11.0

a/ No subsidies are given if bank uses Central Bank rediscounts for that specific lending purpose.

b/ This category has tax and stamp duty exemption.

NOTE: Investment banks are not included within the subsidy system.

Source: SPO, Recent Economic Policies in Turkey, SPO:966-EPD: 304, November, 1970.

given by the Agriculture Bank, a completely state-owned institution. The result of this new system is a raise in the nominal cost of credit to some farmers and no change to others; the previous interest rate on short-term agricultural credit was 9% and 7.0% on medium and long-term credit, respectively.

(2) <u>Short-term credits from the Halk Bank to small business.</u> Small scale business (including manufacturing, craftsmen, artisans and tradesmen) receiving credit from the Halk Bank is among the priority sectors. The effective cost of this credit to the borrower remains at 9% after the subsidy; however the subsidy to the Halk Bank increases its interest received to 11.8%. The Halk Bank is the only recipient of this type of subsidy; it is a state-owned bank established to give credit to small business. The effect of the subsidy under these circumstances will be simply to increase profitability (resources?) of the Halk Bank at the expense of the Budget. There is no reason why it would affect direction of lending policies of Halk Bank. No medium or long-term credits to small business are under priority rates.

(3) <u>"Priority Industry" short-term and medium-term credits.</u> Certain industrial branches are considered as "preferred credit recipients." Short-term credit to these priority branches has an effective rate of 9.5%, 0.5 percentage points above the previous rate. However, the rate received by the lending bank is now 11.8%, 2.8 percentage points above the previous rate. The differential between the non-priority effective rate (11.5%) and this new effective rate (11.8%) at 0.3% does not seem like a large or convincing one given that 1) banks must lend from their own resources, 2) the customers may not be as "credit-worthy" as the already established ones and 3) the burden again falls on the State budget.

The subsidy system for medium-term credit to industry is quite differentiated. The first differentiation is between "investment" and "operating capital" credit. The second is the singling out of tourism and shipbuilding as special sectors. (All export credits are separated into a special category. We will discuss these below.)

In general, priority industrial sectors now can borrow at 10% for investment purposes. This is 0.5 percentage points above the short-term rate. However, the lending bank receives 13.3%, 1.5 percentage points above the short-term lending rate. Here there probably exists an incentive to banks to lend medium whereas the borrower is not paying a substantial difference to borrow medium. The cost to the Budget is 3.3% in subsidies.

Operating capital to priority industry costs 11.0% to the borrower, provides 13.0% return to the lender and costs 2.0% to the Government. This same rate is given to a category called "other investment and equipment credits" and tourism operating capital credits.

Tourism investment credits and the shipbuilding industry are heavily subsidized, at 6.0% and 7.0% rates respectively. The underlying reasoning probably follows from the "export" nature of tourism and the "import-substitution" possibilities in the shipbuilding and shipyards industry. It might be worthwhile to categorize these rates as export-promotion schemes.

b. Comments on Interest Rate-Subsidy Structure.

The new interest rate structure on credits seems to be aimed at directing funds to fulfil the medium-term demand in industry, particularly of export-oriented sectors. Since this subsidy system is not applicable to the

IDB and IICB, medium funds are now cheaper than long-term funds which is theoretically a more rational structure.

Certain questions, however, arise with regard to the probable ramifications of this interest rate-subsidy system.

(1) Administration. Bureaucracies are not famous for efficient administration, particularly in such complex relationships. Questions immediately come to mind, such as:

(a) How is the "borrower" to be classified? Does the bank establish the nature of the loan? (If so, there may be a conflict between which is maximized--the cost to borrower or return to lender.)

(b) What is the source of funds for the subsidy? There is a statement that a "Selective Credit Fund" will be set up at the Central Bank which will receive its resources from outside the General Budget. What, however, are these resources?

(c) When will subsides be paid? At time of loan? After project is finished?

(2) Analysis of effectiveness. The aims of this new interest rate-subsidy system are: a) to persuade the bankingsystem to use its own resources for credit to priority sectors; and b) to determine the precise cost of support policies as they apply to different sectors.

(a) How will it be determined that ultimately the lending bank is using its own resources? That is, if a bank does not rediscount with the Central Bank for a particular credit, is it considered as using its own funds? The problem with this reasoning is that anytime a bank borrows from the Central Bank, it increases its resources. In the case of most short-term credit the rate to banks is only 0.3 percentage points above the normal lending rate. After administrative lags, etc., are taken into account, most banks would still prefer direct, efficient transactions.

(b) It is true that the "subsidy" cost, that is transfers from the General Budget, can be known. In order to gather together such information a large statistical effort must be made which will entail substantial time lags. It is impossible for the budgetary accounts to be detailed enough to provide such data. As it stands now, there are only two or three line items allocated to subsidies, in general. Therefore the information must be collected from the banks themselves. By this time, the following year's budget will be enacted with some arbitrary line item for the "selective credit fund." It is my opinion that this "Fund" will eventually go bankrupt and the "emergency" measures needed to "subsidize" the subsidy funds will cause it to lose its usefulness as a gauge by sector.

Another important point, in my opinion, is based on the structure of the banking system in Turkey. Although the value of the subsidy itself can be known, the other costs to the State of operating a state-owned, specialized banking system must be considered. There are subsidies to the Agriculture Bank for many purposes, often in a form which cannot be distinguished Will this interest rate-subsidy system replace the other subsidy funds? How do we account for the large contributions to capital (by the Budget) of the state banks? The larger the outstanding loans the greater the interest received and made available for further lending; therefore the greater funds originally available, the greater the subsidy volume. But the subsidy is paid by the state essentially to a state enterprise to lend to a sector it already lent to or was established to lend to. So is the subsidy really "urging" the state bank to lend to a new sector? Or is it simply a transfer from the budget to a state bank as a general subsidy?

On the other hand, since private banks service all sectors and are not restrained by purpose, they look for other criteria than the interest rate: 1) credit-worthiness of borrower; i.e., they minimize risk when such narrow profit margins (0.3%) are involved: 2) turnover of funds; particularly in tight money situations, short-term loans are preferable; 3) relation of borrower to bank, i.e., does the bank hold stock or bonds of the borrower? Is the customer likely to return?; 4)and administrative flexibility of making the loan and obtaining its repayment.

In order to test these "theoretical" questions dealing with the new interest rate-subsidy system, supporting data are necessary on the direction of credit flows, the distribution of subsidies by sector and by private-public bank breakdown, borrowing from the Central Bank by private-public bank, etc. So far the published data do not permit such analysis.

(3) Alternative financial institutions. The interest rate reform did not apply to the development banks. The State Investment Bank in particular has large outstanding loans to the State banking system (TL 2.5 billion in December 1970) at relatively low interest rates. Will these funds be considered as "own resources"? This latter financial relationship is an important potential source of conflict. The Social Security Institutions have specialized lending policies for construction, for example. What is its interest rate policy in comparison with that of the Emlak Kredi Bank?

c. Interest on Deposits.

In order to increase available funds of the Turkish banking system, the question of encouraging the public's deposit holdings in banks has been important for years. Several measures have been adopted: lotteries, insurance schemes, opening of convenient branches and interest payments. Lotteries and branch banking have been attacked as cost-raising and serving only to shift deposits among banks. 1/ Not much emphasis has been placed on the deposit insurance and nominal interest rates have rarely been changed despite price increases thus resulting in negative real rates.

The package of reforms accompanying the devaluation included a substantial increase in the rate of interest paid on longer term deposits and a decline in the sight deposit rate for other than "individuals" deposits. As can be seen in Table 4 maximum deposit rates are fixed and differentiated according to term and after 1958 to category of depositor. 2/

The deposit rate change in September, 1970, substantially raised the long-term rate from 6-6.5% to 9%. The effectiveness of this measure is examined in Part II. However first certain points should be made about these deposit categories. Government and interbank categories are obvious in

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1/ However there is conflict on this issue. See Jean van der Mensbrugghe "Domestic Savings in Developing Countries," <u>Finance and Development</u>, No. 1, 1972, p. 37: "Experience shows that the amount of saving depends partly on how widespread these facilities are; . . . "

2/ See p. 138, B. Yaşer, <u>An Analysis of the Financial System in Turkey, 1949-1963</u>.

their composition and therefore consistent. "Individual" and "commercial" demand categories however are interchangeable. For example, a private businessman desiring "current account" credit will maintain high balances in a "commercial account." If, as seen in 1970, he has no need for such credit, he may switch his funds to an "individual demand" account receiving two percentage points higher interest.

A second point is that many deposits of a long-term nature are not included in any of these categories because they are blocked in some way. For example, the State Real Estate Bank requires deposits to sit for $2\frac{1}{2}$ years before housing credits are given yet are not recorded among deposits. Other important, but unincluded deposits are the import predeposit funds. The significance of these funds is that they are "substitutes" for "bank" deposits. For example, it is most likely that in late 1970, the very rapid drawing down of the import predeposits by private businessmen coupled with their hesitancy to invest contributed heavily to the significant rise in time deposits. Furthermore, the uncertain tax situation and other factors connected with the construction sector slump contributed to the decline in housing credits 1/ and to these required deposits.

4. Price and Tax Measures.

a. Statements on Price Policies.

Mesut Erez, Minister of Finance, made the following observation on prices on the day following the devaluation:

1/ In order to obtain housing credits, the foundation must be completed.

TABLE 4

INTEREST PAID BY BANKS FOR DEPOSITS
(%)

	Dates of Change					
	July 1933	June 1938	August 1951	August 1960	June 1961	Sept. 1970
Demand and up to 3 months (4 months) time deposits for government, commercial, and interbank. a/	4.50	4.50	2.50	2.50	2.00	1.00
Demand and up to 3 months (4 months) time deposits for individuals.	4.50	4.50	2.50	3.50	3.00	3.00
All time deposits 3 months to 6 months (4 months to 6 months)	4.50	4.50	2.75	4.00	4.00	4.00
All time deposits 6 months to 1 year	6.50	6.50	3.00	5.00	5.00	6.00
Time deposits more than 1 year and less than 18 months	6.50	6.50	3.50	6.50	6.00	9.00
Time deposits over 18 months	6.50	6.50	4.00	6.50	6.50	9.00

a/ The division between government, commercial, interbank and official was not made until 1968. The separation of time deposits was between up to 3 months and 3 months and over until August 1960 and between up to and including 4 months and over 4 months after August 1960.

Source: Central Bank, Monthly Bulletin.

"The most possible disadvantage of the devaluation will be an increase in prices. However I would like to point out that the increase in prices will not be at the same rate as the devaluation. First, the decrease in the value of the Turkish Lira is actually below the announced rate of 66.6 percent. The reason for this is that before the announcement of devaluation, the Turkish Lira was exchanged at the self-adjusted rate of TL 12 to a dollar. Thus the new adjustment in parity actually devalues the Lira at about 25 percent. Imports on the other hand comprise about 6 percent of our GNP. Under these circumstances, devaluation will not be reflected in prices to a great extent."

Adnan Başer Kafaoglu, Director of the Department of Revenues of the Ministry of Finance, on August 15, 1970, said that the rises in prices will not reach dangerous levels. According to Kafaoglu, danger would arise only if price increases surpassed the limit envisaged by the measures taken by the Government, although this is "unlikely."

An increase in the supply of money was expected because of the higher government support prices, the Personnel Law and the to-be-enlarged volume of credits. Kafaoglu summarized the government measures to prevent this increase from finding its way into higher prices in the following way:

"The 66.6 percent increase in costs of imports will deflate the surplus demand for such goods.

"The new Government support prices will increase the purchasing powers of agricultural producers who will in turn increase their demand for textiles and durable goods. The demand for textiles will be met through existing stocks and increase in production capacities. As for durable goods, the increase in their production costs due to higher costs of imported raw materials will be neutralized by higher rates of customs tax reductions. In these sectors of industry too, the employment of idle factors to increase production capacities will increase the supply of goods. Thus, both in textiles and durable goods, price rises will not be at the rate of the devaluation.

"The most important factor in controlling prices will be the care taken not to follow a deficit financing policy. For this purpose, the 1970 Budget should be well-balanced, the budgets of State Economic Enterprises should be balanced, private sector investment financing should be secured from healthy resources such as bank deposits and deficit financing of public sector investments should be avoided.

"In fact, price increases between 5 and 10 percent in developing countries are a sign of a flourishing economy. We have only to avoid a greater than 10 percent increase in price indices."

