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Wobbling but Still on its Feet: The Turkish Economy in the Global Financial Crisis

Caner Bakir

This paper examines the Turkish economy in a world of current global financial crisis. It shows that Turkey's key economic strengths include relatively prudent fiscal balances and a resilient banking sector. Key economic weaknesses include non-financial private sector foreign debt rollover risk, substantial household indebtedness where the unemployment rate is rising, an overvalued Turkish lira with its potential for rapid depreciation, and contracted growth and demand for Turkish imports. Turkey needs formal and informal institutional flexibility to prioritise social welfare spending and fixed capital investments by the public sector, rather than an exclusive preoccupation with price stability via monetary and fiscal discipline.

Keywords: Turkey; economy; crisis; globalisation

The world's recent experience with the global financial and economic crisis has exposed structural problems of liberal market economies (LMEs), which include coordinating economic transactions through self-regulatory markets and corporate hierarchies. The institutional realities of neoliberalism are increasingly challenged by heightened state intervention and regulation at systemic and national levels. The current global credit crunch (i.e. the sudden contraction of the worldwide credit supply following the bursting of the US housing bubble), which had its epicentre in the US, has shown that any market economy may face financial instability, corporate failures, loss of consumer and business confidence, and subsequent economic recession in a world of global finance. 'The return of depression economics' is not a far distant memory (Krugman 2008). In this context, in addition to the exposed weaknesses of self-regulatory markets in LMEs, neoliberal capitalism, with its supply-side macroeconomics, now faces a crisis of legitimacy. Not surprisingly, governments are increasingly adopting debt-financed economic stimulus plans and state intervention (e.g. welfare spending, de facto nationalisations and corporate bailouts) to cushion the adverse effects on employment and economic growth. In this

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global punctuated equilibrium, Keynesian ideas, based on demand-side macroeconomics with its regulatory state, are increasingly back onto governmental agendas at the systemic and national levels of capitalism restructuring. Arguably, there will be more opportunities for nation-states to seize a collective financial regulatory initiative beyond and within their borders (see Braithwaite and Levi-Faur 2008; Mikler 2008).

Turkey had its own home-grown financial/economic crisis in February 2001, which resulted in the largest economic recession in its history. Real Gross Domestic Product (GDP) contracted by 7.5 per cent in 2001. Inflation (i.e. the consumer price index) was realised at 68.5 per cent, the Turkish lira depreciated by 115.3 per cent against the US dollar, whilst the interest rates on government securities averaged 96.2 per cent (CBRT 2002, p. 16; 2003, p. 12). The financial cost of the crisis in 2001 was US$47.2 billion in taxpayers' money, with recapitalisation of the banking sector (SPO 2004, p. 72). The cost constituted 32 per cent of GDP in 2001. The number of insolvent banks under the administration of the Savings and Deposit Insurance Fund (SDIF) increased by six and reached 22 in 2003 (SDIF 2003). The SDIF held the biggest portfolio of non-performing loans (NPL), which constituted 29.3 per cent of total gross loans in the sector in 2001. The amount of funds injected into the SDIF banks reached US$27.8 billion in 2004 (SPO 2004, p. 73).[1]

The 2001 crisis punctuated stability in the 'crony capitalism' embedded in the Turkish financial system, to eventually give way to fundamental economic policy and institutional changes towards neoliberal restructuring of the economy through institutional/policy entrepreneurship and mediation (Bakir 2009). Following the 2001 financial crisis, Turkey took steps towards a regulatory state in banking in its deregulated market economy (for a critical assessment, see Bakir and Öniş 2009). The banking sector was declared the most urgent problem. The solutions proposed were based on the Washington Consensus and the Post-Washington Consensus. The former included prudent fiscal (e.g. primary surplus, tax reforms, fiscal restructuring, and the removal of extra-budgetary funds) and monetary policy measures (e.g. high real interest rates) to achieve a single-digit inflation rate, and privatisation and rationalisation (see Treasury 2001). The latter included rehabilitation and restructuring of the banking sector including socialisation of bank failures, a new banking law requiring adaptation to international norms (e.g. Basel II, Banking Core Principles and banking norms of the European Union), good governance and central bank independence. These Washington-based ideas penetrated the domestic policy process effectively and caused policy and institutional innovation when a policy entrepreneur with joint membership in domestic and transnational policy communities mediated within and among these communities in the crisis environment in Turkey (Bakir 2009). In the words of an investment bank, 'Turkey became the poster child of the IMF [International Monetary Fund] for successfully implementing its reform and stabilisation programme in the aftermath of the 2001 crisis' (UniCredit 2008, p. 20).

