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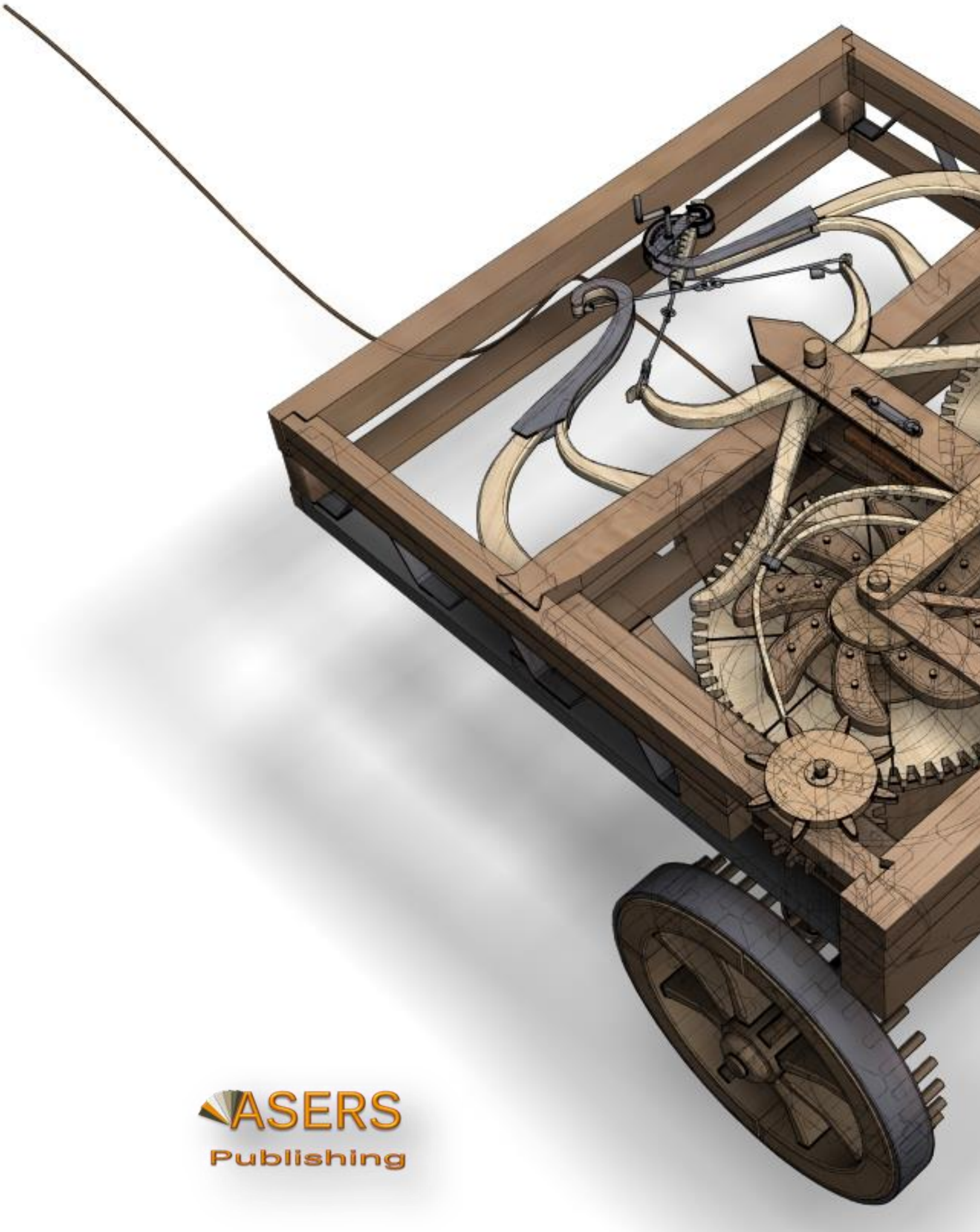

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Theoretical and Practical Research in Economic Fields

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DOES INFLATION INCREASE THE EXPORT? CASE STUDY TURKEY

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Abstract:

In this study the impact of inflation and lower exchange rates on exports is researched and the effects on trade capacity are questioned. Theoretical and practical experiences show that inflation and lower exchange rates can be used as an important instrument for increasing export capacity. However, in Turkey neither higher inflation rates between 1970 and 2000, nor lower inflation rates between 2000 and 2010 made any significant contribution to increasing trade capacity. But, the trade capacity of Turkish producers steadily increased between 1980 and 2010.

The effects of higher inflation on increasing export capacity are still a continuing issue. In this study qualitative and quantitative research methods are used for estimating the impact of inflation on exports? What are the effects of inflation on increasing export capacity? What measures and policies will contribute to increased trade capacity? Also researched, is what the real contribution of the exchange rate regime is to trade capacity.

Devaluation of domestic currency has several effects on the economic parameters; but lower cost production methods, resources advantages, innovation and economic convergences had considerable effects on Turkish trade regime.

Keywords: Export, Turkey, inflation, international trade, trade balance.

JEL Classification: F, F4.

1. Introduction

In international trade some important measures are used to affect trade capacity. One of these tools is the rate of inflation. But there are some other measures and regulations, which support and change the trade capacity. One of the important regulations on Turkish trade was the devaluation of the Turkish Lira, to encourage exports and this measure was used nine times as an instrument for reducing the deficit on foreign trade balance. However, devaluation causes cost inflation as well as an increase in general price levels. This increases the foreign debt amount and may have less effect on increasing export capacity because most of the developing countries are dependent on the agricultural sector, and the demand capacity of agricultural products may not change by reducing prices.

In this study the impact of support measures on Turkish trade is not questioned, but the impact of the inflation rate as a tool for changing the trade capacity is researched. By doing this, the effects of inflation on the current account deficit are also questioned. In addition, political regulations and some other important issues are considered to better estimate the effects of all policies and measures as a tool for increasing export capacity.

