CHAPTER 10

Neoliberal Framework and External Dependency Versus Political Priorities, 2009–2020

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Introduction

As discussed in the previous chapters, Turkey was among the early adopters of the neoliberal policy framework that has increasingly dominated the agenda of the world economy and its institutions. Rapid trade and financial liberalizations of the early 1980s were followed by the liberalization of capital movements in 1989. The 1990s witnessed boom-bust cycles of capital flows that generated episodes of economic growth, followed by sudden stops and outflows, resulting in financial

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and economic crises. The poor design of the IMF-directed stabilization program implemented in 2000 led to another recurrence of such a cycle and resulted in a deep crisis in 2001. This crisis was followed by a series of structural and institutional reforms, still under the guidance of the IMF. The macroeconomic framework of the program reflected the global orthodoxy of Central Bank independence, inflation targeting, contractionary fiscal policy with primary budget surpluses and floating exchange rates. The program aimed to stabilize the economy through a mix of high interest rates and overvalued exchange rates. A widespread privatization program was accompanied by a series of deregulations aiming to diffuse "marketization" through all areas of socioeconomic life.

This extensive deregulation program, widespread privatizations, high interest rates, and an exchange rate policy allowing the Turkish lira to appreciate, coincided with an increase in global liquidity in the 2000s and resulted in accelerated foreign-capital inflows. While higher interest rates attracted short-term capital inflows, privatizations and deregulations in many sectors brought an increase in foreign direct investment. Adherence to the IMF's structural reform program further increased international finance capital's interest in Turkey. Capital inflows both supported economic growth and allowed the Central Bank to bring inflation down by keeping the Turkish lira overvalued. The Justice and Development Party (JDP) that came to power toward the end of 2002 continued to follow these policies to the letter. In fact, the JDP's adoption and implementation of the program were rewarded by the IMF in May 2005 with a new and exceptional credit line of 10 billion dollars, explicitly intended to provide "political capital" to the JDP for the 2007 elections (Boratav, 2018: 248; IMF, 2005: 75).

This pattern continued from 2002 to 2008, until the sudden stop of inflows and the decline in export revenues due to the global financial crisis sent the economy into a sharp recession. Yet, the quantitative easing (QE) policies of the US Federal Reserve System (Fed) and the European Central Bank (ECB) created an unprecedented expansion of liquidity in global financial markets, leading to renewed capital inflows to Turkey and similar economies (Akyüz, 2015). To take advantage of this increase in global liquidity, the Turkish government relaxed regulations that prevented non-financial firms with no export revenues from borrowing in foreign currency and the Central Bank initiated a reserve option mechanism allowing domestic banks to borrow from international

banks at low interest rates and use them for credit expansion and for their required reserves.

While signs of fragilities began to surface starting in the mid-2010s, sudden capital outflows in 2018 led to a currency crisis followed by a recession into 2019. The renewal of capital inflows, albeit at relatively much lower levels, together with increased public spending and government's push for a credit expansion helped the economy recover slowly toward the end of 2019. Yet, the accumulated fragilities persisted, and Turkey was faced with the negative demand and supply shocks of the Covid-19 pandemic with a fragile economy trying to recover. Rapid capital outflows from the "developing and emerging economies," including Turkey worsened the situation and brought the economy that was already hit by the pandemic's negative economic shocks to the brink of a balance-of-payments crisis toward the end of 2020.

We start by depicting the global context in the next section and provide a brief overview of the period. After this overview, we first analyze the developments in external balances and then domestic macroeconomic dynamics in detail, before moving onto a discussion of the period from the 2018 currency crisis to the 2020 Covid-19 shock. In the last section, we provide concluding remarks on the political economy of Turkey in this period.

Overview of the Period

The financial crisis that originated in the US subprime mortgage markets in 2008 spread quickly to the rest of the financial markets and the US economy, and from there to the rest of the world. Complicated derivative products were effective in the rapid spread of the crisis to the US and world financial system. The earlier signs of the crisis appeared in the subprime mortgage markets in 2007. In March 2008, the large US investment bank Bear Stearns declared bankruptcy and in July, the Federal Deposit Insurance Company had to take over IndyMac bank. The September of 2008 witnessed a series of bankruptcies of large banks and financial institutions, including the US-government-sponsored Fannie Mae and Freddie Mac that backed mortgage credits. As the financial markets froze, the fear of a systemic collapse led to a series of rescue operations organized by the US Treasury and the Fed, resulting in the largest bailout operation in history, despite the prevailing pro-market rhetoric. Especially after the collapse of the Lehman Brothers, the fear of a systemic

collapse led the US Treasury and the Fed to intervene and organize the takeover of Merrill Lynch by the Bank of America. The insolvency of the American Insurance Group (AIG)—the insurer of the financial system required yet another massive bailout by the US government (Hein et al., 2015; Orhangazi, 2015; Wolfson & Epstein, 2013).

It was quickly realized that the US and the world economy were faced with the deepest crisis since 1929. The US Congress approved a Troubled Assets Relief Program (TARP) to be run by the US Treasury and assigned 760 billion dollars to that purpose. At the beginning of 2009, the new Obama administration enacted the American Recovery and Reinvestment Act (ARRA), which included various government spending items as well as tax incentives amounting to 800 billion dollars. On the other hand, the Fed, after decreasing the interest rate all the way down to near zero, began a QE program with the aim of purchasing troubled assets held by the banks to stabilize the financial system and to support economic growth by decreasing long-term interest rates in order to spur investment and consumption. The Fed's balance sheet shows that the total amount of QE from late 2008 to early 2014 reached around 3.5 trillion dollars. As the financial crisis spread to the rest of the world, central banks of the United Kingdom, Europe and Japan have also brought interest rates down and began implementing similar QE policies. The sum of total liquidity injected to the world financial markets is estimated to be somewhere between 10 and 15 trillion dollars (Caldentey, 2017).

This unprecedented expansion of global liquidity generated booms in financial asset prices of the advanced economies and started a new cycle of capital flows to "emerging economies" as finance capital sought higher yields as compared to the near-zero interest rates at the center. Furthermore, both banks and non-financial corporations in "emerging economies" began increasing their external borrowing to take advantage of the near-zero interest rates in the advanced economies. As Akyüz (2012, 2015) depicts in detail, this process resulted in furthering the financial integration of the "emerging economies" to the world economy and resulted in new forms of external vulnerabilities. The capital inflows led to currency appreciations, widening current account deficits, credit expansions and asset price inflation to varying degrees in these economies.