This paper examines the Turkish economy in a world of current global economic crisis. It offers an analysis of the initial impact of the crisis on the economy, the national economic background, domestic macroeconomic policy responses to date,

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and the challenges ahead. The remainder of this article deals with each of these issues. In order to do so, it briefly focuses on the four main sectors of the Turkish economy: the public sector, the financial sector, the non-financial sector and the household sector, as well as broad socio-economic and external indicators (e.g. foreign capital flows). It shows that the Turkish economy is in relatively good shape in terms of public finance/debt and banking sector robustness, whereas there are significant weaknesses in non-financial firm and household debt, as well as external indicators in the face of the current global crisis. In particular, some of the key weaknesses include non-financial private-sector foreign debt rollover risk, substantial household indebtedness where the unemployment rate is rising, an overvalued Turkish lira with its potential for rapid depreciation, and finally contracted growth and demand in Europe, Russia and Middle East for Turkish imports.[2]

This article argues that one of the most significant institutional challenges ahead is the 'ideational rigidity' that prevents the adoption of Keynesian demand-side macroeconomic management. It has been previously documented that Turkey has a weak state capacity and cannot adopt *proactive* but only *reactive* industrial and sectoral policies in the face of challenges posed by financial/economic globalisation (Bakir 2006; Öniş and Şenses 2007). The focus in these studies, however, has been limited. They briefly examined formal institutional arrangements only, ignoring the significant role of informal institutions such as normative and cognitive ideas and discourse.[3] Turkey needs to demonstrate at least responsive formal and informal institutional capacity enabling flexible and coordinated policy responses. Formal institutional capacity requires a state leadership facilitating coordination and collaboration between economic bureaucracies and sections of the private sector towards the adoption of Keynesian demand-side macroeconomic management. In doing so, policy responses may progress towards prioritising the achievement of high levels of employment and economic growth as well as social welfare expenditures via government spending.

However, one of the major obstacles to the adoption of such policies arises from informal institutional rigidity. It is striking that this rigidity is embedded strongly in the institutional structure of the economy and prevailed in the absence of IMF conditionality when the crisis hit Turkey. The ideational rigidity is based on a neoliberal supply-side macroeconomic mental framework exclusively prioritising prudent fiscal and monetary policies towards the achievement of price stability even in the current global economic crisis. In particular, Turkey's weak policy responses to the crisis have shown that policy choices are constrained severely by institutional path dependence in the monetary and fiscal policy regimes, which are shaped by the policy parameters of dominant neoliberal ideas and their formal institutions. So far, Turkey has benefited from the adoption of fiscal and monetary institutions of a neoliberal policy regime in terms of economic growth, government debt indicators, inflation rate and relative robustness in the banking sector. However, between 2002 and 2008, the same policy regime did not produce any improvement in the unemployment rate despite economic growth. It was also responsible for high levels of private and

household sector debt, and a wide current account deficit. Turkey's ability to adapt effectively to the socio-economic challenges posed by the global crisis will be a function of the alignment of formal and informal monetary and fiscal policy institutions with Keynesian demand-side macroeconomic management, which focuses on employment, social welfare and industrial policies.

Initial Impact of the Crisis

The Turkish economy is now in recession. The GDP growth declined sharply from 6.7 per cent in the first quarter of 2008 to 0.5 per cent in the third quarter, marking the end of non-stop growth over the last 26 quarters. The global crisis has furthered a falling trend in the GDP growth rate and industrial production (see Table 1). For example, between 2007 and 2008, GDP growth slowed to 1.9 per cent in 2008 from 4.6 per cent, whilst industrial production contracted to −0.8 per cent from 6.9 per cent (Oxford Economics 2009). Not surprisingly, the unemployment rate increased to 13.6 per cent in January 2009 from 10.3 per cent in September 2008, whereby 811,000 people became unemployed (TSI 2009). According to harmonised unemployment rates released by the Organisation for Economic Cooperation and Development (OECD), in the fourth quarter of 2008 Turkey had the second highest unemployment rate (i.e. 10.7 per cent) among the OECD members (OECD 2009).

