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The Impact of Financial Liberalization and the Rise of Financial Rents on Income Inequality
The Case of Turkey

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A. Erinc Yeldan
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ABSTRACT

This study attempts to investigate and assess the impact of financial liberalization and the ongoing rise of financial rents on income distribution in the post-1980 Turkish economy. Our quantitative investigation of the dynamics of macroeconomic development over this period discloses an overall disassociation of financial institutions from the productive sphere to become the dominant segment of capital manipulating the aggregate domestic economy. Our findings underscore the fact that, given the poor vertical linkages among industrial sectors within the historical conditions of peripheral capitalism, the implementation of vigorous export-promotion polices and state-led price incentives created sporadic increases in productivity in the 1980s, yet failed to generate a sustained increase in economic growth and accumulation.

I INTRODUCTION

The last two decades have witnessed a fundamental change in the development strategy for developing economies, with renewed attention on the adverse consequences of this change on income equality and poverty alleviation. UNCTAD's *1997 Trade and Development Report*, for instance, reveals that, over a sample of 124 countries accounting for 93.6 per cent of the world population, the income share of the richest one-fifth of the world population rose from 69 per cent in 1965 to over 83 per cent in 1990 (UNCTAD, 1997: 81). Likewise, the income gap between the richest and the poorest quintiles of the world population widened. The ratio of the average per capita GNP of the richest quintile ($2,281) to the poorest ($74) was 31:1 in 1965. By 1990, this ratio had risen to 60:1, with average GNPs of $17,056 for the richest and $283 for the poorest.

Given this evidence, the UNCTAD report presents the following stylized facts about development and income (in)equality during the post-1970 evolution of the global world economy (UNCTAD, 1997: 65):

1. Taken as a whole, the world economy is growing too slowly to alleviate poverty.

2. Finance has been gaining over industry, and rentiers over investors. Similarly, capital has gained in comparison to labour, and the share of profits has risen within the functional distribution of income.

3. The middle class has been under significant pressure as labour markets have become marginalized and the existing wage inequalities between skilled and unskilled labour have intensified.

While the factors behind these trends constitute a topic of active debate,[1] they are acknowledged to be conceptually a part of a broader set of developments in the world economy that are loosely referred to as the process of *globalization*. This process, even though known to be an integral part of world capitalism

[1] See, for example, the recent contributions by Milanovic (1999), Cornia and Kiiski (1999), Barro (1999), Rodrik (1997, 1998), and Atkinson (1998a, 1998b). See also the 1998, Vol. 8 issue of *The Economic Journal* for a compilation of the theoretical mechanics of income distribution and technological change.

since its very conception, accelerated during the 1970s with the advent of the technological innovations in the electronics and telecommunications industries.

From the point of view of pure economic relations, we observe the process of globalization to entail two related phenomena: (i) the liberalization of commodity and financial markets at the national scale (so-called 'structural adjustment') and (ii) the elimination of all administrative and regulatory statutes hindering the free movement of international capital flows. In this sense, the economic aspect of globalization considers the profitability of capital as the sole indicator of economic rationality and labels all kinds of national regulations which limit the owners of capital in their quest for maximization of profit as 'irrational' or 'backward ideology' (Bourdieu, 1998).

Consequently, for the international capital which aims at the integration of world commodity and financial markets, one can speak of two strategic targets: confinement of the regulatory powers of national states and disempowerment of labourers from their existing, limited, legal rights to collective bargaining and unionization. Thus, in order to sanctify the power of unfettered market forces in the name of economic efficiency, this 'infernal machine' requires the elimination of all administrative or political barriers which limit the profitability of private capital and necessitates 'a programme for destroying collective structures which may impede the pure market logic' (Bourdieu, 1998). The terms, 'globalization' and 'financial deregulation' do, in fact, reflect the ideological underpinnings of these overall processes.

It is the purpose of this study to investigate and assess the impact of financial rents on income distribution and the overall marginalization of labour incomes in the post-1980 Turkish economy.

Turkey initiated its long process of integration in world commodity and financial markets with the 1980 structural adjustment reforms implemented under the auspices of the IMF and the World Bank. Since its early inception, the Turkish adjustment programme was hailed as a 'model' by the orthodox international community, and it was supported by generous financial assistance through structural adjustment loans, debt relief and technical aid.[2]

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[2] This financial assistance represented a resource transfer of 4.7 per cent of GDP in 1980. During 1978-80, Turkey alone accounted for nearly 70 per cent of the total volume of debt rescheduled internationally among all developing countries (Celasun and Rodrik, 1989). See also Ekinci (1998) for the role of foreign financial assistance in the shaping of the post-1980 adjustments in Turkey.

Currently, the Turkish economy can be said to be operating under conditions of a truly 'open economy': a macroeconomic environment in which its capital account is completely liberalized and the process of financial deregulation is completed. In this setting, many of the instruments of macro and fiscal control have been transformed, and the constraints of macro equilibrium have undergone major structural change.[3] Concurrently, the domestic economy has witnessed drastic changes in the modes of surplus creation and extraction and in the interplay of distribution and accumulation.

The paper is organized into five sections. The next section gives a broad overview and presents evidence on the patterns of income distribution in Turkey over the last three decades. Section 3 turns to the evolution of functional categories of income and offers a panorama of the macroeconomic adjustments under post-financial liberalization and the rise of financial rents. Here, of particular importance is the investigation of the inherent tensions caused by the macroeconomic disequilibria embodied in the process of integration with world markets under conditions of a poorly supervised banking system and underdeveloped and fragile domestic asset markets. Thus, it is found to be analytically convenient to decompose the path of Turkish liberalization after 1980 into two major subperiods partitioned by the strategic step of capital account deregulation which took place in 1989 and was completed by the full integration of the domestic market in global financial markets. The section further studies the patterns of the wage cycle and productivity growth using quantitative filtering techniques, and it reports on the disassociation of labour remunerations from the productivity gains in the real sphere of the economy. Section IV provides a detailed analysis of the rise in public sector deficits and the distributive consequences of the widening fiscal gap. Section 5 summarizes and concludes.

II INDICATORS OF INCOME DISTRIBUTION: THE EVIDENCE

Turkey is known to suffer from one of the most skewed income distributions among countries at a comparable level of development. Partly fuelled by the legacy of prolonged import-substitutionist growth patterns, with excessive quota rents and an oligopolistic industrial and banking structure, the economy

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[3] See Voyvoda and Yeldan (1999), Onaran (1999), Tansel (1999), Boratav, Türel and Yeldan (1996), Yeldan (1995), Uygur (1993), Senses (1994), Boratav and Türel (1993), Celasun (1994), and Ozmucur (1986) for analyses of the adjustment patterns and distributional shifts under the Turkish structural adjustment reforms of the 1980s.

suffers further from a relatively stagnant and overpopulated agricultural sector, with loose linkages to domestic industry, high rates of immigration due to both economic and political pressures, and unequal opportunities to access education.

With the advent in 1980 of reforms for openness that aimed at commodity trade liberalization and then, in 1989, with the completion of this through financial liberalization, there were renewed orthodox expectations of more equitable forms of distribution of the national product, since, given the signals of efficiency (world) prices, it was thought that import-quota rents would be dissipated and the domestic structure of production would be transformed. It was further argued that, as labour-intensive domestic industries shifted towards export markets, the factor remunerations of labour would be able to be increased in real terms.

