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The Effects of Economic Policy Choices on Industrialization in Turkiye

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Abstract

This study examines the impact of Turkiye's economic policy choices on industrialization since the Global Crisis. For the study period, TurkStat and World Bank data on the main industrial sector indicators such as production, value added, exports and imports, and technology intensity were used. The study concludes that such choices were shaped in parallel with the global economy until 2019. In terms of the second observation, the relationship between economic policy preferences and industrialization, industrialization increases during periods of protectionist economic policies, and although the industrial sector loses its top priority during periods of liberal economic policies, increased integration with the world economy and private sector entrepreneurship add momentum to industrialization. The third observation is that the structural problems of the Turkish economy lead to economic instability and adversely affect industrialization, regardless of the choice of economic policy. The fourth observation is that after the Global Crisis of 2008, global competition has been increasingly based on technology, an area where Turkiye lags behind. Aiming for short-term economic growth through wrong macroeconomic policy choices, the country moves away from ensuring long-term economic growth and economic development through industrialization based on technological development, and the whole economy faces increasing risks.

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1. Introduction

Since the early 1980s, neoliberal policies have led to the financial sector replacing the real sector in economy. The Global Crisis in the mid-2000s changed the direction of economic policies in the world. On one hand, Keynesian policies gained prominence, and on the other hand, the importance of the real economy and the manufacturing industry was resurfaced.

Economic policy in Turkiye has generally followed a trend parallel to developments in the global economy. The economic policy adopted also determined the country's industrialization policy and shaped industrialization. However, industrialization in Turkiye has been greatly affected not only by economic policy choices but also by structural problems in the economy.

In the Turkish economy, the founding period of 1923-1929, the 1950s and the post-1980 period are generally regarded as periods in which liberal economic policies were adopted, while the 1930s and the 1963-1980 period are generally accepted as periods in which statist and protectionist economic policies were implemented. In periods of statist, protectionist, import substitution-based economic policy and industrialization strategy, the first priority was industrialization. In liberal periods, when private sector entrepreneurship and integration with the global economy increased, productivity and production increased thanks to the dynamism of private enterprise, but industrialization ceased to be a priority sector. The impact of economic policy preferences on industrialization was influenced by the structural problems of the economy on one hand, and

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developments such as the 2008 Global Crisis, the Covid-19 pandemic and the fourth industrial revolution as external factors on the other.

The study first touches upon definitions, classifications and indicators related to industrialization. The second section includes literature on the relationship between economic policy preferences and industrialization. In the third section presents a periodic analysis of Turkiye from its foundation to the present day. The industrialization that took place within the framework of the economic policy adopted in each sub-period is outlined. Turkiye's economic policy and the current state of the industry in the face of revolutionary technological developments in the aftermath of the Global Crisis, especially since the early 2010s, are presented through the interpretation of statistical data. The conclusion includes the assessment of the situation and recommendations.

2. Industrialization: What is it, Indicators, Expectations from Industrialization

Industry is one of the main sectors of economy. In literal sense, industry is the processing of raw materials and intermediate goods using labor and capital and transforming them into finished goods. In a broad sense, industrialization refers to the use of new production techniques in production, improving product quality, reducing production costs, increasing productivity, and ultimately the positive change and progress achieved by the country in economic, social and political terms (Karluk, 2014).

Fisher (1939) and Clark (1940) first classified economic activities into three sectors. According to this universally accepted approach, goods produced in the Primary (Agriculture) sector are obtained directly from natural resources. In the secondary (industrial) sector, new products are produced from previously produced goods. Tertiary (Service) sector is the economic activities that are not subject to production and are outside the primary and secondary sectors. In a broad sense, industrialization can also manifest itself as the use of developing technology in primary and tertiary sectors (Karluk, 2014).

On the basis of this tripartite classification, industry-related economic activities can be represented according to NACE Revision 2 (Classification of Economic Activities in the European Community/Nomenclature des Activités Économiques dans la Communauté Européenne) and ISIC Revision 4 (United Nations' International Standard Industrial Classification of All Economic Activities) as shown in Table 1.

