

Globalization and The Turkish Economy

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I am delighted to be at Vanderbilt University thirty years later after my graduation. In 1985 when I was working for the International Monetary Fund in Washington D.C., I visited the Economics Department at Vanderbilt University to deliver a speech on the issue of international debt problem. This time I came here for another meaningful event which is to celebrate the 50th anniversary of Graduate Program in Economic Development. It is indeed a pleasure for me to comment on the globalization process of the Turkish Economy.

Let me first start by defining the word “globalization”. Despite there are various definitions on this process, most commonly accepted is globalization as the increasing integration and independence of national economies and the growing exchange of technologies, information, ideas and cultures across national borders.(1)

However market driven or economic globalization is technically slightly different than the common definition. As Anne Kruger, the first managing director of the International Monetary Fund, says “economic globalization is a phenomenon by which economic agents in any given part of the world are much more affected by events in any given part of the world than before” (2) More precisely David Henderson defines globalization as “the free movement of goods and services, labor and capital, thereby creating a single market in inputs and outputs and full national treatment for foreign investors” (3).

During the last forty years, particularly, after the falling of central planning regimes, economic globalization has been particularly rapid. Market directed capitalism had become the paradigm for most of the world. Three fundamental factors; improvement in the information technology, reduction of the number of wars and more cheaper transportation have contributed to this rapid globalization process.

In my speech today first I will briefly explain economic and structural developments in the Turkish economy and later I will make some comments on the effects of globalization on Turkey.

Performance of Turkish Economy

In the early 1960s until the late 1970s, the Turkish economy heavily depended on import substitution. This process worked successfully, yet began to collapse at the end of the 70's. Compared to the other developing countries Turkish economic growth performance during the 1960's and most of the 1970's was fairly good. Relatively high growth rates had been achieved without the availability of a large amount of natural resources such as oil and in a basically democratic political environment. In the 60's foreign assistance was moderate. However, in the 70's a large flow of workers' remittances mainly from Germany helped to pursue economic policy dependent on import substitution.

Economic growth rate had been achieved at an average annual rate of 7 percent during the years 1960-77 which was much higher than any other developing countries. With this rapid economic growth, there was a substantial improvement in the quality of living conditions. However, some structural problems emerged. First, a higher import orientation of the economy put pressure on the balance of payments. Second, relatively high level of investment as a percentage of GDP increased the gap between investments and domestic savings. Thus the growing of this gap implied a tendency towards relatively high level of external borrowing and domestic inflationary pressures. Third, the public sector continued to play a major role in economic development.

In the world economy during the 70's, there were two major developments. Firstly, a sharp increase in oil prices and secondly recession, inflation and rising unemployment in the industrial countries had deteriorated the international environment. These factors played a major role in the deterioration of the Turkish economic situation. While imports, exports and workers' remittances began to decline, the government's respond to the balance of payments problem was an attempt to borrow from abroad- mainly short-term. As a result, a confidence crisis developed and Turkey faced a severe balance of payments crisis in late 1977.

In order to regain confidence and achieve a stable and sustainable growth pattern, the Turkish authorities adopted an export oriented development strategy in 1980 based on realistic exchange rate. Other measures reduced the bias against exports, increase in domestic savings and increase the role of public sector. This policy was advised by international organizations such as the International Monetary Fund and World Bank. These ideas found ground in early 1980's for more market oriented economy.

During this period, globalization began to speed. In the late 1980's, a set of principles for the growth of developing countries called "Washington Consensus" was introduced. It focused on fiscal discipline, competitive currency and trade, financial liberalization, privatization and deregulation. As Dani Rodrik pointed out that these were perceived to be the key elements of what Paul Krugman has called the "Victorian virtue in economic policy" namely "free markets and sound money" (4)

Under these circumstances, with the export-led growth strategy together with Washington Consensus' principles, Turkey was quite successful. The average annual growth rate was 5.8 percent between 1981 and 1988. The openness of the economy was rapidly increasing. However, fiscal balance and domestic debt had increased by the late 80's. Despite the fact that the annual inflation rate did not reach hyperinflationary levels, it remained around 35-40 percent in early 80's and 60-65 percent in late 80's.

According to Ertugrul and Selcuk (5), in order to contain inflation in late 80's, various forms of nominal anchoring and monetary tightening were implemented without any serious efforts to reduce public sector borrowing. This policy necessitated a higher interest rate on domestic assets and a lower depreciation rate which attracted short-term capital inflow- namely "hot money". The Turkish authorities and as well as the public realized the fact that there is a close relationship between economic growth and foreign flow to the Turkish economy. If foreign flows are available, the economy runs smoothly. If not, serious problems arise. Thus macroeconomic policies were directed to attract external flows either external borrowing or direct foreign investment.

