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ECONOMIC AND SOCIAL EFFECTS OF TRADE LIBERALIZATION IN TURKEY

The article carries out the classification of the social and economic effects of trade liberalization. The evolution of free trade in Turkey during the critical stages in its economic development (1980—2001) is studied, and an approach to estimation of the trade policy liberalization efficiency is developed. This approach can serve as a basis for future research, in particular, for other countries.

Keywords: liberalization, development, competition, export, trade balance, currency regime.

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ЕКОНОМІЧНИЙ ТА СОЦІАЛЬНИЙ ЕФЕКТ ТОРГОВЕЛЬНОЇ ЛІБЕРАЛІЗАЦІЇ В ТУРЕЧЧИНІ

У статті розроблено класифікацію соціальних та економічних ефектів торговельної лібералізації. Досліджено еволюцію вільної торгівлі в Туреччині протягом ключових періодів економічного розвитку (1980—2001 рр.) та розроблено підхід до оцінки ефективності лібералізації торговельної політики. Таким чином, цей підхід може стати основою для майбутніх досліджень, зокрема, по інших країнах.

Ключові слова: лібералізація, розвиток, конкуренція, експорт, торговельний баланс, валютний режим.

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ЭКОНОМИЧЕСКИЙ И СОЦИАЛЬНЫЙ ЭФФЕКТ ТОРГОВОЙ ЛИБЕРАЛИЗАЦИИ В ТУРЦИИ

В статье представлена классификация социальных и экономических эффектов торговой либерализации. Исследована эволюция свободной торговли в Турции в ходе критических циклов экономического развития (1980—2001 гг.) и разработан подход к оценке эффективности либерализации торговой политики. Данный подход, таким образом, может служить основой для будущих исследований, в частности, по другим странам.

Ключевые слова: либерализация, развитие, конкуренция, экспорт, торговый баланс, валютный режим.

Problem statement. Current financial crisis has posed a new set of issues that have to be agreed among all countries. Trade has been one of the economic drivers for centuries thus became the point of controversy in context of global recovery. In order to account for interests of every country the governments should clearly understand the effect of chosen trade policy. While every government strives to protect national export and local market, international trade however requires precise balance. The experience of Turkey vividly shows the consequences of trade liberalization for a developing country. Regarding the fact that trade liberalization in Turkey was conditioned by objective necessity in the early 1980s, its experience may serve as an analogy with modern trade realignment. The impact of liberalization on Turkish economy reflects the role of developing country in global context and emphasizes the importance of developing proper policy, which would account for economic weaknesses and strengths. The period of Turkish economic development under trade liberalization 1980-2001 embraces most of the complications that may occur as a result of economic development imbalances. Taken the growing role of Ukraine in international relations and economic recovery we think it is important to take advantage of international experience in order to ensure sustainable growth in fragile economic environment.

Analysis of publications. Economic and social effects of Turkish trade liberalization has been analyzed by G. Ercel, G. Kaplan, M. Todaro and G. Kopitz. Gazi Ercel discloses Turkish trade liberalization in the context of economic globalization. Therefore, in his works liberalization is stated as an inevitable stage of country's economic evolution with no regard to specific issues associated with free trade. Research by Gonel and Kaplan on the other hand emphasizes the impact of free trade on fostering national competition and technological innovations. Despite the fact that most of their notions have found historical confirmation, their approach has some breaches in terms of international application. The authors emphasize theoretical benefits of free trade rather than address individual economic implications of each country. The work by Kopits, analyst of International Monetary Fund, provides broad analysis of liberalization effects, costs and consequences. The author suggests possible models of trade policy for a country entering free trade. Despite large number of studies by many prominent economists, the issue of trade liberalization in developing countries has no unequivocal approach. Besides, free trade theory based on Turkish experience requires adjustment to modern economic situation.

The main goal of the research is to disclose economic and social issues associated with trade liberalization in developing countries in fragile economic environment. Research is conducted on the basis of trade liberalization in Turkey from 1980 to 2001.