Table 1. Classification of economic activities in the European Community and United Nations

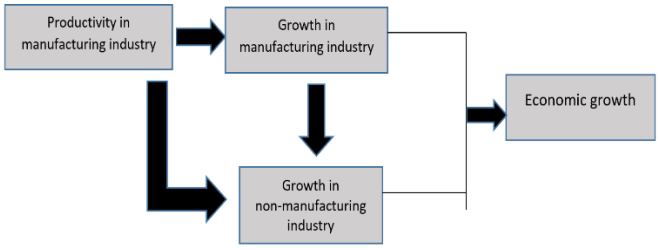
ISIC Rev. 4 / NACE Rev. 2 sections	**Description**
B	Mining and quarrying
C	Manufacturing
D	Electricity, gas, steam and air-conditioning supply
E	Water supply, sewerage, waste management and remediation

Source: European Commission 2008.

To analyze the level of industrial development of an economy, the importance and weight of industry in the country's economy and the level of development of the country, some indicators related to industry are required. The main indicators are industrial production index, capacity utilization rate, employment, productivity, turnover index, share in gross domestic product (GDP), share in foreign trade, technology level of exported and imported industrial goods (https://ec. europa.eu/eurostat/ data/database).

Within the concept of industry, the manufacturing industry is particularly important in terms of the process of transforming raw materials and intermediate goods into finished goods. The development of the manufacturing industry is parallel to the development of the country's economy. Figure 1 shows expectations from industry in an economy.

Figure 1. Manufacturing industry and economic growth



Source: Yülek, 2017.

We can explain the direct and indirect effects of industrialization with Kaldor's Laws (1966). According to Kaldor's first law, manufacturing industry is the engine of GDP, that is, economic growth. According to Kaldor's second law, the manufacturing industry grows through productivity growth. According to Kaldor's third law, the growth of the industrial sector increases the productivity of non-industrial sectors. High productivity growth in industry leads to a decrease in the share of industry in total production and total

employment in the economy. The employment depot is now the service sector. The manufacturing industry is an incubator for productivity and innovation. Therefore, the manufacturing industry continues to be the driving force of economic growth. Although industry has been replaced by the service sector in advanced economies, productivity growth in industry is higher than in the service sector, as explained in Kaldor's third law. Productivity in the service sector increases thanks to productivity increase in industry (Yülek, 2019). Although the manufacturing industry is the driving force of economic growth, the multiplier effect of the manufacturing industry on economic growth is higher in countries with strong domestic suppliers in the production of industrial goods. In countries with weak domestic suppliers, imports of manufactured goods reduce the multiplier effect (Yülek, 2019).

3. The Relationship between Economic Policy Choice and Industrialization

There are two basic strategies that enable a country to industrialize: i) Import substitution strategy, ii) Export-based industrialization strategy. Import substitution strategy is generally favored by countries with low national income, a small domestic market, and technologically underdeveloped countries which intend to achieve rapid economic development. However, most industrialized countries implemented this strategy in the early stages of their industrialization. According to this strategy, the main objective is to produce imported goods domestically. To this end, consumer goods are produced domestically in the first phase of the import-substitution industrialization strategy, followed by production of intermediate goods and investment goods in the next phase. Therefore, domestic industry is supported by protectionist policies until it reaches a certain level of development. Export-led industrialization strategy is based on the economic idea that the driving force for industrialization and economic growth comes from foreign demand rather than domestic demand. Both the increase export value and the change in the composition of exports in favor of industrial goods render exports an important financing tool for the economic development of developing countries (Eşsiz & Özdemir, 2013; Kazgan, 2000: Minibaş, 1992).

The main expectation of newly industrialized countries from the import substitution policy is to ensure economic development. These countries do not have sufficient export potential and foreign exchange to finance development, and their demand for foreign exchange is high due to imports. This situation causes problems such as deficits in the balance of payments, foreign borrowing, etc. Producing imported goods domestically enables foreign exchange savings. However, saving foreign exchange is not sufficient to create sustainable industrialization. To import advanced technologies and investment goods in the later stages of industrialization, foreign exchange earning strategies are needed rather than foreign exchange saving strategies. Therefore, the import substitution strategy, which is no longer sufficient, gets replaced by an export-oriented industrialization strategy. The export-oriented industrialization strategy is an industrialization path that is in line with the theory of comparative advantage, as it is a strategy to develop the country only in industries with export potential. Since the aim of this strategy is to focus on foreign markets, it is possible to benefit from economies of scale. Since industrialization is based on foreign competition instead of protectionism, the power of monopoly and oligopoly markets decreases, product quality increases, the economy gains dynamism, and technological developments accelerate. The success of countries such as South Korea, Hong Kong, Taiwan and Singapore in terms of exporting industrial goods and the economic growth they have achieved can be considered as examples in this respect (Bhagwati, 1986; Eşsiz & Özdemir, 2013; Yülek, 2019).

