

The Financial Crises in Turkey: A Self-Fulfilling Prophecy

Draft paper to be presented for 14th conference on 'Stabilising an unequal economy?' Public debt, financial regulation, and income distribution' organized by the Research Network Macroeconomics and Macroeconomic Policies (FMM). 29 – 30 October 2010, Berlin. Draft version, please do not quote.

Ismail Doga Karatepe, idkaratepe@gmail.com, Graduate Student at Global Political Economy at the Faculty of Social Sciences at the University of Kassel

Ozgur Genc, ozgurr.genc@gmail.com, Graduate Student at Global Political Economy at the Faculty of Social Sciences at the University of Kassel

Abstract:

This descriptive study sets out to demonstrate the origins of financial crisis in Turkey after the year 1989, when the controls on capital account were lifted, in the framework of Minsky's financial fragility and instability hypothesis. Through illustrating past encounter with financial crisis, the question of whether it can happen again is asked. The claim of this study is that the *de facto* projections of financial liberalization in late 1980s have been financial crises and macroeconomic fragilities, and the question of whether it can happen again is a naïve question. Considering the entire fragile structures of Turkey's economy, the question should really be when, how and to which extent.

I. Introduction

The year 1989 is a milestone in Turkey's economic history. In August 1989, controls on capital account were lifted in parallel with the tendencies in the rest of the developing countries' financial liberalization policies. Neoliberal orthodoxy evaluates financial liberalization as a remedy which brings about the increment of savings and the betterment of economic efficiency for developing countries. Accordingly, in theory, financial capital may move to a developing country which has a relatively low saving level and the need for foreign currency, under the condition that this country will fulfil the requirements of neoliberal orthodoxy. Financial capital, inflowing to this developing country, provokes investments and

increases capital accumulation, which bring about sustainable growth (Cizre and Yeldan, 2005:388). This paper, in contrast to neoliberal orthodoxy, claims that the *de facto* projections of financial liberalization in late 1980s have been financial crises and macroeconomic fragilities in the case of Turkey thus far.

The paper is divided into five sections including the introduction. In the second section, the post-Keynesian approach, particularly Minskyan boom-bust cycles, which constitute the theoretical background of this study, are discussed. In this section the attention is especially confined to the financial fragility and instability hypothesis of the post-Keynesian approach on developing countries. The third section provides a brief historical analysis on the pre-financial liberalization era in Turkey. The aim of this section is to demonstrate the transition period to the neoliberal economic policy implementations. The next section demonstrates some empirical evidence concerning the boom-bust cycle in the case of Turkey. The final section is solely reserved for some comments and evaluations as a conclusion. The comments and evaluations which shed light on new patterns of dependency in developing countries in the world system in the era of so-called globalization, particularly Turkey, constitute the relevance of this study.

The basic aim of this study is to demonstrate the origins of financial crises in developing countries through the case of Turkey. Also, this study gives floor to further research questions on the financial and macroeconomic fragility in general.

II. Theoretical Framework – An Overview on Minskyan Boom and Bust Cycles

This section presents briefly the Minskyan boom and bust cycles in the context of developing countries. The basic aim of the section is to demonstrate the vicious circle of persistent high interest rates and hot money flows of which most of the developing countries suffer from. The theoretical framework of this section grounds on the systemic financial fragility and instability hypothesis of Minsky (1982, 1986) and the post-Keynesian extended version of this hypothesis for developing countries which is discussed elaborately in Akyüz (2006), Boratav and Akyüz (2002), Frenkel and Rapetti (2009), Gabel (1995), Kregel (1988), Taylor (1988), and Onaran (2006, 2007).

Since the current global crisis revealed the substantial fragility in the financial system worldwide, Minsky's works and his model on financial instability started to attract attention (Frenkel and Rapatti, 2009, Nesvetailova, 2008). This attention owes to Minsky's ontological explanation of financial crises, which distinguishes his works from other mainstream models.

Concerning ontological explanation, in contrast to mainstream financial crises models, two points should be mentioned. Firstly, Minsky (1982) evaluates “financial crises as systemic, rather than accidental, events” (:63). Secondly, the roots of financial crises are concealed during the periods of financial tranquillity; the crises are the reflection of risky financial activities during these periods (Arestis, 2002:238, also see: Minsky, 1982 especially:9-11).

The pace of investment plays a crucial role in Minsky’s financial fragility and instability hypothesis. The interest rates of borrowing and lending activities and of assets are the important determinants of the investment pace, and thus of employment, output and profit as well. During the boom phase, when the economy “does well” (Minsky, 1982:63), investors’ expectations become more optimistic and thus investment and the proportion of debt financing increases. Investors start to take risky positions through mostly reducing the margins of safety and therefore the demand curve for short-term debt increases, which results in that the elasticity of demand curve steepens. This obviously pushes the interest rate upwards under the circumstances of inelastic supply of finance. The upward pressure on the interest rate ultimately brings about deterioration in the firms’ balance sheets. Some firms start to borrow in order to fulfil their payment commitments¹ and become vulnerable to the interest rate and to credit possibilities. At that point, the economy transforms from doing well to an increasing fragility, which results in financial and macroeconomic instability. As Minsky points out, this transformation “is the basic instability in a capitalist economy” (1982:66).

When the system once becomes fragile, “distress begins” and in case of any pessimistic expectations, this fragility leads to a financial crisis and bankruptcies (Frenkel and Rapetti 2009:2). As Onaran argues in her many studies, the reasons and the sources of pessimistic expectations which cause financial crises are “not important” (among them see:2006:5). In this respect, the roots of financial crises should be searched in the vulnerability embodied in the fragile financial and economic structure.

The phenomenon of financial crisis is unavoidable and inevitable in a given capitalist society; however, the length and intensity of a crisis and the time of its occurrence are not deterministic variables. These variables are affected by both the magnitude of the vulnerability and its dimensions, and by the expectations which cannot be known easily

¹ Minsky calls these firms Ponzi unit, in his words: “a speculative financing unit for the which the income component of the near cash flows fall short of the near term interest payments on debt so that fore some time in the near future the outstanding debts will grow due to the interest on existing debt” (1982:23).

(Onaran, 2006, 2007). As Nesvetailova discusses, “[t]he precise nature and outcome of the collapse depends on the specific characteristics of the economy in question” (:2).