On August 18, Prime Minister Demirel, made a strong statement warning that the Government

". . . is determined to take all available steps against needless and baseless price upping by both the manufacturers and importers. I have already announced that the prices of public sector goods and services will not be increased. As for the private sector goods and services, the rises in their prices will have to be approved by the Economic Committee. In cases contrary to this, steps will be taken against such price rises within the framework of Law 1567 which envisages penalties as far as imprisonment. The enterprises responsible for unauthorized price rises will not be benefitted by various incentive measures. Such enterprises will be subjected to restrictions in their activities within the framework of the Foreign Trade Regime."

A number of measures were written into the law to reinforce the Government's strong moral stand against excessive price increases.

b. Specific Price Increases .

The Turkish Government has extensive direct and indirect influence on prices. This influence derives from:

(1) Specific laws which allow ministries to determine maximum sales prices, e.g., pharmaceuticals and tractors,

(2) Government agricultural support price policies whereby minimum prices of certain agricultural goods are, in effect, established,

(3) Pricing policies of government-owned enterprises authorized by the basic State Economic Enterprise Law 440, and

(4) The "moral suasion" of the Government by its ability to use, selectively, import quota allocations, tax rebates and other investment incentives, etc.

As part of the devaluation package, several specific price measures were set out. The price of sugar (powder, refined crystal and cube) was raised "in order to compensate for the rise in the price of the sugar beet." (State-owned sugar factories supply main inputs to beet farmers, purchase all sugar beets, and produce all sugar products consumed in Turkey and exported abroad.) The factory to distributor delivery prices and retail prices of domestically produced chemical fertilizers were raised. (Although private fertilizer factories exist, the public sector dominates the industry.) Finally, the support prices were raised as shown in Table 6 below. There were no detailed explanations given for these price changes. 1/

TABLE 5

SELECTED AGRICULTURAL SUPPORT PRICES
(kuruş per kilo)

	1969	1970	% Increase	1971	% Increase
Seedless Raisins, No. 9	242	280	15.7	292	4.3
Dry Figs, Type 6/w	165	200	21.2	235	17.5
Cotton, Çukurova	230	275	17.4	320	18.5
Olive Oil, Aegean	545	630	15.6	780	23.8
Pistachio nuts, dry red skin, unshelled	800	1,000	25.0	1,100	10.0
Hazelnuts, mill run, unshelled	580	750	29.3	850	13.3
Wheat, soft, for bread	78	80	2.6	85	6.3

NOTE: Support prices for co-op members. Non co-op members have lower support prices.

1/ However, according to research results found by Mrs. Nimla Heplevent, and myself, sugar and fertilizer have been sold below cost and subsidized mainly by budget transfers.

c. Tax Measures.

The tax measures were explained in the following way.

(1) The stamp duty on imports was decreased from 25 percent to 10 percent. " . . . to keep the increases in the prices of imports below the rate of devaluation."

(2) New rates of production taxes were imposed on petroleum products, i.e., LPG, high octane gasoline, normal gasoline, kerosene, motorine and fuel oil "in order to curb an abnormal rise in the demand for fuel after devaluation" because the "consumption of fuels will rise due to certain sub-measures taken with the announcement of devaluation." 1/

(3) New taxes were introduced in certain sectors "which have revealed a tendency to develop excessively and without stability," i.e., vehicle purchase tax, enterprise operating tax, real estate appreciation tax, and the construction tax. 2/

(4) The existing system of tax rebates on exports "was completely modified." The previous system had comprised all items subject to tax rebate under a single list. The rates of rebate applied on each export were shown in this list. The new system comprised exports subject to tax

1/ Wholesale and retail sales profit rates were set, a "Fuel Stability Fund" was set up, production tax rates were increased and stocks were taxed. (See Attachment 2 for details).

2/ On August 12, 1970 "The Law on Financing the Budget" ratified by the National Assembly on July 29, 1970 was made official as Law 1318. The new taxes introduced by this law were: the vehicle purchase tax, enterprise operating tax, real estate appreciation tax and the soccer pool (Spor-Toto) tax. It further made alterations to the following taxes: production tax, real estate purchase tax, inheritance tax, stamp duties, legal fees tax, securities and official documents issuance taxes. (See Attachment 3 for details.)

rebate under four main groups to which the rebate rates of 40 percent, 35 percent, 30 percent and 20 percent were applied, respectively. (It reduced the tax rebate rates on forestry products in a separate list.) It was stated that tax rebates applied to exports were decreased in order "to lighten their burden on the budget."

(5) Custom tax exemptions were given to cast iron products, ferro-alloys, scrap iron blooms, billets, sheet bars, sheet iron in rolls, iron and steel rods, and beams, high carbon steel products and iron ore with the condition they were imported with the permission of the Ministry of Industry.

ATTACHMENT 1

SPECIAL EXCHANGE RATE FOR "TRADITIONAL" AGRICULTURAL EXPORTS

In the August 10, 1970 devaluation a special exchange rate of TL 12/$1 was made applicable to foreign exchange receipts from the major traditional Turkish exports of cotton, tobacco, hazelnuts, seedless raisins, dried figs, fig paste, olive oil, oilcakes and molasses. Finance Minister Mesut Erez explained this measure in the following terms:

> "The bulk of Turkish exports consist of agricultural exports. As most of these can still be exported at the rate of U.S. $1 equals TL 9, the application of the new parity to these exports will unnecessarily introduce a large purchasing power into the economy, which in turn will increase prices. The parity applied to such products will gradually reach normal parity thus preserving price stability. On the other hand, the application of the new parity would affect negatively the export sales prices of these products and would decrease our foreign exchange revenues."

The reason for this measure given in the 1970 Central Bank Annual Report, p. 39, was " . . . because the foreign market competitive power was already great while elasticity of demand was low."

The Government promised the TL rate would be increased to the TL 15 = $ 1 exchange rate within a few years; however, producers and exporters were very critical of this measure. On July 8, 1971, these exports were adjusted to a TL 13=$1 rate. (In January the rate for tobacco exports alone was increased to TL 13=$1.) In March 1972 the processed hazelnuts exchange rate was raised to TL 14 = $ 1.

A special fund, "The Foreign Exchange Equalization Fund" was set up at the Central Bank wherein the difference between the foreign exchange received for the export and the amount paid to the exporter was deposited to the account of the Treasury. This money was to be used for financing of exports. 1/

1/ For example, if hazelnuts worth TL 120.00 are exported, the Central Bank receives $10.00 in foreign exchange. TL 120 is given to the exporter and TL 31.50 is deposited in the Fund because the Bank can resell these dollars at TL 151.50. Thus TL 120 enters into circulation rather than TL 148.50, lowering the initial inflationary effects. TL 3 are soaked up in the second sales transaction.

However, according to the TFY 1972 Government Budget, the amount remaining in the Fund and further accumulation from this source will be handled as direct income of the government.

From the devaluation to the end of 1970, a crude estimation of the amount accumulated in the Fund is shown in the following table.

EXPORTS OF "TRADITIONAL" CROPS
SUBJECT TO SPECIAL EXCHANGE RATE OF $1 = TL 12

	Total 1970	($ Million) Aug. - Dec.
Raw Cotton, Linters and Refuse	173.2	79.8
Nuts, raisins, figs	116.4	70.5
Olive Oil	0.2	0.2
Oilcakes and Residues	23.0	9.9
Tobacco leaves and refuse	78.4	25.4
	$391.2	$185.8 x 3.15 = TL 585 million

Since these exports accounted for 64 percent of exports in this period, the accumulation is substantial, around TL 585 million for five months alone.

ATTACHMENT 2

PRICES, TAX AND PROFIT RATES OF PETROLEUM PRODUCTS

According to the Official Gazette decrees of August 10, 1970 the following sales prices, profit and tax rates are fixed for petroleum products.

	Gasoline	Kerosene	Diesel-Oil	LPG	JP (1,3,4) Jet Fuel
			(krş.)		
1. Profit Rates:					
a. Wholesale:					
Per jerrican	-	15.00	-	-	-
In bulk (kilo)	1.00	1.00	1.00	5.00	-
b. Retail:					
Per jerrican	-	42.00	-	-	-
Per kilo	6.00	6.00	4.00	35.00	-
Per liter	4.41	4.80	3.40	-	-
		(TL per 100 kg.)			
2. Customs Tax	13.65	2.40 1/	4.45	-	13.65
		(Kuruş per kilo)			
3. Production Tax Rates	162.45	71.10 1/	(78.50 (72.10	60.00	109.70
		(Kuruş per liter)			
4. Sales Prices	150.00	129.00	125.00	-	-
5. Tax on Stocks 6/	(43.00 2/ (50.00 3/	(34.00 (12.50 4/	34.00	55.00	43.53 5/
6. Pipeline Tax		Crude oil: 3TL/barrel			

1/ Includes jet fuel (JP-5,6)
2/ Normal
3/ High Octane
4/ Jet Fuels, JP - 5,6
5/ No. 4 only
6/ Above 200 kilos

ATTACHMENT 3

NEW TAXES

1. Vehicle Purchase Tax

The vehicle purchase tax (1) applies to cars, pick-up trucks, station wagons and vans. It is distinguished between weight, age, and use of car. Rates shown below are double for racing and sports cars. Purchase by persons covered by Law 507 (professional drivers) are exempt for the below categories, and for up to 7-ton trucks and 25-person buses.

Vehicle Purchase Tax (1)
(TL)

Weight (kilos)	1 Year-old	2-3 Years-old	4-5 Years-old	6-8 Years-old	9-11 Years-old
950 and below	5,000	4,500	4,000	3,200	2,500
951 - 1,200	7,000	6,500	6,000	4,800	3,500
1,201 - 1,600	12,000	11,000	10,000	8,000	6,000
1,601 - 1,800	15,000	14,000	13,000	11,000	9,000
1,801 and above	20,000	19,000	18,000	16,000	13,000
Trucks					
3,000 and below	7,000	6,000	4,000	3,000	2,000
3,001 - 5,000	9,000	8,000	6,000	4,500	3,000
5,001 and above	12,000	10,000	9,000	7,500	5,000
Buses, Minibuses, etc.					
No. of Persons					
25	8,000	7,000	5,000	4,000	3,000
26-35	11,000	10,000	8,000	5,500	4,000
36 and above	14,000	13,000	11,000	8,500	6,000

Other Vehicles
(TL)

Type of Vehicle	1 Year-old	2 - 5 Years-old	6 - 11 Years-old
Motorcycles	500	300	200
Motorcycles	1,100	700	500
Triporters	1,500	1,100	800

2. Enterprise Operating Tax: The Enterprise Operating Tax is to be based on the sales of goods and services by such enterprises as casinos, restaurants, bars, beauty shops, clubs, hotels, motels, jewelry shops, saunas, dischoteques, silversmiths, furniture shops, perfumaries, fur shops, spare parts shops, TV shops, cyrstal ware shops, in cities with over 30,000 population (with some exceptions).

3. Real Estate Appreciation Tax: This tax is based on the profits secured from the sale of real estate, that is, the difference between the cost and sale price.

Difference in Cost and Sale Price	Rate of Tax
For the first 50,000 TL	15%
For the next 50,000 TL	20%
For the next 200,000 TL	30%
For the next 300,000 TL	40%
Over and on 600,000 TL	50%

4. Spor-Toto Tax: The Spor-Toto or Soccer Pool Tax is baded on the TL 2 bet per column, at the rate of 20 percent.

5. Modifications and alterations in the Law on Production Tax: One of the most important alterations made in the Law on Production Tax by the "Financing Law" is the inclusion of the assembly industry production to the base of the Production Tax.

6. Modifications and alterations in the Real Estate Purchase Law: The "Financing Law" introduced a number of modifications on the Base of the Real Estate Purchase Tax, to the effect that the rate of this tax applied on the acquisition of real estate is changed according to the type and value of real estate.

7. Modifications and alterations introduced into the Inheritance Tax: The alteration made in the Inheritance Law is to the effect that as of the

publication of the "Financing Law" the tax levied on inherited real estate and movable goods will be based on the "current value" of the estate.

8. Modifications in the Law on Stamp Duties: The "Financing Law" altered the methods of collecting and the rates of Stamp Duties levied on contracts, deeds, petitions, securities, balance accounts, etc.

9. Modifications in the Law on Legal Fees: The "Financing Law" increased the rates of about all existing legal fees.

10. Modifications in the Law on Securities and Official Documents Issuance: The "Financing Law" increased the acquisition prices of most of the securities and Official Documents such as Residence Permits, Identity Cards, Passports Notary Papers.

