ISTANBUL BILGI UNIVERSITY
INSTITUTE OF GRADUATE PROGRAMS
ECONOMICS PHD PROGRAM

POLITICAL ECONOMY OF TURKEY'S EXTERNAL IMBALANCES

MEHMET ANIL DOĞAN
116806008

PROF. DR. ASAF SAVAŞ AKAT

ISTANBUL
2021

Political Economy of Turkey's External Imbalances

Türkiye'nin Dış Dengesizliklerinin Siyasal Ekonomisi

Mehmet Anıl Doğan

116806008

Tez Danışmanı:	Prof. Dr. Asaf Savaş Akat İstanbul Bilgi Üniversitesi
Jüri Üyesi:	Prof. Dr. Koray Akay İstanbul Bilgi Üniversitesi
	Doç. Dr. Cemil Boyraz İstanbul Bilgi Üniversitesi
	Prof. Dr. Seyfettin Gürsel Bahçeşehir Üniversitesi
	Prof. Dr. Öner Günçavdı İstanbul Teknik Üniversitesi

Tezin Onaylandığı Tarih : 08.06.2021
Toplam Sayfa Sayısı : 145

Anahtar Kelimeler:	Keywords:
1) İhracatla Büyüme	1) Export-Led Growth
2) Cari Hesap	2) Current Account
3) Dış Açık	3) External Deficit
4) İktisat Politikası	4) Economic Policy
5) İç Talep	5) Domestic Demand

To

My Grandma and Şehriye…

FOREWORD

Here, I proudly present my dissertation with which I have had a love and hate relationship for the past few years. Fortunately, love won. While writing about the recent history of the Turkish economy, I have found myself wandering through my childhood memories. I dedicate my thesis to my beloved Grandma and Şehriye teyze, wishing one day someone will take care of the Turkish economy like they took care of me back in the days.

To start with, I would like to express my sincere gratitude to the *legendary* Prof. Dr. Asaf Savaş Akat, who expanded my horizons more than I could imagine. It has been a privilege to work under his supervision. I will miss him a lot.

I am grateful to Prof. Dr. Koray Akay and Assoc. Prof. Cemil Boyraz for their invaluable contribution, patience, and kindness. I would also like to thank my committee members: Prof. Dr. Seyfettin Gürsel and Prof. Dr. Öner Günçavdı for their valuable comments.

A very special thank you goes to *one and only* Assoc. Prof. Ayça Ebru Giritligil for her encouragement. Words cannot explain how grateful I am to my mentor Dr. Deniz Nebioğlu. Completing this dissertation wouldn't be possible without her never-ending support.

Last but not least, I would like to thank my partner in crime Ezgi Sezar for bearing with me during this journey. I am well aware that it can sometimes be hard. I am grateful to Dr. Nazlı Şahanoğulları for being there for me since the very beginning. I would also like to thank my dear friends Nara Gonzales and David Slattery for proofreading this dissertation. I have to admit that it is not an easy read. Thank you for being awesome.

TABLE OF CONTENTS

ABBREVIATIONS

FX FOREIGN EXCHANGE
ELG EXPORT-LED GROWTH
NIC NEWLY INDUSTRIALIZED COUNTRY
ISI IMPORT-SUBSTITUTION INDUSTRIALIZATION
BOP BALANCE OF PAYMENTS
CHP REPUBLICAN PEOPLE'S PARTY
DP DEMOCRAT PARTY
SEE STATE ECONOMIC ENTERPRISES
IMF INTERNATIONAL MONETARY FUND
AP JUSTICE PARTY
WR WORKERS' REMITTANCES
CBRT CENTRAL BANK OF REPUBLIC OF TURKEY
ANAP MOTHERLAND PARTY
DYP TRUE PATH PARTY
CU CUSTOMS UNION
AKP JUSTICE AND DEVELOPMENT PARTY
EU EUROPEAN UNION
ME MERCHANDISE EXPORTS
LI LATE INDUSTRIALIZER

LIST OF FIGURES

LIST OF TABLES

ABSTRACT

Turkey's post-WW2 economic history consists of repeated periods, in which the current account deficit played a key role in triggering economic calamities. This study primarily aims to demonstrate the aforesaid recurring pattern in Turkey's post-WW2 history. Secondly, this dissertation aims to address why Turkey fell short of engaging in a well-designed, and comprehensive export-oriented industrialization policy scheme to break the recurring curse. This dissertation takes a holistic approach to examine the economic and non-economic underpinnings of Turkey's enduring external imbalances. It argues that confrontation with external imbalances requires a commitment to export promotion and that the road to export promotion passes through industrialization. This study suggests that Turkey's failure to tackle external imbalances rests upon the lack of political will to pursue the ELG policy framework that happens to be costly for office-seeking politicians in the short run.

Keywords: export-led growth, current account, external deficit, economic policy, domestic demand

ÖZET

Türkiye'nin 2. Dünya Savaşı sonrası iktisadi tarihinde, cari açığın sebep olduğu ekonomik krizler göze çarpmaktadır. Bu çalışma sıklıkla tekrarlanan bu söz konusu örüntüyü göstermeyi amaçlamaktadır. Türkiye'nin süregelen dış dengesizliklerinin ekonomik ve siyasi sebeplerini bütüncül bir yaklaşımla incelemektedir. İkincil olarak, bu tez planlı ve kapsamlı bir ihracata yönelik sanayileşme stratejisinin Türkiye'de neden gerçekleştirilemediğini araştırmaktadır. Bu çalışma, dış dengenin ihracata dayalı büyüme politikalarıyla kurulabileceğini ve ihracat ile büyümeye giden yolun ise sanayileşmeden geçtiğini ileri sürmektedir. Fakat, yönetici sınıfların, bu politikaların getirdiği siyasi maliyetlerden ve dolayısıyla ihracat ile büyüme stratejisinden kaçındıklarını önermektedir.

Anahtar Kelimeler: ihracatla büyüme, cari hesap, dış açık, iktisat politikası, iç talep

INTRODUCTION

Turkey's post-WW2 economic history consists of repeated periods, in which the current account deficit played a key role in triggering economic crises. Confrontation with external imbalances requires a commitment to the export promotion. Broadly speaking the export-oriented growth rests on 3 main pillars. Primarily, it entails the undervaluation of the domestic currency, which makes exports more competitive for foreign markets. Secondly, domestic consumption must be restrained to promote domestic savings. And finally, savings must be directed to investment in tradable sectors that have high growth and productivity potential. The export-led growth strategy is arduous to uphold politically in the short run but it is rewarding for the medium to long-run economic prospects. Literature (e.g. Rodrik (2008- 2011), Wade (2015)) on the East-Asian miracle demonstrates that it might even pave the way for economic convergence with developed countries.

On the other hand, there exists an alternative route for economic development that rests on domestic demand rather than foreign demand. Domestic demand-led growth also happens to be less costly in political terms (in the short run) in comparison to export-led growth. Now that we live in the age of *consumerism*, the median voter's utility function is mostly contingent on how much s/he consumes today. Nevertheless, for developing countries such as Turkey, domestic demand-led growth necessitates continuous capital inflows to meet the foreign exchange (FX, hereafter) demand that appears due to a positive relationship between domestic demand and imports. Hence, domestic demand-led growth creates a vulnerability due to the widening of the current account deficit. This study aims to address how Turkish governments handled the inconvenient policy dilemma between export promotion and domestic-demand (or debt-led) growth.

The economic periods in which Turkey enjoyed moderate to high growth rates, coincided with the times when Turkey accumulated large external debt, driven by the surge in domestic demand. The growth trajectory was repeatedly reversed when the economy ran out of fuel, *meaning* when the required FX could not be obtained. A genuine real sector crisis is unheard of in Turkey's post-war economic history (Öniş & Güven, 2011), while external imbalances have frequently triggered economic crises. Rather poignantly, once the economy recovered from these crises through contractionary economic measures, policy makers turned a blind eye on external imbalances until the next balance-of-payments crisis occurred. Promoting exports has rarely been at the focus of the ruling class.

Firstly, this study aims to demonstrate the aforesaid recurring pattern in Turkey's post-WW2 history. It aims to identify the underpinnings of Turkey's external imbalances by using a framework that examines economic and political processes, and the interaction between them. This study suggests that the lack of growth in the manufacturing sector has contributed to the reoccurrence of external imbalances. Secondly, this dissertation aims to demonstrate why Turkey fell short of engaging in a well-designed, and comprehensive export-oriented industrialization policy scheme. Using tools of comparative and data analysis (along with policy analysis), this study aims to assess Turkey's industrialization performance. It argues that the export-oriented industrialization strategy entails moderation of domestic demand which the Turkish political establishment has historically been reluctant to manage. Hence, the Turkish policy makers commonly abstained from following the export-led growth (ELG, hereafter) policies.

The first section of this dissertation reviews the theoretical and empirical literature regarding the ELG strategy. The second section, *Comparative analysis*, presents empirical data on the ELG strategy which the late industrializers and some newly industrialized countries (NICs, hereafter) have successfully followed. It also displays empirical data which suggests that the subjugation of domestic consumption plays a partial, albeit imperative role in export-oriented

industrialization strategy. The third section, *A brief history of the Turkish economy: From Etatism to Import Substitution Industrialization* delivers a snapshot of the economic background before 1980. It illustrates Turkey's early industrialization efforts and its shortcomings. In addition, it depicts the emergence of a matching pattern between domestic demand and external imbalances. The fourth section: *the first phase of economic opening: From the January 24 decisions to the 2000-1 crisis* covers the early years of economic liberalization and the 1990s when the Turkish economy suffered from severe macroeconomic volatility. This section scrutinizes Turkey's first and only sustained export-led growth attempt and searches for the causes of its demise. The final section: *the Turkish import miracle*, focuses on Turkey's now-chronic current account deficits in the post-2001 crisis period. It studies the foundations of Turkey's external imbalances during this period and the motives why the AKP governments abstained from undertaking the ELG policy framework. Furthermore, it studies the efficacy (or non-efficacy) of macroprudential policies to halt domestic absorption, hence imports.

1.THEORETICAL AND HISTORICAL BACKGROUND OF THE STUDY

The first subsection discusses the history and evolution of export-oriented industrialization. It aims to differentiate the ELG policy framework from the laissez-faire economics that has become the dominant paradigm from the 1980s onwards. The second subsection defines the boundaries of the ELG strategy. It also presents competing and supporting empirical evidence about the latter. The third subsection postulates the role of domestic demand suppression on export-led development and presents empirical data regarding the negative association between them. The fourth subsection discusses the politics of the ELG strategy. The final subsection presents the humble contribution of this study to the existing literature.

1.1 History of Export Driven Growth

Following WW2, under the supervision of the Bretton Woods institutions, developing countries adopted import substitution industrialization (ISI, hereafter) policies. The ISI policies were primarily designed to encourage domestic production of previously imported manufactured goods. The aim was to redirect scarce foreign exchange away from non-essential consumer goods and towards capital goods that were necessary for industrialization (Irwin, 2021, p.2). From the 1960s onwards, some developing countries (to name a few: Israel, South Korea) diverged from the then-orthodox protectionist path and adopted export-promotion policies. Yet, the inward-looking industrialization remained to be the dominant paradigm for developing countries. The effectiveness of the import-substitution policies became dubious when the world oil crisis of 1973 instigated balance of payments crises in the Global South. It turned out that rather than saving foreign exchange, domestic import-substituting factories frequently used a significant amount of it on the intermediate components and capital goods

required to keep production going (Irwin, 2021, p.7). Increasing energy prices further exacerbated balance sheets. It took less than a decade for neo-liberal policies to take over policy realm. Williamson's *to-do* list for Latin America known as Washington Consensus placed a strong emphasis on the free market (less government intervention), outward orientation and fiscal discipline (which the Turkish governments failed to deliver at the time).

Economic liberalism didn't necessarily engender healthier balance sheets and (inclusive) economic prosperity in the Global South. Ensuing the removal of trade barriers and capital controls, developing countries without a robust comparative advantage in manufacturing became net importers of manufactured goods (Rodrik, 1990, p.4). To pay for their import bills, they borrowed more from abroad, and the more they borrowed, the more they were exposed to global economic fluctuations. Over the past decades, when the developed *North* sneezed, the developing *South* suffered from *pneumonia*. The emerging economies that didn't manage to post current account surpluses were frequently in financial distress due to FX constrains. With few exceptions, the Global South didn't succeed in catching up with the Global North. The income gap between them remained relatively large. The neoliberal policy measures were almost as unproductive as the former ISI regime to stimulate economic convergence. In developing countries, the median per capita growth rate was 2.5 percent from 1960 to 1979 compared to 0.0 percent between 1980 and 1999 (Easterly, 2001, pp.133-155). Rodrik (2006) states that "the one thing that is generally agreed on about the consequences of these reforms is that things have not quite worked out the way they were intended. Even their most ardent supporters now concede that growth has been below expectations in Latin America" (p.974).

Following those trials, it has been understood that the neoliberal recipes failed to live up to its promise of sustained growth and prosperity. It has been understood that being an open economy is not enough to achieve these goals. Emerging countries should invest in productivity enhancing policies to achieve convergence with developed countries. According to the neoclassical growth model, the output in the long-run depends on the level of technological progress.

Hence, the *total factor productivity* (TFP) growth is the key determinant of economic convergence in the long-run. The productivity growth depends not only on what's happening within industries but also on the pattern of structural change; allocation of resources (mainly labor) from low-productivity to high-productivity sectors (McMillan & Rodrik, 2011, p.27). Rodrik (2011) states that "convergence could be easy if an economy is able to push its resources into the "convergence sectors" … tradable industries and manufactures, in particular, are archetypal escalator industries" (pp. 23-32).

The conformist and *one-size-fits-all* neoliberal recipes (openness, liberalization, fiscal discipline, price stability etc.) have failed to shift production towards the export sectors (tradable industries). Yet a mixture of the orthodox policies (macro stability, investment in human capital, emphasis on exports), with unorthodox ones (undervalued currencies, industrial policies, and significant state intervention) have facilitated sustained convergence (and export-led growth) in East Asia (Rodrik, 2011, p.18). To sum up early development experiences of the Global South show that (1) the export-led growth promotes specialization in the production of tradable goods (2) this process entails a reallocation of resources from less-productive agriculture and non-tradable sectors to more-productive tradable sectors (3) The rise in manufacturing productivity leads to an improvement in the current account and higher economic growth (4) yet, the orthodox neoliberal policy measures have been insufficient to foster and uphold the ELG strategy.

1.2 The ELG Hypothesis: Theoretical Background and Empirical Evidence

In this sub-section, the export-led growth hypothesis and competing empirical research on its validity will be presented. The theoretical grounds of the ELG hypothesis can be traced back to Nicholas Kaldor's *Growth Laws*. Kaldor (1968) posited that (1) the growth of the manufacturing sector was positively correlated with the GDP growth, (2) the productivity growth of the manufacturing

industries was the key determinant of economic growth. Bela Balassa postulated that exports raise productivity and serve as the engine of economic growth. According to Balassa (1978), the ELG policies lead to resource allocation according to comparative advantage, allow for greater capacity utilization (and exploitation of economies of scale), generate technological progress in response to international competition and, in labor-surplus countries contribute to increased employment" (p.181). The central argument here is that international competition incentivizes domestic tradable sectors to be productive. Numerous studies have contributed to the formation of the ELG hypothesis. To name a few, Ben-David and Loewy (1998) presented the relationship between the diffusion of knowledge via trade flows and economic growth. Lal and Rajapatirana (1987) added that an outward-orientated strategy encouraged entrepreneurship and thrift, along with productivity.

Balassa's seminal paper (1978) set the benchmark for testing the ELG hypothesis empirically and provided a supporting evidence for unidirectional causality running from exports to economic growth. In this paper, he showed that export-orientation was an important factor contributing to the differences in economic growth for 11 developing countries under scrutiny (Balassa, 1978). Following his work, empirical research focused on investigating the direction of causality between exports and output. Empirical studies, some of which will be mentioned here briefly, commonly used the VAR (vector-autoregression) framework. Yet, it is worth mentioning that there is not universal support for the ELG hypothesis. Vohra's (2001) results indicated a one-way causality from exports to output for middle-income countries (p.346). Konya (2006) investigated Granger causality between the logs of real exports and real GDP in 24 OECD countries from 1960 and 1997 and found one-way causality from exports to GDP in only 8 of them. Shan and Sun (1998) examined China from 1987 to 1996 and reported a bidirectional causal link between exports and economic growth (p. 1063). They argued that economic growth was an engine of exports as much as exports were an engine of growth. Hatemi-J and Irandoust (2000) studied Greece, Ireland, Mexico, Portugal, and Turkey for the period between 1960 and 1997. Their

results didn't provide empirical support for the ELG hypothesis for Greece and Turkey (Hatemi-J and Irandoust, 2000, p.355). Halıcıoğlu (2007) tested the ELG hypothesis for Turkey using quarterly data from 1980 to 2005. The augmented Granger causality tests indicated uni-directional causation from real exports to real industrial production (Halıcıoğlu, 2007). Öztürk and Acaravcı (2010) also showed that real exports have preceded changes in real GDP for Turkey. The literature on the validity of the ELG policy framework on Turkey's growth performance is limited to econometric studies based on the VAR framework. Previous qualitative research commonly focuses on Turkey's ELG attempt during the 1980s and those will be mentioned in section 3. To sum up, the literature does not offer a conclusive evidence on the direction of the causation between exports and economic growth.

Counterarguments against the ELG hypothesis are based on the principles that (1) economic growth rests on productivity gains (2) the more productive the domestic firms are, the more competitive they are in foreign markets. Hence, according to the ELG skeptics (e.g. Bhagwati (1988), Lancaster (1980)) causation runs from productivity growth to export growth. First, I would like to reiterate that productivity growth is not a prerequisite for economic growth in the short to medium run and that the aforementioned econometric analyses commonly rest upon quarterly data. Although *productivity* largely accounts for business cycle fluctuations according to the RBC (real business cycle) theory, the new-Keynesian literature highlights that other shocks (such as monetary, investment, risk premium, and markup shocks, etc.) predominate the trajectory of economic production. The predictive power of *productivity* increases as we move towards longer time horizons.

Secondly, the envisaged causal link from *TFP* growth to export growth is debatable. For the past few decades, developing countries have been rapidly urbanizing. Eventually, *TFP* has increased due to the shrinkage of the less-productive rural sector and the expansion of the more-productive urban sector. Hence, we must have observed an export boom in the developing world due to the surge in *TFP*. Yet, only some of them (*to name a few* China, Vietnam and

Thailand) have managed to become only low-cost manufacturing export hubs. Ironically, *premature deindustrialization* has become a common phenomenon for numerous developing countries (*see* Rodrik (2015)) especially after the neoliberal agenda expanded its influence. The developments in *TFP* cannot single-handedly predict the growth (and productivity) of the export sectors.

Although the econometric studies show mixed results, the history provides evidence in favor of the export-led growth hypothesis. The vast majority of today's advanced economies began to industrialize during or just after the Industrial Revolution. In turn, there are only a handful of successful *late-industrializers*. Akay (mimeo) identifies 7 of them: Japan, Israel, South Korea, Taiwan, Singapore, Hong-Kong, and Russia (The USSR) (p.1). Russia will be excluded from further analysis because (1) the Soviet Union, unlike the rest, was a command economy (2) Russia (the USSR) is/was rich in natural resources. Oil and gas constitute(d) a significant share in the export portfolio, (3) Russia went through a period of prompt *deindustrialization* after the demise of the Soviet Union. This study also excludes the *late-industrialized* European periphery, which has long been a part of the European Union (EU, hereafter).

This dissertation suggests that the ELG strategy deserves partial credit for the rapid industrialization of all of the remaining six countries. The export-oriented policies accelerated the industrialization process by providing FX to import technology-intensive capital goods and by directing *resources* (mainly labor) to the manufacturing sector. According to Schwartz (2019): "late industrialization rested on Kaldorian growth… Late industrializers generated two kinds of export streams. The first usually consisted of some kind of raw material or traditional manufactured goods. Late industrializers exported these in order to finance their initial imports of capital goods… The second export stream consisted of new industrial goods" (p.104). In the next section: *Comparative Analysis*, further arguments/data that assert the role of the export-promotion on the *late-industrializers*' growth performance will be demonstrated.

1.3 Empirical Evidence: Domestic Demand and Exports

This subsection presents how domestic absorption affects exports and imports in a developing country framework. Firstly, it will be reiterated that (1) an increase in domestic demand boosts the demand for imported consumer, intermediate, and capital goods (2) exports are positively correlated with domestic savings. Secondly, the empirical studies that present domestic demand as an additional explanatory variable in explaining firm behavior (firms' export supply function) will be reviewed. The negative association between domestic demand and exports will be demonstrated.

The trade literature (Günçavdı & Ülengin (2006), Togan et. al. (1987)) validates that Turkey's import demand is very sensitive to the changes in domestic demand. The parallel between Turkey's import demand and domestic demand will be presented thoroughly from the next section onwards. Regarding (2), *savings* are a key determinant of the current account balance according to the traditional macroeconomic approach. Numerous studies (e.g. Balassa (1978)) presents the positive correlation between exports and domestic savings.

By definition, the current account deficit is equal to the difference between domestic expenditure and domestic output, usually represented by domestic investment and domestic savings. If economic agents consume less today and save more for tomorrow, the gap between investment and savings will diminish, and so will the current account deficit. On the contrary, if there is an increase in investment expenditures, *ceteris paribus*, the current account deficit will widen. Nonetheless, the conventional macroeconomic approach has its shortcomings. First of all, it underestimates the role of foreign exchange rate markets. Secondly, it is a static model. It gives an iniquitous intuition about the impact of investment expenditures on the current account. As long as they are channeled to tradable sectors, higher investment expenditures are desirable for future trade performance. The expansion of tradable sectors is a prerequisite for export growth in the medium-long run. To account for growth enhancing investment, one needs a dynamic model.

Following the *Great Recession*, the role of *savings* on external imbalances has been rigorously debated as trade and capital flow imbalances rose to prominence as the alleged sources of the economic downturns. The European sovereign debt crisis has served as a microcosm of the worldwide economic phenomenon. The European debtor nations have commonly been criticized for their inadequate savings and *spend-thriftiness*. Conversely, Pettis (2014) states that *underconsumption* (in economies with trade surplus a.k.a. *creditors*) is the most likely cause of global trade distortions (p.9). He argues that (1) due to increasing wealth and income inequality in *creditors*, households don't absorb all that is produced in the economy, (2) *surplus savings*, being the difference between total production and consumption, are increasingly exported abroad. By exporting their *excess savings*, *creditors* create foreign demand for their excess production in return. Yet, when things get sour, only *debtors* are held accountable for the economic mismatch.

Although I mostly agree with Pettis (especially regarding the European debt crisis since the members of the European Monetary Union have limited monetary tool instruments), I find his argument a little too deterministic. Pettis squeezes out any role for policy framework in *debtor* countries. Moreover, his argument falls short of explaining how *the late industrializers* gradually managed to become *surplus* economies. De Grauwe once famously said that "for every reckless debtor, there must be a reckless creditor" (De Grauwe, 2015). Hence, *debtors* and *creditors* jointly share the responsibility for the trade and capital flow imbalances. The source of trade imbalances can equally be rooted in *overconsumption* fueled by increased credit in deficit countries.

Debtors consume more than they produce and borrow from *creditors* to pay for their *excess consumption*. The liabilities generated by the inflows are often not linked to an increase in domestic asset growth and productive investment (Pettis, 2014, p.10). Therefore, *debtors* get stuck in an *external debt trap* as their foreign liabilities follow an upward trend, just to finance their inflated consumption. If (1) savings increase and crowds out excess consumption (2) foreign funds (and domestic savings) are directed to investment in tradable sectors (3) domestic

currency adjusts to tackle trade mismatch, an *external debt trap* is escapable in the medium to long run. Yet, when market forces are left alone, *debtors* get stuck in the aforementioned vicious cycle. The *Comparative Analysis* section will demonstrate that the countries whose export-led growth strategy met with success are the ones that managed to curb domestic demand whilst reinforcing productive investment in the manufacturing sector.

Export performance is broadly portrayed as a function of foreign demand and relative price movements. Yet, the export models that omit supply-side variables can only partially explain the variation in exports. While foreign demand and real exchange rates are demand-side determinants of export performance, domestic demand emerges as a supply-side factor at the firm-level analysis. There are theoretical arguments for both a negative substitution effect and a positive complementary one regarding the relationship between domestic demand and exports (Bobeica et. al, 2016, p.108). The substitution effect posits that as the production capacity is limited in the short-run, the quantity of resources devoted to exports, *ceteris paribus*, is higher when domestic consumers absorb less. The complementary effect postulates that fluctuations in foreign and domestic sales appear to be analogous.

The vast majority of the empirical research (some of which will be summarized below) provides evidence in favor of the substitution effect, particularly in the short-medium run. A decline in domestic sales gives the firms (that operate in tradable sectors) greater incentive to search for new markets. Theoretically, since exports are less profitable (mainly due to logistics, marketing, and *bureaucratic* costs), domestic firms are disinclined to quest for new markets as long as (1) domestic consumers absorb their production (2) price they take in foreign markets doesn't make up for the additional expenses (and market risk) they incur. Esteves and Rua (2015) state that "if domestic demand falls firms will try to increase exports as the costs of excess capacity may outweigh the additional costs and effort of selling in the foreign market rather than at home" (p. 6).

The literature that investigates the impact of domestic demand on the export behavior of firms is limited. Yet, the exemplary studies on the aforementioned

causal link appear as early as the 1960s. Ball, et. al (1966) investigated the relationship between domestic demand pressure and the United Kingdom's export performance in manufactures. They argued that the pressure of internal demand may be regarded as a significant explanatory variable in determining the UK's share of world trade (Ball et Al, 1966, p. 516). Esteves and Rua (2015) estimated error correction models for Portugal's exports for the last three decades and discovered that domestic demand developments affect exports significantly and negatively (p. 24). They added that the relationship between exports and domestic demand was asymmetric, being weaker when demand was increasing than when it was falling (Esteves & Rua, 2015). Their results suggest that withdrawal from a foreign market is undesirable for firms mainly due to sunk costs associated with foreign market entry. Hence, once domestic firms enter foreign markets they are (1) less receptive to changes in demand conditions at home (2) disinclined to exit foreign markets (3) and likely to upgrade their products in order to survive international competition.

Bobeica et. al (2016) have studied eleven euro-area countries from 1995 to 2013 and their results (based on a dynamic panel data model) showed a statistically significant substitution effect between domestic and foreign sales (p. 107). Belke et. al (2014) studied 6 Euro-area countries and revealed that "the negative link between domestic demand and exports is a short-run phenomenon linked to current economic conditions. In the long run, export performance is closely related to price developments" (p.16). Günçavdı and Kayam (2019) empirically investigated the short-run effects of domestic demand pressure on Turkish exports by using quarterly data from 1998 to 2015. They provided evidence in favor of the substitution effect for aggregate and manufacturing exports and stated that "the manufacturing firms target foreign market share mainly when the domestic market growth is negative" (Günçavdı & Kayam, 2019, p. 20). The inverse relationship between domestic demand and exports presented above is the basis of one of the central arguments of this dissertation. The next section will present further data/argument about the association between domestic demand suppression and export promotion.

1.4 Non-Economic Factors Behind the ELG Strategy

The preceding subsections have focused on the economic underpinnings of the ELG strategy. All things considered, the abovementioned literature has demonstrated that the export-oriented industrialization necessitates government intervention. Hence, one can simply not ignore the non-economic factors affecting the implementation and persistence of the ELG strategy. This subsection is dedicated to such non-economic factors.

The literature (e.g. Amsden (1989), Öniş (2001), (Kim, 1997)) underlines that state intervention has played a crucial role in late industrialization and that there have been only a few countries that managed to catch up with the developed *West*. So why was Turkey not one of them? Why has the Turkish state not fulfilled its role to get Turkey's industrial capacity up to par with *contemporary civilizations*? A comprehensive answer to these questions is beyond the scope of this study. There are various interrelated economic, sociological and political factors behind Turkey's failure to follow the ELG policy framework. This dissertation aims to pin down one of them: the lack of political will to implement and sustain such policies.

Öniş and Şenses (2007) asserted that *reactive states* like Turkey, are more fragmented, have a lower degree of relative autonomy from key domestic constituencies, and follow the dominant policy norms religiously (p.5). The premises of this study are coherent with the reactive state framework. On the other hand, they also suggested that reactive states are less capable to focus on longer-term strategic priorities such as developing globally competitive export industries is limited (Öniş & Şenses, 2007). This study likewise formulates a hypothesis on intertemporal policy trade-off. It seeks to underline the short-run political costs of the ELG policy framework, which has deterred the Turkish ruling class from its implementation.

A strong institutional state is one of the main conditions for the formation of a successful export-oriented industrialization strategy (Amsden, 1989). The ELG strategy necessitates an autonomous state apparatus that is resistant to interest group pressures. Stubbs (1999) argues that in most third-world countries, interest groups are likely to oppose the ELG policies such as devaluation, tariff reductions, and the removal of restrictions on foreign direct investment. He also argues that in the 7 East Asian countries (Japan, the Asian Tigers, and *near industrialized* Malaysia and Thailand), social groups were relatively too weak to oppose the ELG policies defended by their relatively strong states. Turkish governments weren't as lucky as their Asian counterparts. Keyder (1987) indicates that the Turkish ruling class has not possessed such decision-making autonomy and has succumbed to interest-group pressures frequently. Furthermore, Bayar argues that "the capacity of ruling groups to impose their conception of national interest on everyone else has been weak" (p. 784).

This study assumes domestic demand suppression as an additional prerequisite to the ELG strategy. Therefore, the sustainability of the ELG policies was even more difficult since Turkey held competitive elections from 1946 onwards (given that electorates do not want to see their incomes falling). Institutional economics may hint at why Turkish governments didn't have such power to put the ELG policies into action and maintain them. According to the framework proposed by Acemoğlu, Johnson, and Robinson (2005), groups that possess *de jure* and *de facto* political power conjointly determine economic institutions and the future evolution of political institutions (p.392). In turn, economic institutions influence economic performance and the future distribution of resources. It is worth emphasizing that groups that possess *de jure* (elected officials) and *de facto* (such as the military, business/media conglomerates) political power in Turkey have frequently clashed with each other. This hostility may have further incentivized elected officials to uphold electoral support. Hence, short-run expansionary policies, which Turkish politicians frequently resorted to, can be regarded as a by-product of this urge. Turkish politicians

didn't afford to lose electoral support while pushing for long-run economic policies. Presumably, non-electoral constraints (the constant power struggle between groups that possess *de facto* and *de jure* political power) along with electoral ones have challenged the durability and effective implementation of long-run economic policies.

1.5 Contribution of thesis

Turkey's enduring current account deficit has recursively been at the center of the policy debate. External imbalances have repetitively dragged the Turkish economy into downturns. Primarily, this study aims to portray the history of Turkey's external imbalances. Academic papers often concentrate on particular episodes (e.g. the post-2001 crisis or the economic crisis of 1978-79) and make macroeconomic policy recommendations based on then-prevailing conditions. The main difference between this study and previous research is that it takes a holistic approach to identify factor(s) that generate external imbalances. This study points out that there is a recurring pattern that prevailed in Turkey's post-WW2 history. It suggests that the root causes of external imbalances may rest on Turkey's political deficiencies. The lack of political agility and/or will (1) to take contractionary policy measures, (2) the inability to mobilize resources to fully develop an industrial sector can help explain the emergence of external imbalances repeatedly. Turkey's insufficient industrialization brings us to the second objective of this study. This dissertation also aims to examine why policy-makers didn't succeed in building a robust manufacturing base via the export-led growth strategy. It suggests that political constraints have impeded the formation and maintenance of the ELG policy framework. For the Turkish ruling class, its short-run costs have outweighed its long-run benefits. All in all, the ideas presented in this dissertation may point to one of the causes of Turkey's underdevelopment over the last century.

2. COMPARATIVE ANALYSIS

This section displays empirical observations on the themes of the literature section. Primarily, it shows further empirical data that aims to validate the role of export promotion on the growth performance of late-industrializers. Secondly, this section presents a comparative analysis of South Korea's and Turkey's development paths. It demonstrates that South Korea succeeded in curbing domestic demand whilst reinforcing productive investment in tradable sectors. The final subsection illustrates that *surplus* NICs (China, Malaysia, and Thailand) have been following the footsteps of late industrializers.

2.1 The Export-led Growth Hypothesis and Late Industrialization

In the literature section, the theoretical link between the ELG strategy and industrialization (and economic growth) was scrutinized thoroughly. In this subsection, empirical data that illustrates the parallel between export and GDP growth will be presented. If the European periphery is excluded from the analysis, there are only a few countries that have succeeded in late industrialization. These are the Asian Tigers (Singapore, Hong Kong, South Korea, and Taiwan), Israel, and Japan (Akay, mimeo, p.1). From 1970 onwards, the late industrializers attained high and steady growth rates and closed the income gap with the developed *West*. As I began my quest for pillars of late industrialization, the three common features of late industrializers that grasped my attention were: (1) They tend to have a strong state capacity, (2) They have experienced substantial growth in exports in the last half-century, (3) They have been recording consistent trade surpluses for the past two decades.

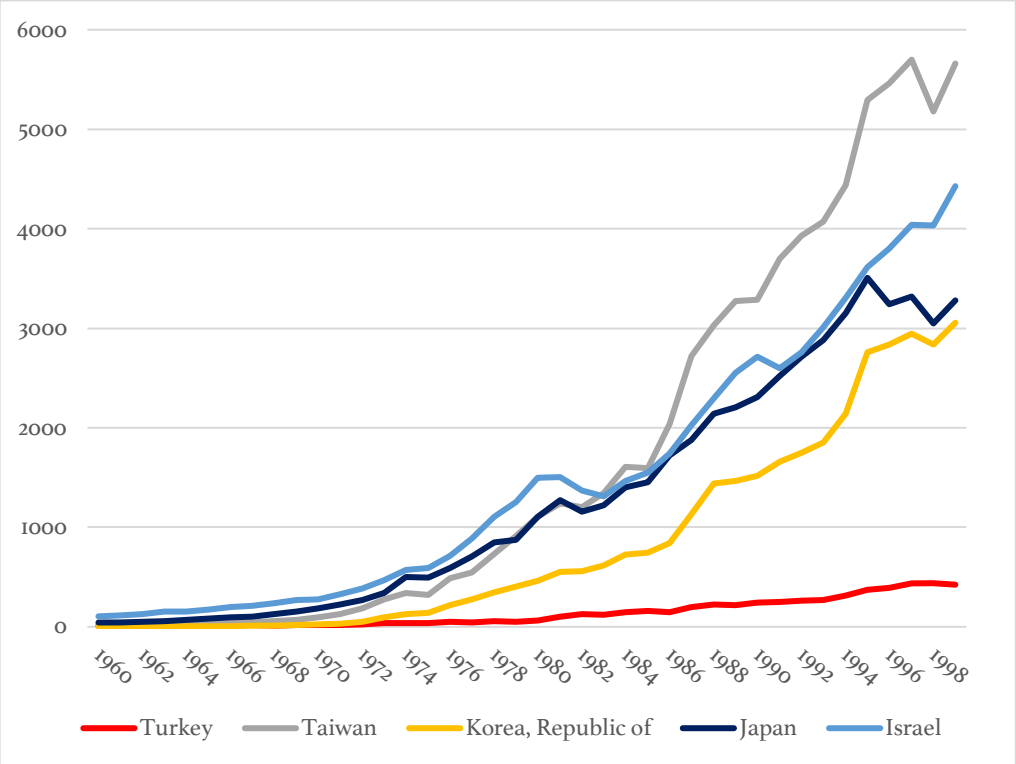
This study argues that the export-led growth strategy requires oversight of an autonomous and interventionist state apparatus. Constant commitment of a capable interventionist state enabled the late industrialization in East Asia (Akay, mimeo p. 2). Strong state capacity can help transform an agrarian economy into an industrial one and facilitate economic convergence if the ruling elite has the willingness and is committed to do so. Yet, numerous authoritarian and highly-centralized regimes fail to undertake effective economic intervention. Authoritarian regimes that have *despotic power* does not necessarily possess *infrastructural power* which would enable them to mobilize resources for long-term economic development, coordinate and organize society, and elicit public consent for their policies (Öniş, 1991, p. 123). Despotic power may not be a prerequisite for late development, whereas infrastructural power is. The abovementioned late industrializers possessed infrastructural power that allowed them to systematically manage the markets as a means to long-run economic transformation (Öniş, 1991, p. 124). Historically, the East Asian kingdoms possessed a centralized bureaucracy that determined aggregate economic production and income distribution (through extraction of surplus production). Thus, the *East Asian model of capitalism* was built on the legacy of Asiatic mode of production. Success of this model are attributed to high savings and export promotion under the strict guidance and backing of the state. It is worth noting that Israel is quite distinct from the Asian tigers in many ways. Most notably, Israel has had a higher level of human capital. Secondly, it has been a functioning democracy. Last but not least, Israel is very different from the Asian tigers in terms of culture and geography. Yet, its unique geopolitical risks necessitate(d) a strong state. Like the Asian Tigers, Israel followed the path of state-led development, in which exports served as the engine of economic growth.

