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Temporary star or emerging tiger? Turkey's recent economic performance in a global setting

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TEMPORARY STAR OR EMERGING TIGER?
TURKEY'S RECENT ECONOMIC PERFORMANCE IN A GLOBAL SETTING

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IN A GLOBAL SETTING

Ziya Öniş and İsmail Emre Bayram*

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ABSTRACT

This article assesses the recent performance of the Turkish economy, questioning whether the currently observed unusual boom conditions will lead to a process of sustainable growth. The latest phase of Turkish neo-liberal transformation in the post-2001 era is placed in a broader historical and global context; at the same time, the performance of the economy in recent years is compared with that of other key emerging markets, based on selected macroeconomic indicators. Utilizing the East Asian experience as the principal benchmark for comparison, this paper examines whether Turkey is on its way to accomplishing tiger-like development performance. Given the current challenges to sustainable growth, we conclude that it is premature to suggest that the impressive performance of the recent years will lead to durable success and tiger-like performance. While the focus is on the Turkish experience, the paper also probes the very nature of tiger-like performance itself, highlighting the fact that in setting standards for exceptional economic performance we need to extend our horizons beyond high rates of economic growth sustained over time, to broader indicators of social, political and human development.

Keywords: Turkey, hyper-growth, East Asian tigers, emerging markets, human development, democratization
JEL: O11, O5, O57.

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Introduction

The Turkish economy has experienced one of its most outstanding phases of growth in recent years. The period following the crisis of 2001 witnessed a successful transformation of the Turkish economy, due to a combination of structural reforms and measures aimed at establishing macroeconomic stability. In the post-2001 period, the Turkish economy managed to achieve high rates of growth. Furthermore, this growth was accomplished in an environment of fiscal discipline and single-digit inflation, which marked a dramatic departure from the endemic instability and chronic inflation that had become a norm over the last few decades. Another striking feature involved large inflows of foreign direct investment, again representing a major contrast to previous years. Privatization also gathered momentum, with large-scale privatization of state economic enterprises during the latest phase of Turkey's on-going neo-liberal structuring process. The wave of regulatory reforms encompassing, among others, the banking sector, the Central Bank, government expenditures and revenues, as well as foreign investment legislation constituted the very foundations of this impressive performance. It is fair to say that Turkey made significant progress in terms of establishing an effective regulatory state during this period. This paper examines the interaction of domestic and external influences that played a critical role in the recent transformation process. More significant, however, is the question whether the new institutional reforms towards establishing a regulatory state will be sufficient for generating outstanding performance on a durable basis. In other words, this paper questions whether or not the Turkish economy can emerge as a "new tiger."

The basic premise of this paper is that exceptional economic performance rests on the following set of interrelated conditions: (a) High levels of investment form the central ingredient of economic growth. (b) The ability to attract foreign investment is important. However, a balanced structure necessitates high levels of domestic investment to complement

foreign investment. This, in turn, requires high levels of domestic savings. (c) The ability to sustain export orientation is essential. Export orientation is also critical for the ability to diversify exports in the direction of high-value added products with significant technology content. (d) The ability to devote resources to research and development as well as to education and human capital are key ingredients for success. The role of the state in development continues to be critical; an improvement of regulatory capacities of the state alone will not be sufficient for exceptional success. (e) Economic and political stability on a sustained basis forms a major underlying element of exceptional success. While the presence of an authoritarian regime is not a precondition for success, weak or unconsolidated democracies find it particularly hard to generate economic and political stability on a sustained basis, which, in turn, undermines their long-term growth potential. (f) Favorable regional dynamics, such as the EU enlargement process, embody a powerful transformative potential. External stimuli can help to generate a virtuous cycle of growth by creating a mutually reinforcing process of trade expansion, foreign investment flows and institutional improvement as part of the democratic consolidation process.

An assessment of the Turkish economy in the recent period necessitates a multi-dimensional analysis within the context of both its own historical development and the global setting. Based on this multi-dimensional approach, the principal sections of this paper are organized along the following lines: The recent success in the Turkish economy will be evaluated based on its own historical standards, with particular reference to its early neo-liberal experience and instability in the 1990s. Achievements in terms of inflation control, attraction of FDI and success on the privatization front will be all the more striking when compared to Turkey's earlier experience in the economic realm (Section 2). Although the comparison of the two key periods in the history of the Turkish economy provides many insights into its continuities and ruptures, the assessment of the recent performance of the

Turkish economy in isolation is still inadequate, and a better understanding requires embedding the Turkish experience in a broader global and comparative context. Before comparing Turkey to key emerging markets, the East Asian (EA) development success and the concepts of "Asian tigers" and "tiger-like performance" will be analyzed in order to use the EA experience as a benchmark for the assessment of long-term sustainable growth in the Turkish case. Examining certain macroeconomic and social indicators of the EA success, this section indicates not only the measures responsible for providing sustainable growth, but also alternative theories specifying the reasons for the EA miracle (Section 3). Based on the insights gained from the EA experience, this section extends the limits and geographical scope of our inquiry, assessing the recent performance of the Turkish economy in a comparative perspective. Not only the EA economies, but also a number of key emerging markets from Latin America (LA) and Central Europe (CE) constitute an essential part of this analysis. The similarities with LA neo-liberal restructuring and the effects of the EU accession process in the CE context provide additional perspectives for the comparison (Section 4). Although the assessment of the recent performance of the Turkish economy supported by inter-temporal and cross-country comparisons highlights its impressive nature, this section argues that there exist certain weaknesses and observable threats to long-term growth. The large current account deficit, low savings rates, and overall dependence on foreign and favorable global liquidity are particularly striking in this context. Furthermore, the weakening of external anchors and rising political instability emerge as major challenges to the sustainability of the recent economic success. However, we also argue that these challenges can be balanced by medium- and long-term opportunities—such as regional cooperation, the geo-strategic importance of Turkey with respect to energy pipelines, and a demographic structure based on an unusually young working population (Section 5). Even though the first sections of the paper explicitly focus on conditions conducive or detrimental

to sustainable growth, in order to have a complete picture of "development" we go beyond the strict economic measures of growth and deal with the social dimensions of long-term development, incorporating into the analysis such factors as unemployment, inequality, poverty, and "human development" (Section 6). The last section summarizes the main arguments.

The Turkish neo-liberal experiment: The 2001 crisis as a turning point

The Turkish neo-liberal experience started in 1980 with the January 24 program, under the auspices of the World Bank and the International Monetary Fund (IMF). The program rapidly reached its initial targets in terms of reducing inflation, achieving higher growth rates, and taking steps towards trade and financial liberalization.[1] With the crisis of the late 1970s, import-substituting industrialization (ISI) policies appeared to have reached their limits; thus, the January 24 program was not only a stabilization program in a conventional sense, but also a starting point for the structural transformation of the Turkish economy along neo-liberal lines. As a result of ISI policies, Turkey managed to sustain high growth rates, introduce planned development, achieve rapid industrialization and outperform most LA cases in the period between 1963 and 1977; however, its growth failed to match the performance of EA economies. Indeed, excessive, indiscriminate and long-term protectionism associated with the ISI era in the Turkish economy was an important contributor to export stagnation and the endemic balance of payments crisis which had emerged by the late 1970s.[2] The first half of the 1980s under neo-liberal structuring appeared to reverse the previous trend and represented a certain progress towards establishing an externally competitive economy through a

[1] For a detailed assessment of the period, see Ertuğrul & Selçuk (2001). According to the data provided by these scholars, the Turkish economy grew steadily by an average of 5.8% in the period between 1981 and 1988. See also Arıcanlı & Rodrik (1990) for a critical assessment of the Turkish neo-liberal experience.

[2] For an account of major policy phases and shifts in Turkish economic history, see Öniş & Şenses (2007) and Pamuk (2007). An important study which investigates the economic and political determinants of growth in Turkey from the nineteenth century to the present is Altuğ, Filiztekin and Pamuk (2007).

significant increase in exports. The ratio of total exports to GDP increased between 1980 and 1988, from 4.1% to 13.3%.[3] Moreover, the process was accompanied by a diversification of exports, involving a striking increase in the share of manufactured exports at the expense of agricultural exports. However, the success on the export front could not be sustained in the second half of the 1980s.[4] This pattern appears to be a rather typical feature of Turkish economic development. There have been a number of such periods of unusual economic progress in the post-war era. However, these periods tended to be relatively short-lived and were followed by periods of stagnation and crisis.

The second phase of Turkish neo-liberalism in the 1990s was characterized by a high degree of macroeconomic and political instability, lower growth rates, chronic inflation and weak budgetary performance. The appreciation of the Turkish Lira (TL) was the major driving force behind the slowing pace of exports and rise of imports, leading to an external deficit. The ratio of external deficit to GDP increased to 2% in 1989, 4% in 1990, and 6% in 1993. Towards the end of 1993, it was more or less obvious that the fiscal deficit and external balance situation became unsustainable.[5] Not surprisingly, given the size of the disequilibrium which had emerged, Turkey encountered its first crisis of the neo-liberal era in 1994—the TL was devalued twice, in January and April of 1994. Not only major shocks, but also chronic inflation turned out to be the essential characteristics of the neo-liberal era in the Turkish context. Due to the government's low level of credibility and its lack of commitment to the stabilization program, as well as the high degree of currency substitution (dollarization) and the high costs of borrowing, chronic inflation could not be reduced during the 1990s. Similarly, due to the serious interest burden on government expenditures, PSBR / GNP ratios reached extremely high levels by international standards, rendering inflation control all the more difficult.

[3] Ertuğrul & Selçuk (2001)
[4] For an explanation of the slow-down in export growth during the second half of the 1980s, see Öniş (1993).
[5] Ertuğrul & Selçuk (2001)

In retrospect, the experience of the 1990s clearly illustrates the fact that the optimism surrounding the early phase of neo-liberal restructuring could not be sustained. Indeed, a number of analysts have pointed out the long-term institutional regularities which led to the reemergence of crisis-generating tendencies during the neo-liberal era. For example, in his analysis of Turkey-EU relations from an economic perspective, Mehmet Uğur, intending to explain why Turkey fell behind Central and East European countries (CEECs), even though Turkey's liberalization efforts predated theirs, has argued that liberalization in Turkey was introduced within an institutional environment marked by excessive discretion and pervasive rent-seeking. As a result of intensive lobbying and rent-seeking activities by various interest groups, these discretionary acts involved a frequent use of governmental decrees and relied heavily on extra-budgetary funds.[6] Similarly, Mine Eder has argued that, in contrast to the rhetoric of neo-liberal economic policies, populism survived in the form of de-institutionalization, patronage politics, and charismatic leadership.[7] In short, the neo-liberal era was clearly not different from the previous periods in respect to the institutional environment, leading to corruption and rent-seeking activities.

In addition, there were two major turning points in the second half of the 1980s, which are crucial for understanding the institutional features of instability in the 1990s. The first dramatic change affecting the institutional dynamics and the patterns of incentives for the actors in the Turkish economy was the revitalization of political competition in 1987, which enhanced the role of the populist element in Turkish politics. After the 1980 military intervention, Turkey was ruled by a military government for three years, and all political

[6] See Uğur (2004). In order to indicate that Turkey falls behind CEECs, Uğur utilizes seven measures taken from the Transparency International and World Bank Governance Indicators. These measures are corruption perception, growth competitiveness, microeconomic competitiveness, quality of public institutions index, macroeconomic environment, company operations and microeconomic business environment. In almost all measures, Turkey falls behind the eight CEECs and is only able to outperform Bulgaria and Romania in some of these measures.