11. Construction Tax: Construction tax applies to construction within municipal boundaries at the following rates.

	TL/m^2		
	Concrete Stone Buildings	Wooden Construction	Other
1. Residential Construction			
A. 101-120 m^2	20	10	7
B. 121-150 m^2	50	20	10
C. 151-200 m^2	60	30	15
D. 200 m^2 +	125	50	25
2. Workshop Construction			
A. 0 -50 m^2	25	15	10
B. 51-100 m^2	50	25	15
C. 100 m^2	75	35	25

The above listed amounts are 5 percent higher in towns with a population of 100,001-200,000, 10 percent higher in those with a 200,001-400,000 population and 15 percent higher in towns with a population over 400,000.

PART II

ECONOMIC PERFORMANCE AFTER DEVALUATION

1. Summary

Government economic policy, political stability and private sector expectations are particularly important in a post-devaluation period. The government must put effective controls on demand, while at the same time bear the political burden of price rises. Industrialists, labor and consumers will be unhappy in the short run, at least, and vested interests will pressure the government for special concessions. The government must be flexible enough to adjust to changing conditions, but at the same time weigh carefully the economic consequences of policy decisions.

A summary of the predominant political and economic phenomena in the months following the devaluation leads off Part II. The following sections present comparative data for pre- and post-devaluation periods. Section 2 is an examination of the characteristics of the money supply, Central Bank assets and credit policy, and commercial bank credit activities. In Section 3 the effect of changes in interest rates on bank deposits is examined briefly. Sections 4 and 5 are a brief look at prices and the government budget, respectively. Finally the detailed accounts of the balance of payments are examined in Section 6.

In the months following devaluation, Turkey's economic performance was under the influence of several extra-ordinary factors.

A. The post-devaluation period was characterized by serious political instability. This instability was mainly the result, on the one hand, of the violent clashes between leftist and rightist groups, street demonstrations, closing down of universities, political kidnappings, etc., and, on the other hand, the accusations of corruption and ineffective control against Prime Minister Demirel. On March 12, 1971 The Turkish military leaders presented an ultimatum to Prime Minister Demirel calling for his resignation. A caretaker "reformist" government mainly composed of ministers with no political affiliation was established under Professor Nihat Erim, who resigned from the Republican Peoples' Party to accept the Prime Ministership. Law and order were restored to a large extent under the Martial Law imposed in eleven provinces. In December 1971, a political crisis threatened with the resignation of eleven ministers, but Prime Minister Erim quickly reorganized the cabinet. However the Erim Government's themes of "reform and reorganization" met with resistance in many quarters and resulted in a very uncertain political and economic climate.

B. A new State Personnel Law was fully implemented during TFY 1970 starting December, 1970. This law raised the government wage bill to such an extent that between the end of November, 1970 and the end of November 1971 current expenditures increased 71 percent. Transfers to state enterprises to cover their increased wage bills as a result of collective bargaining agreements had not been planned for thereby imposing further budgetary difficulties. A third burdening factor was the added coverage and higher rates of the social security agency. Planned public investments could not be carried out given these large current commitments and resort was made to deficit financing. Furthermore new taxes were imposed simply to meet current expenditures rather than as part of a careful tax reform.

C. The record harvest in 1971 coupled with the sharply increased minimum agricultural support prices resulted in large payments to farmers by the Soil Products Office (the price support agency). This agency resorted to short-term Central Bank borrowing which by the end of September 1971 was 140 percent higher than as of the end of September 1970. One side effect of the increased support prices was a twelve percent increase in the price of bread to consumers in Istanbul and Ankara with a direct effect on the Consumer Price Index of two percent. 1/

D. The Government in May, June, and July, 1971 arbitrarily raised the prices of certain essential goods produced by state economic enterprises in order to help them meet their deficits. 2/ Some examples were: Steel, 12-22 %, electricity to municipalities, 30-45%; electricity to consumers, 45%; coke for heating, 180%; industrial coke, 115%; cement, 7-22%; fuel, 7%; and paper, 25-50%. These increases were justified as a measure to

1/ See TOAID A-247, June 14, 1971.

2/ The necessity of these increases as a result of low efficiency, selling below cost and high subsidy in the past is not questioned here; the timing and extent are. Furthermore the statements by the Minister of Finance, Sait Naci Ergin, that "inflation was coming" and the "the treasury is bankrupt" probably had further bad psychological effects.

"avoid further inflationary use of Central Bank financing." However resort to Central Bank financing was not averted.

E. The unexpectedly large foreign exchange remittances from Turkish workers abroad following the devaluation added millions of Deutsche Marks to the reserves of the Central Bank. Adequate measures to offset the inflationary effects of the Lira counterparts were not implemented and these funds simply fueled consumer demand. 1/ Workers' remittances increased 72.9 percent in 1971 over 1970.

F. The recession in the construction industry beginning in 1969 continued through 1971, with annual growth rates at 8.8%, 5.3% and 2.0%, respectively. The imposition of heavy taxes on building had the desired effect of cutting luxury construction, but at the same time cut known and safe investment opportunities without offering readily available substitutes to the smaller savers. [illegible] Furthermore the low construction levels had ramifications on the supporting industries of cement, tiles, bricks, glass, etc. In the peak seasons thousands of workers could not find employment.

The combination of the devaluation and these above factors resulted in an economic situation commonly referred to as "stagflation," that is, high levels of unemployment, low levels of industrial production,

1/ The Central Bank did set up a special "convertible account" for foreign exchange accounts of Turks abroad which paid 6% pre- and 9% post-devaluation interest on long-term deposits. The foreign exchange serves as reserve assets of the Central Bank, but the deposit liability is not counted against reserves. Thus the "free reserves" of the Central Bank are overestimated.

and investment and rapid increases in prices. It is impossible in this short paper to isolate the specific effects of the devaluation on this complicated economic situation. Rather the following sections simply include data on those areas which were directly affected by the devaluation and its related measures.

2. Monetary and Credit Aspects.

Money and credit statistical series in 1970 exhibited unusual and difficult-to-analyze patterns. Changes in money supply and credit during the year reflected not only variations in domestic transactions involving current production and sales, but also speculative influences of several types both before and after devaluation, the devaluation itself, the accumulation of blocked accounts originating from pre-deposits on letters of credit, the acceleration in processing letters of credit following devaluation, changes in interest rate structure imposed by governmental authorities, and the rapid inflow of foreign exchange, partly of a commercial and partly of an official nature. Moreover, it is likely that the velocity of circulation altered over the patterns of previous years as there occurred in the latter part of the year a marked shift in the composition of the money supply to relatively larger holdings of bank notes as against deposits. It is therefore difficult to judge whether certain temporary phenomena dominated the data.

a. Money Supply.

By December, 1970, the money supply (defined as bank notes in circulation, commercial and "savings" demand deposits and deposits with the Central Bank on which checks can be issued) rose by 17.1% over December of the previous year, a little more than the comparable rise in 1969 (16.0%) and 1968 (14.5%). (See Table 6.) By the end of July 1970, the year to year rise in money supply had been lower (9.0%) than in the two previous years (14.6% and 17.2% respectively). In the months following July and particularly in December, the rise in money supply was quite strong compared to the 1968-1969 period; however, this rise was predominantly in bank notes in circulation and not in deposits. As a result a clearly distinguishable trend in 1970 was a large increase in holdings of currency outside the banking system in the second part of the year. (See Table 7). Bank notes in circulation by December, 1970, compared to the end of 1969 rose by almost 3 times the rate (30.9%) it had risen in the previous year's comparable period (10.6%), while in the January-July 1970 period, it had risen virtually the same percentage (10.7%) it had risen during the previous year's comparable period (10.8%). On the other hand, "savings" demand deposits rose only 12.0% in 1970 compared with 17.3% in 1969 and commercial demand deposits rose 9.5% in 1970 compared with 22.2% in 1969. (See comment on page 16.) As a result the currency/deposits and currency/money supply ratios indicated a shift in preference to holding currency (bank notes plus coin).

	Dec. 1968	July 1969	Dec. 1969	July 1970	Dec. 1970	March 1971	Dec. 1971
Currency/deposits	46.45	50.82	43.15	51.53	50.60	66.37	46.40
Currency/money supply	31.72	33.69	30.14	34.00	33.59	39.89	31.70

This shift probably only represented temporary phenomena resulting from the release of TL 2.9 billion in blocked import pre-deposits in the last five months of 1970 a/. These funds may not have been deposited back into

a/ 1970 Central Bank *Annual Report*.

the banking system immediately. 1/ As can be seen from Table 7 October is the peak month for increase in bank notes in circulation at 13.5%. This obviously is a result of a TL 900 million increase in bank notes outstanding plus TL 500 million liquidity from release of import predeposits. In the same month foreign exchange assets increased TL 500 million. Furthermore, after September 1970 there is a decided switch from demand deposits to time deposits which further raises the above ratios. (See Section 3 below.)

The data for end of year 1971 (estimates from Central Bank sources) confirm the suspicion that this shift in 1970 was temporary. The currency/deposits ratio drops back to 1968 levels of 46.4 and the currency/money supply drops to 31.7. The money supply itself is estimated to have increased 23.3% whereas bank notes in circulation only increased 17.9%. In April 1971 (following the Military Memorandum) a sharp increase in bank notes in circulation (8.7%) can probably be explained by business need to build up their cash liquidity position with the resurgence in business activity.

b. Central Bank

Central Bank credit has normally been the major determinant of money supply in Turkey, but in 1970 and 1971 there have been many additional factors at work, including the sharp increase in foreign exchange holdings

1/ A possible reason for this lag is the political and economic instability at the time. Businessmen probably held cash in anticipation of new crises, income tax payments, back debts (outside the banking system, etc.)

TABLE 6

MONEY SUPPLY BY MONTHS, 1968 - 1971

(TL Million)

Months	1968 Amount	1968 Percent Change Over Prior Month	1969 Amount	1969 Percent Change Over Prior Month	1970 Amount	1970 Percent Change Over Prior Month	1971 Amount	1971 Percent Change Over Prior Month
January	21,572	-4.9	25,155	-3.1	29,336	-2.7	34,040	-3.5
February	21,538	-0.2	25,366	+0.8	29,105	-0.8	34,136	+0.3
March	21,880	+1.6	25,391	+0.1	28,389	-2.5	33,486	-1.9
April	21,795	-0.4	25,548	+0.6	28,590	+0.7	34,728	+3.7
May	21,508	-1.3	25,698	+0.6	28,430	-0.6	34,427	-0.9
June	22,443	+4.3	25,727	+0.1	28,048	-1.3	35,090	+1.9
July	22,521	+0.3	26,200	+1.8	28,740	+2.5	n.a.	
Percent change July over prior July		+14.6		+16.3		+9.7		
August	23,108	+2.6	26,740	+2.1	29,448	+2.5	n.a.	
September	23,278	+0.7	26,981	+0.9	30,108	+2.2	n.a.	
October	24,035	+3.3	27,915	+3.5	31,993	+6.2	n.a.	
November	24,494	+1.9	28,499	+2.1	32,338	+1.1	n.a.	
December	25,968	+6.0	30,127	+5.7	35,268	+9.1	43,479 1/	
Percent change December over prior December		+14.5		+16.0		+17.1		+23.3

1/ Estimated in Central Bank 1971 Annual Report.

Source: Ministry of Finance, Monthly Economic Indicators.

TABLE 7

BANK NOTES IN CIRCULATION BY MONTHS, 1968-1971

(TL Million)

Months	1968 Amount	1968 Percent Change Over Prior Month	1969 Amount	1969 Percent Change Over Prior Month	1970 Amount	1970 Percent Change Over Prior Month	1971 Amount	1971 Percent Change Over Prior Month
January	7,677	-	8,033	0.3	9,386	5.9	11,455	-1.0
February	7,535	-1.9	8,350	3.9	9,403	0.2	11,546	+0.8
March	7,790	3.4	8,181	-2.1	8,754	-7.4	10,904	-5.9
April	7,639	-2.0	8,229	0.6	9,036	3.2	11,855	+8.7
May	7,441	-2.7	8,493	3.2	9,258	2.5	11,556	-2.6
June	7,879	5.9	8,271	-2.7	8,954	-3.4	11,432	-1.1
July	7,784	-1.2	8,624	4.3	9,545	6.6	n.a.	
Percent change July over prior July		-		+10.8		+10.7		
August	8,302	6.7	9,082	5.3	10,052	5.3	n.a.	
September	8,198	-1.3	8,916	1.9	10,389	3.4	n.a.	
October	8,537	4.1	9,440	5.9	11,793	13.5	n.a.	
November	8,560	0.3	9,777	3.6	11,846	0.4	n.a. 1/	
December	8,010	-6.9	8,861	-10.3	11,601	-2.1	13,507	
Percent change December over prior December		-		+10.6		+30.9		+17.9

1/ Estimated in Central Bank 1971 Annual Report.

