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Crisis of Turkish Lira: Challenges and Proposals

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Introduction

Some contributed to creation of a state of panic on the recent crisis of Turkish lira, being unaware of several facts, most notably that Turkey significantly adopts principles of capitalism, and that it is normal in the capitalist system that economic crises could emerge every now and then due to internal or external factors. However, the economic policies adopted by governments play the greatest role in addressing such crises.

The existence of crises in the structure of the capitalist system led old capitalist states to change what had been considered as axioms in the capitalist thought, like what Keynes did in 1929 to face the great global depression at the time. The new approach to capitalism that was introduced by Keynes emphasized the role of the state in managing the economy as a new mechanism to address crises such as that of the great depression which hit the global economy in 1929.

Although almost all capitalist states at the time adopted Keynes's views which later became an economic theory taught in universities and economic schools, however Keynes' approach was regarded as a contribution to the capitalist theory, not a substitute for it or in the course of alignment with the role of the state in the socialist system.

During the global financial crisis of 2008, the US Federal Reserve agreed to an $85 billion bailout to give the government control of the troubled insurance giant American International Group (AIG), saving about 300 banks linked to this insurance company. Central banks in Europe also provided loans for commercial banks to protect them from collapsing. However, all these interventions come in violation of some axioms of capitalism such as the “rationalization of laissez-faire”, based on the belief that markets could automatically bring about necessary adjustments.

Accordingly, the emergence of an economic crisis in Turkey is not an indicator for the collapse of the Turkish economy, Government, or the President, and it is not even a justification for raising panic and anxiety.

It is known that economic crises affect investors, savers, and people in general, especially in light of the famous statement that says, “Capital is a coward”. (The statement was first used in 1884 by a US senator when he addressed his audience, saying, “Capital is a coward and is as timorous as a young girl.”). However, the data coming from international markets that operate hours ahead of Turkey on trading the Turkish lira, which helped to instill fear in the internal market, and led to real speculations on lira resulting in a further decline in its price against other foreign currencies.

However, many reports lacking in-depth analysis or awareness of the Turkish economy potential were circulated by the media. These reports only focused on the final scene of many indicators of the macroeconomic aspects of the Turkish economy, especially those related to the current deficit or the external public debt.

While Turkey's current deficit reached about $ 50 billion, it reached about $ 74 billion in 2011. Also, the external debt is divided between the government and the private sector (30% and 70%, respectively). Also, not all the external debt is due to be paid on the short term; and not all debt financing is a disaster. Also part of the private sector debt goes to the Turkish commercial banks, about 181 billion dollars. However, the whole situation needs analysis depending on an overall view of economy, not limited to a partial framework of the performance of some indicators.

Turkey’s positive participation in globalization

The crisis of Turkish lira during August 2018 proved that Turkey's contribution to the economic globalization system is not at all ineffective like many developing countries or even emerging countries. However, the repercussions of the Turkish lira crisis also affected the European, American, and Asian markets, as there are direct foreign investments for these countries in Turkey. Also, there are debts for European financial institutions, which led to reservations - by these countries - on any likely troubles regarding the Turkish experiment, through speculations carried out through some international forces or regional countries.

At the same time, Turkish policy-makers have used some pressure cards that would fit the American performance and expand the Turkish spaces on the international arena, such as increasing tariffs on American products, announcing boycott of American electronic products, and studying the possibility of using local currencies in trade settlements with Russia and China. In fact, this is a sensitive message to the United

States as it is associated with the war to remove the dollar from the throne of international trade settlements during the global financial crisis. In 1947, China called on other countries to seek another international currency as an alternative for the dollar to settle international financial and trade transactions and avoid the problems caused by the US currency. However, the United States fought this proposal strongly during the G20 meetings at the time. The current lira crisis has also shown that Turkey's membership of the G20 relied on an economy with a strong structure, albeit in need enhancement of high-value technology exports.