There were two main reasons behind the economic contraction related to the global credit crisis. The first was a sharp decline in domestic demand from 5.6 per cent to 0.8 per cent between 2007 and 2008, respectively (Oxford Economics 2009). This was due to collapsed consumer and business confidence which was coupled with very sharp consumer credit tightening by the Turkish banks due to the crisis. As such, private consumption and investment expenditures decreased dramatically from 4.1 per cent and 5.5 per cent in 2007 to 2.4 per cent and −3.4 per cent in 2008 (Oxford Economics 2009).

The contraction in the supply of external credit and external demand was the second main reason that furthered the economic downturn. Reduced economic globalisation is one of the major challenges that countries face in a world of current credit crunch and economic recession. In other words, the combination of reduced trade openness (i.e. sum of exports and imports/GDP) and international fixed and liquid capital investments (i.e. sum of inward and outward direct and portfolio investment/GDP) constitutes the main source of domestic economic sensitivities. Turkey, where the economic growth rate has been declining since 2004, is no exception. In November 2008, Turkey's trade openness stood at 37 per cent of GDP, whilst international capital investments constituted 50 per cent of GDP. This was far below western European levels (for example, see Brady et al. 2007). Nevertheless, Turkey, with its 87 per cent integration with the global economy, is still sensitive to external economic shocks.

With regard to exports, in October 2008 the EU-27, Central Asia and Middle Eastern countries represented 49 per cent, 25 per cent and 19 per cent of total exports respectively (SPO 2008a, p. 9). Turkish exports to these countries have been adversely

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Table 1 Main Indicators of the Turkish Economy

General economic indicators	2001	2002	2003	2004	2005	2006	2007	2008/ September
GDP growth (per cent)	−5.7	6.2	5.3	9.4	8.4	6.9	4.6	3.0*
Industrial production, p/p (per cent)	−8.7	9.4	8.8	9.8	5.5	5.8	5.4	−5.2
CPI inflation, year/year (per cent)	68.5	29.7	18.4	9.35	7.72	9.65	8.39	11.1
Treasury Bill rate (per cent)	99.6	62.7	46.0	24.7	16.3	18.0	18.4	18.8
Real foreign exchange rate (1995=100)	112.5	125.3	136.5	143.5	160.0	160.6	175.9	191.9
Socio-economic indicators								
Per capita GDP (US$)	3,006	3,517	4,531	5,779	7,027	7,609	9,305	n/a
Unemployment rate	8.4	10.3	10.5	10.3	10.3	9.9	9.9	10.3
Public sector social expenditures (per cent of GDP)	12.03	13.54	14.26	14.3	14.22	14.27	14.39	13.94
Public finance and debt indicators (per cent of GDP)								
General government budget deficit (EU defined)	24.5	10.2	9.0	4.5	0.6	0.1	1.3	n/a
Public sector gross debt stock (EU defined)	n/a	73.7	67.4	59.2	52.3	46.1	39.9	n/a
Public sector primary surplus (IMF defined)	n/a	n/a	4.8	5.5	5.0	4.6	3.5	2.7
Public sector borrowing requirement	12.3	10.0	7.3	3.6	−0.3	−2	0.1	0.83
Household debt indicators (per cent)								
Household liabilities (per cent of GDP)	n/a	n/a	n/a	6	7.7	9.7	11.7	12.6
Household interest expenditures/disposable income	n/a	n/a	2.1	3.2	4.2	3	3.3	3.4
Household debt stock/disposable income	n/a	n/a	7.5	12.9	20.9	18.1	21.4	22.6
External indicators (million US$)								
Current account balance/GDP (per cent)	1.9	−0.3	−2.5	−3.7	−4.6	−6.1	−5.7	−6.4
Foreign direct investment	2,771	830	1,253	2,024	8,726	19,234	19,766	15,299
Non-financial sector long-term foreign loans	n/a	24,352	24,781	28,221	34,434	53,430	79,211	99,329
Central bank reserves	19,799	28,071	35,162	37,643	52,432	60,707	74,028	80,082
Resilience of the banking sector (per cent)								
Capital adequacy ratio	20.8	25.1	30.9	28.8	23.7	22.3	18.9	17.4
Non-performing loans /gross loans	29.3	17.6	11.5	6.0	4.8	3.8	3.5	3.1
Tier-1 capital ratio	n/a	n/a	n/a	n/a	24.3	21.2	18.2	16.7

Note: * 3^{rd}Quarter.
Sources: State Planning Organisation (2007, 2008b); Treasury (2001); Banking Regulation and Supervision Authority (2007, 2008), Central Bank of Republic of Turkey (2002, 2003, 2008, 2009).