These orthodox prescriptions failed to function, however, as the economy witnessed sharp changes in the underlying economic polity, with the emergence and administration of new modes and mechanisms of surplus extraction throughout the course of 'liberalization'. First and foremost, the pro-liberal stance and the integration of the domestic economy with world markets did not lead to a more competitive environment in domestic industry; on the contrary, the concentration rates in most outward-oriented sectors such as food processing, cement, glass production, and ceramics rose sharply. Furthermore, the financing behaviour of corporations did not show significant change, and the banking sector became increasingly disassociated from credit financing and intermediation and evolved towards the financing of the securitization of the domestic debt.

The new outward-orientation also opened fresh avenues for wealth accumulation based on a renewed form of rent-seeking, this time towards export-promotion subsidies and grants provided by the government. Commercial policies became the leading mechanism for squeezing domestic absorption capacity to generate an exportable surplus for export-oriented manufacturing capital. This exportable surplus was to be obtained through the generation of excess supply by reducing effective domestic demand. This, in turn, necessitated the suppression of wage incomes.

This was in stark contrast with the dual role of wages under the import-substitutionist phase both as a cost element and also as a source of effective demand. Under the new export-orientation, however, as the sources of effective demand would be expected to emerge not from the home market, but from the external economy, wages came to be regarded only as a 'cost' item which needed to be 'minimized'.

Thus, at a more general level, the post-1980 integration process fostered new, intense distributive tensions as the share of non-wage income in national product rose, the marginalization of labour deepened, the existing wage inequalities between skilled and unskilled labour intensified, and the access to social safety nets became increasingly difficult. All of these conditions favoured more adverse consequences in terms of the condition of the poor.

Against this evidence on the functional categories of income distribution, there are serious problems in the documentation of these processes as regards the size levels of incomes. Despite the availability of official and independent studies on the size distribution of incomes during the critical years of macroeconomic adjustment, direct comparisons are quite hard to make, as the studies have been subject to significant changes in both coverage and design over the years. Even so, it might be useful to lay down the existing evidence in its entirety and caution the reader against strong conclusions. Table 1 summarizes the available dataset from studies on the size distribution of income in Turkey over the last three decades.

TABLE 1
SUMMARY OF RESEARCH ON THE SIZE DISTRIBUTION OF INCOME IN TURKEY (% OF INCOME)

Percentage of households	SPO (1963)	Bulutay, Timur and Ersel (1968)	SPO (1973)	SIS (1973/4) rural	SIS (1978/9) urban	SIS (1987)	SIS (1994)
1. 20	4.5	3.0	3.5	3.5	6.3	5.2	4.9
2. 20	8.5	7.0	8.0	11.1	12.0	9.6	8.6
3. 20	11.5	10.0	12.5	14.4	13.0	14.1	12.6
4. 20	18.5	20.0	19.5	18.7	21.0	21.1	19.0
5. 20	57.0	60.0	56.5	52.2	47.0	49.9	54.9
Gini coefficient	0.55	0.56	0.51	0.47	0.4	0.43	0.49

Note: Reference year in parentheses.
Sources: SPO (1973); SIS (1987, 1994); Bulutay, Timur and Ersel (1971).

Over the broad time horizon, the available Gini coefficients seem to show an overall tendency for the improvement of income distribution in the 1970s, followed by a worsening after the 1980s. The rise in the income share of the richest quintile seems to be a concomitant development, along with the fall of the share of the poorest quintile over the post-1978 time horizon. One becomes more confident in this assessment if attention is focused only on the latest two surveys conducted by the State Institute of Statistics (SIS, 1987, 1994).

It is clear that, over the 1987-94 period, the SIS data suggest an expansion of the richest quintile at the expense of the other groups, coupled with an overall rise of the Gini index. Given the SIS data, Table 2 presents a more detailed assessment of the findings, tabulated at 10 percentage intervals across rural versus urban household income categories.

TABLE 2
COMPARISON OF SIS 1987 VERSUS 1994 SURVEYS OF INCOME DISTRIBUTION (% OF INCOME)

	1987			1994		
Percentage of households	Turkey	Urban	Rural	Turkey	Urban	Rural
1. 10	1.9	2.2	1.8	1.8	1.9	2.0
2. 10	3.3	3.3	3.4	3.0	2.9	3.6
3. 10	4.3	4.2	4.4	3.9	3.7	4.6
4. 10	5.3	5.1	5.6	4.8	4.5	5.6
5. 10	6.4	6.1	6.8	5.7	5.4	6.7
6. 10	7.7	7.5	8.2	6.9	6.5	8.1
7. 10	9.4	9.2	9.8	8.4	7.9	9.7
8. 10	11.8	11.6	12.2	10.6	10.0	12.1
9. 10	15.9	15.9	16.3	14.4	13.6	16.2
10. 10	34.0	35.0	31.6	40.5	43.6	31.5
Gini coefficient	0.43	0.44	0.42	0.49	0.51	0.41

Source: SIS (1987, 1994).

The overall message of the 1987 and 1994 surveys is that, while the income shares of all nine income groups declined over the period, the share of the richest 10 percentile increased. Within the economy-wide average, the richest 10 percentile raised its share by 6.5 percentage points, from 34 per cent to 40.5 per cent. The polarization in income distribution is more acute in urban households in comparison with the rural sector. The rural economy's Gini coefficient is mostly stable at 0.41, and the worsening of the urban income distribution seems to account for almost all of the economy-wide skewedness in income. In fact, with a Gini coefficient of above 50 per cent in urban centres, the lowest 20 per cent quintile is calculated to receive only 4.8 per cent of national income, in contrast with the share of the richest quintile, which reaches to 57.2 per cent.

The polarization of income is more visible if the comparison is made using purchasing power parity US dollars at constant prices. Such an exercise conducted on the SIS data reveals that the richest quintile consists of 13.9 million individuals and captures an average of $9,878 per capita. The per capita income of the top 5 percentile, on the other hand, reaches $22,344 in constant 1997 prices (Table 3). Comparing these figures with those for the lowest quintile, the extent of the income gap becomes more apparent: the lowest 20 percentile consists of 10.9 million individuals, with an average income of only $1,119 per head. Among this group, 2.155 million individuals (the lowest 5 percentile) is known to capture only $803 per capita.

TABLE 3
AVERAGE INCOME, RICHEST AND POOREST QUINTILES, 1997 ($)

	Number of individuals	Per capita disposable income	Per capita GNP
The richest 20 percentile			
First 5%	3,406,030	12,927	22,344
Second 5%	3,517,388	4,196	7,252
Third 5%	3,562,951	3,193	5,519
Fourth 5%	3,421,412	2,770	4,787
Average, top 20%	13,907,781	5,726	9,898
The lowest 20 percentile			
First 5%	3,013,322	780	1,349
Second 5%	2,926,201	694	1,200
Third 5%	2,796,454	597	1,032
Fourth 5%	2,155,066	465	803
Average, lowest 20%	10,891,043	648	1,119

Source: SIS (1994).

Another facet of this income concentration in the urban sector is the increased wage gap between the skilled/organized and the unskilled/marginal segments of the labour force. Köse and Yeldan (1998) categorize 'informal/marginal' labour as that part of the employed labour force which is not officially registered for any social security coverage and also is not entitled under the 'self employed or employer' status. Based on the State Institute of Statistics Household Labour Survey data, they report that the ratio of marginal labour to total employment in industry increased from 41 per cent (700,000) in 1980 to 49 per cent (1,170,000) in 1994 and stabilized at around 44 per cent after 1995. This form of employment was found to be very extensive in traditional sectors like food processing, textiles and clothing, wood and furniture, and metal products, where small enterprises have greater importance.

