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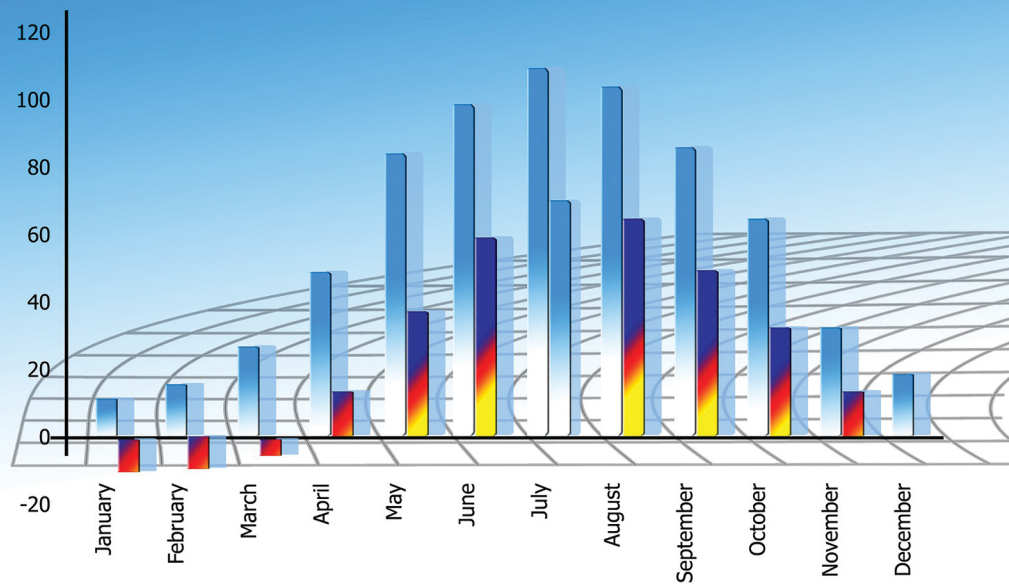
LIVRE DE LYON

THE EFFECTS OF THE GLOBAL CRISIS ON TURKISH ECONOMY



İsmail Ercan Börü

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ON TURKISH ECONOMY

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PREFACE

This study examines, within the context of Turkish economy, the effects of global crisis that is generated from the US in 2007. Although there are many studies about causes and consequences of global economic crisis in the literature, there is no specific study about the impacts of global crisis on Turkish economy. In this regard, the study examines causes of the global crisis and effects on the Turkish economy and also focuses on the economic reforms in Turkey before the global crisis. This dissertation also examines the economic decision making and precautions taking during the crisis process. Although Turkey had affected crisis like other developed and developing countries, but its impacts were not felt for a long time. The aim of this study is to figure out how Turkish economy protected itself and stand strong during this period. Therefore, the study sometimes refers to 2001 crisis for

comparison purposes. In addition, this paper will research to how external and internal factors have affected politic decisions and also impacts of the economic activities. In this sense, the study analysis the performance of Turkish economy after 2001 crisis by applying secondary data that was published by the government or relating papers and applies to researches the literature based on the topic for this purpose.

This book is derived from the master thesis named as ‘’ the effects of the global crisis on turkish economy’’

CONTENTS

CHAPTER 1

INTRODUCTION

The world economy has faced to a systematic financial crisis during 2008 and also international financial system was collapsed. (Arner, 2009). There are some specific experiences about global financial crisis in the last 100 years period. Basically, there are 2 important financial crises which affected deeply the world economy and caused economic devastation. The first one is Great Depression in 1929 which originated in the US. It spread all over the world and became people poor and unemployment. Milton Friedman and Anna Schwartz stated that 'this crisis would not have turned into a prolonged depression if it had not been reinforced by monetary policy mistakes on the part of the Federal Reserve. (Milton and Anna, 1971). The second global crisis began in September 2008

and many countries are still feeling its economic effects. It is generally argued that it was a credit crisis and some investment institutions and banks have played important role to spread the whole world. These institutions wanted to create large funds and increase their profits without thinking the possible side effects on the economy.

The main reasons of global crisis can be classified under three headings. Firstly, the US financial markets created new resources in order to finance property market. Secondly, these resources were involved in the commercial banks' balance sheets to a great extent. Lastly, these investments were funded by using short-term debts (Diamond and Rajan, 2009). Many experts believe that financial institutions caused financial crisis as much as commercial banks because of providing credit to the economy, however they were not subject of same laws. (Timothy, F. Geithner, 2008). Additionally, there was another problem in the economy that is real estate market which plays an important role to develop crisis by giving huge credit majority of people in the US. In the meantime, it is obvious that sub-prime mortgage triggered the credit crisis in the U.S. (Keilis-Borok et al., 2008).

Similarly, Turkey is familiar with economic crises especially in the last 20 years. Firstly, a huge financial crisis started in 1994. The Turkish lira (TL) was devalued; inflation rate increased up to three digit levels and the Central Bank lost almost half of its foreign reserves. Therefore, a stabilisation programme was supported by the IMF but has achieved no result at the end of the recovery programme. (Celasun, 1999).

Due to the politic and economic instability, the second financial crisis occurred in 2001. Excessive borrowing of banks and public sector was mainly responsible for the crisis. Another stand-by agreement was signed by the IMF and floating exchange rate system was started to use instead of the crawling-peg system. Most of the foreign investors left the country and the cost of the financial crisis was more than 50$ billion to the economy. (Temiz and Gokmen, 2010).

Although the global crisis of 2008 has been similar to the 1994 and 2001 crises in some respects, there have been differences in terms of interest rates, budget deficit and inflation. The previous crises was mainly stemming from the internal factors especially politic instability and lack of bank audit whereas the global crisis was totally arising from the foreign markets' instability particularly the US financial markets. (Uygur, 2010).

The first aim of this dissertation is to examine the effects of global crisis on Turkish economy and contribution of previous crises experiences and financial regulations in terms of minimise the harmful effects on financial markets. In this regard, Chapter 2 makes a literature review about the causes and consequences of the global crisis both in Turkey and the major economies in the world.

Chapter 3 gives a brief summary of economic performance of Turkey by starting from 2001 crisis to until now. In addition, this chapter does not only focus on economic performance but also mention about social and political developments throughout

the last decade. This chapter also examines how political stability contributes to the economy and making society more comfortable in terms of economic recovery.

Chapter 4 provides information about Turkish financial crisis that occurred in 2001. The aim of this chapter is to examine which economic decisions and political implementations caused such a deep crisis.

In chapter 5, publish data and figures will be analysed in order to find out whether Turkey protect its economy from the global crisis or effecting in a negative way. Furthermore, some economic indicators such as inflation rate, unemployment and interest rates will be examined with the help of publish data. Chapter 5 is also discussing the importance of previous banking regulations and the policy responses to counteract the effects of the global crisis.

Chapter 6 examines similarities and differences between recent data and literature review in chapter 2. In addition, chapter 6 looks at the general economic situation of Turkey after the crisis and also forecasting future economic performance.

Chapter 7 concludes the dissertation with remarks on the economic situation in Turkey

1.1 IMPORTANCE OF THE FINANCIAL SYSTEM

It is quite important that to being have a healthy financial system and structure because countries have a stronger trade link each other than ever before. According to Douglas Gale and Franklin Allen:

"*Financial systems are crucial to the allocation of resources in a modern economy. They channel household savings to the corporate sector and allocate investment funds among firms; they allow intertemporal smoothing of consumption by households and expenditures by firms; and they enable households and firms to share risks. These functions are common to the financial systems of most developed economies*." (Allen and Gale, 2001).

If there is a problem in the financial market, it will spread quickly other countries like an epidemic because there are strong trade links among countries. In addition, millions of people become jobless, loss their savings and investments. However, due to having a good financial structure, Turkey relatively showed a better performance compared to other developed and developing countries in terms of compete with the harmful effects of the recent global crisis. This powerful structure was mainly stemming from the previous banking reforms and prudent fiscal balances. Therefore, it was able to minimise the interest rate risks and foreign exchange risks during the crisis. (Bakir, 2009). It is clear that all industries have a strong trade link with the financial sector so that if any negative things

happen in this sector, then it creates significant domino effects on the whole market. For these reasons, financial stability is quite important in order to create a strong and competitive economy. For instance, in the case of Turkey, there was a robust banking sector during the crisis and it has enabled to protect the economy against the external factors. (Bakir and Onis, 2010).

In theory, financial stability refers to asset price stability and smooth interest rates without banking crisis. (Goodfriend, M. 1987). Although policymakers and experts always try to find a way to prevent financial problems, they cannot succeed and also come up against new financial crises. Financial system establishes an efficient relationship between investor and depositors and it helps to economic development and also increases national wealth. (Gurusamy, 2008). The performance of financial markets is very crucial for countries and also governments in order to achieve their economic goals. In today's global world, banks play an active role to finance large investment projects and provide loan to their customers that is quite important for money circulation and invigorate the economy.

1.2 THE EFFECTS OF THE GLOBAL CRISIS ON SOCIETY

The crisis quickly spread out all countries throughout the world and leads to job losses and also decreased the amount of income. (Rani and Torres). Some countries have affected more than other countries. There is no doubt that third world countries had affected more than developing countries because they had already struggle with poverty and unemployment. Robert Zoellick, the head of World Bank had warned of a 'human catastrophe' in the poorest countries and said that ''*If we do not take measures, there is a risk of a serious human and social crisis with very serious political implications*.'' (BBC News online, 24 May 2009).

