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Economic Change in Twentieth Century Turkey: Is the Glass More than Half Full?

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Abstract

The paper begins with an overview of Turkey’s economic growth record since the nineteenth century in both absolute and comparative terms. Turkey’s GDP per capita increased about 10 times since 1820 and about eight times since 1880. In relative terms, the gap in per capita GDP between Turkey and the developed economies widened considerably during the nineteenth century. This gap has stayed roughly unchanged since World War I. In other words, after the big divergence until World War I, Turkey failed to converge during the last century. On the other hand, per capita GDP in Turkey increased faster than the developing country averages from the nineteenth century until the 1970s. Due to the strong performances of China and India, however, it has been lagging behind the developing country averages in recent decades. In trying to explain this growth performance, I examine critically long term structural change, industrialization, economic policy and institutional change. I identify low levels of investment in education, macroeconomic instability and the low quality of institutions as the key reasons for Turkey’s failure to close the gap with the developed countries since 1913 or 1950.
Introduction

One metaphor for assessing Turkey’s economic performance in the twentieth century may be to ask whether the glass is half full or half empty. On the one hand, Turkey has experienced far-reaching economic changes since the early 1920s. The primarily rural and agricultural economy of the early twentieth century has transformed into a mostly urban economy. Average or per capita incomes have increased more than five fold during this period. Other indicators of standards of living have also improved significantly. Life expectancy at birth has almost doubled from under 35 years in the interwar era to 69 years. Adult literacy rates have increased from about 10 percent to about 90 percent. (Table 1)

On the other hand, it would be misleading to judge economic performance only in absolute terms. The twentieth century, especially its second half, was a period of rapid increases in the standards of living in most parts of the developing world, of which Turkey is still considered a part. Increases in per capita incomes in Turkey since World War I have been close to, but slightly above, world averages and averages for the developing countries. The income per capita gap between Turkey and the high income countries of Western Europe and North America was about the same in 2005 as it was on the eve of World War I. Certainly, Turkey has not been one of the miracle-producing economies of the twentieth century. Moreover, its record in human development has been weaker than its record in economic growth, close to but perhaps below averages for the developing world. In addition, these increases or improvements have not all been achieved at a steady pace. In fact, Turkey’s economy has been plagued by recurring political and macroeconomic instability that has led to a number of crises, especially in the second half of the twentieth century. The most severe of these, a financial crisis, occurred in 2001. That the economy managed to rebound strongly within a few years should perhaps remind us of the above metaphor.

Also on the positive side, the last decade has witnessed important changes in Turkey’s relations with the European Union. Although the first agreement for cooperation between Turkey and what was then the Common Market dates back to 1963, both sides remained doubtful about Turkey’s integration. Turkey’s first application for membership in 1987 was turned down but it joined the European customs union in 1996. After a reasonably successful implementation of the customs union for one decade, formal negotiations for membership in the European Union began in 2006.

I begin below with several key indicators that offer a summary evaluation of Turkey’s economic development record since 1923 or 1913 in a comparative framework. The rest of the chapter attempts to understand that record. In recent years, a growing literature has emphasized the
contribution of the social and political environment, and more specifically of institutions defined as written and unwritten rules and norms, to long term economic change. In the second section, I will sketch a framework for understanding the linkages between the evolution of institutions and economic change in twentieth century Turkey. I will then examine, in the third section, world economic conditions, government economic policies and the basic macroeconomic outcomes for Turkey in three sub-periods, in order to gain additional insights into its absolute and relative growth record. With its very large share in employment and total output until recently, agriculture is of central importance also for understanding long term economic development in Turkey. Similarly, income distribution, or more generally the distribution of gains, must be part of any long term evaluation. In the fourth section, I focus on these two themes, agriculture and income distribution and regional disparities, before offering some concluding remarks in the fifth section.

I. Economic Growth and Development Record

In the 1920s, less than 25 percent of Turkey’s population lived in urban centers with more than 5000 inhabitants. The rural-urban shares remained little changed until after World War II but Turkey has been experiencing rapid urbanization since then. The proportion of the population living in urban centers, as defined above, increased to 44 percent by 1980 and to 68 percent by 2005. Rapid urbanization has been accompanied by large shifts within the labor force. Agriculture’s share in total employment declined from about 80 percent in 1913 and in 1950 to 34 percent in 2005, while industry’s share rose from about 9 to 23 percent, and that of services increased from 11 to 43 percent. Similarly, agriculture’s share in GDP declined from about 55 percent in 1913 and 54 percent in 1950 and to 11 percent in 2005. Share of industry has increased from about 13 percent in 1913 to 26 percent in 2005 while the share of services has increased from 34 to 64 percent during the same period. (Table 1 and Graph 1)

The beginning date or base year for long-term comparisons of economic growth (1913 vs. 1923) requires an explanation. A decade of wars beginning in 1912 had resulted in a dramatic 20 percent decline in population and as much as 40 percent decline in per capita incomes by 1922. As a result, the GDP per capita levels for Turkey were sharply lower than long-term trend values in the early 1920’s,. For this reason, the year selected for long-term comparisons makes a big difference. While I provide values for both base years in Table 1, for most comparisons I will use 1913, which is also used in most international comparisons.

Per capita incomes in Turkey and the rest of the Ottoman Empire rose during the nineteenth century. Nonetheless, the gap between the high income countries of Western Europe and the United States and the developing world, including the Ottoman Empire, widened considerably during the century before World War I, due to the rapid rates of industrialization in the former group. GDP per capita in the area within present-day borders of Turkey was approximately 1200
dollars in 1913. (Table 1) This was 29 percent of the level of GDP per capita in the high income countries of Western Europe and the United States, calculated on a population-weighted basis, and 168 percent of the GDP per capita income in the developing countries of Asia, Africa and Latin America, also calculated on a population-weighted basis and for the same year.

Two world wars and a great depression later, per capita income in Turkey in 1950 was more than 30 percent higher, at 1620 constant or inflation-adjusted dollars. This was equal to 24 percent of the per capita income of the high income countries and 188 percent of the per capita income in the developing countries. By 2005, GDP per capita in Turkey had reached 7500 dollars, an increase of more than five fold since 1913. This figure corresponded to about 30 percent of the level of GDP per capita in the high income countries of Western Europe and the United States, and approximately 225 percent of the GDP per capita income of the developing countries for the same year. In other words, average incomes in Turkey have increased at about the same rate as those in high income countries since 1913. Turkey has not been able to close any of this large gap. At the same time, increases in average incomes in Turkey since 1913 have been slightly faster than those in the developing world. If 1923 were chosen as the base year, Turkey’s long term record would look considerably better. (Table 1)

In Graph 2, I provide per capita GDP series for Turkey and a number of other regions and continents as percentages of the average for Western Europe and the United States for the period since 1913. This graph allows further insights into Turkey’s comparative economic record in the twentieth century. It shows that while its growth record was better than the averages for Latin America, Middle East and Africa as a whole, Turkey has lagged well behind Southern Europe and East Asia since 1950. (To the Editor: please allow full page for Graph 2)

However, GDP per capita is not an adequate measure of economic development or more generally of standards of living. For this reason, the Human Development Index (HDI), a broader measure first introduced by the United Nations in 1990, has become quite popular. HDI has three components, longevity as measured by life expectancy at birth, knowledge as measured by a weighted average of adult literacy and years of schooling and income as measured by GDP per capita. Estimates for HDI for Turkey and other countries are available for the benchmark years of 1950 and 1975, as well as for the period since 1990. Recently, I made a separate estimate for Turkey in 1913, making use of the data cited above. These estimates allow us to obtain an overview of the standards of living in twentieth century Turkey and insert it into a comparative framework. (Table 2)

It is not easy to compare the evolution of HDI of developing countries with those of developed countries today or in the past. For this purpose, I present in the last column of Table 2 a measure for the extent to which countries have reduced the distance between their level of HDI of 1950 and the maximum attainable score of 1. While Turkey and many other developing countries with
low initial levels have experienced large increases in HDI since 1950, the developed countries have generally shown larger increases when measured as percent of maximum possible increase. In terms of this latter measure, Turkey has done better than African and Eastern European countries, about the same as Latin American countries, and has lagged behind East Asian countries since 1950.

Changes in life expectancy at birth, or $e(0)$, provide a dramatic example of changes in twentieth century Turkey. The earliest period for which we have estimates of $e(0)$ is for the 1930s when the figure was 30 years. Life expectancy at birth had increased to 47 years by 1950 and to 62 years by 1980. In 2004, the latest year for which we have the estimates, $e(0)$ stood at 70 years; 68 years for men and 73 years for women. (Table 1) While official estimates are not available for adult literacy in the early years of the republic, it can be safely assumed that the rate did not exceed 10 percent in the 1920s. In 1935, the literacy rate for individuals over age 15 was 19 percent: 31 percent for men and only 8 percent for women. By 1950, the adult literacy rate had increased to 28 percent; 47 percent for men and 13 percent for women. In 2005, it stood at 89 percent; 95 percent for men and 82 percent for women. (Table 1)

Since 1913 and especially since 1950, levels and improvements in life expectancy in Turkey have been comparable to those in other developing countries with similar levels of income. However, since 1913 and 1950 education levels in Turkey as measured by literacy, years of schooling and school enrollment have been lagging significantly behind education levels in developing countries with similar levels of GDP. At the same time, the incidence of poverty in Turkey has been lower in comparison to developing countries with similar levels of income. These contrasts can be clearly observed in a comparison of Turkey with countries in Latin America since 1913 and 1950. Levels of schooling in Turkey have been below the averages for the larger Latin American countries throughout the twentieth century. The lagging performance in education is not a matter for the historical record alone, however. This deficit will make itself increasingly felt in the decades ahead. For further increases in GDP per capita, Turkey will need a better educated labor force and significant increases in the technology and knowledge component of its economy.

Along with other Muslim majority countries, Turkey also lags behind developing countries with comparable levels of per capita income in indices aiming to measure gender equality and socio-economic development of women. One other reason why many of Turkey’s human development measures have been lagging behind is the large regional differences in these indicators between the mostly Kurdish southeast and the rest of the country, as discussed in Section IV below.

II- Institutional Change and Economic Growth

For decades it was believed that economic growth results in part from the accumulation of factors of production and improvements in their quality through investment in machines and skill
formation, and in part from increases in productivity derived from advances in technology and organizational efficiency. In recent years, however, a useful distinction is being made between the proximate and the ultimate sources of economic growth. The former relates to the contributions made by the increases in factor inputs and productivity as cited above. The latter refers to aspects of the social and economic environment that influence the rate at which inputs and productivity grow. A growing literature emphasizes the importance of institutions or written and unwritten rules of a society and policies such as property rights and their enforcement, norms of behavior, political and macroeconomic stability, which affect the incentives to invest and innovate. In this new perspective, the basic function of institutions is to provide certainty in economic activity. More complex economic structures will not emerge unless institutions can reduce the uncertainties associated with such structures. Recent research has also revealed very large differences in total productivity levels between countries. It appears more than half of the differences in levels of per capita production are due to the productivity obtained from the same amount of resources rather than from the accumulation of more machines or skills per person.ii In this context, the quality of institutions is increasingly seen as the key to the explanation of economic growth and long-term differences in per capita GDP. Economic institutions also determine the distribution of income and wealth. In other words, they determine not only the size of the aggregate pie, but also how it is divided amongst different groups in society.

