

# THE POLITICAL ECONOMY OF INEQUALITY, REDISTRIBUTION AND BOOM-BUST CYCLES IN TURKEY

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# Introduction

- **1)** Turkey's growth regime led by speculative financial capital inflows. Regular boom and bust cycles
  - **2)** The inequalities in Turkey?
    - Declining share of labour, but redistribution within working classes.
  - **3)** Discussion on policy alternatives
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- *Onaran and Oyvat (2016), Oyvat and Yağcı (2018), Oyvat and Tekgüç (2017)*

## PART 1: Speculation-led growth regime



# Speculation-led growth regime

- Neoliberal shift from import-substituting industrialization strategy to export-oriented growth model (1980)
- Capital account liberalization (1989)
- Two economic crises led by capital outflows (1994 and 2001)
- The election victory of the Justice and Development Party (AKP) in 2002.

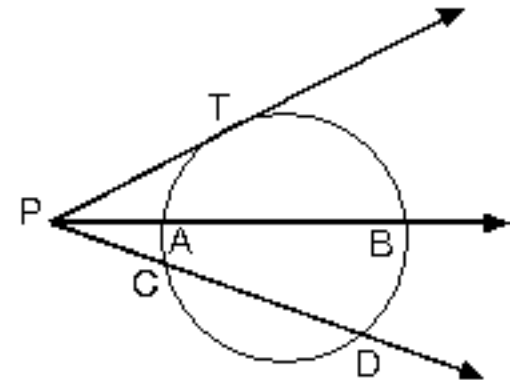


# Speculation-led growth regime

- 7.8% average annual rate of growth in GDP during 2002-2006
- High capital inflows prompted by high real interest rates and Turkey's EU candidacy
- Inflows of FDI led by privatization
- The current account deficit/GDP had reached historically high levels of 5.6% in 2006 and 5.5% in 2007.
- Turkey became one of the most vulnerable- exchange rate overvaluation, high external financing needs, and their dependence on capital flows

# Great Recession in 2008: Did “the crisis pass at a tangent to Turkey”?

- The speculation and finance-led growth model once again proved to be economically unsustainable. With significant decline in capital inflows in autumn 2008, the recession started in the fourth quarter of 2008
- GDP growth rate of 0.8% in 2008 and contraction of 4.7% in 2009 - deeper than other major emerging economies such as Argentina, Brazil, South Korea and Thailand



## The average annual growth of GDP per capita in different country groups with respect to income level

		1990-2002	2002-2013	2002-2007	2007-2009	2009-2013
<b>All Countries</b>	Lower income	1.48	3.18	3.44	2.77	3.14
	Lower-middle income	0.66	3.15	4.27	1.43	2.70
	Upper-middle income	1.16	2.81	4.68	-1.39	2.73
	Higher income	1.70	0.82	1.94	-2.84	1.31
<b>Countries that are not fuel dependent</b>	Lower income	1.10	3.08	2.98	2.79	3.42
	Lower-middle income	0.88	2.93	3.93	1.10	2.67
	Upper-middle income	1.47	2.81	4.78	-1.52	2.67
	Higher income	1.87	1.12	2.29	-2.42	1.49
<b>Turkey</b>		<b>1.40</b>	<b>3.54</b>	<b>5.85</b>	<b>-3.17</b>	<b>6.57</b>

# Great Recession in 2008

- Decline in capital inflows
- Gross fixed capital formation decreased by 2.7% in 2008 and 20.5% in 2009
- 1) Restricted availability of credits: 4.4% gap between savings/GDP and investment/GDP ratios(2007)
- Domestic credits were very dependent on the foreign finance.
- 2) High volatility in capital inflows generated uncertainty
- The real sector confidence index, which was 110.5 in December 2007 declined to 58.5 in November 2008.



# Great Recession in 2008

- 3) Turkey's export revenues declined by 20% through 2007Q4-2008Q3.
- Heavily reliance on the EU-28 countries (56.6% of total exports in 2007)
- A part of exports shifted to Middle Eastern, Asian and African countries
- 4) The imports of goods and services also declined by 4.1% in 2008 and 14.3% in 2009

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# Why did the Great Recession affect Turkey more than the other countries?

	Average annual growth of GDP per capita (% , 2007-09)	Current Account Balance/GDP (% , 2007)	Indices measuring capital account regulations in 2007 (Erten and Ocampo, 2013; Schindler, 2009; Ostry et al., 2012)			
			Capital inflow regulations	Capital outflow regulations	FX-related regulations	Financial sector specific restrictions
Brazil	1.46	0.1	0.25	0.58	0.75	-
China	8.85	10.1	1.00	1.00	1.00	0.67
India	4.77	-0.7	0.92	1.00	-	1.00
Indonesia	3.86	2.4	0.58	0.50	1.00	0.33
Malaysia	-0.19	15.4	0.75	1.00	0.75	-
Mexico	-2.93	-1.4	0.42	0.50	1.00	0.67
Russia	-1.44	5.6	1.00	1.00	0.50	0.33
S. Africa	-0.08	-6.7	0.50	0.92	0.75	0.67
Thailand	-0.10	6.3	0.83	1.00	0.75	0.67
<b>Turkey</b>	<b>-3.17</b>	<b>-5.5</b>	<b>0.08</b>	<b>0.33</b>	<b>0.75</b>	<b>0.00</b>

# Policy response

- Very limited during the first months of the Great Recession
- The consumption expenditures of government increased only by 1.7% in 2008, and the primary budget balance declined mildly from 4.2% in 2007 to 3.5% in 2008
- Very weak compared to the fiscal stimulus in Argentina, Brazil, Russia and South Korea that constituted around 5-6% of their GDPs in 2008 (Öniş and Güven, 2011)