F. List laid the foundation of economic nationalism within the framework of objections to the social and economic consequences of the Classical School of Economics. In the 18th century, this foundation played a major role in Germany's economic unification and industrialization. Strictly adhering to List's doctrine of national economy, Germany established and developed industry by implementing protectionist macroeconomic policies and laid the foundations of being a powerful industrial country even today (Levi-Faur, 1997; Turanlı, 2011).

From this perspective, it can be said that there were two different economic structures with two different models of capitalism in continental Europe before the fall of the Berlin Wall in 1989. One was the Rhine Model, led by Germany, based on building a strong industry; the other was the Anglo-Saxon Model, led by the United Kingdom, based on the liberalization of financial markets. 1989 was a turning point in this respect. After the fall of the Berlin Wall, neoliberal policies gained momentum. The 1990s was a decade of accelerating deregulation and integration in financial markets. The Anglo-Saxon Model became popular, while Rhine capitalism and industrialization fell out of favor (Mosconi, 2015).

But developments in the early 21st century have changed the roles between the two models of capitalism. Today, industrial policies are back on the agenda in both developed and developing countries (Yülek, 2018). Especially the corporate scandals in 2001-2002 and the 2008 Global Crisis shook the Anglo-Saxon Model to its foundations. These developments reminded us of the importance of the real sector and the manufacturing industry.

Thus, the direction of macroeconomic policy preferences in the world began to change. Purely neoliberal policies that linked the liberalization of financial markets and economic

development to financial markets were replaced by more interventionist and/or protective policies that prioritized the real sector and industrial production. As a result of these developments, which paved the way for the emergence of a new industrial revolution, the first signs of the Fourth Industrial Revolution began to emerge in Germany in the early 2010s.

4. Changes in Turkiye's Macroeconomic Policy and Industry

The Izmir Economic Congress (February 17-March 4, 1923) was an important event which determined the macroeconomic policy of the newly established Republic of Turkiye. Congress adopted a liberal economic policy and the private sector was incentivized to develop industry. Türkiye İş Bankası (1924) and Sanayi ve Maadin Bankası (1925) were established to finance trade and industry. In 1927, the Law on Incentive Industry was enacted. The low customs duty practice, which had continued under the Lausanne Treaty, ended in 1929. Thus, customs duties were raised, protecting the domestic market and enabling the development of the domestic industry (Yülek & Gür, 2022a).

At the end of the 1920s, it was observed that the expected level of industrialization could not be achieved under the lead of the private sector due to various internal and external reasons. The private sector had failed to accumulate sufficient capital. The Economic Crisis of 1929 emerging at the end of the decade had begun to spread. All countries turned to closed, protectionist policies (Gür, 2006). Thus, a statist economic policy was adopted to achieve industrialization in the 1930s. Two five-year industrial plans were prepared during this first industrialization period. The Second World War did not allow for the implementation of the Second Industrial Plan, but with the First Industrial Plan, which began to be implemented in 1934, it was aimed to establish 23 factories in weaving, mining, paper, pulp, chemical and soil industries. Sümerbank (1933) and Etibank (1935) banks were established to build factories. In cooperation with countries such as Russia and the United Kingdom, technology was imported in the establishment and operation of factories, and the know-how of these countries was utilized. This plan was largely put into effect (Yülek & Gür, 2022b). Throughout the period, the growth rate of industry outpaced other sectors and was generally above 10%. The import-substitution industrialization policy based on protectionist and statist economic policy yielded successful results; approximately 80% of domestic demand in the weaving, sugar, cement, bottle-glass sectors was met by domestic production (Karluk, 2014).

