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The Political Anatomy of Economic Crises – The Case of Turkey: 1945-2018

Ekonomik Krizlerin Siyasal Anatomisi: Türkiye Örneği: 1945-2018

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ABSTRACT

The foundations of economic and financial crises are conventionally attributed to the technicalities of macroeconomic fragilities. Yet political instability (caused by the deficiency of democracy and/or unfunctional political institutions) can also be considered as a major determinant of economic instability by deteriorating the debt dynamics through depreciation of the national currency or the ascent of interest rates. Analogously, political instability, for instance, disruption of cabinet durability, to a large extent depends on the economic performance of governments. Hence, though most economists conceive macroeconomic fragilities as *the mother of all* crises, the issue is rather complex and there is an intermingled relationship between political and economic crises.

Besides, as macroeconomic fragilities or structural imbalances are results of inappropriate policies, the political rationale and the social motives behind such misleading policies should also be well comprehended. For that purpose, a comprehensive elaboration will enable the negation of the prevalent argument that it is only economic factors that instigate crises.

This study investigates the political background of eight economic crises in Turkey, since 1946. In all of them, significant levels of devaluation and retraction of growth are observed. All of the devaluations were indispensable, except the first one in 1946 which was discretionary and precautionary. The crises of 1978/9, 1994 and 2001 ended with drastic austerity programmes, albeit the others, where governments eschewed them by macroeconomic adjustment through fiscal and monetary measures. The 2001 twin-crises was so peculiar, as it was to a large extent caused by the design-defection of the programme recommended by the IMF. Yet, since the attempt of financial liberalization, all of the other economic crises were prompted by capital flights. The 2008/9 crisis was due to global contagion and the 2018 crisis was caused by the tensions in the bilateral relations with the US, amid high private sector foreign debt. In all economic crises, the profligate fiscal stance of governments has played a prominent role, as well as the continuation of appreciated exchange rates, but such choices had a political rationale. Finally, in the background of all the economic crises in Turkey, we observe stern political instability.

Political instability not only restricts the rational decision-making capacity of the policy-maker, particularly if it converges into a political crisis, but also exacerbates economic sentiment, either by consumer confidence or by investor appetite, which subsequently results in economic decline. It also intensifies risks and causes exchange rate depreciation as well as interest rate hikes, both

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of which degenerates debt dynamics. Since the financial liberalization attempt in Turkey, as portfolio investments have boosted, political stability has become imperative to sustain the stability of risk-sensitive financial markets. Both the experience of the 2008/9 and especially the 2018 financial crisis, have verified the importance of political instability as a determinant of economic crises. In short, economic crises cannot be analysed disregarding their political anatomy.

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ÖZ

Genellikle ekonomik ve finansal krizlerin temelleri makroekonomik kırılganlıklara atfedilir. Oysa demokrasi noksanlığı ve/veya siyasal kurumların işlevselliklerini yitirmesi de siyasal istikrarsızlığa yol açarak, ulusal paranın değerini yitirmesine veya faizlerin yükselmesine neden olabilir ve bu durum borç dinamiklerinin bozulması yoluyla ekonomik istikrarsızlığın temelini oluşturabilir. Tabii benzer biçimde, siyasal istikrarsızlık, örneğin hükümetin devamlılığı da iktidarların ekonomik performansına bağlıdır. Bu nedenle, birçok iktisatçı makroekonomik kırılganlıkların bütün krizlerin anası olarak görmesine rağmen, konu oldukça karmaşıktır, yani siyasal ve ekonomik krizler iç içe girmişlerdir.

Kaldı ki, makroekonomik kırılganlıklar veya yapısal dengesizlikler de hatalı politikaların sonucu olduğuna göre, bu politikaların ardındaki siyasal rasyoneli ve toplumsal güdüleri anlama doğrultusundaki ayrıntılı bir inceleme, aynı zamanda krizlerin sadece ekonomik faktörlerden kaynaklanmadığını da gösterecektir.

Bu çalışma 1946'dan bu yana sekiz ekonomik krizi ele almaktadır. Krizlerin hepsinde ciddi ölçüde devalüasyon ve büyüme daralması gözlenmektedir. İradi bir tedbir olarak ele alınan 1946 devalüasyonu hariç, bu olgu hepsinde kaçınılmaz olarak gelişmiştir. İktidarlar genellikle para ve maliye politikalarıyla makroekonomik uyumdan kaçınsalar da, 1978/1979, 1994 ve 2001 krizleri sert kemer sıkma politikalarıyla sonuçlanmıştır. 2001 krizi ise bunların içinde en özgün olanıdır, çünkü büyük ölçüde IMF'nin tasarım kusurlu istikrar programından kaynaklanmıştır. Bununla beraber, mali serbestleşme sonrası bütün ekonomik krizlerde kısa vadeli sermaye kaçışı gözlenmiş ve etkili olmuştur. 2008/2009 krizi de bir anlamda farklıdır, çünkü küresel bulaşma ile oluşmuştur. 2018 krizi ise, özel kesimin çok yüksek dış borçları olduğu bir ortamda, ABD ile ikili ilişkilerin gerginleşmesinden kaynaklanmıştır. Bütün ekonomik krizlerin öncesinde, döviz kurundaki aşırı değerlilik ile maliye politikasındaki gevşekliğin önemli bir rolü olduğu gözlenmektedir. Kuşkusuz her iki olgunun da siyasal rasyoneli vardır. Ancak hepsinden öte, bütün bu ekonomik krizlerin öncesinde büyük çaplı siyasal istikrarsızlık gözlenmektedir.

Siyasal istikrarsızlık yalnızca politikacıların rasyonel karar verme kapasitesini sınırlamakla kalmaz, özellikle siyasal krize dönüşmesi halinde, tüketici güveni ve yatırımcı iştahı kötüleştirerek ekonomik eğilimleri baltalar ve ekonomik çöküşe neden olabilir. Kaldı ki, artan riskler hem döviz kurlarına, hem de faizlere yansıyacağı için borç dinamiklerini bozar. Özellikle mali serbestleşme girişimi sonrası portföy hareketlerinin ülkede bir hayli yoğunlaşması karşısında siyasal istikrarın sürdürülmesi risk-duyarlı mali piyasalar için adeta bir zorunluluk haline gelmiştir. Hem 2008/2009, hem de özellikle 2018 kriz deneyimleri siyasal istikrarın önemini ortaya çıkarmıştır. Kısacası, siyasal anatomi göz ardı edilerek ekonomik krizler irdelenemez.

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1. INTRODUCTION

Economic crises have political implications as well as political crises having economic foundations. Furthermore, crises cannot be conceived as simple or uniform phenomena. They are complex and they are also intermingled with each other. The economic foundations of political crises have long been discussed in numerous academic studies, generally by political scientists. Yet the political implications of economic crises have seldom been analysed by economists[1]. Economists have rather focused on the macroeconomic fragilities as the principal causes of economic crises, disregarding all other factors as minutiae. The pur-

[1] This does not imply that this study has the aim of being the frontier study in exposing the political dimension behind economic crises. As discussed below, there are quite a number of contributions in this sense in the literature. Öniş (2010) analyses the political repercussions (in his terms transformations) of crises in Turkey whereas our study looks at the political background of those crises.

pose of this study is thus to challenge this conventional, and in a sense parochial approach and to elaborate the political and social implications of economic crises with a synopsis of the Turkish economy.

The political background of economic crises can be conceptualized within two dimensions. Firstly, if macroeconomic fragilities, that are incurred by *misleading policies*, are the principal causes of economic crises, then the social and political motives of those misleading policies should be comprehended. Secondly, there are also direct mechanisms through which adverse political structures, like political instability, may exacerbate economic crises. Below in Section 2 the first mechanism is discussed and in Section 3 the second mechanism is exposed. In Section 4 the political foundations of economic crises in Turkey are explored in a historical perspective and in Section 5 the paper is concluded.

2. THE POLITICAL FOUNDATIONS OF ECONOMIC CRISES AND THEIR CONSEQUENCES

The economic policies of countries exhibit considerable diversity and, according to Nelson (1990), this can be explained by social factors like the rate of population growth, the share of the urban population, the entity of agricultural population, life expectancy, infant mortality and the proportion of secondary education. Acemoglu et. al. (2003) attributes poor macroeconomic policies to weak (or extractive) institutions in the sense that they do not constrain politicians and political elites for the enforcement of property rights for investors, combat widespread corruption, and finally alleviate the high degree of political instability. Furthermore, they contend that macroeconomic problems, just like volatility and the disappointing macroeconomic performance of several countries, are symptoms of deeper institutional causes. Van Rijckeghem and Weder (2008) refer to the importance of political institutions concerning debt crises. Their empirical analysis concludes that political institutions matter in defaults on both external and domestic debt obligations. In democracies where there is a parliamentary system with sufficient checks and balances, there is a guarantee against the risk of default on external debt due to the sufficiently strong economic fundamentals or liquidity. In dictatorships, however, this only rests on high stability and tenure.

The relationship between economic crises and democracy as a political structure has been analysed earlier by Remmer (1990) vis-à-vis the Latin American experience. Remmer mainly questions whether democracies with appropriate policies are less likely than other regimes to address economic crises or tend to aggravate, rather than ameliorate, economic challenges for their survival. He especially examines the characteristics of the political regimes for explaining policy responses to common economic difficulties and concludes that debt crises establish no basis for asserting that authoritarian regimes outperform democracies in the management of economic crises. Remmer, confirming the position of Rijckeghem and Weder, contends that the supposedly delicate new Latin democracies perform as effective as their authoritarian counterparts in managing the debt crises.

A very recent challenging empirical study is held by Lipscy (2018) where he argues that democratic countries are more susceptible to financial crises. Indeed, he argues that democracies are about twice as likely to experience a crisis as autocracies. Lipscy undertakes an empirical study that covers two centuries of world data and although democracy as a regime is characterized by constraints on executive authority, accountability through free and fair elections, protection for civil liberties and large winning coalitions, such characteristics can also have unintended consequences that increase the likelihood of financial instability and crisis[2].

