Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

EliScholar – A Digital Platform for Scholarly Publishing at Yale

YPFS Resource Library

1-1-2009

The 2000– 2001 Financial Crisis in Turkey: A Crisis for Whom?

Ozgur Orhangazi

https://elischolar.library.yale.edu/ypfs-documents2/165

This resource is brought to you for free and open access by the Yale Program on Financial Stability and EliScholar, a digital platform for scholarly publishing provided by Yale University Library.
For more information, please contact ypfs@yale.edu.

Munich Personal RePEc Archive

The 2000-2001 Financial Crisis in Turkey: A Crisis for Whom?

Dufour, Mathieu and Orhangazi, Ozgur
University of Massachusetts Amherst, Roosevelt University

2007

Online at http://mpra.ub.uni-muenchen.de/7837/
MPRA Paper No. 7837, posted 19. March 2008 / 09:56

The 2000-2001 Financial Crisis in Turkey: A Crisis for Whom?

Mathieu Dufour* & Özgür Orhangazi**

* University of Massachusetts Amherst, USA, ** Roosevelt University, USA

ABSTRACT *In this paper, we study the consequences of the 2000-2001 financial crisis in Turkey to identify the impacts of the crisis on capital and labor. We uncover three significant empirical effects of this crisis. First, international capital benefited from the crisis by both increasing its total assets in Turkey and income flows from these assets, while large domestic financial capitalists also increased their profits in the aftermath of the crisis. Second, industrial capital benefited via a repression of labor. Third, the attempt to 'remedy' the economy by imposing structural changes furthered the interests of capital in general.*

Keywords: *financial crisis, finance capital, IMF, external debt, precautionary cost, Turkey*

Corresponding address: Özgür Orhangazi, Department of Economics, Roosevelt University, 430 S. Michigan Avenue, Chicago, IL 60622, Email: oorhangazi@roosevelt.edu.

We have greatly benefited from comments by James Crotty, Andra Ghent, Arjun Jayadev, Andrew Mallis, Gökçer Özgür, Ellen Russell, Ramaa Vasudevan, Erinç Yeldan, and an anonymous referee. Any remaining errors are our own.

A revised version of this paper is forthcoming in the *Review of Political Economy*

1. Introduction

The 2000-2001 financial crisis in Turkey is one among many crises that characterize the current international financial system (Eichengreen, 2001). While this crisis has generated a vast literature discussing its causes[1], comparatively little attention is paid to its effects. This paper remedies this neglect by examining the differential impacts of the Turkish crisis on capital and labor through an analysis of economic indicators, a review of institutional and structural changes, and various pivotal policy choices. Instead of an abstract general theory or a predominantly statistical analysis (for examples of the latter, see Diwan (2000, 2001), Jayadev (2005), or Onaran (2007)), we emphasize the analysis of the political processes and various economic tendencies at work in a country beset by a financial crisis.

In general, we find that the consequences of the Turkish financial crisis of 2000-2001 were largely beneficial to capital, to the detriment of workers. Amongst capitalists, the impacts of the crisis differed for both international and domestic capital, as well as financial and industrial capital. We largely focus on the impacts for international capital, which was able to increase its total asset base in the economy as well as the income flow it receives. However, large domestic financial capital also managed to increase its profits in the aftermath of the crisis, and domestic industrial capital benefited insofar as real wages were reduced and the power of the labor movement declined (although it appears to have been hurt by the crisis in other respects). Finally, a number of consequences ensued from the structural changes imposed after the financial crisis, most of which were generally beneficial for capital. These reforms were broadly in line with the *Washington Consensus*: an acceleration of the privatization process, an increased regressive taxation, Central Bank independence, a

[virtually exclusive] focus on inflation, increasing flexibility in labor markets, the liberalization of the agricultural sector, and so on.

Of course, labor and capital are not homogeneous entities, thus the benefits and costs of the Turkish financial crisis differed according to various characteristics of both capital and labor. Our examination of the consequences of the crisis for capital largely focuses on the impacts on 'international capital', by which we mean capitalists which operate on a world-scale, including international financial capital and multinational and transnational firms. Of course, international capital does not always cooperate, have the same interests, or gain equally from crisis situations, but we do not attempt a detailed breakdown of their potentially divergent interests. "Domestic financial capital" and "domestic industrial capital" (collectively referred to as domestic capital) are analyzed broadly, although these concepts are refined where the impact of the crisis differs between sub-sections of domestic capital and can be empirically distinguished. The relationship between domestic capital and its international counterpart is complex and contradictory – at times they are in competition (such as when domestic firms cohabit with multinationals in a given market), and sometimes they share common interests (in terms of their relationship with the working class, for example). Some specific capitalists may arguably be both domestic in some respects and international in others.

Just as we use broad categories for capital, we do not distinguish between various groups of workers, despite the likelihood that different strata within the working class have different interests. In Turkey, the differences between formal and informal; and public and private employment could be particularly important.[2] Similarly, we do not analyze the situation of peasants or the rural sector in any detail.

We view the state as a locus of struggles, as each of these groups pursues its preferred policy options. Our analysis of the consequences of the crisis assesses both the extent to which the Turkish state lost its autonomy vis-à-vis international capital and other creditors and the extent to which it favored one domestic group or the other. While this first objective may sometimes give a nationalistic flavor to the argument, we are only concerned with the ability of the state to mediate the interests of domestic classes relative to those of foreign entities.

Finally, we see the IMF as being broadly allied to international capital, given their strong commonality of views, the revolving door between the Fund and international financial institutions, the degree to which the IMF's support of the *Washington Consensus* is advantageous to international capital, and the likelihood that the IMF sides directly with international capital in periods of financial crisis (e.g., Bhagwati, 1998; Stiglitz, 2002; Wade, 1998; Wade & Veneroso, 1998). To the extent that policymaking retains some importance within the current international financial system, the influence of the IMF on domestic policy choices makes it an important structural component of that system.

While our analysis concerns Turkey, we believe that several of our conclusions may have a large degree of generality. The way in which the Turkish government has embraced policies benefiting international capital, as well as the role played by the IMF, appears instructive. Moreover, not only is labor disproportionately harmed by the crisis, but it is also attacked on multiple fronts through various governmental policies, revealing that there is some degree of agency involved in addition to impersonal economic processes. Overall, the varied dimensions through which international capital may gain from the Turkish crisis suggests that crises play a supportive role in the current capitalist system and that international capital may profit from them.

This is consistent with the argument that current international financial arrangements should be viewed as a form of 'new imperialism': the creation of conditions that enable international capital to increase its wealth and power over developing economies (Duménil & Lévy, 2003 and Harvey, 2003). Duménil & Lévy (2006) and Crotty & Lee (2001) provide vivid case studies of this new imperialism in Argentina and South Korea, while Ruccio (1991) argues that new imperialism is facilitated by stabilization policies. Similarly, Yeldan (2007) argues that the Turkish economy has been placed under the control of agents of new imperialism in the post-crisis era. Wade (1998), Wade & Veneroso (1998), and Stiglitz (2002) offer a scathing indictment of the degree to which governments of leading industrialized countries as well as the IMF act on behalf of international capital. Several empirical studies suggest that international financial crises hurt labor disproportionately (e.g. Diwan, 2000, 2001; Jayadev, 2005; Onaran, 2007).

2. 2000-01 Financial Crisis in Perspective

The 1990s were unstable times for the Turkish economy. Following the capital account liberalization in 1989, Turkey experienced a 'boom-bust' cycle with annual growth oscillating between 9.3 percent and -5.5 percent of GDP. Average growth rates were low, annual inflation was above 60 percent for the entire decade (sometimes reaching more than 80 percent), and the government ran large budget deficits (Akyüz & Boratav, 2003). Rather than easing government borrowing, capital account liberalization forced the government to offer higher spreads relative to the dollar assets which were freely availably following liberalization. Real interest rates on government debt soared; creating arbitrage opportunities for private banks to exploit the difference between the high rates on government securities

compared to foreign borrowing and domestic deposits (Akyüz & Boratav, 2003). Rising interest rates forced the government to borrow to meet interest payments (which had reached 75 percent of tax revenues by the end of the decade). Finally, the combination of high interest and inflation rates and an open capital account exacerbated volatility in financial markets, including an important crisis in 1994.