Although the industrialization process had started during The Meiji Restoration, the Japanese economy was quite agrarian before the onset of WW2. The East Asian model, which was first established in Japan after WW2, paved the way for the rapid transformation of the Japanese economy and its robust growth. Japan's

development model set a precedent for the Asian Tigers. They experienced a substantial surge in exports from 1970 onwards. From 1970 to 1989, their exports (in million dollars) increased more than tenfold (*see Appendix*). The ELG policies were successful in eradicating the current account deficit in the long run. They not only became *surplus* economies from 2000 onwards but also closed the productivity gap with the developed *West* in due course. (While Turkey's productivity remained well below that of the developed *West*, it registered a current account deficit for 18 years out of 20.) In 2019, output per worker was measured as 84.415$ in the EU (28), while the Asian Tigers' mean labour productivity was 75.252$ (ILOSTAT).

In Figure 2.1, Singapore and Hong Kong is excluded mainly because they are city-states and less populous than the rest. In 1960, Taiwan, South Korea, Japan, and Turkey had low levels of merchandise exports per capita (ME per capita, hereafter) (based on Author's calculations). Israel's initial ME per capita was higher than the others, equal to 105.3$ in 1960. From 1960 to 1980, Taiwan's ME per capita increased from 15.1$ to 912$, South Korea's from 1.3$ to 460.3$, and Japan's from 43.3$ to 875.3$ (see *Appendix*). In 1999, their ME per capita were recorded as 5661$, 3056$, and 3280$ respectively. Turkey's ME per capita increased from 11.7$ in 1960 to 52.6$ in 1980. Turkey was religiously following ISI policies at that time so it is natural that Turkey's export growth had been limited. What's interesting is that Turkey has performed only slightly better after 1980. Despite the implementation of a new set of outward-looking policies from 1980 onwards, the pace of Turkey's export growth lagged behind that of Taiwan, South Korea, and Japan. In 1999, Turkey's ME per capita was 427, well behind that of the late industrializers.

Figure 2.1: Merchandise Exports per capita (LIs and Turkey)

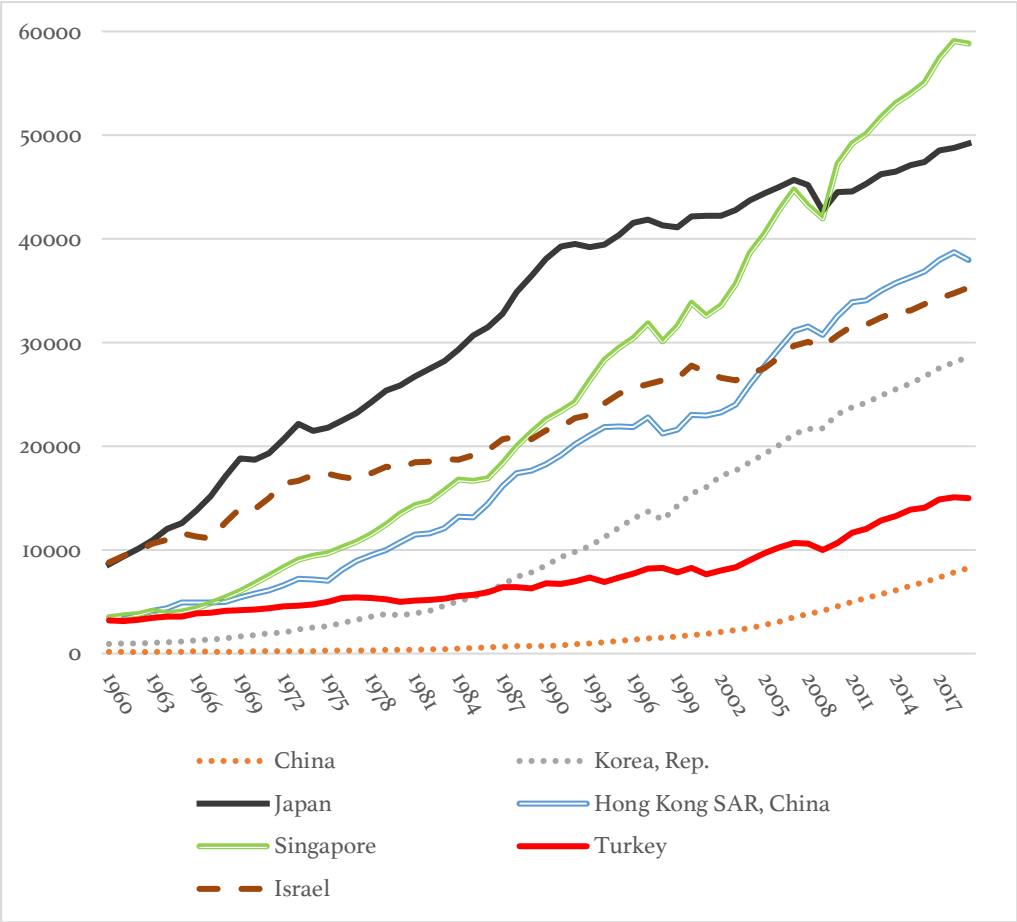


Source: World Trade Organization Database and United Nations World Population Prospects. Notes: Merchandise exports per capita stands for merchandise exports divided by mid-year population in US dollars (based on Author's calculations). LIs stands for the Late Industrializers.

Late industrializers have attained robust growth rates for the past half-century. The Japanese economy expanded more than fourfold from 1960 to 1990 (figure 2.2). South Korea's GDP per capita was lower than Turkey's in 1960 (932$ and 3175$ respectively in constant 2010 US dollars). Nevertheless, by 1987, South Korea was richer than Turkey on capita basis. Over the past half century, South Korea succeeded in breaking the curse of underdevelopment. So, did Taiwan, Hong Kong Singapore, and Israel. Finally, China has been following the

footsteps of late industrializers from 2000 onwards and its economy has been expanding rapidly since then (figure 2.2). China has been devotedly following the export-led growth policies guided by its state apparatus. Figure 2.2 displays that Turkey hasn't followed the footsteps of the late industrializers.

Figure 2.2: Comparison of GDP per capita (in Constant 2010 US dollars)



Source: World Bank Development Indicators

This study argues that a developmental state can keep the ELG policies in place as long as it can overcome electoral and non-electoral constraints against them. Hence, the durability of the ELG framework primarily depends on cooperation between groups that possess *de facto* and *de jure* political power. In the Turkish

case, those controlling *de facto* power such as the Turkish military (e.g. bureaucracy and large business conglomerates), and elected officials that possess *de jure* power frequently antagonized one another. Not to mention, Turkey has witnessed four military coups and numerous coup attempts since 1960, whereas the late industrializers have never experienced one for more than half-century. The late industrializers have witnessed continuous cooperation between groups that share *de jure* and *de facto* political power. The Turkish policy makers weren't as autonomous as their counterparts in the late industrializers. Moreover, they were less immune to interference from special interest groups than their counterparts in the late industrializers. Hence, the Turkish policy makers had to beware of non-electoral constraints whilst making and sustaining economic policies. Secondly, Turkey held competitive elections from 1946 onwards. Whereas the aforementioned *late industrializers* weren't democracies at the time they had followed a thorough export-led growth strategy. The governing elite of the *late industrializers* (1) didn't have to respond to policy priorities of the electorate. Turkey has held multi-party elections since 1946 and *de jure* political power changed hands frequently. When re-election chances looked shakier, not only did the Turkish politicians turn a blind eye on the export-led growth strategy, but they also ignored amassing external imbalances.

2.2. Domestic Demand Suppression and Export Performance

Table 2.1: Main Economic Indicators: South Korea vs. Turkey

Indicator ***Year***	**South Korea** ***1960***	**Turkey** ***1960***	**South Korea** ***2000***	**Turkey** ***2000***
GDP Per Capita *(Current US$)*	158	509	12,257	4,317
GDP Per Capita *(Constant 2010 US $)*	968	3,135	15,214	8,238
GDP *(Constant 2010 billion US$)*	23.3	87.2	724.6	520.9
Population *(in millions)*	25.8	28.1	47.1	63.2
Urban Population *(% of total)*	29	32	79.6	64.7
Political Regime *(10 to -10)*	-7	9	8	7
Industry, value added *(% of GDP)*	17,33	17,33	34.8	26.9
Gross Capital Formation *(% of GDP)*	10.52	9.99	32.8	23.9
Government Final Consumption Expenditure *(% of GDP)*	14.2	8.4	10.9	12.0
Exports *(% of GDP)*	2.6	2.1	33.9	19.4
Household and NPISHs Final Consumption *(% of GDP)*	85.1	56.4	54.5	67.3

Source: World Bank Development Indicators and The Economist OWID database.

To study the role of domestic demand suppression on export performance, South Korea presents a unique example. In 1960, South Korea and Turkey had similar populations, industrial capacities, and levels of urbanization (Table 2.1). In the same year, urban population as a percentage of the total population was 29% in South Korea and 28.1% in Turkey. Similar to Turkey, South Korea's export portfolio consisted of raw materials and agricultural goods. South Korean and Turkish economies (1) were in the early stages of industrialization (2) had limited resources to bolster capital accumulation, (3) were predominantly agrarian (4) suffered from low savings and depended on US assistance to finance their external imbalances. Both countries were neighboring *industry powerhouses*. South Korea procured capital and intermediate goods from Japan while Turkey did from Western Europe. As a result of private investment mobilization, South Korea's manufacturing sector skyrocketed from the mid-1960s onwards (World Bank). In 1971, Turkey's and South Korea's manufacturing share (% of GDP) were identical at 16.6% (World Bank). By 2000, South Korea was an industrialized country, whose GDP per capita (in constant 2010 US$) was nearly twice that of Turkey (figure 2.2). The South Korean economy didn't post a current account deficit since 1998.

It is worth noting that Turkey had its disadvantages compared to South Korea. Taiwan, Singapore, Hong Kong, South Korea, and Japan were (and are) the *Eastern* allies of the USA-led Western bloc. The political alliance almost certainly facilitated economic cooperation. These neighboring countries created an economic synergy in the region as they traded with and invested in each other. Some scholars (e.g. Buffie (1992)) argue that late industrialization in East Asia is unique, and cannot be replicated elsewhere. Secondly, South Korea benefited from heavy interaction with Japan (Öniş, 1991), unlike the experience of Turkey with Western Europe. Following the 1965 treaty between Japan and South Korea, Japanese corporations formed joint ventures with their South Korean counterparts (Kim, 1997, p. 92). These joint ventures facilitated technological spillover, which boosted productivity in South Korea. Under the guidance of its

developmental state, South Korea followed the footsteps of Japan. During the early stages of industrialization, both Turkey and South Korea relied on agricultural (and raw material) exports and US assistance to obtain FX. While South Korea targeted Japan to expand its production (Schwartz, 2019, p. 104), Turkey could not overcome European trade barriers. Yet, attributing Turkey's relative underdevelopment solely to these drawbacks would be misleading.

The state apparatus played a proactive role in the rapid development of the South Korean economy. The South Korean government acted proactively and abandoned ISI policies after South Korea had faced BOP problems triggered by reductions in US foreign aid during the 1960s. The *reactive* Turkish state, however, were sluggish to take immediate action. Pamuk (2007) states that: "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 (p. 285). When Turkey finally adopted the ELG policies in the 1980s, (1) the application of the scheme was rather unmethodical and (2) commitment to the agenda was short-lived. Whereas, the South Korean state remained dedicated to a thorough and well-planned export-led growth strategy.

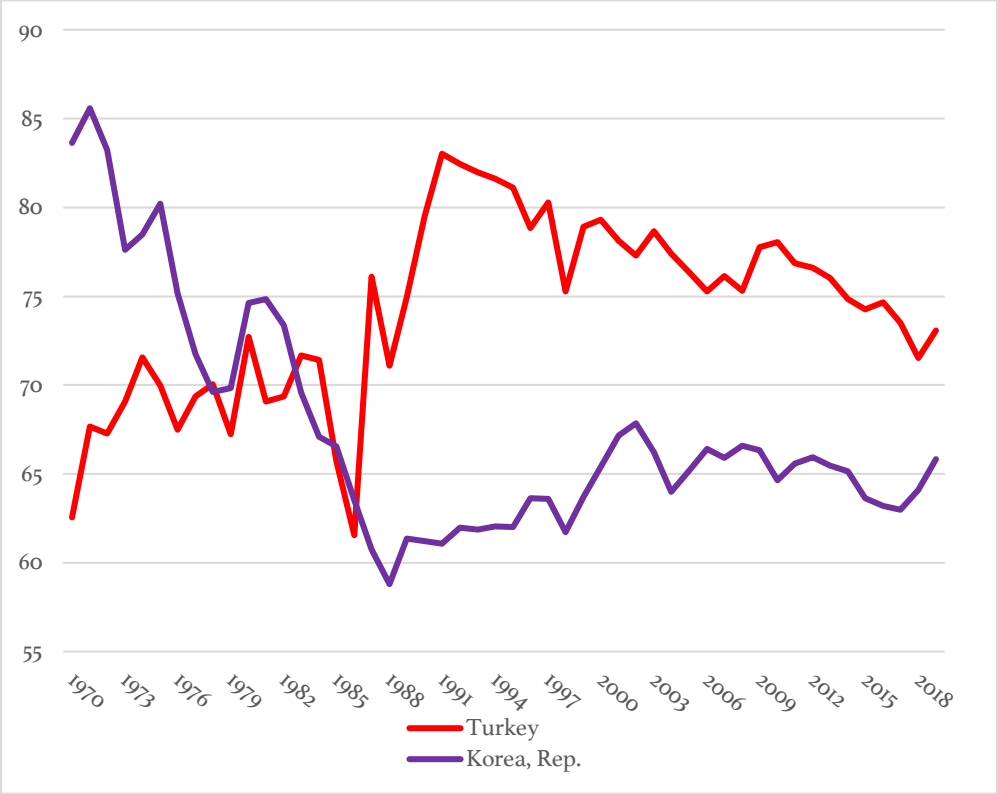
Although the Turkish democracy had its flaws (Turkish political institutions every so often operated under the shadow of the military tutelage), Turkey held competitive elections. At that time, South Korea was a military dictatorship under the command of former General Park Chung-hee (from 1963 to 1979). The transition from autocracy to democracy commenced with the establishment of the 6th republic in 1987. While the Turkish government had to respond to voters' demands and occasionally interest group pressures, the South Korean government enjoyed a high degree of autonomy. The South Korean leadership wasn't politically constrained to make policy decisions and to carry them out (Balassa, 1971, p. 61).

In South Korea, the state has played a major role in transforming an agrarian economy into an energetic urban economy in less than two decades and in mobilizing women to the workplace in unprecedented numbers through export-led industrialization based on light manufactured goods (Kim, 1997, p. 27).

Whereas, the Turkish governments have been unable to mobilize resources and surplus labour to the manufacturing sector. (as will be scrutinized thoroughly in sections 3 and 4). Akin to Japan during Meiji restoration (and uninterrupted Liberal Democratic Party rule from 1955 to 1993) and Taiwan under the rule of Chiang Kai-shek, South Korea went through a period of rapid structural change and industrialization from 1963 to 1987. South Korea's urban population (% of total population) jumped to 69.5% from 30.4%. Industry (including construction) as a percentage of GDP increased from 18% to 36% (World Bank). Turkey's industrial capacity lagged behind that of South Korea since the early 1960s (see *Appendix*).

Given that (1) efficiency requires adoption of increasing return technologies (2) South Korea had limited resources, the government supported a few, selected large producers in targeted sectors (Park, 1990, p. 118) The South Korean government formed a durable alliance with large family-owned corporations (which are known as *chaebol* in Korean) and delivered an export-friendly macroeconomic environment. The competitiveness of South Korean products in international markets was provided by relatively low-paid workers (Kim, 1997, p. 16). South Korea's state-sponsored *chaebol* gradually became *national champions* and the locomotive of export-oriented growth.

Figure 2.3: Final Consumption Expenditures (% of GDP): South Korea vs. Turkey



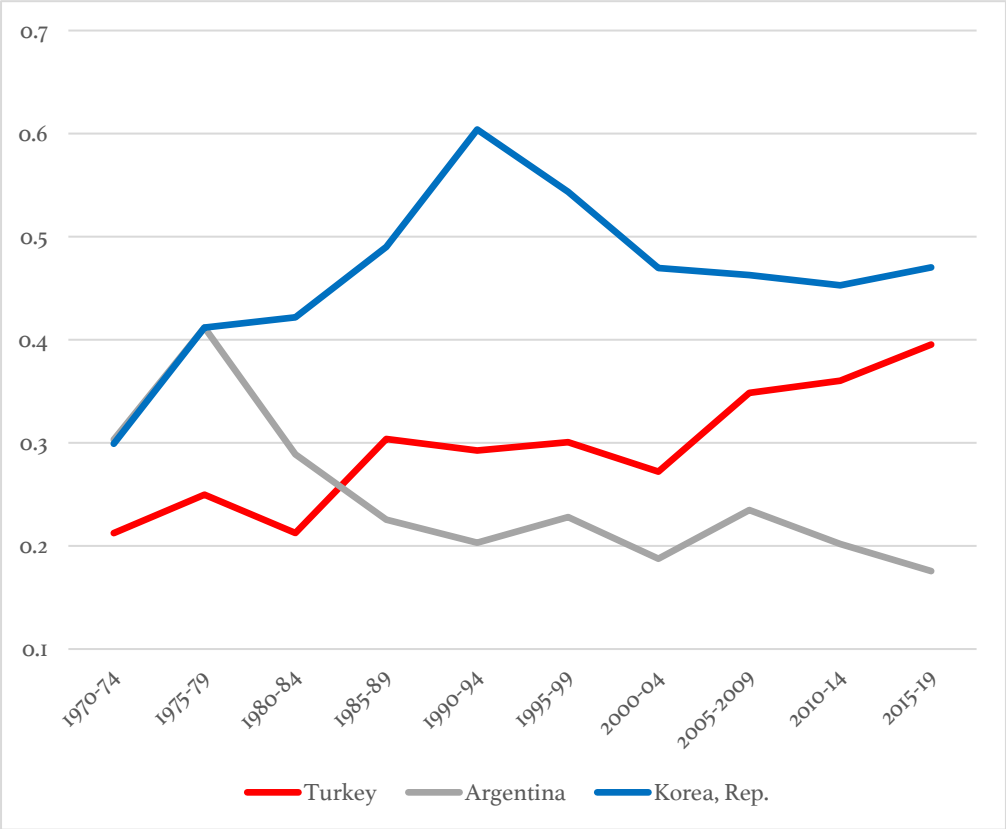
Source: World Bank Development Indicators. FCE (% of GDP) stands for final consumption expenditure as a percentage of GDP. Final consumption expenditure is the total of government consumption expenditure and household final consumption expenditure.

In the literature section, I have highlighted the relationship between domestic demand suppression and export promotion numerous times. The South Korean governments, unlike their Turkish counterparts, succeeded in curbing domestic demand. South Korea's consumption expenditure steadily decreased from 83.6 % in 1970 to 58.7% in 1988, and it has remained below (and less volatile than) that of Turkey in the following decades. There weren't abrupt increases in South Korea's consumption levels, *meaning*, the Korean governments didn't resort to expansionary monetary and fiscal policies to boost domestic demand, and hence

economic growth. As an upshot of the January 24th stabilization program, Turkey's consumption expenditure was restrained temporarily. The Turkish polity attempted to suppress domestic demand in the early 1980s, yet the trend was reversed (figure 2.3). Turkey's consumption expenditure swelled from the mid-1980s onwards due to the political reasons (which section 4 scrutinizes thoroughly. During its final years, the ANAP government didn't enjoy the level of autonomy that the military governments did in the early 1980s.

It was suggested that (1) domestic consumption remained subdued while the South Korean government encouraged private investment (2) resources were channeled into tradable sectors. *I/C* ratio (investment (% of GDP) divided by final consumption expenditure (% of GDP)) will be used to verify (and to quantify) the first proposition, and *manufacturing ratio* (a.k.a. M/(S+A) ratio) for the latter. I/C ratio indicates the relationship between two major components of GDP. Korea's *I/C* ratio had increased twofold in 20 years and was recorded as 0.6 for 1990-94. Korea's *I/C* ratio was identical to that of Argentina in 1975-79 but as two nations took different paths of development, their *I/C* ratios diverged (so did their per capita incomes). The decline in Argentina's ratio demonstrates how Argentina has gradually become a *consumer economy.* Turkish manufacturing neither plunged like Argentina's nor skyrocketed like Korea's. Turkey's consumption expenditure was nearly five times more than its investment until the mid-1980s. Turkey's *I/C* ratio increased from 0.21 to 0.31 in the second half of the 1980s. It has followed a slightly upward trend since then. The interpretation of the I/C ratio requires special care because "I" involves investment in non-tradable sectors (such as construction) as well as tradables. An increase in Turkey's *I/C* ratio doesn't necessarily indicate an expansion in its manufacturing capacity.

Figure 2.4: I/C Ratio

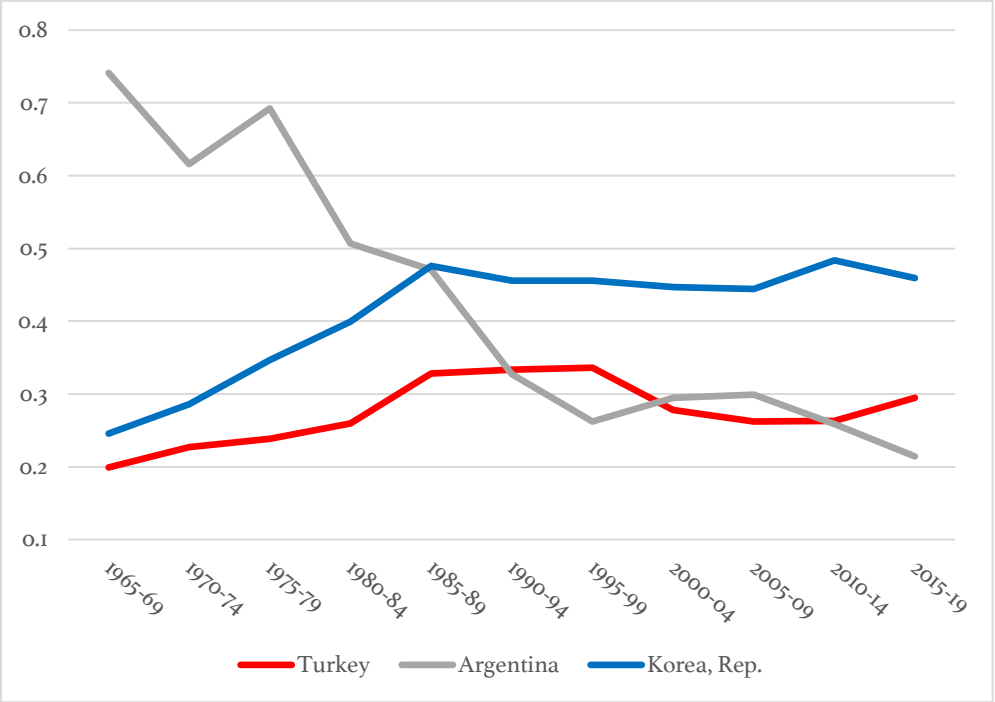


Source: World Bank Development Indicators. I/C stands for gross fixed capital investment (% of GDP) divided by final consumption expenditure (% of GDP) (based on Author's calculations).

In academic circles, Turkey's economic performance is frequently compared and contrasted with Argentina's and South Korea's. Frequently, Turkey is criticized for falling behind South Korea and praised for surpassing Argentina. A similar analogy can as well be applied to their manufacturing sectors. The *manufacturing ratio* serves as a handy proxy to assess the performance of tradable sectors. The manufacturing ratio, which I calculated by dividing

manufacturing by the total of services and agriculture value added (% of GDP), demonstrates the relative strength of manufacturing.

Figure 2.5: Manufacturing Ratio



Source: World Bank Development Indicators. Notes: Manufacturing Ratio a.k.a. M/(S+A) stands for manufacturing value added (% of GDP) divided by the total of services value added and agriculture, forestry, and fishing value added as a percentage of GDP (based on Author's calculations)

While South Korea has been the poster child for rapid industrialization, Argentina has been one for *de-industrialization*. Argentina had developed a robust manufacturing base via import-substitution industrialization policies until the 1970s. Argentina surrendered to neoliberal economic recipes, whereas South Korea single-mindedly adhered to the East Asian model of capitalism. Although Argentina had formerly a larger industrial capacity than South Korea, its manufacturing sector took a heavy blow (After the Washington Consensus

policies took over the policy realm in the 1980s.). Figure 2.5 shows that Turkey neither industrialized like Korea nor de-industrialized like Argentina. South Korea's and Turkey's manufacturing ratios were alike in the late 1960s. While Korea mobilized rural labor for industrialization, and steered investment in manufacturing (which in turn bolstered exports), Turkey could not. Despite its upward trajectory, Turkish manufacturing couldn't catch up with South Korea. Figure 2.5 portrays the expansion of the South Korean manufacturing sector at the expense of its agriculture and services sectors. The steady increase in Korea's *manufacturing and I/C ratios* for more than two decades suggests that new investments concentrated in the manufacturing sector. Figure 2.5 also displays that Turkey has expanded its manufacturing capacity from 1980 onwards. Nevertheless, the upward trend was gradually reversed. Turkish manufacturing couldn't hold on to the level it had reached in the late 1980s, early 90s. The share of manufacturing (% of GDP) series exhibits a steeper downward trend than the *manufacturing ratio* series that show the relative strength of manufacturing. In 2010, the share of manufacturing in Turkey's GDP was well below its level in 1970 (World Bank). Nevertheless, both series show some improvement in Turkish manufacturing for the past few years. Despite the lack of a comprehensive industrial policy, Turkish manufacturing industry has presumably thrived in recent years mainly due to the unprecedented depreciation of the Turkish lira.

2.3. Newly Industrialized Countries: External Imbalances and Economic Growth

This subsection will extend previous arguments on the ELG strategy to NICs. Firstly, it displays the impact of export promotion on NICs' economic performance. Secondly, this subsection illustrates that *surplus* economies tend to *manufacture more* and *consume less* than deficit economies. NICs are developing countries whose economies are transitioning from an agriculture-

based economy to an industrial/urban economy. Political scientists/ economists commonly refer to Indonesia, Malaysia, Mexico, Philippines, South Africa, Thailand, Turkey, and BRICs (Brazil, Russia, India, and China) as NICs. For the past two decades, the relatively more populated BRICs have closed the productivity gap with the rest of NICs and have shouldered the bulk of global economic growth. BRICs' output per worker have increased threefold from 2000 to 2019 (*see Appendix*).

The NICs that have posted an average (and median) current account deficit of less than -2% (of GDP) will be classified as *deficit* economies and the NICs with an average and median surplus of more than 2% (of GDP) as *surplus* economies. South Africa and Turkey have posted an average current account deficit of 3.0% and 3.6% for the past two decades (table 2.2). Hence, they will be referred as *deficit* economies. On the other hand, China, Malaysia, and Thailand, which will be referred as *surplus* economies, have posted an average current account surplus of 2.5%, 9.0%, and 3.5% respectively. To draw the parallel between export growth and economic growth, NICs will be scrutinized in peer groups. This analysis aims to demonstrate that *surplus* economies have attained higher rates of economic growth than their peers.

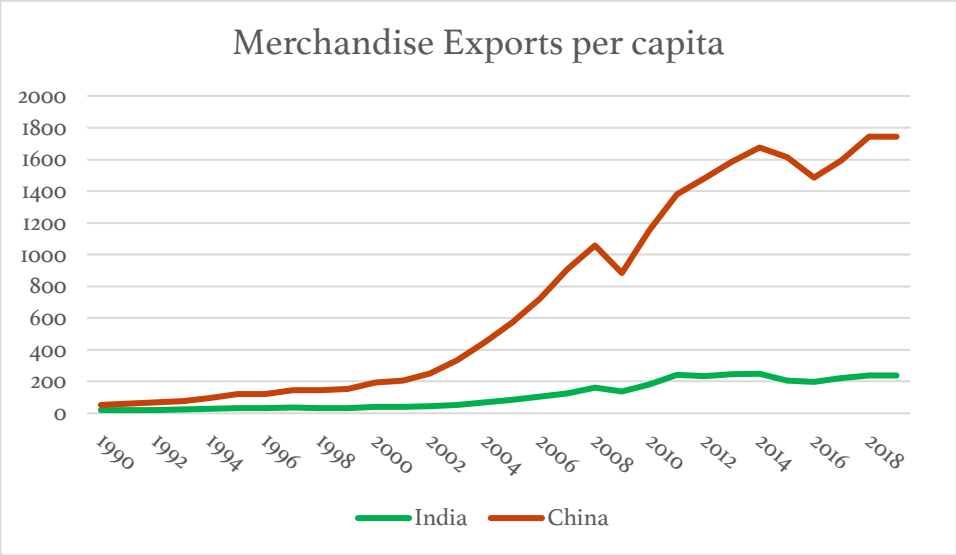
Table 2.2: NICs' Current Account Performance

	Average Current Account Balance (% of GDP)	Median Current Account Balance (% of GDP)
Brazil	-1.7	-1.9
China	3.4	2.5
India	-1.4	-1.2
Indonesia	0.3	0.1
Malaysia	9.0	9.0
Mexico	-1.5	-1.5
Philippines	1.5	1.8
South Africa	-3.0	-2.9
Thailand	3.8	3.4
Turkey	-3.6	-3.9

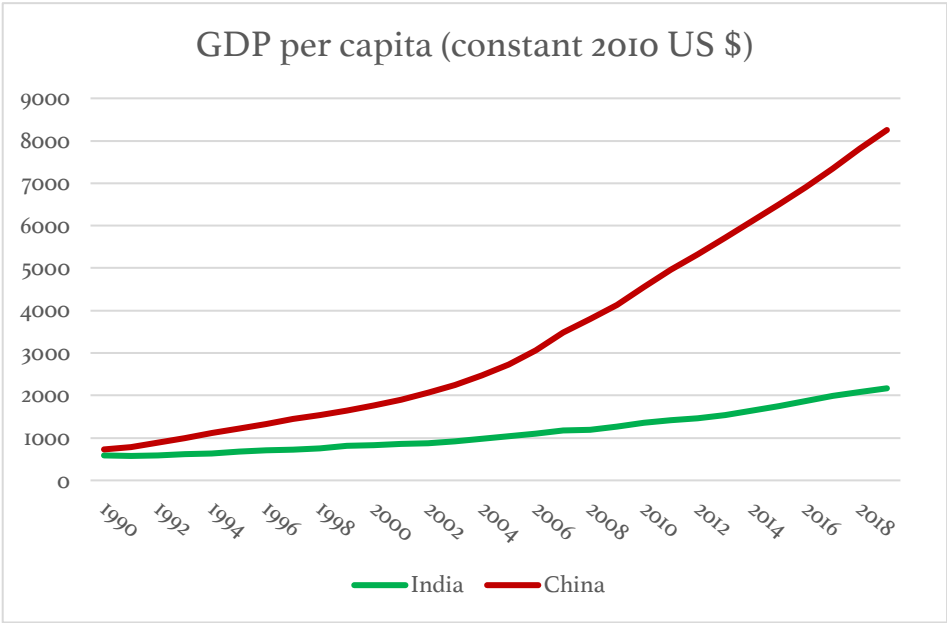
Source: World Bank Development Indicators. Notes: NICs stands for the newly industrialized countries. Notes: Average and Median Current Account Balance (% of GDP) for NICs from 2000 to 2019 (based on Author's calculations).

South Africa's and Malaysia's populations were 29 and 14 million in 1980 (they were/are the least populated NICs). They had comparable levels of ME per capita (see *Appendix*, *based on Author's calculations*). While South Africa's ME per capita slightly increased from 1980 onwards, Malaysia's ME per capita increased by more than seven times. In 2019, South Africa's ME per capita was 1537$, compared to Malaysia at 7455$ (*see Appendix*). In 1980, Malaysia was poorer than South Africa on a per capita basis, yet, Malaysia surpassed South Africa in a short span of time (World Bank). South Africa's GDP per capita (constant 2010 US$) stagnated for the past four decades whereas Malaysia's tripled from 3317$ in 1980 to 12478$ in 2019 (World Bank).

Figure 2.6: Merchandise Exports and GDP per capita (India vs. China)



Source: World Trade Organization Database and United Nations World Population Prospects. Notes: Merchandise exports per capita is merchandise exports divided by mid-year population in US dollars (based on Author's calculations). China and India are the NICs whose population exceeded 1 billion in 2000.



