TURKEY'S ECONOMIC DEVELOPMENT IN THE LAST DECADE, POLICY ISSUES AND THE CHP PERSPECTIVE

During the last decade in which the AKP government has been in power, the Turkish economy's average growth rate was relatively high but not above the long run historic level. A structurally high current account deficit, excessive reliance on one time revenues, fundamental weaknesses in the social and governance domains curtail Turkey's development prospects. The CHP puts forward a potent sustainable alternative strategy based on a coherent set of employment and environment friendly, competitive, equitable and stable high growth policy instruments. It configures a responsible regulatory framework for a corresponding dynamic market mechanism. This strategy at the same time encompasses good governance, transformation to the knowledge economy and convergence to the EU.

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The Background

Although Turkey adopted an export-oriented growth policy path in the mid-1980s, the institutional transformation and macro and microeconomic policy measures needed for this path have, in general, been insufficient. The warranted social measures have also remained weak. These shortcomings led to a highly vulnerable economic structure which was also overly dependent on outside economies both in terms of inputs for the real economy and financial resources. Neither could the social structure be strengthened in conformity with the requirements of contemporary development. The competitiveness of the economy suffered from this state of affairs. And as the stability of economic development could not be ensured, a series of crises occurred, including in the domestic financing sphere. The major February 2001 crisis rendered policy change and the adoption of effective measures imperative.

The government of the time in which Dr. Kemal Derviş became the Minister of State Responsible for Economy, decided to initiate such a policy phase. The latter's technical features were prepared and, upon approval by the political authority, carried out to a large extent by a team in which I was the Undersecretary of the Treasury. Thus, I can speak with firsthand knowledge of the process carried out at that critical phase. To summarize very briefly and selectively; comprehensive restructuring measures also involving legislative changes were taken alongside conjunctural ones. In this vein, public borrowing was taken under control, the banking sector which had become weak, was restructured and endowed with a modern regulatory and control framework, real sector companies were given support and the independence of the Central Bank was guaranteed. The positive impact of this series of reforms was felt quickly and stability was established; growth resumed and exceeded six percent in 2002. Inflation dropped by 39 percentage points to below 30 percent and interest rates applicable in public borrowing decreased by 30 points.

When the Justice and Development Party (AKP) came to power in November 2002, it could count on the existence of such a significantly strengthened economic policy structure as described very briefly above. External conditions, notably in terms of financial resources available to the emerging economies, were also distinctly favorable as the world economy had embarked on a historic period of high growth in which, risk appetite was particularly strong. As the AKP government took office in November 2002, an evaluation of economic development and policies in Turkey's last decade coincides with the assessment of its policy choices and actions.

This article will provide a non-exhaustive, condensed analysis of the following questions: What have the salient features of economic development and policy in this period been, in relation to the developments in the world economy? Beyond their ongoing effects, to what extent and in which way would the present policies affect Turkey's future performance? To what extent can they provide sustainability? What is the significance of, and need for having more potent policy alternatives? And, what are the approaches and policies the Republican People's Party (CHP) is adopting and putting forward in this vein?

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Salient Features from the Last Decade (2003-12)

The Growth Path

Looking into the post-2002 decade in Turkey, first, the magnitude of growth and its oscillation warrants particular examination. During the first three years, i.e. in the 2003-5 period, average growth reached 7.7 percent which is a relatively high rate in international terms. The average growth rate decreased to 5.8 percent in 2006-7, and when the crisis hit the world economy to 0.7 percent in 2008 and 4.8 percent in 2009. The growth rate then increased again to 8.9 and 8.5 percent in 2010 and 2011 respectively. It went down to 3.2 percent in the first quarter of 2012. Thus growth has also displayed a certain volatility.

It is useful to put the post-2002 growth record in historical perspective. In fact the average growth rate of the 1946-2002 period was 5.2 percent. And this is not lower than the average of the 2003-12/Q1 period. In terms of international magnitudes, in 1987, Turkey ranked 14th on the list of economies according to size of

GDP. It was 17th in 2000 and 16th in 2011. Thus, the average growth rate of the 2003-11 period was relatively high, but not higher than the historic average rate.

"One of the critical import related factors affecting the trade balance quite negatively is energy."