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affected due to the global economic recession, whilst finding new markets is not a feasible solution to reduced export revenues in the current global slowdown. Turkey's current account deficit benefited from appreciation of foreign currencies and declining energy and commodity prices, contributing to an improvement in its external balance and financing requirement. Indeed, during the four months between October 2008 and January 2009, the current account deficit declined to US$5.6 billion from about US$16 billion when compared with the October 2007 and January 2008 period (CBRT 2009).

On the foreign capital inflows front, however, Turkey's broad balance of payments (i.e. Current Account + Net Foreign Direct Investment + Net Portfolio Investment) showed considerable weakness with regard to quantity and quality. There has been a sharp decline in net Foreign Direct Investment (FDI) and portfolio inflows, whilst private sector foreign debt has increased sharply. For example, the broad balance of payments deficit increased from US$9.5 billion in October 2007 to US$29.2 billion in October 2008, more than threefold (calculations are based on data provided in SPO 2008a). During the same period, other capital inflows (mostly corporate debt) increased from US$17.8 billion to US$31.7 billion. In the era of global recession, Turkey may face a sharp contraction in external resources to finance private consumption and fixed capital expenditures, which constituted 76 per cent of GDP growth between 2002 and 2007 (Goldman Sachs 2008, p. 19). During the period between October 2008 and January 2009 when the global crisis was felt intensely, the financial account of the balance of payments had a deficit of US$13.1 billion from a surplus of US$ 18.4 billion when compared with the October 2007 and January 2008 period (CBRT 2009). During the same period, it is striking that the net errors and omissions item of the balance of payments shows foreign exchange inflow of about US$14 billion which was in a deficit of US$1 billion, showing a phenomenal increase in unrecorded foreign exchange inflows from unknown sources that compensate for the capital outflow in the financial account.[4]

It should also be noted that international profits derived through outward FDI of Turkish firms are under strong pressure due to reduced investment and consumption expenditures across countries. As portfolio and FDI inflows have reduced sharply, Turkey may also face challenges in financing its current account deficit and become vulnerable when sharp lira devaluations take place. In the absence of the shelter provided by the relative safety of the eurozone, the Turkish lira is vulnerable to further weakening. The Central Bank's *excess* international reserves decreased sharply by over 20 per cent, from about US$80 billion in September 2008 to US$68 billion in January 2009 due to accelerated capital flight (Oxford Economics 2009).

Turkey's gross external debt needs to be examined more closely. Non-financial corporations have substantially increased their foreign debt, due to the high domestic interest rates institutionalised by the Central Bank. For example, long-term foreign exchange denominated debt of such corporations increased from US$24.3 billion in 2002 to US$99.3 billion in September 2008, an increase of 324 per cent (see Table 1). It should also be noted that about 40 per cent of this foreign debt (i.e. US$38.8 billion)

is due to mature in three years between 2009 and 2011 (CBRT 2009). In a world of global recession, Turkey may face a home-grown crisis if non-financial firms face significant difficulty in finding external financing to rollover this foreign debt and if households' repayment capacity disappears (i.e. if there is a household debt crisis). This could occur should the economy experience a deep recession under limited access to credit and higher levels of unemployment.

Macroeconomic Background

Table 1 shows some of the achievements and limits of the post-2001 neoliberal restructuring of the Turkish economy. Between 2002 and 2007 (or following the Turkish crisis in 2001 and before the global credit crunch in 2008), the GDP growth and inflation rates averaged 6.8 per cent and 13.8 per cent respectively. However, despite this economic growth and a relatively low inflation environment, the unemployment rate remained virtually constant.