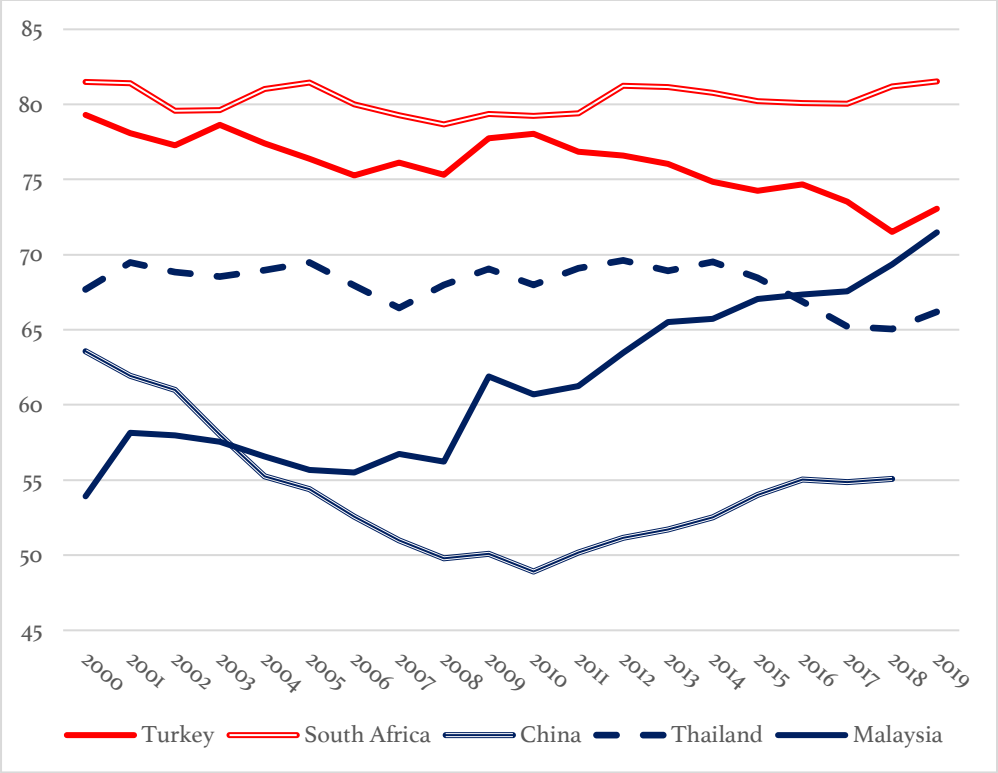
Source: World Bank Development Indicators.

India and China are the most populous NICs, whose incomes and merchandise exports were on par with each other before the so-called Chinese economic miracle (*see Appendix*). China's authoritarian regime implemented the ELG policy package in its totality. To put it briefly, the Chinese government suppressed wages (and domestic consumption), undervalued the Chinese yuan, and gave preferential treatment to export sectors. From 2000 to 2019, China's ME per capita increased from 193$ to 1743$, India's from 40$ to 237$ (Figure 2.6). India, unlike China, hasn't mobilized resources for industrialization. Indian coalition governments have rather followed orthodox economic policies. While the Chinese economy expanded rapidly, India's economic growth has been limited. In 2019, China's GDP per capita (in constant 2010 US$) was 8254$ compared to India at 2169$ (World Bank).

Among the rest of the Asian NICs (Thailand, Indonesia, and the Philippines), the unique one which has single-mindedly followed the ELG strategy, was Thailand. From the mid-1980s onwards, Thailand's merchandise exports followed an upward trajectory while that of the Philippines and Indonesia have stalled. While their GDP per capita levels were identical in 1980, Thailand's GDP per capita was double that of the Philippines and approximately 1.5 times bigger than Indonesia's in 2019 (*see Appendix*).

Lastly, consumption expenditures (% of GDP) and manufacturing ratios of *surplus* and *deficit* economies deserves scrutiny. *Surplus* economies have mimicked the South Korean model as they (1) moderated domestic demand and (2) gave weight to their manufacturing industries. Manufacturing ratios of *surplus* economies have been higher than those of *deficit* economies (see *Appendix*). In 2015-19, China's, Malaysia's, and Thailand's manufacturing ratios were 0.47, 0.41, and 0.36 respectively, compared to South Africa and Turkey at 0.19 and 0.29 (see *Appendix*). For the past half-decade, Turkey's manufacturing ratio has improved, while that of *surplus* economies have slightly descended.

Figure 2.7: Final Consumption Expenditure (Deficit vs. Surplus NICs)



Source: World Bank Development Indicators. Notes: Final consumption expenditure is the total of government consumption expenditure and household final consumption expenditure as a percentage of GDP.

Surplus economies have had lower consumption expenditure (% of GDP) levels than *deficit* economies. Turkey's and South Africa's consumption expenditures (% of GDP) have been higher than those of China, Thailand, and Malaysia from 2000 onwards (figure 2.7). Yet, Turkey's final consumption expenditure has been decreasing along with its current account deficit over the past half-decade. Turkey's current account deficit was, on average, 6.0% for 2010-14, and it decreased to 2.5% in 2015-19 (Author's calculations). China's and Malaysia's consumption expenditures has showed an opposite trend. Malaysia's consumption expenditure has ascended, dragging down its current account surplus from a record-high 16.9% in 2008 to a dismal 2. 1% in 2018 (see

Appendix). China's current account surplus has as well dropped mainly due to the surge in consumer spending. China's surplus has decreased from 2.41% in 2010-14 to 1.46 in 2015-19. (In 2005-09 it was recorded as 7.62%). To sum up, the empirical observations in this subsection suggest that a robust manufacturing sector and moderation of consumer spending provide quasi immunity from the current account deficit.

3. A BRIEF HISTORY OF THE TURKISH ECONOMY: FROM *ETATISM* TO IMPORT-SUBSTITUTION INDUSTRIALIZATION

This section aims to illustrate that before 1980 (1) a comprehensive export-led growth strategy was absent (2) a matching pattern between domestic demand and external imbalances (and *imports*) began to appear (3) Turkey remained an exporter of primary goods.

Turkey fell short of mass mobilization for industrialization and did not capitalize on its comparative advantages such as cheap(er) labor costs in comparison with the developed West and its proximity to the European market. The recurrent devaluations of the Turkish Lira were followed by periods of high inflation that reversed the course by generating real exchange rate appreciation. The policymakers were unresponsive to the real appreciation of the Turkish lira while the overvaluation wiped out Turkey's export-led growth potential.

The Ottoman Empire had suffered from balance of payments (BOP, hereafter) problems like its successor. Modern economic growth started in Western Europe and its offshoots at the end of the eighteenth century, and the Industrial Revolution instigated a historically exceptional gap between Western Europe and the rest of the world in material well-being and industrial power (Sachs, 1999, p. 92). Although there have been a few graduates from the cluster of less developed countries, the development gap between the industrial powers of the West and the periphery economies have persisted for the last one and a half centuries to a large extent. The countries that did not determinedly follow an export-oriented industrialization agenda, have commonly failed in breaking the underdevelopment curse.

The Ottoman state didn't go through the social, political, and economic processes that facilitated the scientific revolution and emergence of the *bourgeoisie* class in Europe. The Ottomans lacked the pre-requisite institutional

and legal infrastructure to promote capital accumulation. On the contrary, the state apparatus religiously stepped in to prevent the formation of private capital. The pre-capitalist Ottoman state fell behind the capitalist (and industrialized) West in economic and military sphere. The Ottoman's ruling elite attempted to recast country's institutional image by introducing market reforms, financial systems, commercial law, modern infrastructure, and even a parliament (Sachs, 1999, 92). Nevertheless, the Ottoman's ruling elite was far from fostering industrialization until the day it ceased to exist. After the Industrial Revolution, the production boom in Western Europe increased the need for raw materials. Like most of the periphery, the Ottoman Empire engaged in the export of primary goods, while importing manufactured goods (Pamuk & Williamson, 2011, p. 171). The 19th century witnessed a trade boom between the Ottoman and the core economies under Ottoman's liberal trade regime and decreasing transportation costs. Ottoman manufacturing gradually collapsed due to the inflow of European manufacturing goods (Pamuk & Williamson, 2011, p.164). In 1915, there were only 255 industrial firms mostly operating in the weaving and food sectors (Boratav, 1988, p. 33). Though the Ottoman economy was once self-sufficient, 79.5% of cotton thread and 91.5% of woven products had to be imported from abroad (Boratav, 1988, p. 33).

According to the economic theories based on Ricardo's comparative advantage, the Ottoman Empire had a comparative advantage in the production of agricultural goods vis-a-vis the developed West. Accordingly, the Ottomans should have benefited from trade as much as the imperial powers of the West did. In practice, however, history has shown that terms of trade are unfavourable to the exporter of agricultural goods and they generate a BOP constraint. The Ottoman Empire suffered from external debt during its last decades mainly due to foreign trade mismatch and the government's fiscal deficits.

During the late 1800s, worsening terms of trade and stagnation in export growth exacerbated economic difficulties in periphery economies. Around the same time, Ottoman state finances had reached alarming levels of deficits. In 1874, the Ottoman's principal and interest payments accounted for 80 percent of its

overall revenue (Cem, 1970, p. 243). As the Empire was stuck in a vicious cycle of foreign debt, European lenders stepped in to seize control over Ottoman public finances. A European-controlled institution, *Duyun-i Umumiye* (Ottoman Public Debt Administration) was founded in 1881 to collect the payments Ottoman owed to the foreign creditors. The Ottoman Empire posted current account deficits every year between 1873 and1914 (Karluk, 2002, p. 478). It is important to note that the BOP problems, which have recurrently triggered economic crises in Turkey, predate the Republic.

3.1 A New State is Born

Torn by prolonged years of war, Turkey's economy enjoyed favourable growth rates without accumulation of foreign debt from 1923 until the Great Depression. Removal of the tithe tax (*Aşar vergisi*), and nationalization of railway and tobacco industries are regarded as notable economic reforms of the early years. In the economic sphere, there was more continuity than disruption between the policies of the late Ottoman epoch and early years of the Republic. By undertaking the legal and institutional reforms (also called superstructure reforms) required by the new nation-state, the Kemalist Revolution prioritized *state-building* and *nation-building* during the early years. The transition from a multilingual and multinational empire to a nation-state brought about the transformation of Turkey's demographic composition. The Ottoman Empire's *Resettlement and Relocation law* of 1915 that ratified deportation of the Armenian population, and the population exchange (*mübadele* in Turkish) between Turkey and Greece in 1923 caused distortions in the urban and rural areas. Despite making up majority of the populace, Muslims possessed only 4% of foreign trade companies, 13% of logistics firms, 15% of wholesale stores, and 25% of retail shops in Istanbul in 1922 (Tezel, 1982, p. 88). Turkish/Muslim populace was merely absent in overseeing those roles which were once executed by the deportees. Anatolia and foreign markets were delinked due to the departure of non-Muslim merchants during and after the war years. It took

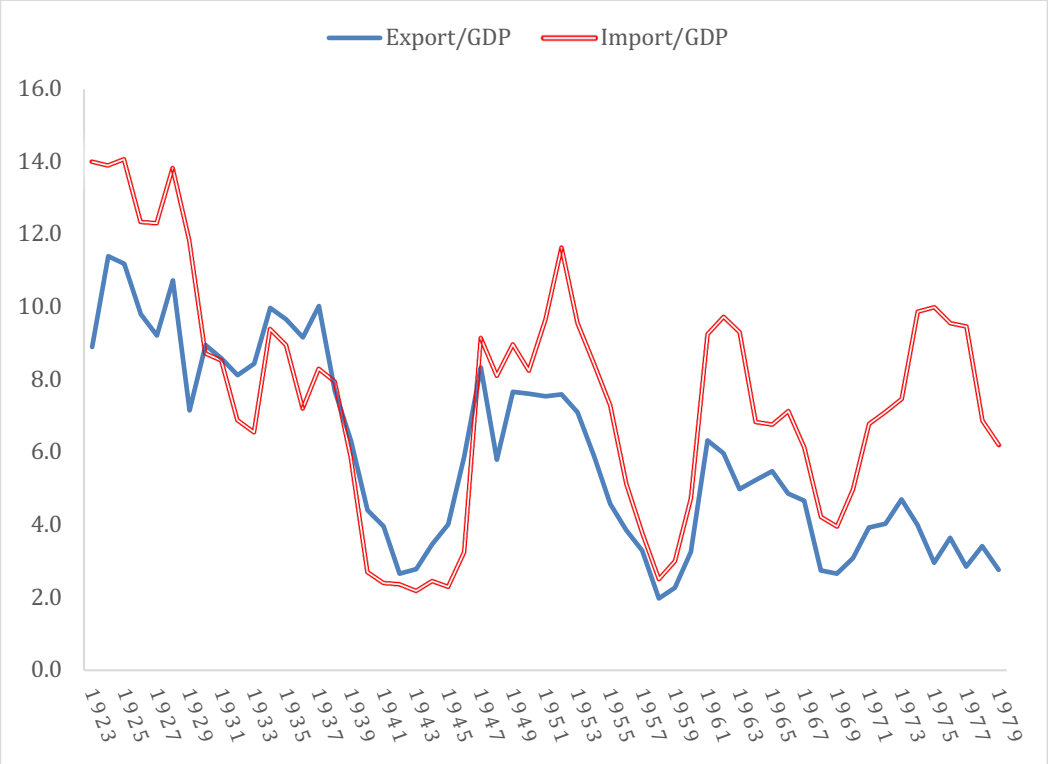
several years for the newly emerging Turkish bourgeoisie to fill the intermediary role that was vacant after population displacement.

The Great Depression severely affected the Turkish economy and marked the beginning of the inward-looking industrialization policies. Similar to its predecessor, Turkey exported raw materials/agricultural goods and imported industrial goods (mostly consumption goods) at the time the Great Depression hit the world economy. During the Great Depression, relative prices of agricultural goods were affected adversely, and deterioration in terms of trade was contractionary for the entire economy (Boratav, 1988, p.63). The policymakers' solution was to avoid the trade deficits that had led the Ottoman Empire to bankruptcy and to initiate domestic industrial production led by the state. In the 1930s, the first wave of state-led industrialization started with *3 Beyazlar* (in English: Three Whites; flour, sugar, cotton). State-owned economic enterprises, in other words, state monopolies that had absolute control over the pricing of subsistence goods (such as sugar and matches) served as an intermediary mechanism to transfer resources from agriculture to newly-emerging industrial sector. In contrast with the totalitarian/authoritarian practices of primitive capital accumulation (such as that of Soviet Industrialization under Stalin and Meiji Restoration in Japan), the rural dwellers weren't mobilized for industrialization. The urban population as a percentage of the total population remained unchanged in the 1930s as the first wave of industrialization didn't stimulate internal migration to the urban centers. As a result of various reasons such as decay of *tımar* system (Ottoman land order), bureaucratic corruption, and costly wars, the Ottomans had resorted to the Imperial European powers to finance its fiscal deficits. Kemalist leadership, being aware of the political troubles that the Ottoman state had gone through due to its financial dependence, was cautious in foreign borrowing. Moreover, they abstained from financing the first wave of industrialization by agricultural surpluses extracted through hefty taxation of the rural sector. Therefore, Turkey's first development attempt lagged behind *Late Developer*'s (like Japan, Taiwan, South Korea, and the Soviet Union) big-push industrialization. Yet, it is

worth noting that the Turkish economy suffered from major negative externalities during the one-party era: The Great Depression and WW2.

Graph 1 summarizes Turkey's trade performance from 1923 to 1980. From 1929 to 1946, in other words, from the Great Depression until the end of World War 2, it is notable that Turkey's imports didn't exceed exports. From 1929 to 1940, during the era defined as *Protectionist and state-led industrialization* by Boratav, both imports and exports constituted less than 10% of GDP. The trade openness as a percentage of GDP declined further during the war years, as expected. 1946 is the last year in the history of the Turkish Republic when merchandise trade surplus prevailed. From 1946 to 1954, the era that Boratav delineates as "*a different attempt for integration to the world economy"*, liberal economic policies prevailed. In 1946, the first major devaluation of the lira occurred in tandem with the liberalization of the trade regime. The Republican People's Party (CHP, hereafter) argued that the devaluation decision was a necessary prerequisite for integration into the new world order. The devaluation of the lira did not result in an export boom, as policy-makers had predicted. On the contrary, it exacerbated price volatility and bolstered the newly formed the Democrat Party's (DP, hereafter) opposition base. From 1946 onwards, imports started to overtake exports in line with the availability of FX.

Figure 3.1: Merchandise Trade (% of GDP) from 1923 to 1979



Source: Pamuk, Şevket. Uneven Centuries.

3.2. The Democrat Party Episode

The 1950 elections marked the end of the uninterrupted CHP rule for 27 years. In 1950 the DP won the general elections and their liberal program determined the framework for economic policy-making until external dynamics caused economic constraints. Turkey was awarded with a total of $184.5 million US$ (which was equal to 94% of Turkey's merchandise exports in 1948 according to WTO data) as part of the Marshall Plan between the years 1948- 1952 (Özer, 2014, p.30). Direct (loan, grants, and conditional aids) and indirect assistances were granted to Turkey to meet the imports from the USA and participant countries respectively (Koç and Koç, 2017, p. 87). The early DP years are described by most scholars as *outward-looking agriculture-led development*.

Productivity gains in the agricultural sector and infrastructure improvements are commonly regarded as the achievements of this period. The highest-level Export/GDP reached, on the other hand, was only 7.6%, and imports exceeded exports consistently during the 1950s. Therefore, it is difficult to claim that looking outward played a major (if any) role in the economic performance of the early 1950s. The rise in agricultural exports wasn't pivotal for the growth engine. Yet, it is clear that *looking outward* translated into fiscal expansion and upsurges in imports at the expense of external debt buildup.

In the aftermath of the Korean war (after 1953) agricultural prices began to decline, deteriorating Turkey's terms of trade. The DP's electoral hegemony rested on rural voters, and the government engaged in price support programs for agricultural products. The DP government relied on short-term expansionist policies, with foreseeable longer-term consequences (Pamuk, 2007, p. 279). As the DP government led by Adnan Menderes resisted to take contractionary fiscal measures and to devalue the Turkish lira, Turkey's *to-be-chronic* foreign deficit began to amass. In 1954, the DP government had to restore price controls and import constraints. The DP rapidly abandoned economic liberalism. Rather ironically the *liberal* DP had to establish new State Economic Enterprises (SEEs, hereafter) from mid 1950s. Imports/GDP ratio fell from its peak level of 11.6% in 1952 to 2.5% in 1958 (see Graph 1). In 1958, the Turkish economy was more inward-looking than ever, even from the 1930s.

Being a net energy importer, fuel shortages, and energy price hikes have historically served as a pictogram for difficulties on the BOP front. A campaign slogan of opposition CHP for 1957 elections, "unfortunately, we are pulling tractors by bulls" (*ne yazık ki traktörü öküzle çekiyoruz*) exemplifies economic sentiment on the eve of 1958 BOP crisis. Suffering from deterioration in BOP, the DP government had to welcome the auspices of the International Monetary Fund (IMF, hereafter) in 1958. Consequently, the Turkish lira was devalued against the US dollar, debt repayment was postponed, and new lines of credit were granted (Boratav, 1988, p. 111). With the availability of fresh credit, imports that had followed a downward trend until 1958, started to hike again.

Turkish imports contracted from 550mn USD in 1952-1953 to 315mn USD in 1958, but jumped back to its pre-crisis level of 500mn USD during 1959-1961 (Boratav,112).

3.3 Turkey meets Import-Substitution Industrialization

Turkish policy-makers *noticed* the benefits of import-substitution without formal guidance of the Bretton Woods institutions from 1954 onwards. The DP government initiated restrictive trade measures, which aimed to allocate resources (especially foreign currency) to support infant industries. Consumer goods imports were constrained due to the limited availability of FX. DP's initial endeavors prepared the basis of Turkey's ISI regime. Institutionalization of the regime, however, was completed after the 1960 coup. The Republic's first major encounter with BOP difficulties and lack of long-term planning during the DP years were the key issues to be addressed in ISI policies.

The 1961 constitution included the establishment of the State Planning Organization (DPT, in Turkish) and formal planning through five-year development plans (Togan, 1996, p.8). The ISI regime showed similarities to *etatism* of the one-party era in terms of the restrictive trade regime and strengthening of domestic industries. Trade restrictions, quotas, tariffs, and over-valued domestic currency were key policy measures (Togan, 1996, p.8). The First Five Year Plan (FFYP) of 1963, and the Second Five Year Plan (SFYP) of 1968 reinforced protection (via import controls on final goods and restrictions on intermediate goods imports) and directed resources to the production of high cost and low-quality consumer goods (Tekin, 2006, p.139-141). Eventually a newly-emerging industrialist class became the chief beneficiary and the strongest advocate of the protectionist trade policy.

On the BOP front, scarcity of foreign exchange became visible through delays in CBRT transactions and the level of existing reserves in the late 1960s. (Tekin, 2006, p. 138). While policy circles were pessimistic about Turkey's export potential, the Justice Party (AP, hereafter) government led by Süleyman Demirel

attempted to alter the ISI regime. Demirel's August 1970 policy package included the devaluation of TL, reduction in import restrictions, additional export incentives, and signaled the direction Turkey took for integration with the European Economic Community (Tekin, 2006, p. 147). There were initial improvements in BOP as exports and Workers' Remittances (WR, hereafter) rose notably in the following year. However, after the 1971 coup, the reform course was reversed, and gradually dismantled. The domestic coalition of industrialists and civil-military bureaucracy weighed in under the circumstances, in which democratic institutions lost their power. The August 1970 package is a missed opportunity because (1) by insisting on pursuing ISI policies, Turkey did not only accumulate foreign debt but also incurred *social costs* as the economic downturn from the mid-1970s onwards paved the way for the 1980 military coup, (2) after *infant* industries matured, productivity in the manufacturing sector stagnated as there was little to no incentive to upgrade. Turkey's ISI regime exploited the opportunities provided by a large and protected domestic market but didn't extend to technologically more sophisticated stage of capital goods industries (Pamuk, 2007, 280). Turkey's industrial sector, of which consumer durables manufacturing (*the new whites*) comprised an important share, was heavily dependent on imported intermediate goods. An expansion in investment in the industrial sector engendered higher import bills due to the increasing demand for intermediate goods and energy (Boratav, 1988, 120-121).

The oil shock of 1973-74 aggravated the FX difficulties and the fragilities of the Turkish ISI experiment began even more visible. Although Turkey was on the verge of a BOP crisis, the politicians rather took measures to delay the date of economic *apocalypse* instead of addressing external and internal imbalances immediately. The Turkish political establishment has historically been disinclined to devalue the lira and to take proactive measures to lower domestic absorption. Thus, once again, political constraints overruled the urgent needs of the economy. The well-known quote of then-Prime Minister Süleyman Demirel ratifies the severity of the BOP crisis in the late 70s, as there were times when Turkey was, indeed, "in need of even 70 cents".

Table 3.1: REER and Imports

YEAR	IMPORTS/EXPORTS	REER
1970	1.61	132
1971	1.73	106
1972	1.77	114
1973	1.58	111
1974	2.47	125
1975	3.38	129
1976	2.62	136
1977	3.31	136
1978	2.01	139
1979	2.24	132
1980	2.72	110

Source: OECD Main Economic Indicators (REER) and Uneven Centuries by Şevket Pamuk (Imports/Exports). Notes: Imports/Exports equals merchandise Imports/GDP divided by Merchandise Exports/GDP. REER is real effective exchange rates based on manufacturing consumer price index for Turkey, (2015=100).

Table 3.1 displays that imports exceeded exports by significant margins during the 1970s. 1975 and 1977 have been the only years in the history of the Turkish Republic when merchandise imports have been more than thrice exports. The *Imports/Exports* ratio reached its peak levels of 3.38 in 1975 and 3.31 in 1977. OECD's REER index shows that excluding the years when there were major devaluations (August 10, 1970, and January 24, 1980), the Turkish lira was by-and-large overvalued during the 1970s. The Lira's overvaluation was a noteworthy contributor to the surge in imports along with rising oil prices. From 1977 onwards, the inflow of imports (that was of high importance to the

industrial production) was limited due to the shortage of FX (Togan, 1996, p. 6) The BOP crisis was accompanied by recession and political instability.

Table 3.2: Workers' Remittances

YEAR	Exports	Imports	WR	WR/Imports (%)
1964	411	537	9	2
1965	464	572	70	12
1966	490	718	115	16
1967	523	685	93	14
1968	496	764	107	14
1969	537	801	141	18
1970	588	948	273	29
1971	677	1171	471	40
1972	885	1563	740	47
1973	1317	2086	1183	57
1974	1532	3777	1420	38
1975	1384	4758	1330	28
1976	1960	5129	983	19
1977	1753	5796	982	17
1978	2228	4599	993	22
1979	2261	5069	1695	33

Source: Akat, Asaf Savaş. Alternatif Büyüme Stratejisi. Notes: Imports, Exports, and Workers Remittances are in Million US dollars, WR/Imports in percentages.

While the export orientation of the manufacturing industry remained weak, Turkey acquired the FX from traditional agricultural exports (Pamuk, 2007, p. 280). Yet, the aforementioned merchandise exports were not the only source of FX during this period. During the Cold War, Turkey occasionally received preferential treatment from its NATO allies, mainly the USA, in economic terms

due to its geopolitical importance and proximity to the USSR. Turkey could spend more FX than it earned due to the availability of official credit and foreign aid. Furthermore, from 1961 onwards, Turkish workers started to migrate, mainly to the Federal Republic of Germany. WR affected the Turkish economy through the current account, in other words, Turkey acquired scarce foreign currency by exporting *labor* directly instead of indirectly through exports of manufactured goods. From 1950-1979, 35% of Turkey's merchandise imports were financed by foreign currency that was not acquired through merchandise exports (Akat, 1983, p. 63). Mainly due to WR from 1964 onwards, and aforesaid external dynamics, Turkey's ISI regime was sustained for a prolonged period.
The ratio of WR to total exports was 20% in 1970 and reached 90% in 1976 (Aydaş et. al, 2005, p. 55). WR was made available in the Central Bank's (CBRT, hereafter) BOP statistics from 1964 onwards, and that (based on constant prices) 57% of merchandise trade deficit was financed by WR from 1950-1979 (Akat, 1983, p. 64). The share of WR in the financing of merchandise trade deficit would be even higher if years of analyses were narrowed down to 1964 - 1979. Turkey's WR receipts from official channels decreased significantly after 1974, coinciding with the world oil crisis and the emerging hyperinflationary environment in Turkey (Aydaş et. al, 2005, p. 56). Following the Cyprus peace operation in 1974, the USA-Turkey relationship followed a rocky road. The USA imposed an arms embargo on Turkey from 1975 to 1978. The sanctions imposed by the USA government further aggravated Turkey's already-fragile macroeconomic imbalances.

3.4. The End of Protectionism

Macroeconomic indicators validate that the ISI regime functioned quite well during the early stages, but lost its transformative power in due course. Industrial value-added (including construction) as a percentage of GDP increased from 17.3% in 1960 to 23.5% in 1980 (World Bank). From 1960 to 1972, the industry's share in GDP followed an upward trend. In 1972 the Industry (% of

GDP) reached 23.7% and stagnated until 1980. The manufacturing value-added as a percentage of GDP series have almost identical trends. Manufacturing (% of GDP) increased from 12.7% to 17.1% from 1960 to 1980, reaching its peak level of 17.6% in 1973 (World Bank). From 1972 onwards, Turkey's stagnation in industrialization demonstrates that the ISI regime stopped serving its purpose. The growth rate of the industrial sector lagged behind that of GDP.

Table 3.3. Urbanization

Year	Urban Population (%)	Change in Urban (%)
1950	25.0	0.1
1955	28.8	3.8
1960	31.9	3.1
1965	34.4	2.5
1970	38.5	4.0
1975	41.8	3.4
1980	43.9	2.1
1985	53.0	9.1
1990	59.0	6.0
2000	64.9	5.9

Source: Turkish Statistical Institute. Notes: Urban Population (%) is the urban population as a percentage of total population. Change in Urban (%) stands for change in Urban Population (%) in five-year intervals. Change in Urban (%) for 1950 is calculated by subtracting the percentage of Urban population in 1945 from that of 1950. (Based on Author's calculations).

The export-led growth strategy requires transformation of the economy that induces shifts towards manufactured goods, away from primary exports. The requisite structural change in the direction of tradables such as manufacturing and modern services isn't simply achieved by unassisted market forces, and that it is rather the result of government interventions (Rodrik, 2011, p. 4). Despite its limitations (urban dwellers who migrate to urban centres don't necessarily find a job in the industrial sector, they may as well work in services), growth of the urban population may serve as a handy proxy to assess the pace of economic transformation. From 1960 to 1980 the urban population as a percentage of the total population increased from 31.9% to 43.9% (Turkish Statistical Institute). Table 3.3 shows that parallel to the stagnating share of industry (% of GDP) during the second half of the 1970s, the rise in urban population (% of total population) is limited to only 2.1 points from 1975 to 1980. Nevertheless, structural transformation accelerated in the aftermath of January 24th decisions in 1980. *Change in Urban (%)* values are significantly higher from 1980 onwards in comparison to earlier stages of Turkey's development course. The share of the urban population increased for a record level of 9.1 pts % from 1980 to 1985. With the launch of January 24th decisions in 1980 and during the Motherland Party (ANAP, hereafter) period, Turkey went through an unseen economic makeover, which will be scrutinized in the next section.

Referring back to the inconvenient policy dilemma that was aforesaid, the Turkish political establishment was disinclined to restrain domestic absorption and devalue the Turkish lira mainly due to their political limitations. As a consequence, domestic demand-led growth triumphed over the export-led growth and protectionism over trade liberalization. Although competitive elections are desirable for a well-functioning democracy, they may lead to less desirable long-run economic outcomes. When politicians face choices between present and future welfare, they make decisions biased against future generations (Nordhaus, 1975, p. 187). As politicians become more responsive to the electorate, they are likely to put short to medium-term economic prospects above the long-term outcomes (e.g. commit to more spending or be less motivated to

depreciate the lira). The government must possess some degree of autonomy from societal pressures to implement forward-looking interventionist policies (Öniş, 1991, p. 123).

In the 1969 general elections, AP had won 46.6% of the votes, while its closest rival: CHP had 27.4% (Grand National Assembly of Turkey). The difference between the first and the second party's vote share was a hefty 19.2%. Whilst the AP government implemented the August 1970 devaluation, the party enjoyed an absolute majority in the parliament. However, the difference between the first and the second political parties was significantly lower than 19.2% in the succeeding elections until 1980. As the elections became more competitive, the politicians were presumably less inclined to alienate the Turkish electorate, (1) who has traditionally perceived the strength of the Turkish lira as a sign of economic well-being and prosperity (2) whose purchasing power is adversely affected by the lira's undervaluation (due to cost-push inflationary pressures).

Yet, the electoral competition and politicians' short-termism only present a partial view. The emergence of *populism* and rising fiscal imbalances had its roots in the political and institutional setting during the late ISI era. Thanks to the labor-friendly features of the 1961 constitution, organized labor became a strong political force during the 1970s. The Turkish working class was granted certain privileges and rights far in advance of their counterparts in other, similarly underdeveloped countries (Keyder, 1987, p. 160). CHP led by Bülent Ecevit and AP led by Süleyman Demirel were two major political parties that dominated the short-lived coalition governments from 1973 onwards. While the economy showed signs of a downturn, the administrations rather turned a blind eye to pre-emptive measures. Demirel and Ecevit like Menderes in the 1950s gave too much priority to short term party goals (Gunter, 1989, p. 66). The austerity measures such as spending cuts and tax increases were too arduous to implement in the aforesaid political setting. Hence, the share of wages in the manufacturing sector rose from 31.7% in 1976 to %38,3 in 1979, a significant part of such increase stemmed from pay increases in the public sector (Boratav,

1988, pp. 143-144). The fierce political competition and bargaining power of the labor unions may help explain the stagnant wage share while the economy contracted sharply.

Since the Turkish policy-makers did not (or could not) take profound measures to restrain domestic demand, the Turkish economy suffered from hyperinflation, public sector imbalances, and current account deficit. As a result of inward-looking industrialization policies that had prevailed for more than two decades, Turkey found itself in the midst of a BOP crisis in the late 1970s. Turkey frequently managed to attain economic assistance from Western institutions during the Cold War. Yet, when the much-needed credit wasn't granted, Turkey went through an economic downturn.

Protectionism of the ISI mainly halted growth in manufacturing exports rather than imports, and Turkey was one of the most closed economies of the world in 1979 (Akat, 1983, p. 69). The domestically produced industrial goods were directed to the domestic market rather than foreign markets while the pace of industrialization was contingent on the obtainability of FX. Since Turkey was neither technologically advanced nor rich in natural resources, technology-intensive intermediate goods and energy imports instigated the buildup of external imbalances. When the availability of FX did not create constraints on economic activity, the Turkish economy by-and-large enjoyed moderate-to-high growth rates.

4. THE FIRST PHASE OF ECONOMIC OPENING: FROM THE JANUARY 24TH DECISIONS TO THE 2000/1 CRISIS

This section recounts the early years of economic liberalization and the turbulent years of the Turkish economy in the 1990s. It tracks the causes of Turkey's external imbalances from 1980 to 2001. It also aims to demonstrate the outcomes and shortcomings of Turkey's first ELG attempt. Moreover, it scrutinizes factors that led to its failure.

Export promotion entails a trade regime that compels less protection on the import front. Hence, restrictive trade measures lose their control over import suppression in an open-economy. Turkey's effective protection rates declined through the 1980s and 1990s, and trade liberalization did not automatically translate into current account surpluses. The export-led growth strategy requires implementation of proactive and interventionist economic policies. Primarily, the government has to resort to non-trade measures to restrain domestic demand for foreign goods to constrain imports. Secondly, it has to follow a proactive industrial policy approach that supports the export sectors. If the policy-makers are reluctant to restrain domestic absorption, trade liberalization may result in more severe external imbalances than before, as has been the case for Turkey in recent decades. The literature suggests that the government should (1) polish an export-friendly macro environment with immediate trade policies to efficiently allocate the resources in the short run (2) implement education policies to target medium-to-high technology products' exports in the long run. The Turkish policy-makers somewhat succeeded in (1) but failed in (2) (*see* the share of high-technology exports in total exports in *Appendix*). The economic program of the 1980s intended to reorient the productive resources towards the sectors in which Turkey had a comparative advantage in foreign markets. In the 1980s, the industrial capacity that had been created formerly through the ISI policies, was

directed to international markets (Pamuk, 2007, pp. 268-270). Exports as a percentage of GDP increased more than threefold from 1979 to 1990. In the 1990s, however, the growth of exports decelerated (figure 4.1).

4.1 The Turkish Economy at the Crossroads: January 24th Decisions

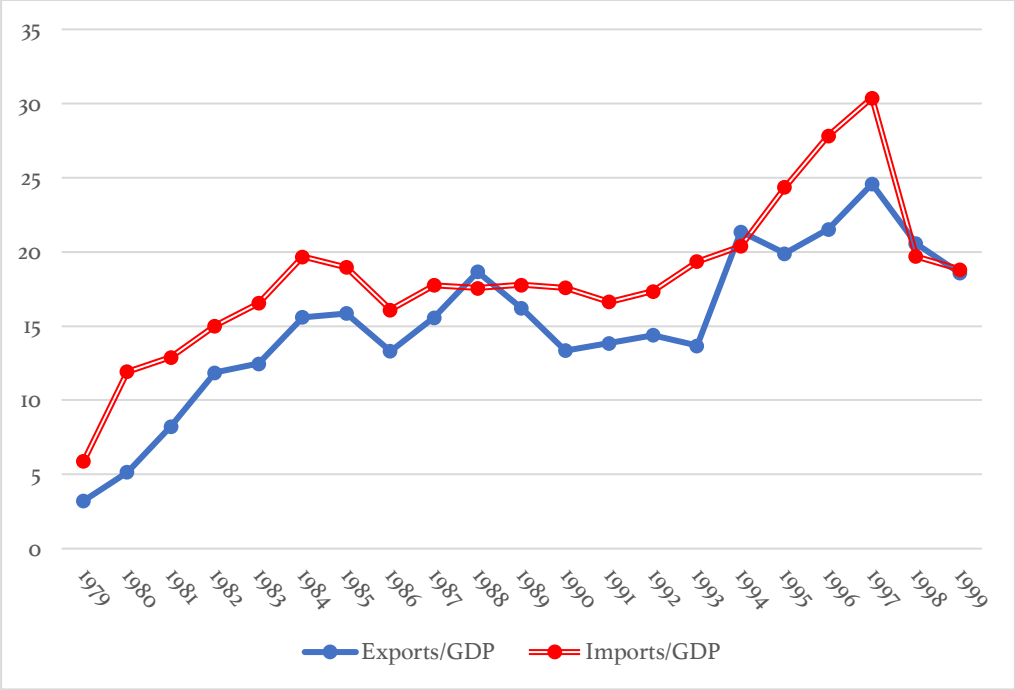
Turkey's ISI regime that crumbled with the BOP crisis officially ended with the announcement of the 24th of January decisions in 1980. The Stabilization program that was announced by the minority government of Süleyman Demirel on January 24th, 1980, marked the beginning of Turkey's integration into world markets. While the political crisis of the late 1970s resulted in a military coup on September 12th, 1980, the remedy for economic turmoil was found in the neoliberal policies of the Washington Consensus. The objectives of the stabilization program were: (1) elimination of disequilibria in major markets, (2) coping with the immediate pressures on BOP, (3) reduction of inflation, (4) removal of trade barriers, and (5) privatization (Şenses, 1991, p. 215). Although macroeconomic discipline was also at the center of the policy package, the Turkey rather handpicked Washington Consensus policies and failed in eliminating fiscal imbalances.

