# 9

# Inward-Oriented Development after World War II

THE POST–WORLD WAR II INTERNATIONAL economic order designed at Bretton Woods by the United States and its Western allies was greatly influenced by the lessons drawn from the Interwar period, most notably the problems created by war debts, reparation payments, and beggar-thy-neighbor policies which had led to the breakdown of the international economy after 1929. The new order supported international trade but controlled international movements of capital and provided more room for national economies to follow their own policies. The United States and western European countries were thus able to expand the role of the state and implemented Keynesian macroeconomic policies. Welfare state policies and state expenditure on education, health care, and other social areas increased significantly. Centrally planned economies in Eastern Europe also experienced high rates of growth during the decades after World War II (Findlay and O'Rourke 2007, pp. 473–526; Berend 2006, pp. 133–262; Eichengreen 2008, pp. 91–133; Rodrik 2011, pp. 67–88).

Thanks to the Bretton Woods order, most developing economies also adopted government interventionism during these decades. Inward-looking policies and more specifically import-substituting industrialization (ISI) became the most frequently adopted strategy for economic development, especially in the medium-sized and larger developing countries (Kemp 1993, pp. 148–236; Hirschman 1968, pp. 1–26). These policies were not in conflict with the international monetary and trade arrangements of the Bretton Woods era and the Keynesian policies pursued in the developed economies. Rates of growth in the developing countries were also exceptionally high during the post–World War II decades.

This chapter will begin with global and national political developments and examine how they led to changes in economic policies and institutions as well

TABLE 9.1. A Periodization of Economic Trends, 1950–1980

| Subperiod | Average Annual Growth Rates: Population | GDP | Agriculture | Manufacturing | GDP per Capita | Level of GDP per Capita at the End of Subperiod (1950 = 100) |
|---|---|---|---|---|---|---|
| 1950–1962 | 2.8 | 5.9 | 4.5 | 7.1 | 3.0 | 142 |
| 1963–1980 | 2.4 | 5.8 | 1.9 | 9.1 | 3.3 | 248 |
| 1950–1980 | 2.6 | 5.9 | 2.9 | 8.4 | 3.2 | 248 |

*Source*: Author's calculations based on the official national income series in Turkey, Türkiye İstatistik Kurumu (Turkish Statistical Institute). 2014.

as the consequences of these changes. The next chapter will review Turkey's record in economic growth, income distribution, and human development in both absolute and relative terms. It will also evaluate the role of institutions and institutional change in economic development during these three decades.

The decades after World War II in Turkey are best examined in two distinct subperiods as summarized in table 9.1. After World War II, Turkey moved closer to the West and toward a multiparty political system. The shift to a more competitive political system brought about a shift toward an economic strategy based on agriculture as favored by the great majority of the population who earned their living from agriculture. While the state-led industrialization of the 1930s began to be abandoned as early as 1947, the new strategy was fully adopted by the Democrat Party government that came to power after the elections in 1950 (Zürcher 2004, pp. 206–40; Ahmad 1977). After some success, the new model ran into difficulties, however, due to macroeconomic mismanagement. After the IMF-led devaluation of 1958 and the military coup of 1960, a new economic model favoring import-substituting industrialization, this time led by the private sector, was formally adopted in 1963 with the launch of the first five-year development plan. ISI remained the basic economic strategy until 1980, when a severe political and economic crisis led to economic liberalization and the adoption of market-oriented policies.

## Political and Economic Changes

After the end of World War II, international and domestic forces combined to bring about major political and economic changes in Turkey, which now had a population close to 20 million. The United States emerged as the dominant world power after the war, but it was also the Soviet territorial demands over the Turkish Straits after the war that pushed the government toward closer cooperation with the United States and membership in NATO. The Marshall Plan was extended to Turkey for military and economic purposes beginning in 1948 as the country began to be drawn increasingly into the American sphere of influence. Numerous foreign experts and official missions visited the country during this period to express their preference for a more liberal and more open economic system. Perhaps the most influential was the report prepared for the World Bank by a commission of American experts that called for the dismantling of a large part of the etatist manufacturing establishments, including the country's only iron and steel complex, greater emphasis on private enterprise, encouragement of foreign capital, a more liberal foreign exchange and trade regime, and greater reliance on agricultural development. These changes, the report stated, were necessary if Turkey was to benefit from US aid and inflow of private American capital in the postwar era (Thornburg 1949; Tören 2007, pp. 143–298).

Domestically, many social groups had become dissatisfied with the single-party regime by 1946. The poorer segments of the peasantry had been hit hard by wartime taxation and government demands for cereals for the provisioning of the urban areas. The gendarme and the tax collector had returned to the rural areas as symbols of government presence. After the war, however, the government tried to mend its relations with small producers in rural areas and passed a Land Reform bill through parliament which gave it the power to redistribute holdings above 50 *dönüms* or 5 hectares. The debate was heated and the bill was strongly criticized, especially by members who had links to medium and large landowners. The group that would later form the Democrat Party began to take shape during these debates.