Executive summary. In 1980 Turkish government has enabled new liberalization reform, the main goal of which was to enforce free trade. The reform was conditioned by system imbalances inherent in Turkish finances and production. The reform itself could be divided into 3 major periods, each starting after a certain economic crisis. As in case of many other developing countries liberalization had both positive and negative impact on Turkish economy and social standards. Taking into account the low level of production progress the country has exposed itself to an aggressive foreign competition, which for long time has undermined technological production. Free trade also imposes certain financial risks, which therefore should be addressed by the government prior to liberalization. On the other hand, free trade was a door into global markets for Turkey. It provided new technology, new information, new standards of production and financial operations. The government of the country has managed to mitigate most of the risks associated with foreign pressure and has entered a new century with a relatively effective structure of export and internal consumption.

Historical Preconditions. Economic development of Turkey was in some way similar to that of the most developing countries. Since 1927 to late 70s the country has experienced several coups and was mainly governed by dictators and military groups. As a result, economic development under heavy state regulation was undermined and was subdued for several decades. For many years economy served not as a basis for overall development and growth, but rather to fulfill interests of governing groups. Ideology that was popular at that time implied that the country is self sufficient in its economic growth and can provide all kinds of production and service on its own. This policy was supplemented by strong protectionism and internal nurturing of state industry oligopolies. Later instead of using its competitive advantages in order to establish efficient production the regulations were focused on import substitution, which became the leading trade doctrine for many years. For the country with relatively scarce resources and level of production and service development, policy of import replacement is considered as one of the worst options. This state of affairs was intact until negative tendencies have reached the critical point in 1980. Lack of contemporary trade policy credibility together with inefficient financial policy has resulted in three digit inflation and massive deficit within the country. In addition to emerging crisis Turkey government was forced to change its economic and financial policies in accordance with informal requirement imposed by accelerated globalization [1].

Liberalization Overview. It is necessary to note that economic liberalization in Turkey was divided into three distinguished periods, each marked with a financial or economic crisis. The start of liberalization is associated with reforms in 1980; transition into unregulated liberalization took place during 1989—1993; market economy development based on floating exchange rate and large foreign investments after the 1994 crisis. Each of the periods had specific features which determined the impact on economic mechanisms. In 1980 the government of the country undertook a cardinal change of major economic principles also known as "January 24th Decisions". Most of the changes were made with the guidance of International Monetary Fund and World Trade Organization. A set of general principles aimed at facilitating economic growth in developing countries (also known as "Washington Consensus") was issued later in 1980s. This was the first step of Turkey on the path of integrating into world economy and establishing international trade relations [2].

Although the policy change was significant it. still provided the minimum required set of adjustments, retaining a large portion of government control. The main change of economic course was adoption of export-based growth rather than enforcing import substituting industry. At this point the exchange rate should have been adjusted to an appropriate level in order to provide certain advantages to national exporters and could not be a subject of active government interventions. Despite the main principles underlying the change of economic drivers the exchange rate existed in a mode of regulated float. The change of economic doctrine helped to hamper inflation rate down to 36% in 1983-1987. The main concern of national government at that point was stimulation of national export and informal protection of consumer market from excessive import [7]. A wide range of incentives to national manufacturers was introduced: tax rebates, credit subsidies, and foreign exchange allocated for the import of intermediate products. Meanwhile, following the recommendations of WTO Turkey had to withdraw its protective tariff and non-tariff barriers. Given a relative immaturity of national production and service sectors the excess of import over export was an anticipated result. This has lead to a problem of further export stimulation. Economic liberalization has generated numerous business and investment opportunities. The government expected that money that was under-distributed among citizens would flow as private investments into export-oriented production. However, private investments were channeled into real estate market, which provided a higher return. This process significantly undermined export growth and current account balance despite provided foreign exchange and subsidy advantages. It was noted, that Turkish export existed in 80s mainly due to development of certain industries in previous years. Anyway economy experienced an astonishing growth of 5-6% annually through most of the decade, accompanied by export growth of 10,5% (Fig. 1). The policy of export based economic growth was justified with an ever increasing share of export originated GDP [1].