In one of the most repressive periods of the recent political history of Turkey, the economic sphere was shaped by a set of free-market policies under the supervision of the Bretton Woods Institutions. The political regime change that took place on September 12 facilitated the implementation of the 'shock treatment' items of January 24th decisions such as SEE's price increases and devaluation of the Turkish lira (Boratav,147). The January 24th decisions and the September 12 coup were major turning points in Turkey's transition to a neo-liberal economic model in the 1980s.

As a result of this market-oriented stabilization program, Turkey abandoned import substitution policies, and for the first time in the history of the republic, the government facilitated an export-oriented growth attempt. Whilst the January 24th decisions were taken, Turgut Özal played a crucial role as Undersecretary

of the Prime Ministry. His influence expanded as he became Deputy Prime Minister responsible for the economy in the military governments (until he resigned in 1982), and the Prime Minister and the leader of ANAP after 1983. The export boom of the 1980s is commonly attributed to prime minister Turgut Özal's tenacity to pursue the export promotion. The stabilization package consisted of; a large devaluation (from TL 47.1 to TL 70 to the US dollar), export subsidies, a rise in interest rates, and the promise to eliminate various government subsidies (Rodrik, 1990, p. 4). The fixed exchange rate regime was shelved, and crawling-peg was adopted under the scope of the new program. As the Turkish lira was devalued with respect to purchasing power parity, the real appreciation of the lira was to be prevented. The government incentivized the private sector to invest in export sectors through "positive lists" (Atiyas & Bakış, 2015, p. 1220).

Figure 4.1: Foreign Trade (% of GDP) from 1979 to 1999



Source: World Bank Development Indicators.

The government's efforts bore fruits and exports of goods and services (%GDP) increased from 5.16% to 15.86% between 1980 and 1985 (Figure 4.1), (3.5 billion in 1980 to 10.6 billion in 1985 in current US dollars *(see Appendix)*) Exports (%GDP) remained in double digits during the second half of the 1980s, reaching its peak (21.36%) in 1989 (Figure 4.1). The real exchange rate depreciation appeared as the main explanation for the export boom; export subsidies are a distant second, and from the mid-1980s onwards, the economic expansion in Turkey's trade partners the third (Barlow & Şenses, 1995, p. 132). Competitive exchange rates are crucial for export promotion mainly because they channel resources from non-tradable sectors to tradable sectors. Undervaluation of the currency cannot sustain economic growth in and of itself, but it can be seen as a facilitating condition to capitalize on existing opportunities for growth (Eichengreen, 2007, p. 13). If learning by doing or technology transfer is relatively rapid in export sectors, then there will be an additional stimulus to the overall economic growth" (Eichengreen, 2007, p. 8).

Even though the merchandise trade deficit persisted in the second half of the 1980s, tourism revenues began to counterbalance. In 1980, the ratio of tourism revenues to export revenues was only 11.2% (TURSAB) and it declined further into single digits in the aftermath of the 1980 military coup. From 1983 onwards, however, due to the initiative pioneered by Özal, tourism revenues skyrocketed. In 1989 tourism (% Total Exports) reached 22% (TURSAB, *see Appendix*). Tourism revenues have continued to be an important source of FX for balancing of merchandise trade deficit since then.

A rather tacit aspect of Turkey's first export-led growth attempt is import liberalization. Throughout the 1980s, quantitative restrictions were abolished and the level of nominal and effective protection rates was substantially reduced (Togan, 1997, p. 171). Scholars tend not to focus on the surge in imports during the 1980s as imports didn't exceed exports by vast margins, and favorable liquidity conditions didn't induce difficulties on the BOP front. Despite the undervaluation of the Turkish lira, imports as a percentage of GDP rose from 5.88% of GDP in 1979 to 19.67% in 1984 (Figure 4.1). Imports were higher than

exports permanently during the 1980s (except in 1989, when tourism revenues drove exports ahead of imports). Nevertheless, the gap between export and import bills was not troublesome. Turkey's current account deficit of 1 billion USD was regarded as "manageable" by 1985 (Togan, 1996, p. 22).

Why didn't current account deficit pose a major problem in the first phase of economic opening in contrast with the later stages? The answer may lie in the moderation of domestic demand through suppressed real wages and deterioration in agriculture's terms of trade. The trade literature demonstrates that Turkey's import demand is very responsive to changes in domestic expenditure with an elasticity greater than its unity (Günçavdı & Ülengin, 2008, p. 3). By definition, an excess sum of domestically produced goods and services is absorbed by foreign markets if Turkey consumes less than it produces. Contrarily, when Turkey consumes more than it produces, it does at the expense of external borrowing. Therefore, further attention must be given to the role of domestic demand to draw conclusions about Turkey's BOP performance in the neoliberal era.

4.2. The Subdued Domestic Demand in the 1980s

In the aftermath of the 1980 coup, the constitution was suspended, political parties were dissolved, and leading political figures were banned from politics. The military regime took draconian measures to paralyze labour union activity. The changes in labour union legislation (1) forbid strikes over issues other than wages, (2) made bargaining rights conditional, (3) introduced a bureaucratic hassle and an immense rise in associated registration costs and for new members (Adaman et. al, 2009, p. 174). Moreover, suspension of democratic institutions removed electoral constraints from the equation. The political parties of the late ISI era were under pressure to please the electorate whereas the military government was not. Although Turkey held parliamentary elections from 1983 onwards, political decision-making remained under the supervision of the military tutelage. The share of wages and salaries in national income declined

from 27% to 14%, while the share of rents, profits, and interest income increased from 49% to 70% between 1980 and 1988 (Rodrik, 1990, p. 24). A descending trend is also visible in wages' share in manufacturing value-added. Wage share in the manufacturing industry steadily declined during the early stages of Turkey's neo-liberal structural adjustment (Onaran, 2007, p. 369.) The economic transition came at the expense of lower incomes for wage earners. Dreadful economic memories of the BOP crisis (in the late 1970s) and oppression of the military regime can be reckoned as factors that pacified resentment against economic transition.

Table 4.1: Rural Population (% of Total Population) and REER in the 1980s

Years	Rural Population	REER
1979	56.65	132
1980	56,22	110
1981	54.11	114
1982	53.00	103
1983	51.19	99
1984	49.37	94
1985	47.55	95
1986	46.07	78
1987	44.74	73
1988	43.41	70
1989	42.10	77
1990	40.78	86

Source: World Bank Development Indicators and OECD Main Economic Indicators.
Notes: Real Effective Exchange Rate is based on Manufacturing consumer price index, 2015=100.

Rural incomes were, too, affected adversely by Turkey's transition to a neoliberal economic model. Although the agricultural sector accounted for only 26% of GDP (*see Appendix)* in 1980, the Turkish society was quite agrarian/rural. The rural population as a percentage of the total population was 56.22% (Table 4.1). Agricultural terms of trade (1973=100) declined from 69.8 to 54.1 from 1980 to 1988 (Rodrik, 1990, p. 45), whilst the rural population accounted for almost half of the population on average during this decade. The deterioration in agriculture's terms of trade and real wages was matched by a substantial increase in the profitability of the manufacturing sector (Celasun & Rodrik, 1989, pp. 193-211). Deterioration in agricultural incomes did not only moderate domestic demand but also reinforced Turkey's prompt *de-agrarianization* and structural transformation during the 1980s.

In the 1989 municipal elections, the political hegemony of ANAP came to an end. ANAP was defeated in the major cities, and after the 1991 general elections, it lost its parliamentary majority. By 1989, Turkey's transition from autarky to open economy was largely completed. Apart from privatization and price stabilization, the reforms that had made up the backbone of the 1980 stabilization program were carried out. The Turkish economy was clearly more outward-looking than ever before. Trade as a percentage of GDP expanded to 34% in 1989 (World Bank). A decade after the BOP crisis of the ISI, Turkey achieved current account surplus ratios of 1.8% and 0.9% of GDP in 1988 and 1989 respectively (Figure 4.2). Yet, the political setting that had facilitated moderation of domestic demand began to wane. Turkey's institutional deficiencies prepared the basis for a decade of economic havoc that endured until the 2000/1 crisis.

4.3 Turkish Neoliberalism in Crisis: The Lost Decade

During the 1990s, the Turkish economy suffered from enduring high inflation and fiscal deficits on the economic front, and short-lived coalition governments and rising social tensions on the political front. The moderation of domestic absorption was not feasible for the ruling party(ies) in a shifting political climate

from the late 1980s onwards. After the abolition of political prohibitions in 1987, banned politicians returned to the political arena and the elections commenced to be more competitive. In the 1991 elections Demirel's True Path Party (DYP, hereafter) won the most seats in parliament. One of DYP's campaign pledges: "*her aileye iki anahtar" (two keys to all households*- meaning *one key for a car, and another one for a house)* exemplifies the political sentiment prior to the elections and what was yet to come. Political competition stimulated higher levels of government spending through *clientelism*, and eventually revived economic populism until the first major economic meltdown of the neoliberal era: the 1994 economic crisis. The compensation of employees (% of total government expenses) increased from 29.35% in 1988 to 51.6% in 1992 (World Bank), while Turkey's public spending grew steadily until the 1994 economic crisis. From 1988 to 1993 the public sector borrowing requirement jumped from 5% to 12% of gross national income (Yeldan & Sakallioglu, 485). The public deficit was one of the key factors that spawned desperate straits in the 1990s. The 1990s are defined by some scholars as *the lost decade* since fragile and short-lived coalition governments from 1995 onwards were not resilient enough to overcome social, political, and economic challenges that were brought about by the Turkish economy's abrupt (and disorganized) transition to a neoliberal economic model and prompt structural transformation.

In 1989, during his last year as prime minister, Özal carried out an unanticipated policy reform and removed restrictions on the movements of capital in and out of Turkey. Capital account liberalization of 1989 allowed the accumulation of external debt without checks and balances. The 1989 reform made Turkey a primary target for *hot money* flows as the financial and non-financial private sector began to borrow from abroad. Nevertheless, the government's regulatory capacity was not sufficient to provide a buffer against speculative capital movements and to constrain the financial sector's risk inclination. The financial/banking sector became more vulnerable to shocks caused by capital outflows. Foreign and domestic financiers began to take advantage of the arbitrage opportunity provided by high-interest rates and the crawling-peg

regime. The banking sector likewise took advantage of arbitrage profits by borrowing from abroad and lending to the government by investing in high yield treasury bonds.

Financial capital inflows have caused phases of an economic boom; which were later followed by capital flight and economic calamities. These boom and bust cycles have shaped Turkey's economic growth trajectory since 1989. From 1989 onwards, the Turkish economy has suffered from recurrent *sudden stops* and has witnessed economic downturns at least once (occasionally more than once) per decade. Turkey could not attract non-speculative capital inflows (such as foreign direct investment) mainly due to its institutional deficiencies. As a result, capital inflows have remained volatile.

The inflation rate that rose to the high two-digit levels from 1988 onwards, stood out as the major weakness of the Turkish economy until the 2000-1 crisis. Turkey, being a net intermediate (and capital) goods and energy importer, the lira's depreciation has traditionally aggravated cost-push inflationary pressures. However, the lira's depreciating path does not single-handedly explain Turkey's chronic inflation. The rate of inflation stood at 94.3% in 1980 and declined to 37.6% in 1981 as an upshot of the stabilization program (World Bank). It persisted at 29.1% in 1982 and 31.4% in 1983 (World Bank) but began to rise as the government resorted to *seigniorage* to finance budget deficits. The sources of inflation *a-la-turca* is beyond the scope of this dissertation. Yet, it's worth mentioning that CPI levels got out of control, remaining well above %50 (annually) until 2002 (*see Appendix*).

The external debt wasn't distressing mainly due to inflow of Islamic capital from Gulf countries and the bilateral relations of the Özal administration with the Western debtor institutions until the late 1980s. Moreover, the current account balance was considered to be unproblematic. Table 4.1 demonstrates that the lira depreciated in real terms until 1988. From 1988 onwards, however, the *lira*'s real depreciation has discontinued mainly because the nominal depreciation of the *lira* was offset by the increase in the inflation rate. The lira has appreciated in real terms from 1988 to 1993. Consequently, appreciation of the lira

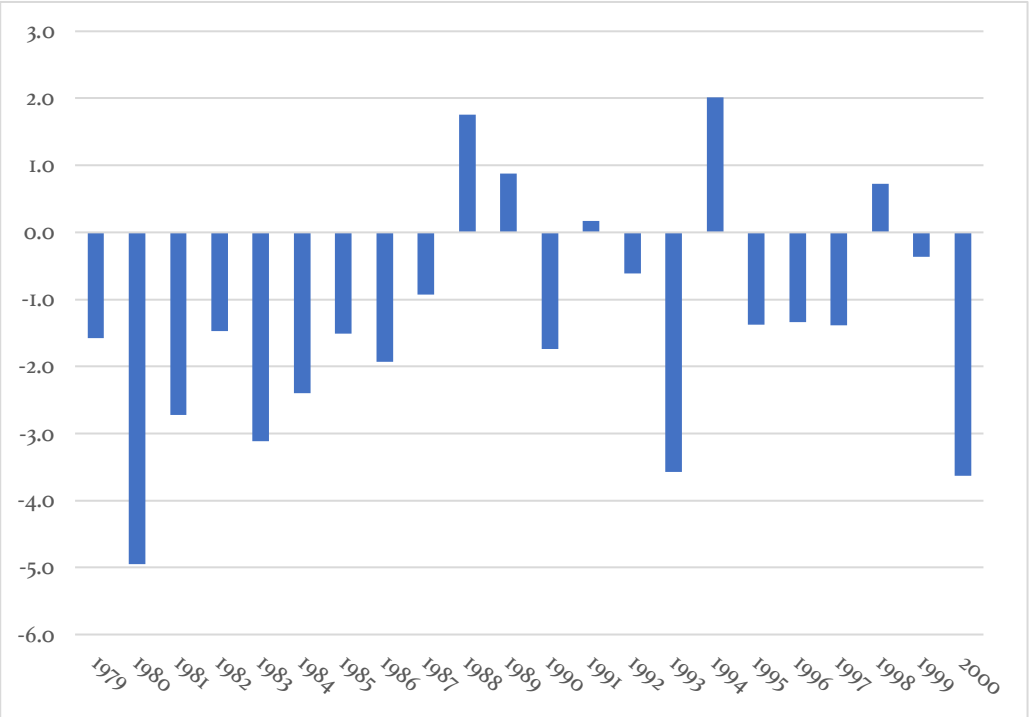
encouraged imports. The current account deficit reached 3.6% of GDP in 1993 (figure 4.2).

The aforementioned external (e.g. current account deficit) and internal imbalances (e.g. inflation and public sector deficit) paved the way for the 1994 economic crisis. The 1994 economic crisis was triggered by the government's rambling attempts to mitigate fiscal pressures by cutting interest expenditure. DYP and the Social Democratic Populist Party (SHP) coalition government led by prime minister Tansu Çiller sought to reduce the public debt burden by cancelling treasury auctions and raising taxes of interest income on government bonds. The government avowed to raise revenues from the partial privatization of the telecommunications industry instead of costly borrowing practices. Nevertheless, the government's disorderly effort resulted in capital flight as the constitutional court revoked the privatization bill. The Çiller government announced an IMF-backed austerity package, known as the 5th of April decisions to combat the economic downturn. The most striking element of the 5th of April decisions was the massive devaluation of the Turkish lira. Competitive exchange rates once again played a key role in export promotion and exports (% GDP) rose steeply in 1994. Exports (% GDP) surpassed imports (% GDP) in 1994. (Figure 4.1) In 1994, current account surplus stood at 2.0% of GDP, mainly driven up by the surge in exports. Note that the comparable figure for the year before, 1993, was -3.6% (Figure 4.2). Exports (% GDP) increased from 13.67% in 1993 to 21.36% in 1994(Figure 4.1). As a result of the program real wages plummeted. The distributional pressures were once again levied on wage earners. The index of real wages in private manufacturing (1988=100) decreased by 29.2% from 1993 to 1994 (Yeldan & Sakallıoğlu, 2000, p. 485). The 5th of April decisions did not only lower domestic absorption but also reduced labour costs for tradable sectors.

Turkey joined European Customs Union (CU, hereafter) in 1996, and Turkey's effective rate of protection came under further downward pressure. It was an historical turning-point for the Turkish manufacturing sector. After decades of total and quasi protection of domestic industries, the Turkish manufacturing

sector met international competition. Unlike the Southern European countries that joined the CU, Turkey was to bear the costs of adjustment without the EU assistance. As of 1 January 1996, industrial goods that complied with the CU norms began to circulate freely between Turkey and the EU (Togan, 2005, p. 1230). Turkey's membership in the CU did not have immediate repercussions in the current account balance. Although imports grew substantially in 1996-97, current account balance as a percentage of GDP remained rather unaffected due to the pick-up of GDP. Yet, the gap between imports (% of GDP) and exports (% GDP) widened to 5.8% in 1997 (Figure 4.1). The merchandise trade deficit was balanced by a sharp increase in tourism revenues (TURSAB). *The doom scenarios* that had projected the sudden demise of the manufacturing sector after Turkey's membership in the CU, did not prove to be true. The current account balance (% of GDP) remained at moderate levels until 2000 (Figure 4.2). Nevertheless, manufacturing as a percentage of GDP followed a decreasing trend from 1995 onwards (*see Appendix*). It contracted from 22.6% in 1995 to 18.75% in 2000 (World Bank*)*.

Figure 4.2. Current Account Balance (% of GDP)

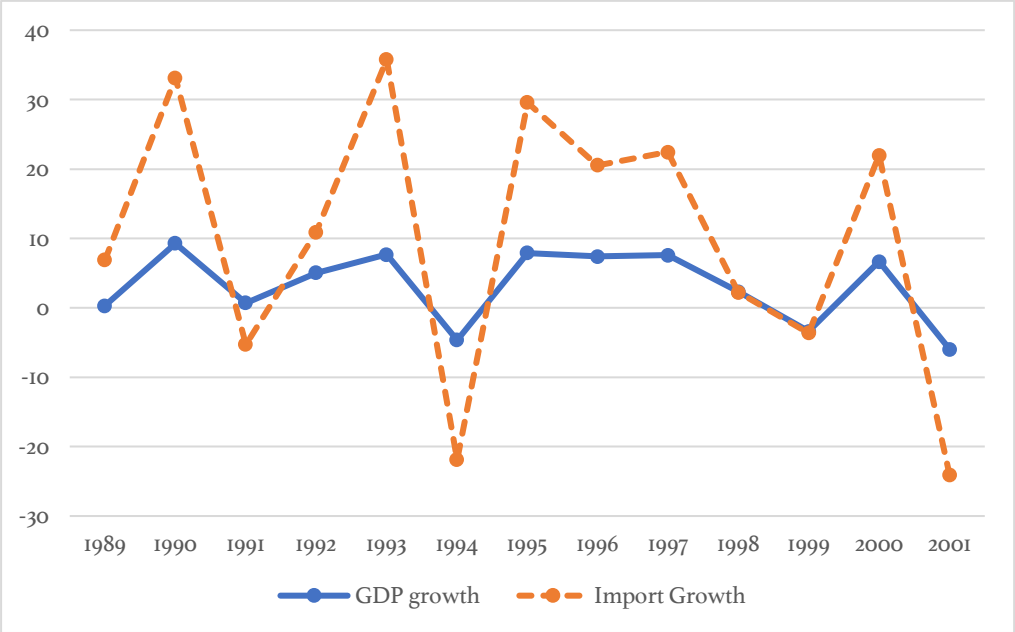


Source: World Bank Development Indicators

The 5th of April decisions were quite effective in controlling for the external imbalances for a short time horizon. Yet, the inflation rate remained at high double digits (World Bank) and the public deficits continued to accumulate in the second half of the 1990s. Government debt grew sharply exceeding 60% of GDP at the end of 1999 (Akyüz & Boratav, 2003, p. 1550). Whilst interest rates exceeded inflation by some 30 percentage points, fiscal sustainability could only be tenable with slashing inflation and hence interest rates (Akyüz & Boratav, 2003, p. 1551). The Turkish economy was adversely affected by the Russian financial crisis in 1998, and the Marmara earthquake in 1999. Turkish economy contracted by 3.39% in 1999 (Figure 4). At the end of 1999, Turkey resorted to an IMF stabilization program that primarily targeted at eradicating high inflation. Central to the program was the policy of using a pre-determined exchange rate

path as a nominal anchor for lessening inflationary pressures (Togan & Ersel, 2005, p. 4)

Figure 4.3. Real GDP and Import Growth from 1989 to 2001



Source: World Bank Development Indicators. Notes: GDP growth is annual percentage growth rate of GDP at market prices based on constant local currency. Import growth is annual growth rate of imports of goods and services based on constant local currency.

The coalition government of the Democratic Left Party (DSP), Nationalist Movement Party (MHP), and Motherland Party (ANAP) strictly adhered to the policy recommendations of the IMF. The exchange-rate based disinflation program of 1999 made improvements particularly in public sector debt, interest rates, and inflation in the beginning. However, it further increased arbitrage opportunities for foreign financiers and the Turkish banking system whilst the essential regulatory framework was still absent. Following the implementation of the program, the Turkish economy attracted large amounts of capital inflows. Appreciation of the lira, unusually low real interest rates, and a falling rate of

inflation generated a robust domestic demand-led recovery (Akyüz & Boratav, 2003, p. 1555). The annual percentage growth rate of GDP was recorded as 6.64 in 2000. In line with the availability of FX, imports grew by 21.9% (Figure 4.3), dragging current account balance down to – 3.6% of GDP (Figure 4.2).

The sustainability of the crawling-peg regime and public-sector debt came under scrutiny as *Demirbank*, a mid-size private bank, lost its access to interbank credits due to its deteriorating balance sheets in the fourth quarter of 2000. Üçer and Von Rijckeghem (2005) stated that "on November 22, the day that would be remembered as "Black Wednesday", foreigners apparently already concerned about a possible devaluation, began to exit *en masse*" (p. 58).

Foreign investors' withdrawal from the Turkish market caused a substantial fall in security prices. The Turkish banking system, being heavily invested in treasury bills, came to the verge of collapse due to the sell-off. The CBRT lost a substantial amount of its international reserves due to capital outflow. The turmoil was calmed only after the IMF granted a new line of credit in December 2000. Although the CBRT received the much-needed FX to defend the Turkish lira, the recovery was short-lived. The turbulence in Q4 of 2000 signalled that the exchange-rate based disinflation program was neither credible nor sustainable. A single-minded approach to tackle hyperinflation was insufficient to treat weaknesses that had accumulated during Turkey's transition to an open economy in nearly two decades.

The sudden stop was triggered as prime minister Bulent Ecevit stormed out of the periodic meeting with president Ahmet Necdet Sezer after a bitter dispute over the handling of a corruption case. The overnight interest rates jumped to historically unseen levels. As the Turkish lira's crawling peg broke, it experienced significant losses against the dollar within a single day. GDP contracted by 5.96% in 2001 (figure 4.3) as a result of a sharp contraction in all components of aggregate expenditure function except *the net exports*. The former vice-president of the World Bank Kemal Derviş was summoned by prime minister Bülent Ecevit to lead the Turkish economy out of its crisis. In May 2001, an additional standby credit was granted by the IMF, and the Turkish lira was

allowed to float freely. The Turkish economy was projected to stabilize by surges in exports and contraction in domestic demand. The government sought strong fiscal adjustment through cuts in public employment and investment while adding to its liabilities by the take-over of insolvent banks by SDIF (Saving Deposit Insurance Fund) (Akyüz & Boratav, 2003, p. 1556).

The Turkish economy was introduced to the Post-Washington consensus norms in the aftermath of the 2000-1 crisis by the adoption of Kemal Derviş's *Transition to a Strong Economy* program. The post-Washington consensus norms reinstated the government's role in the economy and improved Turkey's institutional infrastructure. The program mainly (1) reinforced budget discipline, (2) transferred decision-making and regulatory authority to autonomous agencies, and (3) introduced transparency in government procurement procedures (Acemoglu & Üçer, 2015, p. 1). With the implementation of the "Transition to a Stronger Economy" program, twin deficits were subjugated, and the regulatory framework was substantially upgraded.

Turkey's GDP and imports has historically been strongly correlated. While the GDP contracted by 5.96% in 2001, imports decreased by 24.08% (figure 4.3). Over the years 1989 – 2001, the correlation coefficient between the annual growth rate of imports and GDP was positive at 0.956 (Author's calculations based on figure 4.3). Meantime the sample standard deviation of *Import growth* (19.703) was more than thrice the standard deviation of *GDP growth* (5.283). Yet, determining the direction of causality requires further analysis.

The 24th of January decisions had marked the beginning of Turkey's transition to an open economy, whereas the 2000-1 crisis confirmed the end of uncontrolled liberalization. Although Turkey's export performance improved significantly, the economic liberalization from 1980 onwards didn't bear fruit in the eradication of twin deficits. The Turkish economy's growth trajectory remained contingent on capital inflows. The jury is still out whether Turkey's first and last (and enduring) export-led growth attempt was successful. Given that the exports more than tripled during the 1980s, it would be unfair to disparage the export promotion efforts. Yet, during the 1990s, the export-led

growth attempt lost its direction. The growth in exports stagnated and didn't fuel economic growth. The disruption in the export-led growth attempt is mainly attributable to (1) the capital account liberalization of 1989 (2) the lack of political agility and will. Easing access to foreign credit and FX overextended borrowing practices to spend on imports. The stabilization program of 1994 brought about substantial improvements in the macroeconomic imbalances. However, signs of progress were not long-lived, and were gradually offset by domestic demand pressures. While external and internal imbalances exacerbated, Turkey headed into one of the worst economic crises of the history of the Republic in 2001.

5.TURKISH IMPORT MIRACLE

This section examines the underpinnings of Turkey's now-chronic current account deficits from the 2000-1 crisis onwards. It aims to (1) investigate the reasons why the AKP governments chose not to implement the ELG policy framework (2) the effectiveness (or lack thereof) of macroprudential policies in preventing domestic absorption, and thus imports. Furthermore, it makes evaluations on Turkey's recent export performance.

The 2000-1 crisis had catastrophic repercussions for the Turkish political establishment. As a result of the 2002 general elections, only two political parties; the newly-formed Islamist leaning Justice and Development Party (AKP, hereafter) and CHP, which was wiped out of the legislature in the 1999 general elections passed the 10% electoral threshold for parliamentary representation. The insurgent anti-politics party: AKP formed the majority government. Yet, Turkish economic policy-making showed signs of continuity rather than disruption in the following years. During its first term in power, the AKP conformed to the IMF policy recommendations like its predecessors.

Turkish economy enjoyed moderate-to-high GDP growth rates in a gradually falling inflationary environment before the 2008 financial crisis. Under the guidance of the IMF and the influence of a powerful EU anchor, the AKP pursued a series of social and economic reforms that paved the way for socially and geographically inclusive economic growth. The economic growth brought prosperity for large segments of the society and bolstered the AKP's electoral support. Between 2002-2006 Turkey's GDP per capita grew by 6% (per annum), its fastest growth since the 1960s, and public-sector debt declined sharply from a post-2001 peak of 75% (of GDP) to about 35% (Acemoglu & Üçer, 2015, pp. 4-6). The AKP's commitment to austerity measures of the *Transition to a Strong Economy* program and favourable global liquidity conditions fortified

macroeconomic and financial stability. The AKP government is commonly credited for its pro-reform EU agenda and for upholding fiscal discipline during this period.

The moderation of internal imbalances such as inflation and public deficit came at the expense of external imbalances. Due to the collapse of savings rates, Turkey relied on external financing to spur investment and to sustain high growth performance (Kutlay, 2015, p. 6). Monetary policy-makers targeted disinflation by setting very high domestic interest, which led to a surge in capital inflows and rapid currency appreciation. Akat and Yazgan (2012) state that "Emerging market economies such as Turkey, following a surge in capital inflows that entail expansion in domestic credits, generally experience a consumption-driven boom period. This period entails a series of weaknesses such as real appreciation, low returns in tradable sectors, and current account deficits" (p. 24). The Turkish lira has by-and-large been an overvalued currency for over a decade after 2002. During the AKP's first term, the nominal (dollar/lira) exchange rate remained stationary and below 1.5 $/TL (World Bank), whilst the inflation in Turkey persisted at double or more the inflation in the USA. Driven by the real appreciation of the Turkish Lira, foreign financiers maintained the arbitrage opportunities that they had enjoyed in the 1990s.

The public sector borrowing requirement fell radically in the aftermath of the 2000-1 crisis. Karaçimen (2014) states that: "the regulatory changes and new fiscal and monetary policies of the post-2001 era put pressure on domestic banks accustomed to earning the majority of their revenue from financing the public deficit" (p. 162). After losing their "favourite customer", the Turkish banks pursued new outlets for profitable lending opportunities (Akçay & Güngen, 2019, p. 8). Pushed by a series of interrelated factors, the Turkish banks have focused on household financing (Karaçimen, 2014, p. 168). On the demand side, the increasing demand for consumer credit had its roots in the stagnant wages during the AKP's first term. Despite the economic growth, employee compensation as a percentage of value-added remained sluggish (OECD). The borrowing patterns with respect to income and occupation demonstrate that

consumer credit has been mostly used by wage earners and lower-income groups (Karaçimen, 2014, p. 174).

Households were presented with previously unseen borrowing opportunities, which resulted in a fall in private savings and an increase in consumer spending. Households' (and Non-Profit Institutions Serving Households) final consumption expenditure increased sharply during AKP's first term. The real average growth of the Households' final consumption expenditure between 2002 and 2007 was 6.58% (Author's calculations based on World Bank Development Indicators). Not surprisingly, high economic growth that was driven by the surge in consumption, led to a deterioration in external imbalances. Turkey's current account deficit was averaging less than 1% of GDP during the 1990s (Akat & Yazgan, 2012, p. 15), however, it reached 5.6% in 2006 (Figure 5.2).

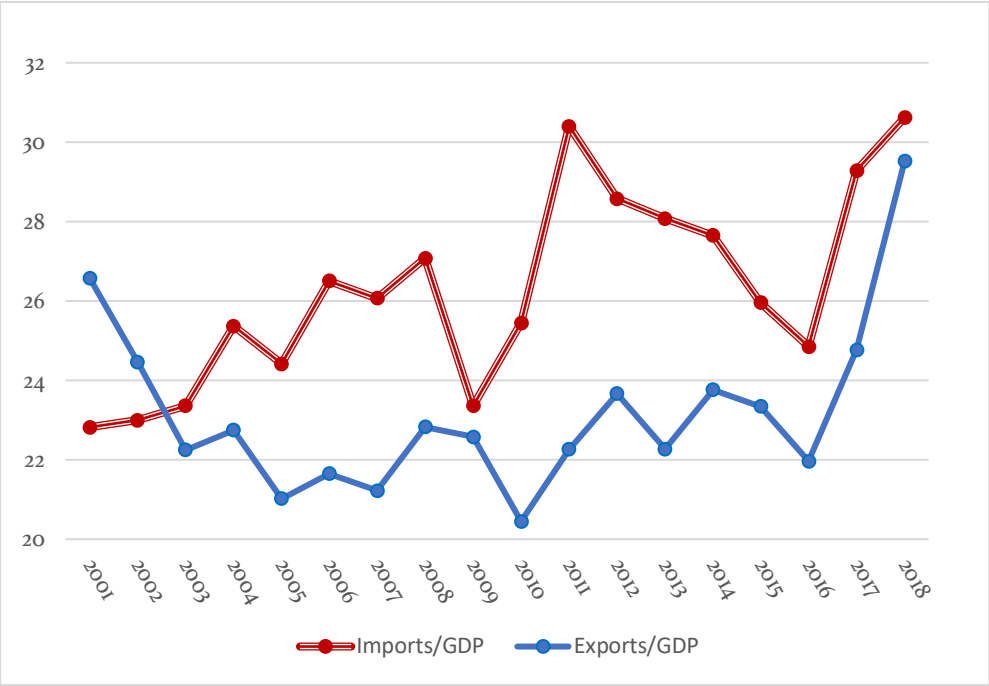
Throughout Turkey's economic history, external imbalances repeatedly materialized, and the balancing of the economy was only possible after these triggered an economic crisis. The AKP, like its predecessors, didn't break the recurring curse of the Turkish economy. During the AKP's first term, the current account deficit came back to the spotlight and evolved into an *Achilles' heel* of the Turkish economy. The government didn't take proactive measures to moderate domestic demand whilst the real appreciation of Turkish Lira exacerbated the widening of the current account deficit. The AKP did not have political limitations unlike the coalition governments of the 1990s and enjoyed a sizeable lead in parliament and the polls. Besides, the preceding coalition government had already paid the price of fiscal adjustment before the AKP came to power. Therefore, why didn't the AKP pursue the export-led growth strategy? (1) Although the export promotion was given emphasis in the party's 2002 election manifesto (Great National Assembly of Turkey Archive), the AKP leaders lost interest (2) In line with the availability of FX thanks to the continuous inflow of capital, the AKP didn't have a political incentive to undertake the export-led growth strategy.

The AKP had its roots in the political parties that had been shut down by the Turkish constitutional court due to their Islamist agenda. The leader of the party

was banned from politics and could not run for a seat in the parliament when the elections were held in 2002. The prominent AKP figures bore in mind the non-electoral political constraints since *the establishment* (mainly the judiciary branch and the military) was uneasy and sceptical about the AKP's governing prospects. Moreover, Perhaps, being political-outsiders, the party leadership chose to fulfil the electorate's consumption appetite (who suffered from economic volatility for over a decade) over the medium to long-term economic growth prospects and embattled to maintain a domestic winning coalition. Presuming that the export-led growth strategy was costly in political terms, the AKP chose to please the electorate to oppose the natural forces of Turkish politics.

During the AKP's first term, the abundance of foreign credit and FX aggravated domestic demand pressures. As a result of the surge in imports, the gap between imports and exports widened until the 2008 global financial crisis (Figure 5.1). Turkish manufacturing sector specialized in low-tech and low-value added products while more-technologically advanced goods added to the current account deficit (Özer & Böke, 2015, p. 102). The surge in global energy prices have as well contributed to the growth of import bills. The import growth accorded with the GDP growth. Yet, the growth of exports fell behind that of the GDP.

