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SHAKY EMERGING ECONOMIES IN VIEW OF THE GLOBAL FINANCIAL CRISIS:

THE TURKISH ECONOMY AFTER THREE DECADES OF LIBERAL REFORMS

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Abstract

In the wake of the global change of a new accumulation regime in main capitalist economies, the opening up and liberalisation process of emerging economies from the 1980s has provoked great expectations that resulted in recurrent disappointing crises. Studied as a stylized fact, the Turkish experience leads us to evaluate the role of liberalised macroeconomic environment, unsuitable economic policies and hesitant and weak regulatory mechanisms as the main sources of perverse sequencing in the reform area. The paper shows that the Turkish crises since the 1980s arose from bad macroeconomic policies which implemented the neo-liberal shock therapy model and triggered boom-and-bust cycles. After three decades of liberal reforms, the Turkish economy remains still subject to structural downturns as the economic recovery is not guaranteed by a hasty liberalisation but by consistent policies which should frame economic actors' behaviour in the aim of a sustainable macroeconomic development.

Key-words: Liberalisation – stability – sustainable growth regime - Turkish economy

JEL Classification: E6-F32-F36-G01-O52

I. Introduction

In the wake of the global change of a new accumulation regime in the main capitalist economies, the opening up and liberalisation process of emerging economies from the 1980s has provoked great expectations that resulted in recurrent crises. Large capital inflows, without relevant economic policies and regulatory frames, had fuelled structural fragilities and created large economic imbalances as well as social distortions. As the lack of proper institutional structure failed to channel the inflows into sustainable productive plans, the speculative investments gained ground on development objectives and exacerbated monetary and financial instabilities.

The present global financial crisis raises again the issue of how interdependencies between idiosyncratic bank risks and financial systems' stability might be better managed to prevent the recurrence of such crises. Monetary and financial authorities all around the world implement emergency policies. But they do not consider a suitable analysis of the financial-instability hypothesis which would be able to point up the weaknesses of the current market-oriented monetary and

financial regulatory framework. While the emerging markets seem not to be dragged down for the moment with the current crisis, their structural vulnerabilities continue to haunt the future of the path-dependent growth policies.

Turkish economy can be studied as a stylized fact to evaluate the role of weak liberalised macroeconomic environment, unsuitable economic policies and regulatory failures which are the source of perverse sequencing in the liberalisation process.

The main argument in this paper is that since the financial and economic integration of the Turkish economy had (and has) a preference for a hasty and rapid liberalisation process without considering the structural needs and capacities of the whole economy, government had (and has) no room to conduct consistent macroeconomic policies in order to frame sustainable economic and social environment. Consequently, one should expect new crises in the aftermath of the actual global crisis.

In this aim, the paper is organised as follows.

The second section presents some theoretical grounds on the consequences of a hasty financial liberalisation and points out the fact that acting as a magnet for unstable movements in an unstable environment, the swift opening-up of domestic markets and financial liberalisation lead market reforms to fuel several recurrent monetary and financial crises.

The third section recalls the main banking and financial reforms, implemented since the 1980s, and points out their effects on the Turkish economy. Increasing monetary disequilibria and monetary stabilisation programmes put the economy under a persistent burden and reduce its ability to cope with external and internal difficulties in order to reach a sustainable growth path. Then, we argue that the Turkish crises arose from bad macroeconomic policies which had been founded on the neo-liberal shock therapy and triggered boom-and-bust cycles.

The fourth section analyses the preparation of the 2001 crisis through the rise of banking risks inferred by irregular behaviours. It shows that contrary to the hypotheses of shock therapy models, there is no spontaneous mechanism of competition which could push market actors to adopt efficient behaviours on the macroeconomic level. In fact, the reforms provoke modifications that induce irregular bank behaviours and generate a macular degeneration encouraged by the speculative financing of the national debt.

The fifth section asserts that the high growth era in the aftermath of the 2000-2001 Turkish crises is not due to a strengthening of internal (improvement of income

distribution, expansionist stabilisation policies, etc.) and external (current account balance and capital inflows) resilience but to the cyclical opportunities due to the global speculative boom in the world during 2003-2007 as soaring and abundant speculative liquidities on global markets in the aftermath of the dotcom crisis have spurred emerging economies on the whole. In the face of the current global reversal, the Turkish economy seems not to be able to prevent the world-wide consequences of the current financial turmoil as its vulnerabilities remain worrisome. The competitiveness remains weak, the sustainability of the financial system as well as that of the real sector depend closely on unstable capital inflows and the path of the growth is not reinforced by an increase of the national and well distributed accumulation.

The last section concludes.

II. Theoretical grounds on the consequences of a hasty financial liberalisation

The financial liberalisation is regarded as a first step in market-oriented reforms in emerging economies. However, acting as a magnet for unstable movements in an unstable environment, hasty opening-up of domestic markets and financial liberalisation make that market reforms are often accompanied by severe recurrent monetary and financial crises.

The effects of the financial globalisation, usually identified by the liberalisation of capital markets[1], are assumed to be less beneficial to emerging economies (Goldstein and Turner, 1996, Ülgen, 2008) as well as to developed ones (Griefel-Tatje and Lovell, 1996, Humphrey and Pulley, 1997). Also, the negative effects of free capital inflows are often underestimated. Increasing of external (over)liquidities can lead to more conservative monetary policies against expected inflation and then to a rise of domestic interest rates that reduces the available finance for productive plans. Moreover, high capital inflows can provoke exchange rate appreciation and reduce the price competitiveness of tradable goods and impede the growth. Such consequences are sources of macroeconomic instability without improving economic structure. Actually, spontaneous evolution of market institutions reveals to be complex and difficult to be implemented. Great resiliency of local structures, hasty implementations and lacks of regulatory structures can provoke serious disequilibria. Business failures and banking and financial crises succeed one another and reduce

[1] with a outgoing of centralized national regulatory mechanisms.

the credibility of reforms in public opinion (Ülgen, 2007). Another binding constraint to add to this evolution is the growing inequalities and a bad income distribution leading to a worse growth in the long run.

Third generation models of crises show how problems in the banking and financial system interact with currency crises, and how these crises can have real effects on the whole economy (Chang and Velasco, 2001). These models also put into the fore interdependencies between domestic structures and conditions under which the opening-up is implemented. The success of reforms depends on minimal conditions required in the development of the banking and financial system (Rajan and Zingales, 1998) but also on the evolution of regulatory supervision structures previous to the liberalisation. But in emerging financial systems with structural fragilities the liberalisation is implemented quickly despite weak regulatory schemes the soundness of which plays a decisive role in systemic stability (Alper and Öniş, 2002, Ganioğlu, 2007)).

Reforms generate various movements of innovation on financial markets and the opening submits domestic savings to the effects of global phenomena that suddenly expose banks to new practices on public debt and on real estate and derivative markets. The increasing power of the short-term financial flows and the weight of the capital movements on the liquidity of the banking system affect the commitments of banks by leading them to privilege the portfolio investments at the expense of the long-term investments, what engenders severe problems for the efficiency of the system of credit. Moreover, changes in different economies call for different and various ways of imagining and implementing of reforms and their speed should be graduated in order to satisfy the society's targets. Achieving of the targets is related to specific structures of an economy and depends also on the determination of authorities to lead sustainable development policies (Stiglitz, 2008).