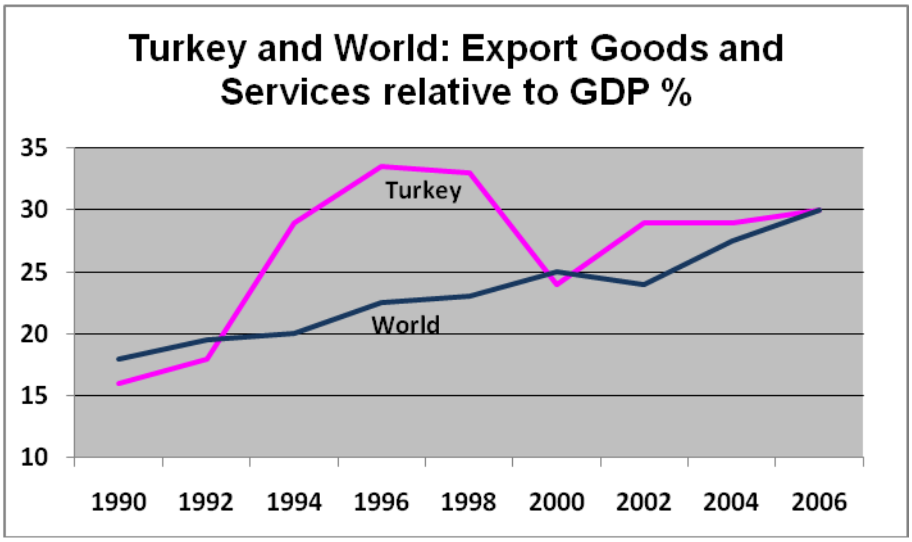

Figure 1. Turkey and World: Export Goods and Services relative to GDP, % [3; 10]

The main economic concern of that period, however, was the growing deficit of current account caused by a significant gap between import and export. This outflow of money as well as gap between public savings and investment was to be covered by government expenses. The first attempt to issue government bonds was made in 1987, when internal reserves turned out insufficient for the purpose of balancing. This was the second step in economic liberalization which was represented by lowering the barriers for capital flow. Capital investments are as crucial for balanced economic development as a steady growth of production and export. Moreover, those factors are often interconnected. In order to allow inflow of foreign investments the government had to undertake a currency regulation reform in 1989, which made Turkish lira a convertible currency [6]. This liberalization has boosted not only investment activity but an increase in international trade, for the currency policy became more transparent. This was the period when Turkey was forced to follow most of the regulations of WTO concerning trade barriers and establishment of free trade with member countries.

High rates of economic growth have attracted foreign investment searching for higher rate of return. However, the abrupt capital inflow carried some significant economic risks. Specialists claim that during the period of 1980-1995 most of the developing countries enjoyed capital inflows of up to 25% of GDP. Turkey, meanwhile, managed to attract an insignificant long-term investment which made 0,5-1% of GDP [9]. The rest of the investments were speculative in nature and were considered as a factor of volatility, rather than business opportunity. Speculative capital demand, also known as "hot money" or "carry trade" represents temporary inflow, allocated in form of most liquid assets (often stocks) of high income businesses. These investments flee the market as soon as the downturn starts. It is hard to limit such an inflow and often hard to predict when the "hot money" exits. This process was occurring in Turkey in the end of 80s. Investors attracted by a relatively high rate of return among many developing countries (15-17%) started withdrawing their investments as soon as inflation stabilized at 22%, despite the fact that average interest rate at that moment was 36%. Investment escape was conducted through a sale of national currency, thus imposing a tremendous pressure on lira. The process was exacerbated by the fact that the exchange rate was kept on a stable level for quite a long time, mainly due to Central Bank interventions [5]. While in any other case this situation would naturally lower the interest rate and exchange rate, which is supposedly favorable for exporters, thoughtless financial policy and fiscal misbalances have created the basis for the next crisis. The currency turmoil of 1994 has conditioned the last critical changes in Turkish economic and trade regulations. The most important change was transition to free floating currency regulation, the mechanisms which besides all the economic merits would enable a more balanced and self-regulating trade. The peak of trade liberalization in Turkey was its entrance to European Customs Union, which implied free trade within it. Taken that the main countries Turkey exports its production to are Germany (11.2%), UK (8%), Italy (6.95%), France (5.6%), Spain

(4.3%) this was a breakthrough in trade relations. In such conditions the share of export in Turkey GDP reached 22,8% in 2006 from 4,2% in 1980 [2].

