Going through the Crisis:
Did Turkey Not Learn Its Lesson From the 2000-2001 Crisis?

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Abstract

When the first signs of the current global crisis occurred in 2007, and then spread throughout 2008, by many academic and political circles Turkey was seen as far from the peril of the expanding crisis. It was, and by some still is, argued that after Turkey had experienced one of the most serious crises in its history in 2000-2001, significant measures were taken and as a result of these reforms Turkish financial and economic system was strengthened. Therefore, due to the sound financial structure, the current crisis would not be expected to have severe impacts on the Turkish economy as on many others.
Despite the thoughts downgrading the seriousness of the implications of the crisis, the reality tells a different story. This paper is developed around two main issues. The first one is to consider the character of the 2001 crisis and measures taken afterwards in order to compare with the current case, whereas the second one focuses on the question whether Turkey is exempt from the current global crisis. While doing that it is inevitable to debate on the nature of the current crisis and the mechanisms through which the crisis can have impacts on the Turkish economy. The paper asks if Turkey learned its lessons from the 2001 crisis, and even so, whether that would be of any help in the current circumstances.

1. Introduction

After the global crisis broke out in the US financial markets in the late 2007, it took some time for some academic and policy circles to recognise that the crash in the USA was more than a temporary and local turmoil. When the crisis became obvious and started to spread globally in 2008, the first reaction of the Turkish government was to claim that the Turkish economy was immune to the crisis since serious lessons were taken and the financial system was strengthened after having experienced the 2000-2001 crisis, which was one of the most severe crises in its economic history. While the current crisis was spreading across the world, obviously, Turkey could not make an exemption, and it did not take long to feel the signs of the crisis.

This paper aims to make a general comparison of the 2000-20001 and 2008 crises. It is developed around two main issues. The first one is to consider the character of the 2001 crisis and measures taken afterwards in order to compare with the current case, whereas the second one focuses on the question whether Turkey is exempt from the current global crisis. While doing that it is inevitable to debate on the nature of the current crisis and the mechanisms through which the crisis can have impacts on the Turkish economy. The paper asks if Turkey learned its lessons from the 2001 crisis, and even so, whether that would be of any help in the current circumstances.

The paper is organised as follows. The next section summarises the transformation in the global economy which started in the 1970s. This brief account is somehow essential to identify the transformation of the Turkish economy from the 1980s to the date as a part of this global process. Section 3, more specifically, focuses on the liberalisation of the Turkish economy which led to the 2000-2001 crisis. In Section 4, the post-crisis growth model is presented whereas the subsequent section provides an overview of the 2008 crisis to date. Finally, Section 6 draws some conclusions.

2. Financialisation of the Global Economy

It has been argued that the global financial liberalisation process, which started in the late 1970s and accelerated in the 1980s, has had a central role for the outbreak of the various crises around the world as well as facilitating their contagion and intensity.

After living the golden age in the post-Second World War, the world capitalist started to have difficulties as a result of declining rate of profits towards the 1970s. On the other hand, financial markets at that time were not able to absorb the financial expansion mainly stemming from rising petrol prices. Volume and variability of financial instruments were limited, local and global markets were restricted by various regulations. External borrowing of some developing countries in the 1970s was a partial solution for that financial expansion. Under these circumstances, in order to liberate financial capital and compensate the decline in rate of profits deregulation of financial markets globally was inevitable.

Financial liberalisation process comprising also developing countries became a global phenomenon with an ambition to remove all obstacles in front of the financial capital. Communication technologies accelerated the process globally. New financial instruments were invented, the volume of financial transactions expanded extremely. In order to balance the decline in the rate of profit from production industrial corporations started to move towards financial areas. Financial markets expanded a few times more than the real sectors. Banking also witnessed significant changes; moved from traditional operations, i.e. taking deposits and/or borrowing and lending, towards more complicated and risky financial transactions.

Economic and financial transformation went along with changes in economic policies. In academic and policy circles, fiscal policy was announced to be ineffective and monetary policy was accepted to be more critical with the 'independence of central banks' argument. The key objective for the monetary policy was the price stabilisation.

On the other hand, this global financial transformation process has brought some serious weaknesses along with in the last few decades. By financialisation, capitalist system maybe postponed the collapse, but on the other hand generated a much more complicated, fragile and unstable system, which is also very obstinate to manage in any case of a turmoil.