The financial stability reveals to be a *sine qua non* condition of the economic growth. In the case of Asian countries (Irwin and Vines, 1999) as well as in the case of the Turkish and Argentina crises (Eichengreen, 2001), vulnerabilities seem to be accentuated by capital markets liberalisation when domestic markets are not yet prepared for the consequences of such changes. Prasad et al. (2003) show that financial integration has to be implemented and controlled with precaution in order to reinforce the reform absorption capacity of economies. Voluntary and conscious intervention of authorities should aim to create and reinforce a frame consistent with the needs and capacities of economies in transition. Stiglitz et al. (2006) advocate

therefore in favour of capital inflows control to protect the inflows from the volatility of speculative finance.

The financial systems in transition which are characterized by a fast liberalisation often undergo the consequences of weaknesses and inadequacy of their regulatory infrastructure in their process of evolution. Turkey, following the example of numerous emergent economies, constitutes a stylized fact corresponding to these issues as the Turkish crises since the 1980s arose from bad macroeconomic policies which implemented neo-liberal shock therapy model of the triptych 'stabilisation-liberalisation-privatisation' and then triggered boom-and-bust cycles.

III. Banking reforms, increasing disequilibria and monetary stabilisation programmes

From 1980, Turkey turns to a liberal model leaving interventionist development policies of the 1960-70s. The abolition of the previous bank regulatory schemes constitutes one of the first steps in the transition of the Turkish economy towards a more opened market economy. During the period of numerous reforms between 1980 and 1994, formal measures are quickly taken by replacing the development of the banking system on a fast liberalisation and on an opening to the international competition.

This period of reforms resulted in a first large-scale twin crisis (exchange and banking crisis) in 1994 and opened a new era of successive stabilisation programmes while with the liberalisation of the capital account in 1989, the economy became more integrated into the international circuits. This evolution made the sustainability of the debt closely dependent on the sensitivity of markets to the current exchange regime and to the problems of liquidity of the banking system.

The first phase (1980-1983) took place within the framework of stabilisation and structural adjustment programmes. This phase of application of the shock therapy was based on the hypothesis that a fast opening and liberalisation would lead markets to stabilise spontaneously. Diverse controls and regulations were appreciably reduced or abolished (ceilings on interest rates, conditions of entry into the banking markets).

The financial modernization was based on the creation of new instruments through the development of securities markets. The first certificates of deposits appeared in July 1980 and the Council of capital markets with discretionary power is established in 1982 to develop the securities market. However, the restrictive

monetary policy followed during this period reduced strongly the domestic demand and contributed to the deterioration of the real sector's situation.

In this context of rapid evolution, the increased competition amongst banks for the collection of the deposits, but also the creation of "bankers", kind of financial intermediaries (of a number exceeding several thousand establishments) working in a Ponzi scheme through the aggressive issues of certificates of deposits, provoked an intense pressure on interest rates[2]. The lack of a regulatory environment which would be able to guide the activities of banks and to intervene in the resolution of possible shocks and growing liquidity problems led to bankruptcies of some financial institutions in 1982. This revealed that the liberalisation and the subsequent increased wild competition were not enough to strengthen quickly the financial system.

The second phase (1983-1988) was more intensive in institutional reforms. In the aim of satisfying the expectations of depositors, negatively affected by the previous bankers' failures, the Savings and Deposit Insurance Fund (SDIF) was created in 1983. From 1984 residents can hold deposits in foreign currencies and banks assets abroad. To develop the new financial markets, Istanbul Stock Exchange was created in 1985. At the same time, a new banking law, to reduce the fragility of the sector, compelled banks to hold minimal reserves for their capital adequacy and to record non-performing loans separately and cover them by reserves. This law also introduced a standardized accounting system and imposed to banks the obligation of annual regular external audit. In 1986, the Banking supervision department of the Central Bank of the Republic of Turkey (TCMB, henceforth) is involved in the supervision of the system under the control of the Treasury. Besides, the TCMB began its open market operations from 1987.

The third phase (1988-1994), expected as the outcome period of the reforms, marked the opening of the capital account (liberalised in August 1989) and the liberalisation of the foreign exchange market. Banks became free to determine their exchange rates but their contribution to the financing of the economy remained rather shy and the opening of the market did not provoke the expected consequences on the monetarization of the economy:

[2] For a Minskian analysis of financial crises in developing countries (as the case of Thailand over 1884-1998) see Schroeder, 2002.

Chart 1: Monetary aggregates and bank loans (Source: TÜİK, 2006)

(%)	1980	1983	1988	1989	1993	1994
M1/GNP	13.28	13.93	8.77	8.5	6.48	5.94
M2/GNP	16.63	23.6	21.06	20.47	14.16	16.22
Domestic bank loans/GNP	25.01	24.59	23.17	19.43	22.72	19.91

On the macroeconomic level, the development strategy, based on the increase of exports and which had given the growth rates on average raised around 7% a year in the previous phase, met its limits and macroeconomic indicators quickly deteriorated. The economy underwent a contraction, the growth rate of the GNP decreased from 9.8 % in 1987 to 1.6 % in 1989. The current account deficit rose to 2625 billion US$ in 1990 (Chart 3). In 1993, the balance was of -6433 billion with a trade account deficit amounting to -14081 billion. The exports/imports ratio fell from 81.4 % in 1988 to 52.1 % in 1993. This picture has also been accompanied by strong fluctuations in the exchange rate US$/TL:

Chart 2: Annual change of US$/TL (Source: TCMB and TÜİK 2006)

1987	35 %
1988	78 %
1990	26,7 %
1991	73,4 %

During the reforms, strong pressures have appeared also on the labour market resulting at the same time from the population growth and from the continuous migration towards big cities whereas the disparities were persisting; the coefficient of Gini rising from 0.44 in 1987 to 0.49 in 1994. In 1994, the average income of the upper quintile in the national income was 9.2 and 11.9 times more than the average incomes of the lower quintile, respectively, in the rural zones and in the urban zones (Şenses, 2003, p. 94). Although the rate of absolute poverty was relatively low on average (7.3% in 1994), it was very high in the poorest region (14.5 %) while it was 2.3 % in the richest region, denoting a very strong interregional disparity.

The liberalisation policies occasioned then a change in the regime of accumulation which is jammed between a very unstable growth path -unable to improve the general well-being of the population- and a more and more fragile monetary and financial structure -unable to contribute to the financing of the production and to the macroeconomic stability-. The outcome of this evolution has been a large-scale twin crisis (exchange and banking crises) in 1994, launching

recurrent monetary stabilisation programmes with ambiguous effects on the expected cleaning up of the economy.

After more than a decade of reforms, the imbalances became dependent on the volatility of short-term capital flows. The sensitivity of these flows, increasing under the influence of international (Gulf crisis in 1990-91) and national events, generated pressures on the growth path.

