# Regulatory neo-liberalism, neo-developmentalism, and Turkey's contemporary political economy: Toward a hybrid model

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## Abstract

The debate on change and continuity in the post-global financial crisis financial and industrial policy remains heavily contested. There is in particular an unresolved question on whether emerging powers have enjoyed increased or decreased opportunity for policy change. To explore this issue, this study analyses dynamics of post-GFC financial governance and industrial policy in Turkey. I specifically seek to identify patterns of continuity and change in organising policy and policy practices, and the balance between internal and external drivers in shaping outcomes. As well as agreeing with prominent analyses that post-GFC change dynamics should be characterized as incremental, overall I argue that a variegated agency displayed across industrial policy and financial regulation in Turkey's contemporary political economy. I find that ideational change has taken place in the global political economy, and the agency of domestic actors and domestic institutions have significant influences on adopting and implementing policies in both spheres. Nevertheless, this thesis argues that the outcome in terms of policy paradigm change in the Turkish political economy reflects a hybrid model with financial governance remaining characterized by key neoliberal principles, and the state's role in the real economy characterized by aspects of neo-developmentalism in the period between the late 2010 and the early 2018.

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## Author's Declaration

I declare that this thesis is a presentation of original work and I am the sole author. This work has not previously been presented for an award at this, or any other, University. All sources are acknowledged as References.

# Chapter 1

# Introduction

## 1.1. Problem Statement and Research Questions

The global financial crisis (GFC) that began in 2007-2008 was a critical juncture in the global political economy. The GFC, on the one hand, helped to accelerate the momentum of global shifts in power and actors, involving a parallel process of weakening the power of established actors in the 'global north' and empowering new actors from the 'global south' (Haas, 2017; Stunkel, 2015). On the other hand, although it is not entirely replaced with a new paradigm, the global crisis put a break on the ascendance of neo-liberal capitalism and the Washington Consensus as the dominant economic ideational framework, which dominated the global economic order over the last three decades (Coen and Roberts, 2012; Quiggin, 2012; Gamble, 2009).

International and comparative political economy places significant analytic value on understanding processes of change. Through the history of the disciplines, key contributions have sought to understand the drivers and detail of paradigmatic changes in the global economy as well as national economies. Key changes the literature has focussed on include the move from Pax Britannica to Pax Americana (Helleiner, 2014a; Steil, 2013); the shift from embedded liberalism during the Bretton Woods era to the period of neo-liberalism post-Bretton Woods (Chwieroth, 2009; Abdelal, 2007; Blyth, 2002; Helleiner, 1994); and the emergence of a post-GFC era (Drezner, 2014; Öniş and Güven, 2011; Helleiner, 2010; Helleiner and Pagliari, 2009; Hodson and Mabbett, 2009).

The GFC has clearly highlighted the need for scholarly enquiries related to continuity and change in policy paradigms. In the aftermath of the crisis, many analysts and even some politicians stated that the world needs a new reform agenda, as it was witnessed after the 'Great Depression' in the 1930s. Moreover, it was hoped that the crisis would produce a new global order (Helleiner, 2010). However, it seems that there is a quasi-consensus in the literatures of international relations and international political economy that the current global political and economic order has been transformed incrementally in terms of political and economic governance structures on the contrary to the expectations emerged following the GFC (Oatley, 2017; Helleiner, 2014b). Despite this fact, the nature and the scope of this transformation through the eyes of established countries as well as the 'top table' of rising powers is still in the center of a lively debate (Ban and Blyth, 2013; Hodson and Mabbett, 2009). Moreover, the core ideas, rules and structures that have governed the world economy over the last a few decades have been investigated in terms of different aspects in the context of post-GFC world (Moschella and Weaver, 2013). For this reason, this study asks the question of how a rising middle power country reacts to this paradigmatic shift in order to fill the gap in the literature related to middle power countries.

Through this study, I add to scholarship that seeks to unpack the most recent points of change in economic governance following the GFC. More in particular, I use my study to explore the extent to which Turkey, as a rising middle power country, has displayed agency. Here, by systematically studying the patterns of change and the drivers of change in Turkey's industrial policy and approach to financial governance, I extend our understanding of the relationship between the GFC and ideational shifts within a rising middle power country case in a post-liberal international order. To put it more explicitly, the aim of this thesis is to understand the transformation of the Turkish political economy with the focus on external and internal dynamics and drivers within the realms of financial and industrial sector policies.

### 1.2. Motivation and Background

Until the outbreak of the global financial crisis, the world witnessed strong economic performance during the first part of the 2000s. Inflation rates were generally low; economic growth rates were generally robust; financial flows largely expanded and the volume of international trade increased; and the world including developed states and emerging market economies witnessed widespread progress in terms of economic side (Obstfeld and Rogoff, 2010). However, the outbreak of the crisis changed this environment very fast and severely. The first signs of the crisis were seen in the US real estate market in 2006, but the crisis intensified in March 2008. Major financial institutions (banks or otherwise) collapsed or were nationalized, and many others were saved with great financial support of public authorities. Global production, world trade and the value of equities in global asset markets all declined (sharply) in the first few months after the intensification of the crisis. This kind of severe economic impact was not seen since the Great Depression in 1929. Although the crisis started in the developed countries' financial markets such as the US and Europe, it spread to all regions of the world, which were affected in different ways and magnitudes (Helleiner, 2010).

The severity of the financial crisis produced some important expectations that the GFC could play a transformative role to create a new global order. The most significant development reinforcing this expectation was the establishment of the Group of 20 (G20), which held its first summit in November 2008. Political leaders such as then British Prime Minister Gordon Brown and French President Nicholas Sarkozy stated the hope of a 'new Bretton Woods' just before the meeting. These sentiments were understandable because the crisis was the worst global economic and financial meltdown since the Great Depression, which led to the Bretton Woods conference in 1944. At Bretton Woods, new international economic institutions were created, which formed the cornerstone of the post-World War II economic order (Helleiner, 2010). However, the rules and institutional foundations of this liberal-oriented international order have been challenged in recent decades by rising non-Western countries, in particular in the post-GFC era. It is in this context that the role of emerging powers in the current global political and economic order has been one of the liveliest debates in the literatures of international relations and international political economy since the financial crisis in 2008.

The main tenets of the (Post)-Washington Consensus were strongly supported by international financial institutions, namely the International Monetary Fund and the World Bank, in developing countries following the liberalization trend in global finance beginning in the late 1970s. In the aftermath of the global crisis, the relationship between rising powers and the prevailing policy paradigm, the (Post)-Washington Consensus, has been investigated by many scholars in order to understand the likely change in the global political and economic order (Nölke at al., 2015; Ban, 2013; Ban and Blyth, 2013; Ferchen, 2013; Mukherji, 2013; Rutland, 2013; Wade, 2011). Most of this literature has focusses on either the role of and implications for established Western powers or rising powers such as the BRICs countries. However, the relationship between middle power countries and prevailing policy paradigm in the post-GFC world is a significant yet understudied issue in the fields of IPE and CPE. In this regard, this study explores the extent to which Turkey, as a middle power country, has displayed agency in its relationship with the prevailing policy paradigm with the focus on internal and external dynamics and drivers in a post-liberal international order.

This thesis investigates the period between the late 2010 and the early 2018. The late 2010 is a critical turning point for the emergence and the adoption of macroprudential measures in the Turkish economy in the post-GFC period. The macroprudential turn, however, not only created a political backlash from within the government elites in the ruling party but also revealed that real and financial sector actors have divergent preferences on the configuration of the Turkish economy (Yağcı, 2018). In addition, the general election in 2011 is another critical turning point for two reasons in the realms of neo-developmentalist policies in the post-GFC period. First, some significant organizational change was embraced, which reflects the changing mind-set related to developmentalist policy framework. Second, a new approach in carving out industrial policies was witnessed in line with the neo-developmentalist turn in Turkey. Despite some early achievements, neo-developmentalist policies for an upgrade of Turkish industry have faltered. In the post-2016 period, these policies have been undermined by return of reactive ad-hoc policies, erosion of institutional autonomy and increasing macro-economic instability (Toksoz, 2023). On the other hand, the presidential election held in June 2018 has been a critical turning point for the fortune of the Turkish political economy. As it is discussed in the later sections, the new presidential system with weak checks-and-balances mechanism shows significant state capitalism features with authoritarian and undemocratic aspects.

Studying the relationship between Turkey and the prevailing policy paradigm, neoliberalism or the Washington Consensus, is significant for several reasons. First, the GFC was an external crisis for Turkey. The earlier transformation periods in Turkey followed a domestic crisis with the direct impetus of external actors as happened in the case of major transformations in 1980 and 2001. Although the transformation cannot be identified as a major overhaul of the current paradigm in the post-GFC period, the Turkish political economy reflected significant changes in terms of the prevailing policy paradigm and the balances between external and internal dynamics. Second, although there is a growing influence of non-Western rising powers and their state-led developmental paradigm in the post-GFC, Turkey has had a prolonged relationship with the Western alliance since the formation of the liberal international order in the post-Second World War period. Turkey is a member of the North Atlantic Treaty Organization (NATO) and a candidate country to the EU. Third, Turkey has had a functional electoral democracy and multi-party system since 1950, despite several military breakdowns. Moreover, Western-oriented grand strategy was formed in the establishment of the republic of Turkey in the 1920s. Last but not least, Turkey has embraced the neoliberal paradigm since the early 1980s with a comprehensive reform template in line with the Post-Washington Consensus following the domestic crisis that happened in 2001.

To foreshadow the core findings from the study, overall I argue that a variegated agency displayed across the spheres of industrial policy and financial regulation in Turkey's contemporary political economy. I find that ideational change has taken place in the global political economy, and the agency of domestic actors and domestic institutions have significant influences on adopting and implementing policies in both spheres. The Turkish case reflects a variegated agency, which is an agency understanding contributing both continuity and change in terms of the country's relationship with the policy (paradigm) change.

### 1.3. Methodology and Data Sources

This thesis relies on case study method. I analyze how the Turkish political economy is transformed in the post-GFC period with the focus on internal and external dynamics and drivers. By and large, the conventional wisdom about case study research - for instance, it is not possible to generalize on the basis of a single case or case studies are subjective and arbitrary - is wrong and misleading. The case study 'is a necessary and sufficient method for certain important research tasks in the social sciences, and it is a method that holds up well when compared to other methods in the gamut of social science research methodology.' (Flyvbjerg (2006, p. 241). In this thesis, the case study is supplemented with multiple data sources.

This thesis mainly relies on in-depth semi-structured elite interviews and also, official documents produced by various Turkish government agencies. Elite interviews allow researchers to access the data which is crucial and very difficult, if not impossible, to gather through primary and secondary sources. Elite interviews are also useful for researchers who investigate contemporary issues that are still understudied (Lilleker, 2003). For the interviews, 'purposive sampling' method is used in order to identify causal processes. Rather than formal survey mechanisms, interviews conducted in-depth are tend to be more qualitative and exploratory. Interviews are also tend to be more concentrated upon the beliefs and personal experience of individuals along with the distinctive features of situations and events (Wromen, 2010). To this end, I contacted relevant actors who were in policy design and implementation to conduct interviews. I utilized interviews for causal mechanisms which led to change in the realms of financial and industrial policy. I also interviewed observers such as academics and think tank researchers.

I conducted in-depth semi-structured elite interviews in Turkey. A good knowledge on the relevant area of study prior to the interviewing period is important. Researchers need to review the available second-hand materials as much as possible and conduct interviews following this process (Lilleker, 2003). Therefore, I conducted seventeen interviews in the third year of my PhD study. Four of them are high level officials from the Turkish central bank and the Banking Regulation and Supervision Agency. Also, I conducted eleven interviews with experts and senior experts from the Ministry of Treasury and Finance, the Presidency of Strategy and Budget, and the Ministry of Industry and Technology. Moreover, I conducted two more interviews, one with an academic from a university based in Istanbul and one with a director in a think tank based in Istanbul. In each interview, I directed 6-7 semi-structured open-ended questions. These open-ended questions allow researchers to reveal 'interviewee's views, interpretations of events, understandings, experiences and opinions' (Byrne, 2004, p. 182). As stated by Aberach and Rockman (2002, p. 674), high-level policy makers 'do not like being put in the straightjacket of close-ended questions.' Therefore, semi-structured open-ended questions were utilized to provide space to participants to think about their responses. In this way, they framed their answers in their own perspectives (Aberach and Rockman, 2002). In addition, I had the opportunity to ask some different questions according to their responses. Average duration of an interview was around 35 minutes.

It is a challenging task for researchers to analyse semi-structured interview responses due to the open-ended nature of these responses. I analysed the data in three steps as Halperin and Heath (2012) suggested: data reduction, assignment and drawing conclusions. I, first, reduced the data gathered through field notes or transcriptions. Then I broke down the data and "assign them to different categories according to the variable to which they relate.' (Halperin and Heath, 2012, p. 280). Lastly, the data was assigned into two broad categories according to the responses. In addition, the ethical considerations were properly addressed before, during, and after the interviews. Respondents were provided a letter outlining the aims and scope of the research. Respondents are not revealed with their names and direct titles for ethical reasons. The content of the research design is approved by the University of York (ELMPS) Ethical Committee. Some more information is provided in the appendix at the end of the thesis.

The interviews do not always provide direct information on the facts and the realities on the ground. However, they allow researchers to have first-hand information about how interviewees perceive the events (Silverman, 2011). Therefore, I also used reports, official documents and statistics produced by governmental agencies such as the Central Bank of Turkey, the Banking Regulation and Supervision Agency, and several ministries as secondary sources. These are mainly related to policies which are implemented by relevant institutions. In addition, I have used newspapers as secondary sources. Newspapers 'have great value in presenting up-to-date political information' (Harrison, 2001, p. 107), despite their reliability and accuracy issues, and limitations (Burnham et al., 2004). The analysis of secondary sources provides some advantages to the researcher. Researchers have more time to spend on the analysis and interpretation of data with these secondary sources. Moreover, if the existing data would be reanalyzed by the researcher, it may offer new interpretations (Bryman, 2008). As documented in the later case study-focused chapters, I also surveyed another secondary resources including publications by academics on the Turkish political economy to advance the detail with which the contemporary trends in industrial policy and financial governance were interrogated.

### 1.4. Structure of the Thesis

This study is formed by seven chapters, including this introductory chapter. The second chapter is a literature review that aims to locate the contribution of this study. Almost all PhD theses include literature reviews and it can be done in several ways. This study engages with the literatures of Comparative Political Economy and International Relations, and the main aim is to explore the extent to which Turkey, as a middle power country, has displayed agency in its relationship with the prevailing policy paradigm.

The second chapter, which is a critical review of the literature related to middle powers as agents of change, consists of five main sections. Section 2.2. presents the relationship between the disciplines of comparative and international political economy to locate the study. Because, this study aims to explore not only internal dynamics and drivers but also external dynamics and drivers in policy (paradigm) change in the post-GFC period in Turkey. In this sense, section 2.3. will present an overview of emerging and middle powers and their locations in the changing global order along with their relationship between the prevailing policy paradigm. This has been investigated by many scholarly attempts, in particular in the post-GFC period.

Section 2.4. is related to the question of how emerging powers and rising middle power countries react to paradigmatic shifts taken place in the post-GFC. Therefore, this section examines the nature and the scope of the change in terms of a policy paradigm change in a middle power country. Because, the drivers of change along with the extent of change and continuity in prevailing policy paradigms have not been fully articulated, especially in the context of a middle power country, in particular, following the global crisis. This is a significant but understudied subject in the literature that emerging powers and rising middle power countries may have profound influences on the nature and the scope of the dominant policy paradigm in global economic and financial order. In this regard, this study focuses on a rising non-traditional middle power country and how a policy paradigm has been shifted through particular domestic actors and factors along with the influences of external drivers. This study, as in the case of Turkey, argues that policy paradigm change within the same country can be incremental and/or deep in different policy realms depending on mixture of internal and external dynamics and drivers.

Paradigm shift or ideational change is not necessarily to be a rupture from the old orthodoxy. Instead, it can be an evolutionary process taking place several years that aforementioned ideational change can be pursued through a process-oriented approach. This allows researchers to identify how particular ideas directly influence specific policy outcomes (Jacobs, 2015). However, the challenge here is defining what the ideas mean and discussing the concrete mechanisms through which they can shape change. In order to overcome this challenge, the study stresses the role of discourse in change, which focuses on how the beliefs of political actors shape their decisions and the reforms they enact (e.g. Daigneault, 2014; Schmidt, 2011; Béland and Cox, 2010; Parsons, 2007; Campbell, 2004). In the case of Turkey, there is a clear tendency for a paradigm shift or ideational change as an evolutionary process rather than a rupture from the old orthodoxy beginning in 2011. In 2012, certain politicians within the same government started to discuss the policy paradigm path that Turkey should have followed through the policies implemented in the financial sector. These discussions can be traced with the discourse utilized by the key political actors in Turkey. On the other hand, institutions are restructured in line with the change taken place in both policy realms, namely financial sector and real economy.

The third chapter presents the politics of financial sector developments in Turkey in the 2000s. Accordingly, the integration of the Turkish economy into the international economic and financial system started with the January 24 decisions in 1980. However, the critical turning point for the Turkish financial system was the full capital account liberalization and currency convertibility decision in 1989. This change, however, caused several crises due to the lack of proper infrastructure in domestic economic and political institutions. Eventually, Turkey experienced a catastrophic crisis in 2001, which paved the way for a substantial transformation in the financial sector. The main reason for the crisis was described as the lack of proper regulation in the financial sector, particularly in the banking sector, along with serious instability in the political system over the 1990s. Therefore, the reform efforts have been restructured in line with the Post-Washington Consensus template with an emphasis on the regulatory aspect in the post-2001 crisis era with the direct impetus of the International Financial Institutions such as the IMF and the World Bank along with the European Union.

The fourth chapter is one of the empirical chapters of the thesis. Its aim is to give a framework that explores the drivers of macroprudential shift in Turkey in the post-GFC period. Due to the measures of advanced countries in the post-crisis period in line with the emergence of macroprudentialism, the increasing volatility in capital flows resulted in significant challenges for developing and emerging economies. Turkey, as other emerging economies, utilized macroprudential policies to mitigate the surge of short-term 'hot money' flows in the post-GFC period. The Central Bank of Republic of Turkey (CBRT) and regulatory agencies adopted several macroprudential measures starting from the late 2010 in order to provide financial stability in the domestic financial system. While significant organizational change has occurred, new 'unconventional' or 'unorthodox' monetary policy tools have been utilized by the CBRT along with the substantial measures implemented by the Banking Regulation and Supervision Agency (BRSA) through the recommendations of the Financial Stability Committee (FSC). Macroprudential policies, especially new monetary tools implemented by the CBRT was efficient in improving the current account balance as well as in curbing the volatility in the exchange rates (Çelik and Oğuş Binatlı, 2022).However, by their nature, these policies have some costs for emerging economies in terms of economic growth. Therefore, these policies created a major political backlash within the government in Turkey. On the one hand, an incumbent politician in the government and policy makers at that time were supporting the implementation of these policies at the cost of economic growth. On the other hand, some government elites were opposing the same measurements for their ideational differentiation in the economic policy-making process. In addition, macroprudential measures revealed that not only actors from the real sector but also from the financial sector have divergent preferences.

While big holdings in the Turkish economy emerged as winners, small and medium-sized enterprises (SMEs) emerged as losers from the macroprudential turn. As representatives of SMEs, and a political and ideological ally of the ruling party, MÜSİAD (Müstakil Sanayici ve İş Adamları Derneği— Independent Industrialists' and Businessmen's Association) criticized policies of the CBRT and the resulting high interest rates. On the other hand, TÜSİAD (Türk Sanayicileri ve İş İnsanları Derneği—Turkish Industry and Business Association) expressed concern about high inflation rates, as the representatives of big holding companies. In addition, some political elites from the ruling party harshly criticized high interest rates and the central bank for political and religious reasons. Therefore, the credibility of the CBRT as well as the coherency and the legitimacy of macroprudential policies was undermined (Yağcı, 2018). Despite all, this process did not result in a major policy change related to the general macroprudential policy framework until 2018.

The fifth chapter presents the politics of industrial policy formulation in Turkey in the 2000s. Until 1980, Turkey implemented an economic policy paradigm which is generally known as import-substituting industrialization (ISI) as many developing countries. This economic policy paradigm is characterized by a repressed financial system, dominance of state-owned enterprises in critical industries and also banking, very high protection from imports, and heavy controls on domestic prices. The ISI paradigm was implemented between 1960 and 1980 in Turkey. The macroeconomic performance of the Turkish economy deteriorated after 1976 and this period ended with a major crisis in 1979. A radical economic program was launched in the aftermath of the crisis. Following the January 24 decisions in 1980, the era of neoliberal restructuring, both in the financial sector and industrial policy formulation, shaped by internationalization and market-based orientation was started to be implemented in the Turkish economy (Atiyas and Bakis, 2015; Taymaz and Voyvoda, 2012).

The sixth chapter is the second empirical chapter of the thesis. Its aim is to give a framework that explores the drivers of the neo-developmentalist shift in industrial policy formulation in Turkey in the post-GFC period. The emergence of neo-developmentalism has been one of the key elements regarding the role of the state in economic policy making in the post-GFC period. With the neo-developmentalist turn, a new form of state activism has been the main characteristic of the national capitalist development method. Turkey has started to utilize neo-developmentalist policy guidance in its industrial policy making in an open-economy setting. While some organizational changes and experimental policies have been carried out in line with the new industrial policy making in the post-2010 period, new discourse utilized by politicians and policy makers heavily influenced the ideational change in alternative developmental paradigm.

Due to the severity of the GFC, neoliberal economic ideas and narratives have been deeply questioned all over the world. In addition, the importance of the real sector and the manufacturing industry led to a new process of technological transformation and development not only in developing economies but also in developed economies. The importance of technological superiority has gained more attention than ever in global competition. It has become more important to create additional capacity based on high-tech in order to attain sustainable long-term economic growth and development. Although Turkey has succeeded to produce advanced technology products, in particular in the automotive sector and the defense industry, there has been no proper industrial policy framework in recent years due to incorrect macroeconomic policy choices (Gür, 2022).

The seventh chapter is the conclusion. It summarizes the trajectory of the Turkish political economy in the period between the late 2010 and the early 2018 with the focus on external and internal dynamics playing a significant role in this process. The conclusion chapter ends with suggestions on new avenues for future research in order to understand the likely trajectory of the Turkish political economy.

## Chapter 2

## Middle Powers as Agents of Change in IPE: A Critical Review of Existing Scholarship

### 2.1. Introduction

International and comparative political economy places significant analytic value on understanding processes of change. Through the history of the disciplines, key contributions have sought to understand the drivers and detail of paradigmatic changes in the global economy as well as national economies. Key changes the literature has focussed on include the move from Pax Britannica to Pax Americana (Helleiner, 2014a; Steil, 2013); the shift from embedded liberalism during the Bretton Woods era to the period of neo-liberalism post-Bretton Woods (Chwieroth, 2009; Abdelal, 2007; Blyth, 2002; Helleiner, 1994); and the emergence of a post-GFC era (Drezner, 2014; Öniş and Güven, 2011; Helleiner, 2010; Helleiner and Pagliari, 2009; Hodson and Mabbett, 2009). In addition, the rise of rising power countries have accelerated the debate on paradigmatic changes in the literature of international and comparative political economy (Nölke et al., 2015; Breslin, 2011; Zhao, 2010).

Through this study, I add to scholarship that seeks to unpack the most recent points of change in economic governance following the GFC. More in particular, I use my study to explore the extent to which Turkey, as a rising middle power country, has displayed agency. Here, by systematically studying the patterns of change and the drivers of change in Turkey's industrial policy and approach to financial governance, I extend our understanding of the relationship between the GFC and ideational shifts within a rising middle power country case in a post-liberal international order. To put it more explicitly, the aim of this thesis is to understand the transformation of the Turkish political economy with the focus on external and internal dynamics and drivers within the realms of financial and industrial sector policies.

To foreshadow the core findings from the study, overall I argue that a variegated agency displayed across the spheres of industrial policy and financial regulation in Turkey's contemporary political economy. I find that ideational change taken place in the global political economy along with the agency of domestic actors and domestic institutions have significant influences on adopting and implementing policies in both spheres.

