Rise and Fall of the Dependent Financialization in Turkey

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Abstract

Turkey's economy has slipped into a recession in the second half of 2018 and it continues as of September 2019. The crisis unfolded in two phases so far. The first was "shock" phase, where currency crises of August 2018 was followed by an interest rate shock. While the former resulted in an explosion in inflation due to the pass-through of exchange rate developments into import prices, the latter caused a credit crunch for particularly Turkish Lira (TL) denominated loans. The second phase consisted of a strong policy response of the government in the form of tax breaks, debt restructuring, increasing public expenditures and a solid increase in credit expansion enabled by public banks in the first quarter of 2019, prior local elections.

This paper argues that the current crisis of Turkish economy can be framed as the crisis of dependent financialization. In line with a recently developing heterodox literature, I suggest that the concept of dependent financialization is suitable for the emerging capitalist countries (ECCs). My departure point is straightforward: since countries' financialization paths are determined by their position in global political economy, peripheral countries' integration to financial globalization are marked mostly by their external dependency. Predominance of the capital flows for ECCs' economic growth, hierarchical nature of global monetary system, which mirrors global hierarchy among states, and structural financial instability are three common traits of dependent financialization of ECCs.

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1. Introduction

The economic recession in Turkey that started in the in the second half of 2018 still continues as of September 2019. Unfolding of the crisis started with a "shock" phase when the currency crises struck the economy in August 2018, which caused an explosion in inflation due to the pass-through of exchange rate developments into import prices. The interest rate shock that followed resulted in a credit crunch that particularly put a strain on TL denominated loans. The government formulated a strong policy response, prior to local elections, in the second phase of the crises by introducing tax breaks, enabling debt restructuring, increasing public expenditures and significantly increasing credit expansion through public banks in the first quarter of 2019. This paper argues that the current crisis of Turkish economy can be framed as the crisis of dependent financialization.

In a widely cited article, Epstein (2005: 3) provided a very broad definition of financialization as "the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies". Financialization literature developed through contribution of various academic disciplines and approaches, however majority of the scholarly effort concentrated on understanding the main dynamics of financializaton in advanced capitalist countries (ACCs). On the other hand, a new sub-brunch has developed in the financialization literature by scholars who focused exclusively on different aspects of financialization in emerging capitalist countries (ECCs) (Becker, et. al., 2010; Demir, 2009; Hardie, 2011; Lapavitsas, 2009, 2013; Painceira, 2009; Powell, 2013; Karacimen, 2015; Rodrigues, et. al., 2016; Bonizzi, 2017; Bortz and Kaltenbrunner, 2018; Kaltenbrunner and Painceira, 2015, 2018; Santos, et. al., 2018; Güngen, 2018; Akçay, 2018a; Ergüneş, 2010; Akyüz, 2015; Akçay and Güngen, 2019)

In line with the developing heterodox literature, I suggest that the concept of dependent financialization is suitable for ECCs. I reason, integration of peripheral countries to financial globalization is marked mostly by their external dependency because financialization paths of countries are determined by their position in global political economy.' Put differently, their integration to financialization is characterized by the "peripheral condition" (Andrade and Prates, 2013), which has three major traits: (i) predominance of the capital flows for ECCs' economic growth, (ii) hierarchical nature of global monetary and financial system, which mirrors global hierarchy among states, and (iii) structural financial instability.

Following are the research questions of this paper: What are the peculiarities of dependent financialization? How does dependent financialization unfold and what are the limits of it in

Turkey? To answer these questions, I provide three interrelated arguments. First, dependent financialization in ECCs begun with a series of financial crises, which were chiefly triggered by the first financial liberalization wave during the 1990s. Financial crises led to further financial openings and deepening during 2000s. Second, deepening of dependent financialization has occurred to the extent that ECCs' external dependency permitted. As Gabor (2010: 256) underlined, "financialization requires low rather than high interest rate"; therefore structurally higher interest rates in ECCs than ACCs hinder financial deepening in the former. Thus, main dynamics about interest rates in core countries determined forms and limits of financialization in periphery as long as they effected the direction of capital movements. Grounded on these points, finally, I also claim that dependent financialization creates serious paradoxes for policymakers and a vicious cycle of financial instabilities, which I will explain in detail in the case study section.

Turkey's integration to international financialization process will be the case study to implement aforementioned theoretical arguments. To dissect Turkish case, I mostly focus on the macroeconomic mechanisms that generate recurrent crises, which are inherent to dependent financialization. I periodize Turkey's financialization experience into to three phases: (i) state-centered financialization (1989-2001), (ii) financial deepening (2001-2013), and (iii) crisis as the limits of dependent financialization (post-2013 period). Since these points are not unique to Turkey, I further argue that we can use this case to derive some preliminary generalizations for ECCs' financialization experiences.

The rest of the paper is organized as follows: in the second and third sections I constructed a theoretical framework of dependent financialization concept by referencing its historical development including initial financial openings of 1990s followed by a series of financial crises and financial deepening in 2000s. Next, I focused on Turkey's dependent financialization experience and its crisis in three sub-sections; state-centered financialization, financial deepening, and crisis of dependent financialization. Regarding the Turkish case, I analyzed Turkish Statistical Office data on economic growth, Bank of International Settlements data for net capital flows, Turkish Banking Regulation and Supervision Agency data for credit flow, and Central Bank of Republic of Turkey data for Turkey's debt structure, and demonstrated the main trends in development of dependent financialization and its crisis in Turkey.

2. First Wave of Dependent Financialization

Collapse of the Bretton Woods system, paved the way for financialization. The main feature of the post-Bretton Woods period was development of an international monetary non-system (Williamson, 1977; Ocampo, 2017), which centered around the USA as a hegemonic power in world economy (Gindin and Panitch 2012). Since this non-system is grounded on the USA's hegemony, the US Dollar became pseudo reserve currency for the rest of the world. Along the same line, Luo (2017: 41) defined financialisation as "the unintended consequence of a change in the monetary system from commodity money to credit money" and emphasized that "collapse of the Bretton Woods System, among all historical and systemic changes, is the strongest underlying impetus to financialisation".

