

## Economic change in twentieth-century Turkey: is the glass more than half full?

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### Introduction

One metaphor for assessing Turkey's economic performance in the twentieth century may be to ask whether the glass is half full or half empty. On the one hand, Turkey has experienced far-reaching economic changes since the early 1920s. The primarily rural and agricultural economy of the early twentieth century has transformed into a mostly urban economy. Average or per capita incomes have increased more than fivefold during this period. Other indicators of standards of living have also improved significantly. Life expectancy at birth has almost doubled from under thirty-five years in the interwar era to sixty-nine years. Adult literacy rates have increased from about 10 per cent to about 90 per cent (see table 10.1).

On the other hand, it would be misleading to judge economic performance only in absolute terms. The twentieth century, especially its second half, was a period of rapid increases in the standards of living in most parts of the developing world, of which Turkey is still considered a part. Increases in per capita incomes in Turkey since the First World War have been close to, but slightly above, world averages and averages for the developing countries. The income per capita gap between Turkey and the high-income countries of Western Europe and North America was about the same in 2005 as it was on the eve of the First World War. Certainly, Turkey has not been one of the miracle-producing economies of the twentieth century. Moreover, its record in human development has been weaker than its record in economic growth, close to but perhaps below average for the developing world. In addition, these increases or improvements have not all been achieved at a steady pace. In fact, Turkey's economy has been plagued by recurring political and macro-economic instability that has led to a number of crises, especially in the second half of the twentieth century. The most severe of these, a financial crisis, occurred in 2001. That the economy managed to rebound strongly within a few years should perhaps remind us of the above metaphor.

Table 10.1. *Economic and human development indicators for Turkey, 1913–2005*

	1913	1923	1950	1980	2005	
Population (mill.)	17	13	21	45	72	
Share of urban pop. (5000 inhab.) in total pop. (per cent)	28	24	25	44	68	
Share of agriculture in the labour force (per cent)	80	85	84	51	34	
Share of agriculture in GDP (per cent)	55	42	54	26	11	
Share of industry in GDP (per cent)	13	11	13	21	26	
GDP per capita, PPP adj. in 1990 US\$	1,200	710	1,620	4,020	7,500	
GDP per capita as per cent of (W. Europe + US)	29	16	24	25	30	
GDP per capita as per cent of developing countries	168	n.a.	188	219	225	
GDP per capita as per cent of world	79	n.a.	77	89	117	
Life expectancy at birth (years)	30?	n.a.	47	62	69	
Adult literacy (ages above 15 in per cent)	10	n.a.	32	69	89	
<b>Annual growth rates (in per cent)</b>	<b>1913–50</b>	<b>1923–50</b>	<b>1950–80</b>	<b>1980–2005</b>	<b>1913–2005</b>	<b>1923–2005</b>
Population	0.6	1.8	2.6	1.9	1.6	2.1
GDP per capita	0.8	3.1	3.1	2.5	2.0	2.9
Total agricultural output	1.0	4.5	2.9	1.2	1.7	2.9
Total industrial output	3.1	5.8	7.7	5.8	5.3	6.5

*Notes:* The inclusion of women working in the family farm in the labour force but the exclusion of urban women working at home from the labour force tends to overstate the share of agriculture in Turkish employment statistics. Per capita GDP in constant US dollars is the basic indicator for examining long-term increases in average incomes. These series are calculated with a purchasing power parity adjustment in order to take into account the fact that price levels tend to be lower and the same dollar income purchases more in lower-income countries.

*Sources:* For Turkish data except per capita GDP: State Institute of Statistics, *Statistical Indicators, 1923–2002*; for GDP per capita series: Maddison, *The World Economy, 2001* and 2003; Eldem, *Osmanlı*; Özel and Pamuk, ‘Osmanlı’dan Cumhuriyete’; and Pamuk, ‘Estimating Economic Growth’.

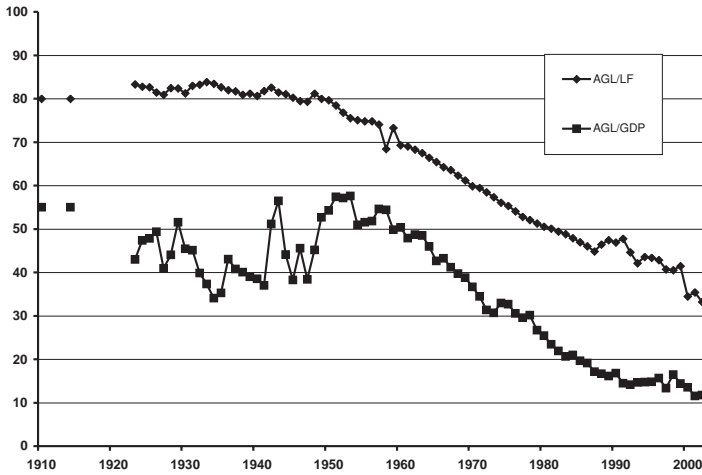
Also on the positive side, the last decade has witnessed important changes in Turkey's relations with the European Union (EU). Although the first agreement for cooperation between Turkey and what was then the Common Market dates back to 1963, both sides remained doubtful about Turkey's integration. Turkey's first application for membership in 1987 was turned down, but it joined the European customs union in 1996. After a reasonably successful implementation of the customs union for one decade, formal negotiations for membership in the EU began in 2006.

I begin below with several key indicators that offer a summary evaluation of Turkey's economic development record since 1923 or 1913 in a comparative framework. The rest of the chapter attempts to understand that record. In recent years, a growing literature has emphasised the contribution of the social and political environment, and more specifically of institutions defined as written and unwritten rules and norms, to long-term economic change. In the second section, I will sketch a framework for understanding the linkages between the evolution of institutions and economic change in twentieth-century Turkey. I will then examine, in the third section, world economic conditions, government economic policies and the basic macro-economic outcomes for Turkey in three sub-periods, in order to gain additional insights into its absolute and relative growth record. With its very large share in employment and total output until recently, agriculture is of central importance also for understanding long-term economic development in Turkey. Similarly, income distribution, or more generally the distribution of gains, must be part of any long-term evaluation. In the fourth section, I focus on these two themes, agriculture and income distribution and regional disparities, before offering some concluding remarks in the fifth section.

### Economic growth and development record

In the 1920s, less than 25 per cent of Turkey's population lived in urban centres with more than 5,000 inhabitants. The rural–urban shares remained little changed until after the Second World War, but Turkey has been experiencing rapid urbanisation since then. The proportion of the population living in urban centres, as defined above, increased to 44 per cent by 1980 and to 68 per cent by 2005. Rapid urbanisation has been accompanied by large shifts within the labour force. Agriculture's share in total employment declined from about 80 per cent in 1913 and in 1950 to 34 per cent in 2005, while industry's share rose from about 9 to 23 per cent, and that of services increased from 11 to 43 per cent. Similarly, agriculture's share in GDP declined from about 55 per cent

## Economic change in twentieth-century Turkey

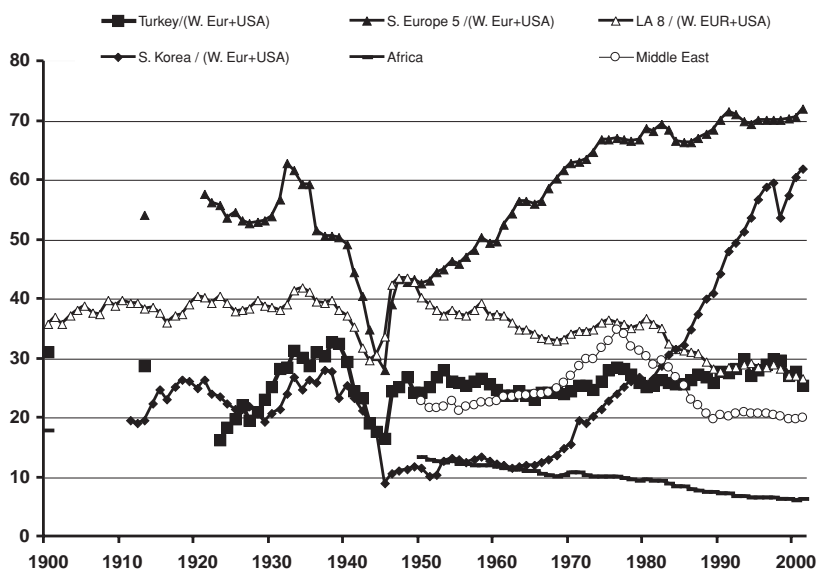


Graph 10.1 Share of agriculture in GDP and labour force in Turkey, 1910–2000

in 1913 and 54 per cent in 1950 to 11 per cent in 2005. The share of industry has increased from about 13 per cent in 1913 to 26 per cent in 2005 while the share of services has increased from 34 to 64 per cent during the same period (see table 10.1 and graph 10.1).

The beginning date or base year for long-term comparisons of economic growth (1913 vs. 1923) requires an explanation. A decade of wars beginning in 1912 had resulted in a dramatic 20 per cent decline in population and as much as 40 per cent decline in per capita income by 1922. As a result, the GDP per capita levels for Turkey were sharply lower than long-term trend values in the early 1920s. For this reason, the year selected for long-term comparisons makes a big difference. While I provide values for both base years in table 10.1, for most comparisons I will use 1913, which is also used in most international comparisons.