Throughout the 1980s and 1990s many countries experienced economic/financial crises, such as the 1994 Mexican, 1997 Asian, 1998 Russian, 1999 Brazilian, and 2000-2001 Argentine and Turkish crises. Although developed countries have also had some difficulties, mostly developing countries have gone through hard times.

The last case appears to be different. However, the story behind it is the simple one. Basically, the current crisis, which erupted in one of the most 'developed' countries and spread globally, is still an outcome of this global transformation.

3. Structural Change in the Turkish Economy: From Financial Liberalisation to the 2000-2001 Crisis

As discussed previously, transformation in the global economy started in the late 1970s with a need for opening up the individual countries to the movements of the global financial capital. Turkey was also a part of this process.

Prior to the 1980s, the Turkish economy had followed an import-substitution industrialisation model for about twenty years. This inward-oriented growth strategy was accompanied by a "repressed" financial regime. Despite unfavourable external circumstances of the 1970s, successive coalition governments attempted to maintain economic growth. However, economic performance rapidly worsened in the second half of the decade and this process culminated in a foreign debt crisis in 1977. Although some *ad hoc* adjustments were attempted in 1978-1979, these efforts failed to improve the macroeconomic situation. Turkey entered the 1980s facing severe economic conditions along with serious political and social instability.

When the Turkish economy was going through hard times as many others, the remedy arrived soon. A stabilisation programme, formed by the conditions of the IMF stand-by agreement and the World Bank loans, was launched on 24 January 1980. The programme was primarily a response to the external crisis of the 1970s. However, its content was more comprehensive and made it more of a structural adjustment programme aiming at major structural changes in parallel with the general tendency towards economic and financial liberalisation in the world.

The implementation of the 1980 Programme was expected to reduce inflation, improve balance of payments through rapid exports growth, and thereby, reestablish Turkey's international creditworthiness in the short run. With the emphasis on the 'market-oriented' and 'export-led' growth strategy, the programme also aimed to develop and liberalise domestic financial system through institutional changes and introduction of new financial assets as a part of the process.[1]

The first few years of the stabilisation programme showed some success in terms of economic growth. This mainly exports-based economic performance made Turkey an exemplar of the structural adjustment process through economic liberalisation in the international economic circles.

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[1] For the features of the Turkish financial liberalisation experience in greater detail see e.g. Akyuz (1989), Akyuz and Kotte (1991), Uygur (1993), Yeldan (1997), Onder (1998), Yulek (1998).

Liberalisation of the capital account in1989 opened domestic markets to the speculative international financial capital, while also transforming the method of public sector borrowing. Moreover, the capital account liberalisation represented the beginning of a new stage of financial sector openness accompanied by macroeconomic instabilities.

Despite the significant transformation and prolonged period of high growth, the economy slowed down for the first time in 1988. Over the ensuing two decades the economy has portrayed an unstable picture with volatile economic growth rates and macroeconomic imbalances, inflationary processes and worsening fiscal balances being some of the main features. Instability in the economy has been confirmed with a number of crises throughout the period, and typically, a number of IMF- supported stabilisation programmes were put into action following each case.

High interest rates on the government borrowing instruments were stemmed from high public sector deficits and the level of accumulated debt stock. These rates, on the other hand, were very attractive for foreign capital inflows under the appreciation of the TL. After the capital account liberalisation the banking sector quickly took the role of intermediary between foreign investors and the public sector. During the 1990s the primary function of the banking sector became to lend the public sector funds borrowed from the foreign markets. This strategy led the banks to hold short-positions in foreign exchange, and as a result, take high risks which would play a significant role in the future turmoil and crises.

Towards the end of 1993 the government's intention to reverse the 'high interest rate - appreciation (or low depreciation) of the TL' policy to the 'lower interest rate - higher depreciation' fashion, and cancellation of the treasury actions forced the banking system to an urgent rearrangement of foreign currency denominated assets and liabilities (Ozatay, 1997). This very hasty adjustment provoked the demand for foreign currency and triggered a series of events that eventually dragged the economy into a crisis in 1994. The government announced a new stabilisation programme on 5 April 1994, and devalued the TL by another 65 per cent. A stand-by agreement was approved by the IMF two months after the programme started.

The 1994 crisis was very destructive. The GDP repressed by 5.5 per cent. The annual CPI inflation rate of 106.3 per cent was the record level of the whole post-liberalisation period. Fiscal balances worsened with more dependency on short-term borrowing and higher interest rates.