[7] See Eder (2004). For a detailed account of Özal's economic legacy and the early period of Turkish neo-liberal era, see Öniş (2004).

parties and labor unions were banned.[8] Although general elections were held in 1983, the old political parties and leaders were not permitted to enter the competition. Without serious rivals, the Motherland Party (MP) emerged as the sole winner of the 1983 elections and established a majority government. The 1987 elections witnessed the re-emergence of political competition, with the entrance of the center-right True Path Party (TPP) as a follower of the Justice Party and the center-left Social Democratic Populist Party (SDPP) following in the footsteps of the Republican People's Party. Although the MP managed to satisfy the government majority due to the uneven nature of the electoral system in the 1987 elections, it was finally defeated by the TPP and the SDPP in the 1991 general elections, and a post-election coalition government was established. What appealed to the masses was the coalition's promise to improve people's living standards, which had been repressed by the wage rigidity of the post-coup authoritarian regime. Combined with the lack of budgetary discipline and loss of pace on the export front, this new populist element in the Turkish economy was responsible for creating institutional instability in the 1990s. The second key turning point is the capital account liberalization and the full convertibility of the TL in 1989. Arguably, this critical decision managed to postpone a possible financial crisis, but at the expense of a highly fragile pattern of debt-led economic growth.[9] Much more importantly, the decision of capital account liberalization was made without establishing the necessary institutional environment to supervise and regulate the high liquidity of international flows.[10]

[8] Although beyond the scope of this paper, another interesting debate on the role of the military intervention in the neo-liberal era is whether military interludes have created a stable environment for reforms. One should be mindful of the fact that the authoritarian nature of the military rule allowed an implementation of repressive policies, reducing real wages and eliminating political opposition by shutting down former political parties, labor unions and other civil society elements, in a sense blocking the mechanisms of interest intermediation in the political process. In addition, it undermined the trust of key social actors and prevented the institutionalization of the party system, leading to discontinuity and fragmentation. For a detailed discussion of the argument, see Öniş (1997). It should also be taken into account that the military intervention and the interruption of the democratic process caused the deterioration of Turkey-EU relations throughout the 1980s and 1990s, preventing the EU from playing its role as an anchor not only in terms of democratization, but also economic development.

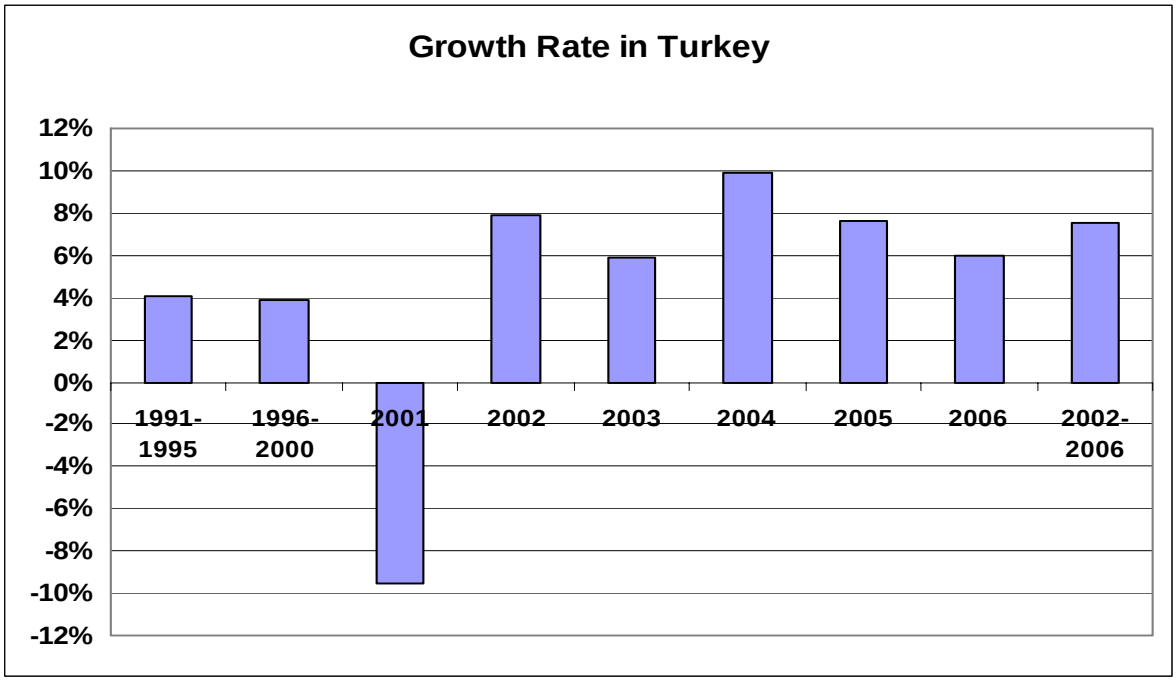
[9] See Öniş (2003) for a detailed discussion on the return of the populist element to Turkish politics and pre-mature capital account liberalization leading to debt-led growth.

[10] For pre-mature capital account liberalization, see Arıcanlı &Rodrik (1990).

Speculative attacks in an environment of large budget deficits proved to be the key proximate causes for the successive crises of 1994, 2000, and 2001.

The post-2001 period represents a clear rupture from the unstable macroeconomic environment of the 1990s in terms of higher growth rates, lower inflation, fiscal discipline, attracting FDI, and success on the privatization front. The recent success of the Turkish economy in comparison to earlier periods can, first of all, be observed through growth performance data. Figure 1 clearly demonstrates that the post-2001 period outperforms the unstable 1990s with regard to the GDP growth. The average growth rate between 1991 and 1995 and between 1996 and 2000 appeared as 4.1% and 3.9% *per annum*, respectively. It should also be noted that in the 1990s growth was not steady and sustainable, as it was challenged by the immense recessions of 1994 and 1999, resulting in a negative growth of 6%. Especially the 2001 financial crisis and the following 9.5% recession is a clear indicator that the Turkish economy is vulnerable to financial shocks in the form of rapid outflows of speculative short-term portfolio investments, external shocks (such as the effects of the Russian crisis of 1998 on trade links in Turkey), and the overall dependence on foreign capital. Although similar vulnerabilities continue to exist at present, it is clear that the recent growth performance between 2002 and 2006 has outperformed the previous periods by a significant margin. On average, the Turkish economy managed to grow at a rate of 7.5% *per annum*.

Figure 1. Growth rate in Turkey



Source: Treasury

An equally striking improvement can be observed for the inflation rate. While the early experience of the Turkish economy with the neo-liberal adjustment was characterized by chronic inflation, the post-2001 period has witnessed a serious decline in the inflation rate. The average inflation in the 1980s was 52% *per annum*; between 1991 and 1995, 78.8 % *per annum*, and between 1996 and 2000, 74.1 % *per annum* (Table 1). In contrast, the average inflation rate between 2002 and 2006 declined to 19.4% *per annum*. Much more importantly, the inflation rate was kept below the 10% threshold *per annum* for the consecutive years of 2004, 2005 and 2006. In contrast to the unstable macroeconomic environment of the 1990s, the achievement on the inflation front—that is, price stability—seems to be the major contributory factor to the macroeconomic stability and investor confidence.

The third major indicator of macroeconomic stability in the post-2001 period is fiscal discipline. A major aim of the 1980 program had involved the achievement of fiscal

discipline. In spite of an initial improvement, however, the program clearly failed to establish fiscal discipline over time. Table 1 highlights the fact that, following a modest success in the reduction of the PSBR ratio in the first half of the 1980s, there is a secular trend involving an increase of the PSBR ratio throughout the 1990s, reaching its peak during the 2001 crisis with more than 16% of the GNP. In the post-2001 era, in contrast, the PSBR / GNP ratio has declined by a tremendous margin, in line with the Maastricht criteria.[11] Hence, the government's commitment to fiscal discipline in the post-crisis era constitutes another element of macroeconomic stability.

Table 1. Crucial macroeconomic indicators of Turkey in the neo-liberal era

	1980 – 1989	**1991 – 1995**	**1996 – 2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2002-2006**
Inflation	51,7	78,8	74,1	54,2	45,1	25,3	8,6	8,2	9,6	19,4
PSBR/GNP	5,0	8,8	9,3	16,4	12,7	9,4	4,7	-0,4	-2,6	4,8
FDI inflows	n.a	756,6	846,4	3352	1.137	1752	2847	9673	19919	5646,6
Privatization Revenues	n.a	432	907	120	537	187	1283	8222	8096	3665

Source: Inflation data are taken from IMF World Economic Outlook; PSBR/GNP data from the State Planning Organization; FDI data from the Secretariat of Treasury; and data on privatization revenues from the Privatization Administration of Turkey.

[11] According to the Maastricht criteria, the PSBR / GNP ratio should be lower than 3%.

Key: The data for the periods are simple averages of yearly data. The data on inflation and PSBR / GNP are in percentages, whereas the data on FDI and privatization revenues are in millions of US$.

In the post-2001 era, Turkey has also managed to attract significant levels of FDI, which represents a striking contrast with both the ISI era and the earlier phases of neo-liberal restructuring. In retrospect, it was not only the macroeconomic stability and rising investor confidence, but also the concrete prospect of EU membership that brought about a significant increase in the amount of FDI.[12] As can be observed from Table 1, following the EU Council's decision to initiate accession negotiations in December of 2004 and its confirmation in October of 2005, the amount of FDI inflows to Turkey has reached the level of 20 billion US$ *per annum*, higher than the total recorded for the period between 1980 and 2000 as a whole.

Parallel to the recent success on the FDI front, privatization revenues have significantly increased in the post-2001 era. In fact, privatization was a strong component of the post-1980 neo-liberal adjustment in Turkey, in the sense that privatization was perceived as a strong contributor to the economic performance, increasing efficiency, reducing the burden of the state stemming from SEEs, contributing to capital market development, and broadening property ownership.[13]. However, lack of the executive authority's strength and coherence, the depth of political and economic crises, and an unfavorable external environment were the reasons for the failure of early privatization attempts.[14] In this respect, the post-2001 period was crucial for privatization in terms of both confidence and macroeconomic stability due to favorable global liquidity conditions. The revenues gained in

[12] For a detailed analysis of Turkey's FDI challenges with specific reference to the EU accession process, legal requirements and the formation of a competitive framework, see Dutz *et al.* (2004).
[13] Ibid.
[14] See Ercan & Öniş (2001).

2005 and 2006 almost reached the 10 billion US$ threshold, an amount equivalent to the size of the budget deficit.[15]

So far, our analysis of the Turkish economy has focused on indicators of recent success in terms of generating macroeconomic stability and an environment conducive to sustainable growth. Yet, a detailed account of the Turkish neo-liberal experience should also highlight transformations in the institutional structure of the economy, which have effectively contributed to the striking improvement in broad macroeconomic indicators. Three elements of institutional reform deserve particular emphasis. First of all, the commitment to fiscal discipline was clearly enhanced through transparency and accountability measures, as well as improvements in the tax administration. Secondly, the banking sector reform and the strengthening of the position of the Banking Regulation and Supervision Agency (BRSA) helped to overcome the weaknesses of the Turkish banking system—one of the central elements of instability in the 1990s that had led to successive financial crises in 1994, 2000, and 2001.[16] Since 2001, the banking and financial system has been tightly regulated in line with international norms and assumed a more robust structure against possible financial crises. Thirdly, measures taken to enhance the autonomy of the Central Bank (CB) were critical to the success on the inflation front, by limiting the scope for "populist" government interventions.[17]

Clearly, a legitimate question needs to be raised at this juncture: if such institutional reforms were so crucial, why were they not implemented earlier? The following framework—which takes into account the role of external actors, crises and domestic policy coalitions, as

[15] It is not yet clear whether the recent large-scale privatization has increased efficiency. There are doubts whether the privatization of state monopolies, such as the Turkish Telecom Company, changes the monopolistic nature of the market and creates efficient competition. A case in point is the Argentine Telecom: while its privatization led to the compensation of the budget deficit and attracted FDI, no significant improvements in efficiency and quality were observed. For an overview of the Argentine Telecom experience, see Luigi Manzetti (2000).

[16] For an evaluation of the Turkish banking system in the 1990s with an emphasis on the lack of regulation and the role of the IMF in the reform process, see Alper & Öniş (2004). For a much more recent assessment of banking system reforms including their nature and limitations, see Bakır & Öniş (2008).