Concerning the experiences of Peru and Chile, Dornbusch and Edwards (1991) argued that macroeconomic populism emphasizes growth and income redistribution but de-emphasizes deficit finance, the risks of inflation and external constraints and the reaction of economic agents to aggressive non-market policies. Needless to mention that the preference of growth and income distribution to that of inflation and external balance is rather a political choice issue than a stark economic matter.

The comparative analysis of the macroeconomic performance of democracies is also analysed by Gasiorowski (1995), by the use of a data set of 75 countries through the 1950s and the 1980s and has found that although inflationary crises inhibited democratization from the 1950s through the early 1970s, they rather facilitated democratization in the late 1980s. Recessionary crises, on the other hand, facilitated democratic breakdown but did not affect democratic transition throughout this period. Thus, Gasiorowski concludes that economic crises do not simply undermine the legitimacy of whatever type of political regime is present in a country, but they incur a regime change in either direction. He later (2000) suggests that more democratic countries have higher inflation and slower growth, and ascribes this phenomenon to fiscal deficits and faster growth of wages. On the other hand, he observes no significant differences between the rates of growth and inflation of the new and mature democracies.

It is not just the types of political regimes that infer policy differences, but also the political dispositions of policy-makers and/or the behaviour of certain social classes.

[2] Truly, the world is getting more democratic since the industrial revolution and the frequency of financial crises are rising since World War I. Yet, to associate financial crises with democracies is rather a contentious issue as we observe such crises generally in developing countries with deficient democratic regimes, i.e. Latin American and some Asian countries.

For example, Weyland (1996) explores the "unexpected affinity" between neo-populism and neo-liberalism which emerged in the 1980s under President Menem of Argentina, President Collor of Brazil and President Fujimori of Peru. He observes that in Argentina, unlike the classical populists like Peron during the 1960s and 1970s (who attracted political support from the urban workers and provincial middle class), neo-populism during the 1970s and 1980s has attracted the political support of the urban informal sector and the rural poor, which have been politically uncommitted, alongside the preceding social groups. According to Weyland, it was democratic politics that stimulated the revival of populism, despite the economic constraints which appeared to condemn it to death. In other words, while democracy paved the way to populism, economic crises which were exacerbated by populist leaders could threaten democracy itself.

However, contrary to Dornbusch and Edwards or Weyland, De Castro (2007) by referring to both the Latin American economic crises of the 1970s and 1980s, and the Asian financial crisis of the 1990s, argues that populism/neo-populism as a political aspiration has not been the *cause* of economic crises but has emerged as a *consequence* of economic and political instabilities or crises. Nevertheless, such an argument naturally underrates the importance of the non-economic factors or the social background of populism.

Concerning the Asian crisis, Haggard (2000) argues that domestic political factors such as crony capitalism, weak leadership or autocratic governments have played significant roles at the onset of financial crises. By focusing on two countries, namely Thailand and Korea, Haggard contends that the institutional arrangements of these two countries rendered them vulnerable to public policy. In Thailand, for example, those peculiar and chronic problems which were ingrained in their parliamentary system had generated non-cohesive political parties and fragile coalition governments.

Similar to the line of Haggard, Feng (2003) argues that financial crises can be associated with political factors such as public governance, the relationship between bureaucracy and the business world. He then engages in a theoretical and empirical examination of three features of countries; political life, political freedom (which involves democratic institutions), and political stability (which is related to the likelihood of the survival of the government) and thus policy certainty (which concerns the shift of policies concerning the degree of income equality). Nevertheless, his main conclusion, in contrast to Weyland, is that democracy has no direct effect on the variables which are found to be associated with growth, but rather it appears as a contributor to political stability, human capital formation, income equality, economic freedom, etc.

Throughout the last century, economic crises have presented a dynamic nature concerning their motives and their progress. There has been a consensus that certain inappropriate policy choices are observed at the onset of crises, but once the crisis breaks, it engenders a chaotic milieu with massive uncertainty which impedes policy effectiveness. Finally, all economic crises have social and political consequences in a distinct manner.

Regarding economic crises, first-generation models, for example, indicate that unstable monetary and fiscal policies violate or contradict the basic principles of economics, particularly regarding the fixed exchange rate regime, and pave the way to economic crises. Second-generation models are those that explain multiple equilibria crises that are caused by a shift in the exchange rate and self-fulfilling expectations. The thirdgeneration crisis models are developed as a result of the 1997 Asian Crisis. These recent models have examined the vulnerabilities or the new maladies of the financial sector such as moral hazard, balance sheet imbalances and financial contagion. Indeed, the rise of third-generation models of economic crises can rather be ascribed to the phenomenon of the globalization of short-term capital flows.

On the other hand, there are political factors that play a key role in the choice of policy.[3] For example, governments favour fixed exchange rate systems, at least in the short-run, since they aspire to economic growth alongside price stability. Besides, many governments perceive exchange rate volatility as a factor of instability and hence refrain from floating exchange rate regimes.[4] Truly, the volatility of the exchange rates that rise during the floating exchange rate regimes can pause political severities especially when political stability is very delicate. Thus, fixed exchange rates are favoured not only in cases where political stability is weaker but also when inflation is likely to be imported.[5]

Another noteworthy issue is the type of fiscal policy maintained by different types of governments. For example, first-generation models of economic crises focus on the public sector deficits and many authors ascribe such a policy choice to the populist or neo-populist political aspirations that surged in the developing world. It is also contended that weak governments cannot venture fiscal discipline or flexible exchange rates, both of which can generate the fundamentals of the first-generation model of economic crises.

The inability to finance the rapidly increasing public expenditures in industrialized economies and hence the subsequent budget constraints are attributed to the advance and spread of the social welfare state. Nevertheless, in developing countries, the motivation for high public expenditure is rather a different matter. The rapid demographic change (in terms of growing population and urbanization)

[3] Persson and Tabellini (2000) explain in detail the political economy of policy choice in their novel book. Again, Acemoglu et. Al (2003) elaborate on this issue historically by an empirical approach and address the fact that weak (extractive) institutions can even deteriorate the performance of appropriate macroeconomic policies.
[4] See Fischer (2001), McKinnon & Schnabl (2004) for a detailed elaboration of the fear of floating exchange rates
[5] Svensson (1994), Williamson (2000), Fischer (2001), Goldfajn and Olivares (2001) and McKinnon and Schabl (2004).

has urged excessive increases in public expenditures despite the limitations of public revenue. Moreover, in democratic regimes, the demand for social justice has also opted for increases in public expenditures. Once these social factors are considered, envisaging the excessive public expenditure patterns in developing countries as mere populism can hardly be justified.[6]

There are also domestic and foreign factors that improve or exacerbate the performance of economic policies. The domestic factors are either peculiar to the policy-makers or to the policy itself. The sociopolitical environment, for example, is particularly important as a domestic factor in the determination of policy performance.

The behavioural pattern of the policy-executor is also one of the principal factors in overcoming potential economic crises, in the sense that the incumbent government should have the *political will* to tackle the social and economic problems that the country encounters. If politicians in a country are indifferent or irresponsible against emerging social problems, in time, these problems may become so acute that may even culminate in economic crises. Such an apathetic behavioural pattern can be termed *lethargy* which is exactly what economists refer to as the inner policy-lag of stabilization policies. Even when politicians feel responsible and act, any delay will reduce the effectiveness of the allocated public resources (just like the delayed medication of an oncological patient). Consequently, the political system or the democratic process may culminate in a complete deadlock. Thus, lethargy is not only the peril of economic stability but also a threat to democratic stability.

The *expertise* of the policy-maker is another imperative in the performance of economic policy as incompetence may instigate or contribute to crises. That is why international organizations, which provide financial support to countries, also require credible actors with technical expertise, alongside the bureaucratic quality, especially about the conditionalities of the macroeconomic policy design.

Analogously, the *credibility* of the government is an important factor in policy implementation. Many governments that face economic crises suffer from credibility losses and the most commonly addressed factor that causes such credibility losses is the existence of cronyism as an extreme version of nepotism. As Haggard (2000) notes, the Asian Crisis has shifted to become as much political as economic, either through policy predictability or through policy decisiveness. Haggard (2000) and McIntyre (1999) both address this issue that in the case of the Indonesian financial crisis the major political effect was those crony investments coupled with the authoritarian regime of President Suharto. The most conspicuous nepotism case was about the son of Suharto when some of the projects undertaken by him were cancelled for the sake of austerity but reinstated later. This reversion amplified the already existing policy unpredictability and overwhelmed the investor confidence. On the contrary in the case of Thailand, although an authoritarian government did not exist, the problem was the weakness of governments, due to political fragmentation. It was followed by several resignations which subsequent coalition governments intensified policy indecisiveness. Hence, the case of Thailand substantiated the institutionalist approach to macroeconomics, due to the inefficiencies in policy-making by the lack of autonomy, capacity and strength.

The case of the Asian financial crisis is so particular as it has shown political stability as a prerequisite of an appropriate and successful stabilization policy. In other words, political instability ensues economic instability which may even accrue an economic crisis. Although political instability is analogously a consequence of economic instabilities, this relation is dependent on the existence of social cohesion and cooperation within the society. In countries where democracy is advanced and social cooperation is high, economic crises may not ensue political instability. Analogously, it is very difficult to pursue a successful stabilization policy in the absence of social cohesion.

The nuisance of the Asian crisis showed us that, once a crisis emerges in a particular country, it spreads akin to another what is termed as *contagion*, due to the herded outflow of portfolio investments. This kinship naturally depends on the similarities of economic fragilities -regionally or even globally. Furthermore, the foreign politico-economic environment of a country also appears to be a critical factor of economic stability. As there is a need for foreign support -not only of international organizations but also of creditors, disregarding the importance of such support would imply the impulsion of the already problematic country to a prospective crisis.

