A Study on Political Economy of Peripheral and Advanced Capitalism:

A Simultaneous Transformation with Different Results in the post-1980 United States, United Kingdom and Turkey

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ABSTRACT

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This thesis focuses on the post-1980 neo-liberal transformation experienced in the United States, the United Kingdom and Turkey. These are the countries which started to implement neo-liberal policies simultaneously under Ronald Reagan, Margaret Thatcher and Turgut Özal administrations. I developed a political economy outlook on these countries in such a fashion that compares welfare state implementations to neo-liberal policies. After having analyzed four main macroeconomic indicators which are real GDP growth, inflation rates, real interest rates and real wage rates in three countries, we see that the outcomes of the transformation were sharply different in the advanced capitalist countries, namely the United States and the United Kingdom, from those of in peripheral countries like Turkey.

Keywords: Political economy, the United States, the United Kingdom, Turkey, neo-liberalism.

ÖZET

Çevre ve Gelişmiş Kapitalizmin Ekonomi Politiği Üzerine Bir Çalışma: Amerika Birleşik Devletleri'ndeki, Birleşik Krallık'taki ve Türkiye'deki 1980 Sonrası Eşzamanlı Dönüşümün Farklı Sonuçları

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Bu çalışma, Amerika Birleşik Devletleri'nde, Birleşik Krallık'ta ve Türkiye'de 1980 sonrası yaşanan neo-liberal dönüşüm üzerine odaklanmıştır. Bu ülkeler, Ronald Reagan, Margaret Thatcher ve Turgut Özal yönetimleri altında neo-liberal politikaların uygulamasına eşzamanlı olarak başlamıştır. Refah devleti uygulamalarını neo-liberal politikalarıyla mukayese eden bir ekonomi politik görüş geliştirdim. Reel GSYİH, enflasyon oranları, reel faiz hadleri ve reel ücretler gibi dört ana makroiktisadi göstergelerin analiz edilmesinden sonra, bu neo-liberal politikaların gelişmiş kapitalist ülkelerde, Amerika Birleşik Devletleri ve Birleşik Krallık gibi, çevre ülkelere nazaran, Türkiye gibi, daha farklı sonuçlar ortaya koyduğunu görüyoruz.

Anahtar Kelimeler: Ekonomi Politik, Amerika Birleşik Devletleri, Birleşik Krallık, Türkiye, neo-liberalizm

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CHAPTER 1

INTRODUCTION

The purpose of this thesis is to address the transformation experienced in the United States, the United Kingdom and Turkey emerged from their simultaneous motion towards neo-liberal framework in the 1980s. In other words, it seemed, for these countries, as if someone waved a flag and then a race for a policy-shift started under Reagan, Thatcher and Özal administrations. A radical change in priorities, preferences and paradigms was witnessed under these leaders who were strict believers and followers of liberal democracy. Reagan, Thatcher and Özal were supported by major segments of their societies that suffered from the political and economic turmoil created by welfare state tradition. While inflation, unemployment and deficits were creating hostility towards Keynesian legacy in the 1970s, they prepared a legitimate and suitable ground for a neo-liberal transformation which promised an instant solution to all problems.

Since the transformation was built and even, justified on the demise of welfare state, I seek to address welfare state understanding together with Keynesian school of economic thought. This is why in the second chapter, I make a brief analysis of what pre-welfare state and welfare state were. The chapter goes on with a theoretical approach to Conservative or neo-liberal schools and ends with the historical evidences from the United States and the United Kingdom. These two countries are put under scrutiny in order to observe the transformation period witnessed in the 1980s.

Third chapter concerns Turkey's political economy during the 1960s, 1970s and 1980s. This part has details from both economics and politics so as to see the whole picture for Turkey. The motive to have such a detailed chapter on Turkey is coming from the fact that Turkey constitutes the main axis of this dissertation.

The fourth chapter includes economic data, graphs and interpretations for my sample of countries. Nevertheless, the political side is not neglected and each and every economic explanation is backed by a political emphasis. The simultaneous transformation is clearly seen from the results which are derived from data analysis. However, statistical outcomes concerning inflation, real interest rates and real wages highlighted the different results of this simultaneous neo-liberal transformation witnessed in two advanced capitalist countries and one peripheral country.

CHAPTER 2

Theoretical Framework

2.1 Pre-Welfare State

Since the early eighteenth century, the political economic thought has witnessed a continual and cumulative transformation. This chapter tries to analyze the essential features and basic pillars of the welfare state experienced in the United States, the United Kingdom and in Turkey, over the last three decades, and accordingly, the liberalization period after the 1980s in the same set of countries.

In the eighteenth and nineteenth centuries, the exhibited logic for the world was a pure liberal approach to economics and politics. “Economic policy primarily aimed at the stabilization of prices and was pursued primarily in the form of monetary policies.” (Spiegel, 1991: 612). The main concern of the pre-welfare state of the twentieth century was inflationary pressures. This necessitated strict monetary policy, accompanied by wage cuts and was considered the only appropriate way for full employment (Spiegel, 1991: 612). The theory had been summarized succinctly under the so called Say’s Law which states that supply would create its own demand (Spiegel, 1991: 612). The significance of this law concerns the prioritization of the supply-side of the economy as being the determinant in calculation of national income.

Politically speaking, the principle, called *laissez faire* of Adam Smith was the dominant ideology of eighteenth and nineteenth centuries in which Smith opposed governmental restraints on the economy. The state was to play a minimal role in the allocative and distributive spheres. The economy was believed to operate properly if the state apparatus remained outside of the free market where individuals were seeking their self-interest. The only roles of the government during this classical time were external protection, justice, and certain public works such as infrastructure (Spiegel, 1991: 256). To sum up, what can be derived from the pre-welfare or liberal state period of the eighteenth and nineteenth century is that classical economic and political perceptions were dominant in individuals' self interest and in the state's role in the economy. In other words, there was a liberal aggregation of the economy through the principles of price stability and full employment. It was also true for politics, by leaving government out of market and identifying it with its ability to generate profit.

2.2 The Welfare State: Theory and Application

2.2.1 Theoretical Basis and the Performance of the Welfare State

In the eighteenth and nineteenth centuries, the fundamental principles of classical economics had dominated the agenda of policy makers in terms of their economic and political projects. The projects and targets had been shapened until the Great

Depression of 1929. But then the theories and principles of Adam Smith and his followers could not have been sufficient in explaining the rapid rise in unemployment and the crisis of the 1930s. More specifically, the full employment principle by which it would be reached via wage cuts was no longer true because unemployment rates, particularly for Western countries rose sharply to dramatic rates and levels, and, additionally, the market fell into a liquidity constraint (Curwen, 1997: 4).

As a result of these deficiencies in the system, a new and critical theory emerged to explain what went wrong in the classical economic and political approaches. It was in Keynes's book, entitled, "General Theory of Employment, Interest and Money", written in 1936. Throughout the book, it was quite clear that Keynes himself was proposing an alternative way of looking at economics and economic policy. The priorities, diagnose and the proposed remedies for the problems of the world economy that had crashed during the1930s were clearly outlined in his book.

The main departure of the Keynesian theory from the previous period concerned the terms and pillars of economic targets. As I have outlined, the nineteenth century economy in particular revolved around the primacy of price stability over any other economic indicators. However, the major target and issue for Keynes was not prices, but the rapid rise of unemployment rates that were regarded as the direct outcome of the tight monetary policies of the previous era (Curwen, 1997: 5). The basic and inevitable side effect of these policies was a decline in the amount of liquidity in the market. In accordance with the liquidity shortage, interest rates increased sharply. Thus, the classical theories of interest rate determination became also one of the prominent targets of the Keynesian school.

However, more important than these economic implications, Keynes brought the expectations issue to the fore. “Keynes felt that decisions with respect to the expansion or curtailment of output were to a considerable degree dependent upon the prevailing set of expectations about future held by households and firms.” (Curwen, 1997: 4). The expectations issue gained a remarkable importance in the years following after the Great Depression of 1929. Nations were left with idle factories, firms and manufacturers; there was a high rate of unemployment so that consumers had no disposable income to consume. There was no hope of a recovery in the minds of any sector of society. Hence, Keynes saw the expectations issue as an obstacle during crisis, and as an obstacle on the way to recovery.

This emphasis on expectation driven economic analysis issue can be regarded as the reason why the Keynesian school has been described as a demand sided one (Spiegel, 1991: 612). The underlying logic at the full-employment principle of classical economists was believed that the economy operating at full-employment was not in need of an analysis of the demand-side. Keynes argued that a market economy may fail to operate at a state of full employment and that the economies could operate at less than full capacity, the prime mover of economies should be seen as the demand side. In other words, unlike the classical liberal theory, Keynes believed that in the largest component in the calculation of national income, which was the demand side (Spiegel, 1991: 612).

The political implications of Keynesian economic thought can easily be regarded as the revival of the state as an active participant in the economy. Keynes asked the question: What if households did not spend their wages and firms did not purchase capital machinery in order to increase their sales? If both of them did these expected things, then full employment could be reached. But Keynes claimed that expectations shaped the patterns of the households and the corporate sector in their saving-investment decisions. In this situation, the economy needed another triggering mechanism which could give the economy a chance to recover, and for Keynes it was unquestionably the state (Curwen, 1997: 5). When the economy underwent recession, Keynes argued that the households and firms might be reluctant to spend their earnings. The state should feel responsible for creating demand via public spending in order to decrease the unemployment rate. The demand management to reduce unemployment rate became the principal target of Keynesian economics (Curwen, 1997: 7). The state might become a major entrepreneur, or as Keynes stated "the state can represent somewhat comprehensive socialization of investment" (Keynes, 1936: 164). Keynes did not expound public ownership of the means of production; rather he deeply believed in the state's role in the efficient allocation of resources (Fletcher, 1989: 178).

This call of duty for the state in market operations was radically contrary to what classical economists had argued as I have stressed above. Another of Keynesian concern was the priority given to the principles of equity and efficiency. The previous approach to economics was based on the profit motive, even for state affairs so that the search for efficiency became vital. In order to generate high levels of profit with the lowest amount of input was a basic principal idea of the pre-Keynesian classical ideology. Accordingly, "efficiency in the market is dependent upon the profit motive, and the profit motive has to be subjugated to the wider 'public interest' if equity issues are to be given greater priority." (Curwen, 1997: 8). In contrast, what mattered for Keynes was the realization of equity through the active interventions of the state.

From the economic and political formulations of Keynes, as the architect of welfare state in general, we can summarize the duties of the welfare state as follows:

> (i) State provision of social services to individuals or families in particular circumstances or contingencies: basically social security, health, social welfare, education and training, and housing…
>
> (ii) State regulation of private activities (of individuals and corporate bodies) which directly alter the immediate conditions of life of individuals and groups within the population (Gough, 1992: 3-4).

The validity and importance of these principles concerning the role of the public sector in the welfare state is going to be analyzed in the following section, combined with the political economic reasons lying behind the eventual demise of the welfare state.

2.2.2 The Demise of the Welfare State

The legacy of John Maynard Keynes on the political economy orientations of many countries, not merely English speaking ones, persisted for decades, particularly starting from 1945 to1979. Having affected the major pillars of policies, the welfare state faced recoveries, booms and, in the end, crises whose reasons we need to have a closer and deeper analysis.

As was said before, the major target of the welfare state polices was the unemployment problem that had arisen after the Great Depression in the United States. The labor market issue and its efficiency were the fundamentals behind nearly all actions undertaken by the legislators of those times. In fact at least until 1970, the policies were successful as a way to prevent the undesirable consequences of unemployment (Fletcher, 1989: 189). Even though unemployment rates, especially in the developed countries, displayed a decreasing inclination, the outcome was not good for inflation rates after 1970. Since the primary goal was to reduce the tension in the labor market, the governments paid relatively less attention to the decreasing purchasing power of their currencies. The state had a primary role of creating a demand in the economy where the private domains could not do so. With the help of increasing demand generated in the economy, it was expected to have a decrease in unemployment rates. The harmful effect of acting in this manner was that the state could not avoid issuing money (Krugman, 1994: 40) in order to finance expenditure which was far above budgetary income of the public sector. As an inevitable result, inflation levels reached peak levels.

Economies started to suffer from a simultaneous rise in unemployment rates with an enormous increase in the general price levels. This was in contrast to what Keynesian economic theory predicted. Although there were basic propositions claiming a trade off between the unemployment and inflation rates, the monetary expansion in the market resulted not only in the inflation but in a return to the previous experience of unemployment rates. The concurrence of unemployment with inflation, called stagflation, began to be observed at the end of 1960 in the developed regions of the world (Fletcher, 1989: 190). Economists and political scientists tried to explain such a contradictory consequence of welfarist policies. According to most of them, one of the possible reasons might be extra market forces, such as sociological ones such as severe class struggles between workers and capitalists. The other important reason was the monopoly of trade unions on the way to raise wages

(Fletcher, 1989: 190) to excessive levels that could not be financed. Though there was a demand created by the state apparatus via monetary expansion, the tremendous increase in wage levels, which came through the class struggles of the 1960s and 1970s, forced employers to lay off workers because they could not afford the wages. Hence, on the one hand the monetary bases of the economy was enlarging yet on the other workers were under the threat of being laid off.