Figure 5.1: Foreign Trade (% of GDP) from 2001 to 2018



. Source: World Bank Development Indicators.

Through the AKP's first term in power, which corresponded with the boom phase in between the busts of 2000-1 and 2009, the international community was quite generous in praising the so-called AKP's *Economic Miracle.* Some scholars (e.g. Yeldan & Ünüvar (2016)) went against public opinion and criticized the demand-led and debt-led nature of Turkish growth *(see Appendix)*. Nevertheless, policy-makers at home and stakeholders at the international level were rather unconcerned about Turkey's indebtedness because financing of the current account deficit was not challenging at the time. The level of external debt didn't cause complications on the BOP front. Mainly due to Turkey's institutional upgrade (and its EU anchor), Turkey was successful in attracting not only capital inflows but also foreign direct investment. Foreign direct investment as a percentage of GDP began to rise from 2002 onwards, reaching a record of 3.65% in 2006 (World Bank).

The Turkish economy was hit hard by the 2008-9 financial crisis. The GDP contracted sharply in 2009 (Figure 5.2) and imports (% GDP) fell accordingly (Figure 5.1). Current account deficit narrowed down to 1.76% of GDP in 2009 during the peak of the Turkish crisis. Yet, it slipped back to 5.78% in 2010 along with Turkey's economic recovery (Figure 5.2). Structural reforms to promote exports and improve private savings weren't at the centre of policy debate before the global recession. As the economy recovered from the downturn, external imbalances grew to be *too big to ignore* and the AKP government's benign neglect of the current account deficit came to an end. Strong domestic demand and the real appreciation of the lira stimulated imports, while the economic outlook in Turkey's trading partners didn't contribute much to exports (Kara, 2016, p. 10).

5.1. The Great Recession Onwards

The literature commonly splits the AK Party era into two distinctive phases. Democratization processes and inclusive economic growth define the first phase; economic volatility and increasing authoritarianism prevail in the second one. Economists generally refer to the global financial crisis as a turning point. Turkey became a one-party dominant state as the AKP won three consecutive general elections (2002, 2007 and 2011) with large margins. The usurpation of power by the AKP came at the expense of weaker institutional framework, deterioration in the *rule of law* and dismissal of external anchors. Turkey's institutional backsliding made the financial markets more vulnerable to externalities, while the Turkish economy depended upon capital inflows to finance its amassing current account deficit. In contrast with the AK Party's earlier years in power, (1) the Turkish lira has followed a rocky yet depreciating path from 2010 onwards (Table 5.1), (2) the GDP growth rates have become more volatile (Figure 5.2). The inflation rate has remained in the single-digit range; yet, the two-digit inflation rates came back to the spotlight from 2017 onwards (Table 5.1). Domestic demand and imports moved harmoniously in the

post-crisis period (Table 5.2). Turkey recovered from the 2008-9 crisis via the surge in domestic demand, which was accompanied by the prompt increase in imports (Table 5.2). Turkey's current account deficit reached a record-high of 8.93% (of GDP) in 2011 (Figure 5.2).

Table 5.1: Inflation and REER from 2009 onwards

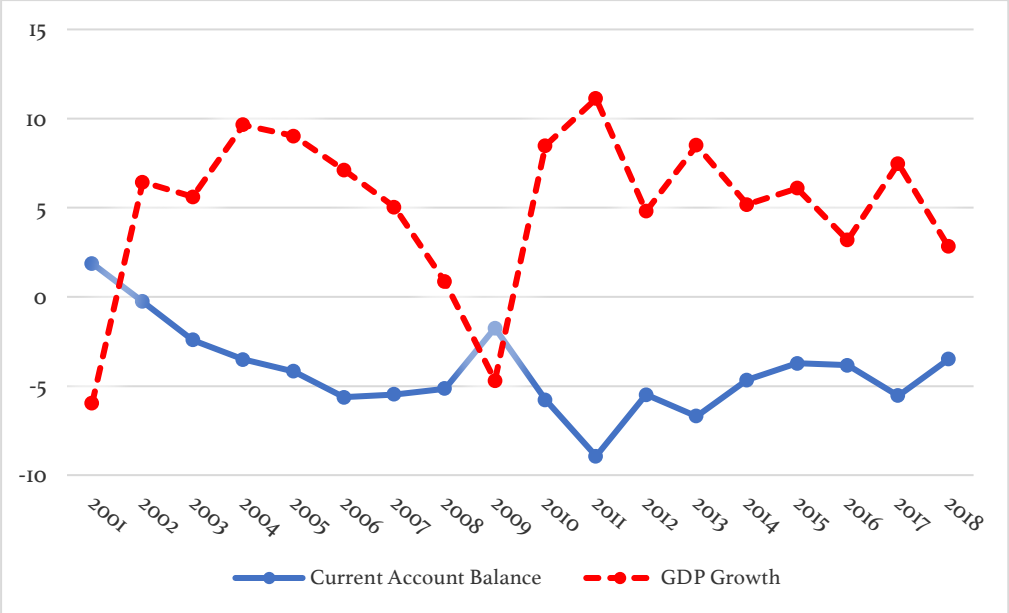
Years	Inflation	REER
2009	6.25	114
2010	8.57	120
2011	6.47	104
2012	8.89	111
2013	7.49	101
2014	8.86	106
2015	7.67	99
2016	7.78	94
2017	11.14	86
2018	16.33	76

Source: CBRT and World Bank Development Indicators. Notes: Inflation (consumer prices) in percentages. CPI based Real Effective Exchange Rate (2003=100)

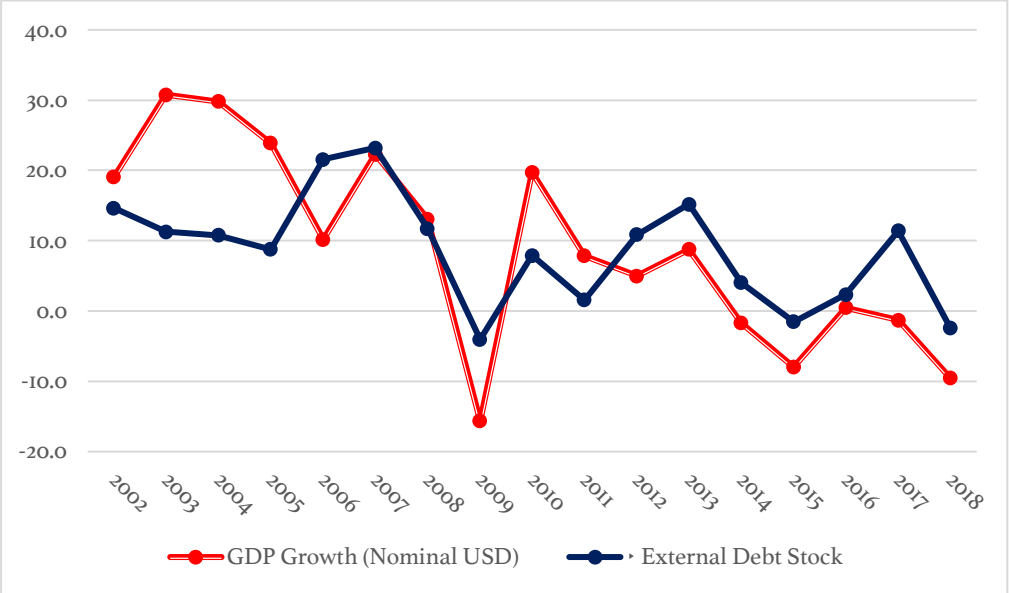
The macro-financial risks associated with external imbalances became the AKP government's concern after the 2008-9 crisis (Kara, 2016, p. 10). The AKP government took particular measures under the leadership of then-Deputy Prime Minister Ali Babacan to tackle the current account deficit at the expense of lower domestic absorption. In 2011, the CBRT increased reserve-requirement ratios to halt the growth of credit and commenced the use of heterodox monetary tools (such as the asymmetric interest-rate corridor) to restrain the volatility of capital

inflows. Then came the second wave of reforms in 2014. The Financial Stability Committee facilitated the execution of macroprudential measures to (1) contain credit growth mainly by reducing household indebtedness to regulate over-borrowing practices that deteriorate the current account deficit, and (2) improve the quality of bank liabilities to provide a buffer against volatile capital inflows (Kara, 2016, p. 131). External imbalances showed temporary signs of improvement after 2011. Imports (% of GDP) followed a downward trend from 2011 to 2016 (Figure 5.1). The current account deficit declined to 5.49% of GDP in 2012 and remained below the 5% threshold in 2014, 2015 and 2016 (Figure 5.2).

Figure 5.2: Current Account, GDP Growth, and External Debt Stock



Source: World Bank Development Indicators. Notesfinal: Current Account Balance is represented as percentage of GDP. GDP Growth is the annual percentage growth rate of GDP at market prices based on constant Turkish lira.



Source: World Bank Development Indicators. Notes: Δ External Debt Stock stands for annual percentage change in Turkey's total external debt stock in current US dollars (based on Author's calculations). GDP growth is annual percentage change in GDP in current US dollars. The correlation coefficient between these two variables are 0.65 for given time period.

Although contractionary macroprudential policies are insufficient to tackle the structural component of the current account deficit, they help contain domestic absorption. They can be regarded as second-best solutions that save time until structural reforms bear fruits (Kara, 2016, p. 137). In a theoretical framework, high real interest rates, *ceteris paribus*, help confinement of domestic consumption and investment. However, they may also prompt a surge in capital inflows, resulting in the overvaluation of the Turkish Lira. As imports become cheaper, the current account deficit widens. Contrarily, keeping real interest rates low halts the inflow of foreign capital, and help maintain competitive real exchange rates to bolster exports. Yet, lower real interest rates trigger higher domestic consumption and investment. Such an increase in domestic absorption ultimately causes a deterioration both in inflation and the current account. Hence, monetary policy tools can't solely get the job done. Macroprudential and monetary policies serve as complementary tools to break the aforementioned vicious cycles. The AKP government employed restrictive macroprudential measures to moderate household spending, whilst the real interest rates were falling. Households consumption expenditure for 2012- 2016 was lower than that of the AKP's first term (World Bank). The average real growth of Households consumption expenditure was 4.62% for 2012- 2016 compared at 6.58% for 2002-2007.

External balancing comes at the expense of internal balancing, and contraction of public spending as well as private spending. However, the government's fiscal program was expansionary in contrast with the earlier policy stance of the party. While the budget deficit increased temporarily in 2009, government spending increased permanently (Gürkaynak et Al, 2015, p. 11). From 2012 onwards, general government final consumption expenditure as a percentage of GDP followed an upward trend. The decline in interest rate spending facilitated financing of increased government spending (Gürkaynak et Al, 2015, p. 9). Government's budget balance remained unchanged.

Whilst household consumption was meant to be toned-down, the private sector was soaked in credit. Domestic credit to the private sector as a percentage of GDP had ascended until the lira crisis materialized in 2018. Moreover, in 2009, the AKP government passed a decree that allowed corporations without foreign exchange revenues to borrow in foreign currencies, which resulted in a sharp growth in foreign exchange-denominated debt levels of the private sector (Akçay & Güngen, 2019, p. 9). The increase the private sector's external debt was partially matched by the increase in investment. While final consumption expenditure (% of GDP) followed a downward trend from 2012 to 2016, gross fixed capital formation (% of GDP) moved in the opposite direction (World Bank). Thus, at the expense of the further *dollarization* of the economy (and further accumulation of foreign debt), economic growth was pulled partially by the surge in investment. The rise in government expenditure and investment upheld the GDP growth and enabled the AKP to retain its political base during the election frenzy until the 2018 currency crisis.

Table 5.2: Domestic Demand, Import, and GDP Growth

Years	Domestic Demand (%) Growth	Import (%) Growth	GDP (%) Growth
2009	-7.8	-14.3	-4.7
2010	12.9	19.5	8.5
2011	10.7	15.4	11.1
2012	1.8	0.7	4.8
2013	10.6	8.0	8.5
2014	3.0	-0.4	5.2
2015	5.3	1.7	6.1
2016	4.5	3.7	3.2
2017	7.4	10.3	7.5
2018	-1.6	-7.8	2.8

Source: World Bank Development Indicators and OECD Database. Domestic Demand (% Annual Growth) is the final private and public consumption, gross capital formation and changes in inventories real terms (OECD). Import Growth (%) is annual percentage growth of imports of goods and services under constant Turkish Lira. GDP (%) Growth is annual growth rate of GDP at market prices based on constant Turkish lira.

In 2017, Turkey's *soft-landing* scheme was shelved in its totality. The real growth of domestic demand and imports was 7.4% and 10.3% respectively in 2017 (Table 5.2). While the Turkish economy grew substantially, the current account deficit passed the 5% threshold (Figure 5.2). The AKP government did not act to rein in Turkey's overheated economy. Quite the reverse, the President and the senior AKP figures frequently took aim at the Central Bank over high interest rates. Following a period of monetary and fiscal expansion, Turkey held snap elections in June 2018. The AKP lost its majority in the parliament, nevertheless, Erdoğan won the presidency.

A few months thereafter, President Erdoğan experienced a bitter political conflict with his American counterpart Trump over the imprisonment of an American pastor in Turkey. The lira crisis was triggered by the political conflict between the two NATO allies. Yet, its roots rested in Turkey's external imbalances. The political shock triggered a *sudden stop*; hence the Turkish economy went through a text-book hard-landing. The Turkish lira lost more than 30% of its value against the dollar in 2018 (*see Appendix for yearly averages*). The Turkish economy went through a phase of external adjustment in the aftermath of the lira crisis. From the lira crisis onwards, imports decreased noticeably, and exports moved in the opposite direction. From 2018 to 2019, imports (in nominal US dollars) decreased by 9.1%, and exports rose by 2.1% (Turkish Statistical Institute). Turkey's current account balance posted a surplus of 1.647 billion USD in 2019 (CBRT). The real GDP increased by 0.9% (TUIK). The magnitude of the 2018 lira crisis was minimized due to the surge in foreign demand. Although depreciation of the Turkish Lira has been and continues to be vital for the export promotion, it only serves as a politically-expensive and transitory *magic wand*. We do not know yet whether domestic demand will pick up and the current account deficit will return to the spotlight as the economy recovers from the Covid-19 pandemic in 2021.

To sum up, from the Great Recession to the Turkish lira crisis of 2018, neither domestic demand nor imports were restrained in a coordinated manner. The Turkish economy remained to be under the curse of *low savings and high current account deficit* duality. The macroprudential policy framework and the real depreciation of the Turkish lira were slightly effective in constraining household spending. Yet, government expenditure and investment predominated the trajectory of domestic demand. The government's *soft-landing* attempt was gradually reversed mainly due to political reasons beyond the scope of this paper. The AKP government was incapacitated to carry on policies to lower domestic absorption and initiate an outward-looking development agenda. Over the last half-decade, Turkey has gone through an unforeseen period of political

instability and autocratic restructuring. Turkey had two elections (presidential and municipal) in 2014, repeated general elections in 2015 (in the elections of November 1st, the AKP regained the parliamentary majority it lost in the June 7th elections), a referendum on the presidential system in 2017, and a general election in 2018. Not to mention, in 2016, a section of the military initiated a *coup d'état*, yet, didn't succeed in overthrowing the government. From 2015 onwards, national security issues have become a major concern due to the surge in terrorist activities not only in Turkey's South-Eastern region but also in the commercial centres of the West. The AKP's plate has been full with domestic and international political conundrums. Hence, the AKP government's electoral and non-electoral constrains impeded formation of an economic agenda with long-term focus.

5.2. Turkey's Recent Export Performance

In the previous subsection, it was argued that half-hearted attempts to subdue domestic demand and imports were not effective. What's worse, on the export front, the AKP government disregarded the industrial policy framework in its totality. While Imports (% of GDP) followed a downward path from 2011 to 2016, Exports (% of GDP) stagnated (Figure 5.1). From 2014 onwards, the Turkish lira has followed a depreciating path (Table 5.1), yet, the real growth of exports ddidn't pick up until 2017. Exports have expanded both in real (real annual growth) and relative (% of GDP) terms from 2017 onwards (World Bank). It is worth mentioning that tourism receipts in US dollars increased 20.6% from 2016 to 2017 (Author's calculations based on World Bank). The tourism sector underperformed compared to other tradable sectors from 2015 onwards. It took 4 years for the share of tourism receipts in total exports to bounce back to its initial level in 2015. The fall in tourism revenues help partially explain the stagnation in total exports despite the real depreciation of the lira. Due to the failed coup attempt and the surge in ISIS terrorism, tourism revenues decreased sharply in 2016 (*see Appendix*). The tourism revenue as a percentage of total exports declined from 21.9% in 2015 to 15.5% in 2016, and it stayed at 16.7%

in 2017 (TURSAB). As the competitive lira was not supported by methodical industrial policies, and a conforming political milieu, Turkey's export performance has been mediocre from the Great Recession onwards.

Turkey's macroeconomic variables only present a limited view of what may have gone wrong. One of the main reasons behind the standstill in exports was the decrease in foreign demand. Exogenous variables such as the sovereign debt crisis in the Eurozone and the *post-Arab Spring* turmoil in the Middle East have had a considerable impact on Turkey's foreign demand. Half of Turkey's top 20 export destinations are members of the European Union (Table 5.3). The remaining 6 of 20 belong to Middle-East and North Africa (MENA) region. The Eurozone economy has gone through a period of secular stagnation following the Eurozone crisis from 2009 onwards. Meanwhile, in the aftermath of the Arab Spring, the MENA region has endured a period of political havoc and economic instability.

Table 5.3: Top 20 Countries by Exports

Country	Average Share (2010-2019)
Germany	9.5
United Kingdom	6.5
Italy	5.1
Iraq	6.1
USA	4.2
Spain	3.4
France	4.4
Netherlands	2.4
Israel	2.0
Romania	2.0
Russia	3.1
UAE	3.4
Egypt	2.0
Poland	1.6
Belgium	1.8
Saudi Arabia	2.0
China	1.8
Bulgaria	1.4
Iran	2.8
Morocco	0.9

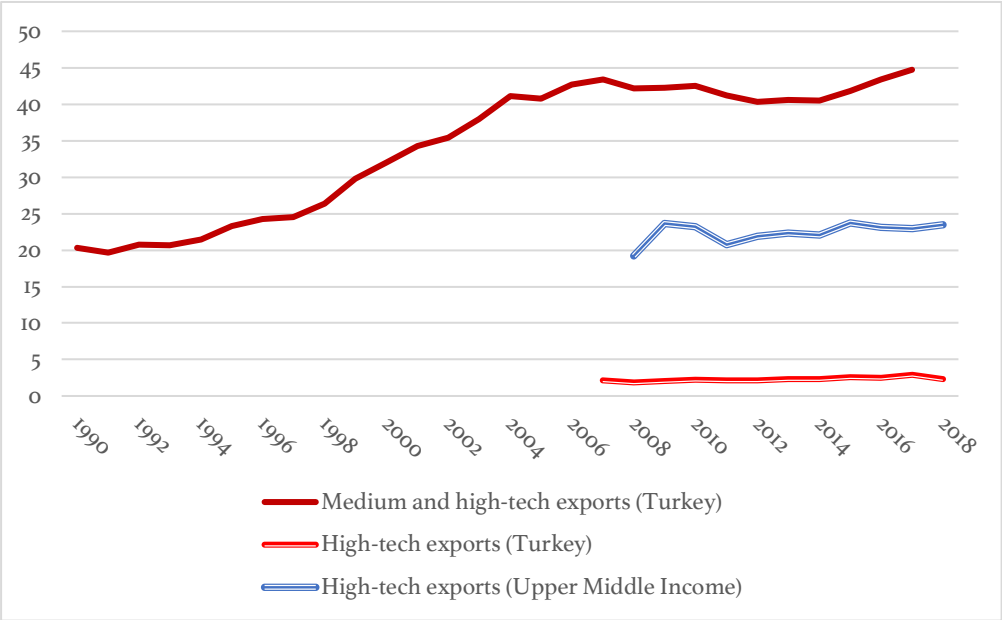
Source: Turkish Statistical Institute. Notes: Merchandise Exports by country, share in total exports (%). Average share is based on Author's calculations.

CPI-based Real Effective Exchange Rate fell from 106 (2003=100) in 2014 to 96 in 2016 and further down in the succeeding years. (Table 5.1). In line with the depreciation of Turkish lira, the share of the tradable sector (more specifically, the industrial sector) must have risen to pave the way for export promotion. From the Great Recession onwards, the growth trend of the industrial sector decelerated, closely following the general trend in GDP (Demiralp et. al, 2015, p. 8). Industry (including construction) as a percentage of GDP increased

from 26.93 in 2011 to 28.18 in 2016 (World Bank). Construction (% of GDP) jumped to 9.7% in 2016 from 8.2% in 2011 (United Nations Economic Commission for Europe). Demiralp et. al (2015) states that a shift from the industrial sector to the construction sector can partially explain the slowdown in growth trend because of the lower *TFP* of the construction sector compared to the industrial sector (p. 8). While manufacturing plays a key role in increasing *TFP* levels, the construction sector's contribution to *TFP* is limited. The share of the construction sector in Turkey is akin to other emerging countries (Demiralp et. al, 2015, p. 13); yet, the stagnating share of the industrial sector is troublesome for Turkey's growth aspirations and export prospects. To achieve the latter, the policymakers must reflect on (1) industrial policies to channel resources away from construction (and other non-tradable sectors) to tradable sectors in the short run, (2) research and development, and innovation policies that will upgrade technological intensity of Turkish exports in the long-run.

In line with the stagnating share of the industrial sector, Turkey's exports (% of GDP) have remained low relative to comparable countries (Ozer & Boke, 2015, p. 94). The share of medium-technology exports in total manufacturing exports have significantly improved in the past three decades (figure 5.3). Yet, Turkey didn't show any signs of progress in high-tech exports (figure 5.3). The share of high-tech exports for the upper-middle-income countries was 23.5%, while Turkey's high-tech exports only constituted 2.3% of total manufacturing exports in 2018 (World Bank).

Figure 5.3: Technological Composition of Turkey's Manufacturing Exports



Source: World Bank Development Indicators. Notes: Medium and high-tech exports are the percentage share of medium and high-tech exports in total manufacturing exports. High-tech exports are the percentage share of high-tech exports in total manufacturing exports.

Turkey has been trapped in medium and low-tech exports and the technological composition of Turkey's exports has put a downward pressure on export growth (Özer & Böke, 2015, p. 105) Although the share of Turkey's traditional exports such as textiles and garments have declined, the degree of sophistication of the exports is still low relative to a number of countries such as Romania, Mexico, and Thailand (Atiyas & Bakış, 2015, p. 1226) Industrial policy – so called "production transformation policy" is an "inner wheel" whose effects depend on "outer wheels" of macroeconomic conditions, more specifically, the exchange rate (Wade, 2015, p. 68). In order to capitalize on competitive exchange rates, two wheels must go in the same direction.

CONCLUSION

While telling the history of Turkey's external imbalances, this dissertation demonstrated that domestic demand-led growth, which has been politically more feasible, came at the expense of higher import bills, hence large current account deficits. Through Turkey's economic development course, rapid economic growth has commonly resulted in a surge in the current account deficit. Equally, the current account improved, when (1) contraction in domestic demand contained imports and encouraged the tradable sector to chase new markets (2) the devaluation of the Turkish lira boosted exports and made imports overpriced for the domestic market. This dissertation took a holistic approach to examine the root causes of Turkey's enduring external imbalances and to investigate why Turkey has failed to implement an export-led strategy (ELG) thoroughly. In summary, this dissertation suggested that (1) the Turkish economy has suffered from external imbalances mainly due to insufficient growth of the manufacturing sector, a robust indicator of industrialization (2) Turkey's failure to deliver and sustain the ELG policy framework is due to political and institutional setbacks.

External imbalances have been the "underlying condition" that has repeatedly hospitalized the Turkish economy. External imbalances played a major role in the economic crises of 1958, 1978-80, 1994, and 2018. It played an indirect but complementary role in the formation of the 1999, 2000-1, and 2009 crises. However, once the economy recovered from the crisis, policies that addressed external imbalances were disregarded until the next BOP crisis. Turkish politicians have commonly opposed taking contractionary fiscal steps and devaluing the Turkish lira unless Turkey was in the midst of a BOP crisis. After the dust settled down, the signs of improvement were short-lived, and domestic demand pressures eventually offset them. Turkey's export performance has been quite receptive to exchange rate fluctuations. Yet, Turkish citizens have

perceived the overvalued *lira* as a sign of the nation's economic potency and purchasing power. The Turkish electorate has punished political parties that didn't single-mindedly defend the lira. Hence, policy-makers paid no attention to the real appreciation of the lira. The Turkish economy has experienced balance-of-payments crises recurrently throughout its post-WW2 history.

Turkey, like its predecessor Ottoman Empire, didn't succeed in mobilizing its resources for industrialization. The Turkish political class has commonly abstained from undertaking a thorough industrialization agenda. In the earlier stages of development, rapid industrialization is made possible primarily by diverting resources away from agriculture and suppressing wages in the emerging urban sector to uphold primitive capital accumulation. It might just as well be fueled by borrowing from abroad as long as there exists political agility to channel resources to long-run investment in the industrial (tradable) sector. Rural voters (a.k.a. farmers) and the newly-emerging urban working class, which accounted for a significant portion of the electorate, were very receptive to changes in their income and punished political parties accordingly. Unlike Japan, Taiwan, South Korea, the Soviet Union, and China during the course of (big-push) industrialization, Turkey was a flawed democracy, albeit a functioning one.

The ELG strategy primarily requires the subjugation of domestic demand, channeling of resources into tradable sectors, and an undervalued domestic currency. This translates into (1) lower wages for working masses, (2) lower incomes (and fewer subsidies) for farmers, (3) less purchasing power, hence consumption for all (whose income is in *lira*). The export-led growth strategy takes *time* and *resilience*. It entails a well-organized industrial and macroeconomic policy platform to bolster exports and political agility to combat domestic demand pressures to limit imports. While the government oversees contractionary policy measures to control for domestic absorption, the elected officials incur political costs associated with the implementation of such policies. To keep a long-term economic policy going, the government needs some autonomy from social pressures. Moreover, maintaining the export-led growth

strategy also compels a strong state capacity (*infrastructural* power) to orchestrate policy schemes. Potential for further research here could include investigating if Turkey's state apparatus possesses (or possessed) such infrastructural power to facilitate the ELG strategy.

The Turkish political establishment wasn't inclined to incur political costs associated with the ELG strategy. Firstly, Turkey has held multi-party elections since 1946, in which *de jure* political power frequently switched between political parties. The more the electoral competition was, the less likely politicians were to alienate voters. Secondly, the balance of power between elected politicians and groups that possess *de facto* political power such as the military, business conglomerates (and later faith-based organizations) was delicate. They frequently sought to coerce one another instead of searching for a common ground to build cooperation. Hence, elected officials were often under pressure to uphold electoral support. When they were presented an intertemporal trade-off, they were inclined to embrace short-term expansionary policies over long-term growth strategies.

The second subsection: *comparative analysis* argues that a robust industrial sector is a prerequisite to carry out the ELG strategy and safeguarding from external imbalances. Late industrializers (Japan, Israel, and the Asian Tigers) have attained robust economic growth as a result of the successful implementation of the export-oriented industrialization strategy. These economies have not posted a current account deficit for the past two decades. *Surplus* NICs (China, Malaysia, and Thailand) have been following the footsteps of late industrializers in recent decades. Unlike their Turkish counterparts, their governments have curbed domestic consumption while bolstering investment in manufacturing industry. The stagnant share of the industrial sector and relatively high share of domestic consumption in national income have jeopardized Turkey's export prospects and growth aspirations. Moreover, the relatively low technology content of Turkish exports and the absence of education policies to upgrade Turkish manufacturing in the long-run have further undermined Turkey's economic growth potential.

The third section: *a brief history of the Turkish economy* demonstrates that Turkey was unable to transcend the Ottoman Empire's legacy of external imbalances. Second, it argues that the ruling classes failed to *industrialize the nation* despite their genuine efforts. From 1923 to 1946, known as the one-party era, the government did not only abstain from transferring resources from agriculture but also borrowing from abroad to bolster industrialization. Hence, the pace of industrialization was rather mediocre. But on the bright side, Turkey didn't face BOP problems during the one-party era. The new regime opted to use its political capital to facilitate superstructure reforms rather than economic ones. After the Great Depression materialized, the Kemalist regime shelved liberal economic policies inherited from the Ottomans. Yet, the protectionist regime that replaced it, didn't stimulate big-push industrialization and urbanization. From 1946 onwards, Turkey's foreign debt spiral began along with the rise in the current account deficit. Until 1980s, Turkey continued to be a primary goods exporter while developing a diversified industrial base that targeted the domestic market. The emerging industrial sector heavily depended on foreign inputs, raw materials, intermediate products and capital goods, for its operations. Hence, Turkey's ISI regime was heavily reliant on the availability of foreign exchange. It was able to survive for a prolonged time thanks to financial assistance from Western institutions and WR. The oil crisis of 1973 exacerbated Turkey's already fragile macro imbalances. As a net energy importer, Turkey's current account has historically been vulnerable to fluctuations in energy prices. The ruling parties couldn't take proactive policy measures until the BOP crisis unfolded. With the stabilization program initiated on the 24th of January, 1980, Turkey overhauled the ISI regime, and on the 12th of September of the same year, the military junta suspended the operation of democratic institutions.

The fourth section: *the first phase of economic opening: From the January 24 decisions to the 2000-1 crisis* are two-fold: First, the military and ANAP governments restrained domestic demand, hence external imbalances in the early stages of the neo-liberalization of the Turkish economy, yet, the trend was reversed later due to the changing political climate. Second, Turkey's first and

last ELG attempt in the 1980s was half baked and short-lived mainly due to the lack of political persistence. From 1980s onwards, Turkey followed Washington Consensus policies and abandoned restrictive trade measures. Turkey followed the export promotion scheme, yet, the determination was short-lived. Wage-earners and farmers saw their incomes fall as a result of the economic transition to a neoliberal model. To constrain imports, the government has successfully subdued domestic absorption. After the policy-makers directed the manufacturing base to foreign markets, merchandise exports per capita more than tripled in a decade. Nevertheless, the industrial base didn't expand remarkably. Partly owing to the political setting in the aftermath of the 1980 coup, the government somewhat succeeded in executing the ELG agenda and controlling for the current account deficit. Yet, in a shifting political climate from the late 1980s onwards, the ruling parties found it difficult (1) to moderate domestic demand (2) to provide an export-friendly macroeconomic environment. Increasing electoral competition didn't only trigger public deficits but also stalled the ELG strategy. Capital Account liberalization of 1989, which can be regarded as Özal's final attempt to revitalize the broken economy, hence his political prospects, further aggravated Turkey's dependence on capital inflows to sustain economic growth. Turkey's economic cycles of high growth have coincided with periods when Turkey have accrued significant amounts of external debt. The neoliberal restructuring of the economy didn't stimulate a sufficient level of investment in the tradable sector. The manufacturing sector stagnated from the 1990s onwards. External imbalances had played a crucial role in the overhaul of the ISI regime in the late 1970s. During the 1980s and 90s, it was predominantly internal imbalances that spawned desperate straits. Turkey's internal imbalances, such as inflation and the public debt, were moderated as a result of the *Transition to a strong economy program*, which was initiated after the 2001 crisis. Yet, the recurring curse of the Turkish economy: external imbalances came back to the spotlight.

The conclusions of the fifth subsection: *the Turkish import miracle* are three-fold: First, the current account deficit is an inevitable outcome of the debt-led

growth model. Second, the AKP's non-electoral constraints bounded the formation of a policy-framework with long-run focus. Third, macroprudential policies were partially effective in constraining external imbalances, yet they were shelved due to the lack of political will to maintain them. The newly-elected AKP government took no policy measures to curb domestic demand, while the real appreciation of the Turkish Lira and a surge in capital inflows (and credit expansion accordingly) exacerbated the current account deficit. After the global recession, the AKP government took limited measures to address Turkey's external imbalances, which had grown to be too large to ignore. The macroprudential policy formation and the real depreciation of the Turkish lira partially restrained domestic demand temporarily. However, from 2015 onwards, the AKP resorted to expansionary policy measures to sustain its electoral support during the election frenzy. The Turkish economy cooled down only after the 2018 Lira crisis (which is referred to in this dissertation as *text-book* sudden stop). During its early years, the AKP lacked the political will to pursue the ELG strategy although it had enjoyed a sizeable lead in the parliament and the polls. Embattling against the groups that possess *de facto* political power such as the secularist military and judiciary, the mildly-Islamist AKP's prime goal was to maintain a domestic winning coalition. From the mid-2010s onwards, Erdoğan has domineered those groups and eliminated checks and balances on his authority. Yet, his power grab coincided with the times when the AKP and *himself* began to lose electoral support. Hence, Turkey's international and domestic political challenges impeded the formation of an economic agenda with a long-term focus.

All in all, the road to late industrialization passes through capital accumulation in the manufacturing industry while working classes and the agricultural sector bear the burden. Turkish governments have refrained from contractionary policy measures due to political concerns frequently mentioned in this thesis. Such reluctance, however, has often condemned working masses to more painful economic prescriptions. It is worth noting that working classes still paid the price of the economic crises that occurred almost every decade in the post-WW2

period. They were proportionally more affected by economic hardships such as high inflation in the 1980s, 90s, and late 2010s and jobless growth in the 2000s. This dissertation has argued that the domestic demand-led growth model is not desirable for Turkey's long-run economic prospects. The latest macroeconomic developments in Turkey affirm that it is also not attainable anymore. This dissertation suggests that the export-led growth model is within reach if the ruling elite can only build a social consensus in the future. The policy-makers must convince the public about the necessity of a thorough export-led growth agenda to combat external imbalances for good.

REFERENCES

Acemoglu, D., & Ucer, M. (2015). *The ups and downs of Turkish growth, 2002-2015: Political dynamics, the European Union and the institutional slide* (No. w21608). National Bureau of Economic Research.

Acemoglu, D., Johnson, S., & Robinson, J. A. (2005). Institutions as a fundamental cause of long-run growth. *Handbook of economic growth*, *1*, 385-472.

Adaman, F., Buğra, A., & Insel, A. (2009). Societal context of labor union strategy: the case of Turkey. *Labor Studies Journal*, *34*(2), 168-188.

Akat, A. S., & Yazgan, E. (2013). Observations on Turkey's recent economic performance. *Atlantic Economic Journal*, *41*(1), 1-27.

Akat, Asaf Savaş (1983). Alternatif Büyüme Stratejisi: İktisat Politikası Yazıları. *İstanbul: İletişim Yayınları*.

Akay, Koray. The remaining mystery of late industrialization. *Istanbul Bilgi University*, manuscript draft.

Akcay, Ü., & Güngen, A. R. (2019). *The making of Turkey's 2018-2019 economic crisis*. Berlin School of Economics and Law, Institute for International Political Economy Berlin.

Akyüz, Y., & Boratav, K. (2003). The making of the Turkish financial crisis. *World Development*, *31*(9), 1549-1566.

Amsden, A. H. (1989). *Asia's next giant: South Korea and late industrialization*. Oxford University Press on Demand.