Per capita income in Turkey and the rest of the Ottoman Empire rose during the nineteenth century. Nonetheless, the gap between the high-income countries of Western Europe and the United States and the developing world, including the Ottoman Empire, widened considerably during the century before the First World War, due to the rapid rates of industrialisation in the former group. GDP per capita in the area within the present-day borders of Turkey was approximately US\$ 1,200 in 1913 (see table 10.1). This was 29 per cent of the level of GDP per capita in the high-income countries of Western Europe and the United States, calculated on a population-weighted basis, and



Graph 10.2 GDP per capita as percentage of (USA + W. Europe), 1900–2000

168 per cent of the GDP per capita income in the developing countries of Asia, Africa and Latin America, also calculated on a population-weighted basis and for the same year.

Two world wars and a great depression later, per capita income in Turkey in 1950 was more than 30 per cent higher, at US\$ 1,620 constant or inflation adjusted. This was equal to 24 per cent of the per capita income of the high-income countries and 188 per cent of the per capita income in the developing countries. By 2005, GDP per capita in Turkey had reached US\$ 7,500, an increase of more than fivefold since 1913. This figure corresponded to about 30 per cent of the level of GDP per capita in the high-income countries of Western Europe and the United States, and approximately 225 per cent of the GDP per capita income of the developing countries for the same year. In other words, average incomes in Turkey have increased at about the same rate as those in high-income countries since 1913. Turkey has not been able to close any of this large gap. At the same time, increases in average incomes in Turkey since 1913 have been slightly faster than those in the developing world. If 1923 were chosen as the base year, Turkey's long-term record would look considerably better (table 10.1)

In graph 10.2, I provide per capita GDP series for Turkey and a number of other regions and continents as percentages of the average for Western

Europe and the United States for the period since 1913. This graph allows further insights into Turkey's comparative economic record in the twentieth century. It shows that while its growth record was better than the averages for Latin America, Middle East and Africa as a whole, Turkey has lagged well behind Southern Europe and East Asia since 1950.

However, GDP per capita is not an adequate measure of economic development or more generally of standards of living. For this reason, the human development index (HDI), a broader measure first introduced by the United Nations in 1990, has become quite popular. HDI has three components: longevity as measured by life expectancy at birth; knowledge as measured by a weighted average of adult literacy; and years of schooling and income as measured by GDP per capita. Estimates for HDI for Turkey and other countries are available for the benchmark years of 1950 and 1975, as well as for the period since 1990. Recently, I made a separate estimate for Turkey in 1913, making use of the data cited above. These estimates allow us to obtain an overview of the standards of living in twentieth-century Turkey and insert it into a comparative framework (table 10.2).

It is not easy to compare the evolution of HDI of developing countries with those of developed countries today or in the past. For this purpose, I present in the last column of table 10.2 a measure for the extent to which countries have reduced the distance between their level of HDI of 1950 and the maximum attainable score of 1. While Turkey and many other developing countries with low initial levels have experienced large increases in HDI since 1950, the developed countries have generally shown larger increases when measured as per cent of maximum possible increase. In terms of this latter measure, Turkey has done better than African and Eastern European countries, about the same as Latin American countries, and has lagged behind East Asian countries since 1950.

Changes in life expectancy at birth, or  $e(0)$ , provide a dramatic example of changes in twentieth-century Turkey. The earliest period for which we have estimates of  $e(0)$  is for the 1930s, when the figure was thirty years. Life expectancy at birth had increased to forty-seven years by 1950 and to sixty-two years by 1980. In 2004, the latest year for which we have the estimates,  $e(0)$  stood at seventy years: sixty-eight years for men and seventy-three years for women (table 10.1). While official estimates are not available for adult literacy in the early years of the Republic, it can be safely assumed that the rate did not exceed 10 per cent in the 1920s. In 1935, the literacy rate for individuals over the age of fifteen was 19 per cent: 31 per cent for men and only 8 per cent for women. By 1950, the adult literacy rate had increased to 28 per cent: 47 per cent

Table 10.2. *Changes in the human development index, 1913–2003*

Country	1913	1950	1975	2003	Change in 1950–2003 as per cent of possible
Western Europe	0.580	0.707	0.848	0.935	77.8
North America	0.643	0.774	0.861	0.945	75.7
Japan	0.466	0.676	0.851	0.943	82.4
China	n.a.	0.225	0.522	0.755	68.4
India	0.143	0.247	0.406	0.602	47.1
Africa	n.a.	0.271	n.a.	0.549	38.1
Greece		0.625	0.800	0.912	76.5
Russia	0.345	0.694	n.a.	0.795	33.0
Bulgaria	0.403	0.607	n.a.	0.808	51.1
Argentina	0.511	0.526	0.784	0.863	71.1
Mexico	0.270	0.484	0.688	0.814	64.0
Brazil	0.249	0.448	0.641	0.792	62.3
South Korea	n.a.	0.459	0.687	0.901	81.7
Malaysia	n.a.	0.407	0.614	0.796	65.6
Thailand	0.388	0.603	0.757	0.778	44.1
Indonesia	n.a.	0.337	0.467	0.697	54.3
Tunisia	n.a.	0.303	0.512	0.753	64.6
Iran	n.a.	0.331	0.507	0.736	60.5
Egypt	n.a.	0.291	0.433	0.659	51.9
Nigeria	n.a.	0.194	0.326	0.453	32.1
<b>Turkey</b>	<b>0.190</b>	<b>0.382</b>	<b>0.592</b>	<b>0.750</b>	<b>59.5</b>

*Notes:* Regional or continental averages are weighted by the population of the individual countries. For definition of HDI, see the text. In the last column, the maximum possible improvement in HDI is 1-(HDI in 1950).

*Sources:* Crafts (1997) and (2002) for 1913–1975 values except for Turkey in 1913 and United Nations Development Programme, *Human Development Report 2005* for 2003 values.

for men and 13 per cent for women. In 2005, it stood at 89 per cent: 95 per cent for men and 82 per cent for women (table 10.1).

Since 1913 and especially since 1950, levels and improvements in life expectancy in Turkey have been comparable to those in other developing countries with similar levels of income. However, since 1913 and 1950 education levels in Turkey as measured by literacy, years of schooling and school enrolment have been lagging significantly behind education levels in developing countries with similar levels of GDP. At the same time, the incidence of poverty in Turkey has been lower in comparison to developing countries with similar levels of income. These contrasts can be clearly observed in a

comparison of Turkey with countries in Latin America since 1913 and 1950. Levels of schooling in Turkey have been below the averages for the larger Latin American countries throughout the twentieth century. The lagging performance in education is not a matter for the historical record alone, however. This deficit will make itself increasingly felt in the decades ahead. For further increases in GDP per capita, Turkey will need a better-educated labour force and significant increases in the technology and knowledge component of its economy.

Along with other Muslim majority countries, Turkey also lags behind developing countries with comparable levels of per capita income in indices aiming to measure gender equality and the socio-economic development of women.<sup>1</sup> One other reason why many of Turkey's human development measures have been lagging behind is the large regional differences in these indicators between the mostly Kurdish south-east and the rest of the country, as discussed on pp. 296–97 below.

### Institutional change and economic growth

For decades it was believed that economic growth results in part from the accumulation of factors of production and improvements in their quality through investment in machines and skill formation, and in part from increases in productivity derived from advances in technology and organisational efficiency. In recent years, however, a useful distinction is being made between the proximate and the ultimate sources of economic growth. The former relates to the contributions made by the increases in factor inputs and productivity as cited above. The latter refers to aspects of the social and economic environment that influence the rate at which inputs and productivity grow. A growing literature emphasises the importance of institutions or written and unwritten rules of a society and policies such as property rights and their enforcement, norms of behaviour, political and macro-economic stability, which affect the incentives to invest and innovate. In this new perspective, the basic function of institutions is to provide certainty in economic activity. More complex economic structures will not emerge unless institutions can reduce the uncertainties associated with such structures. Recent research has also revealed very large differences in total productivity levels between countries. It appears that more than half of the differences in levels of per capita production are due to the

<sup>1</sup> Based on the World Bank, *World Development Report*, and United Nations Development Programme, *Human Development Report* for recent years.



productivity obtained from the same amount of resources rather than from the accumulation of more machines or skills per person.<sup>2</sup> In this context, the quality of institutions is increasingly seen as the key to the explanation of economic growth and long-term differences in per capita GDP. Economic institutions also determine the distribution of income and wealth. In other words, they determine not only the size of the aggregate pie, but also how it is divided amongst different groups in society.

The process of how economic institutions are determined and the reasons why they vary across countries are still not sufficiently well understood. Nonetheless, it is clear that because different social groups including state elites benefit from different economic institutions, there is generally a conflict of interest over the choice of economic institutions, which is ultimately resolved in favour of groups with greater political power. The distribution of political power in society is in turn determined by political institutions and the distribution of economic power. For long-term growth, economic institutions should not offer incentives to narrow groups, but instead open up opportunities to broader sections of society. For this reason, political economy and political institutions are considered key determinants of economic institutions and the direction of institutional change.<sup>3</sup>

The evolution of economic institutions in Turkey and their consequences for economic growth and distribution of income have not been closely studied. In the next section, I will examine structural change, industrialisation and the basic macro-economic outcomes in three sub-periods: the interwar years or the single-party era until the end of the Second World War; the import-substituting industrialisation era after the Second World War; and the globalisation era since 1980. I will thus seek to gain insights not only into Turkey's record of economic growth and distribution, but also into the evolution of the economic institutions that played a key role in these outcomes. Briefly, there were significant institutional changes in Turkey during the interwar period. Ultimately, however, political and economic power remained with the state elites. Despite the rhetoric to the contrary, the regime remained decidedly

<sup>2</sup> There is growing evidence that this generalisation applies to Turkey as well: Şeref Saygılı, Cengiz Cihan and Hasan Yurtoğlu, 'Productivity and Growth in OECD Countries: An Assessment of the Determinants of Productivity', *Yapı Kredi Economic Review* 12 (2001); Sumru Altuğ and Alpay Filiztekin, 'Productivity and growth, 1923–2003', in S. Altuğ and A. Filiztekin (eds.), *The Turkish Economy: The Real Economy, Corporate Governance and Reform* (London and New York: Routledge, 2005).