[17] For a detailed account of the reform process involving the Turkish Central Bank, see Bakır (2007).

well as their mutual interaction—may offer an explanation for this puzzle.[18] The dominant external actors were the EU and the IMF. The involvement of the IMF can be explained in reference to US geo-strategic interests. What is new and much more important in the recent Turkish context is the emergence of the EU as an external anchor in the post-Helsinki era. With the concrete prospect of EU membership, the incentives and conditionality provided by the EU turned out to be the most important determinant of political and economic change in Turkey. On a domestic level, the new policy regime was strongly supported by the key segments of big business as well as small and medium-sized interests.[19] The domestic actors believed in the necessity of a properly regulated macroeconomic environment in order to achieve stability and sustainable growth. However, this account does not explain why external and domestic actors changed their policy preferences. At this point, the role of crises should be embedded into the analysis, with respect to their effects on the incentives and interests of certain key actors in economic management. Namely, the East Asian Crisis of 1997 challenged the role of the IMF in many respects and led the IMF to support a certain level of state regulatory capacity. This shift in the policy paradigm can be observed in the IMF's insistence on the establishment of the BRSA in Turkey. Similarly, it can be argued that the 2001 crisis changed the incentives of key actors in the Turkish economy, pushing them toward accepting the necessity for reform and structural transformation. However, one last question remains: why was it the 2001 crisis, and not the 1994 or 2000 crises, that led to a significant change in the incentives and interests of key domestic actors? The simple answer to the puzzle lies in the very depth and intensity of the 2001 crisis. It was undoubtedly far more detrimental in its effects and, unlike the previous crises, not only affected middle and lower classes, but also directly challenged the interests of dominant groups in the financial and real sectors of the economy.

[18]This framework has been developed in Öniş and Şenses (2007) and used as a basis for understanding major policy reversals in post-war Turkish economic history.
[19] Ibid. p 21.

Having analyzed the internal dynamics and differences of the Turkish neo-liberal experiment over time, this analysis has so far examined the positive developments in the Turkish economy. However, for a better assessment of this recent performance, it is necessary to compare the Turkish case with other countries' experiences. Thus, the following section will discuss the bases of the EA success, a striking element of which is a high rate of economic growth sustained over long time intervals.

The East Asian development experience and the characteristics of tiger-like performance

The EA economies were the clear winners of the post-war development, given that they achieved steady and high growth rates in an environment of low inflation, low inequality, and political stability. Numerous scholars have devoted their work to understanding the extraordinary growth performance of EA economies. These economies have been called "Asian tigers,"[20] based on their outstanding growth rates sustained over the long run. The concept of "tigerhood" or "tiger-like performance," then, turned out to be a trademark for those countries who achieved extraordinary success in long-run growth performance. That is why, in order to assess the recent performance of the Turkish economy in a global setting, the first step should be to clearly identify what we mean by the concept through analyzing the experience of EA countries.

What makes these EA economies distinctive? What are the economic measures and indicators that make them divergent from the rest of the world? Obviously, the foremost indicator is their growth performance. Eight of twelve hyper-performers or outliers are from

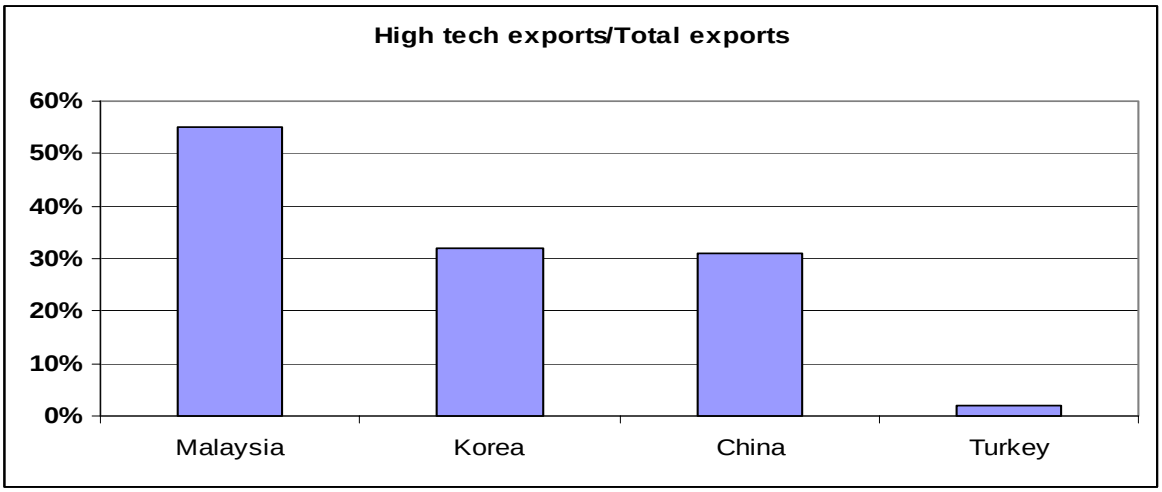
[20] In the literature, EA economies are categorized under four groups with respect to the date of their take-off phase. Japan by itself constitutes the first subset, emerging as the outperformer in the post-WWII context until the 1980s. Japan is followed by the "Gang of Four," namely South Korea, Hong Kong, Taiwan and Singapore, which started to grow in the 1960s and 1970s. The third group is composed of Thailand, Malaysia and, to some extent, Indonesia. This group started to grow in the 1980s, but could not achieve growth levels similar to those of the first two groups. The last group is composed of China only; although a latecomer due to its socialist regime, it has been the fastest-growing economy in the world for the past twenty years. For these terms and categorization, see Haggard (1995) and Rowen (1998).

East Asia.[21] Japan and the "Gang of Four" managed to sustain growth rates of around 5.5% *per capita* (PPP), whereas Thailand, Malaysia and Indonesia achieved 3.5% between 1965 and 1990.[22] The second characteristic of the EA development is their achievement of sustainable growth in a relatively low inflation environment. With the exception of Indonesia in the 1960s and South Korea between 1960 and 1980, all EA economies experienced inflation rates of less than 10% *per annum*.[23] Thirdly, EA economies are characterized by high domestic savings and investment. The data on the savings and investment level for 1995 indicate that all EA countries have 30-40% domestic savings, coupled with generally 2-3 % percent higher investments.[24] This not only allows them to invest and grow at high rates, but also makes them less vulnerable to global liquidity conditions and foreign capital dependence. We will discuss the issue of a low level of domestic savings and externally dependent growth in the Turkish case as a major challenge to sustainability of growth below.

The fourth distinctive characteristic of EA economies to be taken into account is their export competitiveness in comparison to other developing countries. These economies managed to increase their exports significantly between 1960 and 1990. They diversified their exports and achieved a shift from low-technology to high-technology products (Figure 2). A comparison of Turkey with Malaysia, South Korea and newly rising China clearly indicates the differences in terms of export competitiveness. While Malaysia, South Korea and China are able to devote 55, 32 and 31%, respectively, of their total exports to high-tech products, only 2 % of total Turkish exports are products with high technology content.

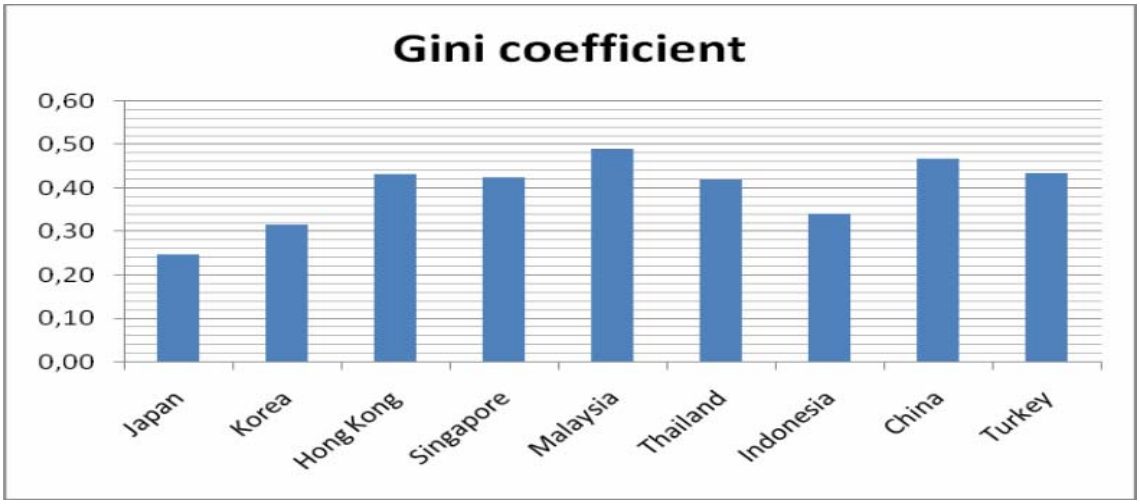
[21] Petri (1993), according to his calculation, has argued that it is a possibility of 1/1.000.000 that eight of twelve outstanding performers come from the same region. This is a clear expression of why we should pay particular attention to East Asia and regional dynamics. The other four successful countries are Botswana, Malta, Mauritius and Cyprus.
[22] Rowen (1998), p. 2
[23] For the exact figures, see Table 1.2 in Sönmez (2003), p.39.
[24] Ibid., p. 40.

Figure 2. Ratio of high technology exports to total exports



Source: World Bank, World Development Report 2007

Figure 3. Distribution of income in EA and Turkey



Source: UNDP, Human Development Report 2007

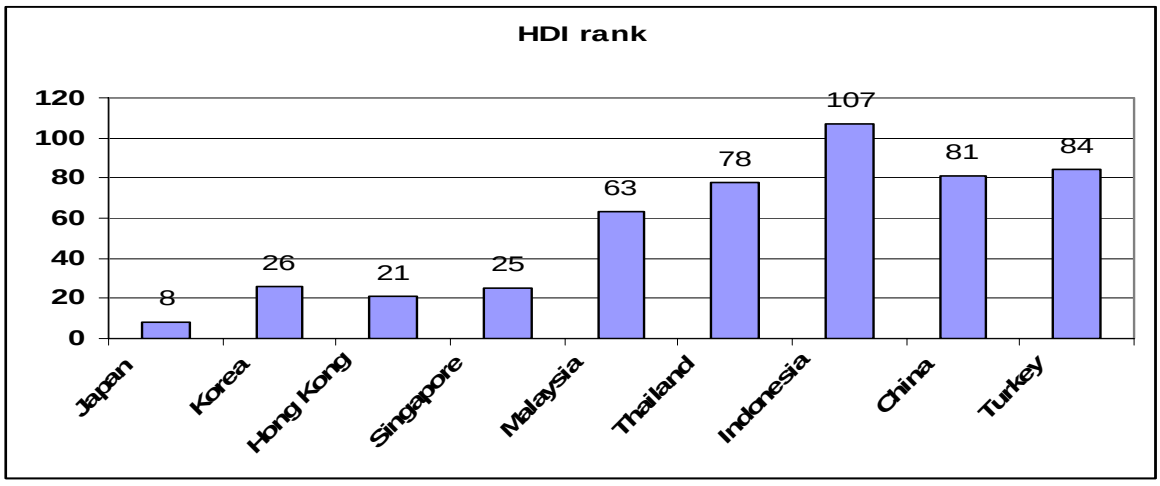
Yet another dimension of EA development is its relatively egalitarian pattern of income distribution.[25] This observation needs to be qualified, however, given that Figure 3 portrays a mixed picture. While Japan and South Korea, as more egalitarian societies, have relatively low Gini coefficients, other countries are similar to Turkey in terms of income inequality,

[25] For historical figures on income inequality, see Sönmez (2003), p. 326.

with coefficients higher than 0.35. Although the equality aspect of EA development is widely discussed in the literature, the recent data on the Gini coefficient supports the validity of the argument only for the Japanese and South Korean case, but cannot be extended to other cases.