In the urban areas, the Wealth Levy of 1942 had caused unrest and suspicion among the Muslim bourgeoisie even though the measures had been used to discriminate against the non-Muslims. After more than two decades of the single-party regime, the Turkish economic elites wanted to change their privileged but dependent status even though many of them had benefited from the wartime conditions and policies. They now preferred less government interventionism. Workers who constituted a small minority and other wage and salary workers including the civil servants had also been hit quite hard by the wartime inflation, shortages, and profiteering (Keyder 1987, pp. 112–14; Boratav 2011, pp. 63–67).

The opposition to the regime thus began to demand greater emphasis on private enterprise, the agricultural sector, and a more open economy. In response, the single-party regime led by President Inönü decided to open the political system to contestation and began to move toward a multiparty electoral system. The opposition, including the representatives of large landowners and merchants, founded the Democrat Party in 1946. The new party promised to promote the private sector, reduce the role of the state in the economy, and place greater emphasis on agriculture. In later years, party leaders would summarize the government's development philosophy with the slogan "creating a millionaire in each neighborhood."

In response, the single-party regime began to adopt some of the positions of the opposition. In 1947, the Republican People's Party decided to set aside the Third Five-Year Plan and began to move in the direction of greater reliance on private capital and greater emphasis on agriculture. It also offered a new definition of etatism which still reserved for the state such activities as public works, mining, heavy and military industry, and energy, but assumed the transfer of all other enterprises to private capital (Boratav 2011, pp. 73–81).

The Democrat Party also hoped that foreign capital would occupy an important place in its economic program. In spite of legislation that made it easier to transfer profits and the principal, however, direct foreign investments remained very low in the 1950s. Of the total foreign direct investments, which averaged less than $10 million annually, companies from the United States accounted for approximately 40 percent. Bilateral funds provided mostly by the United States under the Marshall Plan, NATO assistance, some multilateral loans and other programs, and reflecting Turkey's geopolitical importance in the Cold War environment, were larger. These public capital inflows averaged more than $100 million per year, or more than one-third of the country's annual export earnings during the 1950s.

## Agriculture-Led Growth

The Democrat Party led by President Celal Bayar and Prime Minister Adnan Menderes won the elections and came to power in 1950. At the center of its economic policies was the agricultural sector, where more than three-fourths of the electorate earned their livelihood. After sharply lower prices during the Great Depression and difficult times during the war, the agricultural sector recovered and expanded after the war. By 1960, the volume of agricultural output had risen 60 percent above its 1948 level and it was close to double its pre–World War II level. One important reason was the expansion in cultivated area. Thanks to the availability of marginal land, total area under cultivation increased by 55 percent until 1953 (figure 9.1). Rapid expansion of the agricultural frontier was supported by two complementary government policies, one for the small peasants and the other for larger farmers. First, even though the Land Reform Law of 1946 included a clause for the redistribution of large holdings, it was used instead to distribute state-owned lands and open up communal pastures to peasants with little or no land. This policy served to strengthen small ownership across Anatolia, except in the southeast where the Kurdish landlords and tribal leaders dominated.

Second, the Democrat government used the Marshall Plan aid to finance the importation of agricultural machinery, and especially tractors, whose numbers jumped from less than 10,000 in 1946 to 42,000 at the end of the 1950s. Most of these were purchased by the more prosperous farmers, who were given favorable credit terms through the Agricultural Bank and used to expand the area under cultivation. According to a rule of thumb of the period, a pair of oxen could cultivate 5–10 hectares in a given year; a tractor raised that figure to 75 hectares. The tractors were also rented by smallholders who paid for their use by crop sharing (figure 9.2).

Agricultural producers also benefited from favorable weather conditions, increasing demand, and improving terms of trade during this period. Domestic prices began to move in favor of agriculture in the late 1940s, and the country's external terms of trade improved by more than 40 percent as world market demand for wheat, chrome, and other export commodities rose thanks to American stockpiling programs during the Korean War (Hirsch and Hirsch 1963, pp. 372–94, and 1966, pp. 440–57; Hershlag 1968, pp. 157–68).

The agriculture-led boom of the early 1950s meant good times and rising incomes for all sectors of the economy. It seemed in 1953 that all would go well and the promises of the liberal model of economic development would be fulfilled rather quickly. The GNP increased by an average annual rate above 8 percent from 1947 through 1953. Urban groups shared in this growth as evidenced by the increases of wages and salaries. Most important, however, were the gains of the agricultural sector, especially the market-oriented agricultural producers. The Democrat Party entered the 1954 elections under these favorable circumstances and won again, by an even wider margin (Keyder 1987, pp. 117–35; Hansen 1991, pp. 338–51; Yenal 2003, pp. 77–84).