In this study qualitative and quantitative research methods are used to estimate the effects of inflation and the exchange rate mechanism on trade capacity. In quantitative research empirical data and theories are used to support the survey in this study. The aim of this research is to estimate the effects of inflation on exports and to determine whether inflation and the exchange rate can be used as a tool for increasing the export capacity in a home country, as well as to determine which instrument and policy is used as a tool for improving trade capacity.

2. General glance at trade in Turkey

Since 1980 the Turkish trade policy has had considerable positive effects on the development of exports. In the 1970s the Turkish trade regime was based on import substitution and concentrated especially on the domestic market. After a decade, in 1980, some economic regulations came into force on 24th January, when liberal economic adoption was realized. After the 1980 economic regulations, the

Turkish foreign trade regime was replaced with the export-oriented industrialization model. The above-mentioned model was dependent on Ricardo's Comparative Advantages theory. This model was deliberately selected, because some Far Eastern Asian Countries such as South Korea, Taiwan and Singapore had successfully adopted 'the export-oriented industrialization' for economic development. In this model, countries with cheaper relative cost advantage will become trade partners and regions with abundant factors are expected to profit. In addition, development of Turkish exports was supported by cheaper credit opportunities, tax deductions and/or exemptions, a floating exchange rate, and some other fiscal policies. As a result of the1980 regulations, the export capacity began to increase. Diversification of production, improvement of innovation and research and development increased not only in the domestic investment, but also the foreign investments in Turkey. In addition, the development of the Turkish production and export capacity, the adoption of a stable monetary policy and maintenance of a stable currency unit had considerable effects on the expansion of Turkish exports from Turkey.

One other important development for Turkish exports was the EU's Customs Union which was extended to the Turkish market in 1995. However, in the beginning, insufficient production operation techniques and lower quality of production and standards reduced the challenging power of Turkish products exportation from Turkey to the EU member countries, whilst imports from the EU increased in Turkey (see Table 1). But in a short period of time producers in Turkey adopted the EU regulations and standards into their production operation processes, which had considerable positive effects on Turkish exports. Due to this adoption, the export capacity of Turkish producers and other foreign markets into the EU steadily increased in the last decade.

In Turkey the amount of exports of agricultural products' is still not of considerable importance. The share of exportable agricultural products relative to imported products is still not sufficient, which causes a considerable deficit on trade balance and current account. The export of high technological production is still in progress and the share of total export capacity is not sufficient. At the beginning of the 1990s, in order to promote exports, Eximbank credits were introduced and used until 1998. At the end of the 1990s, the introduction of new fiscal policies caused economic construction, which reduced incomes, expenditures on private consumption and investments. In 1999, the earthquake negatively affected both production and trade capacity.

By the year 2001, continuous appreciation of foreign currencies against the Turkish Lira and economic difficulties forced the government to adopt a new economy program called "Turkey's Transition Program for a Stronger Economy", introduced in 2001. This program aimed "to reduce inflation and provide a favorable environment to revive growth. As well as involving a tight fiscal policy and comprehensive structural reforms, exchange rate targets were announced in line with the targeted inflation, and monetary policy was set in a framework that strictly linked liquidity creation to the inflow of external capital."[1] The program aimed to reduce inflationary pressure and increase capital inflow, thus relaxing the financial sector by increasing the amount of money supply in the market. The new program affected many macroeconomic parameters in a positive direction. As a result of this program, a considerable increase in production capacity was observed but internal consumption stayed almost intact. And after the financial crises two main problems emerged in the Turkish economy. One of these problems was the higher interest rate, which continued to increase after the transition program dealing continuous damage to the financial structure of the banking system. Under these difficult circumstances which the Turkish economy faced, endeavors were undertaken to boost Turkish exports. This is done to promote an export-oriented industrialization model. However, economic developments were also observed in the agricultural sector, where the amount of exported products was in decline in total exports. However, considerable important regulations have been put into circulation for protection of the Turkish agriculture. Namely, maintenance of the agricultural sector is secured by the adoption of the Agricultural Reform Implementation Project (ARIP) between 2001 and 2005. Some market support

[1] Central Bank of the Republic of Turkey: Strengthening the Turkish Economy, Turkey's Transition Program, http://www.tcmb.gov.tr/yeni/announce/strengteningecon.pdf.

measures such as, direct income support (DIS), have begun to be applied in Turkey to reduce the disparities between regions. However, export subsidies, import tariff, import/ export quotas, sanitary and phytosanitary measures, product quality and standards and some other measures continued to be applied to increasing the Turkish trade.

The above-mentioned developments had also considerable effects on consumer preferences, which changed in favor of Turkish products both inside and outside Turkey. The results of the above-mentioned important government regulations and maintenance of a sustainable economy policy had positive effects on increasing the export capacity from 2.9 billion USD in 1980 to 134.9 billion USD in 2011[2] (see also Table 1). However, until 2000, the foreign trade balance was contributed for increasing imports, which total imports amount was double the amount of exports. But the ratio of exports to imports between 1980 and 1999 continued to increase. After 2000, the export capacity increased and almost caught up with the imports. The exports total was only one fourth smaller than the total imports. After 2001 the amount of exports in the total trade capacity continued to decrease until 2007, but the ratio of exports to imports was in decline until then. After 2007 the ratio of exports to imports continued to increase until 2009. In 2010, a decline in exports in total trade capacity was observed. However, total trade capacity continues to increase (see Table 1).