Source: Ministry of Finance, Monthly Economic Indicators.

the low demand for private sector credit, and the factors causing an increased portion of the money supply to be held as currency.

At the end of July 1970, Central Bank credits had increased 24.8% over July levels of the previous year, compared to comparable July increases of 28.9% and 19.8% in 1969/68 and 1968/67 respectively. Thus the pace of new credit creation in the first seven months of 1970 was on a par with the pace of increases in previous years. At year's end, however, the 1970/69 increase was but 12.7% compared to much higher percentage rises in previous years. (See Table 8.) Central Bank credits were decreasing in the last five months of the year, and accounted for the relatively low increase recorded by December 1970 over the previous year. This decreasing trend continued into early 1971. There was a sharp decrease in rates by July (5.5% over July 1970) although in later months credit flows pick up somewhat. The rate of increase in Central Bank credit in 1971 is less than in any of the past four years, at 11.7%.

Table 9 reveals a significant shift in the direction of Central Bank credit from the private sector to the public sector, particularly to the Treasury and the Soil Products Office. By the end of 1971, these two agencies accounted for 55.8% of total Central Bank credit compared with 34.2% and 37.6% at the end of 1969 and 1970, respectively. This tendency was apparent even prior to the devaluation. (See July 1970 data). It is not surprising given (a) the budetary difficulties of the Government as the result of the Personnel Law and (b) the larger and higher rates of support payments by the Soil Products Office. On the other hand the combination of higher banks' own resources and lower private sector demand than in previous years are reflected in lower bank

TABLE 8

CENTRAL BANK CURRENT CREDITS, 1968-1971

(TL Million)

Months	1968 Amount	1968 Percent Change Over Prior Month	1969 Amount	1969 Percent Change Over Prior Month	1970 Amount	1970 Percent Change Over Prior Month	1971 Amount	1971 Percent Change Over Prior Month
January	7,991	-9.0	9,853	-3.1	12,784	-1.1	13,885	-4.9
February	8,565	+7.2	10,554	+7.1	13,540	+5.9	13,413	-3.5
March	8,825	+3.0	10,600	+0.4	13,267	-2.0	13,331	-0.6
April	8,468	-4.1	10,461	-1.3	13,159	-0.9	13,616	+2.1
May	8,413	-0.6	11,051	+5.6	13,582	+3.2	13,436	-1.3
June	8,753	+4.0	10,887	-1.5	13,877	+2.2	13,668	+1.7
July	8,877	+1.4	11,444	+5.1	14,281	+2.9	15,069	+10.3
Percent change July over prior July		+19.8		+28.9		+24.8		+5.5
August	9,267	+4.4	11,669	+2.0	14,745	+3.2	14,881	-1.3
September	9,445	+1.9	11,965	+2.5	14,628	-0.8	15,031	+1.0
October	9,753	+3.3	12,523	+4.7	14,607	-0.1	16,031	+6.7
November	9,901	+1.5	12,648	+0.1	14,541	-0.5	15,751	-1.8
December	10,168	+2.7	12,920	+2.2	14,565	+0.2	16,273	+3.3
Percent change December over Prior December		+15.9		+27.1		+12.7		+11.7

Source: Central Bank *Monthly Bulletins*

TABLE 9

SECTORAL DISTRIBUTION OF CURRENT CENTRAL BANK CREDITS, 1968-1971

(TL Million)

	Credit Outstanding				Annual Percentage Change			
	1968	1969	1970	1971	1968	1969	1970	1971
A. To Public Sector	5,676	7,140	8,088	11,795	15.2	25.8	13.3	45.8
1. Central Government	3,801	5,217	6,109	7,838	22.2	37.3	17.1	28.3
a) Treasury	2,591	3,467	4,359	6,088	9.8	33.8	25.7	39.7
Short-term advances	2,181	3,057	4,359	6,088	11.8	40.2	42.6	39.7
Treasury bills	348	348	-	-	-	-	-100.0	-
Advances on gold	62	62	-	-	-	-	-100.0	-
b) Monopolies	1,210	1,750	1,750	1,750	61.3	44.6	-	-
2. State Economic Enterprises	1,875	1,923	1,979	3,957	3.3	2.5	2.9	100.
Soil Products Office (Cereal price support)	1,020	950	1,125	3,000	-	-6.9	18.4	66.7
Sugar Industry	654	734	709	709	8.3	12.2	-3.4	-
Sümerbank	110	145	145	248	-	31.8	-	71.0
Real Estate and Credit Bank	91	94	-	-	-3.2	3.3	-100.0	-
B. To Private Sector	4,229	5,527	6,155	4,186	18.1	30.7	11.4	-47.0
Commercial and Industrial	672	862	1,126	990	-15.4	28.3	30.6	-13.7
Artisans and small traders	405	506	490	359	29.0	24.9	-3.2	-36.5
Tobacco financing	239	298	248	214	2.6	24.7	-20.2	-15.9
Agricultural sales coops	1,213	1,617	1,419	227	43.8	33.3	-14.0	-525.1
Other agricultural credits 1/	1,437	1,824	2,297	1,990	38.8	27.4	25.9	-15.4
Others	263	420	575	406	-27.3	59.7	36.9	-42.7
C. Bank Liquidation Funds	263	253	322	292	-2.2	-3.8	27.3	-10.3
TOTAL	10,168	12,920	14,565	16,273	15.9	27.1	12.7	11.7

1/ Mainly credit to the Agricultural Credit Cooperatives.

Source: Central Bank, *Monthly Bulletin*.

TABLE 9 (continued)

SECTORAL DISTRIBUTION OF CURRENT
CENTRAL BANK CREDITS, 1968-1971

(TL Million)

	Percentage of Total 1968	1969	1970	1971	July 1969 Amount	July 1969 % of Total	July 1970 Amount	July 1970 % of Total	July 1971 Amount	July 1971 % of Total
A. To Public Sector	55.8	55.2	55.5	72.5	6,549	57.2	8,476	59.3	10,720	71.1
1. Central Government	37.4	40.4	41.9	48.2	4,740	41.4	6,353	44.5	7,397	49.0
a) Treasury	25.4	26.8	29.9	37.4	3,280	28.7	4,603	32.2	5,647	37.5
Short-term advances	21.4	23.7	29.9	37.4	2,870	25.1	4,208	29.5	5,647	37.5
Treasury bills	3.4	2.7	..	-	348	3.0	333	2.3	-	-
Advance on gold	0.6	0.4	..	..	62	0.5	62	0.4	-	-
b) Monopolies	11.9	13.6	12.0	10.8	1,460	12.8	1,750	12.2	1,750	11.5
2. State Economic Enterprises	18.4	14.8	13.6	24.3	1,809	15.8	2,123	14.8	3,323	22.1
Soil Products Office (Cereal price support)	10.0	7.4	7.7	18.4	1,025	8.9	1,175	8.2	2,453	16.3
Sugar Industry	6.4	5.6	4.9	4.4	784	6.8	709	5.0	709	4.7
Sümerbank	1.1	1.1	1.0	1.5	-	-	145	1.0	159	1.1
Resal Estate and Credit Bank	0.9	0.7	-	-	-	-	94	0.6	-	-
B. To Private Sector	41.6	42.8	42.3	25.7	4,642	40.6	5,565	39.0	4,043	26.9
Commercial and Industrial	6.6	6.7	7.7	6.1	945	8.3	1,379	9.7	1,081	7.2
Artisans and small traders	3.9	3.9	3.4	2.2	531	4.6	586	4.1	489	3.2
Tobacco financing	2.3	2.3	1.7	1.3	308	2.7	303	2.1	326	2.2
Agricultural sales coops.	11.9	12.5	9.7	1.4	845	7.4	837	5.9	294	2.0
Other agricultural credits 1/	14.1	14.1	15.8	12.2	1,808	15.8	2,289	16.0	1,853	12.3
Others	2.6	3.3	3.9	2.5	205	1.8	171	1.2	-	-
C. Bank Liquidation Funds	2.6	2.0	2.2	1.8	253	2.2	240	1.7	306	2.0
TOTAL	100.0	100.0	100.0	100.0	11,444	100.0	14,281	100.0	15,069	100.0

1/ Mainly credit to the Agricultural Credit Cooperatives

Source: Central Bank, Monthly Bulletin.

rediscounts at the Central Bank. Although the Central Bank was given the authority to give medium term credit after November 1, 1970, none was given in 1970 and only TL 148 million was given in 1971.

Table 10 below provides for a comparison of the various items of the Central Bank balance sheet. It should be noted that increases in assets and decreases in other liabilities are normally reflected as increases in bank notes issued, while decreases in assets and increases in other liabilities are reflected as bank notes withdrawn.

There is a sharp change in the composition of the movements in the Central Bank balance sheet between 1969 and 1971. Net foreign exchange reserves account for 71 percent of the asset change in 1971. This is reflected as increases in bank notes' importance as a liability item. In 1970 credits are very low and gain only slightly in late 1971. Deposits increase significantly in 1971, but as a function of the legal reserves of the commercial banks, which, in turn, are a function of the deposit increases of commercial banks discussed below. The significant decline in Central Bank "other assets" and "other liabilities" reflect mainly the effecting of foreign exchange transfers, i.e., the decreases in letters of credits and import pre-deposits. In summary, in 1970 and 1971 the foreign exchange accounts dominate the Central Bank activity.

c. Commercial Bank Credit

The rise in bank credits by all banking institutions outside the Central Bank increased moderately in 1970 relative to previous years. By December 1970 bank credits outstanding had risen 11.5 percent over the

TABLE 10

CHANGES IN CENTRAL BANK ASSETS AND

LIABILITIES, 1969-1971

(TL Million)

	1968/1969	% of Total Change	1969/1970	% of Total Change	1970/1971	% of Total Change
Assets						
1. Net Foreign Exchange Reserves	1,167	22.4	4,451	50.0	4,494	70.8
2. Credits	2,752	52.9	1,645	18.5	1,708	26.9
3. Other assets	1,283	24.7	2,808	31.5	142	2.3
4. Total	5,202	100.0	8,904	100.0	6,344	100.0
Liabilities						
1. Bank Notes	1,049	20.2	2,941	33.0	3,117	49.1
2. Deposits (of which)	1,050	20.2	1,531	17.2	3,304	52.1
Legal reserve deposits of banks	(741)	(14.2)	(617)	(6.9)	(2,663)	(42.0)
3. Other liabilities	3,103	59.7	4,432	49.8	-77	-1.2
4. Total	5,202	100.0	8,904	100.0	6,344	100.0

Source: Central Bank 1971 Annual Report, Table 24.

previous years compared to December rises of 20.0 percent in 1969/1968 and 18.0 percent in 1968/1967. (See Table 11). In the 1970 period prior to the devaluation a very tight credit situation is observed relative to previous years. By the end of July 1970 credit had not even regained December 1969 levels. Post devaluation data however show an important increase in bank credits, particularly in December 1970.

An examination of bank credits reveals that except for a small change in proportions of agricultural and industrial credit in 1970 there are no significant movements in the direction of bank credit in 1970 and 1971. The result is that the lower amounts of credit were distributed similarly in the last three years. (See Table 12).

By June 1971 bank credit had increased 14.5 percent over July 1970. The estimates for 1971 indicate that bank credit in late 1971 has continued increasing rapidly, for a 16.9 percent increase over 1970.

Table 13 shows changes in the major transaction items of the banking system between 1969 and 1971. It is clear that the liquidity of the banking system has improved considerably as a result of the very significant increases in deposits. Advances and rediscounts from the Central Bank, particularly for agriculture credit purposes, has dropped in 1971 as a result of these deposit resources. Furthermore, these deposits are long-term, i.e., only 53.7 percent and 58.0 percent in 1970 and 1971 are included in the definition of the money supply, and are reflected in the growing importance of legal reserves as an asset of the banks and a liability of the Central Bank.