Financial liberalization has been a crucial deregulation act, which linked ECCs to gradually developing trends in ACCs towards financialization in the post Bretton Woods period. It was also one of the main parts of the policy package of IMF's conditional structural adjustment programmes implemented by many developing countries in early 1980s as a cure for their balance of payment and debt crises. Moreover, financial liberalization was among Washington Consensus policies, which set the main development agenda for developing world after the 1980s (Lapavitsas 2009). Neoclassical theory justifies financial liberalization by claiming that the period of "financial repression" was hindering economic growth (McKinnon 1973). 1990s saw a series of financial crises in developing countries, who joined financial liberalization wave during 1980s and 1990s.

First line of argument asserted that domestic problems of countries were causing financial crises. Krugman (1999) argued that 1997-1998 Asian crisis was different from both first and second generation crises. While the former centered around continues deterioration of fundamentals that resulted in balance of payment crises (Krugman 1979), the latter focused on self-fulfilling prophecy framework (Obstfeld 1996). Rather, Krugman (1999: 317) claimed that excessive risk taking of financial institutions under the assumption of existence of implicit public guarantees for foreign exchange denominated loans of financial intermediaries was the key dynamic for Asian crisis. In the same vein, (Corsetti, Pesenti, and Roubini 1998) maintained that moral hazard would occur where private actors are incentivized to engage in risky investments or borrowings in foreign exchange denominated currencies. The main driver for these risky investments or barrowings was the belief that government would step in and bail-out private loses in a crisis. However, they also argued that "financial liberalization is a key factor in magnifying the adverse implication of moral hazard on macroeconomic stability" (Corsetti et al. 1998). Hence, although Corsetti et. al. (1998) underlined negative role of financial liberalization in Asian financial crisis, Krugman (1999) focuses more on poorly regulated domestic market conditions, which led him to argue that "crony capitalism" is to blame.

Second line of explanations mostly focused on financial liberalization as a major causal factor in financial crises. For instance, while (Johnson 1998) maintained that crony capitalism was an inadequate explanation for the Asia crisis, (Taylor 2001) contended that financial deregulation was the key dynamic for crises in ECCs. Similarly, Chang, Park, and Yoo, (1998) also argued that the main reason for the crisis was "dismantling of the traditional mechanisms of industrial policy and financial regulation", contrary to Krugman's crony capitalism explanation. Likewise, Wade (1998) argued that instead of institutional weaknesses or market distorting government interventions, financial liberalization paved the way for financial crisis. He underlined that financial opening engendered financial crisis when capital inflows suddenly stopped (Wade 1998).

Arestis and Glickman (2002: 258) introduced Minskyan approach to explain Asian crisis by arguing that "financial liberalization has acted as the key euphoria-inducing factor", which rapidly shifted financing conditions from speculative to super-speculative. Kaltenbrunner and Painceira (2015) improved Minskyan approach by covering developing countries and argued that external vulnerabilities are an embedded nature of ECCs' integration to world economy, because inherently and endogenously instable capital flows are the key connection point in this integration.

In short, in conjunction with financial liberalization, which came after the collapse of Bretton Woods system, ECCs were included in the financialization trend mainly through capital movements. Although this first wave of financialization in ECCs faced a series of financial crises during 1990s, the result was, ironically, deepening of their financial integration to world economy. Next phase for the ECCs was financial deepening, including domestic financialization, which was both facilitated by and depended on capital inflows.

3. Deepening of dependent financialization and its limits

Becker et.al. (2016: 41), revisited Dependency School's arguments on external dependency from a Regulation School perspective and reformulated them for applying to the era of financialization. From this perspective, they argued that Baltic and Southeast European counties relied on "dependent financialization" model. According to the authors, one of the key features of dependent financialization is its dependence on capital inflows, which stimulates domestic financialization through credit growth (Becker et.al., 2016: 41).

Similarly, Andrade and Prates (2013), from a Post-Keynesian perspective, suggested that ECCs financialization process has been marked by their "peripheral condition". The chief trait of this peripheral condition for the dependent financialization is that "the currencies of emerging peripheral countries have a lower liquidity premium in relation to the key currency and other convertible currencies" (Andrade and Prates 2013). Hence, lower level of convertibility of peripheral countries' currencies creates an incentive structure for economic units to demand hard-currencies to undertake national or international operations. This has been the key driver for dollarization or euroization in ECCs (Becker, 2010: 230). Furthermore, this hierarchical structure that was organized under the key currency, i.e. the US Dollar, "engenders structural volatility in emerging peripheral economies, making them especially vulnerable to capital flight and their currency markets more susceptible to volatile short-term capital flows" (Andrade and Prates 2013)

Bonizzi (2017) argued that, in tandem with financial liberalization, there is an additional link between financialization in ACCs and ECCs. Low interest rate regime in core countries, mainly in the USA, created a double push for financialization in ECCs. First, it creates an incentive structure for financial institutions in ACCs to "search for profitable venues" (Bonizzi, 2017: 30). Second, it also allows policymakers of ECCs to lower their interest rates, which is a key factor for domestic financialization. As low rate regime become the main avenue in the post crisis period in the USA, capital flows to ECCs increased between 2010 and 2013. Thus, as Karwowski (2019: 1017) emphasized "low interest rates in the USA have fueled financialisation" both in ACCs and ECCs.

Two more developments were crucial for deepening of the dependent financialization: (i) monetary transfers from ECCs to ACCs through reserve accumulation strategy of ECCs, (ii) foreign bank entry to ECCs. While financial liberalization was part of the policy agenda along with deregulation and privatization for global South during 1980s, it also triggered a series of financial crises in ECCs in the 1990s, as I summarized in the preceding section. As a response to these unstable international financial conditions, policymakers of ECCs increased international reserves as a precautionary buffer. Yet, it had an unintended consequence: monetary transfer from ECCs to ACCs (Lapavitsas, 2009).

Painceira (2009) revealed that ECCs central banks increased their international reserves to defend their currencies against "sudden stops" in the post-Asian crisis period as a policy response. Since ECCs central banks hold their reserves mostly in US Treasury securities, because of the hierarchical character of international monetary system, net capital flows to developing countries has been negative. Additionally, Gabor (2010) emphasized the role of sterilization practices of central banks to respond to capital inflows on reserve accumulation. Put differently, increasing financial instability in conjunction with financial liberalization, under the monetary dominance of the US, generated a monetary transfer mechanism from developing to developed countries. In short, net capital flows "run from poor to rich countries" (Akyüz, 2015: 15).