In cooperation with the IMF, Turkey designed in 1998 a stabilization program to reduce inflation (IMF, 1998). The IMF and domestic policy makers attributed inflation to large budget deficits, so the stabilization program included strategies for debt reduction, notably an ambitious privatization scheme.[3] To facilitate foreign ownership, a constitutional amendment allowing international arbitration for contracts between the state and foreign investors was passed (IMF, 1999a). The government also pledged to keep capital flows free from any restriction and to refrain from intensifying trade restrictions (IMF 1999a, 1999b). The government announced it would curtail spending via a reduction in labor costs and a reform of social programs; wages of public sector employees were to be frozen in real terms, while the financing and accessibility of important social programs, such as social security, was cut (IMF, 1999b).

In contrast with the efforts to attain budgetary balance, however, banking laws were amended to force the Savings Deposits Insurance Fund (SDIF)[4] to recover any insolvent banks for restructuring or liquidation, while it was forbidden to provide liquidity to any bank not under its full control (IMF 1999b). Following some financial disruptions on the eve of the financial crisis, the SDIF was given full authority to borrow as needed from the Treasury and full protection was even granted to the creditors and depositors of domestic deposit-taking banks (IMF 2000c), ostensibly to restore confidence in the program. These two measures would eventually prove so costly that they exceeded the savings garnered from

restraint on the fiscal front, including the large revenues from privatization. Thus while social spending and public wages were capped, investors were guaranteed full reimbursement for any loss incurred.

The stabilization program was implemented starting in December 1999. The program was framed around a crawling peg designed to move with anticipated inflation, and it rapidly experienced strains as price increases outpaced expectations. However, virtually every other target was met, and both government officials and IMF staff proclaimed they were satisfied with the program's progress (IMF, 2000a, 2000b) and Turkey earned praise from international financial analysts for its stabilization policies. Nonetheless, the currency kept appreciating in real terms and signs of trouble eventually culminated in a flight from the currency in November. The last week of November alone witnessed a $5.3 billion outflow as a result of short-term speculative operations, causing a severe liquidity shortage in domestic financial markets and sending overnight interest rates as high as 2,000 percent. The outflow of capital was halted and devaluation fears allayed only after the IMF granted $7.5 billion in additional support (Yeldan, 2002).

The respite was short-lived; in February 2001, a new wave of capital outflows led to the collapse of the economic program. Jittery investors pulled $5 billion out of Turkey on February 19th alone. The foreign exchange reserves of the central bank, standing at less than $20 billion, were at a risk of being depleted. As policymakers attempted to maintain the managed exchange rate regime amidst financial turmoil, overnight interest rates soared to several thousand percent. This impeded the government's ability to raise money, and the devaluation of the Turkish lira seemed inevitable. When the pegged exchange rate system was abandoned, the lira immediately depreciated about 30 percent against the US dollar (Orhangazi, 2002). In the aftermath of the February crisis, inflation started increasing again,

government debt as a percentage of GDP had nearly doubled, and interest rates were still high (Akyüz & Boratav, 2003).

Without attempting a complete assessment of the IMF program, it is evident that it failed to achieve its stated purposes: to reduce inflation, real interest rates, and government debt. Moreover, the crisis occurred in the context of an absence of any controls on capital flows, during a privatization drive, with tight fiscal policies, a state commitment to take over any bank becoming insolvent, as well as an implicit guarantee on the loans made to domestic banks. This policy environment affected the outcome of the crisis to a great extent.

3. Impacts of the Crisis on Capital

International capital emerged largely unscathed from the crisis, thanks to protections introduced that guaranteed foreign investments at public expense. In fact, international capital increased its assets, notably via foreign direct investment and external debt, which subsequently increased income repatriated from Turkey. Moreover, while a number of domestic banks went insolvent during the crisis, their losses were also covered by the public. Large domestic banks even benefited from the crisis thanks to increased interest income. Finally, following the crisis, the Central Bank of the Republic of Turkey (CBRT) sought to deter future instability by accumulating greater foreign exchange reserves, which created an additional burden that indirectly benefited international capital.

3.1 External Debt and Protection of Finance Capital

The IMF stabilization program included a crawling peg designed to devalue the currency in line with targeted inflation. As inflation targets were unattained, the Turkish Lira became increasingly overvalued during 2000 (IMF 2000a, c). This encouraged Turkish banks to increase their short-term external debt by about 28 percent in 2000 (IMF, 2000b, 2000c; Akyüz & Boratav, 2003), despite serious attempts by the state to restrict external borrowing, notably through high reserve requirements for external positions exceeding a preset ceiling. By the end of 2000, the total external debt was 59 percent of GDP, compared to 47 percent only two years before.

<TABLE 1 ABOUT HERE>

Heavy foreign borrowing in search of short-term arbitrage gains arguably contributed to the flight from the currency in November 2000 and the February crisis. However, the stabilization program had included amendments to banking laws that prevented the provision of liquidity to distressed banks. Thus the government was forced to wait until financial institutions were technically insolvent before taking action (IMF, 1999b). These legal restrictions, as well as a new law protecting creditors and depositors of deposit-taking banks, forced the government to take over several troubled banking institutions and assume the entirety of their liabilities. Since a large portion of the liabilities of these distressed banks was denominated in dollars, the government was obliged to borrow heavily abroad to honor its commitments. According to a report by the Banking Regulation and Supervision Agency of Turkey (BDDK), the government spent $47.2 billion to bail out the Turkish financial system, including $25.3 billion to rescue private banks (BDDK 2003).

Table 1 presents external debt indicators as a percentage of GNP between 1996 and 2005. Total external debt reached record levels during and after the crisis, and only leveled off around 2005, after 4 years of increased debt servicing and relatively higher GNP growth. While most of this increase in total external debt was public external debt[5], this is in large part a result of the nationalization of private debt via the bank bailouts.

<FIGURE 1 ABOUT HERE>

<FIGURE 2 ABOUT HERE>

While it offered an arbitrage opportunity for investors who bid against the currency, the devaluation itself was very costly to the government. The day before the devaluation, the government sold $5 billion to banks at the lower exchange rate (CBRT). Interest rates rose to triple digits while the government fought to maintain the peg, thereby increasing the implicit and explicit liabilities of the government and the strain on private institutions. Overall, the crisis led the government to borrow an amount equivalent to 17 percent of GNP, an increase of 66 percent in its foreign liabilities (Table 1). A large portion of these funds came from the IMF (Figure 1), including an unprecedented loan of almost 9 billion SDRs. In that year alone, the amount owed by the government to multilateral agencies nearly doubled, increasing from $11.4 billion to $22 billion (CBRT).

<FIGURE 3 ABOUT HERE>

This large increase in foreign indebtedness drained domestic resources for debt repayment and interest charges. The level and duration of the commitment is illustrated in Table 1, which presents the total level of debt servicing costs in terms of GNP, and Figures 1, 2, and 3, which focus on the public debt situation. The total cost of external debt servicing reached 17 percent of GNP following the crisis and still exceeded pre-crisis levels three years later (Table 1). Total interest charges on the public debt actually surpassed tax revenues in 2001, an increase of more than twenty percent from the previous year (Figure 3).[6] This debt service burden is a long-term economic drag: five years after the crisis the interest charges paid to the IMF still have not diminished (Figures 1 and 2). What is more, it was incurred largely to reimburse foreign financial institutions through the bailout of the domestic institutions that had borrowed from them. This shifted the entire cost of this foreign indebtedness on the domestic population at large.

Perhaps more importantly, Turkey was effectively pushed into debt peonage. The burden of international debt commitments provides the IMF and other important international creditors with leverage vis-à-vis government policymakers, both at the moment the money is lent and as long as the debt overhang persists. In this case, there indeed seems to have been a loss of government autonomy, which along with the large interest burden, effectively came in large part in exchange for a bail out of international capital.[7] It would be hard for international capitalists to ask for a better deal. One of the ways in which this loss in autonomy seems to have played out is through the quick enactment of laws that considerably reduced the risk borne by international capital when the stabilization program started experiencing troubles in November 2000. Specifically, the full guarantee of loans made to Turkish banks, combined with the necessity for the SDIF to take over any insolvent bank (IMF, 1999c, 2000c), amounted to a nationalization of the debt of all financial institutions

facing the risk of being unable to service it. An IMF country report prepared in the aftermath of the crisis praised the government for putting the governmental guarantee on private banks' liabilities on 'firmer legal grounds' (IMF 2001b: 16). Consequently, these loans became risk free and the entire cost of the adjustment in domestic financial markets was shifted to the domestic population. The only way international capital could lose was via its portfolio and direct investments, which were not given the same level of protection. We show the overall gain in these sectors below.