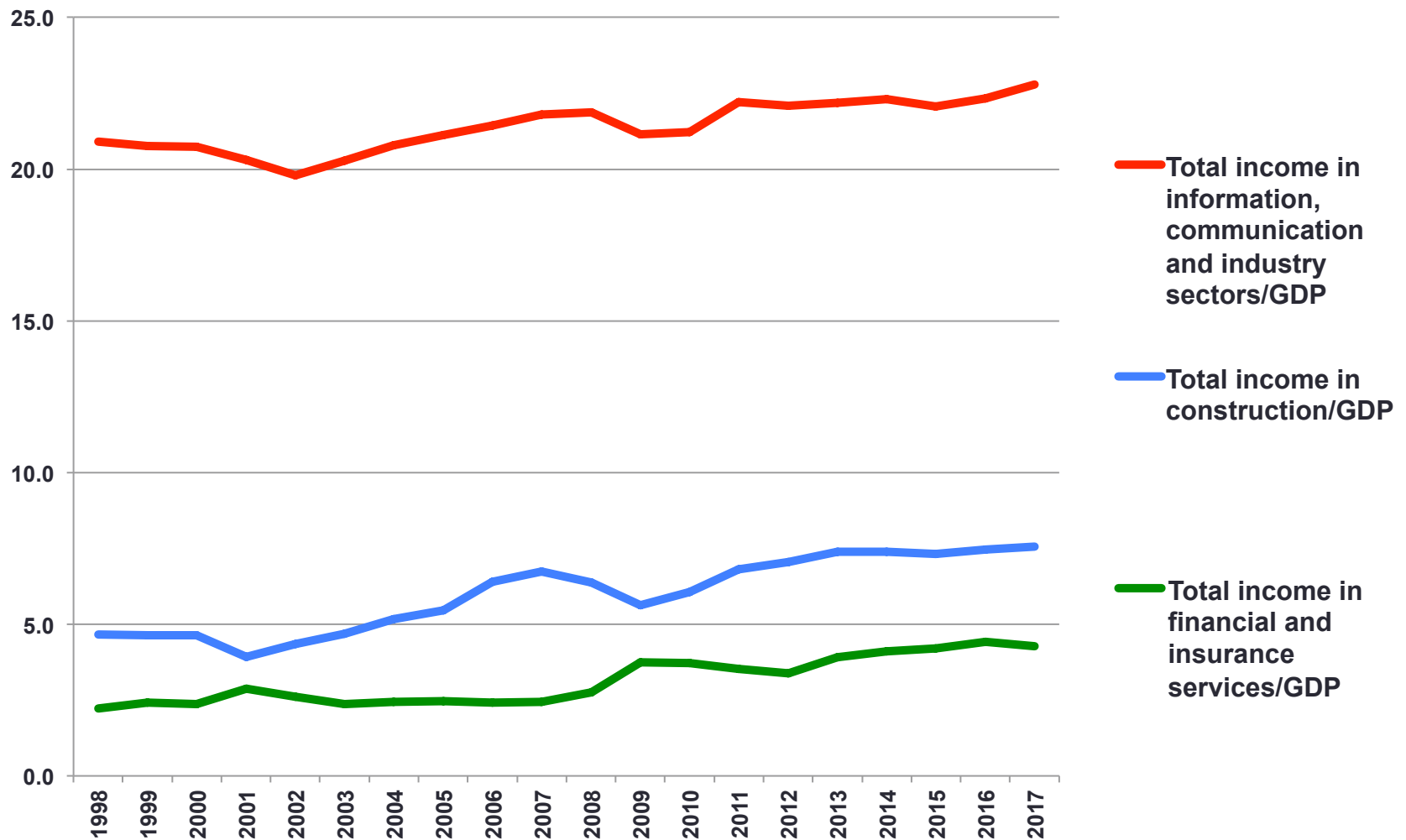
# Policy response

- December 2008 – Eximbank export rediscount credit pool widened, eligibility criteria eased
- January 2009 – A public subsidy program supporting part-time employment
- March 2009 - Tax cuts on real estate, vehicles and many consumer goods
- June 2009 – Sectoral-regional investment subsidies through tax cuts, cheap credits and social security premium reductions
- Overall, the consumption expenditures of government by 7.8% in 2009

# Post 2009 period

- Continued to be highly dependent on speculative financial capital inflows (supported by low interest rate policy of FED, ECB, BOE, BOJ)
- Financial and construction sectors grew significantly faster than the industry sector
- Share of imports in GDP increased from 23.3% to 28.0%. (2009-2013, 85% is imports of intermediate and capital goods)
- Current account deficit/GDP still stayed above 5% (2010-2013) and peaked at 8.9% in 2011

## Total income earned in financial and insurance services; construction; information-communication and industry sectors as a share of GDP (1998-2017, %)

