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Turkey in Turbulence: Heterodoxy or a New Chapter in Neoliberal Peripheral Development?

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ABSTRACT

While global monetary tightening by central banks, led by the US Federal Reserve, has heightened concerns about a slowdown in the world's economy and an increased likelihood of debt crises across developing countries, Turkey has attracted attention for doing the opposite. Indeed, the country's economic policy makers have intensified monetary easing towards credit expansion at the risk of increased exchange rate instability. This article analyses the Turkish case and makes four contributions. First, it establishes a framework through which we can understand and interpret the policy choices of the government. Second, it shows the binding effects of the trilemma in the context of an economy fully integrated in the global economy and discusses how the government tried to tackle these effects through a series of ad hoc policy measures. Third, the article discloses the distributional consequences of such policy manoeuvres and argues that the burden of adjustment fell on the shoulders of wage labour, while various competing rentier interests benefited from these policies. Fourth, the authors analyse these policies from a broader perspective of whether they can be interpreted as a courageous attempt by a peripheral developing economy to claim some policy space, or whether these policy choices in essence only amount to a deepening of neoliberal peripheralization.

INTRODUCTION

Following the lead of the United States (US) Federal Reserve, developing economies have been raising their policy rates since early 2022, causing concerns about a slowdown in global economic growth and an increased likelihood of debt crises among developing countries (UNCTAD, 2022). In a world of global monetary tightening, Turkey has attracted attention as the country's economic policy makers swam against the tide and continued with

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the monetary easing that began in the last quarter of 2021. The Turkish case is interesting as the country's economy has been struggling with a fragile external account since the 2018 currency crisis, yet Turkey has managed so far to avoid a debt crisis and/or an International Monetary Fund (IMF) programme. In fact, Turkey once again provides an ample source of distraction with its recent refutation of monetary orthodoxy in pursuit of an ever-expansionary growth trajectory, with heavy interventions in the market, all blended with the colourful jargon of 'indigenous', 'national' and even 'patriotic'. The ad hoc and loose usage of concepts and their contextual dramatization have unavoidably created a terminological battle in the domestic policy arena; Turkey's interventions have been hailed by its government as a prime example of heterodox uprising against the orthodoxy of Western superpowers, as well as against the finance lobby that threatens Turkey's national values.[1]

This all began in September 2019 when President Erdoğan enforced and acted upon his often-repeated motto, namely 'high interest rates, the reason; inflation, the end result!'. In his repeated interventions, Erdoğan did not hesitate to use his executive powers, sacking three governors of the Central Bank of the Republic of Turkey (hereafter CBRT or the Central Bank) and two directors and key bureaucrats of the Statistics Agency, TurkStat, within the course of two years. As the government tried to sustain economic growth through credit expansion in the second half of the 2010s, this strategy resulted in a currency crisis in 2018 and stability in foreign exchange markets was regained with a sharp interest rate hike. Another credit expansion brought the economy to the brink of a balance-of-payments crisis in the autumn of 2020, resulting, once again, in a policy U-turn towards orthodoxy with higher interest rates. However, in 2021 Erdoğan intervened once more with the introduction of a new cycle of interest rate cuts. As real interest rates fell into negative territory, Turkey's currency quickly depreciated leading to a rapid increase in inflation, which in turn pushed real interest rates into even deeper territory. Although this approach seems to have contributed to economic growth, this growth was at the expense of a steep decline in real wages and the labour share of income. Through heavy interventions in the foreign exchange market as well as in the credit market and the banking sector, the government tried to sustain credit-led growth while limiting the depreciation of the currency.

This history of interventions and twists is mostly viewed as a series of ad hoc, often irrational and conflicting policy manoeuvres with a consequent erosion of institutional trust, accompanied by very high inflation. This

1. The terminological drama reached its zenith with the depiction of Turkey's new economic programme by Nureddin Nebati, the Minister of Economy, as 'the heterodox approach, which represents an epistemological break with neoclassical economic thought, is increasingly prominent today; it becomes more important with behavioural economics and neuroeconomics' (*Habertürk*, 2022).

article argues, however, that this series of events cannot be fully understood with a simple mechanistic analysis of conjectural policy swings, nor can it be attributed entirely to irrationality and loss of credibility. Irrational and ad hoc, no doubt; yet, if cast over a broader perspective underlining the historical role of the Justice and Development Party (JDP) governments as the most ardent agencies of speculative finance capital (Apaydın and Çoban, 2022; Bedirhanoğlu, 2019; Cizre and Yeldan, 2005; ISSA, 2006), many of these policy swings were in fact consistent with the overall objectives of acquisition and transfer of surplus to capital and the rentier power houses.

Given the acceleration of global inflation and the deepening debt crisis, we contend that Turkey presents an interesting case of extremes: deeply negative real interest rates, high and persistent inflation, a large current account deficit, and a central bank whose net foreign exchange reserves were estimated at around a staggering *minus* US$ 50 billion at the end of 2022. Yet, despite the abundant fragility indicators and the severe disequilibria, the predicted moment of crisis and collapse has not arrived, the economy continues to grow, and the current policy stance of JDP's economic strategy has not admitted any change of track, with its continued determination to deal with challenges through a series of ad hoc regulations and policy zig zags.

The tragedy of the Maraş earthquake in February 2023 hit Turkey under these adverse economic conditions, with severe macro imbalances, deteriorating personal incomes under an inflationary environment, and a widening budget deficit. Initial estimates by the World Bank (2023) suggest that real economic losses could reach US$ 45 billion, while the Turkish Enterprise and Business Confederation reports estimates as high as US$ 84.1 billion (TURKONFED, 2023). Turkey went through presidential and parliamentary elections just a few months later, in May 2023, under these conditions. As President Erdoğan was re-elected and the JDP gained a majority in the parliament, many commentators of the Turkish economy observed that economic growth and the increase in employment — despite a decline in real wages — showed that the low interest policy seemed to have preserved the government's popularity. Yet, growth came at the expense of a widening current account deficit and significant depreciation pressure on the currency, leading to the appointment of Mehmet Simsek, a more orthodox figure in the Ministry of Treasury and Finance, with the explicit expectation that the new economic management team would implement policies to appease international finance and attract speculative foreign finance capital to avoid a balance-of-payments and/or a debt crisis.

This article studies the original path followed by Turkey and aims to make four contributions to the literature. First, it establishes a general framework through which we can understand and interpret the government's economic policy choices. Second, it shows the binding effects of the so-called (unholy) economic trilemma in the context of a developing economy that is fully integrated in the global economy in terms of both trade and financial flows. It also discusses how the government tried to tackle this trilemma through a series of ad hoc policy measures. Third, it argues that the burden of adjustment fell on the shoulders of wage labour, while various competing rentier interests seem to have benefited from the policies. Finally, notwithstanding our criticisms of the path chosen by the government, the article concludes by asking whether the Turkish case can be interpreted as a courageous attempt by a peripheral developing economy to claim some policy space, or whether the policy choices of the Turkish government amount, in essence, to a deepening of neoliberal peripheralization.