As a result of this policy orientation, together with capital account liberalization in 1989, the Turkish economy unfortunately experienced several severe financial crises in the year of 1994. Political instability and uncertainties did not allow implementing a comprehensive macroeconomic program until the end of 1999. Despite a severe financial crisis in 2001, the program under the guidance of an IMF Stand-by arrangement achieved a successful result concerning inflation rate, fiscal deficit, and structural reforms and forward looking policies. However currency appreciation and current account deficits of balance of payments are still risky areas.

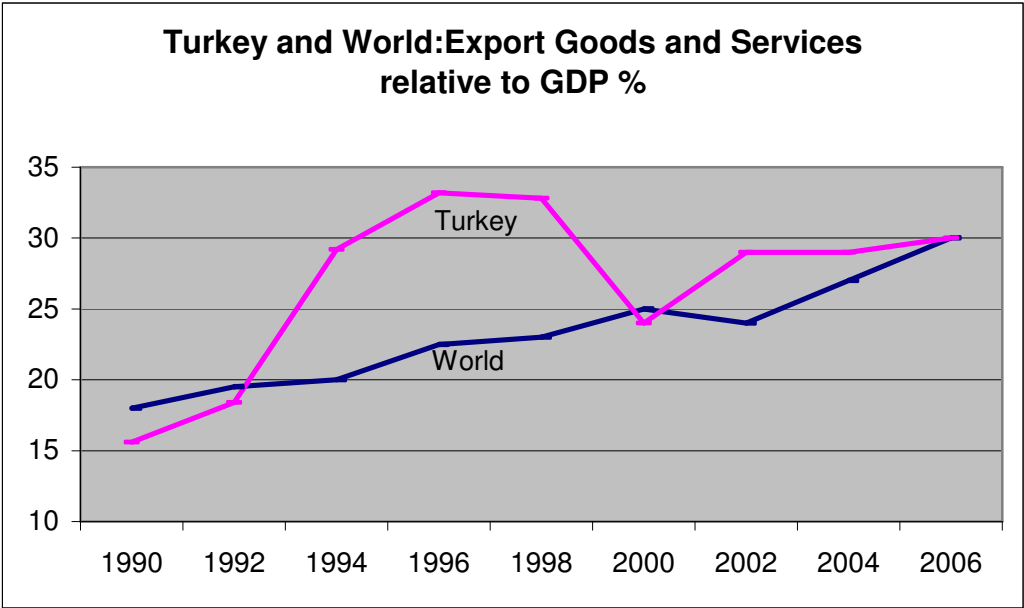
After a brief history of the Turkish economy, let me make some comments about the effects of globalization on growth, welfare, openness, inflation and financial crisis in the Turkish economy.

Effects of globalization

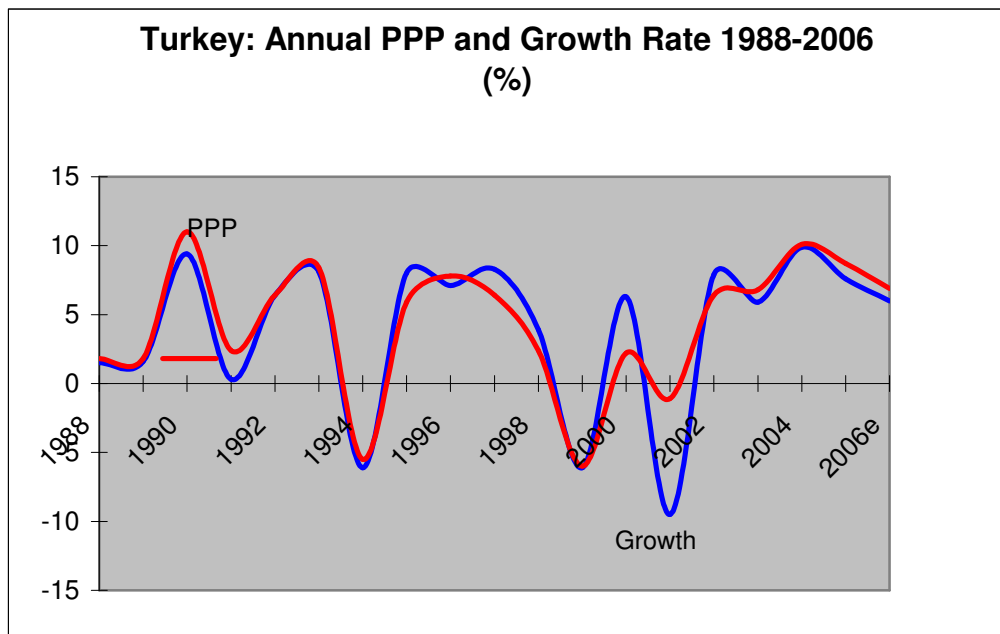
There is a widespread support of trade liberalization in order to provide more benefits to the people in a more integrated global economy. Theory or empirical evidences clearly show that trade liberalization could be an important contribution for economic development particularly for poor countries.