Liberalization Effects Analysis. Due to its favorable geographic position Turkey has always been considered an infrastructure of trade between Europe and Asia along with Ukraine and Russia. The opportunity to obtain numerous trading partners was mainly for Turkey's benefit. Liberalization has brought many positive aspects to economic development of the country, which by general opinion would be inevitable anyway. In order to properly evaluate the effect of liberalization on social and economic life of the country it is necessary to distinguish positive and negative aspects as well as internal and external influences.

Open economy, especially open trade is advertised by many politicians around the world. Free trade is stipulated in many international relations treaties as a mandatory condition. Despite its popularity and seemingly obvious positive sides different countries have different reaction to liberalization, as well as exposed to different degree of risk. Turkey was considered a developing country at the beginning of its liberalized economic path. Therefore, most of economic and production achievements it had in the beginning of 1980s were the ones developed within the country in favorable conditions created by government. Free trade implies that Turkey does not have a separate market; instead it becomes a country-entity on the global market with its competition, rules, and its innovations on the other hand. Absence of formal and informal barriers means that any manufacturer from another country will be able to enter the market and provide its product at a price, created on its territory. This creates a healthy competition among local businesses, which have gotten used to low market pressure and government support. The anticipated result is an increase in quality of local business production and its international competitiveness [8]. This mechanism is called to filter out weak and inefficient companies and retain the strongest. This notion does not confront the common sense, but has its limitations. When the country opens its market for other countries it should be sure that it enters a fair competition. However, most of the developing countries, which are required to withdraw barriers by developed countries, are often not competitive in many fields. Therefore, the import of high quality, technologically based production floods the national market, causing imbalances in current account balance, exchange rate and what is the most important often resulting in decline of local production. This poses a dilemma before the government of the opening country. In order to access international market the country has to open its own market, but obviously at expense of its own economic development. There are countries (such as China) which rely in their development mostly on export, while their internal consumption is very low. These countries are in some way protected from a negative impact of international import inflow. Turkey is not the case. Most of its industries are technologically underdeveloped and incapable of generating high added value. In this case the government should determine the fields which have competitive advantages for the country [11]. These fields should be subjects to some degree of government support, until they become more competitive and would be able to maintain the growth without government stimulation. When the industry chosen for government support turns out to be the same as the main exporting industry of main trading partner, the clash occurs. Therefore, it is necessary to either stipulate certain conditions for local business or evaluate feasibility of entering free trade unions. In case of Turkey the negative effect was not dramatic, although it significantly increased the account deficit.

Another positive effect of trade liberalization for Turkey was switch of focus onto country's competitive advantages rather than conducting ineffective policy of import substitution. The country is predisposed to certain types of business based on historical, national, cultural, demographic and other determinants. The whole international trade is based on the principles of relative competitive advantages, meaning that each country produces goods and services which imply lower production costs, higher quality, larger volumes, less labour spent etc. Historically Turkey was competitive at textile production and mining of certain resources. While in modern environment these industries are not considered extraordinary drivers of economic growth, this state of affairs precisely resembles the structure of Turkish export in 1996, the first year of trade within Customs Union (Fig. 2). The government of Turkey has made many attempts to make a shift from low-skilled and non-technological production to such production as machinery and electronics. This tendency may be noticed on the diagram, however given that equipment and fruits represent equal shares of export there is a long way to go until the structure will become more progressive. Present export structure does not allow deepening of financial and economic system keeping production mainly flat with only 2-3 stages before the sale. The added value is also low which limits the overall state tax income. On the other hand Turkey as a rapidly developing country requires new technology and equipment in order to keep up with international production rates. Therefore, its import structure is mainly represented by machinery, equipment, electronics, basically something that the country is not competitive in (Fig. 3). The main risk of open economic environment in this case is strong competition of German, UK and US manufacturers. The government should introduce stimulus packages for certain emerging industries (e.g. electronics, IT and machinery), which is going to be problematic both in terms of international discontent of trade discrimination and government debt and budget deficit. Thus being open for free trade, Turkey has automatically limited opportunities in some businesses that are essential for sustainable economic growth.