3. THE RELATIONSHIP BETWEEN POLITICAL INSTABILITY AND ECONOMIC CRISES: INEXTRICABLE TIES BETWEEN CRISES

First of all, we should distinguish the difference between political instability and political crisis. Political instability is the changing nature of political power distribution and subsequently the weakening of government. Political crises, on the other hand, are the climax of political instability where there is total ambiguity about the destiny of the government, let alone the degradation of its governing capacity. According to Bussière and Mulder (1999), political instability is caused by electoral indecision and thus political fragmentation, political polarization and loss of cohesion within the government.[7] Political

[6] Roubini and Sachs (1989) contribute to the explanation of political and economic determinants of budget deficits in industrial democracies.
[7] A seminal empirical study is undertaken by Bussière and Mulder which measures the impact of the causes of political instability on the economic vulnerabilities of 23 countries.

crises can have several social outcomes; including unrest, tensions and even disorder within the society. Analogously, there may be various political repercussions such as the reshuffling of the cabinet, resignation and change of the incumbent government or call for early elections. In immature democratic regimes, if the prevailing government insists upon staying in power, despite the loss of public support, this may pave the way for a (military or civil) coup. Naturally, the deterioration in the macroeconomic conditions also plays a key role in causing political crises. That is why we contend that political and economic crises are very much intermingled.[8]

As seen in Figure 1. political instability is a function of political risks. The acuteness of political instability may cause a political crisis and political crises are one of the main two determinants of economic crises, especially when the other predominant cause, *macroeconomic vulnerabilities*, are prevalent. Thus, there is a self-fulfilling and reciprocal relationship between economic crises and political instability.

Such a dual relationship or simultaneous determination is also confirmed by Chang (2003) where he addresses his axiomatic exercise by referring to the crisis experiences of Indonesia in 1998 and Argentina in 2001. Yet Chang strongly refutes the arguments that political disequilibria can cause financial crises per se. He argues that social uprising in Indonesia and Argentina appeared due to widespread anger about the adjustment measures to overcome financial difficulties. He maintains that arguing the unidirectional effect that political crises causing financial crises are a denial of the existing theories of crises. Chang stems his analysis on two factors; firstly, the self-fulling expectations of foreign lenders as any change in these would not only lead to a financial crisis but also the collapse of the government, and secondly on the information asymmetry between the government and the public concerning the public debt. Chang marks the issue of multiple equilibrium arguing that if foreign lenders are pessimistic about the country's stability, they demand a high interest rate on the debt and exacerbate distortions which might even lead to a political crisis[9], and if foreign investors are optimistic, it may rule out political crises vice versa.

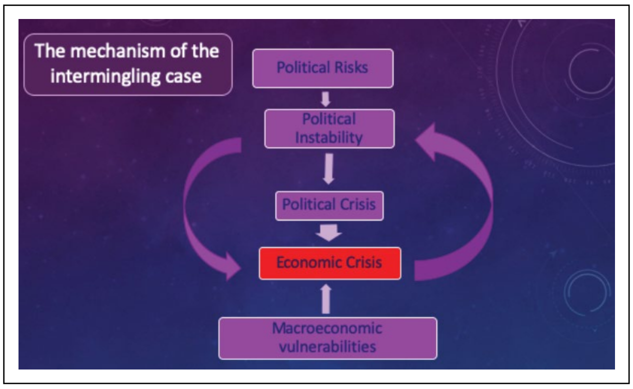

Figure 1. The mechanism of the intermingling case between political and economic crises.

Financial and political crises are also related to social psychology. In the narrow sense, political or economic crises are *unexpected* or unforeseeable *events*. The main characteristics of political crises are the loss of governmental power and subsequently the loss of social credibility. Likewise, the most important feature of economic crises is that markets come to a cessation. This loss of functionality of either markets or governments is the main mechanism that intertwines political and economic crises. When markets do not function, governments cannot perform, and when the governmental system is in a crisis, markets soon oblique towards instability.

There are two main determinants of this intermingled relationship between crises; the first, as noted above, is uncertainty, and the second is the higher costs due to higher risks. Uncertainty is the foremost feature of crises, whether economic or political. Accordingly, when a political crisis outbreaks, it may generate an economic crisis through deteriorated expectations of market agents (firms and consumers). Once expectations deteriorate, the subsequent uncertainty due to higher risks causes the faltering of both the investor appetite and consumer confidence. Foreign capital starts to exit and domestic investors revert or at least postpone their investment plans. Similarly, consumers postpone their expenditure especially on durable goods which are not among their immediate needs.

The second mechanism of political uncertainty that instigates an economic crisis is again through escalated risks. Higher risks, as economic theory predicts, causes domestic interest rates to rise and thus not only discourage investment but also pose a major threat to public debt dynamics. Moreover, most developing countries, suffer from current account imbalances and chronic inflation which entail currency substitution as a precautionary instrument. Higher risks also hasten such a substitution mechanism and cause the exchange rate to rise further. This would not only cause a pass-through to consumer prices but also impose a serious threat on the foreign debt dynamics.

Jianping (1999) has undertaken an empirical study to test the role of political uncertainty on financial crises with the usage of a combination of probit and switching regression analysis where he incorporates 22 emerging countries for the period 1994-1997 (panel data). He mainly looked at

[8] Leblang & Satyanath (2008) in their extensive empirical analysis where they test political factors in three separate baseline models of Frankel & Rose; Kamin, Schindler & Samuel; and Bussière & Fratzscher, conclude that political economy models predict currency crises much more accurately. Their political economy model includes two major parameters; recent turnover in government (time left for elections) and the dividedness of the government (parliamentary majority).

[9] One can hardly understand why such a state would not cause any economic instability but only cause political instability. Besides, political instability could easily accrue economic instability, if not a crisis.

the political election cycles and witnessed that 8 out of 9 financial crises happened during periods of political election and transition.

He argues that the main causal mechanism between political instability and financial crises was increased market volatility.

4. THE POLITICAL FOUNDATIONS OF ECONOMIC CRISES IN TURKEY: A HISTORICAL PERSPECTIVE

Although political instability has always existed as a key factor in affecting economic crises, it has gained prominence since financial liberalization, when the economy became more prone to foreign capital, especially since the rise of the public debt ratio. Öniş (2010) in his seminal study explores the political repercussions of financial crises in Turkey. Our present study is the reverse, although not contrary, that we attempt to explore the political background of these economic crises.

4.1. The Political Background Of The Devaluations During The Period 1946-1971

From 1945 until 1970 there had been three major devaluations which can be considered as major economic instabilities. The first one occurred on September 7th, 1946, 2.5 months after the general elections of July 21st, 1946. The election results were quite surprising, besides being contentious. Nonetheless, despite the spectacular performance of the opposition during the elections, there was no governmental change. The immediacy of this devaluation (as it was right after the elections) shows that the government had long necessitated and planned such an action but had postponed it until the elections. At the first sight, this devaluation might seem unnecessary as the trade balance did not need any amelioration. This is because until 1947 there were repetitive trade surpluses throughout the war years and there was no vital shortage of foreign reserves. Nonetheless, due to consecutive inflation rates averaging about 58 per cent between 1940 and 1944, there was an accumulated real appreciation of TL. Furthermore, during the War years, there was an accumulated stock of goods that could only be cleared by exports, if a devaluation stimulus could be provided. There was also an augmented level of public debt alongside some gold reserves. It was conceived that a devaluation would make better use of gold reserves in the repayment of public debt. Finally, the country was at the doorstep of the membership of the IMF which would restrict its capacity to devalue and curb imports. Hence it aspired to undertake a contingency devaluation in advance.

The resultant devaluation rate was enormous; (116 per cent from 1.30 TL/$ to 2.80 TL/$), but surprisingly, let alone increasing the trade surplus, it resulted in a trade deficit. Imports were doubled immediately and the rise in exports was not only limited but also temporary.

The devastating effects of this devaluation (particularly higher inflation) amplified the already existing social grievances from the one-party government, especially due to the agonies of World War II, which altogether caused a change in government in 1950.

The second major devaluation happened in 1958. The timely elections were in 1958, yet the incumbent government of the Democrat Party called for early elections on September 27th, 1957 to hinder the possible electoral losses that would be caused by the adverse economic conditions and subsequently rising political instability. This time devaluation was postponed to August 4th, 1958, 10 months after the general election.

The period of 1954-1960 is quite peculiar as it shows the intermingled relationship between economics and politics very vividly. There was an economic necessity for the devaluation of 1946 due to the global economic conditions of World War II, although its timing was politically arranged. The 1958 devaluation case was also of economic necessity but (unlike the previous one which had been a result of global economic conditions) it had stemmed from the socio-political implications of those policies pursued by the Democrat Party. In other words, those economic policies (which consequently led to a devaluation) had certain political implications.

When DP came to power, peasants constituted a large majority of the Turkish population (75 per cent) and agriculture had contributed to 41 per cent of national income. Low cereal prices and the inevitable drought during World War II had caused an enormous agony of the peasantry alongside the shortages of basic goods. Despite these stringencies, due to the maintenance of fiscal discipline, external balances and gold reserves were enhanced and, in this sense, DP was quite fortunate. While worldwide agricultural prices started rising, Turkey was receiving excessive precipitation. Thus, the DP government in its early years was able to respond to the peasantry gust in two ways. Firstly, a high pricing policy was implemented in agriculture and farmers became better off. Secondly, investments in infrastructure were accelerated which encouraged urbanization.

The year 1954, however, marked a milestone, as the sudden drought caused a 20 per cent fall in agricultural output at a time when world prices began to falter. As a result, Turkey started to import wheat. When the purchased tractors broke down due to lack of maintenance, and soil erosion emerged to be a serious issue in the new arable areas, the deficit started rising, but more importantly, the external deficit started to spin out of control causing gold reserves to wane remarkably. Thereupon, sugar was rationed in 1955. Most importantly, national income declined by 3 per cent in 1954. The external deficit surged from 373 million US dollars in 1950 to 579 million US dollars in 1957. Social reactions spread rapidly and consequently, the political choices of the government started shifting. DP, amid the economic slowdown, called for early elections in 1957 to retain its power. Despite the very problematic elections, DP was successful in winning. After the elections, it recanted resisting an agreement with the IMF and (in 1958) initiated an IMF-supported stabilization programme which included a devaluation of TL from 1 US =2.80 TL to 9.00 TL.