These developments had mixed impacts on domestic capitalists. In some respects, they benefited from policies forced on Turkey thanks to the leverage that international capital held over the government. But while some legal and policy changes clearly benefited domestic capitalists, some of which we review in sections 4 and 5 below, other developments may have been less favorable. For example, restrictions on foreign investment were eased in various sectors at a moment when domestic capital was not in a good position to compete. The fact that the portion of the banking sector owned by foreigners went from being marginal before the crisis to 38.8 percent in 2006 (CBRT 2007: 27) may be a direct result of the timing of these policy changes.

3.2 Acquisition of Domestic Assets and Income Outflows

Increased economic fragility together with a financial crisis creates opportunities for international capital to penetrate the domestic economy. Otherwise solvent companies experiencing temporary problems may be forced to liquidate some of their assets at relatively low prices. Similarly, the disarray in domestic financial markets may put local companies at a disadvantage compared to the affiliates of multinationals, whose relationship with the parent

firm gives them more reliable access to credit.[8] Via direct acquisition of assets or the expansion of the activities of existing affiliates, the financial crisis could offer international capital the occasion to take a greater hold of the economy.

<FIGURE 4 ABOUT HERE>

As has been the case in other financial crisis (Duménil & Lévy, 2003; Harvey, 2003; Wade & Veneroso, 1998), international capital seized the opportunity afforded by the 2000-2001 crisis in Turkey. Net foreign direct investment (FDI) increased markedly after the crisis (Figure 4).[9] After a spectacular jump in 2001, which was largely linked to the privatization that had occurred in the telecommunication sector the previous year[10], FDI went on an upward trend and even surpassed 2001 levels in 2005. While FDI may consist of many components (such as intra-company loans, equity capital, and greenfield investment), evidence suggests that it was largely mergers and acquisitions, much of it in turn linked to privatizations. For example, some of the financial assets recuperated by the SDIF were sold back to foreign investors, notably Demirbank (a large private domestic bank, which was acquired by HSBC in 2001). Assuming a delay between the moment when the deals were struck and when the actual payments were made, as happened with the telecommunication industry, much of this FDI can be seen as the acquisition of productive assets by international capital while the Turkish economy was still in the thralls of the financial crisis.

This pattern in the rise in FDI following the crisis conformed to IMF expectations. While praising the government's efforts when it approved a new law "implementing the constitutional amendment on international arbitration enacted in 1999" right after the crisis,

IMF officials noted that "it may take some time before FDI responds to the improved macroeconomic environment" (IMF, 2001b, p. 17).

<FIGURE 5 ABOUT HERE>

<FIGURE 6 ABOUT HERE>

The investment inflow following the crisis soon generated an outflow of repatriated profits, which increased to record levels in 2003 and 2004 and show no sign of subsiding (Figure 5). Likewise, portfolio income has reached unparalleled heights since the crisis, rising from negligible amounts in 1999 to $1.2 billion two years after the crisis.[11] A similar pattern can be observed for portfolio income following the previous financial crisis in 1994, when it suddenly rose from nothing to more than $700 millions within a year, although the increase was more short-lived than for the 2000-2001 crisis. Finally, as expected, net interest outflow has also risen since the crisis, peaking at $4.35 billion in 2001 and remaining higher than pre-crisis levels thereafter (Figure 6).[12] These measures suggest that many profitable investment opportunities were seized by international capital during the 2000-01 financial crisis. This enabled international capital to increase its clout over the economy, both by acquiring existing firms and enlarging market shares, but also to secure a large wealth transfer for the years to come in the form of repatriated profits, portfolio income, and interest payments.

3.3 Precautionary Cost of the Crisis

Reserves accumulated to deter future financial troubles represent a more insidious drain on the country's resources. We refer to the necessity of maintaining these additional international reserves as a *precautionary cost*. Before a devaluation, attempts to support the currency imply a major expense of reserves, which then translates into a direct capital loss if these efforts fail. Since the liberalization of the capital account in the late 1980s, Turkish reserves have exhibited a steep upward trend, especially after the 1994 financial crisis (Figure 7). From a low-point of $5 billion during the 1994 crisis (which was still higher than at the time of the liberalization), reserves had ballooned to over $45 billion ten years later. Reserves accounted for 47 percent of public foreign debt in mid-2005. These reserves represent net resource drains on the Turkish economy; they finance the governments that issue the reserve currency. Stiglitz (2002, p. 66) illustrates the costs associated with the holding of foreign reserves:

> To manage risks associated with these volatile capital flows, countries are routinely advised to set aside in their reserves an amount equal to their short-term foreign-denominated loans. To see what this implies, assume that a firm in a small developing country accepts a short-term $100 million loan from an American bank, paying 18 percent interest. Prudential policy on the part of the country would require that it would add $100 million to reserves. Typically reserves are held in US Treasury bills, which recently paid around 4 percent. In effect, the country is simultaneously borrowing from the United States at 18 percent and lending to the United States at 4 percent. The country as a whole has no more resources available for investing. American banks may make a tidy profit and the United States as a whole gains $16 million a year in interest. But it is hard to see how this allows the developing country to grow faster. Put this way, it clearly makes no sense. There is a further problem: a mismatch of incentives. With capital market liberalization, it is firms in a country's private sector that get to decide whether to borrow short-term funds from American banks, but it is the government that must accommodate itself, adding to its reserves if it wishes to maintain its prudential standing.

Hence reserves act as an insurance policy, for which Turkey pays a fee to the issuer of the reserve currency. As such, it gives issuers of reserve currencies an interest in the perpetuation of systemic instability to compel 'developing' countries to continue to accumulate reserves. Thus governments of industrialized countries have a common interest with international capital insofar as both benefit from the consequences of international financial instability. Added to the fact that international capital has vast resources to lobby these governments and that public officials often come from its midst, this may explain why they often adopt policy stances which seem in line with the interests of international capital (Wade, 1998; Wade & Veneroso, 1998).

<FIGURE 7 ABOUT HERE>

3.4 Gains of Domestic Capital

While international capital seems to have profited from the crisis overall, large portions of domestic finance capital have also improved their position. In December 2000, between the November 2000 shock and the February 2001 crisis, "some TL 3.8 quadrillion in treasury securities were issued to recapitalize private banks taken over by the SDIF" (IMF, 2001b, p. 10). Following the crisis, the government covered the losses of private banks: "By end-April 2001, the total public sector debt required to cover these losses and provision for additional nonperforming loans amount[ed] to an estimated [TL] 13.7 quadrillion. This amount does not include the loss in market value of treasury bills currently held by SDIF banks" (IMF, 2001b, p. 10). The rationale for this bailout was presented by the IMF as "to stabilize

confidence in the financial system at a moment of severe crisis, and thereby contain the risk of wholesale capital flight" (IMF, 2001b, p. 22). The gains of the large banks during and after the crisis is well summarized by the same IMF report: "... the financial condition of most of the largest and some small commercial banks, altogether representing nearly half of the commercial banking system, has been strengthened as a result of exceptionally high earnings during the recent crises episodes" (IMF, 2001b, p. 12).

In addition, some banks even benefited from the crisis thanks to increased interest income. For the whole banking sector, the net interest income as a percentage of total assets varied between 6 and 10 percent in the five quarters preceding the crisis (CBRT, 2005, p. 117). This ratio reached almost 18 percent during the crisis and stayed around that level for four quarters. Banks did report negative earnings on average during the crisis, but the profitability of the banking sector as a whole had recovered by the first quarter of 2002 (CBRT, 2005, p. 113).[13]

However, the recovery in profitability was most vigorous for the biggest banks (CBRT, 2005, p. 114), while small banks were under particular strain.[14] This created opportunities to transform the domestic banking sector in favor of larger banks. Smaller banks that became insolvent could be acquired by larger banks thanks to the government-orchestrated bail-outs. This enabled large banks to eliminate some of their smaller domestic competitors. Hence the 10-bank concentration ratio increased from below 70 percent in pre-crisis years to almost 80 percent by the end of 2001, and further increased thereafter (CBRT, 2005, p. 54).

Although large corporations in the non-financial sector saw their net income as a percentage of total assets decrease from 4.2 percent in 2000 to -2.3 percent in 2001, they quickly recovered and this ratio reached 3.8 percent in 2002 and 6.2 percent in 2003 (CBRT,

2005, p. 33). This is not to say that there were no problems in the sector – FDI patterns suggest that at least some firms were ripe for acquisition. In fact, the increase in repatriated profits shows that foreign capitalists benefited from the recovery, either via the firms they owned directly or their partnerships with domestic corporations.