TABLE 11

CONSOLIDATED

BANK CREDITS, 1968-1971

(TL Millions)

Months	1968 Amount	1968 Percent Change Over Prior Month	1969 Amount	1969 Percent Change Over Prior Month	1970 Amount	1970 Percent Change Over Prior Month	1971 Amount	1971 Percent Change Over Prior Month
January	23,172	-0.8	27,658	+0.3	32,562	-1.9	35,930	-3.0
February	23,531	+1.5	28,280	+2.2	32,565	+0.0	36,201	+0.8
March	23,681	+0.6	28,703	+1.5	32,683	+0.4	36,838	+1.8
April	23,985	+1.3	29,027	+1.1	32,595	+0.3	37,369	+1.4
May	24,336	+1.5	29,474	+1.5	32,740	+0.4	37,474	+0.3
June	24,488	+0.6	30,177	+2.4	32,708	-0.1	37,505	+0.1
July	24,787	+1.2	30,219	+0.1	32,770	+0.2	n.a.	
Percent Change July over prior July.		+16.6		+21.9		+8.4		
August	24,813	+0.1	30,327	+0.4	33,268	+1.5	n.a.	
September	25,508	+2.8	31,090	+2.5	34,365	+3.3	n.a.	
October	26,440	+3.6	31,732	+2.1	34,640	+0.8	40,713	
November	26,592	+0.6	31,900	+0.5	35,193	+1.6	n.a.	
December	27,575	+3.7	33,182	+4.0	37,005	+5.1	43,255	
Percent Change December over prior December.		+18.0		+20.0		+11.5		+16.9

Source: Ministry Of Finance. Monthly Economic Indicators.
Central Bank. Monthly Bulletins.

TABLE 12

SECTORAL DISTRIBUTION OF

BANK CREDITS

(TL Million)

	Credit Outstanding			Percentage Change			Percentage of Total		
	1968	1969	1970	1968	1969	1970	1968	1969	1970
Total Bank Credit	27,940	33,714	37,543	17.9	20.3	11.5	100.00	100.00	100.0
Public Sector	2,671	2,997	3,209	-4.0	12.2	7.1	9.6	8.9	8.5
General Government	1,446	1,610	1,848	2.3	11.3	14.8	5.2	4.8	4.9
Public Enterprise	1,225	1,387	1,361	-11.3	13.2	-1.9	4.4	4.1	3.6
Private Sector	24,904	30,185	33,796	20.9	21.2	11.8	89.1	89.5	90.0
Agriculture	7,115	8,554	9,030	28.2	20.2	5.6	25.5	25.4	24.1
Industrial	1,248	1,498	2,132	19.7	20.0	42.3	4.5	4.4	5.7
IDB	925	1,024	1,594	17.5	10.7	55.7	3.3	3.0	4.2
TICB	323	474	538	26.2	46.7	13.5	1.2	1.4	1.4
Housing	1,901	2,030	2,342	2.3	6.8	15.4	6.8	6.0	6.2
Small Business	777	971	1,108	32.8	25.0	14.1	2.8	2.9	2.9
Commercial	13,860	17,132	19,184	20.0	23.6	12.0	49.5	50.8	51.1
Interbank	365	532	538	11.6	14.6	1.1	1.3	1.6	1.5

Source: Central Bank *Monthly Bulletin*.

TABLE 12 (continued)

SECTORAL DISTRIBUTION OF

BANK CREDITS

(TL Million)

	July 1969 Amount	July 1969 % of Total	July 1970 Amount	July 1970 % of Total	June 1971 Amount	June 1971 % of Total
Total Bank Credit	30,662	100.0	33,261	100.0	38,075	100.0
Public Sector	2,777	9.1	2,726	8.2	3,090	8.1
General Government	1,473	4.8	1,663	5.0	1,373	3.6
Public Enterprise	1,304	4.3	1,063	3.2	1,717	4.5
Private Sector	27,442	89.5	30,044	90.3	34,415	90.4
Agriculture	7,287	23.8	8,066	24.3	8,795	23.1
Industrial	1,431	4.7	1,598	4.8	2,279	6.0
IDB	978	3.2	1,089	3.3	1,711	4.5
IICB	453	1.5	509	1.5	568	1.5
Housing	1,877	6.1	2,052	6.2	2,355	6.2
Small Business	925	3.0	1,065	3.2	1,173	3.1
Commercial	15,922	51.9	17,263	51.9	19,813	52.0
Interbank	443	1.4	491	1.5	570	1.5

Source: Central Bank *Monthly Bulletin*.

TABLE 13

CHANGES IN COMMERCIAL BANKS'

ASSETS AND LIABILITIES, 1969-1971

(TL Million)

	1968 1969	% of Total Change	1969 1970	% of Total Change	1970 1971	% of Total Change
Assets						
1. Cash	199	2.9	203	4.6	1,210	11.3
2. Free deposits at Central Bank	340	4.9	-215	-4.9	626	5.8
3. Legal reserves	752	10.9	617	13.9	2,663	24.8
4. Credits	5,607	81.3	3,823	86.3	6,250	58.1
5. Total Assets	6,898	100.0	4,428	100.0	10,749	100.0
Liabilities						
1. Deposits	4,644	67.3	5,487	123.9	12,194	113.4
(of which) Money supply	(3,306)	(47.9)	(2,378)	(53.7)	(6,235)	(58.0)
2. Loans from Central Bank	1,336	19.4	534	12.1	-1,866	-17.4
(of which) Agricultural Bank	(789)	(11.4)	(269)	(6.1)	(-1,499)	(-13.9)
3. Agriculture Finance	122	1.8	3	-	0	-
4. Difference 1/	796	11.5	-1,596	-36.0	421	3.9
5. Total liabilities	6,898	100.0	4,428	100.0	10,749	100.0

1/ Simply the difference between assets and liabilities included in this table. The liability decrease in 1970 reflects the decline in import predeposits and letters of credit.

Source: Central Bank, 1971 Annual Report, Table 32.

3. Deposits in the Banking System

In this section we examine the evidence as to whether or not any significant change has occurred in the amount and/or structure of deposits since the devaluation. It was stated that the interest rate reform 1/ associated with the devaluation would have a positive effect of diverting an increasing flow of savings into the banks. 2/ We have suggested previously that the temporary phenomena following the devaluation, i.e., release of import pre-deposits, low investment levels, etc., were influential in the increase in bank deposits and therefore complicate the analysis. Furthermore the available observations are too few to allow for statistical correlation.

Table 14 contains a classification of bank deposits by term and category. In 1970 the only significant change observable from these data is the change within the "savings" category of "demand and up to four months" term to longer term categories. This seems to represent a "switching" since there is very little change in the percentage of total deposits within the "savings" category, i.e., 65.5 percent in 1969 to 65.8 percent in 1970. No such switching is obvious in other categories. This result is consistent with the relatively greater return available on longer term deposits as a result of the reform plus the lottery and insurance benefits special to "savings" deposits. It is interesting to note the 1.3 percentage point increase in "interbank" category deposits, mainly at the expense of "commercial demand and up to four months" deposits. This may be the result of low demand for credit leading to banks' own income-earning substitutes.

1/ Interest rate reform is described in section 2 of Part I above.
2/ SPO, <u>ibid.</u>, p.24.

TABLE 14

CLASSIFICATION OF DEPOSITS BY TERM AND CATEGORY,

1962, 1967, 1969, 1970

(TL Million, End of Year)

		Value				Percentage of Total Deposits			
		Demand and Up to Four Months	Up To One Year	More Than One Year	Total Deposits by Category	Demand and Up Four Months	Up to One Year	More Than One Year	Total Deposits
	Total	8,465	528	698	9,691	87.3	5.4	7.2	100.0
	Cfficial	1,718	100	205	2,023	17.7	1.0	2.1	20.9
1962	Commercial	1,769	36	90	1,895	18.3	0.4	0.9	19.6
	Interbank	269	1	1	271	2.8	-	-	2.8
	Savings	4,709	391	402	5,502	48.6	4.0	4.2	56.7
	Total	17,581	2,184	1,951	21,716	81.0	10.1	9.0	100.0
	Cfficial	2,121	287	236	2,644	9.8	1.3	0.9	12.2
1967	Commercial	3,622	137	276	4,035	16.7	0.6	1.3	18.6
	Interbank	635	22	36	693	2.9	0.1	0.2	3.2
	Savings	11,203	1,739	1,402	14,344	51.6	8.0	6.5	66.1
	Total	25,962	3,149	2,778	31,890	81.4	9.9	8.7	100.0
	Official	2,610	382	296	3,288	8.2	1.2	0.9	10.3
1969	Commercial	6,068	187	349	6,604	19.0	0.6	1.1	20.7
	Interbank	1,111	12	8	1,131	3.5	-	-	3.5
	Savings	16,174	2,568	2,125	20,866	50.7	8.1	6.7	65.5
	Total	29,847	4,406	3,810	38,063	78.4	11.6	10.0	100.0
	Official	3,113	384	436	3,933	8.2	1.0	1.1	10.3
1970	Commercial	6,706	202	361	7,270	17.6	0.5	1.0	19.1
	Interbank	1,717	37	63	1,817	4.5	0.1	0.2	4.8
	Savings	18,310	3,784	2,949	25,043	48.1	10.0	7.7	65.8

Source: Bankers' Association Reports.

Table 15 includes consolidated deposits and their rates of change (excluding interbank deposits) by category, demand and time, for 1969 and 1970. A comparison of columns (6) and (7) reveals that all categories of deposits grew at higher rates in the July-December 1970 period than in the same period in 1969. Particularly significant is the 33.5 percent growth of time "savings" deposits from July-December 1970 compared with 8.3 percent in the same period in 1969. Furthermore a comparison of column (9) results, i.e., compound average annual rates of growth between 1962 and 1970, with 1970 growth rates shown in column (8) supports the thesis that time "savings" deposits grew at a very high rate in 1970, i.e., 40.6 percent compared with 29.7 percent. On the other hand demand "savings" deposits grew at a lower rate in 1970 than the average for 1962-1970, i.e., 20.0 percent versus 21.0 percent. This latter fact lends support to the "switching" theory mentioned above, i.e., from demand to time deposits. Finally total deposits grew at a slightly lower rate in 1970 than the average for 1962-1970.

The average size of 'savings" deposits increased in 1970 over 1969 as a result of the larger average holdings in time accounts. The number of time "savings" accounts increased about 29 percent in 1970 compared with 22 percent in 1969, whereas the number of demand "savings" accounts increased 12 percent in 1970 in comparison with a 15 percent in 1969, other evidence of "switching." (See Table 16 on page 52).

TABLE 15

CONSOLIDATED DEPOSITS BY CATEGORY, DEMAND AND TIME

(TL Million, End of Year)

	Dec. 1962 (1)	July 1969 (2)	Dec. 1969 (3)	July 1970 (4)	Dec. 1970 (5)	Percent Dec. 1969 Over July 1969 (6)	Percent Dec. 1970 Over July 1970 (7)	Percent Dec. 1970 Over Dec. 1969 (8)	Compound Average Annual Rate of Growth 1962-1970 (9)
Total Deposits	9,418	26,579	30,759	29,273	36,246	15.7	23.8	17.8	18.3
Official	2,023	3,281	3,288	3,559	3,933	0.2	10.5	19.6	8.7
Commercial	1,894	4,746	6,605	5,026	7,270	39.2	44.6	10.1	18.3
Savings	5,501	18,552	20,866	20,688	25,043	12.5	21.1	20.0	21.0
Demand Deposits	7,921	19,884	23,487	21,651	26,441	18.1	22.1	12.6	16.2
Official	1,687	2,520	2,455	2,696	3,031	-2.6	12.4	23.5	7.5
Commercial	1,747	4,212	6,014	4,429	6,591	42.8	48.8	9.6	18.1
Savings	4,487	13,152	15,018	14,526	16,819	14.2	15.8	12.0	17.9
Time Deposits	1,497	6,695	7,272	7,622	9,805	8.6	28.6	34.8	26.5
Official	336	3,281	833	3,559	902	-293.8	-294.5	8.3	13.1
Commercial	147	534	591	597	679	10.7	13.7	14.9	21.0
Savings	1,014	5,400	5,848	6,162	8,224	8.3	33.5	40.6	29.7

Source: Central Bank, <u>Monthly Bulletions.</u>

TABLE 16

AVERAGE SIZE OF SAVINGS ACCOUNTS, 1968 - 1970

	1968	1969	1970
Total	2,101	2,148	2,273
Demand	1,671	1,712	1,714
Time	6,364	6,215	6,802

Source: Bankers' Association Reports.

A comparison of rates of increases in time "savings" deposits by month in 1969, 1970 and early 1971 show the sharply increasing rates after the devaluation.