Lapavitsas (2009) added another point as to financialization dynamics in ECCs. He argued that foreign bank entry to ECCs has accelerated domestic financialization. Gabor (2010) also underlined that privatizations guided by Washington Consensus policies were notable for opening domestic banking and finance sectors of ECCs to international investors. Foreign bank entry, thus, facilitated domestic financialization through fueling rapidly growing consumer loans sector (Lapavitsas, 2009; Gabor 2010). Claessens and van Horen (2012) showed that the number of foreign owned banks increased from 24% to 46% in developing countries. Additionally, Chen et al. (2017: 22) found that increasing foreign bank entry led bank instabilities on hosting ECCs, opposite to the orthodox view.

In short, a series of financial crises of 1990s were not enough to reverse financial liberalization trend in ECCs; on the contrary, 2000s saw further financial integration with a surge in capital flows to developing countries. Four salient features of this recent financial deepening move in ECCs during the 2000s are worth to be noted: (i) there has been a common trend of privatization of debt in ECCs, meaning dominant role of public sector replaced by private one in total external debt, (Celasun and Harms 2011), (ii) private external debt is mostly in foreign currency (Akyüz, 2015), (iii) the composition of private international debt shifted from bank loans towards debt securities (Akyüz, 2015: 48), (iv) while persistent low interest rate regime in ACCs facilitated financial deepening in ECCs, Fed's short-lived attempt to raise interest rate was enough to trigger sudden stops in ECCs. Taken together, these recent trends not only deepened financialization in ECCs but also made them more crisis-prone because of their growing external dependency.

4. Turkey's Dependent Financialization

So far, I made three points on financialization experience of ECCs through lenses of dependent financialization concept. First, initial attempts of financial liberalizations faced a series of financial crises in the periphery during the 1990s. Second, low interest rate regime in core countries facilitated domestic financialization in periphery, which was the main driver of financial deepening of 2000s. Third, growing external dependency exposed ECCs to policy reversal in core countries. In this section, I argue that these three points are also explanatory for Turkey's financialization experiences and her crises. To support this argument, I will analyze Turkish experience in three phases.

4.1. State-Centered Financialization (1989-2001)

Liberalization of capital account in 1989 was a turning point regarding financialization experience of Turkey. Boratav, et. al. (2000) argued that financial liberalization occurred not because it was a condition in a structural adjustment programme of IMF, but because it was a political choice of Turkey's political class, who was challenged by what I called "structural adjustment dilemma".[1] The authors described this dilemma as an attempt of "giving to labor/the poor without taking from capital/from the rich" (Boratav et.al., 2000: 28). Indeed the key motivation of policymakers was seeking an alternative way to finance public debt without implementing a fiscal austerity and taxing capital, under the pressure of increasing real wages first time since 1980.

To clarify, I am not arguing that financial liberalization was just a side effect of political class' survival strategy. Rather, Turkey had already been in the avenue of neoliberal reforms since 1980, however the timing of financial liberalization was determined by domestic class struggles. I summarized notable features of the state-centered financialization, which was characterized by the dominance of the public debt and its financing requirements, the period between 1989 and 2001, in Diagram-1.

<Diagram-1>

Channel-1 shows the relationship between the Central Bank and the Treasury, called short term advance facility. According to the regulations, Treasury could borrow 15 % of its budget expenditure directly from Central Bank (Özatay 2000). It was a direct credit line, which had been operational since 1954, and usage of this line intensified, when public borrowing needs increased in the 1980s and the 1990s. The channel-1 was eliminated by the 2001 reform program, which included the reform in the monetary policy structure that brought about central bank independence.

[1] For a detailed explanation, see Akcay (2018).

Channel-2 (includes the relationships 2 and 3) has been operational since 1986 when the banking system began to mediate the borrowing relationship between the central bank and the treasury. The main tool in this mediation was Treasury's debt securities (T-bonds). The direct relationship between the Treasury and the Central Bank has taken the form of indirect financing through the banking system. Here, the banks meet the financing needs of the Treasury through purchasing the T-bonds by borrowing from the central bank. The profit of the banking system comes from the interest rate arbitrage between Central Bank's policy rate and Treasury's debt security rate.

Channel-3 (includes the relationships 4 and 3) has been operational since 1989 when capital account was liberalized. Here, the banks borrowed from international financial markets and started to use this funding as a source for financing the Treasury. Again, here the banking system is making profit out of this mediation role. Finally, the channel-4 (includes the relationship 5), represents the Treasury's direct debt financing from the international markets.

In short, early phase of the financialization in Turkish economy was dominated by the financing requirements of public debt. During the first phase, Turkey's integration to the international financial system was completed and Turkish economy became vulnerable to the international financial flows and fluctuations. The result was repeated financial crises in 1994, 1999 and 2001. As Akyüz and Boratav (2003: 1555) affirmed, the mechanism that caused crises in Turkey was similar to the ones that were operative in Asian crisis: "a surge in capital inflows, an upturn in economic activity, a significant appreciation of the currency, mounting trade deficits, worsening balance sheets and rising exchange rate risks".

4.2. Financial Deepening (2001-2013)

The second phase of the dependent financialization in Turkey started with the elimination of the Channel-1 (see Diagram-1) by the reform program, which came after the 2001 crisis. While an agreement with IMF constituted the economic aspect of this reform agenda, Turkey's European Union (EU) membership process composed the political aspect of it. As far as the IMF agreement was concerned, the Transition to the Strong Economy (TSE) programme was formulated as an exit strategy in the aftermath of 2001 crisis. A former Vice President of the World Bank, Kemal Derviş, was invited to Turkey as a minister and the founder of TSE programme after the 2001 crisis. As part of the programme, Turkey's Central Bank (CBRT) gained an independent status from the government. The AKP embraced and implemented the IMF-brand TSE programme when it came to power in 2002. The AKP's double anchored (IMF and EU) reform agenda consisted of three elements: (i) inflation targeting system and fiscal discipline, (ii) labor market reforms that aimed to create more flexible workforce, (iii) privatizations of publicly owned companies (Akcay 2018b).

First, newly established monetary policy framework worked well in terms of curbing inflation. Tight monetary policy coupled with fiscal austerity resulted in declining inflation and narrowing public debt quickly. Second, the inflation targeting system was implemented hand in hand with a new labor regime after 2003. One of the key features of the new labor law of 2003 was the legalization of flexible, part-time work conditions, and sub-contracting relations. According to OECD data, trade union density in Turkey decreased from 29.1 per cent in 2001 to 6.3 per cent in 2015 (OECD, 2017), which points out that the AKP was successful at disempowering the working class. Therefore, precarious work conditions and stagnant real wages were two important results of the labor market reforms. Third, the AKP has achieved an unprecedented success on privatization (Privatization Administration of Turkey, 2019). Privatizations not only aimed to reduce the public debt by selling the State Economic Enterprises (SEEs), but also to reduce power of organized labor, since the SEEs had been a stronghold of the organized labor movement. Taken together, these reforms created an authoritarian labor regime in Turkey (Çelik, 2015).