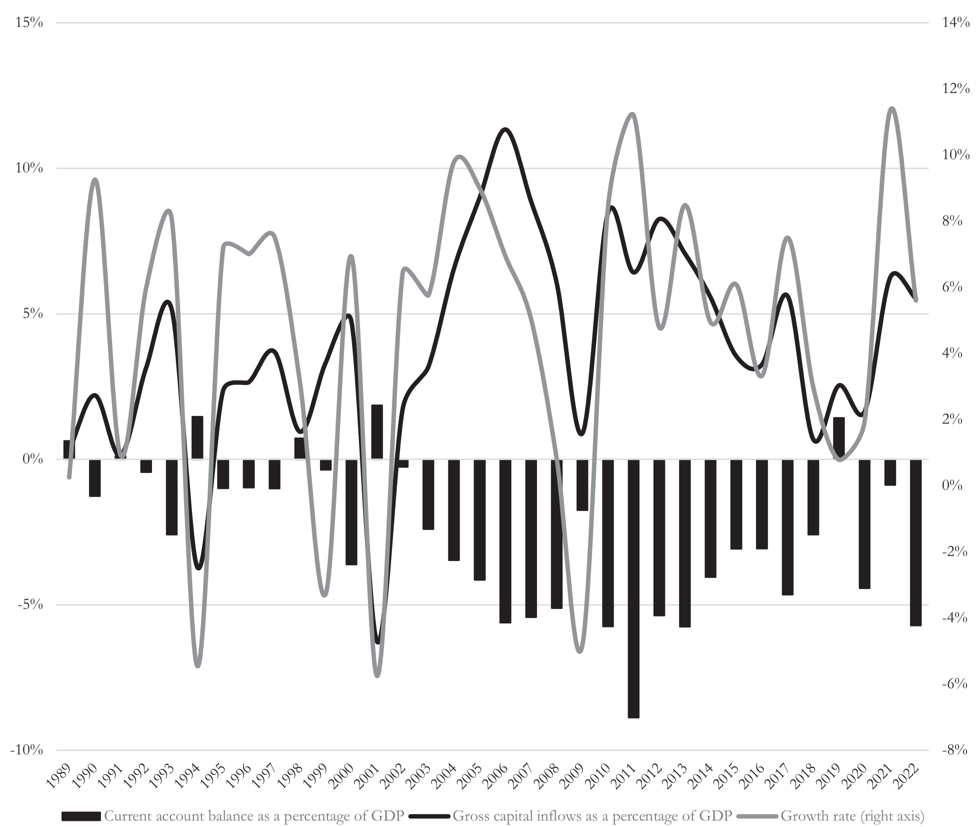
GROWTH VERSUS EXCHANGE RATE STABILITY?

This section provides a brief overview of Turkey's financial integration in the global economy to establish a general framework through which we can understand and evaluate the economic policy choices currently operating in Turkey, along with their implications for growth, stability and crisis dynamics. Following trade and financial liberalization in the early 1980s, Turkey removed capital controls in 1989. This transformation led to deep fluctuations and resulted in boom–bust cycles whereby pathways of national output are ultimately conditioned by the speculative caprices of financial arbitrageurs. The course of domestic economic activity has thus been set by capital flows, especially short-term flows. Rapid capital inflows and economic growth were followed by outflows and crises, much like the experiences of many developing economies of Latin America in the aftermath of their liberalization of capital flows.

This is vividly portrayed in Figure 1. Following the liberalization of capital flows in 1989, capital inflows and economic growth display a high correlation, while deficits in the current account become chronic. The 1990s were characterized by increased instability, eruption of twin deficits of the current account and the government budget (the so-called *bi-cycle* à la Diaz-Alejandro, 1985; Grabel, 1995), and high inflation, which resulted in the IMF becoming heavily involved in the macro management of the economy by 1998. The IMF provided financial assistance of US$ 20.4 billion between 1999 and 2003 (Yeldan, 2006). Following the severe crisis of 2001, Turkey implemented an orthodox strategy of raising interest rates and maintaining an overvalued real exchange rate administered under unfettered capital mobility. The government adopted a contractionary fiscal stance and initiated a series of privatizations and steps towards 'market friendly' structural reforms under the direction of the IMF.[2]

2. For a thorough overview of the post-1990 Turkish macroeconomic history, see Akyüz and Boratav (2003), Boratav et al. (2001), Cizre-Sakallıoğlu and Yeldan (2000), Ertuğrul and Selcuk (2002), Orhangazi (2020) and Yeldan (2002). For similar analyses based on the effects of international speculative financial capital flows on the Turkish economy, see Bicer

Figure 1. Capital Inflows, Current Account and Economic Growth



Sources: Central Bank Electronic Data Dissemination System (https://evds2.tcmb.gov.tr/index.php) and IMF World Economic Outlook Database (www.imf.org/en/Publications/SPROLLs/world-economic-outlook-databases, accessed 30 August 2023).

The post-crisis economic and political adjustments were mainly overseen by the then newly founded JDP that came to power enjoying an absolute majority in the parliament in the November 2002 elections. Shortly after the JDP took office, it abandoned its populist discourse as an anti-IMF and anti-liberal reactionary movement and fully adopted the neoliberal policy framework that aims to entrust national resources and the economic future of the country directly to speculative foreign capital and the unbounded dynamics of market forces (Cizre and Yeldan, 2005; ISSA, 2006). Although maintaining a pro-Islamic political agenda, the JDP nevertheless distanced itself from the previous 'national view' orthodoxy of the traditional Turkish Islamic movement and reinvented itself with a more friendly view towards the West, ready to do business with global finance capital and willing to privatize strategic public assets. In the political arena, the JDP was strongly supportive of US interests in the Middle East.

The distinguishing feature of the series of JDP governments over the post-2002 period was their deliberate adoption of the mission to execute the neoliberal project under the discourse of a 'strong and efficient state', operating mainly through the technocratic agencies of 'governance'. Over this period, Turkey continued to specialize in standard low- to medium-grade technologies within a fragmented, informalized domestic labour market. On the macroeconomic policy side, there has been a significant shift towards 'speculation-led growth', where 'macroeconomics' became almost synonymous with 'monetary policy' (at the expense of fiscal policy) (Yeldan and Ünüvar, 2016). Furthermore, monetary policy has often taken the exclusive form of inflation targeting whereby an 'independent' central bank has the sole objective of attaining price stability with its policy rate utilized as the major instrument.

The initial years of JDP governance coincided with a conjectural boom of the global economy. Lured by lucrative rates of return on domestic assets operating within a favourable global setting, all staged with a great show of moderation, Turkey enjoyed a rapid and massive influx of short-term capital inflows and high economic growth, as shown in Figure 1. The 'hot' component of such inflows was rather conveniently ignored, as was the ensuing currency appreciation in real terms, with the result of widening current account deficits. In the course of the 2000s, distressed firms suffering from the aftermath of the 2001 crisis, as well as widespread privatizations, attracted foreign direct investment in the form of mergers and acquisitions.

Figure 1 also shows that the current account deficit rose to 6 per cent of GDP by 2006 and jumped above 10 per cent after the 2009 global financial crisis. It should be noted in this context that economic growth in

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and Yeldan (2003), Öniş and Aysan (2000), Yeldan (2002) and Yentürk (1999). Somel (2003) and Yeldan (1995, 1998), respectively, discuss the characteristics of the post-1990 Turkish macro adjustments in terms of creation and absorption of the economic surplus, and provide a quantitative analysis on the strategic role played by the state apparatus.

the 1990s was accompanied by moderately low levels of current account deficits, which turned into surpluses during years of crisis and recession. However, after the 2001 crisis a deep deterioration occurred in the current account balance as Turkey became trapped within the constraints of external deficit financing at the same time that import dependency of domestic production was increasing due to overvalued real exchange rates (Orhangazi and Yeldan, 2021).