It is also important to note that the single currency, which had been put into circulation in some EU member countries in 2002, made only a small contribution to Turkish exports. Over time the Euro appreciated in value against foreign currencies, especially for the Turkish Lira. An appreciation in value of the Euro had also made a small contribution to increasing exports to the EU market, because of the support measures applied by the community agencies to protect internal producers in EU countries. As mentioned above, similar measures and protection were observed in Turkey where a higher import tariff prevented manufacturers of cheaper products accessing the Turkish market. Such protection was a hindrance both for producers and consumers inside and outside the internal market, as this created an unfair market share for some domestic producers.

Table 1. Turkey's foreign trade

Years	Exports (Bn/$)	Imports (Bn/$)	Balance of foreign Trade (Bn /$)	Balance of foreign Trade (Bn/$ %)	Ratio of Exports to Imports (%)
1980	2,91	7,91	-4,310	-5,0	36,8
1987	36,7	27,5	-3,967	-3.9	72,0
1990	12,95	22,30	-9,342	-9,4	58,1
1995	21,63	35,71	-14,071	-14,1	60,6
1999	26,58	40,67	-14,084	-14,1	65,4
2000	27,77	54,50	-26,727	-26,7	51,0
2001	31,33	41,40	-10,064	-10,1	75,7
2004	63,17	97,54	-34,372	-34,4	64,8
2005	73,48	116,77	-43,297	-43,3	62,9
2008	132,03	201,96	-69,936	-69,9	65,4
2009	102,14	140,93	-38,785	-38,8	72,5
2010	113,88	185,54	-71,661	-71,7	61,4
2011	134,971	240,834	-105,862	-105,8	56,0

Source: Turkish Statistical Institute (TUİK), Statistical Indicators 1923- 2011 in table 16.1 Imports and Exports p.477-478

Note1: Exchange rate has been taken TL/$ for 1923-2004 and TRY/$ for year 2005 and after.

Note2: Data unit values for the years 2005, 2006, 2007 and 2008 are given as TRY.

Note3: From 1.1.2009, TRY expression is changed to TL.

[2] Report on the Evaluation of Turkish Export and Export Subventions given by State, MARKA Doğu Marmara Kalkınma Ajanı, 2011 Marka Yayınları serisi, Http://www.marka.org.tr.

3. Theoretical perspectives of free trade

One important reason for free trade is the increasing impact of multinational firms on world politics and economics. In the past, international trade depended on international relations between politicians. In the last decade the increasing role of multinational firms reduced the role of national states in world economy and politics. The new world order is directly related to the theories of world politics.

There have been three main approaches to world politics: "Realism on the power relations between states, liberalism on a much wider set of interactions between states and non-states actors and world system theory on the patterns of the world economy."3 Liberalism affects the world's economy, social, cultural and also political events. Neo-liberal economics empowers and enriches big business, especially multinational companies (MNC's). Governments' debt reduction policies shift income and wealth from wages to profits. The reaction to the EU's economy policies, which reduce the wages and increase the profits of multinational companies, is the proof of income shift from wages to profits. However, in free but fair trade it is also important to maintain the welfare of the nations. Increasing market capacity in international markets is based on a higher challenging power and the competition capacity of MNC's. Trade capacity and exports will be enlarged with lower production costs and prices and higher quality products with considerable promotion and marketing techniques designed to capture a sufficient market share. On the one hand, lower production costs, which are the realized results of lower wages, will create a problem in maintaining a sustainable free but fair trade. On the other hand, reducing product prices results in the devaluation of the domestic currency; this will contribute to an increase in the export capacity. However, the result of this devaluation is that it produces some other inevitable problems which must be considered, such as welfare loss for consumers, an increased burden on debtors who borrowed foreign currency and an increase burden of those producers who are using foreign input.

Therefore, reducing wages is one of the important tools to increase competition. But it is also important to note that, "a comparison of countries' competitiveness will be done more accurately if the unit labor cost of production is considered instead of labor cost (wages)"4. Because reducing the unit labor cost of production contributes to the maintenance of considerable productivity in the production operation process. This implies that considerable productivity in production is an important tool in increasing competition and reducing the current budget deficit in economies. In Germany, labor wages are very expensive compared to other countries' wages. "In comparison to China's population, which is about 1.5 billion, Germany's population is about 84 million. Although Germany's current budget surplus was about 190 billion USD; against this China's budget surplus was about 260 billion USD in 2011."5 Germany's higher unit labor cost of production is the reason for a higher challenging power in the international market and a higher budget surplus. It is important to note that an increase in current budget surplus will increase a nation's welfare as well. It is obvious that the unit labor cost is more important than wages. It must be considered by governments as an important issue for controlling both the product prices and consumers' welfare. Governments' economy policies mostly concentrate on employee wages; however, it is also important that the unit labor cost of production be taken into consideration. Calculation of the unit labor cost, as above-mentioned, will considerably increase the countries' productivity. By doing this calculation of productivity the contribution to their GDP can be more accurately calculated. Assessing the cost of labor only is not sufficient to compare countries' competitiveness. The increasing profits of MNC's have made less of a contribution to increasing the GDP of member countries, because incorrect calculations of labor costs and the amount of profit included in the GDP were mostly realized at a lower level and as a result of this, the welfare of the country has been incorrectly estimated.

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[3] Baylis, J.and Smith, S. The Globalization of world Politics. Oxford University Press, Oxford, 1999, p.6.

[4] Hürriyet newspaper, Ege Cansen: Oyunun Kuralı 'Krizde Her Çözüm Milli Gelirin Yeniden Dağılımına Çıkar'February 4th 2012, p.8.

[5] Hürriyet newspaper, Ege Cansen: Oyunun Kuralı 'Krizde Her Çözüm Milli Gelirin Yeniden Dağılımına Çıkar' February 4th 2012, p.8.