The sixth and last aspect of EA development is its superiority in terms of broader indicators of development, rather than simply narrow measures of growth. Figure 4 demonstrates the ranks of EA countries and Turkey with respect to the Human Development Index.[26] The countries are ordered in line with their take-off phase, and the HDI ranking is quite representative of this four-subset model.[27] One can also look at government spending on education and the corruption index in order to gain a better understanding of the improvements in both human capital and business environment in EA economies. However, for the sake of clarity, these figures are omitted from our analysis.

Figure 4. HDI ranking[28]



Source: UNDP, Human Development Report

[26] The Human Development Index (HDI) is a measure provided by the United Nations Development Program (UNDP). The measure consists of three elements: life expectancy at birth, adult literacy, and GDP per capita (PPP).
[27] See footnote 20 for the four subsets of EA development. The HDI ranking is in line with this fourfold logic, with the only exception of China, which outperforms Indonesia with its recent development.
[28] The data on Taiwan are not provided by the UN and UNDP since the diplomatic status of Taiwan is disputed.

Having examined the distinctive features of EA development, it is necessary to explain the nature of this distinctiveness in order to shed light on the dynamics of sustainable growth. Our treatment here will, of necessity, be very selective, as our objective is to single out the crucial elements of EA success, which will then be used as a basis for comparison with the recent Turkish experience.

The *neo-classical perspective* emerged with the critique of ISI, on the grounds that short-run efficient resource allocation leads to long-term growth. Therefore, "getting the prices right" through market mechanism and minimum state intervention is an essential part of the neo-classical perspective.[29] From the 1970s onwards, economists have used this paradigm to examine the outstanding success of EA.[30] What makes EA economies distinctive to them is their effort to create an outward-oriented and export-competitive economy in contrast to inefficient domestic-oriented ISI strategies. Balassa has associated this export orientation with limited government intervention, stability of incentives, well-functioning labor and capital markets, as well as reliance on private capital.[31] High domestic savings, capital formation (both physical and human), stable exchange rates, and the ability to attract FDI were also considered as the main impetus for sustainable growth.[32] However, this perspective has been heavily criticized for being ahistorical, in the sense that it cannot satisfactorily explain the reasons for capital formation, technological improvement, and investment in human capital. Furthermore, this perspective has been criticized for underestimating the role of state intervention and political dimension.[33]

The *statist perspective* stems from the latter criticism, namely the neglect of the role of the state. In contrast to the neo-classical perspective, statists argue that the state has a strategic

[29] See So & Chiu (1995), p.4.
[30] For earlier studies from this perspective, see Balassa (1981), Balassa *et al.* (1982), Hughes (1980), Little (1982), and Patrick & Rosovsky (1982).
[31] See Balassa (1988), and So & Chiu (1995).
[32] Stubbs (2005), p.4.
[33] Ibid., p.4; Haggard (1990).

role in taming market failures and provides better allocation of resources in the long run.[34] This argument is based on the "infant industry principle" going back to Friedrich List.[35] Statists emphasize the "developmental" role of state because of its ability to make development its foremost objective and maximize economic growth by mediating market forces through various pilot agencies—for example, the Ministry of Trade and Investment (MITI) in Japan.[36] In order to answer the neo-classical critiques of ISI and state intervention in economics, statist scholars clearly emphasize the duality of subsidies and discipline. Furthermore, bureaucratic autonomy and public-private cooperation is examined in the EA context in order to indicate the complementary nature of state and markets.[37] Linda Weiss and John Hobson have presented a much more nuanced version of the statist perspective that does not reject markets, but works with them in tandem; they have argued that "its emphasis is on the *synergy* of competitive collaboration between guided markets, in the pursuit of developmental objectives. In sum, bringing the state back in does not entail kicking the society out."[38] In a sense, it is not a matter of whether the state should intervene or not; what is important is to find the appropriate balance between state and market. The statist perspective has been criticized for not achieving a consensus on what kind of intervention should be prescribed for developmental states.[39] Nevertheless, the statist perspective has significantly challenged the dominancy of the neo-classical paradigm in explaining EA development. Studies within the statist perspective have provided much more detailed accounts and empirical analyses of the development trajectories of particular EA states.[40]

[34] So & Chiu (1995), p.12.
[35] For a renewed version of the infant industry argument within a historical and developmental perspective, see Ha-Joon (2002).
[36] The "developmental state" concept is used by Johnson (1982).
[37] See Amsden (1989) and Öniş (1991).
[38] Weiss & Hobson (1995), p. 138. For the argument about "bringing the state back in," see Evans *et al.* (1985).
[39] Stubbs (2005).
[40] For the leading studies, see Johnson (1982) on Japan, Amsden (1989) on South Korea, and Wade (1990) on Taiwan. For a review article, see Öniş (1991).

The *culturalist perspective* identifies the nature of EA development within a context of values, attitudes, practices and institutions that underpin particular policy choices for developmental strategy.[41] Culturalist scholars link certain traits of the more than two-thousand-year-old Confucian culture with the developmental aspects of EA countries. Confucian culture is thought to be conducive to the EA type of capitalist development.[42] From this perspective, Confucian culture is associated with obedience to legitimate authority, familialism, and respect for education, duty, hard work, and discipline.[43] It is argued that the reasons for the authoritarian nature of the government, family-oriented business structure, and policy choices concerning education and investment in human capital are the direct outcome of Confucian cultural traits. However, this perspective fails to explain why these Confucian societies failed to maintain comparable steady growth rates and development in the early part of the twentieth century, in marked contrast to their achievements in its second half.

Japan-centered explanations emphasize two central points: On the one hand, the former Japanese colonial experience in the region, although repressive, established the institutional features for long-term growth.[44] On the other hand, in the post-war era Japan played the leading role in the regional development through financial aid, being a role model for others, and, most importantly, through the transfer of industrial capacity to other economies, in line with its technological advancement and increasing cost of labor.[45] This perspective provides many insights into regional development and the role of external actors in the achievement of sustainable growth.

American hegemony explanations are based on dependency theory, arguing that the US and its strategic interests in the region during its fight with communism constituted a

[41] See So & Chiu (1995), p.8.
[42] On Confucian culture and its effects on development, see Rozman (1992), Pye (1985), and Hofheinz & Calder (1982).
[43] Hicks & Redding (1983), and Stubbs (2005).
[44] See Stubbs (2005), and Kohli (1994).
[45] The "flying geese model" with Japan playing the leading role can be considered in this context. See the seminal article by Akamatsu (1962).

major force for providing financial aid to these newly industrializing countries. EA economies were encouraged to adopt some type of capitalism which the US imported to the region.[46] However, this approach has been criticized on the grounds that it cannot explain cases other than those of Japan, South Korea, and Taiwan. Yet, from a political economy perspective it is crucial for shedding light on the role of external influences and strategic interests in shaping economic policies.

The explanation of tiger-style economic performance requires a historical perspective that takes into account the complex interplay of external and domestic institutional and political forces. Since our aim is to use the EA experience as a basis for a comparison with the recent Turkish economic performance, we would like to highlight the following interrelated dimensions of the EA experience regarding conditions for sustainable growth: (a) high domestic savings and investment provide the resources for physical and human capital formation without the risk of running a serious balance of payment deficit; (b) in line with the latter, a lower degree of dependence on foreign capital and global liquidity conditions; (c) outward-oriented, export-competitive and technologically developed industrialization; (d) selectivity, discipline and dialogue in industrial policy, in contrast to perverse incentives and heavy and indiscriminate protectionism associated with typical ISI experiences; (e) the importance of a highly dynamic regional environment for attracting FDI; (f) single-minded focus on human capital development, *i.e.* education and health; and (g) relative stability of the underlying institutional and political environment or governance structure.

Although the insights gained from the EA experience provide fertile ground for a comparative analysis, our assessment of the recent Turkish economic success in a global setting incorporates also certain key emerging markets from Latin America, Central Europe, India and Russia. Our reasons for this are as follows: firstly, a broader comparison of the

[46] See Arrighi (1996) and So & Chiu (1995).

Turkish economy provides alternative venues for a theoretical debate; secondly, and much more specifically, there are strong similarities between the emerging markets in Latin America and Turkey in terms of their early experience with neo-liberal structuring; and, thirdly, the incorporation of CE emerging markets provides extra leverage with respect to the EU accession process, FDI attraction and democratization. Moreover, even though the EA model seems to be an outstanding example of sustainable growth, it might not be the best model for Turkey, given the illiberal nature of EA countries' governing structures and weak democratic credentials. Last but not least, tiger-like performance is not unique to EA countries. To the best of our knowledge, the term has recently been applied to the cases of Ireland and the Baltic states.[47] In this respect, the extended boundaries of our comparative analysis should provide a better outlook for the sustainability of Turkey's economic growth. In other words, we ask whether Turkey will emerge as a new tiger, but not necessarily an East Asian-style new tiger.

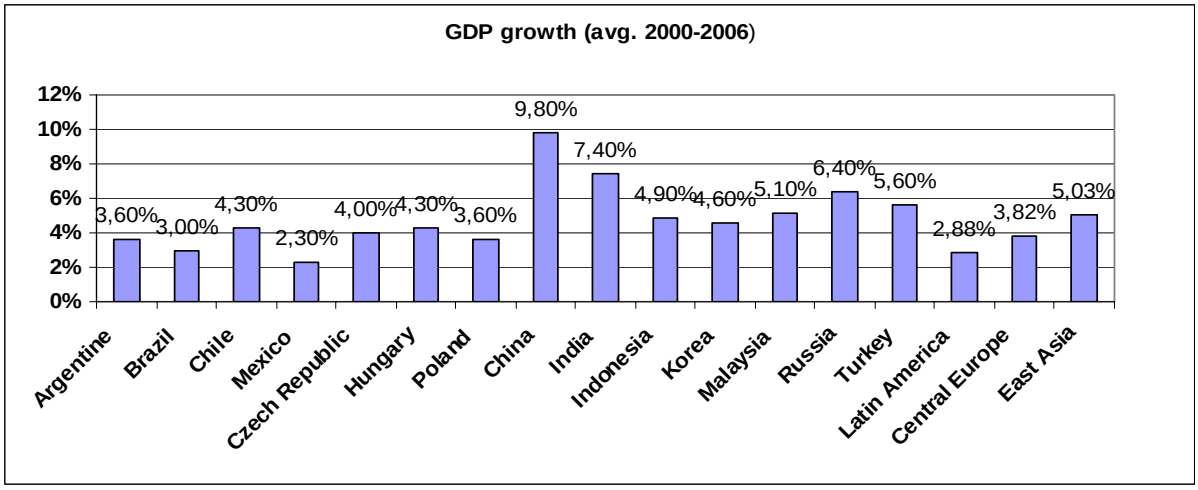
The recent performance of the Turkish economy in a global setting

Embedding the Turkish experience in a comparative analysis enables us to better grasp the global trends affecting key emerging markets, as well as to better identify the achievements and limits of the recent reform process and structural transformation of the Turkish economy. The comparative data on growth between 2000 and 2006 indicate that Turkey achieved a successful growth rate higher than the regional averages and most of the emerging markets, with the exception of China, India and Russia with the growth rates of 9.8, 7.4 and 6.4% *per annum*, respectively. The fact that the GDP in Turkey fell by 9.5% in 2001 due to a major financial crisis makes the Turkish success in terms of growth performance even more striking. Thus, the growth performance data covering the period between 2002 and 2006 indicate a

[47] For an analysis of Irish success and the term "Celtic tiger," see O'Hearn (2000).