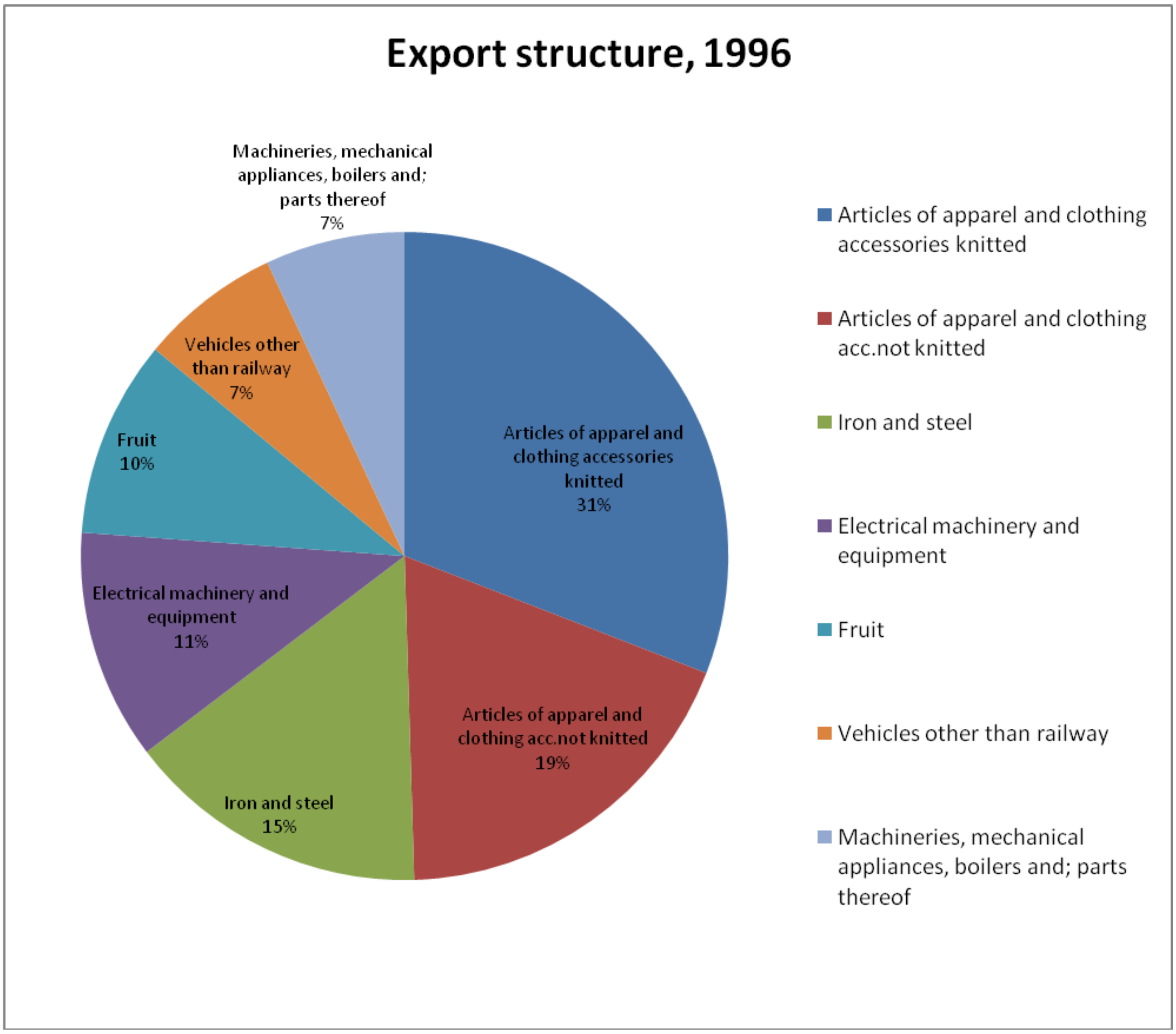

Figure 2. Export structure, 1996 [10]