Chart 3: Macroeconomic indicators 1980-1994 (Source: TÜİK, 2006 and 2009)

(%)	1980	1983	1987	1988	1989	1990	1993	1994
CPI (change/year)	101.4	31.4	38.9	73.7	63.3	60.3	66.1	106.3
Average interest rate on 1 year deposits (end of the year)	33	45	52	83.9	58.8	59.4	74.7	95.6
Discount rate of TCMB	26	48.5	45	54	54	45	54.5	55
Growth rate (GNP, constant prices)	-2.8	4.2	9.8	1.5	1.6	9.4	8.1	-6.1
Domestic debt Stock/GNP	13.6	22.8	23	22	18.2	14.4	17.9	20.6
External debt Stock/GNP	19.34	31.08	46.79	45.02	38.82	32.59	37.45	48.29
External debt service/GNP	0.29	6.03	5.9	7.44	6.44	4.79	4.44	6.99
Share of the short-term external debt/Total external debt	n. a.	11.86	18.95	15.76	13.76	19.37	27.51	17.24
Current account (million US$)	-3408	-1923	-806	1596	961	-2625	-6433	2631
Trade account (millions US$)	-4603	-2990	-3206	-1813	-4190	-9448	-14081	-4167
Current account/GNP	-4.98	-3.18	-0.94	1.76	0.89	-1.74	-3.6	2.0
Total domestic bank loans/GNP	25.01	24.59	27.74	23.17	19.43	18.62	22.72	19.91

From 1990, the economy has had high growth rates but without real stabilisation in the key indicators. In spite of a restrictive monetary policy, the inflationary trend has been persistent. The consumer price index (CPI) varied over 1983-1994 between 31.4 % and 106.3 %. Despite an increased competition on financial markets, interest rates remained high. Over 1983-1994, the average rates on term deposits have been between 45 % and 95.6 %. The average interbank repo rate was of 39.09 % in 1986 and of 106.31 % in 1995. The macroeconomic fragilities have fed the increasing internal and external deficits. Domestic debt stock/GNP ratio varied between 21.9 % and 20.6 % over 1983-1994. That of the external debt followed an ascending evolution from 31.08 % in 1984 to 48.29 % in 1994 by which the share of the short-term debt increased parallel to the total external debt (Chart 3).

In order to mitigate the persistency of the disequilibrium, the Turkish government started a programme of disinflation from the mid-1998 under the control of the IMF. But the effects of the Asian and Russian crises of 1997-1998 have provoked a break in the capital flows in 1998 without causing banking and exchange crises. However, the uncertainties of the general election of April and the earthquakes in 1999 have contributed to the deterioration of the public accounts. In front of the persistency of the inflation and the frank deterioration of the economic

activity (the growth declined from 3.9 % in 1998 to -6.1 % in 1999), the authorities opted for another programme of disinflation, based this time on the external credibility of the national currency. They put into place a crawling peg exchange regime[3] at the end of 1999 with the approval of the IMF.

While a new banking law and the creation of the Banking Regulation and Supervision Agency (BRSA) tried to frame this programme, strong tensions on the liquidity of the banking system appeared and 5 private banks have been declared insolvent and transferred to the SDIF. These tensions provoked, in November, 2000, sharp increases in interest rates and markets' expectations turned to a close devaluation. The monetary stabilisation policy, based on an almost fixed exchange rate regime, in an environment of free capital movements, showed itself unbearable.

Chart 4: Macroeconomic indicators 1995-2001 (source: TÜİK, 2006 and 2009)

(%)	1995	1996	1997	1998	1999	2000	2001
CPI (change/year)	88	80.4	85.7	84.7	64.9	54.9	54.4
Average interest rate on 1 year deposits (end of the year)	91.30	93.80	96.6	95.5	46.7	45.6	62.5
Discount rate of TCMB	50	57	67	80	60	70	70
Growth rate (GNP, constant prices)	8	7.1	8.3	3.9	-6.1	6.3	-9.5
Domestic debt stock/GNP *	17.3	21	21.4	21.7	29.3	29	69.2
External debt stock/GNP *	41.93	43.45	43.8	46.6	55.7	59.3	78
External debt service/GNP	5.77	6.2	6.5	8	9.9	11	16.9
Share of the short-term external debt/Total external debt *	21.43	21.5	21	21.6	22.2	23.9	14.4
Current account (million US$)	-2339	-2437	-2638	-2000	-925	-9920	3760
Trade account (million US$)	-13152	-10264	-15048	-14038	-9771	-22057	-3363
Current account/GNP	-1.4	-1.3	-1.4	1.0	-0.73	-4.9	2.3
Total domestic bank loans/GNP	20.66	24.44	27.02	22	22.19	22.81	20.46

*** New series from 1996.**

While the competitiveness has been deteriorated and financial markets remained very weakly directed to the financing of productive activities, the economy became completely dependent on capital inflows for the sustainability of the external debt. Also the short open position of the banking system has started to increase; of 4.6 billion US$ in 1999 it raised to 8.55 billion in 2000. The mechanisms of financing, under the influence of a high volatility of interest rates, underwent then what we can call the "macular degeneration"[4]. The short rates (from 1 day to 1 month) increased from 70 % to 300 % at the end of November 2000 and in December 4, they reached

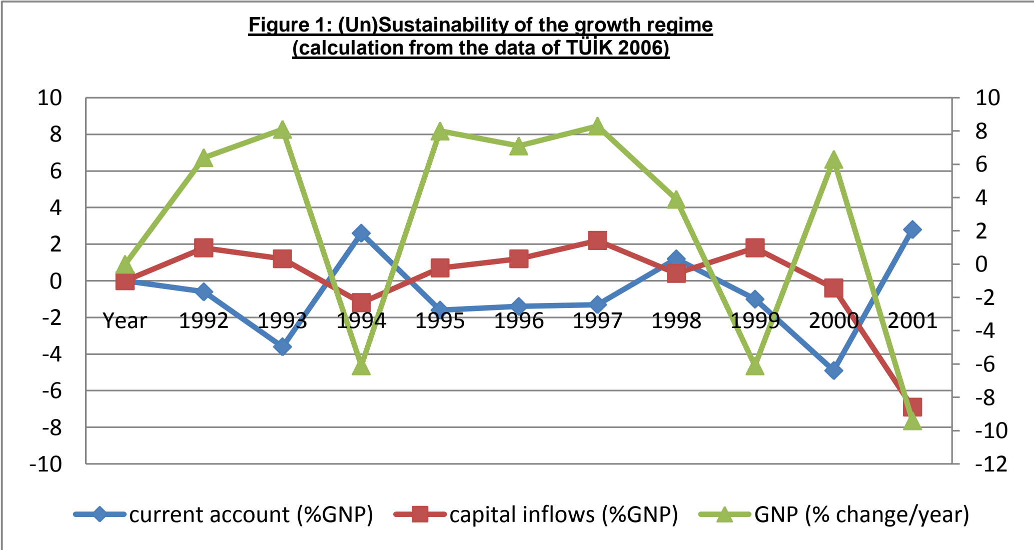
[3] The par value of the stated currency is adjusted frequently due to some factors such as inflation or growth rate. This gradual shift of the currency's par value is done as an alternative to a sudden and significant devaluation of the currency.
[4] Macular degeneration is a loss of vision in the center of the visual field (the macula) because of damage to the retina. Macular degeneration, in the Turkish case, made it difficult or impossible to recognize vulnerabilities, although enough peripheral vision remained to allow short-term economic activities.

