

Macroeconomic Developments in Turkey, 2003

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Introduction

The last two decades witnessed an extensive shift in the development strategy with the rise to hegemony of the neo-liberal orthodoxy dictating market rationality over any other form of collective decision-making. In the words of Bourdieu (1998), this infernal machine, termed globalization, has sought to destroy all collective structures, which are held as a hindrance to the profitability of private capital. Thus, trumpeted with the rhetoric of TINA (**T**here **I**s **N**o **A**lternative) the neo-liberal orthodoxy juxtaposed new rounds of conditionality as part of its hegemonic agenda: privatization, flexible labor markets, financial de-regulation, flexible exchange rate regimes, central bank independence (with inflation targeting), fiscal austerity, and good governance...

The neo-liberal ideology attempted to explain the motives behind financial liberalization arguing that such measures would restore growth and stability by raising savings and improving economic efficiency. Accordingly, as the “strangulation” of the so-called financial repression is dismantled, loanable funds would expand; real cost of credit would fall; and increased pace of capital accumulation would generate sustained growth. A major consequence, however, has been the exposure of these economies to speculative short-term capital (hot money) attacks, which increased instability, and a series of financial crises. In the last 20 years alone, the world economy experienced about 70 financial crises, with about two-thirds hitting the developing countries (Adelman, 2000).

Furthermore, contrary to expectations, the post-liberalization episodes were inflicted with the divergence of domestic savings away from fixed capital investments towards speculative financial instruments with often erratic and volatile yields. As a result, developing economies with weak financial structures and shallow markets suffered from increased volatility of output growth, shortsightedness of investment decisions, and financial crises with severe economic and social consequences. Often the economic crises were realized hand in hand with the ensuing political crises. All these led to severe contraction of labor incomes and increased unemployment together with marginalization of the work force, and resulted in violation of basic labor rights in trade union activity, deprivation of rights to engage in collective bargaining and participatory democracy.

Turkey initiated its tide of neo-liberal reforms in 1980 with the liberalization of commodity trade and flexibilization of its labor markets. Capital account was de-regulated and financial

liberalization was completed in 1989. After going through a series of short-term cycles of instability-crisis-(unsustained) growth-instability throughout the 1990s, Turkey entered a period of severe economic-cum-political crisis in November, 2000 with a final burst of the financial bubble in February, 2001.

The official view is that the February crisis was the result of the failure of the public sector to maintain the austerity targets set by the IMF-led stabilization program initially initiated in December 1999. It is often alleged that the crisis in Turkey was the end result of the failure of the Turkish government to maintain its austerity targets and to implement the necessary structural adjustment reforms on time, thereby disturbing the market agents and causing foreign capital to leave the country.

We argue, however, that the February 2001 political and economic crisis in Turkey was not the product of a few technical errors or mismanagement, but was the end result of a set of cumulative processes that were set in motion by the overly premature attempt to liberalize and deregulate the economy. Contrary to the official stance, economic evidence clearly shows that the fiscal targets were reached throughout the implementation of the program in 2000, and the central bank (CB) was successful in maintaining its monetary targets. It is our contention, therefore, that as the fragile and shallow domestic asset markets of Turkey's peripheral capitalism were prematurely exposed to foreign competition, all the underlying conditions for the financial crisis were already in place.

Thus, the question is whether the causes of the crisis and the proposed remedial reforms are as simple and mono-causal as the neo-liberal thinking behind the IMF-backed recovery program in Turkey would lead us to believe. This Report addresses these issues based on recent economic evidence.

Macroeconomic Developments in 2003

Turkish economy has grown by 4.5% in real terms in the first three quarters of 2003. It is projected that the real rate of growth of the manufacturing sector will be 8.5%, and that the size of the aggregate GNP will reach to \$238.1 billion by the end of the year. Price movements were also brought under control through the year and the 12-month average inflation rate has receded from 51.2% to 27.4% in consumer prices and from 59% to 28.5% in wholesale prices. The deceleration of price inflation has also brought together falling interest rates and the annual average compounded rate of interest on government's debt instruments (GDIs) have been reduced to 29.4%, from 62.7% of the previous year. 2003 has also meant a period of acceleration of export, and export revenues have reached to \$33.5 billion over January-September. Nevertheless, with the rapid rise of the import bill over the same period, the deficit in the current account exceeded \$4 billion (or about 4% of the GDP).