In fact, higher GDP and GNI per capita are the indicators of economic development. However, political parties' interests or preferences sometimes affect the governments' decisions. In many countries, politicians avoid reducing the income of the voters. Decline in national income is the indicator of welfare and wealth loss, and this means that politicians do not readily use this option, because income reduction has also meant the loss of voter support. In Greece, for example, the GNI per capita is rather high, but economic problems and fiscal difficulties are well-known current issues. The reason for this higher GNI per capita and inefficient economic performance and fiscal problems is probably maintained by politicians who want to secure their voters support.

The above-mentioned problems cause an unfair distribution of wealth. This creates difficulties in the distribution of incomes and increases the governments' budget deficits in many countries. In some EU countries, financial support for producers has increased the government's burdens in the last decade.

3.1. Effects of the exchange rate on free but unfair trade

In international trade the exchange rate effect is assumed to be realized "when domestic interest rates raise due to an expected increase in inflation the domestic currency depreciates"[6] It is obvious that depreciation of domestic currency against foreign currencies is either realized by inflation or intervention into the fiscal sector through the devaluation of the domestic currency. Both applications are supposed to contribute to increasing the export capacity and savings account by increasing the interest rate. In Turkey, the past nine devaluations have been made by governments between 1970 and 2010. However, neither devaluation nor higher inflation and interest rate made any considerable contribution to an increase in the export capacity. In those days, Turkey's foreign trade policy was concentrated on internal market regulations, but the foreign countries' trade regime was neglected. Although in EU countries, where Turkish trade considerably increased in a given period, several support measures and regulations were implemented to reduce exports of non-member countries. In particular, the Common Custom Tariff (CCT), direct payments, export subsidies and sanitary and phytosanitary measures reduced the access of non-member countries and Turkish producers into the EU markets. In the EU artificially increased product prices, due to support measures, caused an increase in the general price level and led to a trade distortion effect. A consequence of this trade distortion effect which was defined by Viner, was that some lower cost production of exportable commodities in third world countries are replaced by inefficient products of the home country, whereas currency depreciation or the application of support measures caused a price increase for imported products from third world countries. Such resource allocation between Turkish producers and EU producers is not consistent with fair trade which is mostly dependent on the comparative advantages theory, which states, that the relative cost advantage must be considered an important factor when becoming a trade partner. And it is also realized in the EU and several reforms and regulations considerably reduced the support measures. However, although Turkey became a member of the Customs Union in 1995, sanitary and phytosanitary measures and some other irrelevant measures still remain on the EU's agenda and prevent enlargement of trade capacity for Turkish producers in the EU markets. Since free but fair trade is dependent on the comparative advantages theory (D. Ricardo), it is therefore necessary to verify whether or not the theory of comparative advantages still has unquestioned importance for fair trade relative to other international trade theories.

This question can be either empirically or theoretically answered. The theoretical answer can be a conclusion in favor of the comparative advantages theory, for the reasons explained below.

Clarification is given below of the theoretical perspective, which is, that the comparative advantages theory is of major importance in defining free but fair trade, i.e. price support for the sustainability and equity of traders in order to decrease trade distortion. And empirical evidence shows that trade distortion occurs, when some tariff and non-tariff trade measures applied for protecting the internal producers. And results of this trade capacity between internal producers are increased, whilst

[6] Mischkin, F. The Economics, Money, Banking, Financial Markets. Sixth Edition, Addison Wesely, Boston 2002, p.170.

trade capacity of external producers is assumed to be distorted (see also Viner's Customs Union Theory).

International trade can be explained by the comparative advantages theory (Ricardo). Firstly, this theory is based on free trade and perfect competition. Secondly, comparative costs are related to technological advantage, because such an advantage also plays an important role in becoming a trade partner. And thirdly, this theory depends on the lower relative cost of advantage on trade which allows countries to compete freely in the market on their lower relative cost advantage as a trade partner. As stated by Gilpin "Most economists believe that the international community should concentrate its efforts on creating an open multilateral world economy rather than on making regional arrangements, because a world economy based on the principle of comparative advantages and national specialization would not only produce superior economic benefits but an open and non-discriminatory economy would also reduce international economic friction and perhaps even promote peace."[7] This explanation is obviously of major importance in the argument that the comparative advantages theory supports free but fair trade.

3.1.1. Depreciation of the currency and impact on trade

Depreciation of the currency increases product prices and prevents cheaper imported product access into the home market, but also causes higher prices in the domestic market, which implies inflation. Increasing prices has also meant an increase in the level of money supply. And increasing product prices on the one hand reduce the purchasing power of domestic consumers and reduce real income. This causes an increase in imported product prices, because the decreasing value of the domestic currency reduces the exchange rate value against foreign currencies.

The effects of the currency depreciation on importers cause an increase on the burden of imports in the domestic market. Effects on consumer: Results in inflation imported product prices becoming more expensive and higher import prices reduce imported product consumption in the domestic market. Effects on export: Results in depreciation of the currency as exports of domestic production are expected to increase. Effects on trade balance: An increase in export capacity is expected to reduce the deficit on trade balance. Effects on producers: Depreciation of currency contributes to an increase in value over production and of producers' reserve capital amounts. As in Turkey in the1980s, an increase in the reserve capital amount is observed. This implies that the depreciation of currency causes net income transfer from consumers to producers. And this will increase the abyss between rich and poor. Effects on production: If production is based on imported input, it is expected that production will become expensive. As observed in Turkey, many finished goods are produced by using imported inputs. This implies that the application of inflationary policies may not only reduce the amount of imports, but may also reduce exports. Therefore, the selection of political instruments as a tool for contributing to economic development must be analyzed carefully.

3.1.2. Appreciation of the currency and impact on trade

Appreciation of the currency is realized when the domestic real interest rate rises. This implies a decline in money supply which will reduce the general price level. As a result of a low level of money supply, the exchange rate is expected to increase the value of the domestic currency. The effects of currency appreciation cause an important change in internal and foreign markets, because appreciation increases the value of domestic currency, which means it is worth more in terms of foreign currency.