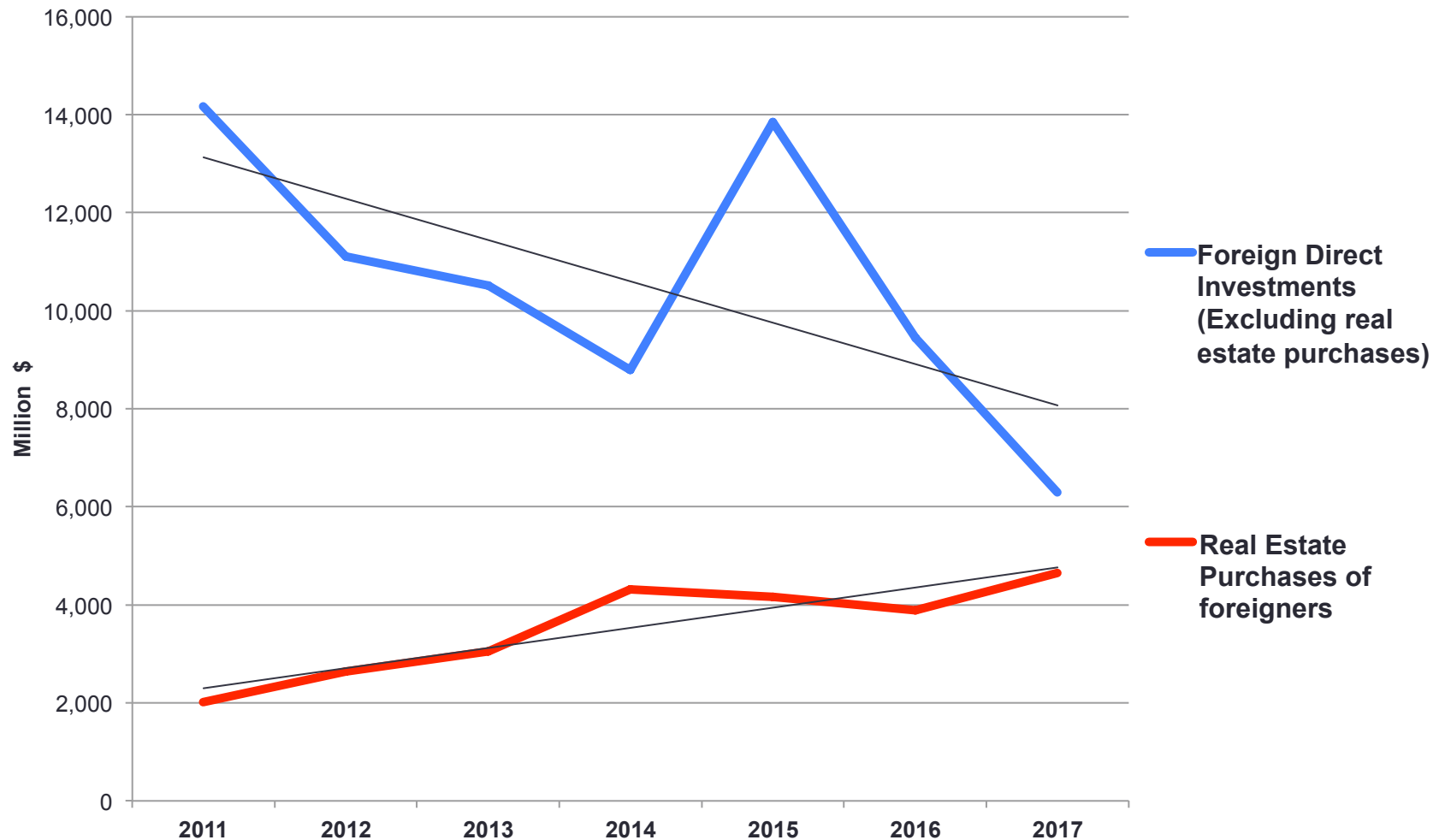


# Post 2013 period

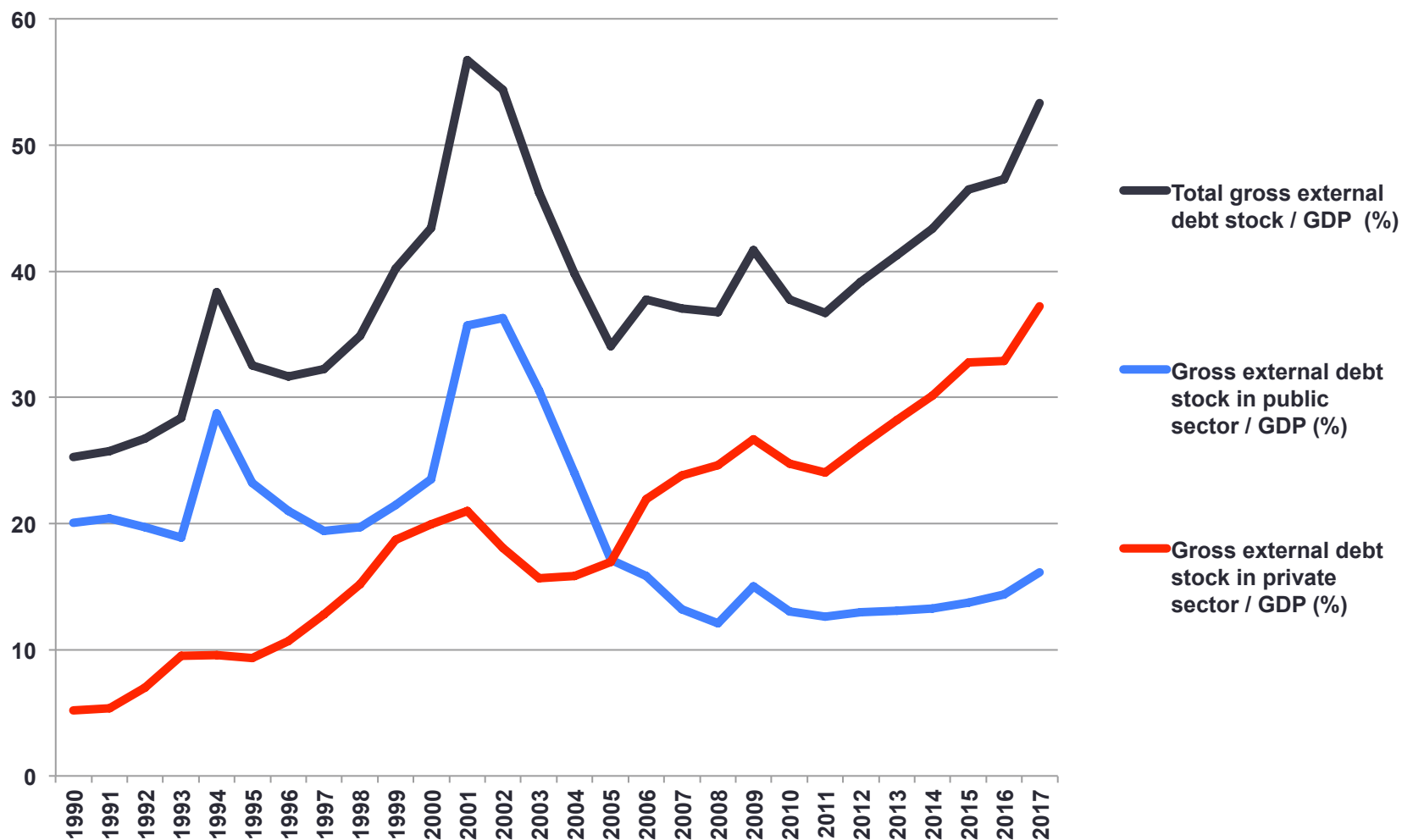
- Rising economic fragilities with rising interest rates of FED and rising political tensions
- Rapidly growing external indebtedness (due to rising indebtedness in private sector)
- Rising current account deficit/GDP (5.5% in 2017 and 6.7% in 2018 Q1)
- Increase in foreign real estate purchases as opposed to other FDI
- Depleting foreign exchange reserves of Central Bank of the Republic of Turkey (from 112 billion USD in 2013 to 80 billion USD in June 2018)
- Significant depreciation of Turkish Lira



# Increase in foreign real estate purchases as opposed to other FDI



# Rising external debt stock



# Signs of an incoming economic crises?

	1990-1999 (Average)	2000 (Pre-crisis)	2001 (Economic crisis)	2002-2016 (Average)	2017
<i>Gross external debt stock/ GDP (%)</i>	31.6	<b>43.4</b>	<b>56.7</b>	41.3	<b>53.4</b>
<i>Gross external debt stock in private sector/ GDP (%)</i>	10.3	<b>19.9</b>	<b>21.0</b>	24.2	<b>37.2</b>
<i>Household debt stock / GSYH (%)</i>	1.0	<b>4.0</b>	<b>2.0</b>	12.4	<b>17.3*</b>
<i>Current account balance / GSYH (%)</i>	-0.5	<b>-3.6</b>	<b>1.9</b>	-4.5	<b>-5.5</b>
<i>Gross foreign exchange reserves of Central Bank / Gross external debt (%)</i>	15.3	<b>16.6</b>	<b>16.5</b>	24.2	<b>18.6</b>