Turkish media and the official centers have hailed the "positive" rates of real growth as the end of the crisis and transition to sustained, long term growth. Furthermore, according to the same circles, this achievement is the end result of the government's credible and decisive reforms. Accordingly, the current AKP government is following the IMF program with strong faith, and the "markets" are celebrating its successful "governance" with increased inflows of foreign capital and rising credit ratings.

Yet, such hasty and dogmatic assessments that tend to see the macroeconomic performance of an economy as only a matter of algebraic rate of growth calculations often overlook the structural bottlenecks and the conjectural shifts surrounding the commodity and the labor markets. The travestisites of financial orthodoxy often regard the macroeconomic developments only front the point of view of short-run financial gain, and celebrate the speculative surges in stock exchange as evidence of “growth and prosperity”. However, they fail to note the underlying imbalances in the commodity markets and choose to remain silent against the culminating pressures of rising unemployment, falling wages, increased poverty and stagnating fixed investments. In fact, developments in Turkey during 2002 and 2003 reveal that the growth performance has been thoroughly based on inflows of short-run international capital and on the conjectural developments in the international currency markets which enabled Turkey windfall gains of favorable terms of trade, none of which are sustainable even in the medium run.

Tabl3 1. Developments in the Turkish Economy, 2003-Summary

	2002	2003
Gnp Growth Rate (%)	7.6	4.5 (forecast)
GNP (Billions \$)	181.7	238.1 (forecast)
Inflation (CPI, 12 months averages)	51.2	27.4
Inflation (WPI, 12 months averages)	59	28.5
TL / US \$ Exchange rate	1,696,000	1,485,000
TL / Euro Exchange rate	1,688,000	1,723,000
Public Sector Debt Stock (Billions \$)	148.5	182.6 (ekim)
Domestic debt stock (katrillions TL)	149 (Aralık)	194 (December)
Gov Debt Instruments Interest Rate (%)	62.7	29.4
Foreign Debt Stock (billions \$)	131.4	142.1 (October)
Exports (billions \$)	36.1	46.8
Imports (billions \$)	51.5	68.7
Current account Balance (billions \$)	-1.5	-6.8
Unemployment Rate (Open, %)	9.3	10

Source: Central Bank of Turkey (www.tcmb.gov.tr)

Firstly, when we study the balance of payments (BOP) statistics closely, we see that the growth performance of the economy depended directly on inflows of international finance capital. Over the first nine months of 2003, the finance account of the BOP displayed a net surplus of \$5,974 billion. In contrast, the same account showed a deficit of \$364 million in 2002. If we add the unrecorded foreign exchange flows of \$3.6 billion displayed under the “net errors” account, we reach a total sum of \$9.5 billion of liquid inflow into the Turkish economy in the first nine months of 2003. This magnitude is on the order of ten-folds compared to 2002, and clearly reveals the fragility of the sources of growth.

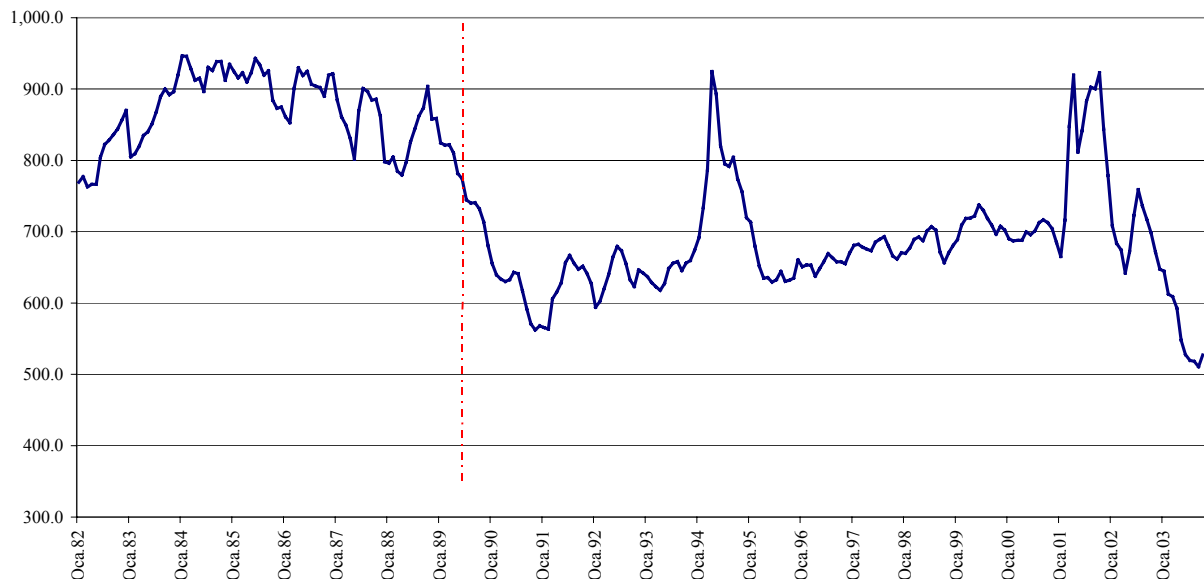
Balance of Payments and the Real Exchange Rate Appreciation in 2003