According to International Labour Organizations the number of unemployment could increase at least between 30 and 50 million all over the world from 2007 to 2009. It also estimates that at least 200 million people will be pushed into poverty, especially in developing countries during this period. (Blankenburg and Palma, 2009). In addition, this crisis also played an important role to declines in consumer wealth and a slowdown in economic activities and also caused to the European sovereign-debt crisis. (Williams, Los Angeles Times, 2012). There is no doubt that the global crisis mostly affected the society, especially people who live in the US. The unemployment rate in the US increased almost 10 percent in 2009 which was about 5 percent in 2007. (http://data.bls.gov/pdq/SurveyOutputServlet).

Furthermore, there were almost 20 million homeowners that need to help to lowering the mortgage balance because total payments are larger than the mortgage balance. (Nouriel Roubini, - Forbes.com). The crisis was also triggered liquidity problems. Investors could not find credit to investment because of the credit tightened and consequently international trade declined. (IMF, World Economic Outlook, 2009). The European countries also affected by financial crisis, especially in Iceland. During the crisis, three major banks have collapsed in Iceland and many workers lost their jobs and people became poorer. (The Economist, 11 December 2008). However, there was no banking failure in Turkey during the crisis because banks did not involve any toxic assets in their balance sheets and also they were still borrowing from the abroad. (European Economy, 2009). There is no doubt that there is a relationship between wealth and consumption. People did not want to spend money except basic needs because they were afraid of economic situation and wanted to keep their money safely. In order to reduce these fears, world leaders and central banks keep in touch with each other during the crisis. (Ralph Atkins, Financial Times).

CHAPTER 2

LITERATURE REVIEW

The weather of the global stormy conditions has affected most of the developed and developing countries all over the world. Many publications have studied potential impacts of the crisis on global economy. In the case of Turkey, there are also some studies that economists examined on the basis of the effects of the crisis on Turkish economy. For instance, Uygur (2010), Bakir and Onis (2010) and Coskun (2011) state that Turkish financial sector has not affected during the global crisis as much as other developed and developing countries because of the strong banking system and fiscal policies. However, Temiz and Gokmen (2010) state that the real economic situation is different as opposed to popular belief. They also believe that the budget deficit and unemployment rate are

worse than it seems so that they played an important role in this critical situation. Yet, this aims to not only focus on economic situation during the crisis but also looks at previous economic performance for comparing purposes. At first glance, previous studies are likely to seem true and acceptable in terms of bad economic situation; in fact it does not reflect the real situation because most countries have chose excessive borrowing policy during the crisis in order to enliven the economy. Basically, the most important failure of separating Turkey from the other countries is that no public funds have been transferred to the banking sector during the crisis. The reason behind this achievement is that having a strong government and previous fiscal reforms.

It is widely accepted that one of the root cause of the global crisis is that rising credit facilities and consequently blowing up the real estate market. Diamond and Rajan (2009) and Arner (2009) stated that excessive mortgage loan and declining housing price in the US lead to turbulence in the economy. On the contrary, David Rubenstein, the co-founder of the Carlyle Group, told Financial Times at 2007 ‘ *’I do not think it is a bubble. I think really what is happening now is that people are beginning to use a different investment technique, and this investment technique, private equity, adds real value*.’’ (Farzad et al. 2007).

Basically, most economists argue that developing countries has affected global crisis more than developed countries because of having weaker economic situation. Naude (2009) and Uygur (2010) mainly classified these impacts under 3 headings that are

banking failures, decreasing in export earnings and reductions in financial flows. However, in this period, Turkey was walking on eggshells at that time because she took lessons from the past crises experiences. Coskun (2011) and, Kilinc and Turhan (2011) argued that Turkish real estate market showed a better performance than expected. They also stated that using primary mortgage finance was very low level in Turkish mortgage market during this period.

2.1 Causes of Global Crisis

Financial markets have experienced an extraordinary year in 2008 which was based on the US. Many economists believe that it was the worst financial crisis since 1930s. (Reuters, 27, February, 2009). One of the main ideas and the strongest one is that this crisis derived from the Asian economic crisis that is substantially composed of emerging markets and some developing countries such as Turkey, Argentina and Brazil faced to economic distress. (Diamond and Rajan, 2009). These countries were very important for developed countries because they were borrowing money from abroad in order to finance their economies and major importers of capital. However, they reduced consumption, protecting themselves of foreign assets and investments were cut back by households, corporations and governments so that they became exporters of capital. (Krugman, the New York Times).

Export-led growth was the best way to protecting country against economic and financial crises. As time goes

on, developing countries have got a huge foreign exchange reserves and most of the money went to US as consumption. The low interest rates encouraged the demand for housing and house prices started to increase because of high demand. (Diamond and Rajan, 2009). Additionally, banks encouraged the borrowers those who wants to use credit in order to buy house because they had borrowed almost the full value of the property. It provided a huge advantage for borrowers if anything goes wrong in the future because it was fully financed by banks and they can easily walk away from the mortgage. (Carmassi, et al. 2009). Uygur stated that although Turkish economic growth performance and economic situation are quite sparkle between 2002 and 2007, borrowers would not use credit easily. It was mainly because of the keeping the banks under tight control in order to prevent loan repayment problems during the credit period. (Uygur, 2010).

The US financial sector was very powerful and more profitable than before and also only a few investment banks and insurance companies dominated this industry. At this time, three rating agencies have evaluated them and gave information for investments. (Diamond and Rajan). Thanks to easy credit conditions and low interest rates, banks borrowed huge amount of money to their customers and they did not to take any notice of borrowers' repayment capacity. Indeed, they borrowed money whoever wants even if they do not have any income, in other words it is called ninja (no income, no jobs, and no assets). (Lal, 2010).

The house prices have increased dramatically in this period not just in the US, but also in the UK, Spain and Ireland until 2006. (The Economist, 18 October 2007). Many investors believed that increasing in the price of households is artificial and it will lead to a big problem in the real estate market sooner or later. However, Coskun (2011) argued that Turkish housing market is quite strong thanks to powerful banking sector and socio-economic structure.

Investment banks created some derivatives in order to give an opportunity to investors to invest in the US. This innovation was different from the old system. In the old system, when people borrowed money from the lender, they paid it on a regular basis and money went to the lender. Naturally, lender was very careful and considered repayment capacity of borrowers. However, in the new system, lenders sold these mortgages to the investment banks and then investment banks combined all loans as a derivative called CDO (collateralized debt obligation) and sold these loans to the investors. (Lysandrou, 2011). Such kind of derivatives was accumulating in the balance sheet of banks as a toxic asset. However, keeping toxic assets was restricted by Turkish government because it makes banking sector more vulnerable and less powerful. (Bakir and Onis, 2010). Thanks to this innovation, when borrowers paid their mortgages, the money went to investors all over the world. The CDOs became very popular because rating agencies evaluated the CDOs by giving AAA rating which means that it is the safest and highest investment rate. It was very important for investment banks in

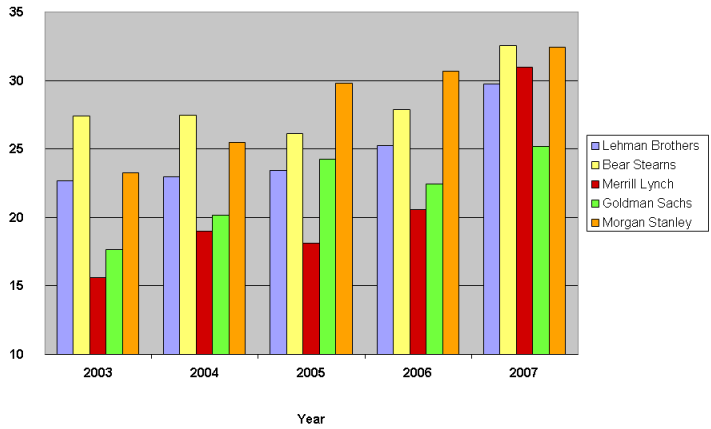
order to generate income because the more they sold CDOs, the higher profit they can earn. (Diamond and Rajan, 2009).

Previous studies showed that high level of leverage ratio contributed to financial crisis. The meaning of leverage ratio is that the proportion between borrowed money and a bank's or company's own money. (Ghosh and Sherman, 1993). Prior to the crisis, investment banks increased their borrowing and became highly leveraged. It was mainly because of the Securities and Exchange Commission (SEC) decided to let banks to increase their level of debt. This overleveraged made financial institutions more vulnerable, increased risk level and contributed to outbreak of crisis. (Simkovic, 2009).

Figure 1

Leverage Ratios For Major Investment Banks

The leverage ratio is a measure of the risk taken by a firm; a higher ratio indicates more risk.
It is calculated as total debt divided by stockholders equity. Each firm's ratio increased between 2003-2007.



Source Data: Company Annual Reports (SEC Form 10K)

The US five big investment banks increased dramatically their leverage between 2003 and 2007. The leverage level reached up to 33 to 1 in 2007 which means that if asset value decreases 3 %, they will be insolvent. In addition, the total amount of debt of these five investment banks is 4.1 trillion dollar in 2007 which is equal to 30 % of US nominal GDP. It is quite obvious that leverage became very frightening and began to threat financial markets. (Lebaton, 2008).