In sum, the IMF-backed devaluation of 1958 should be conceived as a result of exaggerated infrastructure investments and excessive support of the peasantry at a time of drought and declining world prices. During, 1950-1953, the average annual inflation rate was 5.4 per cent, but during 1954-1957 it surged to an average of 13.7 per cent. At the same time, the trade deficit almost doubled during 1952-1957 compared to its previous averages.

At this point, one would naturally inquire about the socio-political motives of those policies that incurred economic instability and thus devaluations. Firstly, as noted above, the peasantry was the main political base of DP. The DP government conceived *populism* as the "provision of the welfare demands of peasants" and *nepotism* as "political loyalty" to its political clientele. Moreover, the failure of the DP government to contemplate an urgent strategy against forthcoming economic problems ascertained its *lethargy* as it postponed the stabilization programme for more than 10 months, after the elections.

Following the spectacular economic performance of the period 1963-1968, the devaluation attempt of August 10th, 1970 is a rather intricate matter, in the sense that, at the first glance, there seems no urgent necessity for such an action. The average rate of inflation between 1965-1970 was 6.6 per cent. The budget deficit was less than 1 per cent of GDP in 1969 and almost insignificant in 1970. The growth rate was positive and moderate, 4.1 per cent in 1969 and 3.2 per cent in 1970. Furthermore, although the trade deficit had soared from 264 million dollars to 360 million US dollars in 1970, the current account deficit was still less than 1 per cent of GDP.

Yet, of course, such an action was not pointless. There were some anxieties besides some particular expectancies in the country. The first anxiety was the continued faltering of export performance in 1968, mounting the chronic trade deficit due to the import substitution strategy of the 1960s. Moreover, the persistent inflation rate had accrued an appreciation of the exchange rate in real terms which was evident from the shadow exchange rates[10]. As a result, the government was in the pursuit of encouraging exports by the readjustment of the real exchange rate. Furthermore, there was anxiety about the transition to the Common Market which might deteriorate the trade deficit. To offset such an effect, the government intended a certain level of devaluation in advance. Yet, this expectancy was over-optimistic as the structure of the economy did not have the competitive capacity due to the import substitution strategy. One other expectation was to foster workers' remittances by a depreciated TL. Despite the high trade deficit, the current account of the country, for a long time, was much lower due to these remittances, which were thus of vital importance.

Nonetheless, the prominent reason for the 1970 devaluation was again the pressures of the IMF as the foreign indebtedness queries had mounted once again. The government eventually consented and implemented a drastic devaluation by depreciating TL against USD from 9 TL to 14.85 TL. Since a major part of the year had already bygone, the impact of this devaluation was not felt in 1970. Moreover, the trade deficit neither declined in 1971 nor 1972.

The period between 1970 and 1972 was one of the most challenging periods of modern Turkish political history. Just 7 months after the devaluation, the memorandum given to the government declared the explicit desire of the Army to seize political power once again. Although there was *some* deterioration in the macroeconomic balances, especially due to the inconclusive drastic devaluation, the memorandum did not refer to such economic issues, but solely to law and order. However, the social tension and disorder were to a large extent due to the devastation of the devaluation which was forced by the IMF.

In sum, the 1946 devaluation was due to a presumed economic necessity of accumulated real exchange rate appreciation, the 1957 devaluation can be conceived as an obligation to restore the trade deficit which was caused by the fiscal consequences of agrarian populism and the 1971 devaluation was undertaken at a time when the foreign debt had surged. Both of the last two devaluations were by the conviction of the IMF.

4.2. The Crises Years of 1978/9: Oil Prices, The Failure Of Import Substitution Strategy Or Political Polarization?

The 1970s have been years of stagflation globally due to sharp rises in the oil prices provided by the new international cartel; OPEC. Import dependent countries, such as Turkey, were immensely affected by these rises, as the price of oil rose from $1.26 per barrel in 1970 to $9.40 per barrel in 1974 and then further to $24 per barrel in 1979.

During the period between 1968-1973, the average annual trade deficit of Turkey was 471 million USD, but since the first phase of the Oil Crisis in 1974, this deficit immediately soared and during 1974-1976 it reached an average of 2.9 billion USD. Then onwards, during 1977-1980 the trade deficit widened to a level of 3.5 billion USD on average.[11] The Oil Crisis came into effect at a time when there was a coalition government of two dissimilar parties (CHP

[10] There was a large discrepancy between the official and the black-market rates exchange rates.

[11] As a result of the higher burden of oil imports, throughout the 1970's the trade deficit rose; in 1973 it was 769 million USD, in 1976 it was 3.2 billion, in 1977 it exceeded 4 billion USD and then reclined back to 2.3 billion in 1978 due to the stabilization attempt. But it started rising again to 2.8 billion in 1979 and almost to 5 billion USD in 1980. Consequently, while the foreign debt of the country was equivalent to the total exports in 1976, that ratio rose to 232 per cent in 1979.

and MHP). Both political parties had come to power by an aspiration to raise the public spending for farmers and low-income families to expand their electoral bases. In other words, there was the inherent populist tendency of the coalition partners despite the unfortunate economic environment in the world.

At the start of the oil price escalation, the government was unable to recognize the imminent risk of external deficit due to two fortunate factors; firstly, at that time foreign exchange reserves were relatively strong, and secondly, workers' remittances in foreign currencies had boosted (almost to 5 per cent of GNP) levelling the export performance.

During the period 1971-1976, the average growth rate was 8.1 per cent, budget deficits were restricted and inflation was on average 18.3 per cent. Due to all of these economic advantages, the macroeconomic balances did not deteriorate right away, albeit the limited resilience of the economic structure to external shocks which were incurred by the import substitution strategy of the 1960s. With the relief of the two advantages, the government was reluctant to reflect the higher costs of imported oil to consumers. Similarly, excessive price supports were provided to farmers, particularly in cereals and tobacco, which accrued to higher budget deficits.

One can naturally inquire about the policy prospect of a presumed single-party government after the general elections of 1973. If such a government had longer durability[12], would it be similarly populistic or would it venture fiscal prudence which might avoid the imminent crisis? Our immediate answer would be that, although the profligate policy aspirations could be moderated, the rapid urbanization process of the 1960s and 1970s had stipulated higher public expenditure, alongside the redistribution policy of the social democratic CHP -which was the major partner of the coalition. Besides, macroeconomic balances had deteriorated particularly by the second phase of the Oil Crisis in 1979.[13]

The budget deficit suddenly peaked at 4.6 per cent of GNP in 1977, but since an IMF-led stabilization policy was introduced in 1978 by the CHP government, it was reduced to 1.7 per cent in 1978 and was maintained at 2.7 per cent in 1979. This stabilization policy had included a significant devaluation, adjustment of public enterprise prices and restructuring of short-term debts. Yet, such an effort was not rewarded as the government was soon replaced by a patched coalition of 4 political parties. In other words, political instability became the principal trait of the period. However, this new right-wing coalition government, in less than 2.5 months announced the most radical economic transformation decree of the Turkish economy on January 24th, 1980.

The decree had two major dimensions: The first dimension was the austerity measures towards price stabilization, and the second dimension was the departure from the long-standing import-substitution industrialization strategy towards an export-orientation development strategy.

For price stabilization; subsidies to public enterprises, fertilizers, energy consumption and transportation were abandoned, agricultural support was restricted and the Central Bank advances to the Treasury was controlled. On the other hand, for export orientation foreign trade was liberalized, daily determination of the exchange rate was put in effect following a 33 per cent devaluation.

The instability of the macroeconomic structure since 1977, which ended up in an economic crisis in 1979, can be attributed to several social, political, economic and even foreign factors. First and foremost, the energy crisis has been the principal factor that dilapidated the macroeconomic balances, especially through higher costs and widened trade deficit. The longstanding import substitution strategy had failed to provide an efficient industrial structure that could be competitive in international markets and with the occurrence of the Oil Crisis, the import-substitution development strategy has become almost obsolete.

In the meantime, political fragmentation hampered the establishment of a government with sufficient duration which could be committed to undertaking several reforms regarding the restructuring of the economy. Consequently, prescriptions changed from one government to another creating inconsistencies and invoking unpredictability. Furthermore, coalition governments required arduous reconciliation efforts on the policy choice, but many times, these efforts were inconclusive. Due to the prevalent public disorder, there was also a lack of social cohesion or social support for the stabilization efforts.

The adverse foreign environment was not solely confined to the Oil Crisis. As noted above, the military sanctions imposed on Turkey due to the Cyprus Intervention, the politically hostile treatment of foreign investments in the country alongside the reluctance of governments to collaborate with the IMF, exacerbated the economic instability and subsequently paved the way to the economic crisis of 1978/9.

It is no coincidence that the coups of May 27th 1960, March 12th 1971 and September 12th 1980 were all followed by massive devaluations.[14] The common economic cause of these devaluations was the foreign debt-service problem whilst massive foreign deficits. These deficits were caused by both the lax nature of fiscal and monetary policies, and the real appreciation of the exchange rate. Naturally, all those policies had a socio-political rationale; the pursuit of real exchange rate appreciation and the populist trait in

[12] Lijphart (1984) attempts to measure those political and economic factors which determine cabinet durability

[13] Needless to add that the Cyprus Peace Operation of Turkey met fierce international reaction and some economic, as well as military, sanctions were imposed against Turkey. Furthermore, the intensity of domestic political instability supplemented all these detrimental factors.

[14] Öniş (2010) analyses the political results of these early economic crises as well as the others.

public spending were political choices and without comprehending the motives of these choices, an analysis of the 1978/1979 economic crisis could not be complete.

4.3. The 1994 Economic Crisis: Hasty Financial Liberalization Or Contra-Market Intervention?

Since the implementation of trade and financial liberalization, the first major economic crisis broke up in 1994. To a large extent, this crisis can be attributed to the failures of the liberalization attempts. Some scholars have also marked this crisis as a result of high public deficit and mismanagement of the public debt. Although both explanations carry validity, for a better understanding of the background of this crisis, the social and political background of those economic policies should be explored.