This fragility has in fact revealed itself in the foreign exchange market. In the last two years the price level in Turkey has increased by 70% in cumulative terms. Yet the foreign exchange rate of the Turkish Lira has remained virtually stagnant in nominal terms in the course of the same period. Thus, in spite of the “free floating” characteristic of the foreign exchange regime, the Lira is observed not to float at all. The pressures of international finance simply hold the necessary adjustments in the Lira at bay, and with excessive inflows, the Lira continues to appreciate at the expense of deepening current account deficits.

After the 1989 decision to de-regulate the capital account and to fully liberalize the financial markets, Turkey opened its domestic markets to the speculation of international finance capital. In this structure the Central Bank has lost its control over the money markets, and deprived it from affecting the exchange rate and the interest rate which actually became an exogenous variable, totally dependent on the decisions of international arbiters. This financial structure has trapped the Turkish economy to a policy of overvalued exchange rates and very high real interest rates.

Figure 1 below, the long term behavior of the real exchange rate of the Lira vis-à-vis the US\$ is depicted. The nominal conversion rate is deflated by the whole sale price index in Turkey in 1987 fixed prices (with the US inflation being assumed away). As can be observed, as of December of 2003 the Lira is at its most appreciated point. The culminated appreciation of the lira since 1982 reaches to 40%. In fact the Figure also narrates one more observation: after the 1989 decision of full de-regulation, the rate of exchange of the Lira against the major currencies has moved to a lower plateau structurally (showing appreciation of the Lira). Two “spikes” of corrective devaluations in 1994 and yet again in February 2001 worked to let the steam out and to correct the imbalance, but after each round the tendency towards appreciation became visible once more.

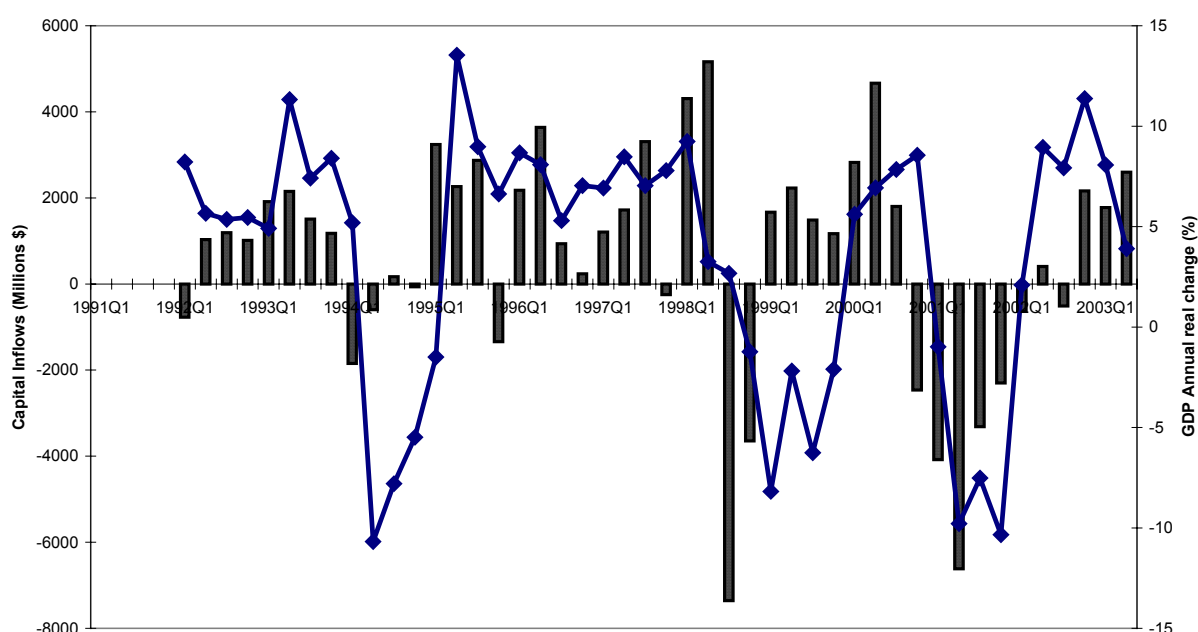
**Figure 1. Real Exchange Rate (TL/\$)
(Deflated by the Fixed 1987 Wholesale Prices)**