It should be borne in mind that Minsky constitutes his hypothesis on the link between financial and real variables. During the bust phase, accordingly, the financial crisis diffuses to the whole economy and investment, output and private consumption decline drastically. Thus it leads to a systemic macroeconomic crisis which results in loss of wealth. This fact could be observed in several crises in both developed and developing countries. However, as many observers underline, the dynamic of the financial crises in both the developed and the developing countries have distinctive as well as similar features (among them see: Frenkel and Rapetti, 2009, Akyüz, 2006). In most of the cases the distinctive features emerge from the first (boom) phase of the Minskyan cycle. Either the de(re-)regulation of the domestic financial market, the liberalization of capital account or implementing a new exchange regime may trigger the boom phase (Taylor, 1988) in a developing country. This sort of new macroeconomic policy implementation, which brings about a profitable environment through arbitrage possibilities for both the domestic and the international assets, pushes the country into a vicious circle, a financial quagmire, as it will be discussed.

Adelman and Yeldan (2000), Boratav (2003, 2004), Diaz-Alejandro (1985), Onaran (2006, 2007), Taylor (1988) and Yeldan (2001, 2006a, 2009) discuss the vicious circle as such and the nature of the transformation to a fragile economy. High interest rates, emerged from the liberalization of domestic market with the de(re-)regulation of the financial institutions, are the initial point of a vicious circle. The emergence of high interest rates constitutes the conditions for a boom phase in a developing country. Simultaneously, it is the first step to the road to a fragile and vulnerable economy.

Through liberalising capital account in later stage, and through high interest rates, the developing country starts to attract financial capital. The net differential of the interest rates above the world average attracts large financial capital inflows which include, however, a high portion of short-term arbitrage-seeking financial capital inflows, in other terms hot money, to this developing country. During the boom phase, investors have a high appetite for risk and thus the margins of risks start to decrease, which result in further capital inflows. These capital inflows generate illusionary currency appreciation with the help of the (mostly flexible and crawling peg) eligible exchange rate regime.

This process consequently causes loss of competitiveness for this country because of the appreciation of the exchange rate and illusionary growth. While export is stagnating, import is increasing because of the lack of both competitiveness and growth. This process expands the

current account deficit. In short, in Boratav's (2004) words, "causality relations realize along *capital inflows* → *growth* → *current account deficit*" (Boratav, 2004:234). Obviously, this causes fragility; moreover, meanwhile the firms' balance sheet deterioration occurs because of the possibilities of overvalued domestic currency. The firms in this developing country can borrow relatively cheap foreign currency in order to finance their investments.

As mentioned above, once the system becomes fragile, "distress begins" and, in case of any pessimistic expectations, this fragility leads to a financial crisis and bankruptcies. As it is stated in Onaran (2007), "the combination of some adverse shocks like the bankruptcy of a firm or a bank, or problems in the export markets, neighbour country, world economy, or in the domestic political arena" could cause a pessimistic expectation. When the expectations turn to pessimism, so-called 'investors' start to signal financial capital outflow which could lead to the depreciation of domestic currency and, thus, to currency mismatches in firms' balance sheets. As Yeldan (2001) underlines, "[...] in order to overcome the rising country risk and gain international creditworthiness, the central bank (hereinafter, CB) is compelled to raise the interest rate [...]" (:6). Raising the interest rate is, in this case, also the endpoint of the vicious circle. However, raising the interest rate through mostly an austere fiscal policy or central bank interventions could just postpone and no doubt intensify the current problem. Eventually, investors decide to leave because of a perception of risk and a possible financial crisis, in other words, drastic depreciation of the exchange rate. In Onaran's (2007) words, "in the end an expected depreciation becomes a self-fulfilling prophecy" (:6). The bust phase starts and causes loss of wealth in a developing country.

During the bust phase, depreciation of domestic currency diffuses the real variables of the economy through two direct effects which roll back investment and GDP, and thus the consumption level. Firstly, the number of Ponzi units in this economy increases drastically; secondly, the cost of inputs especially in manufacturing industry increases. In this context, macroeconomic instability may show up as different phenomena such as inflation, an increment in high unemployment rate, bankruptcy, etc.

III. A Brief Historical Background on Pre-Capital Account Liberalization Era

The Turkish economy faced an economic crisis in the end of the 1970s. One of the important dimensions of this crisis was the crisis in the balance of payment. Especially in 1977, the shortage in terms of foreign currency - particularly the US dollar - became apparent. There is no doubt that the main reason of the foreign currency problematic was the trade

imbalance; in other words, the widening gap between imports and exports. The gap widened sharply from 1970 to 1980, almost fourteen times greater than previously. Increasing oil prices and thus increasing relative price of manufactured goods deeply affected this gap in the 1970s. Furthermore, it is noteworthy that one of the reasons for the widening gap throughout the 1970s was petrodollars which emerged after the first oil shock and then were pumped into developing countries by the US-led policies (Kazgan, 2004:105). The petrodollars, financing imports to some degree, promoted them with the help of import liberalization policy in Turkey during the 1970s. On the other hand, this situation led Turkey to external debt problems, as it did other developing countries during the same era.

The abundance of loanable petrodollars, sometimes loaned at the negative real rates of interest, increased debt, especially the short-term debt of Turkey in late 1970s. The significant alteration in favor of the short-term external debt over other terms of external debt generated the problem of ‘liquidity’. In 1978, the proportion of short-term external debt reached 52% among all-term external debt (Kazgan, 2004:106). Far from supplying sufficient foreign currency for imports in 1978, the policy makers in Turkey were not even able to provide foreign currency to cover the matured liability. In view of these facts, it was attempted to defer or convert short-term debt into medium-term or long-term debts. Meanwhile, policy makers tried to obtain loans from IMF and OECD. However, for the new loans these key international organizations demanded more than before: the demand for a transition to an export-led and market-oriented economic model.

In the end of the 1970s, the domestic bourgeoisie also started to criticize the existed macroeconomic indicators and economic policy implementations (Başkaya, 2009:240). Their critiques clustered around the constraints on foreign currency and thus the scarcity of the necessary import for the production chain. Their policy suggestions overlapped with those of the key international organizations such as IMF and OECD. At this point, in the words of Öniş, “Turkey shifted to a neoliberal model not through voluntary choice but as an inevitable and forced outcome of a major balance of payment crisis” (2004:9). The ‘24 January Measures’, as a structural adjustment program, in this context, were the symbol of shifting to the neoliberal model in the Turkish economy in 1980. As for example in Chile, Argentina and many other developing countries, the neoliberal model was accompanied by “strong government” (Şener, 1998). Only nine months after the declaration of the 24 January Measure, in the morning of 12th September 1980, the military intervened to the politics and the well-known 12th September coup d’état took place in Turkey.