4. Crisis and Labor

The 2000-01 crisis imposed a heavy burden of adjustment. Economic activity slowed down considerably, the financial system was disrupted, and the crisis itself proved very onerous for the government. While some sectors – such as bank creditors – fared well, the burden of adjustment appears to have been borne largely by workers and the beneficiaries of social programs. The taxation system became increasingly regressive and the real wages and the labor share decreased markedly after the crisis (Figure 10 and Table 2). All in all, we find that the crisis shifted the balance power in favor of capital. This case is not unique in this respect; there is increasing evidence that financial crises generally hit labor more harshly than capital (Diwan 2000, 2001; Jayadev, 2005).

The changes in real wages and the labor share around the time of the crisis are symptomatic of the shift in the balance of power between labor and capital. The difficult post-crisis economic conditions, such as an unemployment rate that exceeded 10 percent following the crisis and stayed at that level afterwards (Table 2), gave capitalists a lever to undercut labor's bargaining power. At the same time, the government cut the wages of public employees and froze the real wages of civil servants (IMF, 1999b). These policies and the increasing unemployment both reflected a worsening of workers' fall-back options. An active income policy to reduce wages was also implemented in the aftermath of the crisis

(IMF, 2001b, p. 21). This policy was carried out under the euphemism of "strengthened social dialogue to promote wage moderation and social protection" (IMF, 2001b, p. 21).

Meanwhile, organized labor was also losing ground. The number of unionized workers decreased by about one-sixth in 2001 alone, after having been on an upward trend for the preceding five years (Table 2). The annual number of workdays lost in strikes, a direct indicator of labor militancy, had also been slowly trending up in the five years before the crisis. It decreased abruptly by a factor of 7 from 2001 to 2002. This conjuncture resulted in major wage concessions: in 2001, real wages experienced a decline of about 19 percent (IMF, 2001b, p. 21).

<TABLE 2 ABOUT HERE>

This outcome is not unique to the 2000-2001 financial crisis. While data on the general level of hourly wages only cover the period between 1993 and 2002, data on real hourly wages for production workers in manufacturing span over a much longer period, thus illustrating the evolution of real worker remuneration. Just as the general real wage level fell after the 2001 crisis, there was a decrease of about 30 percent in real hourly manufacturing wages following the 1994 financial crisis (Table 2). Manufacturing wages then stayed around that level until 1999, when they increased by about 10 percent, only to drop again by 15 percent in 2001 (a pattern which closely resembles that of the general wage level). The data for real hourly wages in manufacturing beyond 2002 indicate that they have not yet recovered from the combined impacts of the two financial crises. The labor share displays a pattern similar to that of real wages. After dropping to 22 percent as a result of the 1994 financial crisis from a pre-crisis level of 31 percent, it steadily increased in the ensuing years

and even reached 31 percent again in 1999 (Table 2). The labor share then decreased once more to 26 percent as a result of the 2000-2001 crisis, a drop from which it still had not recovered in 2004. The decline of the labor share is all the more important given that the GDP was itself decreased substantially, so that workers ended up with a smaller proportion of a much smaller pie.

5. Structural Changes Following the Crisis

The impact of the 2000-2001 financial crisis was also felt in the realm of policymaking. While the economy, and especially the external sector, had been gradually liberalized in the 1980s and 1990s, the government had retained a strong role in managing the economy. Then, in response to the macroeconomic turbulence of the 1990s, as well as the deteriorating financial position of the government, the IMF was called upon. The stabilization program it devised in collaboration with the government made IMF help conditional on several reforms in line with the *Washington Consensus*, such as the privatization of several publicly-owned enterprises. However, the 2001 financial crisis acted as a catalyst for further neoliberal reforms, which in turn influenced the subsequent relative bargaining power of capital and labor.

The government borrowed a lot of money from the IMF in the course of the crisis (Figure 1). Between December 2000 and the end of 2002, the total debt owed to multilateral institutions rose from about $8 billion to $31 billion (Figure 8). Five years after the fact, the government still owes over $23 billions to these institutions. These funds were urgently needed at the time they were borrowed, thus as lender of last resort the IMF had considerable leverage vis-à-vis the government's policy agenda. It was in this context of

cooperation with the IMF throughout the crisis that the government nationalized the debt of all the insolvent banks while maintaining the country's complete openness to capital flows. After the crisis, the implementation of the policies contained in the stabilization program was to be sped up and further neoliberal reforms were introduced.

<FIGURE 8 ABOUT HERE>

Prior to the crisis, the IMF was dissatisfied with the pace of privatization. The only major privatization that had occurred before the crisis was in the telecommunications industry, and even this one had only been partial (Figure 9). The IMF believed that "slippages had emerged, partly because of market conditions, partly because of delays and less than a full commitment to privatize" (IMF, 2001, p. 17). Following the crisis, the new privatization strategy envisaged a "stronger effort on the side of the authorities to put Turkey in the best position to privatize its public enterprises" (*ibid*.). This 'effort' included the full privatization of Turk Telekom, sale of the state monopolies in sugar, tobacco, and gas sectors, the sale of Turkish Airlines, ERDEMIR (steel), and TUPRAS (petroleum refineries); and a privatization of the companies responsible for the generation and distribution of electricity (IMF, 2001b, pp. 17, 60). The state also expressed a will to attract more FDI in conjunction with this privatization effort (IMF, 2001b, pp. 17, 60). This new emphasis did indeed generate more privatizations following the crisis, especially in 2004 and 2005 (Figure 9).

<FIGURE 9 ABOUT HERE>

The restructuring of the banking sector following the crisis was a key part of this new privatization drive. To preempt objections to the nationalization of failing banks and their subsequent (re)privatization, a complete immunity from prosecution was granted to the individuals involved in this restructuring (IMF, 2001c). This is a rather exceptional privilege, heretofore only awarded to the military – by itself – after the 1980 coup.

The stabilization program regarded the level of government debt as highly problematic. The large-scale privatization effort was envisaged as a solution to that situation. However, government borrowing to honor guarantees to foreign investors and support an unsustainable peg was seen as acceptable. By the end of 2001, the government was left with a debt amounting to 93 percent of GDP, up from 44 percent when the program was designed in 1998 (Akyüz & Boratav, 2003). As some other objectives ostensibly trumped debt reduction, the discourse evolved and efficiency considerations, rather than government financing needs, came to be cited as justification for privatization (e.g., IMF, 2001a), suggesting that privatization was in fact an end in itself.

Government spending grew in large part thanks to the $47.2 billion bailout of the financial system. Social spending and labor costs in the public sector were reduced, indicating that the government prioritized spending on financial creditors rather than their less affluent counterparts. It will be difficult to reinstate social spending, since debt servicing costs currently absorb a very large portion of tax revenues (Figure 3). Taxes themselves have become more regressive, as the government has increasingly resorted to indirect taxes instead of income taxes (see Figure 10). (See IMF, 2001b, p. 18 for a review of fiscal policy in the aftermath of the crisis).

<FIGURE 10 ABOUT HERE>

The 2000-2001 crisis also provided an impetus for further neoliberal organizational changes within the government. In response to the crisis, key amendments were made to the law governing the Central Bank to give it formal independence from the government. The Central Bank then started pursuing 'inflation targeting' as its primary goal.

We do not wish to suggest that there is a unilateral relationship of subservience between the IMF and the government. What we argue is that the crisis has given leverage to certain entities, notably the IMF, which has allowed them more power in the contested field of policymaking. This resulted in the establishment of policies that were both largely neoliberal in their thrust and advantageous to capitalists and affluent groups in general.

6. Concluding Remarks

While there has been much written on the Turkish financial crisis of 2000-01, this literature has been mostly centered on the underlying determinants of the crisis. Here we shift the debate to focus on the consequences of the crisis rather than its roots. In doing so, we argue that capital benefited in the aftermath of the crisis, while labor was disadvantaged. We found that international capital benefited from the crisis by increasing its total assets in the economy as well as the income flows it receives from it, while large domestic financial capitalists also increased their profits following the crisis. Second, industrial capital benefited via a reduction of real wages and a decline in the strength of the labor movement. Third, the structural changes imposed on the economy in the aftermath of the crisis, in order to 'remedy' to the situation, furthered the interests of capital in general by promoting increased privatization and changes in public finances, including most notably an increase in regressive

taxation. Furthermore, policies associated with neoliberalism, such as central bank independence, labor flexibility, the liberalization of agriculture, and so on, have been extended and deepened in the economy.

Our findings provide empirical support to the contention that financial crises could be supportive of the current capitalist order, notably the international financial system and large financial capitalists. We deem this to be important insofar as it suggests that financial crises not only stunt the economic development of the countries they beset, but they could also both slant that development in favor of capital and deprive the government of these countries of some of their autonomy. Of course, far-reaching inferences cannot be drawn from the study of only one country and other financial crises should be analyzed before any general conclusion is reached (see, for example, Dufour & Orhangazi, 2007).