Wage data strongly suggest that the substantial improvement in average wages during 1989-93 was almost totally due to what was happening in the organized/formal sector. Wage gaps between large/small and public/private enterprises widened significantly and exceeded the magnitude of the early 1980s. In particular, highly organized mining and electricity/gas workers improved their relative economic positions significantly. In comparison to averages in manufacturing, wages in the clothing industry, on the other hand, eroded by 20 percentage points over the same period, falling below the 1981 level at the start of the liberalization programme (Köse and Yeldan, 1998; Boratav, Yeldan and Köse, 2000; Yentürk, 1997).

Given the extent of polarization indicated by these numbers, it is clear that 'traditional' explanations of income inequality, such as unequal access to education, unequal distribution of assets and land concentration, and the urban-bias, do not suffice to provide a coherent portrait of the macroeconomic processes which have given rise to the outcome.

Even though easy generalizations can be misleading, one may nevertheless associate the rising income inequality with the broad tendency towards the marginalization of labour due to informal industrial relations, advances in new technologies which favour skill-intensive production patterns, and an unequivocal trend towards the disassociation of the financial sector from the productive sphere of the economy and the concomitant expansion of financial rents.

A careful analysis along these lines necessitates a shift of focus towards the functional categories of income and the underlying processes of macro adjustment. The next section turns to these issues.

III MACROECONOMIC ADJUSTMENT UNDER FINANCIAL LIBERALIZATION AND THE RISE OF FINANCIAL RENTS

The Turkish economy experienced two distinct phases along the post-1980 adjustment path. The first covers broadly the period 1981-88, and its main characteristic is structural adjustment with export promotion, albeit under a foreign exchange system of regulated foreign capital inflows. During this period, integration in global markets was achieved mainly through commodity trade liberalization. More importantly, both the exchange rate and direct export subsidies were the main instruments for the promotion of exports and the

TABLE 4

MACROECONOMIC PHASES OF THE TURKISH ECONOMY, 1980-99

	Post-crisis adjustment	Export-led growth	Exhaustion	Unregulated financial liberalization					Financial crisis	Reinvigoration of short-term foreign capital-led growth			Contagion of world financial crisis	
	1981-2	1983-7	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999.I*
I. Production and accumulation (real rate of growth, %)														
GDP	04.2	6.5	2.1	1.2	7.9	1.1	5.9	8.0	-5.5	07.2	07.0	07.5	02.8	-8.5
Fixed investment														
private sector	-5.3	12.3	12.6	1.7	19.4	0.9	4.3	35.0	-9.1	16.9	12.1	11.9	-6.7	-6.7
public sector	0.2	10.3	-20.2	3.2	8.9	1.8	4.3	3.4	-34.8	-18.8	24.4	28.4	30.0	05.0
manufact. industry	-5.1	2.1	-4.8	-14.2	41.6	-4.8	1.1	16.1	-4.7	15.2	02.9	-3.4	-4.8	
As % of GDP														
savings	17.7	19.5	27.2	22.1	22.0	21.4	21.6	22.7	23.1	22.1	20.0	21.3	21.2	
investment	18.3	20.9	26.1	22.5	22.6	23.7	23.4	26.3	24.5	24.0	25.0	25.3	25.6	
PSBR	03.7	4.7	04.8	5.2	7.4	10.3	10.6	12.1	07.9	05.2	08.8	07.6	08.7	
stock of dom. debt		3.5	05.7	6.3	7.0	8.1	11.7	12.8	14.0	14.6	18.8	21.4	22.5	
interest exp. on dom. debt			02.4	2.2	2.4	2.7	2.8	4.6	06.0	06.2	09.0	07.7	10.9	
II. Distribution and prices														
Inflation rate (CPI)	33.2	39.5	75.4	64.3	60.4	71.1	66.1	71.1	106.3	88.0	80.4	85.7	92.6	73.5
Depreciation of TL/$ (a)	45.0	39.7	66.0	49.0	23.0	60.0	65.0	59.0	170.0	54.0	77.0	78.0	76.0	54.7
Real interest rate on GDIs (b)	..	..	-5.8	-2.7	-4.0	5.3	13.9	09.9	28.6	18.1	31.1	22.1	15.8	32.6

Real wage growth rate (manufacturing)													
private (c)	0.4	-1.5	-5.7	16.1	22.2	20.2	-5.4	-0.1	-30.1	1.4	-1.4	-8.2	3.3
public	-0.4	-5.9	-7.8	47.5	18.8	37.1	5.8	-0.9	-18.1	-18.0	6.0		
Av. mark-up rate, private manuf'ing (%)	31.0	32.6	38.0	33.5	38.6	39.1	41.5	43.9	47.0	42.0	39.0		
Wages/manufacturing value added (%)													
private manuf'ing	30.0	24.2	20.0	24.0	25.0	27.0	25.0	25.0	20.0	18.0	23.0		
public manuf'ing	27.0	22.2	15.0	20.0	25.0	31.0	37.0	34.0	29.0	20.0	22.0		
III. Internationalization													
Man. export, growth (d)	19.7	12.5	14.0	-1.0	11.0	4.0	8.0	4.0	18.0	19.0	7.2	6.7	1.3
As % share of GNP													
imports (e)	14.0	15.9	15.8	14.5	14.6	13.8	14.3	16.2	17.8	20.8	23.6	25.2	22.9
exports (e)	8.5	10.8	12.8	10.7	8.5	8.9	9.2	8.4	13.8	12.6	17.8	17.1	15.7
current account (e)	-2.7	-1.9	1.8	0.9	-1.7	0.2	-0.6	-3.6	2.0	-1.4	-1.3	-1.4	1.4
foreign debt	27.1	37.8	44.8	38.8	32.5	33.6	35.2	37.7	49.6	42.8	46.1	47.8	51.7

Notes: * Annual % rate of change from the same period of the previous year. a. According to the $1.5 + 1 DM basket. b. Annual average compounded interest rate on government debt instruments deflated by the CPI. c. Private manufacturing labour data pertain to enterprises employing 10 or more workers. d. Annual growth rate in manufacturing exports (millions, $). e. Inclusive of the luggage trade after 1996.

Sources: State Planning Organization and Undersecretariat of Foreign Trade and Treasury data on main economic indicators and State Institute of Statistics manufacturing industry surveys.

pursuit of macroeconomic stability. The macroeconomic phases of the post-1980 Turkish economy are sketched in Table 4. The table illustrates the various mechanisms of adjustment that have taken place in the spheres of production, distribution and internationalization.

Accordingly, three major cycles of adjustment-growth-recession/crisis are evident in the table. First was the cycle of export-orientation, 1981-7, followed by the recession of 1988. The second cycle, 1989-93, was generated by foreign capital inflows following the financial deregulation in 1989 and came to an end with the eruption of the 1994 financial crisis. Lastly, the post-1995 growth was short-circuited by the contagion of the East Asian and Russian crises after 1998.

The underlying mode of adjustment in the 1980s was the export orientation of manufacturing industries. During the decade, export revenues increased at an annual rate of 15 per cent, and GNP rose per annum by 4.2 per cent in 1981-2 and by 6.5 per cent between 1983 and 1987. The depreciation of the currency exceeded the rate of domestic inflation for purposes of export promotion and attaining foreign balances, and the Turkish lira was caught in a declining trend in real terms until 1989.