The Democrat Party also pursued an ambitious policy of infrastructure-building, especially highways and secondary roads. In the Interwar period, the Republican People's Party had emphasized railroad construction. Railroads aimed especially to link the eastern part of the country with the center and other regions had been the most important investment item in the national budget. The railroads were not supported with highways and paved roads, however. The Democrat Party, with the backing of the Marshall Plan, decided to concentrate on highway transportation. A new government agency for highway construction began to develop the highway and road network, taking advantage of recent developments in road construction techniques and machinery. One important aim was to link villages to the cities and the cities with each other in order to support the agriculture-based development strategy. Railroads had been the monopoly of the state sector. With the shift to

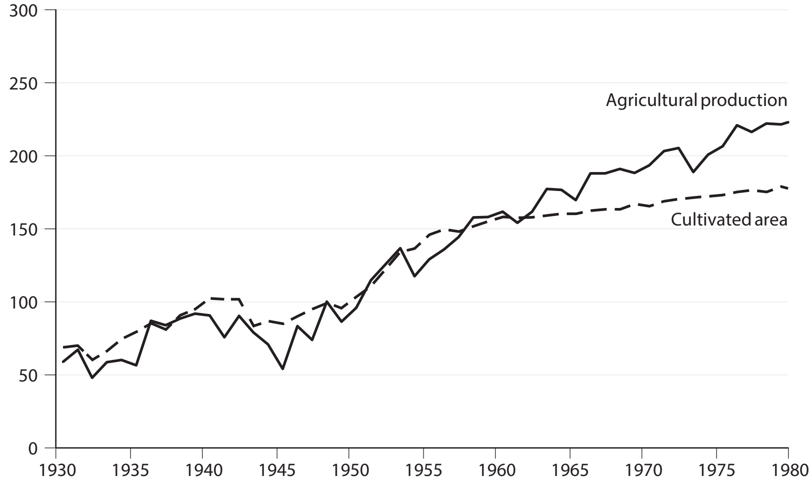


FIGURE 9.1. Total Cultivated Area and Agricultural Production, 1930–1980 (indexes = 100 in 1948). Source: Official series from Turkey, Turkish Statistical Institute 2014.

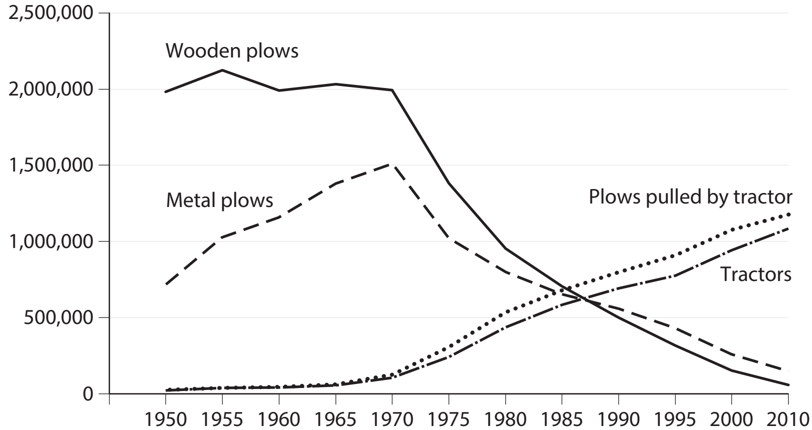


FIGURE 9.2. Changes in Agricultural Technology after World War II (numbers of agricultural equipment). Source: Official series from Turkey, Turkish Statistical Institute 2014.

the highways, the leadership in the transport sector was being transferred to the private sector and local enterprises (Tekeli and Ilkin 2004d, pp. 399–429). In addition, the foundations were laid for big infrastructure projects such as dams. In 1950, less than one-fifth of Turkey's population were able to use electricity in their homes. The government began to invest in electricity production and the development of a national grid that would extend toward rural areas. The roads and highways that were opened helped raise expectations as well as mobility in the countryside and migration to urban centers increased.

The golden years of agriculture-based development did not last very long, however. With the end of the Korean War, international demand eased and the prices of export commodities began to decline. At the same time, the weaknesses of the agricultural sector began to assert themselves. The Anatolian countryside continued to rely on dry farming with virtually no use of chemical fertilizers during the 1950s. Irrigation did not yet rank high on the list of government investments. Only 5.5 percent of the total cropped area was being irrigated at the end of the decade. With the disappearance of the favorable weather conditions, agricultural yields thus began to stagnate and even decline. Moreover, the expansion in cultivated area slowed down considerably in the second half of the 1950s because of less favorable weather conditions.

The agricultural sector was able to increase output relatively easily by bringing new land under cultivation. As the frontier was reached in land available for cultivation toward the end of the 1960s, however, increases in output became more difficult and costly (figure 9.1). From that point on, increases in output began to depend on increases in yields through the intensification of cultivation, the use of improved plant varieties along with increased inputs of chemical fertilizers and some expansion of irrigated lands. The shift toward more intensive agriculture was supported by the government policy of subsidizing inputs and low-interest credit but it was also a response to market forces from both small and medium-sized producers. The new varieties were first adopted by larger farmers, but after a time, other producers started using them too. The long-term trend rate of growth of agricultural output thus declined, from 4–5 percent per year after World War II to about 3 percent in the 1960s and 1970s. These rates lagged well behind the growth rate of the urban economy, and the share of agriculture in the economy declined from 38 percent in 1960 to 25 percent in 1980.