However, our analysis raises an interesting point. In Marxian crisis theory, the capitalist system is inherently unstable and prone to crisis. Although there are various explanations regarding the reasons behind these crises, the Marxian approach usually sees a crisis as setting up the next expansion by bringing wages and interest rates down, devaluing capital and preparing the ground for organizational and institutional change. Hence crises automatically play the role of "the irrational rationalizer of the economic system" (Harvey 1999: 305). In the Turkish financial crisis of 2000-2001, even though various sections of capital and the capitalist system in general seem to have benefited from the crisis, this was not an automatic process per se.

Rather, this outcome was the result of a combination of impersonal economic forces, such as the fact that viable Turkish firms were available at a bargain after the crisis, and direct actions taken by various groups, notably important private and public creditors with some leverage over policymakers. We believe that the two worked in tandem, insofar as they

reinforced each other: While there is some automatism in the functioning of many of the economic forces, they more often than not still need some measure of direct action on the part of policymakers... actions that would be useless without those forces at work. Coming back to the availability of cheap Turkish firms, for example, international capital will only be able to secure ownership of these firms if capital flows remain free of any hindrance. One of the things that would be interesting to see if the sample of crises is expanded is the extent to which each of those two components – economic forces and policymaking – reinforce or oppose each other during episodes of international financial crises.

References

Agénor, P.-R., Jensen, H. T., Verghis, M. & Yeldan, E. (2006) Disinflation, Fiscal Sustainability, and Labor Market Adjustment in Turkey, *World Bank Policy Research Working Paper Series* 3804.

Akyüz, Y. & Boratav, K. (2003) The Making of the Turkish Crisis, *World Development*, 31(9), pp. 1549-1566.

Alper, E. (2001) The Turkish Liquidity Crisis of 2000: What Went Wrong?, *Russian and East European Finance and Trade*, 10(37), pp. 51-71.

BDDK. (2003) *Bankacılık Sektörü Yeniden Yapılandırma Programı Gelişme Raporu-IV* (Ankara).

Bhagwati, J. (1998) The Capital Myth; The Difference Between Trade in Widgets and Dollars, *Foreign Affairs,* 77(3), pp. 7-12.

Boratav, K. (2001) 2000-2001 Krizinde Sermaye Hareketleri, *Iktisat, Isletme ve Finans*, 186, pp.7-18.

Boratav, K. & Yeldan, E. (2002) Turkey, 1980-2000: Financial Liberalization, Macroeconomic (In)-Stability and Patterns of Distribution, *CEPA and The New School for Social Research, mimeo*. http://www.bilkent.edu.tr/~yeldane.

Central Bank of the Republic of Turkey (CBRT) (2005) *Financial Stability Report*, Vol. 1, August.

Central Bank of the Republic of Turkey (CBRT) (2007) *Financial Stability Report*, Vol. 4, May.

Crotty, J. & Lee, K. (2001) Korea's Neoliberal Restructuring: Miracle or Disaster, *Political Economy Research Institute Working Paper* 44.

Desai, M. A., Foley, C. F. & Forbes, K. J. (2004) Financial Constraints and Growth: Multinational and Local Firm Responses to Currency Crises, *NBER Working Paper* 10545.

Diwan, I. (2000) Labor Shares and Globalization, *mimeo, prepared for the OECD Conference on Globalization and Inequality, Paris.*

Diwan, I. (2001) Debt as Sweat: Labor, Financial Crises, and the Globalization of Capital, *mimeo, World Bank.*

Dufour, M. & Orhangazi, O. (2007) "International Financial Crises: Scourge or Blessing in Disguise." *Review of Radical Political Economics*, 39 (3): pp. 342-350.

Duménil, G. & Lévy, D. (2003) Neoliberal Dynamics - Imperial Dynamics, *Paper prepared for the* Conference on Global regulation, *held at the University of Sussex, Brighton, UK, May 29-31, 2003*.

Duménil, G. & Lévy, D. (2006) Imperialism in the Neoliberal Era: Argentina's Reprieve and Crisis, *Review of Radical Political Economics*, 38(3), pp. 388-96.

Eichengreen, B. (2001) *Financial Crises and What to Do about Them* (Oxford: Oxford University Press).

Ertuğrul, A. & Selçuk, F. (2001) A Brief History of the Turkish Economy, 1990-2000, *Russian and East European Finance and Trade*, 10(37), pp. 6-28.

Harvey, D. (1999) *The Limits to Capital* (London and New York: Verso).

Harvey, D. (2003) *The New Imperialism* (Oxford: Oxford University Press).

IMF (1998) *Turkey - Memorandum of Economic Policies*, Washington, DC: International Monetary Fund, 26 June.

IMF (1999a) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 29 September.

IMF (1999b) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 09 December.

IMF (1999c) *Public Information Notice: IMF Concludes Article IV Consultation with Turkey*, Washington, DC: International Monetary Fund, 22 December.

IMF (2000a) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 10 March.

IMF (2000b) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 22 June.

IMF (2000c) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 18 December.

IMF (2001a) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 03 May.

IMF (2001b) *Turkey: Sixth and Seventh Review Under the Stand-By Arrangement-Staff Report; Staff Supplement and Press Release on the Executive Board Discussion*, Washington, DC: International Monetary Fund, June.

IMF (2001c) *Turkey Letter of Intent*, Washington, DC: International Monetary Fund, 26 June.

Jayadev, A. (2005) Capital Account Liberalization, Growth and the Labor Share of Income, in Gerald A. Epstein (ed.), *Capital Flight and Capital Controls in Developing Countries* (Northampton, MA: Edward Elgar), pp. 15-57.

OECD (2004) *Economic Outlook* (Paris: OECD).

Onaran, Özlem (2007) Wage Share, Globalization, and Crisis: The Case of the Manufacturing Industry in Korea, Mexico, and Turkey, *Political Economy Research Institute Working Paper* 132.

Orhangazi, O. (2002) Turkey: Bankruptcy of Neoliberal Policies and Possibility of Alternatives, *Review of Radical Political Economics*, 34(3), pp. 335-341.

Ruccio, D. F. (1991) When Failure Becomes Success: Class and the Debate over Stabilization and Adjustment, *World Development* 19(10), pp. 1315-1334.

Sönmez, M. (2006) Waged Workers Reach 56 %, One-Third of Waged Workers are Undocumented, *mimeo*, www.bagimsizsosyalbilimciler.org.

Stiglitz, J. (2002) *Globalization and its Discontents* (New York: W. W. Norton).

The Economist (2005) Special Report: A Survey of Turkey, London, March 19-25, pp. 54-55.

Wade, R. (1998) The Asian Debt-and-development Crisis of 1997-?: Causes and Consequences, *World Development* 26 (8), pp. 1535-53.

Wade, R. & F. Veneroso (1998) The Asian Crisis: The High Debt Model vs. the Wall Street-Treasury-IMF complex, *New Left Review*, March April, pp. 3-23.

Yeldan, E. (2001) *Küreselleşme Sürecinde Türkiye Ekonomisi: Bölüşüm, Birikim, Büyüme* (Istanbul: Iletişim).

Yeldan, E. (2002) On the IMF-Directed Disinflation Program in Turkey: A Program for Stabilization and Austerity or a Recipe for Impoverishment and Financial Chaos? In: N. Balkan (Ed.) *The Ravages of Neo-Liberalism: Economy, Society and Gender in Turkey* (New York: Nova Science), pp. 1-28.

Yeldan, E. (2007) Patterns of Adjustment under the Age of Finance: The Case of Turkey as a Peripheral Agent of Neoliberal Globalization, *Political Economy Research Institute Working Paper* 126.