The sudden stop in capital inflows in 2009, together with declining exports due to the global economic slowdown sent the Turkish economy into a recession. Following 2009, similar to the 2003–2007 period, the 2010–2013 period witnessed large foreign-capital inflows, approaching

to a total of 250 billion dollars in four years. In order to take advantage of the global liquidity and low interest rates, regulations were relaxed to allow non-financial firms with no export revenues to borrow in foreign currency. At the same time, the Central Bank began implementing a reserve option mechanism, allowing domestic banks to use foreign currency as part of their required reserves. Hence, the early 2010s witnessed an increase in the external debt of the private sector, both banks and non-financial corporations, as well as an increase in portfolio flows into the stock and bond markets.

Large volumes of capital inflows allowed the "success story" of the 2000s to continue into the early 2010s with high growth rates, especially as compared to most "emerging economies." In fact, by 2013, Turkey was being presented as an exemplary case by the World Bank: "Turkey's rapid economic and social progress holds many useful lessons for policy makers in other emerging markets and has been an inspiration to reformers, particularly in the Middle East and North Africa" (World Bank, 2013: 2).

However, a series of structural imbalances and financial fragilities were accumulating at the same time, complicated by their economic repercussions and incidence of political difficulties facing the JDP. Even in these years, wide current account deficits and unprecedented levels of private-sector external debt were accompanied by a domestic credit expansion, giving a "debt-led" character to growth and generating fragile balance sheets for non-financial firms. The government's almost exclusive focus on a construction-centered growth strategy together with the premature deindustrialization tendencies due to overvalued exchange rates for an extended period generated an unstable growth path, insufficient employment generation and persistent inequalities.

Fed's 2013 "tapering" announcement had a large impact on global financial markets and by the end of 2014 Fed stopped QE, announced its aim to "normalize" its balance sheet and began increasing the interest rates at the end of 2015. As Fig. 10.1 below shows, capital inflows to Turkey slowed down in this period, from 70.4 billion dollars in 2013 to 51 billion dollars in 2014, and 33 billion dollars in 2015.

As the global liquidity conditions have changed and foreign-capital inflows slowed down in the second half of the 2010s, both external and domestic fragilities together with the JDP's quest for electoral majority at all costs led the government to attempt keeping the rate of economic growth high via a low interest rate policy, which began to jeopardize both

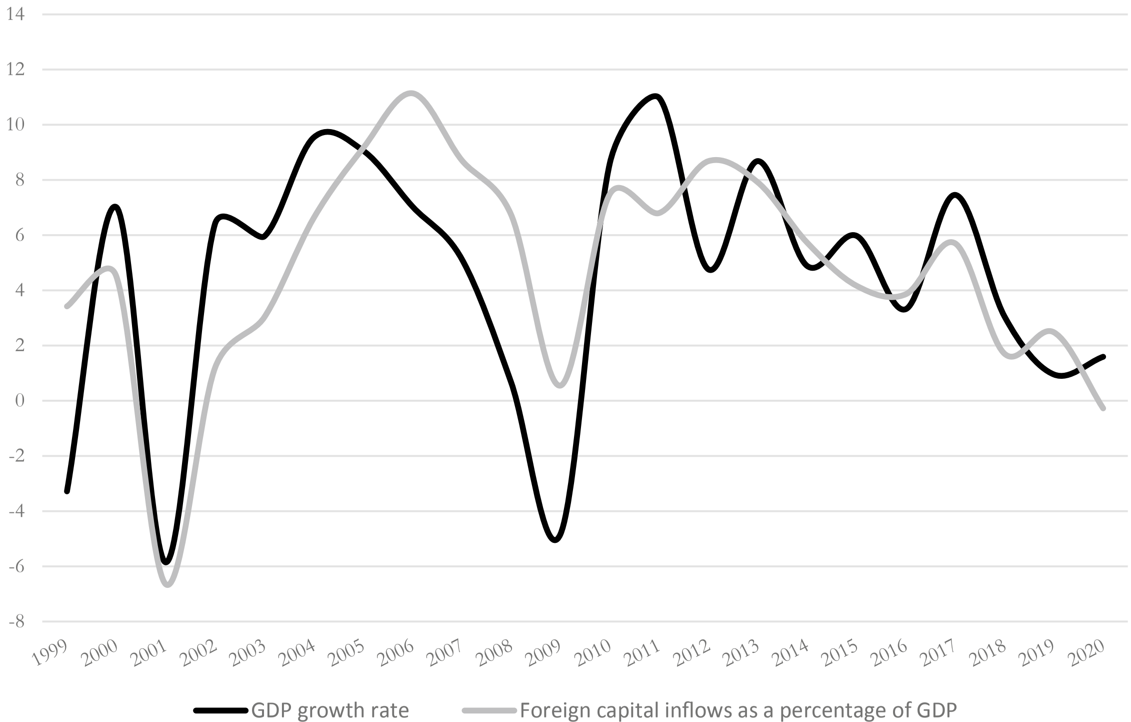

Fig. 10.1 Foreign capital inflows (% of GDP) and GDP growth rate (%) (*Source* Authors' own calculations, using Balance of Payments and National Accounts data from the Electronic Data Delivery System of the Central Bank of the Republic of Turkey [https://evds2.tcmb.gov.tr/index.php]. Accessed on 1 March 2021)

the so-called independence of the central bank and its inflation targeting. In fact, President Erdoğan began to argue publicly that inflation itself was the consequence of high interest rates, despite briefings from the governor of the Central Bank, who emphasized that low interest rates would lead to currency depreciation and increased inflationary pressures via the pass-through effects (Başçı, 2015). In 2016, policy interest rates of the central bank were lowered and to ensure economic growth from 2017 onwards, the low interest rate policy was accompanied by various credit support mechanisms, such as the use of the Credit Guarantee Fund (*Kredi Garanti Fonu*), originally established to support small and medium-sized businesses. Credit expansion continued despite increasing debt-repayment problems in the non-financial sector.