The 24 January Measures, as a structural adjustment program” basically aimed to liberalize trade in the name of promoting exports. For this purpose, as Yeldan (2006a) stresses, “[...] both the exchange rate and direct export subsidies acted as main instruments for the promotion of exports [...]”(196). On the other hand, liberalized trade accompanied by liberalization domestic financial market and fiscal austerity. In addition, with the help of military power, wages were suppressed for a while. However, the heyday of neoliberalism did not last so long. As some observers have noticed, as popular movements and trade unions were regaining power in 1988-89, the government was pushed to be populist, in particular to increase wages (Boratav, 2003:121). One of the main “macroeconomic response to the increased wage costs” was implementing the capital account deregulation (Yeldan, 2006a:199): In 1989, the Turkish Lira (Hereinafter: TL) was declared a convertible currency and controls on foreign capital transactions were lifted in this context.

IV. A Look at Some Evidence: The Case of Turkey

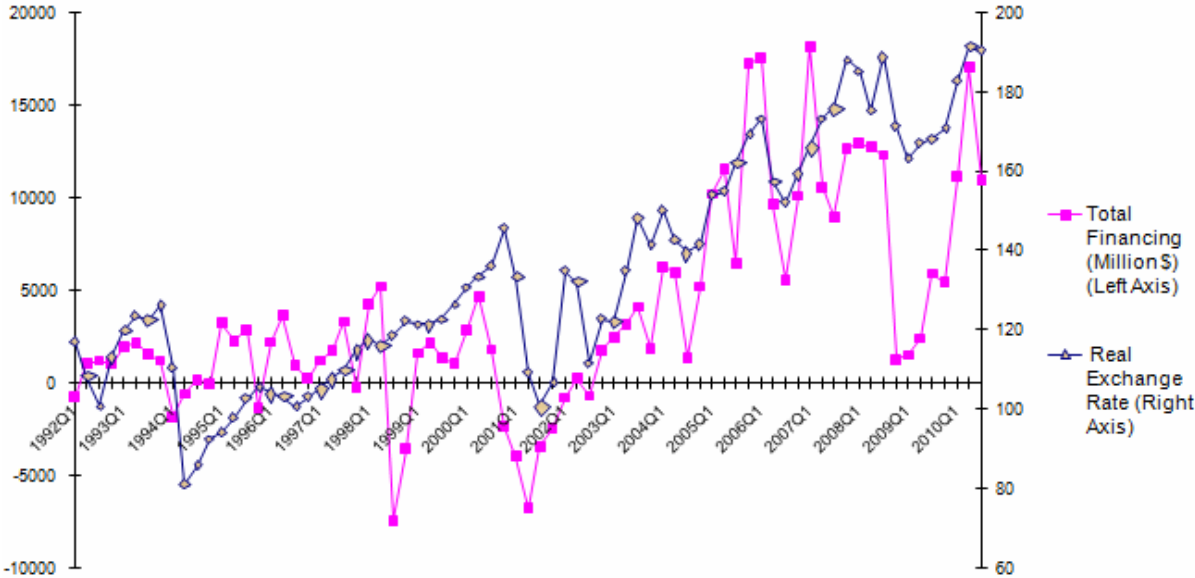
Minsky’s well-known paper, ‘Can “It” Happen Again’ which was published in 1963, discusses why the Great Depression (Minsky’s “It”) can not happen again in the US (Minsky, 1982:3-13, also see: Kregel, 1998:1-2). Minsky discussed that two factors which are related to the “role of federal government” will prevent a possible crisis. Firstly, expansionary fiscal policy tends to stabilize the income level and thus the aggregate demand. Secondly, the interventions of the Federal Reserve as a ‘lender of a last resort’ play a crucial role in preventing a collapse of the asset values. The Federal Reserve refinances asset holders in any situation, therefore “they are not being forced to sell out their position” (Minsky, 1982:xvi).

It could be argued that the two factors which prevent financial crisis were eliminated during the financial liberalization process in Turkey. Firstly, in early 1980s, through the mentioned structural adjustment program, fiscal austerity started to be implemented. Since then, Turkey’s governments have tried to diminish the income level in the name of promoting export. Secondly, after lifting the controls on capital account and declaring the convertibility of the TL, the CB of Turkey lost its control on monetary measurement, interest rates and exchange rates. As Yeldan (2006a) discusses, “these practically turned into exogenous parameters set by the chaotic conditions of financial arbitrage in the global markets” (:199). Besides, the firms and the financial institutions in Turkey could borrow or lend in any foreign currency and the CB’s intervention capability as a lender of last resort has ever since had some limits due to its foreign currency reserve stock. Eventually, Turkey experienced two big

financial crises in 1994 and 2001 after the controls on capital account were lifted and due to the lax regulation this resulted in.

Since the beginning of the post-capital account liberalization era, Turkey has attracted financial capital through providing an appetitive financial arbitrage rate. Turkey’s appetitive offer to the so-called ‘investors’ brings about financial inflows and thus makes Turkey an ‘emerging market’. These financial flows constitute high correlation with the value of the domestic currency, the TL. As it could be observed in Chart 1², where an increase in the real exchange rate refers an appreciation of the value of the domestic currency and vice versa, total financing denotes net capital flows, there is a high correlation between the net capital flows and the value of the TL in the post-capital account liberalization era in Turkey.