TABLE 17

RATE OF INCREASE OF TIME SAVINGS DEPOSITS
(Over Previous Month)
(%)

	1969	1970	1971
January	2.5	2.0	5.0
February	1.0	0.9	2.6
March	1.3	1.3	3.8
April	2.2	1.1	3.1
May	0.8	0.1	2.0
June	1.2	0.1	2.1
July	0.5	-0.1	
August	0.4	2.6	
September	0.4	8.7	
October	0.5	5.2	
November	1.5	3.8	
December	6.0	9.6	

Source: Calculated from data in Central Bank, Monthly Bulletins.

Table 18 is composed of the latest available data on deposits, i.e., October 1971, compared with those of October 1970.

TABLE 18

DEPOSITS,

OCTOBER 1970- OCTOBER 1971

(TL Million)

	October 1970			October 1971		
	Amount	% Change Over October 1969	% of Total Deposits	Amounts	% Change Over October 1970	% of Total Deposits
Total Deposits	31,257	13.1	100.0	42,937	37.4	100.0
Total Official	3,442	11.9	10.9	4,922	43.0	11.5
Total Commercial	5,797	8.8	18.5	8,160	40.8	19.0
Demand	5,160	7.9	16.5	7,439	44.2	17.3
Time	637	16.9	2.0	721	13.2	1.7
Total Savings	22,018	14.5	70.4	29,855	35.6	69.6
Demand	14,786	7.8	47.3	18,749	26.8	43.7
Time	7,232	31.1	23.1	11,106	53.5	25.9

Source: Central Bank, 1971 Annual Report and Monthly Bulletins.

Although the rate of increase of deposits is very large (37.4%), there is no major change in deposit categories as a percentage of total deposits, other than the "switching" between demand and time savings deposits observed in the earlier data.

It is difficult to ascertain whether this tendency toward time savings deposits is simply a function of the increase in the interest paid or the result of the temporary phenomena following the devaluation. Further research is necessary when the data become available.

4. Prices

It has been stated that the large increase in prices in late 1970 and 1971 was the result of an interaction of cost-push, demand-pull and inadequate supply factors. That is, the implementation of the policies of overall personnel reform (early 1971) and devaluation (late 1970) put cost-push strains on the economy which were not adequately compensated for by complementary government policy and expected private sector investment behavior. On top of these, the economy experienced on extraordinary agriculture sector growth out of proportion to all expectations (9.5 percent in real terms) with only relatively small increases in industrial production. Finally, the political instability and experimentation of the first reform government added a very important element of uncertainty to the already disturbed economic situation.

This section begins with brief statements on the macroeconomic variables of consumption, investment and GNP. These are followed by comments and data concerning price developments since devaluation.

a. Summary

Gross National Product (GNP) By Use data for 1969-1972 (in current prices) show a very rapid growth of public consumption as a percentage of GNP. This growth mainly reflects the effects of the state personnel law

since 85 percent of public sector current expenditure are wages and salaries. Lessened investment activity also is seen for both the

TABLE 19

CONSUMPTION AS

PERCENTAGE OF GNP, 1969-1972

	Actual 1969	Estimate 1970	Estimate 1971	Planned 1972
Public	11.9	12.4	15.2	16.2
Private	68.2	68.0	65.8	63.9
Total	80.1	80.4	81.0	79.9

Source: SPO 1972 Annual Program Summary, December 1971.

public and private sectors in 1971; in particular for the public sector, from 10.6 percent of GNP in 1970 to 9.5 percent in 1971 and from 9.5% to 9.2% in the private sector. Total investment thus fell from 21 percent of GNP to 19.7 percent. In summary these ratios reflect declining proportions of total investment demand and private consumption demand with a sharp proportional increase in public consumption demand over the last two years.

Production increases between 1969 and 1971 show irregular patterns as can be seen in Table 20. The key shifts are in agricultural production, industrial output and income from the rest of the world. These shifts in supply most likely had distruptive effects, especially given the changes in structure of demand as a result of shifts in purchasing power of several income classes. An examination of this question is beyond the scope of this paper, however the following hypothesis is proposed.

The rate of growth of GNP in 1971 was 9.2 percent, a TL 8.7 billion increase. Agriculture plus industrial growth contributed 31.0 percent of this increase, while income from abroad contributed 14.9 percent. In 1970 agriculture plus industry contributed only 14.3 percent while income from abroad made up 16.3 percent of the total TL 4.9 billion increase. Therefore actual supply conditions in 1970 were very much worse than implied in 1971 data since workers' remittances provide purchasing power (income) to Turkey, but no product. Furthermore a large proportion of these workers' remittances ended up as purchasing power

through an increase in the money supply outstanding. Secondly, the increase in agricultural support prices coupled with the record crop year necessitated large payments to farmers financed through Central Bank bank note issue resulting in large purchasing power in the hands of the farmers. 1/

In summary, new purchasing power came into the hands of farmers, families of workers' abroad and public sector employees which tended to increase their demand for consumer goods in all likelihood. However certain offsetting factors might explain the drop in the private consumption/GNP ratio between 1970 and 1971: (a) the high levels of debt repayment to the State Agricultural Bank by farmers to reduce liabilities incurred in previous bad crop years; (b) large increases in deposits, particularly "savings" deposits coupled with relatively low private demand for credit; and (c) the low levels of construction activity, a traditional investment area, which might have fostered hoarding. These questions need to be examined as data become available.

1/ Central Bank credit to the Soil Products Office (TMO) increased 151 % between October 1970 and October 1971. TMO credit equalled 22.9% of the current increase in agricultural income in 1971.

TABLE 20

GNP INCREASES, BY SECTOR

1969-1971

	1969			1970			1971		
	(TL billion) Actual Change	(%) Rate of Growth	Actual Change % of Total Change	(TL billion) Actual Change	(%) Rate of Growth	Actual Change % of Total Change	(TL billion) Actual Change	(%) Rate of Growth	Actual Change % of Total Change
Total GNP	5.3	6.3	100.0	4.9	5.5	100.0	8.7	9.2	100.0
Agriculture	-0.03	-0.1	-	0.3	1.4	6.1	1.3	9.5	14.9
Industry	1.3	9.4	24.5	0.4	2.5	8.2	1.4	8.7	16.1
Construction	0.4	8.8	7.5	0.3	5.3	6.1	1.1	2.0	12.6
Transportation	0.5	8.8	9.4	0.4	6.5	8.2	0.5	7.9	5.7
Government Services	0.6	8.7	11.3	0.6	7.8	12.2	0.6	6.9	6.9
Net Income from rest-of-world 1/	0.1	55.9	1.9	0.8	205.8	16.3	1.3	111.6	14.9
Other sectors	2.4	-	45.3	2.1	-	42.9	2.5	-	28.9

1/ Mainly workers' cash remittances.

Source: Based on SIS data. 1971 data are provisional.

b. Price Data.

Price rises following a devaluation are a normal phenomenon, however the important element is that the expected effects of the devaluation are not wiped out by extreme price rises, particularly for export and import-substitute goods.

Overall prices began to rise (gradually at first) at increasingly faster rates after the devaluation than in the months preceding it. (See Tables 21 and 22.) By December 1970 the 6.1 percent increase over December 1969 compared favorably with the 5.2 percent increase over the December 1968-December 1969 period. However, by July 1971 wholesale prices were up 23.2 percent over July 1970 compared with 3.0 percent and 6.2 percent respectively in the previous two year periods. The sharpest monthly increases occurred in January 1/ and July 1971. 2/ The December 1971 rate of increase over December 1970 was 23.0 percent. Therefore from the end of July 1970 to December 1971 wholesale prices have increased 33.3 percent compared with the 67 percent devaluation of the Turkish Lira. Food and fodder prices increased 29.4 percent while industrial goods and raw materials increased 49.8 percent.

In contrast with previous years, the December 1971 price increase over December 1970 at 23 percent, is the same for the Ankara and Istanbul Cost

1/ As a result of a 16-20% cement price increase and a 17% average increase in Sümerbank products.

2/ As a result of increases in agricultural support prices, another increase in cement prices and heating coal, paper, electricity and petroleum price increases by state enterprises.

TABLE 21

WHOLESALE PRICE AND COST OF LIVING INDICES, 1969-1971

(1963 = 100)

MONTHS	WHOLESALE PRICES									COST OF LIVING					
	General			Food & Fodder			Industrial and Raw Materials			Ankara			Istanbul		
	1969	1970	1971	1969	1970	1971	1969	1970	1971	1969	1970	1971	1969	1970	1971
January	136.4	144.6	156.7	137.8	146.3	154.1	134.1	141.1	160.9	129.0	141.7	162.8	141.8	151.0	165.5
February	136.6	146.3	159.8	138.1	148.8	155.2	134.2	142.2	167.4	130.5	142.2	165.2	142.2	151.8	169.5
March	136.7	145.1	160.7	138.3	147.9	156.2	134.2	140.5	168.3	130.2	144.1	164.9	142.2	152.0	171.1
April	137.2	144.8	167.5	138.9	147.7	159.1	134.3	140.1	168.3	130.5	143.3	164.9	142.6	152.3	174.9
May	137.7	144.0	164.8	139.3	143.4	161.3	135.1	145.0	170.6	130.0	144.1	171.7	143.7	153.2	176.5
June	135.2	141.8	163.8	134.9	139.7	159.2	135.7	145.5	171.5	131.5	144.4	177.4	143.7	154.8	179.6
July	134.6	138.7	170.9	134.0	134.4	159.4	135.5	145.7	190.0	132.8	143.8	183.6	143.3	154.2	189.5
August	135.7	141.7	172.6	134.9	136.3	160.9	137.1	150.7	192.2	132.2	148.8	190.0	144.1	155.4	194.4
September	135.9	144.0	172.4	134.3	138.2	160.6	138.5	153.9	193.6	132.6	152.0	195.0	143.7	156.9	196.7
October	136.7	145.7	177.1	135.0	140.0	165.2	139.5	155.2	197.0	134.3	154.4	195.7	146.0	159.9	200.3
November	138.2	147.5	181.9	137.6	142.6	168.3	139.1	155.6	204.5	137.8	158.3	198.8	147.1	162.1	202.3
December	141.7	150.3	184.9	142.6	147.2	173.9	140.1	155.5	203.3	140.5	160.9	198.1	149.8	163.7	202.0
Annual Average	136.9	145.7	168.9	137.1	141.0	161.0	136.5	153.6	182.1	132.7	148.3	180.7	144.2	155.6	185.2

Source: Ministry of Finance, Monthly Economic Bulletins.
Central Bank, 1971 Annual Report, Tables 49 and 50.

TABLE 22

PERCENTAGE CHANGES IN

WHOLESALE PRICE AND COST OF LIVING INDICES, 1969-1971

(1963 = 100)

MONTHS	WHOLESALE PRICE INDEX: Change over Previous Month 1970	1971	Change over Previous Year Same Month 1969	1970	1971	ISTANBUL COST OF LIVING: Change over Previous Month 1970	1971	Change over Previous Year Same Month 1969	1970	1971	ANKARA COST OF LIVING: Change over Previous Month 1970	1971	Change over Previous Year Same Month 1969	1970	1971
January	2.0	4.3	7.4	6.0	8.4	0.8	1.1	5.0	6.5	9.6	0.8	1.2	3.8	9.8	14.9
February	1.2	2.0	6.2	7.1	9.2	0.5	2.4	5.0	6.7	11.7	0.3	1.5	4.2	9.0	16.2
March	-0.8	0.6	6.9	6.1	10.8	0.1	0.9	5.6	6.9	12.6	1.3	-0.2	4.0	10.7	14.4
April	-0.2	1.1	6.7	5.5	12.2	0.2	2.2	5.6	6.8	14.8	-0.5	0.0	5.1	9.8	15.1
May	-0.5	1.4	6.7	4.6	14.4	0.6	0.9	6.1	6.6	15.2	0.5	4.1	4.2	10.8	19.2
June	-1.5	-0.6	6.2	4.9	15.5	1.0	1.8	5.3	7.7	16.0	0.2	3.3	5.2	9.8	22.9
July	-2.2	4.3	6.2	3.0	23.2	-0.4	5.5	4.1	7.6	22.9	-0.4	3.5	6.2	8.3	27.7
August	2.2	1.0	6.1	4.4	21.8	0.8	2.6	4.1	7.8	25.1	3.5	3.5	5.0	12.6	27.7
September	1.6	-0.1	6.0	6.0	19.7	1.0	1.2	3.8	9.1	25.4	2.2	2.6	5.3	14.6	28.3
October	1.2	2.7	4.1	6.5	21.6	1.9	1.8	4.1	9.5	25.3	1.6	0.3	5.4	15.0	26.7
November	1.2	2.7	4.8	6.7	23.5	1.4	1.0	4.5	10.2	24.8	2.5	1.6	7.4	14.9	25.6
December	1.9	1.6	5.2	6.1	23.0	1.0	-0.2	5.9	9.3	23.4	1.6	-0.4	9.1	14.5	23.1

Source: Ministry of Finance, Monthly Economic Indicators.
Central Bank, 1971 Annual Report, Tables 49 and 50.

of Living Indices. However, the patterns of monthly price increases are quite different for the two series, so that from July 1970 to December 1971, the Ankara Index shows a 37.8 percent increase while the Istanbul Index indicates at 41.0 percent increase in the cost of living.