The chapter starts with an overview of Comparative Political Economy (CPE) scholarship and its link to IPE in order to locate the study. While CPE is useful to understand the developments on domestic political economic change, IPE provides a perspective on how domestic political economic change is influenced by the change in global order and world economy. Then the chapter continues with a review of the literature on the current setting in the liberal global order along with emerging powers in it. While BRICS countries (Brazil, Russia, India, China and South Africa) are the focus as an example of emerging powers, different states such as Canada, Australia, South Korea and Turkey are examined as middle powers. The chapter then moves to the debate on the change in the current global political and economic order in the post-GFC period with a focus on policy paradigm change. Firstly, the change in the governance structures of the global economy is examined and then policy paradigm change in the fields of financial governance and the real economy is presented. Secondly, the role of ideas, interests and institutions in policy paradigm change is utilized as the theoretical background of the study. The fifth section gives a framework for analysis to locate internal and external drivers in the study, while the sixth section gives an overview on policy transfer literature.

## 2.2. Comparative Political Economy and Its Link to International Political Economy

Comparative political economy doesn't have a clearly defined focus. Nevertheless, key scholars in the field analyse state/market relations and the politics of economic institutions and economic policy. Peter Katzenstein is one of the prominent scholars in the field. He analysed states' responses to the crisis of the 1970s and found that national economies have differentiated with their solutions to the crisis. This has been an important opportunity for scholars who investigate responses to the GFC as this study does. Katzenstein and his collaborators in the book titled *Between Power and Plenty* (1978) noted that these advanced states had different social, political and domestic structures. Responses of these countries were dependent on their export/import dependencies, and the relative openness and competitiveness of their economies. In short, this study highlighted that the world economy imposes different limitations on different economies depending on their economic structures (Clift, 2014).

Katzenstein doesn't pursue an analytical separation between domestic and international levels of analysis. Instead he explores the interplay between domestic and international drivers. As Katzenstein (1978, p.11) notes 'international and domestic factors have been closely intertwined in the historical evolution of the [global economy] since the middle of the 19th century'. Therefore, a clear-cut separation between international and domestic realms are limited and also foreign economic policy making needs careful attention for making domestic economic policy compatible with the world economy. In relation to this, Great Britain promoted free trade internationally in the early 19th century. Because, domestic politics with Britain's international ascendancy was in favor of this policy. It has to be stated that Britain's choice on domestic politics became vital for a particular world order. Therefore, political and economic forces shaping outcome at internal level as well as international level has been important for CPE scholars (Clift, 2014).

In addition, Peter Gourevitch, who is another prominent scholar in the field, pointed out the importance of *complex interactions* between domestic and international levels of analysis. He (1986) indicates that states are different in their responses to the same international context. Internal affairs or domestic structures of states and governments will affect the evolution of political economies in the aftermath of crisis and changes within global economy and world order. Full understanding of change in the international political economy is an integral part of exploring how international influences are contested and channelled within domestic contexts (Clift, 2014).

It is worth noting that IPE and CPE have different approaches on how best to interpret and analyse political and economic change, which could be understood from their relative isolation between them. For instance, domestic political economies are under the impact of changes in international financial markets as it was obvious during and in the aftermath of the global financial crisis in 2008. As Susan Strange (1997) points out, significant qualitative change happening at international level is sometimes missed by some comparativists due to overstating national institutional continuity. On the other hand, there is a risk that IPE scholars can focus too much on the global level of analysis. In this case, domestic institutional and ideational structures and processes can be neglected in dealing with the global pressures. Therefore, CPE analysis can enhance with the increasing dialogue and engagement with the IPE scholarship. In this way, domestic political economic change and/or continuity can be investigated whether there is an influence of international political economic or ideational change and/or continuity on domestic level. This study, therefore, utilizes both literature in order to understand how and what ways international political economic and ideational change can influence the change on domestic political economy in the example of an emerging power.

Considering that advanced countries and global order itself are being subject of many scholarly investigations in IPE and CPE literatures, this study will focus on an emerging power, Turkey, in the changing global political and economic order. In this sense, the next section will present an overview of emerging powers and their locations in the global order.

### 2.3. Emerging Powers, Middle Powers and Global Order

The rise of BRICS countries has sparked a lively debate about whether and in what ways these emerging powers will challenge to the rules and institutional foundations of liberal-oriented international political and economic order that the United States and Western European countries constructed following the post-World War II (Stuenkel, 2016; Wade, 2011). However, less attention has been paid to the second category of emerging powers, which are called as middle powers, in the literature (Cooper at al., 1993; Jordaan, 2003). Thus, this study explores to what extent an emerging middle power country, Turkey, has displayed agency in the post-GFC setting in the field of financial governance and industrial policy. In other words, it is investigated that to what extent and how domestic actors and domestic institutions are influenced by changing ideas and policies in the global political economy.

In this post-GFC context, the attempts of middle power countries in order to take advantage of their expanded policy space are significant yet understudied issue on the contrary to the studies conducted on rising powers such as BRICS countries (Gray and Murphy, 2013; Huotari and Hanemann, 2014). To this end, this study focuses on the nature of changes to prevailing economic governance paradigm in the post-GFC period in Turkey as an important middle power country. The post-GFC, and especially the late 2010, clearly marked the beginning of a new era of Turkey's political economy that it could be named as a hybrid governance model representing the features of regulatory neoliberalism, on one hand, and neo-developmentalism, on the other.

### 2.3.1. The BRICS in the Post-GFC Order

The rules and institutional foundations of liberal-oriented international order constituted in the post-World War II are being shaped by new global challenges and rising non-Western countries. Power, especially the economic aspect of power, is more widely diffused between established and emerging powers than ever before. Western countries, in particular the United States as the founder and the leader, need partners and a more explicit set of institutional bargains that share governance, authority and the burdens to maintain the current global order (Ikenberry and Mo, 2013). It is in this context that the role of emerging powers in the current global political and economic order has been one of the most lively debates in the literature of international relations and international political economy since the financial crisis in 2008.

There is no common consensus on what an emerging power is, however, it may refer to some main commonalities for those countries. The most well-known and acceptable commonality is the increase in economic weight of these countries, which has gone hand in hand with an increase in their economic and financial power in the last couple of decades, both individually and as a group. In this regard, the ‘BRICs’ country grouping is the most prominent example in the literature. The ‘BRICs’ term was firstly mentioned in a 2003 Goldman Sachs report which refers to Brazil, Russia, India and China as major developing economies (later called as the ‘BRICS’, with a capital ’S’ after South Africa’s inclusion in 2010) (Hart and Jones, 2010). The institutionalization of BRICS countries began in 2009 for the first time. They assumed ownership of the term of the BRICS, started to organize yearly summits and most importantly initiated a relatively broad range of cooperation in different issue areas, which extended from economic and financial cooperation to health, security, business, and science, technology and innovation. However, it was surprising how these countries have come together, considering they have little, at first glance, in common.

As Stuenkel (2015) states, many observers in the United States and Europe have argued that the differences between BRICS countries far outweighed than their commonalities, despite the acronym’s usefulness and capacity offering an easy account of the new distribution of power in the global order. For instance, while Brazil and Russia are large commodity exporters, China is a big commodity importer. Also, while Russia is a major energy exporter, India is a big energy importer. These differences matter significantly as they cause each member country to generate economic growth in different and opposing ways. In addition, while Brazil, India and South Africa are democratic countries, Russia and China have authoritarian governments. Furthermore, and more importantly, the BRICS country grouping is considered an incoherent group as they have different positions in the global political order. Brazil and India support a revision in the redistribution of institutional power in the today’s global governance structures, whereas Russia and China, both permanent members of the United Nations Security Council, are essentially reluctant for any change in the system which has served them well during the past decades (Stuenkel, 2015; 2016).

Despite the critics for BRICS countries that they are not a coherent group, Hurrell (2006) gives four reasons to consider these countries in a similar way, in addition to their increasing hefts in the global economy. The first reason is that they have a range of political, military and economic power resources; a potential for effective state action, to some degree; and some capacity to provide contribution for the production of regional and even global order. Secondly, each country believes that it has a more influential role in current world affairs. A third reason is that considering these countries together, the relationship between and among them have developed in the last couple of years and especially in the post-crisis era with the institutionalization of the cooperation efforts. The final reason is that BRICS countries can be differentiated from other middle-powers and second-tier states. The important thing about BRICS countries is they haven't been closely integrated with the US (in an alliance system or otherwise), while Japan, South Korea, Canada, Australia and other major European states have been. In addition, Stuenkel (2015, p. x) asserts that there was an overlooking element that unifies these countries, all four initial members ‘have global ambitions—a global project, however vaguely defined, voiced frequently’. This is the most significant point, in terms of understanding the current and the future global political and economic order, because it is already considered by some that the world entered a new global order (Zakaria, 2008; Haas, 2017, Stuenkel, 2016). In this sense, the role of emerging powers, such as BRICS countries, would be hugely important (Armijo and Roberts, 2014; Stuenkel, 2015).

The efforts for creating a new order either in political or economic terms if there is, or transforming the old one is a critical point to understand the future of the global economic order. Germain (2001, 2009) states that cooperation between G7 countries as old powerful ones and new emerging powers would be at the heart of the discussion. However, he asserts that there seems no consensus, especially in political terms, between these two sides at generating a new order. Each country will prioritize its own benefits rather than supporting global financial governance structure. At this point, the role of the US is important as the founder and the most powerful actor. The US faces a double dilemma whether emerging powers to include the current order or not in solving global problems that affect its interests and if it does so, how can the US better secure its interests in an evolving multilateral order. On the one hand, emerging powers don't share the same world-views with the US and their possible priorities in the future might not be so compatible as in the current neo-liberal order. On the other hand, there are questions on the capacity of the US in controlling the evolution of a new global order that includes these countries. Some claim that if emerging powers are involved in the current shaping structure of global governance, they will be more responsible stakeholders. So the US can secure its own influence in the current architecture. However, this is questionable whether the new order will really serve the benefits of the US or not. On the contrary, if it shares power with emerging powers and restricts itself, it would lose its ability to act unilaterally (Vezirgiannidou, 2013).

At this point, there is a more important question which seems difficult to answer. What kind of global order will emerge from this transition period? Schweller (2011) states that literature has two camps as pessimists and optimists. The former camp believe that the coming world order will cause significant problems such as rivalry, intense competition for scarce resources, nationalism, arms races and insecurity. They predict that the world will witness a war between China and the US because of the intense security competition. This assumption is based on the belief that there would be no change without a global war. On the other hand, the latter camp thinks that we will see a smooth transition from unipolarity to multipolarity. They predict that old and new powers will find smart ways to build and jointly manage a new global architecture which preserve the fundamental features of existing global order.

Rather than telling what is likely to happen in the future, it would be better to mention a few initiatives that BRICS countries, the majority led by China, have made so far. The New Development Bank (NDB) has seen a remarkable step for BRICS history. The NDB has $50 billion initial capital and five countries in the grouping all have equal voting shares in the bank. It is still early to see the explicit impact of this institution but will have a key role for lending practices that traditional development lending was often described as ‘too rigid, inflexible and slow’ (Stuenkel 2016). In addition, Stuenkel (2016, p. 129) asserts that ‘the creation of the bank along with the Contingency Reserve Agreement (CRA) is set to strengthen the relationships among central banks, national development banks, and finance ministries’. The CRA was first discussed among BRICS leaders, unlike the NDB, and then was created with a $100 billion budget to tackle any likely financial crisis in emerging economies. It is envisaged that this initiative will increase investor confidence considering the increasing frequency and magnitude of financial crises in the past decades. In short, the creation of the NDB and the CRA by BRICS countries are considered as some kind of game changer in terms of the traditional development aid model that Western countries have advocated in the last more than six decades (Smith, 2013; Warah, 2013).

Acharya (2018) states that the decline of the USA, whether it is the case or not, is less important than the decline of the 'American World Order' created in the post World War II. In other words, he asserts that the 'American World Order' is coming to an end regardless of the weakening of the USA. In this sense, Wade (2011) draws a good analogy by saying that the evolving global order is a 'multipolarity without multilateralism'.

The flexible structure of the BRICS has some advantages to play a key role in reforming the global economic governance towards mentioned multilateralism. They state that they have intentions to change governance structure and the priorities in the global economic and financial governance. In this sense, the 'club-like' diplomacy in the formation of the BRICS grouping provides considerable power which can help reinforce their agenda in the global governance forums, however, they have to avoid from the contesting issues among them (Cooper and Farooq, 2013). At this point, two debates become important, power and intentions of these countries. For example, Huotari and Hanemann (2014) claim that the institutional power of the BRIC country grouping only marginally increased, although there have been ongoing reforms in the structure of global financial governance. On the other hand, even the ascent of the BRICS and the initiative of the creating the NDB represents a challenge to the Western-dominated world order, the intention of these countries is not to overhaul the current global economic and political order. Also, Ikenberry (2011) claims that emerging powers such as Brazil, India and China have no intention to change the fundamental liberal principles of the global economic order. Moreover, they want to maintain the liberal system which provides many benefits to them. So, it is difficult to see the BRICS taking on a more comprehensive role as a system transformer (Qobo and Soko, 2015).

Nevertheless, there are some different views on the roles of the B(R)IC grouping in the future of global order that it is worth considering. Some scholars assert that these countries have different domestic economic models which have succeeded an important developmental trajectory. This will produce a legitimacy problem for the global liberal economic order along with the generation of a new hybrid governance model including less liberal market orientation (Nölke et al., 2015; Stephen, 2014). In a nutshell, the ascent of BRIC countries has sparked a lively debate on whether and in what ways these rising powers challenge/will challenge the current global order. However, the rise of middle powers has paid less attention in the literature.

An international context dominated by neoliberal economic ideas and narratives about the dos and don'ts of economic policy making has been the case for the global political economic landscape since the late 1970s. In other words, neoliberal economic globalization severely constrained the policy options of developing countries, especially economic policy-making in the developmental realm (Wade, 2003a; Gallagher, 2005). However, some developing economies, particularly large emerging countries, have enjoyed a less restricted environment for the last two decades (Güven, 2016). During this period, these countries also reclaimed the role of the state in development far beyond the limits of the Washington Consensus policy paradigm. The most striking example has been BRICS countries that have a significant degree of policy autonomy from the Washington-based international financial and economic institutions, the IMF and the World Bank, than other states in the category of emerging powers (Woods, 2006; Pop-Eleches, 2008). As Ban (2013) points out, Brazilian governments adopted a hybrid policy regime which has interventionist aspects associated with neo-developmentalist thinking as well as liberal priorities in light of the Washington Consensus. Although Brazil carried out significant privatization, deregulation and liberalization reforms, at the same time the state kept increasing its role as investor and owner in banking and industry while using an open economy industrial policy model. Brazilian governments defended the goal of macroeconomic stability and sidelined full employment, but also embraced largely off-the-books stimulus packages during the global financial crisis. Therefore, the BRICs ‘attempted to balance their adoption of select parts of the Washington Consensus template while defending and often reinventing the relevance of state-led development policies under the guise of being compliant with the Washington Consensus itself’ (Ban and Blyth, 2013).

In sum, it is certainly important to look at emerging powers in order to understand how global governance and world order is going to be challenged or changed by these newly rising powers. However, the debate on emerging powers has mainly focused on the potentials and limits of BRICS countries as the first category of emerging powers. This causes an inadequacy in order to understand the post-liberal international order. Therefore, in contrast to the dominant trend in the literature of international relations and international political economy, this study focuses on the relationship between middle powers and the Washington Consensus in the case of Turkey as an important emerging middle power country.

#### 2.3.2. Middle Powers in the Post-GFC Order

The Great Recession has accelerated the trend towards re-emergence of state activism in the governance of finance and real economy in advanced industrial countries as well as in emerging market economies (Öniş and Given, 2011). On the one hand, a macroprudential ideational shift has occurred in the governance of financial regulatory frameworks that implies a redefinition of the role of public authorities in market activities (Baker, 2013a). On the other hand, the IMF displayed a ‘productive coherence’ moment in response to the crisis, freeing policy space for borrowing governments (Grabel, 2011) and more importantly, industrial policy efforts led by states in many developing countries have been stepped up (Aggarwal and Evenett, 2012; Wade, 2010). In this post-GFC context, the attempts of middle power countries in order to take advantage of their expanded policy options are significant yet an understudied issue in international relations and international political economy literature on the contrary to the studies conducted on rising powers such as BRICs countries.

The literature on middle powers argues that these states tend to comply with the rules in the global political and economic order, in particular when geopolitical contestation gives them little bargaining power and room for manoeuvre (Mastanduno, 2009; Beeson, 2018). However, the end of the Cold War, the decline of American hegemonic power and especially the new age of uncertainty and experimentation following the GFC, have opened up a political economic and ideational space that middle powers can use and have used for change (Coen and Roberts, 2012; Ikenberry and Mo, 2013; Baker and Carey, 2014).

Beyond the BRIC country grouping, middle power country grouping such as MIKTA are likely to play greater roles in various diplomatic initiatives and platforms despite their limited capacity and power. The future of global order depends largely on the leadership of countries both from large developed and large developing country blocs. However, the role of middle powers, located between major and small states, are significant in affecting the stability and the character of global financial and economic governance. Traditional middle powers such as Australia, Canada and Nordic countries don't belong to any country grouping, large developed or large developing, that they are expected to continue to play their middle power diplomacy in various diplomatic initiatives. These countries are described with their significant role in coalition-building in the international system. In doing so, they assist in fostering cooperation. For example, Australia and Canada, along with other middle sized ranking countries, had a cooperation relationship in the formation of Cairns Group in securing agricultural reform in the Uruguay Round of trade negotiations (Cooper et al., 1993). Also, these countries are considered as 'catalysts' for promoting liberal order and 'managers' to disseminate orthodox norms and practices in their own regions (Ravenhill, 1998; Carr, 2014). However, what is important and striking in the current international political and economic landscape is the emergence of rising middle power countries such as South Korea, Mexico and Turkey. These countries are upper-income or upper-middle-income developing countries that have succeeded better economic and political development than relatively low-income developing countries. Therefore, these rising middle power countries have different national interests related to global economic and financial governance compared to the low-income developing countries (Ikenberry and Mo, 2013). South Korea, for example, has taken on new global responsibilities in different issue areas such as economic cooperation to development assistance. Korea is a new economy that gives a development assistance ability for other developing countries. Korea, also, has significant multilateral economic diplomacy missions in areas including its role in expanding FTA (Free Trade Area) networks and South-South cooperation on energy (Ikenberry and Mo, 2013). On the other hand, Turkey is a significant emerging middle power country that it has been more visible in three areas in recent years in international realm: its growing economic influence in its respective region along with international arena, its increasing international development cooperation activities, and its presence and active role seeking in the G20 and MIKTA like informal groupings (Parlar Dal, 2018; 2014)

On the other hand, traditional and rising middle powers have a number of similarities and differences. These two country groupings are constrained by material capacity in terms of demography, size and also military power. However, they are significantly different in terms of governance and role model capabilities in the international system. For instance, rising middle powers reflect different qualifications. Parlar Dal (2014) examines to understand the global governance activism of Turkey by using its 2015 G20 presidency as a test case. Accordingly, Turkey is in favor of ‘less hierarchical G20-type forums in which developed and developing countries are equally represented and middle power countries are allowed more manoeuvring capacity’ (p.107). To sum up, the role of emerging powers in transforming the global order is a contested situation in terms of their capacity/powers and also their intentions. However, it is obvious that the current affairs of established and emerging powers are not the same as it was in the 1980s.

Therefore, the role of emerging powers in the current structure of global economic and political governance represents an important challenge to understand the future of the global order. The role of middle powers is significant along with rising powers through their role in the current international political and economic landscape that they can affect the stability and the character of the changing global financial and economic order. The assumed relationship of these newly rising middle power countries with the policy paradigm of the Washington Consensus is another striking research area in order to understand the dynamics surrounding the post-GFC financial and economic governance. In this sense, I extend the existing literature on middle powers, which mostly deals with established powers such as Canada and Australia, by focusing on Turkey. Turkey experienced its worst economic and financial twin crises in 2000 and 2001, and transformed its economic and financial system with the help of international institutions, especially the International Monetary Fund (IMF). However, I argue that the developments taken place in the post-GFC period demonstrate that Turkey, as a middle power country, is going through an internal political economic change without a domestic crisis and direct impetus of external actors following the crisis. This stands in contrast to the earlier economic and financial policy transformations of the early 2000s.

Following the GFC, recent points of change in economic governance have been explored in a number of approaches. However, to what extent a middle power state has displayed agency was an understudied issue. Here, by systematically studying the patterns of change and the drivers of change in Turkey's industrial policy and approach to financial governance, I extend our understanding of the relationship between the GFC and ideational shifts within a rising middle power country case in a post-liberal international order. To put it more explicitly, the aim of this thesis is to understand the transformation of the Turkish political economy with the focus on external and internal dynamics and drivers within the realms of financial and industrial sector policies.

The post-GFC period in Turkey can be characterized by the electoral dominance of the Justice and Development Party (AKP) and its increasingly changing perspective in terms of state-economy relations in financial sector policy and, particularly, industrial policy. Also, this period can be considered as the weakening of Western external actors: stand by agreements with the IMF have been ended in 2008 by the AKP and significant problems taken place in EU accession negotiations have unfolded.

Moreover, this period revealed an increasing but indirect ideational influence of the illiberal capitalist model of China and Russia (Dorlach and Savaşkan, 2018; Öniş and Kutlay, 2019). On the core findings from the public policy sphere in these two realms, overall I demonstrate notable variation in the form of agency displayed across the spheres of industrial policy and financial regulation. I argue that a variegated agency has been the main character of both policy areas. External ideational change towards macroprudentialism and neo-developmentalism in both policy areas on an international level has provided a favorable environment for countries seeking more policy space. However, agencies of domestic actors and domestic institutions have played a key role for policy change in both areas. As it is investigated in chapter four and six, this finding of variegated agency adds to scholarship on middle powers in changing intentional economic order. In relation to the scholarship on post-GFC change, I here extend findings that ideational change in the field of financial governance and industrial policy on a global level can influence domestic actors and institutions in different ways and magnitudes.

### 2.4. Policy Paradigm Change

It seems that there is a quasi-consensus in the literatures of international relations and international political economy that the current global political and economic order has been transformed incrementally in terms of political and economic governance structures on the contrary to the expectations emerged following the GFC (Helleiner, 2014b; Oatley, 2017). Despite this fact, the nature and the scope of this transformation through the eyes of established countries in the order is still in the center of a lively debate. However, the question of how emerging powers and rising middle power countries react to this shift is an important question that keeps its place on the agenda. Therefore, this section examines the nature and the scope of change in terms of a policy paradigm change in a middle power country.

Major crises may cause historical and radical changes in society, polity and economy (Gamble, 2009). In other words, economic crises as well as wars play an important mechanism for change (Goldstein and Keohane, 1993; Blyth, 2002; Widmaier et al., 2007). The GFC in 2007-09 has sparked a lively debate in the literatures of IPE and CPE on the current setting of policy paradigm, namely neo-liberalism or neoliberal economic globalization, prevailed in the global economic order over the past several decades (Helleiner 2010; Öniş and Güven, 2011; Nölke et al., 2014). The Great Recession, as the most severe crisis since the Great Depression in the 1930s, has offered one of the most vivid examples of the significance of continuity and change of dominant policy paradigms. In this sense, the state of the art in the dominant policy paradigm has been explored by many scholarly attempts in terms of different perspectives and distinct pillars of global economic activity in the post-GFC era (Babb, 2013; Drezner, 2014; Helleiner, 2014b). Yet, the drivers of change along with the extent of change and continuity in prevailing policy paradigms have not been fully articulated, especially in the context of a middle power country, in particular following the global crisis. This is a significant but understudied subject in the literature that emerging powers and rising middle power countries may have profound influences on the nature and the scope of the dominant policy paradigm in the global economic and financial order.