In 1989 (August 11th) Turkey initiated its financial liberalization attempt amid an inconvenient economic environment where there was a lax fiscal stance with high public sector borrowing requirement (in 1987 PSBR was 5.7 per cent of GNP). As a result, a high level of public debt (23 per cent of GNP) was accrued, albeit moderately high price inflation of 38.9 per cent. By the liberalization challenge, average nominal interest rates immediately hiked to 83.9 per cent from 58 per cent, whilst the price inflation surged from 38.9 per cent to 73.7 per cent, and then the growth rate slumped from 9.8 per cent to 1.5 per cent in 1989.

Hence under such inconvenient economic conditions (high PSBR, high public debt with short maturity, alongside high and volatile inflation rates and consequently very high-interest rates), one can hardly justify the rationale behind such an attempt, as it would naturally encounter excessive rises in interest rates. For example, whilst the interest payments of domestic debt had made 10 per cent of budgetary expenses in 1987, in 1988 it surged to 15.1 per cent and at the onset of the crisis, in 1993, the ratio had reached 18.8 percent![15]

Although the 1994 economic crisis cannot be entirely attributed to the hasty and thus misleading financial liberalization endeavour[16], it certainly constituted the main economic backdrop of the crisis. It is contended that financial liberalization is the complementary stage of trade liberalization and thus the government was in a sort of obligation to undertake such an endeavour. Another alleged explanation is the influence of the market-led liberal policies which had become widespread globally, including financial markets. It is also suggested that the economic counsels around Prime Minister Özal, who had strong ideological convictions for market-led liberal policies, might have convinced him to undertake this audacious change. However, if a one-party government had not prevailed while enjoying a solid parliamentary majority, such an audacious attempt would be beyond imagination. Besides, the economic results of the financial liberalization were sounfavourable and costly for the incumbent ANAP government that it lost most of the major municipalities in the 1989 local elections.

Alongside the inanity and hastiness of financial liberalization, there were major economic and political influences that contributed to the emergence of the crisis. First of all, the Gulf Crisis of 1990 should be mentioned as the major geopolitical instability factor in the region. On August 2nd Iraq invaded Kuwait and as a result, 37 countries initiated a military intervention on January 17th, led by the US, which took more than 6 weeks. Although Turkey refrained from this military operation, its markets were distressed.

A consensus argument[17] for the occurrence of economic crises during the 1990s is the existing political instability due to incoherent coalition governments which suffered short duration. Such governments, let alone tackling a prospective fiscal discipline, on the contrary, created profligate behaviour in the pursuit of fiscal policy.

A political example is the incidence of the 1987 general elections. When the votes of ANAP declined to 36 per cent, (from its previous level of 45 per cent) it was alarmed by the impending political risks of the next elections. The Prime Minister reacted immediately unleashing the fiscal discipline to such an extent that the ratio of public expenditures in GDP surged from 17.1 per cent in 1987 to 20.9 per cent in 1991. This expansion was mainly due to the excessive pay rises (wages and salaries within the budget had soared from 23.4 per cent in 1987 to 37.1 per cent in 1991). Hence, the profligate attitude of the ANAP government was incurred by its political anxieties since the 1987 elections. Unfortunately, this policy coincided with the financial liberalization attempt and put the budget in a dual strain: On the one hand, there was the burden of rising interest payments caused by financial liberalization, and on the other hand, there was the populist behaviour of the government. Needless to remind that considering its timing, neither the political structure nor the fiscal structure was appropriate for this immature financial liberalization.[18]

In 1987 PSBR was 5.7 per cent of GDP, but had surged to 7.3 per cent in 1990 and then further to 10 per cent in 1991. In 1991 a new government was established by a coalition between centre-right (DYP) and centre-left (SHP) political parties. Yet, the pace of populist spending policy did not change due to the fragmented structure of the political system. The new government did nothing to curb this borrowing and maintained its level until 1993. This huge deficit naturally distorted the budgetary composition to such an

[15] One can imagine the immense income distribution repercussion (from taxpayers to interest-earning rentiers) of this budgetary deformation.
[16] Rodrik (1990) qualifies this liberalization attempt as disastrous for inflation and macroeconomic stability. He furthermore notes that the external finance which was due to this attempt, replaced domestic borrowing at times highly disadvantageous for the public sector.
[17] See Cömert and Yeldan (2018) and Öniş (2010). Largely, coalition governments that have been largely unsuccessful should not necessarily imply that they are always prone to economic and political instability. During 1961-1965 three separate coalition governments were maintained with political difficulties but without incurring any consequential economic instability.
[18] Rodrik (1990) a similar argument is held in this article

extent that interest payments, on their own, comprised 25.8 per cent of public expenditure. At that time, Prime Minister Çiller, who was an economics professor, aspired to reduce this burden by discretion. She attempted to intervene in the auctions of the Treasury by limiting its borrowing requirement and replacing it with Central bank advances. The financial markets were so exasperated by this intervention that a currency attack became inevitable immediately in January 1994 which resulted in repetitive and massive devaluations, despite the efforts of the Central Bank to defend the exchange rate until exhausting its foreign reserves. Eventually, the Decrees of April 5 was announced as an austerity policy prescription which included the temporary floating of the exchange rate, fixing the wages and adjusting the public enterprise prices concerning the targeted (future) inflation. Some further steps were also taken regarding the Central Bank autonomy, the restructuring of the public funds by reducing their number and allocating more resources to the Treasury. Despite the painful social cost aspects of these decrees, they were inconclusive due to the lack of political stability.

In the case of the 1994 economic crisis, the inexistence of fiscal discipline can be attributed to durability problems of governments and the profligate fiscal stance can be attributed to political fragmentation. Yet, the regional geopolitical instability and the frequency of domestic terrorist activities should also be reminded as significant non-economic contributors to the crisis.[19] In this sense, Prime Minister Çiller's contra-market intervention can only be considered as the triggering of the crisis.[20] This incidence also demonstrates, as was noted above, that the expertise of the policy operator is imperative in the pursuit of economic stability. It was senseless, if not incompetence, to attempt reducing the market interest rates by discretion and with manipulative efforts in the borrowing auctions of the Treasury, especially since financial liberalization. Interest rates could only be reduced by fiscal discipline, reduction of the foreign deficit and improvement in country risks especially by higher foreign reserves, of which none had been ameliorated during that period.

4.4. The Economic Crisis Of 2001: The Result Of The Political Crisis Or The Design Flaw Of The IMF Programme?

4.4.1. The Background

The 1994 economic crisis had serious political impacts: firstly, although the timely general elections were in 1996, the current DYP-CHP coalition agreed on calling for early elections in December 1995, as there were too many frictions within the government. Secondly, the economic crisis had cost a substantial level of electoral losses for the ruling political parties in the local elections of 1994 and consequently, most municipalities had been won by the fundamentalist Welfare Party, albeit by small margins. Thirdly, the electoral results were quite stern, in the sense that the political outcome was so fragmented, making it very problematic to form a new coalition government. Finally, the first runner, though by a small margin, was the fundamentalist Welfare Party which traumatized, even exasperated some social quarters and institutions, including the Army. Under such taut conditions, a coalition was established between RP and DYP, but it was under the immense strain of annulation demands by these social sectors (i.e. main NGOs declared such a demand publicly). The strain was so excessive that it provoked a post-modern coup of the Army on February 28th,1997, delegating the President to announce their request.22 After the collapse of this coalition, by the resignation of the Prime Minister, several other coalition attempts were undertaken but all of them were inconclusive. Political instability in this period (due to short cabinet durability) was so elevated that since the general elections of 1995, four separate coalition governments were formed until the timely elections of 1999.

In 1997 the Asian financial crisis broke out. Although the Asian crisis was rather regional, it had some contagious effects on the Turkish economy as well as other emerging economies.[22] For example, the growth rate in the Turkish economy declined from 7.6 per cent in 1997 to 3.2 per cent in 1998. Needless to mention that this decline was, to a large extent, due to political instabilities and distortions in the macroeconomic fundamentals. In 1999, the growth performance of the Turkish economy continued to deter by a decline from 3.2 per cent to a contraction of - 4.7 per cent. To reiterate, there may be two effects in the background of this contraction: firstly, as we keep emphasizing, political instability not only hindered fiscal frugality but also, caused a profligate fiscal stance, deterring macroeconomic balances. Indeed, there was not even a mention of *stabilization strategy* in any of the coalition protocols. Secondly, it was quite unfortunate that the Russian economic crisis broke out in August 1998, following the Asian crisis.[23]

After the post-modern coup of 1997, a three-party coalition government was attempted, which had a limited duration, due to its inherent incoherence. By the failure of this last attempt, a minority government was established by Prime

[19] Cömert and Yeldan also remind the coincidence of the rise of the FED funds rate that constituted an unfortunate major disadvantage for foreign debt balances.
[20] Özatay (2007) contends that the Turkish episode of 1994 had little relations to models of self-fulfilling crises as it was a case of a policy mistake. We would agree with this argument if only such the policy mistake of auction manipulation was conceived as the triggering effect of the crisis, as the budgetary structure was already in a serious mess. Celasun (1998) objects to the sole contribution of the crisis to mistakes at the monetary front, suggesting that if several steps had been taken, as some had argued, the crisis could not be hindered. She argues that the fragilities in the fundamentals, especially fiscal discipline, were the main reasons of the crisis.
[21] Celasun (2002) shows substantial influences of the Asian crisis that contributed to the economic background for the 2001 crisis.
[22] Although the negative impact of the 1999 earthquake also contributed to this economic contraction, its role had been relatively limited on the annual figures, since the earthquake occurred in the third quarter of the year.
[23] Indeed, when the Financial Crisis of 2000/2001 broke-out, the interest payments ratio also peaked at almost 47 percent of the budget. Cömert and Yeldan (2018) qualified this crisis as finance-led and finance-driven similar to that of 1994.

