On Economic and Social Life

in Turkey in Early 2005

Independent Social Scientists' Alliance of Turkey is a group of academicians and researchers who have come together in November, 2000 in order to resist against the neoliberal assault against Turkey, and the developing world at large. The primary aim of the ***alliance*** is to provide scientific research against the neoliberal agenda as dictated by the institutions of the new-imperialism (*i.e.*, the World Bank, the IMF and the WTO…), and to support the rights and well-being of the labouring classes by seeking out viable alternatives against the IMF-led neoliberal macro-economic policies in Turkey. The research output of the ***alliance*** is documented in our web site at: http://www.bagimsizsosyalbilimciler.org/

We invite all interested colleagues who share our goals to visit and contribute to our struggle by sharing their work with us, and to be members of the web-site.

FOREWORD by Ajit Singh

The Turkish Economy and its IMF Burden

The question of the desirability of developing countries implementing capital account liberalisation is raised in an acute form by the recent experience of many developing countries including those involved in the Asian crisis of 1997-2000, the previous Mexican crisis of 1994, the later Russian crisis and the Argentinean crisis among others. During the Asian crisis Malaysia successfully demonstrated that a policy of restrictions on capital movements can benefit, and an absence of such a policy can cause enormous damage to an economy (e.g. Indonesia). Nevertheless, most countries have not rolled back capital account liberalisation and installed capital controls, although they have not further liberalised their capital accounts either. In this context the recent evolution of the Turkish economy is of special interest.

Following wide ranging economic crises in the 1990s, Turkey has been implementing an IMF programme in the new millennium. As is the standard practice with other such programmes in many emerging countries, it has involved free capital flows, including short term capital, further trade liberalisation, privatisation and deregulation within the Turkish economy. A centrepiece of the programme was a stabilisation policy, which purported to reduce the rate of inflation from 80% in 2000 to single-digit levels. What have been the effects of these policies?

In this important contribution by a collective of progressive Turkish economists, the authors provide a comprehensive analysis of the successes and failures of this policy regime. The successes are clearly that GDP growth has been very fast (7.8% in 2002, 5.9% in 2003 and 9.7% in 2004) and the rate of inflation has fallen (to 9.3% in 2004 in terms of the consumer price index). However, the authors emphasise that this record, impressive though it is at first sight, is misleading in suggesting a successful IMF programme. Rather, they argue convincingly that the programme is unsustainable; it is based entirely on the vagaries of the short-term capital inflows and is likely to lead to a big crisis and economic volatility, to the detriment of the long-term prospects of the economy. They note that the current account deficit, as a result of the measures taken to attract short-term capital inflows, has greatly increased and is at the highest level recorded in recent history. The proximate causes are high real interest rates and an appreciating exchange rate, both of which can be attributed to the policy regime which emphasises short-term capital in-flows. The authors also note that even in the short-term, the IMF programme is far from being successful in important dimensions other than GDP growth and reduced inflation. Specifically, they suggest that unemployment has worsened despite high growth of GDP; the rate of investment has fallen, the public finances have deteriorated and income distribution has become even more unequal than before as a result of a fall in real wages and increased profits. These developments do not bode well at all for the long-term development of the Turkish economy.

If the authors of this report are correct, Turkey is likely to be added very soon to the long, sorry list of countries which have experienced serious economic crises following the liberalisation of their capital accounts. The report is a highly professional and fascinating analysis of Turkish experience under the IMF programme which deserves to be widely read, not just in developing countries but within the portals of the IMF itself. In crisis situations, when developing countries approach the IMF for assistance, they have little clout and are virtually in the position of being supplicants, whereas most power lies with the IMF which can impose in these circumstances conditionality with a wide degree of latitude for the assistance that it is able to provide. Although nominally the crisis country's government and the IMF "agree" on a programme, the latter is actually "owned" by the organisation providing financial assistance, i.e. the IMF.

It is, therefore, the Bretton-Woods institutions who would benefit most from this objective analysis of their programme in Turkey. To be fair, there is evidence that the IMF has begun to listen to some of its critics and is attempting to re-appraise its policies on capital account liberalisation for developing countries. It has received critical comments on its policy approach to these issues for developing countries from its own Evaluation Unit. Moreover, contributions from the organisation's Research Department have come to the conclusion that, while there is no robust evidence that free capital flows lead to faster economic growth in developing countries, there is unambiguous evidence that they have lead to greater volatility and more variable consumption paths. The latter result contradicts a central neo-classical conception that free capital flows should lead to greater availability of liquidity and thus help to smooth the effects of economic shocks, particularly with respect to aggregate consumption. The reasons why this does not happen in the real world have been explored in a number of recent contributions both from within the framework of neo-classical economics itself as well as from Keynesian and post-Keynesian analysis. The former emphasise the special nature of financial contracts which invariably involve problems of asymmetric information, transactions costs, time inconsistency and adverse selection, amongst other serious departures from the standard assumptions of the orthodox model. The Keynesians and post-Keynesians, on the other hand, emphasise the significance of the speculative element in price formation in such markets. In the light of these developments in mainstream economic analysis, as well as the weight of empirical evidence from emerging market countries from around the world, a drastic change of course from the IMF is required: the organisation should not only abandon its project of free capital flows for emerging countries, but also take the essential further step and recommend where appropriate capital controls for countries in economic distress. There is every reason to believe that the outcome would have been hugely different in Asian crisis countries if the IMF had recommended capital controls to these countries right at the beginning of the Asian crisis.

This well-researched empirical and analytical contribution from progressive Turkish economists is a highly timely. It will hopefully prove to be the last nail in the coffin of the IMF advocacy of capital account liberalisation for developing countries. The world would be much the better for that; in economic terms it would certainly be much more stable and less short-termist than it has been under the regime of free capital flows and "hot money".

Ajit Singh
Professor of Economics
University of Cambridge,
Senior Fellow,
Queens' College, Cambridge.

June, 2005

FOREWORD by Lance Taylor

The Mexicans have a telling description of their geopolitical plight: “Poor Mexico. So far from God, so close to the United States!” Without venturing into the realm of the Diety, in geoeconomic terms it seems fair to say something like “Poor Turkey. So far from Brussels, so close to the IMF.”

An EU connection that could help remove the Turkish economy from its perilous state is a faint hope presented below. But first one has to understand why the economy is in such a mess. A good background to the clear diagnosis in this book is to consider the long-standing IMF (and World Bank) connection. It is interesting to recall that thirty years ago those institutions (and world financial markets more generally) thought that Turkey was a striking example of a successful "early reformer."

What happened is that there was a planned-in-Washington push toward market liberalization coming on the heels of an external crisis in the late 1970s. Outcomes in the 1980s and 1990s make an interesting contrast, as initial current account and labor market deregulation set up a jerky transition toward liberalized external and internal capital markets. The early 1980s witnessed a major export push, facilitated by rapid demand growth in Turkey's major trading partners and pushed on the domestic front by devaluation, aggressive export subsidies, and policies aimed at cutting real wages and the agricultural terms of trade. Despite rapid export growth, investment in traded goods sectors did not increase, so that capacity limits helped choke off the boom later in the decade. Moreover, higher exports were matched by imports so that demand was not externally led.

More fundamentally, the model broke down as repression of wages and the terms of trade could no longer by sustained -- there was a wage explosion in 1988 accompanied by a marked political shift toward "populism" à la Turk. However, the government was unwilling or unable to raise taxes to fund its higher expenditures. Liberalizing the capital account was the expedient adopted to permit higher public borrowing. The pattern was for the banking system to borrow in external markets, and then re-lend the money to the government with a handsome interest rate spread. Rapid financial boom-bust cycles through the 1990s took over.

Effective demand was led by the government, with private and external contractionary effects alternating in importance in tune with the cycle. Productivity growth was slow, and fairly evenly balanced between traded and non-traded goods. Labor force participation went up, accompanied by informalization and widening of wage spreads between skilled and unskilled labor. Although data are scarce, it is likely that poverty increased. Shifts toward and away from populism on the political front were dramatic and the sequence of deregulation efforts was non-standard, but otherwise Turkey exemplified the most familiar adverse effects of external liberalization.

There severe fluctuations in aggregate macroeconomic performance over the 1990s. In per capita terms Turkish GDP was just about at its 1990 level by the end of the decade. Persistent disequilibria and ongoing price inflation for more than two decades finally led to the initiation of a comprehensive disinflation program in 2000, aimed at re-structuring the domestic economy to fit the needs of external finance capital.

That effort took the form of an exchange rate-based anti-inflation package like those applied in Brazil, Russia, and elsewhere. The Turkish package was designed, engineered, and monitored by the IMF.

Unlike Brazil's Real plan and others around the world in the 1990s, it dramatically failed in the short run. The causes lay with a financial cycle driven via a liberalized capital account – Turkey went through four such oscillations in the 1990s. The pattern featured real appreciation and high domestic interest rates leading into the bust.

The unsuccessful stabilization package followed this pattern. With inflation running between 60% and 70% in 1999 (with the WPI rate below the CPI), the program targeted rates in the 20-25% range at the end of 2000. Various restrictions on central bank activities effectively forced it to act as a mild currency board. A nominal devaluation rate of 20% was pre-announced as in the infamous Argentine *tablita* of the late 1970s.

Non-resident capital inflows totaled $15.5 billion in the first 10 months (in a $150 billion economy). Risk premia narrowed and internal interest rates fell. The current account deficit was $9.5 billion at yearend, driven by deterioration in the trade balance. The bigger deficit was associated with real appreciation because prices rose between 30% and 40% over the year (in contrast to the pre-announced 20% nominal devaluation). The ratio of short-term debt to central bank reserves rose from 101% at the beginning of the year to 152% in December.

Lance Taylor
Arnold Professor of International Cooperation and Development,
Director, Center for Economic Policy Analysis,
New School for Social Research,
65 Fifth Avenue New York NY 10003 USA.

June 2005

On Economic and Social Life in Turkey in Early 2005

Independent Social Scientists

http://www.bagimsizsosyalbilimciler.org

1. INTRODUCTION

Turkey has undergone a process of a deep crisis social implications of which are still getting more and more intense. Economic policies shaped with the accompaniment of the International Monetary Fund (IMF) and World Bank (WB) generates transforming effects on the whole social fabric of the country. The social cost of these transformations that proceed through the policies of privatisation and narrowing the domain of public authority is manifested in increasing unemployment and poverty. As in other spheres of life, ever-deepening contradictions also clarify different stances adopted by social scientists and further justify such questions as *"what do social sciences deal with and what do researches in social sciences explain."* Those economists who appear daily in papers and TV channels seem to have forgotten the rich heritage of economic thought while they talk about markets and their "rationality." As *Independent Social Scientists* (ISS) we, on our part, are conveying our messages to the society while observing the scientific tradition of our profession. Keeping in mind that economy is nowhere else but embedded within the society and not independent of it, we are trying to assess the problems that our society is confronting.

Throughout a period over 80 years since the establishment of the Republic, working classes in Turkey could manage to gain some footholds against imperialism and ruling classes of the country in spite of all turbulences. The present programme of international and local capital implemented under the guidance of the IMF and WB, on the other hand, aims at liquidating these achievements either gradually or rapidly in specific conjunctures. It is therefore necessary to resist against this process which places working classes in a defenceless, unorganised and helpless position, protect past achievements and even to further expand them in favourable circumstances. The slogan of "inevitability and absence of any other alternative" performs a strategic function in weakening the resistance of working classes and ensuring ideological submission to capital. Submission of this kind will undoubtedly make it more difficult to materialise political and ideological transformations that may carry popular classes to political power in future. On their part, social scientists who are sensitive enough to observe these adverse processes would naturally analyse neo-liberal policies in detail, bring criticisms in depth and place emphasis on the unmasking of any argument of "no other alternative" if they are committed to contribute to the "defence of past achievements by the popular classes and their further expansion."

By taking one more step at this point and applying this overall approach to debates on financial crises which had a permanent place in agenda for the last 15 years, it needs to be stressed in plain and explicit terms that the ***short-term future of Turkish economy is entrusted to international finance capital.*** This state of affairs introduced a systematic fragility to economy and made it vulnerable to potential crises. The ISS has no such intention as forecasting further crises or undertaking the task of "warning market actors against impending crises just for the sake of having been justified." Historical experience has proven that crises, no matter where they break out, always make people desperate, disorganise workers, liquidate their power for collective resistance and struggle and drive them further away from politics. As a matter of fact, all crises experienced in the recent history of Turkey created favourable grounds for the flourishing of dark, fascistic ideologies and religious fundamentalism.

The analyses and diagnoses of the ISS in this overall context intend to shed light on processes that may bring such scenarios to the agenda and draw the attention of working people to the possibility of emerging crisis environments that may push the country to even darker avenues.

This work prepared by the ISS consists of five parts including introduction and an annex. The second part deals with how the neo-liberal model and its division of labour is reflected in Turkey and discusses relations between Turkey and European Union (EU) in the context of negotiations for full membership. Part Three is reserved for an elaborate analysis of developments taking place since the Justice and Development Party (AKP) took power, with a specific emphasis on the year 2004 developments. Part Four focuses upon public administration and health related implications of what is called "structural adjustment" to which Turkey maintained her loyalty with the new AKP government as well. The fifth and last part examines the nature of IMF programmes and the new stand-by agreement covering the period 2005-2007.

The way in which the neo-liberal approach politically and economically conditions peripheral countries including Turkey cannot be grasped if abstracted from economic developments taking place in the US as the hegemonic power. Hence, the annex of this study focusing on recent trends in the world economy and that of the US is an inseparable part of the work which also requires careful reading.

2. TURKEY IN THE NEW INTERNATIONAL DIVISION OF LABOUR

World Division of Labour and Turkey

It is well known that Turkey stepped in to the new millennium with stabilisation policies guided by the IMF and WB. In spite of two major crises (November 2000 and February 2001) which immediately followed the implementation of the programme, both ruling coalition of the time and ensuing AKP government maintained their "firm" commitment to the underlying philosophy of stabilisation policies. With the new *stand-by* on which the existing AKP government reached consensus with the IMF in 2004, the international system was assured that the process would continue up to 2007 along the same lines. The programme was officially declared as a bundle of policies aimed at checking increases in both domestic and external debt and putting the country again onto the path of "stable" growth. However, it is widely known that, beyond what has been declared officially, the programme envisages much more radical arrangements in restructuring social life as a whole. It is also common knowledge that primary and most important target of these arrangements is to chop off public services and related achievements in the fields of *social security, education and health*, which we may refer to as "public sphere", and to "commodify" these services through privatisations. The point at which governments of the recent period including AKP in the first place displayed their "most determined" political stand is their full neglect to *reactions coming from the people and working classes.* Taken from this angle, it will be safe to assert that Turkey constitutes one of the best examples of those societies where only formal aspects of political democracy are observed and nothing deeper.

Is Turkey alone in experiencing all these? To what extent those economic and social policies designed, implemented and defended by governments and bureaucrats are genuinely specific to Turkey? We can incorporate these questions relating to the recent history of the country to a more generalized one: "What kind of common economic and political transformations has been imposed since the 1980s on underdeveloped peripheral economies like Turkey?" We maintain that this overarching question is of crucial importance in coming to grips with our recent past. Possible answers to this question is of vital importance in disclosing the political roots and real intentions and champions of such concepts as *public reforms, efficient state, civil society and democracy* which have become so common in the daily discourses of both existing political cadres and the bureaucratic elite.

Hence we think the following reminder to be pertinent: The early 1980s were shaped, for many peripheral economies like Turkey, by "stabilisation and structural adjustment" programmes championed by the IMF and WB. Later, early in the 1990s, economic and social policies deriving from the *Washington Consensus* first and then *Post-Washington Consensus,* both of which can be described as the harmonisation of the policies and objectives of both organisations, were presented to all nation-states as structural targets which they had to adopt for the global re-structuring of capitalism. Of these two policy impositions, the first generation arrangements placed more emphasis on economy and envisaged the unlimited opening of markets in nation-states to the rules of global capitalism. Hence, the overall framework of these first generation policies was set by the full liberalisation of trade, removal of all constraints for capital and opening of individual countries to international finance networks and policies of de-regulation and privatisation fine-tuned to the former. As a matter of fact, Turkey's process of opening outward in years to follow 1989 by liberalising capital flows is mainly the part of this process in which these first generation policies were put in practice.

If we remember, the discourse of the dominant economic policy in this period cherished such concepts as *efficient markets, clumsy state, greedy unions seeking too high wages, unproductive State Economic Enterprises (SES) and necessity of privatisations.* Although second generation "reforms" are in essence supplementary to the first round, they still differed significantly in terms of the *function assigned to the state.* This difference clearly manifests itself in importance attached to institutions and legislation in ensuring the operation of domestic markets as required by global markets. In other words, while the first generation of reforms placed the state in a *passive* position vis-à-vis of market rules, the second generation reforms envisage an *active-regulating state* (re-regulation) undertaking the mission of expanding the influence of market to all social spheres whatever. Consequently, national states are imposed the task of redefining and re-arranging their institutional and legal structures, which have been shaped by their historical and social relations, in line with what global law and institutions ask for. All these arrangements seeking to establish coordination and common standards embracing institutional and legal arrangements of individual nation-states, which are presented as "new" modernisation and "democratisation", are in fact nothing more than the effort of global capital to bring the world under a single "legal system".

Two important consequences of these transformations come to the fore as the basic problem of almost all countries including Turkey: Speaking in broad terms, these are related to the *transfer of decisions relating to the public sphere from constitutional institutions of respective countries to "independent" supreme bodies of regulation working under global rules* and further *commercialisation* of public sphere. This process, whose legitimisation is presented as "dissociating politics from economics" enhances the hegemony of global capital and its domestic extensions on society by keeping large sections of people and working masses afar from political processes. Political leaders in all countries where these reforms are being implemented commonly refer to *clumsily working* "old" state and bureaucratic structures, also tainted by *corruption,* and the new model is championed by reference to its so–called efficient, strong, rule-abiding and accountable features. Any reader with further interest in a more elaborate and advanced analysis of these reforms and the *new state* in agenda as well as the *new public sphere* may refer to any website managed by IMF, WB, OECD or EU.

Reports containing mentioned policy suggestions not only define necessary measures and arrangements to be adopted, but also go as far as advising ways of securing public support in this field. The example below is from an OECD Report (2002) titled *Regulatory Reforms in Turkey: Important Support to Economic Improvement: Governance:*

> "…It is vital to have open communication channels in order to have continued public support for the reforms. There is a need for dissemination of the targets and the advantages of the regulatory reforms. Another benefit of this approach is to eliminate the widespread public view that the reforms are imposed from abroad. For this reason, the public perception should be treated as an important issue within the communication strategy of the government" (page 11, emphasis is ours).

Assessing the process which Turkey has undergone since 2000 along with these arrangements, it becomes clearer, as we mentioned earlier, that it is not simply an effort to "stabilize" the economy, but goes much beyond it to radically alter the social structure of the country. The executing actors include political circles who shut their ears to reactions coming from different segments of society, justify their stance by repeating "*it is us who decide on policies to be adopted*" and maintain these policies at any cost whatsoever while keeping themselves content with the slogan "*firm commitment is a virtue"*; top level bureaucrats whom we can classify as a "global elite" sharing same mode of living and discourse worldwide and finally some intellectuals attached to these groups. Extremely intolerant to any criticism including very minor ones, these groups may well behave far distant from what can be given as the *sine qua non* of any democracy.

Turkey in Pre-accession Negotiations with the EU

Of all issues in the political and economic agenda of Turkey, it is hard to find another one which is as far pushed out of the realm of rational thinking and analysis as country's full EU membership. At present this issue seems to be fully chained to a "pro or con" dilemma where both sides resort to arguments, validity of which is largely questionable, to influence the public and decision makers.