### 2.4.1. Paradigm Change in the Governance of Global Economy

Paradigms can be a source for stability or inertia. Once a paradigm is settled in formal institutions and informal practices, it stabilizes policy makers' expectations about how the global economy should be governed, what policy goals should be adopted and which policy instruments should be used to attain those goals. The positive feedback loop between paradigms and policy makers can reinforce stability or inertia in the existing paradigm. However, the feedback loop is not necessarily self-reinforcing. It may break down due to several reasons as explained below. As a consequence, paradigm change or third order change, in the words of Hall (1993), can be seen.

The financial crisis in 2008 has been a significant threshold for the prospect of a likely radical change in terms of the global economic order. Moreover, some developments in the post-crisis period have reinforced those expectations that the GFC would play a path breaking event with regard to the main principles along with the governance of the world economy (Moschella and Weaver, 2013; Cairney, 2012). There are several ways that paradigm change can take place in the governance of the global economy. Changes in international institutions such as acquiring a seat in the management level has potential in order to trigger a paradigm change by providing a platform for discussion on alternative ways of thinking about the organization of the global economy.

The GFC has paved the way for an important change in terms of institutional structure of global economic and financial governance. The G20 leaders' forum was designed as a body to help the management of the ongoing crisis along with the systemic problems that arose and to promote the dialogue on financial and global economic governance issues. The G20 has a different model of governance structure from the traditional formal international institutions created in the post-war period. The new structure of it reflects the 'tectonic shift in the global economy' as well as in the international balance of power towards emerging economies and rising-non Western powers (Beeson and Bell, 2009). In fact, this forum had been established after the Asian financial crisis in 1997-98 but it became more influential during the recent crisis. Also, the G20 presented itself as a steering committee for global economic governance and the leaders of the member countries swiftly committed to a broad reform agenda for international financial regulations (Helleiner, 2014b). In addition, while the quota and voice reforms at the IMF and the World Bank have occurred, a new international regulatory body was established in April 2009, namely the Financial Stability Board (FSB). FSB was created by the G20 as the successor of the Financial Stability Forum (FSF) created following the Asian financial crisis. This new institution represents the most important institutional innovation in the governance structure of the global economy. The FSB was tasked with the initial and urgent coordination of the regulatory response to the financial crash and it was also described as the 'Fourth Pillar' in global economic governance along with the IMF, the World Bank and the World Trade Organization (WTO). Furthermore, the FSB has been given a central role in promoting international financial stability along with the regulatory response (Pagliari, 2013).

Repeated failures of policies prevailed in the relevant policy area can be another trigger for paradigm change. More importantly, in addition to changes in institutional structure of the global economic order and the repeated policy failures, the rise of new economic powers can be a source in challenging and changing dominant understanding of how the economy should work and how it should be organized. This is the case, particularly, when the rise of new powers is accompanied by the decline of previously dominant players (Moschella and Weaver, 2013). These are precisely the conditions witnessed in the post-crisis environment that would be significant sources for likely policy paradigm change in the global economic order.

There are plenty of studies in the literature on the GFC and paradigm shifts have focused on the global level along with authors have looked at domestic level by focusing on developed economies. For example, Hodson and Mabbett (2009, p. 1041) examine the UK's economic policy following the global crisis. Accordingly, the UK government contends 'unconventional monetary policies, a surge in public-sector borrowing and the need for a rethink of financial supervision', however, it is not 'a fundamental reordering of the instruments, institutions and aims of economic policy'. In addition, Princen and Van Esch (2015, p. 355) focus on the EU's Stability and Growth Pact (SGP) that the article examines whether this pact has been underpinned by a policy paradigm. According to the authors, 'the policy beliefs behind the SGP have been a mixture of economic policy paradigms' rather than a single policy paradigm's tenets. This implies that a mixture of policy paradigms are possible as long as they are inherently coherent. Starting from this point of view, this study focuses on a rising non-traditional middle power country that how a policy paradigm has been shifted through particular domestic actors and factors along with the influences of external drivers. This study, as in the case of Turkey, argues that policy paradigm change within the same country can be incremental and/or deep in different policy realms depending on mixture of internal and external actors and factors.

### 2.4.2. Paradigm Change in the Governance of Finance and Industrial Policy

Global financial governance in the pre-crisis period was strongly structured in line with the orthodox economics and the belief that unhampered pursuit of self-interest and profit, disciplined by the self-regulating market economy, would yield long-term stability and growth. This was the strong adherence to the efficient market hypothesis that it was a part of prevailing policy paradigm since the 1980s. Accordingly, public authorities should adopt a framework that market discipline exercises its stabilizing force and private actors decide when and how to self-regulate. In other words, public authorities should adopt a hands-off regulatory style for the best practice of financial markets. However, the global financial crisis has profoundly undermined this belief and practice that self-regulating markets can be a source of the most severe crisis since the Great Depression rather than a base for long-term stability and growth (Moschella and Weaver, 2013).

As Blyth and Shenai (2010) point out, the reason for the financial crisis is explained within the intellectual ascendancy of rational expectations and Ricardian equivalence perspective. Even public and party discourses in advanced western countries and also international organizations such as the IMF and the OECD tells a similar story. In this context, a striking development emerged following the crisis that was the sudden rise of macroprudential ideas in the regulatory circles (Baker, 2013a). Many scholars in the field of financial governance explained the earlier developments as representing orthodox and incremental forms of governance presenting symptoms of path dependence, ideational inertia and cognitive locking (Baker, 2009; Tsingou, 2009; Moschella, 2011). However, macroprudential ideas have become a fundamental regulatory approach in financial governance all over the world in a relatively short period of time for financial technocrats and regulators seeking to respond to the crisis and enhancing financial stability (Baker, 2013a).

On the other hand, the crisis also caused the re-examination of the principles which had guided sustainable economic growth and development economics over the past decades, from the role of the governments in the markets to the strategies for poverty reduction and business competitiveness (Canuto and Giugale, 2010). The effects of the GFC on the real economy has caused to be questioned the legitimacy and effectiveness of the Western development models that looked down upon the role of the state. Neoliberal policy prescriptions have perceived the state as a constraint for the efficient functioning of the markets. Neoliberalization was promoted by neoliberal political economists as well as international organizations such as the IMF, the World Trade Organization and the World Bank as the most efficient means for economic development and sustainable growth.

Neoliberal policies mentioned above were started to be embraced by Western countries at first but it soon spread to the other parts of the world. These policies were prescribed to Latin American countries by the Washington-based Bretton Woods institutions such as the World Bank and the IMF in the early 1980s that the policy package of neoliberalism was sometimes labeled as the 'Washington Consensus' (WC) in the following years. What is striking here is that these policies became the common global framework for proper and strong economic development in the 1990s for all developing countries. The neoliberal orthodoxy promoted a development model based on the market liberalism, outward-orientation, primacy of individualism and, particularly, a minimal state whose primary task to provide the necessary infrastructure for market and to secure law and order (Öniş and Şenses, 2005).

There are a number of important features which describe the nature of the Washington Consensus prescribed to the developing world as an ideal policy package that leads to vibrant economic development in those countries. The WC, however, was challenged seriously by many due to the crises taken place in developing countries in the 1990s. The most significant one is that neoliberal ideals were based on superior economic performance that according to neo-liberal orthodoxy full-scale liberalization, at all costs, will provide proper development. It is noteworthy that the WC represents ten different policy instruments prescribed in the technocratic Washington (Table 1).

| **Table 2.1: The Washington Consensus** |
|---|
| 1- Fiscal discipline, providing a balanced budget |
| 2- Public expenditure priorities, redirecting expenditure to areas with high econon returns |
| 3- Tax reform, broadening the tax base and cutting marginal tax rates. |
| 4- Financial liberalization, the ultimate objective is marked-determined interest rate |
| 5- Exchange rates must be competitive, which will assist to export-led growth |
| 6- Trade liberalization, tariffs should be reduced and import licensing should abolished |
| 7- Foreign direct investment, entry barriers should be abolished to promote FDI |
| 8- Privatization, state enterprises should be privatized to be managed efficiently and be improved the performance of them |
| 9- Deregulation of the economy, governments should abolish regulations that impede t entry of new firms or restrict competition, |
| 10- Protection of property rights, the legal system should provide secure property right |

**Source: Williamson, J. (1993). Democracy and the "Washington consensus". *World development.* 21(8), 1329-1336.**

The intended results are 'that the standard economic objectives of growth, low inflation, a viable balance of payments, and an equitable income distribution' (Williamson, 1990, p. 8). Initially, the WC policies were not prescribed as a policy package for proper development, however, that is how interpreted. Yağcı (2016, p. 32) asserts that the WC 'involved not only a shift from state-led development to market-oriented development, but also, more importantly, a shift in how development problems were framed and, relatedly, how appropriate policy solutions were justified' in line with structural adjustment and stabilization programs of the Bretton Woods institutions. In addition, repaid capital account liberalization was not included in the early formulation of the WC, however, the IMF and the World Bank, promoting this policy, contributed to the crises in emerging economies in the 1990s. In sum, the desired outcome of the WC has not been generated, and the economic crises in the developing world were interpreted as the results of the failure of this policy package (Yağcı, 2016).

The financial crisis in Asia in 1997-1998 was significant due to the effectiveness of dominant policies called as the policy package of the WC was under criticism in emerging economy cases. Economic growth in these countries fell dramatically compared to declines during the crises in the early 1980s. Some who support the WC at first announced that the problem was crony capitalism and excessive government intervention, while others inferred the reasons of the crisis as speculative financial flows and contagion. Particularly, the domestic policy failures of these countries were blamed. However, it was not convincing to consider the domestic mismanagement as the sole reason for the crisis or analytically to separate internal and external factors. Moreover the IMF and the World Bank diverged in their views on the reasons for the crisis and how best to overcome it. At this point, the leading scholar, Joseph Stiglitz (1998, 2005), who occupied a critical position at the World Bank during the years of the Asian crisis, has argued that there is a need for a new paradigm named 'Post-Washington Consensus' which should seek broader objectives than the WC (Gore, 2000).

The process leading to the Post-Washington Consensus (PWC) started earlier at the World Bank than in the IMF due to the renewed interest in governance and poverty issues at the institution in the early 1990s. The broader objective of the new paradigm should have been to focus 'on the living standards of people and the promotion of equitable, sustainable and democratic development' (Gore, 2000, p. 799). In this sense, due to their crucial positions in the development process, research and publications at the Bank emphasized the need to improve the performance of the state as a necessary component of market-oriented reforms and, particularly, the importance of independent regulatory institutions.

The key component of the PWC is the recognition that the state has had a significant role to play in the development process, particularly, in developing countries. The neoliberal ideal or the WC policy paradigm advocated a minimal state that the dominance of the market in the economy has implied state contraction. States and markets are considered as complementary rather than substitutes for each other in the PWC which promotes ‘liberalization of the economy and greater reliance on the market’ (Öniş and Şenses, 2005, p. 275). In other words, the PWC favors ‘to use a wider range of instruments to build markets as well as to correct market failure, and to foster competition as well as liberalization and privatization’ (Gore, 2000, p. 799). In addition to the highlighting that the state should play an activist role in a market-oriented and predominantly open environment, the PWC gives more attention to certain aspects such as the recognition of regulatory aspects, particularly in the financial system. Undercapitalized banks may tend to be take excessive risks, which could be the cause of a major crisis, therefore, ‘proper regulation of the financial system is important in terms of mobilizing capital, giving depositors more confidence in the banking system and improving allocation of investment’ (Öniş and Şenses, 2005, p. 275). Moreover the role of the states are regarded as critical in fostering the development of the market in the PWC.

The other key element differentiates the PWC from the WC is the recognition of the necessity of domestic institutions which are considered as an essential ingredient of the new paradigm in development thinking and practice. Well-structured and effective domestic institutions are considered as a part of successful development. Also, social and income distributional consequences got bigger attention for the economic policy making process on the contrary to the Washington Consensus. For example, fiscal discipline is important as much as the earlier neoliberal ideal but attention is centered on where the expenditure cuts are concentrated. Finally, on the contrary to the earlier neoliberal thinking, the PWC recognized the growing importance of an accountable and transparent state in line with democratic regimes. The PWC advocated democracy and democratic institutions which are vital for the effective implementation of the required reform process (Öniş and Şenses, 2005).

Although the PWC, by staying in line with the self-regulating market principle of classical liberal ideal, was regarded as a significant critique on the agenda of the earlier neoliberal orthodoxy or the WC, the global financial crisis in 2007-2008 have been considered by some as a game-changer in public attitudes and policy content of this classical liberal ideal or neoliberalism. In this sense, whether the 'Beijing Consensus' (BC) has its own distinct and separate model of political economy and/or development is a significant scholarly enquiry in the post-GFC. Because 'China's state-driven industrial transformation over the course of the past few decades has been quite remarkable and has undoubtedly given a predominantly benign face to the 'Beijing Consensus'' (Öniş, 2019, p. 3). This is the case, particularly, with the growing importance of the Russia-China axis along with the relative decline of the West in terms of rising and middle powers in a new developmental trajectory. China is a significant example for an alternative to the prevailing neo-liberal models of development. In addition, the rise of China has expanded the developmental space, by challenging the dominance of advanced Western countries and Western-dominated international institutions along with the dominant ideational framework, for the Global South and contributed to the broadening of global governance structures (Breslin, 2011; Öniş, 2019). Yağcı (2016, p. 30) asserts that the emerging of Chinese paradigm in international political economy accelerated the debate of the possible economic and political implications of rising China and puts:

*The "Beijing Consensus" (BC) as a concept has been utilised to make the point that China's successful economic development experience over the last three decades offers an alternative to the policy toolkit offered to developing countries by the International Monetary Fund (IMF) and the World Bank, the so called "Washington Consensus" (WC).*

There are significant differences between the (Post)-Washington Consensus and the Beijing Consensus in terms of their characteristics (Table 2). The policy packages, key goals, the structure of financial systems and, particularly, the assigned role for the states are totally different. However, as stated above, it is important to note that ‘China Model’ or ‘Beijing Consensus’ is gaining more attention from developing economies along with the countries in the European periphery (Öniş, 2019; Öniş and Kutlay, 2019). There are several reasons for this development not only for emerging economies but also and particularly for Turkey. First and foremost, changing the global environment following the global crisis provides a significant impetus for a major policy shift from the old paradigm to a newly emerging paradigm. Turkey has been more eager to follow this changing landscape taking place in the global political economy.

Secondly, deep economic crises experienced by the US and European countries such as Greece discredited the ‘old’ policy paradigm. This also allowed room for transition to a new model or policy paradigm along with disempowering external actors involved in the Turkish economic structuring in the earlier periods. Third, the emergence of a compatible domestic coalition of key actors, who are in favor of a new policy paradigm. And finally, the importance of the role of agency. Key actors who lead the ownership of the emerging policy paradigm can be vital in order to implement the new model or policy paradigm and transnational actors who popularize the new policy paradigm or provide political support for it can play a key role in translating the new paradigm into action (Öniş, 2019).

| Table 2.2: (Post)-Washington Consensus and Beijing Consensus versus Turkey's Experience | | | | | |
|---|---|---|---|---|---|
| | Washington Consensus | Post-Washington Consensus | Beijing Consensus | Turkey 2001-2009 | Turkey 2010-2017 |
| Role of the State in the Economy | Minimal | Regulatory | Market Maker | Regulatory | Neo-liberal Developmentalist |
| Financial System | De-regulation | Optimal Regulation | Strictly Controlled | Prudential Regulation | Regulatory Neo-liberalism Broadly Intact with Increasing Political Discretion in Regulatory Governance |
| Trade Policy | Free International Trade | Free International Trade | Export Promotion and Protection | Free International Trade | Free International Trade |
| Investment Policy | Liberalisation of Inward FDI | Liberalisation of Inward FDI | Regulation of Inward FDI and Technology Transfer | Liberalisation of Inward FDI | Liberalisation of Inward FDI |
| Social Policy | Very Limited | Limited Redistribution | Poverty Alleviation | Poverty Reduction via Growth of Employment | Selectively Driven |
| Pace of Reform | Fast | Regulation First | Incremental and Experimental | Regulation First | Incremental |
| Policy Implementation | One Size Fits All | Policy Recomendation | Flexibility - Chinese Characteristics | Policy Recommendation | Contradictory Experimentation |
| Key Goal | Integration to World Economy | Proper Domestic Regulation | Industri-alisation | Sound Financial Regulation with Strong Regulatory Institutions | Industrialisation |

**Source 1: Yağcı, M. (2016). A Beijing Consensus in the making: The rise of Chinese initiatives in the international political economy and implications for developing countries. *Perceptions*, 21(2), 29-57.**

**Source 2: Author's analysis.**

In sum, the strong adherence on neoliberal policy paradigm was questioned by politicians, experts and scholars in the post-GFC period in terms of different aspects. Neoliberal policy prescriptions were prepared in line with the market efficiency by Washington-based international institutions for developing countries. Accordingly, state was a constraint for a best practice of markets, so, the development of these countries depended on a minimal state perspective. However, the significant effects of the GFC on the real economy as well as the financial sector have caused a turning point to reconsider the endurance and validity of these policies. Therefore, public authorities have been called to clear the mess. Macroprudential policies in finance and the state involvement in economic development and growth policies, namely neo-developmentalism, have been the direct answers in the case of many emerging and middle power countries.

This shift from neoliberal policy paradigm for developing countries deserves to be investigated in a detailed way in order to understand actors and factors behind. Therefore, the following section sketches an analytical framework identifying the main drivers by which a policy paradigm shifts by beginning with some necessary clarifications.

### 2.4.3. The Politics of Paradigm Change

Many studies related to policy paradigms in political economy literature have been drawn on Peter Hall's (1993) seminal work. Paradigm is defined by Peter Hall as a 'system of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing' (Hall, 1993, p. 279). Accordingly, policy paradigm consists of three interrelated central levels or components: (1) 'the overarching goals that guide policy in a particular field' or 'ideas about the subject and how it should be governed (interpretative framework)', (2) 'the techniques or policy instruments used to attain those goals' or simply 'policy goals', and (3) 'the precise settings of those instruments' or simply 'policy instruments' (Kern et al., 2014; Béland and Powell, 2016). The study of Hall's (1993) on economic policy making measures the ability of ideas, or the process of 'social learning' as indicated in the study, to cause first, second and third order change. Hall (1993) regards change in policy instruments as first order change; changes in policy instruments and policy goals as second order change; and changes in all three components (policy instruments, policy goals and overarching goals that guide policy) as third order change.

While first order change is incremental, second order change is a more wholesale change despite holding the same overarching goals. However, third order change refers to a radical form of policy change. If significant changes can be identified in all three components, then a paradigm change or paradigm shift can be claimed (Kern et al., 2014). In other words, first and second order change is called 'normal policymaking' because it refers to adjustments made within the existing paradigm without challenging the interpretative framework of the old paradigm. Third order change, on the contrary, is seen as a more radical change and requires a major departure from the way that policy makers would normally think and act in the policy making process (Hall, 1993).

According to Howlett and Cashore (2009), the seminal work of Peter Hall (1993) served to break a long-term 'old' orthodoxy in studies of policy change dominated by Lindblom-inspired incrementalism. They argue that Hall's work has challenged the dominant view in the existing scholarship that tended to argue all change was incremental in nature (Béland and Powell, 2016). Incrementalism is the other edge of the spectrum in the studies of policy change, considering policy paradigm change is a significant shift from the old orthodoxy. Incremental change identifies a single type of policy dynamics - marginal increments from the status quo - that characterizes almost all instances of policy change. This perspective implies that path-departing or paradigmatic change is particularly difficult due to the fragmentation of political power and the related influence of interest groups in the relevant policy area (Béland and Powell, 2016).

Hall (1993) considers that paradigm change is an episodic rupture from the past rather than an evolutionary or gradual process. Accordingly, policy failures and economic crises as exceptional results are the initial trigger for paradigm change. According to Hall, paradigm change begins with anomalies: some events that diverge from the paradigmatic assumptions about how the world works, and repeated failures of policies predicated on this paradigm to solve the problems brought on by those events. In his famous study on policy paradigms, he (1993) highlights that some developments contradict the assumptions of Keynesianism about how economies work. These anomalies should be correct with some incremental reforms. Otherwise, the normal equilibrium was broken down and a new paradigm (monetarism or neoliberalism) would displace Keynesian economy (Skogstad and Schmidt, 2011).

As this thesis argue, on the contrary to the model viewing that paradigm change is a rupture, an alternative model considers that paradigm change is an evolutionary process: the results of cumulative reforms made in a decade or so (Sabatier, 1993) and the outcome of these reforms doesn't have to be a decisive rupture from the past (Howlett and Cashore, 2009). The term 'paradigm' used here to define such change is sometimes contested, therefore, 'ideational' change is used as a preferred substitute term for 'paradigm change' in the literature. 'On such a view, rather than focusing on how an all-encompassing system of ideas shifts radically in response to crisis, theories of paradigm development are better directed to demonstrating how and why an agreed set of loosely interrelated ideas changes slowly over time.' (Skogstad and Schmidt, 2011, p. 12). In this view, paradigm shift is a figurative expression for an ideational change rather than being a specification of a crisis-driven revolutionary movement for change.

As Skogstad and Schmidt (2011) point out, evolutionary models of paradigm change use some of the concepts of historical institutionalism in order to explain processes of change. In other words, it is basically grounded in the historical institutionalist variant with some divergences. However, the constructivist (discursive) institutionalism makes two basic criticisms to the other institutionalist variants. Before examining these criticisms and the constructivist version of 'new institutionalisms' in the literature of political science and international relations, it would be useful to explain what we mean by the term 'institutions' and then what constructivist (discursive) institutionalism is.

Instead of a narrow definition of institutions being components of a constitutional trinity of executive, legislature and judiciary, a broader definition is used that includes systems, networks and bureaucracies as well as organizations (Savigny and Marsden, 2011; Cairney, 2012). Di Maggio and Powell present institutions as a 'phenomenological process by which certain social relationships and actions are taken for granted ... conventions that take on a rule like status in social thought and action' (Di Maggio and Powell, 1991, p. 5). For Hall, institutions are 'formal rules, compliance procedures and standard operating practices that structure relationships between individuals in various units of the polity and the economy' (Hall, 1986, p. 20). According to a more recent conceptualization, institutions are described as 'formal and informal rules, regulations, norms and understandings that constrain and enable behaviour' (Morgan et al., 2010, p. 2).

Savigny and Marsden (2012) state that the definitions of institutions quoted above have the potential to make the concept of institution covering everything and excluding nothing and thereby having little meaningful explanatory potential. Therefore, Peter Hall and Rosemary Taylor (1996), in their seminal study, examined and theorized institutionalism based on their epistemological and ontological positions. Accordingly, there are three new institutionalisms: historical institutionalism, rational choice institutionalism and sociological institutionalism (Hall and Taylor, 1996). Colin Hay (2006), a decade later, added constructivist variant to the literature as the newer new institutionalisms.

Constructivism draws attention to the status of our knowledge: 'whether things are simply given and correctly perceived by our senses (empiricism) or whether the things we perceive are rather the product of our conceptualizations (constructivism)' (Kratochwill, 2008, p. 80). The second part of the above sentence suggests that the real world is a construction of a social world rather than real. However, it must be explained what that means. Blyth (2002), for example, relates it to the role of ideas as shared beliefs. In some cases, ideas or (shared) beliefs become institutionalized: they are accepted as starting points for policy (paradigm) change as this study concerns or sometimes they are taken for granted and rarely questioned. As Hay (2006, p. 65) states, the constructivist institutionalism can conclude with a path dependence, but this would be related to ideas as much as governmental structures: ‘it is not just institutions, but the very ideas on which they are predicated and which inform their design and development, that exert constraints on political autonomy’. In other words, ideas are an important factor to explain continuity as well as change in institutions and policy along with the other factors. In this respect, structures can be very stable but institutionalized ideas can not be as much as structures. Rather ideas ‘are constantly in flux, being reconsidered and redefined as actors communicate and debate with one another’ (Béland and Cox, 2010, p. 5). Therefore, change via ideational processes in policy making (policy paradigm shift in this study) can be a significant part and parcel of change in institutions and policies, especially in this new age of uncertainty that very fundamental assumptions for the governance of global as well as domestic economies are contested and challenged (Coen and Roberts, 2012).

