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THE EFFECTS OF THE GLOBAL ECONOMIC CRISIS ON TURKEY'S ECONOMY AND THE RECENT TILT IN HER INTERNATIONAL RELATIONS

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─Abstract ─

Turkey was one of the worst hit countries from the global crisis that started in September 2008. She had relied heavily on external financing by charging a high interest take. Her external debt and current account deficit had risen and the lira had become overvalued. Following the global crisis, the fall in the flow of financial funds, direct private investments (DPIs) as well as exports caused a great fall in her GNP. But though refusing to make a stand-by agreement with the IMF, she managed to relief relatively fast; gradually lowering the interest rate.

As detailed statistics attest, before the years '90s and the onset of globalization her international economic relations had already started to diversify; with the share of Middle Eastern Islamic countries and Russia rising. After the 2008 global crisis economic problems in many EU member countries put further brakes on the EU. Hence, Turkey was obliged to further diversify her exports, imports, inflow of financial flows, DPIs as well as her outflows; the latter including her construction undertakings. Therefore, much of the recent tilt in Turkey's international economic relations can be considered an outcome of the globalization process, plus the recent global crisis, necessitated by economic factors.

Yet many of the recent political moves that the Turkish government has made does not fit to the picture as an economic contingency. Major cases in point are Turkey's over-reactionary hostiles toward Israel, over-support of Hamas and also of Iran plus the stackening of political reforms, hence membership negotiations with the EU. It is hard to explain all these excesses with plain economic contingencies. Evaluations vary; some foreign observers explain it as an effort by the Turkish government to act as a regional power, others put the major blame of *the cooling relations between Turkey and the EU. Still others may see it as a real political tilt towards more radical Muslim countries as well as emerging non-Western powers. This is less a subject for economic research but one for political economy*.

Key Words: *effects of global crisis, tilt in international relations, detailed statistics*
JEL Classification: E01, E66, 052

1. INTRODUCTION

This study investigates the effects of the September 2008 global financial crisis and global recession on the Turkish economy and the following developments. Turkey was praised for having recovered swiftly from the global economic crisis without aid from the IMF. Only more recently, by about March 2011, at the time of writing this study, some doubts are being raised by sundry representatives of international financial circles as well as rating organizations about the danger of continuously increasing current account deficit. A study of Turkey's economy against the background of the September 2008 global economic crisis should, therefore, provide an interesting case study.

In this study we will cover only the period since 2002, when the present AKP government implemented open economy model, outward orientation and globalization. But, the process of changing development strategy from a closed economy model to market economy and outward orientation, it should be noted here at the outset, had started long ago, since 1980. This strategy was widely expanded later, during the years 1983-89. The last thorough re-structuring had been effected in 1999 and 2001, in compliance with the IMF *stand-by* agreement. These policies were continued with the AKP government that came to power in 2002. After the 2008 global economic crisis, doubts were also raised as to whether Turkey is changing her axis. Part of the recent change in Turkey's international economic relations was necessitated by the worldwide economic conditions after the global crisis. But there are also political aspects of this question which is a topic of political science rather than economics.

2. ECONOMIC POLICIES IMPLEMENTED SINCE 2002 UNTIL THE 2008 GLOBAL CRISIS

2.1. The Pre-2008 Global Economic Crisis Period

As noted above, the AKP government that came to power in 2002 found before them an economy that had already been re-structured in 1999 and 2001 in compliance with the IMF *stand-by* agreement for a better working of the market economy, outward-orientation and globalization. Therefore, credit should go to AKP not for initiating the economic re-structuring but for continuing with the economic policies and reforms already started. Similarly, closer ties with the EU had also already been achieved and Turkey had been nominated a “candidate member” in the 1999 Helsinki Summit.

In the beginning, the AKP government, despite its extremist religious roots, did stick with what is evaluated by the Turkish public as “center-right” policies and strategies. The political emphasis was pro-private sector, pro-DPIs, pro-USA, pro-EU and pro-NATO. They continued with and accelerated the privatization programme, encouraged the entry of DPIs and, along with the advent of globalization, the inflow of financial funds and external credits to the Turkish economy. All these policies and development strategies were, in principle, in the right direction. Basic economic indicators related with the growth of the economy during the period studied is presented in Table 1, below.