The process of how economic institutions are determined and the reasons why they vary across countries are still not sufficiently well understood. Nonetheless, it is clear that because different social groups including state elites benefit from different economic institutions, there is generally a conflict of interest over the choice of economic institutions, which is ultimately resolved in favor of groups with greater political power. The distribution of political power in society is in turn determined by political institutions and the distribution of economic power. For long-term growth, economic institutions should not offer incentives to narrow groups, but instead open up opportunities to broader sections of society. For this reason, political economy and political institutions are considered as key determinants of economic institutions and the direction of institutional change.iii

The evolution of economic institutions in Turkey and their consequences for economic growth and distribution of income have not been closely studied. In the next section, I will examine structural change, industrialization and the basic macroeconomic outcomes in three sub-periods: the interwar years or the single party era until the end of World War II, the import-substituting industrialization era after World War II and the globalization era since 1980. I will thus seek to gain insights not only into Turkey’s record of economic growth and distribution, but also into the evolution of the economic institutions that played a key role in these outcomes. Briefly, there were significant institutional changes in Turkey during the interwar period. Ultimately, however, political
and economic power remained with the state elites. Despite the rhetoric to the contrary, the regime remained decidedly urban in a country where the overwhelming majority lived in rural areas and engaged in agriculture. As a result, these institutional changes did not reach large segments of the population. Rates of increase of per capita GDP remained low in Turkey as in most developing countries during this period. Pace of economic growth accelerated in both the developed and developing countries including Turkey after World War II. With the transition to a more open political regime and urbanization, urban industrial groups began to take power away from the state elites. The economic institutions began to reflect those changes. This transition, however, has not been smooth or easy. For most of the last half century, political and macroeconomic instability including three military coups and a series of fragile coalitions and the shortcomings of the institutional environment seriously undermined the economy’s growth potential. The glass has remained only half full.

III.1 World Wars, the Great Depression and Etatism, 1913-1946

The Ottoman economy, including those areas that later comprised modern Turkey, remained mostly agricultural until World War I. Nonetheless, per capita incomes were rising in most regions of the empire during the decades before the war. But the destruction and death that accompanied the Balkan Wars of 1912-13, World War I and the War of Independence, 1920-22, had severe and long-lasting consequences. Total casualties, military and civilian, of Muslims during this decade are estimated at close to 2 million. In addition, most of the Armenian populace of about one and a half million in Anatolia were deported, killed, or died of disease, after 1915. Finally, under the Lausanne Convention, approximately 1.2 million Orthodox Greeks were forced to leave Anatolia, and in return, close to half a million Muslims arrived from Greece and the Balkans after 1922.

As a result of these massive changes, the population of what became the Republic of Turkey declined from about 17 million in 1914 to 13 million at the end of 1924. The population of the new nation-state had also become more homogeneous, with Muslim Turks and the Kurds who lived mostly in the southeast making up close to 98 percent of the total. The dramatic decline in Greek and Armenian population meant that many of the commercialized, export-oriented farmers of Western Anatolia and the eastern Black Sea coast, as well as the artisans, leading merchants and moneylenders who linked the rural areas to the port cities and the European trading houses had died or departed. Agriculture, industry and mining were all affected adversely by the loss of human lives and by the deterioration and destruction of equipment, draft animals and plants during the war years. GDP per capita in 1923 was approximately 40 percent below its 1914 levels. (also Table 1)
The former military officers, bureaucrats and intellectuals who assumed the positions of leadership in the new republic viewed the building of a new nation-state and modernization through Westernization as two closely related goals. They strived, from the onset, to create a national economy within the new borders. The new leadership was keenly aware that financial and economic dependence on European powers had created serious political problems for the Ottoman state. At the Lausanne Peace Conference (1922-23), which defined, amongst other things, the international economic framework for the new state, they succeeded in abolishing the regime of capitulations that had provided special privileges to foreign citizens. The parties also agreed that the new republic would be free to pursue its own commercial policies after 1929. The new government saw the construction of new railroads and the nationalization of the existing companies as important steps towards the political and economic unification of the new state inside new borders. Despite its rhetoric to the contrary, the regime’s priorities lay with the urban areas. It considered industrialization and the creation of a Turkish bourgeoisie to be the key ingredients of national economic development. vii

Nonetheless, the new regime abolished the much-dreaded agricultural tithe and the animal tax in 1924. This move represented a major break from Ottoman patterns of taxation and a significant decrease in the tax burden of the rural population. While this decision has been interpreted as a concession to the large landowners, the new leadership was concerned more about alleviating the poverty of the small and medium sized producers, which made up the overwhelming majority of the rural population. In the longer term, the abolition of the tithe and tax-farming helped consolidate small peasant ownership. The recovery of agriculture provided an important lift to the urban economy as well. By the end of the 1920s, GDP per capita levels had attained the levels prevailing before World War I. viii

The Great Depression

The principal mechanism for the transmission of the Great Depression to the Turkish economy was the sharp decline in prices of agricultural commodities. Decreases in the prices of leading crops, such as wheat and other cereals, tobacco, raisins, hazelnuts and cotton, averaged more than 50 percent from 1928-29 to 1932-33, much more than the decreases in prices of non-agricultural goods and services. These adverse price movements created a sharp sense of agricultural collapse in the more commercialized regions of the country, in western Anatolia, along the eastern Black Sea coast and in the cotton-growing Adana region in the south.ix

Earlier in 1929, even before the onset of the crisis, the government had begun to move towards protectionism and greater control over foreign trade and foreign exchange. By the second half of the 1930s, more than 80 percent of the country's foreign trade was conducted under clearing and reciprocal quota systems. As the unfavorable world market conditions continued, the government announced in 1930 a new strategy of etatism, which promoted the state as a
leading producer and investor in the urban sector. A first five-year industrial plan was adopted in 1934 with the assistance of Soviet advisers. By the end of the decade, state economic enterprises had emerged as important and even leading producers in a number of key sectors, such as textiles, sugar, iron and steel, glass works, cement, utilities and mining. \(^x\) Etatism undoubtedly had a long-lasting impact in Turkey, and later in other countries around the Middle East. However, the initial efforts in the 1930s made only modest contributions to economic growth and structural change. For one thing, state enterprises in manufacturing and many other areas did not begin operations until after 1933. Close to half of all fixed investments by the public sector during this decade went to railroad construction and other forms of transportation. In 1938, state enterprises accounted for only 1 percent of total employment in the country. Approximately 75 percent of employment in manufacturing continued to be provided by small-scale private enterprises. \(^xii\)

Etatism did not lead to large shifts in fiscal and monetary policies, either. Government budgets remained balanced, and the regime made no attempt to take advantage of deficit finance. In fact, “balanced budget, strong money” was the government’s motto for its macroeconomic policy. The exchange rate of the lira actually rose against all leading currencies during the 1930s. The most important reason behind this policy choice was the bitter legacy of the Ottoman experience with budget deficits, large external debt and inflationary paper currency during World War I. Ismet Inönü, the prime minister for most of the interwar period, was a keen observer of the late Ottoman period and was the person most responsible for this cautious, even conservative, policy stand. In other words, government interventionism in the 1930s was not designed, in the Keynesian sense, to increase aggregate demand through the use of devaluations and expansionary fiscal and monetary policies. Instead, the emphasis was on creating a more closed, autarkic economy, and increasing central control through the expansion of the public sector. \(^xiii\)

**Economic Growth and its Causes**

Available estimates suggest GDP and GDP per capita grew at average annual rates of 5.4 and 3.1 percent respectively during the 1930s, despite the absence of expansionary fiscal and monetary policy. (See Table 1 and Graph 2) One important source of the output increases after 1929 was the protectionist measures adopted by the government ranging from tariffs and quotas to foreign exchange controls, which sharply reduced the import volume from 15.4 percent of GDP in 1928-29 to 6.8 percent by 1938-39. (Graph 3) Import repression created attractive conditions for the emerging domestic manufacturers, mostly the small and medium-sized private manufacturers.

There is another explanation for the overall performance of both the urban and the national economy during the 1930s, which has often been ignored amidst the heated debates over
etatism. Thanks to the strong demographic recovery, agriculture—the largest sector of the economy, employing more than three fourths of the labor force and accounting for close to half of the GDP—did quite well during the 1930s.  

Given its balanced-budget policy stand, government actions in response to sharply lower agricultural prices after 1929 were limited to purchases of small amounts of wheat. It is remarkable that despite the adverse price trends, agricultural output increased by 50 to 70 percent during the 1930s. The most important explanation of this outcome is the demographic recovery in the countryside. In the interwar period, Anatolian agriculture continued to be characterized by peasant households who cultivated their own land with a pair of draft animals and the most basic of implements. With the population beginning to increase at annual rates around 2 percent after a decade of wars, expansion of the area under cultivation soon followed. It is also likely that the peasant households responded to the lower cereal prices after 1929 by working harder to cultivate more land and produce more cereals in order to reach certain target levels of income, very much like the peasant behavior predicted by the Russian economist Chayanov. In other words, behind the high rates of industrialization and growth in the urban areas were the millions of family farms in the countryside, which kept food and raw materials prices lower until World War II.  

**Difficulties during the War**

Although Turkey did not participate in World War II, full-scale mobilization was maintained during the entire period. The sharp decline in imports and the diversion of large resources for the maintenance of an army of more than one million placed enormous strains on the economy. Official statistics suggest that GDP declined by as much as 35 percent and the wheat output by more than 50 percent until the end of the war. In response, the prices of foodstuffs rose sharply and the provisioning of urban areas emerged as a major problem for the government. Under these circumstances, etatism was quickly pushed aside. Large increases in defense spending were financed by monetary expansion. High inflation, wartime scarcities, shortages and profiteering accentuated by economic policy mishaps soon became the order of the day. Measures such as the 1942 Varlik Vergisi, or Wealth Levy, which was applied disproportionately to non-Muslims, only made things worse.  

As declining production and sharply lower standards of living combined with increasing inequalities in the distribution of income, large segments of the urban and rural population turned against the Republican People’s Party, which had been in power since the 1920s. In terms of economics, the war years, rather than the Great Depression and etatism era, thus appear to be the critical period in the political demise of the single party regime.  

Despite two world wars and the Great Depression, per capita levels of production and income in Turkey were 30 to 40 percent higher in 1950 than the levels on the eve of World War I. (see
Table 1 and Graph 2) xvii Around mid-century, the economy was much more inward-oriented than it had been in 1913. Due to the impact of two world wars and a depression, rural-urban differences and regional disparities were considerably higher than they had been in 1913.

III.2. The Post-World War II Era, 1946-1980

Domestic and international forces combined to bring about major political and economic changes in Turkey after World War II. Domestically, many social groups had become dissatisfied with the single party regime. The agricultural producers, especially poorer segments of the peasantry, had been hit hard by wartime taxation and government demands for the provisioning of the urban areas. In the urban areas, the bourgeoisie was no longer prepared to accept the position of a privileged but dependent class, even though many had benefited from the wartime conditions and policies. They now preferred greater emphasis on private enterprise and less government interventionism.xviii

International pressures also played an important role in the shaping of new policies. The emergence of the United States as the dominant world power after the war shifted the balance towards a more open political system and a more liberal and open economic model. Soviet territorial demands pushed the Turkish government towards close cooperation with the United States and Western alliance. The U.S. extended the Marshall Plan to Turkey for military and economic purposes beginning in 1948.