Deepening Resource Misalignment

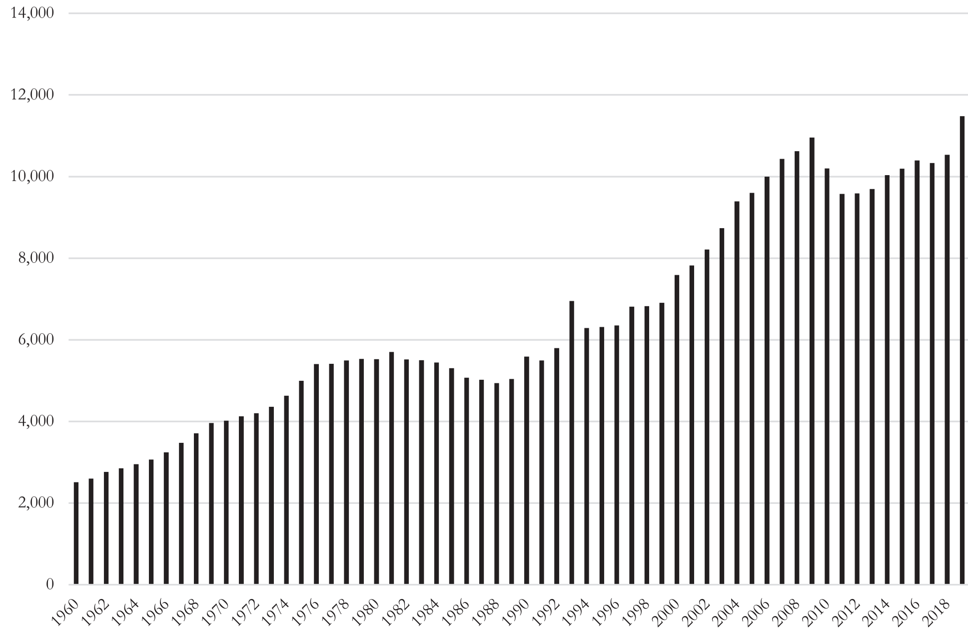
All of this was accompanied by the increasingly capital-intensive pathway of the domestic economy. The secular rise of capital per unit of employment has, in fact, been an indispensable characteristic of the many emerging economies that have prematurely deregulated their capital account to integrate with the global financial markets. Figure 2 depicts this situation under Turkey's neoliberal transition. Measured in fixed Turkish lira prices, utilization of capital per worker employed has more than doubled from 1989 (completion of Turkey's capital account deregulation) to the eruption of the global financial crisis in 2008, from TRY 4,000 to TRY 11,600; it then hovered around that rate for the remainder of the 2000s.

The implied pathway resulted in labour shedding and structurally persistent unemployment. As shown in Figure 3, the meagre job creation had been a concomitant feature of the post-2003 neoliberal era, where labour employed per TRY 1 million real value added (in 2017 prices) was cut by almost half from 25 workers to less than 15 by 2021. The rate of open unemployment has not fallen below 10 per cent over two decades. Thus, the adverse effects of the debt-intensive mode of financing of external deficits were not solely a matter of increased external fragility leading to loss of confidence and credibility for the financial arbitrageurs, but further meant a diversion of the indigenous development pathways away from labour-intensive technologies towards increasingly capital-intensive modes of production, financed by speculative hot money finance and external debt accumulation. All of this meant intensification of the import-dependence of the domestic industry and reduction of the domestic value-added content of output.

Post-2016: Growth at all Costs, Currency Shocks and Policy U-turns

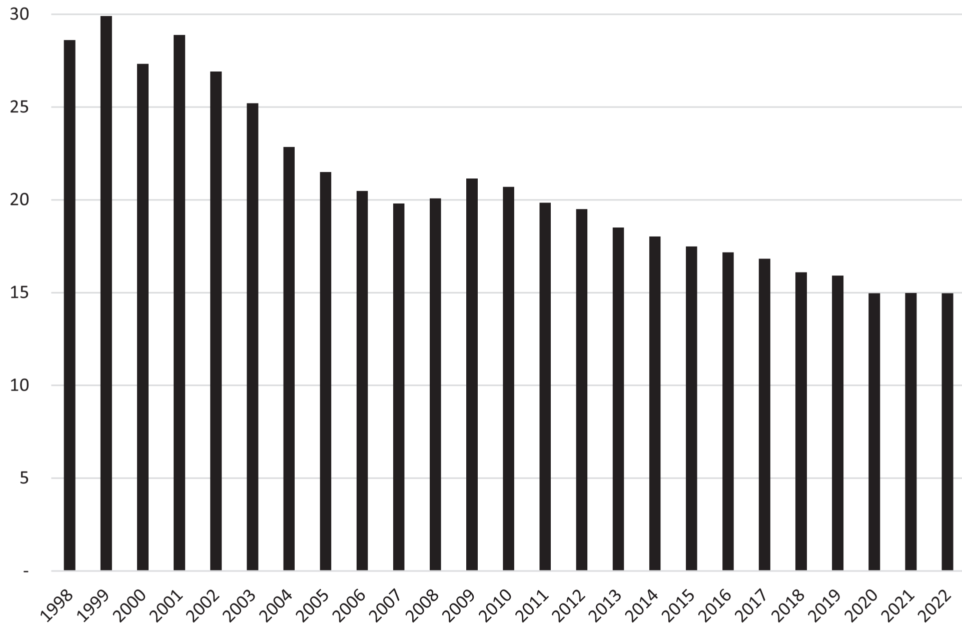
Dependence on foreign capital inflows, large current account deficits and a high level of external debt increased the fragility of the economy in the mid-2010s as the global conjuncture was also changing with the end of the quantitative easing policies of the US Federal Reserve and rising global interest rates. As these developments put downward pressure on the Turkish

Figure 2. *Capital per Labour Employed (in 2017 Turkish liras)*



Sources: For capital stock, see University of Groningen, PWT data set (Feenstra et al., 2015); for labour employment data see TurkStat Labour Statistics (https://data.tuik.gov.tr/Bulten/Index?p=Labour-Force-Statistics-June-2023-49374 accessed 30 August 2023).

Figure 3. Labour Intensity of Gross Value Added (employment/real GDP) (persons/TRY 1,000,000)



Sources: authors' calculations based on TurkStat Household Labour Force (https://data.tuik.gov.tr/Bulten/Index?p=Labour-Force-Statistics-June-2023-49374) and National Accounts Statistics (https://data.tuik.gov.tr/Kategori/GetKategori?p=ulusal-hesaplar-113, accessed 30 August 2023).

lira the government now had to face the well-known un-holy (impossible) trilemma head on.

Simply narrated in textbook terms, the trilemma of an open macro economy is that a central bank cannot simultaneously choose all of the following: openness of the capital account (external mobility of finance capital), the exchange rate regime (flexible *versus* fixed exchange rates) and an independent monetary policy (freedom in setting the domestic interest rate). Originally cast in the works of Fleming (1962) and Mundell (1963), under a liberalized capital account with a floating exchange rate regime, the conditionalities of the trilemma restrict a central bank to an either/or choice in the selection of its monetary policy: if the domestic interest rate sails above the world rate of interest (corrected with a proper risk premium) incoming foreign inflows will put upward pressure on the domestic currency (appreciation); otherwise any attempt to maintain a low rate of domestic interest against the caprices of financial transactions will likely feed capital outflows with consequent depreciation (and ensuing inflation).