In addition, the theory of the welfare state failed to respond to the growing needs of the public because of the international market players. For instance, the cut in annual oil production in 1973-1974 and 1979-1980 by Organization of Petroleum Exporting Countries (OPEC) posed a deep threat to those countries which were highly dependent upon oil as an energy resource (Curwen, 1997: 11). As a consequence, not only did domestic conditions create obstacles for the welfare state but the international environment paved the way to consecutive crisis.

These two reasons, namely stagflation and increases in the prices of energy resources are seen as insufficient explanation from the point of the view of some conservative thinkers. According to them, the slowdown experienced in productivity rates could not only be linked to those reasons and that there were further inconsistencies in the basic Keynesian logic itself. First and foremost, they thought that advancement and progress in technological processes and devices had come to an end because research and development studies had reached their limits. Since there was no development in scientific techniques, productivity rate, during the 1970s, the welfare state would eventually fall (Curwen, 1997: 59). The decline in technological progress could be linked to the budgets of the state whose main responsibility was to provide free and coherent social security to its citizens. As the income generated from taxes reached its limits, as in the case of technology, the state found itself in a great dilemma in terms of allocation of income and redistribution of it.

Another conservative explanation for the crisis of the welfare state was the fact that governments had committed a great error in their taxation policies. The expansion of social expenditures, as expected from a welfarist state, necessitated high levels of taxation generating from both households and firms. According to Krugman:

> The Social Security system…guarantees a pension to everyone who has worked in his or her lifetime. The system became increasingly generous during the 1970s, and largely as a result of this generosity the poverty rate among the elderly fell sharply (Krugman, 1994: 72).

> During the 1970s, there was a growing body of economic analysis that attributed the nation's economic difficulties largely to a basic cause: the distortions and reduced incentives caused by taxes and regulations (Krugman, 1994: 65).

The tax revenues and highly regulated markets were the basic focus of the conservatives, who began to affect policy makers, especially after the late seventies, while criticizing the legacy of Keynes in the welfare state tradition. In the next section of this thesis, the emergence and the theoretical foundations of this conservatism is analyzed in economic and political terms.

2.3 Neo-Conservatives In Power: Theory

2.3.1 Neo-Conservative Economics

In this section, the economic reasoning of the conservatives, which found the opportunity to rise to power in the early 1980s, is going to be analyzed in order to grasp the major departures from the Keynesian economic tradition. As was explained before, although the welfare state aimed at eradicating chronic unemployment in the world economy, Keynesian theory failed to explain the concurrence of unemployment with inflationary pressures on the price levels during the seventies. The monetarist school, which provided the theoretical basis for the rise of conservative economics, provided a counter argument against the Keynesian school of economics, especially on the grounds of policy priorities.

Although details of these priorities will be emphasized in the following part of the thesis, it is necessary to see the formulas conservatives proposed to remedy problems. Firstly, what they offered was the prioritization of the price stability in the economy. Unlike Keynesian inflationary policies, the monetarist school had obsessive sensitivities over the issue of stable prices. "It contends that the price level is the most important economic objective because real variables such as employment can best be stimulated in the context of a non-inflationary environment." (Spiegel, 1991: 12) Together with this purpose, the monetarists saw a control over the money supply as being the state's sole instrument in the economy for achieving stable prices: "Hence it follows that the growth of the money supply should be geared to the expected growth rate of real output…" (Spiegel, 1991: 12). Since there was a trade off between inflation and unemployment, the problem of the latter might again come onto the agenda with the implementation of this kind of tight monetary policies. However, what the monetarists thought was that "the unemployment that would be created by applying monetarist policies would be small and transitional, the unavoidable price that had to be paid to get the economy back on a sound footing." (Gamble, 1988: 41). The 'sound footing' was obviously the sound money which would no longer create a threat to price levels.

In addition to this radical departure from the Keynesian tradition, the second significant difference between these two mainstream schools of thought concerns the determination of the national income. More to the point, as we discussed earlier, Keynes thought that income could only be determined via the demand side of the economy. Unlike Keynes, monetarists' concern was towards the supply side which was believed to have been neglected during the welfare state period.

> [Moentarists] give priority to reawakening enterprise and restoring incentives…They urge major reductions in public expenditure and taxation as the priority for economic policy, because they believed that it is the high taxes social democracy requires financing its programmes that is stifling enterprise, depressing productivity, and leading to high inflation and high unemployment (Gamble, 1988: 46).

To sum up, what the conservatives focused on are the price stability and the supply-side of the economy. They saw the solution in the facilitation of these two factors in the economy. Nevertheless, it is necessary also to consider the political dimension of the conservatives so that we can see the whole picture about what they aimed by formulating their theory of economics.

2.4 The Rise of Conservative Economics in the Developed Countries

In this part of my thesis, I will be looking at the transformation experienced in the developed countries, specifically the United States and the United Kingdom; because the most notable impact of economic liberalization trends were initiated in these countries. For methodological reasons, the countries will be analyzed individually so as to see the details for those countries in terms of what they experienced at the time during those fundamental transformations.

2.4.1 The United States and the Reagan Administration

Hostility against the system of the welfare state, whose priority was to redistribute wealth through expansionist policies, was the primary factor lying behind Reagan's rise to power from the governorship of California within less than a decade.

Starting from his years of office in California, Reagan was affected by the innovative ideas of Nobel Laureate Milton Friedman. Particularly, the words of Friedman collected in his revolutionary book entitled "Free to Choose", had an important impact on Reagan's understanding of macroeconomics in general. Being as the forerunner and leader of the Chicago School in economics, Milton Friedman became a close associate to Reagan (Rayack, 1986: 13). Thus, the theoretical basis of Reagan's economics was constructed by Friedman so his ideas are worth consulting comprehensively.

The obsession to extinguish the inflationary pressures on general price levels, as the fundamental idea of Friedman, was the radical element that directed Reagan's mentality because the experience of inflationary years of the 1970s necessitated radical reforms which were formulated to diminish the push on the price levels. The sensitivity over price stability occupied the main campaign instrument of Reagan. Unlike Keynesian economics of the welfare state, the Reagan presidency relegated labor issues below monetary issues.

Another criticism claimed by Reagan against the welfare state concerned the role of the government in the economy. It was widely known that the interventionist characteristic of the American government was shattered by Friedman and Reagan: "Not only does it threaten our economic and political freedom, big government has slowed economic growth and depressed the productivity." (Friedman, 1981: 145-146). In line with this stand, with Reagan's rise to power, the place of the state in the economy was reduced with clear borderlines that meant a return to Adam Smith's regulatory and arbiter state:

> Professor Friedman's political economy is in essence a restatement of the classical liberalism of the eighteenth and nineteenth century. His defense of a laissez-faire economy and his belief that the scope of government should be limited differs little from the economic philosophy expounded by Adam Smith in the Wealth of Nations, published in 1776 (Rayack, 1986: 9).

Fiscal policy was intended to be strictly disciplined without any reservations. This brought the understanding of a tight fiscal policy which required close supervision of government expenditures and transfers. This was quiet necessary because the budgetary indicators in the 1970s had begun to erode regarding the expenditures. The government was making unsustainable transfer payments with respect to revenues generated from taxes. Thus, President Reagan showed persistent opposition to spending, “demanding that Congress produce a balanced budget.”(Rayack, 1986: 187). By the same token, Friedman was a long time advocate of a constitutional amendment that would order a balanced budget, and President Reagan gave strong political support to this path to nirvana (Economic Report, 1986: 6-7). That’s why the period of Reagan as a product of Friedman was referred to as a return to the classics of economics, which meant neo-liberal orthodoxy and a minimal state implementing a strong fiscal discipline.

The choice of monetary policy plan was not totally different from the one for fiscal policy. Monetary plans were directed and drafted for the sacred purpose of price stability which reflected a war on the inflation created by Keynesian economics during welfare state period. Together with his advisers, Reagan blamed inflation on one cause: “the FED’s tendency over the past 15 years to let the money supply grow faster than the national output.”(Rayack, 1986: 192). Tight monetary policies associated with the Fed’s independence were foreseen as permanent remedy to the inflationary characteristics of the economy. More specifically, in its Program for Economic Recovery, the Reagan administration claimed that it wanted growth rates of money and credit to be reduced by 1986 to one-half of those existing in 1980. The administration predicted that by 1986 the inflation rate would have fallen to 4.2 %. (Campagna, 1994: 85). The major idea derived from these underpinnings of Reagan and Friedman’s approach to monetary policies was that the economy would be forced to be a supply-sided one because by the fulfillment of tight monetary policy, demand in the economy would be diminished to such low levels that the supply side would benefit from the decline in wages as a consequence of an increase in the labor supply.

This clear departure from Keynesian economics as a means to reestablish stability in the economy was clear in Reagan plans. In other words, he would put all his efforts into reversing the conditions that gave him the opportunity to be elected as president. This is why Reagan put the objectives of his administration as follows:

> First, we must cut the growth of Government spending. Second, we must cut tax rates so that once again work will be rewarded and saving encouraged. Third, we must carefully remove the tentacles of excessive government regulation which are strangling our economy. Fourth, while recognizing the independence of the institution, we must work with federal Reserve Board to develop a monetary policy that will rationally control the money supply. Fifth, we must move, surely and predictably, toward a balanced budget (US Committee on Budget, 1981-1985: 3).

More specifically, in the fiscal policies, President Reagan continually proposed a wide range of radical reforms to reduce government spending, and therefore cut the large deficits. According to him, high priority programs should remain adequately financed, unnecessary programs eliminated, and other programs reduced to a more appropriate scale. He believed that the programs which could be better done by the private sector should be shifted there, and services better provided by the state and local governments should be transferred (Boskin, 1987: 117). In other words, Reagan announced the priorities and preferences of his administration. The list of the Reagan administration shaped the budgetary indicators of the USA radically. While doing this, the primary objective was to achieve a balanced budget by decreasing the amount of government expenditures or diminishing the ‘unnecessary’ needs of the nation. For example, funds allocated for education, training, employment and social services declined from 5.4% to 3.2% of general budget. Similarly and more decisively, the funds for community and region development decreased from 19.0% to 0.5% (Campagna, 1994: 69). Both units included welfare programs like unemployment insurance, family assistance programs and Medicaid, etc.. In contrast, "national defense spending rose to 26.5 % of total outlays, up from 22.7% in 1980, an increase of over 68%. Most of these increases [were] accounted for by increases in research and development, for example, star wars fantasies."(Campagna, 1994: 69).

The results of tight fiscal policy did not, however, conform to Reagan's expectations. In fact, under his presidency, "the nation [saw] unprecedented peacetime deficits, resulting in a $2 trillion national debt, a debt twice the size of that when he took the office." (Campagna, 1994:69). Hence, although the Reagan administration did not succeed in reducing the size of government spending, it managed to alter the composition of that spending.

The story for taxation policies was not different from the one for budgetary processes. Since orthodox economists like Friedman and president Reagan worried about high and rising tax rates, even more for corporate investment, the tax cuts were a major concern for Reagan. He proposed dramatic reforms like a rapid reduction of marginal personal income-tax rates rapidly and the making of saving investments universal (Boskin, 1987: 140). While implementing these tax reforms, "the intention was to have a rise in the real net rate of investment, and the growth performance." (Boskin, 1987: 145). In other words, the reduction in personal and corporate tax rates was the heart and soul of supply-side economics which he argued that "these reductions would awaken the sleeping giant of U.S capitalism." (Rayack, 1986: 174)

However, the results of the tax cuts did not follow what the Reagan administration expected when they put those policies into effect (Rayack, 1986: 174).

The fiscal policy that Reagan pursued during his term of office failed in all its aims. However, the fact that the failure of this fiscal policy did not have any economic impacts on the USA economy but makes us think about the real intent behind neoclassical or conservative policies: the assault on government spending and taxes was in essence an assault on social spending, an assault largely directed at the poor and disadvantaged, an assault on those who were not so free to choose, as Rayack claimed in his book (Rayack, 1986: 190).

The Reagan administration placed high priority on monetary policy issues which were blamed as the major causes of the high inflation and real interest rates produced by Keynesian economic policies. That's why "a gradual reduction of inflation to a level where it was no longer a major threat in economic decisions was considered desirable and a necessary prerequisite to restoring incentives to produce income and wealth." (Boskin, 1987: 52). Unlike in welfare state economics, which did not give priority to price stability or to monetary growth, the money supply was closely kept under surveillance in order to decrease the velocity of money in the economy, which was believed to be a leading factor for stable development (Boskin, 1987: 53). These monetarist views, formulated by Milton Friedman, appeared first in the campaign of Reagan in which he declared that "the economy was out of control and had to be subdued; interest rates must come down, and inflation must be brought under control. Accordingly, a tighter monetary policy was necessary." (Campagna, 1994: 86).