The Second World War years was a period of war economy conditions. After the war, liberal economic policies were adopted in the 1950s. The Vaner Plan (Turkiye Development Plan) (1947) was adopted instead of an İvedili (Urgent) Industrial Plan (1946), which was prepared within the framework of the statist industrialization policy. This plan, although not officially implemented, is evidence that the statist-protectionist industrialization policy was abandoned. Instead of industrialization based on the domestic market, an economic growth oriented towards the foreign market and based on mining, construction and infrastructure investments, especially in agriculture, was envisaged. The number of state-owned enterprises (SOEs) gradually increased during this period of liberal economic policy due to reasons such as the end of the expansionary conjuncture after the Second World War, the decline in demand for export goods, the increase in the foreign trade deficit, increasing foreign dependency, the decline in imports of consumer goods and the desire to meet the demand for consumer goods with domestic production (Boratav, 1998). Therefore, it can be said that the industrial policy of the early Republic, which was based on producing basic consumer goods by using domestic raw materials (agriculture, mines), largely continued until 1963. Especially in the period between 1952-1957, the industrial sector grew by a record 12.5% on average due to the buoyant domestic demand after the war. In technological terms, the structure of industry did not change much. Private sector industrial enterprises were mostly SMEs, technology was outdated and agricultural equipment had been provided under the Marshall Plan. However, the private sector was developing significantly (Karluk, 2014).

The 1960s and 1970s were years of import substitution policies in industrialization. Three five-year development plans were prepared covering this period. The aim was to start with durable consumer goods and move on to intermediate goods and capital goods. Although the target was not sufficiently achieved despite significant industrial investments, the private sector concentrated on the production of durable consumer goods during the period between 1963-1980, while the state concentrated on the production of intermediate goods and investment goods, almost creating a division of labor between them (Cengiz and Öruç, 2016; Karluk 2014). Thus, while the industrial sector grew, the structure of industry also changed. In particular, intermediate goods began to be produced domestically to a large extent. For the first time in 1973, the share of industry in GDP overtook agriculture. However, the import-substitution industrialization policy led to more imports, resulting in import dependency and thus a foreign exchange bottleneck. At the end of the third development plan (1977), intermediate goods production accounted for 37.7% and capital goods production for 13.3% of the manufacturing industry. While energy prices rose due to oil crises, oil crises also slowed the flow of remittances. Despite the emerging foreign exchange bottleneck, industrial investments continued. The protection of industry against foreign competition led to a decline in industrial productivity. In order to overcome the foreign exchange bottleneck, a new

short-term borrowing instrument called the foreign currency convertible deposit account (DCA) was developed with an exchange rate guarantee. However, increased borrowing, import dependency, rising oil prices, political instability and social unrest fed each other (Karluk, 2014; Yenal 2010).

After 1980, a liberal economic policy was adopted. An export-oriented industrialization strategy began to be pursued. Business operation by state was ended. In the 1990s, state industrial investments were privatized. The Anglo-Saxon capitalism spread by globalization also affected the Turkish economy. In the 1990s, the real sector and the production of manufactured goods were replaced by an economic structure based on financial markets. In the 1980s, the export-led industrialization strategy increased industrial productivity. In the 1990s, the 5 April 1994 crisis (Turkiye), the Asian Crisis (1997), the Russian Crisis (1998), the Marmara Earthquake (1999), and the November 2000-February 2001 economic crisis (Turkiye) reduced total factor productivity and slowed down industrial production. The state withdrew completely from industry, which it left to the private sector. As a result of the implementation of a fixed exchange rate regime to reduce inflation and severe exchange rate-inflation-interest rate shocks in the environment of a fragile banking system, private consumption expenditures and domestic demand contracted, leading to the 2002 Crisis. After the 2000s industrial production increased, making up for the lost years. Despite this increase, the industry's structural problems still persist in the form of increased import dependency in energy, raw materials and intermediate goods. The recession that had started in the Turkish economy deepened with the impact of the Global Crisis (2008) (Gürsel, 2013; Şahin, 2016). In the early post-1980 liberal period, productivity and exports increased, but over time the competitiveness of the private sector declined, and low value-added sectors developed in the face of increasing competition due to globalization. China's increasing competition in global markets resulted in market losses in labor-intensive markets (Karluk, 2014).