For Turkey, under the darkening external conditions of the post-2015 US Federal Reserve tightening period, while currency stability required higher central bank interest rates, the underlying debt-led character of the domestic economy necessitated lower interest rates to sustain economic growth. Prior to 2015, strong capital inflows allowed a relatively stable currency with low interest and inflation rates enabling rapid economic growth. Subsequently, in an attempt to spur economic growth with low interest rates and to simultaneously maintain stability in the rate of exchange, the CBRT proactively used an 'interest rate corridor', which allowed it to operate on the lower band of the corridor when the conditions permitted and on the higher band of the corridor when currency markets were unsettled.

To create further incentives to national assets, the Turkish government established a sovereign wealth fund (SWF) in 2016.[3] The SWF brought together all public assets such as the Bank of Agriculture, the Istanbul Stock Exchange, the Postal Agency, Turkish Airlines and Turkish Petroleum Refineries Inc. In the absence of significant natural resources to sustain trade surpluses, the creation of the Turkish SWF had the sole purpose of providing a global market for its domestic assets within a trust fund with the expectation of foreign inflows. The SWF came under severe criticism for its covert operations and crony practices, as it had been granted immunity from the rules of the Procurement Law and any legal public screening.

On the political front, a highly dubious referendum in 2017 gave all executive powers to the President and effectively abolished the role of the parliament. The executive branches were thoroughly restructured. Various offices and ministries of the 'old' regime, such as the Ministry of Development (previously the State Planning Organization), were dismantled; new forms

3. In 2018, Erdoğan's son-in-law, Berat Albayrak, was appointed as the SWF's deputy director by a public decree that was signed by Erdoğan himself.

of ministerial power were generated, which now acted as appointed secretaries directly responsible to the President, such as the Ministry of Environment, Urbanization and Climate Change, in an attempt to create new rent-seeking opportunities in urban municipalities as well as potential sources of greenwashing.

In 2017, the government sponsored a zealous credit expansion through a Credit Guarantee Fund facility, which eventually contributed to the eruption of the 2018 currency crisis (for details, see Boratav and Orhangazi, 2022; Orhangazi and Yeldan, 2021). The turmoil in the currency market was brought under control only by sharp interest rate hikes by the CBRT, with a brief recession in late 2018 and early 2019. The COVID-19 pandemic hit in early 2020, just as the economy was slowly recovering and re-adjusting. In what has been a common and well-documented experience, capital outflows from developing and emerging economies put a heavy strain on their currencies (see, for example, UNCTAD, 2020, 2021). However, in an environment of continuous capital outflows, the government chose to tackle the economic fallout of the pandemic with a new round of credit expansion that relied on presidential directives to the central bank to decrease its interest rate and to the public banks to expand their lines of credit. The profits of Turkey's CBRT were set to be transferred to the Treasury, which meant effectively monetizing budget deficits in the short run. The Banking Regulation and Supervision Agency (BRSA) was granted more powers to increase its effective screening and control of the credit allocation channels of the banking system via a series of politicized interventions (Apaydın and Çoban, 2022; Yağcı, 2021). The public banks came to be increasingly used as finance officers under executive decrees both to direct credit to specific conglomerates and to curb the depreciation pressures on the Turkish lira.

Given the collapse of tourism revenues during the pandemic and ongoing capital outflows, the result was a rapidly depreciating currency that brought the economy to the brink of a balance-of-payments crisis by late 2020. The CBRT leaned heavily on its foreign exchange reserves, using a backdoor mechanism to transfer its reserves to public banks, which then used them to meet the foreign currency demands of the market. As the CBRT ran out of reserves, a sharp U-turn in monetary policy with a series of interest rate rises was once again deemed necessary to stabilize the currency, yet this time within the challenging environment of the pandemic. Nevertheless, the ongoing credit expansion enabled the Turkish economy to maintain positive rates of growth in 2020 at a time when most of the world's economies were contracting.

The policy U-turn in late 2020 involved both higher interest rates and conservative signals from a new economic management team pronouncing that Turkey would stick with the requirements of orthodox economic policy making. In response, late 2020 and early 2021 were characterized by strong portfolio inflows, appreciating the currency. However, higher interest rates were dampening economic growth; as the domestic conglomerates began to complain about the interest burden, exporters had been putting pressure on the government to allow further depreciation of the Turkish lira. Finally, in March 2021, President Erdoğan once again intervened and sacked both the governor of the CBRT and the Minister of the Economy, replacing them with individuals who would be committed to the lower interest rate policy.

This time, however, the new policy of low interest rates and a depreciating currency were supported by the government on the grounds that Turkey was *changing* its economic model: lower interest rates were to spur investment, while a depreciation of the currency would encourage exports and initiate import substitution, resulting in a balanced current account that would put an end to all economic problems. The rhetoric for this approach was based on Erdoğan's long-standing argument that 'high interest rates are the cause of inflation' and the new 'model' was hailed as 'local, as well as national' (*The Economist*, 2022). Under Erdoğan's conceptualization, backed by Islamic theocracy, the interest rate is seen as the *source* of inflation, rather than merely as an instrument of control. Accordingly, not only is inflation to be fought with interest rate reductions, but inflation is considered *the result* of any positive rate of interest in the first place.

The initial reaction of the markets to this policy shift was clear: the expectation that low interest rates would increase investment and a depreciating currency would almost automatically bring the current account to balance was thought to be rather naïve, if not outright unrealistic. While the direction of foreign finance capital turned towards outflows and led to a rapid depreciation of the Turkish lira, the domestic asset markets faced a massive shift of domestic savings from lira to foreign currencies (dollarization). To make matters worse, low interest rates resulted in increased borrowing, not to finance fixed capital investments but to generate further speculative demand for foreign currency. The rapid meltdown of the Turkish lira could only be avoided by tackling this speculative demand through the introduction of a mechanism of exchange rate protected deposit accounts (ERPDA). This new type of account promised that if deposits were kept in Turkish lira, and if the lira depreciated at a rate higher than the announced deposit interest rate, the difference would be paid to the deposit holder by either the CBRT or the Treasury. The 'announced' rate of interest, in turn, would be constrained by an upper bound and would not exceed 3 basis points above the policy rate (which was to be set on a declining path). This move was effectively accompanied by heavy backdoor interventions on the foreign exchange market by the CBRT, mostly depleting the borrowed reserves from swap operations.

While most domestic critics depicted this loose monetary policy orientation as a policy mistake and an irrational policy choice stemming from the lack of merit among economic policy makers, the policy essentially prioritized economic growth, rent generation and resetting the contours of income distribution. The government's immediate response to inflation, in turn, varied from denial to forcing the statistical agency to report lower inflation rates. Currently, almost no one trusts the officially announced inflation rates, with a number of economists and independent research bodies attempting to estimate the 'correct' rate of inflation.[4] Other responses from the government to inflation included decreasing the rate of value added taxes on some staples (*Daily Sabah*, 2022), forming 'anti-inflation teams'(Karanfil, 2022) to investigate whether merchants were stock-piling certain staples and speculating over price rises, and using the Competition Authority to investigate the pricing practices of large supermarket chains with the claim that these practices were among the major causes of rising inflation (*Daily Sabah*, 2021; *Milliyet*, 2021; T24, 2022)

Over the course of 2021 and 2022, 'economic governance' was characterized by a series of ad hoc interventions and regulations — often on a daily basis — that aimed to keep interest rates low and currency depreciation orderly, as inflation got out of control. The main constraint was, inevitably, the trilemma. The next section explores the trilemma and the government's attempts to tackle it.