The renewal of capital inflows in 2017, amounting to 48.8 billion dollars, helped growth in that year but also resulted in a widened current account deficit and historically high external debt levels. In the face of mounting vulnerabilities, sudden capital outflows triggered by a diplomatic spat between the US and Turkey led to a currency crisis in the summer of 2018 and sent the economy into a recession into 2019.

Economic slowdown together with liquidity problems in some of the financial markets in the US led the Fed to begin decreasing the interest rates again in the second half of 2019 and gave renewed impetus to global liquidity expansion. Turkey began receiving capital inflows again, although at lower levels. These inflows, together with increased public spending and government's push for a credit expansion helped the economy recover toward the end of 2019. Yet, the accumulated fragilities persisted and Turkey was faced with the negative demand and supply shocks of the Covid-19 pandemic with a fragile economy recovering from a recession. In short, as the government attempted to offset the adverse impact of capital-inflow slowdowns and reversals by an enforced credit expansion, it had to confront the external constraint twice, in 2018 and in 2020. In 2020, rapid capital outflows and persistent current account deficits resulted in a rapid depletion of Central Bank reserves and brought the economy to the brink of a balance-of-payments crisis. Following the sharp depreciation of the currency, the Central Bank governor and the Treasury Minister were replaced in November 2020 and the new economic team immediately began monetary tightening while promising austerity policies. This development helped stop capital outflows and started a new cycle of inflows by short-term financial investors, who

wanted to take advantage of the high interest rates. Whether this return to orthodoxy will prevail or not is yet not clear.

External Constraints

Dependence of Economic Growth on Capital Inflows

Following the liberalization of capital movements in 1989,[1] the growth-recession cycles of the economy came to be driven mainly by foreign-capital flows and Turkey experienced four episodes of crisis within the next two decades (1994, 1998–1999, 2001, 2009). Before 1989, when capital flows were regulated and limited, the short-term growth dynamics of the economy were mainly determined by domestic factors. For example, a change in public spending (including investment), taxation or monetary policy would directly incorporate or impact the investment and consumption decisions, while the exchange rate policies would be formed in line with the needs of the export sector and/or import-competing industries. Changing domestic demand conditions would be the main determinant of trade and current account balances. The chronic trade deficit of Turkey would reveal itself through the following mechanism: *policy-linked or autonomous domestic demand expansion → growth → current account deficits → capital inflows.* An autonomous domestic demand expansion could begin from private investment due to "animal spirits" (in Keynesian parlance) or from an increase in real wages and salaries such as the one in 1989. After the liberalization of capital flows, the autonomy of domestic demand declined significantly as foreign-capital inflows started to become the main determinant of growth. The new mechanism became the following: *capital inflows → domestic demand expansion → growth → current account deficit.*

Figure 10.1 reflects the foregoing relationship between foreign-capital inflows and economic growth during, especially the first two decades of the twenty-first century. Indeed, this figure covers the main economic "success story" of the JDP. It should be kept in mind that the JDP came to power after the 1998–2002 period characterized by a declining GDP per capita. The following high-growth episode was due both to the "base effect" of the preceding five "lost years" and abundant capital inflows of the post-2002 era. The annual average growth rate of the economy in the 2002–2007 period was 7.3%. However, in the 2010–2015 period, the average growth was only 4.8%, despite continuing foreign-capital inflows,

reflecting the decline of the potential growth rate of the economy in the 2010s.

The impact of capital inflows on domestic demand operate through various channels.[2] Capital inflows enable an expansion of liquidity, while inflows into stock and bond markets lead to asset price increases in these markets. Increases in demand through wealth effects or credit expansions are likely to follow. Banking sector's external borrowing can also be used to support domestic credit expansion and nonfinancial corporations' external borrowing stimulates domestic demand. A second type of dependency is observed when autonomous domestic demand expansion due to fiscal or monetary policy actions leads to a deterioration in the current account. In the Turkish case, this dependency was aggravated by the increased dependence of domestic production on imports, a point we will come back to shortly.

Inflows of foreign capital also allow the central bank to carry an expansionary monetary policy, while home-currency appreciation supports demand through the expectations channel. When capital inflows slow down, stop or are reversed, these processes also respond in the same way. However, the effects of inflows and outflows are not symmetrical. The positive demand effect coming from foreign-capital inflows gets smaller as the economy approaches full capacity. Expansionary fiscal policy, for example, during election periods, can still generate autonomous expansions in production. Or, in a similar vein, minimum wage increases such as the one in 2016 may lead to demand expansions. In such cases, when part of the demand increase is directed toward imports and leads to increases in the current account deficit, a corresponding increase in capital inflows is required to maintain economic growth. In the absence of capital inflows, a depletion of the central bank's foreign-currency reserves and/or depreciation of the home-currency would follow.

The second dependency indicator can be observed through the link between the growth rate and the current account deficit. Turkey historically suffered from chronic current account deficits. However, while these deficits constituted around 1 to 2% of the GDP before the 2000s, they have significantly widened in the 2000s and reached record levels in the early 2010s, as seen in Fig. 10.2. It was only in 2019, following the currency crisis of the preceding year, when the current account went into a surplus. But the current account moved, once again, into a deficit in 2020.

