A NOTE
ON THE TURKISH CONVERTIBILITY
OF THE TURKISH LIRA

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In Turkey, in the process of liberalization leading to the TL convertibility, gradual rather than once for all approach was taken, and the implementation has been through reforming the banking sector so that it would be the central sector in foreign exchange transactions. Even though the beginning of the liberalization and outward oriented restructuring policies can be dated the January 24, 1980 stabilization package, with the elimination of multiple exchange rate practices and the starting of daily exchange rate adjustment, the major steps towards deepening of liberalization have taken place after 1983. The Decree 28 of December 1983 and Decree 30 of July 1984 introduced substantial degree of trade and external financial liberalization simultaneously. With these decrees, in the import regime all quantitative restrictions were lifted, and negative list approach was adopted. As for the capital account liberalization, decrees lifted all restrictions related to buying and selling and owning of foreign exchange and allowing residents to open foreign exchange deposit accounts. However, they were partial on the other areas of external financial liberalization such as borrowing freely in international markets, since only authorized banks and corporations holding investment incentive certificates and foreign trade companies were allowed to contract for loans. Later, with the Decree 32 of August 1989, together with modifications in February and March 1990, the scope of the capital account regime was widened. All restrictions on capital movements and on borrowing by residents in international markets were lifted. Finally, in April 1990, Turkey notified the IMF that she accepted the obligations of Article VIII, sections 2,3,4 of the IMF’s Articles of Agreement which meant the declaration of the TL convertibility.

It is still too early to judge the effects of convertibility; however, it can be said that the timing of the capital account liberalization was not necessarily optimal, given the inflationary environment and the large public sector borrowing requirement that Turkey was facing. High interest rates together with the expectations about the slower depreciation of the US dollar led to capital inflow both in 1989 and 1990, which in turn supported the real appreciation of the TL against the dollar. However, in 1991 with the change in risk premia and the expectations about the value of the dollar, there has been a capital flight, and the TL was depreciated in real terms. So, although both in 1989 and 1990 the opening of capital account seemed like an advantage, in 1991 it seemed more like a cost. Of course, there may be other factors coupled with the opening of capital account that led to these results. Hence, by just looking at those three years it may be too early to judge the effects of capital account liberalization, probably we can say more in the longer run. One thing is clear though, opening to the outside world makes the system more fragile.
One other argument against liberal foreign exchange regime in Turkey was that allowing foreign exchange deposit scheme resulted in currency substitution. Given the fact that these foreign exchange deposits were paying interest rates, there may be a truth in that argument. However, without interest earning foreign exchange deposits, there could have been a capital flight. It seems difficult to judge a priori, the trade-off between the degree of external financial liberalization and the degree of currency substitution. We do not know the extent of the currency substitution initiated by the liberalization movement in Turkey; however, we can say that the reversal of currency substitution requires in the final analysis macroeconomic stability.