FIGHTING THE TRILEMMA

As argued above, the preferred tool for supporting economic growth has primarily been monetary policy and credit expansion. In September 2021, the Monetary Policy Committee (MPC) reduced the policy rate from 19 to 18 per cent, at a time when the official inflation rate had accelerated beyond 20 per cent. This was the first signal that the CBRT would no longer aim to keep its policy rate above the rate of inflation — a policy shift from the previous governor's stated aim to ensure a positive *real* rate of interest. Over the next three months the policy rate was reduced to 14 per cent. The rapidly rising inflation rates resulted in negative real interest rates as the easing cycle continued throughout the rest of the year and the policy rate was brought all the way down to 9 per cent, while the official rate of inflation was close to 85 per cent.

While pushing the real interest rates into negative territory was the government's preferred means of supporting the non-financial businesses and maintaining economic growth, it quickly realized that this policy orientation would result in several macroeconomic problems. The first problem was that, despite a lowering of the policy rate, effective market interest rates did not come down as quickly, as Turkey started to face increased risk premiums in the global financial markets. Second, even when the interest rates came down, the risk averse banks rationed credit. In response, the government used several regulatory decrees to push the banks to extend more credit at lower rates, while also using the public banks to ensure credit growth. A

4. See ENAGRUP data: https://enagrup.org/?hl=en

third problem occurred when borrowers started to use credit at low interest rates to invest in foreign currency for speculative purposes to reap gains from the expected fall of the Turkish lira. All these occurred while at the same time persistent current account deficits were putting downward pressure on the value of the currency.

Faced with these reactions, the government tried to target a low rate of interest *and* a limited and controlled depreciation of the currency simultaneously, effectively attempting to fight against the constraints imposed by the infamous trilemma. Various new instruments and policies were employed towards that end, including the use of foreign exchange reserves as well as the introduction of new financial products. The result, however, was the unavoidable acceleration of the inflation rate in the face of low interest rates and a rapidly depreciating currency, with large swings in transfer of wealth and income redistribution. Reluctant to raise interest rates to deal with high inflation, the government attempted to use non-market tools to slow down inflation, albeit unsuccessfully.

Against this setting, when the banking sector showed reluctance to extend credit at the lower rates and began rationing credit, the government pushed public banks to extend cheap credits, and began introducing ad hoc regulations to force the overall banking sector to expand its credit portfolio. For example, a regulation introduced in August 2022 aimed to bring the market interest rates in line with the policy rate by requiring the banks to hold Treasury bonds for a proportion of the loan varying from 10 to 90 per cent, depending on the interest rate that they applied (CBRT, 2022c). Various other regulatory changes were implemented to serve the same objective. As a follow up, the BRSA limited consumer credits and increased credit card minimum payments in June 2022. Furthermore, credit was limited for firms with foreign currency holdings in their balance sheet that exceeded TRY 15 million. At the same time, various regulations were used to subsidize loans to exporting firms with the expectation of increased export revenues (Gökçe, 2022). When it became clear that a significant portion of the new credit lines were not being channelled into new investments but have been contributing to a flight to foreign currency, the government introduced further regulations rather than re-evaluating its monetary policy stance.

Burning through Foreign Exchange Reserves

As discussed above, economic growth in Turkey has been accompanied by large current account deficits for most of the last two decades as the import dependence of the economy has deepened. Hence, every episode of growth by credit expansion resulted in intensified pressures on the currency. Table 1 shows the main balance of payments and external debt items between 2020 and 2023. As can be observed from the table, an initial policy choice has been to use the foreign exchange reserves of the CBRT for continuous

Table 1. Balance of Payments Movements and External Debt, 2020–22 (US$ billions)

	Current account	**Capital inflows**	**Net errors and omissions**	**Resident outflows**	**Reserves**	**External debt stock**	**Public**	**Central Bank**	**Financial sector**	**Non-financial corporations**
2020-Q1	−7.1	−4.4	−5.5	−0.5	−16.5	411	174	8	105	124
2020-Q2	−11.2	−7.4	−2.8	−7.7	−13.6	408	168	20	103	117
2020-Q3	−7.2	9.1	−2.4	12.1	−12.5	417	170	21	104	121
2020-Q4	−6.4	14.5	3.1	0.4	10.8	432	178	21	107	126
2021-Q1	−6.7	8.1	4.0	7.0	−1.7	430	179	23	104	124
2021-Q2	−4.6	16.0	1.2	3.6	8.9	444	182	26	102	134
2021-Q3	5.3	20.2	5.6	5.6	25.5	452	190	26	99	137
2021-Q4	−1.2	6.7	−9.1	5.9	−9.5	442	180	26	96	140
2022-Q1	−17.8	13.0	5.6	8.5	−7.7	450	183	30	95	143
2022-Q2	−11.0	8.9	6.8	9.5	−4.7	445	180	29	93	144
2022-Q3	−9.1	15.2	9.0	1.5	13.6	443	174	32	90	147
2022-Q4	−10.8	10.0	6.0	−5.9	11.1					
2023-Q1	−9.8	5.7	−0.1	5.1	−9.3					

Note: 2023Q1 figures are as of mid-March 2023.
Source: CBRT Electronic Data Dissemination System (https://evds2.tcmb.gov.tr/index.php, accessed 30 August 2023).

intervention in the foreign exchange market to stave off these pressures. However, this was not done through normal central bank operations in the foreign exchange market, but rather through informal and undisclosed channels. It transpired that an agreement between the Treasury and the CBRT was used whereby the CBRT would release some of its reserves to the Treasury, which in turn would channel these to the public banks to intervene in the foreign exchange market. There was no official explanation as to why this method was preferred (Bloomberg News, 2021). However, an examination of the balance sheet of the CBRT revealed that it had used around US$ 128 billion of reserves through 2020, sending the net reserves into negative territory (Ghosh, 2021). Still, this can be seen as an initial attempt to fight the trilemma, in that interest and foreign exchange rates were targeted together, at the expense of depleting foreign exchange reserves.

It is estimated that a portion of these released reserves were used by non-financial corporations to meet their external debt payments, resulting in some improvement in their net foreign currency positions (CBRT, 2021a: 34). It is not exactly clear how much arbitrariness and cronyism were involved in these foreign exchange operations, and despite the mounting criticisms and public ridicule, Turkey's Central Bank has not changed its politicized style of covert interventions. Rather, the CBRT initiated a series of currency swap agreements with a number of other central banks and began using these borrowed reserves as well as the banking sectors' required reserves of foreign currency to finance its market interventions in 2021 and 2022.[5]

In Search of Foreign Currency, in any Way or Form Possible

Given the chronic current account deficits and darkening prospects of needed inflows of foreign capital, the government attempted to initiate new sources of foreign currency. One move to that end was the foreign exchange regulations imposed on exporting firms that required them to sell a certain proportion of their foreign exchange earnings to the Central Bank. Exporting firms were initially required to deposit 25 per cent of their export earn-

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5. While much of the detail remains unknown, these swap agreements included the following. On 30 May 2019, a first bilateral currency swap agreement with People's Bank of China. On 15 June 2021, this agreement was increased by TRY 35.1 billion and CNY 23 billion, reaching a total of TRY 46 billion and CNY 35 billion. On 12 August 2021, a bilateral currency swap agreement with the Bank of Korea for an amount of TRY 17.5 billion or KRW 2.3 trillion, effective for three years, which could be extended by mutual agreement between the two sides. On 19 January 2022, a bilateral currency swap agreement between the Central Bank of the United Arab Emirates (CBUAE) and the CBRT. The nominal size of this swap agreement is mutually AED 18 billion and TRY 64 billion for three years (authors' compilation from CBRT press releases, see: www.tcmb.gov.tr).

ings with the Central Bank in January 2022. This ratio was raised to as much as 40 per cent in April.