The results of the monetarist mode of economics under the Reagan regime should be analyzed with respect to the sequence of his terms of presidency. For the first term between 1980 and 1984, the monetary authorities managed to diminish the monetary base to the desired levels. To illustrate, the growth rate of money dropped from 16.9% in 1980 to 3.8% in 1984. Inflation rates exhibited the same pattern of tendency with a decline from 12.4% to 4.0% (Campagna, 1994: 87-88). So, in the first term, the administration achieved what it wanted in terms of monetary policy targets but, unfortunately, it had not foreseen the social costs of such a policy. Since real interest rates did not show a decline, investment expenditures fell to levels lower than the 1970s. Thus, "the unemployment rate rose steadily and sharply from 7.2% in April 1981 to a high of 10.7% in November 1983." (Rayack, 1986: 192). It becomes clear that in the battle against inflation, not everyone was called to duty, meaning that the lower income groups were obliged to sacrifice for the benefit of the nation.

However, things began to alter in the second term of office for the Reagan administration. A recovery started in 1984 and lasted throughout the remainder of his presidency. For example, the unemployment rate gradually fell to 7.4% in 1985, and eventually to 5.4% in 1988. The inflation rate was kept at about 3.8% until it rose again to 4.4% in 1987 and 1988. The figures concerning the growth rate of money did not reflect what monetarists predicted or theorized about. More to the point, the inflation rate of 3.8% in 1984 fluctuated between 4.3% and 15.3% during Reagan's second term (Campagna, 1994: 92). Thus, the monetarist claim which argued a direct proportional relation between monetary accommodation and price levels failed to explain this trend in the United States.

I tried to give the main points of economic policy and political aspects of the Reagan administration. The point concerned the monetarist school of economics for whatever reason; monetarism's credibility was badly damaged after its failure under the Reagan regime between 1984 and 1988.

Even though the success of Reagan administration in economic policy is ambiguous as the results of policies in his two terms of office are different, the clearest effect of his presidency is the struggle against the basic legacies of the welfare state. While the administration was 'balancing' the figures in the budget and prices, their policy variables created 'imbalances' for the working people of the nation.

2.4.2 The United Kingdom and Thatcherism

The need to analyze what happened in the United Kingdom (UK) emanates from the fact that though the country had experienced a similar transformation like that of the United States, it exhibited some differences and originalities with respect to the policies implemented and the priorities made. Since nearly all necessary theoretical explanations have been provided already in discussing the United States, while analyzing the United Kingdom, the emphasis will be put on merely what was done in order to rescue the economy from the problems created by the welfare state tradition.

Like the United States, "the 1970s were a time of major and repeated crises in the UK economy." (Curwen, 1987: 318). More specifically, the economy was in a vicious circle of inflation and unemployment, like the United States. As a result of this damaging crisis, a change in government occurred in the UK as well. The Conservative Party won the elections with a landslide victory under the leadership of Margaret Thatcher. The reasons that brought Thatcher to the power were hidden in the lines of her election manifesto, published in 1979: “Our country’s relative decline is not inevitable. We in the Conservative party think that we can reverse it. We want to work with the grain of the human nature, helping people to help themselves… The Conservative Government’s first job will be to rebuild our economy…” (Gamble, 1988: 96).

As can be easily grasped from the manifesto, Thatcher’s primary purpose was to stimulate the economy, which was in crisis. Together with her approaches to economic principles, Thatcherism in politics dominated the entire decade from 1980. The principal features of her approach were as follows:

1) The necessity of eradicating inflation is of fundamental importance, not only for its own sake but because of its effects on the level of unemployment.” (Curwen, 1987: 322). Like the United States, stagflation -the coexistence of inflation and unemployment- was also the case in the UK so that Thatcher’s conservative government sought to remedy the problem. What they pursued regarding this aim was quite similar to what Reagan did in his term of office. It was “the Monetary cure for inflation before the onset of recession [that] it persevered with the policy even when the severity of the recession became apparent.” (Gamble, 1988: 98).
2) The policies destined for exercising control over the money supply and the provision of a stable non-inflationary framework, meant to be a *strict monetarist* for Thatcher administration. Like the Reagan administration, the Thatcher government imposed severe restrictions on the expansion of the monetary base.
3) “Free market supply-side policies constitute the main weapons for tackling unemployment and raising the rate of growth of output.” (Curwen, 1987:

322). The emphasis given to the demand side by the welfare state shifted to the supply side of the economy as a remedy to the chronic problems of the economy in the UK. Supply-side economics included "tax cuts to boost incentives, privati[z]ation and deregulation to extract the State and its agencies from economy…" (Curwen, 1987: 322). The political definition of the role of the state in the UK can be easily grasped from this proposal of Thatcher Conservative government. It should be as minimal as possible so that, like the United States, free market operations would be realized more efficiently and effectively.

These were the basic policy aims of the neo-conservatives and they were immediately executed. The results of the Thatcher administration's policies should also be analyzed to assess the accomplishments and failures. While doing this, monetarist policies of the Thatcher government will be analyzed with respect to her two main terms of office, namely 1979-1982 and 1982-1987.

In the first term, the government started to restructure the burden of taxation. While "the rate of Value Added Tax was almost doubled, income tax was reduced from 33 to 30 percent." (Gamble, 1988: 99). In the context of tight monetary policies and a supply-side economy, public expenditure was cut by £1.5 billion and since annual cash limits were limited also, the reduction reached £2.5 billion by a further £1 billion reduction (Gamble, 1988: 99). The result of these monetarist polices was a clear recession which deepened during 1980.

> High interest rates and soaring oil prices combined to push up sterling by 12 per cent…A mounting wave of bankruptcies, plant closures, and lay-offs was the result. Unemployment rose rapidly month by month. By the

> end of the year it had reached 2.13 million, an increase of 836.000. Inflation was soaring too, peaking at 21.9 per cent in May 1980 (Gamble, 1988: 101).

The statistics for Thatcher's first term supported the argument above. Inflation reached 11.2 per cent from 8 per cent in 1979; the unemployment rate rose to 8.4 per cent whereas real GDP growth declined to 1 per cent from 2.3 per cent in the same year (Curwen, 1987: 326). In a time when the economy was in a severe recession, Thatcher raised the pay of the police and army by substantial amounts, as her manifesto had promised and the budget for defense was enlarged remarkably (Gamble, 1988: 105). As was seen before, the same thing happened in the United States as well in order to strengthen the defensive powers of the state.

However, things began to change in Thatcher's second term (1982-1987). According to Gamble, "these years were golden years for Conservatives." (Gamble, 1988: 110). The main reason for this recovery was mainly due to the same trend experienced in the United States, as was explained earlier. As supply-side economics reached its peak in the United States, it created demand in the world economy which contributed to the recovery of the United Kingdom (Gamble, 1988: 111). With respect to this recovery period, the rise in the unemployment rate declined and inflation fell sharply. To illustrate, inflation rates decreased to 4.7 per cent and the real GDP growth rate rose to 3.5 percent (Curwen, 1987: 326).

In terms of the role of the state in this transformation and its place in the economy, it can be easily said that all necessary actions were undertaken by the Thatcher government in order to keep the state out of the economy, except for its role in defense. In accordance with the manifesto of 1979 and developed bilateral relations with the United States, as a result of an alliance against the former Soviet Union, military expenditures reached a peak under Thatcher's rule.

What we can derive from this condensed account of the transformation in the United Kingdom is that, like the United States, the Thatcher administration led to severe recession in the economy for the first four years and the burden was paid by poor sections of the society, again. Another similarity with the United States was the extensive use of state mechanisms to reverse the downturn in the economy. More to the point, although the policies were directed towards excluding the state from the economy, they were implemented by the direct involvement of the state itself through its agents. The active role of the state in the transformation of these developed countries is going to be analyzed in relation to Turkey in order to observe their transition to neo-conservative economic principles.

CHAPTER 3

The Transformation of Political Economy in Turkey

3.1 Introduction

Life in Turkey, damaged by crisis and downturns leading to significant transformations in politics, has found itself in turmoil since the time of late Ottoman Empire. Misalignment between the expectations from the implemented economic and political policies and their outcomes led to a deterioration of relations among the classes of Turkish society. Although the policies themselves were designed to achieve terrific targets, their impacts on the composition of the classes were never favorable, specifically from the view of workers.

In this chapter of my thesis, I attempt to figure out the relationship between the transformations experienced after 1960 and their effects on different segments of the society. The fundamental questions I will answer are as follows: "what are the basic pillars of the transformations?", "what do they mean for social classes and especially, "For whom the policies are implemented?" and "What are the political motives lying behind the economic projects conducted during the period in question?". In other words, the political economic affiliations in Turkey for the last decades are put under scrutiny so as to incorporate political, economic and sociological aspects into my historical analysis.

The method I utilized during the preparation of this chapter is a mixed form of both historical and interpretative approaches. In terms of historical analysis, I divided the paper into three periods: pre-liberalization (1960-1980), liberalization (1980-1987) and post-liberalization (1987-2001). For the interpretative approach, I try my best to find the ideas between the lines and the logic behind the statistical observations and derivations. Since I would like to write in a condensed and intense way, I give solely the crucial points which could themselves be the individual subjects of other thesis. In a nutshell, I try to give a varied version of this long history in an interdisciplinary style, composed of economics, politics and sociology.

3.2 The Pre-liberalization Period (1960-1980)

3.2.1 Industrialization as a Remedy

Severe economic crisis under Democrat Party rule (1950-1960), especially concerning the current account balance, made the system paralyzed because production came to a halt in Turkey. As a result of international aid flows coming from the United States under Marshall Plan, Turkey lacked all of its productive capacities, except agriculture. In other words, the industrial production centers, which could have enhanced the growth of the country, seemed to be paralyzed. This was why there emerged diversified opinions on how to enrich the productive capacity of Turkey in terms of industrial matters.

Among the alternative proposals, “a coalition of interests which had emerged on the eve of the 1960 coup believed that the solution to Turkey’s chronic problems lay in industrialization.” (Barkey, 1990: 60). The priority given to industrialization stemmed from Turkey’s over-dependency on foreign goods except food, textiles and steel manufacturing (Zürcher, 2001: 386). Actually, the importation of goods, which had been increased to incredible amounts under Democrat Party regime, reached unsustainable levels. It was unsustainable because the deficit could only be financed via international aid flows and exportation. However, the former became reluctant to transfer money and the latter solution could not be realized only by exporting agricultural products.

The international markets did not wish to be involved in the paralyzed system of Turkey. Therefore, the core of the industrialization project was the domestic market and its effectiveness in the determination of economic behaviors. Mainly due to this, this time period was called “inward-oriented industrialization”. There were some significant features of this preference:

- **Planning:** Economic and political decisions were taken with respect to the planning principle. Almost all investment projects and other expenditure policies were subject to this ultimate planning because they should give reference to the five-year plans formulated by newly-established State Planning Organization together with government actions (Boratav, 1995: 94). Public investment should be organized in line with the points declared in the planning projects. In the same sense, private investments could be granted and subsidized by the state if and only if they acted in compliance with the points in the plan (Boratav, 1995: 118). The most important consequence of such intensive planning of economic transactions was that the state became highly involved in the market in terms of its allocative and distributive targets and policies. The public authorities carried out an intense surveillance concerning all investment projects and initiatives so as to satisfy the predictions of the plan. As I explained in the previous chapter, this is a basic reflection of a Keynesian economic model and Turkey, like other developed countries, implemented the same model in the same time periods.

- **Shift in Consumption Preferences:** When compared to the previous periods in Turkey, consumption habits altered radically. Particularly, a major change arose from the intense use of white durable goods like washing machines, refrigerators (Boratav, 1995: 118). Thus, transition to industrialization became an absolute necessity in order to satisfy consumer demand because, according to Boratav, the tendencies and preferences of those consumers gained enormous significance as they were dominant in the decision making processes of the country. Since the importation of those goods could easily deteriorate the already damaged current account balance, the project was to produce them in the domestic markets with domestic means of production, though also with the incorporation of international capital, in the form of oil, for example. Moreover, the existing economic structure, shaped by agricultural revenues, could not cope with this change in the content of the consumers' demand. Eventually, the industrialization strategy generated contrary outcomes to the ex ante expectations. More to the point, high dependency on foreign raw and intermediary materials, like oil, could not allow the Turkish economy to avoid being a simple function of the international economic and political conjuncture. While the domestic market was the motor of the economy, the grease for it came not from national but international resources. As a result the industrial sectors could not compete with international actors as they were inward-oriented and outward-dependent (Boratav, 1995: 119).

- **Political Regime:** The post-1960 coup political regime is mainly described in the literature as a significant instance of a populist one (Boratav, 1995:99). Why was it called populist? First of all, the government and its executive apparatus were caught between the demands of both the capitalists, who were the major actors of industrialization project, and the workers as the choosers of the government composition in the elections. Although the government served the ultimate needs of the capitalist class via fiscal, monetary and trade policies, it was also highly sensitive to the demands of the workers. In other words, the governments of this period composed their policy variables in such a way that they could fulfill the long-term interests of the industrial capitalist class and the short term demands of the workers. This was a kind of 'balancing' project.