Effects on consumer: Appreciation of the domestic currency increases the purchasing power of internal consumers, due to an increase in real income. And as a result of deflation, imported product prices will become cheaper for internal consumers. Effects on importer: Imported product prices will become cheaper. An increase in value of domestic currency reduces the burden on importers in the domestic market who import from (foreign countries) abroad. Effects on Export: The increasing value of the domestic currency means exports will become expensive and this will reduce the exported product capacity, because less exported products will be demanded. This will reduce the export amount of

[7] Gilpin, R. The Challenge of Global Capitalism. Princeton University press, New Jersey, 2000, p.338.

Turkish producers (domestic producers) whilst imports increase. Effects on trade balance: A decline in exports and an increase in imports is expected to increase the deficit on trade balance, which will also lead to lower growth.

3.2. Inflation and interest rate

From a theoretical aspect it is assumed that "lower price level reduces the interest rate, encourages greater spending on investment goods and thereby increases the quantity of goods and services demanded. Conversely a higher price raises the interest rate, discourages investment spending and decreases the quantity of goods and services demanded."[8] Price increase is also an indicator of excessive money supply in the economy. And a higher interest rate is one of the important instruments for controlling and reducing the excess money from the market. As stated in Keynesian economics, on the one hand, "people will sacrifice the ability to earn interest on money that they want to spend in the present, and that they want to have it on hand as a precaution. On the other hand, when interest rates increase, they become willing to hold less money for these purposes in order to secure."[9] Since high inflation has a positive effect on increasing the interest rate and export capacity, then it is assumed that price increases will stimulate the interest rate and a higher interest rate will contribute to an increase in savings - which in Turkey is very low. The amount of savings is estimated at less than 15% in total reserves and it is expected to increase up to 25 % to allow for better allocation of resources. Therefore, the interest rate plays an important role in controlling the money supply and slows down the economy. This is obviously a continuous process in the economy.

It is clear that growth and stability are major problems of the economy, and economic stability is not an easy issue. As experienced in the 1980's, in the era of Thatcher in UK and Regan in the USA, a nation's welfare was dependent on economic stability. And due to this approach, globalization and the concept of a New World Order were introduced as important aspects of economic development and increased welfare in the nation. The New World Order is based on three factors, of which stabilization, privatization and liberalization are accepted as important contributors to economic welfare and prosperity, with economic stability being mostly achieved by stable prices in the market. However, at that time such price stability and lower inflation was not observed in Turkey (See table below). Until 2000higher consumer prices were observed in Turkey. Neither economic stability, nor privatization secured economic growth. Turkey's export capacity continued to increase between 1980 and 2010. Although inflation and important price changes between these periods made a small contribution to an increase in export capacity, (as can be seen in Tables 1 and 2), decreasing domestic prices, or in other words, appreciation of the Turkish Lira had no negative effects on the development of Turkish exports.

Table 2. Inflation Rates Currency (unit: Turkish Lira's) and exchange rates between 1980-2010

Consumer price index The rate of changes -previous year's December values considered-	
1978	34.2
1979	77.7
1980	93.0
1982	33.2
1984	70.7
1986	48.1
1990	69.4
1994	215.0
1997	81.7

[8] Mankwin, N. G. Principle of Economics, Harvard University, South Western Cengage Learning international student edition, US 2009, p.747.

[9] Keynes, J. M. The General Theory of Employment, Interest, and Money, Atlantic Publisher and Distributor, New Delhi Chapter 13: The General Theory of the Rate of Interest, 2008, p.148.

Consumer price index The rate of changes -previous year's December values considered-	
2001	76.8
2002	24.5
2003	12.6
2004	11.6
2005	2.7
2006	19.2
2007	9.4
2008	14.5
2009	5.7
2010	3.27

Source: North Cyprus and Turkey's State Statistical Institutes – Statistic and Research Department.

Despite these positive developments in Turkish trade, the deficit on current account in Turkey continued to increase between 1970 and 2010. However, the development and growth rate, with the exception of years 2001 and 2009, continued to increase considerably (see Figure 1 and Table 3). But, as mentioned above, price stability alone is not sufficient for a stable economy. Price stability is requires support from fiscal policies designed to further economic stability. "Fiscal instability can be related to the three factors which may be observed in the economy. These are: An enormous increase in individual wealth, which is not related to the development of the national income and national savings, budget deficit, which causes an increase in the public debt and finally, a continuous increase in the current account deficit,"[10] They are considered important factors which affect and change the stability and economic development of a country. Inefficient economy policies, that affect and slow down economic growth, may reduce the Gross Domestic Product (GDP), which causes a reduction in governmental revenues, and in some other parameters such as saving, investment, employment, trade capacity etc. The occurrence of these negative effects in an economic recession is inevitable. And in recession, the production and export of goods and services will be less. Especially in Turkey, where considerable amounts of input and energy are imported from third countries, the deficit on current account continuously creates a problem in the balance of payments and reduction in trade capacity and loss of producer gain and consumer welfare continues.

Figure1. Turkey's GDP and unemployment rate between 2000 and 2013

Source: The Economist, June, 14th 2013 *The New young Turks*, article p.21.

[10] Hürriyet Newspaper: article: "İstikrarsızlaştırma" Ege Cansen, March 31st, 2012, p.10.

