

# Turkish Economic Review

www.kspjournals.org

Volume 5

September 2018

Issue 3

## Letter to the Editor: Rejoinder

By Zubair HASAN<sup>†</sup>

Dear Editor,

The Turkish Economic Review Volume 5, June 2018 issue 2, contains a letter to the editor from Steve H. Hanke professor at John Hopkins University “on *Turkey’s Precarious Economic Situation*”, which is imposed on the country by the hegemonic approach of US to international relations<sup>1</sup> with developing economies like Turkey using the trade weapon as President Erdogan puts it.

The letter of Hanke carries arrogance, lacks urbanity, and contains much economic nonsense, to put it mildly. Surprisingly, the narration soon assumes a question-answer format as if it were an interview! Let me tear across his main points.

1. Hanke makes a mountain out of a mole hill where he finds a difference in his estimation of the inflation rates he estimates at 38.5% as opposed to 39.9% of the editor’s – an absolute difference of just 1.4%; relatively not more than 0.037%. I am sure Hanke was not weighing gold. Same applies to his challenge (his point 3) that as per his *thought* that the GDP growth rate was lower at 7.0% than the official 7.4%; what a difference. Incidentally, the learned professor does not say why he “thinks” so? May be, he saw a dream. He wonders what it was that grew in 2017. Better, Hanke must answer that question as he does say that in his view the economy grew by 7%.

2. Hanke claims greater accuracy for his measurement of the inflation rate in Turkey XIS-A-VIS the government. I cannot verify his claim as I do not have the necessary with me. But I do have to offer a few observations to offer on what Hanke has done and claims. First, he finds the use of daily data not monthly the governments not only in Turkey but across countries normally use, monthly figures are more stable and accurate. This is corroborated also by the fact that in an economy incomes are mostly received monthly and households plan expenditure on that basis, not per day. Monthly data provides better averaging for the year as well.

A more serious objection is to the selection of the regimen for constructing index numbers. It is startling to hear from Hanke that the most important price for a country is the value of foreign currency, to him US Dollar in terms of domestic currency. It could be valid in case of highly open economies like Singapore or Hong Kong that depend heavily on foreign trade for their living. Countries like India, China, Brazil, Indonesia, even Turkey do not fall in that category. Like was rentals are important for measuring cost of living changes not the property values, or event the prices of other durable that Hanke includes to arrive at his estimates.

<sup>†</sup> INCEIF, Malaysia.



✉. zubhasan@gmail.com

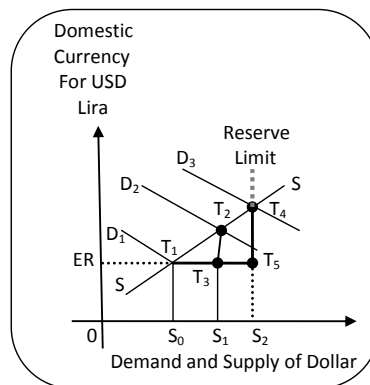
<sup>1</sup> Hegemony refers to leadership or dominance, especially by one state or social group over others. After the Second World War USA has increasingly assume this role though of late it tends to wane.

## Turkish Economic Review

Finally, prices of all commodities are not equally important for cost of living index construction. A carefully designed weighting system has to be used that has to be periodically reviewed and revised to reflect changes in consumption patterns. Selection of base and its periodic shifting also matter. Hanke's estimations seem oblivious to these essentials. His is an exercise in futility meriting out right rejection in favor of the government series.

3. The central point of Hanke's thesis is that to overcome her current economic difficulties, essentially of West's making, Turkey must submit to stabilize its currency according to the hegemonic dictates that Hanke so crudely, if not unashamedly, puts forth. For this his letter contains both the carrots and the stick elements. We can best evaluate his suggestions using a simple diagram.

4. Following Hanke, let us grant for the moment that stability of the external value of her currency should be the primary monetary policy objective of Turkey. To achieve this objective the country should express the value of Lira in terms of gold or US \$, the reserve currency of the world. As return to gold is not possible, what Hanke de facto suggests is the pegging of Lira to US dollar at a fixed rate. According to him, rate must be the same ratio as the purchasing power ratio of the two currencies. We shall soon discuss this suggestion. Presently, let us examine how stability of exchange rate would be achieved following Hanke. To put his suggestion into operation, Turkey must always have a dollar stock sufficient to convert at least its base money  $M_0$  coins and currency notes, into US dollars. Let us assume that the purchasing power parity sets exchange rate that the initial equilibrium in the foreign exchange market before pegging is ER at point  $T_1$  in the Figure and this ER is considered good enough for the economy for pegging to the dollar. However, the dollar stock starting rate of exchange as set by the purchasing power parity (PPP) were ER at  $D_1$ . The stock, plus minus periodic adjustments, remains sufficient to meet current supply deficiencies to meet demand, say at  $D_2$ , by selling at ER,  $T_1T_3$  amount of dollars to fill  $T_2T_3$  demand from reserves. Likewise, later monetary authority sells  $T_3 T_5$  dollars to meet excess demand  $T_4T_5$ .



But this cannot go on infinitely, given the weakening balance of payments position with most developing countries like Turkey. What if the country has no dollar reserves to maintain the ER. Here enters into the picture the carrot-stick formula of Hanke. However before we turn to that part of his letter, let us examine the efficacy of using the PPP for determining the ER in Hanke.