Another measure was the introduction of a deposit and participation scheme for non-resident Turkish citizens (YUVAM accounts) by the CBRT which aimed to encourage non-resident Turkish citizens to repatriate their savings to Turkey (CBRT, 2022a). This scheme was intended to protect YUVAM account holders from exchange rate volatility while the CBRT would provide additional returns varying by maturities (ibid.). It was complemented by yet another policy to support the marketing of real estate to foreigners with the promise of Turkish citizenship if foreigners bought real estate valued above a certain threshold.[6] Finally, the government tried to encourage Russians and Ukrainians to invest their savings in Turkey by following a policy that avoided taking sides in the conflict or following the sanctions imposed on Russia by the US and other countries.[7]

Attempting to De-dollarize Savings ('Liralization')

On 21 December 2021, amidst yet another currency shock in which the Turkish lira suffered a free fall, the government introduced another protection scheme, the Exchange Rate Protected Deposit Accounts (ERPDA). Under the ERPDA, existing foreign currency deposits that were converted to Turkish lira deposits would, in addition to the domestic rate of interest promised by the account, receive an extra return given by the difference in exchange rates at the beginning and at the end of maturity. Regardless of the exchange rate difference on the day the account was opened and upon maturity, the principal and the interest would be paid to the client by the bank. If the amount to be calculated using the exchange rate applicable at the time of maturity were to be greater than the sum of the principal and the interest, the difference would be covered by the Central Bank (CBRT, 2021b). These deposits could carry maturities of three, six, or 12 months. On 29 December 2021, the Central Bank installed a similar system for gold deposits (CBRT, 2021c) and on 11 January 2022, corporations were also allowed to participate in this system (CBRT, 2022b). In April coverage of the system was expanded. If the ERPDAs were not converted from foreign currency, but instead started with Turkish lira deposits, the same system applied but this time the difference would be paid by the Treasury. At the same time, to discourage the banking sector from holding foreign currency deposits, the

6. See: www.invest.gov.tr/en/investmentguide/pages/acquiring-property-and-citizenship.aspx
7. The record amount of inflows penned under the 'net errors and omissions' line of the balance of payments is thought to be at least partially a reflection of these inflows. There is also a debate on whether the high 'net errors and omissions' also reflect money-laundering operations taking place in Turkey to which the government turns a blind eye since it desperately needs foreign currency inflows.

Table 2. Dollarization

As a % of total	Turkish lira deposits	Foreign currency deposits	Exchange rate protected deposits
2021 December	35.5	64.5	0
2022–01	38.6	61.4	0
2022–02	31.8	58.8	9.4
2022–03	31.7	58.1	10.2
2022–04	30.1	56.6	13.2
2022–05	27.7	58.5	13.7
2022–06	28.1	56.9	15.0
2022–07	28.3	56.4	15.2
2022–08	28.4	55.1	16.5
2022–09	28.9	53.8	17.4
2022–10	29.4	53.1	17.4

Source: Banking Regulation and Supervision Agency database (www.bddk.org.tr/BultenAylik/en, accessed 30 August 2023)

Central Bank tightened the reserve requirements for these accounts (CBRT, 2021d). Table 2 shows that the volume of these accounts quickly reached 17.4 per cent of the total volume of deposit accounts, yet foreign currency deposits remained above 50 per cent of the total deposits.

Various Foreign Exchange Market Interventions

While it is not the main focus of this article, it should be kept in mind that Turkey's Central Bank has been involved in a series of foreign exchange market interventions over the past few years. These interventions are summarized by the CBRT itself in a recent document published by the Bank for International Settlements (BIS, 2019), as reproduced here in Table 3. These measures aimed to support liquidity in foreign exchange markets and find ways to increase foreign exchange reserves, even though most of the time this increase was of a temporary nature.

A few notes are in order here. First, largely because of the aforementioned ad hoc policy interventions, often made in an arbitrary manner, most of the foreign capital invested in stocks and bonds had already left Turkey by mid-2022. While this has put downward pressure on the currency, it has made it easier for the government to target the exchange rate without fear of further capital outflows. Second, currency speculation through swaps with the London financial market was prevented by forcing the Turkish banks not to engage in these kinds of swaps, through regulations on the banking sector. Third, external debt — although high by international standards, could still be turned over at a high rate, possibly because not rolling it over would hurt the European lenders. Fourth, both the government and the central bank increased their external borrowing and brought in some of the much-needed

Table 3. Reserves Management and FX Interventions

Instrument	Mechanism	Provide FX hedge	Support FX market liquidity	Economize on use of FX reserves
TRY-settled forward FX sale auctions	CBRT sells forward FX through auctions and pays/receives TRY depending on the exchange rate at maturity date.	Yes, TRY payment/ receipt offsetting FX valuation loss/gain	Yes, support management of FX liquidity	Yes, no FX payment
TRY-settled forward FX sale transactions at the BIST Derivatives Market	CBRT sells forward FX contracts and pays/receives TRY related to changes in exchange rate throughout holding period	Yes, TRY payment/ receipt offsetting FX valuation loss/gain	Yes, support management of FX liquidity	Yes, no FX payment
FX deposits against TRY deposits auctions	CBRT sells FX and purchases TRY at the auction date	Yes, against market risk	Yes, supplies FX liquidity	Yes, only temporary supply of FX
FX deposit facility	Banks can borrow FX from the CBRT and also borrow from and lend to each other	Yes, against market risk	Yes, supplies FX liquidity	Yes, only temporary supply of FX.
Collateral FX deposit facility	CBRT accepts FX deposits at TRY providing operations	Indirectly yes, against market risk	Yes, economize on excess FX liquidity as a collateral	Yes, temporary increase in FX reserves
TRY currency swap market	CBRT buys FX and sells TRY at the spot leg of the transaction	Yes, against market risk	Yes, support both TRY and FX liquidity management	Yes, temporary increase in FX reserves
Rediscount credits	CBRT extends credits in TRY, repayments are in FX	No	No	Yes, permanent increase in FX reserves
Repayments of rediscount credits in TRY	CBRT extends credits in TRY, repayments in TRY, instead of FX	Yes, repayments in TRY from fixed exchange rate	Yes, supplies liquidity when demand for FX increases	No
FX sales to energy- importing state- owned companies	CBRT sells FX to energy importing state owned companies	Yes	Yes, supplies liquidity when demand for FX increases	No
FX reserve requirements	Banks maintain FX to fulfill their FX required reserves	No	Yes, balances FX market liquidity	Yes, temporary increase in FX reserves
Reserve option mechanism	Banks can maintain FX and gold accounts to fulfill their TRY required reserves	No	Yes, balances FX market liquidity	Yes, temporary increase in FX reserves

Source: BIS (2019: 270, Table 1)

foreign currency. Fifth, foreign currency inflows through 'net errors and omissions' increased, partly because of the Russia–Ukraine war and partly because of the government's soft stance on the issue. However, the sustainability of this approach is dubious, given the constraints of import dependence and current account deficits.