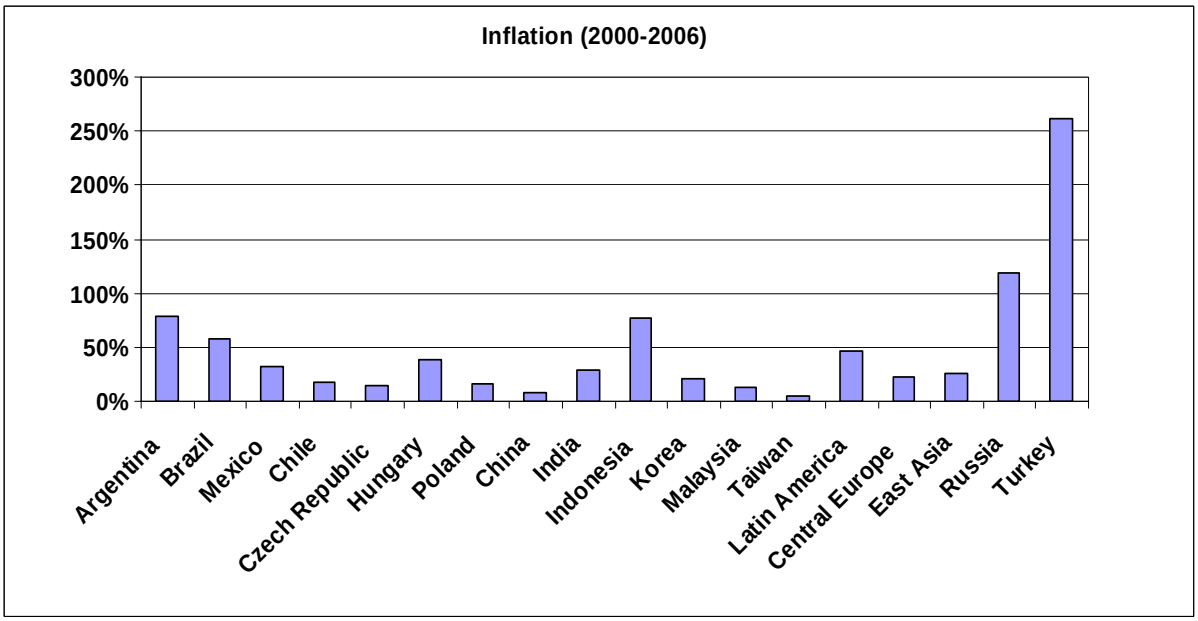
7.5% average growth *per annum* for Turkey. This comparative data also indicates that EA countries continue to be the outstanding performers of growth, exceeding LA and CE.

Figure 5. GDP growth in a global setting [48]



Source: World Bank, World Development Report 2007

Figure 6. Cumulative inflation (2000-2006) in key emerging markets[49]



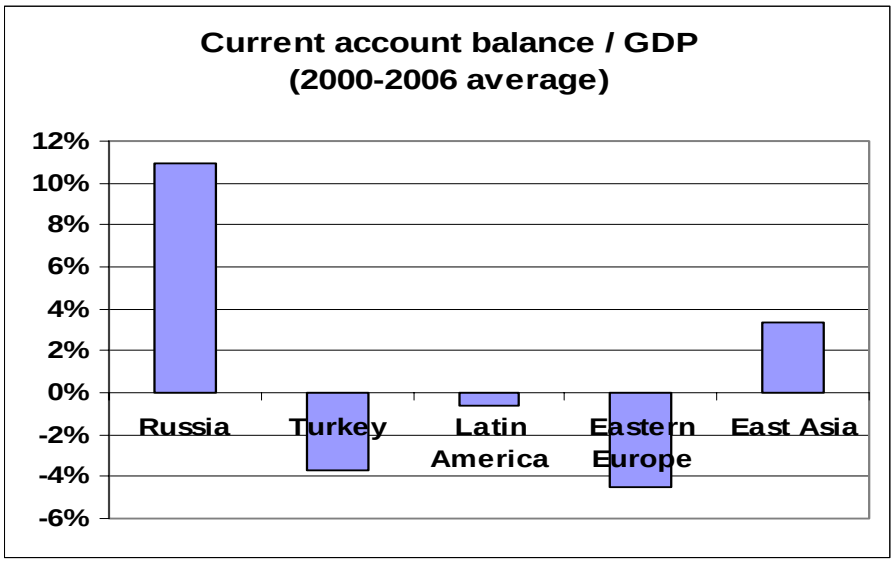
Source: IMF, World Economic Outlook Database

[48] The regional growth rate was calculated as the weighted average of the countries located in particular regions.
[49] Regional inflation was calculated as the simple average of the countries in particular regions.

As we have argued above, Turkey has also achieved significant success on the inflation front. However, a cross-country comparison indicates a less impressive picture. In relative terms, Turkey appears to be the worst performer among the key emerging markets, followed by Russia, Argentina and Indonesia (Figure 6). Even the recent trend of the 10% inflation threshold is well above the emerging market averages. In a global environment characterized by low inflation rates, Turkish policy-makers should not feel over-confident about their achievements concerning inflation.

Comparative data on current account balance (CAB) highlights another weakness of the recent Turkish economic performance. While EA countries and Russia register current account surpluses and LA countries maintain balanced current account positions, Turkey and CE countries tend to display serious current account deficits.

Figure 7. Current account balance as a ratio of GDP in key regions[50]



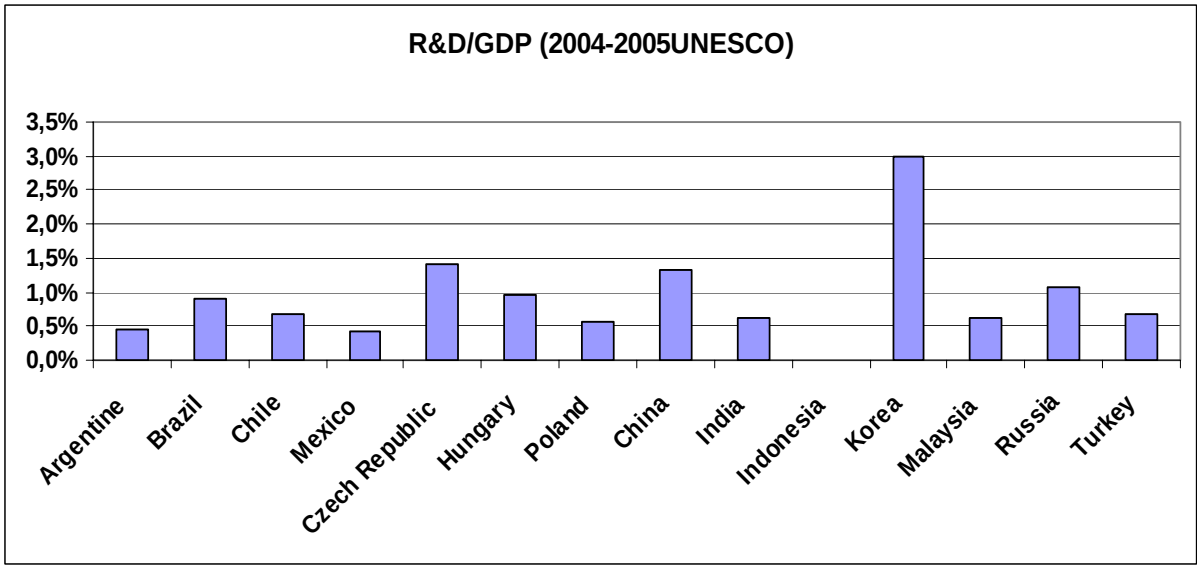
Source: Source: IMF, World Economic Outlook Database

[50] The regional CAB / GDP ratio was calculated as the weighted average of the countries in particular regions.

Arguably, EA countries followed a much more cautious current account balance policy after the East Asian Crisis in 1997. Similarly, LA countries such as Argentina are careful not to become dependent on foreign capital and short-term portfolio investment, having experienced a major economic crisis in 2001. However, Turkey seems to be unaffected by its earlier experience of current account deficit and dependence on short-term portfolio investment. The current account deficit and the dependence on foreign lending seem to be some of the major challenges to sustainable growth in Turkey, especially as favorable global liquidity conditions are in the process of serious reversion.

The fourth lesson to be drawn from the EA experience and the international comparison of key emerging markets is the importance of an externally-competitive and export-oriented economy. EA economies both diversified their exports and enhanced the level of technology required for their export products. In other words, they succeeded in transforming their economies from low-value added products to technology-intensive high-value added products. Figure 8 indicates the research and development (R&D) expenditures as a share of the GDP. Countries like Korea, the Czech Republic, China, and Russia spend more on R&D activities, which in turn enhances their long-run growth and technology-intensive export competitiveness. Turkey's performance is more modest in this respect, more in line with LA countries, Poland and India.

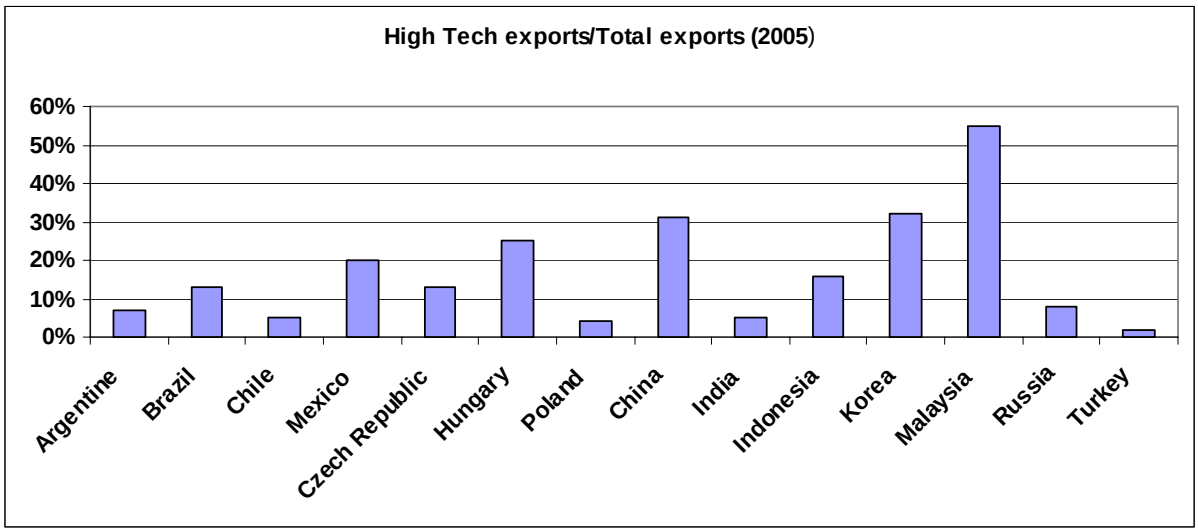
Figure 8. R&D expenditures as a share of GDP



Source: UNESCO, 2004-2005

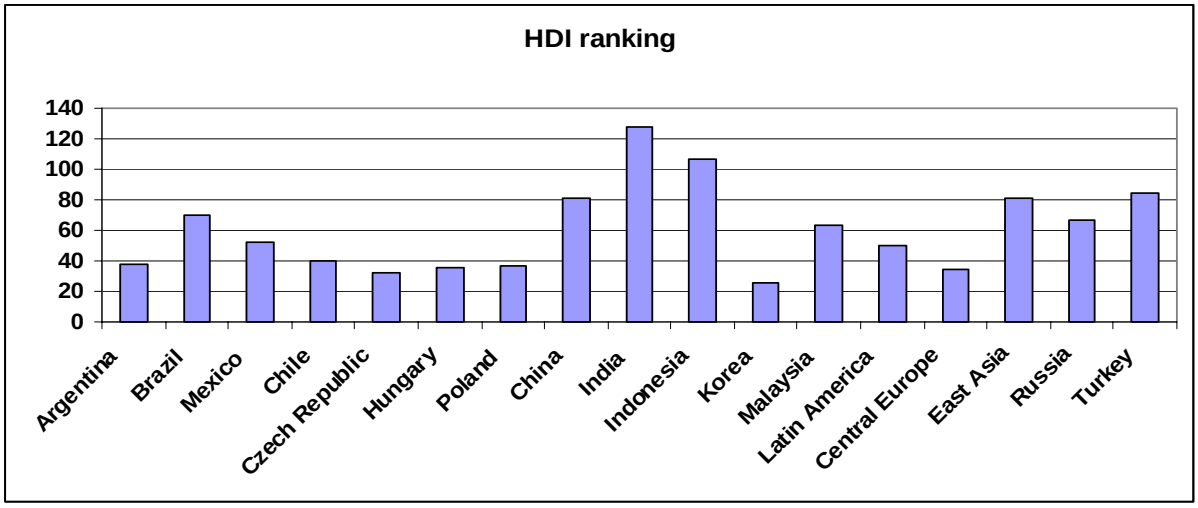
Similarly, there are clear differences between the key emerging markets with respect to their export products. Figure 9 indicates that the exports of countries such as Malaysia, Korea, China, Hungary and Mexico are largely comprised of high-tech products. In contrast, Turkey has a low figure in this regard. It should also be noted that there is no direct short-term correspondence between R&D investment and high technology exports, due to the long-term effects of these investment, the disadvantage of being a late-comer, and other factors such as FDI. An analysis of the key regions enables us to see that EA countries and, to some extent, CE countries managed to increase their R&D investment and their high technology exports.