The role of ideas and what ideas mean will be explained later in this section, however, the criticisms of constructive (discursive) institutionalism to the other variants of institutionalism in terms of ideas, inertia and change will be explained at this point. As it stated above, constructive institutionalism has two basic criticisms to the other variants of institutionalism. First, historical, rational choice and sociological institutionalism are ‘better at explaining continuity than change’. All three frameworks treat institutions primarily as constraints. Rational choice institutionalism is based on rational actors who pursue ‘their preferences following a ‘logic of calculation’ within political institutions, defined as structures of incentives’; historical institutionalism focuses the development of political institutions, ‘described as regularized patterns and routinized practices subject to a ‘logic of path-dependence’’; and sociological institutionalism focuses on social agents who behaves in a ‘’logic of appropriateness’ within political institutions, defined as socially constituted and culturally framed rules and norms’. The scholars in these three new institutionalisms explain ‘change as coming from the outside, as the result of exogenous shocks’ due to their definition of institutions, which are largely ‘given, static and constraining’ (Schmidt, 2010, p. 2). In other words, they consider that institutions are 'stable or relatively fixed, only to be changed radically before another stable institution is formed’ (Cairney, 2012, p. 84).

According to constructivist institutionalism, institutions represent ‘paradigms’ or ‘established ideas’. These ideas are defined as ‘cognitive filters’ or primary tools through which people interpret their environment in which they live. The scholars in this institutionalist variant try to understand how such ideas are ‘contested, challenged and replaced’. In this sense, they are not interested in describing the notion of radical change or punctuated equilibrium caused by external shocks. Instead, the aim is to understand and explain often gradual institutional change from within the institutions. Therefore, maintenance of dominant ideas generates institutional stability, and if those ideas are successfully challenged, then change will emerge (Blyth, 2002; Hay, 2006). In other words, the solution to explain change is ‘to identify processes of instability or more regular institutional change by exploring the role of ideas’ (Cairney, 2012, p. 84).

Second, as Olsen (2009, p. 3) points out, political institutions are described as a source of inertia and resistance in three new institutionalisms. Also institutions are seen ‘as excessively static and likely to remain on the same path unless some effort is made to divert them’ in these perspectives. In other words, the three variants of new institutionalism are ‘overly structuralist’ and do ‘not grant purposeful actors a proper role’. Therefore, they can not explain change. As Cairney (2012) put it, the solution is to explore also how actors challenge ideas and beliefs rather than focusing only on how institutions influence agents.

The role of ideas and the related discursive processes have been central in politics and institutional/policy change in the last a few decades (Goldstein and Keohane, 1993; Campbell, 1998; Béland and Cox, 2010). This literature suggests that while power relations is a central theme of the discussion, it also suggests that this is only a part of the story. When we try to explain how actors shape behavior or action, or in some cases how they exercise power, we also need to explain how those actors treat ideas or beliefs. These ideas, sometimes, can be a matter of dispute. For example, there may be a competition to establish how the world works and what policies are appropriate to solve the ongoing problems. Or, the basis for shared beliefs may change eventually as actors come to challenge them in different ways (Axelrod, 1986). The aim in the studies exploring the role of ideas in institutional/policy change is to conceptualize the relationship between power and ideas or the way how to balance a study of ideas and interests. Or it is the question of how to use the concept of ideas to explain behavior of policy actors or political actors. These are not easy tasks because the term 'idea' has multiple meanings like the term 'power'.

As Cairney (2012) argues, there are two main ways to explore these tasks. First, ideas are treated as more or less important to the overall explanation. In some discussions, the role of ideas is described as the source of explanation or, in other words, the role of ideas is the independent variable. This means that ideas have power of their own and that the power of an idea itself explains why this particular idea has been accepted. In some cases, ideas may be considered as structures which highly constrain behaviors of actors, particularly when we account for big ideas such as capitalism or socialism. In some other discussions, the role of ideas is a dependent variable, or in other words, the phenomenon to be explained. Political actors produce and promote the ideas and then those ideas considered by decision makers. In this case, the focus will be the recipient of ideas. For example, why and how do decision makers choose a particular idea from an infinite number of ideas at the expense of other ideas (Cairney, 2009).

The second way that this thesis focuses is on the role of ideas in policy development as part of the overall explanation. Ideas are used in policy development together with other concepts such as power, institutions, socio-economic factors and policy networks rather than by itself, on the contrary to the previous explanation (Cairney, 2012). To put it differently, ideas are not the sole locus of policy change as ideational analysis literature, which stresses the role of discourse and ideas in policy change, argues in this policy episode (Béland and Powell, 2016). Ideas interact with other factors such as powerful institutional forces and political actors, so they become politically influential in part. Therefore, political actors and institutions with which they interact must be examined very carefully in the study of ideational processes. High-profile actors such as elected officials and political parties are mostly 'instrumental in the propagation of policy ideas and rhetorical frames. Institutional forces create major constraints and opportunities that affect both the behavior of these actors and the diffusion of their ideas' (Béland, 2009, p. 708). Two actors in the same economic and institutional position may think differently about what their interests are, although the concrete economic and institutional position of policy actors influences the way they mobilize and see their interests (King, 1973). This is the case especially in the periods of high uncertainty that at such times existing institutional arrangements are less likely to affect the behavior of key political actors (Blyth, 2002). Throughout this period of high uncertainty, ideational processes provide a significant ground for actors to define or redefine their interests (King, 1973; Hay, 2010). As Hay (2010, p. 24) points out, 'Conceptions of self-interest provide a cognitive filter through which the actor orients herself towards her environment, providing one (of several) means by which an actor evaluates the relative merits of contending potential courses of action'. Broadly, ideas help political actors to shape their goals, identities and perceived interests.

Béland (2009) states that when we recognize ideas as not purely epiphenomenal, we should be aware that three interrelated factors can constrain the influence of ideational processes on policy change. First, particular ideas can be more politically influential when powerful actors such as dominant or major political parties decide to promote them. Second, the mobilization of major constituencies such as labor unions and business organizations against a reform proposal may jeopardize those attempts. And third, the fragmentation of political power and the existence of enduring previous policies may be a strong obstacle to reform attempts as historical institutionalism suggests.

Ideas shape how people understand social and political problems and give descriptions to their aims and strategies, and also are the material which people use to communicate about politics. When people define their values and preferences, ideas provide them with interpretive frameworks that make them see some facts are more important than others. Béland (2009) suggests that ideas influence policy change in three main ways. First, ideas have a significant role in the construction of the problems and issues entering the policy agenda. Ideas can help political actors to narrow down their policy agenda in which most pressing issues of the day can gain a priority. In other words, ideas can participate in the construction of the social, economic, and environmental problems that political actors may address.

Second, ideas can be in the form of social and economic assumptions that they either challenge or legitimize existing policies and institutions. The work on policy paradigms written by Hall (1993) illustrates the role of such assumptions in policy making. For example, neo-liberalism, in the field of economic policy, is the dominant policy paradigm in many respects that constitutes the ideological and intellectual background of contemporary policy debates and learning processes (Fourcade-Gourinchas and Babb, 2002). During the periods of high uncertainty, assumptions embedded in this policy paradigm can change over time. Actors who face the problems they have to solve can turn to alternative ideas in such a time. This ideational logic can be likely a trigger for a policy change (Blyth, 2002). Third, ideas can be a powerful ideological weapon that actors can challenge existing institutional arrangements and the patterns of distribution that they approve. These ideas form a public discourse that, through framing processes, can help to convince policymakers, interest groups, and the general population that change is necessary (Béland, 2009).

## 2.5. A Framework for Analysis: Internal and External Drivers in Policy (Paradigm) Change

The students of comparative political economy, who have taken the 'ideational turn' in the social sciences (Béland and Cox 2010; Blyth, 1997), generally focus on policy paradigms (Hall, 1993), ideas and discourses (Schmidt, 2008). This scholarship tends to consider how ideas create a path dependency in the policy making process. On the other hand, more recent literature tends to explore how ideas can create a new basis for new principles of necessary and appropriate courses of action (Schmidt, 2008; Hay, 2006; Blyth, 2002). The analysis of how ideas can create a path dependency or a policy paradigm change in national contexts is a major puzzle for this scholarship to study.

Ideational mechanism constitute a take-off point in the construction and change in political and economic orders (Hay, 1999; Capoccia and Kelemen, 2007). In times of increasing uncertainty and anxiety, ideas play a significant constitutive role when 'agents are unsure as to what their interests actually are' (Blyth, 2002, p. 9). An ideational shift occurs in two different levels: collapse of old ideas, and the construction of new ideational frameworks (Legro, 2000).

In this sense, this study utilized the collapse of old ideas as an external dynamic shaping policy change in a rising middle power country case. The global financial crisis was a critical juncture for neoliberal ideas, also known as the Washington Consensus, advocating financial liberalisation, privatization and the independence of regulatory institutions in financial realm including Central Banks, and a minimal state perspective discrediting all kinds of state intervention in policy making process (Öniş and Şenses, 2005). The neoliberal policy paradigm was put to a severe test following the collapse of giant financial institutions, sharply increasing unemployment figures and mounting household debt in the US and Europe as the main advocates of the Washington Consensus along with the IMF and the World Bank (Hodgson, 2009).

On the other hand, the construction of new ideas is utilized as an external dynamic shaping policy (paradigm) change. Following the global financial crisis, the rise of macroprudential ideas in the regulatory circles was a striking development. Macroprudential ideas have become a fundamental regulatory approach in financial governance all over the world in a relatively short period of time. With the macroprudential shift, central banks and regulatory institutions around the world expanded their implementation of precautionary measures to provide financial stability against the systemic financial risks (Baker, 2013). Neo-developmentalist ideas, also, created a new framework for state activism in the capitalist development method, especially in the post-GFC period. Although this industrial policy formulation was not new, the 2008 crisis made a critical juncture for emerging market economies.

Along with the collapsing of old ideas and the construction of new ideas in the governance of finance and industrial policy in the post-GFC period, the more striking phenomena was the growing influence of the non-Western powers as the primary driver in the construction of new ideas. The alternative paradigm, primarily driven by the non-Western powers, has a different approach related to the governance of economy compared to the neoliberal paradigm. These non-Western great powers embrace a strategic model of capitalism - that is, 'state capitalism' or 'state-permeated capitalism' which prescribes state intervention as a permanent feature of the organisation of national economies (Bremmer, 2010). Hence, this model diverges from the central prescription of neoliberal ideas. The literature of comparative political economy suggests that the strategic model of capitalism has distinct variety in key domestic institutional spheres: (1) government-led industrial and innovation policies, (2) strategic utilisation of financial statecraft and political control over regulatory institutions, and (3) state-permeated corporate control (Nölke et al., 2014; McNally, 2012).

Ideational approach is also utilized in this study to analyze how political actors shape their goals, identities and perceived interests. Ideational analysis aims to 'explain actions as a result of people interpreting their world through certain ideational elements' (Parsons, 2007, p. 96). In other words, the growing literature on ideational analysis 'stresses the role of discourse and ideas in policy change, which focuses on how the beliefs of political actors shape their decisions and the reforms they enact' (Béland and Powell, 2016, p. 133). In this sense, this study put the ideational mechanism into the analysis in order to understand how political elites as internal drivers influence policy change. As this study shows, ideas and beliefs of political actors have an unignorable influence on policy development in a rising middle power country.

## 2.6. A Supplementary Framework for Analysis: The Literature Review on Policy Transfer

As it is detailed in the above sections, ideational change in the governance of finance along with the approach of industrial policy making has been a lively debate over the last years, in particular, in the post-GFC period. In this sense, this thesis draws on political science and international relations literatures along with the literature on international political economy in order to explain the transformative political economic change by utilizing historical institutionalist approach with some divergences as constructivist (discursive) institutionalist approach highlights. Nevertheless, this thesis, also, draws on policy transfer literature in order to understand how key domestic actors and institutions react to external ideational change in the spheres of financial governance and industrial policy.

Policy transfer term is used to describe the transfer of policy solutions or ideas. Policy transfer literature refers to three different policy transfer processes: direct coercive transfer; negotiated transfer; and voluntary transfer. The first and second processes of policy transfer involve varying degrees of coercion. If a government is forced to introduce a policy change against its will by another government, this is the direct coercive policy transfer. This was a common policy transfer process in the times of formal imperialism. Negotiated policy transfer, however, refers to a process in which governments have to introduce a policy change in order to secure grants or loans given by international financial institutions or international organizations. Most developing countries during the 1980s and 1990s had structural adjustment programs with the IMF and the World Bank in return for loan and investment. This is a form of negotiated policy transfer to developing countries. Lastly, voluntary transfer is a rational, action oriented approach to dealing with public policy problems emerging from different reasons such as dissatisfaction with the existing policy in terms of its poor performance, a new policy agenda emerging with change in the management or an attempt of a political actor to upgrade items of the policy agenda to neutralize political enemies or promote political allies (Evans, 2017; Cairney, 2012).

Lesson-drawing, policy diffusion and policy convergence terms are also used for policy transfer. Learning from other countries as well as from the past is described as lesson drawing in the policy transfer literature. The spread of policy solutions among the US states is identified as policy diffusion. Policy convergence refers to evidence for similarities. The important point in the policy transfer literature is the question of what causes this convergence and who pursues such similarities (Cairney, 2012; Bennett, 1991). In other words, the actors involved in the process and the reasons for policy transfer are important. Focusing on policy transfer helps us to understand why policy changes and the extent to which this policy change is common throughout the world. As Dolowitz and Marsh (2002) states, the literature on policy transfer primarily focused on voluntary transfer between developed countries as a process of policy development. Accordingly, the political actors who transfer policies are rational actors and they examine the policies before transfer for their potential utilization in their own political systems. Until recently, however, policy transfer from developed countries to developing countries, and from developing countries to developed and developing countries has been largely ignored in the literature (Evans, 2017).

There are mainly two discernible schools that policy transfer literature can be organized into. One uses the ‘policy transfer’ term directly, while the other doesn’t. And these approaches can be classified into three: diffusion studies, process-centered approaches, and ideational approaches. Although they have some inevitable overlap among themselves, they each have different areas of focus. While policy diffusion studies investigate why some states adopt certain policies or innovate and others do not, process-centered approaches include policy learning and lesson-drawing. According to the ones following this approach, organizational learning is very significant and interpersonal interaction between agents of transfer play a key role for organizational learning. On the other hand, ideational approaches consider that policy makers are influenced by systems of ideas. This influence has a key role on how policy makers learn how to learn (Evans, 2017).

It is worth noting that the actors who transfer policy are merely the regular and most powerful actors within the domestic policy making process. These are politicians and bureaucrats/civil servants. And the countries which transfer policy, importing countries, prefer different programmes from different countries at different times. If importing and exporting countries share a similar policy condition, geography and ideology, this would influence countries in their transfer process. Ideology can be a very significant indicator. When exporting and importing countries have a similar vision, this would play a solid base for policy transfer. For example, the UK was very keen on neoliberal ideas of the US during the Thatcher and the Reagan administrations (Dolowitz and Marsh, 1996).

In sum, there are three main processes for policy transfer, namely direct coercive transfer; negotiated transfer; and voluntary transfer. Policy transfer can not be taken for granted because policies that are transferred will be adopted in the existing domestic institutional environment, which could have some flexibilities as well as some rigidities for new policies. The domestic institutional setting will be one of the key factors in shaping the future of the policies that are transferred. Whether the goals of the transfer initiative are achieved or not will be dependent on this domestic setting and local conditions. In addition to this, there are two other main questions for policy transfer. The actors and the reasons for policy transfer. Why do countries need policy transfer and who transfers these policies (Evans, 2017; Cairney, 2012).

## 2.7. Conclusion

This thesis argues that Turkey, as an emerging middle power country, has shown a variegated agency as a reaction to changing landscape of international political economic order in the realms of the governance of finance and the real economy. In terms of the change in financial governance, macroprudential ideas embrace a quite different conception of market relations and behavior that it asserts on the contrary to the efficient market theories. Accordingly, the role of public authorities is redefined and their power is increased in order to intervene and set limits to activities in the financial system. As it is stated above, the EMH argued that public authorities should adopt a hands-off regulatory style for the best practice of financial markets. On the other hand, the emergence of neo-developmentalist turn in the international political economy has been one of the key elements regarding the role of the state in economic policy making. With the neo-developmentalist turn, a new form of state activism has been the main characteristic of the national capitalist development method.

In the state of ideational shift in these two main policy areas in the post-GFC, Turkey has adopted macroprudential policies as well as neo-developmentalist policies. While Turkey is transferring policies in these two areas, it has shown a variegated agency. Internal and external drivers both have different amounts of influence in shaping policies. In terms of financial governance, the macroprudential ideational shift in international level has a particular influence on Turkey to adopt new policies in banking and finance in line with the new policy framework of Basel consensus. However, domestic actors and institutions such as the Central Bank and its governor, and a politician, who was a deputy prime minister in charge of economy back then, have significant influence in adopting this new policy framework in a more direct way. What is interesting here is that there was a strong opposition to this new policy framework coming from the prime minister and a minister, who was in charge of the economy, back then. These high level politicians, in a way, supported continuity rather than adopting this new macroprudential shift which inherently cools down the economy against likely financial instability.

On the other hand, Turkey has transferred the neo-developmental policy framework emerged as an alternative policy framework to the Washington Consensus policy paradigm orthodoxy. The financial crisis in 2008 put a break on the ascendance of neoliberal globalization as the dominant policy paradigm over the last three decades. Turkey was influenced by the increased prominence of neo-developmentalist ideas that fashioned, in particular, in the aftermath of the GFC. In this sense, experimental policies along with some organizational changes have been carried out as a reaction to this alternative developmental paradigm. Nevertheless, new discourse utilized by politicians and policy makers has also influenced this newly emerged ideational shift at the domestic level. In overall, Turkey's case presents a variegated agency, which is an agency understanding as a factor contributing both to continuity and change in the politics of policy paradigm change.

Chapter 4 covers the reaction of Turkey to macroprudential turn in the post-2010 period with the focus on internal and external drivers. How this ideational shift was embraced at the domestic level and what policies were implemented with their reasons. Then, it is investigated how neo-developmentalist turn emerged in Turkey with the focus on internal and external drivers (Chapter 6).

# Chapter 3

# The Politics of Financial Sector Developments in Turkey in the 2000s

## 3.1. Introduction

The integration of the Turkish economy into the international economic and financial system started with the 24th January Decisions in 1980. Therefore, this chapter deals with the economic and political developments taken place from the beginning of 1980 to the global financial crisis in the late 2000s with a focus on the Turkish financial sector.

As this chapter highlights, internal and external factors played a crucial role in the transformation of the financial sector in Turkey. Despite the significant importance of 24th January Decisions on the financial sector, the critical turning point for the Turkish financial system was the full capital account liberalization and currency convertibility decision in 1989. This change, however, caused several crises due to the lack of proper infrastructure in domestic economic and political institutions. Eventually, Turkey experienced a catastrophic crisis in 2001, which paved the way for a substantial transformation in the financial sector. The main reason for the crisis was described as the lack of proper regulation in the financial sector, particularly in the banking sector, along with serious instability in the political system over the 1990s. Therefore, the reform efforts have been restructured in line with the Post-Washington Consensus template with an emphasis on the regulatory aspect in the post-2001 crisis era with the direct impetus of international financial institutions such as the IMF and the World Bank along with the European Union.

In the next part, I will present the restructuring of the Turkish financial sector in line with the neoliberal policy paradigm following the 24th January Decisions in 1980. This part is presented under three sub-sections and gives a detailed story of the financial sector until the devastating 2001 crisis with a focus on the Turkish banking sector. The second part focuses on the developments in the aftermath of the 2001 crisis. The first sub-section in the second part presents the emergence of the regulatory state in Turkey in line with the Post-Washington Consensus with the direct impetus of the international financial institutions such as the IMF and the World Bank along with the key internal actors. The second sub-section focuses on the transformations in the Turkish financial sector in the post-2001 crisis period. This sector has a substantial importance that the main tenets of regulatory neoliberalism are implemented in this realm in the Turkish case.

### 3.2. Neoliberal Restructuring in the Pre-2001 Crisis Period in Turkey

The efforts in order to reverse the globalization of finance in the 1970s and the early 1980s were followed by a dramatic liberalization trend as advanced states started to abandon capital controls. The trend of liberalization began with the decision of Britain in 1979 after forty years of the restrictive Bretton Woods financial order. Thereafter, many countries decided to embrace more liberal domestic and international financial policies (Helleiner, 1994). The integration of developing countries to this globalization process has been achieved with the liberalization of their financial systems. Turkey was no exception in this trend. In fact, it was one of the earliest countries which transformed its system to liberal financial policies. Following the major crisis in the late 1970s, Turkish authorities decided to liberalize the financial system. These efforts had a significant role in increasing economic growth rates in most of the 1980s. However, this early success was overshadowed by the occurrence of severe financial crises in 1994, 1999, and 2001. In particular, the 2001 crisis was so devastating that more than one out of three of Turkey's GDP evaporated due to the crisis.

Turkey's neoliberal policy paradigm experience can be divided into two main periods. Namely, 1980-2001 and post-2001 periods. The first period was dominated by the principles of the Washington Consensus, which is mainly characterized by a liberalization of the economy. In other words, this is the integration process of domestic economies to the world commodity and financial markets. Trade liberalization and export promotion along with a financial market reform aimed at reducing the role of the state in economic affairs marked the 1980-1988 period.

Flexible crawling-peg regime was adopted by replacing the existing fixed exchange rate regime. The other major development in the first period of the neoliberalization story of Turkey is the capital account liberalization in 1989. It was considered as one of the most important policy initiatives Turkey undertook to sustain the culminating huge amounts of fiscal deficits and macroeconomic imbalances in the late 1980s. However, this development accelerated the injection of liquidity into the domestic economy. These capital flows were in the form of short-term foreign capital that caused erratic movements in the current account balance and ever-increasing vulnerability to external shocks of the Turkish economy. Eventually, these hot money flows resulted with the crises in 1994, 1999 and finally 2001. The second decade of the first period of neoliberal policy paradigm reflects the negative side of the Washington Consensus and it is referred to as ‘the lost decade’ (Taymaz and Voyvoda, 2012).

The post-2001 period in the neoliberalism story of Turkey is referred to as the 'Post-Washington Consensus’ period in which its principles guided the Turkish economic restructuring process following the devastating 2001 crisis. Accordingly, the creation of new independent and supporting regulatory institutions along with the concerns of social consequences of market-oriented reforms, contrary to the earlier neoliberalization period, has been the main emphasis of the reform template. Good governance through supporting regulatory institutions (particularly, in banking and financial sectors) along with the competition regulations and consumer protection in order to achieve sustainable economic growth is regarded as the main characteristic of the PWC. In accordance with the economic reforms taken place in Turkey following the 2001 crisis, the Central Bank was granted its independence and inflation targeting monetary policy was assigned to the Central Bank in order to maintain price stability. Fiscal policy was shaped in accordance with the ‘primary surplus target’ in order to decrease the risks of the country that huge fiscal deficits had been the main issue in the earlier period. Thereby, the credibility of the Turkish economy was intended to increase as a requirement for foreign investors (Taymaz and Voyvoda, 2012; Bakir and Öniş, 2010).

As stated above, neoliberal restructuring of the Turkish economy in the post-1980 era can be divided in two main periods. First period is referred to as the Washington Consensus period, while the second one is referred to as the Post-Washington Consensus. The section below examines these two periods. First, the developments taken place between 1980-2001 were detailed and, then the period following the 2001 crisis was narrated in order to exhibit the Turkish economy's main structure in the leading up to the global financial crisis in 2008.

### 3.2.1. The Integration of the Turkish Economy to Neoliberal Paradigm Between 1980-2001

The liberalization trend in international finance started in the late 1970s and in the beginning of the early 1980s. Country and country decided to embrace more liberal domestic and international financial policies. In this sense, the inclusion of developing countries into this evolving international financial system has been achieved by a series of policies aimed at their financial sectors liberalization. The motivation behind the liberalization process was to provide long term growth and stability by improving economic efficiency and raising domestic savings rate. However, these policies have generated speculative short term capital flows to domestic economies. Hot money flows to developing economies increased financial instability and resulted in serious financial crises in these countries. Moreover, domestic savings are directed to speculative financial instruments instead of fixed capital investments, contrary to the expectations. These speculative instruments mostly had erratic and volatile yields (Boratav and Yeldan, 2006).