<sup>3</sup> Daron Acemoğlu, Simon Johnson and James A. Robinson, 'Institutions as a fundamental cause of long-run growth', in P. Aghion and S. N. Durlauf (eds.), *Handbook of Economic Growth* (Amsterdam: Elsevier, 2005); see also Elhanan Helpman, *The Mystery of Economic Growth* (Cambridge, MA: Harvard University Press, 2004).

urban in a country where the overwhelming majority lived in rural areas and engaged in agriculture. As a result, these institutional changes did not reach large segments of the population. Rates of increase of per capita GDP remained low in Turkey as in most developing countries during this period. Pace of economic growth accelerated in both the developed and developing countries including Turkey after the Second World War. With the transition to a more open political regime and urbanisation, urban industrial groups began to take power away from the state elites. The economic institutions began to reflect those changes. This transition, however, has not been smooth or easy. For most of the last half-century, political and macro-economic instability, including three military coups and a series of fragile coalitions and the shortcomings of the institutional environment, seriously undermined the economy's growth potential. The glass has remained only half full.

*World wars, the Great Depression and étatism, 1913–1946*

The Ottoman economy, including those areas that later comprised modern Turkey, remained mostly agricultural until the First World War. Nonetheless, per capita income was rising in most regions of the empire during the decades before the war.<sup>4</sup> But the destruction and death that accompanied the Balkan Wars of 1912–13, the First World War and the War of Independence, 1920–2, had severe and long-lasting consequences. Total casualties, military and civilian, of Muslims during this decade are estimated at close to 2 million. In addition, most of the Armenian populace of about 1.5 million in Anatolia were deported, killed or died of disease, after 1915. Finally, under the Lausanne Convention, approximately 1.2 million Orthodox Greeks were forced to leave Anatolia, and in return, close to half a million Muslims arrived from Greece and the Balkans after 1922.

As a result of these massive changes, the population of what became the Republic of Turkey declined from about 17 million in 1914 to 13 million at the end of 1924.<sup>5</sup> The population of the new nation-state had also become more homogeneous, with Muslim Turks and the Kurds who lived mostly in the south-east making up close to 98 per cent of the total. The dramatic decline in the Greek and Armenian populations meant that many of the commercialised, export-oriented farmers of western Anatolia and the eastern Black Sea coast,

4 Şevket Pamuk, 'Estimating Economic Growth in the Middle East since 1820', *Journal of Economic History* 66 (2006).

5 Based on Behar Cem, *The Population of the Ottoman Empire and Turkey, 1500–1927* (Ankara: State Institute of Statistics, 1995) and Vedat Eldem, *Osmanlı İmparatorluğu'nun iktisadi şartları hakkında bir tetkik* (Istanbul: İş Bankası Publications, 1970).

as well as the artisans, leading merchants and moneylenders who linked the rural areas to the port cities and the European trading houses, had died or departed. Agriculture, industry and mining were all affected adversely by the loss of human lives and by the deterioration and destruction of equipment, draft animals and plants during the war years. GDP per capita in 1923 was approximately 40 per cent below its 1914 levels<sup>6</sup> (also table 10.1).

The former military officers, bureaucrats and intellectuals who assumed the positions of leadership in the new republic viewed the building of a new nation-state and modernisation through Westernisation as two closely related goals. They strove, from the onset, to create a national economy within the new borders. The new leadership was keenly aware that financial and economic dependence on European powers had created serious political problems for the Ottoman state. At the Lausanne Peace Conference (1922–3), which defined, amongst other things, the international economic framework for the new state, they succeeded in abolishing the regime of capitulations that had provided special privileges to foreign citizens. The parties also agreed that the new republic would be free to pursue its own commercial policies after 1929. The new government saw the construction of new railways and the nationalisation of the existing companies as important steps towards the political and economic unification of the new state inside new borders. Despite its rhetoric to the contrary, the regime's priorities lay with the urban areas. It considered industrialisation and the creation of a Turkish bourgeoisie to be the key ingredients of national economic development.<sup>7</sup>

Nonetheless, the new regime abolished the much-dreaded agricultural tithe and the animal tax in 1924. This move represented a major break from Ottoman patterns of taxation and a significant decrease in the tax burden of the rural population. While this decision has been interpreted as a concession to the large landowners, the new leadership was concerned more about alleviating the poverty of the small and medium-sized producers, who made up the overwhelming majority of the rural population. In the longer term, the abolition of the tithe and tax-farming helped consolidate small peasant ownership. The

6 Işık Özel and Şevket Pamuk, 'Osmanlı'dan cumhuriyet'e kişi başına üretim ve milli gelir, 1907–1950', in Mustafa Sönmez (ed.), *75 Yılda Paranın Serüveni* (Istanbul: Tarih Vakfı Yayınları, 1998), based on a comparison of the Turkish agricultural statistics of the 1920s as summarised in Tuncer Bulutay, Yahya S. Tezel and Nuri Yıldırım, *Türkiye milli geliri, 1923–1948*, 2 vols. (Ankara: University of Ankara Publications, 1974) with the Ottoman agricultural statistics before the First World War as given in Tevfik Güran, *Agricultural Statistics of Turkey during the Ottoman Period* (Ankara: State Institute of Statistics, 1997).

7 Şerif Mardin, 'Turkey: the transformation of an economic code', in E. Özbudun and A. Ulusan (eds.), *The Political Economy of Income Distribution in Turkey* (New York: Holmes & Meier, 1980).

recovery of agriculture provided an important lift to the urban economy as well. By the end of the 1920s, GDP per capita levels had attained the levels prevailing before the First World War.<sup>8</sup>

### The Great Depression

The principal mechanism for the transmission of the Great Depression to the Turkish economy was the sharp decline in prices of agricultural commodities. Decreases in the prices of leading crops, such as wheat and other cereals, tobacco, raisins, hazelnuts and cotton, averaged more than 50 per cent from 1928–9 to 1932–3, much more than the decreases in prices of non-agricultural goods and services. These adverse price movements created a sharp sense of agricultural collapse in the more commercialised regions of the country, in western Anatolia, along the eastern Black Sea coast and in the cotton-growing Adana region in the south.<sup>9</sup>

Earlier in 1929, even before the onset of the crisis, the government had begun to move towards protectionism and greater control over foreign trade and foreign exchange. By the second half of the 1930s, more than 80 per cent of the country's foreign trade was conducted under clearing and reciprocal quota systems.<sup>10</sup> As the unfavourable world market conditions continued, the government announced in 1930 a new strategy of *étatisme*, which promoted the state as a leading producer and investor in the urban sector. A first five-year industrial plan was adopted in 1934 with the assistance of Soviet advisers. By the end of the decade, state economic enterprises had emerged as important and even leading producers in a number of key sectors, such as textiles, sugar, iron and steel, glass works, cement, utilities and mining.<sup>11</sup> *Etatisme* undoubtedly had a long-lasting impact in Turkey, and later in other countries around the Middle East. However, the initial efforts in the 1930s made only modest contributions to economic growth and structural change. For one thing, state enterprises in manufacturing and many other areas did not begin operations until after 1933. Close to half of all fixed investments by the public sector during this decade went to railway construction and other forms of transport. In 1938, state

8 Özel and Pamuk, 'Osmanlı'dan cumhuriyet'e'.

9 İlhan Tekeli and Selim İlkin, *1929 Dünya Buhramı'nda Türkiye'nin iktisadi politika arayışları* (Ankara: Orta Doğu Teknik Üniversitesi, 1977); Yahya S. Tezel, *Cumhuriyet Döneminin iktisadi tarihi (1923–1950)*, 2nd edn. (Ankara: Yurt Yayınları, 1986), pp. 98–106.

10 Ibid., pp. 139–62

11 Korkut Boratav, 'Kemalist economic policies and etatism', in A. Kazancıgil and E. Özbudun (eds.), *Atatürk: Founder of a Modern State* (London: C. Hurst, 1981), pp. 172–89; Tezel, *Cumhuriyet Döneminin*, pp. 197–285; İlhan Tekeli and Selim İlkin, *Uygulamaya geçerken Türkiye'de devletçiliğin oluşumu* (Ankara: Orta Doğu Teknik Üniversitesi, 1982).

enterprises accounted for only 1 per cent of total employment in the country. Approximately 75 per cent of employment in manufacturing continued to be provided by small-scale private enterprises.<sup>12</sup>

*Etatisme* did not lead to large shifts in fiscal and monetary policies, either. Government budgets remained balanced, and the regime made no attempt to take advantage of deficit finance. In fact, 'balanced budget, strong money' was the government's motto for its macro-economic policy. The exchange rate of the lira actually rose against all leading currencies during the 1930s. The most important reason behind this policy choice was the bitter legacy of the Ottoman experience with budget deficits, large external debt and inflationary paper currency during the First World War. İsmet İnönü, the prime minister for most of the interwar period, was a keen observer of the late Ottoman period and was the person most responsible for this cautious, even conservative, policy stand. In other words, government interventionism in the 1930s was not designed, in the Keynesian sense, to increase aggregate demand through the use of devaluations and expansionary fiscal and monetary policies. Instead, the emphasis was on creating a more closed, autarkic economy, and increasing central control through the expansion of the public sector.<sup>13</sup>