Yet, the underlying feature of the 1981-8 period was the suppression of wages in an attempt to lower production costs and squeeze domestic absorption capacity. Indeed, one of the first measures of the military regime of 1980 was to regulate the labour market through political authoritarianism and the depoliticization and demobilization of the labour force (Cizre-Sakallioglu, 1991; Yeldan, 1995). With the imposition of the 1982 Constitution and new articles in the 1983 Labour Code, the position of wage labour vis-à-vis capital commenced to erode severely throughout the decade. As soon as it assumed power, the military government shut down the major labour union confederations, and trade unions were barred from engaging in political activity and establishing formal and informal links with political parties. With the new Labour Code of 1983, the right to strike was severely restricted and was limited only to collective bargaining disputes. Even then, a strike could be prohibited or postponed, and any dispute could be settled from the outside by a newly formed body called the Supreme Board of Arbitration. Through this body, the state exercised strict control and supervision over labour relations and regulated the evolution of wage demands effectively. Consequently, the share of wage labour in private manufacturing value added receded from 30 per cent to 20 per cent and in public manufacturing from 27 per cent to 15 per cent between 1980 and 1988. In this process, the average mark-up rate (profit margins) in private manufacturing increased from 31 per cent to 38 per cent (Table 4).

The other side of this distributional shift was the rise in financial rents. With the advent of the deregulation of domestic financial markets and the liberalization of the capital account, the Turkish economy had completed its integration with global financial markets by 1989. In this setting, the Central Bank lost its overall control over the exchange rate and the interest rate as instruments of independent policy-making, as these practically turned into exogenous parameters set by the chaotic conditions of financial arbitrage in global markets.

Conceptually, the financial liberalization reform agenda was expected to achieve a more efficient and flexible financial system capable of converting national savings into productive investments at the lowest cost. Contrary to what was expected, however, the reforms were not accompanied by any significant change in the financing behaviour of corporations and did not lead to lower investment costs (Akyüz, 1990). The state maintained its dominance in both commodity and asset markets through its complex system of price and fiscal incentives. The real rate of interest, in fact, rose to unprecedented levels, and domestic asset markets, impacted by sudden changes in speculative foreign capital flows, became volatile and uncertain.

Table 5 documents the distributional consequences of the post-1980 financial deregulation episode. The share of interest income within aggregate domestic income stood at around 15.2 per cent by 1998, reaching almost the total value added of agriculture—a sector which houses 45 per cent of the civilian labour force. The share of interest income was virtually nil in 1980.

From the perspective of a more extended time frame, the overall decline of agricultural and wage and salary factor income is phenomenal. The share of agricultural income has been reduced by almost half in the course of the last three decades. The wage cycle, on the other hand, displayed a rising trend in the 1970s and followed a declining course during the outward orientation of the domestic economy in the 1980s. The share of non-agricultural wage labour reached its lowest level in 1986 at 17.1 per cent from the peak of 36.8 per cent realized in 1977. A fall of such magnitude clearly reflected the faltering employment response of domestic industry to the significant reductions in real wages. The implication is that the scope for capital-labour substitution has been greatly limited in the productive sectors of the Turkish economy (Celasun, 1989: 20).

TABLE 5
THE FUNCTIONAL DISTRIBUTION OF DOMESTIC FACTOR INCOME, 1970-98 (%)

	Total domestic factor income	Agricult.	Non-agricultural factor income							
			Total	Wages and salaries			Non-wage income			
				Total	Public sector	Private sector	Total	Income on rent	Interest income	Other factor income
1970	100.00	31.08	68.92	31.15			37.77			
1971	100.00	31.31	68.69	31.33			37.36			
1972	100.00	30.32	69.68	31.57			38.11			
1973	100.00	29.13	70.87	31.56			39.31			
1974	100.00	30.20	69.80	29.77			40.03			
1975	100.00	30.76	69.24	31.51			37.73			
1976	100.00	31.28	68.72	33.11			35.61			
1977	100.00	29.12	70.88	36.81			34.07			
1978	100.00	26.66	73.34	35.19			38.15			
1979	100.00	24.33	75.67	32.79			42.88			
1980	100.00	27.51	72.49	25.27	14.60	10.67	47.22	8.97	0.73	37.52
1981	100.00	25.27	74.73	22.28	11.86	10.42	52.45	8.04	3.54	40.87
1982	100.00	23.52	76.48	20.09	10.17	9.92	56.39	8.13	5.35	42.91
1983	100.00	22.14	77.86	22.02	10.98	11.04	55.84	8.15	5.41	42.28
1984	100.00	22.43	77.57	19.37	9.58	9.79	58.20	7.56	7.68	42.96
1985	100.00	21.17	78.83	17.40	8.49	8.91	61.43	7.78	6.74	46.91
1986	100.00	21.03	78.97	17.08	8.32	8.76	61.89	7.24	7.01	47.64
1987	100.00	19.19	80.81	20.39	9.43	10.96	60.42	6.26	7.80	46.36
1988	100.00	18.58	81.42	20.91	9.10	11.81	60.51	4.80	8.89	46.82
1989	100.00	18.20	81.80	24.07	12.37	11.70	57.73	3.92	5.90	47.91
1990	100.00	19.07	80.93	28.11	15.02	13.09	52.82	3.39	5.79	43.64
1991	100.00	16.35	83.65	33.78	18.27	15.51	49.87	3.76	8.44	37.67
1992	100.00	15.97	84.03	34.42	19.43	14.99	49.61	3.84	7.95	37.82
1993	100.00	16.77	83.23	33.29	19.10	14.19	49.94	3.38	6.97	39.59
1994	100.00	16.70	83.30	27.50	15.47	12.03	55.80	3.23	8.62	43.95
1995	100.00	17.18	82.82	24.56	12.68	11.88	58.26	3.24	11.61	43.41
1996	100.00	18.34	81.66	26.81	12.28	14.53	54.85	3.08	14.71	37.06
1997	100.00	15.73	84.27	29.45	13.50	15.95	54.82	3.10	14.40	37.32
1998	100.00	18.51	81.49	27.44	13.83	13.61	54.05	3.38	15.17	35.50

Sources: 1970-9: Ozmucur (1986); 1980-98: Temel and Associates (1999).

Given this background, it would be illuminating to trace out the dynamics of the real earnings of wage labour against (labour) productivity growth over an extended time horizon. In what follows, recent advances in the business-cycle literature are employed, and the variations in the average product of labour and the real wage rate in Turkish industry are decomposed to obtain the underlying long-term trends. Hodrick and Prescott (1980) filtering methods are used to reveal the cyclical variations in productivity growth and wage rates from their respective historical trends. This exercise enables us to isolate the underlying trend paths of the two variables and to make inferences about the evolution of the wage cycle against the long-term productivity patterns in Turkish industry.

Data for our analysis come from the annual manufacturing industry surveys reported by the State Institute of Statistics. For the 'wage rate' series, 'total wage earnings' divided by 'total workers engaged in production' are used. The average labour product is derived by dividing 'total value added' by the same labour employment magnitude. Both series are deflated by the wholesale price index and are filtered in logarithmic form. The exercise covers the extended time frame, 1950-96.

