The Inner Connections Between Productive and Money Capital in Turkey

Nuray Ergüneş and Fuat Ercan

İstanbul University/Marmara University

The main argument of this paper will be the last decade of Turkey. In particular, inner connections between productive and money capital in Turkey will be discussed by moving from changing structure of real and banking sector and behaviour as well. As is widely emphasized, 2000-01 crisis has been a turning point for Turkey. Since then, Turkey is living a fast capital accumulation process. While a transformation has been witnessed towards intermediate and investment goods, economy globally integrated.

This period has also been that Turkey has had intense experience of the impact of financialisation in the form of capital inflows, in other terms in the form of foreign direct investment (FDI) and portfolio equity investment, such as other developing countries. However, to promote capital accumulation domestically, Turkey tried to facilitate capital inflows and has realized the transformation in the economy through these capital inflows. In this context, the policies to attract these capital inflows into the country have formed as a necessity of cheap foreign exchange in other terms as a necessity of imported investment goods financing. The needs of the money capital in the form of the foreign exchange have been provided from these international capital inflows.

The Monetary Policy of Turkey in Financialisation Era

After 2000-01 crisis, Turkish production has witnessed a structural transformation towards intermediate and investment goods. However, this production structure is highly dependent on imported materials. That is the basis on which domestic capital has become increasingly internationalised. As will be explained later, this structural transformation has also brought important changes in the financing of the productive sector, thus intensifying the process of financialisation. To promote capital accumulation domestically, Turkey tried to facilitate capital inflows. As mentioned before, the economic policies to attract these capital inflows into the country have formed as a necessity of cheap foreign exchange in other terms as a necessity of imported investment goods financing.
The main policy option of Turkey has been reserve accumulation. Accumulated foreign exchange reserves are aimed at stabilising the currency and protect countries against sudden capital outflows. In accordance with reserve accumulation, the other main policy option of the country has been contractionary monetary policy, with near-exclusive focus on price stability and so, it is started to adopt inflation targeting (IT). Actually, inflation targeting has meaning more than a monetary policy; it implemented in accordance with requirements of capital accumulation process in the course of global integration of Turkey. In this process, IT works as a mechanism to attract capital inflows into the country, to lowering wages and to providing predictability and instability for the investment environment. The below figures indicates ITs functions:

**Figure 1. The Functions of Inflation Targeting**

- **The role in regulating capital inflows**
  - The critical element of IT is ex ante commitment to high real interest rates. High interest rate is tool to attract foreign capital flows into the country.
  - In this manner, IT works as a mechanism to attract capital inflows. Capital inflows, in other terms money in the form of foreign exchange, is very critical in the capital accumulation process.

- **The role in lowering wages**
  - IT has also been functional to lower labour wages. This is one of the specific components of the so-called non-inflationary growth policy that relies on deregulated labour markets.
  - In this manner, IT works as a mechanism to lower wages allowing developing countries to compete globally and to increase accumulation. Thus, IT has played critical role in capital accumulation process in the era of financialisation

- **The role in predictability and instability for the investment environment**
  - IT is important for achieving price stability and related that to encourage investment environment

**IT in Turkey and Its Outcomes**

Turkey has started to implement IT in 2002, after 2000-01 crisis. After that, the growth had been very high in the economy. The annual growth rate of GDP averaged 7% since 2001.
This growth rate was mainly driven by massive foreign capital flows. The high rate of interest has pulled foreign capital into the country, the financial account ratio to GDP was 0.6 in 2002, and it rose to 5.6 in 2007. Relative abundance of foreign exchange led to overvaluation of Lira. Turkey’s reserves have also increased similar to the other developing countries. The current ratio of reserves/short term debt is 1.81. The Central bank has invested its reserves mostly to US treasury bonds such as the other countries.

However, this rapid growth has failed to create corresponding level of employment. Unemployment ratio has increased. According to official figure, unemployment rate was 6.5% in 2000 and it has realized as 9.6% in 2008. Real unemployment rate is higher than this official ratio. It is around 20%. (Ergüneş, 2009).

**Improvements in the Productive Sector**

Throughout this process, technology-intensive and investment goods has gained weight in the production of Turkey and also in its export, despite the overall level of the production has still relied on the production of the intermediate and consumption goods. This is a new phase of capital accumulation in Turkey.