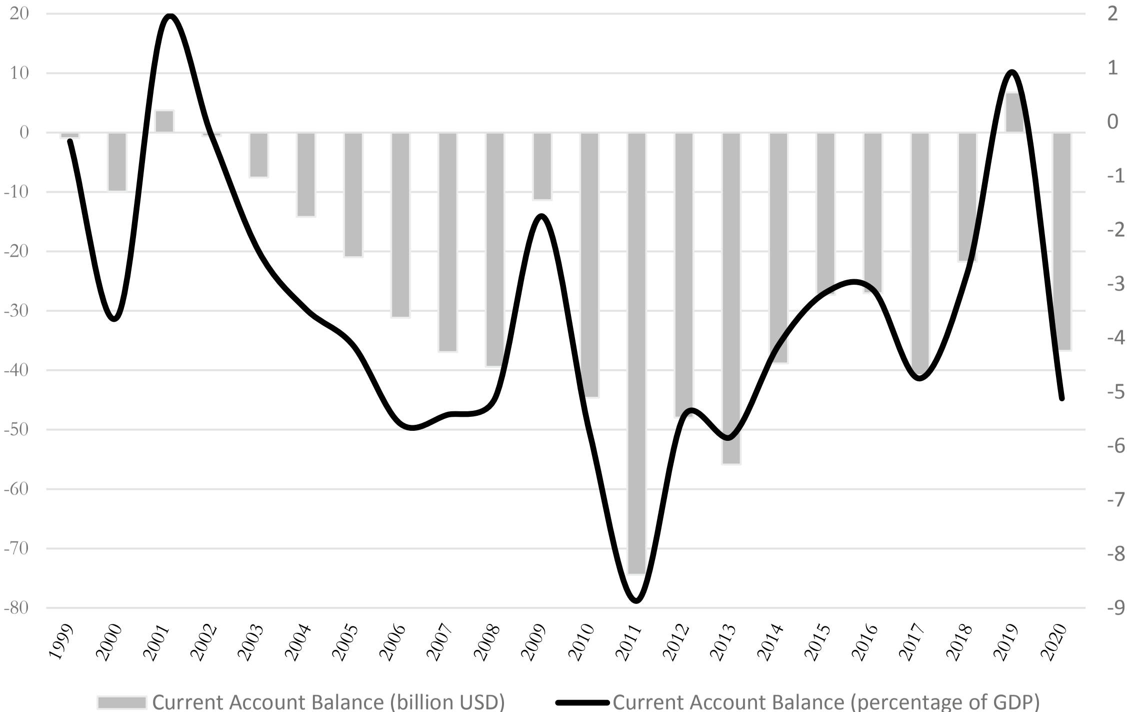

Fig. 10.2 Current account balance in billion USD (bars, left axis) and as a percentage of GDP (line, right axis) (*Source* Authors' own calculations using Balance of Payments and National Accounts data from the Electronic Data Delivery System of the Central Bank of the Republic of Turkey [https://evds2.tcmb.gov.tr/index.php] Accessed on 1 March 2020)

In short, we observe two types of increasing dependency patterns during the 2010s. On the one hand, growth dynamics of the economy is directly determined by the decisions of international finance capital based primarily on global conditions. On the other hand, increases in domestic demand require additional external funding due to the rising import-dependency of the GDP in this period.

The persistence of current account deficits reflects the increased dependence of the economy on imports. According to the *Foreign Trade Statistics* of the Turkish Statistical Institute, in the 2010s, around 85% of the total imports were capital and intermediate goods. Calculations presented by Orhangazi and Yeldan (2021: Fig. 5) show that the Turkish Lira appreciated almost continuously in real terms from 2002 to 2011 and even though it started depreciating around 2013, it remained overvalued for much of the 2010s.[3] This long period of currency overvaluation led to increased dependence of production on imports, undermined export competitiveness in some industries and brought up worries about the premature deindustrialization of the economy. The results have been slow growth in industrial production and the declining share of this sector in the GDP (Bakır et al., 2017; Orhangazi, 2020; Rodrik, 2016).

Using input–output tables, Tek et al. (2017) show that import content of exports in manufacturing has increased from 27.2% in 2002 to 30.6% in 2012. A similar study by Yükseler (2019) finds that total import content of production in all sectors was 13.8% in 1985, 12.4% in 1998 and 18.9% in 2012. If one looks at the ratio of the imports in total value added for the same years, according to this study, the figures are 24.9%, 21.2% and 38.1%, respectively. Özmen (2015) and Karadam and Özmen (2015) also estimate an increase in the import-dependence of production. Karadam and Özmen (2015) show that Turkey is a net exporter in low-technology and a net importer in medium–high and high technology products.

The estimates presented by the OECD TIVA data-set show that Turkey's exports had an import content of 15.4% in 2005, which increased to 19.4% in 2011. From 2011 to 2016, parallel to global trends, this ratio went down to 16.5%, but was still higher than the 2005 level. The expanding sectors within Turkey's exports, such as motor vehicles, basic metals and electrical equipment, had the highest import content. Indeed, 29.1% of imported intermediate goods and services was used in the production of export goods. This ratio is below the OECD average of 45.5%, but shows an increase from the 2005 level of 25.2%. The leading industry in this aspect is motor vehicles with a ratio of 46.5%, indicating

that this industry has become more integrated with the global value chains over time (Taymaz et al. 2011).

The depreciation of the exchange rate later in the 2010s was unable to trigger import substitution and export promotion. Therefore, current account deficits remained significantly higher than the pre-2000 period, both in dollar terms and as a percentage of the GDP. These observations suggest that import dependency of the economy has reached a level and a structural feature that cannot easily be reversed simply by short-run movements in relative prices. To better understand this crucial issue, further research is needed in terms of detailed and industry-specific studies. Reversing this structural deformation would require active industrial policies, together with a reevaluation of free-trade and capital-mobility.

We need to point out two other issues in terms of the external accounts. First, by the 2010s, current payments to international finance capital have become a large component of the current account deficit as the international investment position of the country worsened. Total payments to international financial capital[4] began increasing in the 2000s and were around 11–12 billion dollars per year in the early 2010s. By 2019, these payments approached 20 billion dollars. Second, this is also the period when domestic residents' capital outflows also increased significantly. Especially in the second half of the 2010s, such outflows surged at a remarkable pace. Between 2014 and 2019, resident capital outflows averaged to 15 billion dollars a year. In other words, foreign-capital inflows in the 2010s financed not only the trade deficit but also the current payments to international finance capital and resident outflows.

External Debt Accumulation

Taking a closer look at the external debt position of the Turkish economy is crucial in understanding the dependence of the economy on capital flows. The ratio of external debt stock to GDP shows the weight of international finance capital on the domestic economy and its distribution across sectors and industries, its structure and its turnover rate all constitute potential fragilities, especially at times when global liquidity conditions change. For example, one of the transmission channels of the 2008–2009 global crisis to the Turkish economy has been through external debt repayments. In the thirteen-month crisis period, the credit flows to Turkey turned negative, amounting to 23 billion dollars due to the decline of the external debt turnover ratio. Between September 2008

and March 2009, net payment on the external debt amounted to 26.4 billion dollars (CBRT Balance of Payments Statistics).

