BRIEF HISTORICAL BACKGROUND for the TURKISH ECONOMY

Laying the Foundation

Following the collapse of the Ottoman Empire in the First World War, the Republic of Turkey was founded on 29 October 1923, under the leadership Mustafa Kemal Atatürk who is the first President of Turkey. During the era of Atatürk, a series of far-reaching reforms were initiated and accomplished to make Turkey a developed modern state.

Economic policies, introduced and implemented at that time, aimed to create agricultural and industrial consensus in cooperation with the state and individual enterprises. In the Izmir Congress of Economy held in 1923, the decisions were taken in order to establish an industrial manufacturing structure based on abundant raw materials and to support private entrepreneurship financially by setting up banks to provide necessary financial instruments for investors. In parallel with those decisions, many important institutions for Turkish Economy such as the Central Bank, Ziraat Bankasi (Bank of Agriculture), Is Bankasi (Business Bank) and Chambers of Trade and Commodity Exchanges were established in that epoch.

The Great Depression of 1929 urged Turkey to follow new policies towards more state-led initiatives especially in terms of industrial development. Under the First Five Year Plan, adopted in 1934, five primary industries were selected in line with local and natural resources and basic consumer needs and human resources. As a result of planned economy, a significant growth rate was achieved in the selected sectors namely weaving, mine operations, paper, soil products and chemicals.

The Second Five Year Plan introduced in 1939 was not concluded because of the outbreak of the Second World War. Turkey did not actually enter the War, but major part of national resources was allocated to defense industry, thereby reducing capacities in production and foreign trade.

Following the elections of 1950, the second political party which was established in 1946, came to power. With the adoption of the new economic policies towards a more liberal economic system 11.1% growth rate was achieved in the years 1950-53. However, this achievement could not be sustained during the 1954-1958 period and when growth rate fell to 2-3% in 1958, it became necessary to take new economic measures.

Firm Central Planning

The 1961 Constitution made economic planning a legal requirement by setting up the State Planning Organization (SPO). Following the establishment of SPO, the First Five Year Development Plan, covering years of 1963-1967 achieved a growth rate of 6.7%. Between 1968-1972, during the Second Five Year Development Plan, the growth rate surpassed the targets set as 7.2%. In those two periods, industrial sector was regarded as the locomotive of the economy and under the coordination of SPO the target sectors were defined in accordance with their degree of forward linkage features. Under the governmental protection and availability of financial facilities, the "import substituting industrialization" policy was implemented in order to empower the infant industries of Turkey.

The oil shock of 1973 which had shaken the world economy, also crippled the developing Turkish economy largely because of a high oil import bill, which led to overall price increase and energy bottlenecks as in other oil importing countries. Nevertheless, in the face of those negative developments, Turkish economy accomplished to grow 8.5% during the era of Third Five Year Plan between 1973-1977.

Following the interim plan for 1978, the Fourth Five Year Development Plan covering the period of 1979-1983 was introduced to put the economy into order. However that new plan could not restore the negative effects of the oil crisis which caused high inflation, foreign exchange shortages, unemployment, growing public deficit and therefore devaluation of the Turkish currency.

Opening Up

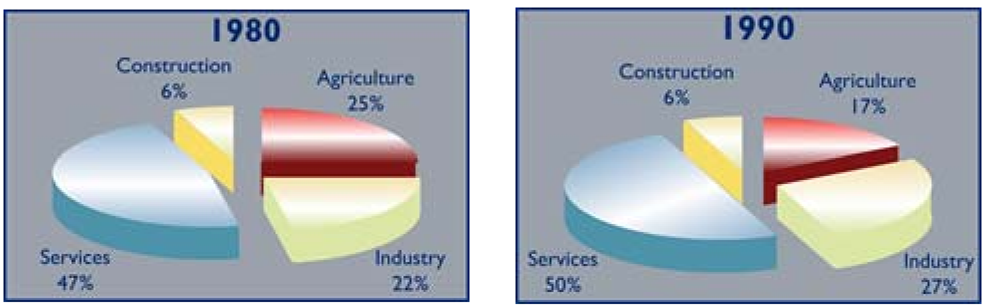
On January 1980, a package of economic stability measures known as "January 24 Decisions" were adopted to restore the worsened problems emerged in the late 1970's. In addition to restore the Turkish economy, "January 24 Decisions" also introduced radical changes in economic modeling and preferences. With those decisions Turkey switched its economic policy from "import substituting industrialization" to "export-led growth strategy" which brought about the introduction of liberalization in financial markets and more emphasis on foreign trade. In this context, import regime was liberalized to a great extent, export promoting incentives were initiated, supply and demand system in foreign exchange markets was put into practice and thus, Turkish Lira was allowed to float in a controlled monetary environment.