Practically, the essence of the reform program was separation of economics and politics, and formation of a technocratic structure for monetary policy for the sake of central bank independence and inflation targeting system (Ergüneş, 2010). There are three features of the second period of dependent financialization in Turkey: (i) rapid increasing household indebtedness, (ii) rising borrowing capacity of the private firms, and (iii) decrease in public debt's share in the gross external debt stock.

I argue that the reform on the monetary policy structure, that is to say central bank independence in the post-2001 crisis period was the precondition of the transition from the first to the second phase. In other words, the new central banking policies provided a basis for the changing debt structure in the Turkish economy. First, inflation targeting system has limited the wage increases during 2000s, which created an incentive for the households to have more loans. Second, monetary policy implementations has fostered the private sector indebtedness level. Third, this new monetary policy framework set the stage for implementing a strong fiscal discipline.

In order to keep inflation under control, central bank uses the interest rate as a policy tool. An increase in the interest rate resulted in tightening of the domestic credit expansion and a reduction in the investment level. However, in an open economy, an increase in the interest rate level accelerates capital inflows. Once capital inflows increase, then local currency starts to appreciate. Therefore, the target of keeping inflation under control resulted in an appreciation of the national currency. As Gabor (2010: 255) mentioned "central banks' disinflation efforts focused on ensuring real exchange rate appreciations by attracting capital inflows through a variety of mechanisms such as sterilizations". Higher interest rate brought about overvalued exchange rate. Overvalued exchange rate, created two results: First, it created an incentive structure for the NFCs to import medium goods and raw materials instead of producing. Cheaper import opportunity helped the central bank with controlling the inflation.

This resulted in widening the gap between import and export and increasing the current account deficit. Second, appreciation of the national currency created an incentive structure for the banks and especially for the nonfinancial companies to borrow money from the international financial markets. The last development resulted in the increasing level of indebtedness of the NFCs in Turkey. As a result of these implementations and exceptionally positive international financial conditions, capital inflows surged in Turkey between 2002 and 2007, and they reached 50 billion US Dollars in 2007 (see Figure 1). The capital inflows made relatively high growth rate and declining inflation simultaneously possible. An average Gross Domestic Product (GDP) growth rate of 7,4 % was reached between 2002 and 2007 (see Figure 2).

< Figure 1>

The Global Financial Crisis (GFC) of 2008 had contradicting effects on Turkey. The first effect was the collapse of international trade and capital movements, which resulted in 1,9 % average contraction in GDP growth in 2008 and 2009. Nevertheless, contraction was short-lived and there was a robust rebound in economic growth between 2010 and 2013 (8,2 % on average) thanks to the surge in capital flows to Turkey (see Figure 2). The main driver of capital inflow was not related to pull factors, rather it was a direct result of the policy response of major central banks (quantitative easing programmes). US central bank Fed's announcement about the monetary policy normalization has been the main dynamic for drying of the capital inflows to the emerging markets (Eichengreen and Gupta 2013), including Turkey, which paved the way to crisis of the debt-driven growth model of the AKP governments in the post-2013 period.

<Figure 2>

Ghosh and Chandrasekhar (2009: 733) stated that financial liberalization of 1990s in India triggered domestic financialization, whose one of the key elements has been "an increase in credit dependence in the Indian economy". Similar developments took place in Turkey. In the post-2008 period, policymakers liberalized borrowing in foreign exchange-denominated loans especially for NFCs (Akcay and Güngen 2019). The main motivation for this deregulation was to benefit from the positive international financial conditions.

<Figure 3>

Nevertheless, this liberalization act resulted in a sharp increase in foreign exchange-denominated loans of NFCs: while government debt remained low, NFCs' debt level doubled after GFC. "Turkey has had the fastest increase in private indebtedness. Bank borrowing in that country grew by almost three-fold between 2008 and the first quarter of 2014" (Akyüz, 2015: 45). Indeed, Turkey's debt structure has dramatically change after this decision (see Figure 3). Even though household debt ratio to the GDP was almost close to zero until 2001 crisis, it increased 10-fold from 1.8 % of the GDP in 2002 to 19.6 % in 2013. (see Figure 3)

In short, 2001 market reforms complemented the financial liberalization of 1989 in Turkey. 2001 IMF programme paved the way of the debt-driven growth model of the AKP. The main goal of the post-2001 stabilization program was keeping inflation under control. Normally, tight monetary policy would be a basic policy response of a conservative central bank, which aims to control inflation. However, extraordinary international economic conditions temporarily suspended this necessity. CBRT was able to lower interest rate and sustain TL's stability during this period, thanks to the low interest rate regime in core countries. Turkey benefitted generously from this positive international credit conditions between 2010 and 2013, since it received even larger amount of capital inflows than 2002-2007 period (see Figure 1). Towards the end of this period, especially in 2013, Turkish economy was enjoying a "Minsky moment". This engendered domestic financialization as well. Nevertheless, since financialization has a dependent nature in ECCs due to the "peripheral condition", monetary policy decisions in the core countries such as the USA set the limits of financializations in ECCs.

4.3. Crisis as the Limits of Dependent Financialization (post-2013 period)

2013 was a turning point because exceptionally positive international policy conditions ended as a result of Fed's tapering policy. Many ECCs were effected negatively in this period when "the US Fed revealed its intention to start tapering its bond purchases" (Akyüz, 2015: 56). Since then, economic conditions that made domestic financialization possible reversed, and AKP governments faced a serious dilemma: lowering interest rates for faster economic growth simultaneously with preventing devaluation of the TL became impossible. A declining trend in the capital inflows was a key dynamic regarding crisis of the debt-driven growth model of Turkey (see Figure 4).

<Figure 4>

In fact, this is a typical dilemma of dependent financialization, since interest rates in core countries set the limits of financialization in the periphery. Although the AKP governments have managed to postpone an economic bottleneck in 2014 thanks to the expansionary monetary policies of the European Central Bank against Eurozone crisis, and another one in 2016 through state led credit growth policy (see Figure 5) the third one turned into a recession after the full-fledged currency crisis in August 2018.