This appreciation was mostly due to inflows of short-term financial capital (hot money). Such flows had enabled, on the one hand, accelerated growth through cheapening of imports, and on the other hand, they motivated speculative transactions in the financial markets. Yet, this “speculative-led growth” could not be sustained for long, and each growth cycle (1990-93; 1995-98; 2000) came to an abrupt halt with the crises of 1994, 1999, and 2001.

In Figure 2 we further depict the dependence of growth on the financial capital flows. On the left-hand side of Figure 2, we numerate the financial capital inflows in quarter periods. On the right-hand side we have the growth rate of the GDP. The Figure discloses the dependence of the growth rate cycles to the in- and out-flows of financial capital very clearly.

Figure 2. Balance of Payments Finance Account + Net Errors and Omissions (Millions \$) and GDP Annual Change (%)

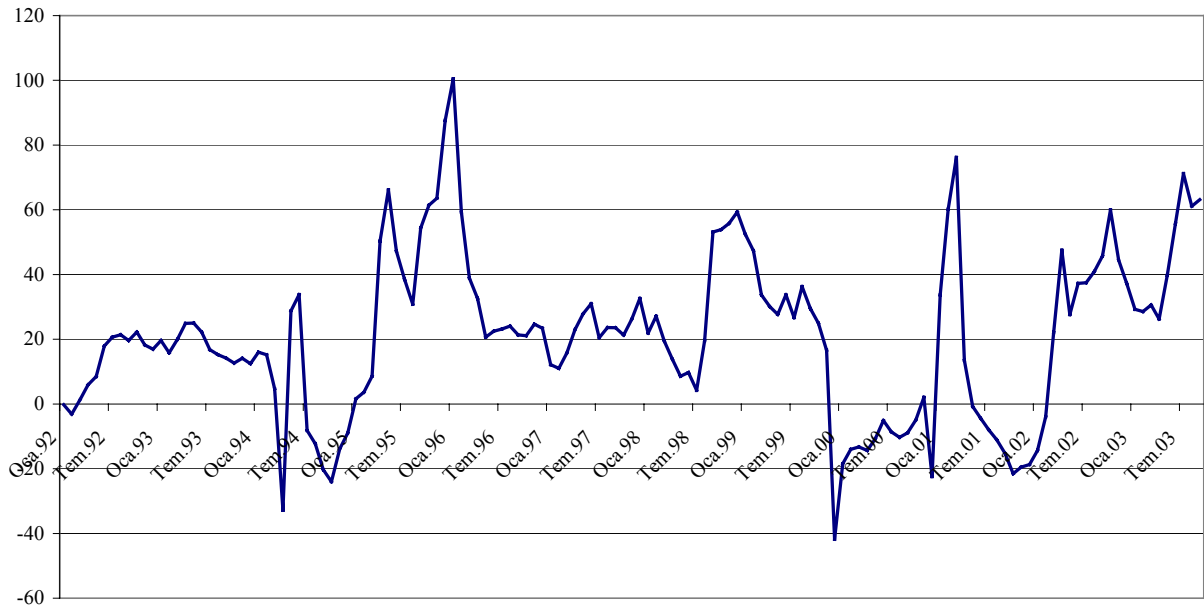


Sources of Growth

Thus, after 1989, growth performance of the Turkish economy is observed to follow directly the direction of flows of foreign financial capital. In 2003, as well, the fact behind the positive rate of growth is understood to be inflows of foreign capital. Turkey is able to attract such capital inflows with the aid of very high rates of financial arbitrage that it offers in the international capital markets. Such arbitrage gains are calculated by the difference between the rate of interest and the exchange rate depreciation and are portrayed in Figure 3. Accordingly, speculative arbiters had gained a financial rent of %20 on the average in their operations within the Turkish financial markets during the last twelve years. Such gains had