There was another problem in the financial markets which is called credit default swaps (CDS). It is a bilateral derivative which can be used to protect against default. The world largest insurance company called AIG was selling these derivatives to investors those who want to protect themselves against default. If investor agrees to pay money for credit default swaps, they would buy it. This is like an insurance policy between seller and investor which means that if CDO goes bad, seller promises to pay all losses. (Arner, 2009). On the other hand, there were speculators in the market and they could also buy these swaps. Obviously, this system generated huge profits for company in a short term; therefore they continued to use this method until it caused the bankruptcy in the long term. Basically, although this system may be seemed very complex, it was worked on a simple insurance transaction. However, the main difference is that they could insurance a single CDS more than one person so that if something goes bad, the number of losses would be very high in this system.

There is no doubt that this system encouraged people those who works in the finance sector because the more they sell financial instruments the more they generate profit. Nevertheless, some economists believe that it will cause catastrophic meltdown in the future because this method is very insufficient. Raghuram G. Rajan, the chief economist of International Monetary Fund stated on his article that ‘’ *my main concern has to do with incentives. Any form of intermediation introduces a layer of management between the investor and the investment. A key question is how aligned are the incentives of managers with investors, and what distortions are created by misalignment. I will argue in this paper that the changes in the financial sector have altered managerial incentives, which in turn have altered the nature of risks undertaken by the system, with some potential for distortions*.’’ (Rajan, 2006). Basically, Rajan believes that this system promised huge profits with less risk but the fact of the matter is that they found a way to make profit by increasing the risk rate.

In October 2008, financial markets collapsed and crisis rapidly spread out all over the world as a global economic tsunami. (Lim, 2008). Due to bad economic situations, some financial institutions were takeover by government and also some of them failed such as Lehman Brothers, Merrill Lynch, Fannie Mae, Freddie Mac, Citigroup and AIG. (Altman, 2009). Many countries were affected heavily global crisis because they had a strong trade link with the USA even if they had a strong economic structure. In order to reduce the effects of

crisis, governments made some provisions against the financial shock by cutting interest rates and launched recovery packages. (McKibbin and Stoeckel, 2010).

CHAPTER 3

THE CONTEXT OF TURKEY

The Republic of Turkey is located between Europe and Asia as a bridge and naturally, she has been of vital importance in terms of political and economic relations. Turkey became integrated her economy to the world in 1980s. (Temiz and Gokmen, 2010). Although Turkey has experienced big economic crises in 1994 and 2001 respectively, she has succeeded to overcome the crises. Turkey is defined as an emerging market by the IMF; and it is one of the G-20 major economies in the world. (IMF Advanced Economies List, 2011). According to the World Bank report, Turkey has the 15th largest GDP-PPP and the 17th largest economy in the world. (http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf).

Due to excessive borrowing from abroad between 1980 and 2000, the economy has become vulnerable in Turkey. In addition, it is possible to say that the economy was growing just by focusing on the domestic market. (Gunalp and Celik, 2006). Consequently, in 1994 and at the beginning of the 2000, Turkey has experienced two big economic crises and it caused a big economic collapsed, interest rates increased dramatically and a Turkish lira was devalued. This was mainly because of politic and economic instability and eventually it triggered economic chaos. During the economic crises, foreign investment decreased significantly, budget deficit reached high level and Turkish central bank lost billions of dollars of its reserves. (Ekinci and Erturk, 2007).

Turkey is a developing country that has been regulating financial markets since 1990, but crises interrupted this process regularly. In order to eliminate economic vulnerability, previous governments preferred to co-operate with the IMF and the World Bank. The main aim working to these institutions is that to gain credit and trust in the international arena. (Erturk, 2003).

Before the 2001 crisis, there was a stabilisation programme implementing in Turkey in order to strength the economy and prompt the foreign investment. The main aim of this program is that to compete with the chronic inflation by using crawling peg exchange rate regime. The main characteristics of this program can be classified as follows (Temiz and Gokmen, 2001):

- *Financial sector adjustment (restructuring and reform in the sector),*
- *Using nominal exchange rate as the pillar,*
- *Far teaching indexation in the government sector,*
- *Managing the fiscal performance for a sweeping public sector consolidation,*
- *Intensified privatisation,*
- *Implementation of a structural reform in the social security system, government budget expenditures, agricultural sector and infrastructural investments,*
- *Banknote issue only in compliance with foreign exchange purchases by the Central Bank of the Republic of Turkey (CBRT) and no sterilisation by monetary policy.*

However, no achieve has succeeded during this program because the Turkish lira was still overvalued and high current account deficit threatened the economy as well as the vulnerability of the banking system. (Capoglu, 2004). In addition, the political instability was another factor that has negative impacts on the markets so that the financial markets were devastated in 2001. It was one of the worst economic crises in Turkish financial history, interest rates reached to 5 digit levels, the Turkish lira was devaluated and also foreign debt increased to 114$ billion in 2001. Due to economic and political distress, the coalition government called for an early election in 2002. (Temiz and Gokmen, 2001).

After the 2002 election, people have reflected their reaction on the ballot box and then a single party came into

power called the Justice and Development Party (AKP). The majority of people surprised after the election result because it is rarely seen in Turkish political history. The message was very clear that people wanted to political stability and confidence because they knew that it was the only way to finish economic crisis. (Carkoglu, 2002).

The government made some financial and structural adjustments after the election, especially in banking sector because the main reason behind the 2001 crisis is that lack of inspection and high debt ratio. In addition, the new government has faced to some serious problems such as poverty alleviation and unemployment. Therefore, the government began to struggle with the poverty under the leadership of the World Bank. (Bozkurt and Yalman, 2011). It is important note that it was not a temporary implementation because AKP government assured these projects by making law.

Thanks to these legal reforms, the financial markets and social life would be healthier than before and economy began to grow year by year. It is possible to say that between 1999 and 2002 is a turbulence period for Turkey in terms of economic situation. However, the average annual growth is 7% from 2002 to 2006. (Uygur, 2010). Before the global crisis, Turkey began to feel some impacts on the economy. For instance, unemployment rate increased to almost 15% and the value of exports fall drastically in 2008. However, it is important note that they did not leave a lasting impression on the economy; they were follow-on cost the effects of the current crisis. (Ibid).

It is true that the global crisis affected Turkish economy directly, but Turkey showed a strong resistance thanks to previous reforms. (OECD Economic Surveys: Turkey. September, 1, 2010). In addition, Turkish stock market prices increased almost doubled from December 2008 to December 2009 and credit rating agencies which are Moody's and Fitch upgraded Turkey's sovereign rating. (K. Ersin et al, 2012).

CHAPTER 4

THE TURKISH FINANCIAL CRISIS IN 2001

In the last twenty years, Turkey competed with two big financial crises which occurred 1994 and 2001 respectively. The Turkish economy was in need to support in order to fix high inflation and financial fragility. Thus, the Turkish government got a financial support from the Bretton Woods Institutions in December 1999. The main aim of this program was that to stabilise the exchange rate and put down inflation. However, this program was not feasible so they could not get any result. (Akyuz and Boratav). Turkey struggled with the chronic inflation problem in the last 25 years. In order to overcome this problem, the previous governments made many agreements

with the IMF but they could not stabilise the economy. It is important to note that most of these agreements have resulted currency crisis, devaluations or liquidity crisis. (Alper, 2001).

Although previous governments made some agreements with IMF in order to fix economic instability, Turkey experienced a huge political and economic crisis at the beginning of the 21th century. There was an unsustainable situation at the beginning of the millennium in terms of economic and political, and then average interest rates began to increase dramatically in the last quarter of the 2000. In February 2001, a big financial and political crisis occurred after the official meeting between the prime minister and president of the republic. After 'there is a big crisis' announcement, the foreign exchange reserves of the central bank of Turkey dropped about 20 percent and also the dollar rate increased almost 50 percent from 685 thousand liras to 958 thousand liras in a day. Then, financial markets collapsed, overnight interest rates increased significantly up to 6200 percent and the government declared that the floating exchange rate system was implemented from now on instead of fixed exchange rate system. (Ozatay and Sak).

There were different ideas about causes of the 2001 crisis. Some economists believe that this crisis occurred because of the internal factors, others state that external factors played more important role than other factors. For instance, Ozatay and Sak argued that huge amount of public borrowing played a key role in the crisis and it caused a huge current account deficit. However, according to IMF report in 2001 "*The speculative attack on*

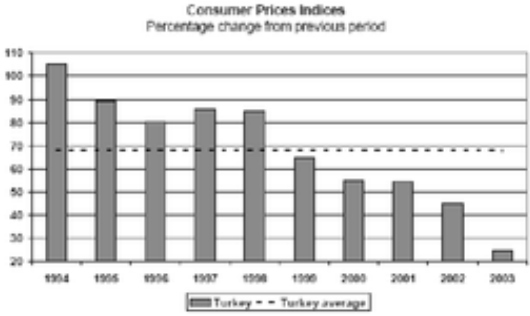
the Turkish lira took place against the background of increased political uncertainty, policy slippages and a weakening of economic fundamentals." (IMF 2001c.). Additionally, Cottarelli argued that '*The Turkish authorities were initially very effective in implementing the IMF supported program, but they were less successful in coping with unexpected events such as the tripling of oil prices, the strong dollar, rising international interest rates, and an overheating economy*." (Akyuz and Boratav, 2002).

