SEEKING STABILITY IN THE TURKISH ECONOMY DURING THE SPRING OF 1999

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Our topic today is "Seeking stability in the Turkish Economy During the Spring of 1999." I have been in search of this stability during the entire three years of my tenure as Governor of the Central Bank. Indeed, we are still looking for stability. But I would just like to elaborate a bit on the answer to the question "When and where are we looking for stability?" The title of today's topic brought four questions to my mind. The first is, "Are we seeking to stabilize the economy, or are we just trying to pursue the policies needed to bring inflation down?" The second question is, "Are we seeking to achieve stability in an environment of high inflation, or do we really want to have stability in a low inflation environment that will put us in a much more satisfactory situation." The third question that came to mind is "Where are we searching for stability? Are we seeking stability in the economy or in politics?" And the fourth question is, "Does stability alone mean much? What other objectives might be associated with the pursuit of stability in the future? Will we really derive much benefit by attaining stability alone?"

Obviously, what I mean by stability is economic stability. I do not understand it as identical with stabilization policy. I think it is a mistake to discuss the issues connected with inflation in terms of whether they belong to a stabilization program or a disinflation program. As you know, when we use the word stability to denote the most important objective of a stabilization program, we are speaking of preserving the external equilibrium. But although stabilization programs are directed at preserving or restoring external equilibrium, I believe that what we in Turkey are searching for is a kind of stability that will bring inflation down to single digits. This is a disinflation policy.

As to the second question, it is my opinion that we should seek to achieve stability in an environment of lower inflation. Bringing inflation down to its lowest possible levels is a prerequisite for attaining stability. Within the limitations of Turkey's realities, we have found a degree of stability in wholesale price indices in the ranges of 40, 50 or 60 percent. In addition, we have managed to steer the economy skillfully to the threshold of the elections, even though their date has been known for ten months and a wide range of expectations were in place. We do not, of course, wish to have stability with high inflation. And we all know very well that for Turkey, economic stability and political stability go hand in hand.

Finally, the best answer to the question of "What other objectives combine with stability to make it worthwhile?" can be found in the "Stability and Growth Pact" signed by countries of the European Union last year. The first aim of the Pact is to hold inflation at the lowest possible level, and then to pursue growth and employment in the medium- and long-term. In this, central banks have an important role to play. Indeed, the first target of the European Central Bank is to achieve price stability, and then to tackle unemployment and promote growth in the medium- and long-term. So, stability does make sense, but only to the extent that it serves the goals of ensuring growth, restoring the balance of payments, and reducing unemployment.

I would like to share something with you that I read recently, which I found very interesting. At a conference held at the National Liberal Club in London in December 1923, John Maynard Keynes identified "three evils of the economy." The first is poor income distribution. The second is volatility of expectations. And the third is high unemployment. When all three factors come together, the economy will end up in a state of disappointment, and stability will vanish.

Now, let's look at these three conditions as they apply to the Turkish economy. Of course 75 years have passed since Keynes identified them, but as economists we have all read his works and are familiar with his views. He was a good intellectual, economist, and economic policymaker. I have been looking into some of his works to see how well they apply to our day and have found some remarkable points. The criterion of poor income distribution seems to be valid for Turkey. We all know that in Turkey income is unevenly distributed. There have been some efforts to improve or reverse the worsening trend of the Lorenz curve, but they have not wholly succeeded. In the spring of 1999, Turkey's income distribution has to be judged as still very unequal, although its worsening trend has ended.

The second condition is high unemployment. With a real unemployment rate of around 6 percent, Turkey cannot be said to have a high unemployment rate. The OECD made the same point in its annual report some four or five years ago. Turkey's real unemployment rate is not that high. It has even fallen to 5.6 percent according to figures compiled by the State Institute of Statistics. As the OECD has noted, however, Turkey's problem is in the area of productivity. Even though Turkey's jobless rate is low, we have some problems with labor productivity, partially in the public sector.

The third evil Keynes identified is volatility of expectations, which is abundant in Turkey. To summarize, the Turkish economy can be characterized as one where uncertainty is at a maximum, income is poorly distributed, and the unemployment rate is kept low. If the unemployment rate rises or income distribution gets worse, we are certain to enter the Devil's triangle. This is why we must primarily pursue policies that will bring inflation down, which will reduce uncertainty; secure political stability; and establish a stable environment of subdued inflation. Other conditions to be "stabilized" are the reinforced balance of payments position, low unemployment, and increased labor productivity.