2500 %. The central bank continued to defend its credibility programme through the stabilisation of the exchange rate whereas the imbalances persisted and soiled the relevance of the monetary system and the sustainability of the growth regime. The ratio of current account/FX reserves, highly fluctuating and often negative, shrank from 8.97 % in 1998 to -4.16 % in 1999 and to -43.13 % in 2000:

Chart 5: Current account and FX reserves 1992-2001 (Calculation from the data of TÜİK 2006 and TCMB)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
(A)Current account (million US$)	-974	-6433	2631	-2339	-2437	-2638	2000	-925	-9920	3760
(B)FX reserves (million US$)	4800	6900	5300	13300	15700	17400	22300	22200	23000	19100
A/B (%)	-20.29	-93.2	49.64	-17.58	-15.52	-15.16	8.97	-4.16	-43.13	19.7

The capital flows overturned and put the market into a position of illiquidity. In November 2000, 5.037 billion dollars outflowed. First five months of year 2001, the net outflows had been about 3.562 billion:



The IMF announced, in December 2000, an additional line of loan of 7.5 billion dollars and the government declared its guarantee on all the commitments. But despite this prompt financing from the IMF, markets' ardours have not been calmed; the capital outflows became more marked and resulted in February 2001 in the gravest crisis of the republican history: a depreciation of about 60 %; the short rates had been fluctuating until 5000 % between 21/12/2000 and 19/03/2001 to come down to 150 % in May 2001 and to 66 % at the end of the same year.

The high sensitivity of the economy to the problems of illiquidity is increased by a preliminary inappropriate preparation of the financial liberalisation. Alper and Öniş (2002) characterize the role played by the banking system in the escalation of imbalances by the distortions inferred by the dominance of public banks, the problem

of open positions of banks and the "politicization" of new entries into the banking sector. Özkan-Günay and Günay (2007) identifies the inadequate regulatory system, the weak supervision and the political interferences as the factors that contributed to the intensification of the banking system fragilities. Yayla et al. (2008) underline the high sensitivity of the Turkish banking and financial markets and the weight of a high probability of systematic default until 2003 resulting from the institutional vulnerability of banks to the volatility of capital and risk markets. The weaknesses of regulatory mechanisms, which reduced the capacity of supervision and intervention of the authorities, appear to be a decisive concern in this picture. The absence of new regulatory rules that should accompany the process of liberalisation left the banking system in a highly risky environment (Green et al. 2005).

IV. Banking risks inferred by irregular behaviours

Contrary to the hypotheses of shock therapy models, there is no spontaneous mechanism of competition which could push market actors to adopt efficient behaviours on the macroeconomic level. In fact, the reforms provoke modifications which reduce sharply the efficiency and the field of regulatory mechanisms on banking and financial markets, and so create a fragile institutional environment.

On the one hand, it is worthy of underlining the distortion led by the rule of the public banks whose loan strategies remained under the influence of the electoral considerations and determined the rent-seeking strategies of certain groups of interest close to the government. Two public banks (Ziraat Bankası -directed to the agricultural sector- and Halk Bank -directed to the small business and artisans) were at the centre of this process after the crisis of 1994. 6 stabilisation programmes, under the control of the IMF, aiming mainly at reducing the importance of the extra budgetary funds, have had the effect of placing on these establishments the burden of the distribution of rents.

On the other hand, the entry into the sector has been dominated by similar political considerations (Alper and Öniş, 2002). After the elections of 1991, 6 new private banks are authorized to enter the sector in particular through networks of influence between some industrial groups and the government. These banks all went bankrupt in the followed years. The example of Interbank, Türkbank, İmarbank and Egebank, owners of which were close to the government and which were transferred to the SDIF from 1999, is eloquent (FEMISE, 2005). The huge costs of such bankruptcies (estimated at several billion dollars) stem from the phenomenon of

tunneling (Johnson et al. 2000) which consists of the appropriation, through illegal ways, of the assets and profits of a firm by a small group of persons who hold the control of management and decision. This phenomenon is not related only to the liberalisation but it is well fuelled in such an environment. Hellman, Jones and Kaufmann (2000) support the idea that this phenomenon is mainly related to the capture of the power[5] by some groups of interest after the liberalisation and mainly due to the deficiencies of the regulatory mechanisms implemented by the authorities. In this environment, instead of contributing to revitalize and to modernize the sector, the entry of new and/or foreign banks is directed to operations of implicit cooperation with public authorities or with domestic banks aiming to benefit from high returns on an increasing national debt.

Hellman, Murdock and Stiglitz (2000) underlines that with the increase of the competition on financial markets, banks are more incited to enter into competition for the collection of deposits by offering higher interest rates to the expenses, often, of their balance-sheet stability. This, accompanied by the limited liability of banks in the regulatory system, creates an environment dominated by the moral hazard; the highly risky investments -the cost of bankruptcy of which is partially transferable on public funds- becoming more attractive. More interesting is that the model suggests that on highly competitive markets, there is no equilibrium at which a bank would choose to invest in a sound way. Indeed, banks adopt excessively optimistic and short-sighted positions by financing firms or holdings which are not financially and economically sound. This *macular degeneration* is also increased by more and more speculative opportunist behaviours under the pressure of markets recently opened.

An incentive factor of this myopia is the way of financing the national debt through speculative instruments which fed a new regime of financial accumulation. In the first phases of reforms, the need of financing of the public sector reported to the GNP followed a downward path (passing from 8.8 % in 1980 to 5.7 % in 1989). But from the 1990s, a noteworthy increase is observed reaching 7.4 % in 1990 and 12 % in 1993. Then, from the 1990 onwards, the borrowing requirement of the debt has directed the monetary policies and consequently banks' strategies (Aydın, 2002). The

[5] The corruption of the power develops between public decision-makers and private actors because of the weakness of supervisory structure in the process of transformation. This weakness provokes the "state capture" phenomenon (Hellman, Jones and Kaufmann, 2000). Generally, economies where the state capture is strong, the less developed institutions are mainly intended to supply specific advantages to lobbies and influential firms without trying to improve the institutional structures and the modalities of management of economic relations.

continuous increase of returns on the national debt financing incited private banks to neglect the distribution of credit in the economy. The ratio of Domestic bank loans (DBL)/Public debt hold by banks (as Government bonds and Treasury bills, PBB) fell in a considerable way denoting a real modification in the market strategy of the system. Now, between 1986 and 2001, on a consolidated base, the bank assets increased more than the GNP (Chart 6) without improving the real sector financing. One can observe, on the contrary, a decline of the share of commercial loans; the ratio DBL/GNP decreased from 19.6 % to 18.1 % over the period whereas the ratio DBL/Bank deposits shrank from 70.4 % to 31 %:

Chart 6: Change of banks' market strategies 1986-2001
(Source: TCMB, Treasury Undersecretary and Aydın, 2002)

(%)	1986	87	88	89	90	91	92	93	94	95	96	97	98	99	2000	2001
DBL/PBB	6,8	4,5	3,7	3,5	4,3	3,5	3,7	3,9	3,9	5,2	3,5	4,8	3,1	1,6	1,8	0,6
PBB/Total issue of public bonds	n. a.	77,7	90,5	90,2	85,9	92,8	79,1	77,8	71,5	81,6	84,4	89,5	86,8	85,3	75,9	74,5
Assets/GNP (banking system)	45,4	52,4	49,9	42,42	38,8	41,5	45,14	47,8	45,6	46,8	54,1	59,4	62,55	82,75	76,3	85,1
DBL/Bank deposits	70,4	72,7	64,7	62,87	74,31	63,96	66,48	76,1	49,46	56,55	57,02	66,12	54,14	40,25	47,08	31