Table 1: GDP (in US$), Growth Rate of GDP 1999-2009

Years	GDP billion US$(1)	Growth Rate of GDP (%2)(2)
1999	247.5	-3.4%
2000	265.4	6.8
2001	196.7	-5.7
2002	230.5	6.2
2003	304.9	5.3
2004	390.4	9.4
2005	481.5	8.4
2006	526.4	6.9
2007	648.6(3)	4.7
2008	742.1	0.7
2009	616.8	-4.7

(1)Calculated on the basis of current GDP (in TL, buyers’ prices) and the current exchange rate.
(2)Calculated on the basis of real GDP in TL terms.
(3)Note that major part of the increase in GDP level and the growth rate stems from a change in the method of calculating the GDP and GNP.
Source: TÜİK (internet)

There were several reasons why the Turkish economy prospered. Firstly, there was, on the surface, political stability of a single strong party in power, following a short period of, what seemed, an unstable or undependable coalition government. Secondly, the economic re-structuring measures that had been initiated in the previous coalition government in compliance with the IMF stand-by agreement, had begun to bear fruits and show positive results. Thirdly, the world had already fully recovered from the 1997-8 global financial crisis that had emanated in the Southeastern Asian countries. Therefore, both DPIs and financial flows had already began to rise. Thus, Turkey was able to attract large flows of both since she had reached the status of an “emerging market”.

The total GNP of Turkey in US dollars placed Turkey amongst the 20 countries with the largest GNP level, hence a member of the G20 (for instance, in 2007 Turkey was 17th (re: IMF, World Economic Outlook, 2007). Presently Turkey ranks as the 16th. (IMF, ibid., 2009).

More relevant to the September 2008 global economic crisis, the AKP government had followed a strategy of globalization and development that had left the Turkish economy fragile for such a crisis. In addition to the encouragement of DPIs which continued to rise significantly over the years in question, the AKP government over-encouraged the flow of financial funds and credit by means of sustaining very high interest rate levels. This enabled a large flow of financial funds to Turkey which, in turn, financed the increase in imports well over exports. This policy, including flow of funds, increase of imports (most of which are energy, components, inputs and investment goods) was definitely instrumental in raising the GNP growth rates to relatively high levels. Concomitantly, privatization efforts were also accelerated and DPI flow and privatization went hand in hand. The yearly figures for DPI flows can be followed from Table 2 submitted below.

But to finance infra-structural investments and other expenditures, the AKP government also had recourse to large amounts of both internal and also external debt. The figures for external and internal debt (both public and private) are given in columns (II) and (III) and (IV), again Table 2.

Table 2: Yearly flow of DPIs, External and Internal Debt, 2002-2009

	(I)	(II)	(III)	(IV)
Years	DPI flow million US$	Gross Public External Debt billion US$	Gross Public Internal Debt In terms of billion US$	Private Sector External credits billion US$
2002	939	88.4	54.8	29.2
2003	1.322	96.2	144.5	30.0
2004	2.005	102.9	174.9	36.8
2005	8.967	99.0	193.6	50.6
2006	19.261	108.6	190.8	82.2
2007	19.941	133.7	234.6	121.4
2008	16.955	151.2	196.5	140.1
2009	6.858	146.0	230.7	127.7

Source: Ministry of Finance, State Planning Organization and Under-secretary of the Treasury**.**

This policy enabled the Turkish government to finance the rising level of total imports, by causing a large rise in the trade and current account deficits. Turkey's exports, imports, trade and current account balance is given in Table 3, below.

Table 3: Exports, Imports, Trade and Curren Account Balance 2001-2010 all figures in million US$

	(I)	(II)	(III)	(IV)
Years	Total Exports (1) (fob)	Total Imports (cif)	Trade Balance	Current Account Balance
2001	34.729	38.092	-3.363	-3.760
2002	40.719	47.109	-6.390	-626
2003	52.394	65.883	-13.489	-7.515
2004	68.535	91.271	-22.736	-14.431
2005	78.365	111.445	-33.080	-22.309
2006	93.612	134.669	-41.056	-32.246
2007	115.361	162.213	-46.852	-38.434
2008	140.800	193.821	-53.021	-41.959
2009	109.647	134.497	-24.854	-13.991
2010	120.925	177.277	-56.356	-48.561

(1)Note that since 1996, hence during the years taken up in this Table, suitcase sales (that is, goods sold to tourists) are also included in total exports.
Source: Turkish Central Bank (TCMB), through the internet