Chart 1: Total Financing and Real Exchange Rate



Source: CBRT Electronic Data Delivery System

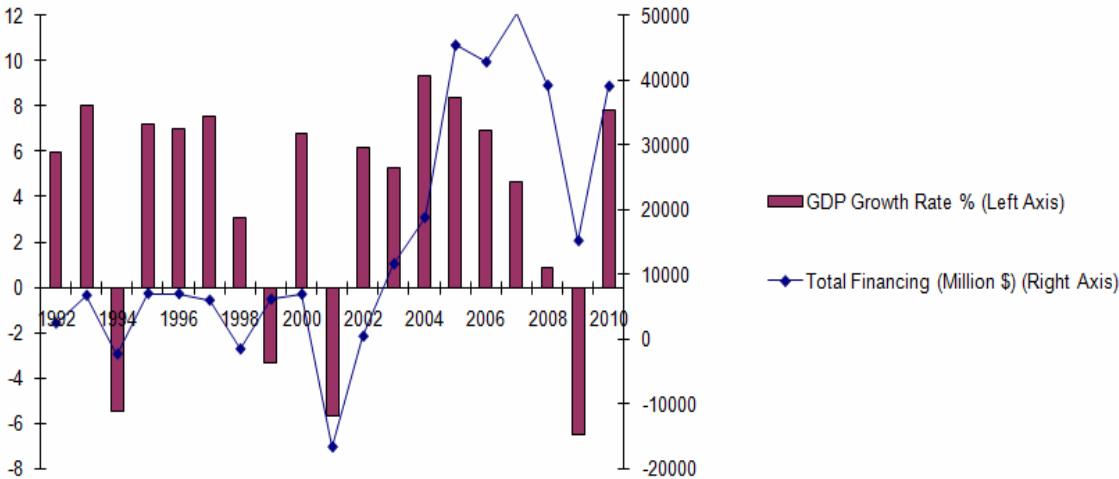
‘Total Financing’ on the left axis can be calculated as the sum of the financial account and of the net error and emission, which represents unrecorded net capital flows from Turkey’s balance of payment data. It can be clearly observed from the chart above that during

² CPI based real effective exchange rate index, which is utilized in this chart, is calculated by the CB of Turkey using the IMF weights for 19 countries including Germany, USA, Italy, France, United Kingdom, Japan, Netherlands, Belgium, Switzerland, Austria, Spain, Canada, Korea, Sweden, Taiwan, Iran, Brazil, China and Greece.

the years of crisis – 1994 and 2001 – Turkey faced sudden capital outflows and this encounter ended up with the devaluation of the TL, in other words, the sudden depreciation of domestic currency. Also, the chart points out that shortly after the devaluations in 1994 and 2001 capital inflows began to increase and thus the sign of net capital flow became positive.

Not only the real exchange rate but also the growth rates of Turkey’s GDP became dependent on capital inflows, which include a high portion of short-term arbitrage-seeking financial capital inflows, in other terms ‘hot money’, in the beginning of the post-capital account liberalization era. In order to illustrate this phenomenon, Chart 2 is portrayed. Short-term portfolio investments and credit inflows, by financing the current account deficit and through fuelling import, have played a crucial role in the ‘continuity’ of the growth rate. As Yeldan points out, “under the deregulated financial environment, sources of growth originated not from domestic capital accumulation but from the ad hoc and often irrational decrees of foreign (speculative) financial capital” (2006a:200). The chart below clearly allows us to observe this speculation-led growth pattern (a la Gabel, 1995). FDI, which is included in the capital flows data, on the other hand, has an insignificant role and proportion in the flows to Turkey. As it is stated in Onaran (2006), “even the FDI inflow of 3.2 billion dollars in the 2005 January-October period, which is very high from a historical point of view, is forming only 10% of the total capital inflow in this period” (:9).

Chart 2: Speculative-led Growth in Turkey



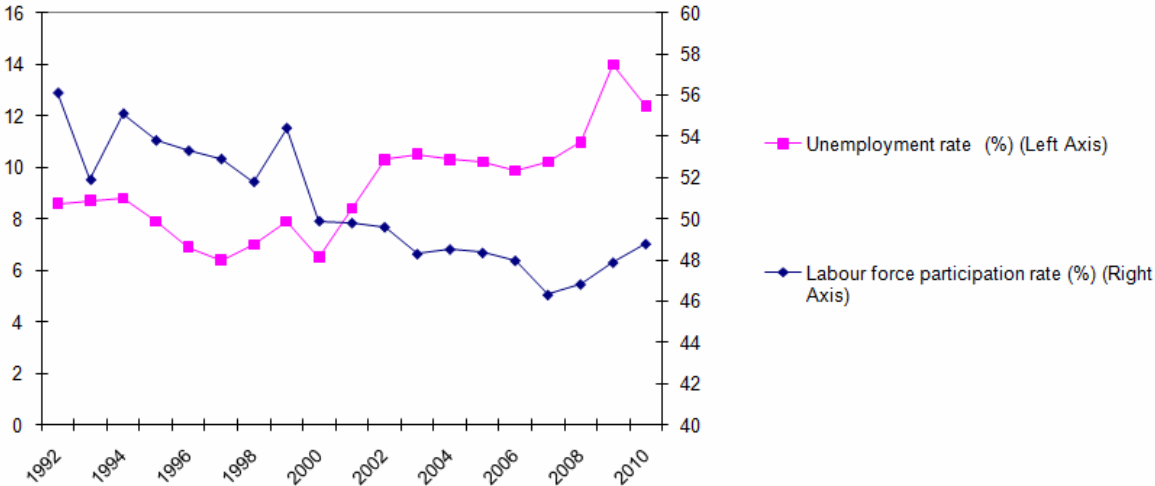
*GDP growth rate for 2010 IMF staff estimate

Total financing data for 2010 only comprehends first 3 quarter

Source: CBRT Electronic Data Delivery System, IMF Word Economic Outlook Database

The ‘jobless growth’ pattern is one of the important the features of and the results of the speculation-led growth pattern in Turkey. The speculation-led growth pattern in Turkey has not created employment throughout the 1990s and early 2000s (Yeldan, 2001, 2006a, Onaran, 2006). As it can be seen by the Chart 3, especially after 2001, in spite of a decrease in the labour force participation rates (right axis), the unemployment rates (left axis) have been increasing.³ Even though Turkey had high average growth rate of GDP in the period between 2002-2008, including 2004 when the GDP grew at record high of 9.3%, Turkey was neither successful to decrease high unemployment rate nor was it able to maintain it. The unemployment rate, which was 6.5% in 2000, rose to 8.4% in 2001 and accelerated to 10.3% in 2003. Since the beginning of the 2003, until the global crisis unfolded, it had been fluctuating around this level. In 2009, the rate reached at record high of 13.93%. In this respect, the Chart 3 underpins the observation that the origins of growth in Turkey should not be searched in the domestic capital accumulation but in the magnitude and the direction of capital flows.