Özatay and Sak (2003) reveal that the 2001 crisis has started through the increase of the fragilities of the banking sector. The risk accumulation and the rise of imbalances for the whole sector are mainly related to the enrolment of banks in speculative operations through very short-term commitments that are mismatched in their maturity as well as in their currency denomination and accompany an increase of non-performing loans. In such a strategy, the banking system external borrowing in foreign currencies has been used to finance the public debt in TL. The ratio FX Liabilities/Total Liabilities of banks went from 11.7 % in 1986 to 42.7 % in 1995 and to 50.8 % in 2001. So, since the 1990s, the external open positions of banks were increasing, banks trying to benefit from uncovered interest differentials without improving their structural profitability in a stable way:

Chart 7: Open positions and the profitability ratio of the banking system 1988-2000 (source: TBB, 2009)

(%)	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
FX Assets/FX Liabilities	103.8	105.3	88.1	90	86.8	84.6	96.5	90.6	93.6	89.6	84.9	79.4	76
Open position (FX Liabilities-FX Assets)/Equity Capital *	-14.6	-16.5	39.6	44.2	80.7	104.8	26.6	73.4	50.6	81.1	123.1	362.7	212.2
Net profit at the end of period/Total Assets	n. a.	2.1	2.8	2.4	2.8	3.5	2.2	3.4	3.9	3.4	2.7	-0.6	-3.1

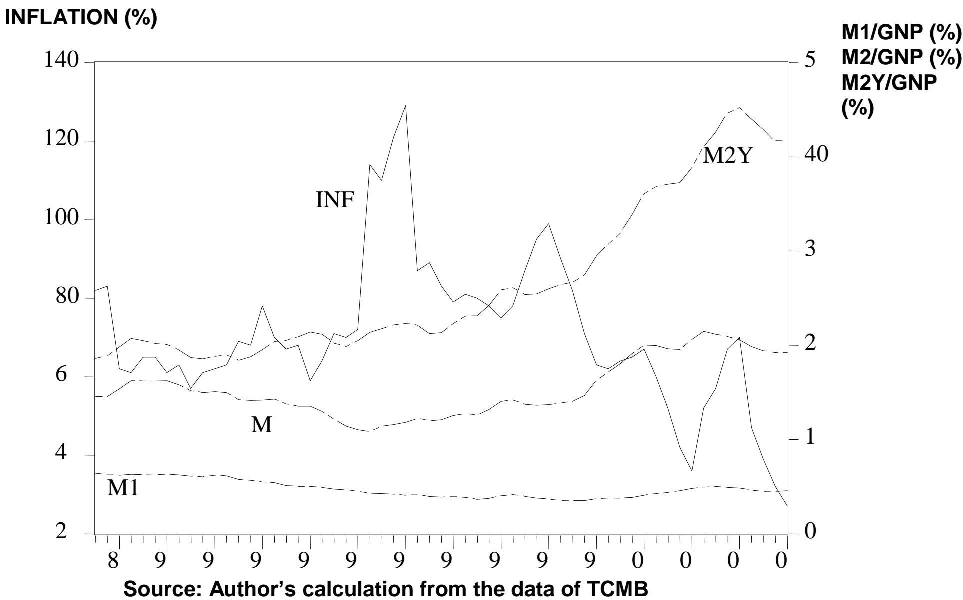
*** A negative value means a long position, assets being higher than liabilities.**

So we find one of the characteristics of a speculative environment with a structural incentive for banks to make commitments in highly profitable operations but which are fed by a continuous growth of their short open positions. Under such circumstances, currency crisis usually provokes banking crisis. When the monetary

authorities remain attached to the anchoring of the exchange rate in spite of increasing of the public debt borrowing requirement, banks are encouraged to finance public issues through their FX borrowing from abroad, so the phenomenon of dollarization becomes dominant. The part of FX assets in total bank assets increased from 26 % in 1998 to 38 % in 1999 and that of FX liabilities from 25 % to 48 %. The share of FX deposits in total bank deposits was 50 % in 1999 and 61 % in 2001 with an average term of 3 months.

Mohanty and Klau (2004) show that the monetary authorities in emerging countries are in front of a dilemma by respecting their anti-inflationary commitments through a fixed exchange rate and their access to foreign capital what holds interest rates at high levels and harms the growth. As also stated by Stiglitz et al. (2006), constraints can be more binding on emerging economies than on advanced ones as the authorities are not always able to use counter-cyclical fiscal and monetary policies; they are under the constraint of calming the ardours of foreign capital flows. In such an environment, the main activity of the Turkish banks was based on foreign capital inflows led by the stabilisation of the exchange rate, what allowed investors to arbitrate between high domestic interest rates and lower international rates. This financial path increased the open positions of banks and generated the dollarization of the economy (M2Y (M2+FX deposits). Then, the viability of the system became closely dependent on the probability of a sudden depreciation:

Figure 2: Evolution of monetary aggregates 1989-2003



Source: Author's calculation from the data of TCMB

The persistency of the current account deficit and the vulnerability of the banking system prevented the structural transformations from reaching a stable

macroeconomic state and stumbled over a sudden stop of the capital flows. The consequence of this crisis has been to contract the GDP of 9.5 % in real terms and the domestic demand of 21 % in 2001.

The crisis intervention was designed to overcome banking system's and public debt's weaknesses while meeting the claims of the creditors. Much of the crisis resolution effort has been used to pay foreign private liabilities and to cover the outflows of foreign portfolio investments. Without a credible strategy for involving the private sector (and especially bankers and debt holders) in crisis resolution through temporary standstills on sovereign debt, the Turkish government has been reluctant to implement long-term structural development-seeking policies for fear of worsening its access to global capital markets. Such a choice put the burden of the resolution on the entire economy, saving the *rentier* (bond-holding) class. As Akyüz and Boratav state "For obvious reasons neither monetization nor a capital levy nor any other measure that would place a sizeable burden on the rentier class can be successfully applied when the capital account is open and the domestic currency is fully convertible. In other words, the conditions that make it difficult to manage the external value of the currency also aggravate the difficulties in managing internal debt" (2002, pp. 30-31).

V. Great expectations, deceptive recovery and future trouble in the wake of the financial turmoil

The pre-crisis vulnerabilities such as large account deficits, bad directed credit growth, high levels of short-term debt, are giving cause for concern and remain open to several spillovers. Changes in the international trade and international borrowing conditions serve as key transmission channels. While not directly exposed to the roots of the financial crisis on advanced markets, many emerging economies experience sharp downturns. The turmoil in advanced financial markets serves as a potent channel of transmission to these countries. Even in the economies with relatively low international financial integration, financial channels transmit advanced economies growth spillovers[6] as well as the trade channels spur similar distress in emerging economies.

[6] Such spillovers are called by Masson (1998) "mansoonal effects" as the policies implemented in industrial countries can contemporaneously provoke crisis effects in emerging economies (through trade linkages and the dependency of emerging economies' monetary stabilisation programmes on the monetary and exchange rate policies in advanced economies).

It is usually admitted that as it came out of the 2001 crisis Turkey succeeded to improve some of its sources of fragility through an inflation-targeting monetary policy, a public-debt reducing fiscal policy (with a high primary surplus objective of 6.5% on average) and the restructuring of the banking system's balance sheets.