When all these conditions are added together we may think we are seeking a utopian or perfectionist stability. But a look at the world in general reveals plenty of countries, states, and economies that have already secured just this kind of stability.

Now let me briefly review the latest developments worldwide, before surveying the Turkish economy in April 1999. The following is based on the most recent analyses of the IMF, which keeps close track of the world economy.

The United States is presently the leading power of the world economy. GNP is growing at an unexpected rate. According to Larry Summers, Undersecretary of the U.S. Treasury, "The airplane should take off with three engines and we are just one of them. The other two engines, Europe and Japan, must absolutely accompany and help us." Unfortunately, however, there are little positive expectations for growth in Europe. We are all aware of the problems in Japan.

In the emerging market economies, the problems caused by the Asian crisis seem to have been brought under control for now. But they could reappear at any time. In addition, there is a bitter warning in the desperate situation of some poor countries in Asia and Africa. Almost nobody cares for them.

To summarize, we are living at a time when the United States is the engine dragging the world economy behind it, while Japan and Europe are having difficulty helping the airplane fly. A statistical survey shows that a general world growth rate of 2 percent is expected for 1999. This clearly represents a worldwide decrease in output, which was 2.7 percent in 1998 and 3.2 percent in 1997.   The United States takes the lead with a growth rate of 3 percent and gets the airplane moving. Europe grew by 2,8 percent in real terms last year, and it is estimated that the figure will be around 1.9 percent this year. Japan's growth rate is negative at -1.1 percent.

It would be reasonable to expect Turkey to face difficulties in such a worldwide environment, and last year was extremely hard. Nonetheless, Turkey saw its inflation move downward and its balance of payments position and primary surplus improve. This was partly achieved by because our monetary and exchange rate policies supported these outcomes.

However, we have not been able to find a way of reducing the massive uncertainties. As a matter of fact, the uncertainties gradually intensified after the Russian crisis. Then came the Brazilian crisis. And just when we seemed to see a little improvement, the fighting in Kosovo got in the way. In the end, we began the year 1999 in an adverse external economic environment accompanied by various regional conflicts.

Looking at Turkey's economy overall, we see four strengths and three weaknesses. Turkey's strengths are the well-established fundamentals, smooth balance of payments, and high growth prospects. Turkey's average annual growth rate over the last 25 years is 4.7 percent. By this measure Turkey's growth prospects are among the brightest in the world. Turkey's fourth strong point is the well functioning infrastructure underlying its market economy. On the other hand are Turkey's three weaknesses: its budget deficit, its inflation, and its political instability. A look at this table also shows the things that must be accomplished and the solutions that must be found. To generalize, we must further reinforce our strengths and make a concerted effort to find solutions for correcting our weaknesses. The targets we have set to move in this direction are to contain the budget deficit, curb inflation, and achieve political stability. We hope stability will emerge from the elections to be held this weekend. And we expect that a stable government will be formed to address these problems in a timely manner.

By following this scenario we will be able to solve the inflation problem, which is our economy's greatest encumbrance. In addition, there is a host of other accumulated tasks and problems, which we will also begin working on. These include improving the banking act and reforming the social security system and agricultural policies, which are preconditions for the success of Turkey's disinflation process. Once these have been accomplished, the time will be ripe to take on legal reforms, structural changes enabling Parliament to work faster, an overhaul of the medical system, and improving the quality of education. We must also continue reinforcing our infrastructure, improving our balance of payments position, putting the economy on the growth track, and improving the functioning of the market economy by means of extra arrangements and fine-tuning.

At this point, I would like to refer to two recent studies from abroad concerning Turkey's outlook. The first is a report dated April 9, 1999 prepared by the Deutsche Bank. The second is a report by Morgan Stanley report dated April 6, 1999. The Deutsche Bank says, "Turkey has two issues, which are political instability and domestic debt." And Morgan Stanley, having come to the same conclusion, says, "The downward trend in inflation must continue for a certain time. The budget deficit may increase a little bit in 1999, but the turning point will be the general elections to be held on April 18, 1999. Foreign financial institutions now continuously draw up these reports. They do this because until recently they made evaluations by compiling information from several sources but missed some important issues. They were the ones who suffered most from the recent crises in Asia, Russia, and Brazil. They were the ones who lost money. So for the last two years, they have been paying much more attention to ongoing developments by continually preparing detailed country reports and regional reports. They hired persons capable of making country analysis. And it is interesting to see that their evaluations on the outlook of Turkey in this spring of 1999 echo my thoughts as I have outlined them above.

Thank you for listening.