Maintaining foreign exchange reserves

The existence of foreign exchange reserves up to nearly $120 billion has been targeted for some time, which was clear during the fluctuations experienced by the Turkish lira over last year. The Central Bank of Turkey was then expected to intervene and pump quantities of dollars to protect the price of Turkish lira, leading to depletion of reserves of foreign exchange. But, fortunately, the Turkish central bank did not slip into such scheme; the Turkish lira was left to witness some declines and then return to equilibrium rates, although it did not return to previous prices before fluctuations. The policy of maintaining the foreign exchange reserves at the Central Bank of Turkey is stable: the central bank uses other tools for intervention without prejudice to freedom of exchange rate. This policy was reflected in the procedures that the Turkish central bank took on Sunday, August 12, to achieve and maintain price stability of money exchange and "support effective functioning of financial markets and flexibility of the banks in their liquidity management" through the following:

- Reducing Turkish lira reserve requirement ratios by 250 basis points for all maturity brackets.

- Reducing reserve requirement ratios for non-core FX liabilities by 400 basis points for the following maturities:

Other FX Liabilities	Current Reserve Requirement Ratios	New Reserve Requirement Ratios
Up to (and including) 1-year maturity	24%	20%
Up to (and including) 2-year maturity	19%	15%
Up to (and including) 3-year maturity	14%	10%

- Raising the maximum average maintenance facility for FX liabilities to 8 percent.

- In addition to US dollars, euro can be used for the maintenance against Turkish lira reserves under the reserve options mechanism.

With this revision by the Central Bank of Turkey, approximately 10 billion TL, 6 billion US dollars, and 3 billion US dollars equivalent of gold liquidity have been provided to the financial system.

This policy reflects full awareness of the negative experiences of some countries which tried to protect their currency through depleting their reserves, but finally lost their currency and reserves altogether.

But the policy of maintaining reserves and resorting to other instruments does not mean that it is up to monetary policy alone to achieve a state of success. However, other policies, such as production and export policies, must be reactivated to increase their capacity in terms of quantity and quality, to be one of the tools of foreign currency inflows, along with the service sector, especially tourism, which must maintain its high performance and attract more tourists.

Challenges posed by the crisis

In general, performance of local currency is one of the manifestations of the strength or weakness of economy. As we have mentioned above the Turkish lira has been fluctuating over last year, if not earlier. In addition to the political factors (internally, regionally, and internationally – especially differences with the United States) that caused the recent crisis of the Turkish local currency, there are economic factors that contributed to the current crisis.

This paper focuses on the economic considerations and the challenges that must be faced by Turkish economic policy-makers in the coming period, for early recovery from the crisis, preventing its reoccurrence or exploitation to practice economic and political pressures on Turkey.

These challenges include:

- Increasing hi-tech exports

World Bank data show that there is a weakness that should be addressed, i.e. the low rates of Turkey's high technology exports. In 2003, Turkey's share of high-tech exports was about $763 million, and increased in 2016 to only $2.18 billion, while Turkey's exports in general increased from $47.2 billion in 2003 to $156.9 billion by the end of 2017.

The period of time spent by Turkey in the production of traditional goods has been long and therefore it must undergo a qualitative leap. Turkey should consider proposals to encourage investments in high technology through tax incentives or allowing contributions to the technological development from Waqf institutions (charitable endowments).

- Fighting inflation

Inflation is the enemy of both societies and individuals, and has severe negative economic effects, confusing economic policy-makers. According to figures from the Central Bank of Turkey, the inflation rate has been rising since April 2018, reaching 10.8%. With the expansion of speculations on the lira, the rate of inflation in May, June and July increased significantly, reaching 12.1%, 15.3% and 15.8%, respectively, and is expected to see further gains in August because of the decline in the lira price.