Chart 3: The Unemployment and the Labour Participation Rate in Turkey



Source: Turkstat: Household Survey

The chart above clearly demonstrates the low labour force participation rate which is fluctuating between 48% and 56% level. The main reason behind this fact is low female

³ By utilizing Granger causality test and Final Prediction Error, Yılmaz (2005) claims that there is no reciprocal causality relation between the growth rates of Turkey’s GDP and the rates of unemployment in the post-capital account liberalization era. The growth rate whether it is high, low or negative does not affect the rate of employment.

labour force participation to the labour markets. Even when the highest growth rate in GDP was recorded in 2004, the female labour force participation rate was just slightly over the 25%. To underpin this argument, it is noteworthy that the rate of the female employment in 2004 was 22.9%. It should be mentioned that, especially after year 2000, the rates of female employment were fluctuating around the same level (22-25%). As Onaran (2006) stresses, “[t]he low participation and employment rates of women are not only due to male-dominated domestic division of labour, but also to the working conditions and low wages, which is making most jobs acceptable for only young single women”(:9).

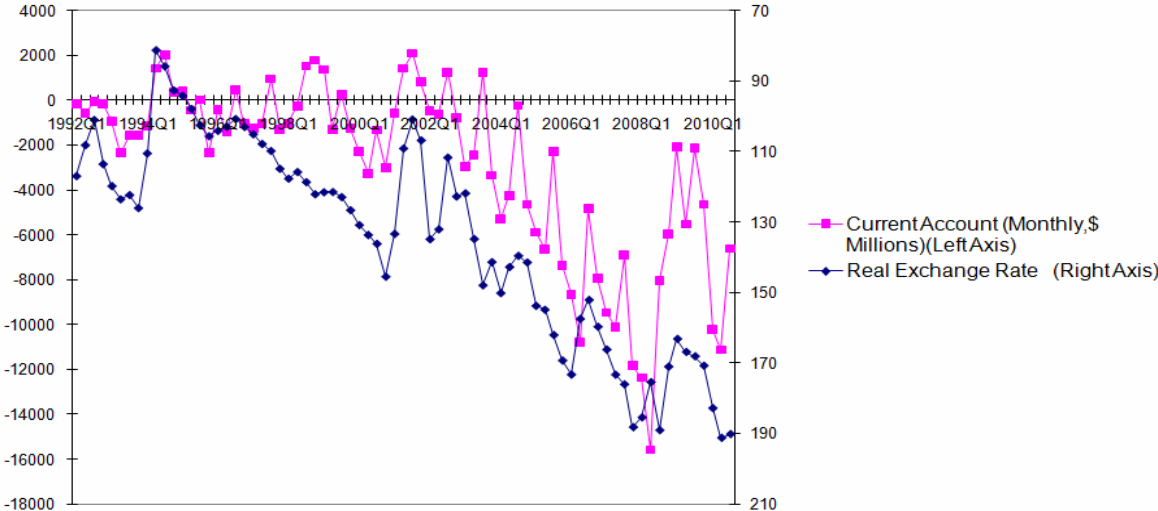
Regarding the unemployment phenomenon in Turkey, the non-agricultural unemployment rate is always higher than the agricultural unemployment rate. For instance, according to the data, drawn in the Chart 3, in the year 2000, when the overall unemployment rate reached its minimum level (6.5%), the non-agricultural unemployment rate was 3 points more than the overall unemployment rate. Concerning the gender division of labour, the female non-agricultural unemployment rate is much higher for the all years. For instance, in 2000, the female non-agricultural unemployment rate was more than twice as much as the overall unemployment rate. While the female non-agricultural unemployment rate was 13.5%, the male non-agricultural employment rate was just slightly over the overall unemployment rate.

The appreciation of the TL which makes the import cheaper for Turkey and the high interest rate plateau for attracting capital flows has undermined investments, in particular fixed capital investments in the manufacturing industry. The portion of fixed capital investment in GDP has fallen apparently after 1980, despite a sharp decline in wages and thus unit costs in the post-capital account liberalization era (Şenses and Taymaz, 2003; Onaran, 2007). The sharp decline in wages, on the other hand, has resulted in the contraction of the domestic aggregate demand, and therefore has created vulnerability in the manufacturing industry. The manufacturing industry consequently became more dependent on the condition of the world market.

The appreciation of the TL and the illusionary growth, originated from capital inflows, have generated the current account deficit problematic in the case of Turkey, as well as in other developing countries. Chart 4 is portrayed in order to illustrate the relationship between the value of the TL and the current account deficit. The chart clearly demonstrates that an increase in real exchange rate (drawn upside down on right axis) has a negative effect on the current account balance (on left axis). Since the beginning of the post-capital account liberalization era, the appreciation of the real exchange rate has widened the current account

deficit (except for the year of earthquake of 1999). The positive current account balance in the post-capital account liberalization era is exceptional and occasional, and mostly emerges from a sharp depreciation of the domestic currency or a sudden expansion in Turkey’s export market.

Chart 4: Current Account Deficit and Reel Exchange Rate:



Source: CBRT Electronic Data Delivery System, IMF Word Economic Outlook Database

After lifting the controls on capital account in August 1989, the first wave of capital inflow reached a level that constituted 3.7% of GNP in 1993 (Onaran, 2007). Until 1994, especially the foreign investors enjoyed the Turkey’s high arbitrage offer. In the post-capital account liberalization era, during the first boom phase which came out along with the capital inflows, the growth rate of GDP reached 8% in 1993. The government started to take risky position and public external debt stock increased drastically by the help of relatively cheap foreign currency. The public external debt stock, which was 13.7 billion dollars in 1980, leaped to 47.2 billion dollars in the beginning of 1990s. On the other hand, the capital flows, which included high portion hot-money component enabled Turkey to finance its import, fuelled by the overvalued TL. The current account deficit as a percentage of GDP was 0.045 in 1992 rose to 3.2 in 1993. The high growth rates in this boom phase were carried out in exchange for the increasingly fragile and vulnerable economy and the dependent structure on the continuity of the capital inflows.