George Stiglitz who is also in favor of trade liberalization indicated that it has several benefits of increase in welfare of the people, but it's long-term positive effects on economic growth rate has not been strong. He pointed out that "The economic growth literature has been successful in demonstrating the importance of some variables for economic development, including education, institutions, health and geography. However, the relationship between trade liberalization and growth is much more controversial"(6).

In the Turkish case, trade liberalization has been successful since it started in 1980's. The ratio of total exports of goods and services to GDP in the Turkish economy has progressively increased from 16 percent in 1990, to 33 percent in 1998. Now it is running in the 30 percent level. The same ratio in the world economy was smaller than for Turkey during most of the period between the years of 1990-2005.

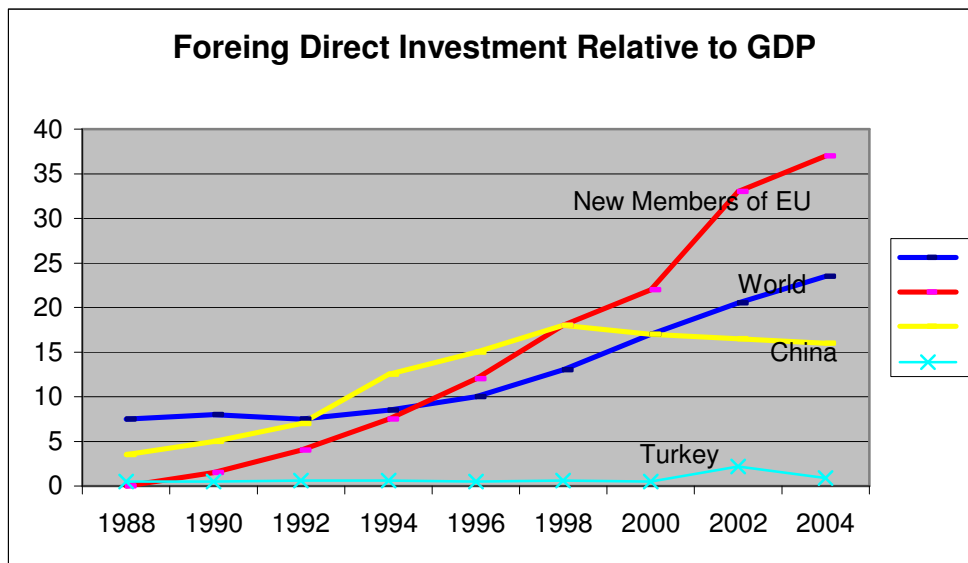


Despite the relatively high degree of openness of the Turkish economy, sustainability of growth rate could not be established. Since the end of 80's, the economy faced two major and three minor recessions mainly because of high inflationary environment and public sector debt. Macroeconomic programs for correcting imbalances were not long-lived and created additional problems. Thus current and capital account opening has not helped Turkey to achieve a sustainable growth performance.



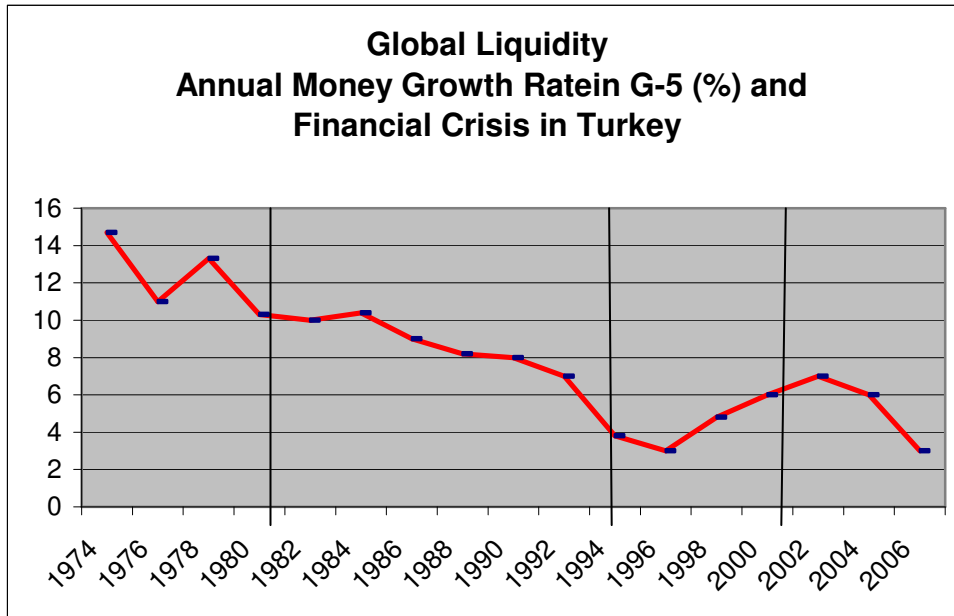
The pace of integration in the world economy since the late 1990's, foreign direct investment as a percentage GDP has accelerated substantially, particularly in China and in the new member of European Union. This ratio is now 24 percent for the world economy. However, Turkey has not found maximization of foreign direct investment (FDI) over total capital flows; Turkey has only attracted 0.5 percent FDI relative to GDP.