## Populism

Rather than accept lower incomes for the agricultural producers in response to the decline in international and domestic prices, the Democrat Party government decided in 1954 to shield them from the adverse price movements by launching a large price support program for wheat. Price supports thus became the most important government program to affect agricultural incomes until the 1980s. The purchases of wheat were not financed directly out of the budget but by Central Bank credits to the Soil Products Office, the state agency responsible for the purchases as well as the distribution of low-priced wheat to urban areas. These subsidies were the leading cause of the inflationary wave that began in the mid-1950s. The outstanding Central Bank credits to the Soil Products Office account for most of the increase in the money supply during this period. Another culprit was the credit extended from deposit banks to the private sector, including the cooperatives (Hershlag 1968, pp. 143–56; Hansen 1991, pp. 344–46).

Despite the stagnation in agricultural output and the decline in international prices after 1954, the domestic terms of trade remained in favor of agriculture and the rural producers managed to hold on to their gains until 1957 thanks to the price support policies of the government. The countryside thus emerged as the real beneficiary of the Democrat Party era. In the meantime, however, exports declined even further due to the overvaluation of the currency, and the foreign exchange reserves were quickly exhausted. As imports began to be curtailed, the economy moved, from the relative abundance of the early 1950s into a severe balance-of-payments crisis characterized by the shortages of many of the basic consumption items. From coffee to sugar and cheese, many goods were in short supply and long queues became part of daily life. Moreover, the inflationary wave squeezed out wages and salaries in the urban areas (Boratav 2011, pp. 90–93). The decline of the standards of living and social status of the military personnel as well as civil servants during this wave of inflation played an important role in the military coup of 1960.

One casualty of the crisis was the political as well as economic liberalism of the Democrat Party. Just as it responded to the political opposition with the escalation of political tensions and restrictions of democratic freedoms, in most economic issues, the government was forced to change its earlier stand and adopt a more interventionist approach. Quantity restrictions on imports were generalized and controls on the use of foreign exchange were tightened. In the domestic market, price and profit controls were initiated and credit began to be allocated through non-price mechanisms. The government rediscovered the state economic enterprises as useful instruments for coping with their difficulties, for relieving some of the bottlenecks, and for capital formation in manufacturing, infrastructure, and mining.

With the balance-of-payments crisis of the mid-1950s, the experiment for a more open, more market-oriented economy thus came to an end. Amidst the shortages and bottlenecks induced by the severe restrictions on imports, domestic industry began to produce some of the goods that were imported in large volume only a few years earlier. In other words, a return to import-substituting industrialization began, not yet as explicit government policy but as a de facto shift out of necessity.

From 1956 until 1958, the government negotiated with the IMF and OECD for loans and foreign exchange relief but refused to undertake the major devaluation they demanded until after the elections of 1957. As a result, the crisis lasted for several years. The magnitude of the devaluation of 1958 from 2.80 to 9.00 to the dollar reflected the extent of the overvaluation of the lira. The stabilization program also included most of the elements of what was later referred to as the IMF package: import liberalization, changes in the export regime, removal of price controls, increases in the prices of state economic enterprises, and consolidation and rescheduling of the external debt. While the balance-of-payments picture improved and the rate of inflation declined as a result of these measures, the economy plunged into a recession which was then prolonged by the military coup until 1961 (Hansen 1991, pp. 344–48; Boratav 2011, pp. 73–81; Kazgan 2005, pp. 93–128).

In comparison to the Interwar period, the Democrat Party pursued a development strategy that was more open to the outside world and more focused on agriculture. After achieving good results early on, however, the government rushed to promise much more than it could deliver. In contrast to the cautious stance and the balanced budget-strong currency policies of the one-party era during the 1930s, the macroeconomic policies of the Democrat Party in the mid-1950s represented Turkey's first experiment with macroeconomic populism in the twentieth century. The government targeted a large constituency and attempted to redistribute income toward them with short-term expansionist policies with the predictable longer-term consequences. The increasing economic difficulties during the second half of the decade also suggested that a strategy based solely or mostly on agriculture was difficult to sustain.

Nonetheless, the Democrat Party era brought a good deal of mobility to agriculture. Tractors were introduced in large numbers, new land was brought under cultivation, and incomes rose. The construction of highways and roads increased mobility across the country. These market-oriented populist policies were welcomed by the small and medium-sized agricultural producers who constituted the majority of the country's population. That is an important major reason why the era of the Democrat Party and Prime Minister Adnan Menderes, a large landowner, is remembered as "the golden years," not just among the rural population and agricultural producers but also among their children and grandchildren, most of whom live in the urban areas today (Sunar 1990, pp. 745–57).

## Migration and Urbanization

The 1950s also witnessed the dramatic acceleration of rural-urban migration in Turkey. The urbanization rate, defined as the share in total population of centers with at least ten thousand people, rose from around 17 percent in 1950 to 44 percent in 1980 and to about 80 percent in 2015. Landlessness and unemployment ranked high among the causes of the emigration from rural areas. However, migrants were also attracted to the cities by the prospect of higher incomes and better education and health services, for their children if not for themselves. The direction of migration was mostly from the rural areas of poorer, largely agricultural regions in the east and the north along the Black Sea coast toward the urban areas of more developed regions in the west, in the Marmara and Aegean regions, and to a lesser extent in the south along the Mediterranean coast. The strong migration flows did not reverse the large regional differences in per capita income, but they ensured that eastern and southeast regions did not fall even further behind.