Asafu-Adjaye, J., & Chakraborty, D. (1999). Export-led growth and import compression: further time series evidence from LDCS. *Australian Economic Papers*, *38*(2), 164-175.

Atiyas, İ., & Bakis, O. (2015). Structural change and industrial policy in Turkey. *Emerging Markets Finance and Trade*, *51*(6), 1209-1229.

Aydas, O. T., Metin-Ozcan, K., & Neyapti, B. (2005). Determinants of workers' remittances: the case of Turkey. *Emerging Markets Finance and Trade*, *41*(3), 53-69.

Balassa, B. (1978). Exports and economic growth: further evidence. *Journal of development Economics*, *5*(2), 181-189.

Balassa, B. (1971). Industrial policies in Taiwan and Korea. *Weltwirtschaftliches Archiv*, *106*(1), 55-77.

Ball, R. J., Eaton, J. R., & Steuer, M. D. (1966). The relationship between United Kingdom export performance in manufactures and the internal pressure of demand. *The Economic Journal*, *76*(303), 501-518.

Bayar, A. H. (1996). The developmental state and economic policy in Turkey. *Third World Quarterly*, *17*(4), 773-786.

Barlow, R., & Şenses, F. (1995). The Turkish export boom: Just reward or just lucky?. *Journal of Development Economics*, *48*(1), 111-133.

Belke, A., Oeking, A., & Setzer, R. (2014). Domestic demand pressure and export dynamics–An empirical threshold model analysis for six euro area countries. *EcoMod2014*, *6780*.

Ben-David, D., & Loewy, M. B. (1998). Free trade, growth, and convergence. *Journal of economic growth*, *3*(2), 143-170.

Bobeica, E., Esteves, P. S., Rua, A., & Staehr, K. (2016). Exports and domestic demand pressure: a dynamic panel data model for the euro area countries. *Review of World Economics*, *152*(1), 107-125.

Boratav, K. (1988). *Türkiye iktisat tarihi, 1908-1985* (Vol. 1). Istanbul: Gerçek Yayınevi.

Celasun, M., & Rodrik, D. (2007). 9. Turkish Experience with Debt: Macroeconomic Policy and Performance. In *Developing country debt and the world economy* (pp. 193-211). University of Chicago Press.

Cem, İ. (1970). *Türkiye'de geri kalmışlığın tarihi* (Vol. 11). Cem Yayınevi.

De Grauwe, Paul. How to Tackle Europe's Secular Stagnation. *World Economic Forum*,www.weforum.org/agenda/2015/01/how-to-tackle-europes-secular stagnation/.

Cizre-Sakallioglu, U. M., & Yeldan, E. (2000). Politics, society and financial liberalization: Turkey in the 1990s. *Development and Change*, *31*(2), 481-508.

Demiralp, S., Demiralp, S., & Gümüş, İ. (2015). *The state of property development in Turkey: facts and comparisons* (No. 1503). Working Paper.

Easterly, W. (2001). The lost decades: developing countries' stagnation in spite of policy reform 1980–1998. *Journal of Economic growth*, *6*(2), 135-157.

Eichengreen, B. (2007). The real exchange rate and economic growth. *Social and Economic Studies*, 7-20.

Esteves, P. S., & Rua, A. (2015). Is there a role for domestic demand pressure on export performance?. *Empirical Economics*, *49*(4), 1173-1189.

Goldberg, P. K., & Pavcnik, N. (2007). Distributional effects of globalization in developing countries. *Journal of economic Literature*, *45*(1), 39-82.

Gunter, M. M. (1989). Political Instability in Turkey during the 1970s. *Journal of Conflict Studies*, *9*(1).

Günçavdı, Ö., & Ülengin, B. (2006). On the determinants of the monthly demand for imports in Turkey: A VECM approach. *Yapı Kredi Economic Review*, *17*(2), 3-15.

Günçavdı, Ö., & Ülengin, B. (2017). Tradable and non-tradable expenditure and aggregate demand for imports in an emerging market economy. *Economic Systems*, *41*(3), 445-455.

Günçavdı, Ö., & Kayam, S. S (2018). Demand Pressure and Export Performance in Turkey.

Gürkaynak, R. S., Kantur, Z., Tas, M. A., & Yildirim, S. (2015). *Monetary policy in Turkey after Central Bank independence* (No. 520). CFS Working Paper Series.

Halicioglu, F. (2007). *A Multivariate Causality Analysis of Export and Growth for Turkey* (No. 3565). University Library of Munich, Germany.

Hatemi-J, A., & Irandoust, M. (2000). Time-series evidence for Balassa's export-led growth hypothesis. *The Journal of International Trade & Economic Development*, *9*(3), 355-365.

Irwin, D. A. (2021). The rise and fall of import substitution. *World Development*, *139*, 105306.

Kaldor, N. (1968). Productivity and growth in manufacturing industry: a reply. *Economica*, *35*(140), 385-391..

Kara, H., & Sarikaya, C. (2014, November). Current Account Deficit in Turkey: Cyclical or Structural?. Koc University-TUSIAD Economic Research Forum.

Kara, H. (2016). *Turkey's experience with macroprudential policy* (Vol. 86, pp. 123-139). Bank for International Settlements.

Karaçimen, E. (2014). Financialization in Turkey: The case of consumer debt. *Journal of Balkan and Near Eastern Studies*, *16*(2), 161-180.

Karluk, R. (2002). Türkiye ekonomisi. *Betaş Yayınları, İstanbul*.

Keyder, Ç. (1987). State and class in Turkey. *A Study in Capitalist Development. London and New York: Verso*.

Kim, E. M., & Kim, Ŭ. M. (1997). *Big business, strong state: collusion and conflict in South Korean development, 1960-1990*. Suny Press.

Koça, N., & Koça, B. (2017). Affects of Marshall Plan on Turkish Economy. *Sociology*, *7*(2), 83-121.

Kónya, L. (2006). Exports and growth: Granger causality analysis on OECD countries with a panel data approach. *Economic Modelling*, *23*(6), 978-992.

Kutlay, M. (2015). Turkish Economy at a Crossroads: Unpacking Turkey's Current Account Challenge. *Global Turkey in Europe III: Democracy, Trade, and the Kurdish Question in Turkey-EU Relations*, *19*, 219.

Lal, D., & Rajapatirana, S. (1987). Foreign trade regimes and economic growth in developing countries. *The World Bank Research Observer*, *2*(2), 189-217.

McMillan, M. S., & Rodrik, D. (2011). *Globalization, structural change and productivity growth* (No. w17143). National Bureau of Economic Research.

Nordhaus, W. D. (1975). The political business cycle. *The review of economic studies*, *42*(2), 169-190.

Onaran, Ö. (2007). Capital flows, turbulences, and distribution: The case of Turkey. *European Journal of Economics and Economic Policies: Intervention*, *4*(2), 353-374.

Onis, Z. (1991). The Logic of the Developmental State. *Comparative Politics*, *24*(1), 109-126.

Öniş, Z., & Güven, A. B. (2011). Global crisis, national responses: The political economy of Turkish exceptionalism. *New Political Economy*, *16*(5), 585-608.

Öniş, Z., & Senses, F. (2007). Global dynamics, domestic coalitions and a reactive state: Major policy shifts in post-war Turkish economic development. *METU Economic Research Center Working Paper*, (20636).

Ozer, M. H. (2014). The effects of the Marshall plan aids to the development of the agricultural sector in Turkey, the 1948-1953 period. *International Journal of Economics and Financial Issues*, *4*(2), 427.

Ozturk, I., & Acaravci, A. (2010). Testing the export-led growth hypothesis: empirical evidence from Turkey. *The Journal of Developing Areas*, 245-254.

Özer, S. K., & Böke, S. S. (2015). The Export Performance of Turkey (1996-2013). *Iktisat Isletme ve Finans*, *30*(350), 93-120.

Pamuk, Ş., & Williamson, J. G. (2011). Ottoman de-industrialization, 1800–1913: assessing the magnitude, impact, and response. *The Economic History Review*, *64*, 159-184.

Pamuk, Ş. (2007). Economic change in twentieth century Turkey: Is the glass more than half full?. *The Cambridge History of Turkey*, *4*, 266-300.

Park, Y. C. (1990). Development lessons from Asia: The role of government in South Korea and Taiwan. *The American economic review*, *80*(2), 118-121.

Rodrik, D. (2006). Goodbye Washington consensus, hello Washington confusion? A review of the World Bank's economic growth in the 1990s: learning from a decade of reform. *Journal of Economic literature*, *44*(4), 973-987.

Rodrik, D. (2008). The real exchange rate and economic growth. *Brookings papers on economic activity*, *2008*(2), 365-412.

Rodrik, D. (2016). Premature deindustrialization. *Journal of economic growth*, *21*(1), 1-33.

Rodrik, D. (1990). *Premature liberalization, incomplete stabilization: the Ozal decade in Turkey* (No. w3300). National Bureau of Economic Research.

Rodrik, D. (2011). *The future of economic convergence* (No. w17400). National Bureau of Economic Research.

Pettis, M. (2014). *The great rebalancing: Trade, conflict, and the perilous road ahead for the world economy*. Princeton University Press.

Sachs, J. D. (1999). Twentieth-century political economy: A brief history of global capitalism. *Oxford Review of Economic Policy*, *15*(4), 90-101.

Schwartz, H. M. (2019). *States Versus Markets: Understanding the Global Economy*. Macmillan International Higher Education.

Şenses, F. (1991). Turkey's stabilization and structural adjustment program in retrospect and prospect. *The Developing Economies*, *29*(3), 210-234.

Shan, J., & Sun, F. (1998). On the export-led growth hypothesis: the econometric evidence from China. *Applied Economics*, *30*(8), 1055-1065.

Stubbs, R. (1999). War and economic development: Export-oriented industrialization in East and Southeast Asia. *Comparative Politics*, 337-355.

Tekin, A. (2006). Turkey's aborted attempt at export-led growth strategy: Anatomy of the 1970 economic reform. *Middle Eastern Studies*, *42*(1), 133-163.

Tezel, Y. S. (1982). *Cumhuriyet döneminin iktisadi tarihi* (Vol. 4). Yurt Yayınevi.

Togan, S. (1997). Opening up the Turkish Economy in the Context of the Customs Union with EU. *Journal of Economic Integration*, 157-179.

Togan, S. (1996). Trade liberalization and competitive structure in Turkey during the 1980s. In *The economy of Turkey since liberalization* (pp. 5-51). Palgrave Macmillan, London.

Togan, S. (2005). Turkey: Trade policy review. *World Economy*, *28*(9), 1229-1262.

Togan, S., & Ersel, H. (2005). Macroeconomic policies for Turkey's accession to the EU. In *Turkey: Economic reform and accession to the European Union* (pp. 3-35). World Bank and Centre for Economic Policy Research-CEPR.

Van Rijckeghem, C., & Üçer, M. (2005). *Chronicle of the Turkish financial crises of 2000-2001*. Boğaziçi Üniversitesi.

Vohra, R. (2001). Export and economic growth: Further time series evidence from less-developed countries. *International Advances in Economic Research*, *7*(3), 345-350.

Wade, R. (2015). The role of industrial policy in developing countries. *Rethinking development strategies after the financial crisis*, *1*, 67-79.

Yeldan, E. (2006). Neoliberal global remedies: From speculative-led growth to IMF-led crisis in Turkey. *Review of Radical Political Economics*, *38*(2), 193-213.

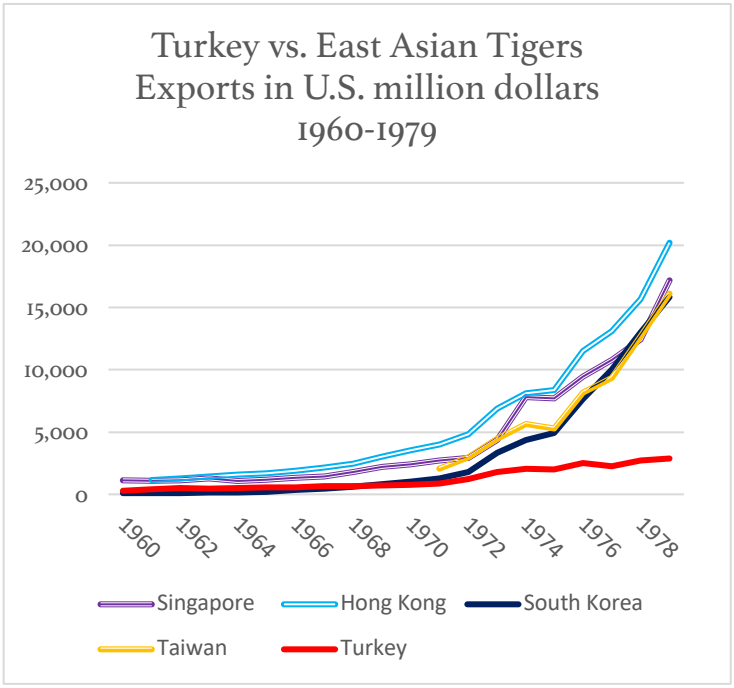
APPENDIX

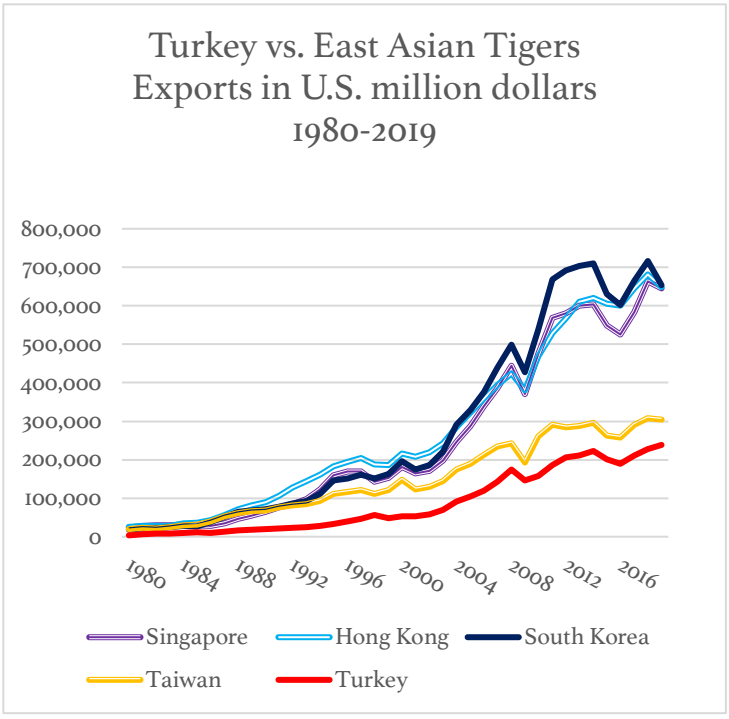
Table A

Country	High-technology exports (% of total manufacturing exports)	Medium to high-technology exports (% of total manufacturing exports)	High-tech exports in current US dollars (in billions)
Japan	17.3 (2018)	81.0(2017)	104.0 (2019)
Romania	11.1 (2019)	61.3(2017)	7.0 (2019)
Mexico	20.7 (2019)	80.3(2017)	73.4 (2019)
Thailand	23.3 (2019)	63.8 (2017)	44.8 (2018)
South Korea	32.4 (2019)	75.5 (2017)	153.6 (2019)
Upper-Middle-Income	23.5 (2018)	N.A.	884.8 (2017)
Turkey	2.3 (2018)	44.7 (2017)	3.1 (2018)
Russia	11.0 (2018)	28.6 (2017)	10.2 (2018)
Israel	22.8 (2018)	59.5 (2017)	13.0 (2018)
Singapore	51.7 (2018)	70.6 (2018)	155.4 (2018)
Malaysia	52.8 (2018)	66.1 (2018)	90.4 (2018)
China	31.4 (2018)	60.5 (2018)	731.9 (2018)
Poland	10.1 (2019)	54.1 (2018)	20.4 (2019)

Table B. Source: World Bank Development Indicators.

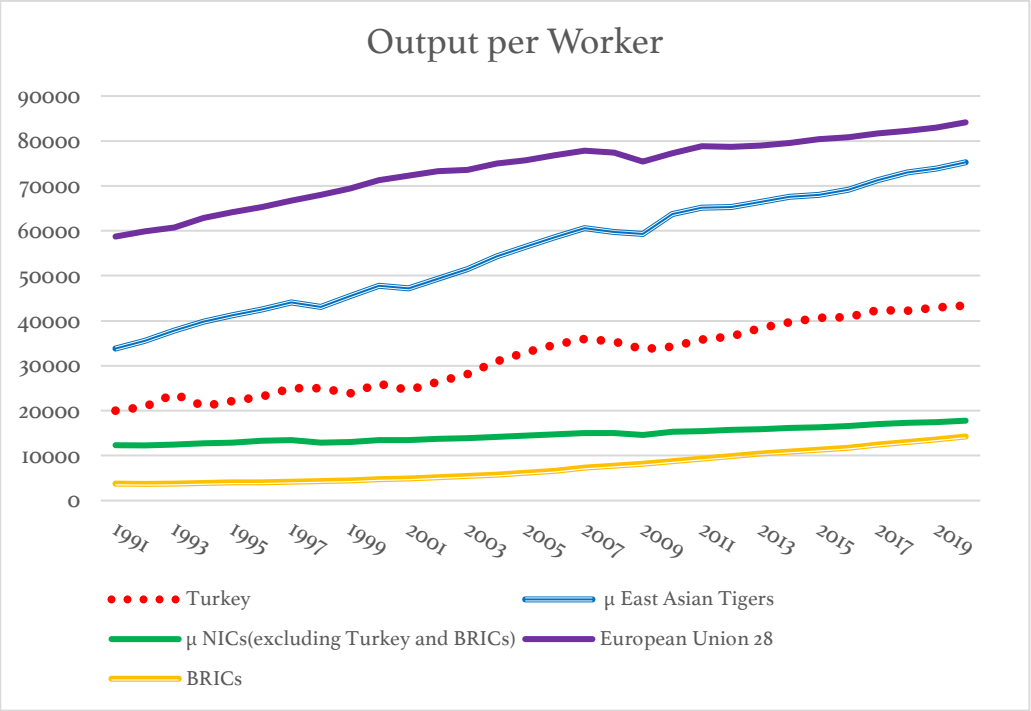
Figure A





Source: World Bank Development Indicators and Republic of China (Taiwan) Ministry of Finance Trade Statistics Database.

Figure B



Source: ILOSTAT (International Labour Organization Department of Statistics). Notes: Output per worker is measured in constant 2010 US dollars. μ NICs (excluding Turkey and BRICs) is the average output per worker for newly industrialized countries: Thailand, Philippines, South Africa, Mexico, Indonesia, and Malaysia (based on Author's calculations). μ East Asian Tigers is the average output per worker for South Korea, Hong Kong, Singapore, and Taiwan (based on Author's calculations). BRICs stands for Brazil, Russia, India, and China.

Figure C.1

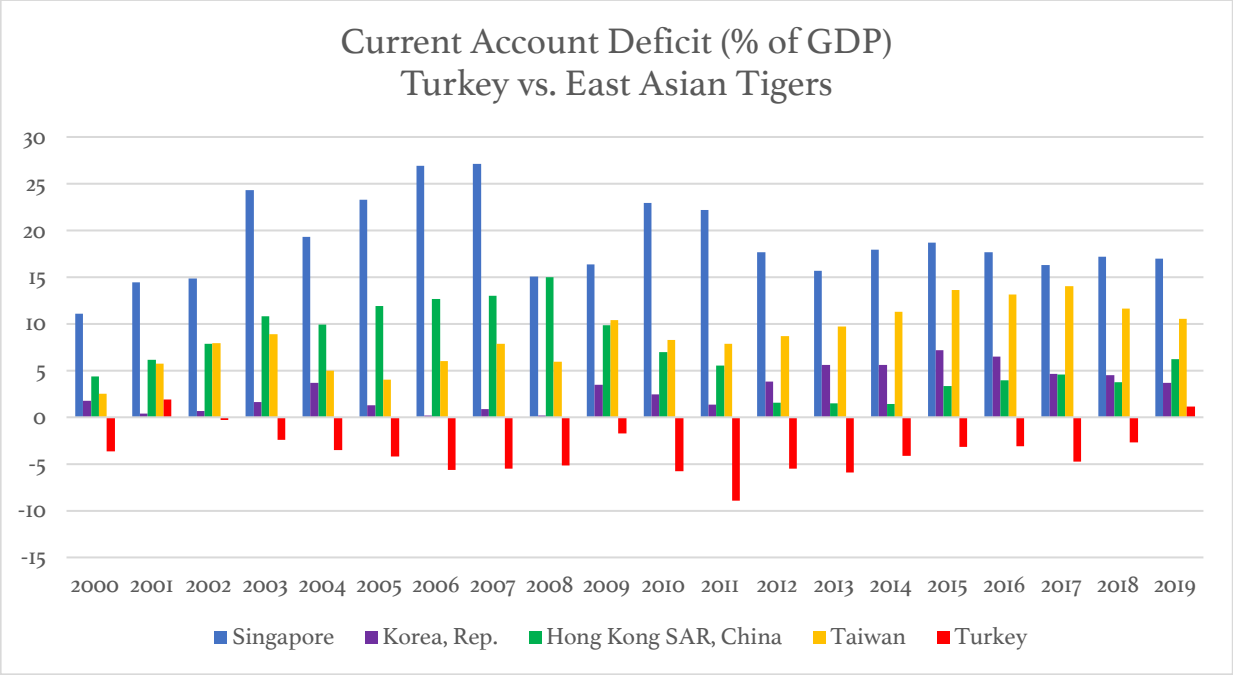


Figure C.2

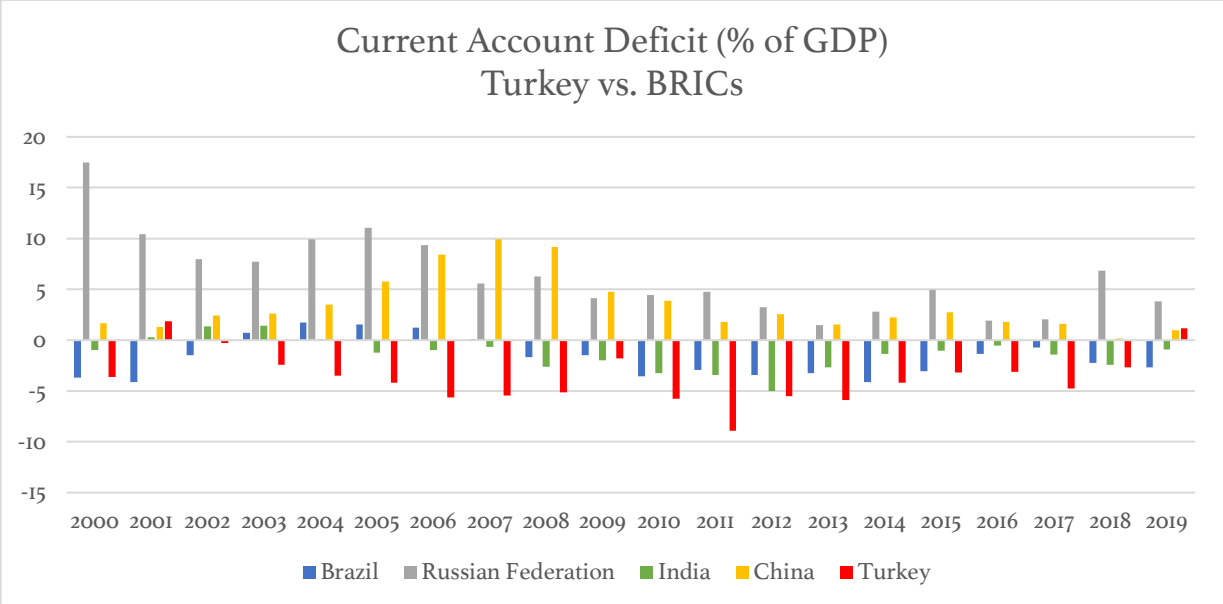


Figure C.3

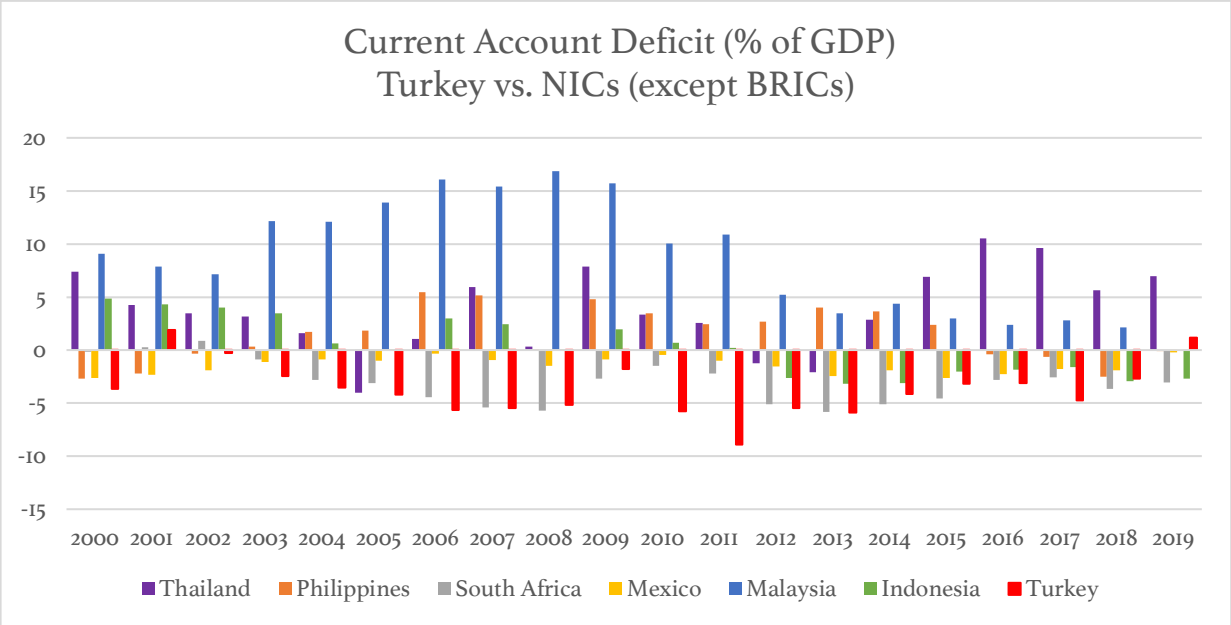
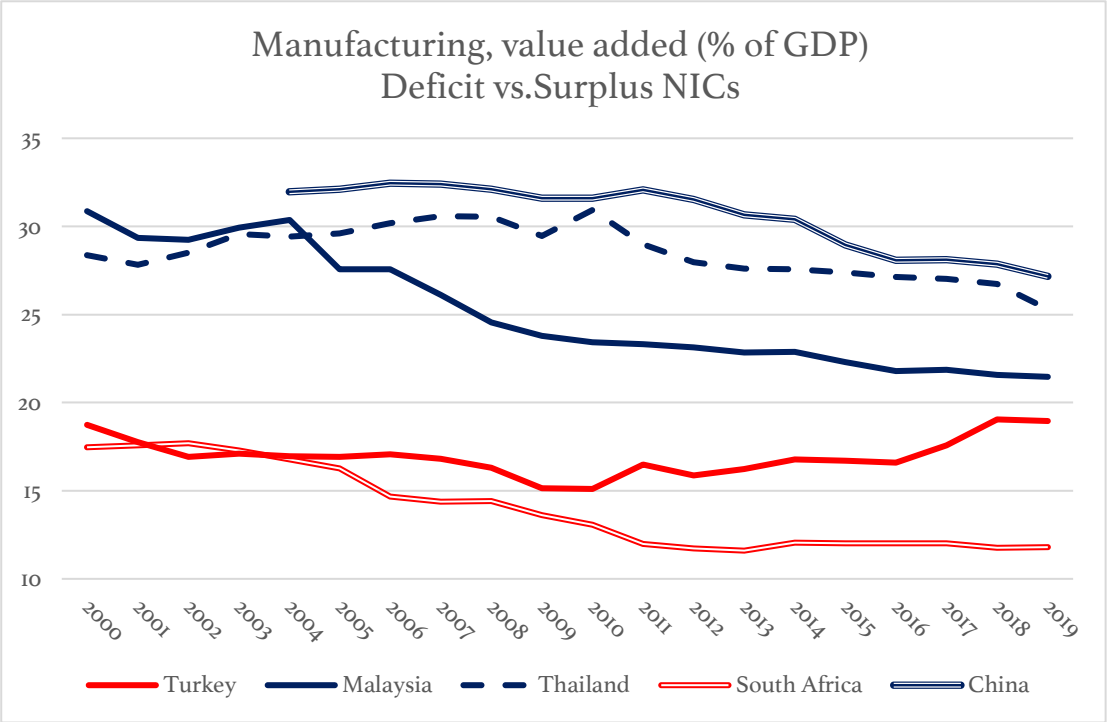


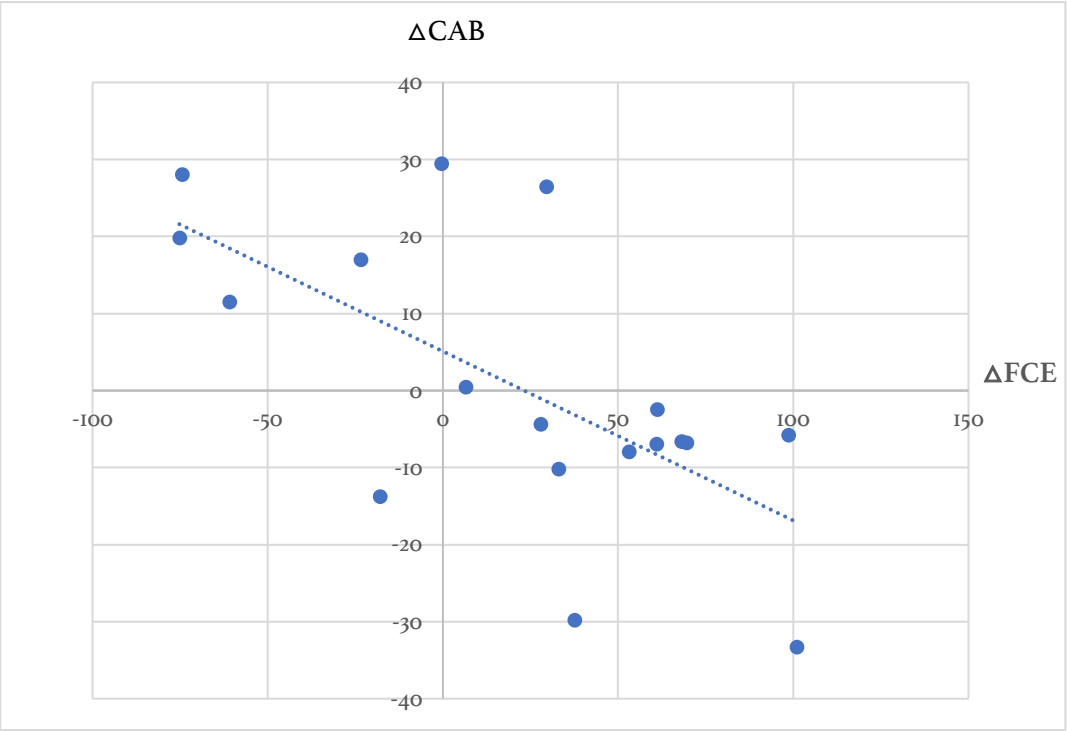
Figure D (1,2,3). Source: World Bank Development Indicators and OECD Database). Notes: NICs stands for newly industrialized countries. BRICs stands for Brazil, Russia, India, and China.

Figure D



Source: World Bank Development Indicators. Notes: The NICs that have posted an average current account deficit of less than -2% (of GDP) for the past two decades are shown in red. The surplus countries (NICs with a surplus of more than 2% (of GDP)) are in blue.

Figure E



Source: World Bank Development Indicators. Notes: ΔCAB stands for the annual change in Turkey's current account balance in billion US dollars from 2002 to 2019 (Author's calculations). ΔFCE stands for the change in Turkey's final consumption expenditure in billion US dollars (Author's calculations).