Although measuring the magnitude of potential output with precision is not an easy matter, it can be postulated that in a broader context, Turkey has a high growth potential, provided a number of structural reforms –including in the social and governance spheres– are realized. According to the CHP's New Economy Strategy published in April 2011 calculations show that the average growth rate necessary for meeting Turkey's economic development requirements, including in the fields of competitiveness and employment, is approximately a challenging seven percent on average. This is significantly higher than the present levels of potential output measured at the 4.5-5 percent range on average. In fact the increase can be achieved. The CHP's corresponding policy approach and selected measures are summarized further below.

The Current Account and Related Problems

Second, one of the most critical aspects of the ongoing economic development policy framework is that higher growth rates are associated with high current account deficits in a structural way. In fact, although the deficit started to decrease in the first quarter of 2012, it is accompanied by a slowdown of growth. Different economies can have different thresholds in terms of levels of danger associated with current account deficits. However the ten percent ratio to GDP reached in 2011 is undoubtedly a very dangerous level by any account. At 77.2 billion dollars it was the second highest in the world after the U.S., the main currency reserve country.

The principal source of the deficit is the negative trade balance, which is itself associated with a high import dependency ratio in production, including for exports. This dependency ratio reached 43 percent for manufacturing in 2011. It restricts the positive effect that the high increase in exports should have. Equally significant and related, the share of high technology products in manufacturing production and exports is not increasing, but decreasing. In the case of exports, the decrease was from 6.2 percent in 2002 to 3.4 percent in 2010. This lack of competitive edge in higher technology markets could also push Turkey's short-term and maybe also medium-term export prospects to the EU further down. The EU's share in Turkey's total exports has already fallen to 37 percent, following the latest phase of decrease in demand in the Union.

One of the critical import related factors affecting the trade balance quite negatively is energy. Since Turkey is very dependent on a limited number of energy sources and exporters, price changes greatly impact the balance.

The financing of the current account in which short-term flows and the elusive net errors and omissions item play a significant role, constitutes a source of concern. And so is the overvaluation effect of unduly large and unpredictable periodic inflows of short term capital on the Turkish Lira (TL). Although the currencies of countries in Turkey's position are expected to appreciate along their economic growth path according to the phenomenon called the Balassa-Samuelson effect in economic theory, in Turkey's case the appreciation observed tends to exceed the level which can be attributed to this effect.

The Central Bank has declared that one of its significant policy instruments is to create deliberate uncertainty so as to contain unwarranted fluctuations in capital flows. This very likely to show its insufficiency especially in case external conditions, notably in the EU, deteriorate further. On the other hand, inflation has increased again to above ten percent at the end of 2011, although it is lower at present in mid-2012.

Another related source of concern is the very low level of savings which decreased from 19 percent of GDP in 2002 to a mere 12 percent in 2011. The recent strong measure taken by the government of subsidizing a significant proportion of premiums paid to private pension schemes reflects the severity of the problem.

Turkey's short term external debt stock reached 100 billion dollars at the end of June 2012 with a 19 percent rise, compared to the end of 2011. The private sector's foreign debt increased fivefold in ten years to reach 208 billion dollars while the debt/disposable income ratio of households went up from 5.5 percent to 52 percent. In fact, as reflected in some measure by these figures, conditions of vulnerability exist. This is related to the fact that debt and credit have played an excessive role in the growth process.

At the Fiscal Side

Third, although it is overlooked at times, there are critical matters on the fiscal front too, notably the government's overly extensive recourse to one-time-only income sources. For example, nine tax amnesties have been declared and put into force so far. The other is the thwarted tax structure which firstly is unfair on low income earners as indirect taxes constitute 68 percent of the total to start with, and secondly is both inefficient and subject to vast abuses.

All the problems underlined above curtail sustainability significantly, and restrict competitiveness-enhancing development.

Problems of the Social Domain and the Missing Women of the Labor Force

> *"There are critical matters on the fiscal front, notably the government's overly extensive recourse to one-time-only income sources."*

Fourth, deficiencies in the social policy-related fields constitute critical issues in terms of sustainable development and they are interrelated with economic factors. Regarding employment, although unemployment rates appear to have decreased markedly in 2012, the average rate in the 2003-11 period has been above 11 percent while it was 8.3 percent in the 22 preceding years; however, the Labor Force Participation Rate (LFPR) has decreased to 47 percent in the 2000-9 period from 47.8 percent in the previous corresponding period. Average youth unemployment has increased to above 20.7 percent in the 2003-11 period from 15.8 percent in 1988-2002. Women's unemployment rate increased from eight percent in the 1988-2002 period to 11.6 percent on average in 2003-11 while women's LFPR decreased from 33.3 percent to 28.2 percent in the corresponding period. The OECD women's LFPR rose from 59.6 percent to 62.7 percent in the same period. These figures show that the employment situation as a whole has followed a relatively negative course in the last decade under the AKP government's policies, and that the employment prospects of youth and women have been affected even more adversely.