In Turkey during 1980 and 2000 an increasing rate of inflation is observed, and in this period the GDP was not stable and in most years was in decline (see Table 3 below). But, in a given period trade capacity increased, as indicated in Table 1. In 1980, exports were 2.910,122 billion US dollars, which increased by 28.7% and the import capacity was 7.909,364 billion US dollars which increased by 56% in 1980. And in 2001 the export capacity rose to 31.334,216 billion US dollars, which was an increase of 12% compared to the previous year's export capacity, while the import capacity decreased to 41.399,083 US dollars. Of which reduced by 24% compare to the previous year import. In 2011, exports increased to 134.971,545 billion US dollars, which represented an 18% increase compared to the previous year, while in the same year the import capacity increased to 240.834,392 Billion US dollars, which showed an upward development of 29.8%.

The improvement of Turkish trade in a given period is an indicator that inflation is not the only factor in increasing trade capacity. Since 2001, the Turkish Lira has been a stable currency and the effects of inflation on Turkish exports contributed less to an increase in Turkish exports. Then it is obvious that a rise in export capacity cannot be based on the inflationist policies, because before 2001, where hyper-inflation was observed in the Turkish economy, export capacity continued to increase, whilst import capacity also considerably increased. Therefore, development of Turkish trade is dependent on lower cost of production, and successful Turkish politics and foreign policies and trade regimes are applied by Turkish governments in order to move closer to world politics and economics. But part of this success comes from the Turkish producers and businessmen who engaged in considerable bilateral business agreements with the aim of expanding Turkish trade.

Table 3. Turkey's GDP Real Growth Rate between 1980 and 2001

Year	Gross domestic product, constant prices	Year	Gross domestic product, constant prices
1980	-0.779	1991	0.926
1981	4.365	1992	5.984
1982	3.429	1993	8.042
1983	4.758	1994	-5.456
1984	6.823	1995	7.19
1985	4.258	1996	7.007
1986	6.941	1997	7.528
1987	10.027	1998	3.092
1988	2.121	1999	-3.365
1989	0.253	2000	6.774
1990	9.255	2001	-5.697

Source: http://www.indexmundi.com/turkey/gdp_real_growth_rate.html

4. Export-oriented growth

In the 1970's, economic policy was based on import substitution and a closed economy, and the Turkish government's trade policy was concentrated on imports substitution and production for the domestic market. After 1980, following Thatcher's and Regan's three important policy changes, namely, stabilization, privatization and liberalization in the world economy, Turkey's trade policy was also affected and changed by new cabinets, after the military intervention of September, 1 980.

The export-oriented development model was introduced and many political and democratic changes realized for the adoption of a liberal economy. However, the implementation of the liberal economy model brought many problems, one of which was fictitious exports. As a result of these fictitious exports, the deficit on current account increased considerably and after 2000 this deficit continued to increase. This is still one of the country's most important fiscal problems - preventing a current account deficit and increasing the saving amount in the Turkish economy. For this reason, devaluation of the Turkish lira and an increase in nominal interest rate is on the government's agenda in order to promote saving. However, a rise in real interest rate must be expected, because, in the long run, higher nominal interest rates will contribute to higher inflation and depreciation of the Turkish lira, and this will contribute to an increase in the country's foreign debt amount. However, in the long run, real interest rate must be increased in order to lower inflation and raise domestic currency. By doing this the foreign debt total will decrease and the welfare of consumers and gain for producers who are using foreign input, will be increased.

In Turkey, in the long run, a sharp reduction in real interest rate is targeted. As one of the journalist and financial analyst Y. Bulut stated, "Interest is haram" (anything forbidden by the Islamic religion) and continued", interest is one of the most important problems which negatively affected the performance of the Turkish economy between 1940 and 2001."11 This is actually a more fundamentalist approach, where interest is assumed to be a haram profit, and suggests that people may increase their incomes through working, not through interest. In fact, the current government's attention is also concentrated on developing a better and fairer economy and equalizing the interest rate. The inflation rate is also on the cabinet's agenda. It is clear that equalization of the interest rate and inflation rate is a possible advance solution for the protection of both producers' gain, and consumers' welfare. By doing this, on one side, the consumer will be protected from higher inflation and on the other; investors will be able to borrow at an acceptable interest rate, thus promoting investments.

A deficit on current account and a decrease in exports relative to increasing imports creates a considerable problem for Turkish trade. Some political changes have been made in the regulations, but the export-oriented trade regime remained intact between 1980 and 2010. Maintenance of export-oriented trade policy caused some problems which continue to increase the burden on Turkish trade in the last decade. As stated in The Economist, "Turkey has not just overheated. It has a growing competitiveness problem and a dangerous addiction to the riskiest types of foreign capital."12 "Last year, in Turkey, according to the Central Bank's report in 2012, the current account deficit was 50 billion 186 million dollar which was 10% in excess of the GDP in 2011. And for the last 7 months of 2012, the current account deficit dropped to 34 billion 462 million dollars."13 In spite of considerable reduction in the current account deficit, this deficit would be a considerable problem for any economy nowadays; the Turkish cabinet is still struggling to reduce the deficit in current account.

Fiscal problems and debt crises affecting many economies both developed and developing countries and the balance of trade is the indicator of trade flow in the current account between countries. In a nation, the balance of trade is the difference between sales of exports and the cost of buying imports. "The balance on goods and services (or net export for short) is a major component of aggregate demand for expenditure on the reporting country's aggregate output."14 However, the current account together with the financial account is the two most important parts of international transactions, relative to the capital account. And most of these problems are observed stem from deficits on current account in many economies. Last year similar problems caused serious debt crises in several EU countries, such as Greece, Portugal, Italy, Ireland, and Spain, the so called PIIGS countries, and these crises later spread to other member countries, Slovenia, Slovakia, Malta, Luxembourg and Cyprus.

In fact, such a fiscal problem in the nations of the world is not deliberately created, but it is a topic under discussion that many of the most powerful economies in the EU, especially Germany, France and some other countries' global interests such as energy needs, increasing market share and profit expectations contributes for creation of such economic problems. Consequently, smaller members become more dependent on the larger members' sovereignty in economic and political matters.