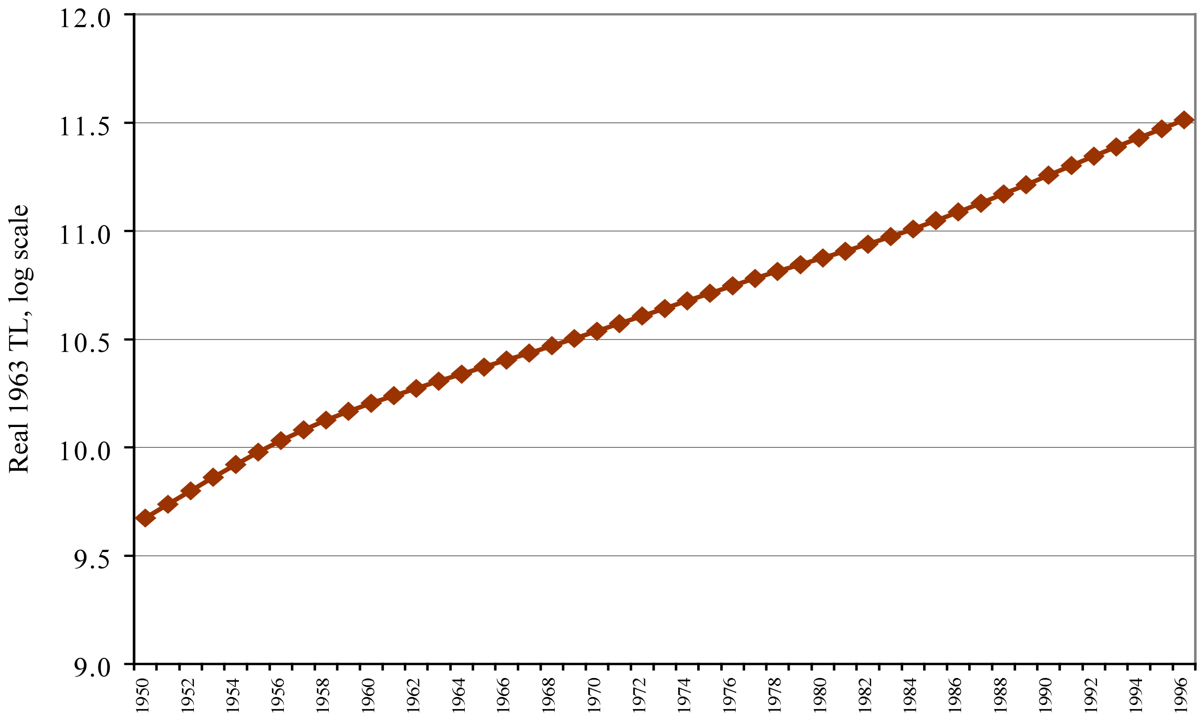
The results of the filter are portrayed in Figures 1a and 1b. The units on the y-axis are in real 1963 TL prices in log scale. In Figure 1a, we observe the historical long-term trend of the real average labour product in Turkish manufacturing. The trend has a secular upward slope, with an average rate of annual growth of 3.8 per cent for the whole time horizon (1950-96). This is to be contrasted with the trend in the real wage rate portrayed in Figure 1b. The trend in real wages fluctuates along an increasing path until the mid 1970s, enters a deceleration between 1980 and 1988 and recovers after 1989. The observed recovery in the real wage is clearly the result of post-1989 populism which enabled sharp increases in real wages between 1989 and 1993, as outlined in Section 4 below. On this record of events, it seems plausible to argue that the post-1989 upswing in manufacturing real wages was, in fact, in line with the real average product of labour as far as the long-term trends of the two series are concerned.[4]

Consequently, the fluctuations in the real wage trend document the periodization of the overall political cycle affecting Turkish labour markets. The fundamental characteristic of this cycle is that it discloses a relatively weak connection between wage remunerations and labour productivity in manufacturing industries. The trend path of real wages clearly signals a break following 1979/80. This is the era when the domestic economy was subjected to a new transformation in terms of foreign competition and integration with global commodity and asset markets. The ongoing wage suppression as manifested by the downswing in the wage cycle indicates that the adjustments in labour markets had served as one of the main mechanisms to bring forth this transformation. Implemented under a military rule which imposed severe

[4] See Boratav (1991) for narrative support for this claim.

restrictions through the Labour Code on collective bargaining and unionization, the cost savings on wage labour were instrumental in extracting an economic surplus which, in turn, was oriented towards export markets via a generous export subsidization programme.

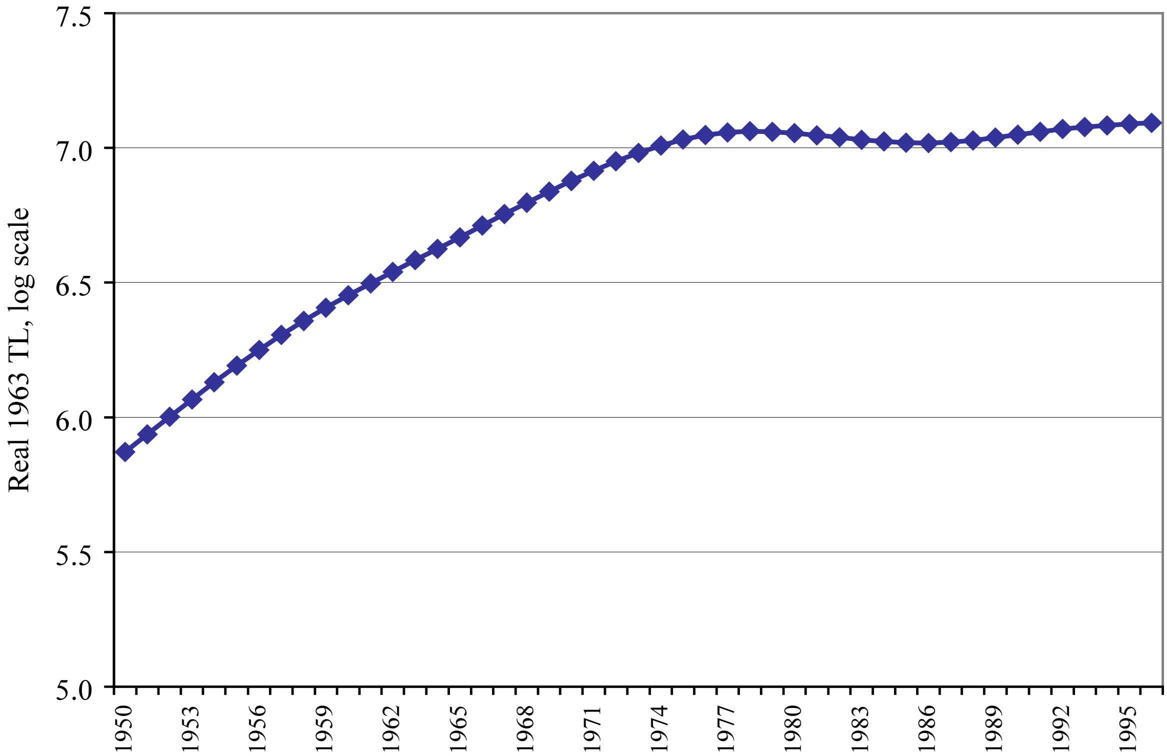
FIGURE 1A
TREND IN REAL AVERAGE LABOUR PRODUCTIVITY IN TURKISH MANUFACTURING, 1950-96



Source: SIS Manufacturing Industry Surveys (various), and author's calculations.

Read from a different perspective, the sharp contrast in the trend in labour productivity against real wage earnings following the 1980 transformation clearly displays the extent of disassociation between the productive sphere of the domestic economy and its indigenous processes of accumulation and distribution. As the internationalization of commodity and financial markets intensified, the links between the processes of savings generation and the productive use of these funds in the enhancement of capital accumulation—the so-called 'process of intermediation'—were severed. With the complete deregulation of financial transactions and the consequent ascendancy of finance over industry, international finance capital was able to assume a dominant role so as to act as the sole arbiter, aiming at immediate financial gain rather than at long-term economic development and sustainable growth.