The public sector scored well in public finance and debt-related indicators, due to a primary surplus which averaged above five per cent of GDP during the same period. In 2007, Turkey performed well with regard to two of the Maastricht criteria for eurozone entry. Its general government budget deficit stood at 1.3 per cent compared with the criterion of below 3 per cent. Its public sector gross debt stock, at 38.9 per cent, was also well below the 60% EMU criterion.

Turkey has a bank-based financial system. The banking sector is in relatively good shape due to the post-2001 restructuring. Apart from strengthening the equity capital of insolvent banks, post-crisis banking sector regulations set maximum exposures to interest rates, liquidity and foreign exchange risks and also limited related-party exposure (Alper and Öniş 2003; Bakir 2006; Aysan and Ceyhan 2007). The capital adequacy ratio (CAR, the ratio of own funds to risk-weighted assets) and Tier-1 capital ratio (i.e. Tier 1 capital divided by risk-weighted assets) are two widely used measures of the strength of a bank's balance sheet. Although these two ratios of the banking sector in Turkey exhibit a declining trend, both are well above the minimum requirement of eight per cent and the target ratio of 12 per cent.[5] These ratios are higher than other South European countries (see IMF 2008, p. 217).

In addition to the bank capital, bank asset quality exhibited significant improvement. For example, the NPL to gross loans ratio decreased sharply from 17.6 per cent in 2002 to 3.1 per cent in September 2008. Finally, the sector does not have significant exposure to the foreign exchange risk with its US$227 million short position in September 2008 (BRSA 2008, p. 24). Consequently, the banking sector has become much more robust than it was in the early 2000s, in terms of its ability to counteract possible shocks, which became particularly evident in the context of the recent global credit crunch. However, the Turkish banks are likely to experience asset quality problems should the availability of foreign loans to non-financial corporations be limited in the current environment and households increasingly face an unemployment problem.

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Although the public and banking sectors are in relatively good shape in the face of current global economic crisis, the non-financial and household sectors show considerable vulnerabilities along with external indicators. On the monetary front, the legally independent central bank kept interest rates artificially too high to push inflation down to single digits through cheap imports, whilst allowing the Turkish lira to appreciate in real terms against major currencies. Indeed, between 2002 and 2007, real interest rates for government securities averaged 15.76 per cent whilst financial arbitrage averaged 22.8 per cent (Bakir and Öniş 2009). On the one hand, this policy was responsible for an increased current account deficit and created perverse incentives for firms to borrow from international foreign currency markets, benefiting from excess global liquidity conditions. On the other hand, the high real interest rates attracting global liquidity were the main factors behind increased foreign capital inflows which contributed to a high economic growth rate.

There are also firm- and sector-specific implications for Turkey's exposure to reduced trade openness in a world of global recession. For example, key export-oriented sectors such as auto manufacturers, ready-to-wear, consumer durables and white goods producers are under considerable pressure due to the worldwide economic slowdown and reduced external demand. In particular, exports to European and Middle Eastern countries and Russia have shrunk considerably. Job cuts in these sectors contributing to higher levels of unemployment have occurred as these firms have increasingly adopted cost-reduction strategies. The economic contraction has hit especially hard small and medium sized enterprises (SMEs), which constitute 98.8 per cent of Turkey's approximately two million enterprises. SMEs account for 45.6 per cent and 37.7 per cent shares in employment and production respectively (Yaşar and Topçu 2008). It should also be noted that SMEs' access to bank loans has traditionally been limited due to their higher costs and weak capital base.

Another major concern when the economy is sliding into a recession is Turkish household debt. Turkey has the worst income distribution with a Gini index of 45 per cent compared with the new European Union (EU) member states' average of 32 per cent (UniCredit 2008, p. 33). According to a survey conducted by the Ankara Chamber of Commerce in 2007, 15.4 per cent of the population earns an income below the hunger line, while 74 per cent live on an income below the poverty line. These groups correspond to 10.9 million and 52.3 million people respectively (Today's Zaman 2008). In this environment, 'household debt accounted for 15 per cent of total private consumption in 2007 compared to a mere three per cent in 2002 ... the average debt of Turkish households peaked at €2,900 at the end of 2007 from only €260 as of the end of 2002' (UniCredit 2008, p. 33). Thus, an increase in household sensitivity to adverse economic conditions is illustrated by the phenomenal increase in the ratio of household *interest* payments to disposable income, and the ratio of household *debt* to disposable income (see Table 1). Between 2002 and 2007, the annual compounded rate of growth in household debt was about 50 per cent, whilst the real growth in household income was around 8.5 per cent (UniCredit 2008, p. 33). Not surprisingly, during the same period, the share of the financial burden derived from