<Figure 5>

The transition from parliamentary to "executive presidential" system after the June 2018 elections created a political uncertainty, because this change in the political regime required a total restructuring of the state institutions, and all decision making processes were centered around the presidency. This political uncertainty coincided with quickly escalating tensions between Turkey and the USA about a detained American citizen, Pastor Andrew Brunson, in Turkey, in August 2018. What is more, Fed's monetary tightening steps created adverse financial conditions for ECCs. As a result, a "sudden stop" took place in August 2018 and the TL devaluated about 40 % since January of that year (Akçay and Güngen 2018). The economic situation quickly deteriorated in the following months. Between January and October 2018, inflation shot up from 10.3 to 25.2 %, while interest rates for consumer loans jumped from 18.5 to 38.2 %. Unemployment rate sharply increased to 14.7 % in February 2019 (Turkish Statistical Institute, 2019).

<Figure 6>

Government's main policy response was launching a new credit expansion cycle under the leadership of the public banks to prevent possible negative results of economic recession prior to the 31 March 2019 local elections (see Figure 6). Public banks was leading a new credit expansion campaign in the first quarter of 2019. However, initiating a new credit expansion cycle as an exit strategy from the crisis of debt-driven growth model is just deepening the current crisis more because the new credit cycle "widened the current account deficit sharply and increased Turkey's dependence on foreign capital inflows' (IIF, 2019). According to the OECD (2019), government's initial response "moderated the contraction in early 2019".

After 31 March 2019 local elections "Structural Reform Steps" package was announced. Despite it resembled an IMF-style structural adjustment program, in fact it was an emergency rescue package consisted of three elements. The first was 4.9 billion US Dollars of fresh capital injection into Turkey's public banks (FT, 2019). AKP's policymakers previously used public banks as a counter-cyclical policy tool during the 2008-2009 crisis (Marois and Güngen 2016). The same tool was employed to recover after the credit crunch in 2018 (see Figure 6). However, public banks rapidly reached legal limits due to this credit push. Turkey's Wealth Fund stepped in to solve this issue and recapitalized state banks.

The second element was designed to solve the problem of nonperforming loans. Specifically construction and energy sectors were hit hard by both currency crisis and credit crunch. The government announced that two new funds would be set up to restructure these sectors. This operation was also important for banking system itself. Turkey did not experience a twin crisis during 2018-2019 recession, banking crisis was prevented by government's efforts. However, balance sheets of companies were hit by currency crises and these bad loans are still embedded in banking system. To revive credit expansion, removing these bad loans from bank balance sheets was a necessary step. However government's plan was ineffective basically because there was no customer to buy the bad loans of construction and energy sectors (BBC 2019).

Finally, banking regulatory authority stepped in and suggested that these loans should be transferred to nonperforming loans category (Reuters 2019). The third element concerned finding funding for economic recovery in two steps: establishing a severance payment fund and making private pensions compulsory for all employees. Although it was announced that approximately 80 billion US Dollars (10 % of Turkey's GDP) can be created in five years, the plan has not been implemented yet.

In a nutshell, domestic financialization fueled by capital inflows has been the main characteristic of deepening dependent financialization in Turkey. Policy responses of ACCs to GFC further galvanized capital flows to ECCs and Turkey benefited generously from these until 2013. That year was a turning point for Turkey's debt-driven growth model. Since 2013, Turkish economy faced three bottlenecks, with the last one resulting in a currency crisis.

Conclusion

This article aimed to contribute to the recently growing literature on financialization experiences of developing countries by applying dependent financialization concept to

Turkey’s current financial and economic crises. Dependent financialization concept suggests that financialization in ECCs has developed as a result of financial liberalization of the 1980s and deepened in the 2000s with a surge in capital inflows, which triggered domestic financialization as well. In short, financialization in ECCs is conditioned by their location in the division of labor in world economy. Capital flows, hierarchical nature of global monetary system, and structural financial instability are main features of this specific type of financialization.

I show that these three features are observable in Turkish case. First, capital flows have been the primary determining factor in economic growth in each phase of the financialization in Turkey. Second, interest rates have been structurally higher than ACCs and there has been high rate of both deposit and loan dollarization as a reflection of hierarchical structure of global financial system. Finally, economic instabilities have been inherent to Turkish economy since financial liberalization.

I suggest that Turkey’s current economic turmoil should be seen as a crisis of its debt-driven economic growth model. The model brought about positive economic results at the beginning of 2000s mostly because of the positive credit conditions in the international markets. Debt-driven model continued to function well due to the dramatic amounts of capital inflows between 2010 and 2013, after a two year recession in 2008 and 2009. In short, Turkey’s external dependency increased. 2013 was a starting point for economic deterioration due to a change in Fed’s monetary policy towards gradual tightening, which effected Turkey most. Although the government responded to the currency crisis of 2018 with a significant credit expansion under the leadership of public banks, economy has contracted since the second half of 2018 up until September 2019.