FIGURE 1B
TREND IN REAL WAGES IN TURKISH MANUFACTURING, 1950-96



Source: SIS Manufacturing Industry Surveys (various), and author's calculations.

As this unbalanced structure failed to generate the necessary accumulation patterns to achieve sustained growth, the impetus for it was exhausted by the end of the decade. The artificial growth path generated through wage suppression and price subsidies reached its economic and political limits by 1988. As summarized in Table 4, all economic indicators for 1988 signal a stagflationary macro environment. The rate of GDP growth was only 2.1 per cent; the rate of growth of fixed investments was negative, and the inflation rate accelerated to 75 per cent. Furthermore, the real exchange rate had started to appreciate for the first time since the inception of export orientation.

Commensurate with these events, we observe real wage earnings entering a period of recovery following the gains of the union movement and also the new wave of populist pressures. As can be seen from the data in Table 4, real wages in public manufacturing increased by 47.5 per cent in 1988 and then again by 31.1 per cent in 1991. Similar trends were observed in the private manufacturing sector as real wage costs increased by 16.1 per cent in 1989, 22.2 per cent in 1990 and 20.2 per cent in 1991.

Furthermore, the rural economy witnessed a significant improvement in its terms of trade vis-à-vis the rest of the economy. This occurred despite an ongoing process of worsening agricultural terms of trade in world markets, a contrasting signal to the economic signals in favour of the rural economy. Finally, beginning in 1989, there was a major shift in public expenditure accounts towards more socially desirable spending. An overall increase in both the share and the level of public salaries and investments in social infrastructure enabled the working masses to attain improved living standards.

IV THE RISING FISCAL GAP AND THE ROLE OF THE STATE IN REGULATING THE DISTRIBUTIONAL STRUCTURE

The post-1990 balances in the public sector record an unprecedented rise in the fiscal gap. In contrast, post-1988 populism could evidently be financed by taxing capital incomes and moving towards a 'fairer' tax burden for the working classes. Yet, the strategic preference of the state was the maintenance of its favourable stance towards the evasion of taxable capital incomes and towards surplus transfer because of a lax attitude towards so-called 'unrecorded private transactions'. Consequently, the state apparatus turned into a bastion of privilege as it assumed a regulatory role in the creation and absorption of the economic surplus, and fiscal balances took the major brunt of adjustment. The main macroeconomic policy response to increased wage costs and the shift in the rural terms of trade involved the rapid widening of the fiscal gap and support for the profitability of private capital. As a major indicator of the (functional) distribution of income, for instance, profit margins (mark-up rate) maintained a rising trend, and, despite the severe jump in real wage costs, reached 47 per cent in 1994, up from 33.5 per cent in 1989. Simultaneous to this development was the rapid rise of the borrowing requirement of the public sector, as the ratio of the PSBR to GDP climbed to 10.3 per cent in 1991 and 12.1 per cent in 1993 (Table 4).

Given all this, the widening fiscal deficit and the macroeconomic disequilibria it generated clearly should be understood in the context of the historical role of the state in sustaining capital incomes against the faltering performance of export-led growth patterns along with rapid increases in the costs of wage labour. The fiscal deficit of the Turkish state in the early 1990s does not necessarily imply a problem of 'bureaucratic mismanagement' in the abstract, but is a reflection of the administrative and socioeconomic policies on the part of the public sector that were deemed necessary to sustain the generation of an economic surplus for private capital. The state used its taxation-cum-subsidy policies and the prices (losses) of its production enterprises as strategic instruments in this historical manoeuvre and financed its fiscal deficits via forced savings by way of price inflation and increased securitization of domestic debt through short-term capital inflows.[5]

Given these conditions, the stock of securitized domestic debt grew abruptly and rose fourfold in the relatively short time span of only a decade. The stock of government debt instruments was only about 6 per cent relative to GNP in 1989, just when the liberalization of the capital account was completed. It grew rapidly and had reached 22 per cent by 1998.

The underlying characteristic of domestic debt management was its short-term maturity. As a ratio of the stock of existing debt, annual cumulative domestic borrowings increased secularly over the 1990s and reached 103 per cent in 1993, indicating that each year the state had to resort to new borrowing which exceeded the stock of debt already accumulated. In 1996, this ratio reached 163.5 per cent. Even though the ratio seems to have declined over 1997, provisional indicators for 1998 and 1999 reveal that it again surpassed the 100 per cent threshold.[6] Thus, the public sector has been trapped in a short-term debt spiral, a phenomenon called 'Ponzi-financing'. Under these conditions, the fragility of the domestic asset markets gave way to very high real interest rates. Interest payments stood at 2 per cent of GNP in 1990, but then increased very rapidly to reach 4.6 per cent in 1993 and 14.1 per cent by the end of 1999.

On the other hand, the mandated concern to generate a surplus in primary (non-interest) budget balances led to severe entrenchment in the remaining expenditure items in the fiscal budget. Here, the major brunt of adjustment fell on public investment expenditures. The investment expenditures of the public sector, net of personnel payments, were reduced to only 4.6 per cent of total budgetary expenses as of the third quarter of 1998. By comparison, the interest costs of the domestic debt reached 1,010 per cent of public investments and 481 per cent of the transfers accruing for social security expenditures in the same

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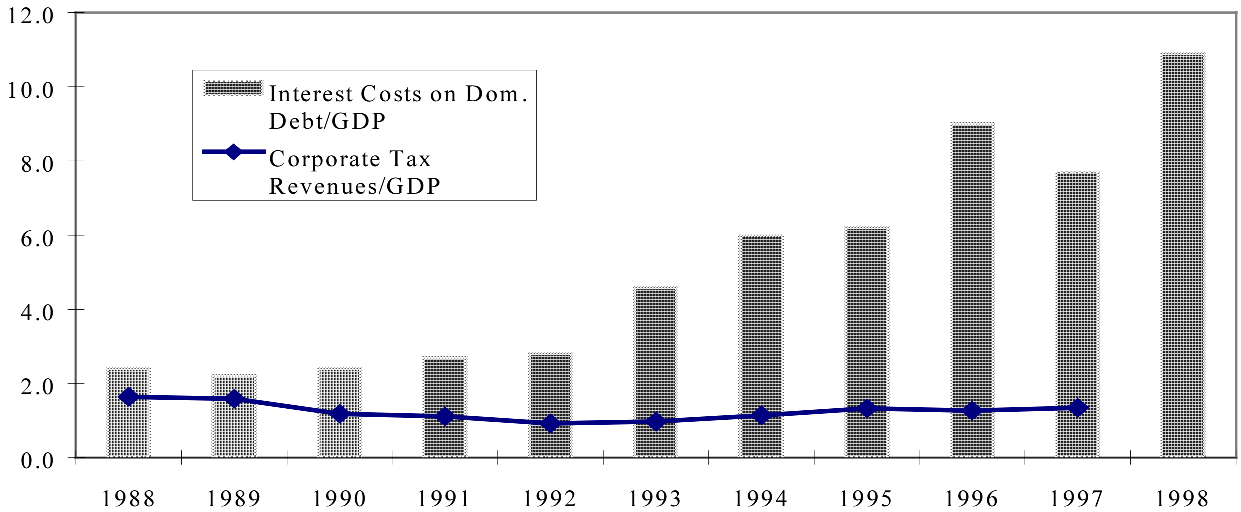
[5] See, for example, Köse and Yeldan (1998), Yeldan (1996a, 1997) and Boratav, Yeldan and Köse (2000) for a more comprehensive assessment of this argument. Yeldan (1996b, 1998), in turn, offers a macroeconomic general equilibrium assessment of the pre-1994 crisis path of the Turkish economy and reports that the fiscal deficits realized between 1991 and 1993 enabled an increase in the real incomes of private industrial capital by as much as 7 per cent per annum.