Figure 9. Share of high technology exports in total exports



Source: World Bank, World Development Report 2007

Figure 10. Human development index (Ranking)



Source: UNDP, Human Development Report 2007

Last but not least, beyond the strict limits of economic growth, one should also take into account the broader aims of development. The Human Development Index (HDI) is the appropriate measure to use in this context. According to HDI data, while Turkey boasts great success in GDP growth, such success cannot be demonstrated in terms of human

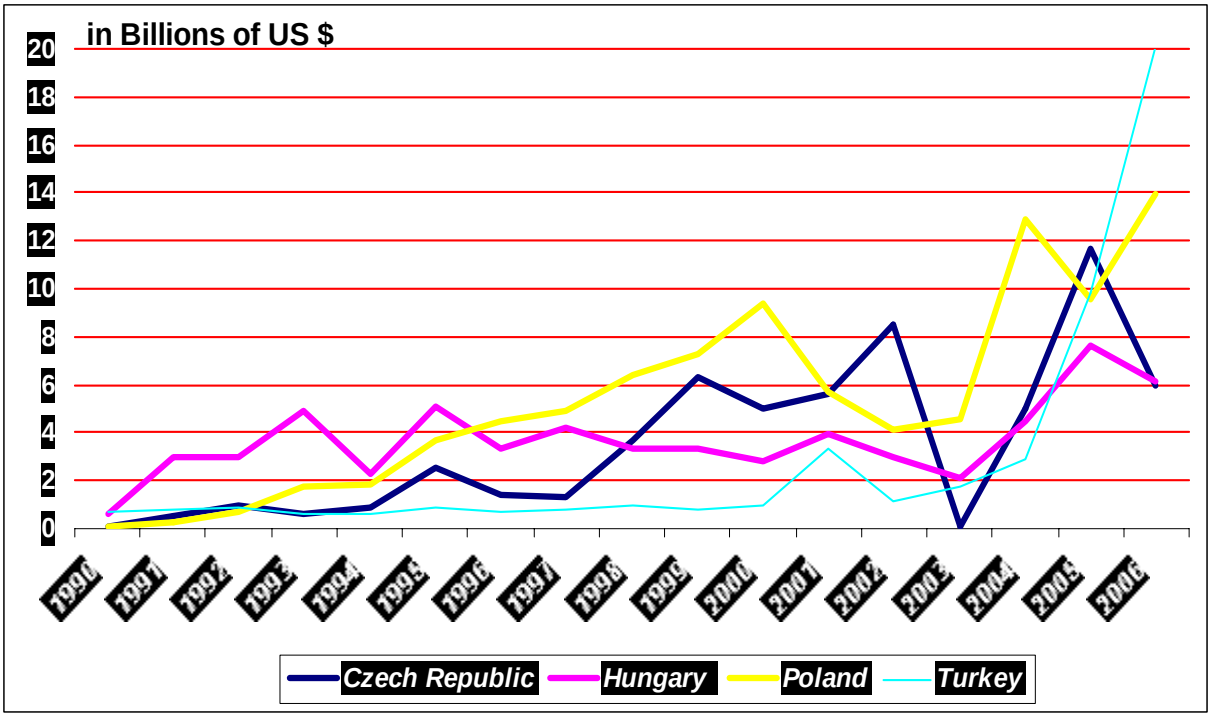
development. All LA and CE countries perform significantly better than Turkey. Only India and Indonesia perform worse than Turkey (Figure 10). Even China as the newly emerging tiger seems to be ahead of Turkey in this respect. The status of Turkey in terms of HDI should be enhanced, not only by focusing on the growth side, but also by investing in human capital—namely, education and health. Sustainable growth in the longer term can only be achieved via an improvement of human capital.

Moving beyond the interpretation of basic data for international comparisons, three crucial points deserve further emphasis. First of all, the EA and LA economies, and much more explicitly Russia, have been very sensitive to their current account balance after having experienced serious financial crises due to the speculative outflow of short-term portfolio investment. Turkey and CE economies, however, appear to follow a different path. Nevertheless, in a changed environment where global liquidity conditions are less favorable, these economies will find themselves much more vulnerable to external shocks.

Secondly, further comparative analysis between Turkey and CE countries is required in regard to the EU accession process and the amount of FDI attracted. Although Turkey started its neo-liberal adjustment in the post-1980 period, having transformed itself from a socialist rule to a liberal market economy, a decade later it was not Turkey, but CE countries that managed to attract a significant level of FDI and to become EU members. The relative failure of Turkey in terms of attracting FDI and becoming an EU member is quite paradoxical in comparison to those three CE countries—namely, the Czech Republic, Hungary, and Poland. Turkey only recently managed to attract significant levels of FDI, following the EU Council's decision to initiate accession negotiations in December of 2004 and the confirmation of this decision in October of 2005. This also indicates the role of the EU as an external anchor, as well as the vicious and virtuous cyclical nature of Turkey-EU relations. In the unstable macroeconomic environment of the 1990s, Turkey failed to receive the EU's

strong signals in the direction of full membership, which, in turn, constituted a significant obstacle in terms of preventing Turkey from sustaining macroeconomic stability, promoting investor confidence and, hence, attracting FDI on a significant scale. In contrast, the post-2001 experience corresponds to a virtuous cycle. As Turkey made important strides towards satisfying the economic and political components of the Copenhagen criteria, the macro-environment became progressively more conducive to attracting FDI on a large scale and the parallel process of implementing an ambitious privatization program.[51]

Figure 11. FDI inflows into Turkey and three CE countries



Source: Compiled from the UNCTAD database

Thirdly, deducing lessons from the CE experience and the EU accession process is crucial for the democratization of Turkey. The EA experience constitutes a benchmark for sustainable development. However, with their repressive and authoritarian regimes EA

[51] For a detailed assessment of the EU's role in shaping the political economy of Turkey, see Öniş and Bakır (2007).

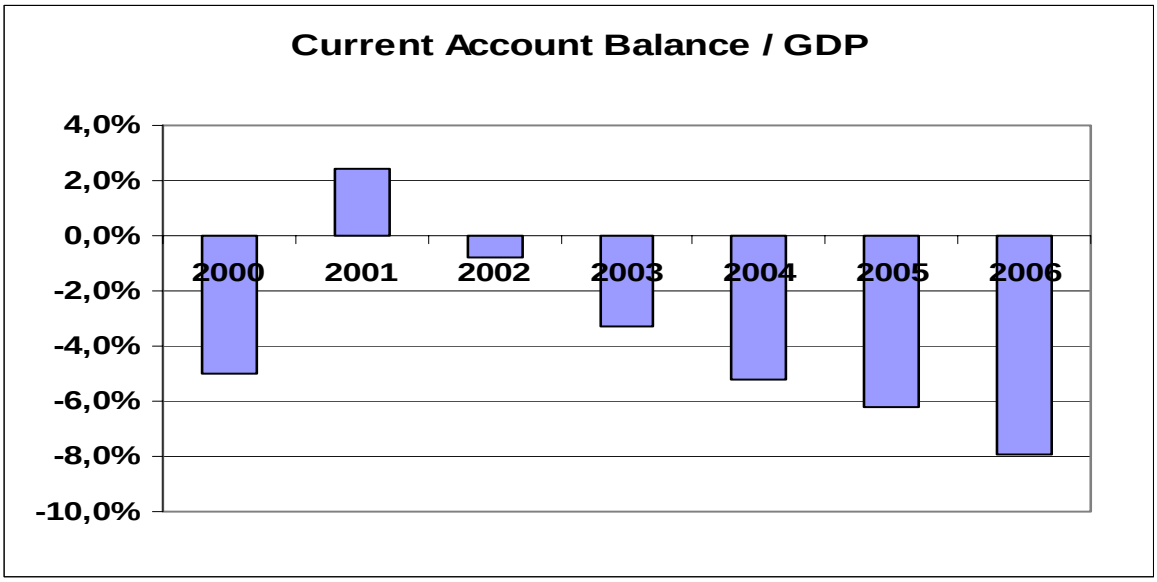
countries fail to satisfy Western democratic credentials. Even the democratic regimes of the region appear to be "illiberal democracies" by the standards of European or Western democracies. What Turkey seeks in the long run should not only be sustainable growth, but also better democratic credentials in terms of governance, rule of law, political rights, and civil liberties. In this respect, the role of the EU as an external anchor and learning from the experience of CE countries are all the more important.

Sustainable growth: Challenges and opportunities

Although our analysis of the performance of the Turkish economy in the recent period indicates that Turkey has achieved an outstanding success in comparison to its earlier experience in the neo-liberal era and modest success in comparison to the key emerging markets, a detailed and balanced account of the Turkish economy should also identify the challenges and possible opportunities for sustainable growth. Turkey will achieve sustainable growth and deliver a "tiger-like" performance only to the extent to which it will be able to overcome its challenges and capitalize on its opportunities.

A. Current Account Deficit: The foremost challenge to the sustainability of growth and macroeconomic stability in the Turkish economy is the high level of the current account deficit (CAD). Figure 12 clearly indicates that the current account deficit has increased tremendously in the post-2001 era, not only in terms of the amount, but also as a percentage of the GDP. The early experience of the Turkish economy has proved that the current account deficit might turn into a balance of payment crisis in an open economy, where capital account is liberalized and full convertibility is guaranteed.