As discussed above, once the system becomes fragile, “distress begins” and in case of any pessimistic expectations, this fragility develops to a financial crisis. The transition between the boom and the bust phase took place in 1994. Just before the election, the government’s attempt at suppressing the interest rate triggered massive capital outflows which

caused the first financial crisis in the post-capital account liberalization era. The net capital flows turned negative (by -135.5 million dollars) and GDP fell by 5.4%. Eventually, Turkey faced the most tragic economic crisis after World War II (Yeldan, 2001).

The devaluation took place in April 1994; and real exchange rate was 124.5 in January decreased to 78. After the devaluation, the current account balance turned to positive, however, this positive trend was able to last until November 1994 due to the increase in the real exchange rate. The real exchange rate rose so rapidly and reached the level of 93.2 in November 1994. The reason behind the increment of the real exchange rate consisted on capital inflows to Turkey, which were observed to start their increasing trend in June 1994. As Onaran (2007) discusses, “[...]the international investors started to enjoy the deflated asset prices in the stock and bond markets and the security that came with the already depreciated currency” (:6). The appetite of investors for the depreciated currency caused a new boom (and dialectically bust) phase which came out along with a new wave of capital inflows.

In 1995, the capital inflows reached 585 million dollars which was more than the capital inflows level in 1993. Till 1998 capital inflows to Turkey were fluctuating around same level⁴. During this boom phase, along with capital inflows, GDP was reinvigorated. In the period 1995-1998, growth rates of GDP were more than 7% level. The high growth rates, which were based on capital inflows and thus on the fragile financial and economic environment, were doomed to slow down. Eventually, starting from August 1998, the Russian and East Asian crises stopped the capital inflows and thus the high growth rates (Boratav and Akyüz, 2002). In 1998, the capital outflows reached almost the 130 million dollars level and that pull down the growth rate by almost 4 points.

In order to combat increasing fragility in Turkey’s economy, an IMF-led dis-inflation programme within the framework of stand-by agreement started to be implemented at the end of 1999. The main instrument of this programme was ‘crawling pegs exchange rate regime’ and the exchange rate was planned to be utilized as a nominal anchor to suppress the inflation rate (Yeldan, 2002, Boratav and Akyüz, 2002). This programme also implemented “quasi-currency board regime” by restricting monetary expansion according to the CB’s foreign exchange reserve movement (Boratav and Akyüz, 2002:17). The idea behind the program was to control inflation, which was fluctuating about 75% in the years between 1995 and 1998, and thus to control the illusionary appreciation of the TL. However, the partial success in

⁴ 585 million dollars in 1995, 581 in 1996, 485 in 1997.

decreasing inflation rate was not enough to prevent the appreciation of the TL. The real exchange rate which was 127.3 in December 1999 rose to 148.1 in January 2001.

The current account deficit, as a percent of GDP in 2000, went beyond the level before the 1994 crisis. The current account deficit/GDP, which was 3.2% in 1993, rose to 3.7% in 2000. Another fragility that emerged in Turkey's economy was external debt stock which increased by 62% from 1995 to 2000 (Ekzen, 2008:4). Although external public debt fell from 68.5 to 63 billion dollars, the private external debt, which was the reason behind the drastic increase in external debt stocks, increased from 7.7 to 55.7 billion dollars in mentioned years. As Demir (2004) discusses, "an important portion of the external debt has been realized by domestic banks with an underlying motivation to gain arbitrage through borrowing abroad and lending to the Treasury at very high interest rates" (:855).

The overvalued exchange rate, accompanied by high interest rate, attracted the massive volume of capital flows in the first 10 months of 2000. The capital inflows in this period reached almost 10 billion dollars. However, it did not prevent one of the "basic instabilities of the capitalism". The transition between boom and bust phase took place one more time in the post-capital account liberalization era at the end of the 2000 and in February 2001. The liquidate crisis of the banks (mostly dependent on Ponzi-finance) in Turkey invited the pessimistic expectations and the speculation opportunities. In November 2000, Turkey encountered an huge increase in the volume of capital outflow (3435 million dollars). Shortly after, in February 2001, the conflict in the political sphere on the reconstruction of the banking sector triggered another massive outflow of capital. As Onaran (2007) stresses, "(t)he political factor played the role of an exogenous catalyst in a fragile economy, where the investors were already waiting for a signal to move out; but even in the absence of a political conflict, there could have been another triggering event, once the fragility is there" (:6). Since February 2001 to April 2001, the cumulative amount of the outflow reached 8,436 billion dollars. GDP, which was 266.439 million dollars in 2000, decreased to 195.545 billion dollars in 2001.

Under the IMF suggestions and controls, after the 2001 crisis, Turkey did not alter its economic policies and continued to follow neoliberal strategies based on providing high interest rates and on maintaining the overvalued TL (Yeldan, 2006b:3). This policy selection generated a new boom phase, in other terms, a new period of financial tranquillity which embraces the roots of a new financial crisis. In this boom phase, if the slowdown in 2008 and the decline in 2009 in GDP are omitted, since 2002 Turkey has experienced an annual average GDP growth rate of 6.93%.

The most important reason of the high growth rates, as in all tranquillity periods in the post-capital account liberalization era have been capital inflows, provided by the persistent increase in the real interest rates which have been provided through implementing contractionary fiscal policies. As Yeldan (2006b) points out, high interest rates have been “conducive in generating inflows to the Turkish financial markets” (:6). Eventually, the abundance of the foreign exchange has created a pressure on the TL to appreciate continuously. In the period starting from 2002, the growth rate of the appreciation of real exchange rate has not been stable; however, the phenomenon of the appreciation has been persistent.

Turkey has been successful in following contractionary fiscal policies in the framework of neoliberal agenda since 2001. Budget balance/GNP decreased rapidly from -16.2, which was the level in 2001, and as a result Turkey experienced budget surplus in 2009. Also in the context of contractionary fiscal policies, the government started to reduce agricultural subsidies and to cut down the public sector in the economic activity mostly through privatization (Yeldan, 2006b:3). The fiscal austerity has been conducive in reducing inflation, and thus since 2005 Turkey has managed to achieve one-digit inflation rates. Meanwhile, public sector borrowing requirement/GDP, which was 12.1 in 2001, reduced sharply throughout the period between 2000 and 2008 and this indicator was 0.8 in 2008. Nevertheless, these policies have been realized at expense of the deterioration and the commodification of education and health infrastructures and the elimination of small-size agricultural system in Turkey. If the sharp declines in the wages in the post-capital account liberalization era are also remembered, it could be claimed that the popular classes’ ‘share’ in this boom phase has been solely pauperization and impoverishment.