The shift to a multi-party electoral regime brought Democrat Party to power in 1950. Undoubtedly the most important economic change brought about by the Democrats was the strong emphasis placed on agricultural development. Agricultural output more than doubled from 1947, when the pre-war levels of output were already attained, through 1953. xx A large part of these increases were due to the expansion in cultivated area, which was supported by two complementary government policies, one for the small peasants and the other for larger farmers. First, the government began to distribute state-owned lands and open communal pastures to peasants with little or no land. Secondly, the Democrat government used Marshall Plan aid to finance the importation of agricultural machinery, especially tractors, whose numbers jumped from less than 10,000 in 1946 to 42,000 at the end of the 1950s. Agricultural producers also benefited from favorable weather conditions and strong world market demand for wheat, chrome and other export commodities, thanks to American stockpiling programs during the Korean War.xx

The agriculture-led boom, meant good times and rising incomes for all sectors of the economy. It seemed in 1953 that the promises of the liberal model would be quickly fulfilled. These golden years did not last very long, however. With the end of the Korean War, international demand slackened and prices of export commodities began to decline. With the disappearance of favorable weather conditions, agricultural yields declined as well. Rather than accept lower
incomes for the agricultural producers, who made up more than two thirds of the electorate, the government decided to initiate a large price support program for wheat, financed by increases in the money supply. The ensuing wave of inflation and the foreign exchange crisis, which was accompanied by shortages of consumer goods, created major economic and political problems for the Democrat Party, especially in the urban areas. One casualty of the crisis was the political as well as economic liberalism of the Democrat Party. Just as it responded to the rise of political opposition with the restriction of democratic freedoms, in most economic issues the government was forced to change its earlier stand and adopt a more interventionist approach. It finally agreed in 1958 to undertake a major devaluation and began implementing a IMF and OECD-backed stabilization program.

To this day, agricultural producers and their descendants, many of whom are now urbanized, continue to view the Democrat Party government and especially the Prime Minister Adnan Menderes, a large landowner, as the first government to understand and respond to the aspirations of the rural population. The Democrat Party also offered the first example of populist economic policies in modern Turkey. Not only did it target a large constituency and attempt to redistribute income towards them, but it also tried to sustain economic growth with short-term expansionist policies, with predictable longer-term consequences. The 1950's also witnessed the dramatic acceleration of rural-to-urban migration in Turkey. Both push and pull factors were behind this movement, as conditions in rural areas differed widely across the country. The development of the road network also contributed to the new mobility.

Import Substituting Industrialization, 1963-1977

One criticism frequently directed at the Democrats was the absence of any coordination and long term perspective in the management of the economy. After the coup of 1960, the military regime moved quickly to establish the State Planning Organization (SPO). The idea of development planning was now supported by a broad coalition: the Republican People's Party with its etatist heritage, the bureaucracy, large industrialists and even the international agencies, most notably the OECD.

The economic policies of the 1960s and 1970s aimed, above all, at the protection of the domestic market and industrialization through import substitution (ISI). Governments made heavy use of a restrictive trade regime, investments by state economic enterprises and subsidized credit as key tools for achieving ISI objectives. The SPO played an important role in private sector decisions as well, since its approval was required for all private sector investment projects which sought to benefit from subsidized credit, tax exemptions, import privileges and access to scarce foreign exchange. The agricultural sector was mostly left outside the planning process.

With the resumption of ISI, state economic enterprises once again began to play an important role in industrialization. Their role, however, was quite different in comparison to the earlier period. During the 1930's when the private sector was weak, industrialization was led by the state...
enterprises and the state was able to control many sectors of the economy. In the post-war period, in contrast, the big family holding companies, large conglomerates which included numerous manufacturing and distribution companies as well as banks and other services firms, emerged as the leaders.

For Turkey, the years 1963 to 1977 represented what Albert Hirschman has called the easy stage of ISI.\textsuperscript{xxv} The opportunities provided by a large and protected domestic market were exploited, but ISI did not extend to the technologically more difficult stage of capital goods industries. Export orientation of the manufacturing industry also remained weak. Turkey obtained the foreign exchange necessary for the expansion of production from traditional agricultural exports and remittances from workers in Europe. The ISI policies were successful bringing about economic growth, especially in their early stages. GNP per capita increased at the average annual rate of 4.3 percent during 1963-1977 and at 3.5 percent per annum including the crisis years of 1978-79. Rate of growth of manufacturing industry was considerably higher, averaging more than 10 percent per annum for 1963-1977. \textsuperscript{xxvi} (Also see Table 1 and Graph 2)

The role played by the domestic market during this period deserves further attention. Despite the apparent inequalities in income, large segments of the population, including civil servants, workers, and to a lesser extent, agricultural producers, were incorporated into the domestic market for consumer durables. Perhaps most importantly, real wages almost doubled during this period. Behind this exceptional rise lay both market forces and political and institutional changes. While industrial growth increased the demand for labor, the emigration of more than one million workers to Europe by 1975 kept conditions relatively tight in the urban labor markets. At the same time, the institutional rights they obtained under the 1961 Constitution supported the labor unions at the bargaining table. Large industrial firms, which were not under pressure to compete in the export markets, accepted wage increases more easily since higher wages served to broaden the demand for their own products. By the middle of the 1970's, however, industrialists had begun to complain about the high level of wages and an emerging labor aristocracy.\textsuperscript{xxvii}

While industry and government policy remained focused on a large and attractive domestic market, they all but ignored exports of manufactures, and this proved to be the Achilles' heel of Turkey's ISI. The export sector’s share in GDP averaged less than 4 percent during the 1970s, and about two thirds of these revenues came from the traditional export crops. (Graph 3) A shift towards exports would have increased the efficiency and competitiveness of the existing industrial structure, acquired the foreign exchange necessary for an expanding economy and even supported the import substitution process itself in establishing the backward linkages towards the technologically more complicated intermediate and capital goods industries.

There existed an opportunity for export promotion in the early 1970's, especially in the aftermath of the relatively successful devaluation of 1970. By that time, Turkish industry had acquired sufficient experience to be able to compete or learn to compete in the international
markets. For that major shift to occur, however, a new orientation in government policy and the institutional environment was necessary. The overvaluation of the domestic currency and many other biases against exports needed to be eliminated. Instead, the successes obtained within a protected environment created vested interests for the continuation of the same model. Most of the industrialists as well as organized labour, which feared that export orientation would put downward pressure on wages, favored the domestic market oriented model. Moreover, political conditions became increasingly unstable during the 1970’s. The country was governed by a series of fragile coalitions with short time horizons. As a result, the government made no attempt to shift towards export oriented policies or even adjust the macroeconomic balances after the first oil shock of 1973.  

The Crisis of ISI

The short-lived coalitions chose to continue with expansionist policies at a time when many industrialized countries were taking painful steps to adjust their economies. Turkey’s existing policies could be sustained only by a very costly external borrowing schemes. In less than two years it became clear that the government was in no position to honor the outstanding external debt stock, which had spiralled from 9 percent to 24 percent of GDP. By the end of the decade Turkey was in the midst of its most severe balance of payments crisis of the postwar period. As rising budget deficits were met with monetary expansion, inflation jumped to 90 percent in 1979. The second round of oil price increases only compounded the difficulties. With oil increasingly scarce, frequent power cuts hurt industrial output as well as daily life. Shortages of even the most basic items became widespread, arising from both the declining capacity to import and the price controls. The economic crisis, coupled with the continuing political turmoil, brought the country to the brink of civil war.

Perhaps the basic lesson to be drawn from the Turkish experience is that an ISI regime becomes difficult to dislodge owing to the power of vested interest groups who continue to benefit from the existing system of protection and subsidies. To shift towards export promotion in a country with a large domestic market required a strong government with a long term horizon and considerable autonomy. These were exactly the features lacking in the Turkish political scene during the 1970s. As a result, economic imbalances and costs of adjustment increased substantially. It then took a crisis of major proportions to move the economy towards greater external orientation.

III.3. The Globalization Era since 1980

Against the background of a severe foreign exchange crisis and strained relations with the IMF and international banks, the newly installed minority government of Süleyman Demirel announced a comprehensive and unexpectedly radical policy package of stabilization and liberalization in January 1980. Turgut Özal, a former chief of the State Planning Organization, was
to oversee the implementation of the new package. The Demirel government was unable to gain the political support necessary for the successful implementation of the package, but the military regime that came to power later that year endorsed the new program and made a point of keeping Özal in the government, as Deputy Prime Minister responsible for Economic Affairs.

The aims of the new policies were to improve the balance of payments and reduce the rate of inflation in the short term, and to create a market-based, export-oriented economy in the longer term. The policy package included a major devaluation followed by continued depreciation of the currency in line with the rate of inflation, greater liberalization of trade and payments regimes, elimination of price controls, freeing of interest rates, elimination of many government subsidies, substantial price increases for the products of the state economic enterprises, subsidies and other support measures for exports and promotion of foreign capital. Reducing real wages and the incomes of agricultural producers were important parts of the new policies.\textsuperscript{xxi}

With the shift to a restricted parliamentary regime in 1983, Özal was elected prime minister as the leader of the Motherland Party. He soon launched a new wave of liberalization of trade and payments regimes. These measures began to open up the ISI structures to competition. However, frequent revisions in the liberalization lists, the arbitrary manner in which they were made, and the favors provided to groups close to the government created a good deal of uncertainty regarding the stability and durability of these changes. The response of the private sector to import liberalization was mixed. While export oriented groups and sectors supported it, the ISI industries, especially the large scale conglomerates whose products included consumer durables and automotives, continued to lobby for protection. \textsuperscript{xxii}

From the very beginning, the program of January 1980 benefited from the close cooperation and goodwill of the international agencies such as the IMF and the World Bank, as well as the international banks. For most of the decade these agencies portrayed Turkey as a shining example of the validity of the orthodox stabilization and structural adjustment programs. In economic terms, this support translated into better terms in the rescheduling of the external debt and substantial amounts of new resource inflows. As a result, the foreign exchange constraint disappeared very quickly and the public sector had less need for inflationary finance at home. These were undoubtedly indispensable ingredients for the success of the program.\textsuperscript{xxxiii}

One area of success for the new policies was in export growth. Turkey's merchandise exports sharply rose from a mere 2.6 percent of GDP in the crisis year of 1979 to 8.6 percent of the GDP in 1990. (Graph 3) Turkey in fact ranked first amongst all countries in rate of export growth during this decade. Equally dramatic was the role of manufactures, which accounted for approximately 80 percent of this increase. Among the exports, textiles, clothing and iron and steel products dominated the market. It is thus clear that the success in export growth was achieved by reorienting the existing capacity of ISI industries towards external markets. In addition to a steady
policy of exchange rate depreciation, the exporters were supported by generous credits at preferential rates, tax rebates and foreign exchange allocation schemes during this drive.

The impact of the new policies on the rest of the economy was mixed, however. Most importantly, the new policies did not generate the high levels of private investment necessary for long term growth. In the manufacturing industry, high interest rates and political instability were the most important impediments. Even in the area of exports, new investment was conspicuously absent; most of the increase was achieved with the existing industrial capacity. The response of foreign capital to the new policies was not very strong either, apparently for reasons similar to those of domestic capital. As a result, the growth performance of the economy was modest. GNP increased at the annual rate of 4.6 percent and GNP per capita increased at 2.3 percent during the 1980's. (Table 1 and Graph 2) Moreover, these were obtained at the cost of accumulating a large external debt, which climbed more than fivefold from less than 10 billion dollars in 1980 to more than 50 billion dollars in 1990.

Another important area where the record of the new policies was bitterly contested was income distribution. From the very beginning, the January 1980 package set out to repress labor and agricultural incomes, and these policies were maintained until 1987 thanks to the military regime and the limited nature of the transition to multi-party politics. Real wages declined by as much as 34 percent and the intersectoral terms of trade turned against agriculture by more than 40 percent until 1987, although some of this deterioration had occurred during the crisis years of 1978 and 1979.

The agricultural sector, which continued to provide employment to about half of the labor force, was all but ignored by the military regime and the Motherland Party. The most important change for the sector was the virtual elimination of subsidies and price support programs after 1980, which combined with trends in the international markets to create a sharp deterioration in the sectoral terms of trade. As a result, the agricultural sector showed the lowest rates of output increase during the post-war era, averaging only 1 percent per year since 1980. Agricultural output has thus failed to keep pace with population growth for the first time in the twentieth century.