The education situation is even worse, as Turkey continues to score third-lowest in Pisa measurements. Furthermore, the recent education law covering the first 12 years of schooling called "4+4+4" and passed unilaterally by the government has thrown the educational system into confusion. One of the law's main flaws is that it forces specialization at a very early age, contrary to world trends and recent practice. It is also worth noting that the educational level of approximately 55 percent of employed women is below the high school level.

Turkey ranks third-lowest in the OECD income distribution classification and lowest regarding poverty. Regional disparities are also very pronounced. Agriculture has not been integrated into the modern economic system to a meaningful degree. While Turkey's total carbon emission levels are lower than those of the more industrialized countries, new investments are not sufficiently efficient in this respect, and in general environmental concerns are not dealt with satisfactorily.

A Serious Governance Issue

Fifth, the deficiencies in terms of rule-based governance constitute a major obstacle to sustainable development. This was exacerbated very significantly and dangerously by a series of decree-laws passed by the government in 2011 which introduced a further component of subjectivity and unpredictability to the civil service, while also imposing moves towards centralization, contrary to the tide prevailing in the world in the realm of good governance. One of the most disconcerting moves in this framework is that all independent regulatory bodies, including banking and competition regulation, are now subjected to a minister's direct power of inspection. These moves come on top of a most worrying and destabilizing process of loss of independence of the judiciary. Apart from the grave damage involved in terms of the democratic system, all this also increases further, the weight of rent-seeking and excessively speculative activities in the economy. It also dents into its competitiveness.

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The CHP's Strategic Perspective and Set of Alternative Solutions

The world economic crisis of 2008 and its aftermath have made it unequivocally apparent that neoliberal policies cannot ensure sustainable economic development and that they exacerbate inequalities to the point of undermining the cohesion of societies. Although different countries' conditions are not identical, this universal result also applies to Turkey where the government openly embraces and pursues what is essentially, a neoliberal approach.

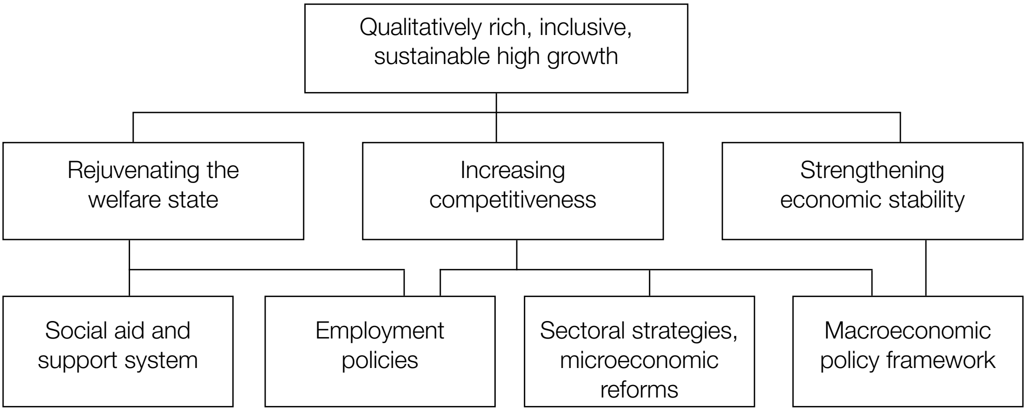
As social democrats, our approach and distinguishing stand is that the efficiency of the market is valid only in a framework regulated objectively in a non-partisan way by the public authority and that ensuring the equality of access to opportunity for all starting from birth, is a fundamental policy objective. This also entails caring for and targeting society's future welfare as well as its present day needs and objectives.

The thrust of our economic policy is to achieve high sustainable growth in an equitable and employment friendly pattern, which will at the same time increase the competitiveness of the Turkish economy and enhance its convergence trend to the EU. We target this convergence not only in terms of level of income but also the relevant structural reforms and in social and governance fields. The average growth rate we envisage to realize through our policies for the period up to 2023 is seven percent on the basis of the calculations reflected in the CHP's New Economy Strategy mentioned above. The other targets are presented in the table below.