Minister Ecevit in January 1999. Right at the beginning of this government, Ecevit was aided by the arrest of Öcalan (leader of the terrorist organization, PKK) in February 1999 and instead of holding the elections in December 2000, he called for early general elections in April 1999. This time his party, DSP became the first, albeit another fragmented political outcome. A new three-party coalition was formed again, led by Ecevit, but this time, the government was quite unfortunate, due to the occurrence of a calamitous earthquake in Gölcük in August 1999 which not only destructed thousands of buildings and caused 18,400 lives to be lost, but also dilapidated the economy via regressed sentiments. As a result of this multidimensional devastation, the government was enforced to send a letter of intent to the IMF, within 4 months, requiring a stabilization programme.

IMF, then, recommended an innovative architecture for stabilizing the price inflation in Turkey. The essence of this stabilization strategy was primarily to restrain the *price expectations* with the presumption that the public sector deficit, the balance of payments problems and even the instability of growth performance were all by-products of this phenomenon. In other words, the new strategy conceived inflationary expectations (inertia) as the core of all macroeconomic problems and considered this phenomenon very much dependent on the exchange rate changes. Thus, if the Central Bank had declared the range of exchange rates in advance, it could also manage price expectations as they would converge into these declared values. Consequently, if price inflation could be controlled, interest rates could be expected to decline and as a result, the fiscal deficit would drop too. The fiscal deficit would contract because interest payments had become the main determinant of the public expenditure. For example, in 1999, interest payments of the public domestic debt had become 35 per cent of the budget.[24] The programme also assumed that once inflation was controlled, not only economic growth could be boosted, but also the balance of payments problems could be relieved due to the restoration of export competitiveness. Before the implementation of the programme, a partial devaluation was undertaken to cushion the possible real appreciation of the national currency. The programme also required the attainment of a primary surplus in the budget as well as certain monetary targets for the Central Bank which were anchored to the level of international reserves.

4.4.2. The Crisis

Such a policy design of the IMF had major political and economic fault lines: First of all, an exchange-rate based stabilization programme was design-defective due to the very existence of the fragile coalition government. Under such conditions of political instability, technically a perseverant stability programme could not be instigated or pursued. In other words, the political assumptions of the programme on the onset were erroneous. The second fault-line was on the impacts of the designed exchange rate regime. One should bear in mind that pegging the future exchange rates at predetermined levels, would not only lure enormous amounts of portfolio investments but also induce imports excessively. Considering the negative growth rate of 1999, the natural rebound of growth would also cause the current account deficit to surge to higher levels.

Thirdly, such an exchange-rate based stabilization programme would require full-flexibility of interest rates, and in a country where domestic public debt is too high, this would entail the further rise of interest rates and deter the public sector financial accounts.

The 2000/2001 economic crisis occurred as a full-fledged financial crisis.[25] As it is briefed above, both political and economic risks were effective in the instigation of this crisis. The programme had accrued an excess current account deficit beyond the calculations of the IMF. (In 1999 the current account deficit was 0.4 per cent of GNP. In 2000 the deficit rose to 3.7 per cent of GNP) Secondly, an immediate structural accommodation was expected, but such an adjustment did not follow. At first, the certainty on the future exchange rates accompanied by high real interest rates attracted portfolio capital, but when investors were distressed by the political crisis, they hurried to exit in herd behaviour. The programme also presumed that the banking system was prudent. Nonetheless, this presumption was completely unfounded as public banks were in duty-losses, and private banks were both in high exchange-rate risks due to their short FX positions and in interest rate risks due to the high allocation of long-term Treasury bills in their assets.

2000/2001 was a typical twin-crises case as the crisis in the banking system was coupled with a currency attack.[26] The first stage occurred in November 2000 as a banking commotion. One major bank suddenly ceased its provision of excess liquidity in the overnight market. Another medium-sized bank, with its assets loaded with fixed interest Treasury bills, was addictively financing these bills by borrowing from the overnight market, showing a huge maturity mismatch. When this bank failed to meet its liquidity obligations from the money market, it applied to the lender-of-the-last resort mechanism or the discount window of the Central Bank. The Central Bank intervened accordingly, despite its limitation of net foreign assets[27] required by the targets of the IMF programme, but the intervention was

[24] Cömert and Yeldan (2018) qualifies this crisis as finance-led and finance-driven similar to that of 1994. Öniş (2010), on the other hand, contends that the 2001 incidence was a fiscal and balance of payments crisis coupled with major structural problems in the banking sector.
[25] Kaminsky and Reinhart (1999) qualify the coexistence of banking and currency crises as twin crises.
[26] The Central Bank could only inject liquidity into the system within the limits of foreign reserves. That is why the system in operation resembled that of a currency board.
[27] Alper (2001) in his article published right after the crisis contends that policies in maintaining the stream of good news were necessary to sustain capital inflows. He also argues that there was inadequate backing for the programme by the IMF, especially to ensure the exchange rate. Nevertheless, we doubt if such an assurance could be justified. Finally, he asserts that there was a design flaw in the sense that there was no sterilization rule to alleviate the interest rate undershooting at the start. Besides these factors, he also considers the fragile banking system and unfavourable external conditions as major causes of the crisis.

far from being satisfactory to extinguish the furore in markets. As a result, the problematic bank had to be seized by the banking authority (Savings Account Insurance Fund). Furthermore, the IMF moved, in return for a new letter of intent by the government, enhancing the foreign reserves with an amount of SDR 5,8 billion under its Supplemental Reserve Facility. This new financial support was of utmost vitality because at this first stage the foreign reserves of the Central Bank had plummeted by 5.2 billion USD. Although most scholars generally focus on the problems of the banking sector of the first stage, the subsequent capital flight was no less important in the instigation of the twin crises.[28]

The most interesting stage of this twin-crises nuisance is the second stage. On February 19th, Prime Minister Ecevit at the exit of the National Security Council declared that there was a *state crisis* between the President and himself. The reaction of the market was horrific, and on that day, there was a capital flight of 7.6 billion USD. Although the Central bank intervened in the money markets, the repo rates hiked to 315.9 per cent. The next day the Central Bank altered some of its monetary obligations as there were funding problems in the interbank money market due to a secondary capital outflow of 6.1 billion USD. The reporates this time soared to 1107 per cent overnight. The capital flight continued on February 21st (4 billion USD) and repo rates hiked to 4474 per cent overnight. By then, there were no exchange rate quotations in the market as the forex market operations had come to a halt. On the 22nd there were rumours about the float of the exchange rates, though the exchange rate had already depreciated considerably in the secondary markets. On the 23rd, the money markets halted completely and by the beginning of the next week rumours spread about the resignation of the chairman of the Central Bank. In short, the second stage is a conspicuous currency attack case triggered by a political crisis announced straight by the Prime Minister! At a time when macroeconomic fragilities were at their apex and the banking crisis was already recent, such an announcement was more than enough to trigger the currency attack.

There is a criticism that IMF preferred banking crisis against currency crisis and insisted on the seizure of troubled banks. This criticism can hardly be justified because the first stage of the crisis was truly due to the weakness of the financial system. The plausible criticism against the IMF should be on its advice of an exchange-rate based stabilization policy under the conditional weaknesses of the political and economic system. As noted above, such a stabilization strategy could not be undertaken during political instability, particularly in the presence of a fragile and inconsistent coalition government. Furthermore, there was no dedicated political will behind the programme. Again, there was no social support or any kind of coordination, as such a strategy was particularly dependent on expectations. Secondly, although limited, there existed a current account deficit (almost 1 per cent of GDP) before the enactment of the programme and it would naturally deteriorate by the managed exchange rates. (The current account deficit soared to almost 10 per cent of GDP in 2000) Besides the foreign debt of the country was already quite high; 41 per cent of its GDP. Thirdly, despite the experience of the Asian crisis, IMF failed to inspect the prudence of the banking sector in advance. Thus, in the first stage, it was the fragile banking system that drove the economy into a crisis. Last but not least, the programme was designed for interest rates to conform with reduced price expectations, but on the contrary high public debt and the strain on the exchange rate was drifting real interest rates.

Even though the 2001 crisis was mainly caused by the design error of the IMF stabilization strategy[29], the blame of the crisis was laid solely on the government, mounting the degree of its disreputability. Some economists, by then, even argued that if a conflict had not occurred between the prime minister and the president, the crisis would not occur. Although a simple logical exercise might contemplate such a conclusion, the macroeconomic fragilities, which have been neglected by the IMF, cannot be disregarded. If macroeconomic vulnerabilities had not existed and if the stabilization strategy of the IMF was appropriate, the quarrel between the president and the prime minister would not cause a financial crisis perse.

Ironically, though the IMF was largely responsible for the crisis, it was encountered as a saviour and a new IMF programme was put into effect with the support of the media and the business world. This time, a different exchange rate regime was implemented and the political coordination of the programme was commissioned to a non-political figure Kemal Derviş, who was a senior officer of the World Bank. The new programme received the support of the media and the business world and contained some important structural reforms as well as measures of macroeconomic adjustment. The prominent structural reform was the abandonment of the losses of the public banks by a prolonged monetization process alongside budgetary constraints to restrain its inflationary impacts. In short, the 2000/2001 program had stemmed on false political grounds and was inappropriate for the macroeconomic fundamentals of the Turkish economy.

4.5. The 2008/2009 Crisis: The First Crisis Without Domestic Implications

The economic crisis of 2008/2009 was distinct by its causes.[30] First and foremost, unlike its predecessors, it was,

[28] The design flaw of the stabilization programme recommended by the IMF was so obvious that since then the IMF never recommended such a programme to any other country.

[29] This crisis had salient political consequences rather than political effects. Besides, the political milieu was rather stable until the 2008/2009 crisis.

[30] In all past crises of the Turkish economy, there was a period of current account surplus due to the contraction of import demand and the rise of exports induced by currency depreciation. Yet, in this crisis, such a surplus never appeared.

to a large extent, a globally-induced economic crisis.