Figure 12. Current account balance as a percentage of GDP

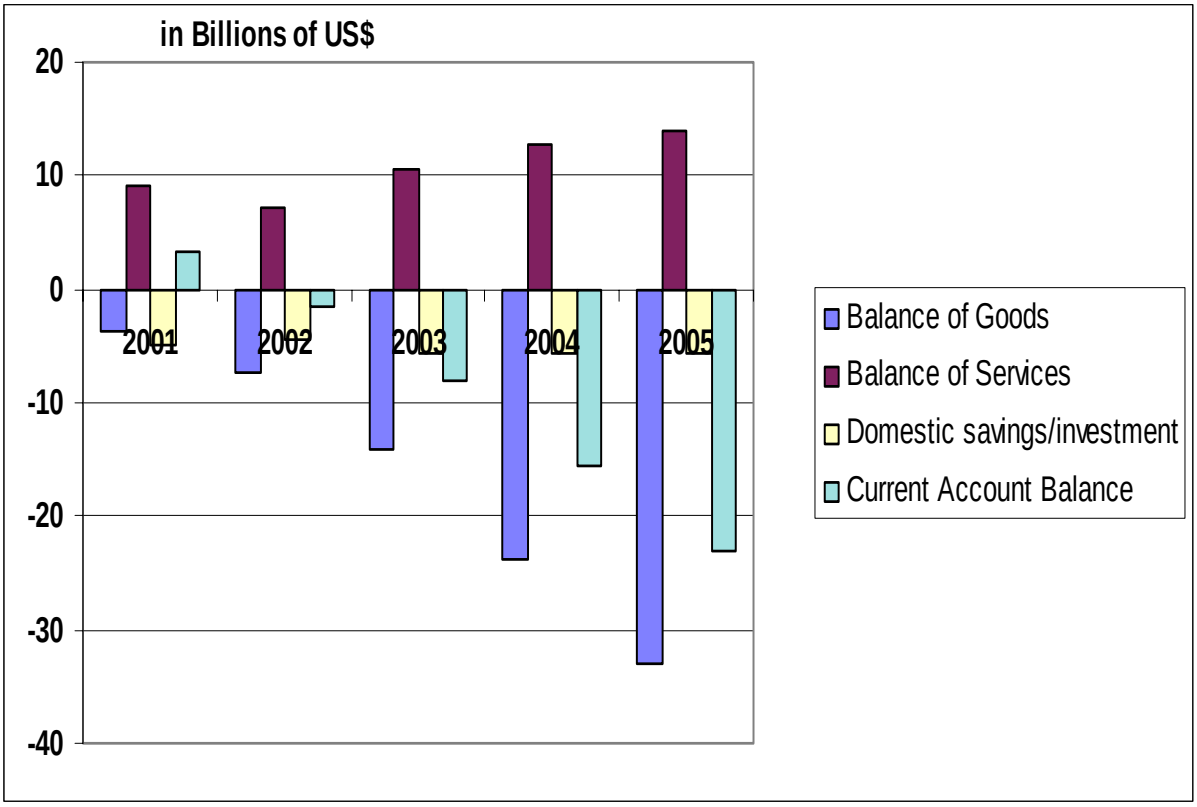


Source: IMF, World Economic Outlook

Figure 13, on the other hand, enables us to recognize the components of the CAD in the Turkish economy and the factors leading to the CAD. The large bulk of the CAD stems from the deficit in commodities trade—that is, the difference between exports and imports. Turkish exports have experienced considerable diversification in the post-1980 period, from primary to manufactured goods, with textiles, iron, steel and manufactured foodstuff representing the major growth industries in the early years of neo-liberal reforms. More recently, during the post-2001 era, manufacture of motor vehicles has emerged as a major export industry. Yet, these transformations have failed to keep in check the increase of the trade deficit during the same period. A number of factors explain the phenomenon. First, export growth and diversification could not be accomplished in a sustained manner. Secondly, Turkish exports display a high degree of import dependence. Thirdly, the Customs Union has created a certain bias in favor of imports. Last but not least, the appreciation of the TL undermines the

international competitiveness of Turkish goods.[52] The second component of the deficit is due to the imbalance between domestic savings and investment. Turkey's domestic savings have been traditionally lower than the gross fixed capital investments, which need to be compensated by foreign capital, in the form of short-term portfolio investment, credit channel, or FDI (Figure 14).[53] The lower level of domestic savings does not only create the CAD, but also hampers investment in the long run. The EA economies, in contrast, have managed to sustain domestic savings of 35-40%, which rendered their investment and growth at least partially immune to external shocks and global liquidity crises.

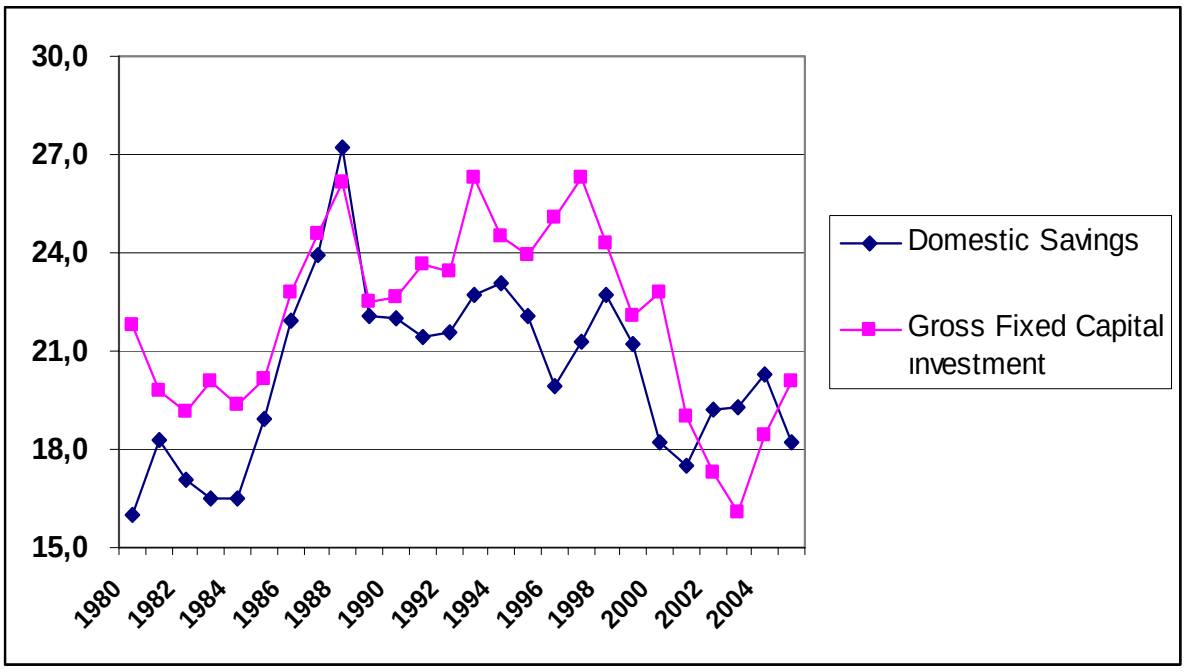
Figure 13. The components of the current account balance in Turkey



Source: State Planning Organization and Central Bank of Turkey

[52] For the details of the argument and recent assessment of the CAD in Turkey, see Eşiyok (2008).
[53] Based on the CB data, Eşiyok (2008) has indicated that 50% of the recent CAD is compensated through FDI.

Figure 14. Domestic savings and gross fixed capital investment in Turkey



Source: State Planning Organization

B: Externally dependent growth: The CAD and low domestic savings make the Turkish economy dependent on foreign capital and global liquidity conditions. The sub-prime mortgage crisis and the possible recession in the US economy may affect the Turkish economy in a number of ways: due to the change in favorable global liquidity conditions, it will be much harder for Turkey to attract foreign capital through credit, portfolio investment and FDI channels. Equally importantly, Turkey will indirectly be affected through the trade linkages with the EU; with the US recession having a direct impact on the EU, Turkey will feel the repercussions.

C: Slowing pace of FDI and privatization: Although the most recent data are not available as of yet, many Turkish economists warn that the recent boom of FDI and privatization is over. This is partly due to the nature of the FDI that has entered Turkey in recent years. The FDI did not come to Turkey in the Greenfield investment form, but mostly

in the form of mergers/acquisitions and privatization. Once the opportunities for large-scale privatization have been exhausted, it might prove more difficult to attract FDI.

D: Decreasing influence of external anchors: One of the reasons for the recent improvement in Turkey's economic performance was the specific short-term influence of the IMF in the stabilization program and reform process, as well as the long-term anchor role played by the EU. The EU anchor not only increased confidence in the overall stability of the economy and the amount of FDI and privatization, but also provided incentives for further reforms in line with membership prospects. However, the end of the stand-by agreement with the IMF and the unwillingness of both EU and Turkish policy-makers to come to an agreement due to the Cyprus issue, the dominance of right-wing Christian Democratic leaders suspicious of Turkish membership because of cultural concerns and immigration issues, and a weakening of the Justice and Development Party (JDP)'s commitment to the EU accession process in its second term—these have all led to the deterioration of relations between Turkey and the IMF and Turkey and the EU; in the long run, this makes the Turkish economy much more vulnerable to external shocks.

E: Political instability: Although this paper focuses on the economic dimension of the Turkish success in recent years, it is obvious that political stability is a critical condition for sustainable growth. One of the reasons for the recent successful performance of the Turkish economy was, of course, the majority government of the JDP. Poorly governed by successive coalition governments in the 1990s, Turkey was in need of political stability. In spite of initial doubts, the JDP showed considerable commitment to the implementation of the new stage of neo-liberal reforms.[54] The government relied on a stabilization program initiated under the auspices of the IMF and the political entrepreneurship of Kemal Derviş in the first term. During its first term in office, the JDP projected the image of a pragmatic and reformist party.

[54] For a detailed discussion of the JDP in Turkish politics, see the edited volume by Yavuz (2006), in particular his introductory chapter and the chapter on the political economy perspective by Öniş (2006).

However, its recent performance has increasingly raised questions about the true nature of its policies, and there has been a growing polarization of the political environment over the course of 2007 and 2008, with potentially damaging consequences for economic performance.[55] The degree of polarization in recent Turkish domestic politics has once more indicated that Turkey has not yet emerged as a fully consolidated democracy. The trial involving the closure of the JDP, a party which received almost half of the votes in the recent elections, constituted a major threat to economic and political stability.[56] Furthermore, recent allegations involving a planned military intervention on the part of retired generals and other high-ranking public figures, which has resulted in yet another major controversial court case, have clearly demonstrated that democracy is not yet the "only game in town." There is no doubt that such uncertainties tend to undermine the trust of key economic actors and create a downward bias in terms of economic performance, which can be clearly detected from the recent behavior of key macroeconomic indicators. Rising interest rates and inflation, as well as the slowdown in FDI and overall growth, highlight the negative bias created by the recent wave of political uncertainties, although it is too early to predict the extent and the depth of the downward bias exerted by this unfavorable set of political developments.

F: The need for second-generation reforms: Most analysts of the Turkish economy have acknowledged the JDP government's success in maintaining fiscal and monetary discipline and implementing important regulatory reforms, building on the process which had already started in the aftermath of the 2001 crisis. Nevertheless, it has been acknowledged that the same government has been less successful in terms of designing and implementing

[55] On the JDP, moderate Islam, and secularist opposition in Turkey, see Somer (2007).

[56] Fortunately, the final decision of the Constitutional Court in July of 2008 did not involve the closure of the party. Instead, the governing party received a serious warning for violating the principles of the secular constitutional order. If indeed the party had been banned from politics, the outcome could have been a much higher degree of political and economic instability, especially if the decision had been associated with the suspension of negotiations with the EU altogether.

the next-generation reforms aimed at longer-term industrial restructuring. Arguably, an active industrial policy has been the missing link in the armory of the JDP's policies.[57]

All these factors indicate the interactive nature of challenges in terms of achieving sustainable growth for the Turkish economy and the vicious and virtuous cyclical nature of economic development. The more the Turkish economy is able to overcome these challenges, the less likely it will turn back to the vicious cycle and unstable macroeconomic environment of the 1990s, and the more likely it will converge with the developed economies of the world, just as EA countries managed in the past and, more recently, CEECs.

The threats and challenges to the sustainability of high growth rates highlighted so far should not lead us to disregard the significant opportunities for economic growth in the medium term. Turkey's role as an energy transit country and its growing economic and political influence in the surrounding regions, particularly in the Black Sea region, assumes a major significance in this context. The revenues generated through pipelines as well as trade and investment linkages with the surrounding regions constitute an important avenue for future economic growth. The growing economic significance of Turkey as a pivotal country in its immediate neighborhood is increasingly related to its role as an energy transit country in the broader context of European energy security. In this context, as argued by Aliboni (2006), the Black Sea Economic Co-operation Project initiated in 1992 is likely to become progressively more important as the EU itself increasingly becomes an "insider" in the Black Sea economic space. The direct involvement of the EU in the Black Sea region might enhance the role of Turkey, and this may in the medium term facilitate a revitalization of the EU anchor.