#### Economic growth and its causes

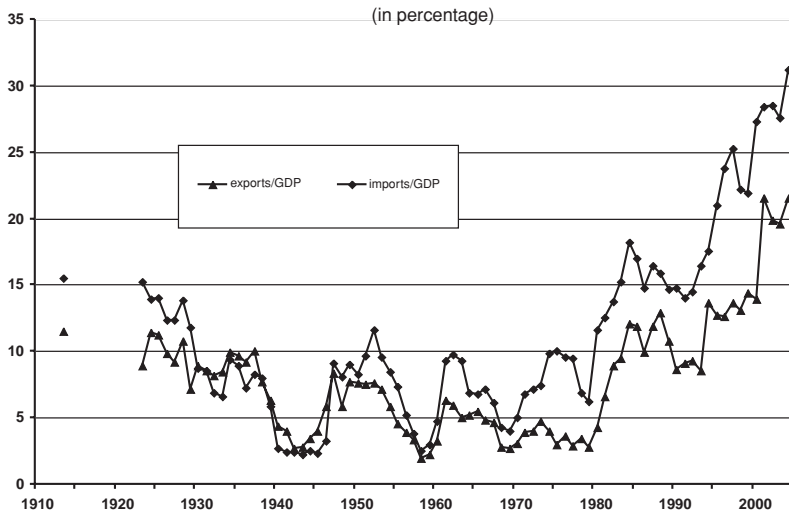
Available estimates suggest that GDP and GDP per capita grew at average annual rates of 5.4 and 3.1 per cent respectively during the 1930s, despite the absence of expansionary fiscal and monetary policy (see table 10.1 and graph 2). One important source of the output increases after 1929 was the protectionist measures adopted by the government, ranging from tariffs and quotas to foreign-exchange controls, which sharply reduced the import volume from 15.4 per cent of GDP in 1928–9 to 6.8 per cent by 1938–9 (graph 10.3). Import repression created attractive conditions for the emerging domestic manufacturers, mostly the small and medium-sized private manufacturers.

There is another explanation for the overall performance of both the urban and the national economy during the 1930s, which has often been ignored amidst the heated debates over *étatisme*. Thanks to the strong demographic recovery, agriculture – the largest sector of the economy, employing more than

<sup>12</sup> Tezel, *Cumhuriyet Döneminin*, pp. 233–7.

<sup>13</sup> Şevket Pamuk, 'Intervention during the Great Depression, another look at Turkish experience', in Ş. Pamuk and Jeffrey Williamson (eds.), *The Mediterranean Response to Globalization Before 1850* (London and New York: Routledge, 2000), pp. 332–4.

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Graph 10.3 Degree of openness of Turkey's economy, 1913–2005

three-fourths of the labour force and accounting for close to half of the GDP – did quite well during the 1930s.<sup>14</sup>

Given its balanced-budget policy stand, government actions in response to sharply lower agricultural prices after 1929 were limited to purchases of small amounts of wheat. It is remarkable that despite the adverse price trends, agricultural output increased by 50–70 per cent during the 1930s. The most important explanation of this outcome is the demographic recovery in the countryside. In the interwar period, Anatolian agriculture continued to be characterised by peasant households who cultivated their own land with a pair of draft animals and the most basic of implements. With the population beginning to increase at annual rates around 2 per cent after a decade of wars, expansion of the area under cultivation soon followed. It is also likely that the peasant households responded to the lower cereal prices after 1929 by working harder to cultivate more land and produce more cereals in order to reach certain target levels of income, very much like the peasant behaviour predicted by the Russian economist Chayanov. In other words, behind the high rates of industrialisation and growth in the urban areas were the millions

<sup>14</sup> Frederic C. Shorter, 'The Population of Turkey after the War of Independence', *International Journal of Middle East Studies*, 17 (1985).

of family farms in the countryside, which kept food and raw materials prices lower until the Second World War.<sup>15</sup>

#### Difficulties during the war

Although Turkey did not participate in the Second World War, full-scale mobilisation was maintained during the entire period. The sharp decline in imports and the diversion of large resources for the maintenance of an army of more than one million placed enormous strains on the economy. Official statistics suggest that GDP declined by as much as 35 per cent and the wheat output by more than 50 per cent until the end of the war. In response, the prices of foodstuffs rose sharply and the provisioning of urban areas emerged as a major problem for the government. Under these circumstances, *étatisme* was quickly pushed aside. Large increases in defence spending were financed by monetary expansion. High inflation, wartime scarcities, shortages and profiteering accentuated by economic policy mishaps soon became the order of the day. Measures such as the 1942 *Varlık Vergisi*, or Wealth Levy, which was applied disproportionately to non-Muslims, only made things worse.<sup>16</sup>

As declining production and sharply lower standards of living combined with increasing inequalities in the distribution of income, large segments of the urban and rural population turned against the Republican People's Party (RPP), which had been in power since the 1920s. In terms of economics, the war years, rather than the Great Depression and *étatisme* era, thus appear to be the critical period in the political demise of the single-party regime.

Despite two world wars and the Great Depression, per capita levels of production and income in Turkey were 30–40 per cent higher in 1950 than the levels on the eve of the First World War (see table 10.1 and graph 10.2).<sup>17</sup> Around mid-century, the economy was much more inward-oriented than it had been in 1913. Due to the impact of two world wars and a depression, rural–urban differences and regional disparities were considerably higher than they had been in 1913.

<sup>15</sup> Pamuk, 'Intervention', pp. 334–7.

<sup>16</sup> Şevket Pamuk, 'War, state economic policies and resistance by agricultural producers in Turkey, 1939–1945', in F. Kazemi and J. Waterbury (eds.), *Peasants and Politics in the Modern Middle East* (Miami: University Presses of Florida, 1991); Ayhan Aktar, 'Varlık Vergisi nasıl uygulandı?', *Toplum ve Bilim* 71 (1996).

<sup>17</sup> Özel and Pamuk, 'Osmanlı'dan cumhuriyet'e'.

*The post Second World War era, 1946–80*

Domestic and international forces combined to bring about major political and economic changes in Turkey after the Second World War. Domestically, many social groups had become dissatisfied with the single-party regime. The agricultural producers, especially poorer segments of the peasantry, had been hit hard by wartime taxation and government demands for the provisioning of the urban areas. In the urban areas, the bourgeoisie was no longer prepared to accept the position of a privileged but dependent class, even though many had benefited from the wartime conditions and policies. They now preferred greater emphasis on private enterprise and less government interventionism.<sup>18</sup>

International pressures also played an important role in the shaping of new policies. The emergence of the United States as the dominant world power after the war shifted the balance towards a more open political system and a more liberal and open economic model. Soviet territorial demands pushed the Turkish government towards close cooperation with the United States and Western alliance. The US extended the Marshall Plan to Turkey for military and economic purposes beginning in 1948.

Agriculture-led growth, 1947–62

The shift to a multi-party electoral regime brought the Democrat Party (DP) to power in 1950. Undoubtedly the most important economic change brought about by the Democrats was the strong emphasis placed on agricultural development. Agricultural output more than doubled from 1947, when the pre-war levels of output were already attained, through 1953.<sup>19</sup> A large part of these increases were due to the expansion in cultivated area, which was supported by two complementary government policies, one for the small peasants and the other for larger farmers. First, the government began to distribute state-owned lands and open communal pastures to peasants with little or no land. Second, the DP government used Marshall Plan aid to finance the importation of agricultural machinery, especially tractors, whose numbers jumped from less than 10,000 in 1946 to 42,000 at the end of the 1950s. Agricultural producers also benefited from favourable weather conditions and strong world market demand for wheat, chrome and other export

18 Çağlar Keyder, *State and Class in Turkey: A Study in Capitalist Development* (London and New York: Verso, 1987), pp. 112–14; Korkut Boratav, *Türkiye iktisat tarihi, 1908–2002*, 7th edn. (Ankara: İmge, 2003), pp. 93–101.

19 State Institute of Statistics, *Statistical Indicators, 1923–2002* (Ankara: DİE, 2003).



commodities, thanks to American stockpiling programmes during the Korean War.<sup>20</sup>

The agriculture-led boom meant good times and rising incomes for all sectors of the economy. It seemed in 1953 that the promises of the liberal model would be quickly fulfilled. These golden years did not last very long, however. With the end of the Korean War, international demand slackened and prices of export commodities began to decline. With the disappearance of favourable weather conditions, agricultural yields declined as well. Rather than accept lower incomes for the agricultural producers, who made up more than two-thirds of the electorate, the government decided to initiate a large price support programme for wheat, financed by increases in the money supply. The ensuing wave of inflation and the foreign-exchange crisis, which was accompanied by shortages of consumer goods, created major economic and political problems for the DP, especially in the urban areas.<sup>21</sup> One casualty of the crisis was the political as well as economic liberalism of the DP. Just as it responded to the rise of political opposition with the restriction of democratic freedoms, in most economic issues the government was forced to change its earlier stand and adopt a more interventionist approach. It finally agreed in 1958 to undertake a major devaluation and began implementing an IMF and OECD-backed stabilisation programme.

To this day, agricultural producers and their descendants, many of whom are now urbanised, continue to view the DP government, and especially the prime minister, Adnan Menderes, a large landowner, as the first government to understand and respond to the aspirations of the rural population. The DP also offered the first example of a populist economic policy in modern Turkey. Not only did it target a large constituency and attempt to redistribute income towards them, but it also tried to sustain economic growth with short-term expansionist policies, with predictable longer-term consequences. The 1950s also witnessed the dramatic acceleration of rural-to-urban migration in Turkey. Both push and pull factors were behind this movement, as conditions in rural areas differed widely across the country. The development of the road network also contributed to the new mobility.<sup>22</sup>

20 Bent Hansen, *Egypt and Turkey: The Political Economy of Poverty, Equity and Growth*, published for the World Bank (Oxford and New York: Oxford University Press, 1991), pp. 338–44; Keyder, *State and Class in Turkey*, pp. 117–35.

