The Pakistan Development Review
28 : 4 Part II (Winter 1989) pp. 949–960

The Liberalization of International Trade in Turkey during the 1980s

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1. INTRODUCTION

In 1979, Turkey was forced to reschedule its debts to western governments and foreign commercial banks. A precondition for rescheduling was the acceptance of the IMFs structural adjustment programme implemented in January 24, 1980. The immediate goals of the programme were the reduction of inflation and the balance of payments deficit. The programme also aimed at changing radically Turkey's development strategy by an increased reliance on market forces.

The most important steps taken towards increased reliance on market forces concerned exchange rate management and trade policy. The traditional policy of fixed exchange rates was replaced by periodic small adjustments. These assumed a daily pattern in July, 1981. As a result, the real exchange rate depreciated with a consequent increase in export competitiveness. Furthermore, the system of multiple exchange rates was phased out by mid-1981. More significantly, in 1984 the government undertook a sweeping liberalization of foreign trade by dismantling all import quotas and import bans.

The purpose of this paper is to investigate to what extent the recent trade reforms have resulted in a more open economy and in what way they have affected the structure of nominal and effective protection. The following section examines the reforms in the import regime of Turkey. Section 3 discusses the characteristics of the inter-industry distribution of protection and the final section provides some policy recommendations.

2. REFORMS IN THE IMPORT REGIME

Since the 1950s successive Turkish governments employed a varying mix of trade restricting measures such as tariffs, tariff-like taxes and surcharges, import quotas, import bans, advanced deposit requirements and foreign exchange controls either to protect domestic industries or to respond to internal and external shocks. These measures are briefly explained below.

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Until 1981 all imports into Turkey were regulated by annual or semi-annual import programmes. These programmes itemized commodities under the free import list (Liberalization List I), the restricted list (Liberalization List II), the quota list, the EEC consolidated list and a list enumerating the commodities to be imported under bilateral clearing arrangements. Importation of goods not enumerated in any of the lists was prohibited. Imports were subject to tariffs and tariff-like charges. The latter consisted of the municipality tax, stamp duty, wharf tax and production tax.

The quota list specified the dollar value of imports and thus implied a binding quantitative restriction on imports. It was partly phased out in 1981. That year a large number of commodities was also transferred from Liberalization List II to Liberalization List I. A major reform was introduced in January 1984 when all imports were classified into three lists. For the first time in Turkish history an explicit Prohibited List was prepared and commodities that could not be imported under any circumstances, arms and ammunitions and certain drugs being typical examples, were specified in this list. A second list, Imports Subject to Permission, specified the items that could be imported with prior official permission.[1] A third list, the Liberalized List, enumerated the commodities that could be freely imported.

At the same time as the classification of all imports into three lists the government replaced the Production Tax, which applied to the domestic production and import of certain commodities, with the Value-Added Tax (VAT) which applied to all imports. Moreover, it revised the import tariffs and the stamp duty and imposed a new surcharge, the Housing Fund Tax, on some imports to finance the Housing Fund set up to aid housing construction for the poor and middle-income families. However, within a couple of years following its imposition, the number of commodities subject to the Housing Fund Tax expanded considerably and this tax became a significant source of revenue for the budget and provided domestic industries with considerable protection.

These adjustments were followed by the imposition of two additional surcharges on imports under the titles of Support and Price Stabilization Fund Tax and Resource Utilization Support Fund Tax in 1986 and across-the-board revision of the import duty and Housing Fund Tax rates in 1988. Table 1 summarises the various surcharges which apply to imports and gives their rates in 1984 and 1989.

3. TARIFF REVISIONS AND THE STRUCTURE OF PROTECTION

Table 2 presents the estimates of the sectoral nominal and effective protection

[1]However, unlike the former quota lists there are no quantity or value restrictions on the imports from this list.

Table 1

Rates of Various Taxes and Funds on Imports

	1984	1989
Taxes		
1. Customs Duty[1]	Commodity Spec.	Commodity Spec.
2. Municipality Tax	15%	15%
3. Stamp Duty	4%	10%
4. Wharf Tax (Sea)	5%	4%
5. Wharf Tax (Land)	N.A.	3%
6. Production Tax[2]	Commodity Spec.	N.A.
7. Value Added Tax[3]	N.A.	Commodity Spec.
Funds		
1. Housing Fund[1]	Commodity Spec.	Commodity Spec.
2. Support and Price Stabilization Fund[4]	N.A.	10%
3. Resource Utilization Support Fund[4]		
Miscellaneous		
1. Guarantee Deposit Rate	15%	7%
2. Domestic Interest Rate[5]	45%	70%
3. Foreign Interest Rate[6]	10.4%	5%
4. Rate of Devaluation of the Exchange Rate[5]	62.05%	41.4%

Notes: N.A. = Not Applicable.