5. Purchasing power parity theory contains the truth that what currencies can purchase domestically has a bearing on their relative exchange rates. But to rely solely on PPP for determining exchange rates has some serious limitations. A limitation of measuring The country GDPs in nominal US dollars was that inter-country per capita income comparisons were falsified to the extent that the dollar values did not reflect the purchasing power of the incomes in various countries. To make comparisons more realistic the IMF launched an income comparison

## Turkish Economic Review

program (ICP) of presenting the GDP data from 1992 onwards based on the purchasing power parity (PPP) of currencies.

Under the program, the prices of 400 to 1000 items are collected from each country and classified into over 150 groups; the price relatives of these groups are then aggregated into average price relatives or the PPPs for the GDP components of the country in question using expenditure ratios as weights.

If the ICP aimed at price equalization across countries for more realistic cross country income comparisons that objective is hardly achieved. Rather the procedure worsens the situation that it sought to improve for ambiguities in price harmonization, source selection, weights assignment and in forging global linkages.<sup>3 2</sup> With reference to exchange rate determination PPP is grossly unsuitable as goods and services entering the balance of payments relevant for the purpose are a much different set than those entering in GDP estimation. Furthermore, rising and at times heightened speculation having little to do with GDP values is major influence on exchange rates.

6. Hanke (point 8) inaptly questions Erdogan's view that current depreciation occurrence in the value of Lira is a plot designed by western countries while the fact is brighter than the sun that currency plunge in Turkey occasioned after the US imposition of economic sanctions on the country for hegemonic reasons. That the West has long been playing this game against developing economies since the establishment of the American led IMF. The currencies of these countries are caught in the loan-interest web or even at times attacked by their fund owners to perpetrate financial crises such the 1997 Asian turmoil to make them seek further loans from the IMF only to tighten the noose further. The story of devaluation of weak currencies – 34 in number - going down on their knees seeking help from the IMF to their dismay continues unabated until we reach Turkey and beyond.<sup>43</sup>

7. Despite lamenting about the current Lira situation, Hanke does not see it in crisis yet but there is danger of having one if measures to stabilize it were not initiated (point9). He is closer to the truth when he observes: "Stability might not be everything, but everything is nothing without stability." And to achieve that stability, his prescription for Turkey is the pegging of Lira to the world reserve currency the mighty US dollar as that could also curb inflation. To oversee the implementation of the policy, he does not trust the central bank of the country palpably under government influence. He recommends the establishment of an independent Currency Board to run the monetary affairs of the country (point 4). The arrangement would bring in foreign capital to strengthen the economy and improve stability.

8. To do otherwise would spell doom. Hanke warns against governmental intervention in the free working of the economy, especially the exchange market. If the stock of reserve currency the dollar falls short of requirement IMF can always be approached or foreign funds operators can step in to help. Interventionist policies would scare away both darkening the future of the Turkish economy. Thus, promise and threat both go hand in hand in Hanke's prescription of amelioration. Where do we go from here?

9. Currency Boards are a thing of the past. They were on the scene mostly during the second half of the preceding century and have a checkered performance history. Today, independence of financial institutions including central banks is a

<sup>2</sup> See for details Hasan, Z. (2008). Ensuring exchange rate stability: Is return to gold (Dinar) possible?, *JKAU: Islamic Economics*, 21(1), 3-22.

<sup>3</sup> See for fuller explanation, Hasan, Z. & Laher, H. (2009). *Macroeconomics*, Oxford University Press pp.239-240.

<sup>4</sup> See for illustration, Hasan, Z. (2002). Recent financial crisis in Malaysia: Responses, results, challenges, *The Indian Economic Journal*, 49(1), 28-49.

<sup>5</sup> See, Hasan, Z. (2002). Recent financial crisis in Malaysia: Causes response, and results – A rejoinder, *Islamic Economic Studies*, 10(2), 45-53.

## Turkish Economic Review

thing of the past. Federal Reserve System itself is not free of political influence. Even global institution like the IMF, Bank of International settlement WTO or the World Bank can hardly claim independent of the Western influence. Anyway, if the governor and the board of directors at the central bank cannot operate independently, how Hanke believes that a currency Board whose members would be nominees of the government could be expected to work independently in overall national interest while that interest itself is politically settled?

10. Finally, here is a word on free operations versus public intervention in currency markets. Let me begin by asserting that market freedom is not a sacred cow that cannot be sacrificed at the altar of national interest; history bears testimony to this contention. There is an illuminating example from the financial turmoil that devastated the south east Asian countries during 1997-1998 brought about essentially by the flight of hot money from the region almost overnight. Thailand sought the IMF help to tide over the difficulty. In contrast, Malaysia imposed exchange controls. Thailand took four years to normalize, Malaysia just one.<sup>5</sup>

After clearing the IMF debt the Thailand Prime Minister laments that IMF help proved very costly and vowed that in future crises, if any, the country would never go to the institution. Professor Hanke The Economic and Social Survey of Asia and the Pacific of the UN released on April 4, 2001 declared: “The experience of Malaysia suggests that capital controls can help stabilize an otherwise difficult situation”. IMF now envisages imposing fewer conditions on loans granted to developing countries so that they may have greater freedom to design their recovery plans in the future (IMF, 2001).

To conclude, Professor Hanke’s letter in content and thrust is a naivety bordering nonsense. President Erdogan is within his right to take corrective measures he may deem fit in the interest of his country including for example the shifting of electronic goods imports from the US to South Korea as he puts it.



### Copyrights

Copyright for this article is retained by the author(s), with first publication rights granted to the journal. This is an open-access article distributed under the terms and conditions of the Creative Commons Attribution license (<http://creativecommons.org/licenses/by-nc/4.0>).