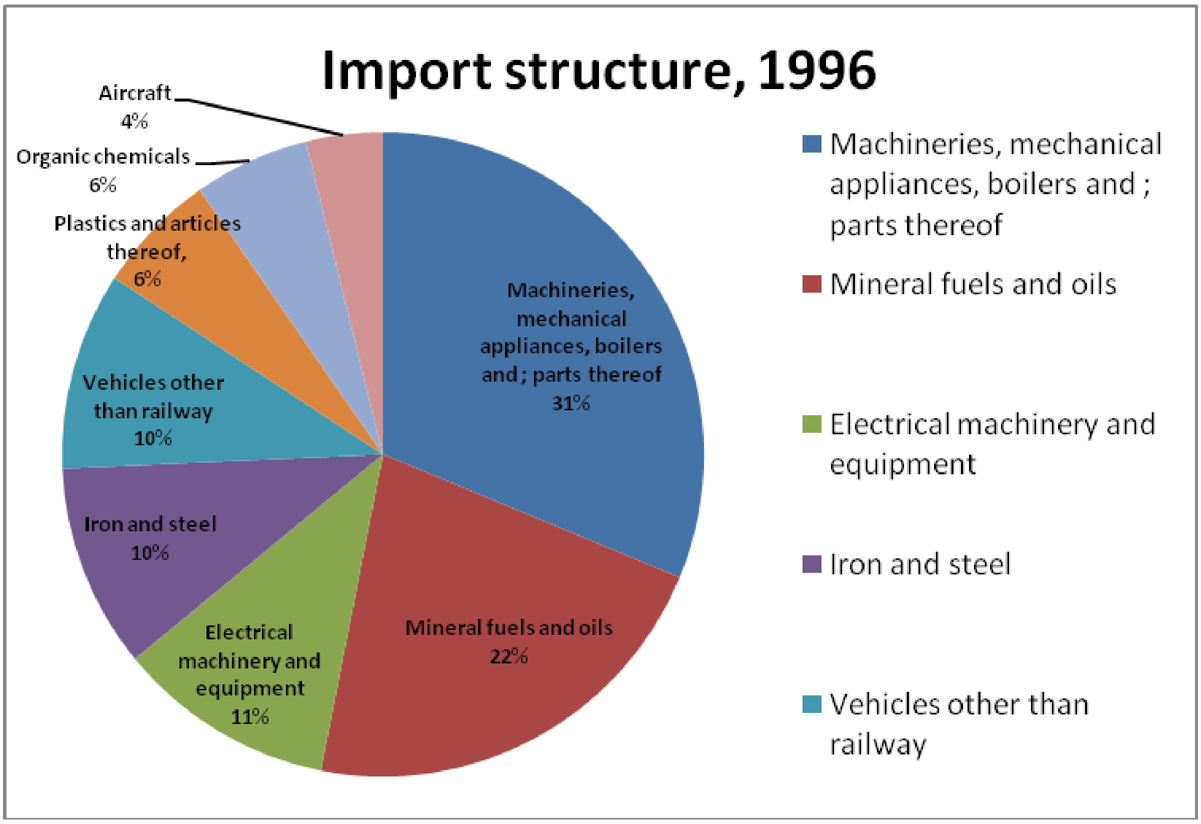

Figure 3. Import structure, 1996 [10]