As to big business and their influential figures in the media who are fully in favour of EU accession without any reservation, their economic arguments can be outlined as follows: (i) The EU is a large trading area *and* focus of rapid growth from which Turkey cannot afford staying away; (ii) Full EU membership will help Turkey close her savings gap and enhance volume of investments by direct foreign capital flows it will encourage, as well as transfer of EU funds for regional development; (iii) Free movement of labour, as a corollary of full membership, will help Turkey transfer its surplus labour force to Europe; (iv) It is observed that per capita income levels in relatively poor countries joining the EU later now enjoy rising income levels, even converging with the EU average; this will also be the case for Turkey in her full membership and the vicious circle of underdevelopment will be broken.

In arguments of this type, development prospects are brought together with convictions and aspirations in an inconsistent manner. For example, there is this implicitly stated invalid argument that the foreign trade between the EU and Turkey cannot possibly develop if full membership is not achieved. Yet, a range of alternatives extending from preferred trade agreements to models of free trade area which will leave larger room of manoeuvre for national policies may be considered to maintain and further raise the present level of trade between the two parties. The Customs Union with the EU, as the political preference of governments after 1995 is only one institutional arrangement in this wide spectrum.

The argument that the EU represents a dynamic focus in terms of growth, productivity and technological advances is not valid in the context of international stagnation effects of which have been felt since the 1980s. In fact, the Lisbon Declaration of the European Council in March 2000 admits that EU's convergence with the US economy as the world leader in income, productivity and innovation has come to a halt and that the EU is facing serious obstacles in allocating financial and human resources to R-D as well as to scientific and technical training to support R-D activities (see *OECD STI Scoreboard,* 2003 for quantitative data). Given the present technology gap between Turkey and EU, the latter cannot be counted on as an exclusive source of high-tech acquisition in the future.

The Lisbon Declaration had set for the EU the target of creating an information society enjoying the most dynamic and competitive economy and preventing social exclusion by boosting employment and employment quality until 2010. Mr. Kok (former Prime Minister of the Netherlands), one of the consultants to the European Commission, stated in his report which was made public in October 2004 that the EU was far lagging behind of this target in spite of the 5 years passed since then and that it was also losing ground to the US and Far East in her competitive power (*Cumhuriyet*, 16 February 2005). Efforts to suppress wages and wage shares as an accumulation model inspired by the US economy date back to the 80s. In fact, the level of wage shares in the EU was quite below that of the US towards the end of the 1990s (see I.-ul Haque, "Globalization, Neoliberalism and Labour", *UNCTAD Discussion Papers No. 173*, UN: Geneva, 2004).

It is natural that the start of negotiations with the perspective of full membership to the EU would encourage direct foreign capital flows to Turkey. Nevertheless, the *extent* of this impact will spread over rather long periods of time and be vulnerable to both ups and downs in slowly progressing negotiations (especially as a result of blocking by those EU countries not so warm about Turkey's full membership) and alternative investment channels of the EU capital (especially in regard to investment opportunities in new Member States and others at the stage of immediate accession). It is clear that the most optimistic view on Turkey's full membership envisages a date no earlier than 2014. Furthermore, it is also clear that income transfers from the common EU budget in this period may be lower, in both proportional and absolute terms, than what we have now and that the EU is unwilling to make any commitment for prospective members. Briefly, Turkey's problem of insufficiency in both savings and investments is far from any solution that can be expected from the EU.

The decision taken in Brussels in December 2004 makes it clear that the EU may introduce *permanent* limitations to labour mobility out of Turkey even after her full membership. Hence, even full EU membership does not seem to offer any solution to the problem of surplus labour especially when unqualified workers are concerned. In any case, such a solution completely depends on the will of the EU and the condition that expected demographic changes actually take place after 2010. On the other hand, there is no serious barrier to the outflow of *qualified* labour force from Turkey even in the process of negotiations. However, the net balance of such movements may be quite negative for national economy.

Any income convergence on the part of latecomers may be considered by focusing on two stages: (i) Opening of full membership negotiations raises expectations and these rising expectations further encourage capital flows and financial transfers to the candidate country in question; (ii) post-membership convergence is essentially attributed to expected increase in economic efficiency. Although an interesting study by Yiğit and Kutan statistically confirms inflection points in income series and thus convergence, there is still no full identification of underlying causes of this phenomenon (see T.M. Yiğit and A.M. Kutan, "European Integration, Productivity Growth and Real Convergence", 2004). In other words, convergence is not the result of EU membership *per se*, but also the contribution of the capital and information flows triggered by this status and, however limited may it be, by another convergence where goods otherwise remaining out of commerce are priced at EU levels after full membership. We have already stated our doubts about the validity of such parameters which may be found meaningful for the second (and southwards) expansion of the EU.

There are two additional arguments put forward by the liberal pro-EU elite: (i) External dynamics set to motion by Turkey's bid for EU membership will ensure the democratisation of the country and fully safeguard human rights for the citizens of Turkey; (ii) In the EU-US confrontation and competition for hegemony, the EU stands for a civilian power whereas the US rests on military power. Hence, by getting closer to the EU in her foreign relations, Turkey will save herself from being a mere element in the active/unilateral military and political intervention model of the US.

These arguments, too, deserve serious criticism. It is true that suggestions and pressures by the EU on issues regarding human rights and democracy have their impact on new legislative arrangements. However (as implied by the concerns of the EU in the field of practical implementation), imparting these legislative arrangements to daily lives depends on the existence of social demands created by internal dynamics. The conceptualisation of "active/unilateral and active/multilateral intervention" in the context of EU-US dilemma is essentially an expression of difference in methods adopted. In essence, once more, the driving motive of these two power centres in their policies *vis-à-vis* third countries is nothing but neo-liberal restructuring. It would therefore be erroneous to assume that the EU fully discards the alternative of intervention in its policies regarding third countries. The EU efforts to develop neighbourhood strategies in the face of the "Greater Middle East Project" may further trouble EU-US relations; but it is much more probable that this competition ends up with a compromise on methods rather than an open clash. To sum it up, regarding EU as a counterweight against the US hegemony is tantamount to a failure in grasping the modes of intercourse between these two imperial projects.

There is another expectation cherished mainly by some union leaders and columnists on the labour front. According to these circles, EU membership of Turkey should be supported since labour code in the EU countries is more favourable to labour than what we have now and adjustments and adaptations in this regard will be beneficial to workers in Turkey. However convincing may it seem at the first glance, this argument too has some points to be discussed: (i) It is indeed stated by the EC that the labour code in Turkey presently fails to conform to ILO norms and areas where there is need for specific improvements are also cited. Yet, this concern of EU authorities expressed both in bilateral meetings and press conferences concentrate mainly on political and religious rights rather than social and economic rights. Moreover one can also perceive motives of protection from industrial competition behind the "humanitarian" insistence on the improvement of working conditions. (ii) The performance of the EU in such fields as expanding employment and preserving social and economic rights gained mainly through the "welfare state" is following a downward trend especially since the 1990s. In other words, rights acquired by labour in the EU should be attributed to the historical struggles waged by workers, not to the expansion of the EU. (iii) Technical studies of the EU, while touching upon ILO norms and labour-friendly themes, expressly back up, rather than criticise, neo-liberal policies that have further triggered unemployment, poverty and inequality in Turkey and in other underdeveloped countries. (iv) In Turkey, constitutional and legislative arrangements declaring the supremacy of the provisions of international law to national legislation have, before EU membership, made it obligatory to adopt ILO norms which represent the gains of the welfare state model. It is this fact that the attention of working people needs to be drawn (see S. Erdoğdu, “AB ve Sosyal Politika (EU and Social Policy)”, *Türk-İş*, September-November 2004, No. 363 and Y. Koç, *AB Emperyalizmi ve İşçi Sınıfı (EU Imperialism and Working Class)*, 2004). It should also be noted that the Copenhagen Criteria 1992, which laid down the basic principles of new accessions to the EU stand as a turning point in the overall approach to the social rights of workers. Indeed, after this date, the EU bodies placed their emphasis not on class-social rights but those rights concerning individuals and minorities. This shift of emphasis is closely associated with EU’s more pronounced engagement with the neo-liberal model in the 1990s and afterwards. To conclude, it would be wiser to underline and discuss this change in the democratisation criteria of the EU.

In spite of all these questions and puzzling developments, the “Europe of Capital” enjoys the general political support of the Turkish public opinion. The AKP is presently manipulating this political support as a tool for building up its international legitimacy, on the one hand, and for strengthening local foci of power, which it can control more easily, at the expense of weakening central state structure, on the other (for an interesting article see İ. Uzgel, “Putting AKP in the Right Place”, *Radikal 2*, 16 January 2005). As far as EU and AKP are concerned, decentralisation in Turkish public administration system gains a political dimension beyond a mere issue of efficiency and this political dimension occasionally finds reflection in statements made by politicians from the EU. Even if the EU policies adopted by the AKP end up with the effective clogging of paths leading to full membership, the AKP would have, by that time, consolidated its influence on big business, gained significant advantages over its political opponents and weakened the secular foundations of the Republic. When such a stage is reached, it may be even wiser for the Islamic right-wing politics to have the AKP fully revert to its original Islamic references and keep a distance to the EU.

The underlying expectation in the Council Decision of 17 December 2004, which practically supplied a two-way road map (full membership or special partner status) and brought no political commitment to the EU, is to “firmly anchor Turkey to the EU structures” whatever the final outcome of the process of negotiation may be (for a detailed analysis of the Council Decision, see Ç. Erhan, “What did the EU Say to Turkey on December 17th?” *Cumhuriyet Strateji Eki*, 27 December 2004). The public in Turkey should be clearly informed about motives that make such a relationship of dependence plausible, while no definite commitments and concessions could be obtained from a supra-national union like the EU.

Coming to the other side, the arguments of EU opponents, who are yet far from reaching any influential political stance, are mostly devoid of analytical integrity. While some focus on trade deficit with the EU (which is expected to swell as a result of trade diverting effects of such arrangements as Customs Union), others capitalise on certain tendencies and initiatives of politicians and citizens of the EU, which seem to be both inconsistent and insincere. Quite interestingly, opposition to the EU is introduced to the public by EU supporters as defence of “oppressive” and “clumsy” state apparatus. Since not all opinions and views can be clearly conveyed to all segments of the society, ongoing debates entirely shift towards subjective arguments.

We are convinced that the intellectuals in Turkey, including political scientists and economists in the first place, have critical duties and responsibilities in fully informing the society on the EU issue and in bringing back ongoing debates onto rational and scientific grounds.

3. AKP PERIOD IN TURKISH ECONOMY: MACROECONOMIC DEVELOPMENT AND FRAGILITIES

General Observations

Shortly after the AKP took office the ISS made an evaluation stating that "the AKP abandoned the discourse manipulating anti-IMF and anti-liberal reactions in the country immediately after taking office and showed no hesitation in fully adopting neo-liberal policies entrusting national resources and economic future of the country directly to foreign capital and non-harnessed dynamics of the market" (See "2003 Başında Türkiye Ekonomisi ve AKP'nin Hükümet Programı Üzerine Değerlendirmeler (On Turkish Economy and the Programme of the AKP Government in Early 2003)", http://www.bagimsizsosyalbilimciler.org/bsbmetin.html). The performance of the AKP in 2003-2004 provides ample evidence supporting this judgement.

The distinguishing feature of the AKP government in this respect is that it has undertaken the mission of executing the neo-liberal project under the discourse of "strong government" without confronting any strong popular opposition. The AKP is behaving faster and more boldly than any preceding government in implementing above mentioned policies for responding to the requests of international capital on the one hand and settling its problem of adaptation to the state and administrative traditions of the country on the other. The claim of the AKP government that these policies are designed by the authorised cadres in Turkey has no meaning at all. These cadres in fact share the same ideology with the IMF and represent the very same interests. Ongoing supervision of economic and political programmes through incessant checks lays it bare that Turkey is being governed more and more by the projects of these organisations.

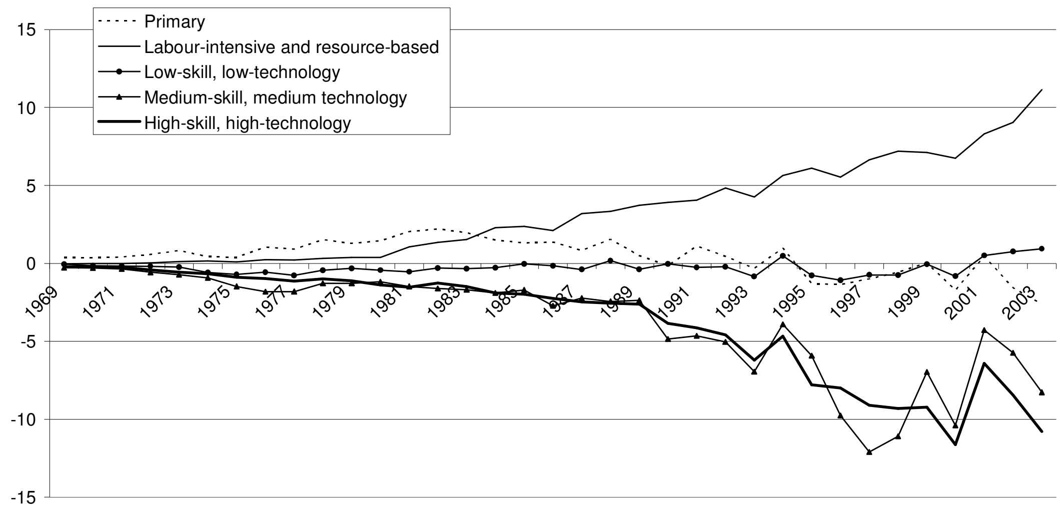
In the international division of labour, Turkey continues to specialise in sectors of production with standard technologies and low labour cost in line with export-based growth strategy. With low fixed investment rate and the policy of leaving the composition of production to the decisions of the foreign and/or domestic private sector as well as to arrangements introduced by international agreements, Turkey is forced to produce whatever she can produce cheaply with the given endowment of productive resources. Figure 1 below shows that this tendency is valid starting from the 80s and getting more consolidated starting with the year 2000. The major sectors in which Turkey enjoys trade surplus are "labour-intensive and resource-based" ones. On the other hand, the country faces continuous deficits in sectors which require high technology and qualified labour and these deficits are swelling since 2000. Another critical observation about ongoing foreign trade deficits is that trade balances in "primary goods" which mostly consist of agricultural goods and raw materials also yield sizable deficits following 2001. It is clear that the recent contraction in agriculture has its serious impact on this development. It should be noted with concern that Turkey, long used to be self-sufficient in food is being driven to trade deficits in this area too.[1]

To sum up, it is possible to say that these rather established trends in foreign trade are the natural outcome leaving a range of vital production activities from wheat to pharmaceuticals to the conditions of the "market." The seriousness of the problem becomes more visible when considered together with the terms of trade given in the Annex. The continuous trend that works in favour of technology-intensive sectors against labour-intensive ones testifies that economies of countries, including Turkey, specialising in labour-intensive sectors actually transfer resources to other countries. Insistence on this pattern of trade and desire to enhance

[1] For sector classifications, groupings made under SITC Rev.2 as given in UNCTAD's *Trade and Development Report*, 2002 were used.

foreign trade through these sectors will have the direct result of suppressing labour costs from above.

Figure 1. Trade Balances with Reference to Commoditiy Groupings, 1969-2003, ($ billion)



Source: A.H. Köse and A. Öncü, "Observations on the Structure of the Turkish Foreign Trade", mimeo, 2004.

This pattern of specialisation in foreign trade leads, whether it is intended or not, to continuous pressures on labour costs and consequent reshaping of income distribution in line with the interests and preferences of capital. If "exportation" is the pretext of capital's design of income distribution in Turkey, its mechanisms are unemployment and public debt.

Unemployment is the primary reason explaining the phenomenon of informal employment which, according to official data has a share of 45% and which makes minimum wage hypothetical. According to the Pre-accession Economic Programme of 2004, the government intends to keep the rate of unemployment around 10% throughout the period 2005-2007. High rate of unemployment makes employment in both public and private sectors more flexible, press down wages and force workers to seek informal employment. Leaving aside sufferings by individuals and families, the unemployment of tens of thousands of skilled workers or their employment in jobs not corresponding to their skills is a great loss for the society in terms of missed production opportunities.

Public debt is used as an instrument to keep unemployment at a certain level. The policies of non-interest budget surplus and privatisation to manage and service debt directly depress economy and employment. The capitalist, either domestic or foreign, uses public debt a means of appropriating a significant part of public revenues as accrued interest and principal. The Pre-accession Economic Programme has its basic scenario envisaging the reduction of the proportion of total debt stock to GDP from 75% in 2005 to 68% in 2007. In case the GDP growth, reel rate of interest or exchange rate deviate from the assumptions of this scenario, it is perfectly possible to have a total debt stock remaining as it is or rising compared to what it is in 2005. It can be inferred that ruling classes are determined to maintain public debt as a policy instrument.

Economic Data for 2004

According to data for the first three quarters of 2004, the economy has grown by 9.7%. At the end of this period, the national income in the country reached 283.9 billion US dollars. The inflation in 2004 continued to fall. The average annual increase in prices receded from 18.4% to 11. 1% on CPI, and from 25.5% to 9.3% on WPI basis. Export revenues too made a jump in 2004 and reached 62.7 billion US dollars. However, since imports too increased in the same period, current account deficit exceeded 15 billion dollars. Foreign trade deficit, which constitutes the major component of current account deficit, hit the record-level of 34 billion dollars (see Table 1).

Table 1. Macroeconomic Developments in Turkish Economy under AKP Government - A Summary

	2002	2003	2004
GNP Growth Rate (%)	7.8	5.9	9.7[1]
GNP ($ billion)	181.7	238.9	283.9[1]
Inflation (CPI, %, p.a.)	29.7	18.4	9.3
Inflation (WPI, %, p.a.)	50.1	25.5	11.1
Debt Stock of the Consolidated Budget ($ billion)	148.5	202.7	226.8[2]
Domestic Debt Stock ($ billion)	91.7	139.3	159.1[2]
Foreign Debt Stock ($ billion)	56.8	63.4	67.7[2]
Total External Debt Stock ($ billion)	130.3	145.8	153.2[1]
Merchandise Trade Balance ($ billion)	-15.6	-22.2	-34.5
Exports ($ billion)	35.9	47.1	62.7
Imports ($ billion)	51.5	69.3	97.2
Current Account Balance ($ billion)	-1.5	-8.1	-15.6
Current Account Balance / GNP (%)	-0.8	-2.8	-5.3
Open Unemployment Rate (%)	10.3	10.5	10

1. As of 3rd quarter 2004.
2. As of November 2004.

Source: Central Bank of Turkey (www.tcmb.gov.tr); Undersecretariat of Treasury (www.treasury.gov.tr)

Sources of Growth

The trend in economic growth in the period starting from 1998 as the last "normal" year prior to the crisis affecting the early 2000s to the end of 2004 may be analysed in two sub-periods: 1999-2000 and 2001-2004. In the first sub-period, the average annual increase in GDP was around 1.1% and in the second 3.7%. If the period 1999-2004 is taken as a whole, the rates of growth of GNP and GDP are, respectively, 2.9% and 2.3%. In other words, in spite of the improvement of 2002-2004, the great adverse shocks of 1999 and 2001 had their effects still felt.