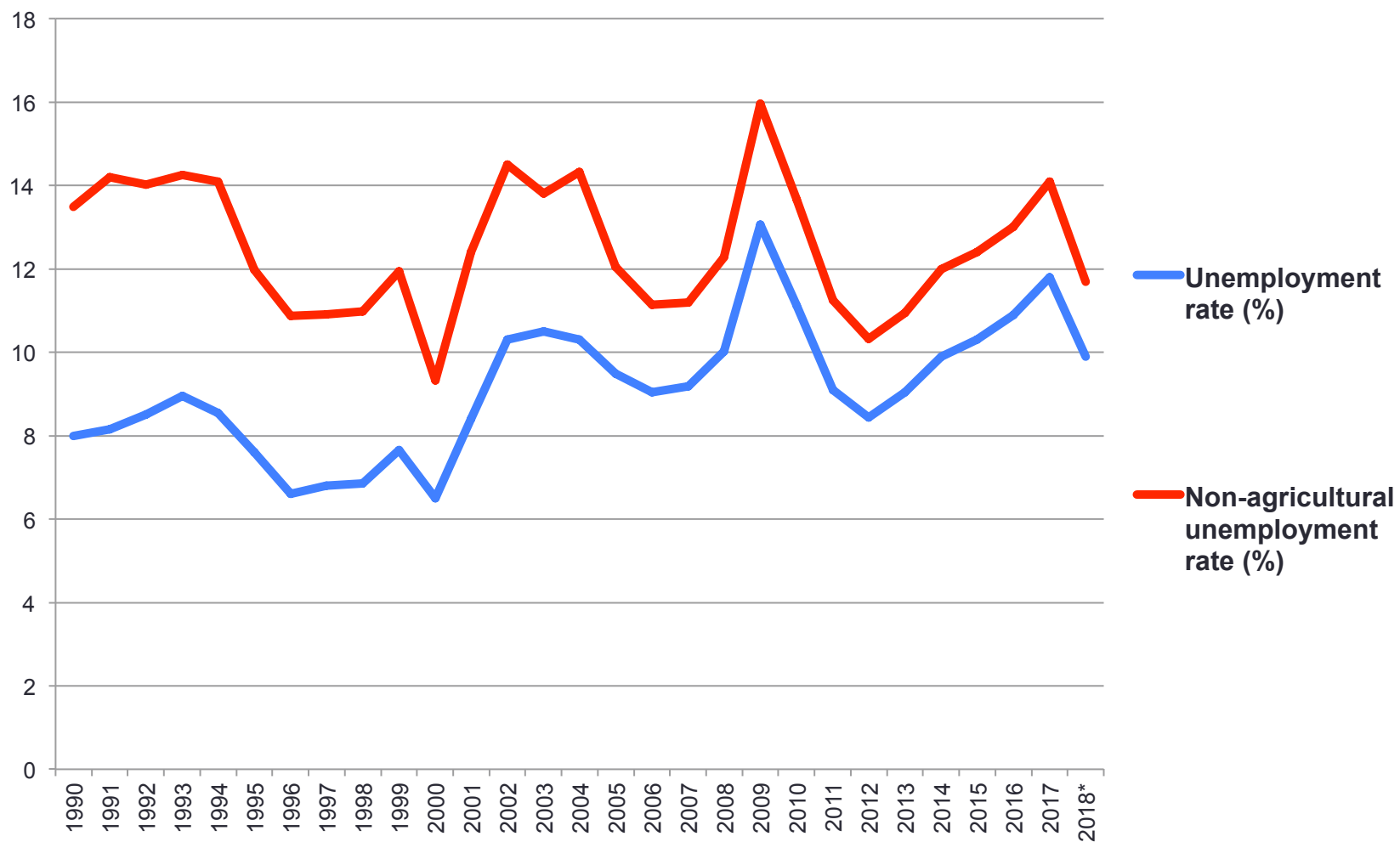
# Deprecation of currencies against the US Dollar between 01/01/2018 and 29/06/2018

Argentine Peso	-33.61
<b>Turkish Lira</b>	<b>-17.23</b>
Brazilian Real	-13.81
South African Rand	-10.20
Russian Ruble	-8.16
Polish Zloty	-7.12
Indian Rupee	-6.72
Indonesian Rupiah	-5.07
Israeli Shekel	-4.99
South Korean Won	-4.09
Taiwanese New Dollar	-2.38
Singapore Dollar	-1.93
Chinese Renminbi	-1.63
Thai Baht	-1.63
Mexican Peso	0.13
Malaysian Ringgit	0.21

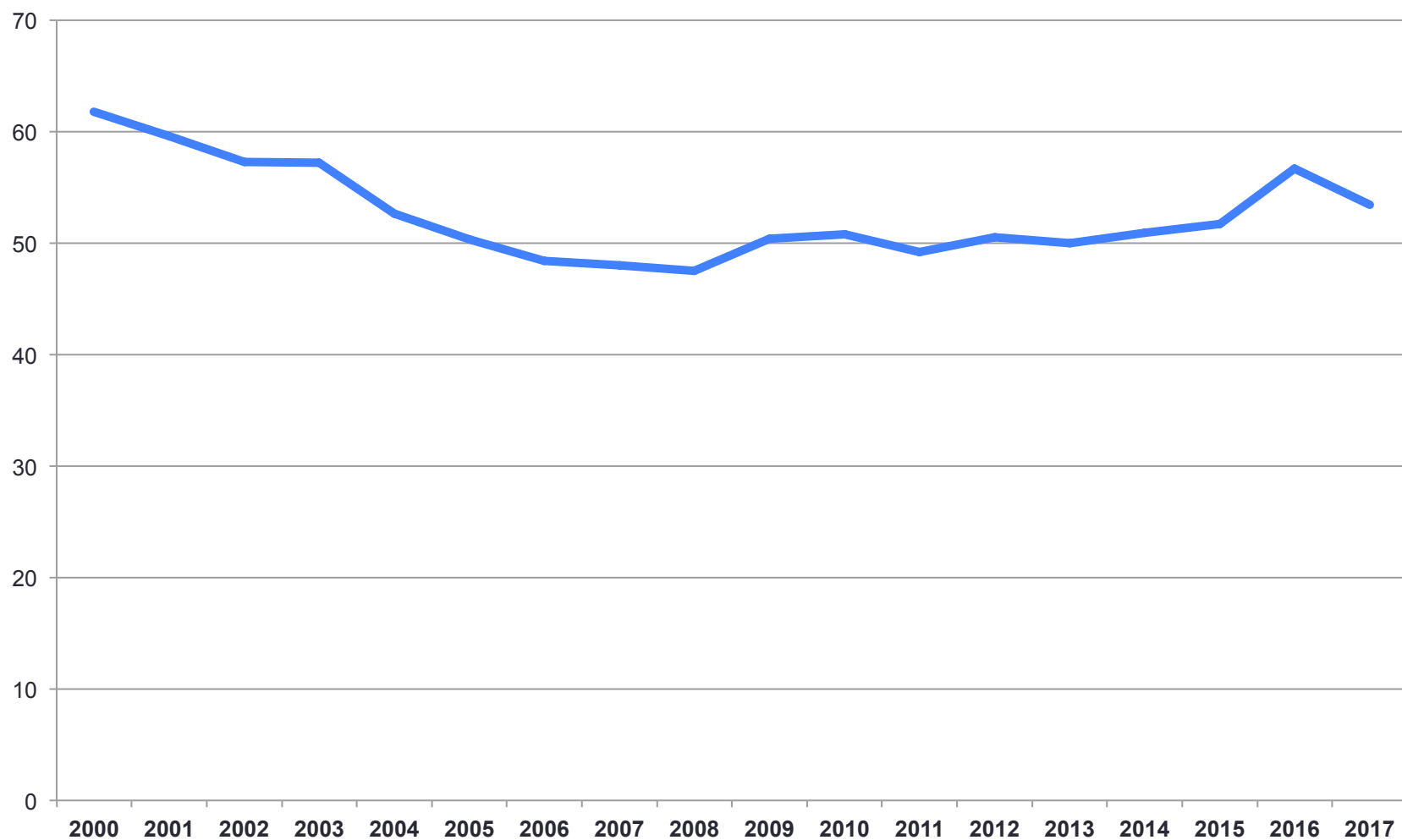
## PART 2: Inequality and employment during the boom-bust cycles and the Great Recession