[6] Data on these indicators can be obtained from the website of the Undersecretariat of the Treasury, <http://www.treasury.gov.tr>.

year. In other words, the central budget lost all its functional power as an instrument of social infrastructure development and economic growth and had been transformed into a tool of financial sector development, regulating the disposition of the economic surplus in domestic asset markets. The central budget of the Turkish state in the 1990s seems to have lost its role as a producer and an investor in the productive sphere of the economy and assumed instead an instrumental role in regulating the distributional conflict in favour of financial rentiers and private capital owners.

FIGURE 2
INTEREST PAYMENTS ON DOMESTIC DEBT AND CORPORATE TAX REVENUES (% OF GNP)



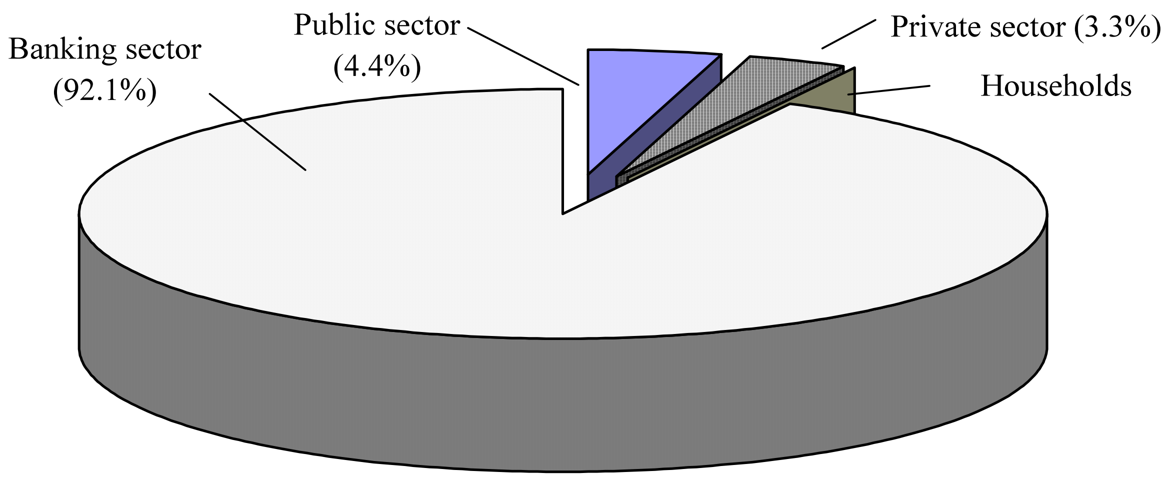
Source: *Monthly Statistics* (various).

The size and extent of this regulation can be more clearly seen when account is taken of the amount of the taxes imposed on capital incomes. Figure 2 illustrates this point. By comparing the interest costs of the state and the tax earnings from corporate capital incomes, one can see the extent of the income transfer accruing to the rentier classes through the fiscal debt management operations of the Treasury. As a ratio of GNP, interest payments on domestic debt had reached 10 per cent by the end of the decade. However, the tax burden on corporate sector capital incomes had reached a meagre maximum of 1.7 per cent over the same period. Thus, the contribution of corporate incomes to aggregate tax revenues lay well below the income captured through interest earnings on the government's debt instruments (GDIs).

It can be seen that capital incomes effectively remain untaxed in Turkey, and as the Treasury offered sizeable premiums on the market yields of its instruments, it became the dominant agent in the financial economy, enabling the banking system to capture significant returns based on the arbitrage of open positions. Consequently, the current mode of domestic debt management through securitization works as a direct income transfer to the commercial banking sector and the rentier classes, and the state plays an active role in regulating this transfer.

The distribution of GDI issues is portrayed in Figure 3. Currently more than 90 per cent of the newly securitized deficit is being purchased by the banking sector. Thus, the so-called 'deepening' of the financial system in the Turkish economy has turned into a process of self-fuelled cycles ready to burst. High real interest rates on the GDIs attract speculative short-term funds, and, through the operations of the banking system, these are channelled to the vaults of the Treasury. In this manner, the Treasury has been able to bypass the regulations of the Central Bank, as well as the restricted opportunities for foreign borrowing from world markets. Capital account liberalization has thus served the government by enabling banks to engage in extremely profitable short-term borrowing abroad so as to finance the Treasury's bond auctions. The major brunt of the costs of this fragile environment, however, have fallen on the productive sphere of the economy, especially the traded sectors.

FIGURE 3
DISTRIBUTION OF DOMESTIC DEBT, BY SECTORS (JANUARY-AUGUST 1997)



Source: *Monthly Statistics* (various).

Indeed, throughout the course of these events, Turkey's banking sector and financial institutions disengaged from production and became the dominant player in the capital manipulating the overall economy. Initially, it was the collapse in public disposable income which led to feverish public sector borrowing. The consequent high interest rates on government bonds and Treasury bills set the course for the dominance of finance over the real economy. As a result, the economy is trapped in a vicious circle: commitment to high interest rates and cheap foreign currency (overvalued TL) against the threat of capital flight leads to further increases in real interest rates. When the adverse impacts on the current account balance become excessively destabilizing, real depreciation seems imminent, which, however, needs to be matched by further upward adjustment in the interest rate if currency substitution or capital flight is to be restrained. This process, as in the case of Mexico in 1994 and the recent crises in East Asia, leads to overvaluation of the domestic currency and the cheapening of imports and thus to an acceleration of domestic consumption demand at the expense of exports and the real productive industries in general. Erratic movements in the current account, a rising trade deficit (from 3.5 per cent of GNP in 1985-88 to 6 per cent in 1990-93) and a drastic deterioration in fiscal balances reveal the unsustainable character of the post-1989 populism financed by foreign capital inflows. In the words of Boratav, Türel and Yeldan (1995):

> ... the post-1990 Turkish experience shows the serious problems confronting a developing economy which decides to move into full external and internal deregulation in the financial system under conditions of high inflation. The spectre of capital flight becomes the dominant motive in policy-making and creates commitment to high interest rates and expectations for cheap foreign exchange. The links of these two policy variables with the real sphere of the economy, i.e. investment on physical capital and the current account balance of payments, are deeply severed. Instability in the rates of foreign exchange and interest rates creates feedbacks which lead the economy into further instability.

