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Author: **Prof. Dr. Nihal YILDIRIM MIZRAK,**
Anadolu University, FEAS, Department of Economics
E-mail: **nmyildirim@anadolu.edu.tr**

The challenging path from the 2001-financial crisis to sustainable growth, and its labour market impact in Turkey

1. Introduction

We can argue that Turkey is familiar with financial crises and the recessions that follow. Lastly, Turkey was hit hardly by the global financial crisis of 2008-2009 which is the fifth in the last 30 years. After this crisis, unemployment reached historic heights, and the drops in GDP and industrial output were exceptionnaly severe.

The aim of my paper is to analyze the pattern of Turkish economic growth over the years and to investigate how the employment is influenced from. My work also suggests a comparative analysis which takes some other cases of different countries both developed and developing. Thereafter I'll conclude my work with a list of policy suggestions for the future. To do this, I'll also try to analyze what are the possibilities for the employment.

As far as to methodology, first of all, the pattern of economic growth in Turkey and in the some EU-countries by using available statistical data (especially Eurostat and Turkstat) will be carried out. This descriptive analysis will also serve to evaluate the business cycles effect on employment in general.

2. A brief historical look and the recent developments in the Turkish economy

From the Second World War until the 2001 economic crisis, Turkey's economic catching-up with the developed economies was weak and volatile. The low productivity growth and relative stagnation through the 1970s was primarily the result of policies of import substitution, subsidisation of agriculture and economic dirigisme which resulted in a suboptimal allocation of resources. And in spite of some steps towards reform and liberalisation in the 1980s, economic growth was plagued by recurrent crises, as a result of inadequate macro-economic policies and financial opening in a weak institutional and regulatory environment. The volatile growth pattern culminated in the 2000/2001 crisis which led to the breakdown of the currency peg to the US dollar, a sharp depreciation of the Turkish lira, and a contraction of GDP by 5.7% in real terms in 2001. But there was a silver lining: the strong incentive the crisis created for bold reforms led to five years of economic recovery during 2002-07.

Turkey was largely spared the horrors and economic destruction of the Second World War, mainly because it maintained armed neutrality. However, its economy stagnated during the 1940s, in large part because of the strongly curtailed foreign trade and increased military expenditure. After the war, it was nevertheless well positioned to engage in a robust process of economic convergence with the United States, like the Western European economies, but it failed to take advantage of the effervescent post-war economic reconstruction, as we can see in the Table 1.

Table 1: Changes in real GDP per capita, 1950-1998 (Average annual growth rates)

	1950-1960	1960-1973	1973-1990	1990-1998	1950-1998
France	3.6	4.4	1.9	1.1	2.8
Germany*	7.1	3.4	2.1	1.3	3.3
Italy	5.4	4.5	2.5	1.1	3.4
U. Kingdom	2.3	2.6	1.8	1.6	2.1
Greece	5.1	7.1	1.5	1.5	3.7
Ireland	2.2	3.7	3.3	6.6	3.7
Portugal	3.8	6.7	2.6	2.4	3.9
Spain	3.7	6.2	1.9	2.0	3.4
TURKEY	3.3	3.0	2.2	2.4	2.7
USA	1.6	3.1	1.7	1.7	2.1
EU**	4.1	4.0	2.0	1.1	2.8

* 1950-1990 and 1950-1998: West Germany, 1990-1998: Unified Germany.
** 1950-1998, 1950-1960 and 1950-1973: Luxembourg is excluded.

Source: United Nations Economic Commission for Europe, Economic Survey of Europe, 2000 No.1.

The period 1950-1973 is regarded as a Golden Age in modern European economic history as it combined very high rates of growth with relatively mild cyclical fluctuations and moderate inflation. According to the UN Economic Commission for Europe (Economic Survey of Europe, 2000 No. 1), real GDP per capita increased by almost 4% annually between 1950 and 1973, well above the 2.4% growth recorded in the United States. Real GDP per capita increased in Western Europe to 62% of the United States level in 1973, up from 45% in 1950. These were years of buoyant growth also for the "peripheral" economies – Greece, Portugal and Spain, except for Turkey and Ireland which made only limited progress in terms of real convergence with the

United States. As a matter of fact, Turkey remained stuck at a level of around 20% of the real GDP per capita of the United States throughout this period.

In the quarter century following 1973 there was a general slowdown in the rate of economic expansion in the industrialised countries, strongly influenced by the two oil shocks. The earlier dynamism at the periphery also waned, except in Ireland, which by the end of the period had achieved the highest per capita GDP growth in the EU. Although Turkey's growth rates of real GDP per capita outperformed those of Greece, Portugal and Spain, they slowed in tandem with the other economies, and its advancement in terms of catching-up with the United States' real GDP per capita level was rather modest (European Economy, Economic Papers 386, October 2009).

The main reason why Turkey failed to close the large economic gap with the developed countries appears to have been the strong state-interventionist and inwardoriented economic policies which it pursued from the early 1930s and which resulted in suboptimal allocation of resources and productivity growth.

Some economists consider Turkey "an interesting case study of relative stagnation" as it is the only founding member of the OECD that has not converged to the US in terms of per capita GDP since 1950. This is despite the fact that Turkey has been part of Western international organisations and has adopted Western institutions (Adamopoulos and Akyol, 2006). Their growth accounting exercise suggests that the relative stagnation of Turkey's living standards has not been due to capital deepening, which was reasonably strong until the 1980s, but rather to its decline in labour force participation and low growth of total factor productivity (TFP), which has not gained any ground relative to the US. They suggest that these are the result of economic policies such as heavy subsidisation of agricultural products, high effective tax rates on labour, and labour market rigidities which kept resources too long in agriculture and when the resources were eventually shifted from the agricultural sector, they left the formal sector altogether.

Altuğ, Filiztekin and Pamuk arrive at fairly similar conclusions in their investigation into the sources of economic growth in Turkey during 1880-2005, with the exception of the role of labour (Macovei, 2009). For the post-1950 era, the growth rate of output has been primarily due to capital accumulation and labour force growth, while TFP growth has been very low, as seen in the Table-2.