# Jobless growth



## Adjusted wage share (% GDP) during the boom-bust cycles and the Great Recession

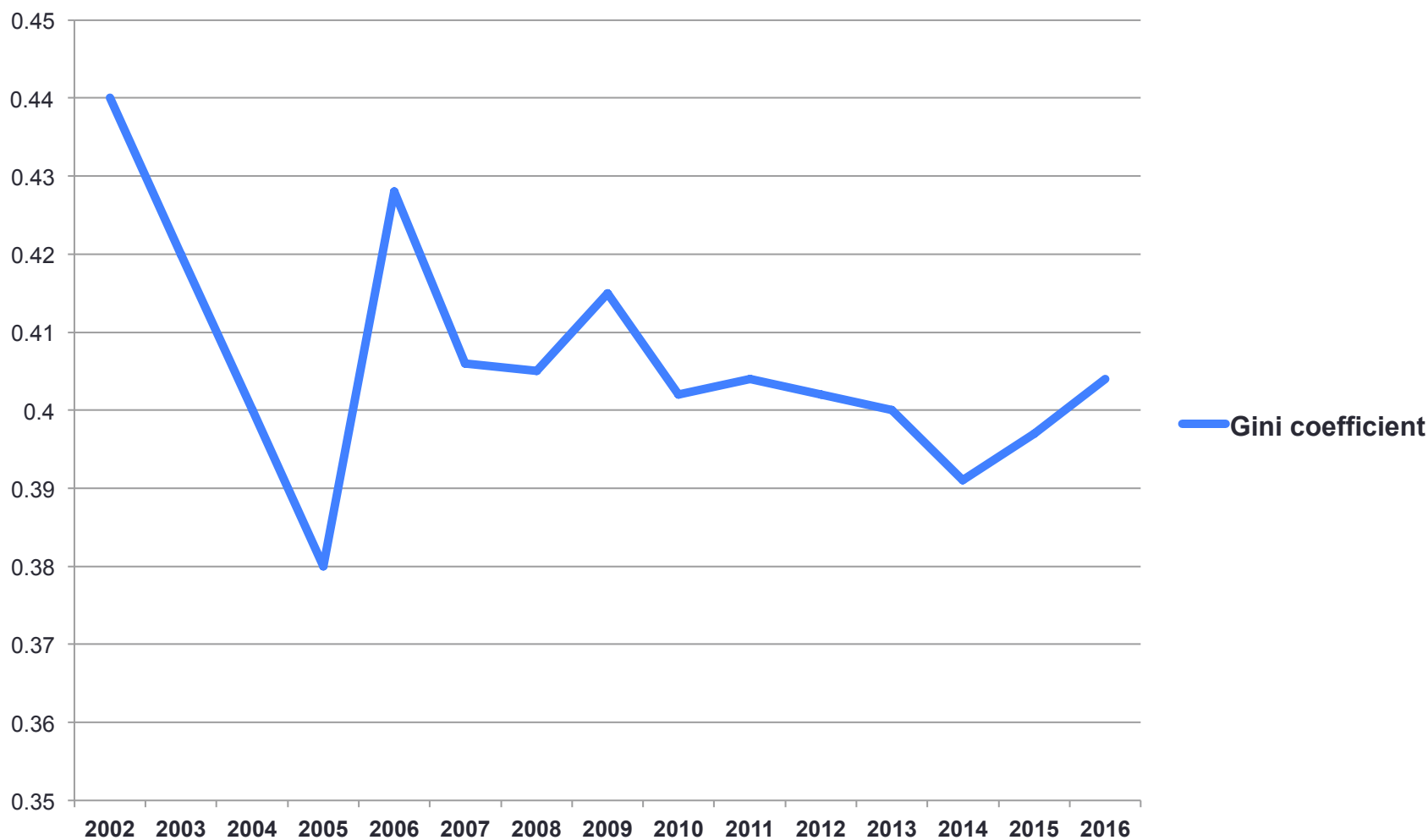


# Inequality during the boom-bust cycles and the Great Recession

- **Adjusted wage share:**
- Declined from 57.3% in 2002 to 48.4% in 2006.
- Declined during the recovery (2009-11) and a slight increase between 2013-2016
- Overall, as of 2017 the wage share is 53.4%
- Still dramatically lower than the wage share in 2000 (61.8%)
- Nevertheless,
- Personal income inequality (Gini coefficient) did not increase (2002-2016)