Even though Turkish economy was supported by the IMF, it could not prevent liquidity crisis and economic instability. It is clear that there were some reasons that have caused the 2001 crisis. Basically, it could be classified under the three main headings. Alper stated that these factors were '' unsuccessful government policies in maintaining the stream of good news and sustaining capital inflows, not enough backing of the program by the IMF in terms of providing enough insurance against exchange rate risk and lastly, the 'no sterilisation' rule, which may be a 'design flaw' in the program, since it led to interest rate undershooting initially." (Alper, 2001).

One of the main problems was current account deficit which was increased dramatically in recent years. It was increased significantly from 1.3$ billions to almost 10$ billion between 1999 and 2000. The first step by having a healthy financial system was cut down budget expenditures immediately and having a new serious economic program. For this reason, the government made a new stand-by agreement with the IMF in order to achieve fiscal targets and economic stability. It was the

16th agreements between IMF and Turkey since 1961 and some of them have failed. (Ibid). The IMF made a new additional loan to Turkey in order to fix the economy and the total IMF credit increased 19$ billion dollar since 1999. It is important note that this agreement was a recovery package rather than monetary aid. The last stand-by agreement also included some banking reforms, bureaucratic mismanagement and struggle with the high inflation. (Akyuz and Boratav).

Figure 2: Turkey, Price Consumer Price Inflation



Source: OECD

Turkey has been showing a good performance in terms of consumer price inflation between 1994 and 2003. The inflation rate was more than a hundred in 1994 because of the economic crisis but then it was reduced almost 50 percent until the 2001 crisis. Although inflation is the big problem for the Turkish economy, the previous governments succeeded to reducing its harmful effects by taking right economic precautions.

There is no doubt that the vulnerability of banking system was the most important problem that has to be solved

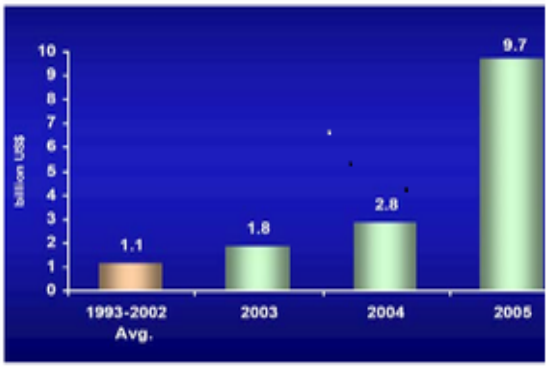
immediately by the policy makers. The requirement of public sector borrowing played a crucial role to increasing the fragility of banking system. Additionally, the stand-by agreement included some reforms except banking sector such as agricultural reform, pension reform and tax reform. Saving Deposits Insurance Fund, this is responsible for controlling banks' activities, took over eight banks before the 2000-2003 economic program. (Ibid). Furthermore, the government established some bodies and agencies in order to have an efficient financial sector and developed an attractive economic environment. For example, Banking Regulation and Supervision Agency (BRSA) that is an independent body established by the government and began to operate in 2000. The main aim of the body was that to improve banking regulation and to enable an independent decision making in banking sector. (bddk.gov.tr). In addition, another reform was made in telecommunication sector by establishing the Telecommunication Authority.

It was quite important for consumers to have new services with lower prices by creating competition. All these regulations were made especially for foreign direct investors because the more money comes into economy, the more invigorate the economy. These structural reforms made the Turkish economy more secure and increased foreign direct investment flows to Turkey. (OECD, 2002).

In spite of the fact that having a bad situation in terms of budget deficit, Turkey reduced its foreign debt in a short time. Short term liabilities was reduced from 28.3$ billions to

15.2$ billions between 2000 and 2002. In addition, banking sector succeeded to decreasing their total short term debt stock from 16.9$ billions to 7$ billion in the same period. Turkey endeavours turned to crisis into an opportunity for the foreign investors. After the regulations and strengthen reforms, banking sector became more popular than other sectors. Foreign investors bought more than 10 banks partly or wholly after the crisis. They bought these banks cheaply because they had lost their branches and personal number during the crisis period. (Aysan and Ceyhan, 2008).

Figure 3: Turkey's FDI Inflows



Source: Central Bank of the Republic of Turkey

According to Turkish Central Bank's historical data, the average of total foreign direct investment was only 1.1$$ billions between 1993 and 2002. However, this trend would change dramatically after the crisis. It rocketed up to almost 10$ billion in 3 years period. There is no doubt that it happened because of

the good economic performance and also sticks to the IMF's economic program.

It is obvious that all these reforms were made in order to create a fiscal and monetary discipline and reducing the effects of external shocks. For example, foreign credits started to rollover by banks and financial markets got used to floating exchange rate regime. In addition, there is no doubt that it was a debt management program. In this regard, the parliament passed some laws immediately such as re-capitalisation law and debt management law. (Akyuz and Boratav, 2002).

CHAPTER 5

EFFECTS OF GLOBAL CRISIS ON TURKISH ECONOMY

Although Turkey has experienced a devastating banking and political crisis in 2001, Turkey has better economic conditions than expected performance throughout the last decade. One main reasons of this performance is that the new government decided to keep the economic recovery program going after the 2002 election. There were some important issues that the new government should focuses on which are fiscal transparency and the rehabilitation of the banks. (Onis and Bakir, 2010).

The biggest problem of Turkish economy was macroeconomic instability. Permanent solutions have not been implementing by authorities until 2001 crisis. However, the new recovery package was implemented by the new single government party. Dani Rodrik, from Harvard University, stated that *"it is to the country's credit that as it came out of the 2001 crisis Turkey succeeded to fix these traditional sources of fragility. Monetary policy is governed by an inflation targeting framework and an independent central bank. Fiscal policy has been generally restrained and the public debt to GDP ratio stable or declining. Banks have strong balance sheets, and regulation and supervision are much tighter than before.*"

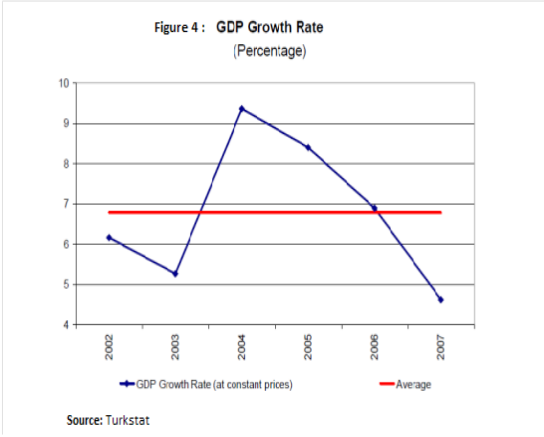
In addition, there were two key elements of this program which were inflation targeting and floating exchange rate regime. In order to succeeded, the Central Bank of Turkey was being independent and Monetary Policy of Committee was found for interest rate setting by the new general instruction. These reforms were quite important for both developing trust in foreign markets and get rid of the economic crisis. (Yigit and Gormez).

Exchange rate policy was the second crucial part of recovery program in order to fix economic instability. 2002 was the first year of the floating exchange regime and there was some volatile movements in the financial markets because it was not well known by market participants. The reason why authorities changed to exchange rate regime in Turkey is that to reduce dollarization effects on the financial markets and enable

to macroeconomic stabilisation. (Gormez and Yilmaz, 2007). What is more, foreign exchange reserve is quite important for developing countries in order to be able to minimise potential external shocks. Durmuş Yilmaz, Previous Governor of the Turkish Central Bank, emphasises on the beneficial of exchange rate policy *"the Central Bank holds foreign exchange buying auctions to build up reserves at times where foreign exchange supply increases relative to the foreign exchange demand."*

5.1 GROWTH OF TURKEY

From the beginning of the 2002 to until the first half of the 2008, the average growth rate of Turkey was over six percent each year and also inflation reduced substantially in this period. It was mainly because of the large amount of the foreign direct investment and banking reforms. Additionally, the IMF was monitoring the Turkish economy and followed the reforms that promised under the stand-by agreement. (IMF working paper, 2011).



It is clearly shown in the above figure that Turkey's GDP was rapidly growing and peaked up in 2004 just after three years of the crisis. This trend was not just special to Turkey because the world economy, especially developing countries had almost the same tendency between 2002 and 2007. In addition, Turkey had the third biggest ranking rate, followed China and India in this period. (Uygur, 2010).

While Turkey was increasing its GDP growth, the budget deficit was increasing at the same time. Turkey was integrated with the international trade much more than before and eventually the volume of exports and imports increased significantly after the 2001 crisis. (Macovei, 2009). With the development of foreign trade, Turkey had a more open economy and had an opportunity to trade all over the world. The value of Turkish exports was 63$ billion in 2005 and then it raised more than 50 percent and reached to about 105$ billion in 2007. However, the value of imports was about 170$ billion in 2007 at the same time. The budget deficit was financed long-term borrowing by the government and also privatisation policies contributed to inflows of hot money. (Uygur, 2010).

Some countries have showed difference performance during the crisis in terms of growth performance. Kalkan and Cunedioglu (2010) classified growth performance under 4 headings that are growing during the crisis period, rapid recoverers, slow recoverers and non-recoverers.