Like other emerging market countries, problems for designing of exchange rate regime, for eliminating inflationary environment and for reducing political uncertainties with the low level confidence of existing legal system have created obstacles to stable and sizeable FDI in Turkey. Thus FDI has played very limited role as a source of external savings in the development of the Turkish economy.



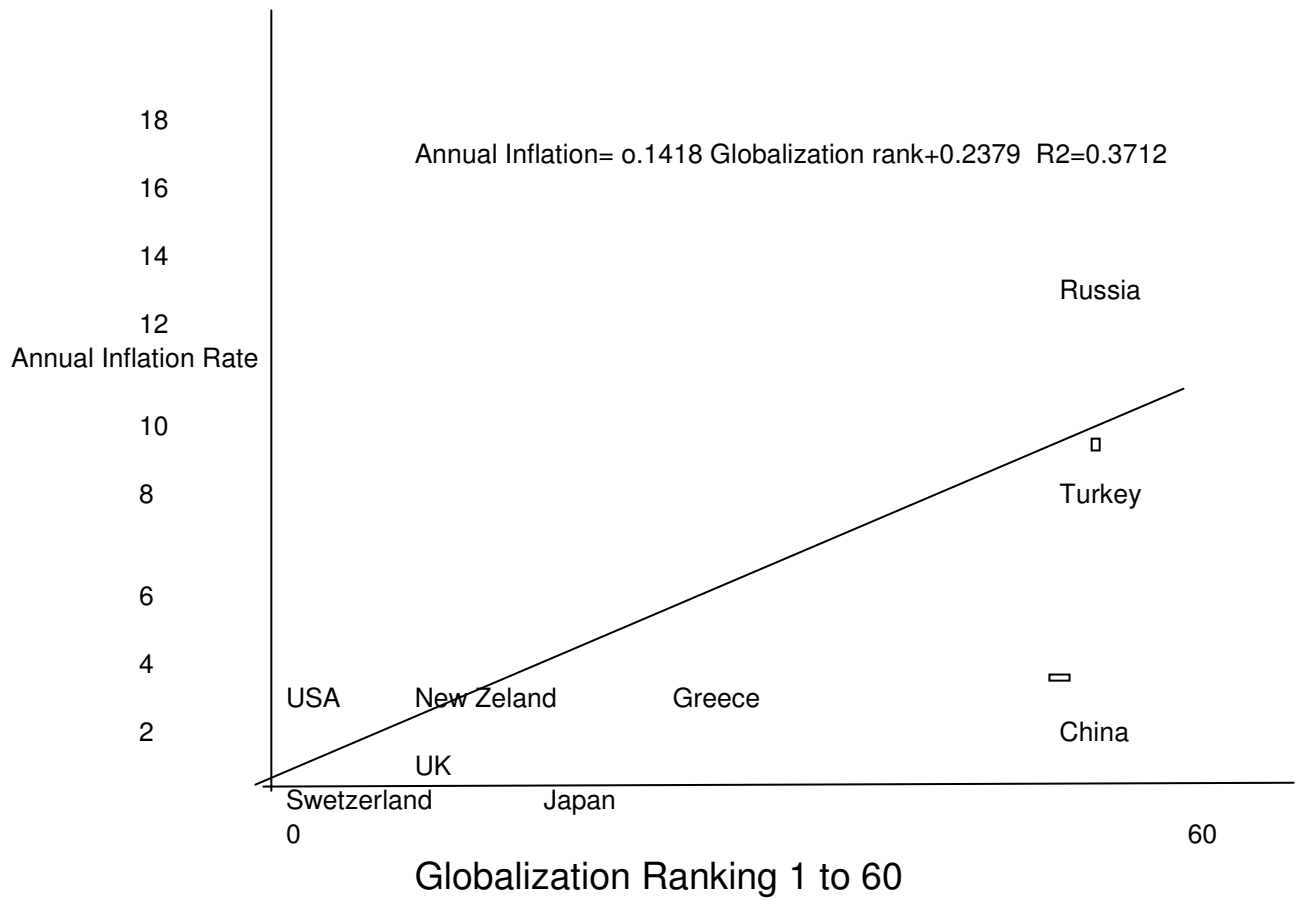
The late 80's and 90's have supported emerging market countries increased participation in global capital markets. Market reforms in emerging economies have been directed towards currency convertibility and deregulation. Low inflation and interest rates in industrialized countries made the higher returns in EMC's increasingly attractive. Paul Krugman was asking an important question in his paper presented in Jackson Hole Conference in 2000. (7) "Is crisis a price of globalization?" His answer is that, growing integration does predispose the world economy toward more crises, mainly because it creates pressure on government financial restrictions.