Following the 1994 crisis the government and commercial banks returned to the hot money policy. Mainly as a result of the exchange rate policy maintaining a lower rate of devaluation, inflation followed a decreasing trend. Large profit margins induced the banking sector to involve heavily in deficit financing again, neglecting the market risk, exchange rate risk, and appropriate management of assets and liabilities. The extensive risk taking behaviour of privately owned banks once more intensified the vulnerability of the system against even small shocks (Ertugrul and Selcuk, 2002).

In July 1998, the Turkish government launched a disinflation programme under the guidance of an IMF Staff Monitored Programme aiming at improving fiscal balances and reducing the long-lasting inflation. The Russian crisis in August 1998, general elections in April 1999, and two devastating earthquakes in August and October 1999 again deteriorated the fiscal balance of the public sector (Ertugrul and Selcuk, 2002). Deficit financing requirements exerted heavy pressures on the domestic financial markets giving rise to significantly high interest rates. The economic turbulence in 1998-99 did not result in an economic crisis, but the banking sector had serious difficulties. Eight insolvent banks were taken over by the state, an operation which led to further deterioration of the fiscal stance.

In December 1999 the government made another stand-by agreement with the IMF, followed by a disinflation programme (the 2000 Programme). The 2000 Programme relied on the exchange rate-based disinflation strategy and monetary control by setting upper limits to the net domestic asset position of the central bank. To maintain this strategy, central bank's monetary expansion operations were limited only to changes in the net foreign asset position in its balance sheet (Alper, 2001; Yeldan, 2002a,b).

In this kind of disinflation programmes, the exchange rate is used as an anchor to hold down inflationary expectations accompanied by currency appreciation which is also expected to attract capital inflows to benefit arbitrage opportunities. While these capital inflows finance external deficits, the consequent build-up of external financial vulnerability eventually gives rise to self-fulfilling expectations of sharp currency depreciations and a rapid capital outflow, leading to overshooting of the exchange rate in the opposite direction and hikes interest rates (Akyuz and Boratav, 2003).

Only ten months after its implementation it became clear that the programme was not viable, and under the massive attacks on the currency and rapid capital outflows, the currency peg had to be abandoned in February 2001 and replaced by a regime of free floating, as suggested by the IMF.

Table 1 . Main Economic Indicators

Key Economic Indicators	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
CPI Inflation, monthly (%)	68.5	29.7	18.4	9.35	7.72	9.65	8.39	10.06
CPI Inflation, year/year (%)	68.5	29.7	18.4	9.35	7.72	9.65	8.39	10.06
GDP Growth (%) T	-5.7	6.2	5.3	9.4	8.4	6.9	4.6	0.9
Capacity Utilization Rate (%)	71.7	76.2	78.5	81.5	80.3	81.0	81.8	78.1
Industrial Production, p/p (%)	-8.7	9.4	8.8	9.8	5.5	7.9	7.2	-0.6
Nominal XR (average YTL/$)	1.2254	1.5058	1.4931	1.4223	1.3408	1.4311	1.3015	1.2929
Real XR (1995=100)	112.5	125.3	136.5	143.5	160.0	160.6	175.9	180.2
T-Bill rate (%)	99.6	62.7	46.0	24.7	16.3	18.0	18.3	19.1
Public Sector (% of GDP)								
Primary Balance	3.8	3.3	4.8	5.5	5.0	4.6	3.1	1.7
PSBR	12.1	10.0	7.3	3.6	-0.3	-2.0	0.1	0.8
Total net debt Treasury	66.4	61.4	55.1	49.0	41.6	34.0	29.5	28.2
External Debt	27.6	25.2	17.2	13.4	6.5	4.0	1.3	2.1
Domestic Debt	38.9	36.2	37.9	35.7	35.2	30.0	28.1	26.1
External Indicators (million $)								
Current Account Balance	3,760	-626	-7,515	-14,431	-22,088	-32,219	-38,219	-41,289
Current Account Balance/GDP (%)	1.9	-0.3	-2.5	-3.7	-4.6	-6.1	-5.9	-5.6
Trade Balance	-3,363	-6,390	-13,489	-22,736	-33,001	-40,962	-46,677	-52,844
Export, fob	34,703	40,666	52,318	68,444	78,174	92,915	114,332	137,311
Imports, fob	37,103	45,701	63,285	87,773	107,053	130,086	156,142	35,086
FDI	2,855	939	1,253	2,024	8,726	19,261	19,940	15,414
CB Reserves	19,943	28,300	35,294	37,642	50,236	60,707	74,692	72,946
External Debt	113,592	129,527	144,095	160,918	169,503	207,325	248,958	278,302
Banking Sector(%)								
Total assets/GDP	67.5	58.5	52.7	52.3	57.4	61.3	64.4	71.5
Claims on public sector/Assets	39.8	40.7	43.4	40.6	37.0	31.5	29.0	27.3
Claims on private sector/Assets	23.0	20.2	24.6	30.3	34.3	39.4	42.9	41.9
Securities/Assets	36.4	41.1	42.5	39.7	35.6	30.8	27.7	25.8
Credits/Assets	24.5	19.9	24.8	30.2	35.0	41.1	44.9	44.4
FX deposits/Total deposits	56.6	56.9	48.4	43.2	35.3	37.3	33.9	33.7
FX loans/Total loans	47.2	48.4	38.1	25.7	17.5	14.9	11.5	13.2
TRLIBOR (%) (O/N)	44.1	45.1	27.6	20.2	15.1	18.0	15.8	15.0
Capital Markets								
ISE market capitalization/GDP (%)	28.3	15.8	21.0	23.5	33.4	30.1	39.6	19.1
ISE National-100,EOP, (January 1986=1)	13,783	10,370	18,625	24,972	39,778	39,117	55,538	26,864
Employment Indicators (%)								
Labor market participation rate	49.8	49.6	48.3	48.7	48.3	48.0	46.2	46.9
Unemployment rate	8.4	10.3	10.5	10.3	10.3	9.9	10.3	11.00