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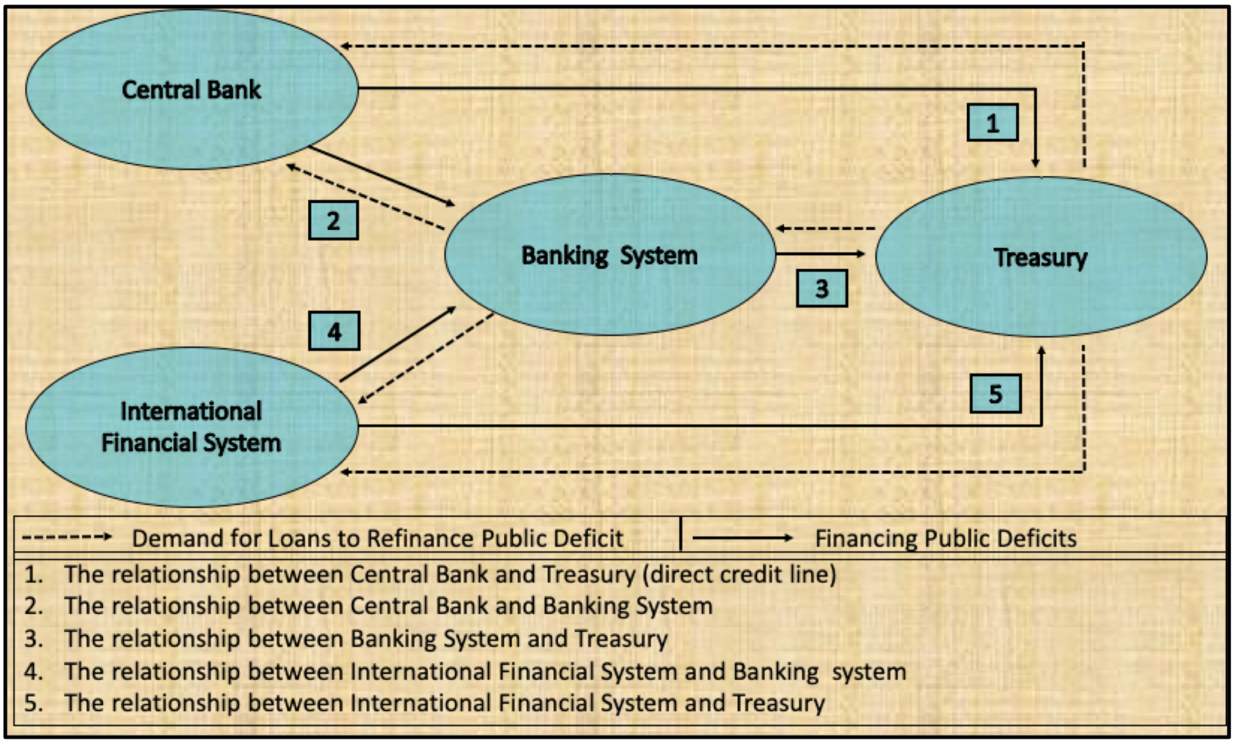
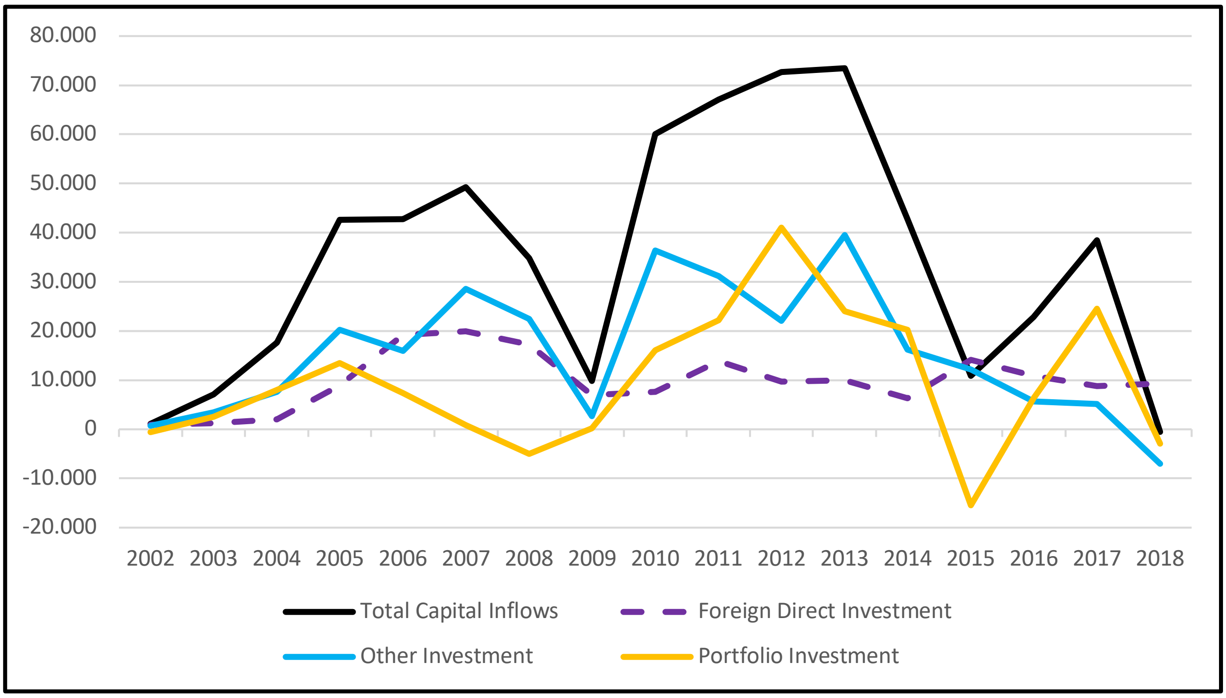
Diagrams and Figures

Diagram-1: State-cantered financialization in Turkey (1989-2001)



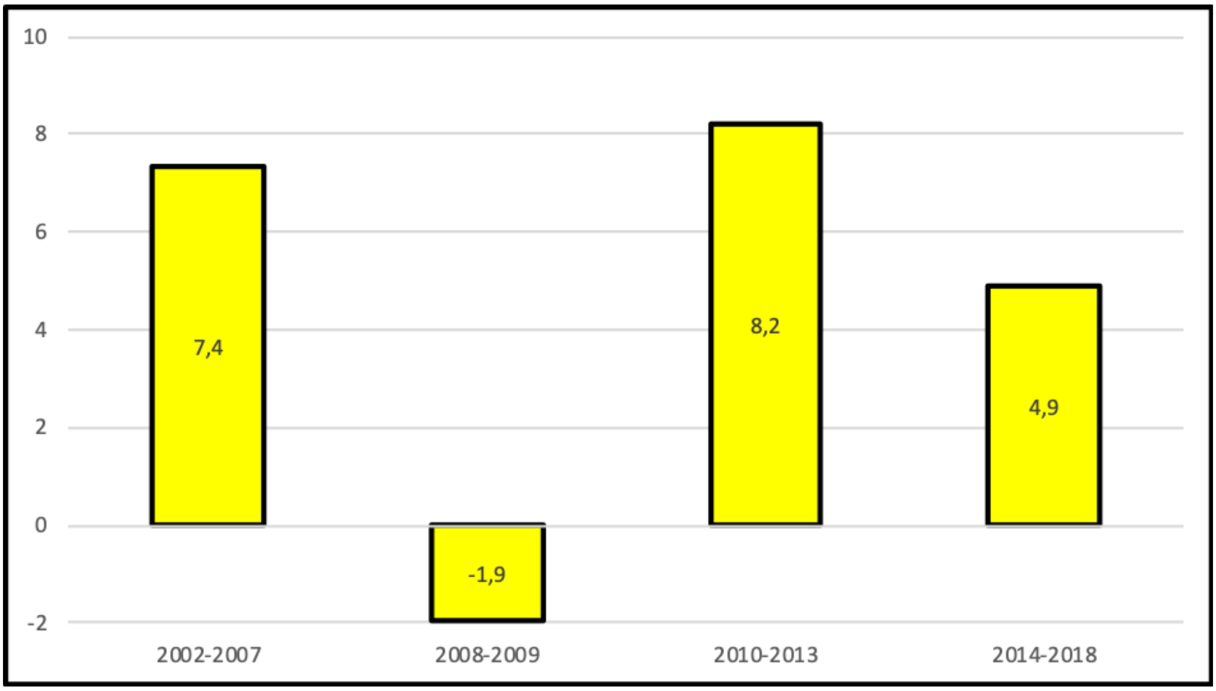
Source: Prepared by the author.