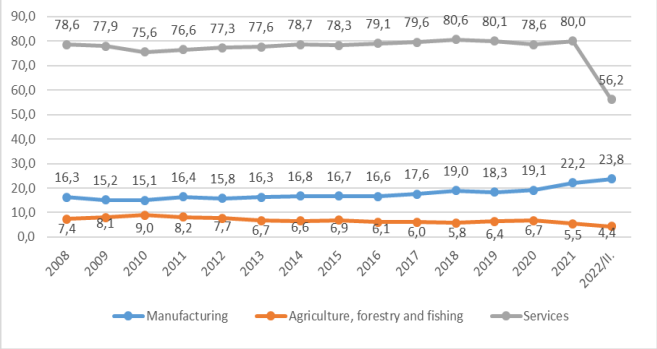
Table 2. Manufacturing, value added, export and import shares (2008-2021)

Years	Manufacturing, value added (annual % growth)	Manufacturing, value added (% of GDP)
2008	0.5	16.3
2009	-9.0	15.2
2010	9.2	15.1
2011	20.2	16.4
2012	2.2	15.8
2013	9.8	16.3
2014	5.6	16.8
2015	5.9	16.7
2016	4.0	16.6
2017	9.3	17.6
2018	1.2	19.0
2019	-2.4	18.3
2020	3.2	19.1
2021	17.2	22.0

Source: https://databank.worldbank.org/source/world-development-indicators

According to World Bank data, while the share of manufacturing industry value added in GDP was around 20% in the early 2000s, it declined steadily after the 2008 Global Crisis. Both the annual growth rate and the share of manufacturing industry value added in GDP increased significantly, especially after 2019, due to the expansionary macroeconomic policies pursued as a result of the Covid-19 pandemic (Figure 2). The value added of the manufacturing industry increased by a high rate of 17% in 2021 (Table 2).

Figure 2. Manufacturing industry and annual economic growth (%)



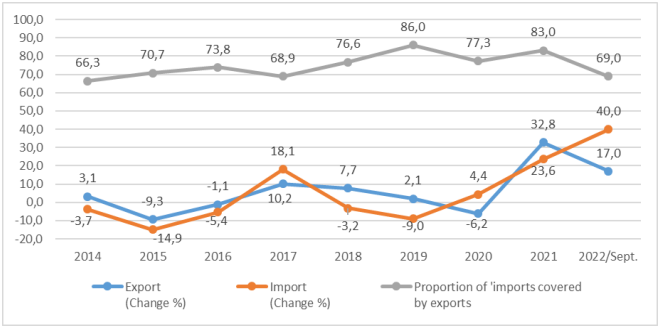
Source: https://data.tuik.gov.tr/

Continuation of expansionary macroeconomic policies during and after the pandemic exacerbated price instability. Turkiye's Economic Model, which was put into practice in September 2021, has opted for economic growth instead of fighting inflation. Therefore, despite high inflation, expansionary macroeconomic policies were continued, aiming to increase production and exports through low interest rates and a competitive exchange rate policy, and ultimately to ensure economic growth.

Thus, the annual consumer price index (CPI) according to the chained index rose from 14.6% in December/2020 to 36%

in December/2021, 61% in March/2022 and 85.5% in October/2022 in a short period of time. Economic growth was 19.1% in 2020, 22.2% in 2021 and 7.6% in Q2/2022, as targeted. However, it should be noted that the sector which had the largest share of the 7.6% growth was the finance and insurance sector with 26.6% (TurkStat, 2022).

Figure 3. Proportion of imports covered by exports and foreign trade by years (2014-2022)



Source: https://data.tuik.gov.tr/

Despite the policy of increasing industrial production and exports based on a competitive exchange rate since 2019, the ratio of exports to imports has been steadily declining. Exports increased by 32.8% in 2021 and by 17% the following year in September/2022. The increase in imports nearly doubled in September/2022 from 23.6% in 2021. In September/2022, exports increased by 17%, while imports more than doubled exports by 40% (Figure 3). This is because both the export-enhancing effect of the competitive exchange rate is not sustainable and a large share of exports is based on the manufacturing industry. Compared to imports, 94% of total exports come from the manufacturing industry (Table 3).