[1]See "Istatistik Pozisyonlarina Bölünmüs Gümrük Giris Tarife Cetveli", Basbakanlik Devlet Istatistik Enstitüsü, Ankara, 1983, Official Gazette No: 18286, January 19, 1984 for the year 1984; "Dis Ticaret ve Yatirim Mevzuati 1989", Ihracati Gelistirme Etud Merkezi, Ankara, November, 1989 and "Istatistik Pozisyonlarina Bolünmüs Gümrük Tarife Cetveli", Basbakanlik Devlet Istatistik Enstitüsü, Ankara, 1989 for the year 1989.

[2]See Yücel A. Esentürkoğlu and Yasar Apak, "Bütün Değisiklikleri ile Gider Vergileri Kanunu ve ilgili Hükümler ile Gümrük Giris Tarife Cetveline Intibaki", Baha Matbaasi, Istanbul, 1966.

[3]See Official Gazette No. 12469, December 30, 1987.

[4]See Official Gazette No. 19959, October 14, 1988.

[5]See "Turkey Main Economic Indicators", State Planning Organization, Ankara, Various Issues.

[6]Foreign interest rate refers to short-term interest rates in USA as reported in the "World Economic Outlook", International Monetary Fund, Washington D. C., 1989.

Table 2

Sectoral Nominal and Effective Protection Rates (Percent)

1–0 Table Sector Code	Industry	1984		1989	
		NPR	EPR	NPR	EPR
1.	Agriculture	36.12	35.88	28.93	31.08
2.	Animal Husbandry	25.90	18.41	20.93	14.37
3.	Forestry	41.11	50.44	59.28	62.57
4.	Fishery	45.03	43.53	126.20	143.22
5.	Coal Mining	85.38	93.06	23.71	27.94
6.	Crude Petroleum	29.49	45.17	24.15	45.11
7.	Iron Ore Mining	20.27	12.62	36.91	40.65
8.	Other Metallic Ore Mining	20.10	16.29	41.79	52.13
9.	Non-metallic Mining	107.07	120.95	57.34	66.51
10.	Stone Quarrying	27.59	22.36	14.59	16.38
11.	Slaughtering and Meat Preservation	78.68	48767.56	43.63	96.37
12.	Fruit and Vegetable Canning	145.54	2325.88	42.39	72.54
13.	Vegetable and Animal Oils and Fats	61.29	105.17	140.06	506.89
14.	Grain Mill Products	51.16	142.16	97.08	−323.86
15.	Sugar Refining	144.43	−611.72	73.76	218.12
16.	Other Food Processing	131.73	1804.39	80.62	194.74
17.	Alcoholic Beverages	95.02	−1890.56	188.78	363.91
18.	Non Alcoholic Beverages	68.35	60.97	93.46	189.47
19.	Processed Tobacco and Products	378.68	−124.65	71.81	101.24
20.	Ginning	9.67	−28.21	10.43	−3.82
21.	Textiles	104.44	212.85	37.48	67.50
22.	Clothing	160.46	188.83	68.18	158.36
23.	Leather and Fur Products	157.05	345.56	38.11	50.97
24.	Footwear	161.75	195.56	54.99	73.97
25.	Wood and Cork Products	88.67	136.85	54.65	65.09

Continued –

Table 2 – (*Continued*)

26.	Wood Furniture and Fixtures	133.85	197.61	74.65	113.72
27.	Paper and Paper Products	63.97	92.31	45.56	93.07
28.	Printing and Publishing	26.83	6.25	25.84	24.70
29.	Fertilizers	35.48	18.43	23.54	21.70
30.	Pharmaceutical Products	30.47	18.12	42.61	49.64
31.	Other Chemical Products	45.17	46.49	37.63	48.08
32.	Petroleum Refinery	62.88	101.76	30.52	50.01
33.	Petroleum and Coal Products	69.85	81.39	24.66	30.81
34.	Rubber Products	61.70	59.94	32.94	36.90
35.	Plastic Products	256.34	–2170.04	69.53	159.30
36.	Glass and Glass Products	74.29	105.36	73.30	99.96
37.	Cement	5.87	0.92	27.55	54.00
38.	Other Non-metallic Mineral Products	58.75	78.83	49.75	83.82
39.	Iron and Steel	42.48	46.14	17.26	31.93
40.	Non-ferrous Metals	53.43	71.99	33.72	62.17
41.	Fabricated Metal Products	86.87	125.96	64.80	202.34
42.	Non Electrical Machinery	57.06	54.42	53.15	80.36
43.	Agricultural Machinery	60.43	67.04	59.04	129.36
44.	Electrical Machinery	58.96	62.59	47.51	62.00
45.	Ship-building and Repairing	66.79	68.56	90.45	125.67
46.	Railroad Equipment	23.64	15.63	42.71	55.14
47.	Motor Vehicles	70.70	94.89	60.17	99.79
48.	Other Transport Equipment	19.01	11.55	8.32	15.64
49.	Other Manufacturing Industries	125.71	193.15	47.50	58.63
Weighted Average(*)		70.19	78.78	41.16	53.80
Standard Deviation		65.39	409.69	33.62	109.99

