Turkey's economic indicators worsen

Sinan Ikinci
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On July 26, Turkey's Deputy Prime Minister Nazim Ekren announced that the AKP (Justice and Development Party) government has decided to establish a committee, comprised of government officials, representatives from the private sector as well as academics, to develop a long-term solution to the country's longstanding current account deficit.

Until now, the AKP government has refrained from any measures to tackle the growing trade and current account deficits, other than making occasional demagogic statements for public consumption.

Since the late 1970s, Turkish capitalism has been on the path of deeper integration into the world capitalist economy. It has been progressively liberalised in line with the structural adjustment programs of the IMF and the World Bank and in response to the European Union's demands in the context of the EU's accession process. The year 1989 stands out as a critical milestone in this integration into the process of globalisation. In that year, the ANAP (Motherland Party) fully liberalised capital movements, adopted the convertibility of the Turkish lira and authorised foreign currency holdings by residents in Turkey.

Given the country's level of integration into the capitalist world economy in the age of the globalisation of production, it is excluded that this new committee will produce any effective or sustainable solution to Turkey's trade and current account deficits. All it can do is give some support to local producers of intermediate goods with half-measures, while at the same time guaranteeing that Turkish capitalism will meet its international commitments.

Ekren's own words are proof of this: "When we discuss the incentive method and assess it together with the current account deficit, the importance of the change in production function becomes important for Turkey." He added that Turkey would not be able to overcome the current account deficit by maintaining traditional production methods. On July 14, just 12 days before Ekren's press conference, Economy Minister Mehmet Simsek told reporters, "There is no short-term solution for the current account deficit."

Nonetheless, the decision to establish such a committee is in itself important as an indicator of the desperation of the AKP and Turkish capitalism as a whole.

Apparently the AKP government wants to avoid any criticism, once the inevitable crisis breaks out, that it did nothing to avoid the crisis. It also aims to share political responsibility for a new financial meltdown with business circles and academia. In this respect, the move makes some sense, as Turkey is entering the second half of the year with growing problems. The favourable global economic conjuncture of 2002-2007 is a thing of the past, and there is no doubt that Turkish capitalism faces a very difficult period.

Turkey is one of the worst-performing countries amongst the so-called "emerging market economies," and its foreign trade and current account deficits have produced concerns for a long time. On November 21, 2007, the *Financial Times* noted, "Turkey's ever-expanding current account deficit has become the Achilles' heel of the country's economy."

Since the devastating financial crisis of 2001, Turkey's current account deficit has been rising dramatically. The deficit stood at $1.5 billion in 2002, rose to $8 billion in 2003, $15.6 billion in 2004, $22.6 billion in 2005, $32.3 billion in 2006 and $38 billion in 2007. For 2008, it is estimated that the current account deficit will reach $50 billion, and, according to some economists, this figure could be much higher.

According to the recent data issued by the Central Bank of Turkey, during the first five months of 2008 the current account deficit grew by 33 percent compared to the same period of 2007. On an annual basis, the current account deficit reached the level of $43.1 billion as of May 2008. In May 2007 the deficit stood at $38.5 billion. This amounts to a 12.5 percent increase on an annual basis.

At the end of 2007, the government was expecting a current account deficit of $39 billion for this year. This huge underestimation is hardly surprising, as the government has systematically and grossly missed its current account deficit targets since 2002, even as it has revised them upwards throughout each year.

As the current account deficit has been growing at a faster pace compared to economic growth since 2002, the ratio of the deficit to national income has skyrocketed. In terms of this ratio, Turkey has one of the most dramatic deficits amongst countries on a similar footing.

The current account deficit, which has reached an unprecedented size in both absolute value and in terms of its ratio to GDP (Gross Domestic Product), is indisputably the most critical indicator of the damage inflicted upon the Turkish economy by the global crisis.

In an article published last November, the *Economist* ranked India, Turkey and Hungary as the most vulnerable countries amongst the 15 biggest "emerging market economies" according to economic risks based on the size of their external and budget deficits, inflation rates and the pace of growth in bank lending.

Since then, financial institutions, rating agencies and individual economists have made similar assessments. For instance, in April, Standard & Poor's decided to reduce the country's credit rating to BB. Fitch and Moody also rate Turkey's long-term foreign currency debt at the level of BB. This means that Turkey now stands three steps below "investment grade".

Long before the *Economist* issued its assessment and the downgrading by the rating agencies, in a study dated July 2005 and entitled "What Might the Next Emerging-Market Financial Crisis Look Like?" economist Morris Goldstein pointed to Turkey as one of the most vulnerable of the "emerging economies." In this study, Goldstein identifies nine indicators for vulnerability of "emerging economies to various shocks, including a slowdown in import demand in both China and the United States, a fall in primary commodity prices, increased costs and lower availability of external financing, alternative patterns of exchange rate changes, and pressures operating on monetary and fiscal policies in emerging economies." Turkey was rated the most vulnerable in five of these categories.