In particular in the non-agricultural sector, TFP growth was either very low or negative until 1980. Although output growth in Turkey derives primarily from capital growth, the rate of 3 capital accumulation has been relatively low compared with faster growing economies like South Korea or Portugal, which goes some way to explaining Turkey's inability to close the income gap with the developed economies.

Table 2: Contribution to Annual Growth Rates*, 1950-2005

	Capital	Labour	TotalFactorProductivity
1950-1980	2.13	2.26	0.58
1980-2005	1.52	1.39	1.14
1950-2005	1.88	1.92	0.83

(*) 2-sector model.
Source: Altuğ, Filiztekin and Pamuk (2007).

After a brief experiment with agriculture-led growth in the 1950s, Turkey settled for import substituting industrialisation, which was based on the protection of its nascent industrial sector from external competition mainly through high tariffs and other barriers to foreign trade, capital controls and subsidies. The policy prevented both a meaningful integration into the international division of labour and an optimal allocation of the factors of production. This is best reflected in the very low TFP growth rates recorded in this period and growth of the informal labour market (Macovei, 2009).

After 1980, Turkey embarked on a process of economic liberalisation. Although this proceeded in fits and starts it made good progress towards removing price controls, subsidies and interest ceilings, freeing foreign trade, relaxing capital controls, encouraging FDI and expanding the private sector. As a result, foreign trade and FDI increased significantly. TFP in industry (though not in agriculture) also picked up from this point and Turkey started displaying non-negligible TFP growth.

Indeed, the contribution from TFP to output growth more than doubled compared to the previous time, reflecting a better allocation of resources in the economy. However, growth performance was increasingly hampered by boom-and-bust cycles characterised by periods of industry-led rapid expansion, followed by balance of payments crises, devaluations of the Turkish lira and austerity programmes to dampen domestic demand for foreign goods, making possible the resumption of foreign indebtedness and yet another cycle. The growth of real GDP was extremely volatile and macroeconomic stability was plagued by high inflation and a weak currency.

As the liberalisation process of the 1980s was not sufficiently supported by sound macroeconomic policies and regulatory and institutional reforms, the economy suffered repeated crises in the 1990s. The four episodes, in 1991, 1994, 1998 and 1999 (the last-1999 resulting partially from a severe earthquake) reflected a number of major weaknesses in the Turkish economy. Lack of fiscal discipline, with sustained primary deficits since the 1970s and heavy reliance on monetary financing, had led to entrenched high inflation. In turn, the high inflation had boosted the risk premium and pushed up real interest rates, reinforcing the public debt burden and dampening Turkey's growth performance vis-à-vis other emerging economies.

Macroeconomic instability was intertwined with structural weaknesses, in particular an inadequate regulatory and supervisory framework for the banking system. After the widespread monetisation of budget deficits was interrupted in 1997, the banking sector became the main instrument of government financing, funnelling short-term borrowing from depositors and investors into government debt. Several insolvent private banks were allowed to operate under a blanket public guarantee, while public banks accumulated large losses from subsidised lending.

At the end of 2000, publicly-owned banks held almost 40% of total assets in the banking sector. State enterprises, generally operating at low levels of efficiency and representing a burden on the government budget, still dominated several economic sectors. Several attempts to stabilise the economy were undermined by political instability. Populist measures such as tax amnesties and repeated reductions in the retirement age further weakened the sustainability of public finances. The boom-bust cycle culminated in the 2000-2001 financial and economic crisis, which was the severest to date, so much so that it at last triggered a wave of reforms.

We can now resume the 2000-2001 crisis, which is a turning point in the recent history of Turkish economy.

2.a. The 2000-2001 financial and economic crisis

In an attempt to stabilise the economy, Turkey entered into an IMF stand-by arrangement (SBA) in December 1999. Its main pillars were an exchange rate anchor, i.e. a crawling peg with a preannounced exit strategy that would mitigate the typical risks of real appreciation for exchange-rate based stabilisations, "currency-board rules" which excluded the possibility of sterilised foreign exchange intervention, fiscal consolidation through a large upfront adjustment in the primary fiscal deficit and a comprehensive agenda of structural reforms.

Initially, the programme was successful. Inflation started to fall, though more slowly than anticipated. Interest rates meanwhile came down much further than projected. This, together with the steady real exchange rate appreciation, fuelled a boom in domestic demand and led to a widening of the current account deficit. Meanwhile, fiscal consolidation and structural reforms (the only policy levers available under the quasi-currency-board rules) lagged behind, fuelling market unease about the SBA programme.

In October 2000, one of the Turkish bank, Demirbank (a major primary dealer and investor in government securities heavily dependent on overnight funds) reached the point where it could no longer refinance itself on the market. Restrained by its ceilings on net domestic assets (part of the quasi currency-board rules), the Central Bank refused to lend to Demirbank, forcing it to sell part of its government securities portfolio and triggering a significant increase in secondary market interest rates and further sale waves on the secondary market.

Faced with a negative impact on other problematic banks and the Treasury's borrowing capacity, the Central Bank eventually injected liquidity in the system in November 2000. This helped prevent interest rates skyrocketing, but increased the drain on official reserves. The IMF pledged to support the programme and replenished the stock of official reserves, thus calming down the markets. Not for long though, because the lira continued to be overvalued as a result of the slow decline in inflation. In January and February 2001 the debt roll-over capacity of the Treasury was seriously tested by the very high interest rates on the market at around 60-70% compared with an annual ceiling of 12% for the depreciation of the lira. In this unsustainable situation, a public disagreement on the measures to be taken was followed by a massive attack on the Turkish lira on the 21st February 2001.

The authorities decided to let the lira float, which led to a depreciation of around 40% against the dollar immediately after the announcement. The financial turmoil and the breakdown of the peg had dire consequences for the real economy. In 2001, real GDP declined by 5.7% and investments collapsed in volume terms by 30%, while industrial output dropped by 8.7% annually. Activity in the manufacturing sector was hit harder and declined by 9.4%, the automotive sector recording a 26% decline. Exports of goods and services diminished by around 1% (compared to 2000), but imports slumped by almost 8% in volume terms, as a result of depressed domestic demand and sharp depreciation of the currency. In tandem with the shrinking economic activity, the unemployment rate surged to 8.4% in 2001 and 10.4% in 2002 from 6.5% in 2000. At the same time, wages in the manufacturing sector suffered a correction of about 15% in real terms.