Resetting the Contours of Distribution

Turkey's recent history as described above offers a textbook exposé of the famous structuralist/heterodox dictum that inflation is always and everywhere an outcome of disequilibria in the labour markets and is a phenomenon of distributional conflict. This brings us to the two main questions of modern political economy: 'Why?' and for 'Whom?'.

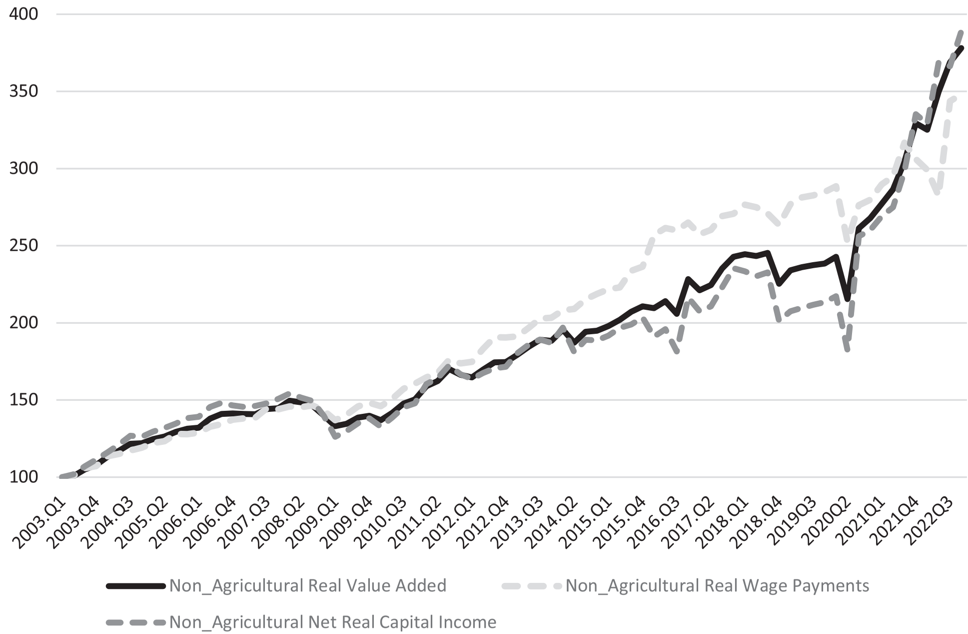
First, it must be noted in this context that, despite its appearance as a single-party government, JDP is in essence a coalition of various religious sects (*cemaat* groups) and conglomerates of a crony capitalist structure. Rent seeking and rent distribution are a sine qua none of this intricate power system, without which the economic bases of this fragile coalition are unlikely to be maintained. This view is very much in line with our previous assessment of the re-making of Turkey's financial crises, in which we argued that: 'contrary to the orthodox explanations emphasizing issues of poor governance, delays in structural reforms, or institutional retreat, Turkey's woes originated from the structural problems and intrinsic fragilities generated by the *speculation-led* economic growth model of the post-2001-crisis era. This model depended on continuous foreign capital inflows and increased indebtedness; and was centered around a construction boom' that proved unsustainable and encouraged disequilibria (Orhangazi and Yeldan, 2021: 3).

We will now follow up the (functional) income distribution consequences of this episode. To this end we will resort to TurkStat's National Income Statistics and — to bypass the complexities of functional income categories within the rural economy — we will focus mainly on the non-agricultural sectors. This choice is unavoidable due to various inconsistencies in the data regarding the crossed sources of income within a peasant economy largely based on non-commercial family farming where capital and labour categories are intrinsically interwoven.[8]

In Figure 4 we portray indices of aggregated labour and capital incomes alongside aggregate value added. The trends in non-agricultural value added and its distribution among wage labour and capital reveal significant shifts over the whole post-2003 JDP era. Three structurally differentiated movements stand out. In the first sub-period starting from 2003, when the

8. Agricultural value added was roughly 6.5 per cent of GDP in 2022.

Figure 4. Distribution of Real Non-agricultural Value Added (2003 = 100)



Source: authors' calculations based on TurkStat National Account Statistics (https://data.tuik.gov.tr/Kategori/GetKategori?p=ulusal-hesaplar-113, accessed 30 August 2023).

JDP assumed power, both wage labour and capital incomes rise secularly, with a slightly higher rate of increase observed in the latter. This is a period where the JDP government enjoyed the easy rents of hot money finance, enabled with the conjectural upswing of the global financial markets. Financed by speculative foreign financial inflows and rents from privatization of the parastatals, the JDP could pursue a 'populist' regime of delivery. As can be observed in Figure 4, the rate of increase of capital incomes remained ahead of wage-earner incomes over the first decade of the 2000s. Yet, with the eruption of the global financial crisis in late 2008 these trends came to an abrupt halt. Starting in 2009, wage incomes outpaced capital income growth. In fact, by 2015 the rate of growth in capital incomes in aggregate fell short of the aggregate value-added growth for the non-agricultural domestic economy. The original structural bases of the popular cohesion under the umbrella of the JDP seem to have broken down through the so-called *great recession* at the core of the global economy. This is when the JDP had to resort to different options to secure its coalition bases within the capitalist class. The secondary indicators of distribution reveal that it is *politics* that set the rules of rent acquisition and the transfer of surplus among competing conglomerates. Loyalty and cronyism often go in hand with the disposition of public procurement projects and large infrastructural investments especially in the privatized energy distribution sector.

Finally, though, this period of continued economic support of wage labour in return for its loyalty to the overall cause reaches its limits by 2019. By then, the domestic economy has already gone through two mini-cycles of growth–crisis–reinvigoration of growth, as narrated above, and the continued rent transfers via mega projects and financial re-engineering came up against the conditionalities faced by an open macro economy integrated to the global economy under conditions of a dependent industry and financial subordination. Data displayed in Figure 4 attest that beyond 2019 it is no longer feasible to sustain wage labour incomes under the fierce contradictions of rapid growth against an eroding external balance. Labour incomes collapse — the end result of the fundamental incompatibility between an independent national social policy and complete financial liberalization. The major policy error was to have an exchange rate policy which was out of alignment with the purchasing power parity (at a time of intensified inflationary pressures) and an interest rate which was out of alignment with domestic macroeconomic balances, while having largely liberalized capital flows. Turkey's post-2016 episode demonstrates graphically that this is an economic impossibility.