Even worse, Turkey's current account deficit continues to grow despite the fact that economic growth is losing steam. As the table below demonstrates, this trend became visible since the end of 2004. Moreover, in 2008, this contradiction will become even starker.

A comparison of economic growth and the ratio of the current account deficit to GDP indicates that the relationship between economic growth and the current account deficit has broken down. For instance, the rapid growth rate of 1990 and 1997 required only a current account balance to GDP ratio of 1.7 percent and 1.4 percent respectively. And in a period when the growth rate is decreasing, the steady increase of the trade and current account deficits shows that this "breakdown" has already assumed a pathological character.

In a recent article entitled "Turkey and the Long Decade with The IMF: 1998-2008" economist Erinc Yeldan underlines this pathological breakdown process: "To understand the significance of this figure [Current Account Balance / GDP], it has to be noted that Turkey traditionally has never been a current account deficit-prone economy. Over the last two decades the average of the current account balance hovered around plus and minus 1.5-2.0 percent, with deficits exceeding 3 percent signalling for significant currency adjustments as had been realised in 1994 and 2001."

This breakdown of the relationship between growth and the current account deficit represents the final stage of the increasing dependency of the Turkish economy on the inflow and outflow of external resources—in other words on the whims of international finance capital. The crises of 1994, 1999 and 2001 are concrete examples of this, leaving behind a trail of economic and social devastation and with the working class and other layers of the population footing the bill.

Meanwhile, the size of the assets owned by foreign capital has reached the level of Turkey's national income for first time in the country's history.

An examination of the main items in the balance of payments shows that foreign capital inflows increased substantially during the period of 2003-2006. Foreign capital inflows reached the level of $57 billion and $55 billion in 2006 and 2007, respectively.

This means that Turkey has managed to attract a relatively larger share of the foreign capital inflows to the "emerging markets." During the last five years, international capital injected a total of $186 billion into the Turkish economy. This has meant a strategic boost for the AKP government, which has slavishly followed the dictates of the international banks and the EU.

The AKP distanced itself from the traditional line of the Turkish Islamist movement known as the "national view" doctrine and adopted a very friendly approach to the West and global finance capital. On the other hand, the AKP has sought to further the interests of the Islamist wing of the Turkish bourgeoisie and thus has been steadily undermining the hegemonic position of the "secular" wing of the ruling class.

In this context, it is important to note that at his recent press conference, when asked a question about the current relations between Turkey and the IMF, Ekren said that the technical studies regarding the IMF are to be announced soon. The AKP government is probably completing the necessary preparations for another three-year standby agreement—this time a precautionary one.

In an article entitled "The domino effect" published on July 3, the *Economist* summarises the mentality of speculative capital movements: "In a world of low interest rates, international investors were hungry for yield, and so piled into currencies that offered higher interest rates, namely those of Britain, Australia, New Zealand and Iceland, as well as many emerging markets." Turkey has been one of the rising stars of the latter group.

In the midst of 2007, the *Financial Times* pointed out the imbalances of national currencies created by these international investors: "A simple purchasing power parity exercise suggests that the New Zealand dollar is 20-25 percent overvalued against the US dollar, while the Turkish lira is about 65 per cent overvalued. The yen meanwhile is roughly 30 per cent undervalued."

The period of the AKP government overlapped —somewhat coincidentally—with an extremely favourable international economic situation for Turkish capitalism. By 2002, the financial markets had recovered from the Asian crisis of 1997, and international capital was again beginning to flow into developing countries like Turkey.

After the 2001 crisis, Turkish capitalism solved the problem of financing the "post-crisis adjustments" by offering very high financial returns based on lucrative arbitrage possibilities to the global markets.

Although, as set forth in the reports prepared by the Central Bank of Turkey, domestic demand is now sluggish, the bank has been increasing its benchmark interest rate in order to maintain "investor confidence" and "international creditworthiness," i.e., placate speculative capital. The short-term interest rate set by the Central Bank is now 16.75 percent, the highest in any major "emerging market."

This means a huge transfer of resources to speculative capital owners—both domestic and international—while the vast majority of people living in Turkey have been struggling against high unemployment, poverty and social and economic inequality. Turkish capitalism managed to achieve an advantage over other countries with cheap labour through unemployment, new pro-business regulations and brutal exploitation. The betrayals of the trade union bureaucracy have played a crucial role in this respect.

In any event, Western business circles are pleased with the performance of the AKP. The French business paper *Les Echos* paid its own tribute to the Erdogan government in its Tuesday edition.