21 İlkay Sunar, 'Demokrat Parti ve populizm', in *Cumhuriyet Dönemi Türkiye Ansiklopedisi*, vol. VIII (Istanbul: İletişim, 1984).

22 Erik J. Zürcher, *Turkey: A Modern History* (London: I. B. Tauris, 1997), p. 235; Keyder, *State and Class in Turkey*, pp. 135–40; Reşat Kasaba, 'Populism and democracy in Turkey,

Import substituting industrialisation, 1963–77

One criticism frequently directed at the Democrats was the absence of any coordination and long-term perspective in the management of the economy. After the coup of 1960, the military regime moved quickly to establish the State Planning Organisation (SPO). The idea of development planning was now supported by a broad coalition: the RPP with its étatist heritage, the bureaucracy, large industrialists and even the international agencies, most notably the OECD.<sup>23</sup>

The economic policies of the 1960s and 1970s aimed, above all, at the protection of the domestic market and industrialisation through import substitution (ISI). Governments made heavy use of a restrictive trade regime, investments by state economic enterprises and subsidised credit as key tools for achieving ISI objectives. The SPO played an important role in private sector decisions as well, since its approval was required for all private-sector investment projects which sought to benefit from subsidised credit, tax exemptions, import privileges and access to scarce foreign exchange. The agricultural sector was mostly left outside the planning process.<sup>24</sup>

With the resumption of ISI, state economic enterprises once again began to play an important role in industrialisation. Their role, however, was quite different in comparison to the earlier period. During the 1930s, when the private sector was weak, industrialisation was led by the state enterprises and the state was able to control many sectors of the economy. In the post-war period, in contrast, the big family holding companies, large conglomerates which included numerous manufacturing and distribution companies as well as banks and other services firms, emerged as the leaders.

For Turkey, the years 1963 to 1977 represented what Albert Hirschman has called the easy stage of ISI.<sup>25</sup> The opportunities provided by a large and protected domestic market were exploited, but ISI did not extend to the technologically more difficult stage of capital goods industries. Export orientation of the manufacturing industry also remained weak. Turkey obtained the foreign exchange necessary for the expansion of production from traditional

1946–1961', in E. Goldberg, R. Kasaba and J. S. Migdal (eds.), *Rules and Rights in the Middle East: Democracy, Law and Society* (Seattle: University of Washington Press, 1993).

23 Vedat Milor, 'The Genesis of Planning in Turkey', *New Perspectives on Turkey* 4 (1990).

24 Hansen, *Egypt and Turkey*, pp. 352–3; Henry J. Barkey, *The State and the Industrialization Crisis in Turkey* (Boulder, CO: Westview Press, 1990), chapter 4; Ziya Öniş and James Riedel, *Economic Crises and Long-term Growth in Turkey* (Washington, DC: World Bank Research Publications, 1993), pp. 99–100.

25 Albert O. Hirschman, 'The Political Economy of Import-Substituting Industrialization in Latin America', *Quarterly Journal of Economics* 82 (1968).

agricultural exports and remittances from workers in Europe. The ISI policies were successful bringing about economic growth, especially in their early stages. GNP per capita increased at the average annual rate of 4.3 per cent during 1963–77 and at 3.5 per cent per annum including the crisis years of 1978–9. Rate of growth of manufacturing industry was considerably higher, averaging more than 10 per cent per annum for 1963–77<sup>26</sup> (see also table 10.1 and graph 2).

The role played by the domestic market during this period deserves further attention. Despite the apparent inequalities in income, large segments of the population, including civil servants, workers and, to a lesser extent, agricultural producers, were incorporated into the domestic market for consumer durables. Perhaps most importantly, real wages almost doubled during this period. Behind this exceptional rise lay both market forces and political and institutional changes. While industrial growth increased the demand for labour, the emigration of more than a million workers to Europe by 1975 kept conditions relatively tight in the urban labour markets. At the same time, the institutional rights they obtained under the 1961 constitution supported the labour unions at the bargaining table. Large industrial firms, which were not under pressure to compete in the export markets, accepted wage increases more easily since higher wages served to broaden the demand for their own products. By the middle of the 1970s, however, industrialists had begun to complain about the high level of wages and an emerging labour aristocracy.<sup>27</sup>

While industry and government policy remained focused on a large and attractive domestic market, they all but ignored exports of manufactures, and this proved to be the Achilles' heel of Turkey's ISI. The export sector's share in GDP averaged less than 4 per cent during the 1970s, and about two-thirds of these revenues came from the traditional export crops (graph 3). A shift towards exports would have increased the efficiency and competitiveness of the existing industrial structure, acquired the foreign exchange necessary for an expanding economy and even supported the import substitution process itself in establishing the backward linkages towards the technologically more complicated intermediate and capital goods industries.

There existed an opportunity for export promotion in the early 1970s, especially in the aftermath of the relatively successful devaluation of 1970. By that

26 State Institute of Statistics, *Statistical Indicators*; see also Aydın Çeçen, A. Suut Doğruel and Fatma Doğruel, 'Economic Growth and Structural Change in Turkey, 1960–1988', *International Journal of Middle East Studies* (1994).

27 Hansen, *Egypt and Turkey*, pp. 360–78; Keyder, *State and Class in Turkey*, chap. 7; Barkey, *Industrialization Crisis*, chap. 5.

time, Turkish industry had acquired sufficient experience to be able to compete or learn to compete in the international markets. For that major shift to occur, however, a new orientation in government policy and the institutional environment was necessary. The overvaluation of the domestic currency and many other biases against exports needed to be eliminated. Instead, the successes obtained within a protected environment created vested interests for the continuation of the same model. Most of the industrialists as well as organised labour, which feared that export orientation would put downward pressure on wages, favoured the domestic market-oriented model. Moreover, political conditions became increasingly unstable during the 1970s. The country was governed by a series of fragile coalitions with short-time horizons. As a result, the government made no attempt to shift towards export-oriented policies or even adjust the macro-economic balances after the first oil shock of 1973.<sup>28</sup>

#### The crisis of ISI

The short-lived coalitions chose to continue with expansionist policies at a time when many industrialised countries were taking painful steps to adjust their economies. Turkey's existing policies could be sustained only by very costly external borrowing schemes. In less than two years it became clear that the government was in no position to honour the outstanding external debt stock, which had spiralled from 9 to 24 per cent of GDP.<sup>29</sup> By the end of the decade Turkey was in the midst of its most severe balance of payments crisis of the post-war period. As rising budget deficits were met with monetary expansion, inflation jumped to 90 per cent in 1979. The second round of oil-price increases only compounded the difficulties. With oil increasingly scarce, frequent power cuts hurt industrial output as well as daily life. Shortages of even the most basic items became widespread, arising from both the declining capacity to import and the price controls. The economic crisis, coupled with the continuing political turmoil, brought the country to the brink of civil war.<sup>30</sup>

Perhaps the basic lesson to be drawn from the Turkish experience is that an ISI regime becomes difficult to dislodge owing to the power of vested interest groups who continue to benefit from the existing system of protection and subsidies. To shift towards export promotion in a country with a large domestic market required a strong government with a long-term horizon and

<sup>28</sup> Barkey, *Industrialization Crisis*, pp. 109–67.

<sup>29</sup> Merih Celasun and Dani Rodrik, 'Debt, adjustment and growth: Turkey', in Jeffrey D. Sachs and Susan Collins (eds.), *Developing Country Debt and Economic Performance*, vol. III (Chicago: University of Chicago Press, 1989).

<sup>30</sup> Keyder, *State and Class in Turkey*, chap. 8.

considerable autonomy. These were exactly the features lacking in the Turkish political scene during the 1970s. As a result, economic imbalances and costs of adjustment increased substantially. It then took a crisis of major proportions to move the economy towards greater external orientation.

*The globalisation era since 1980*

Against the background of a severe foreign-exchange crisis and strained relations with the IMF and international banks, the newly installed minority government of Süleyman Demirel announced a comprehensive and unexpectedly radical policy package of stabilisation and liberalisation in January 1980. Turgut Özal, a former chief of the SPO, was to oversee the implementation of the new package. The Demirel government was unable to gain the political support necessary for the successful implementation of the package, but the military regime that came to power later that year endorsed the new programme, and made a point of keeping Özal in the government, as deputy prime minister responsible for economic affairs.