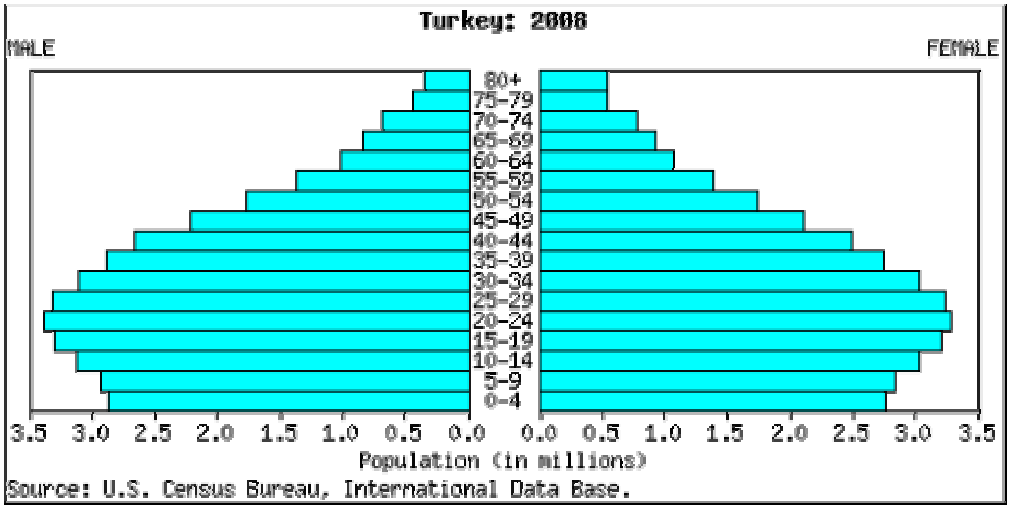
Another medium- and long-term opportunity for Turkey is its demographic dividend. Turkey has a relatively young population, which in the future is expected to increase labor

[57] Indeed, this was the main theme of the TUSIAD (Turkish Industrialists' and Businessmen's Association) -Koç University Economic Research Forum Conference entitled "Turkey's Search for Industrial Policy in the Light of International Experiences," held on December 25, 2007 in Istanbul.

participation rate and domestic savings. Figure 15 indicates that the bulk of the population is less than 25 years old and likely to continue its education. In time, it is expected that this young segment of the population will become a part of the production/employment process, which will not only lead to economic growth, but also to an increase in domestic savings. A recent report prepared by Rijckeghem and Üçer (2008) estimates that the reduction in the youth dependency ratio is likely to increase domestic savings by about 5% of GDP.

Also, the growth of entrepreneurship, as well as its spread across the country beyond the confines of the Marmara region, constitutes important positive developments from the perspective of longer-term growth. The so-called Anatolian tigers, emerging as the winners of the neo-liberal restructuring in Turkey, have not only widened the geographical boundaries of investment, but also created new employment opportunities in Turkey's peripheral regions (Öniş 2006). The emergence of this Anatolian bourgeoisie and the rise of Anatolian cities can be seen as an opportunity to overcome uneven regional development and unemployment in the periphery. Parallel to this development, big business in Turkey has been transformed over time from inward-oriented entities to outward-oriented firms whose operations are increasingly global in nature. Indeed, many of the major conglomerates have established themselves as exporters of capital, which points towards the growing maturity of Turkish industrial capital. The transnationalization of big business in Turkey represents a striking aspect of the recent globalization of the Turkish economy and an important source of longer-term economic dynamism.

Figure 15. Population in Turkey according to age groups



Extending the limits of analysis: The social dimension of the Turkish economy

So far, our analysis of the recent performance of the Turkish economy in terms of inter-temporal and cross-country comparisons has only dealt with the improvements and challenges concerning the strict economic measures of macroeconomic performance and growth. Nevertheless, a complete and balanced assessment of the recent performance of the Turkish economy necessitates incorporating the social dimension into the picture: unemployment, inequality and poverty. The experiences of EA economies have demonstrated that sustainable growth was accompanied by a relatively even distribution of income, creating employment for the masses and reducing poverty.

Achievements in terms of growth in the recent period have not been matched by an equally striking increase in employment. According to recent statistics, the overall unemployment ratio in Turkey is 11.4% and 11.6%, for 2007 and 2008, respectively.[58] The figures are much worse for non-agricultural unemployment and youth unemployment. While non-agricultural unemployment in 2007 was 14.2%, youth unemployment reached 21.7%,

[58] The data are taken from the State Institute of Statistics.

which is likely to create disillusionment and associated social problems, such as a high crime rate and social unrest.

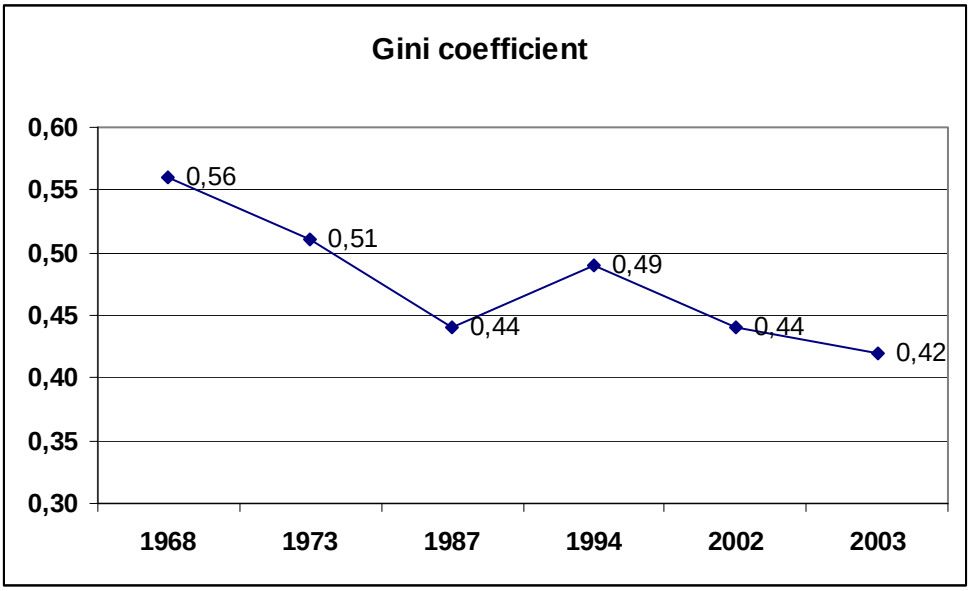
Turkey can be considered a moderately unequal society with respect to income distribution as measured by the Gini coefficient. Inequality in Turkish society does not reach the levels of LA countries, but is higher than in European countries and such EA cases as Japan and South Korea.[59] The latest available datum for the Gini coefficient is 0.42 (Figure 19) for 2003. More interestingly, Figure 16 indicates that there has been a secular decline in income inequality in Turkish economic history since 1968. Even in the neo-liberal era, the Gini coefficient was generally falling, which makes the phenomenon quite paradoxical.[60] Yet, a better distribution of income and a democratic mechanism for interest intermediation may not only contribute to sustainable growth, but also to political stability.[61]

[59] See Figure 7.

[60] Cizre-Sakallıoğlu and Yeldan (2000) only focus on the changes in the period between 1987 and 1994, in which the Gini coefficient rose by 5%. However, the secular decline needs an analysis that considers the post-1968 period and explains the puzzle of how the Gini coefficient decreased in a neo-liberal structural transformation. A possible answer to this paradox is the transformation of the Turkish economy from a rural/agricultural to an urban and industrial/service-based economy, which reduced rural–urban inequality. A strong component of inequality stems from rural-urban differences; the more economy and society are urbanized, the less society will be unequal. Another explanation takes into consideration the fact that the expansion of the neo-liberal coalition over time created new ways to distribute resources. The JDP's electoral coalition with its cross-class constituency, the rise of small and medium-sized enterprises and the practice of informal redistribution mechanisms might all have played a role in the reduction of the Gini coefficient.

[61] It is important to note that such democratic demands can easily turn into populist demands and avenues for rent-seeking, as frequently observed in Turkish politics and economic history. However, it is not democracy *per se*, but Turkey's own democratic deficits which have created an environment in which patronage politics and populism have been associated with corruption and an inefficient allocation of resources. See Öniş and Şenses (2007).

Figure 16. Gini coefficient in Turkey



Source: Duygan and Güner (2006)

Poverty[62] is the third dimension of our analysis focusing on the societal aspects in the assessment of the recent performance of the Turkish economy. Extreme poverty is almost absent in the Turkish context.[63] However, the data provided by the CIA World Factbook and the UNDP statistics indicate that there are serious levels of moderate poverty and poverty adjusted to PPP.[64] In order to maintain steady growth rates in a politically stable environment, policy-makers in Turkey should also consider the social aspects of economic polices and pay greater attention to unemployment, inequality and poverty.

[62] The meaning of poverty and its measurement is a controversial issue. The World Bank defines two measures: extreme poverty measured by the income of less than 1 US$ per day, and moderate poverty (less than 2 US$). Both of these are absolute measures of poverty and do not take price levels into account. That is why some scholars use price-adjusted (PPP) measures of poverty. In addition, some introduce the concept of relative poverty, measured as earning less than a half of the income earned by the median person in terms of distribution of income.

[63] Actually, these numbers are disputed. The data provided by the UNDP claim that 3% of extreme poverty remains, whereas the data by the State Institute of Statistics indicate that extreme poverty is non-existent in the Turkish case.

[64] UNDP: 27%; CIA World Factbook: 20%. See the UNDP Human Development Report 2007 and CIA World Factbook.

Concluding remarks

The central objective of this paper has been to confront the question of whether the recent Turkish growth experience represents a sustainable process. We have compared the performance of the Turkish economy in the post-2001 era not only to its performance in the previous era of neo-liberal reforms, but we have also placed it in a broader global context. In this context, the benchmark is not confined to the experience of East Asian "tigers," but also includes other emerging markets in Latin America and Eastern Europe. Comparisons with its own past have been helpful in terms of highlighting the achievements of the Turkish economy in recent years. Comparative analysis involving other emerging markets has clearly pinpointed the weaknesses and vulnerabilities of the recent Turkish economic performance. Most importantly, the current account balance and dependence on foreign capital and global liquidity conditions can be considered the main challenges to the sustainability of long-term growth in Turkey. Furthermore, the decreasing influence of the EU anchor and its possible effects on FDI attraction and privatization revenues might further deteriorate the current account balance and macroeconomic stability. In addition to these factors, changes in the favorable global liquidity conditions due to the financial crisis in the US economy might affect the Turkish economy which is vulnerable to such external shocks. Last but not least, unlike between 2002 and 2006, the present government can hardly be described as enthusiastically committed to economic reforms and the EU accession process.

Can Turkey emerge as a new tiger, or will it remain a temporary star? So far, this analysis has portrayed a balanced account of the Turkish economy, emphasizing both the positive achievements in the recent period, as well as its weaknesses and major challenges to long-term stability and growth. Turkey can emerge as a new tiger if, and only if, it can manage to overcome the challenges and capitalize on medium- and long-term opportunities. In this respect, the externally dependent growth should be reduced with an increase in

domestic savings and exports—to exceed imports—leading to a decrease in the current account deficit and the vulnerability to external shocks and global imbalances. The EU accession process should continue to be the major objective of the government, creating incentives and conditionality for further reform and structural transformation with real membership prospects. The EU accession process does not only empower domestic actors to achieve economic reforms and increase investor confidence, but also provides certain incentives for further democratization in Turkey. Both as a normative ideal and a contributor to long-term development, democratization is likely to be an essential component of sustainable growth and political stability. In contrast to the EA experience and similar to CE countries, Turkey's targets should aim beyond sustainable growth and incorporate measures of democracy and governance. Last but not least, Turkey can become a new tiger to the extent that it can manage to sustain growth by reducing inequality in society, creating employment, and eliminating poverty. In short, the recent growth rates, the reduction of inflation, FDI attraction, privatization revenues and the reform process have all contributed to the initial phase of tiger-like performance. Yet, this initial phase should be complemented by longer-term development strategies designed to overcome the challenges to sustainable growth. Otherwise, Turkey may yet again experience one of its short-lived growth phases and remain a temporary star rather than an emerging tiger, due to the myopic bias of politicians and other economic actors.

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