consumer loans to GDP showed a substantial increase to 11.5 per cent from 1.2 per cent. In other words, a considerable amount of household disposable income was transferred to the banking sector in the high real interest environment. As such, the post-crisis banking environment has negative repercussions in terms of the sustainability of consumer spending driven economic growth, which contributes to weak domestic savings mobilisation and the current account deficit.

Policy Responses to Date

The collapse of Lehman Brothers on 15 September 2008 marked the beginning of the first global financial crisis, with the US at its epicentre, since the 1929 financial crisis. Apparently, prices of financial securities do not reflect all known information as is assumed by the efficient-market hypothesis. A dramatic loss of confidence in financial markets, especially in the interbank money markets where banks lend to each other, coupled with decimated financial capital, led to a global credit crunch which has subsequently paved the way for the global economic recession. The results included bankruptcies, defaults and job losses.

To restore consumer and business confidence to prevent 'the return of depression economics', governments in developed countries have responded with various monetary and fiscal policy measures. These have included substantial liquidity injections via central banks; financial rescue packages such as purchasing bad loans, injecting capital to troubled financial firms and their nationalisation when necessary; and providing government guarantees to the liabilities of various financial firms. All these measures were aimed at the revitalisation of bank credit flow to the private sector and quantitative easing of monetary policy. They were followed by debt-financed economic stimulus plans such as infrastructure investments and unemployment benefits as well as reduced taxes to cushion the adverse effects on employment and economic growth.

In contrast, Turkey's initial response to the global credit crisis was unconventional. On 14 October 2008, the Finance Minister declared an asset amnesty law so that financial wealth including cash, foreign exchanges, gold, securities and other capital market instruments kept overseas by Turkish citizens would not be subject to any investigation and would incur a low tax rate, i.e. two per cent (Sabah 2008). The law became effective on 22 November 2008 and the deadline for registering financial assets expired on 2 March 2009. Although the government hoped to attract an ambitious US$15 billion from residents abroad, the amount expected by the end of January 2009 was in the range of $2–3 billion (Zaman 2009).

One of the emergency measures taken by most governments against the financial crisis was to increase the limit and coverage of government guarantees for bank deposits. The aim was to shore up confidence in the banking sector and to prevent a systemic run on bank deposits. In Turkey, SDIF provides a deposit guarantee up to 50,000 lira (€23,809 at an exchange rate of TL/€2.1). As a policy response, although some of the EU member states provided deposit guarantees up to €50,000 or a 'blanket'

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guarantee, the Turkish government did not change its guarantees.[6] However, in November 2008, Parliament authorised the government to extend the insurance coverage for a period of two years when necessary.

It is apparent that the Turkish government and its economic bureaucracies showed overconfidence in the economy, since there was no insolvent bank to rescue. In contrast to some of the European countries, Turkish banks did not have any exposure to a home-grown crisis emerging from mortgage-backed securities.[7] Thus, Turkish politicians and bureaucrats were slow in their response to the global credit crunch. Monetary policy responses via the central bank came in the form of injecting liquidity via weekly bank loans, starting lending- and borrowing-rate cuts, and easing liquidity in the foreign exchange deposit market. This was achieved by increasing transaction limits in late October, extending the maturity of foreign exchange deposit to one month from one week. In addition, the lending rate was cut to seven per cent for US$ from ten per cent, and to nine per cent for EUR in late November 2008. During the period between 22 October 2008 and 19 February 2009, the central bank cut its Turkish lira lending rate by 500 basis points to 11.5 per cent and its borrowing rate by 400 basis points to 14 per cent. The lending rate is, however, still twice as high as the year-end expected inflation rate. Further, the monetary policy responses of the central bank summarised above were far from much needed monetary easing. Between October and December 2008, percentage changes in money supply from a year earlier remained virtually constant, at about 26 per cent (see Oxford Economics 2009).