The following can be derived from Table 2 which gives a summary of quantitative evaluation regarding the demand-side sources of growth:

(i) In the sub-periods of both 1999-2000 and 2001-2004, the sources of growth are mainly consumption expenditures and stock increases in the private production sector. The revival of investments in 2003 and 2004 has not yet turned fixed capital formation or growth in foreign trade into an "engine" of growth.

(ii) There is no plausible economic explanation of the observation that stock increases have become such a determining factor in growth arithmetic. In spite of high reel interest rates that left their imprints on the period, it is impossible to imagine an economic conjuncture where stock increases around 7-8% of GDP are realised (see Table 3). It seems that the fact that the economy has recently become more dependent to imported inputs and consequent falls in value added/gross production value ratios in all sectors including industry in the first place are not duly considered by the SIS which keeps using the technical coefficients relevant for the 1990s. Hence, when high estimations are made for GDP growth (basing on gross production values) final demands that cannot be accounted for by changes in investment, consumption and net exports turn into virtual demand elements and reflect themselves in stock changes as a residual (see S.Somçağ, “DİE’den Hayalî Stok İtirafı (Confession of Imaginary Stock by the SIS)”, 11 March 2004, http://www.selimsomcag.org). Another possibility, though weaker, is the underestimation of private consumption expenditures, which are not as closely followed as investments by the SPO, and carrying the impact of this faulty estimation to stock changes.

The fact that ordinary citizen can feel no “improvement” in his daily living in spite of striking growth rates declared is closely associated with these errors. Nevertheless, political and bureaucratic circles needing success indicators to defend structural adjustment policies seem to have no motive for correcting these rather serious mistakes.

Fixed Capital Investments

There is some revival in fixed capital investments by private sector as reflected especially in figures for machinery-equipment importation in 2004 (See Table 3). Still, private fixed investment/GDP ratio is yet to reach its level in 1998. It is also observed that this revival is largely financed by increases in external resources and that the domestic saving/GDP ratio which is 22% for 2004 is still behind 23% which was the figure for 1998.

Again in spite of this revival in private investments in 2003 and 2004, the real volume of fixed capital investment is lower than that of 1998 both for private sector and for the economy as a whole (Table 4). Yet, there is a striking change in the sector composition of private investments which affects overall capital/output ratio in the economy positively: In the crisis-hit years of the early 2000s, investments in housing suffered a sharp decline both in absolute and relative terms while weakness in investment in manufacturing industry characteristic of 2001-2002 partly improved later. It is obvious that these investments concentrating rather on the renewal of machinery and equipment that lost value during crisis years than implying investments in new enterprises and facilities are affected by increasing external financing possibilities and excessive appreciation of TL in 2003-2004. The possibility of maintaining these investments for renewal at the same pace in 2005 seems limited. Investments in transportation sector, on the other hand, recovered the contraction in 2001-2003 in 2004 and caught the level in 1998.

The lack of investment in a sector like housing where capital/output ratio is relatively high and where no exportable surplus is generated manifests itself in problems such as low level of employment and consequent instabilities deriving from periodical oscillations as touched upon in other parts of this study. This low level of employment is obviously the main factor in the background of AKP attempts to encourage investments in housing through Mass Housing Administration (TOKİ) and/or long-term loans based on real estate mortgage.

Table 2: Sources of Growth, 1998-2004 (at 1998 prices, quadrillion TL)

Real Increases	1998-2000 Absolute	1998-2000 Relative	2000-2004 [1/] Absolute	2000-2004 [1/] Relative
GDP	1.203	100.0	8.430	100.0
Fixed Capital Investments	-0.140	-11.6	-0.597	-7.1
• Public	0.898	74.6	-0.988	-11.7
• Private	-1.038	-86.2	0.392	4.7
Stock Changes	1.471	122.3	3.371	40.0
• Public	-0.251	-20.9	-0.006	..
• Private	1.722	143.1	3.378	40.0
Consumption	1.771	147.2	3.631	43.1
• Public	0.634	52.7	0.006	0.1
• Private	1.138	94.6	3.625	43.0
Net Exports of Goods and Services[2/]	-1.899	-157.9	2.025	24.0
Memo Items:				
Average Annual Increases,%				
• GDP	1.1		3.7	
• GDP	-0.1		3.3	

.. : Negligible.

Note: Totals may not be exact since figures are rounded.

[1/] The Annual Programme estimate of the SPO is used for year 2004 realisation.

[2/] Calculated as a residual based on demand elements and GDP estimates.

Source: *SPO Annual Programmes, 2000-2005* and *NI Statistics of SIS*.

Table 3: Balance of Resources and Uses, 1998-2004[1/]

	1998	2000	2001	2002	2003	2004[2/]
GDP	100.0	100.0	100.0	100.0	100.0	100.0
External Resources	0.8	6.5	-1.3	2.6	4.2	5.4
Total Resources	100.8	106.5	98.7	102.6	104.2	105.4
(= Total Expenditures)						
Fixed Capital Investments	24.5	22.6	19.0	17.4	16.1	19.2
• Public	6.0	6.9	6.3	6.3	4.9	4.7
• Private	18.5	15.6	12.7	11.0	11.2	14.5
Stock Changes	-0.6	2.1	-2.9	4.3	7.4	8.3
• Public	0.5	0.1	-0.8	0.0	-0.2	0.0
• Private	-1.2	2.0	-2.0	4.3	7.5	8.3
Consumption	76.9	81.9	82.6	81.0	80.7	77.9
• Public	11.1	12.4	13.2	12.7	12.3	11.9
• Private	65.9	69.5	69.4	68.2	68.5	66.0

Note: Totals may not be exact since figures are rounded.
1/ In terms of proportional shares calculated at current prices.
2/ Estimated realisation.

Source: *SPO Annual Programmes, 2000-2005.*

Table 4: Sectoral Distribution of Private Fixed Capital Investments, 1998-2004 (percentage shares)

Sectors	1998	2000	2001	2002	2003	2004[1/]
Material Production	28.3	30.4	28.3	33.4	44.4	47.6
• Manufacturing	22.4	26.7	24.6	29.7	39.5	42.3
• Agriculture and Mining	5.9	3.7	3.7	3.7	4.9	5.3
Services	71.7	69.6	71.7	66.6	55.6	52.4
• Transportation	19.7	26.2	23.4	26.0	17.0	21.0
• Housing	36.8	23.7	23.9	17.0	14.4	11.8
• Tourism	3.6	5.6	6.2	6.8	8.6	7.2
• Other[2/]	11.5	14.1	18.2	16.6	15.6	12.4
Memo Items:						
Fixed Capital Investment						
Quantity Index 1998: 100[3/]						
• Private	100	89	64	55	66	93
- Manufacturing	100	107	68	73	116	176
- Transportation	100	119	73	72	57	100
- Housing	100	58	40	25	26	30
• Public	100	128	90	100	94	97
• Total	100	99	69	66	73	94

Note: Totals may not be exact since figures are rounded.
1/ Programme estimate.
2/ Energy, education, health and other sectors.
3/ Index values are approximate since sector-based investment deflators are assumed to be equal to total investment deflators.

Source: Taken or calculated from *SPO Annual Programmes, 2000-2005.*

Growth that Fails to Generate Employment: Only at Conditions Preferred by Markets and to the Extent They Accept!

Throughout 2004, unemployment remained as a problem of the economy awaiting solution. There was no significant reduction in open unemployment following the 2001 crisis in spite of fast growth and significant jumps in exports. The rate of *open* unemployment estimated as 10.3% in 2002 first increased to 10.5% in 2003 and then remained at 10.0% as of the last quarter of 2004 (see Table 5). Given that the third quarter of a year corresponds to highest rate of seasonal employment, it becomes clear that the rate of unemployment for 2004 as a whole will be no different than that of 2003. The rate of open employment remains high especially among young urban population.

Table 5. Developments in Turkish Labor Market (in thousands)

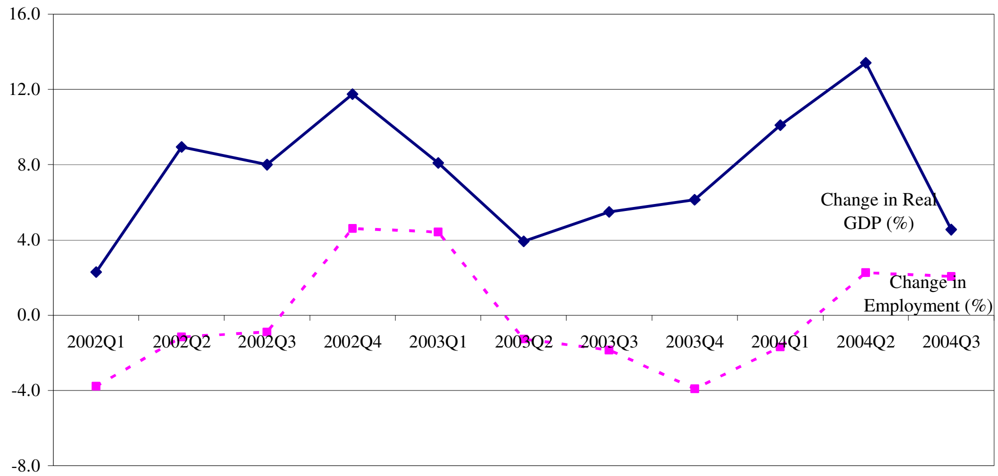
			2003				2004			
	2002	2003	Quarter I	Quarter II	Quarter III	Quarter IV	Quarter I	Quarter II	Quarter III	Quarter IV
Population over yrs. of Age	48,041	48,912	48,587	48,799	49,022	49,250	49,482	49,694	49,944	50,189
Labor Force Participation Rate (%)	49.6	48.3	47.5	49.4	50.5	47.1	45.9	49.2	50.6	48
Civilian Labor Force	23,818	23,640	23,088	24,115	24,739	23,206	22,732	24,457	25,265	24,297
Civilian Employment	21,354	21,147	20,244	21,696	22,411	20,811	19,902	22,188	22,874	21,870
Unemployed	2,464	2,493	2,844	2,418	2,328	2,396	2,830	2,269	2,390	2,428
Rate of Unemployment (%)	10.3	10.5	12.3	10.0	9.4	10.3	12.4	9.3	9.5	10
Underemployed	1,297	1,143	1,161	1,113	1,149	1,166	1,175	1,002	1,010	764
Rate of Underemployment (%)	5.4	4.8	5.0	4.6	4.6	5.0	5.2	4.1	4.0	3.1

Source: State Institute of Statistics (SIS), Household Labor Force Surveys.

Non-institutionalised civilian labour force over age 15 reached 50.2 million as of the last quarter of 2004. The labour force participation rate (LFPR), on the other hand, fluctuated seasonally in the range 46% - 50% from 2002 to 2004. It is known that the LFPR is substantially lower in Turkey than, for example, the EU average. Low LFPR also indicates the size of civilian population who are disillusioned in their efforts to find jobs. Considering *underemployment* data presented by the SIS in addition to open unemployment figures, the rate of idle labour force can be estimated as 13.1% as of the 4th quarter of 2004.

Besides all these, the most striking observation relating to labour market data relevant for the period following 2002 is the presence of rather sharp increases in national income together with too slow expansion in employment. Referred to as *"jobless-growth"* in literature, this process is in fact common to all underdeveloped economies (for further information see UNCTAD, *Trade and Development Report*, 2002 and 2003). In Turkey too, the problem manifests itself in low or even slightly shrinking rates of increase in employment even when national income enjoys a significantly rising trend. Figures 2 and 3 below reflect this situation. Figure 2 compares real annual rates of change in GDP and total employment on a quarterly basis. To make comparison to GDP changes meaningful, each quarterly change in total employment is annualised on the basis of the corresponding quarter in the previous year.

Figure 2. Annual Changes in Real GDP and in Employment (%)



Source: *SIS*

From the 1st quarter of 2002 to the 3rd quarter of 2004, the average annual rate of GDP growth was 7.5%. On the other hand, changes in the average annual employment rates turned out to be *minus* 0.1% in the same period. While GDP growth rates were positive in all 11 quarters considered, there were only 4 quarters in which changes in employment were positive.

These observations relating to total national income are valid also in terms of sub-sectors. Results are similar when we take a closer look at industrial sector, which is seen as the driving force of growth after 2002. In the period following 2002, while the average rate of growth reached 9.5%, the average rate of growth in employment remained only at 1.5%. Again, while total industrial output grew *in cumulative terms* at a rate of over 25% from the first quarter of 2002 to the third quarter of 2004, the rate of growth in industrial employment was only 7%. Figure 3 below compares real growth rates in industry to real employment growth in the same sector.

Figure 3. Annual Changes in Real Industrial Output and Industrial Employment (%)

Source: *SIS*

This wide gap between output and employment growth can be observed in other sectors as well. Table 6 below gives the sector-based distribution of employment and annual changes taking place.

Table 6. Sectoral Employment Levels and Increments, 2001-2004 (in thousands)

	Sectoral Employment				Increments in Employment		
	2001[a]	2002[a]	2003[a]	2004[a]	2002-2001	2003-2002	2004 - 2003
Agriculture	8,105	7,623	7,390	7,414	-482	-234	24
Unpaid Family Worker	4,348	4,023	3,768	3,779	-325	-255	11
Industry	3,767	3,913	3,838	3,955	146	-75	116
Construction	1,114	957	1,046	1,025	-156	89	-21
Services	8,545	8,970	9,116	9,316	424	146	200
Total Civilian Employment	21,524	21,354	21,147	21,709	-170	-207	562
Population over 15 yrs. of Age	47,150	48,041	48,912	49,827	891	871	915

a. Yearly average.

Source : SIS, Household Labor Force Surveys.

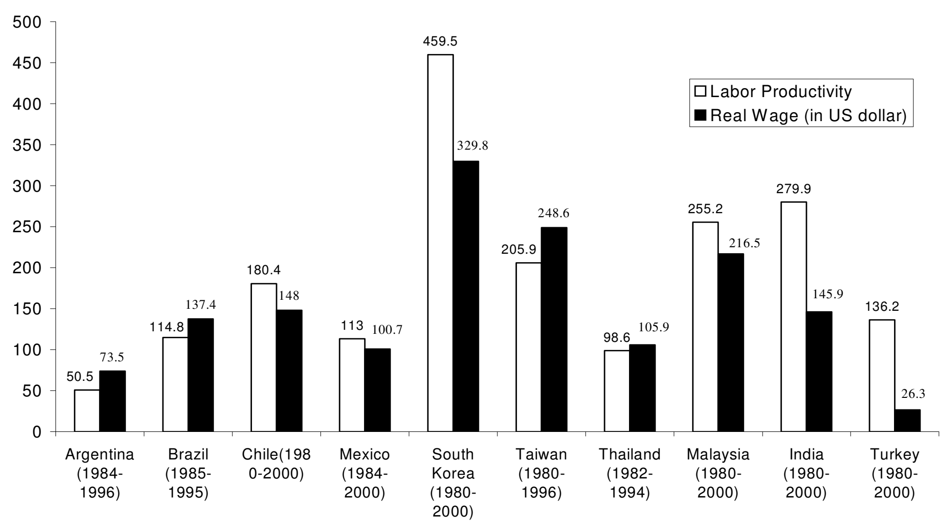
Table 6 above shows that in 2002 and 2003 average annual values for total employment were lower by 170,000 and 207,000, respectively, compared to the average values of preceding years. It is the falling rates of labour participation that explains why these shrinkages did not lead to substantial increases in the rate of unemployment. The average employment figure for the year 2004, on the other hand, represents an absolute expansion by 564,000 persons compared to the earlier year. In the same period, (2003-2004), however, the population over age 15 grew by 1 million as a result of the demographic trends in the country. In this period where the LFPR was around 48%, open employment receded only by 17,000. Given that the rate of growth in national income for the year is estimated as 8%, absence of any serious fall in the number of unemployed casts doubts about the dynamics of the process of growth.

In the light of the analysis above, it can be stated that the growth path of Turkey after 2001 exhibits the features of what is called “jobless-growth.”

Trends in Wage-Productivity Relations

With the 1980s, there emerged a rupture between wage and productivity increases in Turkish economy. Figure 4 derived from UNCTAD reports clearly shows this main trend and also allows for comparisons with other economies in the periphery. The figure takes the year 1980 as index base (100) for trends in wages and labour productivity. In 2000, wages in Turkey dropped to 26.3 from the index value of 100 in 1980, whereas labour productivity rose to 136.2[2] This simply reveals that even when labour productivity increases this increase is not reflected in distribution and that increasing labour productivity does not bring along improvements in the welfare level of wage earners. Another striking point in this respect is that Turkey is the country among those in similar situation where this dichotomy assumes more extreme proportions.

Figure 4. Productivity and Real Wage Developments in Peripheral Economies (1980:100)



Source: Calculated from UNCTAD database.

This rupture between wages and productivity continued in the period 2002-2004. As can be followed in Table 7, labour productivity in manufacturing industry is on a rising trend for the last five years with the exception of a contraction by 1.2% per year during the crisis of 2001. In the same period, however, we see no reflection of this trend on wages; in spite of increase in real wages for the first three quarters of 2004 (4.2% in the public and 4.5% in the private sector) the general wage level is still behind its level in 1997.

[2] Real wage comparison in the source still represents a tendency though it may not be too precise due to fluctuations in real exchange rate.

Table 7. Data on Manufacturing Industry (2000-2004 III)

	2000	2001	2002	2003	2004[1]
Annual Change (%)					
Index of Manufacturing Output					
Public	-6.2	0.2	4.7	2.2	-1.6
Private	9.8	-11.6	12.6	11.0	12.3
Total	6.4	-9.5	11.0	9.3	9.8
Index of Production Workers					
Public	-6.2	-6.5	-9.1	-6.8	-11.4
Private	-1.6	-8.6	2.3	3.1	3.4
Total	-2.4	-8.3	0.6	1.8	1.8
Index of Hours Worked					
Public	-5.9	-7.4	-10.2	-5.6	-10.3
Private	-0.2	-10.8	4.0	3.0	5.5
Total	-1.2	-10.3	2.0	2.0	3.7
Index of Production per Worker					
Public	-0.3	6.5	15.5	9.5	12.7
Private	11.3	-3.0	9.6	7.8	11.0
Total	8.8	-1.2	10.2	7.4	8.3
Real Wage Index					
Public	15.6	-11.5	0.5	-5.3	4.2
Private	-2.6	-14.4	-5.0	0.5	4.5
Total	0.4	-13.8	-6.2	-1.9	2.2
(1997 =100)					
Index of Manufacturing Output					
Public	89.4	89.6	93.8	95.9	94.4
Private	105.4	93.2	104.9	116.4	130.7
Total	102.1	92.4	102.6	112.1	123.1
Index of Production Workers					
Public	83.6	78.2	70.9	66.3	63.1
Private	90.3	82.5	84.4	87.0	91.2
Total	89.1	81.7	82.1	83.7	87.0
Index of Production per Worker					
Public	107.5	114.5	132.3	144.6	160.6
Private	116.5	113.0	123.9	133.7	144.8
Total	114.5	113.9	124.6	133.8	144.3
Real Wage Index					
Public	142.8	126.5	127.1	120.4	125.4
Private	105.0	89.9	85.4	85.8	89.7
Total	111.3	96.0	90.0	88.3	90.2

[1] For the first three quarters

Source: SIS

Starting with the staff monitoring programmes of the IMF, continuing with the "Programme for Transition to Strong Economy" and AKP's Urgent Action Plan, and finally inviting new *stand-by* rounds, the overall policy targeted to suppress wages in this period by controlling public expenditures, domestic demand and price increases under the pretext of checking inflation. In the period 2000-2004, real wages of those working in manufacturing industry receded by 12.2% in the public sector and by 17.1% in the private. In the same period average productivity of labour increased by 25.9% and total output increase in manufacturing industry turned out as 20.6%. In Table 7 one can follow increases in output and labour productivity in manufacturing industry concomitantly by a fall in real wages. Since output and productivity increases in industry are not accompanied by wage increases, labour cost of per unit produced decreases. This trend led to a dramatic shrinkage of labour share in total value added.