  The Import Substitution Industrialization strategy (ISI) was a simple product of this balance. Since the objective of ISI was to avoid the harmful impacts of imported goods on the economy, inward-orientedness and the domestic market became the considerations in policy making. The industrial capitalist class, as mentioned above, was encouraged and supported by the executive apparatus for the final purpose of industrialization. Meanwhile, the workers had a relatively privileged status in policy-making because wages spent by the workers were the cogs of the market machine. Specifically, wages, unlike in other time periods of Turkey, began to have two major functions: The first one, as is accepted widely in economics, had something to do with the costs for capitalists. However, secondly, they were the forerunners of the domestic demand which was quite remarkable for a country to be able to implement ISI policies. Statistically speaking, real wages (adjusted to 1963 prices) in Turkey had tended to increase from 1960 to 1978 (Yeldan, 2002: 69).

The increase in the real wages could not be linked merely to the political regime's prioritization of a lively domestic market. The legislative environment; the constitutional provisions, laws and regulations; allowed the workers to organize politically on the basis of class interests as an opposition to the capitalist class. Turkey, for the first time in its history, began to witness strikes, struggles and demonstrations against unfavorable policies imposed on workers' wages. This was another important reason why we observed a radical increase in the real wage shortly after each and every decrease (Yeldan, 2002: 69).

Another feature of the populist political regime in Turkey was its very advanced social security system (Boratav, 1995: 100). There was a wide range of social security tools changing from education to Medicaid. The working class, as a result of these advanced social security programs, benefited not only from high real wages but also by means of other in-kind transfers generated from health, education and some other infrastructure sectors.

Hence, it can be said that the state had an important role in the transformation experienced in the post 1960 coup period. By drafting out the new strategy as industrialization and encouraging domestic production while discouraging the importation, the state was in the center of policies and their implementations. Industrialization project of the state can be seen in the statistical numbers concerning sectoral breakdown of GNP. To illustrate, while the agriculture produced 37.9 % of GNP in 1960, it was 22.6 % for industry and construction. In 1970, share of industrial production jumped to 28.9 % whereas agricultural contribution decreased to 26.2 %. Eventually, agriculture continued to decline under even 22 %, but industrial sector began to produce 31.5 % of GNP in 1978 (Akbank, 1980: 50). Additionally, while the consumer, intermediary and investment (capital) goods occupied 57.2 %, 31.0 % and 11.8 % of manufacturing industry in 1967, the figures changed in such a fashion that the first became 42.1 %, second 41. 0 % and the capital good output reached 16 % in 1978 (World Bank, 1980: 306).

Regarding workers' status in society, the role of the state was very significant due to its balancing project which produced populist political regime. In other words, the Turkish state during the 1960s and 1970s was both a producer and consumer in the market for the sake of deriving equilibrium between the clashing interests of capitalists and workers.

3.2.2 The Decline of the Model

The statistical findings accorded well with the expectations until the end of 1960s and Turkey had caught a trend of growth. Although the very same story persisted from 1973 to 1977, with an average growth rate of 14.2 percent per annum as an achievement of the third five-year plan and as a result of the remittances coming from Turkish workers abroad, the foreign debt allocated to finance imported intermediary goods (oil, machines...etc.) reached unsustainable accumulating external debt which was the beginning of the end of the heyday years in Turkish political and economic history of the 1970s. The inward-oriented and externally dependent model generated contrary consequences to expectations due to both its internal inconsistencies and inadequacies of political actors in Turkey. According to Sevket Pamuk (1981: 28-29)

> …contradictions manifest themselves in two different forms, depending upon the characteristics of the peripheral social formation and the nature of its ties to the capitalist world: either as a market crisis or as a foreign exchange crisis…But the domestic market in Turkey has been a major force behind the industrial accumulation and the contradictions of import substitution industrialization have manifested themselves in the second form, through periodic foreign exchange reserves.

The ISI model has its own deficiencies in terms of its initial projects, intermediary steps and consequences. As explained above, the initial projects of ISI are to increase the industrial production capacity of the country through large and intensive investment plans. One of the most important components of this initial project is to produce for domestic market and to block the importation of final products via tariffs and other trade barriers. It is believed that the domestic market can finance industrialization and this can lead to the enhancement of a domestic industrial bourgeoisie. Protectionism of domestic producers prepares a suitable ground for them to develop their industrial activities and expand employment opportunities in the economy. However, there are some crucial intermediary steps for the initial projects to be realized. For example, the quality of products should transform from consumption goods to capital goods. In other words, although at the outset, the domestic factories work for consumption goods, in time they should begin to produce capital goods which can produce consumption goods. The shift from the former to the latter is not so easy: it needs research and development strategies, high-quality workers and raw materials like steel, iron, wood and oil. This is why it is hard to start to produce capital goods.

Another intermediary step, very linked to the first step, is the launch of an exportation program. This step is so significant because importation of raw materials can only be financed through export revenues. But the producer who is under the strong protection of government policies and can generate high profits from domestic sales becomes reluctant to take the risks involved in exportation. The low quality of products and the lack of capital goods put other obstacles in the way of projects of ISI. As a consequence, protectionism of producers constitutes a major inconsistency of ISI which had been premature due to the reasons explained above. Hence a crisis seems to be inevitable for an underdeveloped country which, like Turkey, employed populist policies while being dependent on foreign raw materials.

In addition to the effects of a crisis, there were three other components *vis a vis* the industrial capitalist class. At the outset, there was deterioration in distribution of national income[*]. As I explained in the previous paragraphs, politically organized workers increased their demands for higher wages and more social security. Turkey's political turmoil, a result of frequently formed and dissolved coalition governments, prevented the authorities from coping with these demands in order not to lose votes.

[*] For a comprhensive analysis please see: Özbudun, Ergun, and Aydın Ulusan. *The Political Economy of Income Distribution in Turkey.* New York: Holmes and Meier, 1980.

In the end, the industrial capitalist class was convinced “of the necessity of reorganizing the labor market on authoritarian lines.”(Turel, Boratav, 1994: 214)

Second, the flow of the workers’ remittances which allowed the governments to finance the deficits began to be removed from domestic financial institutions due to a lack of credibility of Turkey’s financial status as the international market players continually refused to provide credits to a politically unstable and financially unfit country. Finally, there was a political crisis for the industrial capitalist class as it drifted away from the center of decision-making processes with the rise of both Islamic capitalists (the National Salvation Party electoral base) and leftist governments’ sensitive concerns over the workers’ demands. Thus, the bourgeoisie began to lose its “domination over the state and specifically over economic decision-making…” (Turel, Boratav 1994: 216)

Regarding international business cycle theories, the first OPEC oil crisis of 1974 was not taken into account seriously by Turkish governments. The elections, ISI strategy requirements (like cheap foreign exchange rates) and workers’ remittances were the basic reasons for populist governments’ negligent attitudes towards the oil crisis. There were no rational anti-crisis precautions against the harmful impacts of the rise in oil prices. It was logical to expect a huge downturn in the economy. This was why the second oil shock of 1977 and 1979 affected the Turkish economy more deeply than in other countries.

Consequently, the policies implemented during the pre-liberalization period could not achieve the ultimate targets designed and expected by the planners and authorities due to both political, economic factors observed domestically and internationally and inborn inconsistencies lying behind the system of ISI. The industrial capitalist class benefited from the industrialization strategy which was carried out under ISI policies. As a result of high protection for the domestic producers and barriers against the importation of final products, together with tax and direct incentives, the industrial bourgeoisie became the clear championing class of these times. The emergence of the first conglomerates like Sabanci, Koc and OYAK was not a simple coincidence. These domestic brands were a result of protectionist policies.

On the other hand, the socio-economic situation of the working class exhibited a different even a mirror image path from that the industrial capitalist class followed. At first glance, it seemed as if the workers had a great influence over the decision-making process, and this was partly true until the end of the first oil-shock in 1974. However, through the effects of the first stand-by program signed with International Monetary Fund (IMF), the wage levels were dramatically repressed so as to decrease the inflationary pressures on general price levels. To illustrate, real wages (adjusted to 1963 prices) showed an increasing trend until 1975 whereas, from that year to 1987, they tended to fall. In contrast to this deterioration in real wages, the mark-up rates (profit rates of private manufacturing industry as a whole) of the industrial capitalist class, even under the IMF program, showed an increasing trend (Yeldan, 2002: 69). According to Celasun and Rodrik (1987), the gross government salaries and wages constituted a share of 9 % of GNP in 1980 but they decreased to 6 % in 1985.

As a conclusion, the inward-orientedness which was linked to the import substitution strategy was not able to change the composition of the Turkish economy. High dependency on foreign raw materials, inability to shift from consumption goods to capital goods, being reluctant to export because of high profits in the domestic market and the consequent lack of international competitiveness and effect of the business cycles made Turkey return to its starting point with high external debts, inflation and rising unemployment with a paralyzed industry.

3.3 The Liberalization Period (1980-1987)

3.3.1 Economic Assessment

The inward-oriented, protectionist, import substitutive projects and "balancing" populist governments could not provide sound remedies to the problems of Turkey between 1960 and 1980:

> Turkish economic thinking is stricken with a chronic illness; the bureaucracy and intelligentsia envisage economic life as being totally subordinated to social and cultural goals, whereas the promoters of private enterprise ignore the social and human aspects of economic problems. Practically all economic thinking revolves around these two ideas in a vicious circle that can be broken only by initiating a growth from below, involving the masses in the economic process and giving them a sense of participation by actual sharing in benefits.
>
> (Karpat, 1964: 69)

The country found itself in the midst of threats coming from both domestic and external economic indicators which had their own effects in the deterioration of Turkish economy: "With rapidly declining exchange reserves, rising import bills, and debt-servicing payments, the Turkish economy was thrown into a full-fledged payments crisis, which brought about a total collapse of its credit worthiness in international markets."(Çeçen, Doğruel S., Doğruel F., 1994: 44). In addition to this loss of external credibility, workers in the country acquired an advantageous position in the eyes of the capitalist class because they utilized all their constitutional rights so as to enhance their situation. As Tachau and Heper (1983:24) claimed,

> Turkish Politics in the 1970s was thus characterized by fragmentation and by a lack of decisive authority on the part of the government. Polarization come to characterize not only the parties, but was insinuated into other important social sectors as well, including organized labor, the teaching profession, the civil bureaucracy and, even the police.

This was why the capitalist class explicitly started to submit to the government their requests to halt this trend experienced in the labor market. In order to restore the loss of credibility and reinstitutionalize the state's power in the labor market, the Demirel government announced a program on January 24 1980 which was designed to divert the economy towards market-oriented, export-led and minimal state principles. The major argument behind the measures, whose architect was Turgut Özal, was the fact that "Turkey could not export anything under these relatively high real wages so that putting them under strict control was an obvious requisite for Turkey to generate remedies to its chronic problems like inflation." (Boratav, 1995: 121). As can be understood from the main arguments of the package, Turkey began to change its path in terms of not only economic principles but also political and social ones. The priorities, choices and preferences of the country were subject to newly-formulated proposals, which were quite in line with the industrialist capitalist class of Turkey.

3.3.1.1 Important Points of the 24 January Measures

Since the ideas of 24 January Measures were decisively implemented until 1987, it is necessary to look at these measures in order to have a comprehensive understanding of the liberalization period. There were three main legs which encompassed the essence of the measures:

a) To improve the balance of payments and raise international competitiveness: The principle about increasing the international competitiveness of the domestic producers was the core of the packet. Referring to the previous section of this chapter, it can be noticed that especially the manufacturing industry remained premature as a result of the high protection provided by the state. The premature feature of the industrial productive units made Turkey isolated from international trade operations. Since the domestically oriented political and economic regime could not achieve the fulfillment of the ultimate purpose of the ISI strategy, which was the exportation of nationally produced goods, the industrial capitalists utilized foreign exchange reserves which were not generated by their own efforts but by the state's official reserves fed via external borrowing.

Turgut Özal himself believed that the economy should operate for international markets so as to solve the foreign exchange shortage and inflationary pressures on the price levels (Öniş, Riedel, 1993: 40). The deficit in the balance of payments was believed to be the major reason for the inability of the country to have a stable economy. The opportunities to finance the deficit came to an end.

Since Turkey could not compete in the international market with the low quality its products, the only way to acquire a comparative advantage against the rest of the world was to have price competitiveness. Hence, on the way to increase the international competitiveness of Turkish private manufacturing industry, the first and foremost action undertaken by the Demirel government was a radical devaluation of the Turkish Lira with respect to foreign exchanges. The rate was increased from 47 TL per dollar to 70 TL per dollar (Öniş, Riedel, 1993: 40).

The second action undertaken under the reforms concerned the export-led growth strategy. Unlike the previous period, the state with all its agents and organs began to encourage those employers who were producing directly for international markets. In other words, the state altered its priority towards the ones who work for competitive international markets. "All of the country's major export promotion schemes, including indirect tax rebates, preferential export credit, and duty-free allocations of foreign exchange to pay for imported intermediate inputs were greatly expanded. It is estimated that direct subsidies rose to about 23 percent of the value of exports in 1983." (Öniş, Riedel, 1993: 40). A dramatic increase in the amount of export credit was observed in the economy. While the government gave 15.157 million TL credit to the exporters in 1977, it raised to 479.767 million TL in 1981 and 1.576.894 million TL in 1986 (Öniş, Özmucur, 1988). Accompanied by the devalued Turkish lira and other incentives, the export capitalists were now on the scene as the motor for the economy to function properly in line with the free market principles.