Source: Central Bank of Turkey, TurkStat, SPO, WB

Macroeconomic balances deteriorated, GDP shrank by 7.3 per cent in real terms in 2001, inflation reached to 61.6 per cent, and the domestic debt stock-GNP ratio went from 29.0 per cent in 2000 up to 69.2 per cent in 2001.

As Yeldan (2002b) argues, the 2000 disinflation programme maintained the stance of the 1990s in promoting growth through inflows of hot money and speculative financial capital – a process distinguished as 'speculation-led development' in Grabel (1995).[2] Under the programme, foreign capital inflows were not only primarily responsible for financing the investment and growth patterns, but also for maintaining the liquidity needs of the financial markets. Domestic interest rates became totally dependent on the availability of foreign capital. The programme has left the economy defenceless without any policy option against speculative runs and 'sudden stops' (Yeldan, 2002a; ISSA, 2005).

Following the crisis, one of the crucial steps was to bring serious regulations to the banking sector. Banking system was taken under close monitoring whereas some banks were transferred to the management of Savings Deposits Insurance Fund.

Yeldan (2002b) suggests that many researchers confuse the causes and the triggering mechanisms of the crisis. As opposed to the claims by the local and international bodies such as the IMF and OECD regarding the diagnostics of the crisis, he argues that the underlying cause of the Turkish crisis was not the failure of the fiscal and/or monetary authorities to follow the main targets of the programme as put forward. On the contrary, the authorities were successful in maintaining the programme targets both in exchange rate administration and monetary control, as well as attaining fiscal targets.[3]

Its exclusive reliance on speculative short-term capital inflows was the main weakness of the 2000 Programme. The crisis emerged as a result of a series of pressures originating from the process of integration with the global capital markets and increased external fragility in the financial system, which, in turn, was generated by the uncontrolled and excessively volatile

[2] Grabel (1995) presents a post-Keynesian view on the consequences of financial liberalisation programmes in less developed countries. She argues that financial liberalisation can lead to a particular kind of development, 'speculation-led economic development', which is characterized by a prevalence of risky investment practices and shaky financial structures. In addition, financial liberalisation is likely to induce an increase in directly unproductive profit-seeking activities, a greater likelihood of financial crises, misallocation of credit and, ultimately, diminished rates of real sector economic growth. Given the likelihood of these outcomes financial liberalisation programmes are argued to be a poor foundation for stable and sustained real-sector economic growth, especially in the context of resource-scarce less-developed countries.

[3] Yeldan (2002a) argues that although the current account deficit was one of the clearest indicators of the crisis, it was merely an end-result, not one of the main reasons as official wisdom claimed. Moreover, lax fiscal administration was accused of being the main source of the current account deficit. However, he argues, the consolidated budget and other relevant fiscal data show that public sector had not exceeded the planned or foreseen magnitudes.

capital flows with an exceedingly speculative ‘hot’ component (Yeldan 2002a,b).[4] Although factors such as weak regulation over the banking system, increased corruption within the bureaucracy, or large persistent fiscal deficits were definitely instrumental in aggravating the situation, none of them could have been the cause *per se* (Yeldan 2002a,b).