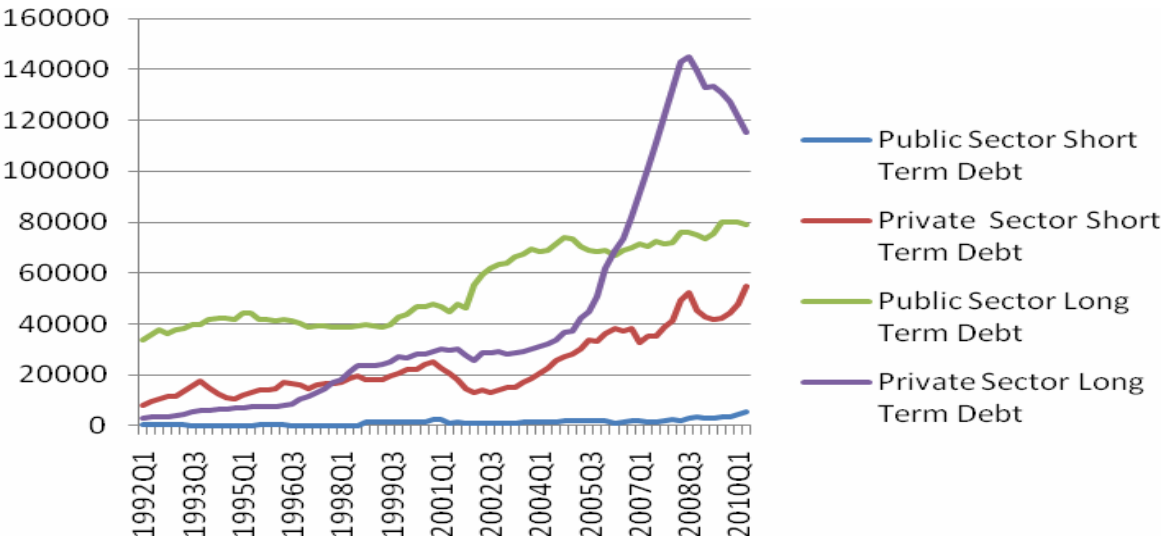
The fiscal austerity has assisted in the shrinkage of aggregate demand in Turkey and thus has created more dependent manufacturing industry. The dependency on the condition of the world market has constituted fragility and this fragility, triggered by the recent global crisis, developed an economic fall down in 2009. When Turkey’s conventional export markets contracted due to the global crisis, the rate of capacity utilization fell below %60 in Turkey’s manufacturing industry. The rapid decrease in the rate of capacity utilization has an important impact on the 6.5% fall in GDP in 2009.

Furthermore, Turkey’s manufacturing industry has an import dependent structure, which has been the result of the overvalued TL and the low capacity in generating value added. This structure has been one of the factors of the generation of current account deficit in the post-2001 crisis period (Yeldan, 2006b:7). In the mean time, the consumption boom, which has

been occurring due to the relatively cheap import opportunities and the illusionary growth, has been another factor of the current account deficit. Consequently, during the period between 2005 and 2010, the current account deficit as percentage of GDP was much higher than the levels recorded in the previous periods of 1994 and 2001 crisis.

The drastic decrease in capital inflows, related with the pessimistic expectations due to the global crises, threatened Turkey’s macroeconomic balance in 2009. The capital inflow, which was 3259 million dollars in 2008, decreased to 858 million dollars level in 2009. However, Turkey’s government has been able to maintain the overvalued TL. This policy obviously has intensified the fragility and vulnerability, and has given floor to possible speculations. On the other hand, it has prevented the depreciation of the TL and, eventually, it has delayed the currency mismatches regarding the external debts in the balance sheet of the firms in Turkey. In order to illustrate the possible magnitude of the currency mismatches, Chart 5 is portrayed.

Chart 5: Private Sector External Debt



Source: CBRT Electronic Data Delivery System

As it can be seen by Chart 5, especially after 2004, there was a drastic increase in the external debt of the private sector. Increment in private sector’s long-term external debt is remarkable. Considering the high levels of the external debt of the private sector, it could be discussed that a possible financial crisis will likely influence the private sector in Turkey

through balance sheet mismatches even more than the ‘recent’ global crises, and probably more than the crises of 1994 and 2001.

V. Concluding Remarks

Will Turkey face a new crisis in the near future like in 1994 and 2001? “Can ‘it’ happen again”? The post-Keynesian theory suggests that this is a naïve question. Considering the entire fragile structures of Turkey’s economy, the question should be when, how and to which extent. The external debt burden on private sector, the volatility of capital flows, the overvalued exchange rate, the import dependent production model, shrinking production due to the shrinkage of export market etc. all contribute to the fragile economic structure. Once the system becomes fragile, in case of any pessimistic expectations, this fragility will lead to a financial crisis and bankruptcies. The emergence of pessimistic expectations in this case is just a matter of time!

In the case of Turkey, in contrast to claims of neoliberal orthodoxy, financial crises are systemic events as in other developing countries. The financial liberalization in late 1980s has been reflected as financial crisis and macroeconomic fragility thus far. In all financial crises that Turkey encountered, the roots of financial crises were concealed in the period of financial tranquillity, in other words, in the boom phase. In all the boom phases, the capital flows generate illusionary growth and the appreciation of the TL. However, the illusionary growth and the appreciation of the TL bring about capital account deficit and external debt burden. The growth becomes dependent on capital flows, including a high portion of hot money. The governments in Turkey, which implement economic policies under the direction and the supervision of IMF, like a ropedancer, try to attract hot money in order to sustain the level of GDP.

In the post-capital account liberalization era, both fiscal and monetary policies have become dependent on the demands and needs of capital flows. The policy makers have been deprived of any instrument which could prevent crisis. The only ‘solution’ against financial crises prescribed by the IMF is maintaining high interest rates through mostly austerity fiscal policy or central bank ‘intervention’. However, this ‘solution’ could merely postpone and clearly intensifies current problems such as deepening import dependent structure, undermining existing domestic industry and giving floor to financial speculation.

Finally, what should be mentioned is Turkey’s position in the world system after 1980. The neoliberal model, which sets Turkey’s role as an ‘emerging market’ wherein development

goals, industrialization targets, decent work etc. are abandoned, is offered as a ‘pseudo’ redeemer from the economic crisis in the late 1970s. Then, what is the redeemer of the developing countries wherein neoliberal model-originated crises occurs often?