The last reform action was taken against the trade regime of the ISI strategy. The protectionist and illiberal trade barriers were seen as the main causes of the improper operation of the Turkish economy. The trade regime and importation was liberalized: "The shift from a system which specified what could be imported to one which specified what could not be imported led to a liberalization of trade in a wide array of products.” (Öniş, Riedel, 1993: 40). But this reform proceeded more gradually than the former reform actions because the idea at the outset was to facilitate the exportation capacity of the country. More to the point, importation was thought of as a function of the exportation. The results of these three reform actions in terms of the export capacity of Turkey have been evaluated as a success when compared to other countries particularly in the early stages of implementation.

b) <u>To combat inflation:</u> The transition of Turkey to neo-liberal orthodoxy in its economic policies can be best understood from its sensitivity to price levels in the market. In other words, as the country drifted away from its Keynesian foundation and moved to neo-liberal policies, the economic targets and goals changed radically. The insistence on importance of the price levels was a clear instance of this transformation.

Since Turkey’s international credibility deteriorated in the last years of the 1970s, external borrowing reached its limits so the populist governments of the previous period had to cover deficits in the budget by printing money. The market had now a larger monetary base than it needed and the reflection of this excess supply on the general price levels of the country was inevitable. The problem of inflation intensified under these circumstances, specifically in the last years of the 1970s.

The measures announced in the 24 January Packet were to offer tight monetary and fiscal policies in order to lower the general price levels in the market. The word “stability” entered the jargon of economic policies in Turkey. To keep price levels stable and the budget in balance, all the expenditure unit of accounts were decreased, whereas income units were increased to enormous levels. The peak inflation rate reached more than 100 percent in 1980. However, through tight fiscal and monetary policies it fell to 36.6 percent in 1981, 30.8 in 1982 and 32.9 in 1983. But, increasing public sector deficits created by the election policies of Özal's government led to another monetary expansion and another rise in the inflation rate to average levels of 40 percent between 1980 and 1987 (Öniş, Riedel, 1993: 43).

c) To give priority to the private sector in the economy: As explained in the previous section, production facilities in the industrial sectors of Turkey had come to halt and were paralyzed. The 24 January Measures took this problem very seriously that there were many policies implemented to stimulate the productive capacity of Turkey. In accordance with the significance given to the price stability, the most harmful effect of the inflation rates was believed to be effective in the private investment levels of the 1960-1980 periods. The accommodated deficits in 1970s created an atmosphere in which the entrepreneurs could not foresee the future prices as the prices at every sector, without exceptions, rose to unexpected levels. The private investment initiatives reached their deepest rates in the Turkish economic history.

In line with the propositions of neo-liberal orthodoxy, deregulation and privatization were taken as effective remedies to chronic problems in industry. In this sense, entrepreneurship and the shift of ownership from public to private were to be encouraged by the governments in the post 1980 period. By doing this, it was thought that not only would the level of private investments increase to an extent which could satisfy the needs of the country, but also unemployment rates would decline to the estimated levels of the program.

The Özal government with its absolute majority in parliament was the forerunner of this deregulation and privatization project. Starting from the very first day of his administration, Özal was eager to undertake an extensive privatization project but it could not be implemented because of legal problems and bureaucratic and social reactions coming from opponents to Özal's government (Öniş, Riedel, 1993: 44).

3.3.2 Political Assessment

Turgut Özal was the Undersecretary of the Prime Ministry during Demirel's government and, as expressed before, he was the architect of the 24 January Measures in 1980. Until the military coup on 12 September 1980, both Demirel's and Özal's ideas about restructuring the economy in accordance with the measures could not be applied because the workers were strong enough to resist the radical reforms which brought disadvantageous decisions for wage earners. The legal environment allowed them to take strong actions against governments. Hence, the points I discussed about 24 January Measures were not easily executed because of this strong opposition of workers.

Therefore, the regime change on 12 September 1980 conducted by a military coup became crucial for the implementation of the reforms. Martial laws and restrictions on unionization, strikes and other kinds of demonstrations were instantaneously introduced by the junta regime because

> the crisis which spawned the 1980 military intervention in Turkey was multi-faceted, including economic breakdown, civil violence, and open challenges to such highly symbolic values as secularist nationalism. But in the eyes of the military, all these facets fused into one major failure of

> the system: the complete erosion of governmental authority. (Tachau, Heper, 1983: 25)

The regime change in Turkey provided a thornless rose garden for Özal's administration in its determination to divert Turkey from an inward oriented faith to neo-liberal orthodoxy.

It cannot be a simple coincidence that, shortly after the coup, Özal became the official manager of the economy and supervised the execution of the program. According to Korkut Boratav, the military regime, for three and a half years, realized the development of economic policies in line with the demands of the capitalist class but against the workers' interests. It was quite interesting to hear complaints about high real wages in the first address of General Kenan Evren in the first day of intervention (Boratav, 1995: 122). In terms of distribution relations, the new model attempted to control the fundamental contradiction between capitalists and workers in favor of the former because both Özal and the junta regime believed that the failure of the previous regime stemmed from its sensitivity towards the demands of the latter.

The outcomes of the program implemented until 1987 were varied with respect to different economic indicators. Although the first five-year plan of the program managed to increase the national income, export levels and to decrease inflation rate; external and internal debts, together with imports, reached unsustainable levels (Boratav, 1995: 128). The allocative and distributive results of the new model were much easier to observe.. More to the point, real wages under the Motherland Party's first six-year term decreased to 1967 levels by 1986. The mark-up rates of commerce capitalists, on the other hand, did not change, or even tended to increase (Yeldan, 2002: 69-77).

Another consequence that can de derived from our political assessment of the transformation experienced after 1980 military coup, it can be easily said that the political turmoil of the 1970s in Turkey had significant effects on deterioration of the indicators in the Turkish economy because the governments and other political actors of those times had a close interest in increasing their votes with respect to other opponent parties. Therefore, the economic downturns or slumps were not seriously taken into account. The populist coalition governments forgot their responsibilities over economic issues. In other words, economic problems were intentionally subordinated to political interests. More to the point, the crisis had far deeper impacts as there were no plausible remedies projected for the resulting economic tensions. The January 24 measures required an environment which was cleansed of all these political struggles and strong opposition of workers. When the military coup of 12 September 1980, with its concomitant impacts on legislative, executive and judiciary branches, is evaluated from this perspective, its effects on the following decade's political and economic situations can be better grasped.

3.4 The Post-Liberalization Period (1987-2001)

3.4.1 The Mini Crisis of 1987

After the Motherland Party won the elections in November 1987, it secured its position at the office until 1992. However, victory came under deteriorating economic conditions because deficits both in current account balances, emanating from a dramatic rise in import levels, and in the budget were being financed through borrowing and monetizing (accommodating), respectively. The sustainability problem was knocking at the door for the Motherland Party in terms of economic indicators.

The former solution of external borrowing came to an end in 1987, as real interest rates promised by the state failed to match the demands of the lenders. The ongoing borrowing pattern led to a decrease in the creditworthiness of the Turkish economy and, as a result, the lenders demanded high rates for providing less amount of credit. This was true not only for bilateral lending but also for multilateral.

The monetary accommodation of fiscal deficits created appropriate conditions for inflation because the growth rate of money in the market was much greater than the growth rate of the gross domestic product. General (relative) price levels in the country rose to such enormous levels that they began to threaten the stability of the economy. Export levels, which were expected to rise, could not finance the importation of the goods whose volume far exceeded that of exports. The program of the 24 January measures together with the sensitivity on the balance of payments issue began to bankrupt the state due the inability of the country to export. Hence, the Motherland Party found itself in the middle of constraints arising from both interest and inflation rates (Öniş, Riedel, 1993: 103). This was why the years 1987 to 1989 were examples of a mini crisis. Amendments to the program were thought inevitable and prospective solutions to the mini crisis of Turkey were formulated on the basis of opening up the country's financial markets to international market players.

3.4.2 The 'Solution' to the Crisis of 1987

The limits on internal and external borrowing arising from high interest rates made the Özal administration think of benefiting from these high rates via liberalizing the capital regime in Turkey. In other words, international portfolio-holders or market-players were to be attracted by profitable returns offered by the financial market of the country. At the outset, "The Law of Protection of the Turkish Lira" was abolished by a parliament controlled by a Motherland Party majority so as to have perfectly mobile capital flows into and out of Turkey. In this sense, the legal provisions that had put barriers on capital movements into Turkey and out of Turkey were abolished. The major aim of this regulation was to finance the deficits in the balance of payments by short-term capital inflows to the domestic market. The foreign portfolio holders were to be stimulated by high real interest rates and they were invited into the Turkish domestic financial market for arbitrage revenues (Yeldan, 2002: 127).

The transition to convertibility in 1989 altered the composition of all economic and political aspects of Turkey. The domestic financial market and the indicators in the balance of payments became dependent on the behavior of short-term and speculative capital inflow and outflow. In other words, all actors in the national economy from the highest market players to the wage earners became dependent on short-term capital inflows, called "hot money" in the literature (Yeldan, 2002: 128). The major determinant of their behaviors, as I explained, is the level of real interest rates, so that, beginning from 1989, the Turkish financial system promised huge profits generated from interest repayments. The stimulated foreign short-term capitals entered the domestic financial market and expanded the consumption volume of the economy through increasing imports (Yeldan, 2002: 135).

The most harmful effect of this inflow of hot-money was seen when these imports reached threatening levels for the current account balance because hot-money existing in the economy was not used to finance business fixed investments that could enhance the employment opportunities and production facilities. Rather, they were allocated to the consumption of foreign final goods so that the initial deficit problem could not be solved. In this sense it can be easily seen that the excess supply of foreign exchange in the economy altered the consumption patterns of people towards a further deterioration of current account balance (Yeldan, 2002: 136).

The most harmful effect of speculative-led growth in Turkey has concerned the high levels of real interest rates. In order to attract international business players, governments and monetary authorities kept interest rates on an increasing trend compared to other emerging markets' rates. In other words, since the short-term speculative capital inflow seemed to be the most instantaneous and easiest measure to cover the huge gaps in the current account balance; the governments gave their consents to the increases in the level of real interest rate. However, especially after 1994, 1999 and 2001 economic crises, it was observed that the most important problem of Turkey was truly the debts which accumulated through rising interest rate repayments.

For the sake of stability in price levels, the Central Bank of the Turkish Republic, after receiving its autonomy via structural reform programs, never thought of accommodating the deficits in the balances. Thus, issuing treasury bills and government bonds emerged as being two ways of financing the gaps. Inefficient utilization of these resources by governments was accompanied with a rise in the interest rates of external borrowing so that Turkey found itself in both domestic and foreign debt problems. The revenue accounts of the budget could not cover debt servicing. This was why the recent programs formulated for a prospective recovery in the Turkish economy includes actions that should be taken against the debt problem.

3.4.2.1 Political Implications of the "Solution"

The emergence of a rentier-seeking capitalist class was born out of the liberalization of financial system. The promise of high interest revenues made both the industrial and commercial capitalist class reluctant to invest because the profit from operating a factory or trading in goods or services could not reach the levels of interest revenues. Thus, we can claim that short-term capital flows created fluctuations in the current account balance instead of financing it and led to the emergence of a new financial capitalist class, who mainly benefited from interest revenues, which in turn brought about defects in the distribution relations (Yeldan, 2002: 141).

Including the last economic downturn we witnessed on February 2001, nearly every crisis after the transition to convertibility in 1989 had something to do with capital flows because they could easily outflow from the national markets without any costs and barriers. But the cost of such an exit to the national economy was significant such as dramatic increases in interest, unemployment and inflation rates. The major source of fragility and vulnerability of the Turkish economy was these speculative, short-term capital flows: "Since Turkey had an experience of transition to financial liberalization without adequate financial deepness and regulatory provisions, crisis became the destiny of Turkey like all other underdeveloped countries." (Yeldan, 2002: 144).

The implication both for the capitalist class and workers is easy to derive from the above mentioned data on the last decade of the Turkish economy. As we see from the movement of capital flows, the financial capitalist class, mainly the banking sector, gained a significant place in the Turkish economy. They were receiving the lion's share of national income because interest rate revenues were being transferred to this newly-emerged class. The story for workers, on the contrary, was not the same. Every time speculative short term capital escaped from the national income, the cost of this outflow was imposed on fixed income groups like workers, civil servants and retired people. The increases in indirect taxes and limited promotions in wages and salaries are clear examples of costs for these groups. While the financial bourgeoisie took the gains, the pain belonged to the workers.

Another important political implication of the transformation Turkey experienced concerned the introduction of autonomous boards like Competition Board, Capital Markets Board of Turkey, Telecommunication Board...etc. On the way towards the realization of neo-liberal orthodox principles, deregulation and a shift of authority from executive power to these boards can be regarded as the major steps. Through these institutions and boards, populist and manipulative actions were to be wiped from the political scene in Turkey. Since they were left to their own rationales in their operations and actions, the decisions taken by the boards began to reflect solely the interests of the market. In order to sustain credibility and stability in economic and financial transactions, they behaved in accordance with the invisible rules of the free market system. As a final point, not only are the financial markets together with trade regime opened to international markets, but also the decision-making processes became a function of regulations legislated at the international level.