4. Growth Mode of the Post-Crisis Era

Following the failure of the exchange rate-based disinflation programme of 2000, a new letter of intent was presented to the IMF, and the new economic programme called ‘Transition to the Strong Economy’ was launched in May 2001. As stated in its introduction, the programme was actually the continuation of the previous programme.

The main goals of the new programme were stated as reducing uncertainties in financial markets, completing structural reforms to promote economic efficiency, and focusing macroeconomic policies on the disinflation effort. Stabilising debt stock of the public sector was again one of the central issues. The programme also targeted a primary surplus of 6.5 per cent to GNP each year until 2004 (then extended to 2006).

One of the most successful aspects of the post-2001 crisis adjustment effort lies on the disinflation front.[5] Inflation rate, both in consumer and producer prices, was brought under control by 2004. The decline in the prices of the imported products helped to have a lower level of inflation as well as promoted higher economic growth.

The growth path of the Turkish economy over the post-2001 period recorded reasonably high levels, though volatile. After the contraction of -7.4 per cent in 2001, the real growth rate was 7.8 per cent in 2002, 5.9 per cent in 2003, and then 9.6 per cent in 2004.

The Turkish economy enjoyed the excess liquidity in the global financial markets in the post-crisis era. ISSA (2005) supports a similar argument. The report argues that from the examination of the balance of payments statistics it is clear that the growth performance of the

[4] The ratio of short-term foreign debt to central bank’s international reserves is regarded as one of the crucial indicators of external fragility and is called as the “most robust predictor of a currency crisis” in Rodrik and Velasco (2000). The 2000 disinflation programme had actually deteriorated the fragility as signalled by this indicator -112 per cent in June, and 145 per cent by December of 2000.

[5] Yeldan (2002b) underlines various demand factors which also played an important role in sustaining the pressures on the aggregate price level even though the persistent inflationary inertia should clearly be regarded as the major culprit in delaying the disinflation process in 2000. In particular, the significant drop in the real interest rate seems to have induced a strong substitution of future aggregate consumption and investment demand and resulted in strong demand pulls over the prices.

economy depended directly on inflows of international finance capital.[6] At times of heavy inflows of foreign finance capital, as in the third quarter of 2000, and second and third quarters of 2004, GDP growth was rapid. Declines in the growth rate are directly related to the outflows of foreign finance capital as in 2001.

The two key characteristics of the post-crisis upswing in economic activity were that; (i) it was mostly fuelled by inflows of hot money, hence, was *speculation-led*; (ii) it was accompanied by high rates of unemployment; hence, was of the *jobless-growth* type.[7] (Yeldan, 2002)

The economic growth was an export-oriented one. Dependent on cheaper imported goods with cheaper dollar and low-cost labour, the industrial production created very low value added and then exported. Between 2000 and 2007 the exports/GDP ratio raised from 10% to 16% whereas the imports/GDP ratio rose from 20% to 25%. Following the decline in domestic consumption after the 2001 crisis, the economic model had to be export-driven.

Real wages had fallen by 20 per cent upon impact in 2001 and could not recover after that. Thanks to the declined wages in the crisis conditions and cheap imports the economy achieved fairly high rates of growth. The productivity increased 45% throughout the 2001-2008 period whereas the real wage decreased 10% on average, the number of workers increased only 5%.

Despite the achievements on the disinflation front, rates of interest were slow to adjust. Turkey offered real rates of 80 per cent during the February crisis of 2001, 60 per cent in December 2002, 75 per cent in the summer of 2003, hence having become one of the leading emerging markets in the world of financial speculation. While the US and the OECD interest rates were at 2.5-4 per cent levels, Turkey continued to offer arbitrage gains over dollar-denominated assets reaching 30 per cent. Such returns enabled Turkey to attract huge sums of speculative finance capital with a significant "hot" component during especially 2003 and 2004 (ISSA, 2005).

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[6] The financial capital flows are expressed as the sum of the capital account and the net errors and omissions terms of the balance of payments statistics.

[7] The most striking observation on the Turkish labour markets over the post-2001 crisis era is the sluggishly slow performance of employment generation capacity of the economy. Despite the very rapid growth performance across industry and services, employment growth was at minimum. Moreover, annual rate of growth of employment year-over-year had been observed to be negative in many quarters over this period. The rate of change of employment averaged minus 0.1 per cent. The discouraged workers who voluntarily chose to move out of the job market prevented a further rise of the unemployment problem. For the comparison of the standard unemployment rates and alternative calculations see ISSA (2005).