Figure F.1

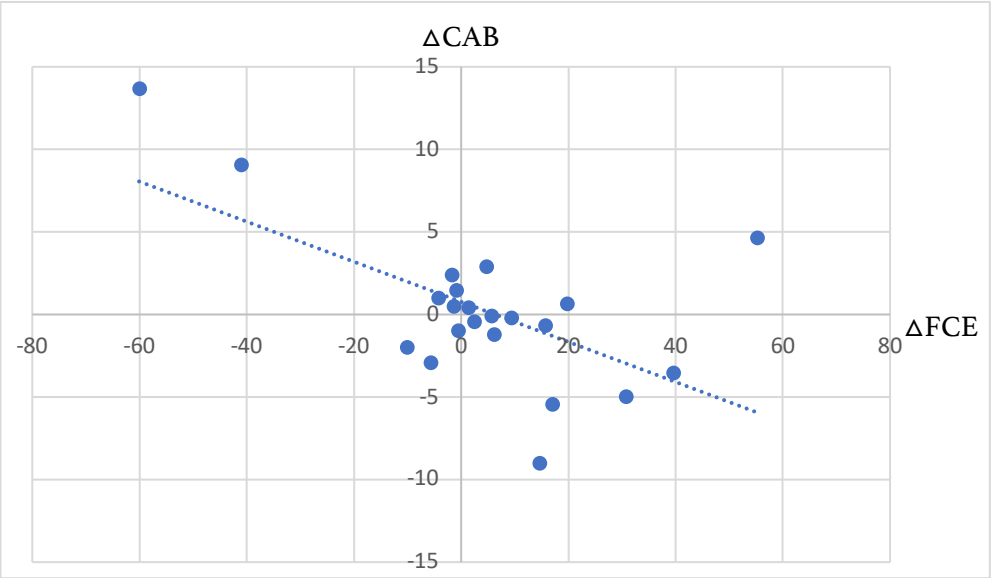
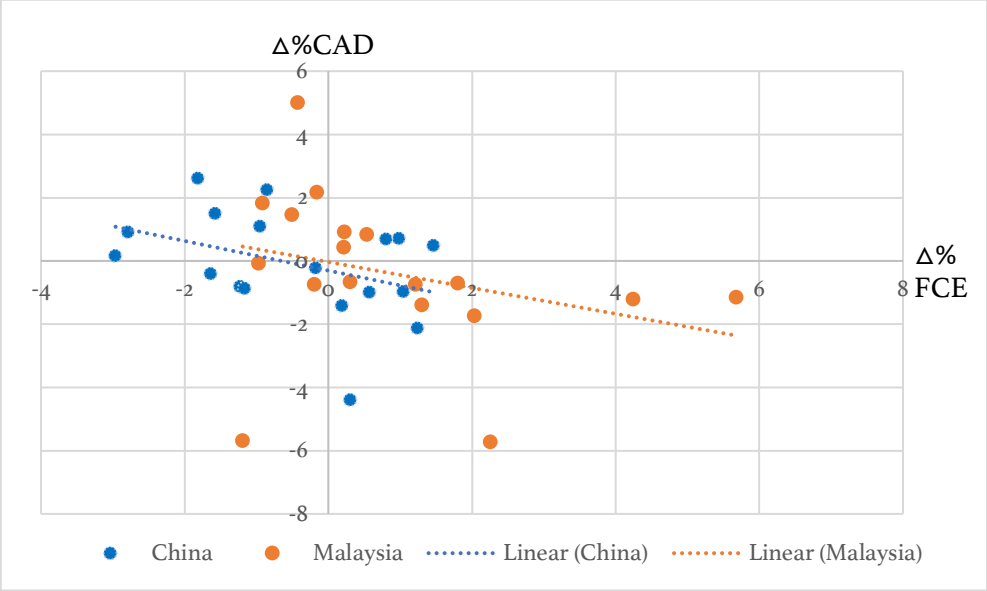
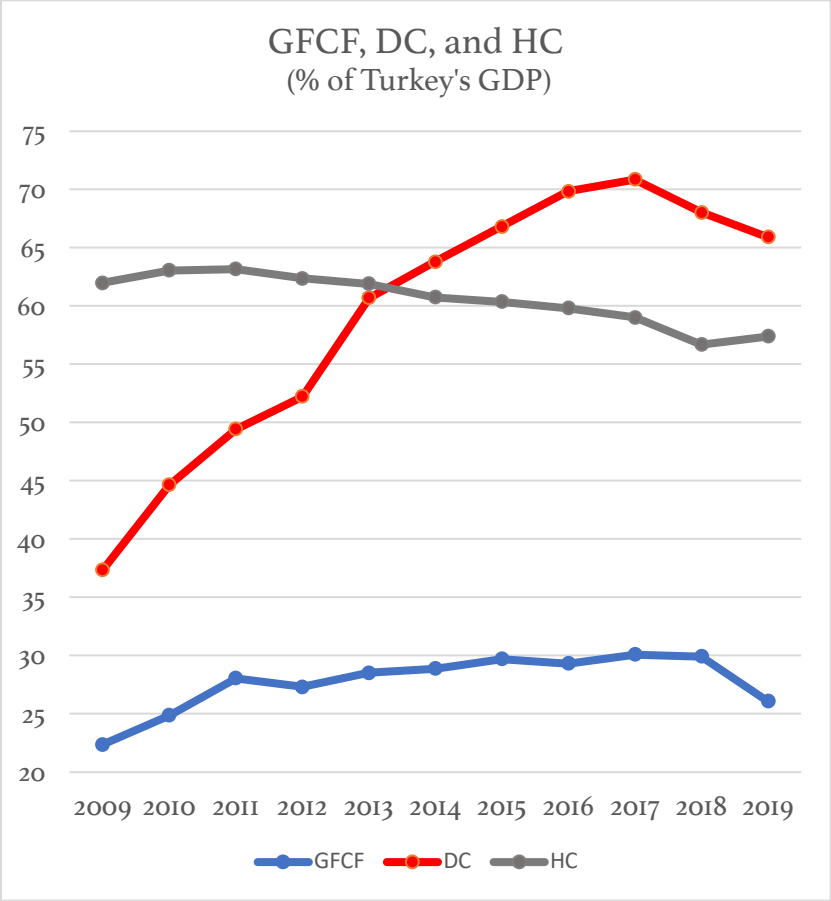


Figure F.2



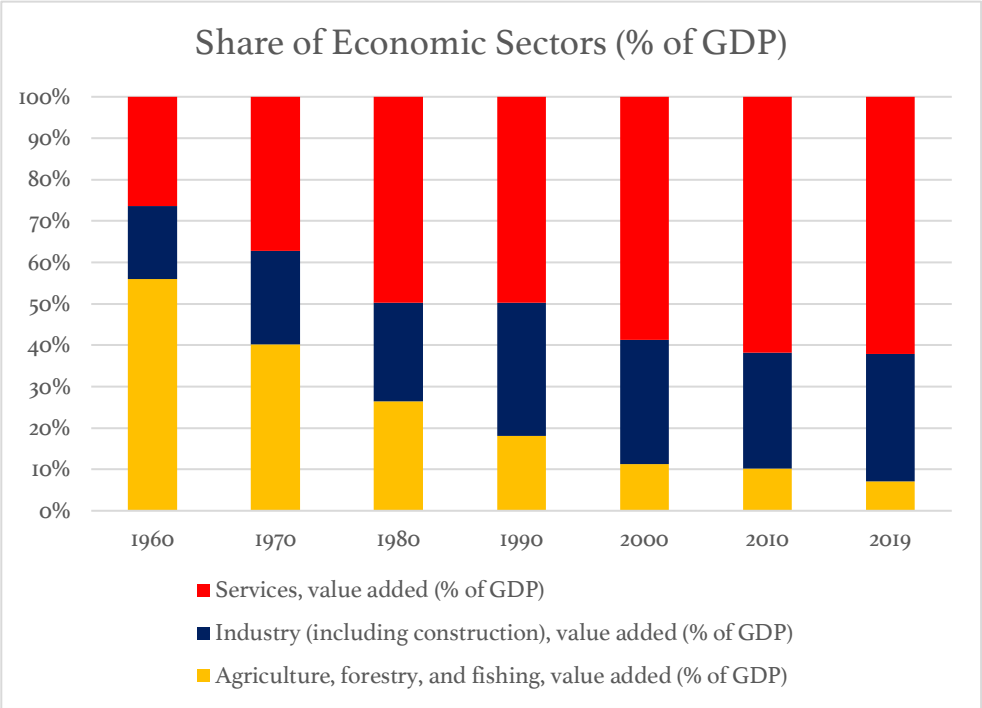
Source: World Bank Development Indicators. Notes: China and Malaysia are classified as Surplus NICs (according to Author's calculations). Δ%CAD stands for the annual change in current account balance as a percentage of GDP from 2001 to 2018. Δ% FCE stands for the annual change in final consumption expenditure as a percentage of GDP from 2001 to 2018.

Figure G



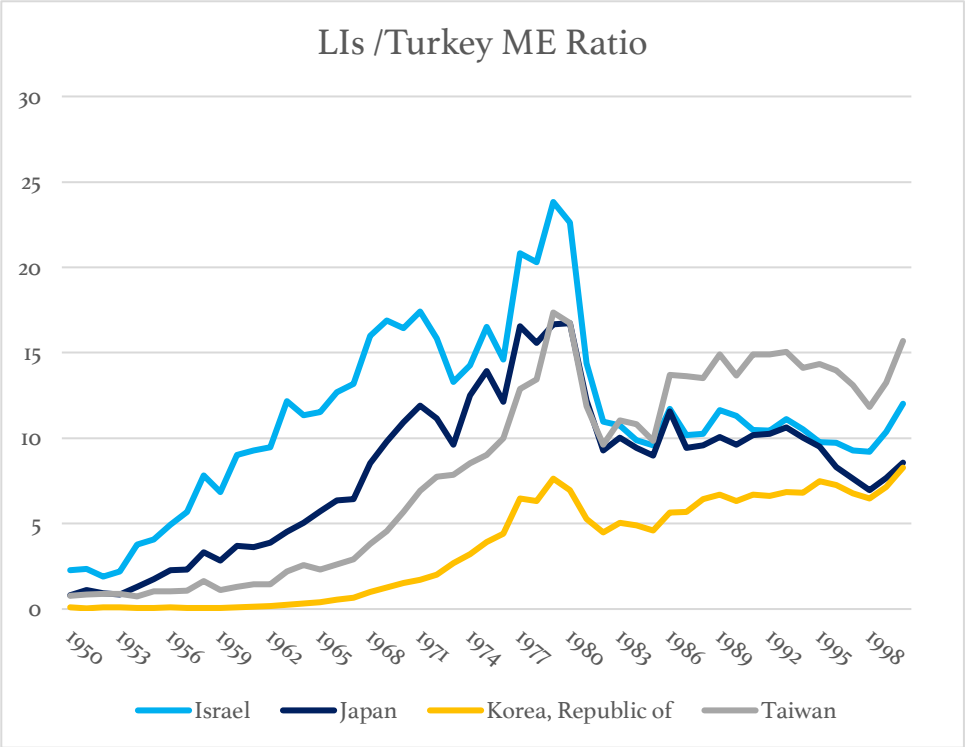
Source: World Bank Development Indicators.Notes: GFCF stands for gross fixed capital formation as a percentage of GDP. DC stands for domestic credit to private sector as a percentage of GDP. HC stands for household and NPISHs final consumption expenditure as a percentage of GDP.

Figure H



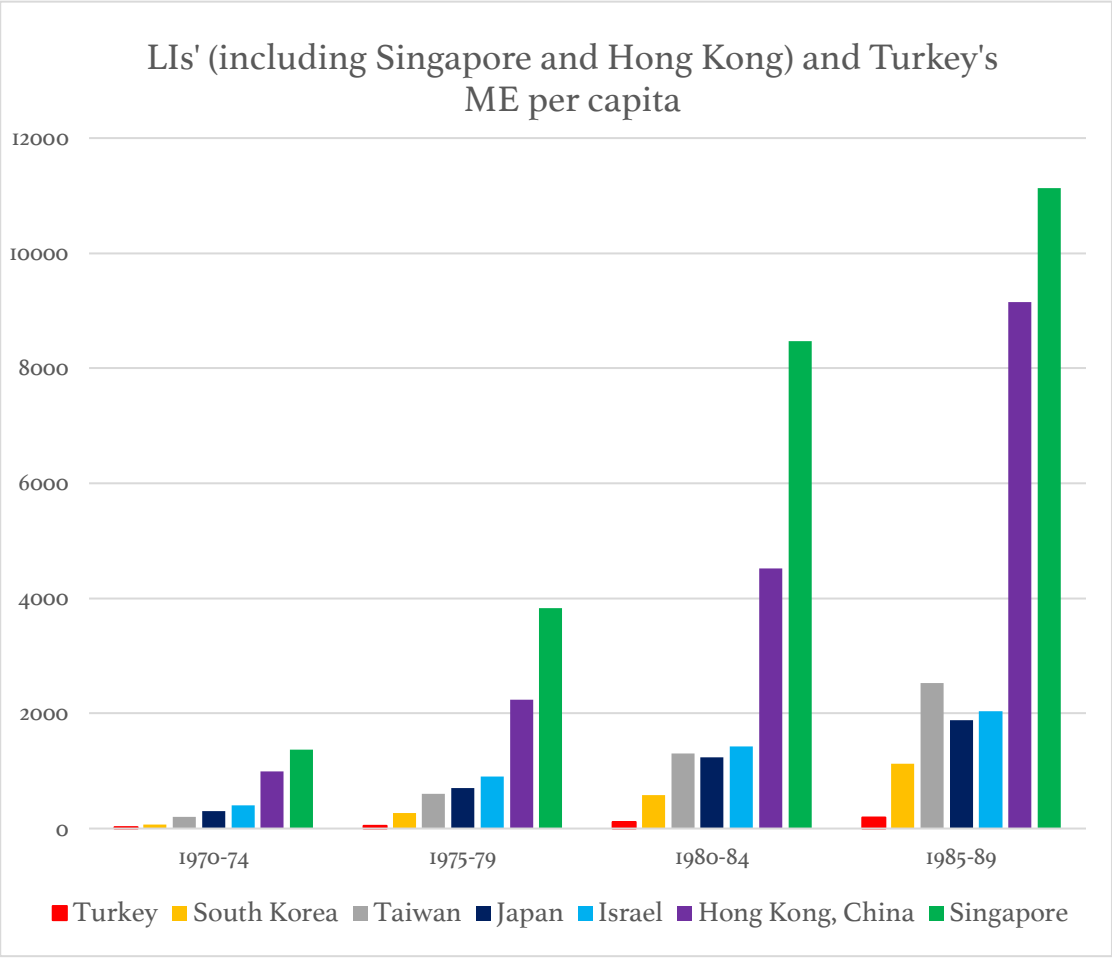
Source: World Bank Development Indicators.

Figure I



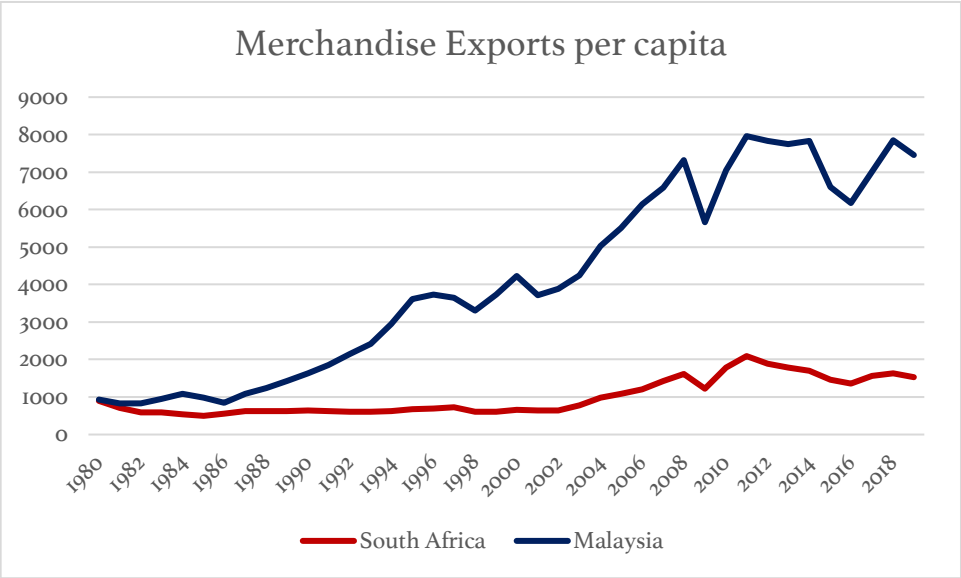
Source: World Trade Organization Database and United Nations World Population Prospects. Notes: LIs/Turkey ME Ratio is Late Industrializers' (Israel, Japan, South Korea, and Taiwan (excluding Hong Kong and Singapore)) Merchandise exports per capita (in Us dollars) is divided by Turkey's ME per capita for given year (based on Author's calculations).

Figure J



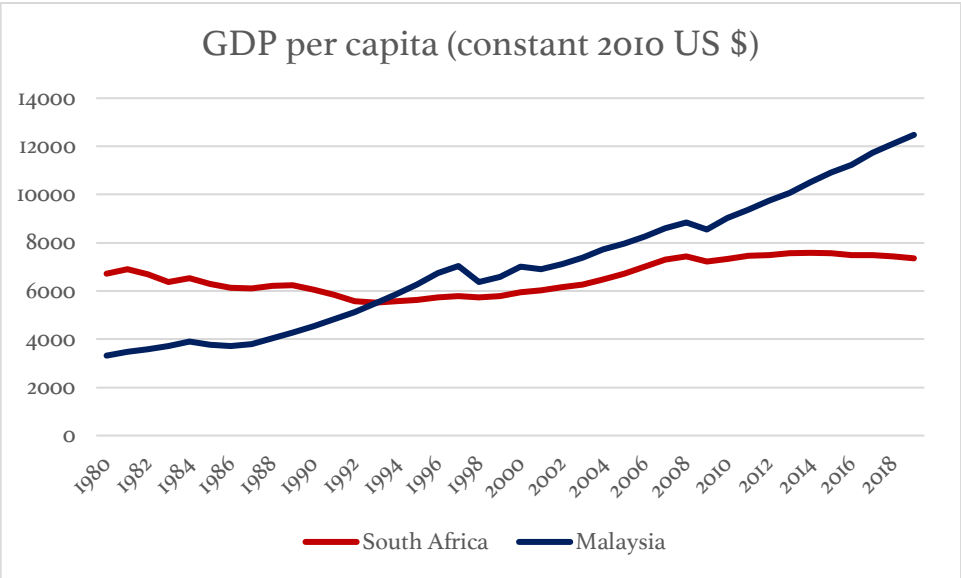
Source: World Trade Organization Database and United Nations World Population Prospects. Notes: Merchandise exports per capita (ME per capita) is merchandise exports divided by mid-year population in US dollars (based on Author's calculations).

Figure K.1



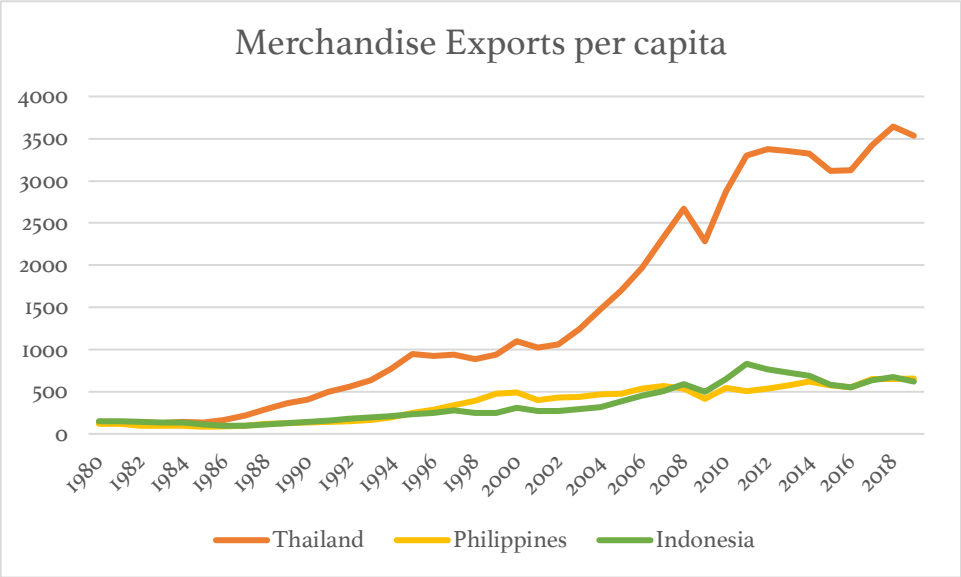
Source: World Trade Organization Database and United Nations World Population Prospects. Notes: Merchandise exports per capita is merchandise exports divided by mid-year population in US dollars (based on Author's calculations. South Africa and Malaysia were the least populated NICs (< 50 million) in 2000.

Figure K.2



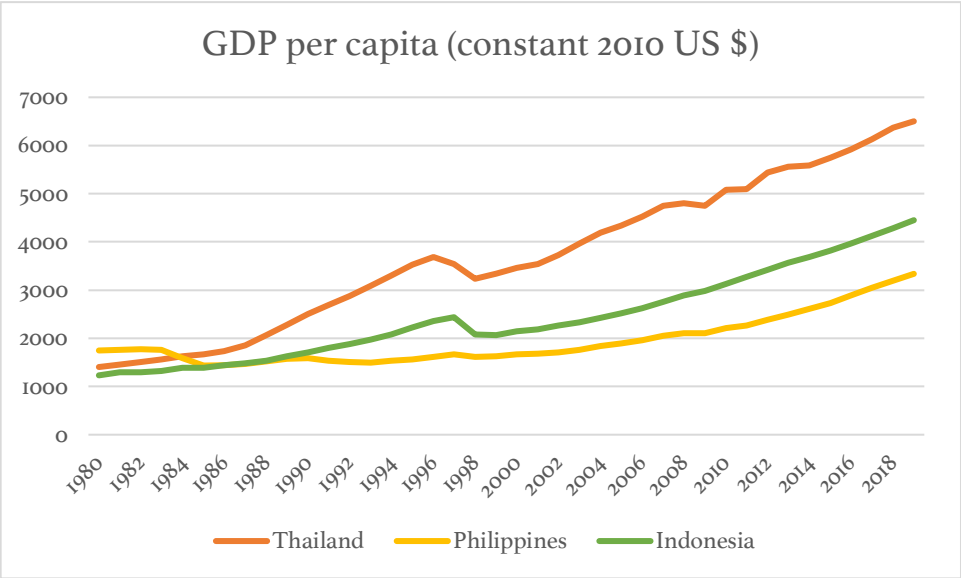
Source: World Bank Development Indicators.

Figure L.1



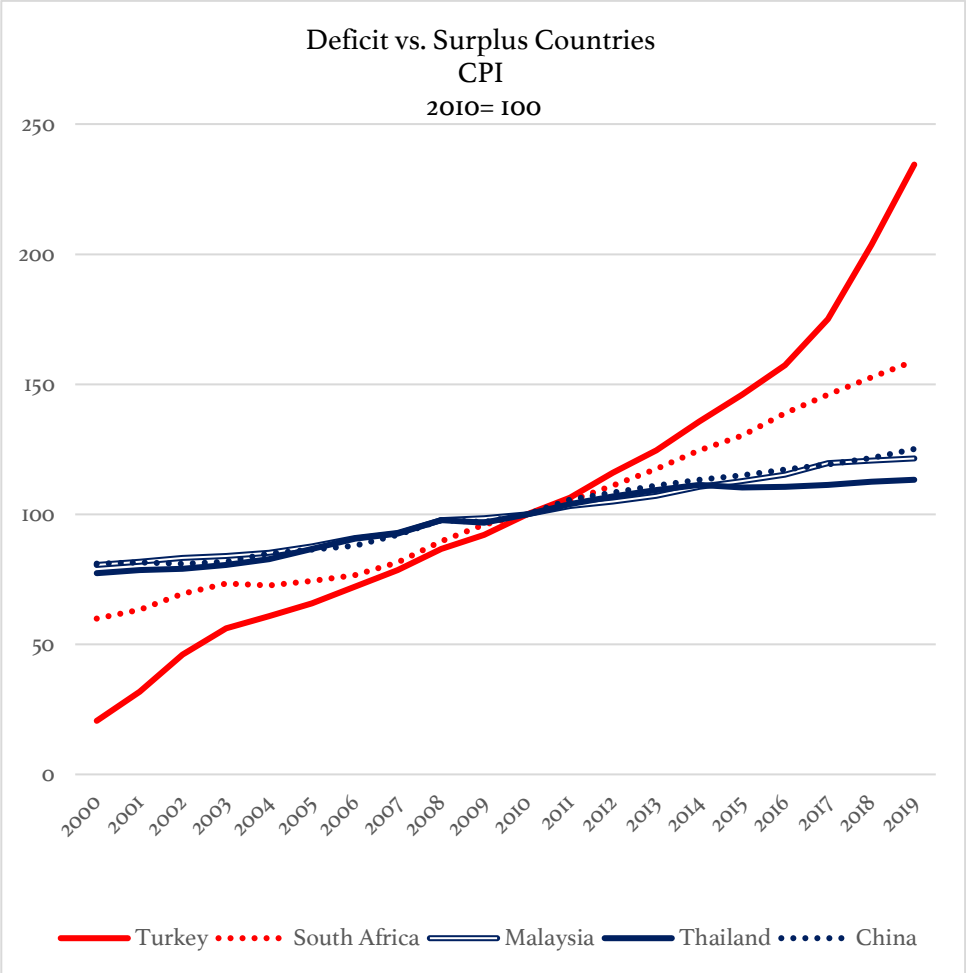
Source: World Trade Organization Database and United Nations World Population Prospects. Merchandise exports per capita is merchandise exports divided by mid-year population in US dollars (based on Author's calculations).

Figure L.2



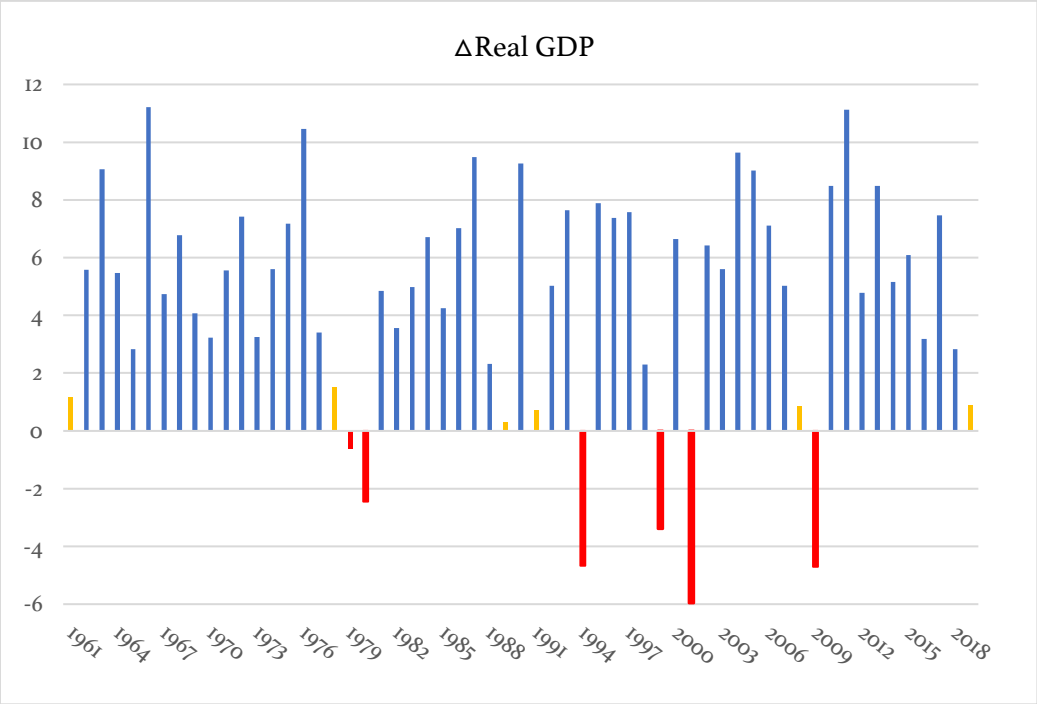
Source: World Bank Development Indicators.

Figure M



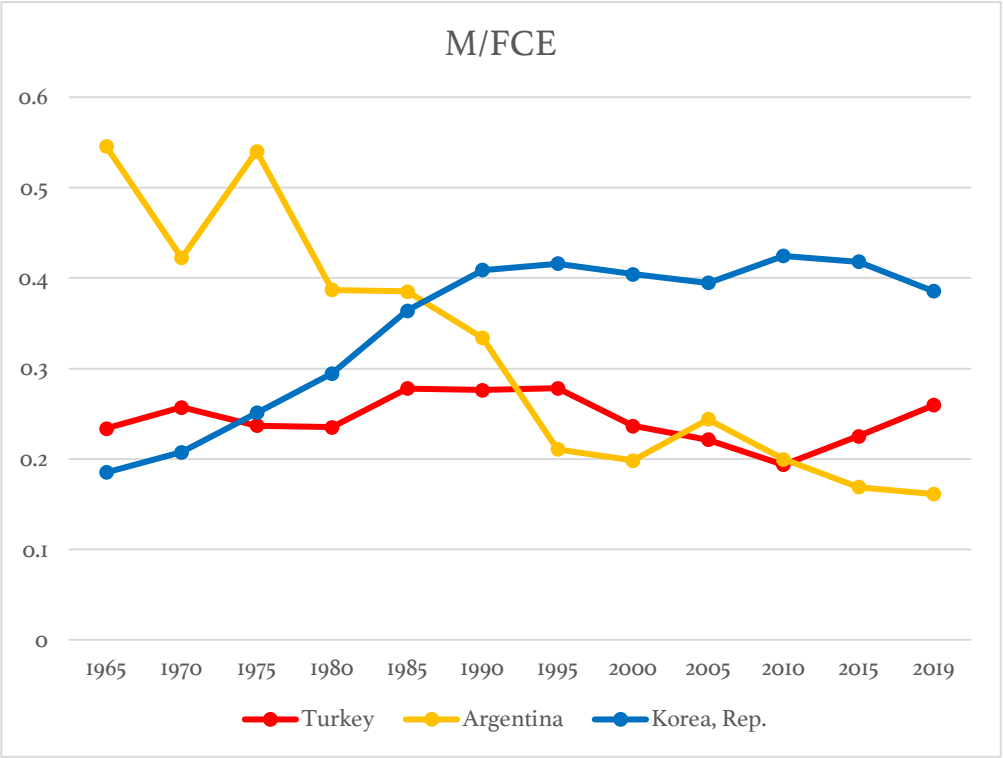
Source: World Bank Development Indicators. Notes: Consumer Price Index (2010 = 100) The NICs that have posted an average current account deficit of less than -2% (of GDP) for the past two decades are shown in red. The surplus countries (NICs with a surplus of more than 2% (of GDP)) are in blue.

Figure N



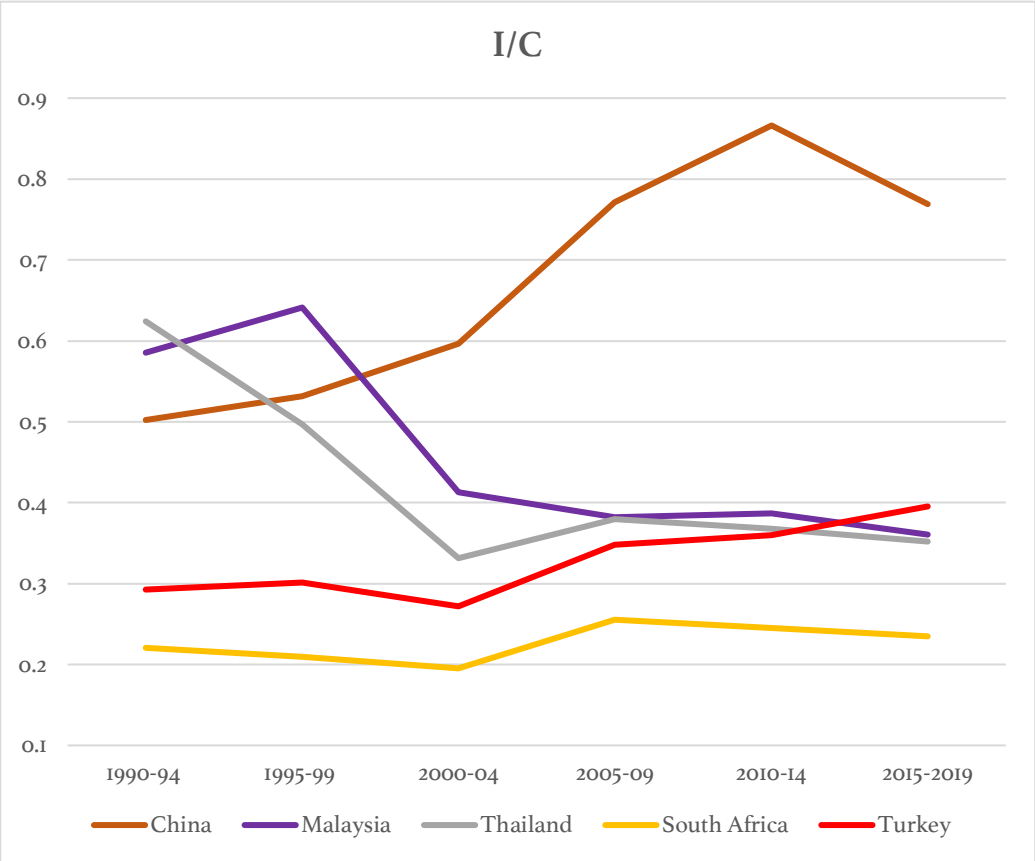
Source: World Bank Development Indicators. Notes: ΔReal GDP stands for the annual percentage change of Turkey's GDP at market prices based on constant Turkish Lira.

Figure O



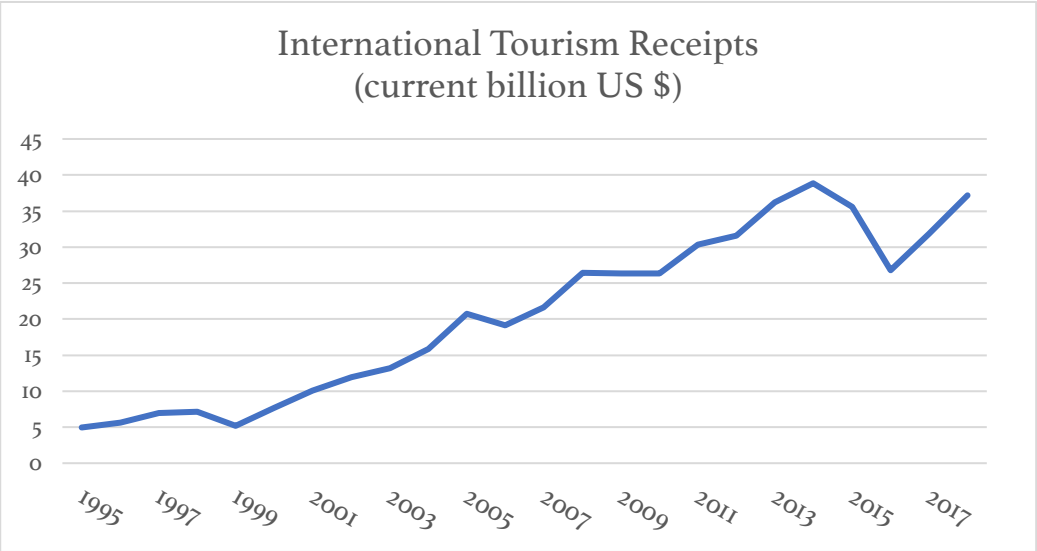
Source: World Bank Development Indicators. M/FCE stands for manufacturing, value added (% of GDP) divided by final consumption expenditure (% of GDP) (based on Author's calculations).

Figure P



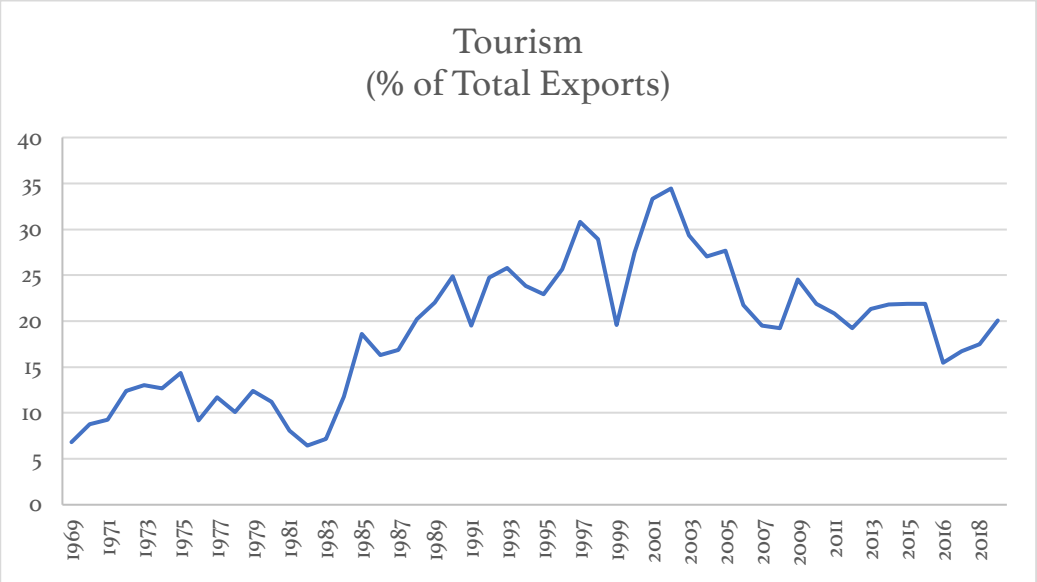
Source: World Bank Development Indicators. Notes: I/C stands for gross fixed capital Investment (% of GDP) divided by final consumption expenditure (% of GDP) (based on Author's calculations).