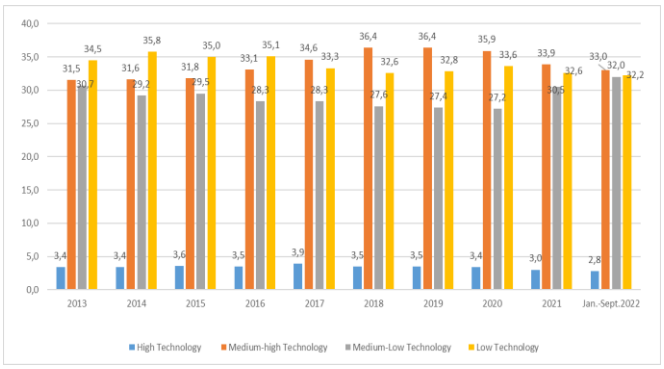
Table 3. Percentage of manufacturing in total exports

Years	Manufacturing/Total Export	Manufacturing/Total Import
2013	93.8	79
2014	93.9	78
2015	94.2	81
2016	94.0	85
2017	94.0	82
2018	94.2	80
2019	94.6	77
2020	94.2	82
2021	94.5	76
2022	94.7	71

Source: https://databank.worldbank.org/source/world-development-indicators

However, on average 65-70% of manufacturing industry exports consist of low and medium-low technology goods. Exports of high-tech goods average 3.5%. It is difficult to say that any significant progress has been made in this regard since 2013 (Figure 4).

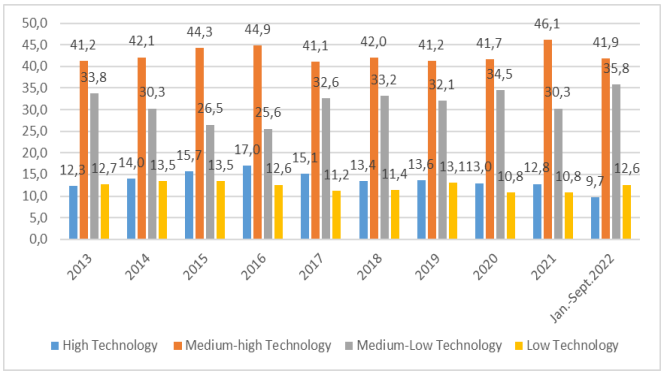
Figure 4. Percent of manufactured exports (FOB) (2013-2022)



Source: https://data.tuik.gov.tr/Kategori/GetKategori?p=dis-ticaret-104

In the same period, medium-high technology goods accounted for 45% of total manufacturing industry imports. Imports of high-tech products are around 13%. Imports of high- and medium-high technology goods account for 50-60% of total manufacturing industry imports (Figure 5).

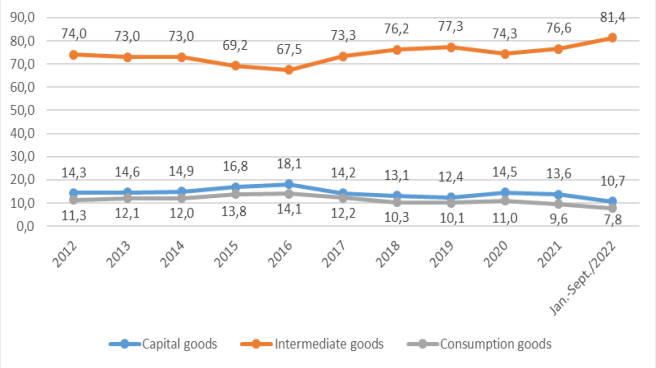
Figure 5. Percentage of manufactured imports (CIF) (2013-2022)



Source: https://data.tuik.gov.tr/Kategori/GetKategori?p=dis-ticaret-104

It is far from sustainable to import high and medium-high technology goods, which account for more than half of total manufactured goods imports, while exporting low-tech manufactured goods with low added value.

Figure 6. Import (CIF) according to general trade system by classification of broad economic categories (BEC) (%) (2012-2022)



Source: https://data.tuik.gov.tr/Kategori/GetKategori?p=dis-ticaret-104

Another obstacle is the increasing dependence on imports for capital goods and intermediate goods used in the production of exported goods. Imports of investment goods increased from 74% to 81.4% from 2012 to September 2022. In the same period, imports of intermediate goods averaged around 15%. Exports of capital goods reached 10.7% in September 2022. Imports of consumption goods lag behind intermediate and investment goods (Figure 6).