3.5 Conclusion

One of the major findings of my research about transformation in Turkey concerns the composition of the beneficiaries and losers in society after the transformations experienced during the last four decades. With the inward orientedness of the 1960s and 1970s, we witnessed the emergence of an industrial capitalist class as the main beneficiary of the new model. During the export-led growth times, with the liberalization of commerce, the commercial capitalist, increased its importance in decision-making processes. Lastly, with a transition to convertibility, a rent seeking financial capitalist class became the most advantaged segment of society. Therefore, the capitalist class of Turkey, by adapting its focus to the changing economic conditions in the world, benefits from the policies implemented by governments.

Moreover, the political economy history of the Turkish Republic demonstrates a tendency towards integration with the international system of the Western world. In the early years, the country determined its regime and political structure with respect to the hereditary principles of Western democracy and secularism. Although a transition to a multi-party system took a long time, namely until 1945, with reforms undertaken by the first republican governments Turkey proved itself in terms of modernization. The period between 1960 and 1980 was a time of a struggle for industrialization in Turkey. The consequences of these efforts were debatable but, at least, the country started to develop large enterprises producing for the domestic market. The fastest movement of Turkey towards the Western system was during Motherland Party under Özal's administration. In other words, the political and sociological reforms undertaken by previous republican governments were completed by economic and especially trade reforms implemented by the Özal administration. Turkey's integration into the international political, economic and financial system matured under Motherland Party governments.

CHAPTER 4

Comparable Economic Performances of the US, the UK and Turkey

4.1 Introduction

In this part of my dissertation, I will deal with the statistical indicators derived from the economic performances of the US, the UK and Turkey. I will focus on the period between 1960 and 1990, as these were the years when these countries passed through a welfare state tradition to a neo-liberal one. My primary aim in doing such a statistical analysis is to base my thesis on quantitative grounds.

I determined four main categories to assess the economic performance: real GDP growth rates, inflation rates, real interest rates, and real wages. The reason why I focus on analyzing these indicators is to have a general assessment of the economies. By not going into the details, I will exhibit the findings provided by official agencies of the countries in question and then I will make an interpretation of the results. Since the contend of my thesis concerns political economy, the attention is mainly given to the political implication of these statistical indicators.

Particularly, the inclination of the real wages will provide the consolidated hints for my political analysis. The real GDP growth rate has something to do with the development path of a country, whether the country has a stable or fluctuating growth path. An analysis of inflation rate is inevitable for my thesis which compares the Keynesian and Monetarist schools of economics. An overview of the trends in real interest rates will provide information concerning who are the losers and the beneficiaries in the financial economy.

4.2 Real GDP Growth Rates

The macroeconomic assessment of three countries begins with a close look at their real GDP growth rates. This constitutes a considerable part of this chapter since the tendency of real GDP over the years is accepted as one of the most important indicators of economic development level. There are basically two reasons for real GDP to change over time: The first comes from the available amount of resources which are capital and labor; the second is related the efficiency in the factors of production, which means productivity increases (Dornbusch, 1994: 10-11). Together with the political background, the aim of this part is to capture the reasons lying behind the fluctuations in real GDP rates.

Figure 1 illustrates the path of growth rates in the US and the UK. The first observation derived from the chart is, obviously, the instability of growth rates in both countries. Between 1960 and 1990, it was hard to find a stable inclination or movement in terms of real GDP growth. Thus, both Keynesian and conservative policies could not create consolidated and sustainable growth rates in the real GDP levels. The fluctuating lines tell us, also, an interesting point concerning the fact that the rates in both of the countries mostly followed the same paths. With some exceptions like 1971, 1985 and 1987, the US and the UK entered recession or reached peaks simultaneously. This was a clear evidence of their concerted actions not only in politics but economics as well.

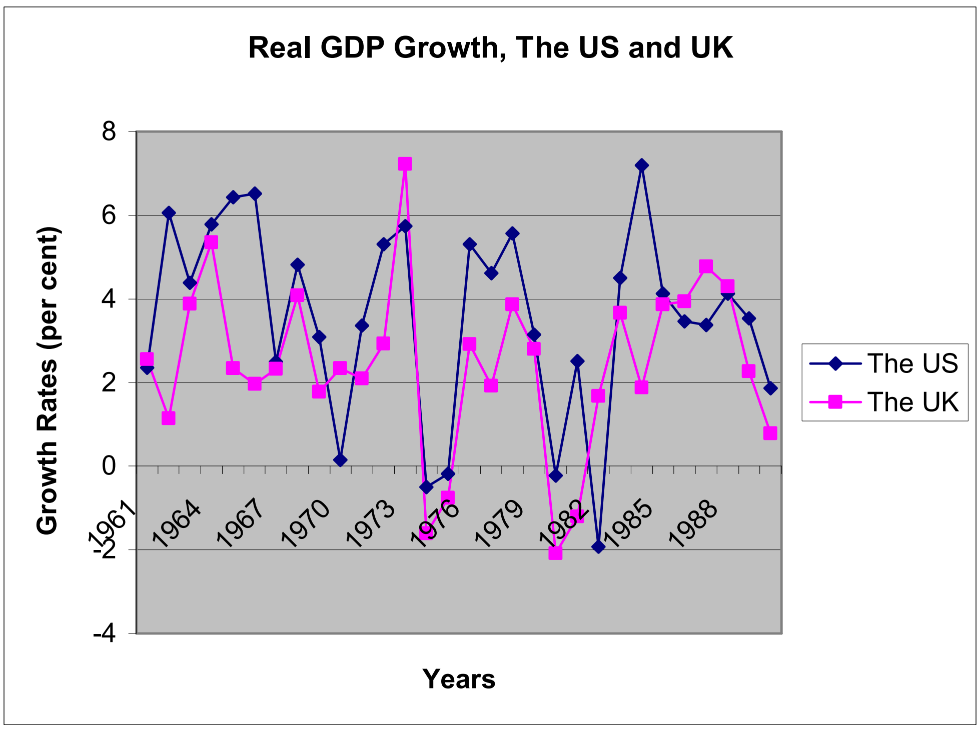


Figure 1, Source: The US Data: Fed, The UK Data: Bank of England

Another result that can be formulated from the Figure 1 has something to do with the real GDP rate they exhibited in 1990. More to the point, the real rates of GDP growth in 1961 were 2.35 % and 2.56 % in the US and the UK, respectively. When we look at the same data for 1990, the rates were 1.87 % for the US and 0.78 % for the UK. Therefore, in real terms, the countries' growth rates declined below what they were in 1960. The policy shift from welfare state to conservative economy created an economic boom instantly but only after one decade, the economic activity in these two countries slowed down to 1960 level. This can be explained by two major reasons: The first one concerned the world business cycle which was on a severe recession beginning from the second half of the 1980s. The other reason comes from the saturated financial demands in the existing internationalized markets. This meant that the opportunities for financial investors came to an end because of the inadequate number of domestic markets which allowed perfect capital mobility.

Figure 2 is depicting the growth rate for Turkey. During protectionist times, Turkey showed the same path with the US and the UK. There was a stable growth in the 1960s and 1990s, but then a sharp decline in the growth rate came to the foreground in 1977. Statistically speaking, the growth rates were 6.4 %, 1.5 % and 2.0 % in 1963, 1978 and 1979 respectively. However, Turkey showed no sign of huge fluctuations during the first decade of import substitution industrialization Strategy (ISI) , when compared to what was the case in the US and the UK for the same time period.

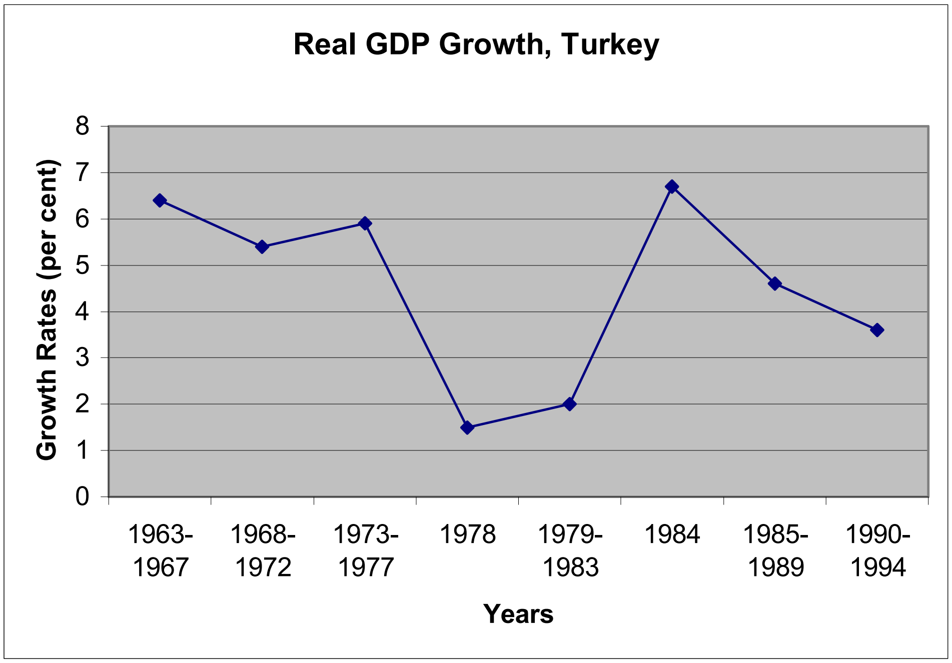


Figure 2, Source: State Planning Organization, "Basic Macroeconomic Indicators"

Like the US and the UK, Turkey displayed a steady increase of growth rates in the first half of the 1980s. Özal government succeeded in achieving a rise in the real GDP rates. This could be explained by several reasons. The most important one was the fact that the Motherland Party government increased international credibility of Turkey due to two major facts: The first concerned the point that the political turmoil and stalemate were evaluated as the outcomes of coalition governments of the 1960s and the 1970s. Hence, the Motherland Party government which held the majority of the seats in the Turkish Grand National Assembly gave the signs of stability and consistency both in the legislation of the laws and the execution of policies. Second factor that increased Turkey's creditworthiness came from Turgut Özal's personal persistence on implementing liberalization strategy. In other words, Turgut Özal believed in the necessity and the significance of internationalization of the domestic market. Eventually, Turkey was awarded with debt relief and increases in the amount of foreign aid flows from the International Monetary Fund. However, the second half of the 1980s showed a decline which was similar to what we witnessed in the US and the UK. Internationally speaking, the world recession, as explained before, was the initial effect on this backlash. Moreover, national recession emanating from the debt crisis was the triggering impact on this downturn of Turkish economy.

4.3 Inflation Rates

Inflation is widely defined as “a rise in the average level of prices-that is, a rise in the price level.” (Lipsey, Courant, Ragan, 1998: 650). While it is located in the main axis of conservative or neo-liberal policies, inflation is not considered as a major economic tension in Keynesian school of economic thought. Although there are many academic explanations for why inflation occurs in an economy, I will not deal with those issues. Rather, my preference will be on policy effects over the inflation rates in the US, the UK and Turkey. I will focus on the turning points in 1960-1990 period. The peak points, the bottom levels and the tendencies observed in this period will be analyzed with clear references to the economic policies executed.

Figure 3 shows the movement of the inflation rates (Consumer Price Index) in the US and the UK. Between 1960 and 1970, the inflation rates in two countries fluctuated within the bandwidth of 1 % and 5 %. It seems that welfare state implementations created an environment in which the general price levels did not expose a threat for monetary base of the markets in the US and the UK.

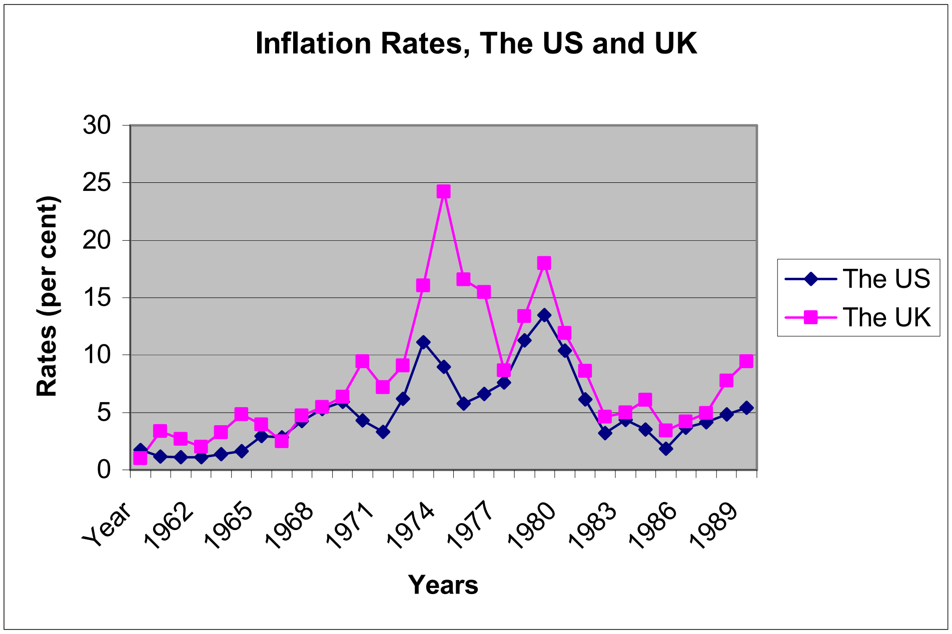


Figure 3, Source: The US data, Fed; The UK data, Bank of England. (Consumer Price Index)

Internal factors like huge budget deficits or expansionary monetary policies did not lead to a major crisis until an exogenous supply shock resulting from OPEC decision. The cartel of oil-producing countries cut down the production first in 1973-1974 and then in 1979-1980. These unanticipated shocks paralyzed the economies of these two advanced capitalist countries because their developed industries were highly dependent on oil as the major intermediary good or input.