The increase in public debt following the depreciation of the lira and the recapitalisation of banks was staggering. It almost doubled from 38.2% of GDP at the end of 2000 to 74.1% of GDP at the end of 2001. The banking crisis had affected about one quarter of Turkey's 81 banks, causing a loss to the budget of about 30% of GDP. The lira continued to decline during most of the year, depreciating by about 60% against the dollar of US from February to October 2001.

A detailed assessment of the factors that triggered the crisis by Özatay and Sak (2002) shows the main cause to have been the combination of a fragile banking sector together with a high public sector borrowing requirement. Public debt monetisation having been absent since 1997, was not the cause of the speculative attack on the currency. The public sector borrowing requirements, which included not only the general government budget, but also state-owned enterprises and other quasi-fiscal deficits, were quite large, hovering above 10% of GDP during 1999-2002.

Moreover, several banks were taken over by the authorities (six banks in November 1999 and an additional two banks in September 2000) and criminal investigations were initiated against owners and executives of five of these banks on suspicion of fraud and stashing away the financial resources of the banks through offshore operations. This strengthened the impression that the private banking industry had significant problems, and that large costs were imminent which would endanger the sustainability of public debt.

In addition, the financing of the budget deficits by the banking sector led to the accumulation of currency and maturity mismatches on the balance sheets of commercial banks, which could not borrow long-term in domestic currency. On the other hand, state-owned banks had accumulated significant "duty" losses and were also engaged in unsound lending practices.

Although both the private and the state banks had mismanaged risks before the crisis, the nature of the problem was different. The private banks were more exposed to the exchange rate risk due to a higher and decreasing ratio of foreign currency to lira liabilities, while state banks were more subject to the interest rate risk, due to their inability to extend financing beyond short-term domestic instruments. As a result, the prudential indicators of the banking system had deteriorated to the point where the sector could no longer ensure a smooth financing of the public debt and was actually undermining its sustainability.

2.b. The impacts of 2000-2001financial and economic crisis on the economy

The Turkish economy has come a long way since the difficult days of the 2001 financial crisis. However, it is not clear whether this was largely owing to the benign global environment or policy action. What is clear is that much more needs to be done. The Turkish economic history is full of balance of payments crises and experiments of different development models, having started with a state corporatist model with capital controls to a financial liberalisation of the 1980s.

Indeed, throughout this period up the 2001 financial crisis, we would characterize the Turkish economy as dominated by "insiders" going about their business as rent-seekers. The key to this process were various governments providing favours to their own supporters, especially using state banks as instruments in this regard. Successive governments resorted to more and more ingenuous ways to increase spending, especially by increasing the use of extra-budgetary funds away from parliamentary scrutiny, thus weakening fiscal discipline and accountability.

When deficits became too large to finance, the central bank was pushed to monetise, thus causing inflation to hover at high double digits for most of the 1990s. And perhaps most important of all, Turkey's growth was always dependent on the availability of foreign capital flows.

In that sense, Turkey's current account deficit was always a key constraint on Turkey's growth performance. Once foreign capital flows were insufficient to cover Turkey's current account deficit, the associated balance of payments crisis led to sharp falls in growth. But all in, Turkey lagged behind several other emerging market economies with higher inflation, lower growth and higher volatility of growth in the 1980s and the 1990s. And more to the point, averaging growth of around 4% was a disappointing performance for a country such as Turkey, and not enough to absorb the fast growing labour force.

Many attempts were made to break this stop-start cycle and various IMF programmes were attempted and ended with dismal failure, culminating in the February 2001 financial crisis, when the Turkish Lira's peg was abandoned and a banking sector crisis ensued.

By now, the causes of the 2001 financial crisis are reasonably well understood: lack of political will to implement fiscal austerity; poor design of the macroeconomic framework, leading to a widening of the current account deficit to unsustainable levels; a weak attempt at structural reforms, especially in the banking sector; and political instability.

Once the 2001 financial crisis ensued, a public sector debt default seemed inevitable. Some factors came together to rescue the Turkish economy from the abyss. The first was the unprecedented access to IMF funds and Turkey's emergence as a potentially. Indeed, the policies and the reforms put in place in the 2001-2002 programme and since then have transformed the Turkish economy (EC, 2008). The fact that Turkey has an independent central bank, reasonably rational management of state banks, independent regulation of the banking sector and has embraced privatization is very important side of the Turkish economy.

However, as we'll discuss in this paper, so much more needs to be done. For example, It's fact that the Turkish economy to have remained very vulnerable to external shocks and just as dependent on foreign savings to finance its growth as in the past. The current account deficit (see Table-3) and, the high unemployment rate would be in the next period the alarm bells to start ringing in the economy. To remember, the main drivers of growth have been fixed capital investment and private consumption and more recently exports which depend on intermediate goods imported.

Table 3: Exports and Imports of Turkey, 1999-2011

	Exports (000 dollars)	Change of Exports (%)	Imports (000 dollars)	Change of Imports (%)
1999	26 587 225	-1.4	40 671 272	-11.4
2000	27 774 906	4.5	54 502 821	34.0
2001	31 334 216	12.8	41 399 083	-24.0
2002	36 059 089	15.1	51 553 797	24.5
2003	47 252 836	31.0	69 339 692	35.5
2004	63 167 153	33.7	97 539 766	40.7
2005	73 476 408	16.3	116 774 151	19.7
2006	85 534 676	16.4	139 576 174	19.5
2007	107 271 750	25.4	170 062 715	21.8

2008	132 027 196	23.1	201 963 574	18.8
2009	102 142 613	*-22.6*	140 928 421	*-30.2*
2010	113 883 219	11.5	185 544 332	31.7
2011	134 971 545	18.5	240 834 392	29.8

Source: Turkstat, Foreign trade by years: www.turkstat.gov.tr

In addition, Turkey's real interest rates are still among the highest among emerging markets and so is the implied problem of investments which are vital for the creation of new jobs. Indeed, although Turkey has come a long way since 2001, significant vulnerabilities remain, in particular, through all these changes, one factor has remained constant: the economy is still reliant on foreign capital flows to finance its growth. In that sense, the Achilles heel of the economy has remained the same: there remains a chronic lack of domestic savings and the mechanism for channeling any available domestic savings pool to productive use is weak.