Turgut Özal was a critical figure in Turkey’s transition to a neo-liberal development model in the 1980s. There can be no question that his bold initiatives helped accelerate the opening and market orientation of the economy. His legacy is not wholly positive, however. Özal preferred to govern by personal decisions and decrees and tended to underestimate the importance of rule of law and a strong legal infrastructure for the effective operation of a market economy. His rather relaxed attitude towards the rule of law had devastating long-term consequences. The significant rise in corruption in Turkey during the 1990s should be considered a direct legacy of the Özal era.
With the transition to a more open, competitive electoral regime, the opposition began to criticize the deterioration of income distribution and the arbitrary manner in which Özal often implemented his policies. In response, the government increasingly resorted to old-style populism and lost its room for maneuver. Public sector wages, salaries and agricultural incomes were sharply increased. Real wages almost doubled from their decade-low point in 1987 until 1990. These, in turn, sharply increased the deficits and borrowing requirements of the public sector. xxxvi

**A Decade to Forget**

The globalization process offered opportunities as well as vulnerabilities to developing countries. In the case of Turkey, political instability and large public sector deficits that lasted until 2002 made it increasingly costly to participate in the new environment. In 1989, as the macroeconomic balances began deteriorate, Özal decided to fully liberalize the capital account and eliminate the obstacles in the way of international capital flows. He made this shift at least in part to attract short-term capital inflows, or hot money, to help finance the deficits. In the longer term, however, the decision to liberalize the capital account before achieving macroeconomic stability and creating a strong regulatory infrastructure for the financial sector was very costly. As the economy became increasingly vulnerable to external shocks and sudden outflows of capital, the 1990s turned into the most difficult period in the post-World War II era.

Public sector deficits continued to widen in the 1990s, with programs directed towards various segments of the electorate, cheap credit to small businesses, lower retirement age and more generous retirement benefits and most importantly, high support prices for the agricultural producers. The war against the Kurdish separatist PKK in southeastern Turkey, which lasted from 1984 until 1999, also imposed a large fiscal burden. Domestic and external borrowing was the most important mechanism for financing the growing deficits. High interest rates and a pegged exchange rate regime attracted large amounts of short-term capital inflows. Private banks rushed to borrow from abroad in order to lend to the government. In addition, large public sector banks were directed by the governments to finance part of these outlays. Last but not least, monetary expansion was used as a regular instrument for fiscal revenue.

Along the way, the structural reforms that would have increased the resilience of the economy to internal and external shocks were pushed aside. Virtually no progress was made in the privatization of the state economic enterprises. Attempts to sell large state enterprises were often accompanied by scandals involving leading politicians. The privatization of some of the smaller public sector banks resulted in very large losses for the state sector as these banks were stripped of their assets by the well-connected buyers, and the full guarantees on bank deposits made the public sector responsible for their large losses. Not surprisingly, inflows of foreign direct investment remained limited.
The result was a period of very high inflation, which peaked at more than 100 percent in 1994 and remained above 50 percent per annum through 2001, very high nominal and real interest rates, steady increases in public debt and increasing vulnerability to external shocks which led to crises in 1991, 1994, 1998 and 2000-1, the last of which was the most severe. GDP per capita continued to rise as a long term trend but at a pace lower than the earlier era. (Graph 2) High inflation and high interest rates made income distribution increasingly unequal, especially in the urban sector. One significant achievement of the period obtained at some political and economic cost was the customs union agreement with the European Union that began in 1996.¹

By the end of 1999 it was clear that the macroeconomic balances were not sustainable. Negotiations with the IMF led to a new stabilization program with a pegged exchange rate regime as the key anchor to bring down inflation. This program was deeply flawed in design, however, as it ignored significant problems in the financial sector, especially the large deficits of the public sector banks, which had been used for financing part of the budget deficits. After some initial successes, the program disintegrated into a full blown banking and financial crisis in 2001. In the face of massive capital outflows, the government was forced to suspend the program and accept a dramatic depreciation of the lira. (To the Editor: Please add FN here: Öniş and Aysan, “Neoliberal globalization”.

In early 2001, the Turkish government invited Kemal Derviş to leave the World Bank and take up the job of Economy Minister. With IMF support, his team developed a program based around fiscal discipline and large budget surpluses. The program adopted a floating exchange rate regime and converted the outstanding liabilities of the public sector banks to long-term public debt. It also featured some long-term structural reforms, including measures to reform the vulnerable financial system, and a series of laws that attempted to insulate public sector banks and state economic enterprises from the interference of politicians and strengthen the independence of the central bank.

The economy has staged a remarkable recovery since. After declining by 9.5 percent in 2001, real GDP increased by about 35 percent during the next four years. By the end of 2005, annual inflation had declined to below 8 percent, a level not seen since the 1960’s. (Graph 2) Nominal and real interest rates also declined sharply. The credit for this turnaround should begin with Derviş and the initial program. The AKP government that came to power after the elections of 2002 should also be credited for maintaining fiscal discipline. The generally favorable international environment, with low interest rates for developing countries, also helped. By 2005, significant amounts of foreign direct investment had begun to flow into Turkey, and the government was making some progress in the privatization of the state economic enterprises. Thanks to economic growth and the large budget surpluses, the debt burden declined from above
100 percent of GDP in 2001 to less than 70 percent by 2005. This was mostly a jobless recovery, however. Despite the substantial increases in output and incomes, unemployment in the urban areas remained above 13 percent through 2005.

**Anatolian tigers**

One important outcome of economic liberalization after 1980 has been the increasing export orientation of the economy. Exports rose from less than 3 billion dollars in 1980 to 70 billion dollars, or 20 percent of GDP, by 2005. (Graph 3) Most of this increase occurred in textiles, steel, automotives and other manufactures, whose share in total exports exceeded 90 percent in the 1990s. The rapid expansion of exports of manufactures played a key role in the rise of the Anatolian tigers, regional industrial centers such as Gaziantep, Denizli, Kayseri, Malatya, Konya, Çorum and others. With craft traditions and non-unionized workforces, these industrial centers began to account for a significant share of growing exports in textiles and other labor intensive industries. Their competitive advantage was bolstered by low wages, long working hours and flexible labor regimes. Large numbers of small and medium sized family enterprises played a central role in the rise of these industrial centers. Their rise was achieved with little state support and little or no foreign investment.

Many of the entrepreneurs in these urban centers have embraced the new liberal discourse. As latecomers to the private sector, they have been more likely to support an Islamist political party and organize under an association of Islamic businessmen as a political counterweight to the Istanbul-based elites. In fact, tensions between the entrepreneurs in the provinces and the Istanbul region’s industrial elites go back to the 1960’s, when Necmettin Erbakan, the first Islamist political leader in the post-World War II era, based his political rise on his election as chairman of the national organization of chambers of commerce.xxxxvi Erbakan, however, appeared to favor various inward oriented industrialization schemes. In contrast, the industrialists of the Anatolian tigers have been supporting the AKP government and its export oriented policies in the most recent period.

Similarly, large segments of protected domestic industry had opposed closer ties with Europe in the 1970’s. In contrast, both the Istanbul industrialists and the entrepreneurs of the Anatolian tigers have supported European integration since the 1990’s. Turkey’s favorable experience with export oriented industrialization and the discovery that the customs union, which began in 1996, did not lead to the destruction of industry as some had feared, both contributed to the change of attitude. After the acceleration of democratic reforms by the new, AKP-led parliament, the European Union decided in 2004 to begin membership negotiations with Turkey. It is not clear when or if Turkey will become a full member of the European Union. Nonetheless, the membership process is likely to accelerate institutional changes and create a stronger institutional framework for economic change.
IV.1 Agriculture and Structural Change

In the first half of the twentieth century, agriculture accounted for more than 80 percent of employment and more than half of the GDP in Turkey. Although these shares now stand at 35 percent and 10 percent, respectively, it is clear that any analysis of long-term structural change, economic growth and income distribution in Turkey needs to examine agriculture closely. (Graph 1)

Total population of Turkey has increased more than fourfold since 1914. Agricultural output has kept pace, increasing more than fivefold during the same period. As a result, Turkey continues to be mostly self-sufficient in food and agricultural goods today. Agricultural output declined by as much as 50 percent during the decade of wars after 1914, but began to recover in the 1920s. Increases in land and labor productivity were modest during this period, but population and total output began to exceed pre-World War I levels by the middle of the 1930s. Agricultural output began to increase more rapidly after World War II at about 3 percent per annum until 1980. This higher rate of growth was supported by rapid increases in the amount of land under cultivation. Thanks to the availability of land, the total area under cultivation more than doubled during the decade after World War II. After the land frontier was reached, a shift occurred towards more intensive agriculture in the 1960s. In this new phase, output rose more slowly but yields and land productivity increased more rapidly with the use of new inputs, agricultural machinery and equipment, fertilizers, irrigation and high yielding varieties of seeds. Total output and land productivity growth have slowed down to 1 percent per annum since 1980, but labor productivity growth has accelerated due to the more rapid labor movement away from agriculture in recent years.

In part because of the availability of land and in part due to government policies dating back to the nineteenth century, small to medium-sized enterprises have dominated agriculture in Turkey, except in the Kurdish southeast and in a number of fertile valleys opened to cultivation only in the nineteenth century, such as Çukurova and Söke. This pattern has encouraged politicians to use government programs as an electoral instrument since the 1950s. With the manipulation of the intersectoral terms of trade in favor of agriculture, the incorporation of the rural population into the national market accelerated. Villages became important markets for textiles, food industries and gradually, for consumer durables, as well as agricultural machinery and equipment. In recent decades, non-agricultural activities including tourism and some manufacturing have begun to expand in the rural areas.

The large and expensive irrigation project on the Euphrates Valley in Southeastern Anatolia stands apart from all other rural development schemes since World War II. It originally envisaged the building of a number of interrelated dams and hydro electrical plants on the Euphrates river in order to irrigate 1.6 million hectares in the plain of Harran, which would double the irrigated area.
under cultivation in the country. The project has since evolved into an integrated regional development program seeking to improve the social and economic fabric of a large and poor region of the country. Now one of world’s largest and most ambitious regional developments projects, it includes large investments in a wide range of development-related sectors such as agriculture, energy, transportation, urban and rural infrastructure. However, until recently the project has been designed and implemented with a developmentalism-from-above approach, and without sufficient understanding or concern for the needs of the local population. The absence of a shared vision between the planners and the intended beneficiaries, namely the local Kurdish communities, has seriously limited the benefits of the project.xi

Despite the large and persistent productivity and income differences between agriculture and the rest of the economy, the strength of small and medium-sized land ownership has slowed down the movement of labor to the rest of the economy. The dominance of small and medium-sized family enterprises in the rural areas was a legacy of the Ottoman era. After World War II, it combined with another Ottoman legacy, state ownership of land, to moderate urban inequalities during decades of rapid urbanization. Many of the newly arriving immigrants were able to use their savings from rural areas to build low cost residential housing (gecekondu) on state lands in the urban areas. They soon acquired ownership of these plots.

Large productivity and income differences between agriculture and the urban economy has been an important feature of the Turkish economy since the 1920s. Most of the labor force in agriculture are self-employed today in the more than 3 million family farms, including a large proportion of the poorest people in the country. The persistence of this pattern has not been due to the low productivity of agriculture alone, however. If the urban sector had been able to grow at a more rapid pace, more labor would have left the countryside during the last half century. Equally importantly, governments have offered very limited amounts of schooling to the rural population in the past. Average amounts of schooling of the total labor force (ages 15-64) increased from only 1 year in 1950 to about 7 years in 2005. However, average years of schooling of the rural labor force today are still below 3 years.xii In other words, most of the rural labor force today consists of undereducated men and women, for whom the urban sector offers limited opportunities. The pace with which rural poverty and population will diminish in the decades ahead will depend on the degree to which the countryside experiences institutional changes and receives greater amounts of education and capital.