The aims of the new policies were to improve the balance of payments and reduce the rate of inflation in the short term, and to create a market-based, export-oriented economy in the longer term. The policy package included a major devaluation followed by continued depreciation of the currency in line with the rate of inflation, greater liberalisation of trade and payments regimes, elimination of price controls, freeing of interest rates, elimination of many government subsidies, substantial price increases for the products of the state economic enterprises, subsidies and other support measures for exports and promotion of foreign capital. Reducing real wages and the incomes of agricultural producers were important parts of the new policies.<sup>31</sup>

With the shift to a restricted parliamentary regime in 1983, Özal was elected prime minister as the leader of the Motherland Party. He soon launched a new wave of liberalisation of trade and payments regimes. These measures began to open up the ISI structures to competition. However, frequent revisions in the liberalisation lists, the arbitrary manner in which they were made and the favours provided to groups close to the government created a good deal of uncertainty regarding the stability and durability of these changes. The response of the private sector to import liberalisation was mixed. While export-oriented groups and sectors supported it, the ISI industries, especially the

<sup>31</sup> Tosun Arıcanlı and Dani Rodrik, 'An Overview of Turkey's Experience with Economic Liberalization and Structural Adjustment', *World Development* 18 (1990).

large-scale conglomerates whose products included consumer durables and automobiles, continued to lobby for protection.<sup>32</sup>

From the very beginning, the programme of January 1980 benefited from the close cooperation and goodwill of the international agencies such as the IMF and the World Bank, as well as the international banks. For most of the decade these agencies portrayed Turkey as a shining example of the validity of the orthodox stabilisation and structural adjustment programmes. In economic terms, this support translated into better terms in the rescheduling of the external debt and substantial amounts of new resource inflows. As a result, the foreign-exchange constraint disappeared very quickly and the public sector had less need for inflationary finance at home. These were undoubtedly indispensable ingredients for the success of the programme.<sup>33</sup>

One area of success for the new policies was in export growth. Turkey's merchandise exports sharply rose from a mere 2.6 per cent of GDP in the crisis year of 1979 to 8.6 per cent of the GDP in 1990 (graph 3). Turkey in fact ranked first amongst all countries in rate of export growth during this decade. Equally dramatic was the role of manufactures, which accounted for approximately 80 per cent of this increase. Among the exports, textiles, clothing and iron and steel products dominated the market. It is thus clear that the success in export growth was achieved by reorienting the existing capacity of ISI industries towards external markets. In addition to a steady policy of exchange-rate depreciation, the exporters were supported by generous credits at preferential rates, tax rebates and foreign-exchange allocation schemes during this drive.

The impact of the new policies on the rest of the economy was mixed, however. Most importantly, the new policies did not generate the high levels of private investment necessary for long-term growth. In the manufacturing industry, high interest rates and political instability were the most important impediments. Even in the area of exports, new investment was conspicuously absent; most of the increase was achieved with the existing industrial capacity. The response of foreign capital to the new policies was not very strong either, apparently for reasons similar to those of domestic capital.<sup>34</sup> As a result, the growth performance of the economy was modest. GNP increased at the annual rate of 4.6 per cent and GNP per capita increased at 2.3 per cent during the

32 Ziya Öniş and Steven Webb, 'Political Economy of Policy Reform in Turkey in the 1980s', *Policy Research Working Paper Series*, World Bank, 1059 (1992).

33 Arıcanlı and Rodrik, 'An Overview', pp. 1348–50.

34 Korkut Boratav, Oktar Türel and Erınç Yeldan, 'Dilemmas of Structural Adjustment and Environmental Policies under Instability: Post-1980 Turkey', *World Development* 24 (1996), pp. 1347–8; Arıcanlı and Rodrik, 'An Overview', pp. 1347–8.

1980s (table 10.1 and graph 2). Moreover, these were obtained at the cost of accumulating a large external debt, which climbed more than fivefold from less than \$10 billion in 1980 to more than \$50 billion in 1990.

Another important area where the record of the new policies was bitterly contested was income distribution. From the very beginning, the January 1980 package set out to repress labour and agricultural incomes, and these policies were maintained until 1987 thanks to the military regime and the limited nature of the transition to multi-party politics. Real wages declined by as much as 34 per cent and the intersectoral terms of trade turned against agriculture by more than 40 per cent until 1987, although some of this deterioration had occurred during the crisis years of 1978 and 1979.

The agricultural sector, which continued to provide employment to about half of the labour force, was all but ignored by the military regime and the Motherland Party. The most important change for the sector was the virtual elimination of subsidies and price-support programmes after 1980, which combined with trends in the international markets to create a sharp deterioration in the sectoral terms of trade. As a result, the agricultural sector showed the lowest rates of output increase during the post-war era, averaging only 1 per cent per year from 1980. Agricultural output thus failed to keep pace with population growth for the first time in the twentieth century.

Turgut Özal was a critical figure in Turkey's transition to a neo-liberal development model in the 1980s. There can be no question that his bold initiatives helped accelerate the opening and market orientation of the economy. His legacy is not wholly positive, however. Özal preferred to govern by personal decisions and decrees, and tended to underestimate the importance of rule of law and a strong legal infrastructure for the effective operation of a market economy. His rather relaxed attitude towards the rule of law had devastating long-term consequences. The significant rise in corruption in Turkey during the 1990s should be considered a direct legacy of the Özal era.<sup>35</sup>

With the transition to a more open, competitive electoral regime, the opposition began to criticise the deterioration of income distribution and the arbitrary manner in which Özal often implemented his policies. In response, the government increasingly resorted to old-style populism and lost its room for manoeuvre. Public sector wages, salaries and agricultural incomes were sharply increased. Real wages almost doubled from their decade-low point in

<sup>35</sup> Ziya Öniş, 'Turgut Özal and his Economic Legacy: Turkish Neo-Liberalism in Critical Perspective', *Middle Eastern Studies* 40 (2004).



1987 until 1990. These, in turn, sharply increased the deficits and borrowing requirements of the public sector.<sup>36</sup>

A decade to forget

The globalisation process offered opportunities as well as vulnerabilities to developing countries. In the case of Turkey, political instability and large public-sector deficits that lasted until 2002 made it increasingly costly to participate in the new environment. In 1989, as the macro-economic balances began to deteriorate, Özal decided to fully liberalise the capital account and eliminate the obstacles in the way of international capital flows. He made this shift at least in part to attract short-term capital inflows, or hot money, to help finance the deficits. In the longer term, however, the decision to liberalise the capital account before achieving macro-economic stability and creating a strong regulatory infrastructure for the financial sector was very costly. As the economy became increasingly vulnerable to external shocks and sudden outflows of capital, the 1990s turned into the most difficult period in the post-Second World War era.

Public-sector deficits continued to widen in the 1990s, with programmes directed towards various segments of the electorate, cheap credit to small businesses, lower retirement age and more generous retirement benefits and, most importantly, high support prices for the agricultural producers. The war against the Kurdish separatist PKK in south-eastern Turkey, which lasted from 1984 until 1999, also imposed a large fiscal burden. Domestic and external borrowing was the most important mechanism for financing the growing deficits. High interest-rates and a pegged exchange rate regime attracted large amounts of short-term capital inflows. Private banks rushed to borrow from abroad in order to lend to the government. In addition, large public-sector banks were directed by the governments to finance part of these outlays. Last but not least, monetary expansion was used as a regular instrument for fiscal revenue.

Along the way, the structural reforms that would have increased the resilience of the economy to internal and external shocks were pushed aside. Virtually no progress was made in the privatisation of the state economic enterprises. Attempts to sell large state enterprises were often accompanied by scandals involving leading politicians. The privatisation of some of the smaller public-sector banks resulted in very large losses for the state sector as

<sup>36</sup> Öniş and Webb, 'Political Economy'; see also John Waterbury, 'Export Led Growth and the Center-Right Coalition in Turkey', *Comparative Politics* 24 (1991).



these banks were stripped of their assets by the well-connected buyers, and the full guarantees on bank deposits made the public sector responsible for their large losses. Not surprisingly, inflows of foreign direct investment remained limited.

The result was a period of very high inflation, which peaked at more than 100 per cent in 1994 and remained above 50 per cent per annum through 2001, very high nominal and real interest rates, steady increases in public debt and increasing vulnerability to external shocks which led to crises in 1991, 1994, 1998 and 2000–1, the last of which was the most severe. GDP per capita continued to rise as a long-term trend but at a pace lower than the earlier era (graph 2). High inflation and high interest rates made income distribution increasingly unequal, especially in the urban sector. One significant achievement of the period obtained at some political and economic cost was the customs union agreement with the EU that began in 1996.<sup>37</sup>

By the end of 1999 it was clear that the macro-economic balances were not sustainable. Negotiations with the IMF led to a new stabilisation programme with a pegged exchange-rate regime as the key anchor to bring down inflation. This programme was deeply flawed in design, however, as it ignored significant problems in the financial sector, especially the large deficits of the public-sector banks, which had been used for financing part of the budget deficits. After some initial successes, the programme disintegrated into a full-blown banking and financial crisis in 2001. In the face of massive capital outflows, the government was forced to suspend the programme and accept a dramatic depreciation of the lira.

In early 2001, the Turkish government invited Kemal Derviş to leave the World Bank and take up the job of economy minister. With IMF support, his team developed a programme based around fiscal discipline and large budget surpluses. The programme adopted a floating exchange-rate regime and converted the outstanding liabilities of the public-sector banks to long-term public debt. It also featured some long-term structural reforms, including measures to reform the vulnerable financial system, and a series of laws that attempted to insulate public-sector banks and state economic enterprises from the interference of politicians and strengthen the independence of the central bank.

The economy has staged a remarkable recovery since. After declining by 9.5 per cent in 2001, real GDP increased by about 35 per cent during the

37 Ziya Öniş and Ahmet Faruk Aysan, 'Neoliberal Globalisation, the Nation State and Financial Crises in the Semi-Periphery: A Comparative Analysis', *Third World Quarterly* 21 (2000).

next four years. By the end of 2005, annual inflation had declined to below 8 per cent, a level not seen since the 1960s (graph 2). Nominal and real interest rates also declined sharply. The credit for this turnaround should begin with Derviş and the initial programme. The Justice and Development Party (AKP) government that came to power after the elections of 2002 should also be credited for maintaining fiscal discipline. The generally favourable international environment, with low interest rates for developing countries, also helped. By 2005, significant amounts of foreign direct investment had begun to flow into Turkey, and the government was making some progress in the privatisation of the state economic enterprises. Thanks to economic growth and the large budget surpluses, the debt burden declined from above 100 per cent of GDP in 2001 to less than 70 per cent by 2005. This was mostly a jobless recovery, however. Despite the substantial increases in output and incomes, unemployment in the urban areas remained above 13 per cent through 2005.