Figure Q.1



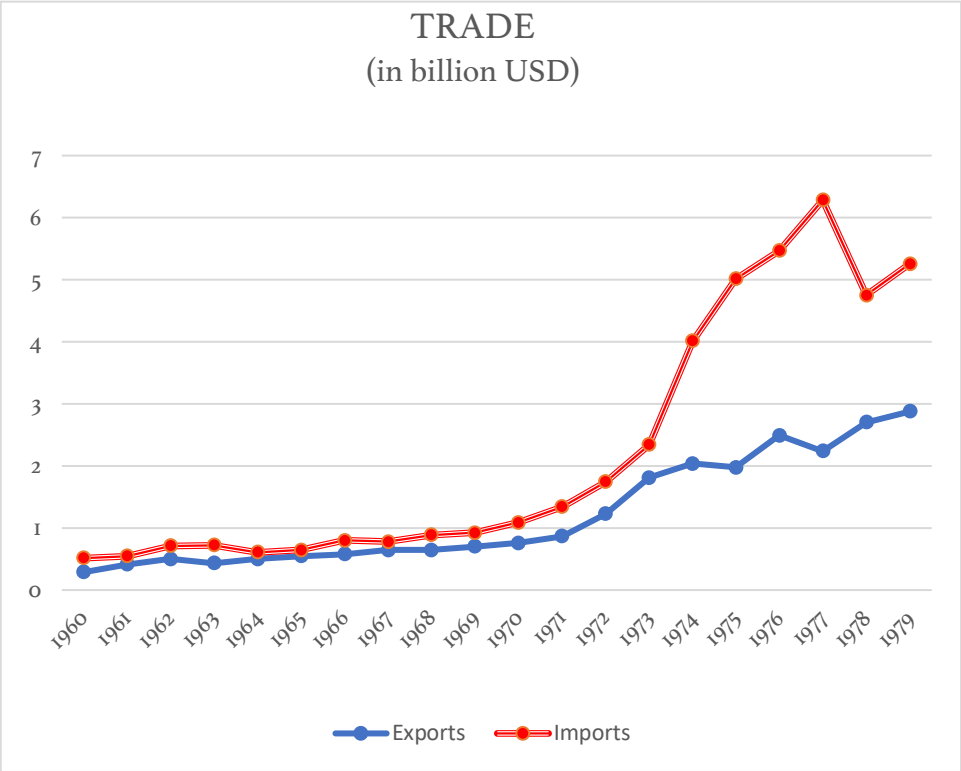
Source: World Bank Development Indicators. International Tourism receipts in current billion US dollars, Turkey.

Figure Q.2



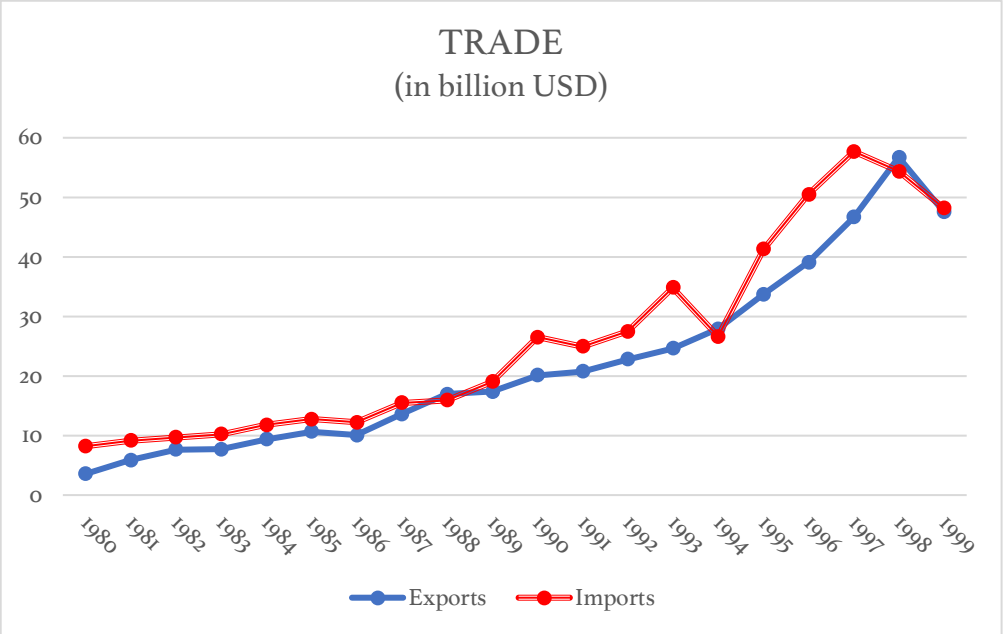
Source: TÜRSAB. International Tourism receipts as a percentage of total exports, Turkey

Figure R.1



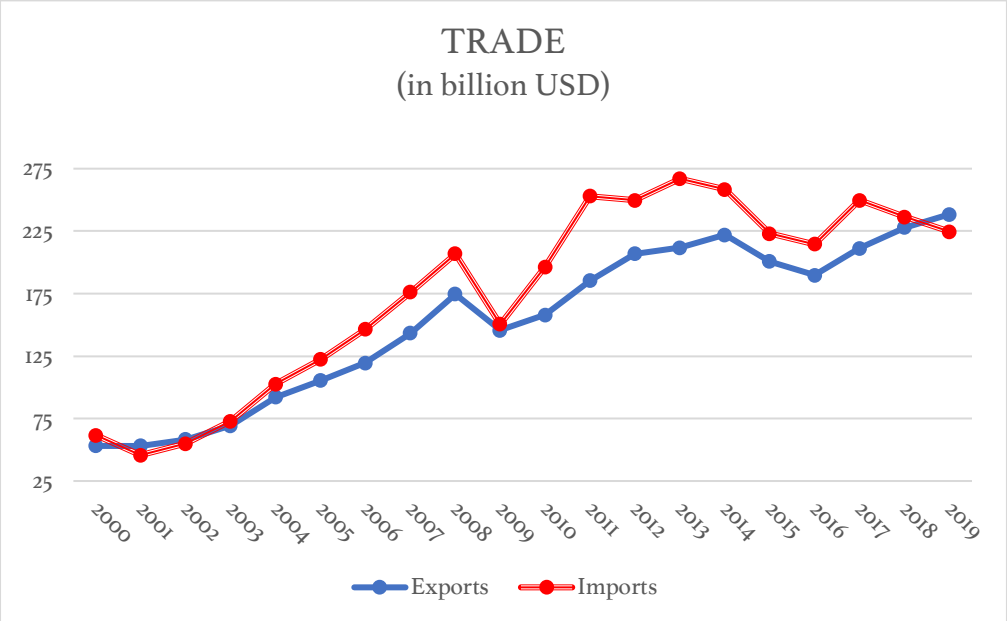
Source: World Bank Development Indicators. Exports and Imports as a percentage of Turkey's GDP from 1960 to 1979.

Figure R.2



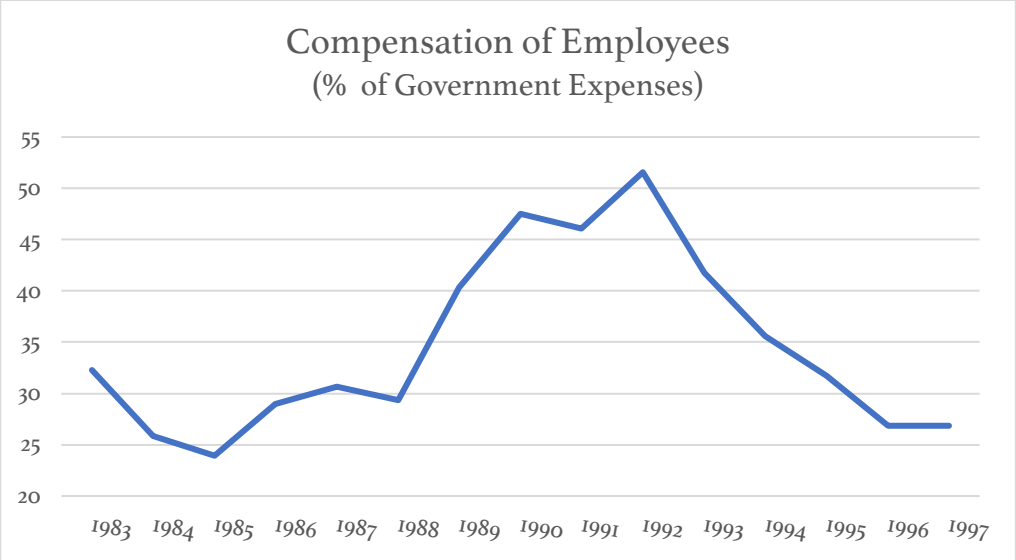
Source: World Bank Development Indicators.

Figure R.3



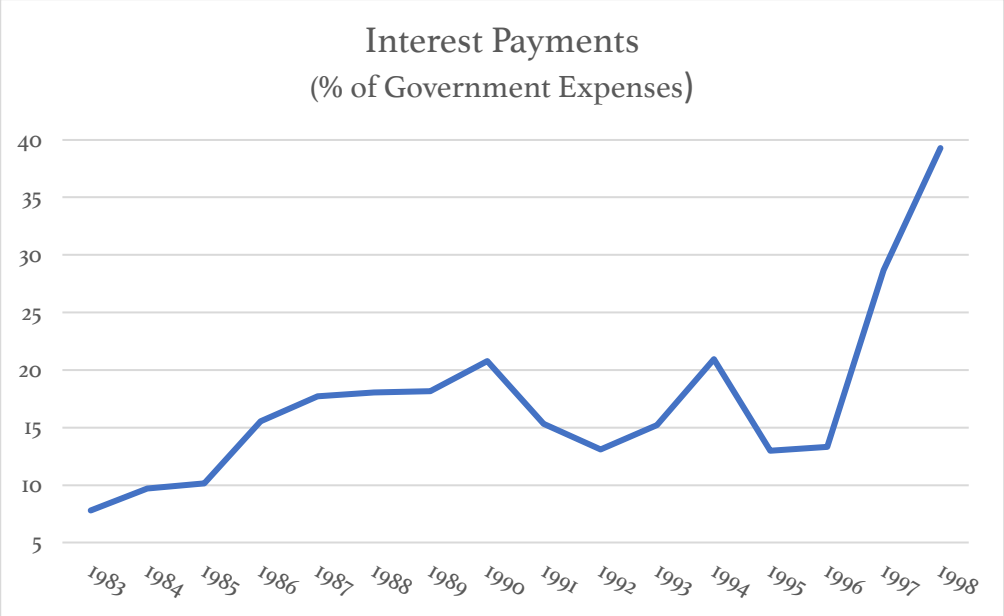
Source: World Bank Development Indicators.

Figure S.1



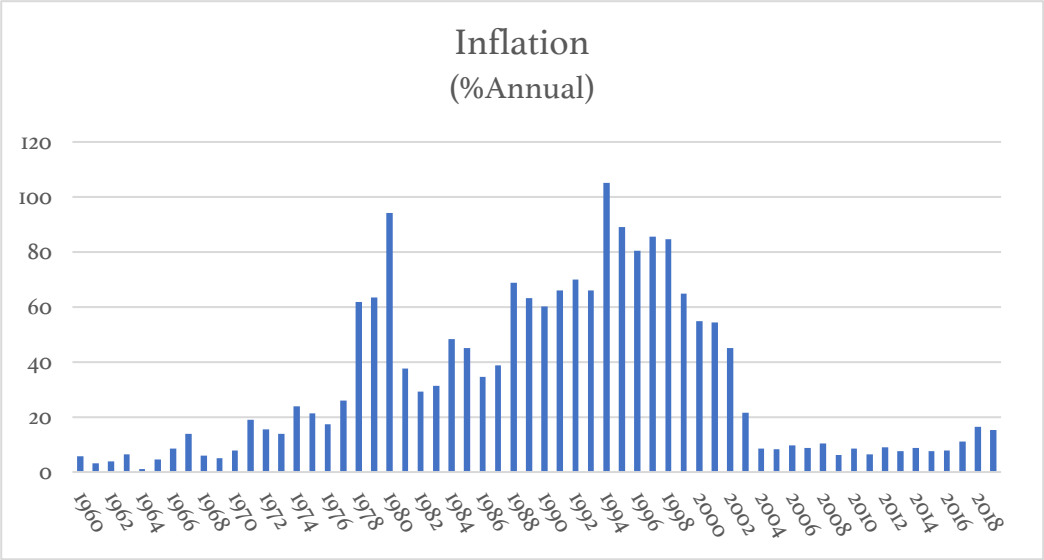
Source: World Bank Development Indicators. Compensation of employees as a percentage of Government Expenses, Turkey.

Figure S.2



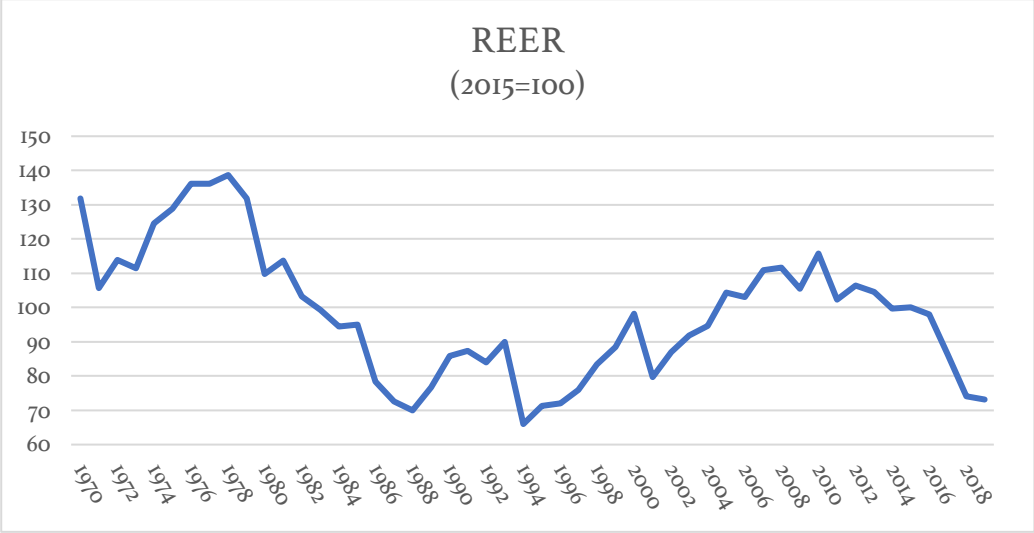
Source: World Bank Development Indicators. Interest payments as a percentage of Government Expenses, Turkey.

Figure T.1



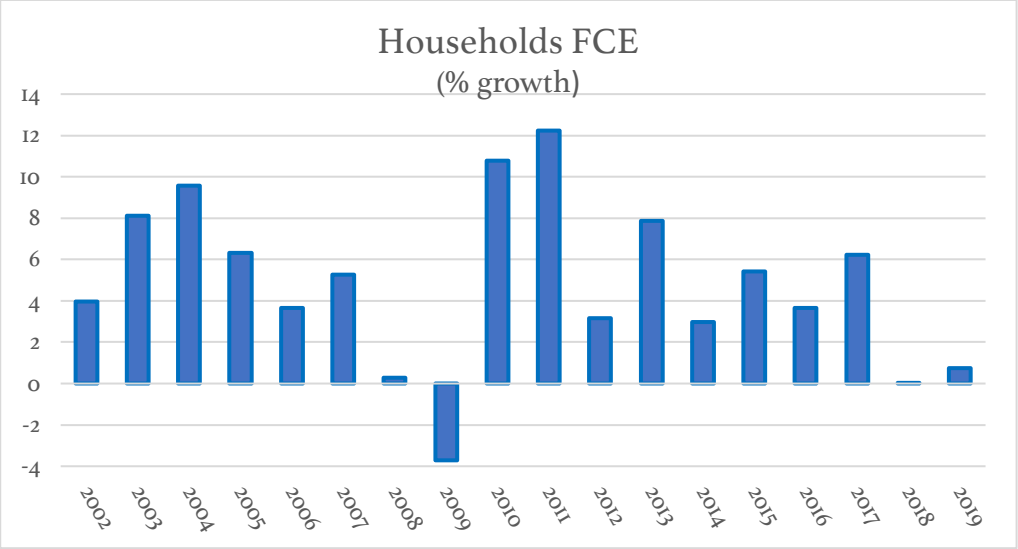
Source: World Bank Development Indicators. Inflation, consumer prices (% Annual), Turkey.

Figure T.2



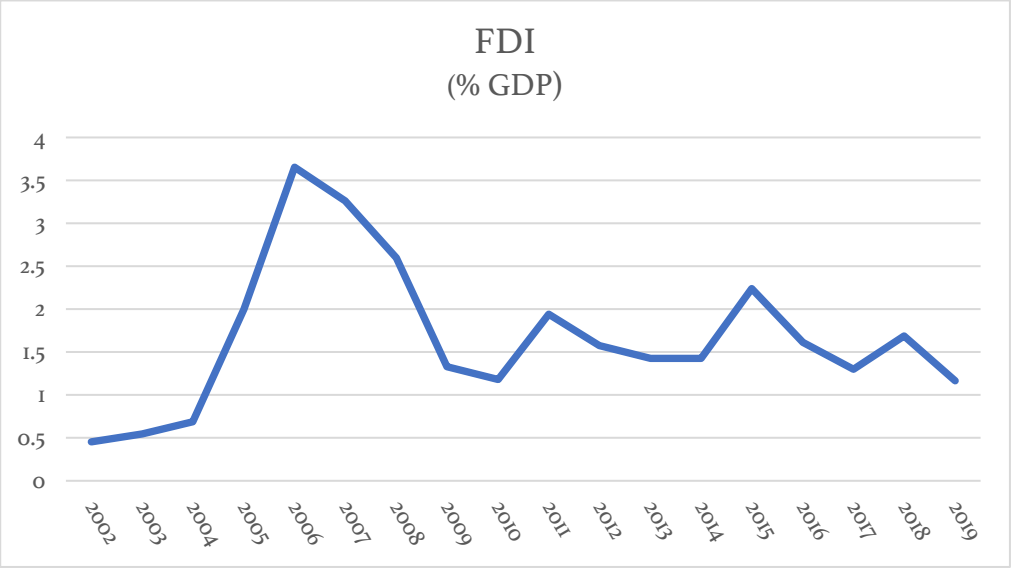
Source: OECD Database. Real Effective Exchange Rate (2015=100, based on manufacturing consumer prices), Turkey.

Figure U.1



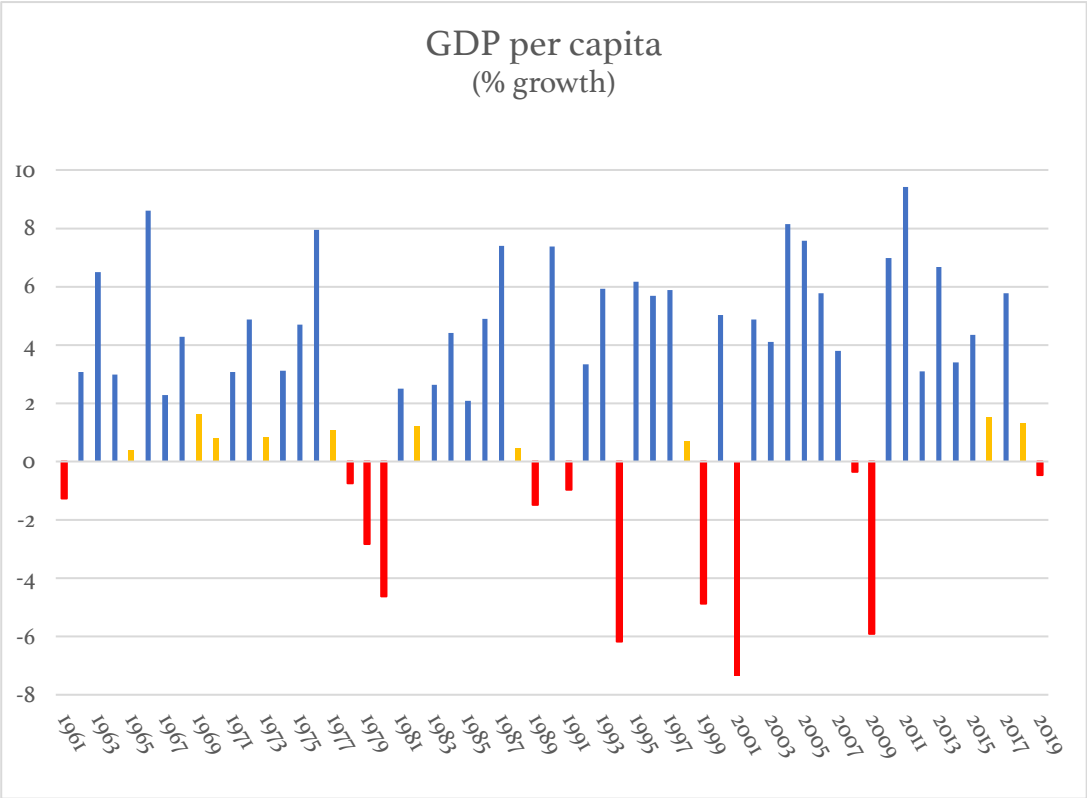
Source: World Bank Development Indicators. Annual percentage growth of household (and non-profit institutions serving households) final consumption expenditure based on constant Turkish lira.

Figure U.2



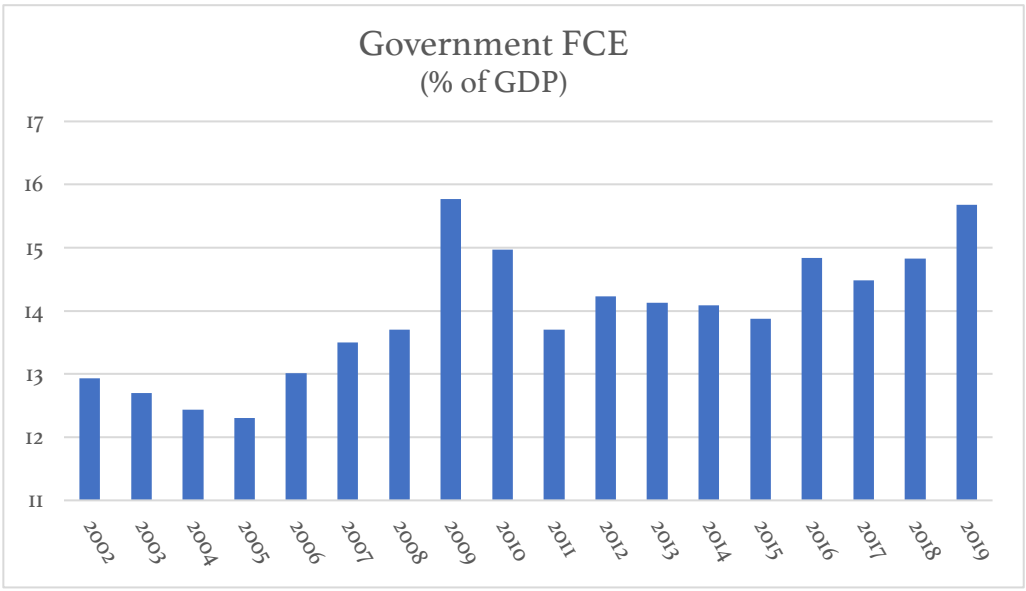
Source: World Bank Development Indicators. Foreign Direct Investment, net inflows, as a percentage of GDP, Turkey.

Figure W



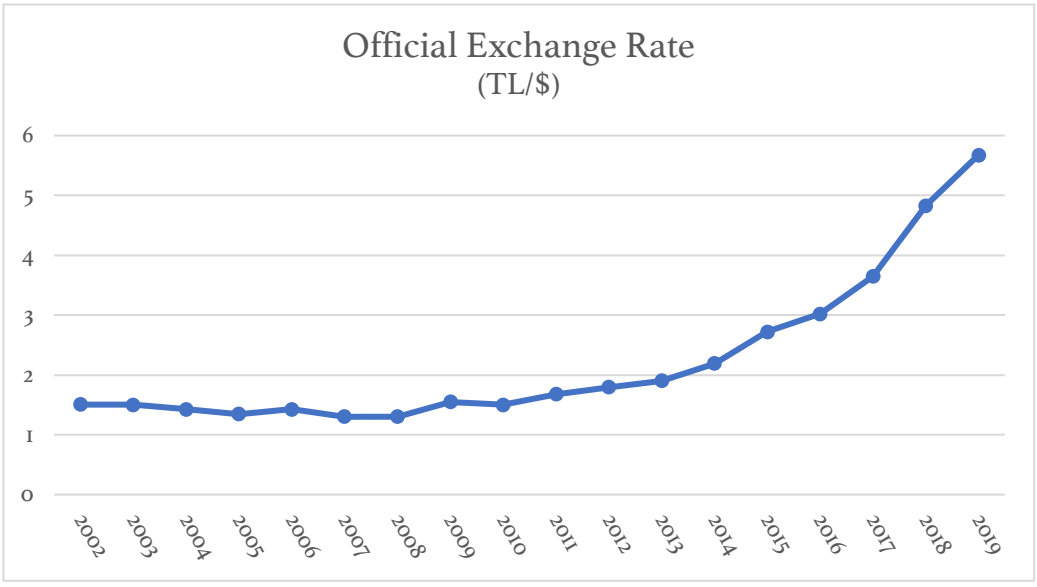
Source: World Bank Development Indicators. Annual percentage growth rate of GDP per capita based on Turkish lira, Turkey.

Figure V.1



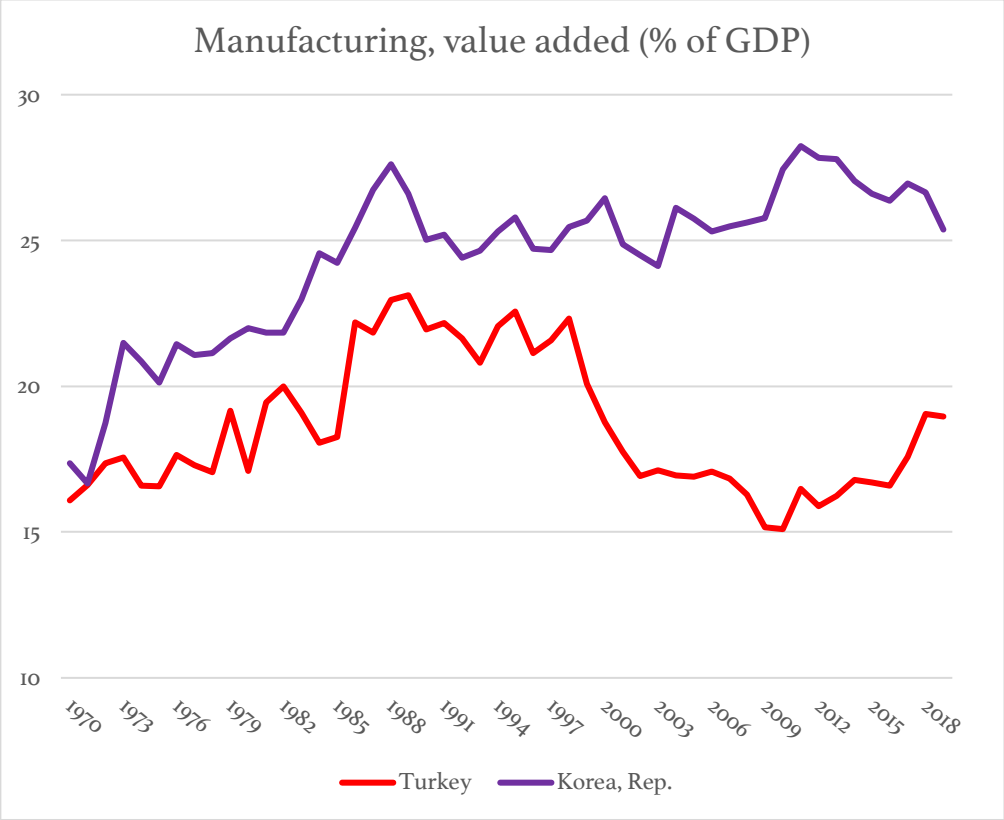
Source: World Bank Development Indicators. Notes: Government FCE stands for Central Government Final Consumption Expenditure as a percentage of GDP, Turkey.

Figure V.2



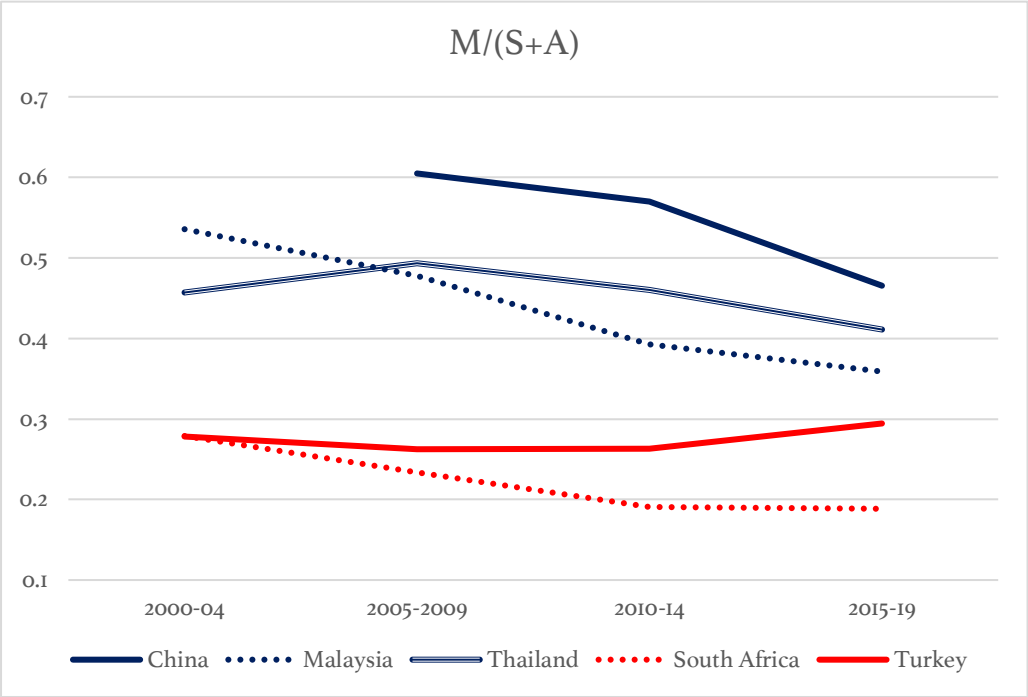
Source: World Bank Development Indicators. Notes: Official exchange rate, TL/$ (period average).

Figure Y



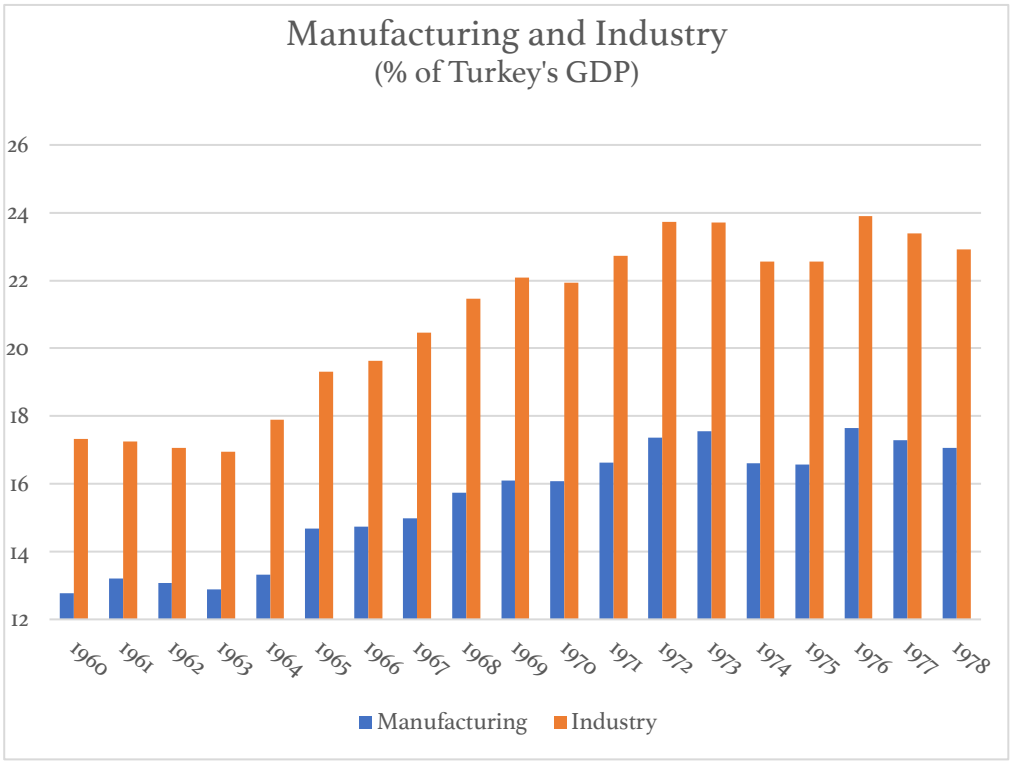
Source: World Bank Development Indicators.

Figure Z



Source: World Bank Development Indicators. Notes: M/(S+A) (manufacturing ratio) stands for manufacturing value added (% of GDP) divided by the total of services value added and agriculture, forestry, and fishing value added as a percentage of GDP (based on Author's calculations).

Figure AA



Source: World Bank Development Indicators.

TABLE B

Newly Industrialized Countries	**GDP per capita** (current US dollars)	**GDP per capita** (PPP 2019 US $)	**Population** (in millions)	**Urban Population** (% of total)	**Global Freedom Score** (100-0)
Brazil	8,717	15,259	211	87	75
China	10,261	16,785	1,398	60	10
India	2,104	7,034	1,366	34	71
Indonesia	4,135	12,302	271	56	61
Malaysia	11,415	29,526	32	77	52
Mexico	9,863	20,410	128	80	62
Philippines	3,485	9,277	108	47	59
South Africa	6,001	12,999	59	67	79
Thailand	7,808	19,228	70	51	32
Turkey	9,043	27,875	83	76	32

Source: World Bank Development Indicators and Freedom House. 2019.

TABLE C1

Newly Industrialized Countries	**Current Account Balance (% of GDP)**	**Exports (% of GDP) 10 yr. Average**	**Exports (% of GDP)**	**External Debt (% of Exports)**
Year	2019	2010-2019	2019	2018
Brazil	-2.7	12.4	14.3	63.9
China	+1.0	22.6	18.4	7.0
India	-0.9	21.6	18.7	31.5
Indonesia	-2.7	22.3	18.4	99.8
Malaysia	3.3	74.1	65.3	N/A
Mexico	-0.2	34.4	39.1	70.1
Philippines	-0.1	28.5	28.3	46.1
South Africa	-3.0	30.1	29.9	74.3
Thailand	+7.0	66.8	59.7	8.3
Turkey	+1.2	24.4	31.6	59.4

Source: World Bank Development Indicators, the Economist Big Mac Index and ILOSTAT.

TABLE C2

Newly Industrialized Countries	**High-tech Exports (% of Exports*)**	**Manufacturing Wages (US $)**	**The GDP-adjusted Big Mac Index (against US $)**
Year	2018		July, 2019
Brazil	13	630 (2018)	+ %30.7
China	31	746 (2016)	-%11.8
India	9	N/A	-%15.6
Indonesia	8	102 (2015)	-%30.2
Malaysia	53	636 (2018)	-%39.2
Mexico	21	357 (2019)	-%24.2
Philippines	61	261 (2019)	-%13.7
South Africa	6	985 (2013)	-%34.7
Thailand	23	470 (2019)	+%14.4
Turkey	2	754 (2018)	-%31.0

Source: World Bank Development Indicators, the Economist Big Mac Index and ILOSTAT. Notes: External debt (% of exports) is the present value of *external* debt divided by three-year export average. Exports (% of GDP) 10 yr. average is based on Author's calculations. *Manufactured Exports