IV.2. Income Distribution

Data on income distribution in Turkey have not been sufficiently detailed and do not easily allow long-term comparisons. In what follows, I will attempt such comparisons by employing simple indicators for which long-term series are available. I will examine changes in income distribution in twentieth century Turkey in three basic components: a) distribution within
agriculture, b) agriculture-non-agriculture or rural-urban differences and c) distribution within the non-agricultural or the urban sector. The relative weights of these three components have clearly changed over time. Until the 1950s, the first two components were more important. With urbanization after 1950, the second component and, especially since 1980, the third component began to dominate country-wide debates and issues and debates of income distribution. \[\text{xlii}\]

Within the agricultural sector, the evidence on land ownership and land use points a relatively equal distribution of land, dominated by small and medium sized holdings in most regions. Despite the limitations of available data, it appears that the Gini coefficients for land distribution and land use have changed little since the 1950s. \[\text{xliii}\] Moreover, distribution within the agricultural sector has been more equal than both the differences between the agricultural and urban sectors and the distribution within the urban sector.

Evidence for agriculture-non-agriculture differences in average incomes can be obtained from the national income accounts. These indicate that intersectoral differences were largest in the interwar period, especially due to the sharply lower agricultural prices during the Great Depression. The intersectoral differences in average incomes declined in the post-World War II period, in part because of government policies, but they increased again after 1980. The acceleration of urbanization and the rapid decline of the agricultural labor force in recent years have helped raise average incomes in agriculture. (Graph 4)

In the absence of other suitable series for long-term comparisons of income distribution within the urban sector, I will focus on the share of labor in per capita income. More specifically, I will follow the index of urban wages divided by output per person in the urban labor force. This ratio was quite low in the interwar period, because of the low levels of urban wages in relation to urban output per capita. This suggests a rather unequal distribution of income within the urban sector until World War II. Share of wages in urban income rose steadily after World War II, however. Together with the decline in intersectoral differences in average incomes, this pattern indicates that the post-World War II era until 1980 had a more equal or balanced distribution of income than other period in twentieth century. (Graph 4) In the globalization era since 1980, intersectoral differences in per capita incomes rose sharply, but they are declining in recent years with the rapid contraction of the agricultural labor force. It is clear, however, that the country-wide pattern in income distribution is now dominated by changes inside the urban sector. Disparities within the urban sector between labor and non-labor incomes and also between skilled and unskilled labor incomes have increased since 1980.

It is also interesting that for most of the twentieth century, the second and third components of the country-wide income distribution, namely intersectoral differences in average incomes and the distribution of income within the urban sector, have moved together. As the value of these two indices increased, income distribution tended to get more equal and vice versa (Graph 4).
This pattern suggests that governments were able to influence both components of the income distribution, especially during periods of multi-party electoral politics.

Large regional inequalities are a fourth dimension of income distribution, which especially need to be taken into account in the case of Turkey. Throughout the twentieth century, large west-east differences in average incomes have persisted. Until recently, the private sector-led industrialization process was concentrated in the western third of the country. The commercialization of agriculture had also proceeded further in the western and coastal areas. In addition to lower incomes, the eastern third of the country has also been lacking in infrastructure and services provided by the government, especially for education and health. The development of tourism in the west, the deterioration of the terms of trade against agriculture, and the rise of Kurdish insurgency in the southeast during the 1980s further increased the large regional disparities, adding to the pressures for rural-to-urban as well as east-to-west migration. Future progress on the Southeast Anatolia Project and the rise of the regional industrial centers may help reduce these disparities. However, economic development in that part of the country hinges, above all, on a political resolution of the Kurdish question.\textsuperscript{xliv}

Large east-west differences in average incomes have been accompanied by large and persistent regional inequalities in human development indicators since the 1920s. The latest country report for Turkey prepared by United Nations Human Development Program for the year 2002 indicates, for example, that the top 10 (out of 80) high income, western and northwestern provinces in the country, including Istanbul, had an average HDI equal to 0.825, which was close to the HDI for East-Central European countries such as Croatia or Slovakia. On the other hand, the poorest 10 provinces in the mostly Kurdish southeastern part of the country had an average HDI of 0.600, which was comparable to the HDI of Morocco or India in the same year.\textsuperscript{xlv}

V- Concluding Remarks

Trying to understand Turkey's economic record in the twentieth century, I began with a distinction between the proximate and the ultimate sources of economic growth. The former relates to the contributions made by the increases in factor inputs and productivity. The latter refers to aspects of the social and economic environment in which growth occurs. In this context, economic institutions are increasingly seen as the key to the explanation not only of economic growth and long-term differences in per capita GDP, but also the question of how the total pie is divided amongst different groups in society. I have emphasized that because there is generally a conflict of interest over the choice of economic institutions, political economy and political institutions are key determinants of economic institutions and the direction of institutional change.
Turkey's transition from a rural and agricultural towards an urban and industrial economy in the twentieth century occurred in three waves, each of which served to increase the economic and political power of urban and industrial groups. Increases in the economic and political power of these groups, on the whole, enabled them to shape economic institutions more in the direction they desired. Each of these waves of industrialization and economic growth, however, was cut short by the shortcomings or deficiencies of the institutional environment. The first of these waves occurred during the 1930s. After a series of legal and institutional changes undertaken by the new republic, a small number of state enterprises led the industrialization process and the small scale private enterprises in a strongly protected economy. Etatism promoted the state as the leading producer and investor in the urban sector. Ultimately, however, political and economic power remained with the state elites and these economic and institutional changes remained confined to the small urban sector.

The pace of economic growth was distinctly higher around the world in the decades after World War II. Turkey’s second wave of industrialization began in the 1960s, again under heavy protection and with government subsidies and tax breaks. Rapid urbanization steadily expanded the industrial base. The state economic enterprises continued to play an important role as suppliers of intermediate goods. The new leaders, however, were the large scale industrialists and the holding companies in Istanbul and the northwestern corner of the country. With the rise of political and macroeconomic instability in the 1970s, industrialization turned increasingly inward and short-term interests of narrow groups prevailed over a long-term vision, culminating in a severe crisis at the end of the decade.

A third wave that began in the 1980s under conditions of a more open, export oriented economy widened the industrial base further to the regional centers of Anatolia. The rapid expansion of exports of manufactures played a key role in the rise of these new industrial centers, which began to challenge the Istanbul-based industrialists. Once again, however, rising political and macroeconomic instability, growing corruption and the deterioration of the institutional environment in the 1990s brought this wave to a sharp halt in 2001.

Ever since the Young Turk era, governments in Turkey have supported the emergence and growth of an industrial bourgeoisie. Helped by the growth of the urban sector and successive waves of industrialization, this bourgeoisie has been gradually wresting control of the economy away from the state elites in Ankara. For most of the twentieth century the country’s industrial elites had remained limited to those of the Istanbul region. With the rise of the Anatolian tigers, the economic base of the bourgeoisie has been expanding socially and geographically. The AKP government of the recent years has been supported by these emerging elites in the provinces.

The political and economic power of the workers, as well as their share in the total pie, was on the rise after World War II, especially during the ISI era after 1960. In the most recent era of
globalization, however, economic and institutional changes have combined to reduce the power of the workers and trade unions. Similarly, agricultural producers enjoyed a sharp increase in influence, if not power, with the shift to a multi-party political regime in the 1950s. Their influence and their ability to shape economic institutions have been declining gradually but steadily, however, with the decline in the share of agriculture in both the labor force and total output.

While economic power has clearly shifted from Ankara to Istanbul and more recently towards industrial groups in the provinces, the shift in political power and the move towards more pluralist politics have been far from easy or simple. Too often during the last half century, Turkey’s political system has produced fragile coalitions and weak governments which have sought to satisfy the short term demands of various groups by resorting to budget deficits, borrowing and inflationary finance. The political and macroeconomic instability also led to the deterioration of the institutional environment. Rule of law and property rights suffered, and public investment including expenditures on education declined sharply. The weak governments have been too open to pressures from different groups or even individual firms or entrepreneurs seeking favors. As a result, the pursuit of favors or privileges from local and national governments has been a more popular activity for the producers than the pursuit of productivity improvements or competition in international markets.

The crisis of 2001 ushered in significant institutional changes, especially in the linkages between politics and the economy, with new attempts to insulate the latter from short term interventions in the political sphere. It remains to be seen, however, whether these institutional changes will be effective and durable or whether politics and the institutional environment will regress to their earlier ways. For most of the last century, Turkey has been considered to have a high economic potential. Similarly, it remains to be seen whether Turkey will remain a country with high economic potential, or whether more of this potential will be realized. It is precisely at this juncture that Turkey’s integration to the European Union assumes critical importance. It is not clear when and if Turkey will become a full member of the European Union. Nonetheless, the membership process is likely to create a stronger institutional framework for economic change. For the economy, the key contribution of the goal of membership will be the strengthening of the political will to proceed with the institutional changes that may raise the water level in the glass and carry Turkey’s economy to a new level.
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### Table 1: Economic and Human Development Indicators for Turkey, 1913-2005

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<th>1923</th>
<th>1950</th>
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<th>2005</th>
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<td>13</td>
<td>21</td>
<td>45</td>
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<td>Share of urban pop (5000 inhab) in total pop (percent)</td>
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<td>24</td>
<td>25</td>
<td>44</td>
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</tr>
<tr>
<td>Share of agriculture in the labor force (percent)</td>
<td>80</td>
<td>85</td>
<td>84</td>
<td>51</td>
<td>34</td>
</tr>
<tr>
<td>Share of agriculture in GDP (percent)</td>
<td>55</td>
<td>42</td>
<td>54</td>
<td>26</td>
<td>11</td>
</tr>
<tr>
<td>Share of industry in GDP (percent)</td>
<td>13</td>
<td>42</td>
<td>13</td>
<td>21</td>
<td>26</td>
</tr>
<tr>
<td>GDP per capita, PPP adj. in 1990 US dollars</td>
<td>1200</td>
<td>710</td>
<td>1620</td>
<td>4020</td>
<td>7500</td>
</tr>
<tr>
<td>GDP per capita as percent of (W. Europe+US)</td>
<td>29</td>
<td>16</td>
<td>24</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>GDP per capita as percent of developing countries</td>
<td>168</td>
<td>n.a.</td>
<td>188</td>
<td>219</td>
<td>225</td>
</tr>
<tr>
<td>GDP per capita as percent of World</td>
<td>79</td>
<td>n.a.</td>
<td>77</td>
<td>89</td>
<td>117</td>
</tr>
<tr>
<td>Life expectancy at birth (years)</td>
<td>30</td>
<td>n.a.</td>
<td>47</td>
<td>62</td>
<td>69</td>
</tr>
<tr>
<td>Adult Literacy (ages above 15 in percent)</td>
<td>10</td>
<td>n.a.</td>
<td>32</td>
<td>69</td>
<td>89</td>
</tr>
<tr>
<td><strong>Annual Growth Rates (in percent)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population</td>
<td>0.6</td>
<td>1.8</td>
<td>2.6</td>
<td>1.9</td>
<td>1.6</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>0.8</td>
<td>3.1</td>
<td>3.1</td>
<td>2.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Total agricultural output</td>
<td>1.0</td>
<td>4.5</td>
<td>2.9</td>
<td>1.2</td>
<td>1.7</td>
</tr>
<tr>
<td>Total industrial output</td>
<td>3.1</td>
<td>5.8</td>
<td>7.7</td>
<td>5.8</td>
<td>5.3</td>
</tr>
</tbody>
</table>