Related to transformation in the production structure, export and import composition has changed. Technology-intensive and investment goods have been most dynamic sectors in its export. The similar tendency can be observed in import. The import of investment and intermediate goods sectors has significantly increased. In the import increase, the utilisation of large amounts of imported intermediate goods in the high-performance export sectors and regional trade have been determinant. In an equal manner, cheapening foreign currency has contributed import increase.

**Table 1 Manufacturing Industry Production Increase by Main Sectors**

<table>
<thead>
<tr>
<th></th>
<th>Total Amount Manufacture Industry</th>
<th>Consumption Goods</th>
<th>Intermediate Goods</th>
<th>Investment Goods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted average</td>
<td>4.07</td>
<td>1.02</td>
<td>4.06</td>
<td>7.58</td>
</tr>
</tbody>
</table>
During these years, Turkey’s production has been heavily export oriented than before. New industries, like automotive and electronics are emerging fast. Turkey has mostly imported from Asia countries (especially China) where most important production area globally due to its competitive prices relied on cheap labour power and exported to Europe Union. EU Countries have been most important trading partner of Turkey after Custom Union Agreement (gradual accession process into the EU) (İzmen and Yılmaz, 2009: 5).

This transformation in the production structure is virtually the indicator of high-level integration of Turkey into global markets through import of the intermediate input and final products, in other words, it shows production structure which is intertwined with international production chain (Narin, 2008).

**Global Competitiveness of Turkey**

Low wages have played crucial role in maintaining global competitiveness. The real wages declined during this period. Total value of real wages index of manufacturing sector was 111.3 in 2000; it declined to 93.7 in 2007. Labour cost declined during the period of 2000-2007. It was 102.4 in 2000; it declined to 59.9 in 2007. Meanwhile, productivity level of production has increased which this increase should be considered as an important factor contributing competitiveness of Turkey. Productivity index of manufacturing sector was 115.7 in 2000; it rose to 169.4. Productivity increase has been associated with reducing number of employees, extending working hours and squeezing wages which situated in a wider context of deregulation and flexibilisation process of labour market. In this sense, IT policy has served as a mechanism to squeezing wages. Through indexing wage increase rate to inflation rate, wages have therefore been kept at a low level (Ergüneş, 2009).

Table 2 Industrial Production, Real Wages, Workers, Productivity Indexes (Manufacturing Industry-Per Hour Worked) and Inflation Rate (CPI)
Transformation Requirement in the Financing of the Real Sector

The real sector has gravitated borrowing externally instead of borrowing domestically. The reason for this changing has stemmed from transformation in the production structure which is characterised as import-dependent investment goods production. This production structure and its requirements have forced the real sector to find cheap foreign exchange to finance its own production. Thus, real sector has been capable to reduce cost of production and to compete globally. In this sense, high interest rate policy implemented as an instrument of IT has been a facility for real sector because it is cheapened foreign currency.

Table 3 Composition of Non-Financial Enterprises External Debt Stock (Billion US Dollar)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium and Long Term</td>
<td>22.7</td>
<td>24.6</td>
<td>25.1</td>
<td>28.5</td>
<td>34.9</td>
<td>53</td>
<td>77</td>
<td>87</td>
</tr>
</tbody>
</table>

Source: Turkey Republic Prime Ministry State Planning Organisation, ‘Main Economic Indicators’, www.dpt.gov.tr

The amount of the medium and long term debt of the non-financial enterprises has reached to US$ 87.095 million in 2008Q1, while it was US$ 24.610 million in 2002. Throughout this process, real sector has severely reduced banks loans share in its own financing. The financing of the real sector is still relied on bank loans and still domestic sources, in this process, shareholder’s equity and external borrowing have started to gain weight in the financing of the real sector. This is because the real sector has been able to finance its own
production by its own resources or by borrowing externally sometimes without the need of to mediation of banks. The implemented economic programme has provided suitable environment for that.

**Table 4 Corporate Sector’ Financing**

<table>
<thead>
<tr>
<th></th>
<th>Shareholders’equity/Total Assets</th>
<th>Banks’Loans/Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>35.9</td>
<td>42.6</td>
</tr>
</tbody>
</table>


**Improvements in the Banking Sector**

The Turkish financial sector which is dominated by banking sector witnessed significant improvements after 1980 liberalization process. To liberalize financial system many restrictions on domestic and external financial intermediation have been removed. Liberalizing interest rate and simplifying bank establishment accelerated growing up the banking sector.