Turkey, without exception, has been on the same path with many developing economies in the neoliberal policy paradigm. Following the 24th January decisions Turkish economy was transformed from an inward-looking to outward-looking system. Liberal economic policies embraced the reform process, in which the international financial institutions such as the IMF and the World Bank actively participated during the first years in the process. Even, these institutions tributed to the early years of reforms due to their achievements. Rapid liberalization process provided economic growth, in particular between 1982 and 1989. Later on, capital account liberalization was a significant step in terms of the destiny of the following years. Early decisions produced hot money flows to the country but weak institutional structure of the Turkish economy caused several economic and financial crises during the neoliberal restructuring period between 1989 and 2001.

#### 3.2.1.1. Early Years of Neoliberal Paradigm in Turkey: 1980-1989

The integration of the Turkish economy to neoliberal paradigm can be described in three main phases. The first one, the ‘de-regulation phase’, started in January 1980 with the 24th January Decisions. In the late 1970s, Turkey experienced severe currency and debt crises driven by the import-substituting industrialization (ISI) paradigm. The main prescription of ISI was to produce consumer goods for sale in the domestic market, by importing capital goods from abroad. This was made possible by a significant amount of state planning. Accordingly, the state calculated investment decisions in compliance with the industry needs on a nation-wide scale, provided cheap inputs and incentives for growing areas of industry, and also implemented import tariffs in favor of productions locally produced. However, this paradigm had a serious internal contradiction that the market was dependent on a large amount of foreign exchange in order to produce capital goods. This dependency made the economy dependent on foreign aid and a huge amount of debt. The internal contradiction of ISI, together with the oil shock in the world in the late 1970s and rapidly increasing fiscal deficit, became important reasons for the coming crisis (Sönmez, 2011).

In the period of ISI paradigm from 1960 to 1980, economic policy-making was often irrational, inconsistent and unstable. Thus, the performance of the Turkish economy deteriorated after 1976 and this period ended with a major crisis in 1979. It was an economic crisis but it had significant political and social consequences. As a result, the government announced a stabilization and economic liberalization program in January 1980. This program was heavily supported by the IMF and the World Bank along with the OECD, however, their influence diminished following the recovery process in the Turkish economy in the late years of the decade. It is worth noting that these international institutions refused Turkey's demand on rescheduling debt repayments unless Turkey shifted its orientation from an inward-looking to an outward-oriented liberal economic system and less state intervention in the market. On the other hand, there was a strong executive and firm commitment to the reform process involving an attempt to reduce the role of the state in economic affairs domestically. The program's objective was to adopt a free market economy in order to restore growth in the long term by improving economic and financial efficiency, attracting foreign capital and increasing domestic savings along with the short-term aims such as reducing the high rate of inflation and eliminating the balance-of-payments problems through rapid export-growth. The liberalization decisions taken on the 24th January were totally different from the earlier adjustment periods because the government aimed for a permanent transformation of the Turkish economy and also the nature of state-economy relations. This program was implemented in two steps. In the first step (1980-1984), the trade regime was liberalized and interest rate controls were ended. With the second step (1985-1989), new bank entries into the Turkish banking system were facilitated and the domestic economy was opened to foreign capital flows (Ari, 2018; Sönmez, 2011; Arıcanlı and Rodrik, 1990).

The Turkish financial markets have been hugely opened up and liberalized following the 24th January Decisions. Reforms were implemented in line with the stabilization and economic liberalization program of the IMF and the World Bank. These reforms had two key elements: first, the policy of controlled interest rates was abolished and directed credit programs were significantly reduced; second, entry barriers to the banking sector were relaxed in order to promote competition and increase efficiency. Also, some measures were implemented in order to develop equity and bond markets. In 1984, banks were allowed to open foreign currency accounts for Turkish residents, thereby increasing product variety and services. This process resulted with the capital account opennes to foreign flows in 1989 and this decision facilitated international trade in financial services along with goods (Denizer, 1999).

The early 1980s was considered as the heyday of the 'Washington Consensus'. With the result of the major crisis in 1979, Turkey had been one of the first countries embracing liberalization trend in the developing world. The transformation process during the 1980s, the first phase of the first period in the neoliberal restructuring story of Turkey, was deeply dependent on Turgut Özal, who was a technocrat when the 24th January Decisions were announced and then prime minister between 1983-1987, and finally the president from 1987 to his death in the 1991. He played a key leadership role first as a technocrat and then a key political figure during the 1980s' reform process. Even the IMF and the World Bank tributed to the success of the first years of the reform process. However, the political instability emerged in the late 1980s, along with the early and premature capital account liberalization decision and the death of Turgut Özal produced a rather unfavourable story on the contrary to the earlier expectations (Alper and Öniş, 2004).

#### 3.2.1.2. The 'Lost Decade' in the Turkish Economy: 1990-2001

The first phase of the first period took place in 1980-1989 in neoliberal paradigm in Turkey was, on the whole, more successful than the second phase which took place during the 1990s. The second phase could be classified as the 'rhetorical transition and institutional crisis' phase. Regulatory institutions were set up during the second phase that this refers to 'rhetorical transition'. However, there was a significant shortage that those regulatory institutions as legal entities were not effective implementers. Therefore, the Turkish state encountered an 'institutional crisis' in 2001, which means that the opening up of the Turkish economy was not supported with an effective regulatory endeavor with the capacity of state's institutions (Öniş and Bakır, 2007). The economic problems along with the political instability caused three major crises in 1994, 1999 and finally 2001. Therefore, these ten years are called the 'lost decade' in Turkish economic history.

The critical turning point of neoliberal paradigm in the second phase in the Turkish economy was the decision of capital account liberalization in August 1989. The forces of financial globalization were completely experienced in the economy after the decision of moving to full convertibility of the Turkish lira. However, it was obvious in the context of the 1990s that the Turkish economy didn't have sufficient means to deal with the forces of financial globalization for two main reasons. First, the macro-economy was chronically unstable; the combination of large fiscal deficits and chronically high rates of inflation was the basic characteristic of the Turkish economy. Second, the financial system was not properly regulated and the decision to liberalize the capital account fully was an early and premature decision (Öniş and Şenses, 2009).

The timing of capital account liberalization was interpreted as problematic considering the predicted risks and drastic ramifications. It was argued that the decision of full convertibility of the Turkish lira was an early and premature decision given the macroeconomic and political circumstances of the country (Cizre-Sakallioglu and Yeldan, 2000). However, there was a certain political logic behind it. The ruling Motherland Party (MP), under the leadership of Turgut Özal, lost its popularity significantly in the municipal elections in March 1989 after outpointly winning two general elections in 1983 and 1987. The ruling party wanted to regain its decreasing popularity. Therefore, the reason for the early capital account liberalization decision can be explained within the following terms. It was expected that the process of economic growth accelerated, an improvement of unemployment rates and solid decline in inflation. In the short run, capital account liberalization helped to attract a significant amount of foreign capital flows which financed an internal consumer boom though higher imports. Besides, these large amounts of hot money flows financed a domestic investment boom. In addition, there was another possible economic logic behind the early capital account liberalization decision. In 1986, the government deficit started to expand and this deficit financed domestic borrowing at the expense of the crowding-out effect on private investment. There was another important development relevant in this context. Financial autonomies of state-owned enterprises (SOEs) and local administrations started to increase. The SOEs and local administrations didn't get automatic government transfers, thereby these transfers weren't monetized. In this context, these institutions had to borrow from domestic markets. Thus, domestic interest rates increased and private investment was excluded. These reasons produced a need for additional funds to increase the pace of private investment. As a consequence of this, capital account liberalization created an obvious avenue in order to achieve this target (Alper and Öniş, 2003; Ersel, 1996).

Fiscal expansionism, which is described as a populist cycle, is utilized to create political support. The electoral logic behind it is to raise current expenditures, which have a positive influence on the voters behavior. The populist cycles were used in Turkey several times that the first two happened in the late 1950s and the late 1970s. These two occurred in an environment where fixed exchange rate policy and capital account controls were in the policy measures. Thus, short term capital flows to the economy had a marginal influence and the dominant element of the balance of payments was the current account. However, the third populist cycle that happened during the 1987-1993 period was experienced in a totally different environment in terms of the structure of the Turkish economy. The third wave of fiscal expansionism occurred in an environment of controlled flexibility of exchange rates and capital account openness. Hot money flows in this period helped to accelerate the populist cycle. Therefore, fiscal expansionist policies became more and more dependent on short term capital flows, which contributed to a pattern of highly fragile and unstable conditions in the economy. In the end of this vicious circle, the inevitable 1994 crisis happened. During this period, Turkish policy makers operated within the assumption of a closed economy model and they tended to overlook the disequilibrium created by short term capital flows to the economy (Özatay, 1996).

It could be said that in the environment of capital account openness and controlled flexility of exchange rates, two main reasons triggered the crisis of 1994. In the high inflation setting, the government tried to control the interest rates as well as the level of exchange rates. Also, it attempted to control the lowering credit rating of the country. In a closed economy, these two main reasons would have a marginal influence on the overall economy, however, capital account openness contributed to growing problems. The Central bank reserves declined in a steady manner that led to the Turkish lira left unprotected to speculative attacks. As a result, a large devaluation was required and the IMF was called to help the Turkish economy once again (Alper and Öniş, 2003).

The IMF along with the UE was temporarily involved following the crisis of 1994, which was the first crisis in the neoliberal period in Turkey (Öniş and Bakır, 2007). The program prescribed by the IMF, introduced in 1994, was in the same line with the standard features of the institution's fund programs. Expenditure switching and expenditure reduction were the main columns of the program. As a result of these policies, significant contraction in output and unemployment was experienced with a negative GDP growth rate. However, the Turkish economy managed to overcome the negative influence of the crisis in the short period of time with the improvement of the current account balance. Short-term capital flows to the country increased by the beginning of 1995, thereby, output growth rate recovered. During this period, the government also implemented two important measures to fix the problems: those measures provided a rapid recovery in the short time. But, these measures caused dramatic consequences for the economy in the longer term. First, the government followed a monetary policy that domestic interest rates were kept high in order to encourage short term hot money flows to the country and discourage outflows. This policy resulted with a huge domestic debt burden, which would be one of the main reasons for the crises in 1999 and 2001. Second, the government implemented a measure for the deposits in the banking sector for banks to breathe in the post-crisis period. Accordingly, deposits were fully insured against any risks emerging in the sector. This measure created a moral hazard problem in the banking sector, which would be one of the other main reasons for the crises in 1999 and 2001 (Öniş and Bakır, 2007; Alper and Öniş, 2003).

As stated above, the measures implemented following the crisis of 1994 provided a rapid recovery for the Turkish economy. In this context, capital flows to the country started to increase again. In the first years of the second half of the 1990s, Turkey benefited from sustained hot money flows due to its relatively sound financial system along with the global conditions. Until the Asian financial crisis of 1997, Turkey benefited capital flows as other emerging market economies. However, fiscal disequilibrium continued to be a fundamental source of instability with a modified term comparing the earlier years. The overall government deficit reached record levels by the end of the 1990s. This caused a major interest burden on the public debt that the official figures substantially underestimate the size of debt burden (Akcay et al., 2001).

The Turkish political environment in the 1980s displayed a number of deficits and they were not unique to this period. There was a system of party politics, which was based on the distribution of patronage resources and clientelism. The main characteristic feature of the key political institutions in the political realm such as political parties and parliament could be characterized by low levels of accountability and lack of transparency (Kalaycıoğlu, 2001). As the legacy of the Özal era, who was the prime minister between 1983 and 1989, and then the president until the 1993, governments utilized extrabudgetary means in order to finance their growing overexpenditures. Fiscal disequilibrium in Turkey seriously increased with two ability of the governments, namely, the ability to disguise the genuine size of the public expenditures and the scale of the rent distribution. Two key deficits of Turkey's political system can be recognized here: they were the low levels of accountability and lack of transparency. During the 1990s, this character of the country became more problematical that fragmentation and politicization of the political system was magnified. Moreover, successive weak coalition governments accelerated the fragmentation and the problems increased. The myopic electoral concerns were the priority of these weak coalition governments. Due to these reasons, the importance of fiscal discipline was overlooked that this, in turn, severely increased the debt burden on the country (Alper and Öniş, 2003; Kalaycıoğlu, 2001).

There was another important development in the 1990s that was the reactivation of the Customs Union (CU) agreement with the EU which was put into practice at the beginning of 1996. Turkish policy makers presumed that this development was a step toward membership of the EU in the long run; but there was no concrete political support for Turkish membership in the EU circles. However, the agreement induced the acceleration and completion of the trade liberalization process which had already started in the 1980s. Therefore, Turkish firms have been exposed to external competition which resulted in a transformative impact on the economy. A number of sectors, which were previously inward-oriented sectors, emerged as significant export industries such as the automative sector. In addition, an important regulatory institution such as the Competition Authority (CA) was established to meet the basic conditions related to the CU agreement. Turkey didn't get any financial assistance, which was a part of the CU agreement, due to the Greek veto. In terms of the Turkish policy makers, there wasn't enough commitment for reforms because the incentives provided by the EU were not sufficient. On the other hand, in terms of the EU, Turkey didn't have enough commitment for reforms that would satisfy the basic conditions for full membership. In short, the agreement had significant influence on the Turkish economy, however, the CU didn't play a sufficient transformative role anticipated in the beginning because there wasn't a prospect for full EU membership (Hoekman and Togan, 2005).

By the end of the 1990s, the Turkish economy had clearly an unstable character. Turkey had experienced major crises until the capital account liberalization decision in 1989. However, crises became more frequent in the era of financial globalization that had a huge deteriorating influence on output, employment and income distribution. The performance of the Turkish economy became heavily dependent on short-term capital flows, which were highly volatile, with costly ramifications due to the capital account liberalization decision in the midst of high level domestic political and economic instability. Although the Turkish economy managed to grow at high rates in certain years during the decade, the average growth rate was low and poor due to the crises. On the other hand, given its domestic weaknesses, the Turkish economy has failed to capitalize on the increasing degree of foreign direct investment that flowed toward emerging market economies during this period, in particular, until the Asian financial crisis of 1997-1998. The 1990s also indicated that the performance of the economy was under the significant influence of the interplay of politics and economics. On the contrary to the 1980s, the political system in Turkey during the 1990s has been dominated by successive weak coalition governments which lacked the political will, capacity to impose fiscal discipline and to create a positive environment for sustainable growth. The political parties in this decade were leader-dominated parties that their primary objective was to distribute patronage resources to their clients rather than to develop coherent and social economic policies. The pattern of growth with ups and downs experienced during the decade created a strong rentier class who were dependent on lending to the government at high interest rates. Besides, there was a striking development in the Turkish economy that the profitability of large industrial establishments became majorly dependent on financial revenues rather than their industrial activities. These deficits produced a significant spill-over effect on the economy that resulted in an economic structure described by 'pervasive rent-seeking and corruption' (Öniş and Şenses, 2009; Öniş and Bakır, 2007; Cizre and Yeldan, 2005).

By the end of the decade, the poor structure of the economy described basically with high interest rates and chronic fiscal deficits in line with the developments stated above increased the awareness of both domestic and external economic actors on the state of the economy. This led to a signing of a stand-by agreement with the IMF in December 1999. Accordingly, fiscal adjustment and medium-term structural reforms were at the center of the program. Although there was political and economic instability along with the two devastating earthquakes experienced in August and December in the industrial cities, the agreement was unique in the history of modern Turkey that there was not a financial or balance of payments crisis in sight. However, an ironic development happened following the agreement that the program prescribed by the IMF didn't prevent another major economic crisis. Two reasons clearly played the major role. First, Turkey didn't get sufficient financial assistance by the IMF, given the depth of adjustment involved in the program. Second, the weak coalition government had not enough commitment to implement the key components of the program, namely privatization and the regulation of the banking system. Therefore, Turkey experienced the biggest economic crisis in its history referred to as the 'twin crises' (currency/banking) in November 2000 and February 2001 (Öniş and Şenses, 2009).

At this point, it would be useful to give the developments in the Turkish banking sector in the 1990s. Because the banking sector is the biggest sector in the financial system in Turkey and also, it is the main reason for the 2001 crisis, which is the most devastating crisis in the history of Turkey.

### 3.2.1.3. Developments in the Turkish Banking Sector in the 1990s

Until the 1980s, the financial system in Turkey had no securities markets. It consisted mainly of commercial banks with a predominance of public banks. Entries of the banking system were limited and the banks in the system were operating with controlled interest rates, high reserve requirements rates and limited range of products. Also, banks were allocating nearly three-quarters of loanable funds as directed credit. These restrictions along with the protectionist policies of the government during the 1980s in line with the ISI paradigm prevented the formation of a competitive banking sector (Akın et al., 2009).

In the 1980s, banking deregulations were implemented in order to allow market forces to more efficiently organize the evolution of financial systems. Besides, capital account openness was adopted in order to allow savings to flow from low to high return countries. Due to these policies implemented not only in advanced countries but also in developing countries, it was expected that worldwide growth would be fostered and low-income countries would have higher income ratios. In 1988, prudential regulations were introduced in order to control risk taking behavior of banks in line with the Basel Capital Accord (Basel-I) in place of classical banking regulatory framework on banks' activities, assets, interest rates and the like. According to the Accord, banks were required to hold equity of at least 8 percent of their risk-weighted assets. The intention behind these regulations was to increase banks' stake in the business. This would make banks internalize risks. However, serious banking sector weaknesses along with the huge amounts of short-term hot money inflows to emerging economies in the 1990s caused several crises in many emerging countries as well as in Turkey (Akın et al., 2009).

In the 1980s, several financial liberalization measures were introduced in the banking sector, which is the biggest sector in the financial sector in Turkey. In order to enhance efficiency and competition in the sector, entry barriers were relaxed, most of the directed credit requirements were removed, and deposit and loan rate controls were abandoned. However, the crisis, called bankers' crisis, experienced in 1981-1982 revealed the necessity of a new regulatory framework for the banking sector. The World Bank and the IMF were actively involved during this process. Accordingly, the Saving Deposit Insurance Fund (SDIF) was established in 1983. A new banking law (Banks Act No. 3182) was passed in 1985 in order to provide legal and institutional foundations of prudential regulations. According to this law, banks had to submit standardized accounting reports, participate in the SDIF and allocate provisions for non-performing loans. The law also entrusted the responsibility of supervising and regulating banks to the Treasury of the Turkish Republic. However, it had two important shortcomings. First, regulatory institutions were not independent and this caused pressures coming from politicians and influential banking lobbies. Because of such pressures, regulators adopted a stance of inaction (regulatory forbearance) that produced nonintervention issues to ailing banks in a timely manner. Second, the Treasury has been assigned as the regulatory institution in the banking sector causing an internal contradictory situation. Its primary objective, budgetary financing, was often conflicted with the responsibility of ensuring banks' soundness. Banks were holding large amounts of government securities for budgetary financing, therefore, unacceptable credit, interest rate and exchange rate risks of banks tended to be overlooked by the Treasury. Likewise, the Treasury was likely to refrain from injecting that amount when a bank was in need of urgent liquidity that could have damaged the equilibrium on the budget (Alper and Öniş, 2004). In addition, the Foreign Exchange and Banknotes Market was established by the Central Bank in 1988. In 1985, the government securities market was established and the inter-bank money market was operationalized in 1986. Also, open market operations were started by the CBRT in 1987.

Growing expenditures of the public sector in the 1990s caused high public sector borrowing rates, inflation and interest rates. Therefore, banks played a vital role. Instead of doing their financial intermediation role, they financed the growing budget deficits by holding a significant amount of government securities in their portfolios. In return, the governments granted many new licenses to politically connected groups in order to reduce these banks' borrowing costs. This led to an inefficient banking system. On the other hand, high public sector borrowing requirements and the resulting high interest rates produced huge amounts of foreign capital inflows via international interbank lending. Private banks procured a significant amount of government securities with the syndicated loans. However, some of these banks assumed a very high level of exchange rate risk that was disregarded by the Treasury in line with the political environment during these years. The government tried to suppress interest rates while trying to maintain a controlled exchange rate regime (impossible trinity), therefore, capital outflow broke out in 1994. After all, devaluation of the Turkish lira started; several banks with high open positions fell insolvent and were taken by the SDIF. As a result of these developments, the government announced a new policy that gave a 100 percent insurance scheme for all deposits in the banking system. This was one of the main reasons of the 2001 crisis that this policy caused a high moral hazard problem in the banking sector (Akın et al., 2009; Uluceviz and Yıldıran, 2009).

In the aftermath of the crisis in 1994, Turkey signed a stabilization program with the IMF. Accordingly, state economic enterprises and extra budgetary funds were constrained in order to consolidate fiscal discipline and reduce government deficits. However, successive governments chose to continue to implement their rent-distributing policies. Therefore, the measures adopted following the crisis became ineffective. Two public banks, Halkbank and Ziraat Bankası, were employed to extend subsidized credits to small and medium sized enterprises (SMEs) and agricultural producers. The duty losses of these two public banks due to these credits reached almost USD 20 billion. The Treasury didn't back these directed lending practices because of budgetary concerns. Therefore, they were obliged to raise funds from the market detrimental to the whole banking sector. This has resulted in very high interest rates on deposits and interbank borrowing (Alper and Öniş, 2004). Also, the number of private banks increased during these years for basically two reasons. First, the private sector was experiencing difficulties to access funds due to high public borrowing requirements rates. Second, deficit financing was a profitable business for the private sector. These two reasons gave motivation to large industrial conglomerates to establish their own banks not only for deficit financing but also for funding their own industries (Akçay, 2003). There was not sufficient regulation in order to check connected lending practices that caused more deterioration in the banking sector and fiscal balance. Therefore, Turkey signed a stand-by agreement with the IMF in order to prevent an economic collapse.

In line with the neoliberal policy paradigm during the 1980s and 1990s, financial sector liberalizations were put into practice all over the world. However, foreign capital inflows caused many crises rather than channeling to investment opportunities in emerging countries due to mainly regulatory weaknesses in banking sectors. Basel-I was severely criticized that the Accord was not adequate to control banks' risk taking. Also, it was criticized for being too crude, not enough to respond to the developments in the markets, not incentive compatible and for leading short term hot money flows to emerging economies. In order to respond to these criticisms, the New Accord (Basel-II) was proposed with some amendments in 1999. The IMF was also severely criticized for offering the same set of policies to all countries and not diagnosing the symptoms of the Asian financial crisis in 1997-1998, in which the banking sector played a major role. In line with these developments, the stand by agreement of Turkey in 1999 reflected the IMF's recognition of the importance of financial sector regulations in emerging economies. A new banking law was enacted (Banks Act No, 4389) in line with the IMF program. In 1999, an independent regulation institution, Banking Regulation and Supervision Agency (BRSA), was established under the strict guidelines of the Financial Sector Assessment Program of the IMF and the World Bank in order to eliminate the shortcomings of the previous law. The BRSA freed itself from the direct influences of banking lobbies and politicians. Also, it was assigned with a single task as ensuring the soundness of the banking sector. To grant banking licenses and to run the SDIF was given to the BRSA. The SDIF was authorized to take over and restructure insolvent banks. All banks were subjected to the same set of rules and regulations by abolishing the distinction between public bank and private bank (Akın et al., 2009; Al and Aysan, 2006; Öniş and Aysan, 2000).

The period started with the capital account liberalization in August 1999 reflects a new phase in neoliberal policy paradigm implemented in Turkey following the 24th January decisions in 1980. Neither the opening up of the capital account nor the financial sector liberalization in this process generated the desired outcomes on the Turkish economy and, in particular, the financial sector. The developments in the Turkish banking sector during the 1990s had a significant influence on the Turkish macroeconomic performance. While distorted banking sector developments had a negative influence on macroeconomic instability, in turn, macroeconomic instability more distorted the banking sector. The Turkish banking sector as the dominant financial sector in the financial system had three major features in the 1990s which played a significant role in the creation of macroeconomic instability. First, the predominance of the public banks in the system. The shares of public banks in the banking system in terms of its total assets and deposits shows that there was a significant weight of public banks in the overall banking structure. These public banks have created undeniable defects in the sector in the post-1994 crisis. Besides, these banks were the major reason for the unequal arena in the sector due to the fact that borrowing and lending operations of these banks have been heavily politicized. Lending operations were directed to favored sectors at subsidized rates which undermined their capitalization, liquidity and profitability. So, it can be said that these institutions were the major instrument of rent distribution in the political process. In addition, the concept of duty losses became an important term in the late 1990s. Duty losses are the quasi-fiscal losses that are generated because of the direct lending which is identified as an obligation by the Treasury. The delays of meeting these obligations by the Treasury resulted with high borrowing on the part of the public banks. This, in turn, generated major distortions in the system (Alper and Öniş, 2004; Alper et al., 2001).