An important component of capital inflows has started to become debt-generating flows, especially after 2009, when the interest rates in major advanced economies approached zero and global liquidity reached unprecedented levels due to the QE policies. Most of the external debt accumulation in the 1990s had resulted from public sector borrowing needs. Government budget deficits were seen as one of the main problems, and primary budget surpluses and widespread privatizations in the 2000s brought these deficits under control. Public debt-to-GDP ratios declined to "respectable" levels thereafter, as compared to most "emerging economies." On the other hand, external debt of the private sector, both banks and non-financial corporations, rapidly increased between 2010 and 2017 and reached record levels (Table 10.1). The increase in non-financial sector's external debt by around 50% was particularly significant. The relative decline of the external debt of the public sector came to an end after 2017 and as the financial sector has reduced its

Table 10.1 External Debt

	Total external debt (billion USD)	*Total external debt (percentage of GDP)*	*Short-term external debt (billion USD)*	*Public sector (billion USD)*	*Financial sector (billion USD)*	*Non-financial corporations (billion USD)*
2010	291	37.5	77	89	89	102
2011	305	36.3	83	96	95	105
2012	342	38.8	102	106	116	112
2013	394	41.2	135	119	150	120
2014	407	43.3	137	121	164	119
2015	399	46.2	105	117	157	124
2016	408	46.9	101	123	149	134
2017	454	52.8	120	136	162	153
2018	443	56.9	117	140	139	158
2019	435	57.1	123	157	109	160
2020	435	60.7	134	166	102	146

Source Authors' own calculations using Balance of Payments and National Accounts data from the Electronic Data Delivery System of the Central Bank of the Republic of Turkey (https://evds2.tcmb.gov.tr/index.php). Accessed on: 1 March 2021. *Note* As of the time of writing this chapter, the latest external debt figure available for 2020 belongs to the end of Q3 in 2020. Public external debt figures do not include the external debt of the Central Bank

external debt significantly, public external borrowing has picked up pace. The non-financial corporations, on the other hand, have begun reducing their external debt in 2020. This was a de-facto socialization of private debt carried out by the central bank, three state-owned commercial banks and, partly, the Treasury.

Total external debt as a percentage of GDP increased from 37.5% in 2010 to 60.7% by 2020 also, in part, due to the rapid depreciation of Turkish lira after 2017, leading to a significant shrinkage of the GDP in dollar terms. The short-term component of the external debt remained above 100 billion dollars throughout most of the period.

In short, during most of the 2010s, together with "hot money" inflows, debt-generating inflows started to become a more significant determinant of the domestic demand expansion. The rise of external debt also made the Turkish economy more sensitive to changes in global liquidity conditions as well as in global interest rates and exchange rates. New fragilities emerged as well, arising from the distribution of external debt among different sectors and also from the shifts in the turnover rate of the debt. The reversal of "hot money" inflows in 2020 coincided with the net debt repayments of both the banking and non-financial sectors, leading to a squeeze in available foreign currency and a rapid depletion of the foreign currency reserves of the central bank.

Macroeconomic Dynamics

Domestic Credit Expansion and Increased Indebtedness

When we turn to the domestic macroeconomic dynamics, one of the most striking observations for the 2010s is the unprecedented domestic credit expansion, along with increased indebtedness of both households and non-financial corporations as well as small- and medium-sized enterprises. Phases of high capital inflows supported domestic credit expansion through two channels. First, portfolio capital inflows led to an increase in financial asset prices and hence in the net worth that could be used as collateral. This process helped to decrease the observed leverage ratios. Throughout the same process, the rise of bond prices contributed to bringing domestic interest rates down. Second, banking sector supported part of this domestic credit expansion through borrowing from abroad. Clearly, these processes were not specific to Turkey. Credit and asset

bubbles following the QE policies led to similar developments in other "emerging economies" (Akyüz, 2012, 2015).

Total credit to non-financial corporations (as a ratio of GDP) had begun increasing in 2005. This ratio was 17.8% in 2004 and quickly reached 40% in 2010 and 67% in 2016 when the pace started to slow down. Its peak value was observed as 68.6% in 2018, before coming down to 65.4% in 2019.[5] As we discuss below, the slowdown in credit expansion in the second half of the 2010s was met by the attempts of the government to initiate policies to support credit-led growth.

During the first years of the twenty-first century, credit to households was historically at very low levels in Turkey. In 2002, the credit extended to households as a ratio of GDP stood below 2%. The 2000s witnessed a rapid expansion of household debt, bringing this ratio to 16% in 2010. This increase continued for a couple more years and peaked in 2013 around 20% of the GDP. Credit flows to the households began declining in the following years and leveled around 15% by 2018. A significant portion of these credits was in the form of mortgage loans. As for the non-financial corporations, leading borrowers were in construction, real estate and energy sectors. As a result of the rapid expansion of credit, the debt service ratio, defined by the BIS as the ratio of interest payments to disposable income, increased from around 7% in 2010 to 15% in 2017 and 22% in 2018.

Construction-Centered Growth and Capital Accumulation

The Turkish economy experienced a recession during the 2008–2009 global financial crisis with annual growth rates of the real GDP falling to 0.7% in 2008 and −4.8% in 2009. Thanks to renewed capital inflows the recovery from the recession was rapid with growth rates reaching to 8.6% in 2010 and then 11% in 2011. The growth performance was interrupted in 2016, partly due to the adverse economic impact of the failed coup attempt that year. However, a relatively strong growth rate prevailed during the 2010–2017 period, generating an annual average of 4.6%. Government-led credit expansion in 2017 pushed the growth rate to 7.5%. Yet, external constraints were reflected into foreign currency markets and starting with the last quarter of 2018, the economy moved into a recession for three quarters.

The share of investment in GDP oscillated between 24–30% during the 2010s, according to the *new* GDP series.[6] However, this investment figure can be misleading as another important development in this period has been the construction-oriented pattern of economic growth. From an expenditure point of view, the construction expenses constituted around 17% of the GDP in 2017, just before the 2018 currency crisis, rising from a low of 7.5% in 2004. When we exclude construction investments and look at rate of "gross fixed capital formation" (GFCF) only in machinery and equipment (excluding construction), we observe quite a weak performance, indeed. This GFCF-to-GDP ratio remained around 10% throughout the decade (Turkish Statistical Institute, National Accounts).