The global liquidity crisis in 2008 which was ignited from the US economy is a commonly known incidence. The high capital account surpluses of the US inferred immense capital inflows which also reduced domestic interest rates and enhanced the suitability of credit conditions, and subsequently caused the rise of asset bubbles especially in the real estate market. This enhanced suitable credit condition had also been accompanied by the massive liquidity injection and reduction of the borrowing rate of the FED since 9/11. Mortgage lenders issued 1 trillion USD of new mortgages each year in 2002 and 2003, and they increased by 40 per cent in 2004. Investment in the residential estate as a share of GDP rose from 26 percent in 2000 to 37 per cent in 2007. Consequently, prices surged by 60 per cent. About 1/3 of these funds were provided with complex financial instruments, like mortgage-backed securities and collateralized debtobligations. Thus, creditors were able to take more risks as they possessed securities at their disposalanyway. Nonetheless, these instruments did not cover the risk of falling housing prices; and housing prices fell by 25 per cent during 2007-2008. Eventually, when they declined to pre-bubble levels, asset-backed securities had lost most of their value. As those institutions that had these securities were highly leveraged, this created a debt-service problem. This is the synopsis of the global crisis in 2008/2009. Meanwhile, before the crisis, the economic climate in Turkey had two major features: On the one hand, the labour-intensive exports, like textiles, had started to falter, especially due to the Chinese competition, and secondly, monetary policy had been tightened due to the inflationary hike in 2006. (The inflationary hike was stimulated by higher food prices and the depreciation of the exchange rate) The average growth rate of the economy during 2002-2005 was 7.3 per cent but had moderated to 4.7 per cent in 2007 before the global crisis.

The global crisis spread to the Turkish economy through two main channels: Firstly, there were net financial outflows for at least 3 quarters, and secondly, there were export shocks due to the slump in the foreign demand albeit the exchange-rate depreciation. Considering the fall in domestic consumer confidence, this implied a more dramatic decline in aggregate demand.[31] When the crisis hit the Turkish economy through these channels, the exchange rate reacted immediately, with depreciation from 1.24 TL/$ to 1.69 TL within a month in October 2008.[32]

The Bloomberg-HT Consumer Confidence Index slumped to 54.5 in April 2008 from a level of 105 in August 2008 and did not recover until the end of the year. (It retrieved back to its original level by June 2009) This decline was caused by several factors: there was the roll-over risk of private sector foreign debt, especially during the liquidity squeeze (credit crunch) caused by the falling risk appetite and overcautious banks. There were also concerns about fiscal discipline since the IMF Stand-By agreement was due to expire by May 2008. Finally, the memories of past crises were still fresh and vivid reviving anxieties. In sum, the main impacts of the global economic crisis on the Turkish economy should be attributed to the global shock and subsequent uncertainties, and the deterioration of domestic confidence. No doubt, the Turkish economy was hit very severely by the global crisis. Nevertheless, except for the Asian economies, most emerging economies were hit worse than Turkey. The Turkish economy, unlike its peers, showed negligible growth performance in 2008 (0.65 per cent) but slumped relatively less (-4.7 per cent) in 2009.

The major disadvantage of the Turkish economy unlike those of previous crises was the very high private sector foreign debt. The total private sector foreign debt was 29.2 billion USD (8.3 % of GDP) in 2002 but it doubled in 2008 to 741.8 billion USD (19 % of GDP). That is why Öniş (2010) terms the 2008/2009 crisis as the *crisis of the real sector.*[33]

The relatively limited contraction of the Turkish economy was due to some resiliencies. First of all, this time the ratio of public debt to GDP was much lower than in the past; below 40 per cent. Furthermore, in 2007 consumer price inflation was at a moderate one-digit level, 8.4 per cent and unlike its predecessors, interest rates did not surge upwards as the floating exchange rate regime had replaced the role of offsetting. The global crisis was quickly ameliorated, by the US Federal Reserve and other major central banks, through lavish quantitative easing measures. Many emerging countries, including Turkey, benefited from this policy choice of the advanced economies by increased foreign investments. Another, important advantage of the Turkish economy was the immediacy of its counter-cyclical policies, both by fiscal and monetary expansion. On the other hand, the banking sector had become prudent due to strict financial regulations and the macroeconomic balances were already relatively healthier due to sound monetary and fiscal policies and most importantly due to political stability.

Although it is mentioned that the emergence of the 2008/2009 crisis cannot be ascribed to political instability per se, this does not imply that financial markets were insusceptible to political events. First of all, on April 27th, 2007 there was an e-memorandum that was declared by the Army through its official website which called for attentiveness about secularism especially in electing the new president. Despite this political event, the results of the general elections of 2007 enhanced the political power of the governing AKP, and soon after, the president was elected in the parliament. Nevertheless, there were certain ramifications of the e-memorandum in 2008, i.e. a legal case for closure was filed against the ruling AKP with the allegation of *misconduct against the secular nature of the state*.

[31] In March 2009, TL was as low as 1.80 TL/$, but then onwards it appreciated back to 1.50 TL/$

[32] Öniş also argues that there had been frequent political crises before the 2008/9 economic crisis but they had no role in its creation.

[33] Relations with the EU and US was rather amicable by then, and tensions in the region had not started. Furthermore, the government very wisely applied to the IMF (for SDR) in 2009 and received an equivalent of 1.5 billion USD as a cushion to offset the reserve losses of the Central Bank.

Similarly, some members of the intelligentsia and army officers were arrested in 2007, by allegations of attempting to overthrow the democratic government. (These arrests intensified in 2009 April.) Although these events were so prominent in creating severe political instability, which might lead to an economic crisis, the 2008/2009 crisis was predominantly incurred by global influences. This is obvious because the economic crisis terminated by the end of 2010, despite the continuation of adverse political conditions. Nonetheless, it must be reiterated that despite these adverse political conditions during the 2008/9 economic crisis, the existence of the one-party (and being recently re-elected) government provided the overriding favourable political factor which procured the resilience of the Turkish economy.

As for economic fortunes, the role of foreign support[34] and the abundance of international liquidity should not be disregarded in the comprehension of quick recovery. Furthermore, the low public debt ratio and the moderate rate of inflation provided the opportunity for fiscal and monetary expansion. Finally, and perhaps most importantly, the prevalence of flexible exchange rates was the main economic advantage when compared to the past economic crises.

4.6. The 2018 Economic Crisis: Tension In Foreign Relations, Domestic Political Instability Or Contra-Market Intervention Again?

The instigation of the 2018 economic crisis is a contentious issue. Although there was no net negative growth in 2018 or 2019, when figures are examined on an annual basis, the substantial economic decline can be detected by quarterly observation. The economic decline started in Q3 of 2018 (2.5 per cent) and turned into a net contraction in Q4 of 2018 (-2.7 per cent). The negative growth continued through Q1 (-2.6 per cent) and Q2 of 2019 (-1.7 per cent). As the recovery in Q3 of 2019 was lean (1 per cent) and as there was a continuous contraction for 3 consecutive quarters, the performance of the economy can be specified as a recession. In 2017, the aggregate demand was quite buoyant which provoked the rise of inflation from 8.5 per cent to 11.9 per cent and imports from 192.6 billion USD to 222.8 billion USD. As a result, the current account deficit surged from 26.9 billion to 40.8 billion USD. Yet, due to the immense exchange rate shock in 2018, consumer inflation hiked to 20.3 per cent by a significant pass-through and the current account deficit contracted to 20.7 billion USD.[35]

Foreign debt was one of the major burdens of the 2018 crisis. As a ratio of national income, it was 47.5 percent in 2016, but increased to 53.5 per cent in 2017 and then further to 56.7 per cent in 2018. This debt was primarily due to the private sector. Whilst portfolio investments were flowing in and repressing the exchange rate, the private sector (both financial and non-financial), kept borrowing from foreign markets.

The private sector external debt was 18.1 per cent of GDP in 2002. At the onset of 2008, this ratio reached 23.5 per cent, and in 2017 it hiked to 36.8 per cent of GDP.

The second but more important economic issue in the background of the 2018 economic crisis was the rapid and dramatic deterioration of the fiscal discipline. Although the ratio of public debt to GDP (by the EU standard) was rather stable (27.4 per cent in 2015 and 28 per cent both in 2016 and 2017), the primary surplus declined very rapidly since 2015. It dropped from 2.2 per cent in 2015 to 0.63 per cent and almost diminished to less than 0.1 per cent in 2017.[36] In short, the *twin deficits* were effective in the economic background of the crisis.

The political aspect of the 2018 economic crisis dates back to the general elections of June 7th, 2015. As there was no parliamentary majority to form a one-party government, the two major parties AKP and CHP looked for the prospect of a coalition. Yet, soon it was recognized that such a coalition was impossible and the newly elected President Erdoğan called for the repeat of elections on November, 1st. Nonetheless, the coalition pursuit caused more than 5 months of uncertainty, and hence incurred significant political instability, which indicated that the absolute political power of AKP was eroding. Moreover, the terrorist activities in the South-East of the country had already exacerbated political instability. On July 15th 2016, a coup was attempted by an iniquitous faction within the Army to overthrow the incumbent and democratically elected government but failed due to civil resistance of all political parties. This incident was the turning point of political stability as consumer confidence started to falter from then onwards. The exchange rate did not respond immediately, but by the second half of the year, it depreciated by 34 per cent. Despite some temporary political stability in 2017, the referendum for constitutional change from parliamentary to presidential system created a divided society and polarized the political system. On April 19th, 2018 the US officials demanded the release of a US citizen and consulate officer Pastor Brunson who was convicted of being involved in the coup attempt. By the plea of the court order, the Turkish government at first rejected such a demand. Yet, the consequent diplomatic tension was so fierce and devastating that it triggered a currency attack[37] (impacted by portfolio capital flight and domestic demand for foreign currency) and subsequently the exchange rate escalated from 3.81 TL/$ until 6.69 TL/$ by September 2018 (76 per cent depreciation).[38] The immense demand for foreign currency and short-term

[34] Once the crisis broke out, the current account deficit retracted to 21.7 billion USD in 2019, similar to past economic crises.
[35] In 2018, there was a net primary deficit of 0.25 per cent of GDP.
[36] On August 10th, 2018 US President posted a tweet 'I have just authorized a doubling of Tariffs on Steel and Aluminum with respect to Turkey as their currency, the Turkish Lira, slides rapidly downward against our very strong Dollar! Aluminium will now be 20% and Steel 50%. Our relations with Turkey are not good at this time!' By next Friday, he posted a second tweet 'We will pay nothing for the release of an innocent man, but we are cutting back on Turkey!'
[37] Boratav (2018) showed that in August 2018 the total foreign exchange demand of foreign investors and domestic residents was equivalent to 14 billion USD which was financed by Central Bank reserves and the current account surplus of 2.6 billion USD procured by the drastic economic contraction.
[38] The weekly repo rate of the Central Bank policy rate is considered as the policy rate.