A detailed study would be necessary to separate those import items whose prices have been automatically increased by the devaluation, those products affected by the devaluation because an imported raw material is among its inputs and unaffected items.

Table 23 lists prices of selected goods and services classified as Istanbul and Ankara retail prices, wholesale prices in the Istanbul free market, and selected commodity exchange prices. Many items on this table show dramatic price increases since the devaluation regardless of whether or not they are imported, an indication that factors other than the devaluation itself as mentioned earlier, have allowed for price increases. Particularly noticeable are the increases in prices of services such as tailoring, hair cuts, shoe repairs, etc. Bread, eggs, sugar, cheese, and meat (non-import and non-export items) show sharp increases also. On the other hand, coffee, an important import item shows no increase, but rather a price decrease in December 1971. (This example indicates the possible price manipulation by a government agency, in this case, the Monopolies' Administration.) Certain export items, for example, copper, cement, cotton cloth, have shown large price increases, however below the rate of devaluation. The prices of goods, such as tin and pig iron, show a decrease after the devaluation--probably as a result of the released hoards of these items and custom tax exemptions. Finally there are seasonal fluctuations in prices.

TABLE 23

PERCENTAGE CHANGE IN PRICES OF SELECTED ITEMS, 1968 - 1971

(Kuruş/Kilo)

ITEM	(1) Price on July 1968	(2) July 1969 Price	(3) July 1969 % Change over Previous July	(4) July 1970 Price	(5) July 1970 % Change over Previous July	(6) July 1971 Price	(7) July 1971 % change over Previous July	(8) Dec. 1971 Price	(9) Dec. 1971 % change over July 1970
ISTANBUL RETAIL PRICES									
Bread	113	120	6.2	129	7.5	169	31.0	169	31.0
Rice	423	650	53.7	500	-30.0	500	-	500	-
Eggs	42	40	-5.0	42	5.0	57	35.7	73	73.8
Crystal Sugar	325	325	-	325	-	395	21.5	395	21.5
Olive Oil	950	817	-16.3	1,150	40.8	1,167	1.5	1,400	21.7
Vita	675	658	-2.6	692	5.2	750	8.4	875	26.4
Balkan Cheese	2,067	2,067	-	1,967	-5.1	2,400	22.0	2,400	22.0
Soap (White, odorless)	550	533	-3.2	537	0.8	817	52.1	800 2/	49.0
Mutton Meat	1,467	1,367	-7.3	1,517	11.0	1,700	12.1	1,750	15.4
Tailoring men's suits	20,000	20,000	-	20,000	-	29,375 3/	46.9	29,375 3/	46.9
Woolen Fabrics, plain (meter)	6,467	6,467	-	6,067	-6.6	8,467 3/	39.6	8,467 3/	39.6
Bus Fare	50	50	-	50	-	75	50.0	75	50.0
Doctor's Fee (Gen'l. Prac.)	1,417	1,417	-	1,700	20.0	2,000 4/	17.6	-	17.6
Hair Cut (men's)	300	300	-	300	-	475 4/	58.3	475 2/	58.3
Rent, per month (2 rooms & kitchen)	40,000	40,000	-	40,000	-	50,000	25.0	50,000 5/	25.0
ANKARA RETAIL PRICES									
Tailoring men's suit	24,250	24,250	-	26,250	8.2	27,500	4.8	30,000	14.3
Cotton Cloth (meter)	275	275	-	320	16.4	400	25.0	496	55.0
Calico (meter)	244	239	-3.8	325	36.0	341	4.9	444	36.6
Men's Shoe Repair	1,767	1,750	-1.0	2,000	14.3	2,500	25.0	3.000	50.0
Glass (one)	160	162	1.2	163	0.6	228	39.9	228	39.9
Doctor's Fee (Specialist)	-	-	-	4,000	-	5,000	25.0	5,500	37.5
Rent, per month (2 rooms and kitchen)	25,000	25,000	-	3[illegible],333	53.3	43,300	13.0	-	-

TABLE 23 (continued)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
COMMODITY EXCHANGE PRICES									
Wheat (Ankara, soft)	81.3	86.3	6.2	89.4	3.6	102.0	14.0	110.0	23.0
Rice (Istanbul, Bersani)	344.9	580.8	68.4	406.8	-30.0	443.4	9.0	394.4	-3.1
Olive Oil (Bursa Yemeklik I)	654.0	625.0	-4.4	788.0	26.1	855.0	8.5	928.0	17.8
Margarine (Istanbul)	629.7	611.7	-2.9	631.8	3.3	747.0	18.2	751.2	18.9
Mutton Meat (Istanbul)	1,131.4	1,133.2	0.2	1,204.1	6.3	1,566.3	30.1	1,548.6	28.6
Raw Cotton (Adana Std White I)	530.0	486.7	-8.2	555.0	14.0	826.7	49.0	866.6	56.1
Soap (Mersin, 2 nevi) 1/	304.0	288.7	-5.0	356.8	23.6	507.1	42.1	500.0	40.1
WHOLESALE PRICES IN ISTANBUL FREE MARKET									
Tea	3,840.0	3,840.0	-	3,840.0	-	3,840.0	-	3,840.0	-
Coffee	3,500.0	3,500.0	-	3,500.0	-	3,500.0	-	2,700.0	-29.6
Crystal Sugar	300.0	300.0	-	300.0	-	360.0	20.0	360.0	20.0
Tin	6,622.2	6,983.3	5.5	11,377.8	62.9	9,988.9	-13.9	8,931.3	-27.4
Coal (run-of-mine)	21,000.0	29,000.0	38.1	29,000.0	-	36,222.2	25.0	42,000.0	44.8
Copper	2,150.0	2,225.0	3.5	2,300.0	3.4	3,100.0	34.8	3,100.0	34.8
Pig Iron	245.0	300.0	22.4	450.0	50.0	333.3	-35.0	350.0	-28.6
Kerosene	100.3	100.8	0.5	100.8	-	132.8	31.8	155.0	53.8
Gasoline	104.8	105.0	0.2	105.0	-	142.8	36.0	147.7	40.7
Black Leather	1,750.0	1,750.0	-	1,850.0	5.7	1,850.0	-	1,950.0	5.4
Coke	20,000.0	21,000.0	5.0	21,000.0	-	41,555.6	97.9	58,000.0	176.2
Corrugated Sheet	500.0	575.0	15.0	575.0	-	575.0	-	625.0	8.7
Cement (Portland)	16,000.0	17,075.0	6.7	16,700.0	-2.2	22,244.4	33.2	24,200.0	44.9
Timber (m^3)	67,500.0	74,722.0	10.7	80,167.0	7.3	80,167.0	-	88,500.0	10.4

1/ May data are substituted for July data.
2/ October data
3/ June data
4/ December, 1970 data
5/ July data

Source: State Institute of Statistics, Monthly Bulletins of Statistics.

5. General Government Budget.

This section contains the budget performance data for 1969 through 1971. 1/

Table 24 identifies key accounts for mid-year and full-year budget performance of TFY 1969, 1970 and mid-year 1971. The large increases in expenditures are mainly attributable to the greatly increased wage bills of the government and public enterprises, whereas direct taxes reflect to a large extent the tax on these higher incomes, regular non-tax revenue and special funds reflect increased social security payments (from increased incomes), increase in miscellaneous revenues cannot be identified, and TL counterpart of foreign borrowing reflects a higher level of foreign aid.

The direct effects of the devaluation on the expenditure side of the budget will be reflected in an increase in the Turkish Lira equivalent of payments on foreign debt and in Turkish Lira costs of items imported by the government, mainly investment goods. The income of the budget will be increased by the devaluation because of the larger Turkish Lira counterparts of foreign aid. Since it is not possible to identify the relevant line items in the published budget documents we have not attempted to calculate these effects of the devaluation.

1/ Further information is available from USAID 10-74 forms, and in particular from the forthcoming Heplevent TFY 1972 Budget Airgram.

TABLE 24

DGET PERFORMANCE,
1969-1971

	(TL Million)					Percentage Change		
	1969		1970		1971	1970/1969		1971/1970
	Mid Year	Full Year	Mid Year	Full Year	Mid Year	Mid Year	Full Year	Mid Year
CONSOLIDATED REVENUES								
1. Total Tax Revenue	9.303	19,114	10,871	22,993	14,822	16.9	20.3	36.3
a. Direct Taxes	3,808	6,777	4,546	8,641	6,508	19.4	27.5	43.2
b. Indirect Taxes	5,495	12,337	6,325	14,352	8,314	15.1	16.3	31.4
2. Regular Non-tax Revenue And Special Funds	695	1,669	796	4,635	1,563	14.5	177.7	96.4
3. Annexed Budget Own Revenues	337	901	419	1,028	513	24.3	14.0	22.4
4. Total	10,337	21,684	12,086	28,656	16,898	16.9	32.1	40.0
CONSOLIDATED EXPENDITURES								
1. Current Expenditures	5,425	12,075	5,471	14,676	9,725	0.8	21.5	77.8
2. Investment Expenditures	2,730	6,806	2,955	6,999	3,216	8.2	2.8	8.8
3. Transfers and Capital Formation	3,838	7,041	4,517	10,486	8,130	17.7	48.9	80.0
4. Total	11,993	25,922	12,943	32,161	21,071	7.9	24.1	62.8
Net Balance	-1,656	-4,238	-857	-3,505	-4,173	-48.2	-20.9	+386.9
FINANCE OF THE NET BALANCE								
1. Savings Bonds	529	731	624	882	789	18.0	20.7	26.4
2. Development Bonds	-	600	-	600	-	-	-	-
3. TL Counterpart of Foreign Aid	756	953	763	2,846	668	0.9	198.2	-12.5
4. Extra Budgetary Sources	371	-1,954	-530	+823	2,716	-242.9	-118.1	612.4

NOTE: Mid-year covers March 1 through August 31.

Source: Ministry of Finance, Monthly Economic Indicators.

6. Balance of Payments.

In this section, major items on the Turkish balance of payments are examined with emphasis on their pre- and post-devaluation performance. It should be emphasized that the primary aim of currency devaluation is to readjust relative prices of import and export transactions so that foreign exchange receipts will be larger than previously and/or foreign exchange payments will be smaller. In other words, the aims are improvements in the balance of payments and increases in a country's foreign exchange reserves. If these occur the devaluation is considered a success, even though to ascertain the role of price changes alone (ceteris paribus conditions) is a very difficult task. On certain criteria, the Turkish devaluation can be considered a major success as shown in Table 25. Foreign exchange receipts have increased substantially

TABLE 25

RATE OF INCREASE OF SELECTED FOREIGN TRADE RELATED ITEMS 1969 - 1971
(%)

	End of Year			January-July	
	1969/1968	1970/1969	1971/1970	1970/1969	1971/1970
1. Exports	8.3	9.5	15.1	9.7	5.1
2. Tourims and Travel Income	80.0	80.0	425.0	-16.0	44.4
3. Workers' remittances	31.8	93.6	72.5	52.9	131.7
4. Gold & Foreign Exchange Reserves	n.a.	153.2	86.1	54.1	132.8
5. Imports	4.8	18.4	23.5	14.9	29.2
6. Trade Balance 1/	+1.5	-36.3	-37.2	-21.1	-55.0

1/ (+ improvement; - worsening)

Source: Calculated from data in Ministry of Finance, Monthly Economic Indicators.

(items 1, 2, 3). However imports have also increased to such a large extent that the trade balance (item 6) deteriorated slightly in 1971 despite the devaluation. This latter fact may not be contradictory with the normal short-term effects of a devaluation. This is, the immediate aim of the 1970 devaluation was to liquidate the backlog of imports waiting transfer of foreign exchange for shipment to Turkey. This can be regarded as an import-allowing and counter-speculation short-term aim which was successful.

The overall balance of payments statement is shown in Table 26. The major items of this statement are analyzed briefly in the following sub-sections.

a. Commodity Exports.