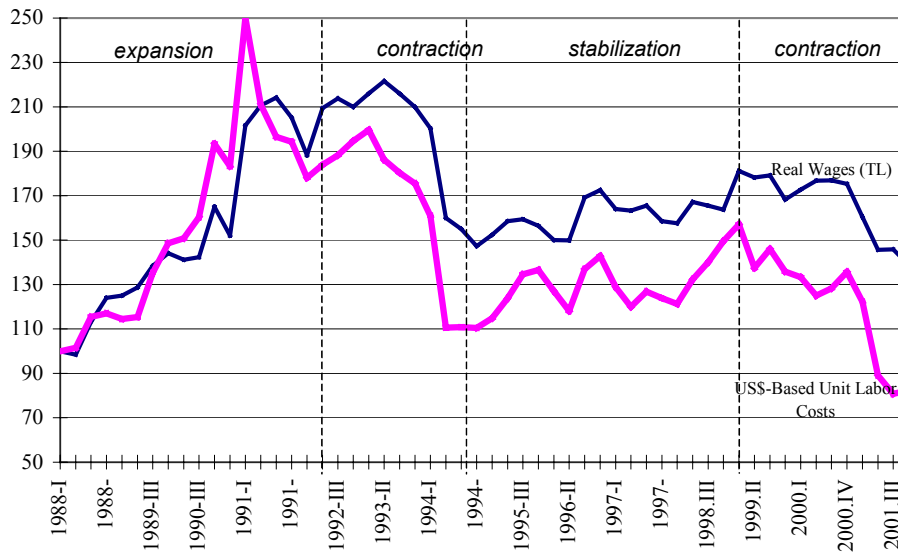
accelerated to above 80% over periods of turbulence, such as May 1996 and September 1988-March 1989.

Figure 3. Speculative Interest Rate - Exchange Rate Arbitrage (%)
 $(1+r)/(1+\epsilon)$



This transfer of the financial surplus through the speculative transactions of the financial system, no doubt, had repercussions on the primary categories of income distribution. It is clear that, creation of such a financial surplus would directly necessitate a squeeze of the wage fund and a transfer of the surplus way from wage-labor towards capital incomes, in general. It is possible to find evidence of the extend of this surplus transfer from the path of the private manufacturing real wages. We portray the dynamics of the private manufacturing real wages in Figure 4, denominated both in Turkish Lira, and also in the US\$ terms.

Figure 4. Real Wages in Turkish Private Manufacturing



After a brief surge over 1990-1993, real wages had plummeted during the 1994 financial crisis, and in a sense have bore the brunt of adjustment of the crisis. During 1996-98, real wages have kept their momentum in general. However, after the 1999 wave of crises, real wages in private manufacturing faced a second cycle of contraction. This contraction was especially pronounced in US\$ terms.

A close inspection of Figures 2 and 4 together is especially informative. This exercise shows very clearly, how, in the Turkish economy speculative financial gains were financed through squeezing of real wages. Each rapid rise in the financial arbitrage is closely associated with a downward movement of real wages and involves a direct transfer of labor incomes towards capital, both domestic and foreign.

Given this evidence, it is easy to disclose the sources of growth during 2002 and 2003 in the Turkish economy. In order to understand the sources of growth in the GDP, we first decompose the sources of demand in real terms. We then calculate the changes in each demand category over the preceding year to obtain the amount of the increase in aggregate GDP as explained by the respective component of demand. Table 2 documents this exercise.