#### Anatolian tigers

One important outcome of economic liberalisation after 1980 has been the increasing export orientation of the economy. Exports rose from less than \$3 billion in 1980 to \$70 billion, or 20 per cent of GDP, by 2005 (graph 3). Most of this increase occurred in textiles, steel, automotives and other manufactures, whose share in total exports exceeded 90 per cent in the 1990s. The rapid expansion of exports of manufactures played a key role in the rise of the Anatolian tigers, regional industrial centres such as Gaziantep, Denizli, Kayseri, Malatya, Konya, Çorum and others. With craft traditions and non-unionised workforces, these industrial centres began to account for a significant share of growing exports in textiles and other labour-intensive industries. Their competitive advantage was bolstered by low wages, long working hours and flexible labour regimes. Large numbers of small and medium-sized family enterprises played a central role in the rise of these industrial centres. Their rise was achieved with little state support and little or no foreign investment.

Many of the entrepreneurs in these urban centres have embraced the new liberal discourse. As latecomers to the private sector, they have been more likely to support an Islamist political party and organise under an association of Islamic businessmen as a political counterweight to the Istanbul-based elites. In fact, tensions between the entrepreneurs in the provinces and the Istanbul region's industrial elites go back to the 1960s, when Necmettin Erbakan, the first Islamist political leader in the post-war era, based his political rise on his

election as chairman of the national organisation of chambers of commerce.<sup>38</sup> Erbakan, however, appeared to favour various inward-oriented industrialisation schemes. In contrast, the industrialists of the Anatolian tigers have supported the AKP government and its export-oriented policies in the most recent period.

Similarly, large segments of protected domestic industry had opposed closer ties with Europe in the 1970s. In contrast, both the Istanbul industrialists and the entrepreneurs of the Anatolian tigers have supported European integration since the 1990s. Turkey's favourable experience with export-oriented industrialisation and the discovery that the customs union, which began in 1996, did not lead to the destruction of industry as some had feared, both contributed to the change of attitude. After the acceleration of democratic reforms by the new, AKP-led parliament, the EU decided in 2004 to begin membership negotiations with Turkey. It is not clear when or if Turkey will become a full member of the EU. Nonetheless, the membership process is likely to accelerate institutional changes and create a stronger institutional framework for economic change.

#### *Agriculture and structural change*

In the first half of the twentieth century, agriculture accounted for more than 80 per cent of employment and more than half of the GDP in Turkey. Although these shares now stand at 35 per cent and 10 per cent respectively, it is clear that any analysis of long-term structural change, economic growth and income distribution in Turkey needs to examine agriculture closely (graph 1).

The total population of Turkey has increased more than fourfold since 1914. Agricultural output has kept pace, increasing more than fivefold during the same period.<sup>39</sup> As a result, Turkey continues to be mostly self-sufficient in food and agricultural goods today. Agricultural output declined by as much as 50 per cent during the decade of wars after 1914, but began to recover in the 1920s. Increases in land and labour productivity were modest during this period, but population and total output began to exceed pre-First World War levels

38 Sencer Ayata, 'Bir yerel sanayi odağı olarak Gaziantep'te girişimcilik, sanayi kültürü ve ekonomik dünya ile ilişkiler', in S. İlkin, O. Silier and M. Güvenç (eds.), *İlhan Tekeli için Armağan Yazılar* (Istanbul: Tarih Vakfı, 2005); Ayşe Buğra, 'Class, Culture and State, an Analysis of Interest Representations by Two Turkish Business Associations', *International Journal of Middle East Studies* 30 (1998); Alpay Filiztekin and İnsan Tunalı, 'Anatolian Tigers: Are they for Real?', *New Perspectives on Turkey* 20 (1999).

39 These long term trends are taken from Şevket Pamuk, 'Agricultural output and productivity growth in Turkey since 1880', in P. Lains and V. Pinilla (eds.), *Agriculture and Economic Development in Europe since 1870* (London and New York: Routledge, forthcoming).

by the middle of the 1930s. Agricultural output began to increase more rapidly after the Second World War, at about 3 per cent per annum until 1980. This higher rate of growth was supported by rapid increases in the amount of land under cultivation. Thanks to the availability of land, the total area under cultivation more than doubled during the decade after the Second World War. After the land frontier was reached, a shift occurred towards more intensive agriculture in the 1960s. In this new phase, output rose more slowly but yields and land productivity increased more rapidly with the use of new inputs, agricultural machinery and equipment, fertilisers, irrigation and high-yielding varieties of seeds. Total output and land productivity growth have slowed down to 1 per cent per annum since 1980, but labour productivity growth has accelerated due to the more rapid labour movement away from agriculture in recent years.

In part because of the availability of land and in part due to government policies dating back to the nineteenth century, small to medium-sized enterprises have dominated agriculture in Turkey, except in the Kurdish south-east and in a number of fertile valleys opened to cultivation only in the nineteenth century, such as Çukurova and Söke.<sup>40</sup> This pattern has encouraged politicians to use government programmes as an electoral instrument since the 1950s. With the manipulation of the intersectoral terms of trade in favour of agriculture, the incorporation of the rural population into the national market accelerated. Villages became important markets for textiles, food industries and, gradually, for consumer durables, as well as agricultural machinery and equipment. In recent decades, non-agricultural activities including tourism and some manufacturing have begun to expand in the rural areas.

The large and expensive irrigation project in the Euphrates valley in south-eastern Anatolia stands apart from all other rural development schemes since the Second World War. It originally envisaged the building of a number of interrelated dams and hydroelectrical plants on the Euphrates river in order to irrigate 1.6 million hectares in the plain of Harran, which would double the irrigated area under cultivation in the country. The project has since evolved into an integrated regional development programme seeking to improve the social and economic fabric of a large and poor region of the country. Now one of world's largest and most ambitious regional development projects, it includes large investments in a wide range of development-related sectors such as agriculture, energy and transport, as well as urban and rural

<sup>40</sup> Keyder, *State and Class in Turkey*, pp. 177–240.

infrastructure. However, until recently the project has been designed and implemented with a developmentalism-from-above approach, and without sufficient understanding of or concern for the needs of the local population. The absence of a shared vision between the planners and the intended beneficiaries, namely the local Kurdish communities, has seriously limited the benefits of the project.<sup>41</sup>

Despite the large and persistent productivity and income differences between agriculture and the rest of the economy, the strength of small and medium-sized land ownership has slowed down the movement of labour to the rest of the economy. The dominance of small and medium-sized family enterprises in the rural areas was a legacy of the Ottoman era. After the Second World War, it combined with another Ottoman legacy, state ownership of land, to moderate urban inequalities during decades of rapid urbanisation. Many of the newly arriving immigrants were able to use their savings from rural areas to build low cost residential housing (*gecekondu*) on state land in the urban areas. They soon acquired ownership of these plots.

Large productivity and income differences between agriculture and the urban economy have been an important feature of the Turkish economy since the 1920s. Most of the labour force in agriculture are self-employed today in the more than 3 million family farms, including a large proportion of the poorest people in the country. The persistence of this pattern has not been due to the low productivity of agriculture alone, however. If the urban sector had been able to grow at a more rapid pace, more labour would have left the countryside during the last half-century. Equally importantly, governments have offered very limited amounts of schooling to the rural population in the past. Average amounts of schooling of the total labour force (ages fifteen to sixty-four) increased from only one year in 1950 to about seven years in 2005. The average years of schooling of the rural labour force today is still below three years, however.<sup>42</sup> In other words, most of the rural labour force today consists of undereducated men and women, for whom the urban sector offers limited opportunities. The pace with which rural poverty and population will diminish in the decades ahead will depend on the degree to which the countryside experiences institutional changes and receives greater amounts of education and capital.

41 Ali Çarkoğlu and Mine Eder, 'Development alla Turca: the Southeastern Anatolia Development Project (GAP)', in F. Adaman and M. Arsel (eds.), *Environmentalism in Turkey: Between Democracy and Development* (Aldershot: Ashgate Publishers, 2005).

42 My calculations based on State Institute of Statistics, *Statistical Indicators* data on school enrolment and graduation.

*Income distribution*

Data on income distribution in Turkey have not been not sufficiently detailed and do not easily allow long-term comparisons. In what follows, I will attempt such comparisons by employing simple indicators for which long-term series are available. I will examine changes in income distribution in twentieth-century Turkey in three basic components: (a) distribution within agriculture; (b) agriculture–non-agriculture or rural–urban differences; and (c) distribution within the non-agricultural or the urban sector. The relative weights of these three components have clearly changed over time. Until the 1950s, the first two were more important. With urbanisation after 1950, the second component and, especially since 1980, the third component began to dominate country-wide debates and issues and debates of income distribution.<sup>43</sup>

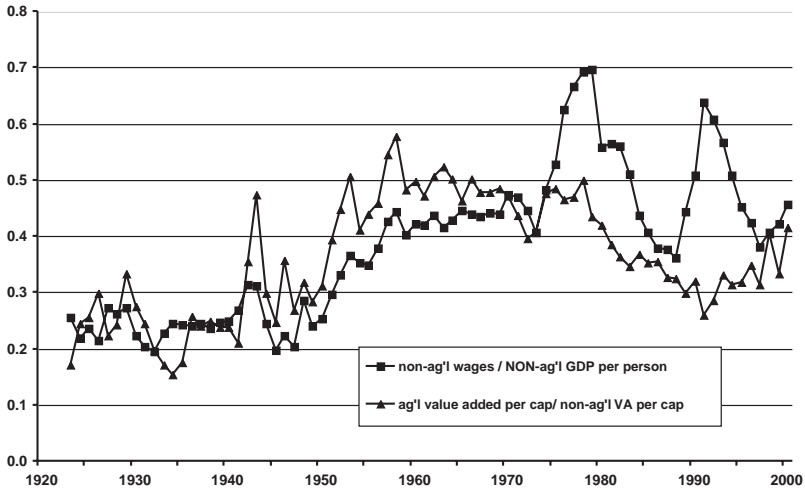
Within the agricultural sector, the evidence on land ownership and land use points to a relatively equal distribution of land, dominated by small and medium-sized holdings in most regions. Despite the limitations of available data, it appears that the Gini coefficients for land distribution and land use have changed little since the 1950s.<sup>44</sup> Moreover, distribution within the agricultural sector has been more equal than both the differences between the agricultural and urban sectors and the distribution within the urban sector.