The rapid shift of the population from the rural to the urban areas corresponded to an equally dramatic shift of the labor force from lower productivity agriculture to industry and service. Share of agriculture in the labor force and employment declined from more than 80 percent in 1950 to 50 percent in 1980 and about 20 percent in 2015. Share of agriculture in GDP declined from close to 50 percent in 1950 to less than 10 percent in 2015. The share of the urban economy, or industry plus services, in the total labor force rose rapidly with urbanization from around 20 percent in 1950 to 50 percent in 1980 and to more than 80 percent in 2015. Its share in GDP increased from more than 50 percent in 1950 to more than 90 percent in 2015 (see chapter 2 and figure 2.9 for details).

As Arthur Lewis and Simon Kuznets pointed out some time ago, this shift of labor from rural to urban areas or structural change had far-reaching implications for patterns of productivity and economic growth in the long term (Kuznets 1966, pp. 86–159; Lewis 1954, pp. 139–91). For one thing, the transition from agriculture to the urban economy was possible only because of the increase in the productivity of the agricultural sector. Even if the decline in the agricultural labor force was not yet absolute, it showed that a smaller share of the country's total population could feed the entire population. Second, because people who moved from the agricultural sector to the urban economy became, on average, more productive and received higher incomes, they contributed to raising productivity and per capita incomes at the national level. In fact, it has been estimated that at least a third and perhaps a greater share of Turkey's rapidly rising rate of economic growth after World War II was due to the shift of labor from the agricultural sector to the urban economy (Altuğ, Filiztekin, and Pamuk 2008, pp. 393–430).

Patterns of rural to urban migration were strongly influenced by the dominant pattern of independent peasant ownership. The average migrant continued to have claims to some land in his village which was typically rented out or left to family members. More often than not, he came to the urban area with sufficient resources to build a squatter house (*gecekondu*—literally, landed at night) on land often owned by the state in a neighborhood already settled by the migrants from his own province if not village. The migrants were soon able to acquire the ownership title for their gecekondus as political parties competed for their votes and local governments provided roads, water, and electricity. After the initial move, the migrant and his family did not easily lose contact with the village. They returned during the annual leave and regularly received supplies in kind, often as compensation for their claims to the land in the village. The rural pattern of small and medium-sized land ownership whose origins go back to the Ottoman era was thus transferred to the urban areas within a few generations by way of the gecekondu and surrounding institutions (Keyder 1987, pp. 135–40; Karpat 1976; Tekeli and İlkin 2004d, pp. 390–429; Yıldırmaz 2017, pp. 51–200).

Only a minority of the migrants found employment in the new industries, however. Instead, they faced a hierarchy of jobs as they arrived at the urban areas. The unionized blue-collar jobs were at the top of that hierarchy and thus out of the reach of a recent migrant. At the lower echelons were a variety of jobs in the informal sector with low pay such as short-term wage work or street vendoring. In time and depending on their skills and connections, some of the migrants began to move up the urban ladder toward higher paying and more stable forms of employment (Keyder 1987, pp. 156–63).

## The Age of Import-Substituting Industrialization

The agriculture-based strategy brought dynamism to the Turkish economy, but the populist economic policies contributed to their demise. One criticism frequently directed at the Democrats was the absence of any coordination and long-term perspective in the management of the economy. One of the first projects by the military regime was thus to establish the State Planning Organization (SPO) in 1960. The idea of development planning was supported by a broad coalition: the Republican People's Party with their etatist heritage, the bureaucracy, the large industrialists, and even the international agencies, most notably the OECD. Planning methodology and target setting were strongly influenced by Jan Tinbergen, who was invited as the chief consultant to the SPO to coordinate the preparation of the First Five-Year Plan.

The five-year development plans aimed, above all, at the protection of the domestic market and industrialization through import substitution by coordinating investment decisions. The planning techniques made heavy use of a restrictive trade regime, investments by state economic enterprises, and subsidized credit as key tools in achieving the ISI objectives. The plans were based on medium-term models and did not give much weight to short-term policy issues, most notably fiscal and monetary policy. They were binding for the public sector but only indicative for the private sector. In practice, the SPO played an important role in private sector decisions as well. Its stamp of approval was required for all private sector investment projects which sought to benefit from subsidized credit, tax exemptions, and import privileges, and have access to scarce foreign exchange. The agricultural sector dominated by family enterprises was left mostly outside the planning process (Milor 1990, pp. 1–30; Hansen 1991, pp. 352–53).

There were different views on the content of the plans and their role in industrialization. The center-right Justice Party, which succeeded the Democrat Party after the military coup of 1960, was initially opposed to planning. On the other hand, the military leadership and part of the Ankara bureaucracy, as well as the academics they had commissioned, were in favor of even stricter planning. They argued that the plans should guide not just the public sector, but also the private sector, and the SPO rather than the markets, should determine which sectors would be supported in the industrialization process. The private sector in Istanbul argued that the public sector should not compete with the private sector, and while the SPO was directing public sector decisions, it needed to support the private sector with tariffs, subsidies, and incentives. Within the Republican People's Party, opinions differed on the content and role of planning. The priorities of the plan would ultimately be determined by politics. However, the new institution gave technocrats and bureaucrats in Ankara new influence.