Under these circumstances, within an economy offering such rates of return to the speculative financial transactions it would not be rational to invest in industrial activities. In consequence, in the aftermath of the 2001 crisis, fixed capital investments destined to the manufacturing industries almost stagnated and did not exceed their real 1998 levels.

The excess of foreign exchange supplied by the foreign financial arbiters seeking positive yields led to significant pressures for the Turkish Lira to appreciate. As the central bank restricted its monetary policies only to control price inflation, and left the value of lira to be determined by the speculative decisions of the market forces, the TL appreciated by as much as 50 per cent in real terms against the USD and by 25 per cent against euro (ISSA, 2005). In spite of the free-floating characteristic of the foreign exchange regime, the TL was observed not to float at all, and continued to appreciate at the expense of deepening current account deficits.[8]

In the meantime, the expansion of the foreign debt stock was almost twice faster than the foreign exchange needs of the real sector, whereas the short-term debt accumulated rapidly and reached USD 29 billion in the same period (ISSA, 2005). These developments can only be understood in the context of the speculative transactions of the finance sector, which constituted the main source of this additional demand for foreign exchange. [9]

The share of the non-financial private sector in foreign debt continued increasing in the post-crisis era. Due to the high domestic interest rates the private sector borrowed abroad, and used those credits in non-productive, financial areas as well as financing exports-oriented production.

In terms of external financing of the economy in the post-crisis period, the short-term 'hot' money had a significant place until 2006 although its share relatively declined. When the economy registered USD25 billion foreign direct investments in 2006-2007 this was regarded as an improvement in the quality of foreign financing. However, this capital entry in the form of FDIs was channelled towards mergers and acquisitions of domestic banks and insurance companies and some privatisations rather than capacity creating fixed productive investments.

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[8] 2003-2004 also meant a period of acceleration of exports, and export revenues have reached USD 62 billions over 2004. Nevertheless, with the rapid rise of the import bill over the same period, the deficit in the current account reached USD 15.6 billion (or about 5.3 per cent of GDP in 2004).

[9] Balance of payments data indicates that the finance account depicted a net surplus of $10.4 billion over 2001-2004. A significant portion of this inflow was due to non-residents' portfolio investments into Turkey. While the residents export financial capital at the magnitude of $5.4 billion, the net inflow was in positive figures. In addition, the *net errors and omissions* term of the BOP accounts is interpreted as an indicator of *domestic hot money flows*. Under this interpretation, the total sum of net speculative finance capital flows reach to$17.4 billion over the three years of the post-crisis adjustments ISSA (2005).