To keep the flow of external financial funds, credits, portfolio investments and also to make sales of government bonds and treasury bills attractive, the interest rate had been raised far above that generally prevailing in the world markets. This means high volumes of the yearly servicing of external debt and interest, that was to be financed by incoming foreign exchange flows. But this policy made the Turkish economy fragile when the September 2008 global economic crisis broke out, on account of consequent decreases in DPIs, financial flows as well as exports (Tables 2 and 3). Another major negative effect of the above explained wrong globalization strategy showed itself particularly in the field of employment and unemployment. The inflow of large amounts of foreign exchange by means of DPIs and financial funds, in addition to exports, during the pre-crisis period had depressed the value of foreign exchange. Foreign exchange had become "under-valued" and Turkish lira "over-valued". The more important negative effect of the over-valued lira was on the agricultural sector. Since agricultural support prices were to be in conformity with the world prices, over-valued lira meant actually too low support prices in terms of Turkish lira. At the same time, because income taxes could never be adequately increased, tax revenue was obtained in large part by means of raising indirect taxes. This caused, during the period in question, abnormally high indirect taxes on petroleum and diesel fuel, an important cost element in agriculture as well as in manufacturing. Thus, the agricultural sector was squeezed both by abnormally low support prices in lira terms as well as rising costs, both decreasing the agricultural revenue precipitously. As a result, the growth rate of the agricultural sector began to fall significantly since 2002, also bringing down agricultural employment, and hence raising total unemployment. Thus, we witnessed a period of GNP growth accompained with an increasing unemployment, as presented below, in Table 4.

Table 4: Employment and Unemployment, 2002, 2006

Years	**2002**	**2006**
(1) Total Civilian Work Force	24.234	25.075
(2) Total Employment (3+4)	21.975	22.800
(3) Agricultural Emp.	7.961	6.488
(4) Non. Agr. Emp.	14.014	16.372
(5) Unemployment (1–2)	2.259	2.127
(6) Unemployment Rate (5) ÷ (1)	9.3%	8.8%
(7) Unemployed who do not seek emp.	944	1.912
(8) Total (broader definition) (5) + (7)	3.203	4.127
(9) Unemp. Rate (Broader definition (8) ÷ (1)	13.2%	16.5%

Source: DPT, Relevant Yearly Programmes, 2003, 2007.

Therefore, the Turkish economy came face to face with the 2008 global economic crisis with a large external as well as internal debt, large yearly payments for servicing the external debt, over-reliance on the ample flow of DPIs and financial funds to make these payments and to meet the foreign exchange requirements of the current account deficit, as well as a large volume of unemployment.

2.2. The Effects of 2008 Global Economic Crisis on The Turkish Economy; Measures Implemented and Results Obtained

2.2.1. The Effects of the Global Economic Crisis on the Turkish Economy

The September 2008 global economic crisis hit the Turkish economy on two important counts. The first was the decline in both the flow of DPIs (re: Table 2) and financial funds, thereby reducing the supply of foreign exchange. The second was the decline in total exports (re: Table 3). This was because the major part of Turkey's exports went to the EU countries which were faced with a serious financial crisis as well as recession. The main part of DPIs and financial funds to Turkey also flowed from the EU. The decline in exports further squeezed the supply of foreign exchange to Turkey to finance her imports as well as the yearly backpayments of external debt. As a consequence, imports, thereby GNP and industrial production declined considerably while unemployment further increased. In fact, Turkey was one of the countries worst hit by the global economic crisis in terms of the fall in the level of GNP and industrial production (re: Table 1, figures for 2008, 2009).

2.2.2. Measures Taken to Combat the Crisis and Results Obtained

Turkey, nonetheless, recovered rather swiftly from the global economic crisis on account of several reasons. Firstly, the Turkish financial sector had already become strong as a result of the thorough restructuring of the banks in conformity with the 1999 and 2001 IMF *stand-by* agreement. The Turkish banks had one more advantage compared to the European banks. By law, they are not permitted to buy derivatives and valuable papers from banks abroad.

Secondly, immediately following the outbreak of the global economic crisis, the Turkish Central Bank started to implement a policy of reducing the interest rate (down from nominal 16.0% in 2008 to 5.75% by November 2010; TCMB: internet).

Thirdly, the stand of the Turkish government in dealing with the crisis was very important. It is interesting that following the global crisis the IMF did start lengthly negotiations with Turkey for giving out aid, presumably over 20 billion US dollars and making another *stand-by* agreement. The negotiations were prolonged and cut twice in futility. It seemed, at the time, that the AKP government did not want to have the budget expenditures to come under strict IMF controls because it was going to face municipality elections in March 29, 2009. The AKP won the municipality elections handily (Hiç, 2009). However, both before and particularly after the local elections the AKP government exercised self-imposed discipline on government expenditures and budget deficits.