Indeed, monetary policy since 2001 has rested on interest rate changes as the only policy option in the impossible trilemma, while capital mouvements are left completely free and exchange rates are allowed to float. This system has created a serious dependence on capital inflows, namely on external savings (Uygur, 2010: 56-57). As we can see in the **Table-4**, over the period analyzed, the savings rate declined from 24.1% in 1998 to 16% in 2008; private savings also declined from 25.5 % to 14.9%.

Table 4: Savings rates (%), 1998-2008

	Private	Public	Total
1998	25.5	-1.4	24.1
1999	24.9	-4.9	20.0
2000	21.8	-3.4	18.3
2001	25.9	-7.2	18.6
2002	23.7	-4.9	18.8
2003	19.9	-4.2	15.7
2004	17.1	-1.0	16.2
2005	13.0	3.1	16.1
2006	12.3	4.4	16.7
2007	13.9	2.3	16.2

2008	14.9	1.1	16.0

Source: Uygur, 2010.

Because Turkey has a very weak private or contractual pension system and the mutual fund industry is also small, private savings are often channeled in three ways (Kannan, 2008):

(i) investment in real estate (partially reflecting a desire to hedge against inflation);

(ii) short-term deposits; and

(iii) individual purchases of government T-Bills usually of up to one year.

These preferences reflect the domestic lack of trust that inflation is well contained and a desire to stay in liquid assets in case dramatic portfolio choices have to be made. However, such a structure of using savings is unproductive for the economy: The lack of a strong contractual private sector pension fund industry means that there are no ready-made pools of saving locally to invest in longterm Turkish Lira assets (Verbeken, 2007).

This has two implications: first, Turkey's capital markets are not deep because of the lack of domestic demand for long-term Turkish Lira (TRL) assets; second, Turkey's private sector has to rely on foreign savings to finance its growth plans. Indeed, it is worth reiterating that aggregate investment remains low in Turkey, despite the support it receives from foreign investors. At its peak in 2006, gross capital formation amounted of 23% of GDP (Rodrik, 2012). The domestic savings rate fell during the 2000s and still remains quite depressed. The record figure of 23 % of GDP in 2006 was only achieved thanks to a substantial influx of funds from abroad, amounting to 6% of GDP.

The implication is that the Turkish economy will grow as long as foreign savers permit it to grow. As long as Turkish companies are able to tap foreign capital, they can invest to expand. And as long as Turkish banks are able to increase their forex borrowing and swap these dollar liabilities for long-term TRL funding in the cross-currency swap market, they can continue to lend.

In that sense, the size of Turkey's current account deficit and the ease of its financing is still the key constraint on whether the economy can continue to grow. That is why the exceptionally benign global environment of 2002-2009 was especially important for Turkey when it was easy for emerging market economies to tap foreign capital. In a sense, the Turkish became less "credit constrained". The result is that Turkey's current account deficit rose from -0.7% of GDP in 2002 to 6% of GDP in 2006 and to 8.8% in the early of 2012 and to 8.2 % in mid-2012 (See Table-5). It is clear that recent economic growth has come at the expense of widening current-account deficits and a pushing up the real Exchange rate.

Table 5: Current account balance, Budget balance, GDP growth rates and Interest rates, 2012

	CA balance* (% of GDP)	Budget balance* (% of GDP)	Interest rates (%), ten-year gov't bonds	GDP growth rates* (% change on year ago)
Turkey	-8.2	-2.0	8.16	3.2
Euro Area-17	+0.2	-3.4	1.38	-0.5
Belgium	+0.2	-3.1	2.59	0.1
Germany	+5.4	-1.0	1.38	0.8
France	-2.1	-4.4	2.10	0.2
U.Kingdom	-2.1	-8.3	1.64	-0.2
Greece	-6.9	-8.0	26.18	-7.1
Netherlands	+7.5	-5.0	1.66	-0.8
Spain	-2.8	-6.6	6.61	-1.6
Italy	-2.4	-2.7	5.93	-2.1
Poland	-3.8	-4.0	4.84	2.6
USA	-3.2	-7.6	1.54	2.1
Russia	+4.5	-0.8	8.18	3.8
Japan	+1.6	-9.3	0.78	2.3
China	+2.3	-2.3	2.82	8.1
India	-4.4	-5.5	8.14	8.4
South Korea	+1.8	+2.0	3.14	2.9

(*) The Economist poll forecast.

Source: The Economist (2012), "Economic and financial indicators", 4th-10th August.

So raising growth in the future will necessitate a dramatic expansion in domestic savings. It is worth arguing that Turkey needs to assess the implications of different saving governance models, including in terms of their impact on the capacity of her economy to benefit from adoption of new investment practices for resolving the problems of labour market.

Indeed, one of Turkey’s economy that fairly cries out for a rethink of economic strategy is its dismal record on employment creation and on unemployment.

3. The impacts of the crises on the growth and employment and recent developments

After the volatility of the 1990s and early 2000s, we can argue that the economy recorded relatively high and stable growth between 2002 and mid-2007 by analyzing the year on year growth rates of quarterly GDP and manufacturing output. But economic growth started to decrease in mid-2007; from an average of 7.2% at the period of 2002-2006, it was down to 3.7% between the second quarter of 2007 and the first quarter of 2008. The growth rate plunged to -6.5% at the end of 2008 and in the early 2009 (Uygur, 2010).