	Total External Debt	Public Sector	Central Bank	Private Sector	External Debt Service
1996	43.2	21.9	6.7	14.6	6.2
1997	43.8	20.2	6.1	17.4	6.5
1998	46.6	19.2	6.3	21.1	8.0
1999	55.7	23.0	5.9	26.8	9.9
2000	59.3	24.3	7.0	27.9	11.0
2001	78.0	31.6	16.7	29.6	16.9
2002	71.9	35.2	12.2	24.6	15.9
2003	60.6	29.1	10.2	21.3	11.6
2004	54.2	24.7	7.1	22.4	10.2
2005	47.4	18.9	4.3	24.3	10.1

Table 1: External Debt Indicators as Percentages of GNP

Source: Treasury External Debt Statistics

	Workdays lost in strikes[1]	Number of unionized workers[2]	Unemployment rate[3]	Annual real wage index[4]	Annual real wage index for production workers in manufacturing[5]	Labor's share in income[6]
1991	39,578,374	-	7.9	-	143.4	31.9
1992	6,754,420	-	8.1	-	147.6	31.7
1993	4,348,805	-	7.8	100	150.4	30.9
1994	1,594,949	-	8.1	95.1	119.6	25.5
1995	20,107,667	-	6.9	75.9	101.1	22.2
1996	1,386,169	2,695,627	6.0	58.6	97.9	23.9
1997	1,581,737	2,713,839	6.4	68.3	99.9	25.8
1998	1,632,726	2,856,330	6.3	65.4	98.1	25.5
1999	1,645,520	2,923,546	7.7	82.7	108.7	30.7
2000	1,928,339	3,086,302	6.6	95.5	110.2	29.2
2001	2,389,008	2,580,927	8.5	77	95.3	28.3
2002	345,705	2,648,847	10.3	76.7	87.8	26.3
2003	608,796	-	10.5	-	82.3	26.1
2004	878,154	-	10.3	-	83.1	26.3

Table 2: Labor Indicators

Sources: (1) CBRT; (2) Sönmez 2002; (3) Turkish Statistical Institute; (4) Turk-Is Research Department (www.turkis.org.tr); (5) CBRT; (6) OECD Annual National Accounts.

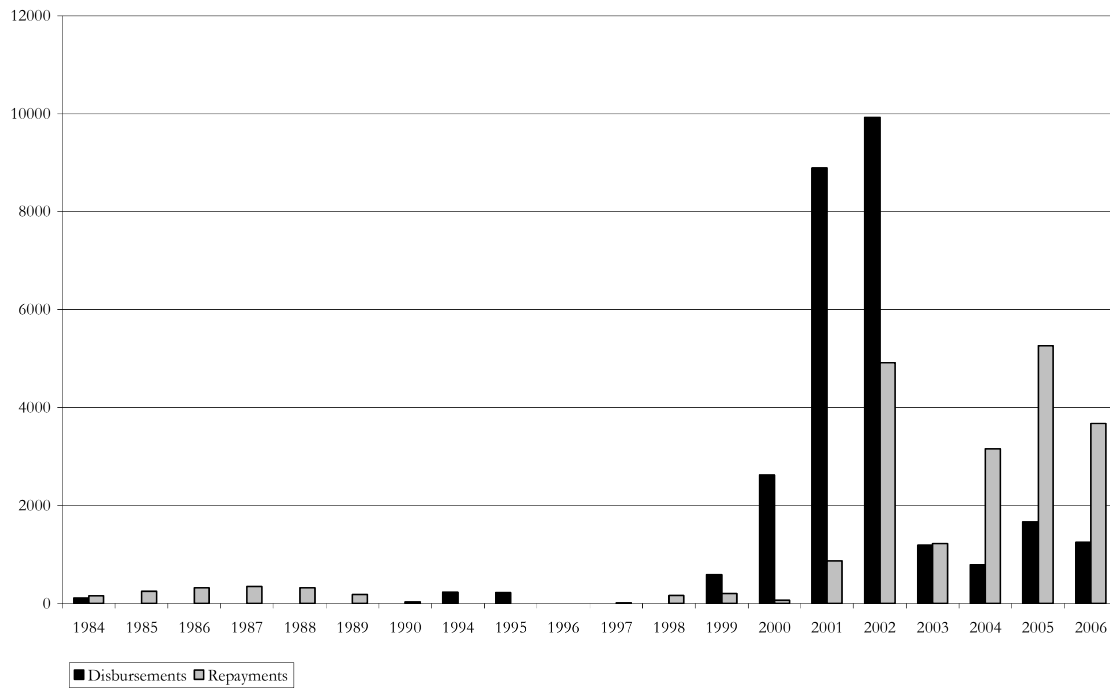

Figure 1: Transactions between Turkey and the IMF (million SDRs)

Source: IMF Country Statistics

Note: Data for 2006 is only for part of the year.

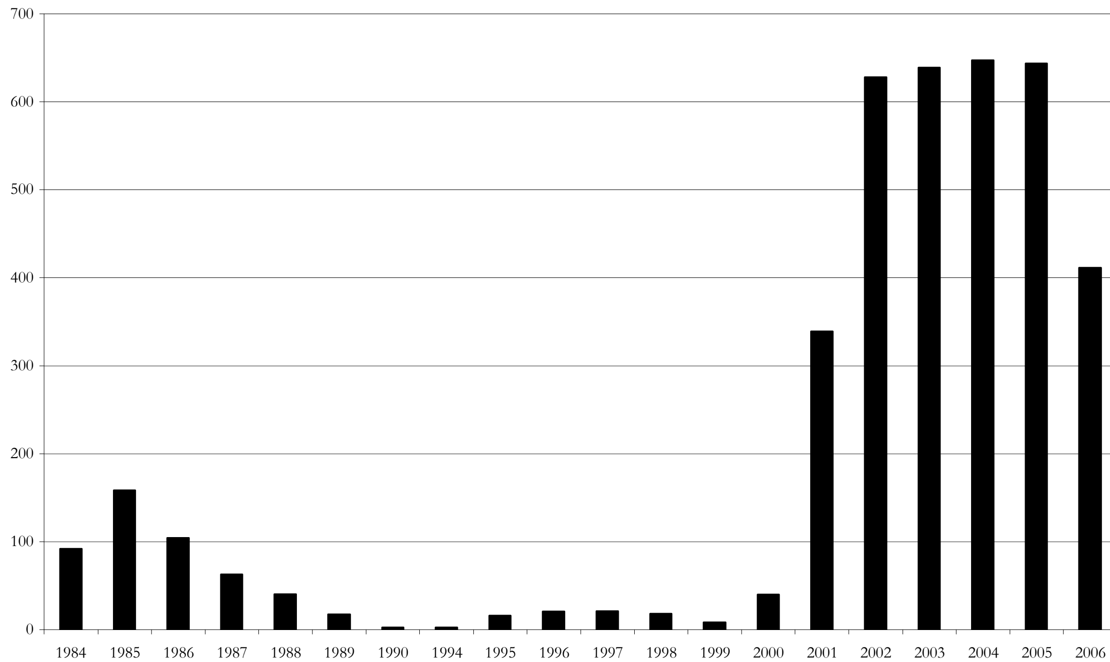

Figure 2: Charges and Interest Paid to the IMF (million SDRs)

Source: IMF Country Statistics

Note: Data for 2006 is only for part of the year.