- Reducing the interest rate:

In a capitalist economy, it is normal to have an important role for the interest rate as one of the important tools of the monetary and financial policies. According to statistics of the Central Bank of Turkey, the interest rate has seen a significant development since May 2013, where the interest rate was 4.5%, increased in January 2014 up to 10%, and later decreased ranging between 8% and 9%. However, early June 2018 there was a large increase in the interest rate, reaching 16.5%, and then one week from the beginning of June, the interest rate reached 17.75%.

The increases observed in June 2018 were to counter speculations on the Turkish lira, a measure the central bank used to counter the phenomenon of dollarization, and actually achieved positive results at the time. But this issue preoccupied the Turkish public opinion, especially those involved in economic activity. The media opposed to President Erdogan at home and abroad tried to portray him as interfering in the central bank's management of monetary policy, which is not true; as many politicians usually express their economic visions or programs and define their position on many issues, including the interest rate; and Erdogan's view on the interest rate was that it is the “source of evils”.

The challenge for economic policy-makers here is to lower interest rates, to achieve more than one advantage: first to encourage investment; and second to help reduce inflation; because high interest lead to high production costs, which may affect exports in the long run.

- Providing cheap energy

According to data from the Turkish Statistics Institute, fuel imports in 2017 amounted to about $ 37.2 billion, the largest item in terms of value among the various items of Turkish imports for the same year. Fuel imports represented about 16% of the total imports for the same year amounting to $ 233 billion. Alos, Turkey's energy import bill in 2017 was about $ 10 billion higher than that of 2016.

Turkey mainly depends on Iran for satisfying its oil needs, covering about 44% of its oil imports. Turkey also relies on Russia for its natural gas consumption. Russia is estimated to supply 53% of Turkey’s natural gas needs.

The energy import bill is expected to rise in 2018, as oil prices moved higher than those of 2017, as Brent crude oil reached $ 77 on average, and US crude oil reached $ 74. The recent trade war, triggered by the imposition of reciprocal customs duties between the United States and China, and the United States and other countries, may limit the demand for oil, which leads to expectations that oil prices will remain as they are at present. This would be in the interest of Turkey; but it may not be in its favor if the trade war had a negative impact on the movement of international trade, where Turkey is an exporter.

The other side of the likely energy crisis during the coming period is related to Turkey’s dealings with Iran and Russia under the US sanctions against them. It is noteworthy that the United States accused Turkey in 2017 of conducting financial transactions for Iran through Halk Bank in violation of the economic sanctions (while Turkey emphasizes integrity of its financial transactions); and the case is still pending before American courts. However, former Turkish Economy Minister Nihat Zeybekci said that his country is not committed to US sanctions as long as they are unilateral and not imposed by the Security Council.

- Rational management of the external debt:

Turkey's external debt file has been most widely used to distort the Turkish experiment. Recently, the file has been used to exaggerate the lira crisis, especially by those who did not bother to look at the Turkish government statements and left themselves prey to the writings of some Western journalists.

It is doubtless that debt financing requires accurate management and follow up, especially in relation to foreign countries. However, we have to look at the performance of such debt to know whether it is so frightening as some propagate. Data from a report issued by the Turkish Treasury in April 2018 indicate that external debt reaches $453.2 billion of which $136.2 billion is government debt, about 30% of the total external debt, while the private sector accounts for $316.4 billion, about 70% of the total external debt. The long-term debt amounts to $335.5 billion, representing 74% of the total external debt, while the short-term debt amounts to $117.7 billion, about 26% of the total external debt. It is necessary to state the private sector's situation in terms of short-term and long-term debts, because it has been used as a scarecrow in the recent lira crisis. The figures in the same report indicate that the private sector’s short-term debt amounted to $95 billion, about 30% of the total private sector's total debt of $316.2 billion, while the private sector's long-term debt amounted to $220 billion, about 70% of the private sector's total external debt. The data show that Turkey's private sector debt in 2010 was $191 billion, with short-term debt of about $ 71 billion, about 37%, while the long-term debt was $119 billion, about 63% of the private sector's total external debt. With this comparison, the private sector debt position, in terms of time commitments, in 2017 is better than that of 2010, although 2017 rates are higher.