With the end of military rule and the return to multiparty politics, the power and influence of strict planning, which had received a good deal of support from the military, began to decline. When Prime Minister Inönü refused to adopt the recommendation to tax the agricultural sector in order to achieve higher rates of industrialization, a leading group of planners resigned. After the Justice Party came to power following the 1965 elections, Prime Minister Süleyman Demirel opted to live with the SPO rather than dismantle it. During his government, however, the SPO would not direct the private sector, but support it. He appointed Turgut Özal as undersecretary for the SPO. From then on, the planning and import-substitution industrialization process would be guided by the preferences of the private sector in Istanbul.

When the SPO was being established, some had viewed it as an autonomous institution which would direct the industrialization process as its counterparts did in East Asian countries. Within a short time, however, the SPO abandoned this role and became a body that responded to the needs of the private sector, open to daily politics and political pressure. The transition from an emphasis on the longer term and heavy industry, to a private sector–led model producing durable consumer goods for the domestic market, took place in these circumstances (Milor 1990, pp. 1–30; Türkcan 2010).

During the 1930s, when the private sector was weak, industrialization was led by the state enterprises and the state was able to control many sectors of the economy. In the postwar period, in contrast, the big family holding companies, large conglomerates which included numerous manufacturing and distribution companies as well as banks and other services firms, emerged as the leaders. Some of these, such as the Koç group, emerged in the 1920s but entered industry in the postwar years either independently or in joint ventures with foreign capital. The Sabancı group began their rise with textiles in the cotton-growing Adana region during the 1950s. There eventually emerged a crude division of labor between the two sectors. The state enterprises were directed to invest in large-scale intermediate goods industries. They accounted for more than 20 percent of the value added and about half of fixed investments in the manufacturing industry. In contrast, the private firms took advantage of the opportunities in the heavily protected and more profitable consumer goods. From food processing and textiles in the 1950s, the emphasis shifted increasingly to radios, refrigerators, television sets, cars, and other consumer durables. Foreign direct investment in the ISI industries remained modest. A large part of the technology was obtained through patent and licensing agreements rather than direct investment.

With the total population exceeding 30 million in the mid-1960s, the large and growing domestic market in Turkey stimulated manufacturing output. Despite the inequalities in income, large segments of the population including the civil servants, workers, and to a lesser extent, agricultural producers were incorporated to the domestic market for consumer durables. Behind the large and growing domestic market, political and institutional changes as well as market forces were occurring. Perhaps most important, real wages almost doubled during the 1960s and 1970s. While industrial growth increased the demand for labor, the emigration of several million workers to Western Europe kept the conditions relatively tight in the urban labor markets. In addition, the institutional rights obtained under the 1961 Constitution supported the labor unions at the bargaining table (Berik and Bilginsoy 1996, pp. 37–64). For their part, the large industrial firms not under pressure to compete in the export markets reasoned that they could afford these wage increases as they also served to broaden the demand for their own products. By the middle of the 1970s, however, the industrialists had begun to complain about the high level of wages and an emerging labor aristocracy (figure 9.3).

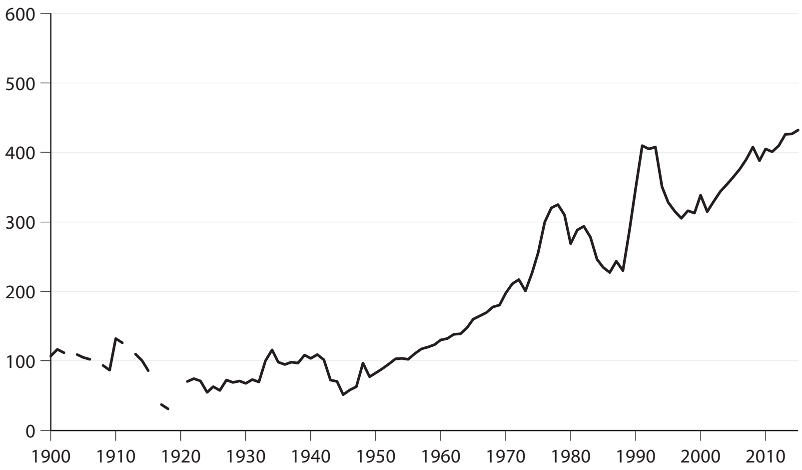


FIGURE 9.3. Purchasing Power of Wages in Manufacturing Industry, 1900–2015 (index = 100 in 1914). Sources: Özmucur and Pamuk 2002, Bulutay 1995 and official series from Turkey, Turkish Statistical Institute 2014.