Second, ‘open positions’ dilemmas and politicization of private bank entry. All private banks tried to take advantage of arbitrage opportunities and floating income in the environment of capital account openness. ‘Open positions’ refer to the fact that some institutions borrowed foreign currencies at very high interest rates to gain advantage from the opportunities provided by holding TL denominated government securities. The existence of open positions of banks made them vulnerable to speculative attacks that the devaluations in 1994 and 2001 generated several bank failures. Besides, the entry of new banks were highly politicized. There were six banks that got their licenses to enter into the banking sector during and immediately following the elections in October 1991. However, ironically, all those six banks failed within the next several years. Finally, very limited entry of foreign banks to the Turkish banking sector. Foreign banks would contribute to increasing development of domestic financial markets and high efficiency in a well-regulated and tightly supervised banking system. However, the Turkish banking sector didn't have such regulatory and supervisory infrastructure that foreign banks were not willing to enter the sector. Only there were some types of banks that are mainly interested in cooperating with domestic banks in sharing profits deriving from imperfections in the market (Alper and Öniş 2004; Alper et al., 2001).

The Asian financial crisis in 1997-1998 highlighted that a sound and well-functioning banking sector in emerging market economies is important for macroeconomic stability, which was lacking in the Turkish economy in the 1990s. Due to the growing concerns, Turkey signed a structural adjustment program with the IMF and followed the guidelines of the Financial Sector Assessment Program of the IMF and the World Bank in order to provide the soundness of the banking sector. However, it didn't prevent a major crisis, mainly because of the lack of commitment to reforms along with the political and economic instability experienced in Turkey during the 1990s. The crisis, especially, revealed that an inadequate banking system could play a trigger for financial crises in emerging market economies as in the case of the Turkish economic crisis in 2001, which is the biggest economic and financial crisis in the history of modern Turkey. In this sense, the following section will focus on the reform attempts in the aftermath of the crisis in Turkey where the neoliberal policy paradigm reemerged with the emphasis of the regulatory aspect.

### 3.3. Neoliberal Restructuring in the the Aftermath of the 2001 Crisis

The liberalization trend in the international financial realm started in the late 1970s in advanced countries. Soon after emerging economies started to embrace liberal policies in financial sectors as well as trade policies. Turkey, rather early compared to its counterparts, accepted neoliberal policy paradigm with the 24th January Decisions in 1980 following a major domestic economic and social crisis. In 1999, capital account liberalization was a critical turning point in the Turkish political economy in terms of its history in neoliberal policy paradigm.

Clientelism and the distribution of patronage resources were at the heart of a system of party politics in the 1980s. Low levels of accountability and transparency were the defining character of major political parties and the parliament. The institutional checks and balances mechanism was not operating effectively. These deficits magnified further in the 1990s with the successive weak coalition governments. This environment in politics helped to become worse from fragmentation and politicization of the system. These deficits, in turn, caused unstable macroeconomic performance in the form of low economic growth, high and volatile inflation, and huge budget deficits and public debts throughout the 1990s. This institutional structure in which basic tenets of the Washington Consensus implemented created a suitable environment for rent-seeking activities rather than productive financial intermediation. Banking related issues served as a fertile setting for rent-seeking activities of corrupt politicians, bureaucrats, businessmen and the mafia (Bakir, 2006). This, in turn, caused financial crises in November 2000 and February 2001 that further weakened the banking sector in Turkey.

The 1990s has been a costly decade for Turkey. The expression of 'the lost decade' for Turkey reflected its economic picture as well as its general political and economic failures. The Turkish economy had experienced many crises in the past, but the frequency of the crises increased during the 1990s with costly consequences in terms of income distribution, employment and production (Cizre and Yeldan, 2005). The growth rates in the Turkish economy were high at certain years during the 1990s but the frequency and the depth of the crises prevented a sustainable and long term growth rate.

By the end of the 1990s, it was clear that the Turkish economy was on an unsustainable course, with high rates of inflation and chronic fiscal deficits. The growth pattern of the Turkish economy is heavily dependent on the external and domestic borrowings along with the inflows of short term speculative capital. These kinds of developments generated a strong rentier class, whose business is dependent on lending to the government at high rates of interest. Therefore, large industrial establishments started to grow with their financial investments rather than manufacturing activities (Öniş and Bakır, 2007).

These developments helped to create an environment in the Turkish economy that a stand-by agreement with the IMF is an important requirement. The agreement signed in 1999 involved some measures on fiscal adjustments and structural reforms, which would be put into practice in the medium term. What is striking here is that this agreement was a unique development in the history of the Turkish economy, because there was no financial or balance-of-payment crisis in sight. However, the ironic thing is that the presence of an IMF program in order to eliminate the weaknesses was not enough to prevent the major crises in November 2000 and February 2001 in Turkish economic history, popularly referred to as the 'twin crises'. At this point, it is important to state that this was partly because of the weak commitment of the weak coalition governments which didn't give necessary attention to the key components of the IMF led program such as privatization and the regulation of the banking sector, and in part, because of the insufficient financial assistance of the IMF as well as the failures in program design about the problems of the banking sector and the adaption of a controlled exchange rate system (Öniş and Şenses, 2009).

### 3.3.1. The Emergence of the Regulatory State in Turkey in the Age of Post-Washington Consensus

The 2001 crisis was the biggest crisis in the history of modern Turkey. Almost two third of the GDP evaporated in a week following the crisis. Interest rate reached 7500 percent that it was record levels. Just a day later following the crisis 57 percent devaluation happened. Almost 15.000 firms went bankrupt. The banking system is locked. Record levels interest rates caused a short term hot money inflows and outflows with the aim of arbitrage. Therefore, financial markets experienced serious fluctuations. The date of the crisis 21 February was called 'black Wednesday'. However, the depth of the crisis helped the balance of power in Turkey's political economy to change quite radically in favor of the coalition of transnational and domestic actors which supports further liberalization with regulatory reforms in the financial sector as well as general economic outlook.

As stated above, the consecutive crises that happened in the late 2000 and the early 2001 in Turkey are called ‘twin crises’. The November crisis of 2000 clearly highlighted the weaknesses in the Turkish economy, in particular the problems of private banks. This crisis was largely considered a ‘liquidity crisis’. Therefore, it was argued that if the IMF allowed the Central Bank to inject more liquidity into the system, the crisis could have been prevented. However, the February crisis of 2001 was more dramatic and devastating in terms of its impact not only in Turkish politics but also in the Turkish economy. The inherent structural deficiencies of the Turkish economy were clearly presented by the very depth of the crisis, particularly in the realm of public banks. The problems that emerged in the public banks could not be simply eliminated by injecting more money into the system. On the other hand, the novel aspect of the 2001 crisis was that all sections of society including rich and poor, educated and uneducated were negatively influenced contrary to the earlier crises. Low income groups and wage earners almost exclusively had the largest share of the burden in the previous crises. This time, however, was different. Almost one million people lost their jobs and output collapse was accompanied by widespread bankruptcies, in particular in the realm of small firms. Large conglomerates experienced a significant reduction in their profit margins. In addition, the banking sector had the impact of the crisis in a drastic manner, and these banks had to answer with a severe cutback in their skilled workforce (Kutlay, 2018; Akyüz and Boratav, 2003).

The impact of the crisis was profound on Turkish politics as well. Domestic political actors and especially the incumbent coalition governments were seriously criticized. The two dominant members of the coalition government, the Democratic Left Party (the DSP), the left-nationalist, and the Nationalist Action Party (the MHP), the ultra-nationalist, were discredited due to their part in the crisis. Therefore, these two parties were left outside of the parliament in the early general elections of November 2002. Also, major political parties of the left and the right of the political spectrum were left outside of the parliament in this early general election. As a consequence, Turkish politics witnessed the emergence of a new political party, the Justice and Development Party (the AKP), a party with Islamist roots, and it has occupied the center stage in Turkish politics since then. However, what is striking here is that the balance of power shifted in favor of the international financial institutions in the post-crisis period in Turkey not only in the period of incumbent coalition governments but also in the period of the AKP government following the 2002 general elections. On the contrary to Argentina, in which the IMF was largely criticized due to the 2001 crisis, the IMF was not the center of criticisms. Although some criticisms stemmed from intellectual circles for the part of the IMF and its policy prescriptions in the Turkish crisis, there wasn't a massive wave of protests as occurred in Argentina. The IMF program was actually being implemented prior to the crisis in spite of some disagreements between the government and the IMF. However, the IMF wasn't blamed or discredited as happened in Latin America and East Asia during the crises in the late 1990s and the early 2000s. On the contrary, there was a certain change in the balance of power in the Turkish context in the post-2001 crisis (Kutlay, 2018; Öniş, 2009).

The shift in the balance of power following the devastating 2001 crisis was particularly seen in the relations of the IMF and the ongoing coalition government. Until the crisis, the government was reluctant to implement the reforms designed by the IMF program in 1999. Following the 2001 crisis, the government's resistance to implement the key components of the reform program was broken and the IMF gained the upper hand in the process. On the other hand, the IMF was willing to allocate a substantial amount of financial resources to Turkey's recovery process after the crisis. This was another reason for this shift in the balance of power in the policy making process. Geo-political considerations were also involved in this process. Turkey was a key ally of the United States in the Middle East region in which the US has critical interest for its foreign policy perspective. This led to a facilitating role in the financial allocation process. The power of the IMF increased in the reform process. This was evident in some key areas such as the banking sector and institutional reforms designed to consolidate fiscal discipline and monetary policies (Öniş and Şenses, 2009).

There was another critical actor in the post-crisis reform process, namely the European Union. The focus of the EU, in the beginning, was on the political side of the reform process rather than the economic side. Turkey was granted candidate country status in the Helsinki decision of the EU Council in December 1999. Following this decision, the role of the EU changed quite radically in the Turkish context. In other words, the EU became a far more powerful actor in the political and economic reform process in Turkey. However, the early focus of the EU was on the political side. Copenhagen criteria was the secondary concern. Because, there was already an economic program designed and monitored by the IMF that implicitly involved a certain division of responsibility. Accordingly, the IMF would take care of economic reforms, while the EU would be more actively involved on the political aspects of reforms with the specific concern of civil and human rights issues. However, this pattern radically changed in the post-2001 crisis period. The EU had a significant role as a critical external actor in the pro-reform coalition. The potential benefits of the EU membership were recognized by internal actors following the impacts of the 2001 crisis on the Turkish economy made these benefits more attractive (Öniş, 2009).

Also, the importance of the EU membership was recognized by both internal and external actors as a long-term and permanent external actor in the reform process. The IMF's role as an external actor related to appropriate reforms was limited. Given that its role is limited by a duration of time due to the withdrawal from the decision-making process once the recovery process is finished, the IMF's role as an external actor is limited. In other words, the Helsinki decision in 1999 opened a new chapter in the relations of Turkey and the EU. The decision broke the resilience of the internal anti-reform coalition and helped the implementation of difficult economic reforms designed by the IMF in the post-2001 crisis period. Therefore, there was a new element of double external actors in the political and economic reform process. As stated by Öniş and Bakır (2007), in the absence of actively involvement of the EU during the reform process, Turkey's reform efforts with the only support of the IMF and the World Bank would have been more problematic as Argentina experienced following the 2001 crisis (Öniş and Bakır, 2007; Derviş et al., 2004).

In addition, there were two key internal actors in shaping the trajectory in the post-crisis period in the Turkish context. First, Kemal Derviş, who was the Minister responsible for the economy in the incumbent coalition government. Second, the AKP governments following the November 2002 general elections. The prime minister Bülent Ecevit, who was the leader of the DSP in the coalition government, invited Kemal Derviş, the World Bank's vice president for poverty reduction and economic management, to handle the ongoing economic crisis. There were two motivations behind this appointment. The first and immediate concern of the government was to extinguish the fire of the markets. The second and long-term goal was to ensure the financial assistance of the IMF and the World Bank, while restructuring the domestic economy. Arguably, in the absence of Derviş, it would be more difficult for Turkey to secure sustained financial assistance on a large scale from international financial institutions (Öniş, 2009).

Bülent Ecevit invited Kemal Derviş to appoint him as the governor of the Central Bank. Kemal Derviş, however, insisted on getting a more powerful post, because he was thinking that the crisis was too deep to handle with solely monetary policy. Then, Kemal Derviş was appointed as a minister of state in charge of economy. From that point onward, he had become a key actor in the management of the economic crisis and in the coordination of the reform process. Derviş considered Turkey's economic crisis as a domestic problem (Kutlay, 2018). According to him, the crisis was the result of deleterious policies pursued by rent-seeking vested interests. He thought that Turkey's task was not 'one of achieving stabilization or restoring liquidity'. Instead, his aim was 'a systemic economic change: shifting from a rent-seeking society to a modern, competitive economy with much greater autonomy in the economic sphere, greater separation of politics and markets, greater transparency, and less privilege and therefore a better distribution of income, which would also lead to a greater legitimacy of governance and decision-making' (Derviş, 2005, p. 66). Hence, Derviş's main goal had been to restructure the financial system and to take irreversible reformist steps related to the banking sector (Kutlay, 2018).

The role played by the AKP in the reform process also deserves serious consideration. The AKP was elected in the general election of November 2002 with a sweeping majority in the parliament. Although it was considered a surprise by many, the AKP has adopted a strong reformist orientation. As a matter of fact, the AKP has displayed a far greater degree of commitment to the EU-related political and economic reforms along with a solid fiscal discipline than any other Turkish political party to date. The reform processes both on the political and the economic fronts were going well during the final stages of the coalition government. Therefore, it would be misleading to give all the credit to the AKP for the steady trajectory of the reform processes. However, it is worth noting that the momentum of the reform process most probably has been lost under the jurisdiction of a different government. Being a single party in government provided a large benefit to the AKP regarding the trajectory of the reform process, because its domain for action would have been seriously limited, if it was in a coalition government with one of the major center-right or center-left parties (Öniş, 2009).

At this point, it is important to ask whether there was a possibility that Turkey could follow any different trajectory rather than restructuring its financial and economic system in line with the regulatory state practices within the neoliberal policy paradigm. In the post-2001 crisis Argentina followed a different path involving heterodox policy practices. However, Turkey was in a totally different structural environment in which Turkey found itself in a position of heavy debt burden accumulated over time in the post-crisis period. In addition to its geo-strategic position, Turkey has had close relations with the US since the joining of NATO in 1952 following the Korean War and a strong European orientation since the application for European Economic Community (EEC) membership in the 1950s. These are the essential factors that have placed considerable constraints on the ability of any Turkish government to follow a radical heterodox path rather than a trajectory in line with the neoliberal paradigm demanding by international financial institutions, namely the IMF and the World Bank (Öniş, 2009; Öniş, 2006).

As a consequence, the calamity of the twin crises and especially the 2001 crisis paved the way for a serious structural reform process in the Turkish economy and, in particular, in the financial sector. The coalition government, which had been ruling before and during the 2001 crisis, however, was reluctant to the reform package designed by the IMF in 1999. The crisis of February 2001 and its depth effectively broke the resistance of the coalition government to the main components of the reform package and a new era started. This process, in the framework of the Turkish neo-liberalism experience, is called the 're-regulation phase'. The new phase is a mixture of re-regulation and de-regulation. Elements of re-regulation can be seen in different areas such as enhancing the autonomy of the BRSA in terms of much tighter regulation of the banking and financial system and strengthening the autonomy of the Central Bank through legal protection, while elements of de-regulation can be seen in the reduction of the corporate tax rate, reducing administrative barriers to foreign direct investment, reduction of agricultural subsidies and revitalization of the privatization program. But after all, this phase represented a radical breaking point from the earlier phases in terms of improving the regulatory capacity of the Turkish state (Öniş and Bakır, 2007).

Following the 1997-98 Asian financial crisis, International Financial Institutions such as the IMF and the World Bank have promoted the Post-Washington Consensus in developing countries. According to this PWC framework, these countries had to develop sound financial regulation and strong regulatory institutions, particularly in the realm of banking and finance. The 2001 crisis in the Turkish economy set the stage for a radical restructuring. It was witnessed the emergence of a regulatory state in the bank-based financial system in line with the regulatory neoliberalism prescribed by the IMF and the World Bank. As stated above, the consecutive crises that happened in the late 2000 and the early 2001 in Turkey were generated with the failure of the banking sector. Therefore, the transformations of the Turkish banking sector in the aftermath of the 2001 crisis deserves a detailed consideration.

### 3.3.2. The transformations in the Turkish Banking Sector in the post-2001 Crisis Period

The Turkish financial sector has shown significant progress following the 2001 crisis until the year of 2008 when the global financial crisis has peaked. Various domestic and international factors played a critical role at this development. The major domestic cause was the restructuring of the institutional setting for the financial system along with the other two causes, namely, the improved macroeconomic conditions in the country and the increased fiscal discipline of the government. On the other hand, international factors were profoundly effective factors for this transformation such as very favorable global liquidity conditions, reforms in the global banking standards and the influences of international institutions.

The serious deficits in the nature of Turkish politics were witnessed in the 1980s. However, these deficits increased during the 1990s due to successive coalition governments contributing to further fragmentation and politicization of the system. The main reason for the country's deteriorating macroeconomic performance was this political environment. Turkey witnessed macroeconomic instability in the form of low economic growth, high and volatile inflation, and huge budget deficits and public debts. In the 1990s, Turkey implemented the basic principles of the Washington Consensus in line with the program designed by the international financial institutions. However, the inadequate institutional structure in the Turkish economic system created an environment ripe for rent-seeking activities rather than productive financial intermediation. Banking related issues became a platform for a rent-seeking coalition of corrupt politicians, bureaucrats, businessmen and the mafia (Bakir, 2006). In turn, this environment resulted in financial crises that further weakened the banking sector.

The severity of the 2000 and 2001 crises in Turkey, especially with the far-reaching impacts of the latter on the Turkish economy, paved the way for a significant economic restructuring process in Turkey. Nevertheless, since the weaknesses in the banking sector were considered as the main cause for the twin crises, efforts for structural reforms were particularly concentrated on the banking sector. The regulatory reforms were the most important factor that brought the Turkish banking sector to its well-capitalized, highly liquid state with high asset quality and low exposure to market risks that Turkey has been one of the rare countries that didn't have to bail out any domestic bank throughout the global financial crisis in 2007-2008 (Öniş and Kutlay 2013). However, there are other, at least, two important factors for this condition. ‘One is the macroeconomic stability and the unprecedented fiscal performance achieved in the post crisis period. The other is the unusually favorable global liquidity conditions that were conducive to 26 consecutive quarters of unprecedented growth’ until the global financial crisis (Akın et al., 2009, p. 80)

The regulatory reforms implemented within the framework of the Banking Sector Restructuring Program had four important goals. First, to structure and rehabilitate the state banks financially, and then to privatize them. Some measures were taken for this purpose such as the elimination of duty losses and overnight liabilities, recapitalization of these banks and determination of deposit rates in line with the market and other efficiency-related operational restructuring plans. Second, to resolve the situation of the banks, which were controlled for some reasons between 1997-2002, under the management of the Savings Deposit Insurance Fund (SDIF) through transfer, liquidation, merger or sale. This number was 20 but by the end of 2002, only two banks remained under the administration of the SDIF. Third, strengthening of private banks according to rules set by the BRSA. The last goal was to strengthen the regulatory and supervisory framework. The major regulatory initiatives categorized under different headings have been sponsored and/or supported by the IMF that they were within regulatory and supervisory framework with the international standards generated by Basel-II (Akın et al., 2009).

At this point, it can be said that this regulatory and supervisory framework reflects the emphasis of the IMF on prudential regulation of the banking sector in the context of the Turkish case. The IMF, as mentioned above, was heavily involved in the latest restructuring efforts in Turkey in the 2000s that combined with the Washington Consensus and the Post-Washington Consensus. After the Asian financial crisis in 1999, the key international financial institutions, namely the IMF and the World Bank, put much bigger emphasis on the development of independent regulatory institutions and central banks, particularly in the realm of finance and banking. The primary concern of these international financial institutions was to improve regulatory structures, domestically, of emerging markets. In this way, their economies would be stronger and their ability to withstand future financial crises would increase (Bakir and Öniş, 2010).

Following the financial crisis in 2001, Turkey developed a robust regulatory state in line with the fundamental principles of the post-Washington Consensus. The neoliberal restructuring in the developing world in the 2000s, following the financial crises in the 1990s, was accompanied by a process of re-regulation; this process can be called 'regulatory neoliberalism' in the Turkish case. The notion of the regulatory state is an approval of the growing recognition for the requirement of key domestic and international actors that 'market liberalization *per se* in the absence of effective regulation will fail to translate into successful economic performance' (Bakir and Öniş 2010, p. 77). This view clearly highlights that independent regulatory institutions and bureaucracies are the major factor for the main organizational scheme of the regulatory state. In this sense, the BRSA has played the most important role as a strict surveillance institution on the Turkish financial system. The effectiveness of these regulatory policies pursued by different regulatory and supervisory agencies were quite obvious during the global financial crisis. However, 'the regulatory shift in the financial system was not complemented by a pronounced industrial transformation strategy; as a result, Turkey has continued to pursue non-selective industrial policies in line with the dicta of orthodox liberalisation' (Öniş and Kutlay, 2013, p. 1420).

Following the restructuring program in the post-2001 crisis, there are two periods, which can be categorized as 'recovery and stabilization period' and 'growth period'. The recovery and stabilization period lasted the the end of 2004 and resulted with the decline in the numbers of bank, branches and employees for the Turkish banking sector. The general elections held in November 2002 resulted with a single party government contrary to the 1990s in which coalition governments were in power. The single-party government continued to implement the reforms within the framework of the Restructuring Program in the banking sector initiated by the former government following the 2001 crisis. Besides, the Copenhagen Summit accelerated the process of negotiations for the goal of full membership of Turkey to the European Union. These two developments were important factors which contributed to the right environment for the restructuring of the Turkish banking sector (Akın et al., 2009).

On the other hand, a new phase which is called the ‘growth period’ started in 2004. In 2005, while the world economy reached a 5.1 percent growth rate, the Turkish economy grew 9.3. The other important development in this period was the beginning of Turkey and EU to accession negotiations in September 2005. The possibility of becoming an EU member for Turkey contributed to the reform process which was set by international financial institutions and mechanisms such as the IMF, the World Bank and Basel-II. Hence, it is worth to state that the EU was an important external actor pushing for regulatory reforms in the Turkish banking sector (Ganioğlu 2008). The assets to GDP ratio of the Turkish banks rose, the number of bank branches and their employees increased in 2005. After 2005, the number of branches and their employees had continued to increase steadily until the global financial crisis. Although the Turkish banking system experienced a slowdown during the 2008-2009 period, it continued to grow after this period. However, it is noteworthy that the job creation of the sector wasn’t as high as the sector’s growth. However, the most significant change in 2005 in the banking sector was the sudden increase of foreign bank entry.

Foreign banks' share in the assets of the banking sector in Turkey was 3.11 per cent by the end of 2002. By the end of 2007, this number was almost five times higher from the initial number, 15.02 per cent. Although the numbers declined following the global financial crisis until 2012, a growing period can be seen in the years 2013 and the rest despite the slowing shares in the total numbers (Şen and Süer, 2016). Foreign bank entry into the Turkish banking sector was negligible in the ‘recovery and stabilization period’ mentioned above. However, the ‘growth period’ witnessed a sudden surge in terms of foreign bank entry to the sector. Various factors shaped this process and those can be stated as global, domestic and home-country related decisions.