Table 2. Balance of Payments

(in million dollars)	1998	1999	2000	2001	2002	2004	2005	2006	2007	2008	2009	January 2009	January 2010
CURRENT ACCOUNT	**1.984**	**-1.344**	**-9.821**	**3.392**	**-1.521**	**-14.431**	**-22.198**	**-32.193**	**-38.311**	**-41.946**	**-14.042**	**-801**	**-5.572**
Exports f.o.b.	30.662	28.842	30.721	34.373	40.124	68.535	78.365	93.612	115.361	140.800	109.686	17.348	17.224
Imports f.o.b.	-44.926	-39.311	-52.680	-38.106	-47.407	-91.271	-111.445	-134.669	-162.156	-193.821	-134.542	-17.384	-22.090
Balance on Goods	-14.264	-10.469	-21.959	-3.733	-7.283	-22.736	-33.080	-41.057	-46.795	-53.021	-24.856	-36	-4.866
Services: Credit	23.686	16.800	19.454	15.199	14.031	22.941	26.763	25.549	28.930	34.824	32.928	2.921	2.837
Services: Debit	-10.180	-9.313	-8.088	-6.067	-6.146	-10.144	-11.496	-11.937	-15.586	-17.703	-16.742	-2.474	-2.538
Balance on Goods and Services	-758	-2.982	-10.593	5.399	602	-9.939	-17.813	-27.445	-33.451	-35.900	-8.670	411	-4.567
Income: Credit	2.481	2.350	2.836	2.753	2.486	2.651	3.644	4.418	6.423	6.889	5.160	957	966
Income: Debit	-5.466	-5.887	-6.838	-7.753	-7.042	-8.260	-9.483	-11.074	-13.526	-15.048	-12.831	-2.498	-2.163
Balance on Goods, Services and Income	-3.743	-6.519	-14.595	399	-3.954	-15.548	-23.652	-34.101	-40.554	-44.059	-16.341	-1.130	-5.764
Current Transfers	5.727	5.175	4.774	2.993	2.433	1.117	1.454	1.908	2.243	2.113	2.299	329	192
FINANCIAL ACCOUNT	**-840**	**4.829**	**9.584**	**-14.557**	**1.194**	**17.702**	**42.660**	**42.689**	**48.707**	**33.547**	**6.226**	**-2.051**	**2.204**
Direct Investment Abroad	-367	-645	-870	-497	-175	-780	-1.064	-924	-2.106	-2.549	-1.554	-313	-145
Direct Investment in Turkey	940	783	982	3.352	1.137	2.785	10.031	20.185	22.047	18.269	7.634	1.787	797
Portfolio Investment- Assets	-1.622	-759	-593	-788	-2.096	-1.388	-1.233	-4.029	-2.063	-1.276	-2.742	-1.016	-1.035
Portfolio Investment- Liabilities	-5.089	4.188	1.615	-3.727	1.503	9.411	14.670	11.402	2.780	-3.770	2.938	-1.724	821
Equity Securities	-518	428	489	-79	-16	1.427	5.669	1.939	5.138	716	2.827	-435	208
Debt Securities	-4.571	3.760	1.126	-3.648	1.519	7.984	9.001	9.463	-2.358	-4.486	111	-1.289	613
Other Investment- Assets	-1.464	-2.304	-1.939	-601	-777	-6.983	-578	-13.437	-4.853	-10.935	4.166	763	2.957
Monetary Authorities	-95	-98	1	-39	-30	-24	-16	0	2	2	-306	-277	-2
General Government	0	-	0	0			0	0	0			0	0
Banks	-942	-1.839	-1.574	233	643	-5.324	-342	-10.293	-3.526	-9.164	5.870	848	1.655
Other sectors	-427	-367	-366	-795	-1.390	-1.635	-236	-3.144	-1.327	-1.773	-1.398	192	1.304
Other Investment- Liabilities	6.762	3.566	10.389	-12.296	1.602	14.657	20.834	29.492	32.902	33.808	-4.216	-1.548	-1.191
Monetary Authorities	571	-231	619	735	1.336	-209	-787	-1.268	-1.450	-1.791	-901	-124	-20
General Government	-1.655	-1.932	117	-1.977	-669	-1.163	-2.165	-712	82	1.742	1.608	329	351
Banks	3.195	2.655	3.736	-9.644	-2.016	6.564	10.524	11.704	3.736	8.195	3.834	-429	974
Other sectors	4.651	3.074	5.917	-1.410	2.951	9.465	13.262	19.768	30.534	25.662	-8.757	-1.324	-2.496
Current, Capital and Financial Account	**1.144**	**3.485**	**-237**	**-11.165**	**-327**	**3.271**	**20.462**	**10.496**	**10.396**	**-8.399**	**-7.816**	**-2.852**	**-3.368**
NET ERRORS AND OMISSIONS	**-697**	**1.721**	**-2.760**	**-1.759**	**115**	**1.071**	**2.738**	**129**	**1.619**	**5.641**	**8.607**	**3.370**	**2.395**
GLOBAL BALANCE	**447**	**5.206**	**-2.997**	**-12.924**	**-212**	**4.342**	**23.200**	**10.625**	**12.015**	**-2.758**	**791**	**518**	**-973**
RESERVE ASSETS	**-447**	**-5.206**	**2.997**	**12.924**	**212**	**-4.342**	**-23.200**	**-10.625**	**-12.015**	**2.758**	**-791**	**518**	**-973**
Reserve Assets	-216	-5.726	-354	2.694	-6.153	-824	-17.847	-6.114	-8.032	1.057	-111	1.717	973
Use of Fund Credits and Loans	-231	520	3.351	10.230	6.365	-3.518	-5.353	-4.511	-3.983	1.701	-680	1.717	973
Exceptional Financing		-										0	0

Source: Central Bank of Turkey

4. The 2008 Crisis: What Went Wrong?

As discussed in the previous section, in the post-2001 era the economy followed an export-driven growth model which was fuelled by massive capital inflows in a period of global credit expansion. Low wage costs and cheap imports helped this growth path as well.

The Turkish economy entered the crisis era with serious fragilities; i.e. import-dependent export-driven economic growth, high unemployment, contracted domestic demand, high current account deficits, high foreign debt stock, an overvalued domestic currency which carried an exchange rate risk potential for the indebted parties.