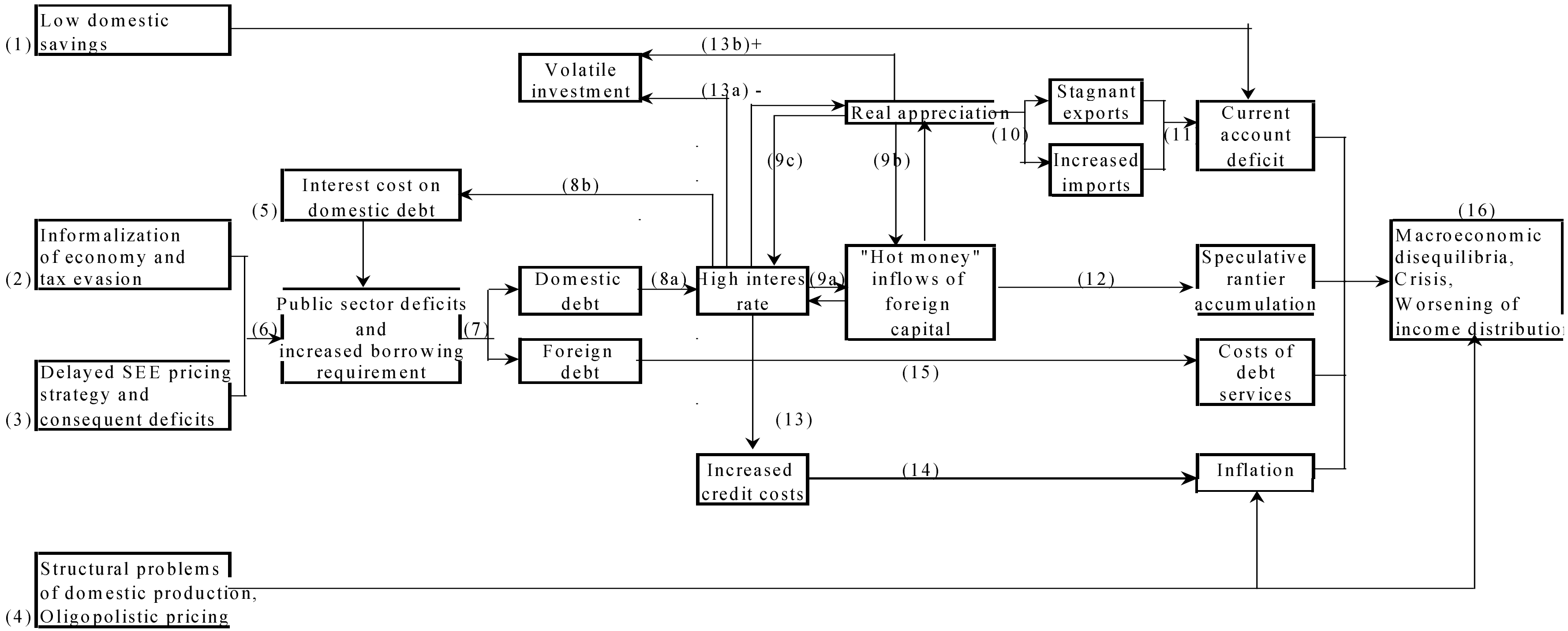
This prolonged instability reached its climax during the fourth quarter of 1993, when currency appreciation and the consequent current account deficits rose to unprecedented levels. With the sudden drainage of short-term funds in the beginning of January 1994, production capacity contracted, followed by a continued fall in industrial output throughout that year. Together with this contraction, post-1994 crisis management gave rise to significant shifts in income distribution and to an intensification of the ongoing process of the transfer of the economic surplus towards financial sectors and away from wage labour and the industrial sectors. Likewise, dollar-denominated wage costs decreased substantially and enabled export earnings to rise. In this manner, Turkey switched once again to a mode of surplus extraction, whereby the export performance of industrial sectors and the burden of macroeconomic adjustment depended on savings on the wage bill. In fact, the disequilibrium could only have been accommodated by the massive (downward) flexibility displayed in real remunerations of wage labour.

As an overall summary of the dynamics of the post-financial liberalization episode in Turkey, Figure 4 characterizes schematically the main mechanisms of macroeconomic equilibrium. Low savings, along with a large fiscal gap, and structural deficiencies in an oligopolistic production structure set the scene portrayed in Figure 4. Low savings generation results directly in disequilibrium in the macroeconomic environment along channel (1). An important addition to the features of the period was the wage explosion and the reemergence of a populist stance within the background of intensified political struggle. In response to these structural characteristics, we observe that the state assumed an active role in the economic sphere, regulating the distribution of national output.

The state carried out this task, first, through its enterprise system by way of a mandated policy of delayed price adjustments on the intermediates and the final wage and capital goods produced by state economic enterprises (Figure 4, box (3)). Second, following the full deregulation of the capital account, the state actively participated in domestic asset markets through the issuance of debt instruments (channels (6) and (7)). This, together with the threat of currency substitution in the context of a convertible currency regime, necessitated high interest rates (channels (8a) and (8b))—the first vicious circle—and real appreciation (channel (9b)). The second vicious circle surrounding channels (9a), (9b) and (9c) is highlighted by the contradictory implications of the three variables involved: short-term capital inflows (hot money), real appreciation, and high real interest rates. Real appreciation was the prime cause of the rise in import volumes and the current account deficits. On the other hand, real appreciation had a direct positive effect on investment demand by reducing the costs of imported capital goods and intermediates (channel (13b)). This positive effect was countervailed by the pressures of real interest rates (channel (13a)), the result being increased volatility in investment demand. High interest rates gave way to inflationary pressures through the increased costs of credit (channels (8b) and (13)) and fed a speculative rentier type of accumulation (channel (12)), with the consequent worsening in income distribution. The limits of this bonanza of a 'short-term foreign-capital-led growth pattern' was the eruption of the financial crisis in 1994 and the continued fragility and the severe disequilibria faced by domestic markets in the late 1990s.

FIGURE 4

MACROECONOMIC DYNAMICS OF THE TURKISH ECONOMY UNDER FULL FINANCIAL LIBERALIZATION (POST-1989)



Structural features:
(1), (4),
wage explosion
return to populism

Policy responses:
capital account liberalizat
(3): keeping SEE prices l

First stage outcomes:
(2), (6), (7),
vicious circle of
domestic debt: (8a), (8b)
vicious circle of capital
account liberalization: (9a), (9b), (9c)
(13a), (13b)

Second stage outcomes:
(6), (7), (8a), (8b) repeated
(10), (11)
(12), (14) (16)

Source: author's sketch.

Clearly, the 'reform fatigue and exhaustion' of the 1988 crisis and the unsustainability of the post-1989 growth path which culminated in the crisis in 1994 and the current crises have been characterized by the operation of quite different macro dynamics. Throughout all these episodes, however, in spite of the official stance towards a policy of 'reducing the economic role of the state', we observe continued use of the state's powers as a regulatory agent, overseeing the distributional conflict over the national product.

V CONCLUDING COMMENTS AND OVERALL ASSESSMENT

This paper attempts to investigate and assess the impact of financial liberalization and the ongoing rise of financial rents on income distribution in the post-1980 Turkish economy. Both the rudimentary data on size distribution and the quantitative investigation of the long-run dynamics of real wages against labour productivity disclose a worsening in income distribution. They also disclose an overall disassociation of financial institutions from the productive sphere to become the dominant segment of capital manipulating the aggregate domestic economy. As financial capital gained supremacy over industry, the links between growth and productivity gains and the intermediation of savings funds for productive capital accumulation were severely hampered, with adverse consequences for the incomes of wage labour and the working poor.

These findings are in stark contrast with the predictions of the standard theory which argued that the expected productivity gains associated with increased competition in global commodity markets would translate into increased wage remunerations within the labour-intensive sectors in which Turkey was said to hold comparative advantage. Our findings thus underscore that, given the poor vertical linkages among industrial sectors within the historical conditions of peripheral capitalism, the implementation of vigorous export promotion polices and state-led price incentives created sporadic increases in productivity in the 1980s, yet failed to generate a sustained increase in economic growth and accumulation.

The Turkish adjustment experience throughout the post-1980 period has been a process in which, in a developing market economy trapped by the needs of domestic industry to integrate with world markets and the distributional requirements warranted by this reorientation, the state apparatus became the bastion of privilege, regulating the mode of income redistribution within society. The elements of this redistribution involved both direct mechanisms to attain favourable production and export subsidies, currency depreciation and wage suppression, as well as indirect mechanisms such as tax evasion on capital incomes and a financial market development strategy which enabled massive income transfers to the rentier class.

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