In January 2009, the government announced a new unemployment aid package which envisages a cash injection to ailing private-sector companies if they keep workers instead of dismissing them (New Europe 2009). Despite prolonged pressures for privatisation before the crisis, the existence of state-owned banks proved vital in contributing to the state's strength in responding to the crisis. For example, Turk Eximbank, a state-controlled bank established to support Turkish exporters, announced an increase in its total financial support to exporters by 37 per cent to US$12.9 billion in 2009 from US$9.4 billion in 2008 (Anka 2009). The government also allocated about US$300 million to Eximbank. State-owned Ziraat Bank, which operates in retail banking, became the first bank to reduce its interest rates on consumer, vehicle and housing loans (Today's Zaman 2009a).

More interestingly, there was a partnership in crisis response between a state-owned bank and a civil society organisation. The example includes a new credit package set up by state-owned Halkbank, which deals with tradesman, artisan and SME banking in Turkey, and the Union of Chambers and Stock Exchanges, Turkey's largest private sector umbrella organisation for SMEs. These organisations jointly set up a new credit package worth about US$900 million for SMEs (Anka 2008). Apparently, the existence of state-owned banks increases the state's capacity to develop a coordinated and joint sectoral response in the global crisis environment. In March 2009, the government also introduced long-awaited temporary reductions in private consumption tax and value-added tax to stimulate such sectors as auto, home appliance, real estate and SMEs (Today's Zaman 2009b).

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Conclusion: Ideational Rigidity as One of the Key Challenges Ahead

The current institutional arrangement of monetary and fiscal policy regimes is based on a neoliberal paradigm which narrowly focuses on the achievement of price stability and budget balance where employment, social welfare and industrial policies are delegated to a residual category. The legally independent central bank, which is preoccupied with price stability, has overseen the economic recession in Turkey. The central bank has officially declared this 'ideational rigidity' and that it is against debt-financed economic stimulus plans in the era of a global economic recession: 'Maintaining fiscal discipline and improving its quality will continue to be critical for economic stability in the upcoming period' (CBRT 2008, p. iv). It will not be surprising that tight monetary and fiscal policy in this period, if persisted with, will prove ineffective, and perhaps counterproductive, by further deepening the economic recession in Turkey.

For example, in mid-August 2008, the central bank's *real* policy rate of 4.7 per cent (i.e. the nominal rate deflated by inflation) was the second highest rate among a selected 37 emerging countries (IMF 2008, p. 46). Further, as noted in the previous section, the central bank did not ease monetary supply in the last quarter of 2008. More recently, it declared that the inflation rate would be realised at 6.8 per cent, below the inflation target of 7.5 per cent for 2009 (Hürriyet 2009). On the back of this expectation, the central bank cut interest rates. However, despite rate cuts, it still keeps the benchmark cash rate at very high levels, which are detrimental to economic recovery and employment. Substantially high real interest rates, which have been responsible for the high current account deficit that prevailed between 2002 and 2008 and increased non-financial corporate debt, are far from helping the economy to recover from the economic recession.

With regard to fiscal policy, the government and its bureaucracy have the same ideational rigidity that prevents flexible policy responses for monitoring broader public interest. The 2009 Annual Economic Programme shows the government's fiscal targets for 2009 (see SPO 2008b). The government aims to increase budget and tax revenues, whilst planning fractional increases in government budget expenditures. Neither substantial debt-financed economic stimulus packages nor welfare spending and fixed capital investments by the public sector had been on the government's fiscal agenda for 2009. To illustrate, the ratio of the central government's primary expenditures to GDP was expected to increase by 0.8 percentage points to 18.4 per cent in 2009 from an estimated 17.6 per cent in 2008 (SPO 2008b, p. 10). The IMF-defined primary balance is planned to increase from 2.73 per cent in 2008 to three per cent in 2009 (SPO 2008b, p. 8). During the same period, the share of central government tax revenues in GDP is expected to increase by 0.6 percentage points to 18.6 per cent from 18.02 per cent (SPO 2008b, p. 9).[8] Further, the share of government budget deficit in GDP is expected to fall to 1.2 per cent from 1.4 per cent. The government plans to increase public fixed capital investments by only 1.6 per cent (SPO 2008b, p. 19).