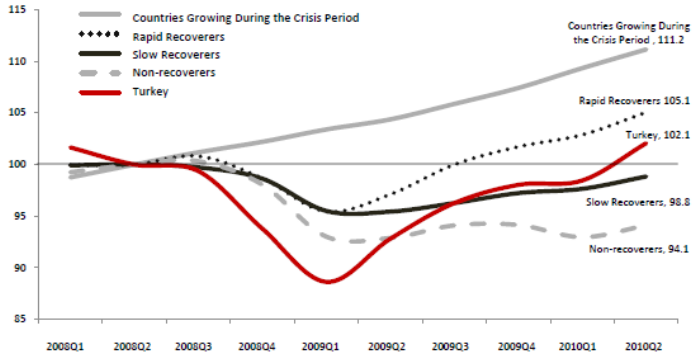
Table 1: Counrty categorisation by growth performance

Growing during the crisis period	Rapid recoverers	Slow recoverers	Non-recoverers
China	Singapore	Switzerland	The Netherlands
India	Peru	Slovakia	Sweden
Indonesia	Brazil	USA	Austria
Poland	Korea	Norway	Japan
	Malaysia	France	Denmark
	Israel	Mexico	United Kingdom
	Hong Kong	Germany	Spain
	Turkey		Italy
	S. Africa		Greece
	Canada		Russia
			Hungary
			Slovenia
			Romania
			Lithuania

Source : Kalkan and Cunedioglu (2010)

Countries that are showing best performance are China, India, Indonesia and Poland. Turkey is one 10 countries that achieved rapid growth pre-crisis period and also after the crisis. Interestingly, there are 14 countries in non-recoverers group and 12 of them are European countries except Russia and Japan. They suffered from recovered their economy throughout the crisis and failed to achieve growth rapidly again. Although some of the major world economies (USA, France and Germany) achieved to better performance in the second period of the crisis, they failed to recover economy as developing countries.

Figure 5: Quarterly production level across country groups and in Turkey over the crisis period 2008Q2 = 100



Source: TEPAV calculations, Eurostat, EIU, BEA, Statistics Canada, Bank of Israel, Banco de Brasil, tradingeconomics.com

In figure 5, there is a comparison between Turkey and country groups in terms of course of production. As mentioned above, there were only 4 countries showing good performance and always growth their economy during the crisis. Turkey, despite of performing the worst performance among the groups in the first quarter of 2009, then rapidly recover the economy with the successful performance in the second period. It can be said that Turkey showed an influential performance among these countries and also Turkey is the 12th country out of 14 countries that achieved rates up to 100. (Kalkan and Cunedioglu, 2010).

Although the Turkish economy is showing a good performance in terms of foreign trade and economic growth until the recent global crisis, some economists thought that there are still unsolved problems which can cause bust in the economy. According to Voyvoda and Yeldan (2006), the Turkish economy

is still vulnerable and has an insufficient monetary policy so that these conditions discouraged the future potential investors. In addition, the policy of high interest rates and overvalued currency does not provide continuity.

5.2 BANKING SYSTEM

Before the global credit crisis, there was a relatively good banking system and a strong fiscal structure in Turkey. It is argued that Turkish financial system was established on base of banking and Turkish banks had one of the highest capital adequacy ratios in the world. Furthermore, the Central Bank of Turkey had a very high foreign reserve almost 77$ billion in September 2008. There is also important note that Turkey had concluded IMF stand-by arrangement in the middle of the 2008. (Onis and Guven, 2010).

It is inevitable that being affected any financial turmoil or political crisis in the world. Naturally, most of the emerging economies were affected the recent global crisis and suffer from bad external financial conditions. The slowdown in the Turkish economy activity has started in the first half of the 2008 and it has put on a brake on the economy compared to last five years growth performance. It was not only a special case for Turkey; but also the majority of countries have affected this crisis in a negative way. Marc Auboin, is an economic counsellor in the World Trade Organisation, stated that ‘*’The World Bank estimates that 85-90% of the fall in world trade since the second half of 2008 is due to falling international demand, and 10-15%*

is attributable to a fall in the supply of trade finance." (Uygur, 2010). Although the majority of developed countries such as the US and many European countries had affected the crisis very badly, its impacts on the Turkish economy have been limited. The reasons of these limitations can be classified under 4 main headings which are healthy and powerful banking sector, strong foreign reserves, floating exchange rate regime and monetary and fiscal discipline policies. (Babacan, 2009).

Table 2 : Ownership and Number of Banks in Turkey, 1999-2009 June

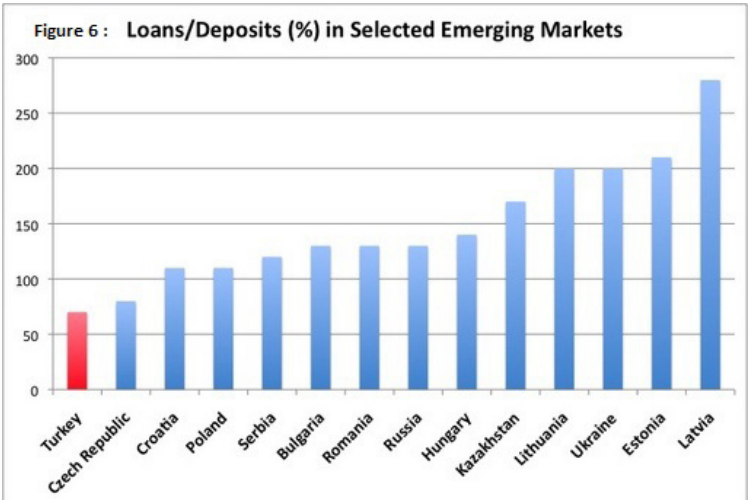
	1999	2002	2008	06/2009
Total Number of Banks (I + II)	81	54	45	45
I: Commercial (Deposit) Banks	62	40	32	32
(1) State	4	3	3	3
(2) Private	31	20	11	11
(3) SDIF	8	2	1	1
(4) Foreign, Founded in Turkey	5	4	11	11
(5) Foreign, Branches	14	11	6	6
II: Development and Investment Banks	19	14	13	13
(1) State	3	3	3	3
(2) Private	13	8	6	6
(3) Foreign	3	3	4	4

Source: Banks Association of Turkey (BAT), Annual and Quarterly Reports.

There were not any banks transferred to the SDIF during the global crisis, whereas the number of banks to be transferred to the SDIF was eight in 2001. It clearly shows that the banking sector is very powerful and still on its feet. Furthermore, there was no reduction in the profitability and had a better balance sheet compared to other international banks. The reason why Turkish banks have been very strong during the crisis is that

they did not involve any toxic financial instruments in their balance sheet. (Uygur, 2010).

In addition, due to having a healthy banking system, Turkish banks found foreign credit at a lower cost compared to other emerging countries. The main reason behind this achievement is that creditor relied on the Turkish financial system and political stability. Consequently, it made the banks relatively liquid and stronger than competitors. (Stokes and Rogovic, 2009). Furthermore, Stokes and Rogovic argued that five factors have contributed to having a healthy banking sector which is asset quality, liquidity risks, capital adequacy, foreign exchange exposure and profitability.



Source: IMF Global Financial Stability Report, April 2009

As shown in figure 6, Turkey has the best loans/deposits rate among selected emerging markets. Turkish loans to deposit ratio is below 100% with Czech Republic. Turkish banks accessed to low cost of funding and almost 60% deposits are generating of total funding. It is a huge advantage for Turkish banks to reducing credit squeeze during the crisis.

There is no doubt that joint ventures and partnership played an important role in this achievement. Before 2000, the market share of foreign banks in Turkey was less than 5 percent but thanks to banking reforms after the 2001 crisis, the total share in the sector reached almost 40 %. (Kartal, 2011). Furthermore, Macoevi (2009) stated that there are two important factors that should not be forgotten in terms of soundness of Turkish banking sector which are *'successful implementation of a reform programme supported by the IMF and the opening up of accession of negotiations with the European Union'*.

5.3 EXPORT PERFORMANCE DURING THE CRISIS

There were also some problems in the foreign trade, especially in exports. The reason behind the falling volume of exports is that Turkish exporters focused only specific countries. For instance, the European Union countries were the major consumers of Turkey in terms of export and they were the most affected countries during the crisis. (Kalkan and Cunedioglu, 2010). There were some specific industries such as car and textile industries that generated high revenue in international

trade. However, due to falling of demand from the EU countries, the total revenue from the exports dropped significantly after the first quarter of the 2008. For this reason, Turkey focused on the another markets in order to close the budget deficit and the percentage of Turkish exports to Middle East countries and Africa has increased dramatically since the crisis has started. Although it provided some relief in the economy, the total revenue was not sufficient yet. (Ibid).