# Income Inequality (2002-2016)

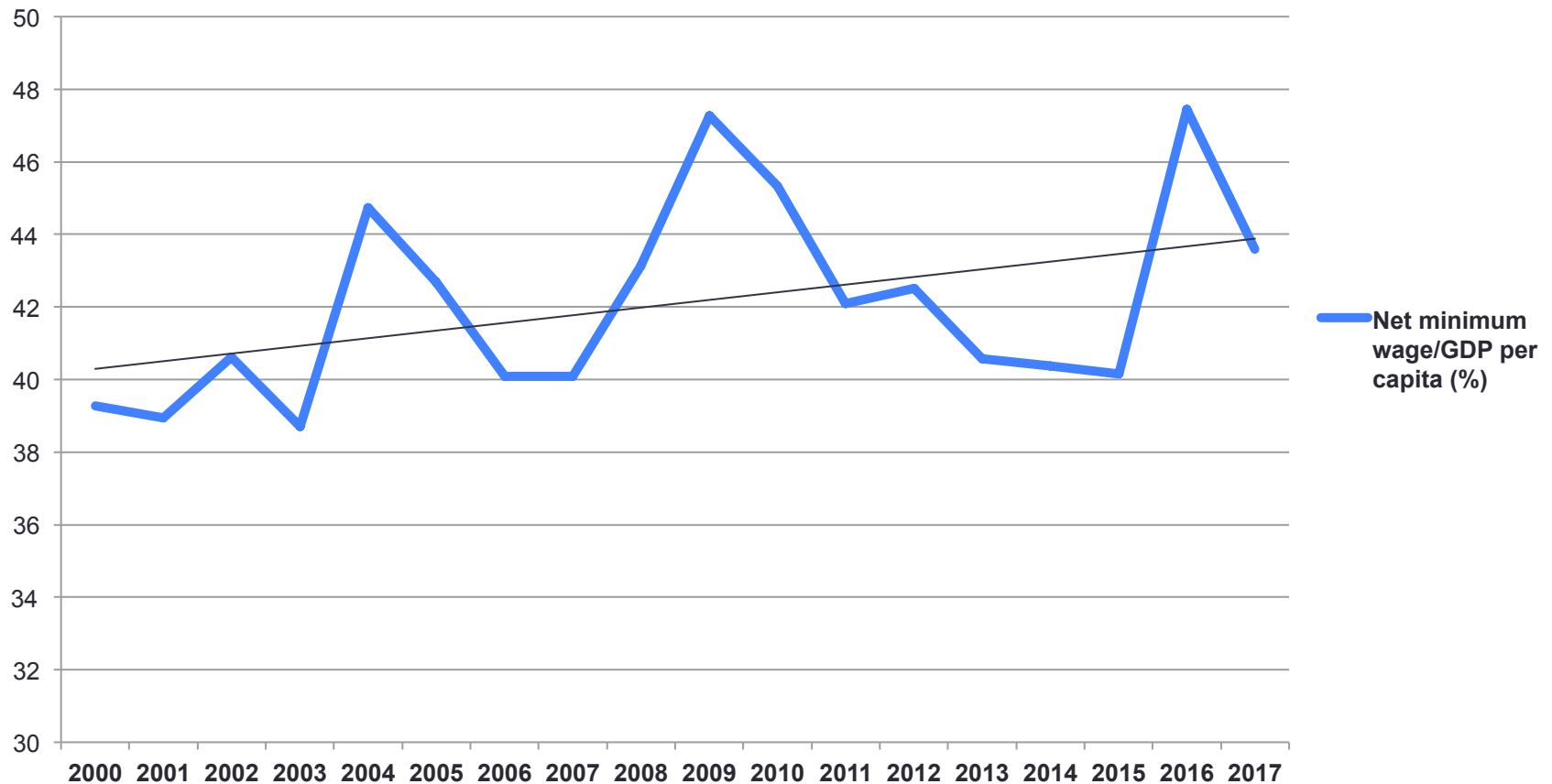


# Gini coefficient (2002-2016)

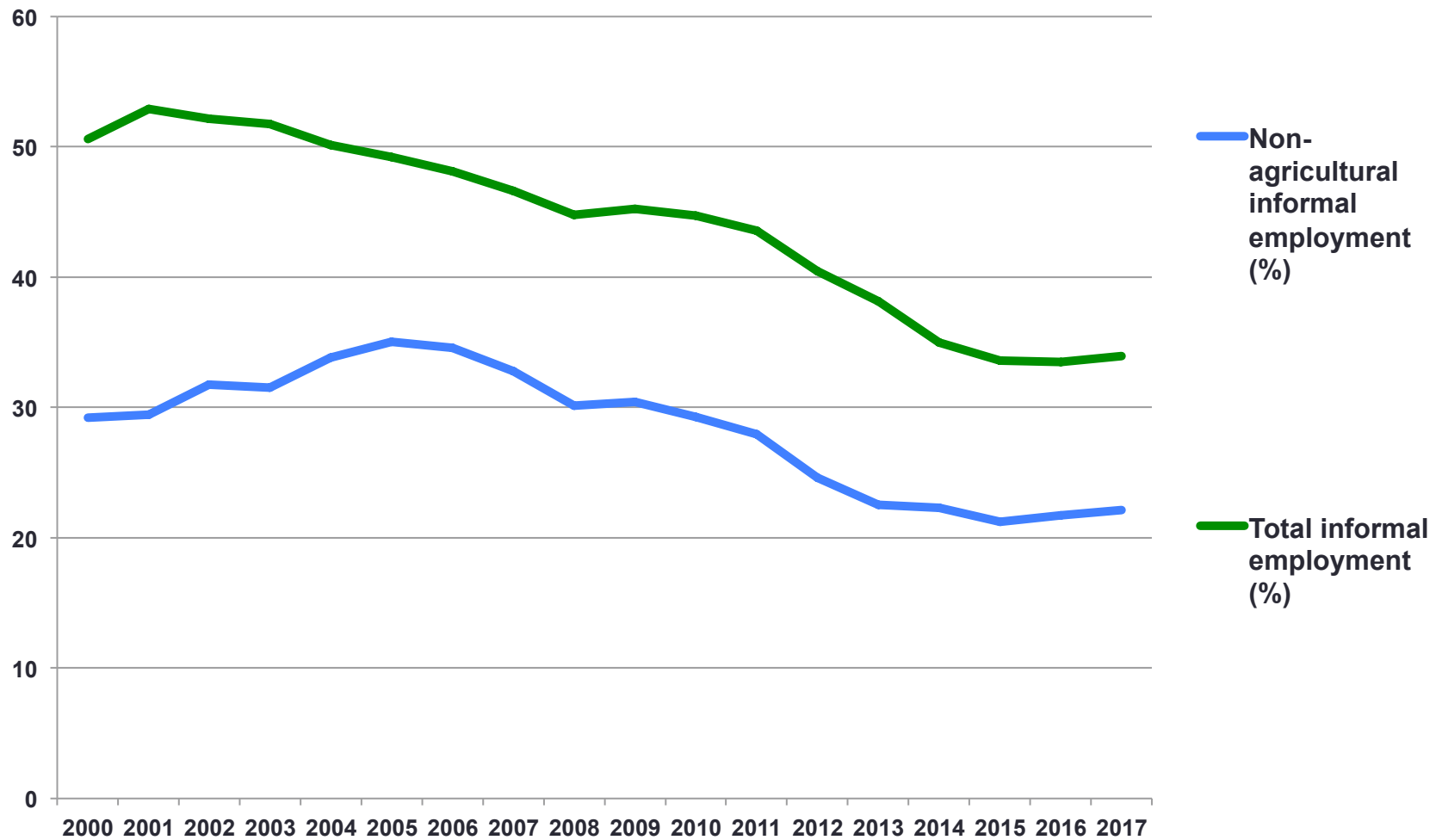
- Data problems - Between 60-67% of total income in Turkey cannot be captured by surveys
- ALSO
- A redistribution of income towards the poorer since 2002.
- The source of this redistribution was declining inequality within the working class  
(The organized blue collar and white-collar/professional working people vs. other workers)
- 1) The share of revenues from transfers in total income significantly increased from 17.5% in 2002 to 22.1% in 2016
- 2) Increasing minimum wages
- 3) Reduction in the share of informal activities