Figure 1: Net Capital Inflows (Million US Dollars), 2002-2018



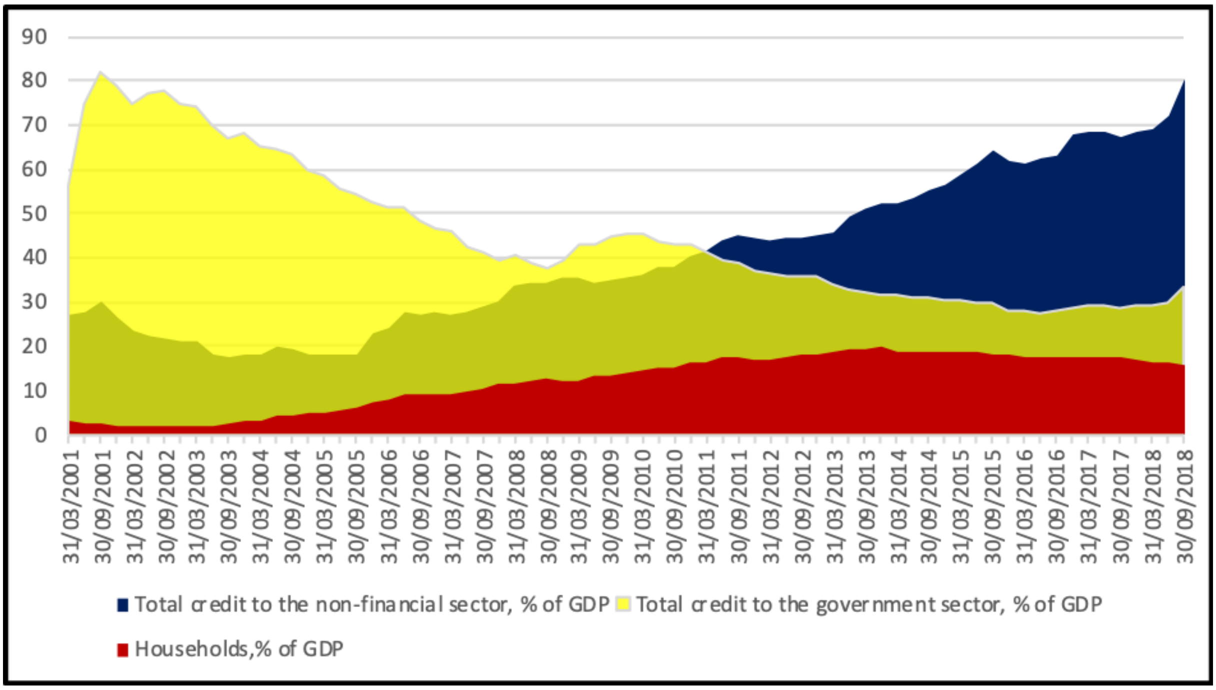
Source: Prepared by the author, BIS: https://stats.bis.org/statx/toc/LBS.html 07.09.2019

Figure 2: Turkey's Gross Domestic Product Growth Rate (2002-2018)



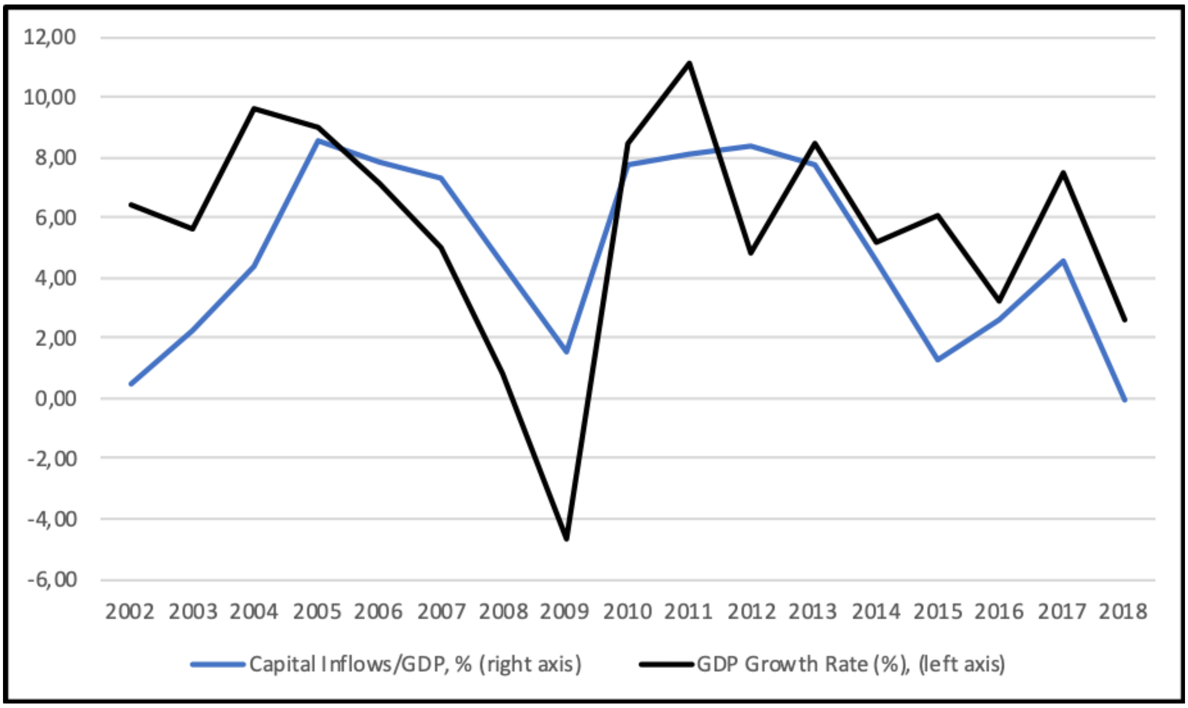
Source: Prepared by the author, Turkstat: http://www.tuik.gov.tr/PreHaberBultenleri.do?id=30886 05.09.2019