Many banks established in that period and also foreign banks were encouraged to operate in Turkey. The new entry into the banking sector was mostly from large industrial conglomerates which want to own banks, since weak regulatory structure allowed to for large amount lending from banks into the group companies. Some of them were Koç Holding, Eliyeşil Family, Uzan Group, Özyol Holding, Doğuş Group, Fiba Holding etc. (Ergünes, 2008). The capital groups had been bank owner by using different mechanisms. Establishing new bank, to be partner to a foreign bank, privatisation had been some of these mechanisms.

At the end of 1980, full liberalization of capital movements made banking more attractive and new entry into the banking sector had continued. The opening of the Turkish economy to outwards in 1980s increased certainly the funding options abroad both for financial system and for corporations.
Restructuring of the Banking Sector

In the wake of 2000-01 crisis, a comprehensive banking sector restructuring programme as a part of Transition to Strong Economy Programme as has been initiated. In particular, *Transition to a Strong Economy* has a specific meaning for the Turkish economy. The reason is that this programme included structural reforms oriented towards the global integration of the economy.¹ This process started in the 1980s and intensified in the 2000s.

**Figure 2. The main elements of the banking restructuring programme**

- A deep financial restructuring of the public and SDIF banks
- Measures to facilitate the participation of private capital in strengthening of the private banking system
- Improving supervisory and regulatory framework

To regulate and strengthen the banking system, Banking Regulation and Supervision Agency (BRSA) has been established in the framework of restructuring banking sector. Furthermore, throughout this process, 20 banks were taken over by SDIF and a consolidation process occurred in banking sector speedily. The number of banks declined from 81 in 2000 to 61 in

¹ These reforms had three pillars: The first pillar was restructuring banking sector; a deep financial restructuring of the public and SDIF banks, strengthening private banking system and improving banking regulation and supervision. The second pillar was improving public governance, including public administration reform and continuing public expenditure management reform. The third pillar, private sector reforms, was concerning privatization, corporate governance, encouraging foreign capital, public administration reform in order to catalyze investments.
2002 and to 54 in 2003. After restructuring process, foreign banks have penetrated the banking sector by buying share from domestic banks, especially after 2005. Fifteen of the domestic banks were bought by foreigners partially or wholly between 2005 and 2007. The market share of the foreign banks has reached to 39.7 % in 2007, constituting almost half of whole sector. Some of banks bought by foreign banks are Dışbank by Fortisbank, Denizbank by Dexia Participation Belgique, Finansbank by National Bank of Greece, Tat Yatırım Bank by Merrill Lynch European Asset Holding, Oyakbank by ING Group (Ergüneş, 2010).

The Reasons for the Foreign Entry

Huge amount of international capital flows which search for profitable markets was one of the important elements of new foreign entry and so this money was mainly directed to developing countries like Turkey. Foreign banks have entered into these countries to explore profit opportunities and to expand their market share.

More specifically 2000-01 crises increased the desire of foreign banks to buy the Turkish banks cheaply; because of merger and acquisitions the number of branches and personnel number have declined. The restructuring of the Turkish banking system after these crises also encouraged foreign banks because the banking sector became more strengthen. The total assets of banking sector increased from $501 billion in 2007 which was $ 132 billion in 2002. The Turkish market was one of the best alternatives with the high profit potential as it is seen from the assets/GDP ratio was 76% in 2007 and well below the EU 25 averages which is over 300 % (Ergüneş, 2010).

The Reasons for Selling of the Domestic Banks

First of all, by partnerships, domestic banks have attained opportunity to increase their credibility as well as they have caught chance for alternative credit facilities, especially in international markets. Thereby, their manoeuvre capability has increased. Besides that, the bank sales provided high profits to these groups.

The primary motivation for the bank selling has been new strategy of capital groups. The restructuring of the capital groups after 2000-01 crisis has been in the form of exiting from the banking sector and to gravitate towards productive sector. For example, Oyak Group
sold its own bank (Oyakbank) and bought Erdemir which this company is the Turkey’s largest and the world’s 30th largest steel producer. The other example is Doğan Group. Doğan Group sold its own bank-Dışbank and bought Petrol Ofis which is the leading petroleum distribution company in Turkey (Öztürk, 2010).

In addition, the capital groups have been able to borrow from the international foreign currency markets in the abundance of liquidity in the international markets. This has been another factor in the behaviour of capital groups. While their ability to borrow from abroad dramatically increases, their reliance on domestic financial institutions declines.