A deliberate policy of supporting the construction sector through rent generation and "clientelist incentivization"[7] emerged in the 2000s. The government went on a massive construction spree of building new public buildings, public universities, highways, subways, airports, hospitals and so on, mainly through public–private-partnership (PPP) contracts. As the primary budget surplus requirements limited the government's spending capacity, the Public Housing Authority (*Toplu Konut İdaresi, TOKİ*) was able to generate and realize urban rents allowing the government to finance large-scale infrastructure projects. The rents generated were transferred to business groups close to the government through the distribution of construction permits, "opaque" selection of projects and developers as well as the opening of public land to construction. The foreign-currency-based Treasury guarantees provided to the PPP projects served not only as another mechanism of rent generation but also as a channel of lavish transfers from the government budget to contractors in the medium run. A large number of changes made to the laws regarding public tenders and procurements gave way to widespread political favoritism (see, e.g., Gürakar, 2016). In addition, construction activities generated substantial employment and provided stimulus to the rest of the economy through increased demand for a large number of products from a variety of industries (Balaban, 2012; Çavuşoğlu & Strutz, 2014; Sönmez, 2015).

Two other factors supported construction growth. First, the decline in agricultural employment and migration toward cities increased the need for both housing and other types of structures (hotels, malls, hospital, schools and so on) as well as infrastructure. In addition, the 1999 earthquake had generated a further need for updating the housing stock.

Second, financial expansion and introduction of long-term housing loans increased demand. Price increases encouraged speculative demand as well. As discussed above, the growth of the construction sector accompanied the credit boom. In the second half of the 2000s, the construction and real estate companies also began borrowing from abroad. By 2018, external debt of these firms rose above 26 billion dollars from 1.5 billion dollars in 2006 (CBRT, 2018). The dependence of the construction-centered growth on credit expansion and external borrowing has proved fragile against shocks to the credit volume, interest rate or exchange rate. Mega-infrastructure projects, malls, ambitious housing projects financed through external credits were essentially oriented toward the domestic market. With the exception of the PPPs benefiting from government guarantees in foreign currency, these corporations had negligible foreign currency revenues. Dollar-based contracts to retailers merely transferred the currency risk.

Jobless Growth and Distribution Issues

The 2000s and the 2010s witnessed increased proletarianization as the share of agricultural employment and small business ownership declined. The share of wage employment within total employment has secularly increased, with a brief pause during the global financial crisis of the 2008–2009, and approached 70% toward the end of the 2010s for the first time. However, the economy's capacity to generate employment did not keep up, leading to persistent high unemployment. The official rate of unemployment, which remained below 9% during the 1990s, stayed above 10% in the 2010s despite economic growth and exceeded 13% at the end of the decade. Most of the jobs generated in this period were in construction and services, while industrial and agricultural employment lagged (Orhangazi, 2019).

The broad unemployment indicator which includes discouraged workers hovered around 17% in the second half of the 2010s. One should keep in mind that the labor force participation rate (LFPR) was between 50–53% in this period, much lower than that of advanced economies, indicating a structural underdevelopment in the case of Turkey, which also limits the growth potential of the economy. This situation deteriorated further under Covid-19 pandemic conditions. By October 2020, the LFPR fell to 50% (from 53% a year ago), and the broad unemployment rate reached 27% (DİSK-AR, 2021).

A crude indicator of the wage share is the ratio of total employee compensation to the GDP. This ratio stood at 30% in 2010, slowly increased to peak around 36% in 2016 and remained around 33–34% for the rest of the decade. However, given that the ratio of wage employment to total employment reached historical heights in this decade, the increase in the wage share seems very small and partly reflects the fact that quite a large portion of the workers are employed at very low wage rates. According to the Turkish Statistical Institute's household income surveys, on average, around 40% of the workers receive a wage equal or very close to the minimum wage. While detailed and continuous series on wages are scarce in Turkey, various calculations and estimates show that the gap between productivity and wages widened in the 2000s and the 2010s (see, e.g., BSB, 2015; Orhangazi, 2019; Orhangazi & Yeldan, 2020).

On the other hand, in terms of the size distribution of income, persistent and widening inequalities have characterized the 2010s. For example, income share of the top one-percent has steadily increased after 2013, while that of the bottom fifty-percent declined (Orhangazi & Yeldan, 2020).

Boratav (2017) compares changes in per capita worker and farmer consumption with their per capita incomes between 2004 and 2013. It turns out that incomes of the two classes lagged behind GDP per capita, but total consumption of both classes rose at much faster rates. In per capita terms, annual average growth rates of GDP, total consumption, farmers' and workers' incomes are denoted by g(y), g(c), g(f), g(w), respectively. In both current and constant prices, the 2004–2013 movements can be summarized as follows: $g(c) > g(Y) > g(f) > g(w)$. Rate of growth of investment lags behind consumption. Consumption-led growth is realized thanks to persistent and rising trade (current account) deficits. In per capita terms, earnings of farmers and workers lag behind GDP, but this deterioration of income shares is more than compensated by higher consumption levels.[8] Rising household indebtedness and higher social transfers from the central and local budgets are behind the improvement. The findings contribute to the explanation on the electoral support of JDP during this period, despite regressive changes in income distribution in class terms.

2018–2020: From the Currency Crisis to the Covid-19 Shock

Increased dominance of finance in the post-1980 world generated a series of financial crises as the financial integration of the "developing and emerging economies" increased. Sudden stops or sharp reversals in capital flows caused crises, for example, in Latin American economies in the 1980s and in East Asia in the 1990s. As discussed in the earlier chapters, Turkey experienced similar crises in the 1990s and the early 2000s. While the crises in the 1980s and 1990s remained limited to the periphery of the world economy, the 2008 crisis began in the US financial markets and spread to the European economies, threatening the very core of the system. The "developing and emerging economies" were also affected by the crisis, mostly due to a decline in their export earnings and a slowdown or a reversal in capital inflows. The unprecedented expansion of global liquidity following the 2008 crisis generated renewed capital inflows to these economies, including Turkey.

However, the Fed announced around mid-2013 that it would start tapering the QE purchases it began after the crisis. Taking this as a sign of changing global conditions, portfolio flows and bank credits to "emerging economies" declined or were reversed (IIF, 2017). As the Turkish lira began depreciating rapidly, the central bank had to intervene with an emergency meeting to increase the interest rates in early 2014. As it became apparent that the Fed was in no rush to decrease liquidity, the so-called taper tantrum soon faded away, and capital inflows to Turkey surged nearly to 50 billion dollars in 2017.