Figure 3: Turkey's Debt Structure (2001-2018)



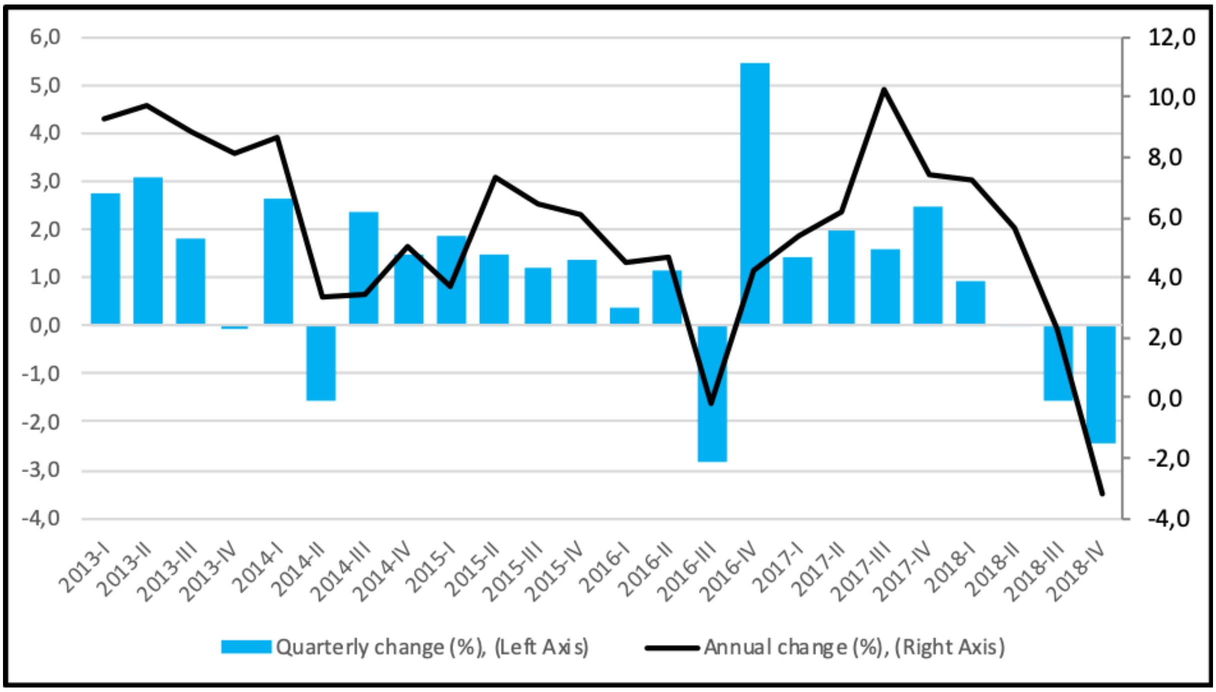
Source: Prepared by the author, CBRT: https://stats.bis.org/statx/toc/LBS.html 07.09.2019

Figure 4: Capital Flows and Economic Growth in Turkey, (annual change), (2002-2018)



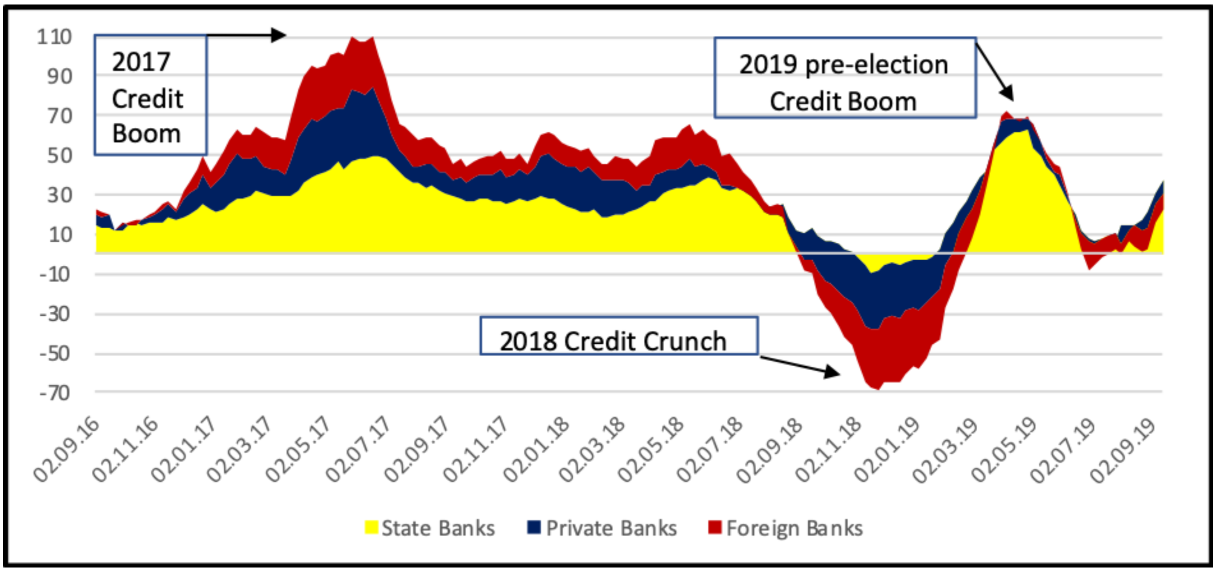
Source: Prepared by the author, CBRT: http://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Statistics/Balance+of+Payments+and+Related+Statistics 05.09.2019

Figure 5: GDP Growth in Turkey, (2013-2018)



Source: Prepared by the author, Turkstat: http://www.tuik.gov.tr/PreHaberBultenleri.do?id=30886 20.09.2019

Figure 6: Turkish Lira Denominated Lending Flow, (13 Weeks Change, billion TRY)



Source: Prepared by the author, Weekly Banking Sector Data, Banking Regulation and Supervision Agency: https://www.bddk.org.tr/BultenHaftalik/en# (accessed on 20.09.2019).