Actually, the current weaknesses of the Turkish economy are not principally founded on the banking system's exposition to external downturns at least in the short-term while the contribution of the banking system to the financing of the real economy remains excessively low[7] (Chart 9). On the whole, the Turkish banking system, under the lessons of the 2001 crisis, has been restructured especially by decreasing its exposition to foreign exchange risks. The number of banks has been reduced to 49 as by 2008 with a relatively high concentration; the share of the 5 biggest of the sector is equal to 60% higher than the average of the Euro zone (of 45%). The ratio of Deposits/GDP has increased to 50% (albeit less than the 117% of the Euro zone). However, the Bank balance-sheet/GDP ratio remains one of the lowest of the EU (less than 90%, just above that of Poland and Romania). The dollarization is, nevertheless, reduced as the ratio of Foreign currency deposits/Total deposits decreased from more than 40% in the 1990s to less than 33% on 2005-2009. As the share of foreign banks in domestic banks' capital structure remains low (less than 25% in 2008 and 2009, less than the new members of the EU), Turkish banks had not been enrolled in the current speculative finance crisis. The profitability (net profit/total assets) of the sector reached again its levels of the pre-2001 crisis with an average of 2.1% on 2003-2008 with a net interest margin of 4.6% on average, higher than that of US banks (3.5%) and of EU banks (1.1%) on the same period. Also, the return on equity ratio evolved on average around 15.8% (USA: 10.9% and EU: 10.3%, with sharp decrease from 2008). The capital adequacy ratio remains high on average albeit on a decreasing path:

Chart 8: Banking system's capital adequacy ratio (%) (Source: TCMB May, 2010)

	USA Banks	EU Banks	Turkish Banks
2003	12.8	12.4	30.9
2004	12.6	11.9	28.8
2005	12.3	11.4	23.7
2006	12.4	11.1	21.9
2007	12.2	11.4	18.9
2008	12.7	11.7	18

[7] The ratio Bank loans/GDP is one of the lowest amongst emerging economies.

Therefore, one can assert that Turkey has adopted the best practices in its financial management in the wake of the 2001 crisis. However, the fact that Turkey was strongly hit in many ways by the current financial crisis shows that a financially liberalised economy always keeps many sources of vulnerability as it remains at the effects of changes in external financial markets. As noted by Cardarelli et al. (2009), who analyse the factors determining the extent to which financial stress can affect economic activity, the financial stress plays a precursor role in the economic slowdown. A rapid expansion of credit, sharp rise in house prices and increasing borrowing by the corporate/household sectors contribute to a higher probability for the financial stress lead to severe economic downturns. Countries whose financial systems are dominated by more arm's-length based markets tend to be under financial turmoil effects and pronounced propagating shocks. Therefore, "prudential measures as well as monetary policy should pay due regard to the vulnerabilities that may build up and that eventually lead to greater output losses if the financial system is hit by a severe shock" (Cardarelli et al. 2009, p. 25). So, Rodrik asserts that "Lesson number one is that policy needs to guard not just against domestic shocks, but also shocks that emanate from financial instability elsewhere" (2009, pp. 1-2). This has several implications for the financial-openness policies for emerging economies like the Turkish economy. Financial liberalisation submits emerging economies to the high speculative sensitivity of external capital flows under the permanent threat of a sudden stop. Domestic banks as well as corporate sector borrowing needs are starved of external financing; the investment and the production are retrenched and aggravate the fall in domestic demand.

The global-capital-flows-dependency[8] dictates the monetary and exchange policies to the Turkish authorities who tried to hold domestic rates sufficiently high, until the last year, to capture more external flows they need to sustain the current account deficit. Real interest rates have evolved between 10-15% during mid-2006-mid-2009 before decreasing at the end of 2009 under more accommodating monetary policies in the face of the global downturn. TCMB overnight interest rates (compounded rates) began a sharp decrease from January 2009 to reach a lower level around 7% in 2010. Foreign direct investment flows followed an explosive path going up from 2.8 billion US$ in 2004 to 10 billion in 2005; 20.2 billion in 2006; 20.2 billion in 2006; 22 billion in 2007 and 18.3 billion in 2008 before reaching a downturn

[8] For several insightful studies on this issue, see Hein, 2008.

with 8 billion in 2009. Parallel to this, stock market prices accompanied the rise of that of developed financial markets inducing a sort of asset inflation and fuelling speculative expectations. Istanbul Stock Exchange index (ISE 100) passed from 25000 in the mid-2005 to more than 55000 at the beginning of 2008. After a decline up to 20000-25000 till the mid-2009, it has increased again up to 65000 during 2010.

In the current crisis, there are some temporary opportunities that external capital can keep. After a sharp capital outflow in 2008, Turkey had become a sizable recipient of inflows once again at the end of 2009. In almost the same way, after a sharp depreciation at the beginning of 2009, the TL had already begun to appreciate by the mid-2009. While these resumptions in external confidence have prevented the economy from a monetary and financial collapse, the relatively high level of interest rates and an appreciated domestic currency posed the problem of the under-competitiveness of the economy. As a result, a sharp decline in real GDP has reached its bottom in 2009. The quick recovery of the economic activity from the end of 2009 could show that the worst of the crisis is over. But the Turkish economy seems not to be able to prevent the world-wide consequences of the current financial turmoil as its vulnerabilities remain worrisome.

Actually, the high growth era in the aftermath of the 2001 Turkish crisis was not due to a strengthening of internal (improvement of income distribution, expansionist stabilisation policies, etc.) and external (current account balance and capital inflows) resilience but to the cyclical opportunities due to the global speculative boom in the world during 2003-2007. As also stated by Ocampo (2009, p. 716), the high performance in this period was a result of “the intensity of favourable external factors rather than of improvements in economic policy, which overall remained pro-cyclical in most countries”. Contrary to main Latin American economies that experienced real improvements in external balance sheets during the boom which provided relative protection against the current downswing, The Turkish economy remained in a fragile interval with an average of 5-6% of current account deficit/GDP ratio that seems to increase parallel to the growth rate during the booms and to maintain its path despite the reversal of the latter as in 2009-2010.

Chart 9: Macroeconomic indicators* 1999-2009 (Source: TÜİK 2009, 2010 and TCMB)

(%)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
CPI (change/year)	54.9	54.4	45	25.3	10.6	8.2	9.6	8.8	10.4	6.5	9 (average on Jan-Sept)
Average interest rate on 1 year deposits (end of the year)	45.6	62.5	48.2	28.6	22.6	20.38	23.72	21.3	25.68	15.7	