In Table 2 we provide national income data measured in fixed 1987 prices. The Table gives the real amount of change of the components of GDP between the first three quarters of 2003 and 2002 in comparison of the same period of the previous year. Accordingly, in 2002 real GDP has increased by 8.5 trillions TL in fixed 1987 prices. 17.4% of this magnitude (1.4 trillions TL) originated from the rise of private demand, while 6% (509 billions TL) was the result of the increase in public demand. Fixed investments contracted by 171 billions TL and resulted in a change of 2% in the GDP. Likewise net exports (exports – imports) led to a decrease of the GDP by 1.1 trillions TL (a contraction of 11.6%).

GDP Expenditures (Constant Prices, 1987, Billions TL)								Contributions to 2002-2001 GDP	Contributions to 2002 (%)	Contributions to GDP 2003Q1 (%)
2002Q1- 2001Q1	2002Q2- 2001Q2	2002Q3- 2001Q3	2002Q4- 2001Q4	2003Q1- 2002Q1	2003Q2- 2002Q2	2003Q3- 2002Q3				
Private Consumption	-321	543	556	713	1,116	439	1,278	1,491	17.4	56.4
Public Consumption	38	60	265	146	-52	-67	-33	509	6.0	-2.6
Fixed Investments	-1,574	-138	353	1,188	364	322	23	-171	-2.0	18.4
Private	-1,410	-184	-157	602	645	501	406	-1,149	-13.4	32.6
Public	-165	46	510	586	-280	-179	-383	978	11.4	-14.2
Changes in Inventories	1,616	3,163	1,296	1,631	1,382	1,185	795	7,706	90.2	69.8
Exports	938	537	1,842	1,309	1,446	1,412	2,709	4,626	54.1	73.0
Imports	-194	-1,837	-1,689	-1,894	-2,276	-2,197	-3,077	-5,614	-65.7	-114.9
GDP	503	2,329	2,622	3,094	1,980	1,092	1,696	8,547	100.0	100.0

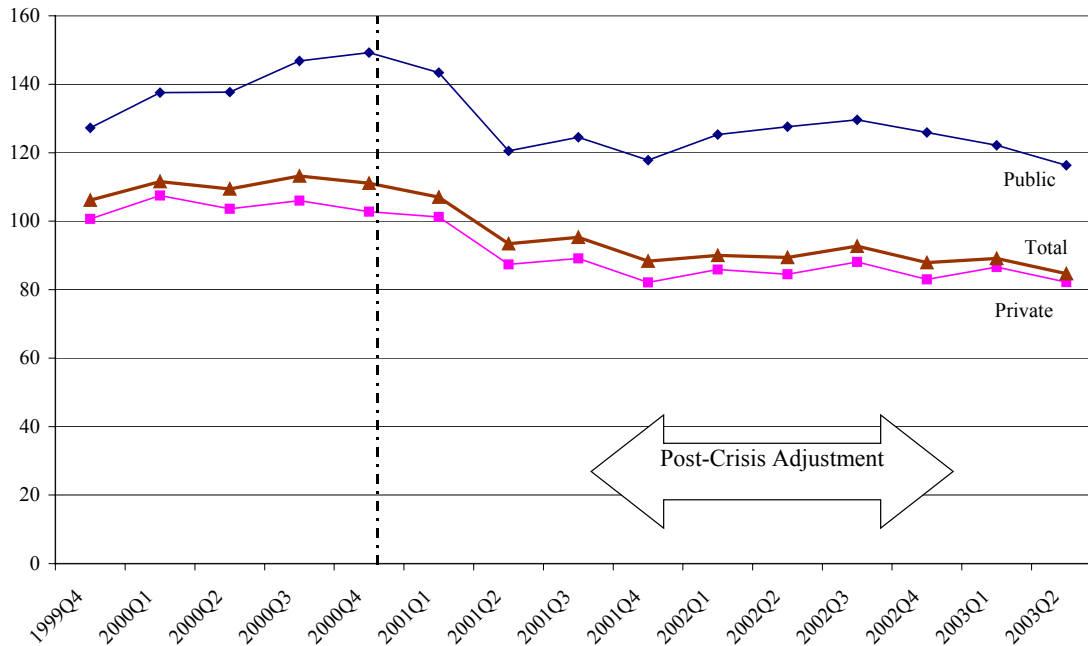
Summarizing the above calculations, our results reveal that, *of the total increase of 8.5 trillions TL in the aggregate GDP, 7.7 trillions have gone to stock accumulation. In other words, 90% of the increase in the real GDP has ended up in inventory accumulation.* This outcome is the end result of the contraction in private consumption and fixed investment demand categories at a time of fiscal contraction and massive unemployment pressures.