We can analyze some characteristics of the growth period of 2002-2007 and of the recession of 2008-2009 for understanding better the growth performance of Turkey. Turkey realized higher and more stable growth during the period of 2002-2007, as opposed to 1995-2001. To remember most of all developing countries were affected by the Asian crisis in the 1995-2001 period. Plus, the Russian crisis had a serious effect on Turkey in 1998-1999. This recession lasted for fifteen months from September 1998 to November 1999. The second feature of growth is related to relative variation in growth rates. After 1980, the growth model in Turkey rested so much on external capital flows, as explicitly prescribed in several IMF-supported programs (Uygur, 2010).

The third characteristic of recent growth Turkish growth is related to employment and to unemployment. As we can see in the Table-6, the rate of unemployment, after reaching 10.5% in 2003 declined very few to 9.8% in 2007. But it increased dramastically in the fourth quarter of 2008 (12.3%) and reached record rates of 16.1% and 15.8% in February and March 2009. We can summarize the policy measures adopted in the country for avoding further rise as follows: Firm-level deals as nominal pay cuts, shortening of working hours and sabbatical schemes, which reflect flexibility in the labour market (Uygur, 2010).

Table 6: Employment and unemployment rates in Turkey (%), 2000-2012

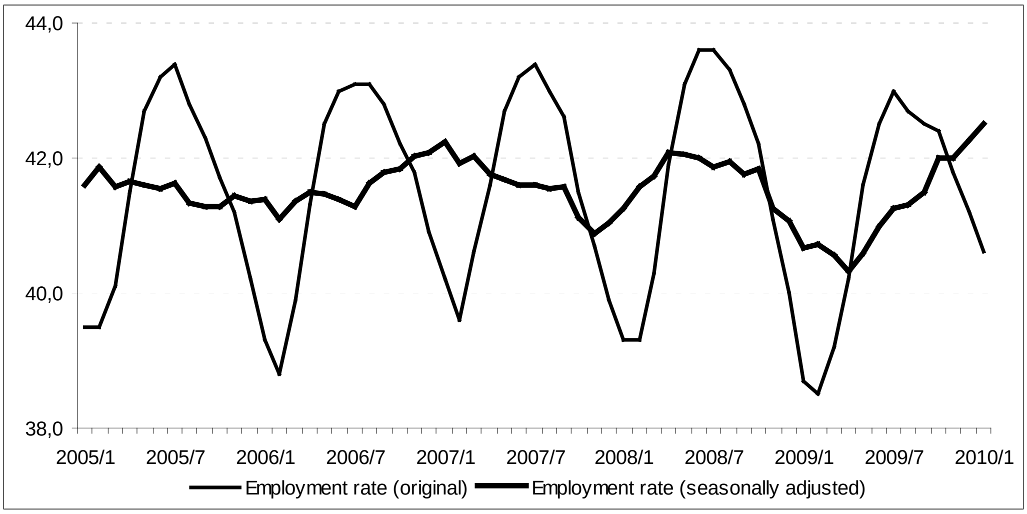
	Employment rate	unemployment rate	unemployment in non-agricultural sectors	Youth unemployment*
2000	46.6	6.5	..	..
2001	45.7	8.4	..	..
2002	44.7	10.4	..	..
2003	43.2	10.5	15.0	20.5
2004	43.7	10.3	14.7	19.7
2005	43.4	10.3	13.6	19.3
2006	43.2	9.9	12.6	18.7
2007	43.2	9.8	12.5	19.4
2008-Q1	40.9	11.2	13.8	20.6
2008-Q4	42.4	12.3	15.6	23.7
Jan.2009	38.7	15.5	19.0	27.9
Feb.2009	38.5	16.1	19.8	28.6
March2009	39.2	15.8	18.2	26.5
June2009	42.5	13.0	16.4	23.7
Dec.2009	41.2	13.5	..	..
Jan.2010	40.6	14.5	..	..
May 2011	45.7	9.4	12.0	17.5
May 2012	46.3	8.2	10.4	15.9

(*) % of unemployed in the age group between 15-24.

Source: For 2000-June2009: Uygur, 2010:11. For Dec.2009-2012: www.turkstat.gov.tr

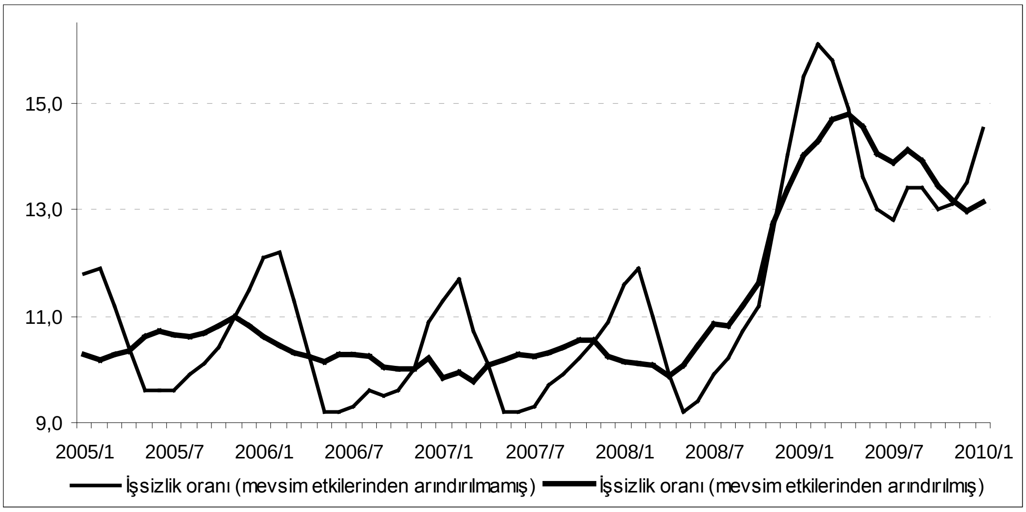
The trend of employment and unemployment rate (seasonnally adjusted) in Turkey in recent years, between January 2005 and January 2010, can be seen very clearly in the figures 1 and 2 prepared by Turkish statistical office.

Figure 1: Seasonally adjusted employment rate in Turkey (%), Jan.2005-Jan.2010



Source: Turkstat.