Most of the crisis emerged at the time of declining trend of global liquidity, except 2001. One of the important reasons is that globalization has enabled governments to borrow more freely in order to finance current account deficits and fill the gap between domestic savings and investments. Nevertheless, this debt-financed growth strategy is a risky business and can not continue forever. Investors, particularly short termed ones, could flee from domestic-assets for safer ones dominated by the Dollar, Euro or Yen. Such a flight could create deep problems and financial crises. It is very familiar for the Turkish economy which faced several financial crises in 1980's, 1990's and 2000's.



The effect of globalization on inflation is a very challenging issue. The chart below depends on an annual survey conducted by AT Kearney and demonstrates the globalization level of some countries and their inflation rate for 2005. The chart indicates that countries with higher ranking in globalization tend to have lower inflation rates. Turkey's globalization rank which was 55 in 2005 clearly reflects the past inflationary environment. Turkish economy has not gotten any benefit from the positive effects of globalization on inflation since 2000. After launching a very comprehensive program in order to reduce the inflation to the single digit level, inflationary dynamics were reverse.

Globalization Index and Annual Consumer Price Inflation in 2005



Source: AT Kearney/Foreign Policy Magazine and IMF

Conclusion

In order to benefit from the globalization process, the quality of a country's macroeconomic policies is the key instrument. Particularly free market and sound money should be established strongly. Since economic globalization has made the task of managing of economy easier in some ways and more difficult in others, the authorities of emerging market countries should be extremely cautious while designing and implementing these policies; there is no room for mistakes.

During the last three decades, Turkey has been successful in establishing a free market economy and opening it to the international competition. At the same time, to achieve a stable and sustainable growth pattern, the Turkish authorities adopted an export oriented development strategy in the 1980s based on a realistic exchange rate. Other measures reduced the bias against exports, increase in domestic savings and increase the role of public sector. However as a result of high inflation and political uncertainties, together with capital account liberalization in 1989, the Turkish economy experienced imbalances and severe financial crises in the years of 1994, 2000 and 2001, and because of that it never fully benefited from globalization.

At the end of 2005, Turkey began full membership negotiations with the European Union. Therefore globalization has come to a different and challenging phase for Turkey. Becoming a member of the EU is the easiest and fastest way to be a more a globalized country. I do believe that the negotiation process will take quite some time, but the results will be fruitful in terms of globalization, not only in the area of economy but in democracy also.

Notes:

- (1) Lucas Papademos, Vice President of the European Central Bank, Globalization, Inflation, Imbalances and Monetary Policy, a speech at St. Louis, 25 May 2006.
- (2) Anne Krueger, Trading Phobias: Governments, NGOs and the Multilateral System, John Bonython Lectures, 10 October 2000.
- (3) David Henderson, The MAI Affair, A Story and its Lessons, London: Royal Institute of International Affairs, 1999.
- (4) Dani Rodrik, Growth Strategies, NBER Working Paper 10050, October 2003.
- (5) Ahmet Ertugrul and Faruk Selcuk, A Brief Account of the Turkish Economy: 1980-2000, Bilkent University, Ankara, February 2001.
- (6) Joseph Stiglitz and Andrew Charlton, Fair Trade for All, Oxford University Press, 2005.
- (7) Paul Krugman, 'Crises: The Price of Globalization?' Paper presented at a Symposium by the Federal Reserve Bank of Kansas City, August 24-26 2000.