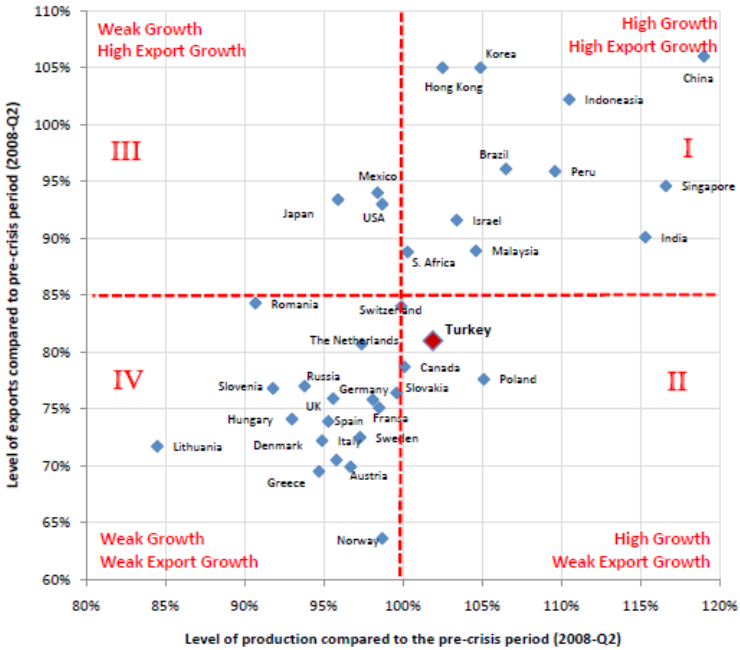
Table 3 : Destination of Exports, % of Total, 2006-2009 August

	EU-27	Other Europe	Middle East	Other Asia	Africa	North America
	1	2	3	4	5	6
2006	56.0	9.3	13.2	4.6	5.3	6.3
2007	56.3	10.1	14.0	4.9	5.6	4.2
2008Q1	51.0	13.7	14.7	5.0	7.3	3.5
2008Q2	50.2	10.9	19.4	5.4	6.3	3.1
2008Q3	45.3	10.6	23.0	5.7	6.4	3.6
2008Q4	45.2	12.7	19.5	5.3	7.7	4.6
2009Q1	40.6	17.9	18.2	4.7	11.8	3.3
2009Q2	46.9	8.6	20.2	6.2	10.8	3.5
2009M7	48.0	6.7	19.6	7.1	9.8	3.8
2009M8	45.1	8.7	20.0	8.2	9.8	3.6

Source: TURKSTAT.

As it shown in table 3, there has been significant decrease in export volume to European Union countries. However, the volume of exports to Africa, Middle East and other Asian countries has been increased until the end of 2009. It can be clearly said that Turkish exporter have changed their strategy during the global crisis in order to eliminate trade risks and protect their profitability to compete with the rivals.

Figure 7 : Level of production and exports during the crisis period



urce: TEPAV calculations, WTO Eurostat, EIU, BEA, Statistics Canada, Bank of Israel, Banco de Brasil, tradingeconomics.com

Figure 7 compares to export performance and growth performance in selected countries. According to figure, Turkey is in zone 2 which refers to high growth instead of weak export growth. Although Turkey has a higher growth rate than some developed countries such as USA, Japan, Germany and France, has a weaker export growth than some emerging countries like India, Brazil and China. In addition, 18 countries performed weakly with respect to both export performance and growth performance. There are only 3 countries remaining at zone 1 that performed high export growth but weak growth namely Japan, USA and Mexico.

5.4 FISCAL REFORMS AND MONETARY POLICY

When Turkey began to feel the harmful effects of the global crisis in the economy in 2008, the majority of people thought that Turkey is likely to go back to old crisis days. However, the government still insisted that the general economic condition is quite good and Turkey will not feel any side effects of the crisis as much as other countries. In addition, although the Prime Minister, Recep Tayyip Erdoğan, said that this crisis would ‘’pass tangent to’’ Turkey, there was not any incentive package in order to accelerate the economy. (Onis and Guven, 2010).

Both some developing countries and advanced economies have introduced some fiscal packages in order to minimise the effects of the global crisis. It is a crucial opportunity for most countries to strengthen and reorganising their social safety nets. Cash transfers to poor households and also public works programme are the most important pillars of the safety net programmes. (Ravallion, 2008).

Due to increasing demand and pressure from the business circles, the government has decided to put the new fiscal stimulus package into project in the first quarter of 2009. This package involved some fiscal measures and they were classified under five headings. The first one is that to encourage consumer spending by reducing special consumption tax and value added tax until the end of September 2009. Secondly, social security premiums were reduced in order to promote the employment. Thirdly, the ‘Asset Peace Law’, which is a tax amnesty, was

announced those who generate income abroad that they could easily transferred their saving without paying any tax. Fourthly, another tax reduction was made for investors. This measure included corporate and income tax reductions in order to stimulus the entrepreneurs. The last measurement is that to promote small and medium enterprises' production and exports. This package helped to invigorate the economy and weather the storm in a medium term. (Uygur, 2010).

Table 4 : Budget Performance of the Central Government, 2001-2009H1, % of GDP

	2001	2002	2005	2006	2007	2008	2008 H1	2009 H1
Total Expenditures	36.2	34.1	24.6	23.5	24.2	23.8	22.1	28.5
Non-Interest Expenditures	19.1	19.4	17.6	17.4	18.4	18.5	17.5	22.3
Current Transfers	7.5	7.3	7.1	6.6	7.5	7.4	7.7	10.5
Social Security Transfers	2.1	3.2	3.7	3.1	3.9	3.7	3.9	5.9
Interest Payments	17.1	14.8	7.0	6.1	5.8	5.3	4.5	6.2
Total Revenues	24.3	22.7	23.5	22.9	22.6	22.0	22.5	23.2
Tax Revenues	18.2	17.2	18.4	18.1	18.1	17.7	18.2	18.0
Non-Tax Revenues	6.2	5.5	5.1	4.7	4.4	4.3	4.3	5.1
Budget Balance	-11.9	-11.5	-1.1	-0.6	-1.6	-1.8	0.4	-5.3
Primary Budget Balance	5.2	3.3	6.0	5.4	4.2	3.5	5.0	0.9

Source: Ministry of Finance and Treasury.

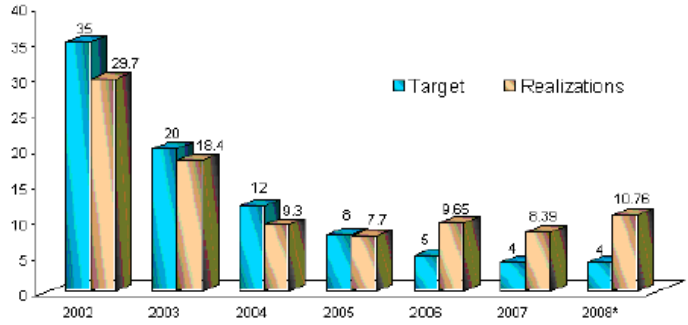
As shown in Table 4, there is a significant saving in total expenditures in order to equilibrate the budget in the last decade. It is clear that interest payments played an important role to reducing the total expenditures. From 2001 to first half of 2008, payment interests of the Turkish government has been reduced almost 80 % and reached the lowest level at 4.5 % in

the share of the general budget. Hence, this high performance has reflected the budget balance and then it reached to positive level in 2008.

It is likely to be said that fiscal policy and discipline is the most important issue of Turkish economic program after the 2001 crisis. Ali Babacan, the previous Minister of Economy and currently Deputy Prime Minister of Turkey, mentioned about Turkish economic reform at his speech in London School of Economic in 2009, ‘*’Fiscal discipline was the cornerstone of our economic program. We have achieved noteworthy success on the fiscal policy front. By generating high primary surpluses, budget deficit over GDP ratio fell sharply from more than 10 percent in 2002 to less than 1 percent. Subsequently, EU defined debt to GDP ratio dropped from 73 percent in 2002 to 39 percent in 2008.”*

In order to be able to overcome the 2001 crisis, Turkey has implemented a new economic recovery program under the guidance of the IMF. Basically, the new monetary policy aimed to achieve sustainable growth, lower inflation and reducing the budget deficit. (Uygur, 2010). The Government mainly focused on the inflation rate rather than other indicators because bringing down inflation rate is more important than increasing income. Hence, ‘an implicit inflation targeting regime’ was used by the Central Bank as a main tool for reducing inflation rate as soon as possible. (Yilmaz, 2008). The Government made no concessions of economic program in order to prevent future economic problems.

Figure 8: Inflation developments in Turkey between 2002-2008



(*) November inflation rate was used for 2008.

Source: TURKSTAT and CBT.

Figure 8 illustrates that historical data of inflation between 2002 and 2008. There has been a big achievement against inflation by reducing two digit levels to single level until 2005. However, due to changing the global conjecture and relatively bad situation in the global economy, inflation rate has affected negatively in a very short period. It is obvious that the real inflation rate exceed the target inflation between 2006 and 2008. Inflation rate reached almost 2 digit levels in 2006 and exceed 10 percent in 2008. External shocks played important role rather than internal factors in this situation because Turkey is an open economy and directly affected the global economic problems.

After the first shock in the international financial markets, Turkey experienced a capital outflow until May 2006. Due to the financial turbulence, Turkish lira depreciated almost 30 percent in this period and forced to Central Bank to additional measures by tightening monetary policy. Additionally, the Central Bank

increased interest rates from 15.25% to 16.75% in order to be able to keep the inflation rate stable between May 2008 and July 2008. (Uygur, 2010).