Source: Own Calculations.

(*)In the calculation of the weighted average EPR the sectors, which have an absolute value of EPR above 4000 have been eliminated. These are the sectors 11, 12, 22 and 35.

rates for 1984 and 1989.[2] The calculations indicate that the 1989 revisions have reduced the overall protection in the economy. Even though the stamp duty and Support and Stabilization Fund Tax were both raised to 10 percent in 1989, downward revisions in the customs duty were so large that the economy-wide average NPR went down from 70 percent in 1984 to 41 percent in 1989. Concomitantly the economy-wide average EPR declined from 79 percent to 54 percent.[3] Obviously these changes are in conformity with the declared intentions of the government to reduce the level of protection in the economy.

It is observed that the revisions have affected all of the 49 tradable sectors considered. However, neither the direction nor the extent of the effects of the revisions were uniform across the industries. For instance, while 13 industries ended up enjoying a higher level of nominal protection, 36 industries ended up with a lower level of nominal protection. Simultaneously, the number of sectors which had an NPR higher than 50 percent declined from 32 to 21, and the number of sectors with an NPR between 20.01 and 50 percent increased from 14 to 24. These changes would suggest a decrease in the coefficient of variation of the inter-industry distribution of the NPR. Indeed, the ratio of the standard deviation of the NPR to its mean declined from 0.93 in 1984 to 0.81 in 1989.

The effects of the revisions on the inter-industry distribution of the EPR, however, have been slightly different. The number of sectors with an EPR between 20.01 and 50 percent went up from 6 in 1984 to 11 in 1989. However, the number of sectors with an EPR higher than 50 percent has also gone up, from 29 in 1984 to 33 in 1989. Nevertheless, the economy-wide average EPR has declined from 79 percent to 54 percent. Moreover, the coefficient of variation of the inter-industry distribution of the EPR declined from 5.20 in 1984 to 2.04 in 1989. This also represents a change in the desired direction given that, as shown by Bertrand (1972), for the maximization of the consumption possibilities the EPR needs to be equalized across the industries.

Another noteworthy consequence of the revisions has been to reduce the number of negative value-added industries from 4 in 1984 to 1 in 1989. This, except for the case of alcoholic beverages, is largely due to the sharp fall in the extent of nominal protection enjoyed by these industries. Thus, sugar refining, processed tobacco products and plastic products which had negative value added at border prices experienced sharp declines in their NPR. The NPR of these industries were

[2] For a more detailed explanation and formulas used in the calculations [See Olgun and Togan (1990)].

[3] The average rates of nominal protection were derived by weighting nominal rates estimated for the sectors by sectoral outputs valued at world prices. The average rates of effective protection were obtained by weighting effective rates estimated for the sectors by sectoral value-added evaluated at world prices.

respectively reduced from 144, 379 and 256 percent in 1984 to 74.72 and 70 percent in 1989.

Another case which illustrates the effects of a change in the NPR on the sign of the value added of an industry measured at international prices is that of grain mill products. This industry was enjoying an NPR of 51 percent and an EPR of 142 percent in 1984, but when its NPR was raised to 97 percent in 1989 its value added measured at border prices became negative and its EPR rose to – 324 percent.

Given the level and structure of the protection rates presented in Table 2, the ginning industry was and is the only one among the 49 tradable sectors considered to possess a clear-cut absolute advantages. Thus, both in 1984 and 1989 this industry had, at the then prevailing official exchange rates, lower value added than that of the foreign ginning industries.

As noted above, the industries were not given equal treatment with tariff revisions. The impression of the present authors with government economists is that the decision-makers were guided by different motives in designing the new structure of protection. The few examples provided below are only intended to illustrate this point.

Till the early Eighties the import of cigarettes into Turkey was prohibited and, hence, cigarette smuggling was widespread. In 1983 the Monopoly Administration was appointed as the sole importer of cigarettes. Since then customs duty on tobacco products have been successively reduced to enable the Monopoly Administration to compete with the smuggled cigarettes on the domestic market. Hence, the observed decline in the NPR on processed tobacco and products from 378 percent in 1984 to 72 percent in 1989 largely reflects this strategy.