It is also useful to investigate the sources of productivity increases for both public and private sectors. In manufacturing enterprises in the public sector, the number of workers is being brought down systematically since 2000 at an average annual rate of 4.5%. According to SIS data, by taking 1997 figures as 100, we find the index value of workers employed in public manufacturing enterprises as 83.6 in 2000 and 63.1 at the end of the 3rd quarter of 2004. Industrial employment in the public sector is being eroded fast and in a determined manner. Looking at the output index for manufacturing industry, we see rather weak annual output increases in the same sector. In other words, rising productivity in the public sector is not a "healthy" one deriving from new investments and associated technological improvements, but another phenomenon giving higher per capita value added merely for employing fewer workers.

Looking into the origin of productivity increase in private manufacturing industry where rising productivity index is coupled by strong pressures on real wages, the first point that strikes attention is that rise in production which was 12.6% for 2002, 11.0% for 2003 and 12.3% for the first 9 months of 2004 was accompanied by employment expansion at rates of only 2.3%, 3.1% and 3.4%, respectively, for the years concerned. The index of employment in private manufacturing industry (1997:100) was 90.3 for 2000, dropping to 87.0 at the end of 2003 and rising only to 91.2 at the end of the first three quarters of 2004 in spite of rather extraordinary growth in production observed during this period. For the same periods, the rates of increase in hours worked are 4.0%, 3.0% and 5.5%, respectively. These figures point out that while the production index that was 105.4 in private manufacturing industry in 2000 rose to 130.7 at the end of the first 3 quarters of 2004, there were fewer workers per unit of production working longer. Indeed, looking at changes in average working hours in manufacturing industry, we observe increases of 1.4% (2002), 0.2% (2003) and 1.9% (first 9 months of 2004).

Throughout the last five years, the industrial sector managed to raise its production by employing fewer workers for longer hours and by paying lower wages. While this increase in production was made possible by rising labour productivity, as a result of constant pressure on labour cost, economic growth added nothing to the welfare of workers and, quite to the contrary, depressed real purchasing power and deepened poverty. In this sense, the programmes of recent years have been "successful" indeed in pushing labour costs down, restricting domestic demand, downsizing the public sector and in further weakening the trade union movement.

Turkey Keeps Offering High Arbitrage Returns to International Financial Markets

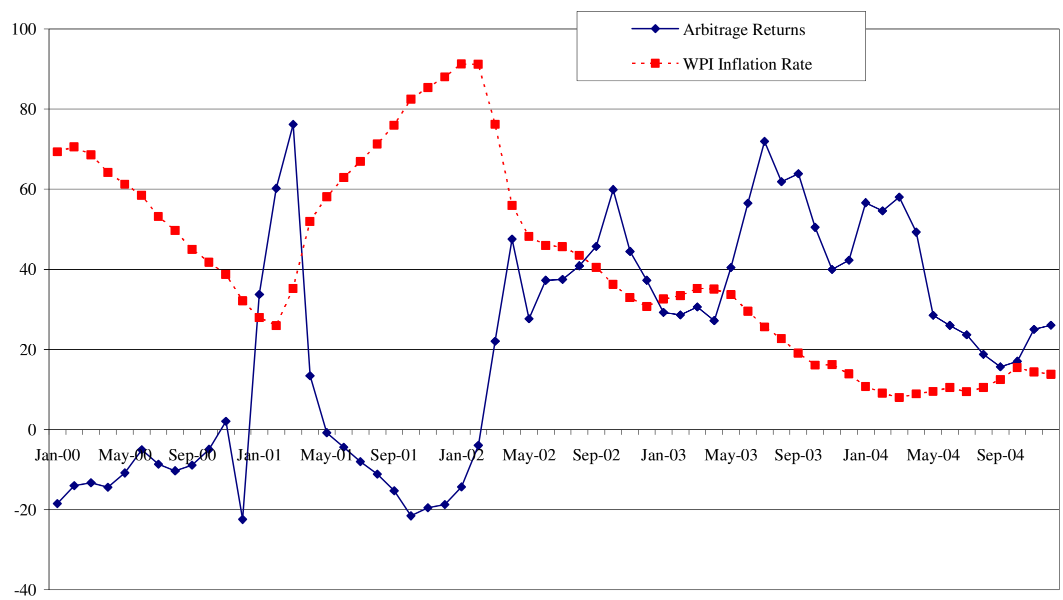
Since 2003, Turkey has been attracting significant amount of speculative financial flows from abroad. As will be clear in the detailed analysis of balance of payments statistics, hot money inflows of non-resident origin reached 5.8 billion US dollars in 2003 and 11.6 billion dollars in 2004. Beyond these figures, it should also be considered that there was a total net inflow of 8.1 billion dollars in the same years in the item errors and omission data that is interpreted as "unrecorded, hot money attributable to residents" in tables to follow. It is known that the major economic variable that stimulates these monetary flows is the arbitrage returns deriving from the difference between domestic real interest rate and annual depreciation in the foreign currency (dollar). Turkey manages to attract such inflows through speculative arbitrage (uncovered interest parity) that is based on high real interest and low exchange rate.

The financial arbitrage variable stands for net return that accrues when 1 US dollar entering financial markets in Turkey is first converted to TL at current exchange rate, then invested for interest return in TL and finally re-converted into foreign exchange as it leaves the country. Therefore, arbitrage returns will remain high as rate of interest remains high and will fall if TL loses value *vis-à-vis* foreign currencies.

If we assume that R stands for rate of interest in TL and that ε is the rate of increase in exchange rate (TL/$), financial arbitrage can be formulated as $[(1+R)/(1+\varepsilon)]-1$.

Figure 5 below gives the rate of annual speculative returns that Turkish economy offers to international financial markets since the beginning of 2000 in comparative terms with the 12-month inflation rate in wholesale prices. In this figure, it is assumed that any external agent will seek the instrument bringing in the highest possible financial return and consequently the rate of interest offered by state bonds (DİBS) of 3-month maturity is selected.

Figure 5: Speculative Financial Arbitrage and WPI Inflation



Source: Calculated by ISS by using data from the *SIS* and *Central Bank of Turkey* (www.tcmb.gov.tr).

Figure 5 shows that Turkey is in a steady process of disinflation starting from January 2002. The yearly rate of inflation which was around 90% in January 2002 in terms of wholesale price index then receded to 13% at the end of 2004. Meanwhile, financial arbitrage possibilities offered to international markets first receded parallel to rapid falls in interest rates in 2002 as a result of the disinflation programme and then jumped to 80% during the February crisis. Returns to financial arbitrage receded parallel to the process of devaluation that followed the crisis but later, starting from the spring of 2002, recovered and reached over 50%. It is these rather lucrative arbitrage possibilities lying behind hot money inflows that characterises the period of AKP in power. While average annual rates of interest in OECD countries run around 4-5%, it is not surprising that Turkey manages to encourage inflows by offering speculative financial returns of almost 30%.[3]

Thus first during the coalition government when Mr. Kemal Derviş was in charge of managing

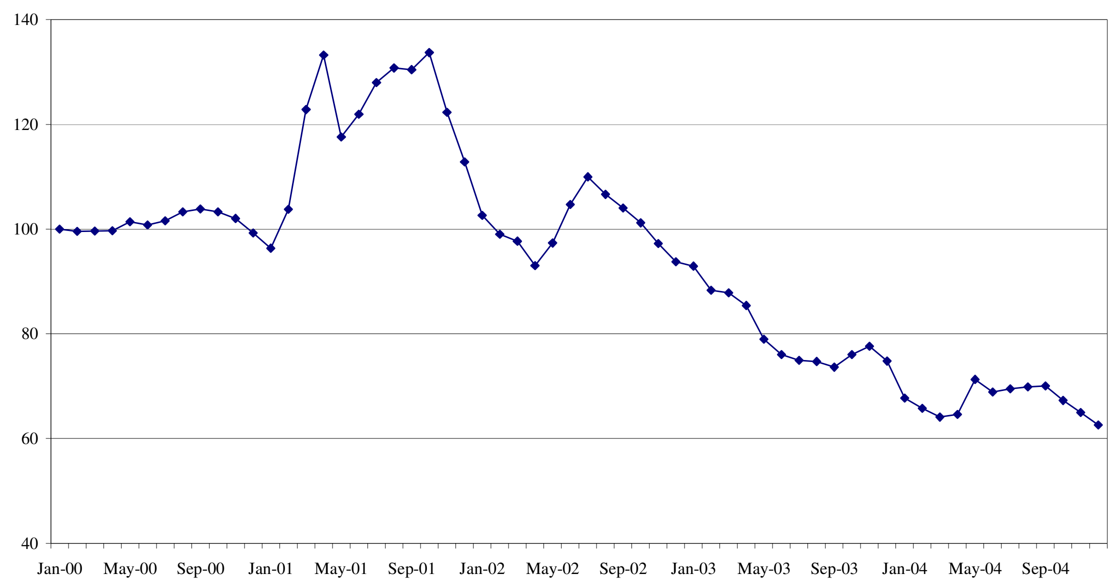
[3] To readers prepared to decode the language of the world of international finance we advise to take a look at the information note by a well known foreign bank active in Turkey "FX Alert-New Turkish Lira", 16 February 2005). This note which is not confidential assumes that YTL will follow a "limited trend of valuation" in 2005 and gives recipes for good arbitrage gains in quarterly periods on the basis of $/YTL rates. The question is how long the Turkish economy can endure this "bleeding" about which we think even ordinary citizens have some idea.

the economy and then during the AKP government, Turkey seems to have solved the problem of financing crisis management after 2001 by offering high financial returns to global markets.

Induced in this way, it is inevitable that such inflows bring along an abundance of foreign exchange. This makes TL overvalued *vis-à-vis* foreign currencies. However, this abundance based on high interest rates and expectations of high financial arbitrage encourages imports and thus leads to enlarging deficits in foreign trade balances while , at the same time, reducing the TL-based external debt burden of the government. Turkey is presently passing through a growth conjuncture based on foreign exchange inflows which, in their turn, are based on highly sensitive speculative considerations. This conjuncture is also characterised by the persisting problem of unemployment and low wages still bearing the imprint of the crises of 2001-2002. Considering all these it is possible to label this pattern of growth as a "speculation-led growth."

Figure 6 below presents the trend in the value of TL *vis-à-vis* US $ (in wholesale prices, 1990:100) in real terms. As can be seen in the Figure, compared to March 2001 when foreign exchange markets were re-liberalised, TL has gained value by almost 40%. [4]

Figure 6. Real Exchange Rate (TL/US$), January 2000:100



Source: *Central Bank of Turkey* (www.tcmb.gov.tr)

Current Account Deficit Gives Alarming Signs

Current account deficit is the most important point of fragility in Turkish economy at the beginning of 2005. While only 1.5 billion dollars in 2002, this deficit first rose to 8 billion dollars in 2003 and then to 15.6 billion dollars in 2004. In national income estimates of 2004, it is estimated that the proportion of current deficit to national income will reach 5.3%.

[4] Although exchange rates of trade partners and rates of inflation should also be considered in real exchange rate calculations according to established definitions, Figure 4 which is derived only on the basis of $ and WPI still gives a meaningful picture on the trend of real exchange rates in Turkey. Any rise of the curve given in Figure 4 means real depreciation.

Current account deficit roughly reflects the balance of the real sector in terms of its foreign exchange transactions with the rest of the world. It consists of such factor income-expenditure items as goods and services traded, remittances by workers abroad, interest payments and profits accrued. In national income accounting, this deficit represents domestic saving-investment deficit.

Table 8. Main items in Balance of Payments (2000-2004, Annual and Cumulative, in million dollars)

	2000	2001	2002	2003	2004	Total
Foreign capital	**16337**	**-2527**	**10574**	**9912**	**22562**	**56858**
Current balance	**-9819**	**3390**	**-1522**	**-8037**	**-15573**	**-31561**
Resident capital	**-3402**	**-1886**	**-3048**	**-2871**	**-9232**	**-20439**
Reserves: increase(-) decrease(+)	**-354**	**2694**	**-6153**	**-4047**	**-824**	**-8684**
Net errors and omissions (NEO)	**-2762**	**-1671**	**149**	**5043**	**3067**	**3826**
Hot money of foreign origin	-410	-12260	-1534	5797	11600	3193
Domestic hot money[1]	-5352	-1846	-1780	4018	-4337	-9297
Hot money balance	-5762	-14106	-3314	9815	7263	-6104
Current account balance/GDP(%)	-4.9	2.4	-0.8	-3.4	-5.3	-3.0[2]

[1] Including NEO

[2] Cumulative (total) current account balance values of the period 2000-2004 ***divided by*** the cumulative GDP in dollars.

Source: *CB Balance of Payment Statistics.*

The first five rows in Table 8 above show the main items of the balance of payments for the period 2000-2004 (in million dollars). The column total of these five items is zero by definition.

Data on the balance of payments suggest that the current account balance that gives deficit in "normal" years, reserves and residents that issue capital outside are offset by foreign capital inflows. The item "net errors and omissions" (NEO) may, as a rule, be interpreted as "unregistered capital movement" of the residents and may also cover some foreign exchange movements where no trans-boundary transaction occurs (i.e. foreign exchange kept "under the pillow"). For three years following the 2001 crisis, NEO is positive and it plays an important role as a factor of external financing. It is clear that these unregistered movements sustainability of which is highly dubious introduce significant uncertainty and risk into the economy.

While focusing on the first two years in Table 8, it will be useful to consider a fact that does not appear in annual and total figures: A part of large capital outflow observed after November 2000 is found in "hot money movements" pertaining to that year, whereas IMF loans obtained after capital outflows (and destructive effects of the crisis) appears in total "capital inflows."

In the balance of payments data of 2004, dramatic increase in the inflow of foreign capital strikes attention. Of this inflow of 22.6 billion dollars, 4.0 billion dollars are those inflows which do not add to external debt (i.e. FDI or portfolio investments for the purchase of shares). Hence, expected increase in total foreign debt is 18.6 billion dollars. However, the increase in total external debt between the end of 2003 and September 2004 appears as 7.4 billion dollars. Upon the finalisation of data at the end of the year, this disaccord may be settled to a large extent, while significant increase in total debt becomes more visible. Meanwhile, throughout the period examined, cumulative current deficit reached 31.6 billion dollars and total foreign debt stock of Turkey increased by 50.1 billion dollars. In this context, it must be stressed that about four-fifths of foreign capital inflow (82.3% in 2004) consists of "debt-creating items" and that the foreign debt stock has assumed an autonomous character, going far beyond the amount of external resources needed for economic growth. In other words, this growth in foreign debt stock is at a pace that is far above the amount of foreign exchange needed to maintain the saving-investment balance of the economy. In case the economy runs into a bottleneck in obtaining foreign debt, the relevant indicator is gross foreign debt and deduction from this amount of receivables by actors in Turkey exporting capital is out of question.

The current account deficit of 2004 is unprecedented in both absolute value and in terms of its proportion to the GDP. There are some who see no problem in this and maintain that the current deficit "is being financed". This is sheer tautology, however. In discussing the sustainability of such a large deficit, it is important to consider to what extent capital inflows which support this deficit consist of short-term, speculative and "hot" (and thus prone to swift leaves) movements. Rows 5-7 in Table 8, give estimates and net balance regarding hot money movements of resident and external nature. The latter component of "hot money" defined as capital movements sensitive to interest/exchange rate arbitrage[5] reached 5.8 billion dollars in 2003 and 11.6 billion dollars in 2004. As to movements of resident nature, they appear as +4.0 and -4.3 billion dollars, respectively, for these two years (under the decisive effect of item NEO). In 2004, -5.8 billion of this total was attributable to the increase in foreign exchange stocks of banks out of Turkey. The net hot money balance is +9.8 billion dollars in 2003 and +7.3 billion dollars in 2004. Any assertion that such a deficit is sustainable for 2005 too has to lean on the "materialisation of what is impossible" or engage in highly optimistic projections on the volume of oncoming hot money inflows.

Growth Process Made Dependent to International Finance Capital

Another point that gives rise to concerns about the growth trend and macro-economic linkages of the Turkish economy is its dependence, to a large extent, to the inflow and outflow of external resources.

Table 9 below makes it possible to examine this dependency *via* three different quantitative variables that reflect external resource inflows. The first is net capital movements of foreign origin (FC in the Table). The second variable is the net balance of capital movements that also includes registered capital movements of residents and net error item (NCM). Finally, the third variable is the net resource transfer (NRT) from national economy, which is defined as current deficit as made free of net interest/profit transfers[6]. The table shows that annual changes in the GDP shares of these variables are influential on annual changes and fluctuations in national income.

An additional indicator that shows *annual changes* in **FC, NCM** and **NRT** as proportions of GDP (in dollars) may be suggested. Any annual *decrease* in external resource inflow will assign negative value to this additional indicator. This may be observed, for example, in net foreign capital inflow (FC) that fell in 2003 compared to the previous year. Hence, this indicator also provides a clue explaining the fall in the rate of growth in 2003 compared to 2002.

---

[5] Domestic hot money movement is defined as the portfolio investments of domestic banks and private sector abroad, foreign exchange holdings and net errors and omissions item of domestic banks and private sector abroad. Hot money of foreign origin, on the other hand, is defined as the investments of foreigners in shares of Turkish companies and state bonds, short-term loans to Turkish banks and private sector (except commercial loans) and their deposits in Turkish banks.

[6] The NRT is actually defined as *current balance minus income account* and any negative value means net resource transfer from abroad to the country in question. In both the text and the table, we used positive values for resource transfer in order to make it easier for readers to follow.

Table 9 thus includes three indicators of foreign resource inflows as proportions of GDP. In 2004 all three indicators increased while the **NCM/GDP** and **NRT/GDP** reaching their highest levels in 2004 for the last five years. Looking at annual changes we observe the **NCM** and **NRT** constantly rising for the last three years. It looks extremely difficult to have external resource inflows which are shaped by speculative and "hot" elements maintaining their 2005 levels or their shares in national income. In case there is net outflow of "hot" elements in capital movements of external origin, this will mean negative growth for the best or a crisis resembling to that in 2001 for the worst.