# Rising minimum wages

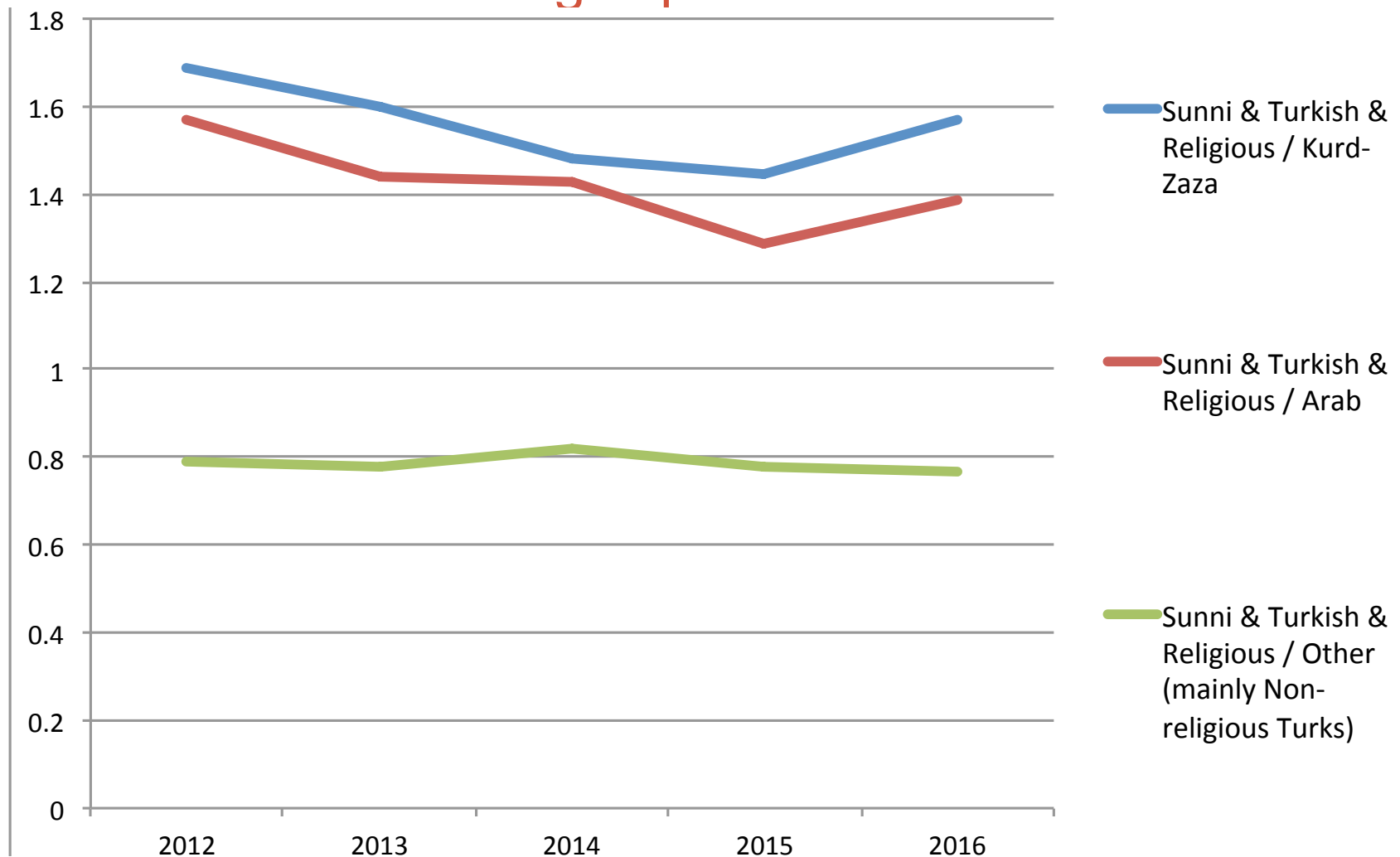
Net minimum wage/GDP per capita (%)



# Decline in informal employment (lately stopped)



# Horizontal Inequalities: Ratios between average incomes of religious / pious & Sunni & Turk vs. other groups



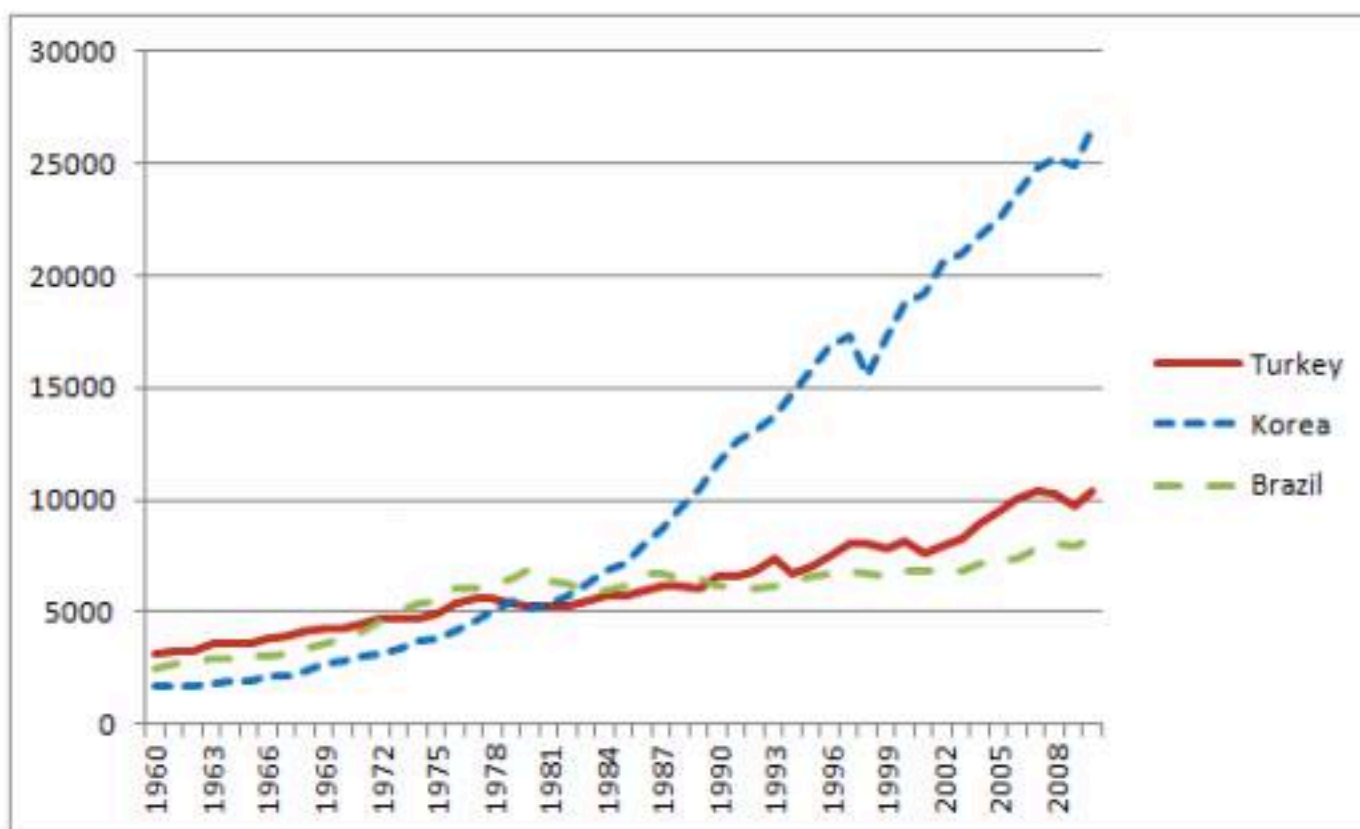
## PART 3: Policy Alternatives



# Industrial policy attempts of AKP government

- Domestically-made car production – Consortium of five companies - Anadolu Group, BMC, Kiraça Holding, Turkcell and Zorlu Holding (planned investment: \$3 billion)
- Subsidies on chemical and pharmaceutical industry, food industry electronic goods, machinery, automobiles (\$110 million) => Mainly on capital goods and intermediate goods
- However three issues:
  - 1) Problems in education and brain drain
  - 2) 'Elite' planning institutions?
  - 3) Rule of law