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[11] Bulut, Y. and Haramdır, F. Cumhuriyet Newspaper, March 29th 2012.
[12] The Economist April 7th 2012. "Message to Ankara", p. 15.
[13] Sabah newspaper. September 11th 2012. "Cari Açık Belli oldu- Current Account is published".
[14] Chacholiades, M. International Economics. McGraw-Hill Companies, New York, 1990, p.292

It is also well known that the gap between rich and poor has been deepening in the last two decades. According to UN reports it is suggested that "the gap between richer and poorer households has widened since the 1990s."15 The profit-oriented MNC's expectations and increasing competition to capture a higher market share is contributing to this result. Increasing energy needs compel developed countries to become more offensive to those countries where energy resources are located. It is obvious that most of the energy resources are located in the southern part of the world, especially in countries in the Middle East. For this reason, the interest of developed countries in these countries has increased in the last two decades. One of these economies is Turkey, with a huge market and a growing economic performance there has been an increase in interest in Turkey from the developed nations. Turkey is also included in the MIST countries where Mexico, Indonesia, South Korea and Turkey are considered. As is known, BRIC was the first group introduced as potential countries which were expected to take a leading position in world economics. However, Turkey's higher economic performance which is assumed to be achieved by its growing export capacity, does not covering its trade balance or deficit on current account, because energy and several inputs (about 70 per cent) used in production operation process are imported. And it is obvious that the development of exports has also meant the development of imports. Therefore, Turkey's current account deficit is expected to continue, unless the country's use of foreign energy and input does not get replaced by domestic resources.

According to recent data published in Trading Economics "Turkey recorded a Current Account deficit of 8170 USD Million in April of 2013. Current Account in Turkey is reported by the Central Bank of Turkey. Historically, from 1984 until 2013, Turkey Current Account averaged -1125.18 USD Million reaching an all-time high of 1132 USD Million in September of 1998 and a record low of -9518 USD Million in March of 2011."16 Since the current account is an important indicator of the debt problem and it is calculated as exports minus imports of goods and services - and in Turkey a higher amount of exported goods are produced using foreign energy and input - then it is very difficult to reduce the amount of debt in Turkey in a short period of time. And the fiscal deficit, which is assumed to be very high, and has reached a risky level, will in the near future cause a considerable depreciation of domestic currencies. This is expected to happen because Turkey's saving account is very low (about 15 percent). It is also expected that the devaluation of the Turkish currency increases prices and interest rates in order to raise the saving amount above 20% for a better allocation of resources and for the creation of some resources to reduce the deficit on current account.

It is obvious that the Turkish economy has developed in the light of exports. However, neither inflation nor the exchange rate mechanism, were used as important instruments to increase trade capacity and GDP between 1980 and 2010 (see Tables 1and 3). In addition, neither in higher inflation, nor in stable price periods, were enormous increases on exports observed, but continuous improvement on export capacity was achieved.

It is also important to note that the development of the Turkish economy has also had positive effects in Turkey on other parameters, such as imports, growth rate, employment and national welfare.

Conclusion

Turkey's export and import capacity between 1980 and 2010 varies from one year to another. An increasing share of exports in total international trade plays an important role in reducing the deficit amount of trade balance. As indicated in Table 1, in 2001 and in 2009, a considerable increase in exports is observed. However, as explained in the theoretical part, it is assumed that exchange rate plays an important role in increasing or decreasing trade capacity. But in 2001, where the USD appreciated almost twofold against the Turkish Lira, Turkish exports had only slightly increased. Similarly, in 2008 where the TL appreciated as much as the USD, there was again a small increase in Turkish exports (See Table 2). In addition, considerable improvement in the GDP occurred after 2000

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[15] UN news Centre. Income gap between rich and poor is huge and growing, warns UN report. Available at http://www.un.org/apps/news/story.asp?NewsID=28590&Cr=INCOME&Cr1=ILO,.

[16] Turkey Current Account. Available at http://www.tradingeconomics.com/turkey/current-account,

when the domestic currency became more stable and appreciated against foreign currencies. Expansion of export capacity cannot only be dependent on the exchange rate regime. Depreciation of currency contributes to the promotion of the country's exportation of goods and services to foreign markets. But product price alone cannot change market capacity. However, devaluation of the domestic currency has several important effects on economic indicators. Some of these important effects are given below:

- Devaluation causes some resource transfer from domestic consumers to domestic producers,
- It reduces the domestic consumer purchasing power;
- It reduces producer gain for those who are using foreign input and energy in the production operation process;
- It increases the consumers' utility in foreign countries;
- Depreciation of domestic currency which implies appreciation of foreign currency - it is expected that the appreciation of foreign currency increases prices and interest rate in order to increase the saving amount to ensure a better allocation of resources;
- It reduces the burden of debtors who borrowed with domestic currency;
- Depreciation of currency will stimulate the money supply in circulation, and an increase in money supply causes an increase in interest rate;
- Depreciation of currency increases people's interest in holding bond and stock papers.