Table 9. Relationship between External Resource Inflows and Growth

	2000	2001	2002	2003	2004
Foreign Capital (FC)	**16337**	**-2527**	**10574**	**9912**	**22562**
FC/GDP (%)	**8.1**	**-1.8**	**5.8**	**4.2**	**7.7**
Net Capital Movement[1] (NCM)	**10173**	**-6084**	**7675**	**12084**	**16397**
NCM/GDP (%)	**5.1**	**-4.2**	**4.2**	**5.1**	**5.6**
Net Resource Transfer[2] (NRT)	**5817**	**-8390**	**-3032**	**2478**	**10004**
NRT/GDP (%)	**2.9**	**-5.8**	**-1.7**	**1.0**	**3.4**
Growth	**6.3**	**-9.4**	**7.8**	**5.9**	**9.7[3]**
Current Balance/GDP	**-4.9**	**2.4**	**-0.8**	**-3.4**	**-5.3**

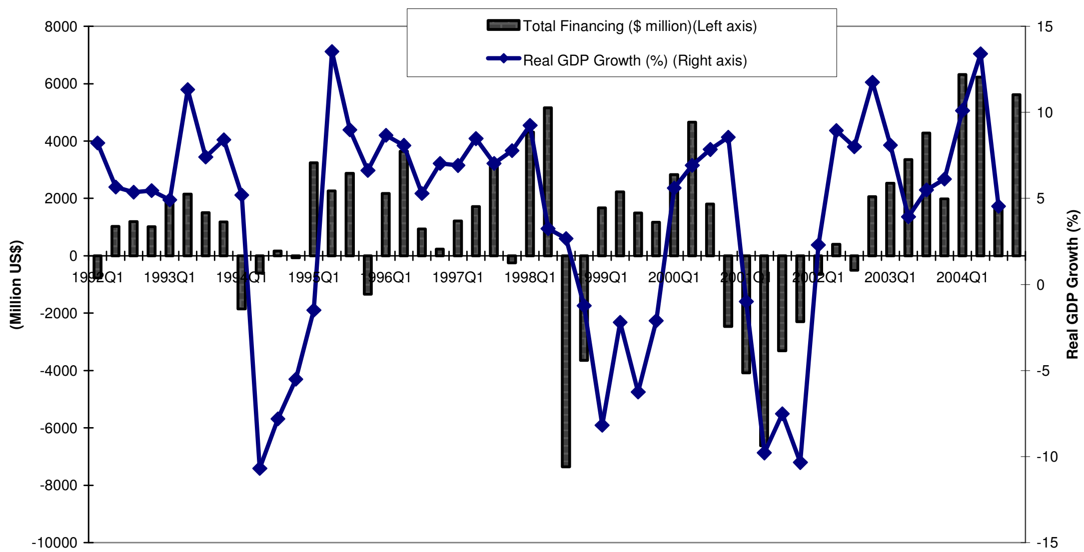
[1] Including NE
[2] Net resource transfer to Turkey from abroad= (Current deficit)-(Net interest + profit transfers abroad). Current surplus is shown with a minus sign and a negative NRT indicates net resource transfer from Turkey to abroad.
[3] Estimate.
Source: *CB Balance of Payments Statistics.*

The last two rows in Table 9 draws out attention to growth/current balance relationship. Leaving aside annual ups and downs, the average rate of growth (logarithmic) in the five-year period covered is 3.2% and current balance/GDP ration shown in the preceding table is 3% (over cumulative figures). These ratios point out significant distortions taking place within the last five years in terms of growth/current deficit relationship. In the sub-periods of 1980-1999, growth rates which mostly remained above growth rates in the period 2000-2004 could be sustained by current deficits which were, on average, lower than 1.5% of national income.

Hot money inflows which make TL overvalued *vis-à-vis* foreign currencies and hence work against Turkey's competitive power in exports also result in increased imports and hot-money driven increases in national income. This wave of speculative nature, however, has never been sustained and consequently each period of expansion (1990-93; 1995-98; 2000) was followed by a crisis (1994, 1999 and 2001).

Figure 7 gives foreign capital inflows as derived from balance of payments statistics and growth in domestic income in quarterly periods from 1992 to 2004. The figure clearly demonstrates the extent to which fluctuations in GDP are triggered by speculative capital inflows and outflows.

Figure 7. Balance of Payments Financing + Net Errors and Omissions (in million US $) and GDP Growth



Source: *Central Bank of Turkey* (www.tcmb.gov.tr)

Hence, short-term movements in national product after 1989 are directly led by capital movements. However, as stated earlier, not each and every increase in national product means any expansion in the productive capacity of the economy. Approached from this point, there is, behind the expansion of 2003-2004, the conjuncture brought about by an inflow of unregistered capital reaching 8.1 billion dollars whose origin is yet to be clarified.

This distortion which manifests itself as falling rates of growth and widening current deficits took place in a period in which developing countries as a block had current surpluses along with the widening foreign trade deficit of the US. The same distortion may also be contributed by other factors including the lagged effects of the Customs Union, overvaluation of TL and structural changes taking place in the composition of foreign trade. Above all, this situation may well be interpreted as the increasing external dependency of the Turkish economy.

Autonomy of the Central Bank and Inflation Targeting

When policies working well in industrialised countries with financial discipline and well established financial markets are suggested to developing economies without any revision, adverse outcomes mostly follow. Monetary policies are no exception to this. In economies with shallow financial markets where short-term flows are used basically to finance public borrowing and where the focus shifts from price and employment stability to mitigation of risks generated by speculative capital, monetary policies would serve their purposes much better if re-shaped by taking account of problems we have mentioned above.

It is also from this perspective that one should look at the "inflation targeting" regime that the Central Bank of Turkey has been engaged in implicitly for the last two years and will be more explicit in it starting from 2005. Other major features of this "inflation targeting" that selects the inflation indicator as the nominal "anchor" include operational autonomy of monetary policies, technical relevance of inflation targeting and transparency in the operation of the Central Bank. After identifying inflation target either by itself or by consulting to other economic actors, the Central Bank aims at clearing out inflation-related uncertainties by informing the public how this target is to be reached and under which unexpected circumstances deviations from this line might be expected. It is figured out that doing away with inflation-related uncertainties would minimise falls in employment that must be endured for pulling inflation down. Certain points, however, need to be discussed in this context.

First of all, discussing economic circumstances that must be in place to adopt any inflation targeting regime is as important as discussing the regime itself. To make this point clear, it will suffice to take a look at a study published in 2002 by the IMF as the most ardent defender of the regime. The study outlines the pre-conditions of inflation targeting under four major headings: (i) ensuring an absolute financial discipline; (ii) well-functioning foreign exchange market; (iii) low level of inflation at the start; (iv) well-established financial markets and maturity of the economy in terms of financial development.

Considering the last period, it is true that the Turkish economy is enjoying a low-inflation environment. This was further encouraged by the US $ losing value in all global markets in an environment where there is easy passage from exchange rates to prices. Nevertheless, financial discipline and the soundness of financial markets are two headings deserving closer attention. Right at this point, special attention must be paid to observations made by Favero and Giavazzi and Blanchard on the Brazilian economy, which suggests similar dynamics with those in Turkey.[7] According to these two studies, in economies where there is high debt stock/national income ratio, low inflation targeting accompanied by tight monetary policies to achieve price stability and high rates of interest will make debt servicing more difficult. In case doubts about this rise further and coincide with a negative external shock (like the US Central Bank tightening its interest policy), short-term capital movements hitherto used in financing current deficit and debt servicing may be lost. Given that pass-through from exchange rates to prices is smooth and fast in developing economies, any depreciation in domestic currency as a result of capital outflow will both jeopardize price stability and also exert negative impact on other macroeconomic variables. Furthermore, in countries like Turkey where total debt stock makes up about 60% of national income, current deficit means a greater risk to the economy. This is why unprecedented rates of current deficit need special emphasis. It must not be forgotten that the combination of high interest /low exchange rate which have become the practical instruments of inflation targeting in Turkey may affect both production and exports negatively.

In the light of these developments, high debt stock in the economy makes it more difficult to follow an independent and effective monetary policy. This also makes it necessary to ensure that debt dynamics are closely followed by monetary policies.

In addition to these "technical" aspects of the issue, it must also be stressed that the interests of an autonomous central bank setting an explicit inflation targeting will coincide most with the interests of finance-capital. Inflation is one of the most significant risks that finance capital having done away with almost all other barriers might face and elimination of this risk is a key to providing full mobility to international financial capital.

---

[7] See C.A. Favero and F. Giavazzi, "Inflation Targeting and Debt: Lessons from Brazil", *NBER Working Papers*, No: W 10390, 2004; O. Blanchard, "Fiscal Dominance and Inflation Targeting: Lessons from Brazil", *MIT Department of Economics Working Papers*, No: 04-13, 2004.

Dynamics of Public Debt

Since 2000, governments in Turkey have focused on a single target in their budget drafts: Managing debts. Technically, this means reducing the proportion of public debts to national income and the only policy that governments have adopted to manage debts is producing primary surpluses. Consequently the *fetish* of governments since 2001 crisis is to keep the non-interest (primary) budget balance, which gives the difference between total public revenues and non-interest expenditures, at surplus a of 6.5% for the whole public sector and 5% for the consolidated budget of the central government as a proportion of national income.

In the IMF projections for Turkey, these budgetary surpluses have to be maintained at least until 2007. Hence, starting from 2000, all public sector budgets in Turkey seem to be bound to yield primary surplus at internationally high proportions in order to manage public debts. In fact, the 2005 budget too follows the same logic.

To what extent has such a budget policy affected the burden of debt? Table 10 below brings some clarification to this question. The total debt of the public sector which was 160.6 quadrillion TL at the end of 2001 jumped to 272.5 quadrillion at the end of the third quarter of 2004. The net debt of the public sector is calculated in financial statistics as gross debt *minus* net assets of the Central Bank, *minus* public deposits, *minus* net assets of unemployment insurance fund. These last three items known as "net assets of the public" was, according to data in Table 10, 30.0 quadrillion TL at the end of 2002 and increased to 56.7 quadrillion TL at the end of the third quarter of 2004. Therefore, the gross debt stock of the public which is actually 329.3 quadrillion TL is adjusted downward by the assets item we have just mentioned.

Table 10: Public Debt Stock (in TL quadrillion)

	2001	2002	2003	2004 (II)	2004 (III)
Total Public Debt (Net) ((1)-(2))	160.6	216.4	251.4	265.4	272.5
(1) Total Public Debt (Gross)	190.6	257.6	297.7	318.2	329.3
Domestic Debt	125.5	154.8	201.3	215.9	224.5
of which, Consolidated Budget	122.2	149.9	194.4	209.2	217.6
Foreign Debt	65.1	102.8	96.4	102.3	104.8
of which, Consolidated Budget	55.8	92.9	88.5	94.4	97.2
(2) Total Net Assets of the Public Sector	30.0	41.2	46.2	52.7	56.7
GNP	176.4	275.0	356.7	384.4[1]	403.8[1]
As a Proportion of GNP (%)					
Total Public Debt (Net)	91.0	78.7	70.5	69.0	67.5
Total Public Debt (Gross)	108.0	93.7	83.5	82.8	81.6
Domestic Debt	71.1	56.3	56.4	56.2	55.6
of which, Consolidated Budget	69.3	54.5	54.5	54.4	53.9
Foreign Debt	36.9	37.4	27.0	26.6	26.0
of which, Consolidated Budget	31.6	33.8	24.8	24.6	24.1

[1] Annual.

Source : Undersecretariat of Treasury (*www.treasury.gov.tr)* ; Central Bank of Turkey, *(www.tcmb.gov.tr).*

The most important items in public debt stock are the amounts of internal and external debt in consolidated budget. Consolidated internal debts rose from 154.8 quadrillion TL in November 2002, when the new AKP government took office, to 224.5 quadrillion TL according to provisional results relating to 2004. Within the same period, consolidated foreign debt stock increased from 92.9 quadrillion TL to 97.2 quadrillion TL.

The IMF and government maintain that the net public debt stock is decreasing in its proportion to national income. Indeed, Table 10 shows that this proportion receded from 78.7% in 2002 to 67.5% during the AKP government. But such a comparison may be extremely misleading, since the 11.2 percentage points fall in net public debt burden may almost entirely be attributed to 12.8 percentage points fall in foreign public debt burden. Net internal debt stock, on the other hand, remained around 56% in its proportion to national income and even displayed a slight increase by 1.6%. It is clear that in a period when national income displays an extraordinary growth, internal debt stock keeps up with this pace. In other words, the government has only succeeded in maintaining internal debt burden constant rather than actually reducing it.

Meanwhile, the *external debt* stock of the public sector is rising in terms of foreign exchange. Data in Table 11 shows that the external debt stock of the public sector increased from 70 billion dollars immediately after the 2001 crisis to 89.2 billion dollars in the third quarter of 2004. That is, there has been 27% increase on US dollar basis within 3 years. Meanwhile consolidated budget external debt stock almost doubled on dollar basis in the same period while total external debts of Turkey including that of the private sector increased from 113.9 to 153.2 billion dollars.

Table 11: External Debt Stock of the Public Sector ($ billion)

	2001	2002	2003	2004 (I)	2004 (II)	2004 (III)
Total Foreign Debt	113.9	130.4	145.8	145.2	148.1	153.2
Total Foreign Debt of the Public Sector	70.0	84.3	91.8	89.3	88.7	89.2
of which, Consolidated Budget	38.7	56.8	63.5	62.6	63.5	64.9

Source : Undersecretariat of Treasury (www.treasury.gov.tr)

The fact that the increase in external debt burden remains limited on TL basis while increasing in US $ basis needs no other explanation than the relative cheapness of foreign exchange (overvalued TL). This relative cheapness of foreign exchange conceals the threat posed by external debt and gives the false impression that some improvements are taking place in country's total debt stock. Yet, coupled with internal borrowing that maintains its earlier levels, this alarming increase in external borrowing will generate a total debt stock big enough to exert serious influences on the course of the economy.

This persisting pressure of debt in spite of highly favourable growth conjuncture and extraordinary measures to curtail basic public services raises concerns that Turkey will soon have to go through a new ordeal in terms of her public sector balances.

Consolidated Budget 2004

It has been reiterated in official documents over and over that the first priority of the fiscal policy is to ensure the financial discipline required to reduce (internal) debt stock down to manageable levels and reach a primary surplus for maintaining macroeconomic balances. Given this stance, we can state that a surplus corresponding to 6.5% of GNP is taken as an "anchor" in budgetary/fiscal policies.

The State Planning Organisation is mandated to plan for the resource utilisation and growth of national economy and monitor the balance between resources and expenditures. The *2005 Programme* of the SPO states its macroeconomic targets as follows: "pulling inflation further down while maintaining economic growth, ensuring the achievement of primary surplus by enforcing fiscal and monetary discipline and reducing total debt stock by maintaining the sustainability of public debts." In this context, "the basic objective of the fiscal policy is to reach programme targets and maintain the sustainability of public debts." (Official Gazette no. 25629, dated 31 October 2004). In fact, officials state that arrangements envisaged by the 19th stand-by agreement covering the period 2005-2007 which is currently presented to the approval of the IMF Executive Board make up a programme for getting out of extreme debt and instability.

The *sine qua non* of this financial "recovery" and "success" of the programme is fiscal discipline and, therefore, that budgetary surplus of 6.5%. Hence (i) consolidated budget is shaped up by the ongoing programme; (ii) fiscal policy is rendered passive, as a tool tailored for debt management. In other words, the process for the full phasing-out of fiscal policy is in progress. The thesis that tightening budgetary/fiscal policy is reconcilable with growth is put forward without questioning the sustainability of a speculation-led growth.

Indeed, estimates related to the realisation of the consolidated budget of 2004 point out that personnel, investment and social expenditures have been pulled down to a minimum. This means as few investments as possible, lower wages and salaries, and liquidation of the domain of public/social services. Taken as a whole with "structural reforms", this strategy has so far led to both qualitative and quantitative erosion in public services, commercialisation of this sphere and pushing the majority of the working people and retirees down to poverty line. Data on consolidated budget confirm these inferences. In terms of expenditures, it is observed that budget size/GDP ratio is down at 33.1%. However since interest payments are made equal to 13.3% of GDP, budget with the exclusion of interest corresponds to a share of 19.8%, which is lower than the 2003 share of 23.0%. In line with the programme adopted, total consumption and investment expenditures of the budget related to real economy make up 32.0% of total expenditures for the last few years. This means that the state has clearly abandoned the policy of inducing domestic demand and employment through its budget (Table 12).

To make a comparison, it may be useful to remind that this ratio was 60% in 1989 and 65% in 1978. As a matter of fact, the shares of personnel expenditures and investments in the 2004 budget turned out as 20.6% (23.5% including state contributions to social security institutions) and 5.7%, respectively. Considering that interest payments make up 40.3% of total budget and 13.3% of GDP, the function of the budget becomes clear in numerical terms as well. The ratio of total budget and tax revenues to the GDP is 25.9% and 21.2%, respectively. All this 62.7% of total tax revenues are earmarked for interest payments; 33.6 quadrillion TL that remains from tax revenues and other budget revenues totalling 19.8 quadrillion TL are used to finance all budgetary real expenditures and other transfers by the state. So the 2004 budget figures confirm once more that the state is focused mainly on interest payments, swiftly dismantling its social character and even giving up its "primary" functions as envisaged by the classical economic theory. In spite of "tight" budgetary policy and keeping expenditures other than interest payments at lowest possible level, there is still no balance but a deficit, giving the consolidated budget deficit for the year 2004 as 7.1% of GDP. Meanwhile, the primary surplus reaches 6.2%, even higher than what has been foreseen (5.0% is the primary surplus ratio as defined by the IMF).

In relation to public finance, official authorities as well as other defenders of the programme in implementation keep asserting that there have been relative improvements in ratios relating to consolidated budget after 2001. Taking the crisis year 2001 as base, it is not surprising to see that relative improvements have actually taken place after such drastic measures. Relative improvements in such ratios as budget deficit/GDP, public deficit/GDP, interest payments/GDP and interest payments/tax revenues derive partly from rapid growth in GDP and partly from falls in nominal rates of interest. While in 2003 the Treasury used to borrow at an average nominal compound interest rate of 45.3%, this fell to 26.6% in 2004 while average real interest remained as high as 14.0%. In 2004, hot money movement based on interest/exchange rate arbitrage was the critical factor making speculation-led growth possible. This means the public finance/budget keeps paying for high real interest rate policy. In fact, data relating to Treasury financing indicate that total debt servicing in 2004 reached 183.9 quadrillion TL. 29.5% of this total consisted of interest payments. The share of domestic debt servicing in total debt servicing is 91.2%. In total financing, domestic borrowing, external borrowing and primary surplus have their shares as 80.7, 6.0 and 13.3%, respectively. The ratio of refinancing around 88.4% can describe the situation in domestic debt management. All these point out to the continuance of domestic borrowing without any slow down and place of primary surplus in debt servicing programme.

Another important point relates to the nature of consolidated budget revenues and tax revenues as a constituent of this item. At the end of 2004, consolidated budget revenues reached 109.9 quadrillion TL and tax revenues 90.1 quadrillion TL. Following the crisis, that part of expenditures financed by budget revenues and taxes continued to increase. However, in 2004, the primary surplus which turned out to be 29.5% above what had been anticipated as a result of nominally increasing budget revenues and especially of pressures on public expenditures could finance only 46.3% of total interest expenditures. Hence there was a rather high budget deficit reaching 21.6% of the total budget.

A closer look at increases in budget and tax revenues allows us to reach some plain but significant conclusions. Budget revenues, which totalled to 100.3 quadrillion TL in 2003 increased to 109.9 quadrillion TL in 2004 while tax revenues increased from 84.3 quadrillion TL to 90.1 quadrillion TL in the same period, denoting increases of 9.6 and 6.9% respectively. However, this increase in revenues remained below average price increase. It shows that sufficient increase in revenues could not be achieved even in a conjuncture of high growth. The SPO expects budget revenues corresponding to 25.9% of the 2004 GDP, which is estimated as 424.1 quadrillion TL and tax revenues corresponding to 21.2% of the same figure. Both of these are lower than what turned out in 2003.

Absolute increases in budget revenues do not originate from any improvement in tax revenues. In fact, miscellaneous non-tax revenues turned out to be 183% higher than what had been targeted, yielding 4.0 quadrillion TL instead of 1.4 quadrillion TL. While only "symbolic" revenues were expected in the grants and assistance item, this item yielded 0.8 quadrillion TL. Annexed budget revenues were 127% above the target.