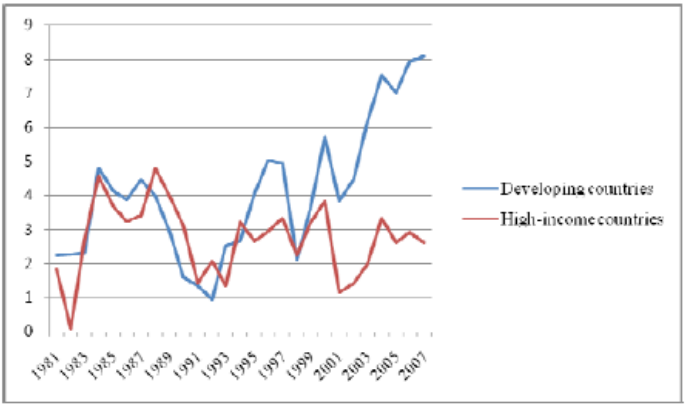
Although the Central Bank was late to make some provision against the global crisis, there were some measures that are taken by the CBRT. For instance, overnight rates were cut 11 times and also the CBRT reduced borrowing rate from 16.75% to 7.25% between November 2008 and February 2009. In order to strengthen capital structures, banks' dividend distribution was restricted. Those kinds of interferences were mainly aiming to price stability because higher inflation became a threat for both domestic and international activities. According to CBRT inflation report in the first quarter of 2010 *''Monetary policy will continue to focus on price stability in the period ahead. Strengthening the commitment to fiscal discipline and the structural reform agenda would support the improvement of Turkey's sovereign risk, and thus facilitate macroeconomic and price stability. In this respect, timely implementation of the structural reforms envisaged by the Medium Term Program and the European Union accession process remains to be of utmost performance .''* (The CBRT report, 2010, I).

CHAPTER 6

DISCUSSION

In evaluating the effects of the global crisis on Turkish economy, this dissertation set out some external and internal factors by reviewing both in literature and publishing data. There is no doubt that the overall impact was negative but not as much as other developed countries such as US and European Union countries. Arner (2009), Lysandrou (2011), Carmassi, et al (2009) and Diamond and Rajan (2009) argued that the epicentre of the global crisis was developed countries mainly the US. Therefore, the destructive effect of the crisis was felt by developed countries more than emerging markets.

Figure 9 : GDP growth in developing and high-income countries, 1981-2007



Source: Naude's (2009) calculations based on World Bank Development Indicators Online

Figure 9 clearly shows that there has been an inverse relationship between developing countries and high income countries in terms of growth rate. When many countries began to feel the impacts of the global crisis, the average growth rates in developing countries reached to 8% in 2007. However, high income countries showed relatively bad performance during the last decade.

Table: 5 G-20 countries statistical data

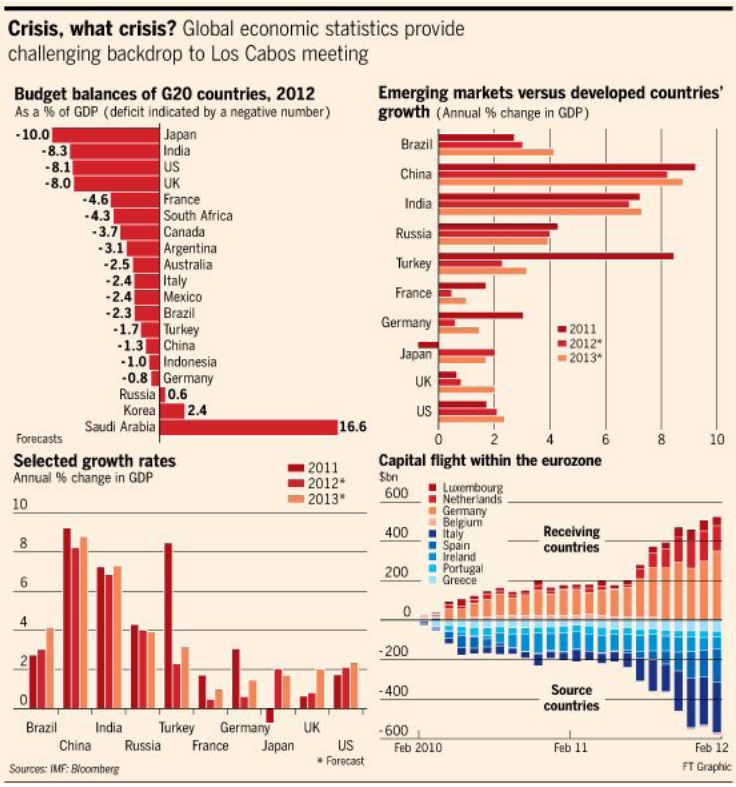


Table 5 was prepared by Financial Times before the meeting of G-20 countries in Las Cabos on June 18 in 2012. There is no doubt that having balanced budget is quite important for all countries in terms of healthy economic growth. As shown in the table, there are only 3 countries among G-20 that are having a positive budget balance namely Russia, Korea and Saudi Arabia. Despite many of big countries having a negative budget balance, Turkey has got one of the best budget balances after China and Germany.

In addition, second figure compares growth rate between emerging markets and developed countries. As it can be clearly seen in the figure, Turkey has the second big growth rate after China among 10 major economies with almost 9 percent. What is more, 2012 and 2013 forecasting shows that growth trend of Turkey will continue in the future. Although growth rate will decrease in next two years, Turkey's average growth will be better than advanced economies such as the US and the UK.

Furthermore, as shown in many tables and figures in this dissertation, the recent global crisis reached at Turkey at the end of 2008. However, it did not affect the Turkish economy as much as other advanced economies in terms of deep recession. The harmful effects of the global crisis took a short time and then the Turkish economy gained speed by the end of first quarter of 2010. Turkish growth performance reached to double digit level in 2010 and also private sector investment played a key role by triggering growth. Bear in mind that this impressive performance had become Turkey as attraction centre among developing countries. (Kalkan and Cunedioglu, 2010).

In addition, some papers in the literature focused on the impacts of the crisis on developing countries. Ocampo (2009) and, Frenkel and Rapetti (2009) argued that developing countries will deeply affected from the global chaos because their economies are not as strong as developed countries. However, Figure 9 clearly represents that developing countries shows better performance than high income countries in

terms of GDP growth. In Turkey case, as mentioned in Table 1, Turkey was one of the rapid growing countries during this period after China and India. Additionally, Figure 7 shows that Turkey showed relatively bad performance in terms of export performance, average annual growth was better than advanced economies during the crisis.

It is generally accepted that investment banks are mainly responsible for the recent global crisis because they preferred to hold many toxic assets instead of healthy growing during this period. Some major investment banks in the US announced their bankruptcy because of excessive borrowing. Gurusamy (2008), Lal (2010) and Simkovic (2009) argued that the main reason behind the global recession is to having an unhealthy banking system and lack of inspection on the banks. It is also clear that policymakers are mainly responsible for this situation by permitting such kind of inefficient growth.

As mentioned before, there were 2 big crises that occurred Turkey in the last 20 years, namely 1994 and 2001 crises. The Turkish banking sector was one of the most vulnerable financial sectors in the world because of high inflation rates and doubled digit interest rates during the 1990s. (Celasun et al, 1999). These crises mainly happened because of lack of implementation of regulations on banking sector. For this reason, a number of banks were transferred to the Savings Insurance Deposit Fund after 2001. It is likely to be said that banking sector was the most vulnerable part of Turkish financial system in this period. However, thanks to financial reforms after the 2001 crisis,

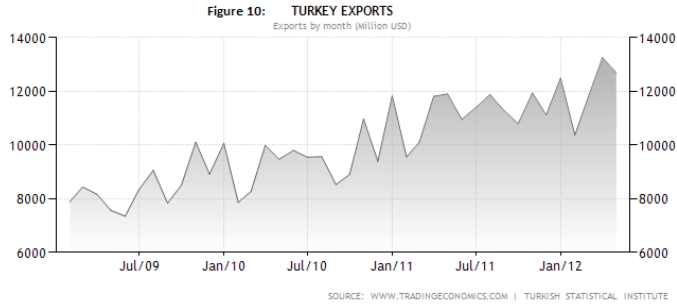
the banking sector was well regulated and organized by the government. (Uygur, 2010).

Turkey is more experienced than other countries in terms of economic crises. Therefore, the impacts of the global crisis on Turkish banking sector have been limited compared to other countries. During the crisis, Turkish banks have maintained their growth and profitability. The key factor in this success was that Turkey was preferred for investments by the external financial investor because Turkey had relatively better political and economic stability. There is no doubt that credit rating agencies played an important role for these decisions by rising Turkish credit rating during the global crisis. (Kartal, 2011). It was an extraordinary performance while most of the huge investment banks were going bankrupt in this devastating atmosphere.

Banking sector is one of the main pillar and quite important for financial activity in Turkey because Turkish financial system was constituted almost 80% by banking sector. In other words, if there is something wrong in the banking sector, whole system will be collapsed in a very short time. Therefore, banks were crucial important for Turkish financial activities and they were keeping a tight control namely by the banking regulation and supervision agency. (Uygur, 2010).

Another important indicator in the economy which is mentioned in this dissertation is that the volume export. It is quite important because it directly affected the country's growth rate, budget balance and level of welfare by increasing capital inflows from the rest of the world to the source country. Thus,

there is a strong relationship between exports and economic growth especially in crisis time. (Temiz and Gokmen, 2010).