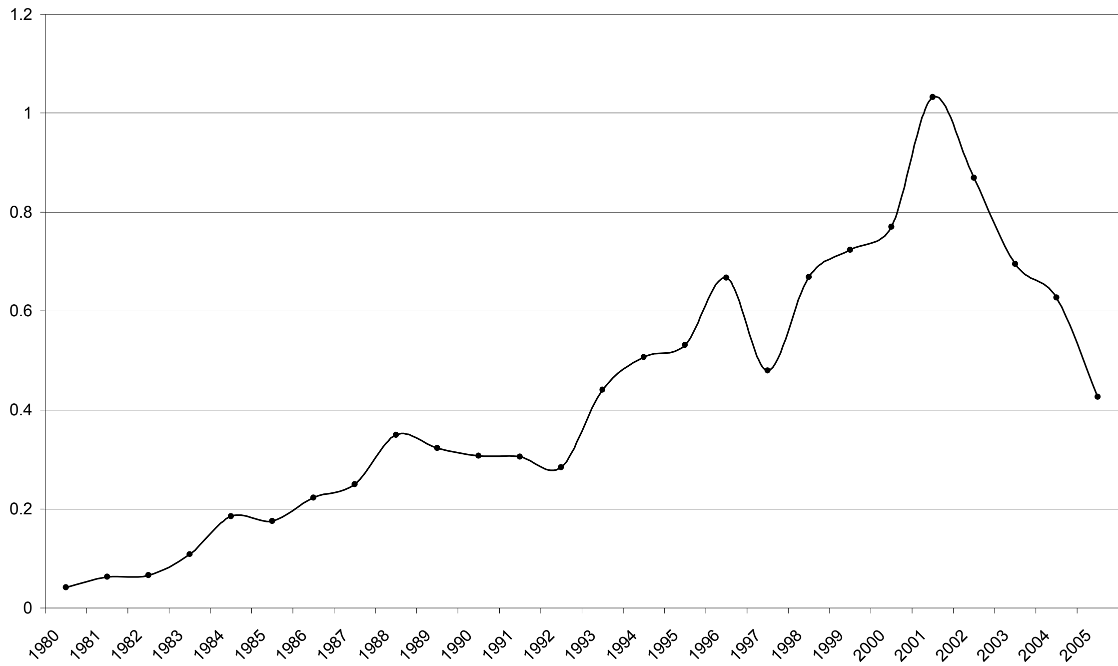

Figure 3: Ratio of Interest Payments to Total Tax Revenue

Source: Treasury External Debt Statistics

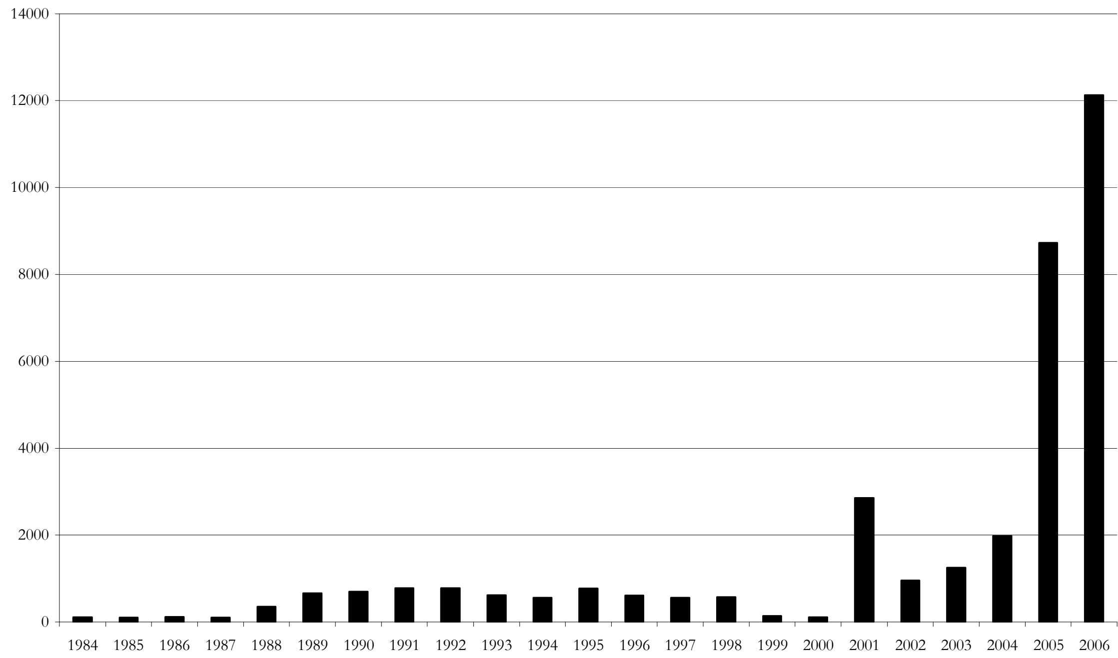

Figure 4: Net FDI in Turkey (million U.S. dollars)

Source: Central Bank of Republic of Turkey Data Delivery System

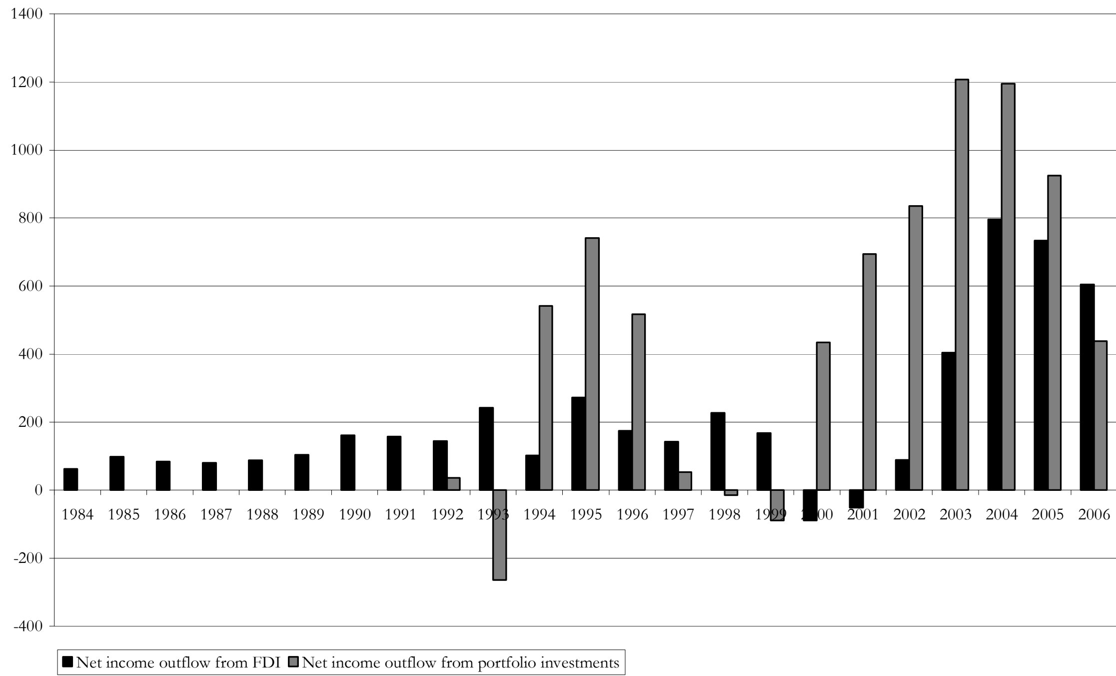

Figure 5: Net Income Outflows from Foreign Direct and Portfolio Investments(million U.S. dollars)

Source: Central Bank of Republic of Turkey Data Delivery System

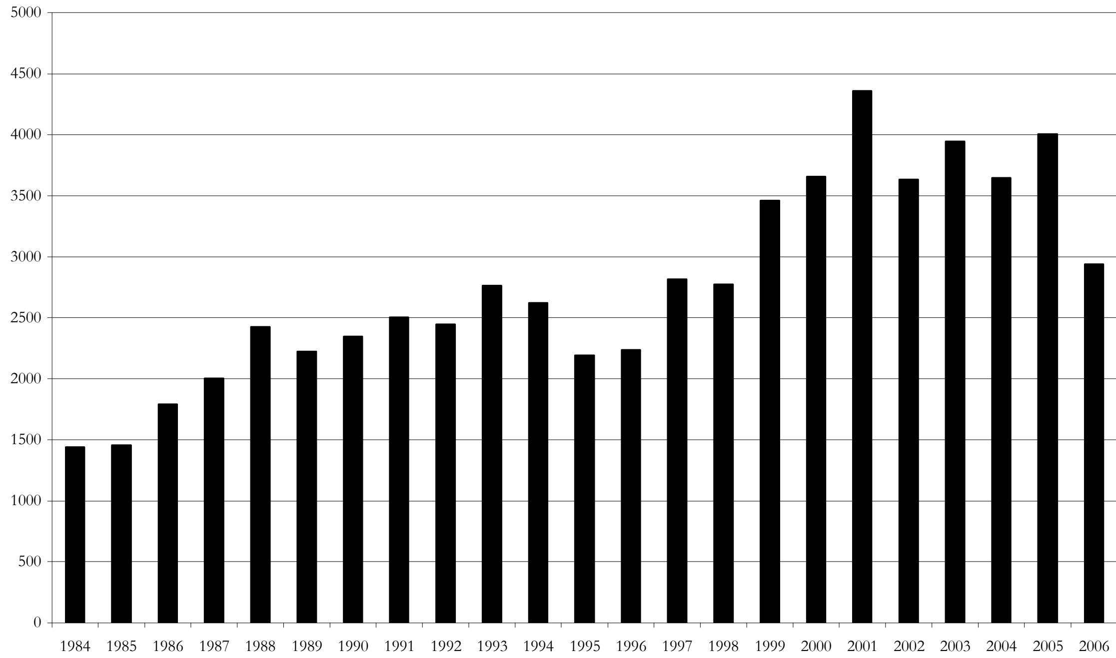

Figure 6: Net Interest Outflow (in million U.S. dollars)

Source: Central Bank of Republic of Turkey Data Delivery System

Figure 7: Central Bank Foreign Exchange Reserves (million U.S. dollars)