The political power of the agricultural producers had remained limited during the Interwar period. With the shift to a multiparty electoral system after World War II, however, the large numbers of agricultural producers who made up as much as three-fourths of the electorate obtained significant political influence if not power. As millions of the more commercialized agricultural producers began to vote for their pocketbook, a large populist bias began to dominate national politics. Governments developed large-scale, multi-crop programs to keep agricultural prices high and input prices low. These programs may not have contributed much to improving long-term productivity, but they accelerated the incorporation of the rural population into the national market. The remittances sent from the family members in Europe added to rural incomes during the 1970s. The villages thus became important markets not only for textiles and clothing but also for consumer durables, radios, TV sets, and refrigerators. For example, share of households with refrigerators rose from less than 3 percent to more than 70 percent between 1950 and 1980. Many agricultural producers also purchased tractors and other agricultural machinery and equipment with credit from public sector banks. Numbers of tractors in the country rose rapidly, from 42,000 in 1960 to 100,000 in 1970 and to 430,000 in 1980 (figures 9.3 and 9.4; Keyder 1987, pp. 165–96; Hansen 1991, pp. 360–78).

These programs tended to support the small and medium-sized family farms, a legacy of the Ottoman era. Large-scale farms using year-round labor

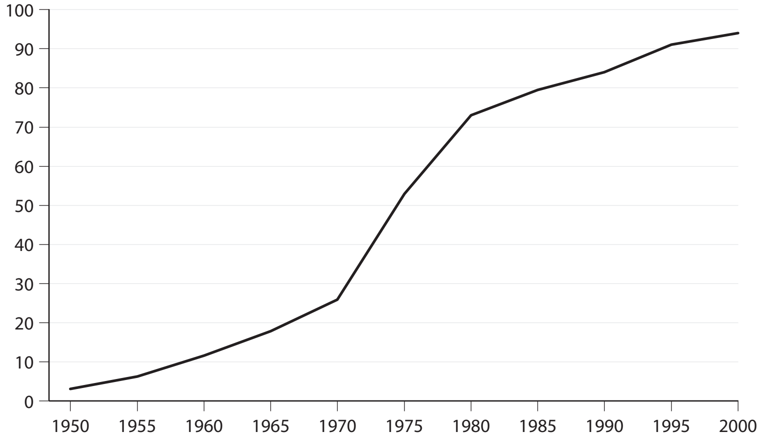


FIGURE 9.4. Share of Households with a Refrigerator, 1950–2000 (percent).
Sources: Based on Turkey, Turkish Statistical Institute 2014
and data from domestic manufacturers.

remained the exception, although more of them emerged in the Kurdish southeast as the tribal leaders registered tribal lands under their own name and began to evict the tenants. As family farms remained dominant in the countryside, agriculture continued to provide employment for more than 50 percent of the labor force at the end of the 1970s. Labor as well as land productivity in agriculture lagged well behind those of other southern European countries such as Spain, Italy, Portugal, and Greece (Pamuk 2008, pp. 382–86; Imrohoroglu, Imrohoroglu, and Üngör 2014).

Another important contribution toward the expansion of the home market came from remittances sent by the workers in Europe. Several million workers from both urban and rural areas emigrated to western European countries from 1961 until the recession in 1973 in response to the strong demand for labor during the golden age. Their remittances remained modest during the 1960s, but they jumped to 5 percent of GDP after the devaluation of 1970 and began to exceed total earnings from exports. The balance sheet for the remittances was mixed, nonetheless. While they supported the balance of payments and growth in the short term, they also contributed to the overvaluation of the domestic currency, thereby reducing the competitiveness of the tradable sectors. The aggregate demand they generated was met by the importation of intermediate goods which ended up hurting the import-substitution process. Remittances began to decline in the second half of the 1970s, however, as immigration restrictions in Europe led the workers to send less to Turkey (Paine 1974).

While industry and government policy remained focused on a large and attractive domestic market, exports of manufactures were all but ignored and this proved to be the Achilles' heel of Turkey's ISI. The share of manufactures in total exports edged up from less than 20 percent in the 1960s toward 35 percent in the 1970s, but that figure may be misleading because the share of exports in GDP remained below 6 percent throughout this period. Share of manufacturing exports in GDP thus remained well below 2 percent until 1980 (Turkey, Turkish Statistical Institute, 2014). A shift toward exports would have helped Turkish industry in a number of critical ways. It would have increased the efficiency and competitiveness of the existing industrial structure, acquired the foreign exchange necessary for an expanding economy, and even supported the import-substitution process itself in establishing the backward linkages toward the technologically more complicated and more expensive intermediate and capital goods industries.

For that major shift to occur, however, a new orientation in government policy and the institutional environment was necessary. Not only the overvaluation of the lira but many other biases against exports needed to be eliminated. Instead, the successes obtained within a protected environment created the vested interests for the continuation of the same model. Most of the industrialists as well as organized labor, which feared that export orientation may put downward pressure on wages favored the domestic market–oriented model. Moreover, the political conditions became increasingly unstable during the 1970s. The country was governed by a series of fragile coalitions with short time horizons. As a result, no attempt was made to shift toward export-oriented policies or even adjust the macroeconomic balances after the first oil shock of 1973 (Keyder 1987, pp. 165–96).