Evidence for agriculture–non-agriculture differences in average incomes can be obtained from the national income accounts. These indicate that intersectoral differences were largest in the interwar period, especially due to the sharply lower agricultural prices during the Great Depression. The intersectoral differences in average incomes declined in the post-Second World War period, in part because of government policies, but they increased again after 1980. The acceleration of urbanisation and the rapid decline of the agricultural labour force in recent years have helped raise average incomes in agriculture (graph 4).

In the absence of other suitable series for long-term comparisons of income distribution within the urban sector, I will focus on the share of labour in per capita income. More specifically, I will follow the index of urban wages divided by output per person in the urban labour force. This ratio was quite low in the interwar period, because of the low levels of urban wages in relation to urban output per capita. This suggests a rather unequal distribution of income within the urban sector until the Second World War. Share of wages in urban income

43 This section is based on Şevket Pamuk, '20. Yüzyıl Türkiye için büyüme ve bölüşüm endeksleri', *İktisat, İşletme ve Finans Dergisi* 235 (October 2005).

44 Hansen, *Egypt and Turkey*, pp. 275–80 and 495–501.



Graph 10.4 Indices for income distribution in Turkey, 1923–2000

rose steadily after the war, however. Together with the decline in intersectoral differences in average incomes, this pattern indicates that the post-war era until 1980 had a more equal or balanced distribution of income than other period in the twentieth century (graph 4). In the globalisation era since 1980, intersectoral differences in per capita income rose sharply, but they have been declining in recent years with the rapid contraction of the agricultural labour force. It is clear, however, that the country-wide pattern in income distribution is now dominated by changes inside the urban sector. Disparities within the urban sector between labour and non-labour incomes and also between skilled and unskilled labour incomes have increased since 1980.

It is also interesting that for most of the twentieth century, the second and third components of the country-wide income distribution, namely intersectoral differences in average incomes and the distribution of income within the urban sector, have moved together. As the value of these two indices increased, income distribution tended to become more equal and vice versa (graph 4). This pattern suggests that governments were able to influence both components of the income distribution, especially during periods of multi-party electoral politics.

Large regional inequalities are a fourth dimension of income distribution, which especially need to be taken into account in the case of Turkey. Throughout the twentieth century, large west–east differences in average incomes

persisted. Until recently, the private-sector-led industrialisation process was concentrated in the western third of the country. The commercialisation of agriculture had also proceeded further in the western and coastal areas. In addition to lower incomes, the eastern third of the country has also been lacking in infrastructure and services provided by the government, especially for education and health. The development of tourism in the west, the deterioration of the terms of trade against agriculture and the rise of Kurdish insurgency in the south-east during the 1980s further increased the large regional disparities, adding to the pressures for rural-to-urban as well as east-to-west migration. Future progress on the South-East Anatolian Project and the rise of the regional industrial centres may help reduce these disparities. However, economic development in that part of the country hinges, above all, on a political resolution of the Kurdish question.<sup>45</sup>

Large east–west differences in average incomes have been accompanied by large and persistent regional inequalities in human development indicators since the 1920s. The latest country report for Turkey prepared by United Nations Human Development Programme for the year 2002 indicates, for example, that the top ten (out of eighty) high-income, western and north-western provinces in the country, including Istanbul, had an average HDI equal to 0.825, which was close to the HDI for East–Central European countries such as Croatia or Slovakia. On the other hand, the poorest ten provinces in the mostly Kurdish south-eastern part of the country had an average HDI of 0.600, which was comparable to the HDI of Morocco or India in the same year.<sup>46</sup>

## Conclusion

In trying to analyse Turkey's economic record in the twentieth century, I began with a distinction between the proximate and ultimate sources of economic growth. The former relates to the contributions made by the increases in factor inputs and productivity, while the latter refers to aspects of the social and economic environment in which growth occurs. In this context, economic institutions are increasingly seen as the key to the explanation not only of economic growth and long-term differences in per capita GDP, but also the question of how the total pie is divided amongst different groups in society. I have emphasised that because there is generally a conflict of interest over the choice of economic institutions, political economy and political institutions

<sup>45</sup> Çarkoğlu and Eder, 'Development alla Turca'.

<sup>46</sup> UNDP, *Turkey 2004* (Ankara: UNDP, 2004).



are key determinants of economic institutions and the direction of institutional change.

Turkey's transition from a rural and agricultural towards an urban and industrial economy in the twentieth century occurred in three waves, each of which served to increase the economic and political power of urban and industrial groups. Increases in the economic and political power of these groups, on the whole, enabled them to shape economic institutions more in the direction they desired. Each of these waves of industrialisation and economic growth, however, was cut short by the shortcomings or deficiencies of the institutional environment. The first of these waves occurred during the 1930s. After a series of legal and institutional changes undertaken by the new Republic, a small number of state enterprises led the industrialisation process and the small-scale private enterprises in a strongly protected economy. *Etatism* promoted the state as the leading producer and investor in the urban sector. Ultimately, however, political and economic power remained with the state elites, and these economic and institutional changes remained confined to the small urban sector.

The pace of economic growth was distinctly higher around the world in the decades after the Second World War. Turkey's second wave of industrialisation began in the 1960s, again under heavy protection and with government subsidies and tax breaks. Rapid urbanisation steadily expanded the industrial base. The state economic enterprises continued to play an important role as suppliers of intermediate goods. The new leaders, however, were the large-scale industrialists and the holding companies in Istanbul and the north-western corner of the country. With the rise of political and macro-economic instability in the 1970s, industrialisation turned increasingly inward and short-term interests of narrow groups prevailed over a long-term vision, culminating in a severe crisis at the end of the decade.

A third wave that began in the 1980s under conditions of a more open, export-oriented economy widened the industrial base further to the regional centres of Anatolia. The rapid expansion of exports of manufactures played a key role in the rise of these new industrial centres, which began to challenge the Istanbul-based industrialists. Once again, however, rising political and macro-economic instability, growing corruption and the deterioration of the institutional environment in the 1990s brought this wave to a sharp halt in 2001.

Ever since the Young Turk era, governments in Turkey have supported the emergence and growth of an industrial bourgeoisie. Helped by the growth of the urban sector and successive waves of industrialisation, this bourgeoisie has

been gradually wresting control of the economy away from the state elites in Ankara.<sup>47</sup> For most of the twentieth century the country's industrial elites remained limited to those of the Istanbul region. But with the rise of the Anatolian tigers, the economic base of the bourgeoisie has been expanding socially and geographically. The AKP government of recent years has been supported by these emerging elites in the provinces.

The political and economic power of the workers, as well as their share in the total pie, was on the rise after the Second World War, especially during the ISI era after 1960. In the most recent era of globalisation, however, economic and institutional changes have combined to reduce the power of the workers and trade unions. Similarly, agricultural producers enjoyed a sharp increase in influence, if not power, with the shift to a multi-party political regime in the 1950s. Their influence and their ability to shape economic institutions have been declining gradually but steadily, however, with the decline in the share of agriculture in both the labour force and total output.

While economic power has clearly shifted from Ankara to Istanbul and more recently towards industrial groups in the provinces, the shift in political power and the move towards more pluralist politics have been far from easy or simple. Too often during the last half-century, Turkey's political system has produced fragile coalitions and weak governments which have sought to satisfy the short-term demands of various groups by resorting to budget deficits, borrowing and inflationary finance. The political and macro-economic instability also led to the deterioration of the institutional environment. Rule of law and property rights suffered, and public investment, including expenditure on education, declined sharply. The weak governments have been too open to pressures from different groups, or even individual firms or entrepreneurs, seeking favours. As a result, the pursuit of favours or privileges from local and national governments has been a more popular activity for the producers than the pursuit of productivity improvements or competition in international markets.

The crisis of 2001 ushered in significant institutional changes, especially in the linkages between politics and the economy, with new attempts to insulate the latter from short-term interventions in the political sphere. It remains to be seen, however, whether these institutional changes will be effective and durable or whether politics and the institutional environment will regress to their earlier ways. For most of the last century, Turkey has been considered to

<sup>47</sup> Keyder, *State and Class in Turkey*; Ayşe Buğra, *State and Business in Modern Turkey: A Comparative Study* (Albany: State University of New York Press, 1994).

have high economic potential. Similarly, it remains to be seen whether this will be realised. It is precisely at this juncture that Turkey's integration to the EU assumes critical importance. It is not clear when and if Turkey will become a full member of the EU. Nonetheless, the membership process is likely to create a stronger institutional framework for economic change. For the economy, the key contribution of the goal of membership will be the strengthening of the political will to proceed with the institutional changes that may raise the water level in the glass and carry Turkey's economy to a new level.