TABLE: Main Macroeconomic Indicators

Macroeconomic projections (Period Average)	**2012-15**	**2016-19**	**2020-23**
GDP growth (%)	6.1	7.2	7.5
Capital stock (contribution share)	3.1	3.6	3.8
Employment (contribution share)	1.2	1.4	1.5
Total factor productivity (contribution share)	1.8	2.2	2.2
Investments/GDP	23.1	24.8	25.0
Savings/GDP	23.1	24.8	25.0
Domestic savings/GDP	18.8	21.2	22.0
External savings/GDP	4.3	3.6	3.0
Macroeconomic projections (End of period)	**2015**	**2019**	**2023**
GDP (Billion current US dollars)	1 127	1700	2600
Per capita national income (current US dollars)	14 700	23 500	31 500
Convergence to the Euro Area (PPP), (%)	56	70	85
Job creation (yearly average of period, thousands)	620	795	970
Unemployment rate (%)	8.6	7.2	6.0
Employment rate (%)	44.9	48.0	52.0
Labor Force Participation Rate (%)	49.1	51.7	55.2
Women	32.8	36.4	40.0
Export (billion US dollars)	245	396	650
Current Account balance/GDP	-3.6	-3.6	-2.5

The main elements of our strategy are presented in this chart.



One of the distinguishing features of our strategy as opposed to the neoliberal approach, is the realization that convergence to the warranted economic and social welfare structure can only happen on the basis of the transformations to be accomplished, and not automatically. This is also the strategic path we consider necessary for overcoming the medium-income trap together with the threat stemming from the inequality trap.

The other main elements of our policies and solutions comprise the following:

- Our macroeconomic policies will be based on: consistent measures ensuring stability, financing expenditures without jeopardizing debt dynamics; a transparent and equitable tax system, decreasing the present excessive share of indirect taxes; and raising the quality of public expenditure, so as to make it contribute more significantly to sustainable growth.

- Our monetary policy, whose main aim will be price stability, will be made transparent. The ratio of international reserves will be raised to safer levels.

- Ensuring an effective governance framework in line with the relevant international practice will be an essential goal. This will encompass the restructuring and strengthening of the corresponding institutional entities. The stability of financial institutions will be ensured at the individual level as well as in the framework of the financial system as a whole.

- Our policy measures will be determined with extensive participation. In this vein we will establish a genuine "Economic and Social Council".

- We will aim to devise and implement transparent, rule based policies with adequate regulations so as to make the market economy function efficiently and in a way that conforms to stability, sustainability and cohesion.

- We consider both the participation of the largest possible share of the population to production through quality jobs with adequate income and benefiting from the basic organizational rights defined by the International Labor Organization (ILO) to be essential factors of sustainable growth, in addition to social justice.

- Special emphasis will be devoted to the employment of women, youth and the handicapped.

- The welfare state will be reinvigorated in line with present needs. Ensuring adequate financing means, especially to Small and Medium Enterprises and start ups, will provide significant support for increasing employment.

- Vocational education and training and cooperation between industry and the educational system will be extended and strengthened.

- Productivity enhancement will be considered a crucial objective.

- Payroll taxes will be lowered.

- The needs of the population in the education and health domains will be treated as priority issues.

- Our social security, and support policies and struggle against poverty will also aim to assist access to employment, contribute to mobility, prevent exclusion and combat poverty, notably through our “Family Insurance” system. It will distinguish itself clearly from the present social aid system which is based to a large extent, on the concept of according favors rather than rights.

- Our growth strategy will focus on increasing net exports while a longer term goal will be the existence of a strong and stable domestic demand.

- We envisage a process of transformation towards the knowledge economy through, above all, boosting the human capital capacity *via* education and cooperation among the private sector, the education system and the state as well as other stakeholders, strengthening the national innovation system and research and development activities.

- Through our industrial policy measures we aim to extend the manufacturing base and its linkages, apply an effective incentives policy and ensure the formation of regional and sectoral clusters and infrastructures, notably in the logistics domain.

- The gradual transformation toward the green economy will also be targeted.

- In agriculture our policies will be based on the objectives of solving the structural problems, reducing costs while increasing productivity, ensuring enhanced access to international markets and achieving nature-friendly, human-centered production.

- Our energy policies will be coordinated with our policies in other domains. We will aim to decrease the level of dependence, ensure supply security increase efficiency and reduce carbon emissions by supporting renewable energies. We will ensure that adequate energy investments are realized and that these are compatible with the public interest.

- Our regional policies will aim at ensuring maximum utilization of the regions' economic potentials, notably in connection with opportunities related to neighboring countries, and at decreasing disparities among regions.