The post-2013 period displayed a central contradiction of the capital-inflow-dependent, debt-led, construction-centered growth model of the economy: low interest rates were crucial for the continuance of this growth pattern but the global conditions and capital mobility would ultimately force the central bank to concede sharp currency depreciations. In the second half of the 2010s, aiming to secure electoral support, the government chose to undermine the autonomy of the central bank to maintain credit expansion with full force in order to sustain economic growth. A major policy tool in this period was the use of the government-sponsored Credit Guarantee Fund, which was initially established to support small- and medium-sized businesses. The Fund was later used to support the rollover of large corporations' debt as well. However, growth supported by credit expansion also caused the current account deficits to

persist, putting downward pressures on the Turkish lira and increasing the fragility of the economy (Orhangazi, 2020; Orhangazi & Yeldan, 2021).

Under these conditions, in 2018, a political rift between Turkey and the US triggered a sudden capital outflow, leading to a sharp depreciation of the Turkish lira and increased instability in the financial markets. The currency crisis rapidly evolved into an emergent debt crisis with a large number of firms applying for bankruptcy protection. Markets could only be calmed down by the central bank's sharp hike of the policy interest rates by 6.25 percentage points to 24% in September 2018. Starting in the last quarter of 2018, the economy went into a recession. Financial markets were subdued and resurgence of capital inflows in 2019 allowed some limited recovery and economic growth was around 0.9% for the whole year (Turkish Statistical Institute, National Accounts).

The outbreak of the Covid-19 pandemic imposed a shock on financial markets in March 2020. Emerging market securities suffered around 83 billion dollars in terms of outflows during March only, a much larger amount than that in a similar period during the 2008–2009 global financial crisis. Debt outflows were 31 billion dollars (IIF, 2020). The adverse shock spread immediately to Turkey. The negative economic impact of Covid-19 coupled with accelerating capital outflows, especially from the stock and bond markets, sent the economy into a sharp decline of 9.9% in GDP in the second quarter of 2020 (Turkish Statistical Institute, National Accounts), similar to most economies in the world. The policy response of the government in the third quarter of 2020 was another round of credit expansion, supported by the central bank's previous policy rate cuts from 12% in December 2019 to 8.25% in May 2020, which remained unchanged up till September, accompanied by further expansion of the public banks' credit volume. Meanwhile, the Covid-19 shock adversely affected exports, especially tourism revenues. These factors resulted in large current account deficits, that is, 36.7 billion dollars during 2020.

For most of the second and third quarters of 2020, the government tried the impossible. In an effort to prevent the Turkish lira from depreciating in a period of capital outflows and lowered interest rates, foreign currency reserves of the central bank were used extravagantly. It is estimated that the central bank burned through close to 100 billion dollars of foreign currency reserves in this process. This futile attempt to keep the value of the currency stable had to be given up in the fourth quarter as the *net* reserves of the central bank went into the negative territory. These inconsistent and erratic policies resulted in a depreciation of Turkish lira

by 21% in real-effective terms from December 2019 up till October 2020 (according to the "real effective exchange rate" statistics of the BIS).

Concluding Remarks

Taking a look at the Turkish economy under the JDP governments from 2002 to 2020, it is possible to make some general observations. First, the dependence of economic growth on the pace of foreign-capital inflows and the dependence of production on imports have increased while the external debt stock reached new heights. Second, economic growth increasingly took a debt-led character through continuous credit expansion, which at times was encouraged and supported directly by the government through public banks. Third, growth in this period was considerably construction-oriented, with limited contributions to increasing the pace of productive capital accumulation, raising the potential growth rate or reversing the "premature de-industrialization" tendency.

Adverse global liquidity conditions and hence the slowdown in capital inflows pushed the Turkish economy into a recession in the 2008–2009 period. Two further phases of economic contraction were encountered, first in late 2018 and in early 2019, and second, aggravated by the impact of the Covid-19, in the second quarter of 2020. In the last few years, the government has adopted a policy discourse that emphasized a "domestic and national development path" and blamed foreign speculators for the woes of the economy. Yet, this so-called domestic and national development path has remained a pretentious rhetoric, lacking any concrete policy reorientation so far. Attempts to support growth by suppressing domestic interest rates despite rapid capital outflows were self-defeating, ultimately resulting in a free fall of the Turkish lira. Given the degree of economic and financial integration of Turkey to the world economy, the official "domestic and national development path" discourse was, indeed, destined to fail. Sharp interest rate hikes in September 2018 and then in November 2020, both accompanied by changes in the economic management team, are a witness to this prominent failure. All in all, the demands of international financial capital ultimately prevailed.

It is important to keep in mind that the JDP has been in power uninterruptedly since November 2002. In its early years, it strictly followed the IMF program based on inflation targeting, primary budget surpluses and high interest rates, along with structural and institutional reforms

and large-scale privatizations. Economic growth supported by high and partly speculative capital inflows accompanied this policy framework. After the 2008–2009 global financial crisis, QE policies and near-zero global interest rates helped domestic interest rates to decline in Turkey as well, supporting the credit expansion and the construction spree. This process paved the way for a surge in external debt stock and deteriorated the international investment position, leading to increasingly more fragile balance sheets of non-financial corporations. In the aftermath of the 2018 currency crisis, the government introduced a number of de facto and hesitant capital controls including limits on Turkish banks' currency swap operations in London as well as a tax on the purchase of foreign currency that was gradually increased. The 2009 deregulation that allowed non-financial corporations without foreign currency earnings to borrow in foreign currency was also reversed in 2018. However, such measures during the 2018–2020 period were not part of a well-designed program to deal with the crisis, but rather a patchwork of hesitant and sometimes incoherent measures.

Throughout all this long-term political-economic process; economic growth, credit expansion and clientelist rent-generating redistribution policies of the JDP governments have been critical to ensure electoral support. A special role was assigned to the construction sector as it enabled the government to support business groups close to itself and create *nouveau riches,* especially through lucrative public projects including the construction of roads, bridges, airports, hospitals and so on, as well as in mining and energy sectors. The small and medium-sized business groups close to the government benefited from both easy access to cheap credit and the persistence of "informalization" and "flexibility" in labor markets. De-unionization of the working class was a prominent feature of the JDP period. Privatization of public enterprises was practically completed, along with widespread privatizations of local and central government land. Substantial segments of public employment shifted to contractual status. Private provision and marketization of education and health expanded significantly. All in all, the state power was used to overcome the barriers in front of pro-capital dynamics, for both conventional surplus value production and accumulation by dispossession.