International trade is not only represented by a simple sales transactions and over-the-border movement of goods. It is indirectly represented by Foreign Direct Investments (FDI). FDI flows with intention to take advantage of local consumer market, local production capacities or higher rate of return. Many multinational companies bypass some of the national trade barriers by creating their subsidiary company on the territory of the country or invest in already existing local companies in order to bring their production quality to a sufficient level [10]. While this process is also associated with the competition that erodes local production it may have some positive consequences: increase in competition, employment, average salary and production standards. Moreover, foreign, investors are able to allocate financial resources into the most profitable and prospective companies, thus naturally enforcing national competitive advantages. Foreign investments, as it has been noted before, have some risks associated with speculative intentions. Therefore, this capital may be as destructive as it is useful under certain circumstances. The government should elaborate specific regulations, which would restrict the inflow of capital with deliberate speculative intentions. Turkey has suffered severely from escape of "hot money", but during this financial crisis (2007-2009) it has introduced certain measures to restrict carry trade (limited investment instruments, minimum investment term with no taxation etc.) [12]. While it is thought that increase in foreign trade activity induces foreign investments, the results of some studies indicate lack of direct relation. There is a theory which states that foreign investments are generated together with trade increase, however are caused by other factors, such as interest rates, exchange rate, tax rate and internal market activity. This notion is a subject for further investigation.

Spillover effect has been considered one of the drivers of economic and production progress. Foreign companies which export their goods to Turkey automatically provide significant knowledge to local businesses. It does not mean that technologies and innovations can be simply copied; instead, such a spillover effect serves as an incentive to keep up with international technological level. Moreover, international trade provides an access to technology and given absence of additional tariffs makes the purchase more accessible. The spillover effect is closely associated with the level of life issues. Many products unavailable on local market prior to 1995 or simply replaced under import substitution policy became available for general public. At present moment Turkey has achieved significant progress in its production and service fields, which puts it in a more competitive position compared to its foreign counterparties. Some of the basic services are provided from within and even exported to other developing countries. Anyway goods produced using the latest technology and the most recent electronic and IT products are acquired from abroad.

Diversification of economic risks may be one of the fundamental principles of foreign trade since the mercantilist doctrine was established. The role of trade has changed with prevalence of certain economic theories; anyway it has always been one of the main drivers of economic growth. There are several reasons for that. One of them is that local markets may be small in volumes of certain production. Companies often search for the most suitable markets for their products, both in terms of price and absolute consumption. Being a part of global trade provides more links with different countries. Turkey had 137 trading partners in 1980s and raised this number to 240 in 2007. As a result, Turkish export is less exposed to crises in particular country or region [7]. Modern economic crisis has shown that in environment of weak domestic demand, external markets may be the remedy from a deep recession. As many countries now fight for their export and protect their local markets this relation has become more obvious. Thus the countries, which have locked themselves from global market with trade barriers and protectionism policies, have only a limited number of trading partners. Most of such countries have encountered a significant decline in demand for their main export-oriented production. Lack of trade diversification has strongly exacerbated economic problems of many developing countries during the crisis of 2007-2009.

Trade liberalization has a two-side effect on financial system of the country. While some studies claim that economic growth is caused by development of financial sector, the opposite relation has also been detected [8]. International trade facilitates improvement and sophistication of a financial system. This process is especially noticeable in capital trade or FDI movement. The country strives to develop a system which would comply with international standards.

Conclusion. Liberalization of trade relations has many implications depending on many factors of country's development. Modern globalization gives no other option for developing countries than to join the process of integration. The reward on one hand is quite generous for liberalized country gets access to new markets, diversifies its economic growth and generates effective competition on its territory. However, those opportunities are going to be realized only if the country has capacities to take advantage of them and is prepared to open its borders to foreign investment and products. Specialists claim that a country should nurture chosen industries before introducing the strong competition environment. While companies from certain industries would be able to withstand foreign competition, and therefore grow and scale up to international level, other companies will be eliminated. Taken into account that bankruptcies of companies are followed by unemployment, we may come to conclusion that free trade may indirectly lead to social and economic problems within the country. In this context it is necessary to assess the benefits and risks of liberalization and create a set of preliminary measures to mitigate its negative impact. It has been noted that openness of national economy imposes certain distortion on national financial system. Hence it is necessary to adopt new standards of financial regulation (currency, current account balance, interest rates, monetary emission, government debt etc.) as well. The future researches should address trade liberalization issues in respect to modern economic recovery and growing competition at international markets.

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