There are various reasons explaining why tax revenues cannot be raised to the desired level. These include inefficient tax administration, poor supervision, lack of relevant "ethics" and large size of informal economy. However, the correct answer must be sought in the accumulation model and relationships between financial and political power circles. The financial accumulation model that makes up one of the building blocks of speculative growth precludes, as a result of its very inner logic and mechanisms, any sufficient taxation of financial gains and the system as a whole encourages informality and tax evasion. In the face of extreme inequality and injustice in income distribution, the system of taxation further distorts these, let alone bringing any relative improvement. Indeed, personal income tax brackets and corresponding ratios, existence of corporate tax only in theory, lack of any real wealth tax and weight given to indirect taxes all add up to cut total tax revenues shorter than what it could be. Furthermore, continuous pardon of tax penalties covering not only those failing to pay their taxes but also others submitting intentionally falsified documents to evade tax naturally weakens the dissuasive nature of existing sanctions.

The make up of budget revenues in 2004 in general and tax revenues in particular clearly demonstrates that the present system of taxation runs counter to the principles of equity and fairness. The combined share of special consumption tax (ÖTV), domestic VAT and income tax on wages makes up 61.8% of total tax revenues in 2004. This further rises to 79.2% if VAT on imports is also included. To compare, we can mention that the share of corporate tax is 9.7% and tax on banking and insurance transactions is 1.6%. Taxes on wages and salaries constitute 89.7% of all income tax revenues. All these point out that total tax revenue rests mainly on the taxation of wage and salary earners, and ÖTV and VAT, both of which are indirect. So while working people are left under the pressure of taxation through ÖTV and VAT, financial rent and profit are both tolerated to be left untaxed. All these show that the adjustment of the system of taxation to what we call speculation-led growth model leads to many economic and social problems.

In 2004, the "success" of the tight budgetary/fiscal policy that focuses on high primary surplus and fiscal discipline geared to the sustainability to domestic debt cannot be assessed by looking at indicators relevant for the crisis year (2001) and its aftermath. The public budget shaped by exclusively considering interest payments proves that not only employment and social policies but also the production and provision of public goods and services have mostly been abandoned. Indeed, during the reign of neo-liberal policies and in 2004, governments seem to have freed themselves of their obligation to deliver public services by commodifying and privatizing this sphere. Furthermore, arrangements made in 2004 and envisaged for 2005 demonstrate the determination of the present government to effectively liquidate such concepts as "public benefit" and "public service." Yet, these are the very concepts that have hitherto served as the essence of public finance. Despite this, payments made out of this tightened budget based on interest payment and privatization priorities have not brought along any reduction in total debt stock. To the contrary, debt stock in consolidated budget has risen in both TL and dollar terms (see Table 10).

Table 12: Proportions in Consolidated Budget (%)

	1988	1989	1999	2000	2001	2002	2003	2004[1]
Budget Expenditure/GDP	20.4	16.9	35.9	37.2	45.7	42.3	39.4	33.1
Real Expenditure/Budget Expenditure	65.7	57.9	38.2	34.5	30.5	32.9	32.5	32.0
Budget Revenue/GDP	18.8	13.2	24.2	26.6	29.2	27.5	28.1	25.9
Tax Revenue/GDP	15.0	11.1	18.9	21.1	22.5	21.8	23.6	21.2
Expenditure Except Interest /GDP	19.9	13.3	22.2	20.9	22.4	23.3	23.0	19.8
Tax Revenue/Budget Expenditure	73.4	65.7	52.7	56.7	49.3	51.5	60.0	64.3
Budget Revenue/Budget Expenditure	92.5	80.7	67.4	71.6	64.0	65.3	71.4	78.4
Budget Deficit /GDP	1.5	8.2	11.7	10.6	16.5	14.7	11.3	7.1
Total Interest/GDP	0.5	3.6	13.7	16.3	23.3	19.0	16.4	13.3
Budget Balance Except Interest /GDP	- 1.0	- 3.3	2.0	5.7	6.8	4.3	5.2	6.2
Total Interest/Budget Expenditure	2.1	21.2	38.2	43.8	51.0	44.8	41.7	40.3
Total Interest/Budget Revenue	2.6	26.3	56.6	61.1	79.7	68.6	58.5	51.4
Total Interest/Tax Revenue	3.0	32.3	72.4	77.1	103.3	87.0	69.5	62.7
Personnel Expenditure/Budget Expenditure	35.3	32.3	24.6	21.4	18.9	20.0	21.5	20.6
Investment Expenditure/Budget Expenditure	20.4	15.0	5.5	5.3	5.1	6.0	5.1	5.7

[1] The SPO estimate is used for the GDP of the year 2004.

Source: Data provided by the Treasury and Ministry of Finance.

4. THE TRUE CHARACTER OF STRUCTURAL ADJUSTMENT PROGRAMMES

Reform in Public Administration

Another process which almost immediately summons the character of the AKP government is so-called "Reform in Public Administration" accompanied by a set of concepts including "regionalisation", "strengthening the local organisations of the government", "transparency", "performance evaluation", "vision-mission studies", etc. The process of reform in public administration, however, had not started with the AKP government, and in our opinion, will not last with that either. The process of reform which targets a comprehensive administrative transformation within the framework of WB, OECD and EU norms is evaluated by the AKP as an opportunity through which it can lay the building blocks of its country-wide political organisation.

Looking closer, we see that the essence of the reform is to introduce a new sharing of authority by the central government and local governments and to authorize both to devolve public services to private persons and companies. In the present system of administration, the central government bears the primary responsibility (legislatively) in terms of content and geography, whereas local governments are authorized to address relevant issues in their specific locality. The reform process targets to alter this radically by limiting the authority of the central government, by specifying its tasks and widening that of local governments, and by assigning them all functions that remain out of the restricted domain of the central government. This clearly runs counter to the structure envisaged by all Constitutions since 1924 as well as to the very spirit of public administration in Turkey. The central administration and hence governments that hold the primary authority to extend public services are divorced of this authority and pertaining tasks under the pretext of "localisation", "democratisation" and "improvements in service quality." This paves the way to the further privatisation of public service provision and transfer of larger resources to sub-contractors and municipalities over public services provided.

It must not be forgotten that the concept "democracy" gains its meaning *vis-à-vis* the State and the public. It is therefore nothing else but deliberate distortion to portray services left to market dynamics and evaluated through market criteria varnished with such concepts as democracy and democratisation. What is going on is merely privatisation or ***"depriving people of means of social solidarity."***

The same is true if we look at the personnel and supervision dimensions of the reform. Under such slogans as "performance evaluation", "vision-mission studies" and "improvement of service quality", the envisaged personnel and financial control system seeks to prepare the environment necessary for the delivery of public services through market actors and in market conditions. In the Turkish public personnel regime, it is essential that public services are delivered by public servants. The new reform package, however, makes short-term contractual service a norm while regarding permanent public service merely an exception and therefore indicates the abandonment of the notion of "social state" where the public sector acts as a regulating force by influencing market actors with its models of secure employment.

In the present public administration model of Turkey, the service provision rationale of the public sector goes together with the employment status of public servants in terms of job security. Such a model doubtlessly has its impact in market-oriented employment models of the private sector and therefore also has its economic consequences. These are all indirect influences, however. In assessing the need for and scope of public services to be provided and the performance of public servants, there is a need to consider a range of social, political and economic pros and cons, establish priorities and strike a balance betweens pros and cons. Furthermore, it is not possible to put many social and political benefits in monetary terms. It will therefore be misleading to assess the employment in the public sector with reference to economic criteria only.

The underlying principles of this public personnel system imposed through the set of reforms can be found in the US model of "position classification". In the process which may be called the "Americanisation of the world", it seems that the personnel regime in Turkey too has been accorded its share. The new system imposes a "job-based" approach, where public servants are to be employed for specific jobs of specific duration and dismissed upon the completion of tasks pertaining to these jobs. This is a shift from permanent to shorter term contractual personnel regime where the job security in public service is compromised. It is clear that this model fits well to the aspirations of the AKP motivated by political "cadre-building" especially through municipalities and local governments. However, the basic question that the AKP is far from answering is "whether the country would accede to this model without any turmoil."

As ISS, we think that the "Reform in Public Administration", steered simply by narrow political interests without elaborating its possible consequences, will push Turkey into an irremediably difficult and destructive avenue.

Another important pillar of the reform package is the process by which the public sector will be left to the supervision of international auditing firms. An interesting example of this can be found in the draft relating to Financial Inspection Boards. These boards which have a tradition of public service for more than a century have been the guarantee of transparency in its real sense. These boards are appointed through compound-decree which enables them to lean on the state rather than government alone in their duty. The draft intends to eliminate these boards. The alternative mechanism referred to as "internal auditing" is the start of a fully "political" process of supervision and auditing since inspectors will then be appointed not through compound-decree but solely by relevant ministries. This type of "transparency" essentially targets "politicisation" and "leaving the public out of the reach of any supervision." The Court of Accounts is another prestigious state body in Turkey. It is presented as the main body in charge of external auditing with its seemingly enhanced powers. Yet this body can presently audit only 13% of the transactions of organisations and agencies within its duty domain. In this case, limiting the task of auditing only to the domain of this body is tantamount to the abandonment of the duty of auditing by the State. It is an enigma how the AKW will fight corruption while, at the same time, further limiting and/or politicizing the task of auditing.

In an epoch in which neo-liberal governments rule in many countries, this public administration reform overlaps with the targets of the AKP as an adherent to this ideology. The ultimate objective is to deprive people of any remaining channels of security, do further away with what is public, surrender all public spheres to the private sector mentality treating the state itself as a "cooperation" and to help the private sector dominate in all these spheres.

In our view, this line will be of no cure to the problems of the country and people who are already trapped by poverty and extremely unequal income distribution.

Programme for Transformation in Health

For the last 20 years, the Turkish society has been imposed a schedule through which steps are being taken to fully commercialize the health sector. Of course these steps have not followed a straight line and various reasons may be called in to explain this. Nevertheless, we should admit that significant distance has already been covered in knocking down the system of public health and achievements in this field, however insufficient may they be. It will suffice to cite few facts to make the present state more visible: Personal expenditures on health reaching one-third of total spending for health; the Ministry of State as a government unit doing nothing more than paying salaries let alone any investment in health; hospitals that can sustain themselves mainly on revolving funds; low wages for health workers; encouragement of private health institutions; introducing fixed-term contractual recruitment as the dominant mode of employment in the health sector as well and full sub-contracting/privatisation of support services in the health sector…

Considering all these facts, it is possible to conclude that the perception of health services as a social right is being destroyed by the commodification of related services. The single party rule of the AKP came upon this ideological ground. In other words, the process of "destruction" had already matured to a certain level for the AKP to undertake a process of full restructuring.

The position of the AKP is well accounted by the assessment of a WB mission who had discussions with health sector executives of the ruling government in early 2003: "They well know what to do, but not how to do it."

It is clear that the statement "They well know what to do" means nothing else but "We have assigned them some tasks." The problematic point or "how to do it" is related mostly to this party's messages to the poor during electoral campaigns and to the fact that the party follows the very same line in spite of popular reaction to the IMF submissive line of the earlier coalition government. Starting from the second half of the 80s, the outcomes of recipes given by the WB in relation to the health sector have become more visible and documented: rise in the incidence of diseases going untreated; lesser use of health services; impoverishment in longer term and increase in cases of uninformed medicine use. The WB formula which is essentially based on the commercialisation of health services and user fees ultimately plays against the poor and health status of working people. The AKP has undertaken the task in the face of these clear outcomes.

The AKP knew well that one of the tasks assigned was "to ensure stability" in Turkey along lines drawn by the WB, IMF, other international agencies and local bourgeoisie dependent to international capital. What was meant by "stability" was merely to sustain the cycle of borrowing and repayment. This, however, was possible only by allocating a larger part of taxes mainly collected from working people to debt repayment. Since tax revenues would be first channelled to debt amortisation and interest payments, all other "burdens" on public finance should be mitigated, or, whenever possible, removed. Social security in general and health protection in particular was such a "burden" even in its much reduced share in the 2003 budget. So there was need to avoid any health financing model based on the general budget. The solution would be to place the burden of funding to individuals/working people.

It was after these considerations that the government decided to accelerate the process of restructuring in health by capitalising on advantages of being a single-party government, by the atmosphere imposed upon working people and by additional efforts in disorganising the public sector.

2004: Year of New Projects in Health

The AKP government spent the first three quarters of 2003 in preparations of "how to do it." The process started with a government communiqué relating to the referral of civil servants to private health institutions and then, on 1 July 2003, a protocol was put into effect by the Ministry of Health and SSK (Social Security Institution). After these initial steps, the following were introduced within 2004: modifications in relevant regulations to establish fixed-term contractual employment of physicians, presented as the "repeal of compulsory service obligation" and to prepare the ground for sub-contracting in provision of health service; performance-based remuneration covering health workers; modifications in the Basic Law on Health Services so as to authorize the Ministry of Finance to sell institutions under the Ministry of Health; transfer of health institutions (except those active under the Ministry of Defence and Universities) including the SSK to the Ministry of Health; legislative arrangements making it possible to charge for diagnostic and curative health services offered by public institutions and introduction of the Law on Pilot Implementation relating to family based medical services accompanied by "good news" to SSK members that now they can apply to any pharmacist with their prescriptions (starting from 10 February 2005).

All these changes starting in 2003 and continuing throughout 2004 should be seen in the context of three basic rearrangements: *Public Administration Law, General Health Insurance* and *Draft Law on Health.*

Before going into details it may be useful to explain what all these mean. Since, in the field of health, a system based on premiums is planned and since, in such a system, the bulk of burden will fall upon working individuals, there is need to make civil servants ideologically submissive and receptive to the new system as a group upon which the burden can be placed without much reservation. Exploiting the long-established image of "good private hospitals vs. bad public hospitals", civil servants were given the "opportunity" to benefit from private health services with the government communiqué on the "Principles and Procedures Relating to the Referral of Patients to Private Health Institutions for Diagnostic and Curative Purposes." Therefore, at present, there is some transfer –yet limited- of resources to the private sector. However, the crucial point in this process is that the contributions by the state were to be kept limited and individuals should be paying higher fees more from their personal budgets to close the gap and to reach "higher quality" medical services.

Accordingly, the "catalyst" for a General Health Insurance Scheme was in place with a wholesale assault on the ideological front. This process was further consolidated by a paragraph added to Article 209 of the State Personnel Law No. 657 providing for the access of civil servants to health care services (this paragraph envisages that all public health care services should charge patients for services they deliver). More specifically, the paragraph was about "the Ministry of Finance establishing principles and procedures, in consultation with the Ministry of Health, in regard to that part of the cost of health services to be covered by the governmental organisation where the patient concerned is employed." (See: the Law No. 5234 on Amendments to Certain Laws and Decrees-by-Laws."

Although there is yet no clarity as to the practical outcomes of the protocol foreseeing the joint use of hospitals attached to the Ministry and SSK, fashionable arguments before the public included those such as "end of queues in SSK hospitals", "SSK members now getting their chance to apply to private health institutions like civil servants" (!) and "possibility for SSK members to buy their medicines from any pharmacy shop."

The SSK is a scheme that delivers low-cost services to a large mass of people and that may be the most serious obstacle to the commercialisation of health services in both practical and legal terms. Thus, its collapse will have critical consequences. It is for this reason that while the issue of medicines and their provision was in agenda, there was simultaneous drafting of the Law No. 5220 on "Amendments to the Law on Health Services" which authorised the Ministry of Finance to sell health institutions attached to the Ministry of Health, followed by another legislative act on the transfer of SSK hospitals to the Ministry of Health. This is a process which may end up in legal bottlenecks that may later be eased by the motto "what is done is done." It is well known that the basic aim is not to bring health institutions under a single administration.

Meanwhile an operation was launched against health workers who presumably constituted a "bad example" both with their large numbers in the public sector second only to education and their job security. Firstly, physicians were given "good news" that compulsory service obligation would be lifted and then arrangements were made to employ physicians on contractual terms on the ground that the public sector had no obligation to employ all physicians whose numbers were increasing by years. After a year, this was followed by a tendering scheme which made it possible to sub-contract all health care services and to "hire" physicians and nurses through public tenders. With all these steps, health workers are now placed in settings where there is no job security and where it is quite difficult to speak about the right to organise.

In 2004, the performance-based remuneration system was introduced in all institutions attached to the Ministry of Health through a directive on extra payments from revolving funds. Under this directive, physicians are to be given points for services they deliver and the performance of each physician is to be evaluated upon these points. This practice which completely disregards the specific nature of health care service further weakens solidarity among health workers and gives rise to a situation which is ethically questionable. The target is to come up with health workers who have lost their self-confidence and dignity and are ready to work for less in the medium-term (as a counter measure for possible resistance by health workers, there are various new drafts to contain the actions of the Turkish Medical Association and also lawsuits have been brought for the union-wise activities of the Association).

The family health care system is a scheme which essentially introduces a market-oriented character to what is called "first step" in the delivery of health care services. A law has already been passed to launch a pilot scale implementation of this scheme. This lays the ground for a competitive environment where physicians will deliver their services while upholding their concerns for "keeping clients" since the scheme as a whole tends to over-utilise medicine and medical technology. Public health and associated preventive services will be made prey to a chaotic environment and fragmentation where the slogan "as much as it can be done" will rule for the best. The three basic arrangements/drafts mentioned above are expected to give "meaning and context" to what have been done so far and to bring the pieces of a puzzle together.

Taken together, these arrangements define each unit in health care service delivery (whether at first or secondary level) as an agent competitive or bound to compete in a market-oriented environment. And they oblige citizens who already pay their taxes to pay for health care services through personal contributions (i.e. additional taxes). It is only under these conditions that citizens may find themselves "insured" by any scheme. However, this guarantee offers the least as health care service and only guarantees suffering without death. It appears that the present health insurance scheme, including the SSK in the first place, will soon be inaccessible for many. In any case, provisions in new draft laws warn citizens that they may be ineligible for insurance if they fail to pay attention to their personal health! Beyond this minimum package of guarantee, citizens are of course free to subscribe to supplementary insurance schemes by using their personal incomes.

To sum up, the AKP government seeks to solve the problem of the financing of health services by deducing premiums as contribution from the incomes of working people. Those who are poor, that is, people whose living standards remain below the minimum, will have the state paying for their premiums (Draft Law on Payments without Premium, 17.12.2004). The "minimum standard of living", according to the same draft, is to be set at a level not to exceed the half of minimum wage. Hence, persons not covered by this category can have no health services unless they pay their premiums. The public health threat here becomes clear if one considers that one-fifth of population in Turkey has not been covered by any health insurance.

The new Public Administration Law foresees the abolishment of the provincial organisations of the Ministry of Health. The accompanying Health Services Law envisages family medicals taking over the primary health care services, whereas secondary services are assigned to health facilities which are to be transferred to provincial administrations. So, this new organisational scheme is expected to employ contractual health personnel and relieve the public sector from the burden of sustaining an "excessively large" workforce in the health sector.

Of course, such a consensus on steps that will threaten the health condition of people in Turkey has its "sound" justifications. In addition to what have been stated above as directly related to policies adopted, total spending in medicines and medical technology are both increasing in Turkey. The share of spending on medicines exceeds 30 % of total spending on medical care against 10-15 % which is considered normal. Similarly, the importation of medical materials is also on rise. Potential returns from "commercialised" health services and existence of a market of 15 billion dollars will naturally seem lucrative to the private sector. Hence there is need to eliminate such schemes as the SSK which, with its 148 hospitals, has a big hand in the market for medicines and potential to reduce the volume of private transactions. This is what actually lies behind the transfer of SSK facilities in the early 2005.