Figure 3 shows us that there were two peak points in the inflation rates between 1960 and 1990. Not coincidentally, they were in close concordance with the OPEC oil shocks. Double-digit inflation rates hit these advanced capitalist countries. Particularly, the years between 1974 and 1982 laid out a huge volatility in the general price levels. Thus, it is not surprising to witness rising voices against inflation. More to the point, neo-liberal orthodoxy in economics targeted the price stability as a primer and an ultimate objective. The populist expansionary pattern was challenged so as to make the things balanced both in budget and in the monetary base.

The consequence of tight fiscal and monetary policies executed under Reagan and Thatcher administrations accomplished dramatic decline in inflation rates. Conservative coalition in the US and the UK got rid of the double-digit inflation rates by 1982. The downward slope of the lines in Figure 3 reached their bottom levels in 1986 (1.86 % in the US, 3 % in the UK). The inflation rate in that year was same with that of in 1965. However, the recession in the world economy pulled the inflation rates to higher levels than they used to be in the previous years. For instance, the upward inclination in inflation rates started to be observed in 1987. The rates were (3.66, 4.17), (4.12, 4.91), (4.81, 7.76) and (5.39, 9.46) in 1987, 1988, 1989 and 1990 for the US and the UK, respectively. Hence, the same faith replicated itself for these capitalist countries.

This is to mean that the pattern of inflation rates changed its path due to a shock coming from an exogenous and international source in the second half of the 1970s. We witness the same historical denouement in the second half of the 1980s. Those were the years when the boom in inflation rates was finally put under control.

I depicted 30 year history of inflation rates (wholesale price index) of Turkey in the Figure 4. Turkey entered the double-digit period in 1971 which was nearly half a decade before the US and the UK. During the planned economy years, the inflation rates in Turkey revolved around an average of 5% per annum. Although it fluctuated in a larger bandwidth (i.e 1.2 % in 1964 and 8.1 % in 1965) than what the US and the UK had, the price stability did not pose a major threat for the economy.

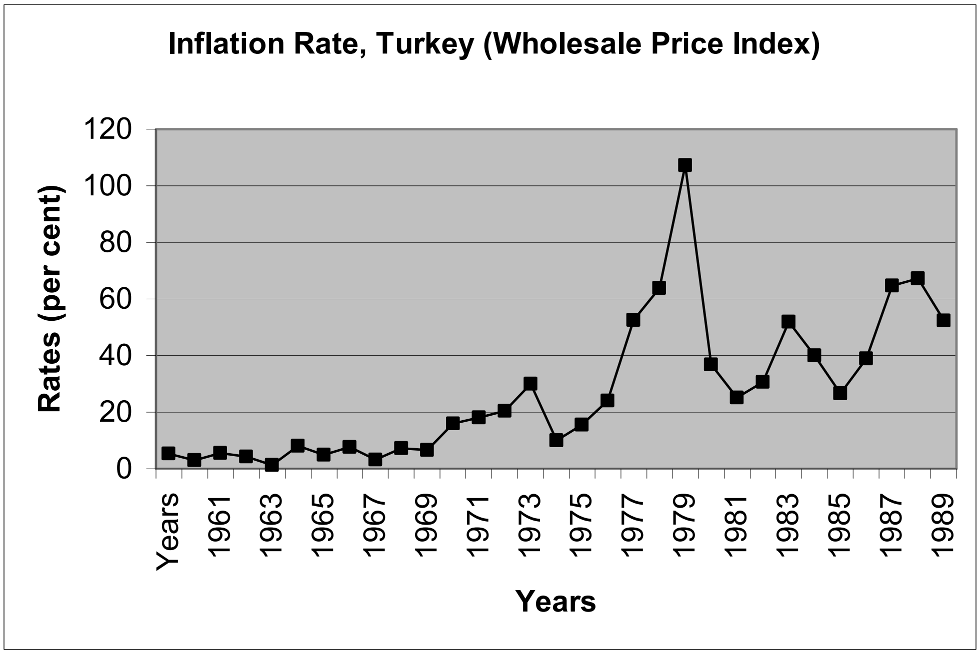


Figure 4, Source: State Statistics Institute (Wholesale Price Index)

The political instability resulting from coalition government, the violence on the streets and the lack of compromise between the workers and the capitalists were known to be the outcomes of the relatively liberal environment backed by 1961 Constitution. Especially, Turkish Armed Forces (TAF) was declaring its discontent concerning the expanded human rights and liberties in the constitution. The culmination point of this aversion was a coup by memorandum in 1971. The economic consequence of this political distress was firstly observed in the inflation rates. To illustrate, while the wholesale price index in 1970 was 6.7 %, the rate jumped to 15.9 % as a result of a dramatic devaluation of Turkish Lira against foreign exchanges. The entrance of double-digit inflation rates started with this year in Turkey. Although the political actors and economic authorities were aware of the breakdown experienced in the economy, the political race or competition for capturing the power, which was frequent in coalition government period, prevented the governments from dealing with the crisis seriously. Their major motive was to hold the power so that populist policies could not be abolished and the balance in fiscal and monetary indicators deteriorated. OPEC crisis came to the scene in such a severe domestic situation. Hence, with the worsening effect of sharp increases in oil prices, the inflation rates transcended 50% threshold and in 1980, the annual rise in general price level reached 107.2 %.

The ISI strategy or inward-orientedness could not achieve a stable economy. Even the development strategy of the 1960s and the 1970s made Turkey paralyzed in terms of foreign exchange shortages. The problem of inflation in Turkey was born out of this conjuncture.

When 24 January Measures were announced under the Demirel government, it was becoming clear that Turkey transformed its path of development from ISI to the export-led growth model. Turgut Özal's insistence on the liberalization of domestic economy had similar policy orientation with that of Ronald Reagan and Margaret Thatcher. When the Motherland Party took over the parliament in 1983, after the military coup in 1980, Özal declared the inflation as the premier deficiency of Turkish economy and like Reagan and Thatcher, Özal put the principle of price stability on the top of priority list. Though the price stability was the major concern of Motherland Party government, success on inflation rate did not go on well with the expectations. During 1983-1990 period, the inflation rate -which declined sharply under the military rule between 1980 and 1983- began to rise from 30.6 %. In 1990, the rate reached 52.3 % which was the level of 1978 and far above the 1960s' rates.

Unlike the US and the UK, the international oil shocks had deeper impacts on the Turkish economy. What's more, the transformation to neo-liberal policies made the inflation problem turn out to be a chronic problem of Turkish economy whereas the US and the UK, with their advanced capitalist mode of production, got over the problem in a relatively short period.

4.4 Real Interest Rates

The distributional implication of an economic policy transformation can easily be measured through the behavioral pattern of real interest rates. It is commonly defined in the literature as follows: "The real interest rate measures the real return on a loan, in terms of purchasing power." (Lipsey, Courant, Ragan, 1998: 459). The gains from real interest rates benefited the capitalist and rentier class of an economy. Thus, an increase in the level of real interest rate means a reallocation and redistribution of national income not in favor of fixed income groups such as retired people, civil servants and workers. This is why I prefer to have a look at the history of real interest rates in the US, the UK and Turkey.

As I explained in the previous chapters, the interest rate was thought to be a typical problem in the Keynesain School of economic thought. Since it has a worsening impact on both investment expenditures and on distributional indicators, welfare state took the issue of interest rate seriously. In contrast, neo-liberal orthodoxy understanding warranted mainly monetary base stability, as the first and foremost priority was price stability for conservative economics.

Figure 5 illustrates the real interest rates both in the US and the UK. As can be seen from the figure, the rates were moving around 4 or 5 % until the first half of the 1960s. The need to finance deficits in the budget, caused by excessive social expenditures, the governments of these tow countries started to have fiscal deficits.

As a conclusion, we began to witness a rise in real interest rate between 1970 and 1982. Statistically speaking, the rate in 1960 was 4.41 % and 5.21 % in the US and the UK, respectively. However, it reached 8.43 % and 13.34 % for the US and the UK in 1974. In 1981, it was 14.14 % in the US and 13.32 % in the UK. Worsened by international supply shocks, the advanced capitalist countries found themselves in the middle of a debt crisis. Even though they were implementing welfare policies for the 1960s and the 1970s, they could not control the real interest rates in the market so that they increased to such levels that were three times of two decades ago.

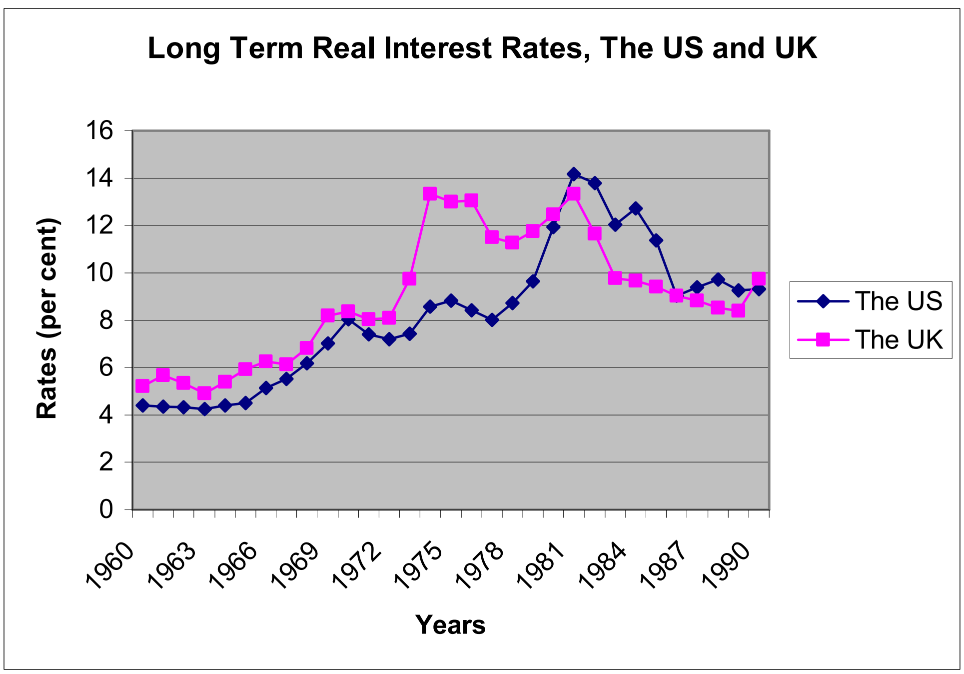


Figure 5, Source: Moody's for the US, Bank of England for the UK

With Reagan and Thatcher administrations, the increasing real interest rates started to move to another plateau. For the first half of the 1980s, relatively high real interest rate was observed for the US and the UK. Although there were adjustment processes to this new set of neo-liberal policies, the rates remained at approximately 9 % which was an average level in the second half of the 1970s. When compared to the 1980s, it seemed for two advanced capitalist countries that they began to control the motion of real interest rates.

The case for Turkey started with the 1970s in Figure 6. As is clearly seen from the chart, unlike the US and the UK, Turkey did not have a volatile structure in interest rates over the 1970s because they were under close supervision of government. After the 24 January measures the determination of real interest rates was liberalized. They began to fluctuate and increase over time. Central Bank's discount rates exhibited higher plateaus for interest rates in each decade. For instance, in the 1970s, average rate was 9.50 %; it was approximately 44 % in the 1980s. This was a strong increase and its consequences in the economy were very severe. The distributional effect was observed in increased incomes of capitalist class which benefited from the huge increase in the real interest rates. It also halted the private investment expenditures in Turkey, except for highway construction and housing investment. The dramatic increase experienced in real interest rates was a signal for imminent debt crisis after 1990 since the debt service of Turkey would accumulate to unsustainable levels.