Figure 2: Unemployment rates in Turkey (%), January 2005- January 2010



Source: Turkstat, www.turkstat.gov.tr

As far as the rate of employment, it didn’t rise. It declined during the high-growth period of 2002-2007. But, as seen in the Table-6, due to crisis of 2008-2009, it decreased to as low as 38.5% in February 2009. We can say that it is the influence of a seasonal decline at the beginning of the year but the seasonality only cannot explain of course this dramatic decline. That’s why, several monetary and fiscal measures were introduced to lessen the impacts of the 2008-09 crisis which were contributed to some improvement in manufacturing production after March 2009 but, they already increased budget deficits (Uygur, 2010).

The unemployment was been higher and increased in the urban non-agricultural sectors and among mainly the educated youth. The mass migration from rural agricultural areas to urban non-agricultural areas. One of the important problems of Turkey stands here: Non-agricultural activities are most of all times unable to absorb the incoming additional workforce. As seen in the Table-7, the activity rate of Turkey is the lowest rate (51.9% in 2010 which also is below the average of EU-27: 71%) among the EU-members and candidates-countries.

Table 7: Total population, active population and activity rate, 2000 and 2010(1)

	Total population (1000)		Active population (1000)		Activity rate, %	
	2000	2010	2000	2010	2000	2010
EU-27	319 598	331 157	222 098	239 608	68.6	71.0
Austria	5 375	5 606	3 849	4 284	71.0	75.1
Belgium	6 719	7 177	4 395	4 895	65.1	67.7
Danemark	3 532	3 622	2 836	2 936	80.0	79.5
Germany	55 062	53 546	39 603	41 684	71.1	76.6
France	37 430	39 972	25 716	28 583	68.7	70.6
U.Kingdom	37 793	40 441	28 919	31 382	75.5	75.5
Italy	38 642	39 546	23 468	24 975	60.1	62.2
Netherlands	10 722	11 017 b	8 116	8 760 b	75.2	78.2 b
Spain	27 373	31 261	17 486	23 089	65.4	73.4
Poland	25 739	26 527	17 319	17 660	65.8	65.6
Ch.Rep.	7 116	7 400	5 126	5 269	71.3	70.2
Hungary	6 764	6 769	4 090	4 256	60.1	62.4
Romania	15 231	14 999	11 474	9 965	68.4	63.6
Bulgaria	5 491	5 046	3 355	3 401	60.7	66.5
Sweden	5 708	6 101	4 494	4 962	77.3	79.5
Finland	3 452	3 537	2 590	2 672	74.5	74.5
Greece	7 078	7 231	4 606	5 017	63.8	68.2
TURKEY	..	47 533	..	25 290	..	51.9

(1) Data refer to resident persons living in private households and aged 15-64. (b) break in series.
Source: Eurostat Labour market statistics, 2011 edition (online data code: lfsi_act_a)

In addition, it is important to indicate that we can not to be optimistic any sensible growth strategy will have to make employment creation in the future. The fact remains that joblessness was already persisting at high levels despite relatively high growth rate (See the Table-8), and this is one of the blemishes on Turkey’s recent performance.

Table 8: Growth rates of GDP in constant prices in Turkey, 2011-2012

Year	Quarter	GDP Current prices (million $)	Growth rate (%)	GDP Constant prices (million TRY)	Growth rate (%)
2011	**QI**	**182 588**	**14.3**	**26 251**	**11.9**
2011	Q2	201 763	16.6	28 021	9.1
2011	Q3	203 375	3.9	31 087	8.4
2011	Q4	184 572	-9.1	29 515	5.2
2011	**Annual**	**772 298**	**5.6**	**114 874**	**8.5**
2012	**QI**	182 743	**0.1**	27 089	**3.2**

Source: Turkstat, 10.09.2012.

As seen in the Table-9 in which we compared Turkey with the EU-members which also have recorded high level of unemployment, Turkey recorded in 2010 a high level of unemployment rate (10.7%) but, it was not so high in regard with Greece (12.6%) and Spain (20.1%). Indeed, these two countries pass at present from a very drastic crisis.

Table 9: Unemployed persons, unemployment rates and long-term unemployment rates, 2007 and 2010 (1)

	Unemployed persons (1000)		Unemployment rates (%)		Long-term unemployment rates (%)	
	2007	**2010**	**2007**	**2010**	**2007**	**2010**
EU-27	17 027	23 158	7.2	9.7	3.1	3.8
TURKEY	2 013 b	2 697	8.8	10.7	2.3	2.8
Germany	3 601	2 946	8.7	7.1	4.7	3.2
France	2 384	2 847	8.4	9.8	3.4	3.9
U.Kingdom	1 623	2 440	5.3	7.8	1.3	2.5
Belgium	353	406	7.5	8.3	3.8	4.1
Spain	1 834	4 632	8.3	20.1	1.7	7.3
Italy	1 506	2 102	6.1	8.4	2.9	4.1
Greece	407	629	8.3	12.6	4.1	5.7
Hungary	312	475	7.4	11.2	3.4	5.5
Romania	641	725	6.4	7.3	3.2	2.5
Poland	1 619	1 699	9.6	9.6	4.9	3.0

(1) Data refer to persons aged 15-74.

Source: Eurostat Labour market statistics, 2011 Edition.

But, when we are analyzing the unemployment rates by level of educational attainment, we can see that in Turkey the rate of unemployed persons in the group of tertiary education is higher than the average of EU-27. Indeed, as we can see in the Table 10, this rate was 9.8% in Turkey while the average of EU-27 has been recorded as 5.4% in 2010.