However, we believe that the government and central bank should monitor the private sector debts and activate their control in this regard to prevent any likely exploitation by some parties as a pressure card against Turkey in the future.

Here we find it appropriate to say that Turkey should consider co-funding, and gradually abandon debt funding, according to its potential and the nature of transformation, at the levels of both the private sector and the government.

- Facing repercussions of trade war

In the framework of trade relations between the United States and Turkey, the figures of the Turkish Statistics Institute show that the trade between the two countries reached 20.5 billion dollars in 2017, and that the balance of trade was in favor of the US by about $3.3 billion. Turkish imports from the US in the same year amounted to $11.9 billion, while Turkish exports to the US amounted to $8.6 billion. In total, trade between the two countries represented 5.2% of Turkey's total foreign trade in 2017, amounting to 390 billion dollars. Among the Turkish goods that will be damaged by US tariffs are steel exports. Turkey has found itself in the face of a trade war imposed by the United States, especially that tariffs were activated and later doubled on Turkish steel and aluminum products in light of US political escalation against the backdrop of the arrest of a US priest in Turkey, not on economic background. The US decisions had a negative impact on the performance of the Turkish lira, and helped to reduce its price at concrete rates.

Proposals for overcoming the crisis

- There is need to review the structure of the foreign exchange reserves of Turkey, so that it would include more than one currency, not just the dollar, especially that the first trade partner of Turkey is the European Union. The structure of the foreign exchange reserve should be divided between the dollar - represented by the US share in Turkey's foreign trade - then the largest share would be allocated for the euro, followed by the Chinese yuan, and the Japanese yen. As for the Russian ruble, it should be excluded because it is a non-international currency, despite Russia's announcement that it is studying Turkey's proposal to use local currencies in trade settlements with Turkey.

- It is important that the Central Bank of Turkey should force Turkish exporters to pump the entire export proceeds inside the country, and not to keep them abroad. Also, there should not be any clearing operations with external partners, provided that the banking system would provide the exporters with their foreign exchange needs at request.

- Monitoring the stock exchange activity and the exit of foreign funds in the short term; and imposing taxes on those funds to stop the hot fund activity that harms economies such as that of Turkey.

- Monitoring the performance of money exchange companies, and ensuring that they do not act outside the established system, because experiences in many countries demonstrate that exchange companies become active in such crises with respect to informal transactions outside the banking system. In fact, many money exchange companies in times of crises contribute to funding the black economy.

- Prompting all domestic and foreign institutions to deal in the local currency within Turkey; as some institutions - at the time of local currency price decline - resort to dealing in foreign currencies, which creates an unrealistic demand for such currencies.

- Monitoring the performance of the import activity to reflect reality, and avoid using it in smuggling foreign exchange abroad through false transactions or excessive prices of imports.

Conclusion

We find it necessary not to lose sight of the regional and international threats that Turkey is exposed to. Also, the lira crisis was in one way or another caused by a conspiracy, albeit relatively, amid ongoing speculations on Turkish lira.

Here we recall what Dr. Mahathir Mohamad, the current Malaysian Prime Minister, wrote when his country experienced its economic crisis at the end of the 1990's and came under the attacks of speculation on its local currency, saying: "We have done for thirty or forty years "We have over thirty or forty years exerted our utmost effort to enable our countries to make progress, and now one of them comes to us, arrogant, pompous, with a few billion dollars ... to destroy within two weeks everything we have achieved."

The position and role that Turkey is seeking regionally and internationally is characterized by pursuit for full independence, abandoning dependence on the West, which has cost it a lot, and the lira crisis significantly comes in this context.

Therefore, Turkey should maintain its economic and development gains. Among the positive results of the lira crisis is probably that it highlighted the fact that Turkey can play roles at the international level to achieve its interests and to ensure its international standing in light of the current differences and conflicts recently created by the United States with several countries.