"Here, Western business pays tribute to a partial triumph of Islam. Yet this is not an inexplicable paradox. While terrorists—in the name of the Koran—endeavour to destroy everything that functions, this form of political Islam has managed to bring a certain measure of political stability to the country, to the delight of investors. ... Prime Minister Recep Tayyip Erdogan has managed to push through a policy of economic development and budgetary discipline and put an end to the repeated cycle of crises. The seeming paradox lies in the fact that in so doing he has favoured the emergence of a powerful new middle class which votes for his party regardless of how Islamist it might be." (05/08/2008)

The IMF and the World Bank as well as the AKP government have tried to portray the post-2001 recovery and relatively fast—albeit jobless—economic growth as the result of "successful crisis management" and the implementation of correct economic policies, i.e., austerity measures and market reforms. The unmentioned reality behind the growth and deflation is the unprecedented appreciation of the new Turkish lira (YTL) as well as sharp reductions in wages and the worsening of working conditions, i.e., a dramatic increase of the surplus value extracted from the working class.

Government officials repeatedly point the finger at the global increase in energy prices. Certainly surging petrol and natural gas prices widen Turkey's trade and current account deficits, as the country is heavily dependent on imported energy. As the chief economist at AK Securities, Hakan Aktar explained to the *Financial Times*, "A $10 increase in petrol prices means Turkey's current account deficit widens by another $4 billion." However, this can only explain a part of the ballooning deficit.

As Yeldan explained in his article, Turkey's relatively rapid economic growth was "speculative-led in nature." Yeldan notes, "The main mechanism has been that the high rates of interest prevailing in the Turkish asset markets attracted short term finance capital, and in return, the relative abundance of foreign exchange led to overvaluation of the Lira [local currency]. Cheapened foreign exchange costs led to an import boom both in consumption and investment goods. The overvaluation of the Lira, together with the greedy expectations of the arbitrageurs in an era of rampant financial glut in the global finance markets, led to a severe rise in its foreign deficit, and hence, in external indebtedness."

Turkey's external debt stock has been increasing substantially—from $130.1 billion at the end of 2002 to $247.5 billion as of March 2008. More importantly, the private sector, especially the non-financial institutions, are responsible for much of the increase in external indebtedness, and this has already created the conditions for a debt crisis. This is why, in March, the World Bank's country director Ulrich Zachau said, "What is a significant risk is the significant exposure of the Turkish corporate sector to foreign currency borrowing ... The Turkish corporate sector as a whole is exposed to foreign currency risk."

Bourgeois economic textbooks offer no solution here, because if the currency of a country with a large current account deficit, such as the Turkish lira, depreciates, this will not help the country reduce its trade and thus current account deficit. A significant devaluation of the Turkish lira would not only put private companies at risk, as mentioned above, but would also raise energy costs. Spiralling exchange rates would further worsen the current account deficit, shatter debt and many other macro-economic ratios and create further pressure on inflation, which is already out of hand. Just a few months ago, the Central Bank's inflation target for 2008 was 4 percent. On July 28, Central Bank Governor Durmus Yilmaz revised the Bank's forecast for year-end inflation to 10.6 percent.

But it is not only the inflation rate that is increasing the vulnerability of Turkish capitalism by causing investors to be more cautious. Dark clouds are rapidly gathering on the horizon.

During the January-May period, FDI (Foreign Direct Investment) inflow declined by 47.9 percent to $6 billion, compared to $11.1 billion during the same period last year. On the other hand, for the same period, FDI outflows increased 12 percent—from $1.4 billion to $1.6 billion. Taken together, the net decline corresponds to 54.6 percent!

As a result of plummeting FDI, the major financing for the current account deficit now comes from increasing the external debt of banks and the non-financial private sector. Net borrowing by non-financial Turkish companies increased 22 percent in the first five months. This compensates somewhat for the decline in FDI, but also exacerbates the risk of a debt crisis even further. Such a change in the composition of external capital flows is very dangerous.

Even worse, the latest figures reveal that the Central Bank's foreign currency reserves have recently been used to finance the deficit. In the first five months of the year, the decline in reserves was $1.1 billion. On July 14, Ali Ihsan Gelberi, manager of the economic research department at Garanti Bank, the Turkish lender co-owned by General Electric Co. told the *Turkish Daily News*, "We used to have a noteworthy amount for financing with foreign direct capital. Then only private sector borrowing and portfolio investments remained. The private sector continues borrowing one way or another. However, it is not easy to tell how long this may continue. A proportion of the deficit financing was reportedly covered with the Central Bank's reserves last month. If we keep on using reserves to finance the deficit, that may create problems in the future. This may cause a significant pressure on the foreign currency."

Turkish capitalism, while suffering a deepening regime crisis, is also on the verge of a new severe economic crisis. This is no isolated occurrence, as in the space of 14 years Turkey experienced three major crises. Once again, the economy is on the brink of collapse and default, while the vast majority of the population has already been suffering immense hardship. No doubt, these hardships will intensify dramatically when Turkey once again finds itself starved of credit from the international banks.