Table 10: Unemployment rates by level of educational attainment (%), 2010(1)

	Pre-primary, primary and lower secondary education	Upper secondary and post-secondary non-tertiary education	Tertiary education
EU-27	15.7	9.0	5.4
Belgium	15.3	8.1	4.5
Germany	14.9	6.9	3.1
France	15.4	8.7	5.5
U.Kingdom	13.7	8.2	4.1
Italy	10.3	7.9	5.7
Sweden	17.6	7.6	4.5
Greece	12.5	14.4	9.8
Poland	17.6	10.5	5.0
Hungary	24.9	10.5	4.7
Romania	6.1	8.3	5.4
Spain	27.3	19.2	11.3
TURKEY	10.2	13.1	9.8

(1) Data refer to persons aged 15-74. Level of educational attainment according to ISCED 1997.
Source: : Eurostat Labour market statistics, 2011 Edition (online data code: lfsa_urgaed)

4. Conclusions and policy suggestions

We can summarize the aspects that we explained in this paper as follows. Turkey needs to grow more rapidly and, it has a growth potential that its recent performance, relatively successful (as not the case for EU-members), has not completely exploited. It is important to mention once again that the domestic savings are insufficient; consequently capital inflows are very important determinants of growth in the country. In other words, given the present structure of the economy, Turkey depends heavily on capital flows to drive growth. To remember, external savings could clearly complement domestic savings, but they should be considered as a source of temporary financing. Heavy dependence on capital flows creates uncertainties which in turn affect private investments.

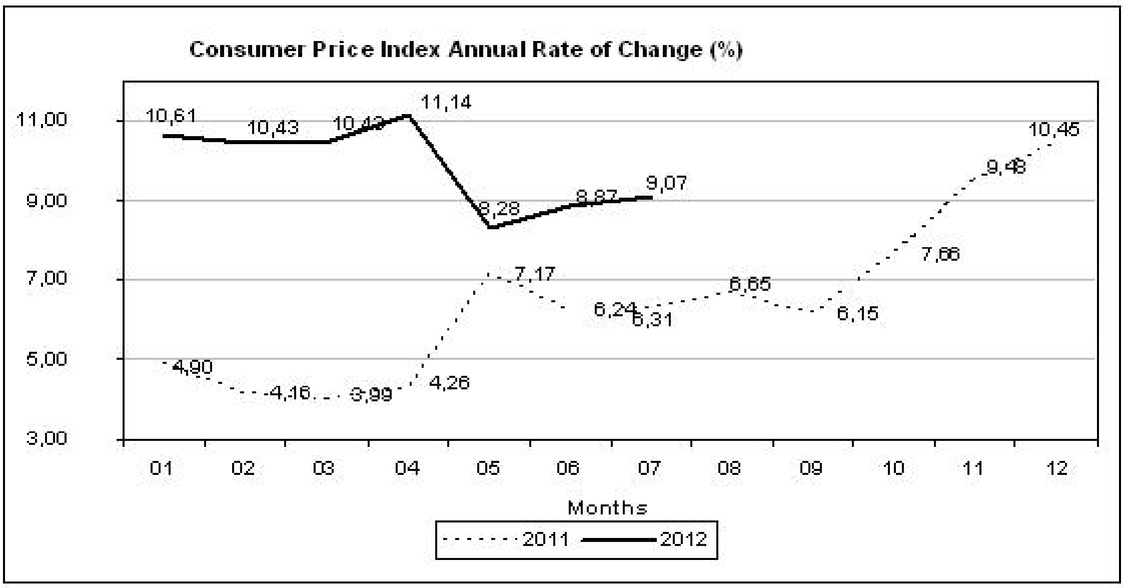
An economic-development model that relies on foreign savings and large current account deficits can generate respectable growth (as we have seen during the 2002-2007 period, the average growth was close to the average growth of the developing countries and considerabl period, the average growth was close to the average growth of the developing countries and considerable higher than that of the world economy), but the future looks uncertain. Indeed, as seen in the Table-8, the growth rate of GDP declined from 11.9% in the first quarter of 2011 to 3.2% in the first quarter of 2012.

Year-on-year growth industrial production also declined from 14.9% in the IQ2011 to 2.7% in the IQ2012. Yet, this is a reminder that Turkey cannot achieve stable and sustainable growth by relying so much on capital inflows.

Another problem to mention is Turkish exports are mostly dependent on EU demand. The essential factor behind the fall in exports when the crisis started was the sharp decline in exports to the EU. So, strong integration with world markets of Turkish economy makes also it vulnerable.

By the way, the monetary policy adopted since 2001 (implying completely free capital flows and floating exchange rates), tried to discipline fiscal policy by way of high interest rates, leading to an overvalued the Turkish currency, which encouraged lower savings (Yıldırım-Mızrak, 2008). This monetary policy succeeded in reducing inflation (it dropped significantly from over 60% in 1999 and 2000 to single-digit levels by 2004), but it has been detrimental to long-term competitiveness and employment generation. According to data given by the Economist (4th-10th August 2012), the forecast of the latest inflation rate is 8.9% in June 2012. We can also see the inflation rates in 2011 and 2012 in the Figure-3, prepared by Turkish statistical Office.

Figure 3: CPI Annual Rate of Change, 2011-2012



Source: Turkstat, 2012.

As a result, Turkey will need a permanently higher savings rate if it want to finanace the growth financed domestically. For moving Turkey onto a new growth path, the government fiscal policy has a critical role here. The most directly way to lift domestic savings is to increase the structural surplus of the public sector. The medium-term programs of the government must target a large enough fiscal surplus to leave room for the Central Bank to move to a permanently lower plateau (Rodrik, 2012). The resulting rise in public saving will reduce of course capital inflows, prevent the CA deficit from worsening, and help sustain a more competitive currency.

In this alternative growth model, some factors can help Turkey to quantify the variables of the model. A CA-deficit should not exceed 3% of GDP; a desirable target for the domestic investment effort would be around 28%, to ensure that high enough growth keeps unemployment in check. This also implies a domestic savings rate of at least 25%. Finally, is this target at all realistic? According Dani Rodrik (Rodrik, 2000), the record of fast-growing countries suggests an answer as “Yes”. Not just Asian economies but also Chili experienced significant savings transitions at the start of their growth accelerations. A positive growth dynamic is a pivotal factor in sustaining a rapid expansion in private savings, especially corporate savings. In fact, when economic growth rises in a sustained manner, it also induces higher savings. For companies, the prospect of strong earnings growth leads them to retain a greater share of their earnings, which in turn feeds into higher investment and growth. A determined fiscal effort, along with a competitive currency, then, has the potential to foster the private savings required to close the gap.