Still another important reason was the effort of the Turkish government to increase export opportunities to countries other than EU members and Europe. She also tried to strengthen her economic relations with Russia, the Near and Middle Eastern and North African Moslem countries.

And finally we had one more factor, an external factor this time, that worked in Turkey's favor. On account of several reasons, DPIs and financial funds started to flow to Turkey once again. Firstly, Turkey showed a relative economic strength as well as political stability. This was in stark contrast to some European EU member countries in the Euro zone, including Greece, Spain and Portugal. Secondly, though the Turkish Central Bank had reduced the interest rate, it was still high compared with the worldwide interest rates. Thus, Turkey offered higher profitability as well as relative security. So much so that in the more recent years and months the Turkish trade and current account deficit again increased along with a notable increase in the GDP growth rate as well as the price increases. Concerns about the relative stability of the Turkish economy began to be expressed about the fragality of the Turkish economy. As a counter measure, the Turkish Central Bank this time raised both the interest rate as well as legal deposit reserve rates of banks to check on private expenditures, growth, price increases and current account deficit.

2.2.3. Does the Tilt in Turkey's International Relations Mean She Is Changing Her Axis?

The question often asked in the political circles is whether the AKP government is recently changing Turkey's axis, away from the EU and towards Middle Eastern and North African Islamic Countries. A correct answer to this question cannot be given based only on economic analysis. Because, as explained above, following the 2008 global economic crisis, the EU countries did suffer considerable from recession, hence Turkey's exports to these countries had fallen while DPIs and financial funds which came to Turkey, again in major part from these countries had also decreased. This, as an economic consequence, did necessitate Turkey's search for increasing her trade and economic relations with other countries. Moslem Countries, in turn, needed Turkey's exports of agricultural and manufacturing goods as well as construction work Turkey could afford to give. In turn, these countries, including Iran and also Russia, could offer Turkey petroleum and natural gas.

The change in the country group distribution of Turkey's international trade, confined to exports as representative, is given below with the aid of figures and ratios for the years 2003 versus 2010. The figures and ratios reflect both the economic changes in the world scene following the 2008 global economic crisis as well as the fruitful results of Turkish government's deliberate efforts to open to international trade worldwide, with particular weight falling on Middle Eastern and African Moslem Countries. Country distribution of imports are not given but show a pattern similar to that of exports, except for a greater weight of countries that supply petroleum and natural gas to Turkey.

Before the 2008 global economic crisis; a substantial part of Turkey's exports were directed to the EU and other European countries, as well as the OECD as a whole. For instance, in 2003, 27 EU countries accounted for 58.0%, other European countries for 7.1%, OECD as a whole accounted for 67.6%, of Turkey's total exports. The share of North Africa was only 3.3%, other African countries 1.2%. Near and Middle Eastern countries had a share of 11.6%, other Asian 5.0%. Union of independent states, including Russia was responsible for 6.3%; Islamic Conference states for 15.2%.

In 2010, after the global crisis, the share of 27 EU countries was down to 46.2% also implying a significant fall in the absolute level of exports. The share of other European countries was 10.0%. The share of OECD, as a consequence, had gone down to 54.0%. The share of North Africa had risen up to 8.2%, other African countries had also risen up to 6.2%. Near and Middle Eastern countries had risen to 20.9%, a substantial rise; other Asian was also up, 7.5%. Russia and union of independent states had also gone up to 9.0%; Islamic Conference states were responsible for a substantial 28.5% (TÜİK internet). Note also that the major bulk of Turkey's construction undertakings went to Near and Middle Eastern, Northern African countries, to Russia and to some near-by Balkan countries.

3. CONCLUSION

Looking only at the economic facts and figures, we may conclude that the more recent shift in Turkey's economic relations is caused by economic factors, that is, the effects of 2008 global crisis on the world economy, and hence an inevitable consequence of the process of globalization and of changes in economic conditions.
A search at political developments recently taking place, on the other hand, may lead us to serious doubts and towards other conclusions.
Therefore, the question whether Turkey is changing her axis cannot be answered merely by studying the developments of the Turkish economy. It calls for an in depth research of political developments that should also include anti-democratic tendencies of the present government, including the pressure on the media, the influence of the government on courts, judges and prosecutors. Hence, as indicated above, it is a topic to be studied by a political scientist.

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