As of the early 2005, the government has brought health facilities together under its hand to turn them into "market agents." This gathering is for the purpose of fragmenting them for good, if possible. The right to health care, which is the achievement of decades of social struggle despite some erosions taking place lately, is now being replaced with market choices of "clients" with purchasing power.

Public Health Problems Turkey is Facing as This Transformation is Imposed

Public health problems are mostly defined as states of ill health that kill, debilitate and threaten the well-being of people. In other words, domestic and external debt burden on the majority of people, regional armed conflicts and emergency situations are all public health problems that Turkey will be facing in the near future. Inequalities constitute the common denominator of all these. No social policy can bring along any positive transformation in health, unless it addresses the problem of inequality. It is, on the other hand, possible to bring this positive transformation out by intervening through social policy preferences favouring the majority of people. In practice, this means opting for the general budget as the most egalitarian instrument in financing and structuring service provision not through competition but solidarity. It is, however, clear that a human resources planning and service provision model that truly upholds health as a basic human right rather than a favour, as well as solidarity on the basis of organised workers will not sound plausible to "markets" that the AKP is striving to represent.

5. CONCLUSION: ON THE NATURE OF THE IMF PROGRAMME

The IMF programme above all targets the repayment of debts by Turkey. In line with this overall target, the underlying approach of the programme is based on arrangements which are assumed to induce the "confidence" of international financial markets. Accordingly, Turkey is now bound to prove that it has a "reliable" and emerging market economy by following restrictive fiscal policies (avoiding any "populist" expenditure) on the one hand and by giving effect to "structural reforms" to reshape her ties with international capital on the other.

The existing "stabilisation" measures programmed and supervised by the IMF is the direct outcome of this logic. The *Programme for Transition to a Strong Economy* developed in May 2001 in line with this logic as well as the macroeconomic targets of ensuing *Letters of Intent* focused on creating primary surpluses in the budgets equivalent to 6.5 % of national income to curb this debt cycle and restore the confidence of "markets". Now, under the new *stand-by,* this target will be kept until 2007.

Top-level staff from the IMF and Turkey announced in December 2004 that they reached a consensus on a new agreement covering the period from 2005 to 2007. The precondition to this agreement was the submission of three structural adjustments to the Grand National Assembly for ratification. These structural adjustments were as follows: The "Social Security Draft" which consists of four different draft laws fully reshaping the existing social security system; the "Draft on Revenues Administration", which intends to make the administration of revenues semi-autonomous from the Ministry of Finance and the "Financial Services Draft" which will arrange the whole system of finance. In February 2005, when the present study was in progress, these drafts were yet to be presented to the Parliament due to delays stemming from some hesitations on the part of the ruling government.

This delay as well as some statements made by the Prime Minister on additional agricultural support schemes and expansion of investment incentives led some low-level IMF staff to warn about the need to "stick to financial discipline." A stronger emphasis on the part of the IMF came from IMF Deputy President Krueger who made a speech at Stanford University in the US in February 2004: "There is still way to go to be complacent that the progress in terms of growth and stability is well grounded enough. Strong fiscal control is a key to stability and this must continue. It is because, in Turkey, net public debt/GDP ratio is still around 70 % and external debt/GDP ratio is around 60 %." (*Hürriyet*, 12 February 2005). It was Mr. Vorking, the World Bank Representative to Turkey, who supported this demarche: (The new draft on incentives) is not directly of interest to the WB for the burden it will bring on the budget. But it is related to our business indirectly since it constitutes an issue to be addressed by the new *stand-by*…if all are accorded with incentives, this is not an incentive system." (*Hürriyet*, 22 February 2005). Further, during his speech at the Seminar on the Evaluation of Social Security Draft Laws organized by the TİSK Mr. Vorkink said "it is just the time for reforms", also adding that tough negotiations would take place in this process and the outcome might not please *all* (*Cumhuriyet*, 23 February 2005; it should not be difficult the infer that the word in italics means 'working people').

At this point, it is essential to explore the true nature of the earlier and present financial support programmes of the IMF and structural adjustment loans forwarded by the Bank. In fact the programme which has been in agenda since 1998 under such headings as *"Staff Monitoring Agreement", "Disinflation Based on Exchange-Rate Anchor", "Transition to a Strong Economy"* or *"18th and 19th Stand-by Agreements"* as well as accompanying WB orientations have reasonably clear objectives. This programme is part and parcel of the neo-liberal project that aims to impose a specialisation in labour-intensive and low-technology sectors in international division of labour; to dissolve the public sector under the pretext of “localisation” and “democratisation based on civil society organisations”; commercialise basic services such as health and education under profit-seeking motives of private sector and to make the most basic needs of the society open to the exploitative initiatives of both national and international capital. Above all, this project brings along open threats to the economic and political independence of Turkey and to the gains of working masses achieved since the 60s.

Consequently, our present stance against this programme monitored jointly by IMF and WB derives from our concerns to maintain our economic and political independence as well as social rights and gains of working masses. The problem is neither that of “economic stability” in its narrow technical sense, nor “what the investor gained or lost in stock exchange-interest rate-exchange rate triangle.” The problem relates to Turkey’s status as a dignified member of international community with a sound economy and uncompromising political independence.

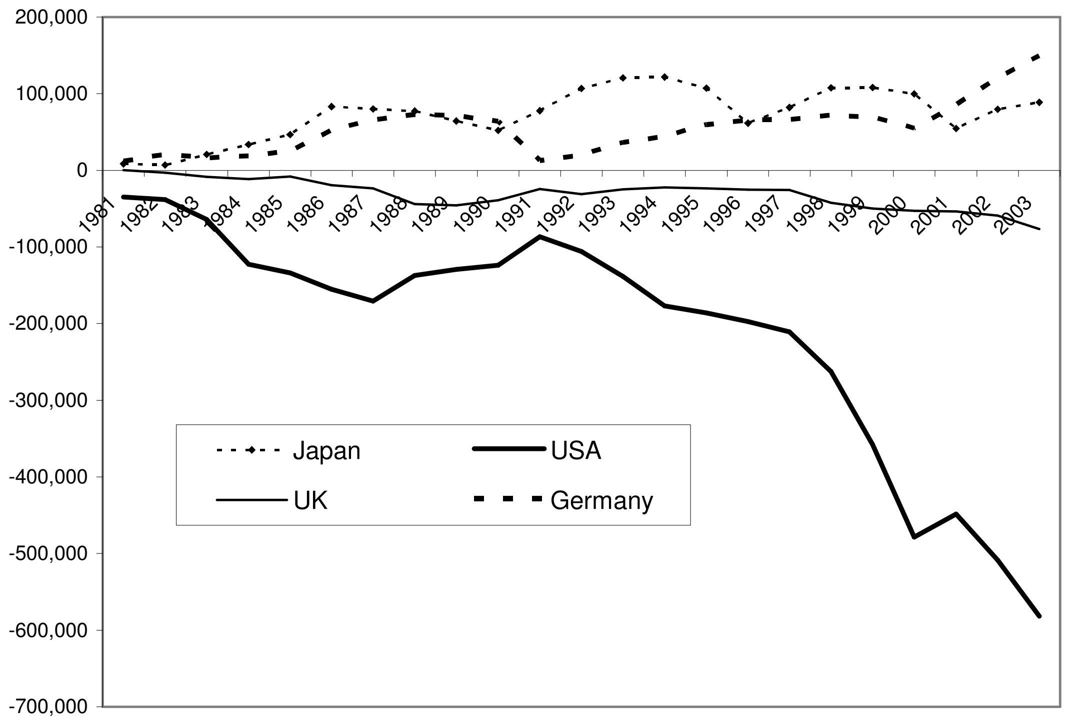
ANNEX

DEVELOPMENT IN THE ECONOMY OF THE US AS THE DOMINANT POWER IN WORLD CAPITALISM

While bearing in mind the present process of political and social re-structuring, we think it will be worthwhile to take a broad look over developments taking place in the world economy since the 80s. The underdeveloped peripheral economies stepping into the 80s with debt crises and "stabilisation" programmes are still doomed to stabilisation and structural adjustment policies after a time lapse of a quarter of century. This is a simple proof that what is meant by "stability" never exists in capitalist economies and the world capitalist system is based on instability. It is quite meaningless to speak about stability in a system which is, by its very nature, unstable. Policies which have long been imposed on peripheral economies with accompanying discourses on stability are, in essence, "debt repayment" policies. A closer look will show that these policies mean nothing much beyond having relatively weaker countries and their peoples pay the cost of instability and crisis that the US, as the focal economy of the existing capitalist system, has been facing.

One of the most significant indicators of instability in the national economies of the world economy is changes taking place in foreign trade balances. The following two figures show trends in trade balances of the four leading economies of the system (the US, Great Britain, Germany and Japan) and peripheral economic blocks starting from the 80s.

Figure 8: Trade Balance of Central Economies (1980-2003, $ billion)

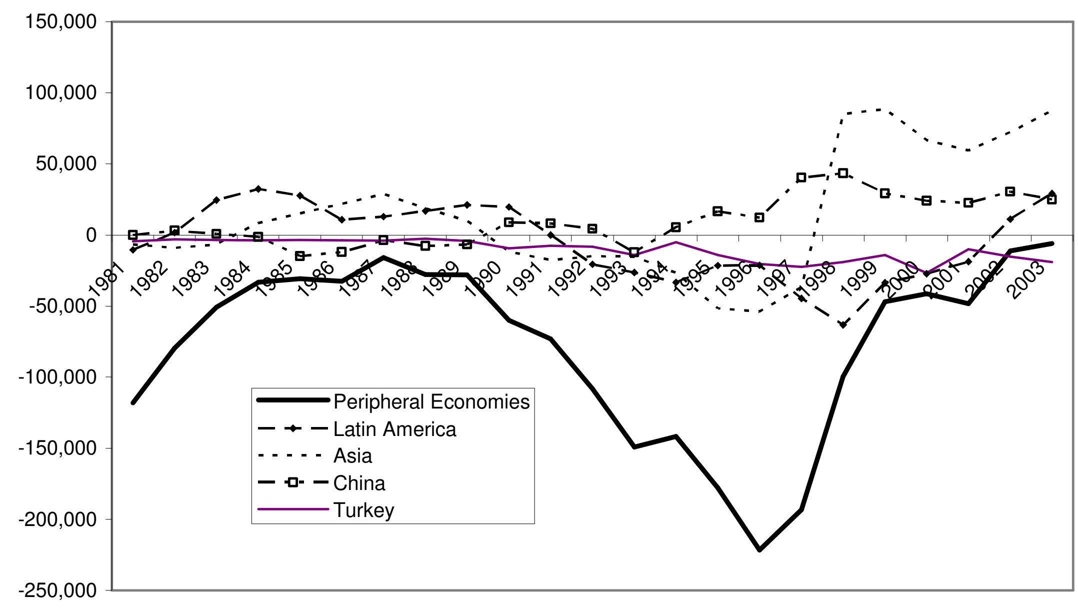


Source: Calculated by the ISS by using *International Financial Statistics* (various issues).

What strikes attention in Figure 8 that shows the trade balances of central economies since the 80s is that both deficit and surplus economies have remained the same throughout the period. Indeed, starting from the 80s, the US and also the Great Britain, which seems to be driven by the former, have continuously displayed deficits whereas Germany and Japan have had their surpluses. The 90s represent a period in which the US started to lose its competitive power over Japan and Germany and trade deficits of the US rose rapidly. In this period, which represents also the initial years of the Washington Consensus, the US, driven by the motive to close her deficits, designed policies to attract global financial capital and imposed these policies also on other economies through such organisations as the WB and IMF. In the same process, the US financed her deficits via trade surpluses of Japan and Germany, while managing to attract resources thanks to means provided by the global-scale financial liberalisation regime.

The first observation on the trade balances of peripheral economies in the same process is that with the contractive effects of the "stability and structural adjustment policies" launched in the 80s in majority of peripheral economies, these economies largely closed their trade deficits. The basic policy line pursued by many peripheral economies including Turkey consisted of restricting domestic demand and boosting exports. The common characteristic of policies targeting the contraction of domestic demand was to put pressure on wages. Thus, the early years of the 80s were years of "loss" for working peoples in almost all peripheral economies including that of Turkey.

Figure 9: Trade Balance of Non-oil Peripheral Economies (1980-2003, $ billion)



Source: Calculated by the ISS by using *International Financial Statistics* (various issues).

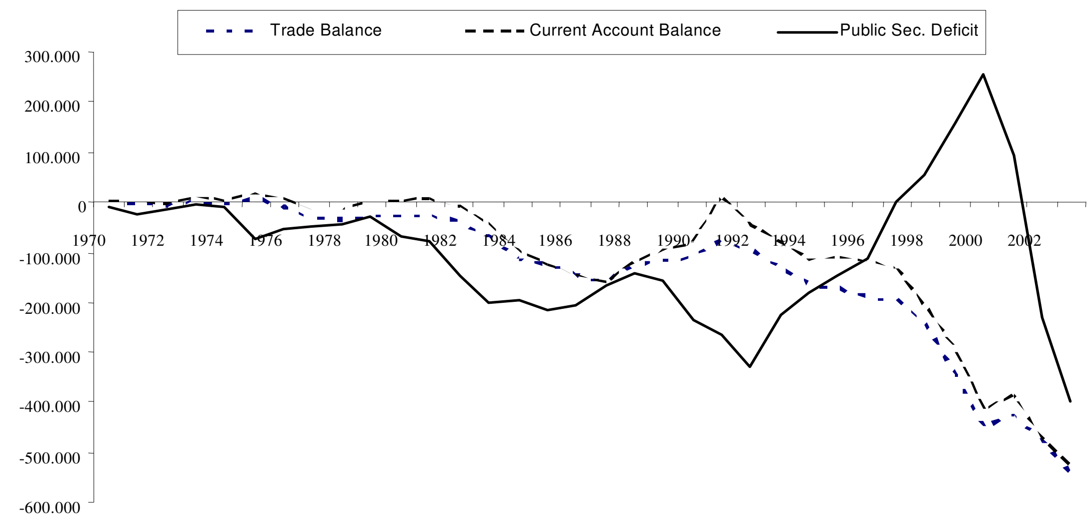
As can be followed in Figure 9, the period 1988-1996 witnessed a new rise in trade deficits of peripheral economies and financial capital rushes to these economies especially in conjunction with financial expansion taking place in the US. The turning point was 1988 and this is almost concomitant to the turning point in Turkey (1989). After lifting of control on capital movements, Turkey and many other peripheral economies witnessed expansions in both imports and trade deficits, accompanied, in most cases, by inflows of speculative funds. As one should remember in Turkey, for example, the same years also witnessed some mitigation in the pressure over wages. Nevertheless, this relative improvement largely triggered by inflow of speculative funds could not sustain itself as expected, and financial crises breaking out starting with 1998 ended up with second generation stabilisation and structural adjustment policies.

At this point, we think that a specific observation on the US economy as the central point in the world economy will provide informative clues about the nature of the process we are now passing through. In the present-day capitalism where all nations are being forced to be subject *solely* to economic rules, the US stands as the single country defying to these rules. As will be shown below in detail, the US is bound by the rules of the political hegemony that she is exerting now rather than those of economics. The global consequences of this policy which assumes a more and more pronounced character are undoubtedly increased violence and militarism. To examine and understand the US economy is important also for professional economists who hold different positions in networks of power. "Uncontrolled" developments which are labelled as "external shocks" by the established outlook to economic events are, to a large extent, consequences of policies followed by the US. In other words, what is external for economies such as we have here in Turkey is the outcome of the political preferences of the US per se.

In terms of macro-level balances, what mainly distinguishes the period 2000 and onwards under the presidency of George Bush is the concomitant deterioration in both *internal and external* balances, which are regarded as the fundamental balances of an economy, and the fact that the US is now facing the largest public and foreign trade deficits in her history (Figure 10). The basic policy pursued in closing these gaps is to impose "surpluses" to foreign trade balances of other countries and to attract these surpluses to the US through financial transactions. *In other words, the US is now having her foreign trade deficits financed by others.* Indeed, other central economies of the world (i.e. Europe and Japan), petroleum-exporting countries and Asian and peripheral (developing) economies are being forced to produce surpluses starting from the early 90s, (the first two throughout the 90s and the latter two starting from 1997). *Evaluated in global terms,* these surpluses function as funds financing the deficits of the US economy. In short, policies that force these economies to continuous surpluses and debt repayment create resources to finance the deficits of the US economy which has never been brought under any "stabilisation programme."

The second observation on the US economy is related to unprecedented growth in public deficit under Bush administration. As a result of insistence in tax policies favouring the business as well as increases in military spending, public deficit in the US reached 400 billion dollars at the end of 2003. It is estimated that this amount will reach **500 billion dollars** at the end of 2004. Military spending doubtlessly has a significant share in this deficit and in its growth. Indeed, the Bush administration proposed 420.7 billion dollars of military spending in the 2005 budget.

Figure 10: Public Deficits and Trade Balances of the US (1970-2003, $ billion)



Source: Calculated by the ISS by using *International Financial Statistics* (various issues).

The objective conditions of our day assign the US capitalism the function of acting as the driving engine of the world economy. Lately, this function is performed through domestic consumption in this country which is fed by borrowing. Table 13 gives respective contributions of expenditure items to the US growth for the 2001-2004 period. As can be seen in this table, during the first 2 years of this 4-year period, while the contribution of investment spending to GDP is negative, the US economy could grow only on the basis of growth in consumption expenditures. Even in the second 2-year period where investment spending is positive, it should not be forgotten that investment in housing has a significant share in total investment spending. Taking 2003, for example, we see that the contribution of housing investments to GDP (0.43) is higher than that of fixed capital investments (0.33). For the same period, it must be added that although to a lesser degree, public spending, including military spending in the first place has also supported growth. For example, the contribution of state expenditures for the year 2004 (0.24) can be explained largely by the contribution of military spending (0.44) (net contribution turns out to be 0.24, since the contribution of non-military spending as well as state/local governments was negative).

Speculative movements in the real estate sector and, to a lesser degree, other consumer credit schemes constitute the basis of last three year's domestic consumption-driven economic growth in the US. This rising demand for consumer credit is mainly the result of the 'dot.com' phenomenon of the 90s that drove many to borrow in order to gain in stock market and stagnancy in wages that characterized the last two decades with the exception of the interval 1996-2001. The result is an unprecedented level of household indebtedness. As of the end of 2003, the total of real estate mortgages and other consumer credits had already reached 108.3 % of total household disposable income. Further, estimates by the CEPR based on borrowing tendencies indicate that this may rise up to 152 % in 2009. It should be added here that the prices of houses have increased in real terms by 35 % since 1995, and along with increases in new house constructions and sales, real estate owners whose estates gained further value boosted their consumption through *re-financing* in an environment characterized by low interest rates.

Consequently, it is safe to infer that, in case of any economic contraction, households will be in an extremely difficult situation in managing this extraordinarily high level of debt and cases of bankruptcy which have already hit record levels will assume incredible proportions. Considering that a collapsing real estate sector will have its negative consequences on a range of related sectors and total employment, it is a serious possibility that ensuing economic stagnancy will trigger a long-term crisis in the economy. We think that this "fictitious" expansion based on real estate speculation and rising consumption has its lessons for Turkey too. Indeed, the recent mortgage scheme in Turkey which is presented as *ultimate solution to the problem of housing* gives rise to serious worries that, as experienced by other peripheral economies, this fictitious expansion may well be followed by a serious process of downturn where many people lose what they have.