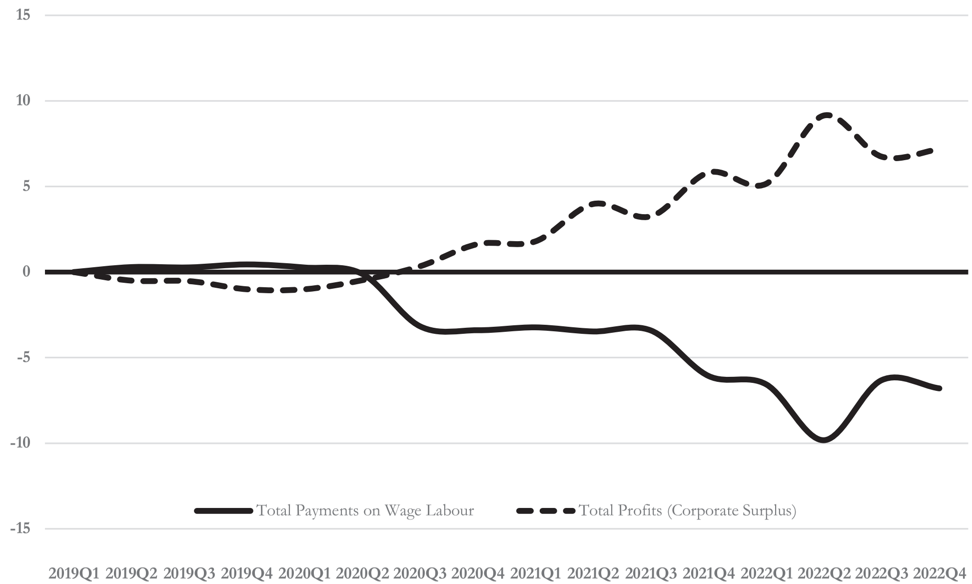
A more detailed investigation of TurkStat data indicates that the real rate of growth of the aggregate GDP averaged 11.4 per cent over 2021 (see Figure 4). Growth impetus was maintained in the first two quarters of 2022 at rates of 7.5 per cent and 7.6 per cent, respectively, which slowed down significantly to 3.9 per cent in the third quarter and settled at a 3.5 per cent rate of growth in the final quarter of the year. Yet, leaving the issues of quality and sustainability of this achievement aside, it is clear that the patterns of growth were unequalizing and even immiserizing. Wage labour has not benefited from positive rates of growth achieved thus far; and as the TurkStat data reveal, income share of wage labour has fallen from 31.3 per cent in 2020 to 24.7 per cent in the fourth quarter of 2022. In contrast, capital incomes (corporate surplus) increased their share from 59.6 per cent to 67.3 per cent over the same period (as shown in Figure 4).

In Figure 5 we follow up the changes in the shares of income across wage labour and capital since 2019 and obtain a striking depiction of what UNCTAD (2019) refers to as crocodile capitalism. Hence, one main result of Turkey's loose monetary policy experiment of the last couple of years has been cheapening of the cost of labour. Rapidly rising inflation against the weak bargaining position of labour coupled with the pro-capital policy stance of the government benefited capital in general, which has increased its profit rates as well as its share in the distribution of national income. Labour-intensive segments of capital stood to gain the most from this tendency. Coupled with the weakening of the Turkish lira, labour-intensive and export-oriented firms clearly benefited from this policy orientation. Furthermore, the negative real interest rate policy helped small- and medium-sized enterprises (especially the ones with close ties to the government, which were prioritized in access to credit from public banks) to finance both their investments and working capital at almost no cost. In addition, credit-worthy speculators used access to credit to finance speculation in land, housing and financial markets.

CONCLUDING REMARKS

In this article, we have summarized the events and policy interferences of the Turkish government in the last couple of years in its pursuit of achieving high rates of growth at all costs — an episode that eventually culminated in a serious macroeconomic debacle with severe regression of wage labour incomes along with high inflation and the collapse of the administrative capacity of the bureaucratic system. As the JDP tried to maintain its targets of high growth through various alternative modes of credit expansion and debt accumulation, it found itself trapped within the contours that had been set by what some scholars called 'dependent financialization' (Akyüz, 2017; Apaydin and Çoban, 2022; Bonizzi et al., 2019) of a peripheral market economy (see also Vernengo, 2006). Even though, in many instances, the initial consequence of this peripheral engagement with the global economy had been rapid growth driven by speculative hot money finance and expansion of foreign debt channels, the long-term result has almost always been the worsening of macro balances. In the words of UNCTAD (1998: 55): 'the ascendancy of finance over industry together with the globalization of finance have become underlying sources of instability and unpredictability in

Figure 5. *Crocodile Capitalism: Percentage Changes in the Distribution of National Income (2019–22)*



Source: authors' calculations from TurkStat National Accounts (https://data.tuik.gov.tr/Kategori/GetKategori?p=ulusal-hesaplar-113, accessed 30 August 2023).

the world economy. … In particular, financial deregulation and capital account liberalization appear to be the best predictor of crises in developing countries'. Almost all recent episodes of financial-cum-currency instability show that the observed sharp swings in capital flows are mostly a reflection of large divergences in domestic financial conditions relative to those of the rest of the world. Reversals of capital flows are often associated with the deterioration of the macroeconomic fundamentals in the recipient country. However, 'such deterioration often results from the effects of capital inflows themselves as well as from external developments, rather than from shifts in domestic macroeconomic policies' (ibid.: 56).

All through this debacle, domestic factors no doubt had an important part to play. Nevertheless, there is now abundant accumulated evidence on the fundamental roles played by the international finance institutions and the subordination of the so-called emerging market developing economies to the global finance logic. As the conditionalities of the so-called impossible trilemma set in, many incumbent emerging economy governments begin to realize that the hot money-driven, speculation-led growth model comes with a severe binding constraint: subordination of control over monetary policy and entrapment in a high interest policy environment. The quest for the answer to the more general question of 'why the structural power of finance takes a particularly violent form of expression in the developing emerging market economies (DEEs)' has been studied by Alami et al. using the umbrella concept of international financial subordination. The authors instrumentalize the concept to offer a working definition of the complex global financial network that is 'both spatial and saturated with power, a relation of domination, inferiority and subjugation between different spaces across the world market, expressed in and through money and finance, which penalizes actors in DEEs disproportionally' (Alami et al., 2022: 1364).

Within a purely economic realm, it has been observed that the global financial logic effectively transforms the trilemma into a dilemma (Rey, 2018). Under an open capital account, for a peripheral economy dependent on foreign capital inflows, the domestic rate of interest and the exchange rate collapse into one single entity, that of the *net financial arbitrage* (or the covered interest parity) governing the flows of speculative hot money.[9] This means that independent monetary policies are possible if — and only if — the capital account is managed (Bonizzi et al., 2019; Rey, 2018).

Furthermore, within the financially dependent globalization logic, the international financial institutions' demands for a continuous stream of 'structural reforms' ultimately exhaust the ability of national governments to create and sustain traditional modes of acquisition and transfer of economic surplus in favour of their domestic clientele. The insatiable appetite of finance capital for structural reforms not only constrains the traditional

9. See Orhangazi and Yeldan (2021) for a discussion and calculation of this net arbitrage in the context of post-1990 Turkish macroeconomic history.

(national) conglomerates' ability to acquire a surplus, but also demands that any such surplus is redistributed and redirected through global financial ventures. As such, it also contributes to democratic backsliding by constraining the policy space of governments (Apaydin and Çoban, 2022).

When the new government was formed in June 2023, following the elections in May, both the Minister of Treasury and Finance and the Governor of the Central Bank were chosen to meet the expectations and appease the power houses of international finance capital, reminiscent of similar moves made in late 2020, when the risk of a balance-of-payments crisis was heightened. The new economic management team is expected to satisfy international investors by raising interest rates and switching to more orthodox policies to attract foreign capital inflows and avoid a costly balance-of-payments and/or external debt crisis. This move shows the limitations of the policy space for an economy that is integrated into the world economy through free trade and free capital flows. Thus, from a political standpoint we would argue that portraying Turkey's policy choices as 'heterodox' would serve only an ill-guided rhetoric, and that the country's recent experiences should be seen in a broader perspective, as the responses of an incumbent government to the conditionalities of peripheral globalization for the maintenance of traditional modes of surplus transfer to its clientele. After all is said and done, the real question remains: are there any real alternatives without regulating capital inflows and bringing down import dependence?

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