**Notes:** The inclusion of women working in the family farm in the labor force but the exclusion of urban women working at home from the labor force tends to overstate the share of agriculture in Turkish employment statistics. Per capita GDP in constant US dollars is the basic indicator for examining long term increases in average incomes. These series are calculated with a purchasing power parity adjustment in order to take into account the fact that price levels tend to be lower and the same dollar income purchases more in lower income countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>1913</th>
<th>1950</th>
<th>1975</th>
<th>2003</th>
<th>Change in 1950-2003 as percent of possible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Europe</td>
<td>0.580</td>
<td>0.707</td>
<td>0.848</td>
<td>0.935</td>
<td>77.8</td>
</tr>
<tr>
<td>North America</td>
<td>0.643</td>
<td>0.774</td>
<td>0.861</td>
<td>0.945</td>
<td>75.7</td>
</tr>
<tr>
<td>Japan</td>
<td>0.466</td>
<td>0.676</td>
<td>0.851</td>
<td>0.943</td>
<td>82.4</td>
</tr>
<tr>
<td>China</td>
<td>n.a.</td>
<td>0.225</td>
<td>0.522</td>
<td>0.755</td>
<td>68.4</td>
</tr>
<tr>
<td>India</td>
<td>0.143</td>
<td>0.247</td>
<td>0.406</td>
<td>0.602</td>
<td>47.1</td>
</tr>
<tr>
<td>Africa</td>
<td>n.a.</td>
<td>0.271</td>
<td>n.a.</td>
<td>0.549</td>
<td>38.1</td>
</tr>
<tr>
<td>Greece</td>
<td>0.625</td>
<td>0.800</td>
<td>0.912</td>
<td>76.5</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>0.345</td>
<td>0.694</td>
<td>n.a.</td>
<td>0.795</td>
<td>33.0</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>0.403</td>
<td>0.607</td>
<td>n.a.</td>
<td>0.808</td>
<td>51.1</td>
</tr>
<tr>
<td>Argentina</td>
<td>0.511</td>
<td>0.526</td>
<td>0.784</td>
<td>0.863</td>
<td>71.1</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.270</td>
<td>0.484</td>
<td>0.688</td>
<td>0.814</td>
<td>64.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.249</td>
<td>0.448</td>
<td>0.641</td>
<td>0.792</td>
<td>62.3</td>
</tr>
<tr>
<td>South Korea</td>
<td>n.a.</td>
<td>0.459</td>
<td>0.687</td>
<td>0.901</td>
<td>81.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>n.a.</td>
<td>0.407</td>
<td>0.614</td>
<td>0.796</td>
<td>65.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.388</td>
<td>0.603</td>
<td>0.757</td>
<td>0.778</td>
<td>44.1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>n.a.</td>
<td>0.337</td>
<td>0.467</td>
<td>0.697</td>
<td>54.3</td>
</tr>
<tr>
<td>Tunisia</td>
<td>n.a.</td>
<td>0.303</td>
<td>0.512</td>
<td>0.753</td>
<td>64.6</td>
</tr>
<tr>
<td>Iran</td>
<td>n.a.</td>
<td>0.331</td>
<td>0.507</td>
<td>0.736</td>
<td>60.5</td>
</tr>
<tr>
<td>Egypt</td>
<td>n.a.</td>
<td>0.291</td>
<td>0.433</td>
<td>0.659</td>
<td>51.9</td>
</tr>
<tr>
<td>Nigeria</td>
<td>n.a.</td>
<td>0.194</td>
<td>0.326</td>
<td>0.453</td>
<td>32.1</td>
</tr>
<tr>
<td><strong>Turkey</strong></td>
<td><strong>0.190</strong></td>
<td><strong>0.382</strong></td>
<td><strong>0.592</strong></td>
<td><strong>0.750</strong></td>
<td><strong>59.5</strong></td>
</tr>
</tbody>
</table>

**Notes:** Regional or continental averages are weighted by the population of the individual countries. For definition of HDI, see the text. In the last column, the maximum possible improvement in HDI is 1-(HDI in 1950).

Graph 1: Share of Agriculture in GDP and Labor Force in Turkey, 1910-2000
Graph 2: GDP Per Capita as percent of (US+W.Europe), 1900-2000

Legend:
- Red: Turkey/(W.Eur+US)
- Green: S. Europe 5/(W.Eur+US)
- Blue: LA 8/(W.EUR+US)
- Teal: S. Korea/(W.Eur+US)
- Gray: Africa
- Yellow: Middle East

X-axis: 1900-2000
Y-axis: 0-80%
Graph 3: Degree of Openness of Turkey's Economy, 1913-2005
(exports / GDP) and (imports / GDP), in percent
Graph 4: Indices for Income Distribution in Turkey, 1923-2000

NON-AG'L Wages / NON-AG'L GDP per person
AG'L Value Added per cap/ NON-AG'L VA per cap
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Fax: (33.1) 47.53.81.33
This paper attempts to provide a general framework to understand the broad features of Turkish political economy by focusing on key crises and their political and economic consequences. Attention is drawn to the transformative impact of the major crises in terms of both shifts in the broad thrust of economic policies and the nature of Turkish private sector development. The paper concludes by underlining the importance of democratic consolidation as a means of overcoming the cyclical nature of economic growth experienced so far, with its far-reaching and costly political and human consequences.

* Ziya Öniş is Professor of International Relations at Koç University, Istanbul. The paper originated from a talk given to students at Bahçeşehir University. The author would like to thank Şahin Alpay, Fikret Şenses, Ali Burak Güven, Merve Çalımlı, and Mustafa Kutlay for their contributions in preparing this paper.
The Nature of Post-War Economic Growth

There is a debate on the beginnings of modern economic growth in the Turkey. The years between 1908 and 1922 are often identified as a turning point in terms of the development of a national entrepreneurial class. Similarly, the decade of the 1930s is identified as critical in terms of Turkey experiencing its first wave of import-substituting industrialization (ISI) policies with the state assuming a leading entrepreneurial role. The Great Depression of the 1930s created opportunities for the first major wave of industrial growth in many countries of the periphery, including Turkey. Yet, the real breakthrough came in the 1950s. The previous decades provided the preconditions for sustained economic growth by creating the beginnings of a domestic industrial base driven by an emerging private entrepreneurial class and managerial elite in the public sector. However, significant structural change and economic transformation are primarily post-war phenomena.

Turkey is a case of moderate economic growth. The post-war growth has been on average in the order of four to five percent per annum. If long-term performance is taken into consideration, it is obvious that although there have been periods or spurts of high growth, they have not been sustainable. Periods of high growth were followed by periodic economic crises which pulled the average rate of growth down by a significant margin. Graph 1 illustrates the volatile nature of economic growth in Turkey. To a certain extent, the Turkish experience resembles Latin American patterns in terms of a common experience of prolonged import substituting industrialization and forced transition to export-oriented growth following a major economic crisis. Turkey, like its major Latin American counterparts, has experienced considerable economic and political instability. Chronic inflation was the norm in Turkey for nearly three decades from the early 1970s onwards. Similarly, Turkey has experienced costly breakdowns of its democratic regimes and painful military interludes. Nevertheless, by Latin American standards Turkey represents a case of “stable instability” since Turkey has not gone through as extreme hyperinflationary waves as Brazil or Argentina encountered. Moreover, military interludes in Turkey, whilst costly in terms of their consequences, were shorter than Latin American standards.

Turkey has failed to match the kinds of growth that the East Asian “tigers” have accomplished on a sustained basis during their crucial take-off phase which enabled their per capita incomes to converge with the levels of advanced economies. In spite of a major transformation of its economic structure over the past six decades, Turkey is still in the “emerging markets” category with some distance to go to meet the living standards of advanced economies.

More recently, the Turkish experience has resembled the pattern of the post-communist EU member states of Eastern Europe. The key element in this context is a pattern of externally driven economic growth based on significant inflows of foreign capital and a powerful external anchor in the form of EU membership. The recent global financial crisis, however, has exposed the limitations of this model. Countries which had more balanced economic structures with high domestic saving ratios have been able to weather the storm more effectively than Turkey or new EU member states.

Finally, the Turkish experience draws attention to the links between quality of democracy and long-term economic performance. In terms of its political regime, Turkey is a moderate performer which has already achieved democratic transition but still falls short of democratic consolidation. Such countries find it more difficult to maintain economic and political stability compared to some countries with deeply rooted authoritarian regimes (i.e. China) or most established/fully consolidated democracies. This, in turn, has a negative influence over long term growth performance. In retrospect, Turkey’s democratic deficits have been a source of economic and political instability and have exerted a downward bias on the country’s economic performance.
**Major Policy Phases and Transformation of Turkish Capitalism**

Turkey’s post-war development experience may be conceptualized in terms of four major policy phases. The 1950s correspond to the liberal turn in Turkish economy involving an attempt to reverse the statist and protectionist policies of the inter-war era. The emphasis especially in the early part of the decade was on integrating with the post-war international economy reconstructed under U.S. hegemony, as a producer and exporter of agricultural products. The second phase, under successive five-year plans implemented during the 1960s and 1970s, represents a shift to national developmentalism and ISI-based strong protectionism of the domestic market. This phase resulted in the institutionalization of the domestic market. The third phase, the 1980s and the 1990s, corresponds to Turkey’s encounter with neoliberal policies and the logic of the Washington consensus which is based on the liberalization of key sectors of the economy. The fourth and final phase constitutes the regulatory phase of neo-liberalism with policy-makers emphasizing strong regulatory institutions and paying more attention to social protection. This phase reflects Turkey’s encounter with the emerging post-Washington consensus. Major policy shifts are typically associated with deep economic and political crises accompanied by costly human consequences. At each stage, crises mark the breakdown of the previous model and create the conditions for a new policy coalition to support a revised model of development.

Turkish development experience has historically been based on an alliance between the state and national capital, with foreign capital playing a secondary role, at least until recently. One of the striking features of these four broad policy phases is that they correspond to different stages in the transformation of domestic capital (Table 1). Turkish big business was transformed over time from an agrarian or commercial orientation (early 1950s) to domestic market based industrial capital (the 1960s and the 1970s). This was followed by a shift towards export-orientation in phase three (the 1980s and the 1990s) and the growing “transnationalization” of Turkish big business in the final phase (the post-2001 era). Another interesting pattern concerns the development of small and medium sized business. The coalition of winners from neo-liberal globalization expanded from the early 1990s onward to include small and medium term enterprises from inner Anatolia, the so called “Anatolian tigers”. The stage by stage transformation of Turkish capitalism is a crisis-ridden process which involves a radical reordering of state-society relations and frequent crises and breakdowns of democracy along the way.

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There is also a high degree of continuity and overlap between the different policy phases. For example, before it became the official development policy, in the post-war period, in the late 1950s, ISI started to be implemented in a piecemeal manner, with governments resorting to protectionism as a short-term response to growing balance of payments. A significant level of continuity with the initial two policy phases exists, most visible in the emphasis on the mixed economy, and the nature and scale of the state enterprise sector. Similarly, the transition to neo-liberalism was associated with significant “export protectionism” (i.e. heavy subsidies to promote exports) in the 1980s, clearly representing a line of continuity with the previous policy phases. Yet another element concerns the transnationalization of Turkish big business, meaning the growing ability to invest beyond the home base and enter into strategic alliances with foreign partners, a process which started in earnest with Turkey’s Customs Union with the EU in the mid-1990s. This point also reflects the considerable continuity in the neo-liberal era in terms of its emphasis on de-regulation and integration into global markets.