Table 1. Presidential intrusion in the determination of the CB Policy Rate

Dates	CB O/N Borrowing	CB O/N Lending	1-Week Repo	T-Bill Compound
25 Jan. 2017	7.25	9.25	8.00	11.00
1 June 2017	15.00	16.50	8.00	11.25
1 June 2018	16.25	19.25	16.50	16.60
8 June 2018	22.50	24.00	17.75	19.00
14 Sept. 2018	22.50	25.50	24.00	25.00
21 Sept. 2018	18.25	21.25	19.75	25.00
26 July 2019	15.00	18.00	16.50	20.30
25 Oct. 2019	12.50	15.50	14.00	14.18
13 Dec. 2019	10.50	13.50	12.00	11.64

capital flight caused gross international reserves of the Central Bank to be drained from 116.1 billion down to 84.4 billion USD within 8 months since February 2018. Consumer confidence also collapsed by 39 per cent (from a level of 87.5 in January to 57.6 in September) regarding the rapid depreciation of the exchange rate.

As a result of this crisis, the government called for early elections on June 24th, 2018. The results of the elections did not provide a parliamentary majority for AKP on its own, but it was in an alliance with the nationalist MHP. Besides Erdoğan was elected as president anyway. Although the economic crisis did not ease until the elections, two factors contributed to the de-escalation of the crisis: firstly, three weeks before the elections the president gave his consent to the increase of policy rate of the Central Bank (which had long been obstructed by him) from 8.0 per cent to 16.5 per cent (a rise of 850 basis points). As this rise was insufficient to impede the depreciation of the TL, within a week the policy rate was raised again by 125 basis points to 17.75 per cent. Nonetheless, the new level of interest rates was still inadequate to extinguish the furore in the financial markets. Thus, this time the Central Bank raised its policy rate[39] by 625 basis points to 24 per cent. The second factor was rather a political change; the Turkish government recanted from its insistence to retain Pastor Brunson in prison, and first extricated and then extradited him.

The above table contains crucial data that depicts President Erdogan's intrusion into the independent determination of the Central Bank (CB) to determine its policy rate independently. The first column of Table 1. shows those meeting dates of the Monetary Policy Committee for policy rate changes. The second and third columns show the overnight (O/N) borrowing and lending rates of the CB. The fourth column displays the one-weekly repo rates of the CB, which is also accepted as its policy rate. In the last column, the compound interest rates of the corresponding auctions of Treasury bills are shown. They correspond to the values of the nearest auction date before the policy-rate change, to show the market interest rate level. It is so obvious that for one year (from June 1st, 2017 until June 1st, 2018) the CB was under an immense political strain to refrain from adjusting its policy rate, despite the escalation of interest rates in the market. Eventually, the CB on June 1st 2018 raised its lending rate by 725 basis points but kept its weekly repo rate (policy rate) intact. Indeed, the CB had effectively raised its interest rate but officially it was still indicating a lower policy rate to markets (and to the President!). Analogously, the interest rates in the bond markets had risen in line with the CB O/N lending rate (lender-of-the last resort window) showing that due to the intrusion and pressure of the President, the official policy rates of the CB had derailed from markets. This disruption remained and the CB had to raise interest rates twice again for the realignment of market and policy rates. Yet such a loss of policy transparency and the complication of the use of policy instruments naturally resulted in the loss of confidence and the erosion of consumer sentiment in markets.

Whichever is overriding, the 2018 crisis is incurred by three factors; the long political instability due to polarization, the tensions between the US and Turkey due to Pastor Brunson and the obstruction of the President of the Central Bank for changing its policy rates.[40]

As noted above, since the financial liberalization attempt in 1989, the Turkish economy has been confronted with four financial crises. In all of them, capital flight or currency attack was effective. In all of these crises, interest rates hiked and the exchange rate depreciated, but each of them had different features. In 1994, both the exchange rate and interest rates hiked. In 2001 the interest rate effect was enormous due to the fixed exchange rate regime. Although in the 2008/9 crisis, consumer confidence plunged drastically by 91 percent from its peak level in 2007, its impacts on the interest

[39] On October 7th, 2019 when there was a conflict over Northern Syria between the US and Turkey, President Trump threatened again to inflict the Turkish economy by posting a tweet 'As I have stated strongly before, and just to reiterate, if Turkey does anything that I, in my great and unmatched wisdom, consider to be off-limits, I will totally destroy and obliterate the Economy of Turkey (I've done before!). They must, with Europe and others, watch over...' But this time effects of this threat on the financial markets were limited due to the attentiveness of the Central Bank.

[40] Peak figures are shown. In August 2018 there was another wave of capital flight of 1.5 billion USD mostly from the stock market.

rates were limited, thanks to fiscal discipline, IMF aid and flexible exchange rates. In the 2018 crisis, consumer confidence declined by 52 per cent, but interest rates were almost doubled and the national currency depreciated by 66.5 per cent despite the heavy losses of international reserves. Our explanation for this difference is the loss of political instability amid the rapid escalation of private foreign debt.

5. CONCLUSION

Economic crises in Turkey have been changing concerning their origin and nature. The devaluation of 1946 was distinct amongst all of the early devaluations, as it was held by the discretion of the government as a contingency against an imminent external deficit. Since then, all devaluations have involved some degree of political instability and were technically unavoidable. For example, though the incumbent political party, DP, was in favour of extending the welfare of the farmers by excessive public spending, it lost most of its credibility during 1955-1957 due to the inflationary pressures and the upsurge of political tension. The 1958 devaluation was an inevitable obligation due to the external deficit. The 1970 devaluation, like its predecessors, followed rising political instability (this time the anarchic environment) albeit a debilitated one-party government. All of these devaluations had political consequences, in the sense that in the first two the incumbent governments lost elections but in the final one, it was pulled down by a military coup.

The 1978/9 crisis was the first foreign-induced crisis that was engendered by the surge in oil prices. Yet, one must bear in mind that it was not just the subsequent external deficit that incurred the 1978/9 crisis. The prevalent political instability, which was affected by the fragmented political structure and political polarization, not only had an impact on the short-living coalition governments but also played a major role in the instigation of crises.

The 1994 economic crisis was also distinct. First of all, there was a mistake in the policy strategy, as the crisis rested on an immature financial liberalization attempt, which mounted the interest burden on the budget. The second mistake was in macroeconomic management. The crisis was indeed triggered by the contra-market intervention of the Prime Minister in financial markets and was the first where there was a portfolio capital flight.

Although in the aftermath of this crisis, fragmentation of the political system deteriorated further, the 2001 economic crisis should primarily be attributed to the design-defective of the stabilization policy of the IMF. This is because an exchange-rate based stabilization policy, through the management of expectations, cannot be implemented during political instability or within a fragmented political system. According to Öniş (2010), poor governance was effective in all crises as they were products of populist cycles. As noted above, the incompetence in public debt management in 1994, the design-defect of the IMF programme in 2001 and the stubborn and inane political obstruction of the Central Bank to raise its policy rate in 2018 contributed to the instigation of crises. The only exception was the 2008/9 crisis, where relative macroeconomic prudence and expertise in countercyclical policy procured quick recovery. In all economic crises, we observe the loss of fiscal discipline and subsequently higher external deficit as common features. The longstanding foreign deficit has caused an accumulation of foreign debt of the private sector, and this has constituted the conventional economic background of crises. Nevertheless, as explained above, the populist tendencies in fiscal policy have social and political motives.

Since financial liberalization, but especially in the last decade, foreign debt dynamics have become essential due to the high risk of a sudden capital flight or a currency attack. Though political instability on its own has a limited role to impair financial stability, since financial liberalization it has become an imperative. By the potential to affect both the consumer sentiment and the investor appetite adversely, political instability can have detrimental effects on macroeconomic balances through the interest rates (domestic debt dynamics) and the exchange rates (foreign debt dynamics).

In this sense, the Asian crisis has been a very illuminating example for the comprehension of the role of political instability, besides other political factors, in the emergence of economic crises. Our analysis here is naturally confined to the Turkish experience. We tried to show *that some po-*

Table 2. The Comparison of the processes of the 2008/9 and 2018 crises

	Consumer Confidence (Bloomberg)	Exchange Rate ($/TL)	Commercial Lending rate	Treasury Bill rates	Intern. Reserves	Capital Flight[41]	% Change in Total Investment[42]
Sept. 2007	105.2	1.25	21.9	20.0	108.3	2008(6)	2009 (Q1)
Nov. 2008	55.09	1.61	24.4	22.8	112.3	= $ -3 bn.	= -35.1
Jan. 2018	87.5	3.76	20.1	13.5	116.1	2018 (3)	2019 (Q2)
Sept. 2018	57.6	6.26	38.5	25.1	84.2	= $ -2.3 bn.	= -21.0

[41] Peak figures are presented with their corresponding dates.

litical instabilities (although *not all*) have led to macroeconomic imbalances. We also showed that all political crises led to macroeconomic imbalances whilst *some* of them have even instigated economic crises.

The influence of political instability on macroeconomic balances depends on the existence and extent of macroeconomic fragilities. Depending on the types of policies pursued, these fragilities differ from one country to another, such as; the entity of current account deficit and subsequently the extent of foreign debt, and/or the entity of budget deficit and subsequently the size of the public debt and/or the shortage of international reserves. Once these fragilities become dominant, political instability becomes instrumental in instigating an economic crisis. Finally, it must be contended that those macroeconomic fragilities caused by the *flawed* policy preferences of governments have certain socio-political implications.

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