The years 1963 to 1977 thus represent for Turkey what Albert Hirschman has called "the easy stage of ISI" (Hirschman 1968, pp. 1–26). Annual rates of growth of manufacturing value added averaged above 9 percent during 1963 to 1980. Annual rates of increase of GDP averaged 5.8 percent and GDP per capita, 3.3 percent during the same period. Moreover, manufacturing industry and more generally the urban sector was able to provide employment to millions who migrated to the urban areas, especially in the northwestern region of the country. While manufacturing value added increased in both final and intermediate goods, value added in the technologically more difficult stage of capital goods lagged behind. Both the relatively low education of the labor force and the related reluctance of the private sector to move into higher technology sectors contributed to this outcome. Turkey lagged behind countries with similar levels of GDP per capita in Latin America and East Asia during these decades when it came to education and human capital, making it harder for manufacturing in both countries to transition toward higher technology, higher value-added goods, and sectors requiring higher skills (van Leeuwen and van Leeuwen-Li, 2014, pp. 87–100).

Moreover, manufacturing exports were also ignored until 1980, largely because of the sizable domestic market. Even though the share of manufacturing in total exports reached 35 percent in the 1970s, the low share of exports in GDP meant that the share of manufacturing exports in GDP remained less than 2 percent. Boosting exports required a new government policy and institutional environment, but protection strengthened vested interests in favor of the old policies. Equally important, political conditions became increasingly unstable during the 1970s. As a result, no attempt was made to adjust even after the oil shock of 1973. Coalition governments chose to borrow abroad under unfavorable terms and encouraged the private sector to do the same, leading to a major balance-of-payments crisis at the end of the decade (Tekin 2006, pp. 133–63; Hansen 1991, pp. 352–53).

## Crisis

Long-lasting political instability played the leading role in Turkey's economic crisis at the end of the 1970s. When oil prices rose in 1973, the total oil bill was still small and the balance of payments awash with workers' remittances. With their short-term horizon, the fragile coalition governments chose to continue with the expansionist policies instead of adjusting. With the support of the foreign exchange reserves and an accommodating monetary policy, the governments directed the public sector toward an investment binge, eventually pulling along private sector investment. As the share of investment rose from 18.1 percent of GDP in 1973 to 25.0 percent in 1977, the growth rate of the economy reached its zenith at 8.9 percent in 1975 and 1976. Industrialists enjoyed the easy profits as they continued to produce for the protected domestic market. Unionized workers bargained for and received higher wages. It is estimated that real wages in manufacturing industry increased about 75 percent between 1970 and 1978 (figure 9.3). In its later stages, this drive was maintained by a costly external borrowing scheme. Just as the foreign exchange reserves were being depleted in 1975, the conservative coalition government of Süleyman Demirel, eager to stay in power, launched a scheme that provided private firms exchange-rate guarantees for all the external loans they could secure. Under inflationary conditions where the domestic exchange rate was already perceived to be overvalued, this was a signal to the private sector to borrow abroad and finance its day-to-day operations at the cost of the treasury. By the end of 1977, it became clear that the government was not in a position to honor the outstanding short-term external debt, which had risen from 9 percent to 24 percent of GDP. Equally striking as the behavior of the government was the willingness of the international banks, overflowing at the time with petrodollars, to play along. As foreign lenders started getting jittery early in 1977, the stage was set for a debt crisis (Celasun and Rodrik 1989, pp. 615–808; Kazgan 2005, pp. 135–94).

At the end of the decade, Turkey found itself in its most severe balance-of-payments crisis of the postwar period. In return for the rescheduling of the outstanding debt and green light for new credits, the IMF demanded the implementation of a full-scale stabilization program including a major devaluation, extensive cutbacks in government subsidies, and elimination of controls on imports and exports. The new coalition government led by social democrat prime minister Bülent Ecevit was reluctant to accept a program of austerity. At the same time, it was too divided to pursue an alternative. As rising budget deficits were met with monetary expansion, inflation, which had been averaging 20–30 percent annually earlier in the decade, jumped to 90 percent in 1979, and the purchasing power of wages and salaries declined sharply. The government responded with various foreign exchange and price controls. Both investment and exports collapsed. The second round of oil price increase from 15 to 30 dollars a barrel only compounded the difficulties. As oil became increasingly scarce, frequent power cuts hurt industrial output as well as daily life. Shortages of even the most basic items arising from both the declining capacity to import and the price controls became widespread. The economic crisis coupled with the continuing political turmoil brought the country to the brink of civil war (Keyder 1987, pp. 165–96).

Perhaps the basic lesson to be drawn from the Turkish experience is that an ISI regime becomes difficult to dislodge owing to the power of vested interest groups who continue to benefit from the existing system of protection and subsidies. To shift toward export promotion in a country with a large domestic market required a strong government with a long-term horizon and considerable autonomy. These were exactly the features lacking in the Turkish political scene characterized by weak and unstable coalitions during the 1970s. As a result, the economic imbalances and the costs, both political and economic, of adjustment accumulated. It then took a crisis of major proportions to move the economy toward greater external orientation in the 1980s (Öniş and Şenses 2007, pp. 263–90).