Source: Central Bank of Republic of Turkey Data Delivery System

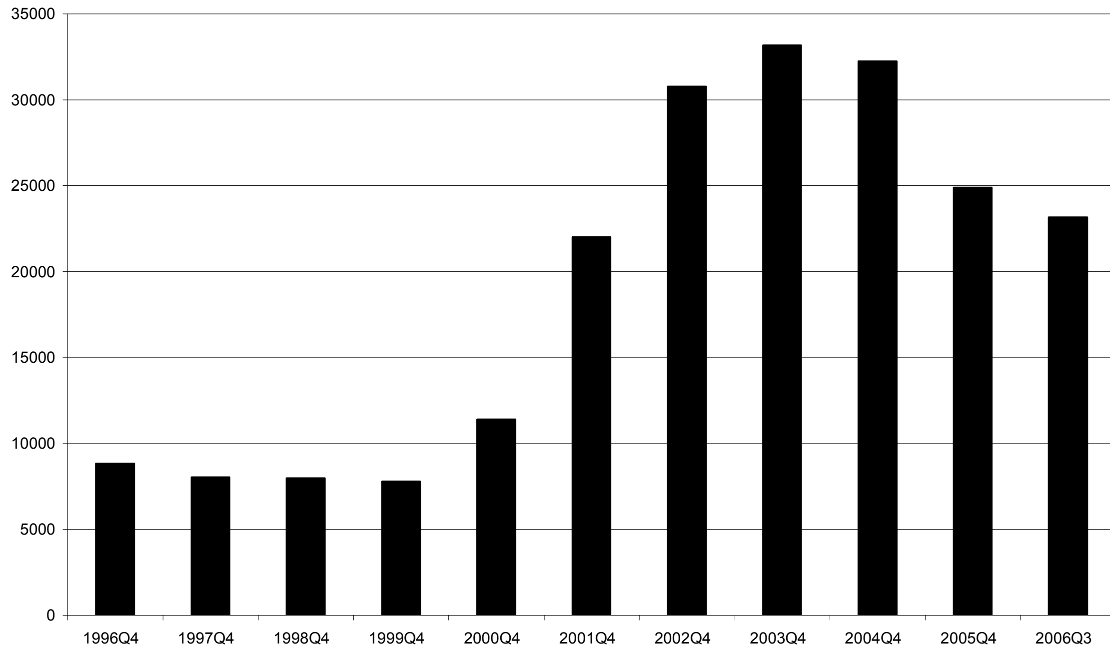

Figure 8: Outstanding Debt Owed to Multilateral Institutions (Million U.S. Dollars)

Source: Central Bank of Republic of Turkey Data Delivery System

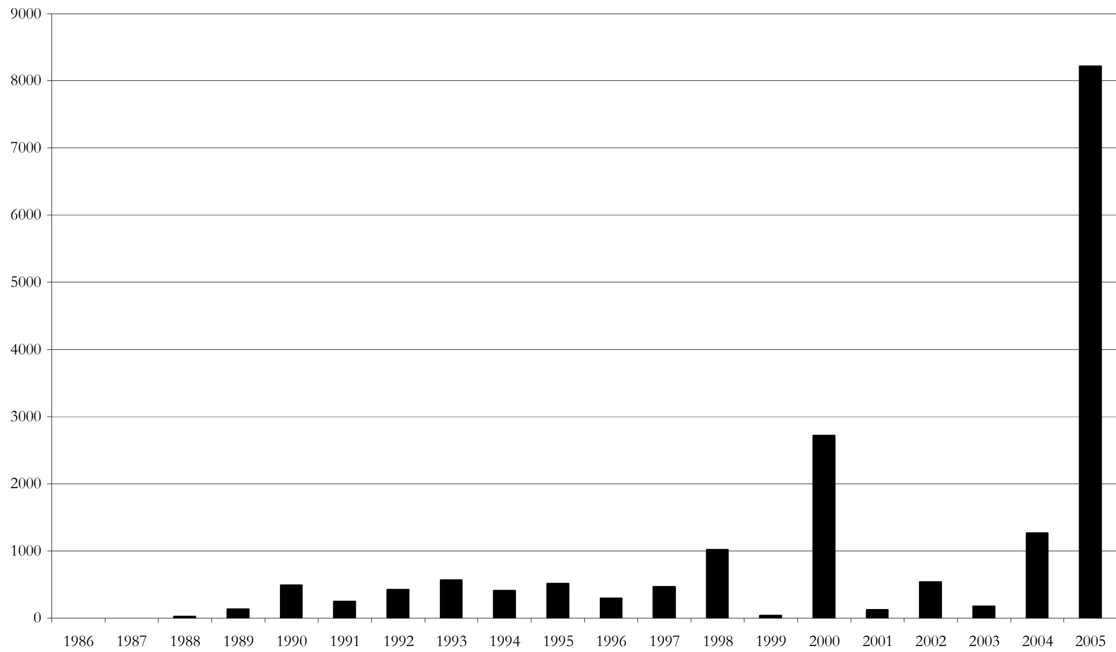

Figure 9: Total Privatization Revenue (million US Dollars)

Source: Turkish Privatization Administration

Figure 10: Ratio of Indirect Taxes to Direct Taxes

Source: Treasury Statistics

Notes

---

[1] Explanations range from political mistakes, insufficient liberalization and flawed IMF-directed policies. See Akyüz & Boratav (2003), Alper (2001), Boratav (2001), Boratav & Yeldan (2002), Eichengreen (2001), and Yeldan (2001 & 2002) for an overview of these arguments.

[2] See Sönmez (2006) for a discussion of the rise in informal employment; and Agénor *et al.* (2006) for a more formal discussion of rural-urban migration, a large urban informal sector, and bilateral bargaining in the formal sector in post-crisis Turkey.

[3] Government finances appeared to have been on an unsustainable path throughout the 1990s as interest payments required increased borrowing. However, in terms of its level, the public debt was not that high at the beginning of the stabilization program. The public debt stood at 36.3 percent of GNP (IMF, 1998) at the outset of the program (42.9 percent of GDP at the end of 1997 according to Akyüz & Boratav, 2003), which is around the OECD average (e.g. 47 percent in 1997 and 46.6 percent in 2004) (OECD, 2004). Moreover, the correlation between the debt (or deficit) and the inflation rate in Turkey in the 1990s is not that clear cut (Akyüz & Boratav, 2003, especially Table 1), the assertion made in support of the program's objectives notwithstanding. In this context, it is interesting to see the initial stress put around debt reduction, especially in light of the relaxation of this concern later on when the financial crisis erupts in Turkey.

[4] The SDIF, which was formed under the Central Bank to provide deposit insurance in 1983, was put under the authority of Banking Supervision and Regulation Authority in 1999.

[5] We include the debt of both the Central Bank and the consolidated public sector in our measure of public debt.

[6] The ratio of interest payment to total tax revenues had been on an upward trend throughout most of the nineties, starting right before the 1994 financial crisis, and culminated in 2001. Though the jump in 2001 is quite spectacular, the 2000-2001 crisis cannot account for the greater part of the interest burden. The root cause of that increase should therefore be sought elsewhere, possibly in relation to the 1994 crisis; we simply observe that the 2000-2001 crisis sent interest payments through the roof.

[7] For other similar cases of IMF bailouts of international capital in times of crisis through an increase of the liabilities of the government of the affected country, see Stiglitz (2002).

[8] See Desai, Foley & Forbes (2004) for a detailed layout of this argument.

[9] The level of FDI was still relatively low after the crisis, especially if we compare it to countries which have a longer history of foreign investment, such as Mexico (The Economist, 2005). However, what is important is that this level of FDI was quite extraordinary *for Turkey*, which is what we believe should be the point of reference, given that a host of other factors specific to Turkey determine the level of investment in that country. What is also striking is that although the capital account had technically been completely deregulated in 1989, FDI only picks up after the 2000-2001 crisis, more than a decade later.

[10] In other words, although the deal was struck in 2000, the bulk of the payments were made in 2001. We thank Erdal Yılmaz from the CBRT for pointing this out.

[11] Some of these profits may also have come from the expansion of foreign affiliates in Turkey. Unfortunately, we do not have sufficient data to be able to quantify this expansion or properly determine the contribution of each process in generating the profits subsequently repatriated. Such a differentiation is perhaps superfluous for the general argument; however, as an investment cum repatriated profits pattern is clearly identifiable from FDI and portfolio data.

[12] Again, the crisis itself does not explain the general rising trend in this variable. However, it is important to note that the crisis has caused a significant jump in this ratio and it reached record levels right after the crisis.

[13] The rapid recovery following fairly high reported losses makes us wonder whether some of these banks took the occasion offered by the crisis to write-off some bad components of their portfolio, though we have no evidence either way.

[14] In fact, "the remaining commercial banks [those whose position was not strengthened through high interest earnings] have experienced substantial losses from high interest rates and the depreciation of the lira" (IMF, 2001b, p. 10).