The global financial crisis had effects on the Turkish economy. Rodrik (2012) states that Turkey was heavily influenced by the global financial crisis in 2008 than by any of the earlier cases of a sudden stop in capital inflows. This was experienced despite the soundness of domestic banks. Also, Turkey suffered from a dramatic loss in revenues gained from export, which was the result of demand shock coming from the EU. Turkey was one of the most affected countries along with several Eastern European countries in the category of emerging market economies in terms of growth, a sudden collapse, and unemployment, a parallel increase, in 2009. However, the main difference from the previous crisis was that 'the government postponed an IMF program and displayed this as a sign of strength and the ability to implement an independent stance and a sign of national sovereignty' despite the external assistance that earlier crisis stemmed domestically required 'external financial assistance for the subsequent recovery process making the encounter with the IMF and the World Bank inevitable' (Öniş, 2010, p. 58).

The unusual aspect of the 2008-2009 experience compared to the earlier domestic crises was that the economy did not find itself in a sudden crisis condition. The banking and financial sector was robust and there was no balance of payment crisis requiring external assistance. Turkish policymakers had a clear mindset conditioned by the previous crisis, so the experience of 2008-2009 did not seem to conform to the previous pattern (Öniş, 2010).

The most notable change in the post-global financial crisis period is, however, the sudden rise of macroprudential ideas in regulatory policy communities in the realm of finance. The crisis has highlighted that there is a need to go beyond a purely microprudential approach to financial regulation and supervision. The growing consensus for macroprudential ideas among the policy makers for financial regulation and supervision is the major consequence in the post-global financial crisis period (Galati and Moessner 2012). In other words, as a consequence of the global financial crisis, countries started to use macro-prudential policies to deal with macro financial risks. Just after six months from the crisis, financial regulatory networks, which were centered around the Swiss city of Basel, had been the president of rapid ideational shift. The idea of macroprudential regulation has moved to the centre of the policy agenda and became the fundamental interpretive frame for financial regulators and technocrats. These attempts of the actors involving the process have sought to navigate and respond to the crisis. Macroprudential ideas have a normative element, while they appear as quite narrow, arid and technocratic. These macroprudential ideas 'challenge and reject efficient market theories, and advance a quite different conception of market relations and behaviour. Such a conception of markets implies a redefinition of the role of public authorities and an increase in their power to intervene and set limits to financial market activities' (Baker 2012, p. 113).

The growing volatility in capital flows during the post-global crisis period has emerged serious challenges particularly for emerging economy countries by worsening policy trade-offs. This environment made the additional tools of macroeconomic and financial policy more valuable. In this sense, Kara (2016, p. 123) states as follows:

*Turkey has taken a number of steps towards building an institutional setup for implementing explicit macroprudential policies since 2011. To this end, the Central Bank of the Republic of Turkey (CBRT) modified the inflation targeting framework by incorporating financial stability as a supplementary objective. Moreover, a formal Financial Stability Committee (FSC) was founded to respond to macro-financial risks in a more systematic and coordinated fashion.*

The Central Bank started a conventional inflation targeting regime in 2001, in line with the neoliberal restructuring process within the framework of the IMF supervision. The inflation targeting became official in 2006. Yağcı (2017) asserts that financial stability has been one of the most important pillars of economic policy-making all over the world and central banks were the main actors. For this purpose, central banks of major economies such as the Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BE) and Bank of Japan (BJ) started to follow unconventional monetary measures like lowering the interest rate to zero level and Quantitative Easing policies. Therefore, short-term capital flows to emerging economies increased and these economies have been vulnerable to their increasing volatility and risks to manage them. Emerging economies such as Brazil, Indonesia and Korea implemented capital flow management measures to avoid the risks, while India and China have continued to have extensive capital controls pursued traditionally. Countries such as Brazil, Indonesia, South Africa and Turkey have substantially liberalized their capital account regimes in the pre-crisis period. Therefore, they faced similar risks, however, their responses were not the same. Turkey, among these countries, followed a different path that it 'is the only case where unconventional, experimental monetary policy measures are utilised for financial stability purposes in an emerging economy and no direct measure of capital flows have been implemented' (Yağcı 2017, p. 542). Accordingly, he (ibid.) asserts that the major actor has been the Central Bank of Turkey. In line with the developments explained above, the implicit inflation targeting role of the central bank was modified by incorporating financial stability as a supplementary objective. Price stability continued to be the overriding objective, while policy focus was extended to involve macro-financial risks, particularly macroeconomic volatility caused by excessive global liquidity cycles (Kara 2016).

To this end, the central bank has devised a new policy mix starting in the late 2010. This policy toolkit was not aimed directly on capital flows but was more in the nature of general macro-prudential policies: 'active use of reserve requirements, liquidity policy, asymmetric interest rate corridor between overnight borrowing and lending rates, and later the reserve option mechanism (ROM)'. The latter two policy mechanisms were the new policy tools. Interest rate corridor can be seen as a tool in order to smooth movements in the supply of foreign funds. ROM, on the other hand, can be thought of as a tool to decrease sensitivity of equilibrium foreign exchange rate to movements in the supply (Aysan et al. 2014).

Additionally, the FSC was founded as an institutional setup to be aimed to respond to macro-financial risks. In this sense, the FSC has been the major step to establish a formal macroprudential framework. This committee is chaired by the deputy prime minister in charge of economy and brings together all the main relevant institutions, namely Banking Regulation and Supervision Agency, Capital Boards Market, Central Bank, Treasury and Saving Deposit Insurance Fund. Despite the lack of having its own tools, the main duty of this committee is to assess systemic risks, identify required measures and make policy recommendations (Kara, 2016).

### 3.4. Conclusion

The 24th January Decisions was a dramatical turning point for the Turkish financial sector. This chapter argued that internal and external factors played a crucial role in the transformation of the financial sector in Turkey. Following the 24th January Decisions, the Turkish financial sector was restructured in line with the neoliberal paradigm, or the Washington Consensus, with the heavy involvement of the international financial institutions, namely the IMF and the World Bank. In the aftermath of the 2001 crisis, however, the Post-Washington Consensus with a regulatory emphasis was embraced with the direct impetus of the IMF and the World Bank in the framework of the structural adjustment and reform program.

The structural adjustment and reform program implemented in the aftermath of the 2001 crisis emphasized the role of new independent and supporting regulatory institutions. Good governance through supporting regulatory institutions (particularly, in banking and financial sectors) was the main focus of the Post-Washington Consensus. As this chapter stated, the Turkish financial sector was restructured in line with the PWC with the crucial role of the international financial institutions and the AKP, the ruling party since the 2002 general election. However, the emergence of the macroprudential shift has assigned a new role for central banks and regulatory institutions involving more direct measures to provide financial stability. Hence, the next chapter focuses on the macroprudential turn in the Turkish financial sector.

# Chapter 4

# Macroprudential Policies in Turkey in the Post-Global Financial Crisis Era

## 4.1. Introduction

As established in Chapter 2 of this thesis, the emergence of macroprudential shift has been one of the key elements of post-GFC change within the regulation and supervision of national and global financial sectors. With the macroprudential shift, central banks and regulatory institutions around the world expanded their implementation of precautionary measures to provide financial stability against the systemic financial risks (Baker, 2013). Due to the measures of advanced countries in the post-crisis period in line with the emergence of macroprudentialism, the increasing volatility in capital flows resulted in significant challenges for developing and emerging economies (Ahmet and Zlate, 2014). Turkey, as other emerging economies, utilized macroprudential policies to mitigate the surge of short-term ‘hot money’ flows in the post-GFC period. In this sense, this chapter sheds light on the transition of Turkey, which is a middle power country in need of external resources for its growing economy, to the macroprudential policies within the emerging economy perspective that it differs significantly from an advanced country approach.

The macroprudential policy framework adoption in Turkey was significantly influenced by the GFC and the resulting ideational shift in the global financial regulatory networks. Nevertheless, the emergence and the implementation of macroprudential policies in Turkey was formed by domestic actors and institutions along with internal dynamics, as well as shifting consensus in the realm of global financial governance. The Central Bank of the Republic of Turkey Turkey (CBRT) and regulatory agencies such as the Banking Regulation and Supervision Agency (BRSA) have implemented several macroprudential measures starting from the late 2010 in order to provide financial stability in the domestic financial system. In addition, the Financial Stability Committee (FSC) was founded in order to provide a formal institutional governance mechanism for macroprudential regulatory approach in 2011.

New ‘unconventional’ or ‘unorthodox’ monetary policy tools were utilized by the CBRT and substantial policy measures were adopted by the BRSA in line with the new Basel Consensus through the recommendations of the FSC. However, the macroprudential turn created a political backlash within the government. In addition, it was revealed that real and financial sector actors have divergent preferences in terms of the Turkish economy. Therefore, macroprudential ideational turn in the Turkish case presents a variegated agency, which is an agency understanding contributing both to continuity and change in policy paradigm change.

The remainder of the chapter is organized as follows. The next section explains the emergence of macroprudential turn in the international political economy. Following section investigates the Turkish case with the focus on emergence and the first phase of macroprudential turn, which differs from not only advanced countries but also other emerging economies. The fourth section provides an overview of the implementation process of macroprudential policies, while the fifth section explains the dynamics of policy (paradigm) change in terms of macroprudential ideational shift in Turkey between the late 2010 and 2017. The last section gives a brief summary of the chapter.

## 4.2. The External Context: The Rise of Macroprudentialism in the International Political Economy

The global financial crisis has clearly demonstrated that a micro-based approach, merely focusing on the robustness of individual institutions, is not adequate to maintain financial stability in financial systems; therefore, financial regulation and supervision has to go beyond and contains a macro approach, focusing on the stability of the whole financial system. The GFC has highlighted that the global build-up of financial imbalances can cause severe macroeconomic consequences, if there isn’t proper analytical frameworks to help predict and cope with such financial imbalances. It was understood that there has been a fundamental lack of understanding of systemic risk. In the environment of robust macroeconomic performance and low interest rates, financial institutions followed an aggressive risk-taking tendency that resulted with massive growth in balance sheets in the financial system. However, the important dimension was the failure to appreciate how aggressive these financial institutions are in risk taking activities. Overconfidence in the self-adjusting ability of the financial system caused the 'Great Recession'. Therefore, the specific goal of macroprudential policy can be described as limiting the risks and costs of systemic crises (Galati and Moessner, 2013).

As a response to the financial crisis in 2008, significant consensus among policymakers in the realm of global financial governance has emerged to adopt macroprudential policy framework (Galati and Moessner, 2013). The emergence of macroprudential ideational shift was truly remarkable in global finance. These policies were relatively unpopular and very much on the sidelines in the pre-crisis era, however, they have been started to research and then promulgate by many international and national institutions within a short period of time in the aftermath of the crisis. At this point, the G20 is important that it approved and legitimized the efforts for new regulatory reforms which have significant macroprudential aspects (Baker & Carey, 2014). Besides, with the instruction of the G20, the FSB was established as the successor to the Financial Stability Forum including major developing countries with a key role in promoting the reform of international financial regulation and supervision in line with the macroprudential shift.

While the change in the structure of global financial governance setting the agenda of financial reforms is salient, the most significant aspect of these policies is, however, their potential to transform the fundamental principles of orthodox economics. Macroprudential ideas embrace a quite different conception of market relations and behavior that it asserts the contrary of efficient market theories. Accordingly, the role of public authorities is redefined and their power is increased in order to intervene and set limits to activities in the financial system. Baker (2013b, p. 418) refers to macroprudential regulation and states that this regulatory framework is "a system-wide top-down approach to regulation and financial stability that seeks to 'curb the credit cycle' through countercyclical regulatory interventions by directing, and sometimes directly constraining, the commercial activities of private institutions". Therefore, macroprudential turn has been one of the major consequences of the global financial crisis. Nevertheless, one of the most significant policy changes within the macroprudential ideational shift was the new practices of advanced countries' central banks.

Central banks of advanced economies such as the US Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BE) and Bank of Japan (BJ) accommodated unconventional monetary policy measures, Quantitative Easing (QE) policies and lowering policy interest rates close to zero level. These measures are coined as unconventional because central banks had used to control short-term policy interest rates and kept them in a positive range before the GFC as a routine central bank practice in line with the general principles of central banking. Besides, with the macroprudential shift, these central banks started to increase their monetary bases with lending programs and massive asset purchases (Ahmed & Zlate, 2014; Gallagher, 2015a). The main reason for these measures were to lessen the impact of the global crisis and stimulate economic growth in severely crisis affected countries along with providing financial stability in their domestic financial systems (Borio & Zabai, 2016; Han, 2016). However, unconventional monetary policy practices of major central banks, especially of the Fed, increased short-term hot money flows to emerging and developing economies. These capital flows resulted in an increasing volatility and risks in managing them (Ahmed & Zlate, 2014, Gallagher, 2015b). Consequently, the main concern of emerging economies for financial stability is raised due to the increasing volatility in capital inflows, while the advanced countries' main concern has been to provide financial stability by lowering interest rates and injecting huge amounts of money to the economy.

It is worth noting that international organizations such as the World Bank and especially the IMF with the United States pushed developing countries to liberalize their capital accounts, although the original articulation of the Washington Consensus (WC) did not extend to short-term capital flows (Chwieroth, 2014; Gallagher 2015a). During the era of the WC the emphasis was predominantly on liberalization of financial and capital accounts (Bakir & Öniş, 2010). In this sense, since the early 1980s, emerging economies have experienced waves of capital inflows, which have followed sudden stops and/or reversals cycles. These sudden stops and/or reversals led to a series of financial crises in these countries - associated with weak and fragile bank balance sheets, high government borrowing requirements, and/or fixed exchange rate regimes together with low foreign exchange reserves. In line with the developments taken place in the aftermath of the Asian financial crisis in 1997-1998, most emerging economies implemented various reform initiatives such as banking sector reforms, adopting flexible exchange rate regimes, increasing foreign exchange reserves and policies to reduce government borrowing requirements (Orhangazi & Özgür, 2015). A new wave of capital flows to emerging economies was triggered by low interest rates and the expansion of liquidity in advanced countries in the early 2000s until the late 2008. However, unconventional monetary policies as mentioned above caused this interruption period to be brief (Akyüz, 2015). Christine Lagarde, former managing director of the IMF, proclaimed that the gross capital flows to emerging economies, 4.5 trillion US dollars, reached almost half of global capital flows from 2009 to the end of 2012 (Lagarde, 2015).

Specifically, capital flows from advanced countries to emerging economies had been high to the Asian and Latin American countries in addition to South Africa and Turkey until the GFC. However, these flows exceeded the pre-crisis levels in many countries (Brazil, Indonesia, Korea and Thailand) due to the policies of major central banks stated above and almost obtained the pre-crisis highs for the rest (Peru, South Korea, Africa and Turkey) (IMF, 2011; Gallagher, 2015a). Moreover, the surge of capital flows creates vulnerabilities to emerging economies according to the IMF (2011), on the contrary to the mainstream theory (Orhangazi, 2014). In some cases, these capital flows not only caused over-appreciating currencies and widening current account deficits but also accelerated domestic economic activity, particularly through credit or asset market booms. The Fed's announcement related to tapering in 2013 revealed the fragility of these emerging economies as capital inflows slowed down, currencies went into a free fall, and some central banks increased interest rate to re-attract capital inflows and to keep the value of their currencies (Orhangazi & Özgür, 2015). In this context, a significant debate emerged on the fragilities of emerging economies.

Whether it was the QE policies of major central banks or the own policies of emerging economies to blame.

### 4.3. The Emergence of the Macroprudential Turn in Turkey

Following the QE policies of major central banks in the aftermath of the GFC, a huge amount of hot money flowed to emerging economies. Turkey, also, is a case in point. Although capital inflows into the Turkish economy has obvious advantages, it poses some serious risks as well. Nevertheless, Turkey differs from other emerging economies' capital flow management measures in the post-GFC era.

China and India have continued their extensive traditional capital account controls in the post-GFC. These two countries are not exactly the same in terms of their substantial capital and exchange control measures but they can not either be considered together with the other emerging economies such as Brazil, Indonesia, South Korea and Turkey, which liberalized their financial and capital accounts in the pre-crisis period. South Africa liberalized capital outflows following the GFC starting from 2009, while Indonesia implemented a six-month holding period for central bank bonds in 2010 (IMF, 2011).

Moreover, Brazil and South Korea decided to re-regulate capital inflows in the wake of the GFC. Gallagher (2015a) asserts that there are several factors which helped Brazil and South Korea to overcome the political constraints related to regulating global capital markets such as the institutional structures, power-interest relations and ideas on how the domestic economy should be governed in these two countries. According to him (ibid., p. 7), Brazil and South Korea achieved modest success against the harmful effects of capital flows with their macroprudential measures and also state that 'both nations established innovative new derivative regulations and extended second-generation capital controls'. However, Turkey followed a different path compared to the other cases in terms of capital flows management measures, although it shares similar risks with Brazil, South Africa and Indonesia. Turkey is the only emerging economy where unconventional, experimental monetary policy measures used for macroprudential purposes and no direct capital flow management measures have been imposed (Yağcı, 2017). The CBRT implemented asymmetric interest rate corridor and reserve option mechanisms (ROM) to mitigate the risks stemming from large capital flows and to provide financial stability in the domestic financial system that these measures also differ from advanced country central bank practices taken place following macroprudential shift.

Increasing capital flows to Turkey in the post-GFC era due to the policies of major central banks caused an overheating in the economy. Economic growth is very high in the overheating periods, however, this could lead to an increase in the debt burden of firms and individuals. A country like Turkey, which has an open capital account regime, could face a likely contraction in the economic growth because of rapid capital outflow. Capital outflows have been the main reason for output losses in Turkey as well as other emerging economies.

It is clear that capital flows have been a significant indicator for the Turkish economy considering that sudden movements in capital flows dominate Turkish business cycles. The increase in capital flows into the country resulted in a vibrant economic environment leading to a boom episode, while a sudden capital outflow resulted in a bust episode. The previous contractions in the economic growth taken place in 1994, 2001 and 2009 reflect such episodes. Net capital outflow (sudden stop) and a disruption in the financial system is experienced along with each of these recessions. In this sense, the developments in the post-GFC evoked such fragilities in Turkey that the private credit growth rate climbed to 40% in the late 2010 along with the rapid appreciation of the Turkish lira. More importantly, the current account balance deteriorated and the deficit widened and was substantially financed by short-term portfolio flows. These symptoms in the economy increased the doubts for the so-called 'sudden stop' risk which would lead to an economic crisis as happened in 2001 (Kara, 2016).

Following the significant reform initiatives in the aftermath of the devastating 2001 crisis, Turkey had been an attractive country for capital flows until the global crisis. There were several reasons for this increase such as easy global liquidity conditions as well as the stability in the political and economic environment of the country. Notwithstanding, the country had considerably tight bank regulation and supervision perspective that this was a reflection of the bitter experience of the 2001 crisis. Bank regulation and supervision had been significantly prudent in this period. For instance, non-financial firms and consumers were not allowed to borrow foreign currency and to have currency mismatches were prohibited to banks. Moreover minimum capital adequacy and liquidity coverage ratios were imposed higher than international standards by the BRSA. All these prudential measures had macro implications, however, the missing part was a formal macro-prudential perspective in the governance of the Turkish financial and banking sectors during the 2000s (Kara, 2016). To this end, unconventional and experimental monetary policy measures have been designed by the CBRT for macroprudential purposes in the late 2010 that was the first step towards an explicit macroprudential policy framework.

Financial stability emerged as a key pillar for economic policy making in the aftermath of the GFC. Also, it has been a new mandate for all central banks in the world. It was the case for the Turkish central bank as well. Although the CBRT embraced its new mandate in the result of shifting external consensus, it has started to actively pursue financial stability goal without any legal amendments. In addition, the CBRT introduced new ‘experimental’, ‘unconventional’ or ‘unorthodox’ monetary policy tools by pointing out the increasing amount of short-term financial flows to Turkey and adding that this may pose a risk to the macroeconomic and financial stability (Yağcı, 2017; CBRT, 2010). The CBRT has introduced two new policy instruments, interest rate corridor and reserve option mechanism (ROM) as unconventional monetary policy tools (Yağcı, 2017). However, as Han (2016) states, the pursuit of financial stability of central banks in an explicit and active way in the post-global financial crisis era has significantly altered their relationships with financial markets and, particularly, governments.

In addition to the CBRT's new mandate and its new unconventional monetary policy instruments for financial stability, there was another significant development in the macroprudential turn in the Turkish case. The establishment of the Financial Stability Committee (FSC) by the Turkish Treasury in 2011 was a major step for formal institutional change in the governance of macroprudential policies and regulations in Turkey. In the aftermath of the global crisis, more than 30 inter organizational financial stability councils in charge of macroprudential policies have been established in the world (Caruana, 2014). Three main different models have been utilized to establish these institutions. In England, the Financial Policy Committee (FPC) was established as in charge of financial stability within the body of the Bank of England in 2013. Some countries such as Belgium, Czech Republic, Ireland and Portugal have embraced the same model with England for the same purposes. On the other hand, the other model is to bring together all regulatory institutions in the country for coordination. In this model, central banks have secretarial duty in this new construction along with their new mandate. While the US is a true case in point for this model, France and Holland can be considered as other examples. The last model is the ones in which financial stability committees are established having an independent organizational structure from the other regulatory institutions. Countries such as Germany, Mexico, Australia and Turkey have chosen this last model. In this model, ministers who are in charge of public finance are the presidents of the committee. The existence of the minister in the committee plays a key role providing strong coordination between the regulatory bodies in the times of crises.

As it is stated, the FSC was established defining the deputy prime minister, who is in charge of economy, as chairman of the committee by the Turkish Treasury in 2011. The committee included all the major relevant institutions for financial stability: the BRSA, Treasury, Capital Markets Board (CMB), Saving Deposit Insurance Fund (SDIF), and the CBRT. The main purpose was to enhance information sharing, coordination and cooperation between the institutions. This was a necessity for the country since it hosts a multiple regulatory system. However, the FSC wasn't established as an institution which has its own tools, in other words, each institution in the committee had its own mandate and responsibility. Through the recommendations of the FSC, the BRSA has taken significant measures in order to contain excessive leverage and to improve households' financial position. As it will be explained later in this chapter, the presence of the related minister in the committee and, more importantly, the approach of the minister to macroprudential measures implemented by the relevant institutions provided an environment in which these measures are implemented relatively smoothly (Interview 1 and Interview 4).

The emergence of the macroprudential turn in Turkey started in the late 2010 with the initiative of the Central Bank. In order to overcome the risks emerging in the form of short-term hot money flows originated by monetary policies of advanced countries' central banks, Turkish authorities including the Central Bank and the BRSA implemented several macroprudential measures in the coordination of the FSC. Notable macroprudential measures were implemented between 2011 and 2014 to contain credit growth and to improve the quality of bank liabilities in line with the shifting external consensus on a system-wide top-down approach to regulation and financial stability in the post-GFC period. However, these measures caused a political backlash within the AKP government, which has been running the country since the 2002 general election. These negative responses coming from the high level politicians of the AKP government deteriorated the overall perception about central bank policies. In addition, it was revealed that real and financial sector actors have divergent preferences in terms of the Turkish economy (Yağcı, 2017). While several policy and institutional changes were carried out in Turkey in line with the global macroprudential ideational shift, strong criticisms coming from leading politicians, and real and financial sector actors caused a coherence and legitimacy problem. Therefore, the Turkish case presented an agency contributing both change and continuity in a policy paradigm change.

### 4.4. The Adoption of Macroprudential Policies in Turkey

Capital flows to emerging economies increased from 139 billion US dollar in 2002 to 1,237 billion US dollar in 2007 due to the surge in global liquidity conditions (Aysan et al., 2014). Turkey received large amounts of capital inflows mainly for two reasons in the early 2000s: the surge in liquidity on a global level and, particularly, the stability of the country in terms of political as well as economic environment. Although capital flows to emerging economies dropped by almost half (to 679 billion US dollar) in 2008, it has rapidly increased in the aftermath of the GFC due to the quantitative easing policies and near zero interest rates in the advanced countries. In this period, capital inflows to Turkey went on increasing after the QE policies firstly began in the US (Kara, 2016; Orhangazi and Özgür, 2015; Aysan et al., 2014).