Discount rate of TCMB	70	70	55	43	38	23	27	25	25	19→15 (at the end of the year)	#
GNP growth rate (1998prices)*	6.3	-9.5	7.9	5.9	9.9	8.4	6.9	4.7	0.7	-4.7	11 (Jan-Aug)
Domestic debt stock/GNP*	29	69.2	54.5	54.5	52.3	50.3	43.7	42.3	39.2	44.4	
New series	21.9	50.9	42.8	42.7	40.2	37.7	33.2	30.3	27.2	34.64	
External debt stock/GNP*	59.3	78	71.9	60.6	54.2	47.4	53	52	51		
New series	44.69	57.74	56.2	47.26	41.24	35.25	39.44	38.45	37.5	43.4	
External debt service/GNP**	11	16.9	12.5	9.1	7.8	7.6	7.6	7.5	7.2	Q4:9.3	
Share of short-term external debt/Total external debt	23.9	14.4	12.6	15.9	20.1	22.4	20.5	17.3	18.2	18.75	
Current account (billion US$)**	-9.92	3.76	-0.6	-7.5	-14.4	-22.2	-32.9	-38.3	-41.9	-14.4	-27.98 (Jan-August)
Trade account (billion US$)	-22.05	-3.36	-6.4	-13.49	-22.73	-33.1	-41.06	-46.79	-53.02	-24.89	-32.04 (Jan-Aug)
Current account/GNP	-4.9	2.3	-0.3	-2.5	-3.7	-4.6	-6.1	-5.9	-5.7	Q4/ -2.3***	-5.4 (target)
Total domestic bank loans/GDP****	17.2	15.3	10.32	11.88	14.91	20.53	24.59	27.14	31.15	34.89	

*** From 2002, the ratios are calculated on the basis of GDP while there is no great difference between the GNP and the GDP in the Turkish economy.**

**** New series from 2002.**

***** Current account balance targets (% of GDP) are: 2011: -5.4; 2012: -5.3; 2013: -5.2.**

******Regarding Chart 4, I used the last data offered by the TCMB to calculate again the ratio for the whole banking system's domestic loans to the economy (interbank loans are excluded) at current prices. In the first two quarters of 2010, total bank loans have increased of 23.6% with regard to the previous year value).**

 # TCMB kept its one-week repo lending rate at 7% for the 11th month and also reduced the overnight borrowing interest rate from 6.25% to 5.75% and held the lending rate at 8.75%. Late Liquidity Window Interest Rates (between 4:00 p.m. – 5:00 p.m.): Lending rate was kept at 11.75% and the interest rate on borrowing facilities provided for primary dealers via repo transactions was kept constant at 7.75 percent (TCMB, Decision of the Monetary Policy Committee, October 14, 2010).

Then the second lesson, emphasized by Rodrik (2009, p. 2), is related to the growth strategy of emerging economies. In Turkey, despite the increasing macroeconomic confidence from 2003, the unemployment rate remained strongly high. It is worth to note that the unemployment rate has remained high despite strong growth rates since 2001 and has reached a contraction level of 16% in 2009 denoting low performance on the macroeconomic front. This seems to be related to the new accumulation regime of the Turkish economy since the beginning of its liberalisation process from the 1980s. The Turkish economy has followed, as stated in the previous sections, through its integration into the liberalised international circuits the same pattern that of the developed economies' finance-based growth regime[9]. The

[9] Stockhammer (2009) suggests the notion of "finance-dominated" accumulation regime as the financial developments shape the pattern and the pace of accumulation in economies integrated into the globalization process and which implement wage moderation policies and credit-driven consumption models through increasing current account deficits.

unemployment rate which was around 10% between 2005-mid-2008, increased from the mid-2008 up to 15% and from the end of 2009, it shrank to 13% (net of seasonal changes) while the employment rate kept its average low level around 42%. According to the latest data given by TÜİK in October 2010, the unemployment rate has reached, at the end of July 2010, 10.6% with 13.6% when the agriculture is excluded and 19.5% for the youth unemployment rate. In addition, while on a slightly decreasing path, the Gini coefficient remains high around 0.40 since 2006, according to a report of TÜIK of 2010 on distribution of annual incomes by quintiles ordered by household disposal income. That reveals that high growth rates of the boom period did failed to put the economy on a job-creating regime of accumulation. As stated by Uygur "In spite of the relatively high growth rates and substantial productivity increases in the 2000s until 2007, there was hardly any rise in real wages (...). In the first six months of the recent recession of 2008-09, real wages fell and it is highly likely that they will continue falling in 2009, as they did in the earlier crises" (2010, p. 8).

In addition, the external deficit continued to its rising path while the international competitiveness was not enough to reduce the trade account deficit (Chart 9). Unlike the changes in the aftermath of the 2001 crisis, exports fell just after the current crisis under the effect of the contraction in the global trade. Then the external demand did not operate as an adjustment mechanism in Turkey. This has also contributed to the widening of the trade account deficit. In the wake of the current crisis, the exports to Latin America and Middle-East countries increased whereas the exports to EU decreased. However, this counter-cyclical diversification of exports has not yet improved the trade balance because of the lower shares of these new markets in the Turkish external trade. Then, on the whole, the international trade downturn from developed regions contracted Turkey's exports by almost 27% in the last quarter of 2008; so, exports kept a decreasing path passing from an average of 35 billion US$ in the first quarters of 2008 to 25 billion per quarter from the end of 2008. However, in 2009, Turkish exports were down by 23% year-on-year, imports also contracted even faster by 45% and the current account deficit went down by 67%. But this trend was reversed in 2010; imports rose by 34% more than the increase of exports (by 15%) leading again to the expansion of the current account deficit (TSPAKB, 2010). This shrank also the trade revenues of the economy relatively to its debt level:

Chart 10: Gross external debt/Exports (Fob) (Source: Undersecretary of Treasury, 2010)

2005	2006	2007	2008	2009	2010Q1	2010Q2
231.2	243	232.7	209.9	262.7	246.9	237.8

The same path of increasing vulnerabilities can be observed in the evolution of the public sector's gross debt stock while this level remains below the level of most of the EU countries (EU27 around 62 to 73.6% over 2004-2009):

Chart 11: Public sector gross debt stock (% of GDP) (Source: Undersecretary of Treasury, 2010)

2002	2003	2004	2005	2006	2007	2008	2009
73.7	67.4	59.2	52.3	46.1	39.4	39.5	45.5

Also, the public sector borrowing requirement (% of GDP), decreasing since 2002, crept up to high levels from 2008 while the public sector primary surplus decreased again sharply manifesting external dependency effects on the national economy:

Chart 12: Public sector borrowing requirement (% of GDP) (Source: Undersecretary of Treasury, 2010)

2001	2002	2003	2004	2005	2006	2007	2008	2009
12.1	10	7.3	3.6	-0.1	-1.9	0.1	1.6	6.4

Chart 13: Public sector primary surplus (IMF definition, % of GDP) (Source: Undersecretary of Treasury, 2010)

1993-2002	2003	2004	2005	2006	2007	2008	2009
0.3	4.8	5.5	5.0	4.6	3.1	1.7	-1.1

Under such circumstances, the real sector has been impacted through two main channels; the contraction of the external demand since the end of 2008 and the fall of the domestic demand as the contribution of resident households' final consumption decreased sharply from 2008, accompanied by an impressive contraction of private investment (with strong decreases in the growth rate of the GFCF, passing from 3.1% in 2007 to -6.2 in 2008 and to -19.2 in 2009):

Chart 14: Contribution of expenditure types to growth rates of GDP (% at 1998 prices) (Source: TÜIK 2010)

	Resident households final consumption	Gross fixed capital formation (GFCF)
2005	5.6	3.9
2006	3.3	3.2
2007	3.8	0.8
2008	-0.2	-1.5
2009	-1.6	-4.5

Such a reversal has obviously accompanied the high volatility of the growth rate during the last three years:

Chart 15: GDP annual growth rates (% at 1998 prices) (Source: TCMB 2010)