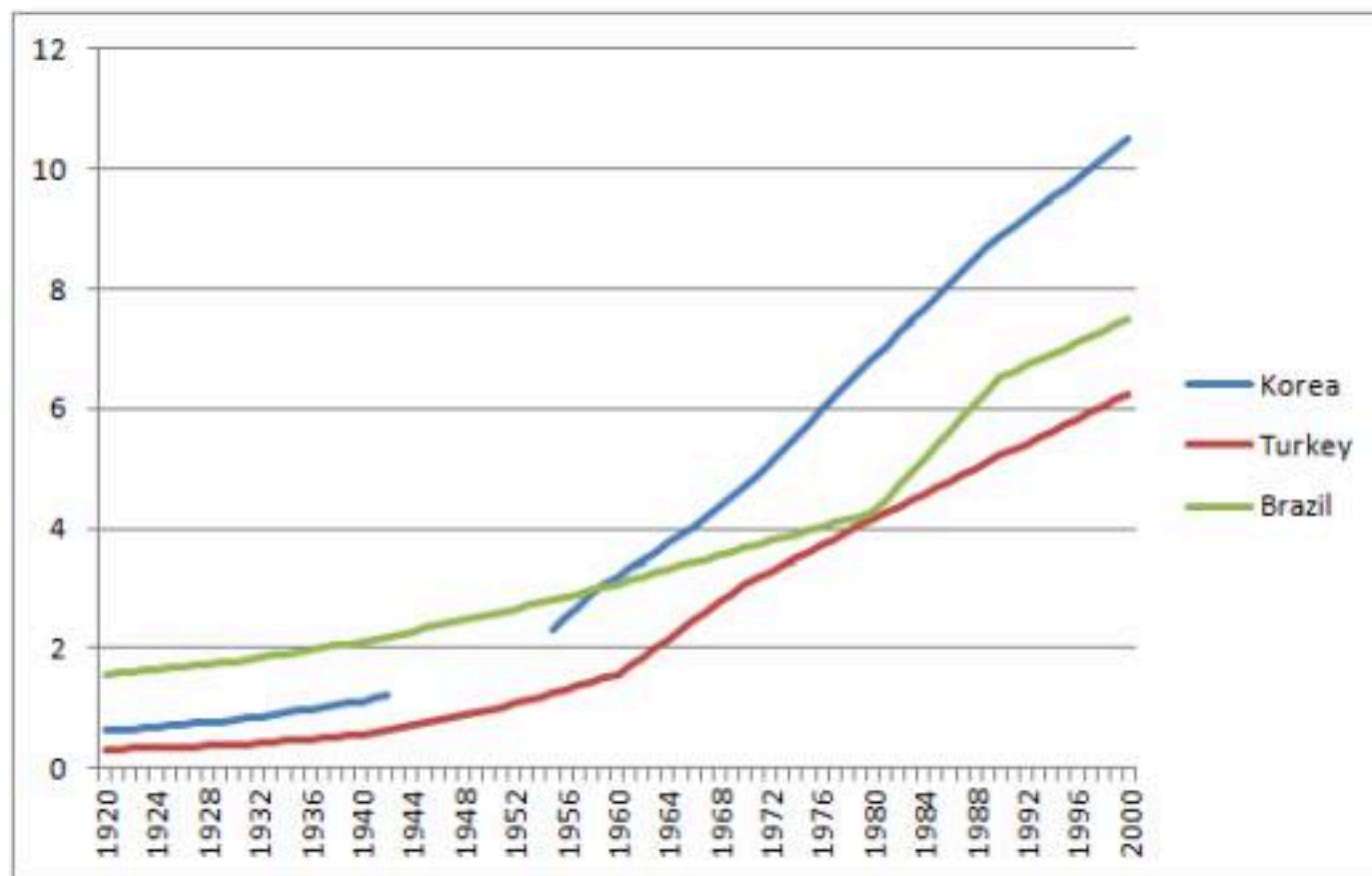
**Figure 3.2.** GDP per capita (PPP, \$) in Turkey, Korea and Brazil (1960-2010)



Source: Penn World Table 7.1(2013)



**Figure 3.1.** Average years of schooling in Korea, Turkey and Brazil (1920-2010)



Sources: Morisson and Murtin (2010); Godo (2011)

Note: The pre-1942 data reflect average years of schooling in Korea as a whole, whereas the post-1955 data only indicate the average years of schooling in South Korea. The data used here are slightly different from Barro and Lee (2012)'s data, which are used in the remainder of the paper.

# Problems in education

- According to the PISA scores that measures quality of education:
- Turkey is ranked as 39<sup>th</sup>-42<sup>nd</sup> in 2012
- 45<sup>th</sup>-47<sup>th</sup> in 2015 (reading, science and mathematics)
- Romania, Bulgaria, UAE and Chile were behind Turkey in 2012 and in 2015 they are above Turkey in all fields
- Increasing elective courses on religion and schools focusing on religion education (students in Imam Hatip middle schools increased by 5 times between 2012-2015, above 1 million students in Imam Hatip middle and high schools)
- Share of students in private schools increased from 2.9% in 2011/12 to 8.1% in 2015/16

# Decline in academic rankings and brain drain

- Times Higher Education's university rankings
  - 2014/15: 4 Turkish universities in top 200
  - 2017/18: 0 Turkish universities in top 300
- METU-URAP rankings
  - 2014/15: 19 Turkish universities in top 1000
  - 2017/18: 15 Turkish universities in top 1000
- ALSO
  - Significant brain drain
  - *"We now export brains to the world"*
  - İsmail Kahraman- The speaker of the Grand National Assembly (2015-18)
- Need for academic freedoms and to prevent brain drain for long-term economic growth

# Planning? Capital Account Regulations?

- MITI (Ministry of International Trade and Industry) in Japan, Economic Planning Board in South Korea played an important role until 1980s in Japan and South Korea's industrialisation
- In Japan in 1970s:  
Elite bureaucracy/ Top bureaucrats from Tokyo and Kyoto Universities
- Does subsidies on private sector lead to crony capitalism?
- According to World Justice Project rankings, Turkey is ranked as 108<sup>th</sup> among 113 countries on “constraints on government”
- Capital Account Regulations to smooth business cycles

# Are lower wages a solution?

- Onaran and Stockhammer (2005); Onaran and Galanis (2014) and Oyvat, Elgin and Öztunalı (2018) find
- Increase in wage shares => higher growth in the short-run
- Yılmaz (2015)
- Decline in wage shares => higher growth in the short-run
- Moreover a wide range of literature point out long-term benefits of lower inequalities (education, better institutions, lower crimes) and find positive impact of lower inequality over the long-run
- Specialise on goods with lower productivity/value added and wages or higher productivity/value added and wages

# Conclusions

- Growth dependent on financial capital flows
- Important risk for the sustainability of growth
- For sustainable growth:
- Egalitarian industrial restructuring
- A combination of industrial and trade policy
- Planning institutions with 'elite' bureaucracy
- Promotion of scientific education and freedom on academic world
- Improvements in rule of law