Our calculations show that the same processes had been operational in the first three quarters of 2003 as well. During the first three quarters of 2003 aggregate GDP has increased in real terms by 1.9 trillions TL, 1.1 trillions TL, and by 1.7 trillions TL, respectively. Stock accumulation has been on the order of 69.8%, 108.4%, and 46.9% of these magnitudes at every quarter, respectively. In the meantime private fixed investments remained stagnant as in 2002, and public expenditures contracted mostly due to ideological preferences of the IMF programme. Private consumption was also mediocre, while the surge in exports was met by an equally significant rise of imports; thus, the contribution of *net* exports to the aggregate GDP had been negative.

The Wage Cycle: Contraction of Wage Incomes and Unemployment Pressures

The real wages contracted severely after the 2001 February crisis and this downward trend continued throughout 2002 and 2003. Calculated from 2000 to mid 2003, the decline in the private manufacturing real wages reached to 19.6%. The decline of wages in the public manufacturing sector has been 15.4% during the same period. Viewed from a longer time horizon, if the index of real wages were assumed 100 in 1997, it is observed that they fell to 82.2 index points in the private manufacturing sector. Figure 5 depicts these trends.

Real Wages in Turkish Manufacturing (Per Hours)
(1997=100)



Parallel to these developments in the labor markets, we witnessed a surge in the unemployment rates. *Open* unemployment rate was 5.6% in 2000. In 2001, the official rate of open unemployment rose to 8% in 2001, and accelerated to reach 10.3 in 2003. More alarmingly, the rate of unemployment among the educated urban young labor force is reported to reach to 31.1% by the end of 2003. This ratio was 28.7% in 2001. Thus, the problem of unemployment persists and is actually deepening in the absence of new investments and an ideological preference towards contraction and austerity in the name of stabilization and debt repayments.

Conclusion: Stability and Credibility, for Whom?

In conclusion, it is observed that the post-2001 crisis administration in Turkey primarily works as a debt-management program. In this sense, it is understood that the main purpose of the IMF-led salvation packages that are hailed as big successes in the international media is actually an operation of foreign debt roll-over, aiming at gaining the confidence of the international arbiters and financial speculators.

We observe that what lies behind the colorful jargon of “effective and transparent government”, “good governance”, and “credibility” is a set of structural transformations to ultimately satisfy the needs and demands of the foreign capital centers, rather than the strategic requirements of the domestic economy. In essence, this model depends on the contractionary monetary and finance policies, and assumes an open (i.e. dependent on foreign capital) economic structure ensuring the liberalization of the international capital flows. In this model what is really meant by the concept of “stabilization” is to establish an exchange

rate system purified from devaluation risk, and to maintain a high real return in the national financial markets to attract the inflow of foreign capital.

Under this structure, the central banks are set to be “autonomous” and all their instruments of intervention are restricted, so that they could not undertake any role apart from “maintaining price stabilization”. Fiscal policies, on the other hand, are to be directly focused on the objective of “budget with a primary surplus”. As result of these policies, boundaries of the public space are severely restricted, and all traditional economic and social infrastructural facilities of the public sector are being left to the strategic interest area of foreign capital at the cost of extraordinary cuts in public spending and investments.

The neo-liberal thought dictates that in order to take advantage of the benefits of “globalization”, national central banks with autonomous monetary, interest and exchange rate policies should not be a hindrance to international capital flows. The real objective of this philosophy is to make the central banks to be in charge of maintenance of price stability and to sustain the level of high real returns in the national financial markets. In so doing, rents allocated to finance would be secured. Public economics, on the other hand, is limited to take all measures directly to enlarge the interest area of international capital.

Departing from all these observations, it is clearly seen that the IMF-led adjustment program that is implemented in Turkey with a media propaganda that portrays it as “having no alternatives”, is actually part of a larger project defining Turkey’s role in the new international division of labor as a peripheral economy wherein industrialization and development targets are abandoned; domestic commodity and asset markets are integrated with the global markets under marginalized conditions; and where the domestic economy has been left unprotected and open to external shocks.