The shift in fiscal policy is the first mean of the new growth strategy; we can suggest as a second plank a new policy attitude towards the exchange rate. For this purpose, the CB of Turkey should replace its actual policy with a clear statement of preference for avoiding overvaluation. And finally, the CB, the Treasury and the Finance Ministry would need to cooperate and coordinate when capital inflows threatened to push the value of the currency up.

Of course, policy makers have many instruments to resort in ordre to stem upward movement of the currency. For example, a combination of sterilized intervention, prudential restrictions on inflows, liquidity requirements aimed at limiting foreign borrowing, and other fiscal measures are effective if deployed with sufficient determination (Rodrik, 2010).

It is important to mention that none this needs to be inconsistent with inflation targeting as long as the performance of tradables features prominently in the CB's evaluation of potential growth of the real economy, and fiscal policy allows enough room for monetary policy to be counter-cyclical with respect to capital flows.

The key point is as follows: The private-sector saving and investment behavior is probably to be transformed unless there is a credible change in the policy concerning the fiscal stance and the exchange rate.

We can point out that some measures to promote employment. It is true actually that government is trying to formulate some measures. For example, in May 2008, social security contributions for youth and female workers were reduced, and these were extended for a second year in May 2009. This is in fact very valuable measure in Turkey, because the youth unemployment is permanently increasing (See Table-6). It is also worth to mention that female employment is low with respect to EU countries (see Table-11 and Table-12 in Appendix). The government prepared in June 2009 an employment package to deal particularly with the youth unemployment problem, as part of a wider package that covers a credit guarantee scheme and measures to promote investment.

In addition, a program of short-time working started in january 2009. In March 2009, this short-time working was extended for another three months and the allowances were increased by 50% (Uygur, 2010).

The result of all these measures looks successful; the unemployment decreased from 16.1% in February 2009 to 8.2% in May 2012 (Turkstat, 2012).

We conclude that if government continues to take similar measures to stimulate the job creation in the medium term, with a GDP growth rate which is still favorable (3.2% in the first quarter of 2012, more than USA and the most of EU countries, as seen in Table-5), it is not wrong to argue that Turkey could has the possibility to reduce more and more the number of unemployed persons.

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Appendix: Some other data about the employment in the countries compared in my paper.

Table 11: Employment and employment growth rates by sex, 2010 (1)

	Employment (1000)			Employment growth rates (% change compared to previous year)		
	Total	Men	Women	Total	Men	Women
EU-27	221 373	120 946	100 427	-0.5	-0.6	-0.3
TURKEY	25 063 f	17 937	7 127	6.2 f	5.0	9.5
Austria	4 120	2 210	1 910	1.0	1.1	0.9
Belgium	4 466	2 445	2 021	0.6	0.3	1.1
Danemark	2 806	1 471	1 335	-2.1	-2.3	-1.8
Germany	40 483	21 833	18 650	0.5	0.8	0.2
France	25 610 f	13 449	12 161	0.1 f	0.2	0.1
U.Kingdom	31 224	16 712	14 511	-0.7	-0.5	-0.9
Italy	24 658	14 698	9 959	-0.7	-1.2	0.0
Netherlands	8 590 b	4 644 b	3 945 b	-0.5 b	-0.5 b	-0.5 b
Spain	18 744	10 451	8 294	-2.3	-3.3	-0.9
Portugal	4 937 p	2 623 p	2 314 p	-1.5 p	-1.6 p	-1.4 p
Poland	15 861	8 692	7 169	0.4	0.1	0.8
Cz.Rep.	5 185 f	2 970	2 215	-0.8 f	-0.7	-0.9
Hungary	4 007	2 143	1 863	0.2	-0.9	1.5
Romania	9 035	4 998	4 037	-1.8	-1.5	-2.1
Bulgaria	3 506	1 847	1 659	-5.9	-6.9	-4.8
Sweden	4 523	2 389	2 134	1.1	1.9	0.3
Finland	2 448	1 259	1 189	-0.4	0.4	-1.1
Greece	4 658 p	2 788 p	1 870 p	-2.1 p	-2.8 p	-1.1 p
Crotia	1 536 f	827	709	-4.3 f	-4.8	-3.7

(1) Data refer to persons of all ages. (b) break in series. (f) forecast. (p) provisional value.

Source: Eurostat Labour market statistics, 2011 Edition.

Table 12: Employment rates by age group and sex (%), 2010 (1)

	15-24			25-54			55-64		
	Total	Men	Women	Total	Men	Women	Total	Men	Women
EU-27	34.1	36.2	31.8	77.6	83.9	71.3	46.3	54.6	38.6
TURKEY	30.0	40.2	20.2	55.4	80.5	30.1	29.6	42.7	17.1
Greece	20.4	24.5	16.2	73.3	85.3	61.1	42.3	56.5	28.9
Germany	46.2	47.9	44.6	81.5	86.5	76.3	57.7	65.0	50.5
France	30.8	33.9	27.7	81.8	87.1	76.7	39.7	42.1	37.5
Italy	20.5	24.3	16.5	71.1	83.5	58.7	36.6	47.6	26.2
Belgium	25.2	27.3	23.1	80.0	85.5	74.4	37.3	45.6	29.2
Danemark	58.1	56.9	59.4	83.2	85.9	80.6	57.6	62.7	52.5
Spain	24.9	25.6	24.2	69.6	75.7	63.2	43.6	54.7	33.2
Portugal	28.5	30.4	26.5	79.2	83.9	74.6	49.2	55.7	43.5
Poland	26.3	30.3	22.1	77.1	82.6	71.7	34.0	45.3	24.2
Romania	24.3	28.1	20.4	74.4	81.5	67.2	41.1	50.3	33.0
Bulgaria	22.2	25.4	18.9	75.7	77.9	73.6	43.5	50.3	37.7

(1) Data refer to persons aged 15-64.

Source: Eurostat Labour market statistics, 2011 Edition.