Export promotion measures were a very important part of the devaluation package. (See Part I, Section 2.) Along with these general measures specific measures emphasized the development of new commodity exports, particularly of manufactured goods, semi-processed agricultural products, and agricultural products with high elasticity of demand. It is still too early to determine the success of these original measures; in fact, there have been so many policy changes since the devaluation that it is difficult to follow them. Table 27 shows rates of change of exports by major groupings: agricultural products, industrial products, and minerals. Changes in certain key traditional export items are also compared. A shift is seen between 1968 and 1969 toward industrial exports. In 1969 this shift is the result of poor cotton and tobacco performance. Cotton regained its proportional importance in 1970 and 1971 but hazelnuts have continued to show poor performance. These exports of course, are subject to production swings which play a major role

TABLE 26

BALANCE OF PAYMENTS, 1968-1971
($ Million)

	1968	1969 July	1969 Dec.	1970 July	1970 Dec.	1971 July	1971 Dec.
I. CURRENT ACCOUNT BALANCE	-224	-197.9	-220	-217.7	-171	-231	-109
A. Commodity trade balance	-268	-221.8	-264	-268.7	-360	-411	-494
1. Exports (Fob)	496	267.7	537	293.6	588	309	677
2. Imports (Cif)	-764	-489.5	-801	-562.3	-948	-726	-1,171
B. Invisible transactions balance	34	18.4	36	47.2	181	183	373
1. Debt interest payments 1/	-34	-18.7	-44	-22.6	-47	-28	-47
2. Tourism and travel	- 9	- 8.1	- 5	- 9.4	+ 4	+ 4	21
3. Workers' remittances	107	66.0	141	100.9	273	+234	471
4. Profit transfers	-32	-16.8	-32	-21.5	-33	-23	-36
5. Payments for services from project credits	-15	(...)	-18	(...)	-30	(...)	-32
6. Other invisibles (consolidated)	17	- 4.0	- 6	- 0.2	+14	- 4	2
C. Infrastructure and off-shore	10	5.5	8	3.8	8	3	6
II. CAPITAL ACCOUNT BALANCE	235	104.9	257	129.0	413	204	337
A. Debt (principal) repayments 1/	-72	-61.0	-108	-69.4	-158	-52	-91
B. Food grants 2/	-	18.6	41	40.3	83	36	55
C. Private foreign capital investments	13	12.8	24	30.9	58	32	45
D. Project credits	127	90.7	174	90.4	179	110	210
E. Imports with waiver	22	11.4	20	14.0	34	13	29
F. Consortium credits 1/	145	32.4	106	22.8	217	65	89
III. RESERVE MOVEMENTS (+ decrease)	6	-32.0	6	48.7	-236	-24	-346
IV. SPECIAL DRAWING RIGHTS (IMF)	-	-	-	18.0	18	10	11
V. SHORT-TERM CAPITAL MOVEMENTS	-	-	-	-	-	-	-
VI. NET ERRORS AND OMISSIONS	-17	125.6	-37	22.0	-24	41	107

1/ Debt postponement is excluded.
2/ Imports paid for in Turkish Lira are included.

Source: Ministry of Finance, Monthly Economic Indicators.
Central Bank, 1971 Annual Report.

in the shifts of their proportion of exports. Fruits and vegetables exports were subject to the effects of the Cholera outbreak in 1970, but are among the fastest growing items. (The Government is encouraging these exports through the MEPA organization and with the help of the World Bank.) Livestock (official) exports are likely to continue in their increasing pattern especially if smuggling is kept under reasonable control.

It is important to note that the drop in proportion of agricultural products from 1968 to 1969, i.e., from 78.2 percent to 71.7% percent of total exports, has been maintained in 1970 and 1971 despite very good crop years. This fact indicates industrial exports have increased relative to agricultural and mineral exports. In 1971, out of an $88.1 million increase in exports, agricultural goods accounted for $51.1 million (58%), industrial goods for $35.9 million (40.7%), and minerals for $1.0 million (1.1%), compared with 85.1%, 8.7%, and 6.4%, respectively, in 1970. 1/

1/ These data are based on Ministry of Finance classifications of exports. According to the USAID classifications in the Economic and Social Indicators (for which 1971 data are not yet available) the following percentages are found.

Export Categories	(Million $) Value		Percent Age Change		Percent of Total	
	1969	1970	1969	1970	1969	1970
Agricultural	442.1	472.3	2.4	6.8	82.4	80.3
Industrial	50.8	61.8	107.3	21.6	9.4	10.5
Minerals	43.9	54.4	8.9	23.9	8.2	9.2
Total	536.8	588.5	8.1	9.6	100.0	100.0

Even though agricultural exports account for a larger proportion, non-agricultural goods increased between 1969 and 1970. Indications show this trend to be continuing in 1971.

TABLE 27

EXPORTS BY MAJOR GROUPS, 1968-1971

($ Million, %)

	Value ($ Million)				Percent of Total				Percentage Change		
	1968	1969	1970	1971	1968	1969	1970	1971	1969	1970	1971
I. Agricultural Products	388.3	385.0	429.0	480.1	78.2	71.7	72.9	71.0	-0.9	14.3	11.9
A. Crops	369.4	361.4	400.5	441.8	74.4	67.3	68.1	65.3	-2.2	10.8	10.3
1. Cotton	139.1	113.6	173.2	193.1	28.0	21.2	29.4	28.5	-22.4	52.5	11.5
2. Tobacco	94.8	81.5	78.6	85.9	19.1	15.2	13.4	12.7	-16.0	-3.7	9.3
3. Hazelnuts	76.0	107.6	87.0	84.2	15.3	20.0	14.8	12.4	41.5	-23.6	-3.3
4. Raisins	23.4	22.8	21.1	22.1	4.7	4.2	3.6	3.3	-2.6	-8.1	4.7
5. Fruits	20.3	21.9	19.0	27.8	4.1	4.1	3.2	4.1	7.9	-15.3	46.3
6. Vegetables	5.6	4.2	8.4	11.8	1.1	0.8	1.4	1.7	-33.3	100.0	40.5
7. Other	10.2	9.8	13.2	16.9	2.1	1.8	2.2	2.5	-4.1	34.7	28.0
B. Livestock and Products	18.9	23.6	28.5	38.3	3.8	4.4	4.8	5.7	24.9	20.8	34.3
II. Industrial Products	94.2	134.8	139.3	175.2	19.0	25.1	23.7	25.9	43.1	3.3	25.8
1. Textiles	21.1	24.3	31.3	42.0	4.3	4.5	5.3	6.2	15.2	28.8	34.1
2. Other	73.1	110.5	108.0	133.2	14.7	20.6	18.4	19.7	51.1	-2.3	23.3
III. Minerals	13.9	17.0	20.3	21.3	2.8	3.2	3.4	3.1	22.3	19.4	4.9
1. Chrome	9.6	12.8	15.7	16.9	1.9	2.4	2.7	2.4	33.3	22.7	7.6
2. Other	4.3	4.2	4.6	5.4	0.9	0.8	0.8	0.8	-2.4	9.5	17.4
IV. Total Exports	496.4	536.8	588.5	676.6	100.0	100.0	100.0	100.0	8.1	9.6	15.0

Source: Ministry of Finance, Monthly Economic Indicators.

b. Workers' Remittances

At the end of 1971 over 600,000 Turkish citizens were estimated to be working abroad on a temporary basis. This exodus to abroad began in 1963 and has picked up greatly since 1968. As a result foreign exchange earnings from this source have increased significantly and unexpectedly provided a windfall gain to the balance of payments. Table 28 indicates the striking growth of workers' remittances. Official remittances per worker grew rapidly between 1964-1966, declined between 1966-1969, then doubled between 1969 and 1971. This statistic appears to be inversely correlated with the black market external value of the Turkish Lira, an expected phenomenon, and one which leads one to believe, given other factors, it is unlikely that actual per capita remittances fluctuated in the manner shown on Table 28. Workers simply transferred funds on the more efficient, but unofficial, black market at the higher available rates.

On the other hand research shows that workers abroad remitted officially and unofficially only some sixty-seven percent of their savings, 1/ that they held the equivalent of TL 4 billion in foreign banks, 2/ and they used savings for asset accumulation abroad and black market speculative activities. 3/ Therefore the government's aims had to be two-fold:to encourage workers to remit their earnings through official channels and to increase the portion of their savings remitted.

1/ Şener Özşahin, "Turkish-European Manpower Movements," mimeo, January, 1969, p.1.

2/ IKA News Agency, June 9, 1970, p.3.

3/ See Duncan R. Miller, "Emigrant Turkish Workers: A Socio-Economic Analysis," Part Two, pp. 197-225 in Essays on Labor Force and Employment in Turkey, USAID, Ankara, 1971.

The devaluation actually raised the value of the workers' foreign exchange some 24 percent which paralleled the available rate on the black market thus curtailing the latter's appeal. Furthermore the government implemented several policies which both curtailed the black market activity in foreign exchange and in goods. Some of these were: 1) raising the interest paid on long-term convertible 1/ bank accounts to nine percent; 2) granting of permits to import automobiles upon deposit of the required foreign exchange, 3) special housing credits through the State Real Estate Bank; and 4) customs taxes on consumer goods formerly customs-free, e.g., radios, record players, televisions.

It can be said with some certainty that the combination of the devaluation and these related measures have contributed to the significant post-devaluation jump in workers' remittances through official channels. 2/ However data are not available on the extent to which a greater portion of savings have been remitted.

c. Foreign Aid and Debt Repayment.

An important source of foreign exchange for Turkey has been foreign aid. However repayment plus interest on foreign debt have put burdens on the

1/ Turkish citizens abroad can maintain foreign exchange accounts in Turkish banks from which they can withdraw the foreign exchange deposited or the TL equivalent. The pre-devaluation interest paid was 6 percent.

2/ There is also some indication that these might be lags in remittances, i.e., workers first accumulate funds for a couple of years, then remit them later.

TABLE 28

WORKERS' REMITTANCES, 1964-1971

	1964	1965	1966	1967	1968	1969	1970	1971
1. Number of Workers Abroad (thousands)	109	161	195	204	247	360	495	600
2. Total Remittances (Million $)	9	70	115	93	107	141	273	471
3. Average Remittances Per Worker ($)	83	434	590	456	433	391	551	785
4. Remittances As Percentage of Exports (%)	2.2	15.1	23.4	17.8	21.6	26.3	46.4	69.6
5. Remittances As Percentage of Imports (%)	.02	12.2	16.0	13.6	14.0	17.6	28.8	40.2

Source: Remittances, export and import data from Table 26. Workers abroad data from Ministry of Labor.

balance of payments in the last few years. Table 29 shows the annual flow of foreign credits to Turkey on gross and net bases. Gross credits increased at an annual average of 5.4 percent between 1965 and 1969; they increased 70 percent in 1970, of which 71 percent was in the five months following devaluation. In 1971 the $299 million of gross aid represented a 32.4 percent drop over 1970. Clearly the devaluation was awarded with and supported by high aid levels.

TABLE 29

FOREIGN CREDIT TO TURKEY, 1965-1971

($ Million)

	Project and Program Loans	Interest and Principal Repayments	Net Inflow of Loans: Value	Net Inflow of Loans: As % of Imports
1965	226	-191	35	6.1
1966	231	-148	83	11.6
1967	245	-133	112	16.3
1968	272	-106	166	21.7
1969	280	-147	133	16.6
Aug-Dec	(160)	(-72)	(88)	(28.3)
1970	396	-205	191	20.1
Jan-July	(113)	(-92)	(21)	(3.7)
Aug-Dec	(283)	(-113)	(170)	(44.0)
1971	299	-138	161	13.7
Jan-July	(174)	(-79)	(95)	(13.1)
Aug-Dec	(125)	(-59)	(66)	(14.8)

Source: See Table 26.

ECONOMIC STAFF PAPERS

DISCUSSION PAPERS

1. Iris Kapil and Hasan Gençaga, "Migration and Urban Social Structures," November, 1971. (Code No. 214)

2. Olan D. Forker, "Agricultural Price Policy in Turkey - Volume One," January, 1972. (Code No. 210)

3. Olan D. Forker, "Agricultural Price Policy in Turkey - Volume Two," January, 1972. (Code No. 210)

4. Charles K. Mann, "Government of Turkey's Policies Relative to On-Farm Land Development," February 1972. (Code No. 224)

5. Betty S. Yaşer, "Economic Aspects of the Devaluation of the Turkish Lira of August 10, 1970," April 1972. (Code No. 226)