After the September 12, 1980 military operation, a new Constitution was accepted in 1982 and the new government came into power in 1983 via general elections. With the decisions taken by the government in December 1983 and January 1984, further radical amendments were made in order to enforce the liberal economic system. State intervention in the economy was reduced to a minimum level and considerable efforts were made in favor of liberal market economy including foreign exchange, foreign trade and tax systems.

In 1986, Turkish Government launched for the first time to borrow from the international markets by issuing Treasury Bills and Government Bonds. In 1989, capital account liberalization was introduced and Turkish Lira became convertible, so foreigners began to purchase stocks (government bonds, equities, bills) from Turkey and foreign exchange deposits were allowed in Turkish banks.

Liberalized import regime, new foreign investment and export promotion policies have enabled Turkey to take its place in the global economy. In this context, steady economic growth has been accompanied by a significant change in the composition of the GNP, the share of industry and services marking an important increase.

Composition of GNP (1980 vs. 1990)



Due to liberalization policies, the activities of the foreign investors accelerated in the eighties mainly in the fields of telecommunication, textile, agro industry, tourism, military aircraft, electronics, food, tobacco, automotive industries and banking. The total amount of foreign investment increased from 35 million USD to 3.4 billion USD between the years of 1980-1990.

During both 1980s and 1990s, Turkish economy endured with high inflation rate stemming mainly from budget deficit and deficit in current accounts. Thus, the devaluation of Turkish Lira was inevitable during that period.

The integration with the world economy after 1980s made the Turkish economy more vulnerable to international crises. In fact, the economic recession in the South East Asia followed by the Russian crisis in August 1998 adversely affected the Turkish economy in 1999. The difficulties became worse with the devastating earthquakes in August and November of that year. The economic losses caused by these natural disasters amounted to roughly 5% of the Turkish GNP. As a result, there has been a 4.7% contraction in GNP in 1999.

After the April 1999 elections, the new government launched an economic stabilization program aiming to achieve a stable and sound economic growth by reducing the budget deficit and the inflation rate. As set forth in the "letter of intent" submitted to the IMF in December 1999, the program was based on three pillars which are "up-front fiscal adjustment", "structural reforms", and a "firm exchange rate commitment supported by consistent income policy". Incorporated in strict fiscal and monetary policies, this program has succeeded to decrease the inflation rate considerably. The annual consumer price inflation decreased from 68.8% to 39% in the year of 2000. Following a 6.1% contraction in the previous year, in 2000, the Turkish economy registered high growth in real terms with rises of 6.1% in GNP and 7.2% in GDP.

The Financial Crises and Stability

Economic measures taken by the government under the supervision of IMF for the Turkish economy could not prevent financial crises of November 2000 and February 2001 which caused a serious contraction in 2001. As a result of the collapse of the fixed exchange regime and 50% depreciation of the Turkish Lira in February 2001, Turkey’s ambitious IMF backed stabilization program has been amended. The revised IMF program was intended to ensure timely debt repayments, prevent further devaluation, control the rise of inflation and support the solvency of the banking system. The strong structural reforms, prudent fiscal and monetary policies under a floating exchange rate regime and an enhanced social dialogue were the main pillars of the revised program launched in March 2001.

In 2002, a considerable economic recovery began to be observed, along with the structural reforms and macroeconomic policies, which were implemented in the aftermath of the financial crisis and later converted into a new three-year economic program. Both GDP and GNP increased by 7.9% in 2002, in spite of the low total domestic demand. Rising exports and public sector consumption facilitated the recovery of the Turkish economy in 2002.

After the November 3, 2002 elections, the current single party AKP Government came into power and confirmed its loyalty to the IMF-supported economic program. Tight monetary and fiscal policy contributed to achieving most of the targets set by the IMF program and an environment of political and economic stability has been mainly achieved. One of the major problems of the Turkish economy, namely chronic inflation, has been overcome, with the single-digit inflation rate achieved in 2004. A sustainable debt stock view has also been provided with debt to GNP ratio on the fall. With structural reforms continued, confidence is restored in many areas and updates are received from the international credit-rating agencies.