Each policy phase may be usefully decomposed into several sub-phases. For example, the ISI period may be analyzed in terms of two separate phases involving the early and the more difficult phases of ISI, with the latter broadly corresponding to the post-1973 era. The Washington Consensus era may also be decomposed into sub-phases with the critical decision to open the capital account fully in 1989 proving to be a watershed event. Another interesting pattern is that, following each crisis, there is a concentration of power in the technocratic elite which becomes the principal agent in accomplishing the major policy shift. In the early phase of Turkish neo-liberalism, during the 1980s, a narrow bureaucratic elite under the leadership of Turgut Özal played a key role in the policy transformation process. More recently, following the 2001 crisis, a similar re-concentration of power occurred with Kemal Derviş and his economic team playing a key role in the transition to regulatory neo-liberalism. The difference between the two periods is that the former case involved a re-concentration of power in an authoritarian environment, whereas in the latter case the shift occurred within a democratic environment, as a coalition government assigned a transnational technocrat armored with extraordinary ministerial powers.

"Turkish development experience has historically been based on an alliance between the state and national capital, with foreign capital playing a secondary role, at least until recently."
<table>
<thead>
<tr>
<th>Policy Phase</th>
<th>Transformation of Big Business</th>
</tr>
</thead>
</table>
| 1950-1959   | Agrarian and commercial orienta
tions in the early part of the
decade; the rise of industrial
capital towards the end of the
decade |
| 1960-1979   | The consolidation of domestic market oriented industrial capital under heavy protectionism |
| 1980-2001   | The rise of export-oriented capital; broadening of the neoliberal coalition in the 1990s to include small and medium sized export-oriented capital (Anatolian tigers); beginnings of transnationalization of Turkish big business especially with the Customs Union. |
| 2001 and Beyond | Accelerated transnationalization of Turkish big business; growing role of foreign direct investment especially in the context of banking and privatization of state economic enterprises |

Table 1: Principal Policy Phases and Transformation of Turkish Big Business

Economic Crises and Political Breakdowns

The political implications of economic crises and the economic implications of political crises have been extensively studied by students of Turkish political economy.\(^4\) In the present paper the focus is on the former. A cursory examination of Table 2 suggests a strong association between major economic crises and political crises in the Turkish context. Major economic crises in Turkey had significant political consequences.

The contrast between the pre-neoliberal era of 1950-1980 and the post-1980 neoliberal era can be discerned from Table 2. The former has been characterized by two major economic crises each involving a deep balance of payments crisis and subsequent recourse to IMF assistance. Both crises could be classified as “crises of economic governance” exposing the limits to trying to achieve economic

stability within the framework of democratic institutions in a country going through early stages of institutionalizing and consolidating its democratic regime. The economic crisis of 1958 was accompanied by a military coup in 1960. Similarly, the deeper economic crisis of 1978-1979 was followed by a military coup in 1980. The interesting anomaly is the military intervention of 1971 which occurred in the absence of a deep economic crisis, again highlighting the fact that the relationship between economic crises and military coups are complex and multi-dimensional in nature.\(^5\) Military coups were also accompanied by a major restructuring of the developmental model. The 1960 coup paved the way for the institutionalization of development planning and the ISI strategy. The 1980 coup played an important role in Turkey’s radical neo-liberal restructuring. The military interlude of 1980, perhaps more so than the previous interludes, had drastically negative human consequences. In the short-term, it was effective in overcoming “the crisis of governance” of the late 1970s by force and dismantling the distributional stalemate of the late 1970s by engineering a major decline in real wages which clearly facilitated the transition to an export-oriented economy. This kind of shift was not unique to Turkey. In Brazil, Argentina and Chile, the underlying crisis of the ISI model and the associated political and distributional stalemate resulted in similar military interventions with drastic consequences. From a longer term perspective, the military intervention of 1980 left a deep imprint on the subsequent political trajectory of Turkey in undermining the country’s “democratic capital”\(^6\) by imposing an authoritarian constitutional framework, de-institutionalizing the party system, and presenting a major setback for the country’s quest for EU membership.

\(^5\) Even in this context, one could refer to a slowing down of economic growth towards the end of the 1960s. Indeed a major devaluation in 1970 preceded the military intervention of 1971.

The links between economic crises and political breakdowns appear to be much more blurred and indirect during the post-1980 neoliberal era. For example, there was no collapse of democracy following the 1994 crisis. A subtle link can be established between the negative distributional consequences of the 1994 crisis, the rise of the Islamist Welfare Party and the “post-modern coup” of February 1997 aimed at dismantling the coalition government that had the Welfare Party

<table>
<thead>
<tr>
<th>Year</th>
<th>Major Economic Crises</th>
<th>Political Breakdowns</th>
</tr>
</thead>
<tbody>
<tr>
<td>1958</td>
<td>Fiscal and balance of payments crisis followed by an IMF stabilization program</td>
<td>Collapse of democracy with a majority government in power; A military coup in 1960 partly linked to economic crisis and the ensuing IMF program</td>
</tr>
<tr>
<td>1978-79</td>
<td>Fiscal and balance of payments crisis as well as a deepening crisis of the ISI model; radical restructuring in association with the IMF, WB and the OECD.</td>
<td>Significant economic and political instability under coalition governments in the late 1970s followed by a military coup in 1980; the longest military interlude (1980–1983)</td>
</tr>
<tr>
<td>1994</td>
<td>The first major crisis of the neoliberal era; fiscal and balance of payment crisis followed by an IMF program</td>
<td>Contributed to the rise of the Islamist Welfare Party; tangential link to the so called “post-modern coup” of February 1997 which was a reaction to the Welfare Party as the dominant component of the coalition government at the time.</td>
</tr>
<tr>
<td>2000-01</td>
<td>The second and third crises of the neoliberal era with the 2001 crisis being the most profound of the three crises; fiscal and balance of payment crisis coupled with major structural problems in the banking sector; radical restructuring in association with the IMF, WB and the EU</td>
<td>No breakdown of democracy. The crisis in line with the EU membership process stimulated a wave of major democratization reforms. The three parties forming the coalition government faced heavy defeats in the ensuing elections of November 2002.</td>
</tr>
<tr>
<td>2008-09</td>
<td>The fourth and the unusual crisis of the neoliberal era; crisis of the real sector with negative growth and rising unemployment</td>
<td>No direct and pronounced political impact although the government lost part of its firm majority in the ensuing local government elections of March 2009; political crises are frequent during the 2000-2009 period, but are not directly linked to economic crises.</td>
</tr>
</tbody>
</table>

Table 2: Major Economic Crises and Political Breakdowns
as its dominant partner. Yet, the link is much less clear and direct than the previous wave of military interventions. The post-1980 military interventions were much more indirect in nature and did not involve an explicit take-over of power by the military.

The most severe crisis of the neo-liberal era, the 2001 crisis, was accompanied by a major wave of democratization reforms as part of formal Europeanization process. This process effectively started with the Customs Union in the mid-1990s and gathered further momentum in 1999 with the EU’s Helsinki decision recognizing Turkey as a candidate country. The economic crisis had a deep political impact by penalizing the three parties in the incumbent coalition government in the 2002 elections. However, the political impact was certainly not in the form of a military coup. Finally, the latest case was the “e-intervention” by the military in April 2007 on the eve of the election of the new president. This occasion was not motivated by economic factors; rather it was an attempt to counter the alleged threats to the secular nature of the regime.

The framework presented above enables us to draw two broad conclusions. First, the development and maturation of Turkish democracy over time, in spite of its continued shortcomings, helps to limit the power of the military by breaking the previously observed linkage between economic crises and direct military interventions. Second, the military continues to be an important political actor in Turkish politics in the post-1980 era. However, its interventions tend to be more subtle and indirect and much more oriented towards overcoming existentialist threats to the regime such as the secular character of the constitutional order. Accordingly, “crises of identity” replace “crises of governance” as the principal source of political instability or breakdowns.

**Single-Party versus Coalition Governments and Linkage to Instability**

A striking feature of Turkey’s political economy is the link between the type of government and overall economic performance. Majority governments have clearly outperformed coalition governments in terms of economic growth. Turkey’s growth spurts have been associated with majority governments in the dominant center right tradition (Table 3), which started with the Democrat Party (the DP) in the 1950s and continued with the Justice Party (the AP) in the second half of the 1960s. The Motherland Party (the ANAP) was the successor to this tradition during the early years of Turkish neo-liberal experience. More recently, the Justice and Development Party, with some qualification concerning its Islamist origins, constituted the latest stage of the line of majority governments in the center right tradition since 2002. The growth figures in Graph 1 clearly illustrate the trend of stronger economic expansion in Turkey during these four episodes.
“Narrow policy coalitions” such as the ISI coalition of the 1960s and the 1970s encompassing major industrialists, bureaucrats and organized labor are numerically not strong enough to generate winning electoral coalitions in the context of multi-party democracy. Center-right parties in Turkey have been successful in extending the domain of narrow policy coalitions to broad electoral coalitions. These parties have used patronage politics to distribute resources to wide segments of society. They have also successfully appealed to religious and nationalist sentiments to generate widespread political support. The problem with these governments, however, is that they have proved to be inherently unsustainable. The DP, after a golden age period in the early 1950s, progressively lost its early momentum in terms of both economic performance and electoral popularity. Indeed, the period ended with a major economic crisis and then the collapse of the democratic regime. Similarly, the golden age of the AP (1965-1971) came to a halt with a military intervention in 1971. The military interlude of 1971-1973 was followed by a major wave of economic instability under weak coalition governments in the late 1970s, again culminating with a major economic crisis in the late 1970s and the subsequent breakdown of democracy in 1980. A similar pattern was evident in the neo-liberal era. The golden age of ANAP was the period from 1983 to 1987, when the party started to lose its popularity. There was no military takeover as in the earlier phases. However, the end of ANAP rule signified a new wave of coalition governments in the 1990s associated with varying degrees of economic and political instability, leading to three successive economic crises in 1994, 2000 and 2001. The AKP so far proves to be an exception in that the party is still in office after eight years. The AKP has also been more successful in containing fiscal deficits compared to its predecessors. Nevertheless, the second phase of the AKP rule since 2007 has been less impressive in terms of political stability, reform orientation and economic performance compared to its golden age during 2002-2005.

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<table>
<thead>
<tr>
<th>Type of Government</th>
<th>Period</th>
<th>Economic Performance</th>
<th>Sustainability</th>
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<tbody>
<tr>
<td>Motherland Party</td>
<td>1983–1991</td>
<td>Reasonably good growth based on an export boom</td>
<td>Weakening of economic performance and rising instability towards the end of the 1980s. The party loses its electoral edge and the period is followed by a wave of coalition governments.</td>
</tr>
<tr>
<td>The Justice and Development Party</td>
<td>2002–2010 and beyond</td>
<td>Good growth coupled with single digit Inflation for the first time for several decades</td>
<td>Weakening of economic performance during the second phase of the government; signs of weakening popularity. However, the support base is still robust; It appears to be more durable than previous center-right governments, but may lose its electoral edge in the force of continuing economic and political challenges.</td>
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<th>Economic Performance</th>
<th>Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Four governments, the duration of the longest two years</td>
<td>1973–1980</td>
<td>Weak performance; low growth; rising Instability</td>
<td>Short-duration of governments</td>
</tr>
<tr>
<td>Seven governments, the duration of the longest three and a half years</td>
<td>1991–2002</td>
<td>Weak performance; significant Instability</td>
<td>Short-duration of governments</td>
</tr>
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*Table 3: Single-Party versus Coalition Governments and Linkage to Economic Instability*
Turkey has the experience of a record number of coalition governments. These governments correspond to three relatively short periods: namely the early 1960s, the second half of the 1970s and throughout the 1990s. The number and short duration of governments is clearly evident from the following figures. Four separate coalition governments were in office between November 1961 and October 1965. Five separate coalition governments occupied office between October 1973 and September 1980. More recently, seven coalition governments have occupied office over a comparatively longer period from November 1991 to November 2002.