At this point, the following questions should be raised: Does the neoliberal model, which brings about more inequality, pauperization and impoverishment for popular classes, have ‘no alternative’ – as one can perceive inside media towers or the corridors of economy departments even now? Further researches’ attentions should be confined the following question: ‘What is beyond the neoliberal model?’ It should be borne in mind that it is also question of our political presence.

Bibliography

Adelman, I. and E. Yeldan, 2000. Is This End of Economic Development?. Structural Change and Economic Dynamics, 11: 95-109.

Akyüz, Y., 2006. From Liberalization to Investment and Jobs: Lost in Translation. Working Paper No.74. Policy Integration Department. International Labour Office, Geneva.

Arestis, P. 1992. The Post-Keynesian Approach to Economics. Vermont, Edward Elgar Publishing. .

Başkaya, F.,2009. Devletçilikten 24 Ocak Kararlarına-Türkiye Ekonomisinde İki Bunalım Dönemi (in Turkish). İstanbul, Özgür Üniversite Yayınları.

Boratav, K. 2003. Türkiye Ekonomisi, 1908-2002 (in Turkish). Ankara, İmge Yayınevi.

_____ 2004.Yeni Dünya Düzeni Nereye? (in Turkish).Ankara, İmge Yayınevi.

Boratav, K. and Y. Akyüz, 2002. The Making of Turkish Financial Crisis. Discussion Paper No. 158 Division on Globalization and Development Strategies, UNCTAD.

Cizre, Ü. and E. Yeldan., 2005. The Turkish Encounter with Neo-liberalism: Economics and Politics in the 2000/2001 Crises. Review of International Political Economy, 12 (3): 387-408.

Demir, F. 2004. A Failure Story. Politics and Financial Liberalization in Turkey, Revisiting the Revolving Door Hypothesis. World Development, 32-5: 851-869.

Diaz-Alejandro,C. F., 1985. Good-bye Financial Repression, Hello Financial Crash. Journal of Development Economics 19:1–24.

Ekzen, N., 2008. 1980 Washington Mutabakatından 2007/8 Washington Krizine: Alternatif Hep IMF. Available: http://www.bagimsizsosyalbilimciler.org/Yazilar_Uye/EkzenDec08.pdf

Frenkel, R. and M. Rapetti, 2009. Some Reflections on the Current Global Crisis from a Developing Countries Perspective. FES Briefing Paper.

Gabel, I., 1995. Speculation-led economic development: a post-Keynesian interpretation of financial liberalization programmes in the Third World. International Review of Applied Economics, 9: 2, 127 — 149.

Kazgan, G. 2004. Tazminat'tan XXI. Yüzyıla Türkiye Ekonomisi-Birinci Küreselleşmeden İkinci Küreselleşmeye (In Turkish). İstanbul, İstanbul Bilgi Üniversitesi Yayınları.

Kregel, J.A., 1998. Yes, "It" Did Happen Again"-A Minsky Crisis Happened in Asia. Working Paper No.234. Presented at the Eight Annual Hyman P. Minsky Conference on Financial Structure April 23-24 1998.

Available at: <http://129.3.20.41/eps/mac/papers/9805/9805017.pdf>

Minsky, H.P., 1982. Inflation, Recession and Economic Policy. New York, Wheatsheaf Book.

_____, 1986. Stabilizing an Unstable Economy. London, Yale University Press.

Nesvetailova, A., 2008. Ponzi Finance and Global Liquidity Meltdown: Lessons from Minsky. Working Papers on Transnational Politics.

Available at:

http://www.city.ac.uk/intpol/dps/WorkingPapers/A_Nesvetailova%20Ponzi%20Finance%20and%20Global%20Liquidity%20Meltdown.pdf

Onaran, Ö., 2006. Speculation-led growth and fragility in Turkey: Does EU make a difference or “can it happen again”?. Department of Economics Working Paper Series. Working Paper No. 93.

_____, 2007. Capital Flows, Turbulences, and Distribution: The Case of Turkey. Working Paper, Istanbul Technical University.

Available at: http://www.bagimsizsosyalbilimciler.org/Yazilar_Uye/OnaranFeb07.pdf

Öniş, Z., 2004. Turgut Özal and His Economic Legacy: Turkish Neo-Liberalism in Critical Perspective. Middle Eastern Studies, 40:113-134.

Şener, M. Y., 1998. The Relationship between Liberalism and Authoritarian States: The Case of Turkey. Working Paper.

Available at: <http://www.rrojasdatabank.info/neolibstate/meltemyilmazsener.pdf>

Şenses, F. and E. Taymaz 2003. Unutulan Bir Toplumsal Amaç: Sanayileşme Ne Oluyor? Ne Olmalı? (in Turkish). In: İktisadi Kalkınma, Kriz ve İstikrar, eds. Köse, A.H., Şenses, F. and E. Yeldan, 429-60. İstanbul, İletişim Yayınları.

Taylor, L., 1998. Lax Public Sector, Destabilizing Private Sector: Origins of Capital Market Crises. CEPA Working Paper Series III. Working Paper No. 6.

Yeldan, E., 2001. The Developmental Agenda in the Age of Neoliberal Globalization. Draft paper prepared for the discussion at the UNRISD meeting on “The Need to Rethink Development Economics”, 7-8 September 2001, Cape Town, South Africa.

_____, 2006a. Neoliberal Global Remedies: From Speculative-Led Growth to IMF Led-Crisis in Turkey. Review of Radical Political Economics, 38:193-204.

_____, 2006b. Patterns of Adjustment under the Age of Finance. The Case of Turkey as a Peripheral Agent of Neoliberal Globalization. Political Economy Research Institute Working Paper Series:126.

_____, 2009. On the Nature and Causes of the Collapse of the Wealth of Nations. The End of a Façade Called Globalization.

Available At: http://www.bagimsizsosyalbilimciler.org/Yazilar_Uye/YeldanMar09.pdf

Yılmaz, Ö. G., 2005. Türkiye Ekonomisinde Büyüme ile İşsizlik Oranları Arasındaki Nedensellik İlişkisi (In: Turkish). Ekonometri ve İstatistik, 2: 63-76.