However, the inability to generate sufficient employment, relatively stagnant wages and persistent inequalities also necessitated social inclusion mechanisms. One way was to extensively use financial inclusion through expansion of credit to households. Under the JDP governments, the

neoliberal marketization logic dominated the transformations in social security provision, health and pension systems as well as labor market regulations. In this regard, a series of social assistance programs were put in place, whereby various irregular transfers and benefits were carried out, in addition to the regular mechanisms of social policy. These transfers and benefits were extensively used as part of electoral politics as well. It is, however, important to note that these practices were not devised as collective rights based on the welfare-state framework of the earlier decades. In contradistinction, they relied predominantly on political discretion in favor of the electoral base.[9] One can also add the role played by faith-based charities, that is, Islamist associations linked to the government, which came to command large financial resources (Özden, 2014).

The preferred method of intervention during the Covid-19 crisis in 2020 was once again to push interest rates down and encourage growth through credit expansion. The share of additional spending on health, as well as direct and indirect transfers to stricken households from the central budget was meager, as compared to G20 countries. In Turkey, the main source used was the past accumulation of the Unemployment Insurance Fund.

All in all, neoliberal economic policies were accompanied by cronyism as well as populist and authoritarian politics, especially during the 2010s. JDP's Islamist and authoritarian orientation gradually prevailed over its pro-EU façade. 2013 was a turning point for the JDP as the Gezi uprising in İstanbul quickly spread to the rest of the country and threatened its hold on power. Authoritarianism began increasing following the Gezi protests and then intensified with the ending of the "peace process" between the JDP government and the Kurdish movement in 2015 just after the JDP failed to gain parliamentary majority in the June elections and pushed for renewed elections in November by refusing to form a coalition government. The renewal of the elections in November of the same year took place under conditions of widespread violence, which allowed the JDP to win the elections by attracting nationalist votes. The failed coup attempt in 2016 was followed by the JDP government's declaration of a "state of emergency" during which both those who were thought to be directly involved with the group behind the coup attempt and people affiliated with the left and/or Kurdish movements were severely persecuted.

The regime change toward an autocratic presidential system following the referendum in 2017 led to further integration of the JDP with the

state apparatus and further alignment with crony businesses. This has been an episode during which the government has shifted to "quasi-fascist" methods of violent suppression at times, accompanied by a shallow rhetoric of nativism and nationalism in the face of economic turmoil. While the autonomy of the central bank and regulatory authorities disappeared almost completely, the JDP lost international credibility at the same time.

As Turkey moves into the next decade of the century, the neoliberal policy framework, that is, inflation targeting and fiscal austerity, seems to have returned with a revenge. If JDP's haphazard violations of the unwritten rules of the game observed during the past three years are repeated, "punishment" via a currency crisis triggered by unsustainable current account deficits will take place. Monitoring of conventional indicators (somewhat flexibly) will be carried out by credit-rating agencies and international banks. It should be noted that the IMF's anti-austerity revisions of its conventional economic doctrine documented during the October 2020 IMF/WB meeting are essentially addressed to advanced economies. Ongoing negotiations with a number of "vulnerable emerging and developing economies" show that conventional priorities continue to prevail there.[10]

Hence, any further credit-led support to the construction sector and sustaining the 5% growth target of the medium-term program are becoming increasingly more difficult. Constrained by its chronic external dependency, Turkey is probably locked within a potential growth rate of around 3% per annum in the medium term. This growth path cannot alleviate record levels of unemployment and widespread poverty prevailing in 2020.

JDP is facing a political impasse. It is confronting widespread dissatisfaction of popular classes—somewhat similar to the 2002 election when voters' reaction against the heavy austerity measures of the IMF program completely eliminated the coalition parties from the parliament. There is an additional complication: after so many years of widespread cronyism, corruption and mismanagement, the current leadership cannot afford to face the consequences of free elections. Further authoritarianism, repression and step by step moving into an Islamist-fascist regime appear as a possible option. At the time of writing this chapter, Turkey has been going through a structural economic crisis. It is yet early to predict the way the country will go through. Nonetheless, rising social discontent,

sharpening contradictions within the ruling bloc and segments of capital can be expected.

Notes

1. The liberalization of capital movements was essentially a response to the substantial increase in public sector wages and salaries that took place in 1989. A revived trade-union activism that year spilled into the public sector and the government had to concede wage and salary increases up to 142% in nominal terms. The liberalization of the financial account provided a mechanism for financing the consequent public sector deficit (Boratav 2018: 193).
2. See Akyüz (2012, 2015) for a detailed discussion of these mechanisms.
3. Bank for International Settlements' real effective exchange rate series show a similar pattern. See: https://www.bis.org/statistics/eer.htm
4. All data in this paragraph come from the balance-of-payments statistics provided by the Central Bank. The gross "investment income" outflows under the current account of the balance-of-payments statistics.
5. Credit data discussed here and in the next paragraph comes from BIS "Credit to the non-financial sector" statistics (https://www.bis.org/statistics/about_credit_stats.htm. Accessed on: December 19, 2020).
6. It should be noted that official methods of national accounts were changed by the Turkish Statistical Institute with the aim of bringing Turkish national accounts in line with the UN's SNA-2008 and EU's ESA-2010 frameworks. However, various aspects of the new GDP series were criticized by a wide range of economists. See, for example, Boratav et al. (2018). Before the revision investment-to-GDP ratio was around 20%.
7. Favoritism in public–private partnership *contracts*; arbitrary and numerous revisions of legislation and regulations *on government tenders* and revisions of *urban planning* by central and local governments in favor of particular contractors and of real estate owners were the three patterns of "clientelist intervention," all closely related to the construction sector. The third pattern affects urban real estate values immediately; but is neutral in terms of

income distribution in the short-run. Hence, "losers" in terms of wealth distribution can rarely emerge as an effective and oppositional pressure group.

8. GDP series before the 2016 revision is used.
9. For detailed investigations on these points, see, for example, Akça et al. (2014), Akçay (2018), Akçay and Güngen (2019), Buğra (2020), Yentürk (2018a; 2018b), Eder (2010), Powell and Yörük (2017), and Adaman et al. (2019).
10. For country examples, see Boratav (2020).

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