In contrast, the sharp increase in the rate of nominal protection on alcoholic beverages from 95 percent in 1984 to 188 percent in 1989 reflects both the desire to raise revenue and impose higher tariffs on luxuries compared to other products. This tendency to raise tariffs on luxuries is also evident in the case of fisheries whose NPR went up from 45 percent in 1984 to 126 percent in 1989.

Another case for which more or less definite explanation can be provided is that of cement. The estimated NPR of 5.9 percent on cement in 1984 reflects the protective effects of the surcharges because that year the customs duty on cement was reduced to zero. The evidence is that both private and public producers have, since then, pressured the government for higher protection. Thus, even though high transportation costs would tend to turn this product into a non-traded good, the NPR on cement was finally raised to 27.5 percent in 1989.

Tables 3 and 4 respectively present the nominal and effective protection rates for broad industry groups. In the former table industries have been classified into ten industry groups and in the latter into four trade categories: export, export-and-import-competing, import-competing, and non-import-competing.[4]

Table 3

Nominal and Effective Protection Rates by Major Commodity Groups (Percent)

	1984		1989	
	NPR	EPR	NPR	EPR
I. Primary Activities[1]	33.14	31.97	28.73	29.66
II. Mining and Energy[2]	60.10	68.37	25.56	32.63
III. Manufacturing	85.40	126.67	46.78	80.17
1. Consumer Goods	133.98	285.83	65.30	147.44
Processed Food[3]	102.99	1323.62	75.22	390.32
Beverages and Tobacco[4]	321.84	–314.59	89.30	13 294
Non-durable and Durable Consumer Goods[5]	122.90	173.67	48.37	60.30
2. Intermediate Goods[6]	59.21	72.46	32.39	47.32
3. Investment Goods	68.00	77.50	56.71	101.31
Machinery[7]	68.51	75.23	55.82	103.81
Transport Equipment[8]	66.57	83.44	59.19	94.77
4. Other Man. Industries[9]	125.76	109.57	47.50	33.26

Source: Own calculations.

[1]Includes sectors No. 1–4.
[2]Includes sectors No. 5–10.
[3]Includes sectors No. 11–16.
[4]Includes sectors No. 17–19.
[5]Includes sectors No. 21, 22, 24 and 26.
[6]Includes sectors No. 20, 23, 25 and 27–40.
[7]Includes sectors No. 41–44.
[8]Includes sectors No. 45–48.
[9]Consists of sector No. 49.

[4]The classification of sectors into four trade groups follows the same rule adopted in Balassa *et al.* (1982). The export category includes sectors whose exports amount to more than 10 percent of domestic production with imports accounting for less than 10 percent of domestic supply. For sectors that are classified as export and import competing both of these shares exceed 10 percent. The import-competing and non-import-competing categories include sectors whose exports amount to less than 10 percent of domestic production, with imports exceeding in the former, and falling short of 10 percent of domestic production in the latter category.

Calculations in Table 3 reveal a well-known characteristic of the structure of protection. There is a marked tendency for protection to escalate from lower to higher stages of fabrication. In general, protection rates are lowest on primary activities, followed by mining and energy and highest on manufacturing. For instance, in 1989 the NPR (EPR) was 29 (30) percent on primary activities, 26 (33) percent on mining and energy and 47 (80) percent on manufacturing. Such an escalation is also evident among the sub-sectors of manufacturing within which the lowest rates apply to intermediate goods and the higher rates apply to investment goods. Secondly, Table 3 indicates that differential treatment has also been present among the broad industry groups and among sub-sectors of manufacturing.

Although one would, in general, expect export industries to be less protected than import competing industries, this expectation is not borne out by the calculations presented in Table 4. It is seen that both in 1984 and 1989 export industries were more heavily protected than import-competing and non-import-competing industries. An obvious implication of this finding is that Turkey's recent success in expanding its exports has been achieved under protection.

Table 4

Nominal and Effective Protection Rates by Trade Category (Percent)

	1984		1989	
	NPR	EPR	NPR	EPR
I. Export Industries[1]	136.78	282.23	58.26	106.04
II. Export and Import Competing Industries[2]	49.01	54.47	31.28	47.89
III. Import Competing Industries[3]	58.20	65.87	53.85	71.91
IV. Non-import Competing Industries[4]	52.61	40.52	34.34	39.38

Source: Own calculations.

[1]Includes sectors No. 12, 16–23, 36 and 41.