Out of these three separate waves, the experiences of the late 1970s and the 1990s proved to be extremely unstable, both in political and economic terms. Indeed, the two major economic crises of the post-war era, from 1978-1979 and 2000-2001, both erupted at the end of successive waves of coalition governments. Compared to single-party majority governments, coalition governments have found it much more difficult to impose macroeconomic discipline and create an environment of political stability conducive to long-term economic growth.

The experience of the most recent coalition government, involving the Democratic Left Party (the DSP), the Nationalist Action Party (the MHP) and the ANAP, is interesting and raises difficult questions for interpretation. Certainly, it is the longest coalition government in office with a period of three and a half years. During its early phase, the government failed to undertake the drastic measures needed and failed to prevent the dual crises of 2000 and 2001. Yet, in the aftermath of the 2001 crisis, this government was also responsible for some of the major economic and democratization reforms in recent Turkish history. This scenario offers support to the interpretation that coalition governments, in principle, are capable of undertaking major economic and political reforms. The obvious qualification is that economic and political reforms were largely driven by key external actors such as the IMF and the EU and a deep crisis empowered external actors by helping to break resistance to reform among key segments of the coalition government.8

The fact that coalition governments in Turkey have been largely unsuccessful should not necessarily imply that coalition governments are always prone to economic and political instability. There are successful cases of coalition governments in countries such as Italy, Belgium and the Netherlands that have been quite effective in terms of managing their economies and contributing to political stability. Moreover, such governments have managed to retain office over long periods of time. This comparison suggests that the problem lies not with coalition governments per se but with the quality of democracy or the level of democratization. Turkey’s democratic deficits in terms of the weakness of democratic institutions and checks and balance mechanisms as well as the weakness of democratic culture are at the heart of the problem. As liberal democracy is consolidated in Turkey over time, it is no longer inevitable that future coalition governments will necessarily be associated with endemic political and economic instability.

The unstable nature of center-right governments in Turkey highlights a problem not unique to center right majority governments per se, and points towards the underlying weaknesses of the democratic regime and its institutions. The fiscal crises successive center right governments have failed to control in their quest to build large electoral coalitions are a clear manifestation of the weaknesses of the democratic regime. In line with the strengthening of democratic institutions and policymaking mechanisms, this pattern is likely to change. The AKP government, in spite of its shortcomings, has a better record than its predecessors in terms of managing the economy and imposing macroeconomic discipline.

The Unique Nature of the 2008/2009 “Crisis”

Turkey found itself in a unusual situation following the onset of the global financial crisis in September 2008. Unlike “the global crises of the periphery” of the 1990s, the 2008 crisis was a “global crisis of the center”. The crisis, originating from the United States, was rapidly transmitted to Europe and the rest of the world. Turkey suffered from a fall in capital inflows as well as a dramatic loss in export revenues, the latter being the result mainly of a demand shock from the European Union. Together with several Eastern European countries, Turkey was among the most affected group in the emerging markets category, with a collapse of growth and a parallel increase in unemployment in 2009.

The 2008-2009 crisis was quite different from the previous crises experienced by Turkey (Table 4). The previous crises were typically domestically generated crises, although external shocks and dynamics had a magnifying impact. They were the products of the expansionary phase of the “populist cycles”. A combination of

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large fiscal and current account deficits were at the heart of each major crisis. Typically, the crises manifested themselves as balance of payments crises; however, underlying each crisis was a deeper problem of the “fiscal crisis of the state”. Again, each crisis necessitated external financial assistance for the subsequent recovery process making the encounter with the IMF and the World Bank inevitable. Key external actors were heavily involved in the post-stabilization and restructuring process of Turkey, with the role of the EU being particularly pronounced after 2001. Financial assistance from external actors was linked to “policy conditionality” which contributed to the subsequent recovery process, but also limited some of the heterodox policy choices such as controls over short term capital flows that Turkey could implement in the absence of a major crisis. What made the 2008-2009 experience rather unusual was that the Turkish economy did not find itself in an immediate crisis situation. There was no balance of payments crisis requiring immediate IMF assistance. The robustness of the banking and financial sector improved considerably following the reforms in the aftermath of the 2000-2001 crisis. The fact that Turkey did not experience a single bank failure in the aftermath of the global financial crisis helped to boost the confidence of policymakers that Turkish economy was in strong shape and would be marginally affected by the crisis. The policymakers’ mindset was clearly conditioned by previous experience; the contours of the 2008-2009 experience did not seem to conform to the previous pattern. If there was no balance of payments crisis, no bank failure and no immediate need to sign an IMF standby agreement, the logical conclusion was that Turkey had largely avoided a crisis which originated from outside and was largely beyond its own control. Given this perception, it was not surprising that the government’s policy response was much more reactive rather than pro-active. Several measures have been implemented to alleviate the impact of the crisis, the most important element being the engineering of temporary cuts in consumption taxes to stimulate consumption. The recovery in economic growth illustrates the short-term bias in government’s policy response. Certainly, we do not observe in the Turkish context the kinds of vigorous growth-oriented fiscal stimulus packages implemented in the vast majority of G-20 countries in the aftermath of the global financial crisis.\(^{10}\)

The one element of pro-active response by the AKP government to the crisis involved its assertive foreign policy. A key element underlying these foreign policy initiatives was a search for new markets and economic opportunities in Turkey’s immediate neighborhood, notably in the Middle East and North Africa. Key private sector associations such as TOBB and TUSKON were actively involved in this process. Perhaps, we can add a fifth phase to Table 1 representing the transnationalization of small and medium-sized Anatolian capital in response to the latest crisis, driven largely by external forces.\(^{11}\) Pro-active foreign policy, however, may not be sufficient to bring about a sustained improvement in Turkey’s economic fortunes in the absence of equally pro-active macroeconomic and industrial policies.


\(^{11}\) Ziya Öniş, “Multiple Faces of the New Turkish Foreign Policy: Underlying Dynamics and a Critique”, *Insight Turkey*, 2011 (forthcoming).
Table 4: Turkey’s 2008–2009 Crisis versus Previous Economic Crises

<table>
<thead>
<tr>
<th>Source of the Crises</th>
<th>Previous Crises</th>
<th>2008 - 2009 Crisis</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Predominantly domestically generated crises although negative external shocks also had some impact.</td>
<td>Predominantly externally generated although weaknesses of the domestic economic performance also had an impact.</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Nature of the Crises</th>
<th>Previous Crises</th>
<th>2008 - 2009 Crisis</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Typically a combination of fiscal and balance of payment crisis together with banking sector problems in 2000-2001; financial and fiscal crises with significant negative ramifications for the real economy.</td>
<td>Absence of a balance of payment crisis and bank failures; weakening fiscal stance but not sufficiently to create a major crisis; leading to policy makers’ failure to diagnose it as a “crisis” in the real sense of the term; external demand shocks creating a crisis of the real sector.</td>
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<tr>
<th>Relations with the IMF</th>
<th>Previous Crises</th>
<th>2008 - 2009 Crisis</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Crises inevitably led to IMF stabilization programs. Other key external actors were also involved. The implementation of IMF programs also limited the options available to governments such as a tax on short-term capital flows.</td>
<td>No immediate need for the IMF; the government postponed an IMF program and displayed this as a sign of strength and the ability to implement an independent stance and a sign of national sovereignty.</td>
</tr>
</tbody>
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<tr>
<th>Nature of post-crisis Recovery</th>
<th>Previous Crises</th>
<th>2008 - 2009 Crisis</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Typically quite rapid due to a combination of previously delayed major policy adjustments and significant external financial assistance.</td>
<td>V-shaped recovery in the short-run; Turkey bounced back from the crisis in 2010. Yet, a return to a high growth trajectory may prove to be more difficult in the face of an unfavorable external environment and continuing structural weaknesses.</td>
</tr>
</tbody>
</table>

The AKP government has managed to maintain its popularity in the face of negative growth and a parallel increase in unemployment during the course of 2009. The party lost part of its large electoral coalition in the municipal elections of March 2009, but still maintains a comfortable majority. The continued electoral support for the AKP was due to the weakness of the opposition parties, which failed to capitalize on the downturn of the economy. The principal opposition parties, notably the Republican People’s Party (CHP), focused primarily on political issues such as the nature of the regime and the threats to the secular constitutional
order. Furthermore, the AKP government was quite effective in terms of its political management of the economic crisis. The government was able to present the crisis as a purely externally generated phenomenon in spite of the fact that the performance of the Turkish economy was on a downward course from early 2007 onwards. Indeed, Turkey experienced a mini-populist cycle in the period leading up to the parliamentary election of July 2007 and in the period leading up to the municipal elections of March 2009, even though growing fiscal instability was not in the order of previous cycles in terms of its ability to cause a crisis on its accord. The government capitalized on the strength of the banking sector and presented an image of the Turkish economy which had progressively become much more robust over time. Similarly, the government continually delayed the signing of an IMF program in spite of pressures from big business that a program would be desirable in terms of enhancing confidence and generating additional external resources. The systematic delay in signing an IMF program was projected as a sign of strength of the Turkish economy and a sign of growing national autonomy. Turkey was no longer in need of an IMF program to help it out of a major crisis. In addition, the government’s progressive and reformist image was bolstered by the revitalization of democratization initiatives in the aftermath of March 2009 as well as the proactive foreign policy stance to improve economic and political relations with neighboring countries in the Muslim Middle East and the post-Soviet world.

Effective political management of the crisis does not imply, however, that the government managed to address the longer-term, structural problems of the Turkish economy effectively during the crisis period. The recent “crisis” is predominantly a crisis of the real sector. Although there are signs of a pronounced recovery during 2010, Turkey may still find it difficult to escape a slow growth-high unemployment equilibrium with potentially destabilizing consequences in the medium-run, particularly given the demographic structure of a large proportion of young people. Growth rates in the order of three to four percent per annum will not be sufficient to catch up with the living standards of advanced economies within a reasonable time span. The AKP government has so far managed to evade the storm and is likely to maintain its broad-based electoral coalition in the run-up to the 2011 general elections. The post-2011 phase, however, may prove to be more difficult.

Turkey’s encounter with the global financial crisis helped to expose some of the structural weaknesses of its growth performance in the post-2001 era, disguised by unusually favorable global liquidity conditions. These included excessive dependence for growth on external financial resources in the face of weak domestic savings and the inability to channel sufficient resources to research and technological development to improve the long-term competitiveness of the real sector. Turkey has made progress in strengthening its regulatory institutions in the aftermath of the 2001 crisis. The developmental arm of the state, however, has
remained relatively weak. To reactivate a process of high growth, in the order of six to seven percent per annum, Turkish governments clearly need to implement structural reforms such as a major tax reform and an educational reform to mobilize public resources for investment and raise the quality of labor force drastically. Similarly, the reestablishment of the EU anchor is also important in economic terms by consolidating stability, attracting long-term capital on a sustained basis and providing a framework for mutually reinforcing economic and political reforms.

Conclusion

Turkey’s post-war development trajectory illuminates the difficulties of accomplishing large-scale economic transformation in an emerging democratic polity. Significant transformation has occurred in the nature of Turkish capitalism over the past few decades; but this was a costly and crisis-ridden project. One of the key lessons is that Turkey’s democratic deficits have prevented the achievement of high economic growth. Turkey has the characteristics of an emerging tiger in terms of its young population, geo-political position, level of entrepreneurship, and the quality of human capital. However, so far it has displayed the characteristics of a “temporary star” with rapid growth taking place in terms of brief spurts followed by periods of deep instability and crises. The consolidation and deepening of liberal democracy in Turkey is likely to contribute to better economic performance by helping to prevent the costly stop and go cycles, an endemic feature of Turkey’s political economy in the post-war period.

“Significant transformation has occurred in the nature of Turkish capitalism over the past few decades; but this was a costly and crisis-ridden project.”

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