Transformation in the Banking Activities

The banks have directed their activities towards individuals rather than industrial enterprises. They have accelerated the supply of consumer credits. The volume of the individual credits rose from US$ 4.0 billion in 2002 to US$ 81.9 billion in 2007. The proportional share of the individual credits within the total credits has also increased to 33.3% in 2007, while it was 13.4 % in 2002 (Ergüneş, 2010).

The Banking Sector Profitability

Although inflation rates and nominal interest rates decreased, the high real interest rates coupled with appreciation of the Turkish lira provided a lucrative environment for the banking sector by encouraging bank-based foreign borrowing (Bakır and Öniş, 2010: 81). The below table indicates that.

Table 5 Development of the Resources Provided from the Foreign Country (Billion Dollars)

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Syndication Credits</td>
<td>3.8</td>
<td>6.5</td>
<td>8.1</td>
<td>12.5</td>
<td>13.2</td>
<td>11.2</td>
<td>7.4</td>
</tr>
<tr>
<td>Securitisation Credits</td>
<td>2.8</td>
<td>3.5</td>
<td>7.0</td>
<td>9.2</td>
<td>13.1</td>
<td>12.4</td>
<td>10.9</td>
</tr>
<tr>
<td>Total</td>
<td>6.6</td>
<td>10.0</td>
<td>15.1</td>
<td>21.7</td>
<td>26.4</td>
<td>23.6</td>
<td>18.2</td>
</tr>
<tr>
<td>Syndication Credits/Total Foreign Resources</td>
<td>2.5</td>
<td>3.3</td>
<td>3.1</td>
<td>4.0</td>
<td>3.0</td>
<td>2.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Securitisation Credits/Total Foreign Resources</td>
<td>1.8</td>
<td>1.8</td>
<td>2.7</td>
<td>3.0</td>
<td>3.0</td>
<td>2.9</td>
<td>2.3</td>
</tr>
</tbody>
</table>
The high real interest rates were the key factor behind the increased net bank profits: the ratio of net bank profits to GDP increased from 0.8 per cent in 2002 to 2 percent in 2007.

As mentioned before, while banks away from the financing of real sector, they have increased supply of individual credits. They prefer to mobilize their savings to individual loans rather than real sector. Therefore, individual credits have provided a certain amount of profit to sector. This also accelerated financialisation of individuals.

### Table 6 Banking Sector Profitability

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>After Tax Return on Asset (ROA)</td>
<td>1.5</td>
<td>2.5</td>
<td>2.4</td>
<td>1.7</td>
<td>2.5</td>
<td>2.8</td>
<td>2.0</td>
</tr>
<tr>
<td>After Tax Return on Equity (ROE)</td>
<td>15.46</td>
<td>18.08</td>
<td>16.5</td>
<td>10.9</td>
<td>19.2</td>
<td>21.8</td>
<td>16.5</td>
</tr>
<tr>
<td>Non-performing Loans/Gross Loans (%)</td>
<td>17.6</td>
<td>11.5</td>
<td>6.0</td>
<td>4.8</td>
<td>3.8</td>
<td>3.5</td>
<td>3.6</td>
</tr>
</tbody>
</table>

*Source: Bakır, C. and Öniş, Z., 2010: 94.*

### End of the Growth Path

Thanks to capital inflows, Turkish economy achieved a rapid growth and became globally integrated. The result of this growth path has been the import-dependent production, huge amount of current account deficit, high level private debts, increasing unemployment and indebted individuals. However, this growth trend continuing since 2000-01s has ended at the beginning of 2008. Turkey entered a new crisis phase. In the first quarter of 2009, the economy has contracted approximately by 13 percent. The current crisis is burst out first in the real sector. The risk to the banking sector has been less pronounced as banks have restructured since 2000-1 in ways explained above.

Today, Turkey is experiencing its crisis on the productive area in a very high level integrated structure with international capital. The huge amounts of the external debt of the real
sector, the liquidity and credit problem and the narrowing of international markets have been main problematic areas of Turkey.

References:


Öztürk, Ö. (2010) Türkiye’de Büyük Sermaye Grupları: Finans Kapitalin Oluşumu ve Gelişimi, SAV.

Republic of Turkey Prime Ministry Undersecretariat of Treasury, available at: www.hazine.gov.tr
Turkey Republic Prime Ministry State Planning Organisation, ‘Main Economic Indicators’, available at: www.dpt.gov.tr