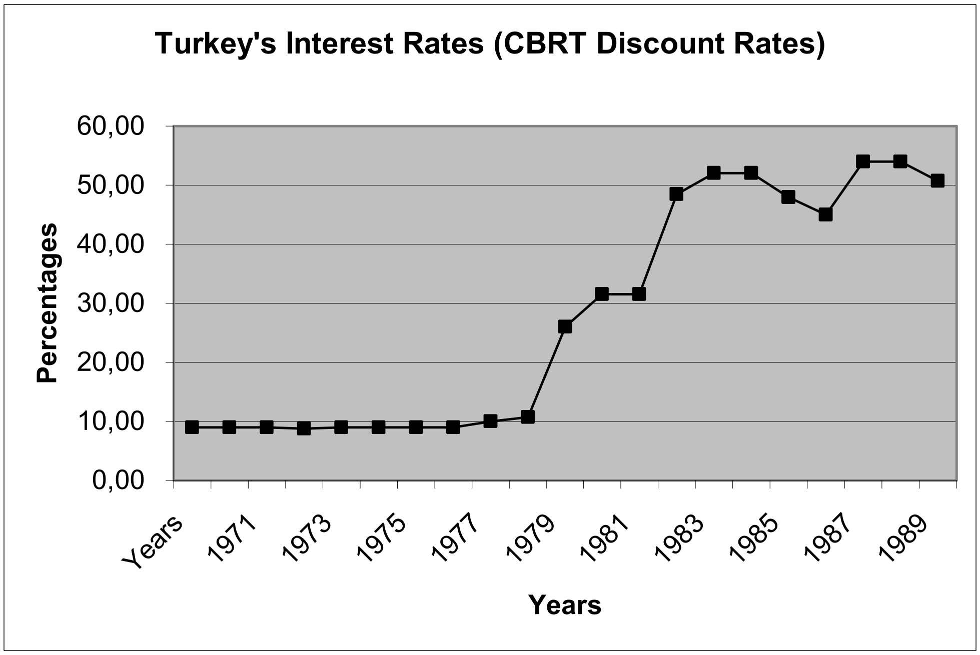


Figure 6, Source: Central Bank of Republic of Turkey

A major conclusion that can be derived from the path real interest rates followed is that advanced capitalist countries were able to cool down the financial sector, whereas the peripheral economies like Turkey could not stop the rise in real interest rates. This may be due to the lack of financial depth of the Turkish economy. In other words, since there was no sufficient capital accumulation in Turkey, as explained in previous chapters, its financial stamina could not cope with the liberalization of interest rates.

4.5 Real Wages

The analysis of the real wages is probably the most important part of this chapter because the political implications arising from the policy shift from welfare state understanding to neo-liberal orthodoxy can be clearly seen when the situation of workers are scrutinized. Since the real wage levels are reliable indicators of distributional relations in the economy, I will make a deeper investigation on real wages than on other macroeconomic variables seen in my dissertation.

The real wage is, by definition, the inflation- adjusted nominal wage which helps us to understand the purchasing power of a current amount of wage in the base year. Thus, while we are giving references to the real wages, workers' share in the national income and their wealth will become visible. As they are giving clues for antagonistic class struggles between workers and capitalists, the real wage indicator is commonly used in political economy researches (Boratav, 1998; Yeldan 2002; Voyvoda, Metin-Özcan, Yeldan, 2000;). When the things change in favor of workers, purchasing power of their wages increases in comparison to the base year. On the other hand, the decrease in the real wages signifies an increase in the profits of capitalists, in general.

In the Figure 7, I tried to depict a chart in which we can see the history of real wage situation in the US and the UK. I hold the time span as 1960-1990 again but in averages of five years in order to see the path more clearly. In general, we do not see large fluctuations in the real wage levels in our sample of advanced capitalist countries. If we took the base year as 1960 (1960=100), the level of real wages seemed to be increasing until 1970-1974 period. The change was a bit more in the UK than in the US. This may due to the highly unionized workers of the UK during the 1960s and the 1970s. Welfare state premiums and social expenditure policy of those years worked in favor of workers and the increase we witnessed could not be regarded as a simple coincidence. In other words, the beneficiaries of the system of

Keynesian school of economic thought were the workers because they can purchase more when compared to what they can do in 1960.

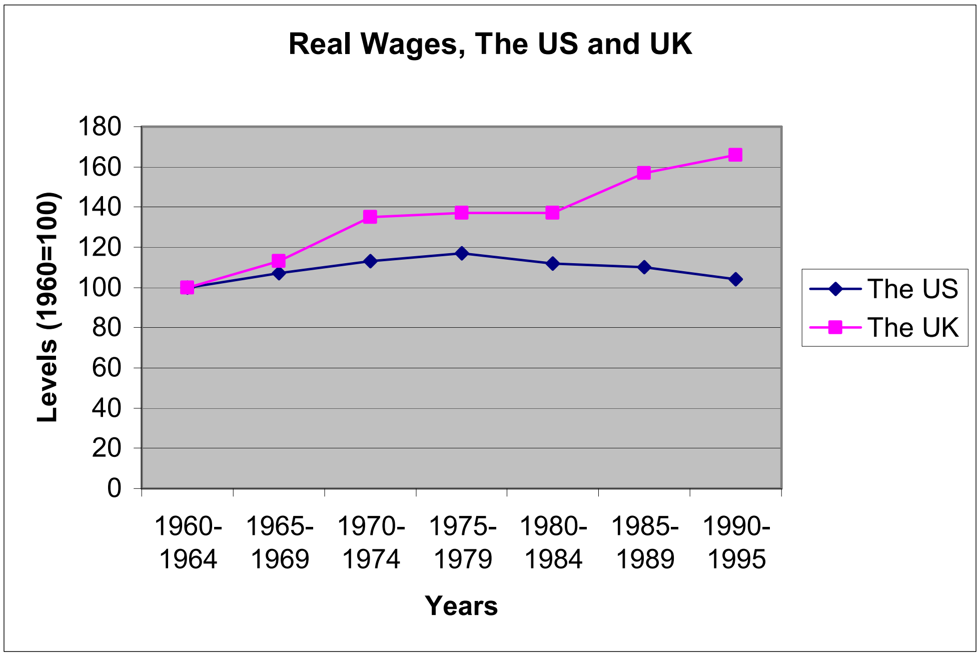


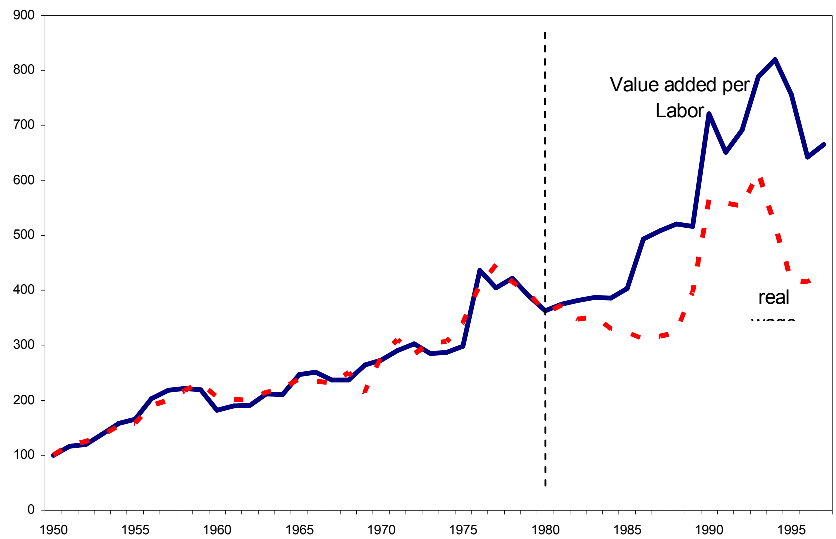
Figure 7, Source: Federal Bureau of Labor Statistics

Afterwards, as we can see from the Figure 7, the increasing inclination came to a halt during the second half of the 1970s and this continued until 1984. More to the point, real wages both in the US and the UK started to become fixed at their current levels by Reagan and Thatcher administrations. As the neo-liberal orthodoxy evaluated the wage levels as the first and the most important cause lying behind the high inflation rates, the conservative governments, quite rationally, introduced policies which were against the well-being of the workers. For example, as explained in the previous chapters, the social expenditures were decreased to their minimum levels and wages were repressed for the sake of price stability in the market. Trade Unions' collective bargaining power were abolished or lessened to ceremonial mode. Hence, the attack on the accomplishments of welfare state gave its antecedent signs on the real wage levels.

The 1980s displayed different outcomes for the US and the UK in terms of real wage levels. Under Reagan administration, the US real wages turned to our base year level. In other words, in 1989, a typical American worker could only buy what he could in 1960. The tendency of decreasing real wages persisted until the first of half of the 1990s as well. Reagan administration was successful in both decreasing the real wages and the inflation during the same period. Repressed wages, decreasing inflation rates, and increasing interest were observed concomitantly. The capitalist and rentier classes were the beneficiaries of this policy change. The case for the UK was different for the same time period. As is seen from Figure 7, the United Kingdom has witnessed an increase in the real wage levels. The reason for this difference from the US could be better explained by the power trade unions in England. Throughout the time, they could put pressure on governments to increase wages. This was why we observed a different pattern of behavior in the UK.

Figure 8 demonstrates the real wage levels and labor productivity of Turkey between 1950 and 1995. We can use the perpendicular dashed line as a separator for two different time periods in Turkey. In the first period, as I explained, welfare state was in effect and the social expenditures were seen as major duties of state. Thus, employment benefits reached their maximum levels between 1950 and 1980. Highly unionized and organized workers, who were benefiting from the freedoms in the 1961 Constitution, had convincing power over the entrepreneurs, factory owners and other capitalists. Right to collective bargaining was excessively used by Turkish workers in order to make their demands fulfilled by the owner of the factories. As a result, nearly four decades, we witness a steady increase in the real wage levels in private manufacturing industry of Turkey. Particularly, the second half of the 1970s was a clear peak level for wages. Since the labor productivity moved along the real wage line in the Figure 8, we could not talk about an exploitation of labor during those years.

Labor Productivity and Real Wages in Turkish Manufacturing (1950 = 100)



Source: Prof. Dr. Erinc Yeldan, Department of Economics, Bilkent University, Ankara, Turkey.

The transformation to the neo liberal regime after 1980 had the greatest effects on both real wage levels and the labor productivity. Wages were repressed intentionally by Özal government in Turkey in order to satisfy the ultimate objectives of neo-liberal orthodoxy: Price stability and restoration of capitalist hegemony. As I explained earlier, Özal found the increases in the real wage levels as the most significant cause for the high inflation rates so that the instant action should be directed towards the acquisitions of welfare state. They were trade unions, employment benefits and liberal environment. However, with the help of military coup in 1980, Özal was able to repress the wage levels until the second half of 1980s. After 1986, Turkish workers began to act collectively in order to secure their wages so that, as we see from the chart, the real wage level increased.

The labor productivity line, on the other hand, tells us a different story from the real wage increases in the second half of the 1980s. The movement along the real wage line was not valid for this period. The value added per labor increased far above the real wage increases. In other words, Turkish workers were forced to work more in return for high wages. Transformation to neo-liberal policies made labor force in Turkey much more productive than they used to be in the past. The question concerning the determination of losers and gainers of this transformation finds its answer in this chart. In sum, it can be said that conservative economy in Turkey created an environment in which the capitalist class as a whole regained their privileges from workers who benefited from the welfare state during the 1960s and the 1970s.

CHAPTER 5

CONCLUSION

Throughout the dissertation, I seek to address the issue of neo-liberal transformation experienced in the United States, the United Kingdom and Turkey. Within a comparative manner, the economic and political performances of them were analyzed both qualitatively and quantitatively. Having supported the title of my thesis, we see a simultaneous transformation to liberal policies which generated distinct results for advanced and peripheral countries. More to the point, there are mainly three points we can count for conclusion. Firstly, the 1980s provided the same political and economic pattern for these countries. In other words, we witness a conservative shift in politics whereas an intense liberalization in economics. Although the political priorities and preferences exhibited a conservative understanding, the economic framework inclined towards liberal orthodoxy. As I mentioned, all these transformations occurred in our country sample at the same time.

Secondly, the liberalization period in these countries was executed or undertaken by personal figures. President Ronald Reagan in the United States, Prime Minister Margaret Thatcher in the United Kingdom and Prime Minister Turgut Özal in Turkey played the most significant role in diverting their countries to neo-liberal policy framework. Particularly Turkey, which was in the middle of tensions arising from populist implementations in the 1970s, could not realize its liberalization unless Turgut Özal was decisive and persistent on the necessity of this transformation. He played a leading role in Turkey's destiny which lost its creditworthiness during the 1970s. Although the beneficiaries of the transformation constituted the minor part of Turkish population, Turkey, with its economic affiliation, became a part of international community.

Thirdly, the outcomes of liberalization period were different when we compare two advanced capitalist countries with Turkey. Especially, the real interest rates, inflation rates and real wage levels were the clear indicators of this difference. For example, the inflation problem was solved in the United States and the United Kingdom in the second half of the 1980s whereas in Turkey, inflation turned out to be a chronic problem in the same period. By the same token, the real GDP growth in the United States and the United Kingdom was not financed via repression of real wages but in Turkey, except for 1989 and 1990, the economic growth was financed through a decline in the real wage levels. Since the purchasing power of workers in the economy decreased via this process of repression, there occurred a surplus in goods and services market so that this surplus could be exported. This way was intentionally chosen as Turkey was believed not to have a production capacity, in those times, to fulfill both domestic and international demands.

As a result, when I look beyond the time period of the dissertation, I can easily say that what we experienced in the 1970s and the 1980s was a transition time from protectionist policies to financial economies. The United States, the United Kingdom and Turkey passed through a way which was directing these countries towards a financial economic rule. Financial economics becomes the major issue for these three countries shortly after 1990. Thus, this dissertation can be furthered by looking at 1990-2000 period in order to observe the transition characteristic of 1960-1990 period.

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