Despite the first statement of the government, Turkey could not stay out of the global crisis due to the characteristics of its economic and financial links with the rest of the world.

Although the second half of 2007 had not recorded high growth performance either, the economy showed the first signs of economic slow-down in the second half of 2008 following a growth path in seven years in a row. While the number of newly established companies declined, number of bankruptcies rose. Gross domestic product shrank 6.5 percent in the last quarter of 2008. Having faced the influence of the global downturn, the economy registered 14.7 per cent contraction in the first quarter of 2009, followed by 7.9 per cent in the second quarter and 3.3 per cent in the third quarter, which represented an 8.4 per cent reduction in the GDP in the first nine months of that year. First time from the outbreak of the crisis the economy exhibited a positive growth rate of 6 per cent in the last quarter of 2009.

Contraction in the economy resulted in a rise in unemployment, which already registered high levels (around 10-11 per cent) in the post-2001 crisis era. Unemployment rate was 11 per cent in 2008, and climbed to 16.1 per cent level in February 2009. Then it started to decline and travelled around 13 per cent in the last quarter of 2009.

According to data of the Turkish Statistical Institute (TurkStat), inflation rate, which had seen two-digit figures since the second quarter of 2008, declined to single-digit figures since the beginning of 2009 due to the economic recession and low demand in domestic markets.

Turkish exports came down after the contraction in global markets. However, it has achieved an upward trend since October 2009, but still under the pre-crisis level. Due to the decline in imports, trade deficits appeared to indicate a decline compared to the 2008 level.

Interest rates on government debt securities were between 16 percent and 21 percent in 2008. In 2009, interest rates floated between 9 percent and 21 percent, while banks' annual deposit

rates were varying between 5 percent and 9.5 percent at the end of the year. Banks were paying interest between 14 percent and 16 percent at the end of 2008.

Also, Turkish Central Bank continued to cut overnight interest rates during the whole year. In late November, the bank lowered interest rates quarter base points to 6.5 percent in overnight borrowing and to 9 percent in lending rates.

Banking system limited lending operations and increased interest rates. Throughout 2008 and 2009 the rise in credit defaults (a great portion being consumer credits and unpaid credit cards) and uncovered cheques was remarkable. As banks acted rather cautiously from the appearance of the symptoms of economic downturn, despite the losses banking system in general achieved high rates of profits.

6. Conclusions

The Turkish economy has undergone a structural change process since the 1980s in parallel with the substantial transformation of the global economy.

Throughout the last three decades, the economy's performance has portrayed an erratic picture, high growth phases followed by contractions, sometimes resulted in crises. Despite the significant changes, continuing tension between financial liberalisation and macroeconomic instability has been one of the key features of the whole period as underlined.

Particularly from the 1990s the rate of growth has fluctuated severely as the economy moved within mini cycles of growth-crisis-stabilisation, and -renewed (artificial) growth. The growth pattern over the post-2001 crisis period displays two typical characteristics of the last decade: *first*, it is speculative-led in nature; *second*, it has limited job-creating capacity (Yeldan, 2002b).

The growth performance of seven consecutive years following the 2000-2001 crisis was stemmed from an economic growth mode which was fuelled by capital inflows, based on low wages and cheap imported goods. This mode of growth could not continue forever, and the worsening circumstances in the world economy after the 2008 crisis accelerated the process. Turkey found itself in an economic crisis where the total production declined, unemployment increased, and other macroeconomic fundamentals deteriorated.

Beside differences in various economic and financial figures, the most important distinction of the current crisis than the 2001 crisis appears to be the channels for the eruption of the crisis. Although both crisis stemmed from the similar fundamental weaknesses of the system,

the 2000-2001 crisis started in the financial sector and then influenced the real sector, whereas in the 2008 crisis the financial system seemed relatively strong and the crisis has affected the real sector more so far. The regulations put into effect following the 2001 crisis and cautious approach helped the banking system prevent from a collapse. On the other hand, the Turkish banking system works in rather a traditional fashion. Derivatives, such as the ones became toxic are not used in the Turkish financial system. All of these factors had a role in terms of the route of the crisis.

Although some slight improvements have started to appear since the last quarter of 2009, the underlying instabilities still persist. It does not seem possible for an economy, which is so much integrated with the world economy, to announce the end of the crisis without a global recovery. Nobody knows how long it will take, but it is for sure it is not going to be easy.

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