[2]Includes sectors No. 8-9, 29, 31, 39-40, 42-43 and 49.

[3]Includes sectors No. 3, 5, 6-7, 10, 13, 27, 30 and 44–48.

[4]Includes sectors No. 1-2, 4, 11, 14-15, 24–26, 28, 32–35 and 37–38.

4. CONCLUSIONS

This paper has examined the changes in the structure of protection in Turkey from 1984 to 1989. It has shown that the 1989 tariff revisions have lowered both the level and inter-industry dispersion of protection. Nevertheless, the structure of protection is not yet conducive to an optimal allocation of domestic resources given the relative border prices and hence, Turkey's potential for foreign trade. To increase the potential gains from trade the dispersion of the effective protection rates among commodities and sectors should be minimized subject to the constraint imposed by the existence of priority sectors.

Although a ceiling of 50 percent on the customs duty was adopted in 1988 the existence of various surcharges, in particular the Housing Fund Tax, greatly enhances the landed cost and raises the NPR on an import high above the level indicated by the import duty. Consequently, the present levels of protection in Turkey are much higher than that of Western economies. The high levels of protection cannot be justified by an appeal to the infant industry argument simply because the industries which are presently protected have been in existence for at least two decades.

There is a belief among government economists that *de jure* customs duty and surcharges overestimate the actual protection granted to the domestic industries because imports, mostly intermediary goods and capital equipment, by those private and public firms which hold Promotion Certificates are exempted from the customs duty and/or the surcharges. This belief, however, is unfounded and misleading. As long as domestic markets are non-competitive, exempting some firms from tariffs will not lower the domestic price of an imported commodity below the tariff-inclusive landed cost to those firms which pay the tariff. Hence, the claim that protection rates calculated from *de jure* tariffs do not measure the extent of protection in Turkey needs to be reconsidered.

Preferential tariff exemptions to some importers of a commodity only serve to create excess profits to the privileged firms without lowering the domestic price and, hence, leads to directly unproductive rent-seeking activities.

Finally, it should be emphasized that the surcharges and the levies with different bases, especially the specific Housing Fund Tax, considerably complicate the calculation of total taxes.

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Comments on "The Liberalization of International Trade in Turkey during the 1980s"

This paper provides a quantitative picture of a shift in Turkey from the import substitution industrialization strategy to an export promotion strategy mainly due to trade reforms i.e., trade liberalization and reduction in protection to industries, especially import competing industries in the 1980s and particularly after the 1988 reforms. My first comment relates to the style of the paper. It appears that this shift from import substituting (ISI) industrialization to export promotion (EP) was made possible only due to trade reforms. However, if we look at the economic history of Turkey over time, we see that this was the outcome of the successful implementation of the third IMF stabilization package in Turkey. Starting with the three-year's standby arrangement of 1980–83 Turkey negotiated two more standby's in 1983-84. These packages included restrictive monetary and fiscal policies, effective demand management and incomes policy, devaluation, maintenance of flexible exchange rates and the removal of restrictions on capital flows. In addition, over this period there was a massive inflow of foreign capital from various international sources without which the success of this package was impossible as had happened before in the case of two earlier devaluation/liberalization packages adopted in 1958 and 1970. (For details see IMF Survey of May 18, 1987).

My second comment relates to the inter-industry distribution of protection. Table 8 shows that the standard deviation of Effective Protection Rates (EPRs) to its means declines significantly and the authors emphasize that the EPRs must be equalized among the industries. However, Krueger (1978) argues that variance in incentives accorded to individual industries is not the central determinant of export performance. While a reduction in variance can yield significant payoffs, it is probably a less crucial factor in affecting the behaviour of exports as compared to policy biasis as was the case in Turkey.

Thirdly in Table 9 the authors show that the revision of tariffs in 1988 favoured primary industries as Nominal Protection Rates (NPRs) on primary activities were increased compared to minning and manufacturing. However we see that in case of investment goods which are a sub-sector of the manufacturing sector NPRs and EPRs are also raised quite significantly compared to the primary goods.

Finally, with regard to the discussion on calculations in Table 10 which show higher protection rates for export-oriented industries the results are not surprising as implied by the discussion in the paper. Since the focus of the 1980 stabilization package was to shift from ISI to an EP strategy and the stabilization programmes were fully implemented in all the sectors of the economy accompanied by massive inflow of foreign capital therefore this is only the logical outcome. In fact, the successful adjustment of Turkey from ISI to an EP strategy confirms one common factor observed in the stabilization history of the developing countries in general: that in addition to the political will power of the governments lack of additional external finance has been one of the major factors in the failure of such adjustment programmes.

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