Table 13: Contribution of Expenditures to Changes in the GDP of the US (%, per year)

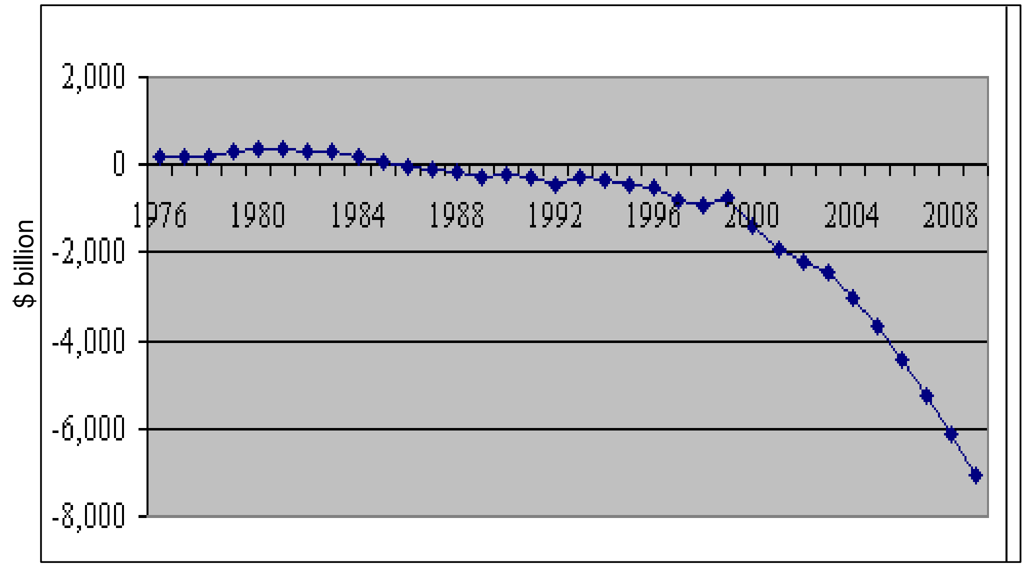
	2001	2002	2003	2004[1]
GDP	0.8	1.9	3.0	3.9
Consumption	1.74	2.14	2.29	3.53
Investment	-1.39	-0.37	0.66	0.46
Net Exports	-0.20	-0.70	-0.43	-0.27
State	0.60	0.79	0.52	0.23

[1] The year 2004 data is for the third quarter of the year.
Source: http://www.bea.doc.gov/bea/dn/nipaweb/TableView.asp#Mid

A developed system of credit and borrowing is essential for capitalist economies. However, it should never be forgotten that saving and investment capacity make up the real basis of growth in capitalist economies. In cases where the state budget and foreign trade run into unsustainable deficits and where household consumption can be sustained only through domestic (direct) and external (indirect) borrowing, it is clear that any economy, including that of the US, will eventually face a troublesome situation.

Moreover, there are various centres that predict further need for borrowing on the part of the US economy and the international system thus evolving into a state of uncertainty. For example, according to estimates made by the CEPR (Centre for Economic Policy Research) the debt burden of the US which is 2.4 trillion dollars as of the end of the 2003 will reach 7 trillion dollars in 2009 (24,000 dollar in per capita terms) (Figure 11). The same estimates indicate that the external debt burden of the US economy which corresponded to 22 % of the GDP as of the end of 2003 may reach 48 % in 2009, a level that has so far never been witnessed by any advanced capitalist economy. The situation is so alarming that even the IMF who has been so rigid in addressing the external debt problem of peripheral economies (which is indeed so small to compare with that of the US) and who has raised no voice about the position of the US, feels it necessary to warn about "exchange rate adjustments of unexpected and extraordinary dimensions."

Figure 11: Foreign Debt Stock of the U.S. ($ billion)



Source: Dean Baker, "Dangerous Trends: The Growth of Debt in the U.S. Economy", *Centre for Economic and Policy Research*, 2004

There is no doubt that it is the foreign trade deficit of the US that is lying behind this possibility of radical adjustment in exchange rates. It may be useful to make two further observations on the structure of the US foreign trade. The first is related to the shrinking share of industrial goods vs. relative expansion of service sectors in the total exports of the US. The second is related to the fact that, as far as commodity trade is concerned, there is no region in the world with which the US has foreign trade surplus in her trade. In these circumstances it would be fully *naïve* to expect that the US economy can manage to alter the state of affairs by further depressing the value of dollar. In spite of this, commonly shared opinion and expectation is that the dollar will inevitably lose its value by 40% against Euro to close the foreign trade deficit of the US economy.

Those who cherish such expectations need to remember one more point and that is naturally the reserve positions of individual countries. In this context we want to make an observation which is characteristic to the nature of the monetary policy pursued by the US. For this purpose, the monetary expansion that the US economy has been realizing since the 60s is given in Figure 12 in terms of "monetary base" which is the narrowest and basic criterion of financial expansion. As can be followed in Figure 12, since the collapse of the fixed exchange rates system (Bretton Woods) the US has steadily increased the supply of dollar as the reserve currency of the world and been able to do this independently of a basic rule that other central and of course peripheral economies are all subject to: *Holding reserves.* Figure 13 shows that the US reserves of other strong currencies and gold have been in continuous fall since the 50s. Indeed, the US used to hold about 60 % of all world reserves and 70 % of the reserves of advanced (central) economies, which turned out as 4 % and 10 %, respectively, in 2003. Consequently, while dollar is becoming a *political asset* for the US, other central as well as peripheral economies are forced to be subject to the economy of this political asset. The real meaning of these dollars pooling (and expected to pool further) in the balance of payments accounts of both central and peripheral economies is that the latter pays or is forced to pay for the US expenditures made in dollars while the dollar remains in the process of further depreciation.

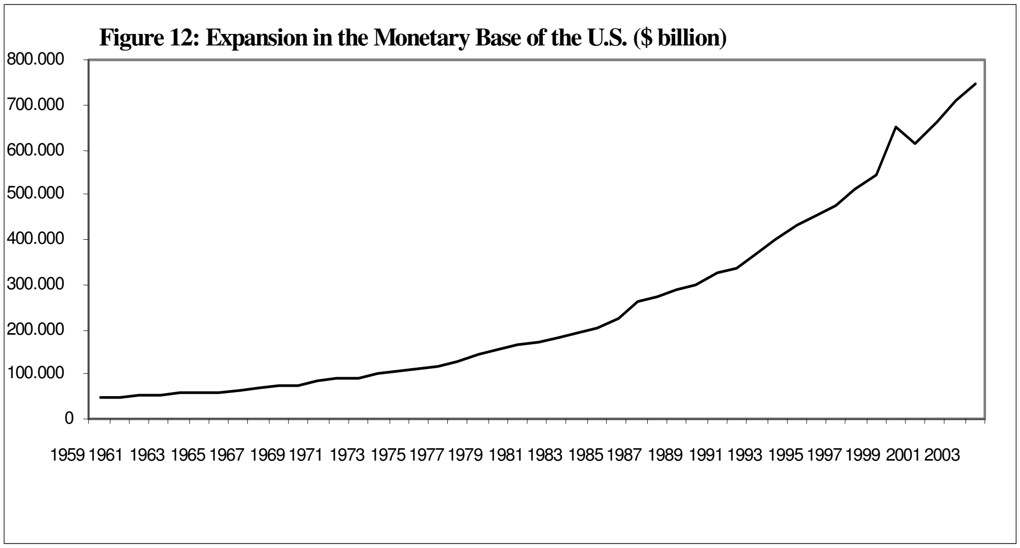


Figure 12: Expansion in the Monetary Base of the U.S. ($ billion)

Source: Calculated by the ISS by using *International Financial Statistics* (various issues).

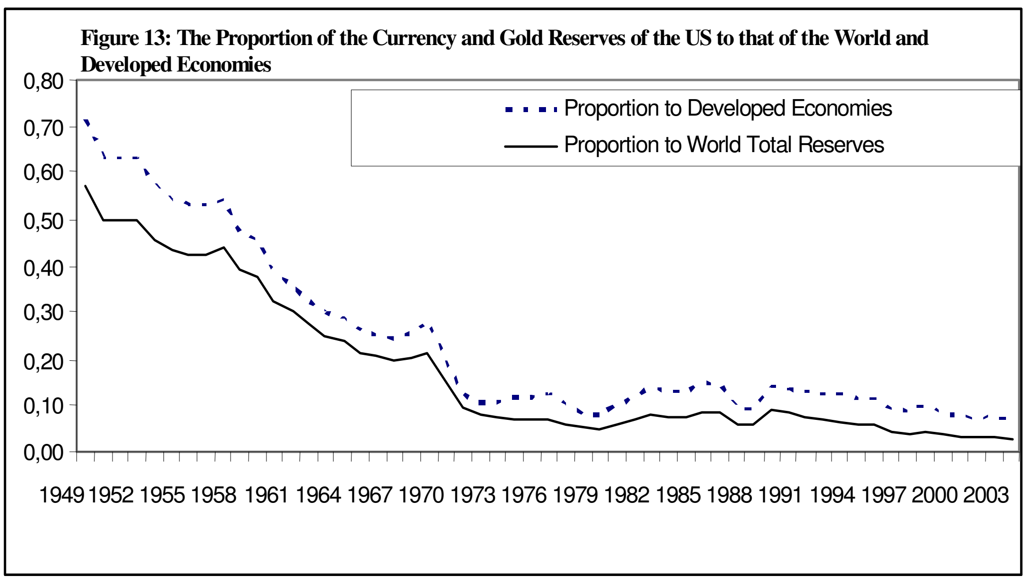


Figure 13: The Proportion of the Currency and Gold Reserves of the US to that of the World and Developed Economies

Source: Calculated by the ISS by using *International Financial Statistics* (various issues).

In the new term of President Bush, professional economists in all corners of the world share a common “worry” or a question in their minds: *How will the US maintain her current deficits? How will any fragility or change of direction in international capital movements affect the global economy? Is it possible to maintain growth and monetary stability with rising reserve costs? Will there be a violent shock in oil prices that will distort the present relationship between prices and costs?* One can add new ones to this list of questions. The real parties to the problem of reserves are undoubtedly Japan and China. It is common knowledge that both of these countries have large dollar reserves. According to 2003 data provided by the WB, 70% of all reserves in the world are on dollar basis (The *Economist* maintains that it is around 65 % nowadays). For Turkey, we estimate that this percentage is somewhat lower and reserves in dollar and Euro are distributed as fifty-fifty. Dollar reserves held by developing countries may exceed 10% or, in some cases, 20 % of the GDP of these countries.

It is clear that countries holding such large dollar reserves will not be pleased by its depreciation. Still, assuming that this downward trend is strong enough, it may be useful to think about what China, the third world countries and even Turkey would lose in the context of different scenarios. It is possible to talk about different projections made by various international agencies. The CEPR estimates the loss that 15 countries including China and Turkey will suffer as a result of falling dollar. This is given below in Table 14 in both absolute values and as proportions to GDP. The calculations are based on 3 scenarios on the depreciation in dollar and the total loss of the group of countries is given as a proportion of their total GDP. In these scenarios, the depreciation in the value of dollar is assumed, respectively, as 13.8, 22.8 and 42.0 % and the GDP equivalents of capital losses due to exchange rate adjustments under respective scenarios are given as 1.8 %, 3.0 % and 5.6 %. Of course, as it is the case with all economic projections, this one too has its specific assumptions and therefore their realisation depends upon whether these assumptions are realistic or not and also upon political conjuncture. The question is not that of whether exchange rate adjustments will take place at all, but of "when" and "to what extent" these adjustments that will push the "exchange rate and interest" spiral up will happen and what peripheral countries like Turkey can do about possible losses. This situation indicates the possibility of an "external shock" for Turkish economy which, during the past phase of low exchange and interest rate, has benefited from low cost of borrowing and is facing an external debt burden of 153.2 billion dollars as of the third quarter of 2004.

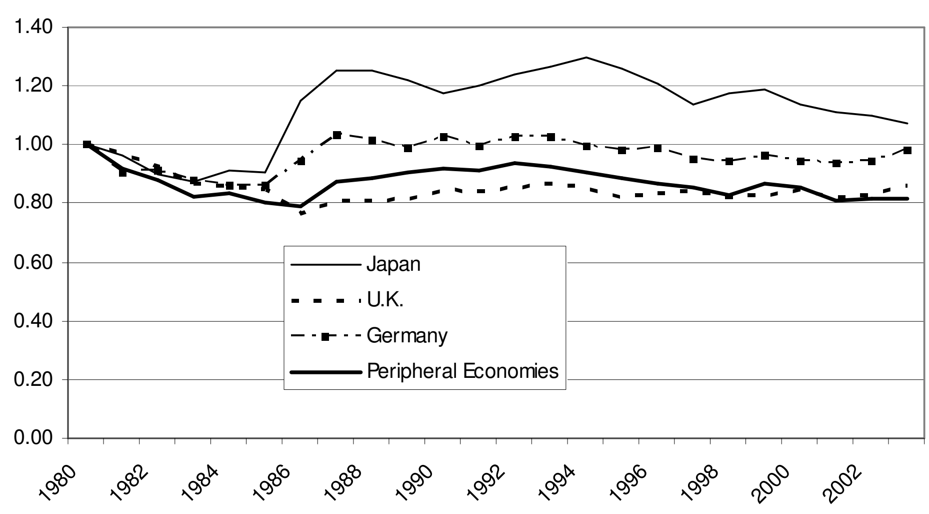
Table 14: Possible Losses that 3rd World Countries will Suffer as a Result of Depreciation of the Dollar

	Loss in $ billion			Loss as a proportion to GDP		
	Low: % 13.8	Middle: % 22.8	High: % 42	Low: % 13.8	Middle: % 22.8	High: % 42
Argentina	$1.70	$2.90	$5.30	1.20%	1.90%	3.50%
Chile	$1.50	$2.50	$4.60	1.70%	2.80%	5.20%
Colombia	$1.10	$1.90	$3.40	1.30%	2.10%	3.80%
El Salvador	$0.20	$0.30	$0.50	1.20%	2.00%	3.60%
China and Hong Kong	$56.40	$93.10	$171.60	3.20%	5.30%	9.80%
Khazakhistan	$0.60	$1.00	$1.90	1.90%	3.10%	5.60%
Kyrgistan	$0.00	$0.10	$0.10	2.00%	3.30%	6.10%
Malaysia	$5.10	$8.50	$15.60	4.60%	7.70%	14.10%
Mexico	$5.80	$9.50	$17.50	0.90%	1.50%	2.70%
Peru	$1.00	$1.70	$3.10	1.60%	2.60%	4.70%
Philippines	$1.50	$2.50	$4.60	1.80%	3.00%	5.60%
South Africa	$2.70	$4.40	$8.10	1.50%	2.50%	4.60%
Thailand	$4.10	$6.80	$12.60	2.60%	4.20%	7.80%
Tunisia	$0.30	$0.60	$1.00	1.20%	1.90%	3.50%
Turkey	$3.20	$5.30	$9.80	1.00%	1.70%	3.20%

Source : M. Weisbrot, D. Rosnick and D. Baker. 2004, "Going Down With the Dollar: The Cost to Developing Countries of a Declining Dollar", CEPR.

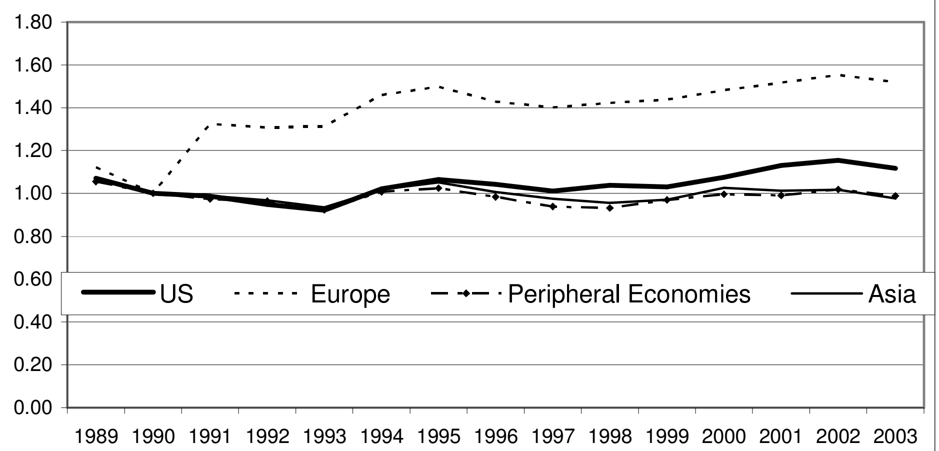
Another observation is related to developments in terms of trade. Terms of trade which is calculated as the ratio of export prices to import prices is a basic indicator showing, *in simple terms,* units of import goods that can be purchased by one unit of export good. As well known, unfavourable terms of trade means, for any given country, higher cost of imports and lower price for exported goods. Steadily falling terms of trade gives rise to larger deficits in balance of payments and heavier pressures for the depreciation of national currency. Figure 14 gives trends in price indices of traded goods of central and peripheral economies *vis-à-vis* the US. These indices were calculated by finding the proportion of the average price of one unit of exported good to the average price of one unit of imported good and dividing it by the corresponding relative price in the US. In cases where this relative price is higher than 1 it can be inferred that the terms of trade for the country concerned is more favourable compared to that in the US. Figure 14 takes 1980 as a basis; in other words, terms of trade for all countries were assumed to be the same for this starting year. As can be followed in Figure 14, the group comprising underdeveloped peripheral economies suffered losses in their terms of trade relative to the US throughout the 80s. In other words, these countries remained in a trajectory where they transferred resources to the US in their trade with this central economy. The situation in three other central economies of the world is more complex. While Japan is enjoying favourable terms of trade *vis-à-vis* the US starting from 1986, the UK seems to be losing and Germany fluctuates around basic values. As stated earlier, the first two of these central economies, Japan and Germany, continuously have foreign trade surpluses while the UK produces deficit. It should be remembered that Japan, although holding a favourable position in terms of trade, is under the pressure of capital movements in the US and has to hold and increase its dollar reserves. It can be said that Japan is one of the leading countries that feeds the US with capital transfers whose origin is foreign trade surpluses.

Figure 14: Terms of Trade of Central and Peripheral Countries Relative to Terms of Trade of the U.S. 1980-2003, (1980=100)



Source: Calculated by the ISS by using *International Financial Statistics* (various issues).

Figure 15: Terms of Trade of Central and Peripheral Economies Relative to that of Turkey, 1989-2003, (1990=100).



Source: Calculated by the group by using *International Financial Statistics* (various issues).

Figure 15 gives the terms of trade for various country blocks relative to the terms of trade for Turkey. In this case we have Turkey at the one side of comparisons (1990 is the base year). Compared to other peripheral economies and the Asian component of this block, it seems that Turkey is facing no significant change in her terms of trade, be it a gain or a loss. This gives a hint about competition amongst peripheral economies to increase their shares in world trade. It is one of the simple economic proofs showing that peripheral economies facing more or less the same situation in their terms of trade compete fiercely with each other *to have larger shares in world trade at similar prices* by pushing down costs, lowering wages especially in labour intensive sectors and launching arrangements for sub-contracting in the world economy.

One important observation for Turkey is that it is continuously losing in terms of trade with Europe, which is the most important trade partner for Turkey and for its membership it is ready to make all concessions. It is interesting that Turkey is *continuously losing in its trade with* Europe which accounts almost for a half of its total foreign trade. Turkey’s trade with Europe seems to confirm the “immiserising growth” theory of development economics. Unless there is any structural change in export goods, in other words unless Turkey shifts from labour-intensive export goods with falling prices to technology-intensive export goods with stable or rising prices, its deficit in trade with the European countries will remain. And it is clear that the economic consequences of this “immiserising growth” making continuous borrowing a must are quite different from “development”.