Since 1990 the percentage of Turkish exports in the total trade has been around 60 percent. The increasing inflation rate in 1990 did not influence and increase amount of exports. However, the share of exports in total trade stayed unchanged between 2000 and 2010, when the inflation rate fell sharply. As is known, a decline in the general price level caused an appreciation of the TL against foreign currencies and it is supposed that an appreciation of the domestic currency decreases the export capacity. However, both exports and imports continued to increase between 2000 and 2010. In short, inflationist policies, or appreciation of the Turkish currency did not cause a considerable change in exports. But, as stated in the theoretical part, appreciation of currency or devaluation of currency is assumed to be causing a considerable change in export capacity. Therefore, the relationship between inflation, exchange rate and export of goods is becoming questionable. Because, in theory, it is assumed that either an increasing amount of inflation or the decreasing value of domestic currency (depreciation of domestic currency) is expected to increase the export amount. However, it is also important to note that price changes alone are not sufficient to increase market share. First of all, all goods and services are not perfect substitutes. And the Consumer Price Index (CPI) items are also not identical, homogeneous and equivalent to each other. Therefore, substitution of goods and services cannot be solely dependent on price changes. In this study, it has been shown that neither inflation, nor exchange rate causes a considerable increase in exports Furthermore; increasing trade capacity in Turkey is assumed to be created as a result of factors other than inflation. These factors can be summarized as given below:

- Adoption of the EU regulations and standards in Turkish production operation processes, increased the production and export capacity;
- Adoption of the EU's sanitary phytosanitary measures;
- Improvement of safety production methods, environmentally- friendly production, labelling, wrapping, warranties, hygienic standards etc.;
- Reduction / removal of tariff / non-tariff trade barriers, results of Customs Union membership realized between EU and Turkey;
- Use of lower cost production technique, which contributes to catch up the relative cost advantage as explained in Ricardo's comparative advantages theory;
- Abundant resource advantage in certain sectors increased trade capacity,
- Transportation cost advantage - location of the factories is near to the both eastern and western countries markets;
- Increasing know-how and innovation technologies;

- Economic convergence effect.

The last factor, economic convergence, plays an especially important role for Turkish producers, as is known, Turkey stands in the middle of east and west. This means producers can easily adopt the new technologies and innovations from western countries and catch up on the developed countries high tech production techniques and marketing strategies. As a result, this adoption of new techniques, achieved faster than in the less developed countries, increases the production capacity and exports. This is achieved by faster adoption of new technologies, lower cost production, results of cheap employee and abundant input advantage, which all causes lower product prices, yet maintains high quality and standards in production operation and the marketing process. As is explained in the Neo Classical Convergence model, less developed countries with catch up effect increase the challenging power in international market and welfare of the nations.

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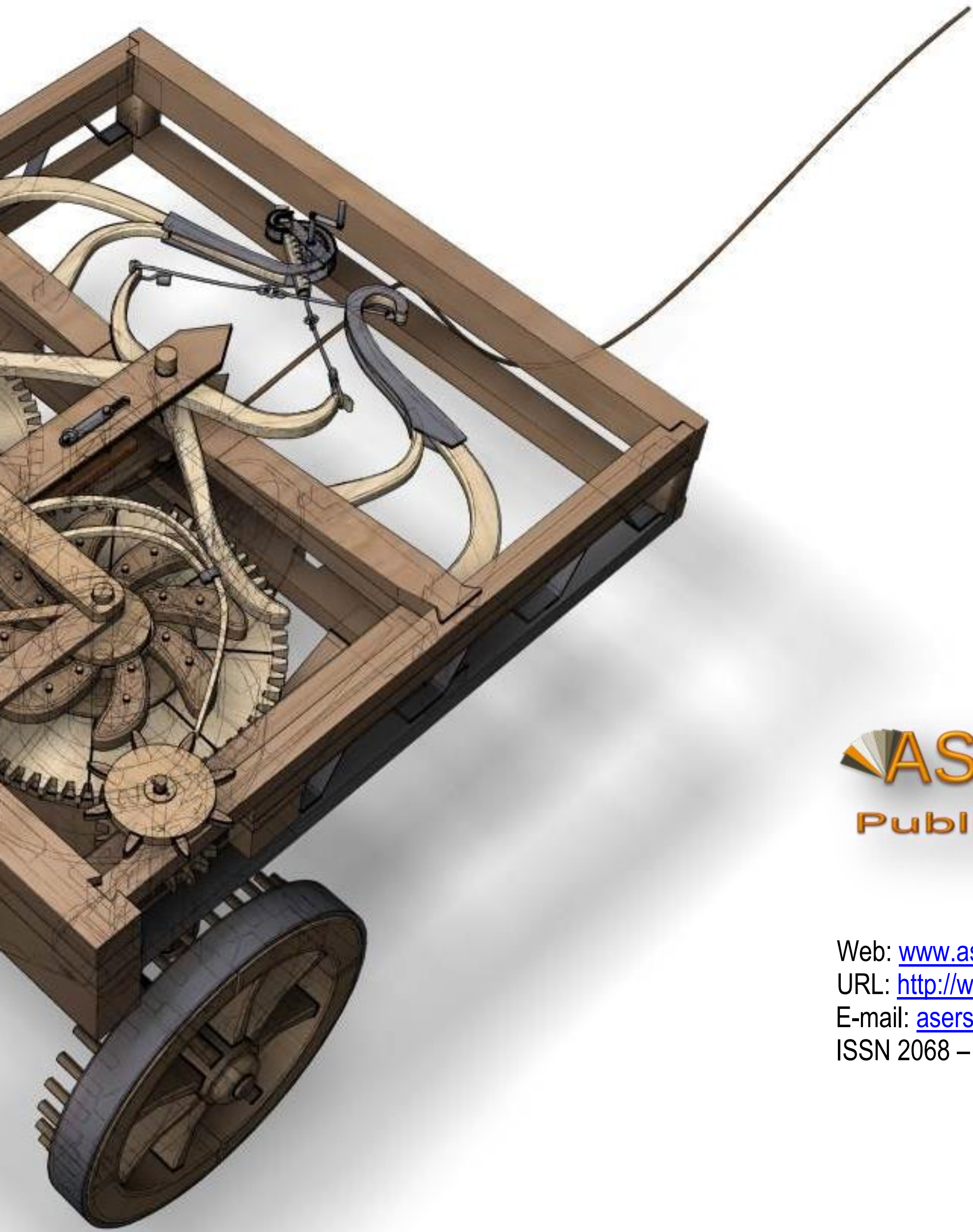

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