	2007	2008	2009	2010

Q1	8.1	7.0	-14.5	11.7
Q2	3.8	3.6	-7.7	10.3
Q3	3.2	0.9	-2.9	
Q4	4.2	-7.0	6.0	

While the external debt stock has been worsened particularly for the private corporate sector:

Chart 16: Private corporate sector's external debt/GDP (%)

2005	2006	2007	2008	2009
17.5	22.9	24.7	24.9	27.8

Contrary to the decrease of the formal external financial dependency of the banking sector, the external debt position of the private corporate sector has followed an increasing path since the aftermath of the 2001 crisis:

Chart 17: Gross external debt stock (at the end of the year, million US$) (Source: TCMB)

	2002	2003	2004	2005	2006	2007	2008	2009	2010Q1
A. Total	129532	144097	160977	169901	207819	249553	277005	268194	266605
A.1.Short-term	16424	23013	32205	38283	42616	43135	50448	49577	54472
Public sector	915	1341	1840	2133	1750	2163	3248	3598	4697
Private banks	5429	8351	12714	16562	19993	16167	21613	22127	26342
Non-financial corporate	8425	10461	13960	16178	17601	22061	23494	21785	21466
A.2.Long-term	113108	121084	128772	131618	165203	206418	226557	218617	212133
Public sector	63619	69503	73828	68278	69837	71361	75037	79819	80174
Private banks	3029	3133	5798	12341	22078	30941	30049	27993	26746
Non-financial corporate	24350	24783	28245	34604	53736	79625	98224	91831	87937
B. Share of the non-financial private corporate sector in total external debt*	0.253	0.245	0.262	0.299	0.343	0.407	0.439	0.424	0.410

* Author's calculations from the data of TCMB

As one can easily observe (Charts 3, 4 and 17), the share of the short term external debt in the total has not really stabilised on a decreasing path in the subsequent period to the 2001 crisis:

Chart 18: Share of the short-term external debt in the total external debt stock 1990-2010

%	1990	1993	1995	1999	2000	2001	2003	2005	2007	2009	2010Q1
Short-term external debt/Total external debt	19.37	27.51	21.43	22.2	23.9	14.4	15.97	22.53	17.28	18.48	20.43

Such developments reveal that the Turkish economy remains under the threat of two main fragilities: the persistent external debt-dependent economic activity (especially for the corporate sector but also, indirectly, for the banking sector) and the

lack of competitiveness which submits the whole economy to the international trade uncertainties and increases its debt burden. These fragilities could hurt the seeming economic stability if the international context in the aftermath of the current global turmoil comes to remove the global markets' volatilities from developed to emerging economies. These fragilities would also keep strong the external constraints that dominate domestic economic policies since the 1990s and prevent possible development strategies from improving the income distribution inequalities and the domestic demand in a sustainable way.

VI. Conclusion

This quick overview of the path of the Turkish economy after three decades of liberalisation reveals that the country evolves in the current crisis with important concerns some part of which is related to unswept structural weaknesses of an internationally integrated emerging economy. Inherent structural failures and lack of long-term directed national and "voluntarist" proactive development strategies make that the economy remains unable to reach a sustainable and more resilient path of growth.

Debates on the processes of transition in emerging economies towards a more open market economy and consequences of the liberalisation on the banking and financial systems in a vulnerable macroeconomic environment underline the complexity of the phenomenon of liberalisation. This complexity appears with more strength today to the observation of the difficulties that the developed financial systems undergo since 2007. The transformations implemented in the Turkish banking system since the 1980s and the ambiguous subsequent results appear as a study case suited to estimate the relevance of the modalities of banking reforms and financial liberalisation, but also to underline the central role that the growth mechanisms can play in the success and the stability expected from this process.

It seems that the Turkish reforms have been carried out through an extremely fragile macroeconomic frame because of the weaknesses of the banking system and also the inadequacy of the stabilisation programmes. In particular from the end of 1999, in spite of increasing deficits, these programmes were based on the exchange rate stability to reduce the inflation and to improve the credibility of the monetary policy on an international recognition of the stability of the national currency and provoked an infernal spiral. This modality of stabilisation fed the underlying macroeconomic and structural imbalances and increased the vulnerability of the

banking system the main transformation of which had been based on a hasty generalized liberalisation. Myopia to disaster and a highly speculative behaviour, which testify of a macular degeneration, arose from irregular banking behaviours under the pressure of markets recently liberalised. This evolution, accompanied with the structural macroeconomic fragilities, resulted in recurring banking crises (1982-84, 1994, 2000-2001) and showed that the reforms depend on the consistency of the economic policies regarding the capacities and needs of the economy.

The sequencing, studied by McKinnon (1991), indeed shows that the success of the financial reforms involves the respect for an order in the liberalisation process which should be based on a preliminary and consistent adaptation of the economy to the opening up of domestic markets in order to reduce the probability of structural distortions. Also, Bhattacharya (1997) emphasizes the decisive importance of the speed of the opening up of the capital account and of the integration of external financing flows to the evolution of the domestic economy. The author advocates then, in the objective of higher stability and credibility on markets, for a gradual liberalisation so as to mitigate the fragilities of the financial structure of the banking and no banking firms.

The Turkish example shows that these conditions and mechanisms are not spontaneously reached by liberalised markets and by the risky dismantling of the public mechanisms of supervision. The financial sustainability (Debt/GNP) and the economic sustainability (competitiveness and growth) are weakened by the new regime of accumulation based on conservative monetary policies and on finance-dominated markets. Such a regime, founding the modernization of the banking system on a fast and weakly structured liberalisation, aimed to satisfy the requirements of the short-term stabilisation programmes without considering capacities and needs of the economy.

Developing and emerging economies suffer from a whole host of problems but as it is well stated by Rodrik “As the experience of successful countries demonstrates, what is required is strategic prioritization” (2009, p. 12). The only financial liberalisation, hastily and anarchically implemented –founded on the belief that free markets clear up spontaneously- could not provide a powerful growth. To date, with the current turmoil, market-oriented policies proponents recognize the relevance of Minsky’s financial instability hypothesis. But a consistent conclusion cannot be founded only on the strengthening of market-friendly prudential regulation and supervision but before all requires some safeguards against global flows’

speculative volatilities. Because capital inflows exacerbate the investment constraint and then reduce economic growth through their effect on the direction of the monetary and exchange policies relied on external confidence, the financial openness can constitute a handicap rather than a suitable and sustainable source of real growth financing. Foreign borrowing boosted growth in Turkey as private returns in tradables were relatively high parallel to high current account deficit. But this growth has not focused on job creation. Large external deficit remained as a blockage factor against the widening of the positive impacts of the growth. More domestic saving mobilisation and the use of funds into job creating activities seem to be the necessary conditions for a sustainable recovery[10]. That requires a substantial effort in terms of new development policies based on the creation of quality and technology producing activities beyond the short-term private returns in tradables.

It is advisable to develop policies within the framework of a macroeconomic action plan beyond the beliefs of the liberalism. One of the first actions to be undertaken in this objective consists in channelling the financial markets regarding the imperatives of the stable development. It seems that any overflowing of financial markets on the absorption capacities of the economy provokes hardly controllable negative consequences and reduces the sustainability of the growth path by creating imbalances which self-feed through uncontrolled global volatilities.

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[10] Over 2002-2008, the saving rate remained, on average, blockaded around 16% of GDP whereas the investment rate evolved around 19-21%.

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