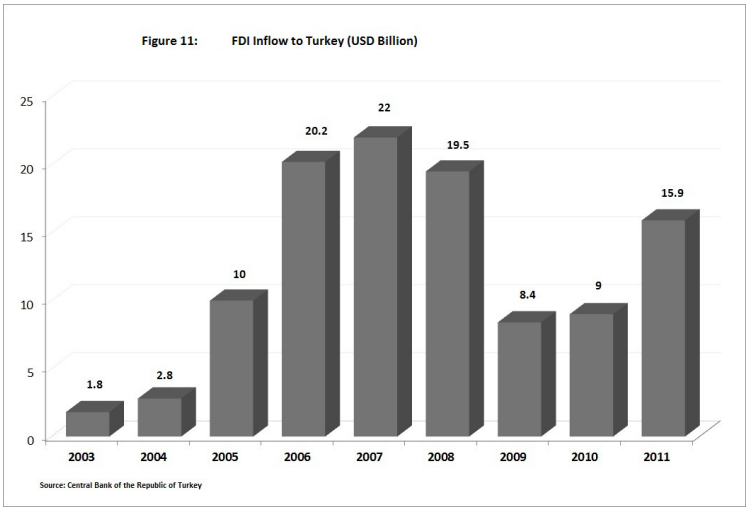


Although the volume of Turkish export fluctuated between 2009 and 2012, there was a slight increase year by year. The value of export increased almost 50% percent compared to July 2009 and July 2011 on a monthly basis. Additionally, there was a significant increase in the value of export between January 2010 and January 2012 by increasing about 30% on the annual basis.

As mentioned before in Figure 7, although Turkish export growth was not as good as other emerging markets such as China, India and Brazil, it was better than many of developed countries the US and Germany. The advantage of relatively good performance attracted foreign capital to Turkey during the crisis instead of other developed markets.

Developing countries need to financial inflows in order to accelerate trade and economic growth. These flows are likely to be foreign direct investment, trade credits or official development assistance. (Naude, 2009). It is also clear that

investors choose more secure countries during the crises time by moving their funds to safer countries. Cali, Massa and Te Velde (2008) estimated that total foreign direct investments in some emerging markets such as Turkey and India dropped almost 40 percent in 2008. However, reduction in FDI was a temporary state in Turkey and then investors decided to move their funds to Turkey as a safe port.



Thanks to financial reforms and rehabilitation programme after the 2001 crisis in Turkey, foreign direct investment increased sharply more than 10 times between 2003 and 2008. This impressive performance has continued to until 2009, and then there was a dramatic decrease occurred from 19.5$ billion to 8.4$ billion in a year period. However, this bad condition stemming from the global crisis did not take a long time and then FDI began to increase after 2009 and reached to almost

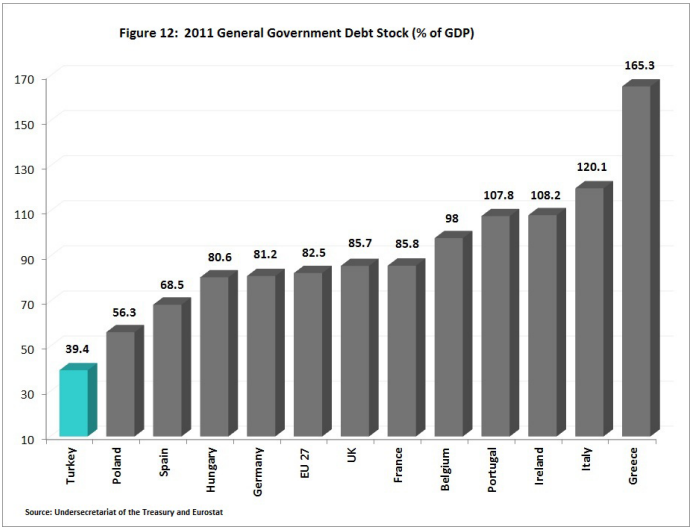
previous level. It is likely to be said that strong economic structure and political stability played an important role in this remarkable developing.

Fiscal and monetary tightening are two main important pillars in order to able to compete with the economic crisis. Lessons learned from the previous crises were very important for Turkey in terms of build a healthy and an efficient economic structure. In some respect, thanks to 2001 crisis, Turkey has gained a huge advantage before the global crisis by implementing such kind of reforms. As a part of rehabilitation programme, some precautions were taken such as decreasing debt stock, reducing consumption spending and to promote the investment. (Uygur, 2010).

On the contrary, there was still a problem in the economy in terms of real interest rates. Kannan and Rodrik argued that Turkey is a finance constrained economy and the real interest rates would be reduced as soon as possible because it makes economy more fragile. Turkey has suffered from double digit interest rate levels until the recent crisis and it was the second high rate among emerging markets. In fact, it was not as high as Asian countries but it should be reduced single digit level in order to decrease cost of capital. However, interest rates have been going down since 2009 and Turkey's risk premium is now lower than many of her southern European countries and developing countries. (Kartal, 2011).

From investors' point of view, the percentage of government debt of GDP is quite important because it reflects

the ability of make future payments of a country. Therefore, they do not prefer to invest a country which has a high debt to GDP ratio. (Jeanne and Guscina, 2006). There is no doubt that the amount of public debt is the crucial part of economic indicators and many countries have suffered from excessive amount of debt during the crisis. It was likely to be stemming from without having a fiscal discipline. Gonenc et al (2010) argued that Turkish financial markets may not protect them from the crisis as for advanced economies because Turkey is an emerging market and need more reforms in the economy.



As shown in Figure 12, Turkey has the best debt stock ratio among in selected countries. There are four countries namely, Portugal, Ireland, Italy and Greece that they are currently compete with the debt crisis and try to solve this huge problem with the help

of euro zone countries. What it is notable that most of selected countries in Figure 12 are the member of European Union and they support each other in terms of financially. Although Turkey does not receive any financial support from any countries, she showed a remarkable performance by decreasing debt stock almost 40 percent with the prudent fiscal policy.

It is likely to be said that fiscal stimulus packages played a crucial role of these excessive debt to GDP ratios. Some developing countries have announced fiscal packages during the crisis in order to enliven the economy. For instance, the cost of fiscal stimulus packages of China, India and Korean are US$586 billion, US$60 billion and US$11 billion respectively. (Naude, 2009).

Although Turkey has suffered from chronic high inflation until 2002, there was a sharp decrease from two digit levels to single digit level between 2002 and 2008. Inflation rate has dropped to 7.7 percent in 2005 which was the lowest level of Turkish inflation history. (See figure 8). However, due to the increasing energy prices such as petroleum and natural gas, inflation rate would reach almost 11 percent in 2009. (Uygur, 2010). Within the scope of struggle with the harsh effects of global crisis on domestic economy, the Central Bank of the Republic of Turkey has focused on policy rates. In this regard, CBRT cut policy rates by 1025 basis points between November 2008 and November 2009. In addition, due to inflationist pressure on the economy, CBRT announced that policy rates will stay at low levels for a long time. (Kartal, 2011). In

recent years, Turkish lira has slightly appreciated against other currencies and then, it would lead to pressure on inflation rate by decreasing again one digit level.

CHAPTER 7

CONCLUDING REMARKS

Over the last two decades, Turkey has experienced big economic and political chaos in 1994 and 2001. Both of them were mainly stemming from internal factors and hit the financial markets. However, the main difference between the recent global crisis and previous crises is that the global crisis hit the non-financial sector in Turkey compared to earlier ones.

The developments in the Turkish economy were evaluated in the previous chapters. The effects of the global crisis have started to be felt at the beginning of 2009 by Turkish economy. Although Turkey has influenced this crisis, like other countries all over the world, the economy has recovered rapidly by the help of previous reforms. On the basis of relevant figures and data,

it is likely to be said that Turkey has relatively well economic situation compared to many of both developed and developing countries. In addition, there are some important characteristics that play crucial role in order to minimise harmful effects of the global crisis. These characteristics can be summarised here as follows.

Firstly, there is no doubt that 'toxic assets' were one of the main reasons of the recent crisis. Therefore, many huge financial institutions including investment banks and commercial banks have failed during the crisis and some of them have been taken over by the Federal Deposit Insurance Corporation (FDIC) in the USA. However, thanks to previous reforms over the last decade, Turkish banking sector has stood strong and no Turkish banks has suffered from toxic assets. It is important note that the government did not support any banks and also there were no banks transferred to the state in Turkey.

Secondly, growth performance plays a crucial role in the days of crisis in terms of keeping the economy stronger and stabile. Although there has been a dramatic reduction on international trade and investments all over the world, Turkey was one of the rapid growing countries during the crisis. Investments from abroad and relatively good export performance were the main pillars of the economy and also contributed to economic integration to the rest of the world.

Thirdly, although the volume of export and capital inflow has increased in the crisis period, the current account deficit has still continued to a big problem. Due to the parliamentary

election, exchange parity has triggered the current account deficit and they have become a big problem especially in 2006 and 2007. However, after the election, financial markets have been recovered again and also budget deficit has started to decrease steadily after the 2009.

Lastly, after the 2001 crisis, the implementation of prudent fiscal and monetary policy has provided a huge advantage for Turkey before the recent global crisis. Although most of the countries have been caught unprepared against the crisis, Turkish financial system was more powerful than others. Price stability and budget balance was the main purpose of the tightening monetary and fiscal policy in order to prevent deep recession in Turkey, like previous ones. What is more, throughout the crisis, Turkey was stronger than other countries in terms of government debt stock, export performance and foreign capital.

To sum up, Turkey has showed relatively good economic and political performance among major economies during the crisis. Even if Turkey suffered from a slowdown in terms of economic activity, it did not cause a big recession in the markets. The main reason behind this powerful structure can be classified under 3 headings that are; having a powerful banking system, previous economic recovery programme and a political stability.

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