Both the export and import figures of the manufacturing industry in terms of technology intensity and the import dependency in intermediate and investment goods used in the production of manufactured goods, which account for more than 90% of exports, pose various risks to the economy when considered together with foreign energy dependency. Moreover, this structure of the industry prevents getting the expected results from the Turkish Economic Model.

5. Conclusion

There is a close relationship between countries' economic policy choices and their industrialization strategies. This study analyzes this relationship for Turkiye in the period from the 2008 Global Crisis to the present. In this respect, first of all, from a periodic perspective, the 1920s, 1960s and 1970s were periods when industrialization was attempted through economic policies with a protectionist, central planning approach. The 1960s in particular was a period of industrialization that was much more institutionalized than the statism of the 1930s and in which planning was more dominant. However, although the 1950s are generally accepted as the years when liberal economic policies were adopted, industrialization by the state also continued to increase. After 1980, when neoliberal policies were established within the framework of the Anglo-Saxon capitalist understanding, industrialization continued to increase thanks to the dynamism and efficiency of private sector entrepreneurship. However, increases in capacity utilization and industrial production, enabled by the revival of the economy following the 2008 Global Crisis, are to be expected. However, due to incorrect macroeconomic policy choices in the face of global economic developments, there has been no industrialization in recent years to ensure long-term economic growth.

The distrust of financial markets following the Global Crisis, the questioning of neoliberal policies, and the realization of the importance of the real sector and the manufacturing industry led to a new process of technological transformation and development in Germany in the early 2010s, which can be called the fourth industrial revolution. Therefore, the importance of technological superiority in global competition has become more important than ever. Creating new and/or additional production capacity based on advanced technology rather than increasing the utilization of idle capacities is now essential for long-term economic growth and economic development.

However, Turkish economy is relatively lagging behind in following this industrial revolution. Although it has succeeded in producing high-tech products, especially in the defense industry and the automotive sector, the technologies developed in the defense industry are not intended for the production of commercial products, and the production process has not yet started in the automotive sector.

As of the early 2010s, manufacturing now accounts for around 94% of exports. In terms of the technology intensity of the manufacturing industry, exports of high-tech products average 3.5% of total manufacturing industry exports. Even when medium-high technology products are included, this ratio is only one-third of total exports. The remaining 70% is exports of medium-low and low technology manufactured goods. Exporting such products is not sustainable to compensate for imports of high and medium-high technology manufactured goods, which account for 60% of total manufacturing industry imports. Moreover, these imported goods are mostly intermediate goods and capital goods. This shows that exports are highly dependent on imported inputs. The expansionary macroeconomic policies that have been in place, and that have continued with the pandemic, constitute an economic policy aimed at short-term economic growth that aims to increase exports and thus industrial production through competitive exchange rates and low interest rates. However, this policy has also made it difficult to produce export goods due to the high dependence on imported inputs and energy due to the rising exchange rate. Therefore, the increase in imports, which reached twice the rate of exports, made it difficult for exports to meet imports even in the short term.

In the long run, for sustainable foreign trade and economic growth, technology intensity needs to be raised in all branches of the manufacturing industry. It may also be important to prioritize certain sectors in a selective manner, such as the defense industry and automotive, but the fact that technology is changing and developing very rapidly, and that there are

increasing and rapidly developing competitors in global markets shows that it is necessary to ensure technological development in many manufacturing industry sectors.

For long-term and lasting economic growth and development, it is not enough to develop technological infrastructure. Capacities of other production factors must also be increased. Education policy is one of these factors. Both the development of vocational education and the organization of the education system within the framework of technological transformation are important for increasing human capital capacity. Because the main factor for the development of the entrepreneurship ecosystem and for catching up with technological developments is the human capital of a country.

In this respect, it will not be sufficient to ensure industrialization, long-term economic growth and economic development of a country only within the framework of economic policy preferences or short-term macroeconomic policies. Similarly, it is not sufficient to stay limited to economic policies either. Economic and social policies need to be addressed in a holistic manner.

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