It is planned that public sector social spending in 2009 will increase about 0.5 per cent to 14.62 per cent from 13.94 per cent in 2008 (SPO 2008b).

It is striking that the government aims to achieve a fiscal balance rather than a deficit in the revenues and expenditures of its social security institutions (SPO 2008b, p. 13). It is evident that the economic bureaucracy is myopic in reading the global economic challenges ahead. This may be due to "ideational rigidity" and the lack of a strong human capital base. Not surprisingly, so far, the government and its monetary and fiscal bureaucracies have delivered weak policy responses to stimulate aggregate demand in order to prevent a deepening of the Turkish economic recession. The government needs to revise its budget and adopt aggressive fiscal and monetary policy responses towards aggregate demand stimulation, social welfare expenditures and public sector fixed capital investments.

Arguably, the ideational monopoly of neo-liberalism is strongly aligned with the institutions of monetary and fiscal policy regimes as well as with societal/bureaucratic interests that prevent Keynesian ideas from being taken up by the governmental agenda. One of the major challenges ahead for Turkey is the blind ideational rigidity among key decision-makers and intellectuals who regard only neo-liberal economics to be worthy of consideration even in the face of the current global economic recession. In the words of 2008 Nobel Laureate in economics Paul Krugman:

> ... over the last few decades there has been a steady drift in emphasis in economic thinking away from the demand side to the supply side of the economy.... The truth is that good old-fashioned demand-side macroeconomics has a lot to offer in our current predicament—but its defenders lack all conviction, while its critics are filled with a passionate intensity. (Krugman 2008, pp. 182–183)

Turkey should demonstrate formal and informal institutional capacity to alter neoliberal policy stability in the face of the challenges posed by the current global recession. In particular, formal, normative and cognitive as well as discursive aspects of monetary and fiscal policy institutions should be aligned with the current needs of the domestic political economy. Failure to do so might threaten economic security among broader segments of society, which in turn could generate rising social and political instability.

This article cannot conclude without taking a glance at Turkey's European future in a world of global financial crisis.[9] The European Parliament, on 27 November 2008, noted that for the third consecutive year Turkey's progress in implementing reforms required for EU membership was weak (see European Commission 2008). Apparently, granting Turkey the status of an EU 'candidate' without a timetable for accession made the EU a weak external anchor. Historical, economic, political, cultural and religious differences between Turkey and the EU have made relations among the parties difficult (Kirişci and Çapan 2004). Now, Turkey's EU candidate status faces two more new challenges. First, the global economic crisis has triggered financial and trade protectionism within the EU, slowing, if not halting, the EU enlargement process (see Financial Times 2009). Second, the low economic growth in Turkey over the last few years has been replaced

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by economic contraction coupled with a high and rising unemployment rate. In the near future, this could be a major source of rising social and political instability, further weakening Turkey's commitment to the EU membership process.

Notes

[1] However, the SDIF collected only US$6.3 billion as of the end of 2006 (SPO 2007, p. 97).
[2] For similar assessments on Turkey, see JP Morgan (2008a, 2008b).
[3] On the role of ideas and discourse in institutional change and persistence, see Schmidt (2008); Hall (1989).
[4] The balance of payments identity states that the current account is the sum of capital account, financial account and net errors and omissions. Factors behind such a phenomenal increase in net errors and omissions in Turkey remain a mystery and deserve a satisfactory official explanation.
[5] The CAR declined from 25.1 per cent in 2002 to 16.8 per cent in September 2008. The recent decline in the CAR was due to increased bank loans and increased weights for letters of guarantee and letters of credit imposed in January 2008. It should be noted that the CAR will fall further with the full application of the Basel II standard depending on the size of foreign currency Turkish government securities holdings which will be the 100 per cent risk weight.
[6] For an assessment of the impact of instituting 'blank guarantees' in 1994 and 2001, see Tanyeri (forthcoming).
[7] It seems that this was partly due to the lack of a legal framework securitising mortgage laws until March 2007. Further, the housing loans accounted for only about four per cent of GDP in September 2008 (BRSA 2008). This ratio was also well below other South European countries (European Central Bank 2008).
[8] The same figures for 2008 and 2009 quoted by the Central Bank are mistaken (see CBRT 2008, p.19).
[9] For a detailed political economic assessment, see Öniş & Bakir (2007).

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