Capital inflows are composed of three main elements: foreign direct investment (FDI), foreign portfolio investment (FPI) and debt. As the volume of these inflows increased in Turkey, the composition has changed over time. A large portion of capital inflows in 2002, in the aftermath of the 2001 crisis, were constituted by FDI, mostly because of "fire sale" prices of assets (Dufour and Orhangazi, 2009). Later on, the portion of FDI constituted the big part of capital inflows due to the high volume of privatizations in 2006-2008 in accordance with the neoliberal regulatory state approach of the government (Bakır and Öniş, 2010). Nevertheless, FPI significantly increased with the introduction of QE, and FPI and external debt constituted more than 80 percent of capital inflows from 2010 to 2014 (Orhangazi and Özgür, 2015). These short-term and highly volatile capital flows posed a serious risk for Turkey, because the surge of capital inflows resulted in an overheating in the economy. Economic growth is very high in the overheating periods, however, the rapid increase in portfolio investments and external debt had three interrelated serious side effects on the Turkish economy. First, a widening current account deficit. Second, external debt accumulation in the economy could lead to an excessive increase in the debt burden of firms and individuals. Third, a credit boom fueled by the surge in capital inflows. In addition, a country like Turkey, which has an open capital account regime, could face a likely contraction in the economic growth because of rapid capital outflows (Kara, 2016; Akçelik et al., 2015).

Sudden movements in capital flows dominate Turkish business cycles. The increase in capital flows into the country resulted in a vibrant economic environment leading to a boom episode, while a sudden capital outflow resulted in a bust episode. The previous contractions in the economic growth taken place in 1994, 2001 and 2009 reflect such episodes. Net capital outflow (sudden stop) and a disruption in the financial system is experienced along with each of these recessions. In this sense, the developments in the post-global crisis evoked such fragilities in Turkey that the private credit growth rate climbed to 40% in the late 2010 along with the rapid appreciation of the Turkish lira. More importantly, the current account balance deteriorated and the deficit widened and was substantially financed by short-term portfolio investment flows rather than FDIs. The current account deficit reached a record level, %-5.7 in 2010, and then it got worsened with a rapid increase by arriving %-8.9 in 2011 (World Bank Open Data, 2020) despite the actions taken by the relevant institutions. These symptoms in the economy increased the doubts for the so-called 'sudden stop' risk which would lead to an economic and financial crisis. To this end, a number of macroprudential measures have been taken to prevent sudden stops risk and further economic overheating by the CBRT and the BRSA throughout the FSC commencing in the late 2010 (Kara, 2016; CBRT, 2010).

Kara (2016), who was the chief economist of the CBRT then, and Yağcı (2017) assert that the CBRT took the leading role in designing financial stability objective via macroprudential policies due to its legal independence status given after the 2001 crisis. It is worth noting that independent regulatory bureaucracies are considered the main organizational manifestation of the neoliberal regulatory state (Gilardi, 2008). This independent bureaucracy ideal for effective regulation in developing countries played a key role in terms of macroprudential measures taken by Turkish authorities. Because, the CBRT as the independent regulatory institution and, particularly, the governor of it as an independent bureaucrat initiated the formal and informal institutional changes regarding active financial stability goal in Turkey starting from the late 2010 (Yağcı, 2017). Also, the importance of individuals, namely Ali Babacan and Erdem Başçı, in macroprudential policy approach of Turkey was mentioned by two interviewees by two high level officials, one from the CBRT and one from the BRSA (Interview 1; Interview 2). The CBRT and its governor, Erdem Başcı, and also Ali Babacan, who was the deputy prime minister in charge of economy back then, are the key actors who are in favor of macroprudential measures in order to mitigate the risks arising from 'hot money' flows into the country. It is worth noting that these actors are the internal actors who have initiated the macroprudential turn and have implemented required measures relatively smoothly, in particular, until the beginning of 2013.

Nevertheless, as Yağcı (2007) accepts, central banks were assumed to take the leading role in pursuing the financial stability goal in line with the changing international consensus related to their role following the global crisis. Therefore, the CBRT (2010), as the first institution, drew attention to global imbalances stemming from capital flows and macro-financial risks facing the Turkish economy. In this context, the CBRT highlighted the importance of financial stability and started to use reserve requirements and the asymmetric interest rate corridor as the new policy mix in addition to conventional central banking practices, which constitutes the first phase of macroprudential policy implementation (Kara, 2016). However, it is important to state that the CBRT as an institution and its Governor as an individual played a very key role in the macrorpduential turn in Turkey. These actors initiated divergent change for financial stability and they also were actively involved in all the policy stages of agenda setting, policy formulation, implementation and evolution. In addition, political support of the deputy prime minister for the governor of the CBRT played a key role. With this support, the CBRT maintained its autonomy and was enabled to utilize experimental measures for financial stability purposes (Interview 1; Interview 2; Interview 4; Yağcı, 2017). As one of high level official from the BRSA stated during the interview, the CBRT had the role to lead the other organizations in the FSC in agenda setting and in compelling to follow its lead. The support of the deputy prime minister was very key in the approach of the Central Bank (Interview 2).

The stability of the financial system is the primary objective of macroprudential policy. The stability of the system, eventually, can contribute sustainable economic growth. Besides, authorities for macroprudential measures can set some intermediate objectives to make these policies more functional (Skingsley, 2016; Borio, 2003). The primary and overall objective of macropruential policies is to preserve and strengthen the stability of the financial system, and to prevent the economy from likely systemic risks. This was the case for all countries embracing macroprudential policies. Nevertheless, Turkey has specified intermediate objectives as other central banks specify their intermediate objectives in line with their domestic financial system requirements. And the intermediate objectives are to contain excessive credit growth and to prevent deterioration of current account balance. These were the result of huge amounts of capital inflows to the country. Therefore, capital inflows can be considered the other main external factor for the macroprudential turn in Turkey. Not only macroprudential policies but also monetary and fiscal policies can have serious effects on the financial system. Moreover, the linkages between these three policy frameworks may cause either positive or negative effects (Uysal, 2017). Therefore, coordination is vital. To this end, the FSC was established in June 2011 in order to provide coordination among the relevant institutions. The FSC as a formal institution established for the purpose of coordination in macroprudential policies is the other main internal actor which has the key role in the process. Besides, the CBRT introduced the reserve option mechanism (ROM) as a novel policy instrument in central banking. These two developments, namely the CBRT's new role along with its experimental monetary policy tools and the establishment of the FSC, constitute the second phase of macroprudential policy implementation in Turkey.

As it is stated, the central bank of Turkey introduced two unconventional and experimental policy tools to mitigate the risks arising from hot money inflows. The CBRT introduced ROM along with the asymmetric interest rate corridor in line with the financial stability objective. ROM is described as a market-friendly tool that 'acts as an automatic stabilizer of exchange rate fluctuations which aims at containing amplified effects of volatile short-term capital flows on the domestic business cycles' (Aysan et al., 2014, p. 59). Accordingly, banks have the option to deposit their Turkish lira reserve requirements into gold or foreign currency. In other words, ROM is basically an instrument that banks could keep their reserve requirements in the US dollars and/or gold at the CBRT, instead of the Turkish lira as it was the case earlier. This would help to moderate the potential pro-cyclical effects of the volatile short-term capital flows on credit growth and exchange rate. This was an optional mechanism that banks could compare the cost of borrowing in foreign currency and in the Turkish lira, when they establish the necessary reserve requirements. To put it simply, banks would go with the lower cost option for themselves via this mechanism (Alper et al., 2013). ROM was constructed at a gradual pace that the financial system as well as banks would adopt it. The CBRT also needed time to assess the result of a mechanism that could make necessary adjustments. The CBRT changed the reserve requirement ratio in order to make this tool effective (Alper et al., 2013; CBRT, 2011; CBRT, 2016).

In order to contain credit growth, the CBRT increased the reserve requirement ratios and stopped paying interest for required reserves in the late-2010 (Başçı and Kara, 2011). As a conventional central bank implementation, a narrow and symmetric interest rate corridor is set around the target policy rate in order to ensure that the money market rate is close to the targeted rate. However, the CBRT utilized this corridor policy asymmetrically to discourage short term capital flows that could create a managed uncertainty about short-term yields. This policy was described as an 'unconventional' or 'unorthodox' and 'experimental' monetary policy tool which is used in line with the macroprudential framework (Yağcı, 2017). The CBRT could 'increase the width of the corridor or alternatively, decrease the lower limit of the corridor making a lower short-term yield more likely. Accordingly, reducing the lower limit during capital inflow periods and increasing the limit during capital outflow periods' would moderate fluctuations in the supply of foreign funds (Aysan et al., 2014, p. 57). In sum, the CBRT could change upper and lower bounds of the asymmetric interest rate corridor to determine the interest rate flexibly in response to cyclical capital flows.

The critical turning point in the implementation of macroprudential policies was the establishment of the Financial Stability Committee in June 2011. This committee included the relevant regulatory bodies such as the CBRT and the BRSA in order to implement macroprudential policies directly aiming at the reduction of risks facing the Turkish economy. Banking sector comprises 90 percent of the Turkish financial sector and thus, macrorpudential instruments used in the sector have mainly targeted this sector. Including the BRSA in the committee was complementary and, particularly, was necessary. The main priority of the committee was containing credit growth and improving the quality of bank liabilities. Kara (2016, p.88) asserts that the FSC 'helped the relevant institutions to internalise the macroeconomic and systemic dimension of financial stability, lifting some of the weight off the CBRT's shoulders'. An official from the BRSA mentioned that the agency took the opinions seriously coming from the

CBRT and took the necessary steps. However, this was possible for the existence of the FSC rather than the direct recommendations of the CBRT. It is worth noting that the FSC played a key role in the implementation of macroprundetial policies and also it served a mechanism helping the CBRT as the leading institution to policy formulation, policy implementation and evaluation of these policies (Interview 7).

The FSC is another internal institution or factor in the macroprudential turn in Turkey. The FSC was an instrumental mechanism to ensure that the implementation process went smoothly in the beginning due to the inclusion of the deputy prime minister in charge of the economy as the chairman. An official from the CBRT described this inclusion as a significant thing that the existence of the politician in the committee accelerated the implementation process as well as easing the implementation (Interview 4). However, the inclusion of a politician in such a committee caused some questions related to the autonomy of the institutions. Yağcı (2017) asserts that the support of the politician was a significant element for the emergence and implementation of the necessary policies without any resistance to the financial stability goal. Same kind of responses were emphasized during the interview process that the personality and the perspective of the politician in terms of the operation of the financial stability goal was an important and significant element in the emergence and the implementation process (Interview 1; Interview 2). A senior official from the bank stated that 'many central bankers from other countries were surprised about the speed of the decision making and implementation process of these policies. But the politician was the key point. He and all other members in the committee were aware of the independence issue and therefore, they behaved very carefully' (Interview 4).

The inclusion of the BRSA in the policy implementation process via the FSC was the second significant step. The QE policies of advanced countries' central banks in the post-GFC period created hot money flows to emerging economies such as Turkey. As indicated, the composition of capital inflows has been mainly constituted by portfolio investments and also external debt through the banking sector. A BRSA official pointed out that capital inflow measures taken by the CBRT were not enough to provide financial stability without a solid credit growth policy in Turkey. The BRSA re-structured in the post-2001 crisis reforms as the independent regulatory body of the banking system in Turkey (Bakır and Öniş, 2010). In this context, the BRSA, through the recommendations of the FSC, took several macroprudential measures in order to contain credit growth along with the CBRT. In addition, improving the quality of external financing in the domestic financial system was an important dimension of effective macroprudential measures that relevant institutions made several decisions in terms of financial stability objective.

Credit expansion due mainly to capital inflows was considered as a systemic risk factor for the Turkish economy by relevant authorities. To this end, the BRSA made new arrangements for credit card minimum payment requirements in 2010 to limit credit expansion. It planned a gradual increase in minimum payment rates until 2014. Accordingly, the minimum payment requirement was 20% regardless of the amount of purchasing, however, minimum payment requirements have been set with the new regulation implemented in 2014. The purpose of this regulation was to change the perceptions of the people on the credit cards, which had started to be used by many as a means of individual finance rather than transaction purposes. Banks started to provide credit cards to many consumers, even students who don't have any regular income, in the beginning of 2010. In addition, the BRSA took other measures to limit the credit expansion in early 2014. First, it limited all consumer loans that the maturity of vehicle loans and loans under vehicle collateral can not exceed 48 months and the maturity of consumer loans except mortgage/housing loans can not exceed 36 months. Besides, the BRSA didn’t allow credit cards to be used as advantage in certain sectors such as telecommunication and jewelry. However, some of those restrictions were relaxed at the end of 2015. Second, the BRSA limited the maximum number of the credit card monthly installments to nine for the purchases used credit cards (CBRT, 2014b; BRSA, 2015; BRSA, 2016).

In addition, Turkey utilized a tool of loan-to-value (LTV) ratio. The power of determining this ratio has been held by the BRSA in the Turkish financial system. This is used as a countercyclical tool to manage the developments in the credit volume in an economy. It became a common practice in financial systems in the world following the macroprudential turn. Therefore, Turkey adopted the LTV tool and the BRSA limited the LTV ratio for housing loans in December 2010. Accordingly, the maximum amount for a housing loan was limited to 75% of the value of a property. In other words, providing a credit for housing that exceeds 75% of the total value of the property is forbidden as a measure to limit credit volume in the economy. Moreover, the rapid credit growth of the vehicle loans forced the BRSA to take another measure for vehicle loans. The LTV ratio was set according to the value of the vehicles. If the value of the vehicle is 50,000 Turkish Lira or less, then the maximum ratio is 70%; if the value of the vehicle is more than 50.000 Turkish lira, then the LTV ratio is the 50% for the exceeding part (CBRT, 2011a; CBRT, 2014b). This arrangement has shown that Turkish authorities transfer international practices to their own regulatory frameworks in a more cautious way. Turkey also used the debt-to-income (DTI) ratio as an instrument to restrain personal borrowing or household borrowing. The tendency of excessive borrowing compared to their income forced the BRSA to take measures. In this sense, the BRSA made an arrangement which set a single, unified spending limit, which was compatible with a person's income level, for real persons who applied to have a credit card for the first time. Besides, a complementary regulation was implemented that, accordingly, the credit card issuing institutions couldn't raise the limits without having permission of the cardholder's formal confirmation (CBRT, 2013b).

On the other hand, domestic banks in the Turkish financial system substantially used external borrowing to finance credit demands after the global financial crisis due to adequate saving rates in the country along with cheap money coming from foreign financial markets. Therefore, improving the quality of external financing was a significant dimension of macroprudential measures. In this context, liquidity-related measures were implemented by the relevant institutions. The CBRT made an arrangement which differentiates the reserve requirements by maturity for the Turkish lira deposits, and later, for deposits in foreign currencies in 2011. Maturity mismatch was potentially a problem for the financial system following the global crisis that refers to a low liquidity level in a financial organization, and it usually emerges as a difference between short-term liabilities and long-term assets. In such a case, banks may not find enough liquidity to compensate for their need for their financial operations. The aim of the CBRT was to increase the costs of short term liabilities of the banks. To this end, the CBRT made several arrangements increasing reserve requirement ratios for local currency and foreign currency according to their maturities in 2011 and 2015 (CBRT, 2011a; CBRT 2015). Additionally, Turkey took some other measures to moderate the possible maturity mismatch problems in the banking sector. In 2013, the Council of Ministers released two resolutions aiming to promote long-term deposits, namely: a tax regulation and an early withdrawal right. Accordingly, the withholding tax is differentiated according to the maturity of time deposits. If the money is kept in the account for more than a year, then the withholding tax would be lower. The second resolution allowed the depositors to withdraw up to 50% fragment on their total deposits without losing any interest gain (CBRT, 2013a). In terms of liquidity-related measures for improving external financing, the CBRT also used reserve requirement ratios as explained earlier.

In addition to all those measures for banks to improve their mechanism using external financing, the BRSA took several capital-related measures in line with the new Basel III accord introduced by Basel Committee on Banking Supervision (BCBS) in the aftermath of the global crisis. A couple of novel instruments such as the leverage ratio and the capital conservation buffers for regulating the capital structure of the finance companies are added to traditional instruments such as capital adequacy ratios by the BCBS. Capital adequacy ratio forces the banks to hold sufficient equity for counter-weighing the assets exposed to risks. Minimum capital adequacy ratio is used as a countercyclical prudential tool. Turkey adopted and used these tools in order to ensure that individual financial institutions have a strong capital structure.

In this sense, the BRSA made a number of regulations in order to ensure that the Turkish banking system has a strong capital structure. The lower limit of the average minimum capital adequacy ratio, which was set by the BCBS, is 8%, however, this ratio in Turkey had been over the lower level due to the arrangements made by the BRSA in the aftermath of the 2001 financial crisis, which re-classified the consumer loans by their maturities in 2011. The risk weight for the loans was increased according to their maturity levels in 2013 by the BRSA (BRSA, 2012; BRSA, 2014). The Turkish regulatory agency, the BRSA, responsible for the banking sector has adopted international standards with a higher ratio than required to accord its regulatory framework to the Basel accord.

On the other hand, banks have to allocate provision for the possibility of potential insolvency of the debtors, or restructuring the loans portfolios of themselves. This provision is described as loan-loss provision which rates the banks' lending capacity. To this end, the regulatory agencies have to make necessary arrangements for credit cycles so that the stability of the financial sector could be assured. The BRSA took an action to contain consumer loans in 2011 that the provision rates were quadrupled for the banks that provided relatively more consumer loans, for loans other than housing and vehicles. However, the BRSA made an additional arrangement that vehicle loans were included in consumer loans. In other words, the BRSA expanded the scope of restrictions by including vehicle loans in 2013. Additionally, in 2015, the BRSA equalized the general provision rates applied to the financing companies and the banks that these two sorts of institutions were granted different rates in the early arrangements (CBRT, 2014a; CBRT 2014b; BRSA, 2016). Profit distribution of the financial institutions can be restricted by relevant authorities in order to prevent that capital has been consumed all or to keep the capital adequacy ratio above a minimum level. The BRSA made an arrangement that the financial operations conducted in 2009 or before were included. This arrangement strengthened the capital structure of the Turkish banks. Moreover, the BRSA made a new arrangement that the banks were obliged to retain additional common equity capital that this arrangement was adopted in order to comply with the regulations in Basel III Consensus. This new rule was introduced to the banks from 2016 and it will indirectly restrict profit distribution (CBRT, 2013b; BRSA, 2014).

Limiting the leverage ratio of financial institutions is a novel macro-prudential tool adopted in the post-global crisis period as another component of Basel III consensus. The idea is to keep the banks' borrowing activities under control. Thus, the risks that the banks may be exposed to will keep minimum due to their tendency of excessive borrowing. A low leverage ratio may cause severe risks to the whole financial system. The banks in Turkey are required to maintain the leverage ratio at least at 3% from

2015 onwards by the regulation of the BRSA made in 2013 in line with the Basel III arrangement (BRSA, 2014). The other two novel measures in Basel III consensus adopted by the BCBS are capital conservation buffer and cyclical capital buffer. These buffers are introduced for protecting banks against the developments in macroeconomic indicators and the credit cycles. The BRSA made the required arrangements related to the capital buffers and officially defined the capital conservation buffer and the bank-specific cyclical equity buffer in 2013. Thus, these measures adopted for Turkish banks in compliance with Basel III consensus (BRSA, 2014).

The global financial crisis has created a new orientation towards financial stability and the resulting macroprudential ideational shift in financial governance (Baker, 2013). With the macroprudential turn, central banks around the world have embraced precautionary measures against the systemic risks and implemented unconventional policy instruments in order to provide financial stability. In this sense, central banks of advanced countries increased their monetary bases with massive asset purchases and lending programs. As a result of this, emerging economies encountered a surge of short-term hot money flows. Turkey was case in point. In order to mitigate the risks arising from hot money flows, the Turkish regulatory institutions, in particular the CBRT and the BRSA, implemented several measures via the recommendations of the FSC beginning with the late 2010. However, macroprudential measures implemented to avoid the problems of an overheated economy resulted in a decline of economic growth beginning in 2012. The sharp decline in economic growth rates created a political backlash within the government against macroprudential measures.

### 4.5. The Dynamics of Policy (Paradigm) Change in Turkey

The global financial crisis in 2008 resulted with the emergence of macroprudential measures for financial stability purposes around the world. In Turkey, several macroprudential measures were implemented starting from late 2010 by the central bank and regulatory agencies. Several macroprudential measures were implemented, and notable mcaroprudential measures were enforced between 2011 and 2014 by relevant institutions. However, the macroprudential turn created a political backlash within the government following slowing economic growth rates in 2012. In addition, it was revealed that real and financial sector actors have divergent preferences in terms of the Turkish economy.

There have been several internal and external dynamics and drivers which influence the patterns of change in approach to financial governance in Turkey in the aftermath of the global financial crisis. One of the internal dynamics has roots in the bitter experience of a crisis that happened in the beginning of 2000s. Following the devastating February 2001 crisis, Turkey restructured its economy in line with the dominant neoliberal paradigm. As detailed in chapter 3, the notion of the regulatory state was an important key factor for transnational and domestic actors in line with the post-Washington Consensus (PWC). Accordingly, market liberalization per se could have been failed without an effective regulatory framework. Independent regulatory institutions are considered as the main distinctive characteristics of the regulatory state perspective (Bakır and Öniş, 2010; Gilardi, 2008). In this sense, the coalition government at the time in Turkey implemented several major institutional reforms with direct impetus of external actors such as the IMF, the World Bank and the EU following the 2001 crisis. Kemal Derviş, who is the former vice president of the World Bank, was in charge of economic affairs and had extensive managerial powers in order to smooth the application process. In this context, nine independent regulatory agencies were established and the central bank was granted legal independence (Kutlay, 2019).

In 2002, the Justice and Development Party (AKP) government took office and pursued the ‘transition to the strong economic program’ (CBRT, 2001) with the ideational and material support of the Bretton Woods institutions and the EU. The AKP embraced the reform program without any discernible edit of the neoliberal ideational paradigm (Kutlay, 2019; Öniş and Kutlay, 2013). Although there are some scholars who argue that the independence of these institutions are criticized with the concerns about the hegemony of bureaucracy over politics by some politicians within the AKP as early as in the pre-global crisis era (Özel, 2015), the central bank and regulatory agencies had their autonomy (Interview 1, Interview 2, Interview 4). Therefore, prudential policies in the Turkish financial sector, which is substantially dominated by banks, were being implemented in the banking system with the bitter experience of the 2001 crisis under the authority and the execution of these institutions. Bank regulation and supervision has been unambiguously prudent during the 2000s. Several measures were implemented. For example, there were restrictions on foreign currency lending to non-financial firms, banks were not allowed to have currency mismatches and foreign currency loans to consumers were prohibited. New bank entry into the domestic financial sector, branch openings for banks and distributing bank dividends were under tight restrictions. Significantly higher minimum capital adequacy and liquidity coverage ratios than required by international standards were imposed by the BRSA. During this period, banks maintain liquidity buffers and ample capital that reflects the prudential framework of the Turkish authorities (Kara, 2016). It is worth noting that Turkey benefited from hot money flows in the 2000s, which resulted with rapid credit growth. This was tried to be controlled with a considerably tight bank regulation and supervision as explained above.

One external dynamic was the global financial crisis and, more importantly, the resulting macroprudential ideational shift as an external dynamic influencing policy paradigm change in Turkey. In the aftermath of the global financial crisis in 2008, financial stability has been the major concern not only of advanced countries but also emerging economies. In this context, the financial stability objective has resulted in a macroprudential ideational shift around the world (Baker, 2013; Baker and Widmaier, 2014). Regulatory institutions in global and domestic financial sectors, and particularly, central banks started to implement macroprudeantial measures to prevent likely systemic risks and also to provide financial stability. In advanced countries, central banks have implemented QE policies along with the massive asset purchases and lending programs in line with the financial stability objective. However, these measures resulted in highly volatile excessive 'hot money' flows to emerging economies (Ahmed and Zlate, 2014) such as Turkey. These short-term and highly volatile hot money flows was another critical external dynamic in terms of macroprudential turn in Turkey. The Turkish economy faced an increasing sudden 'stop risk' due to large external financing needs and the deterioration in the quality of inflows in 2010. The main trigger for output losses across emerging economies have been sudden capital outflows

(Claessens and Ghosh, 2013). This has been the case for Turkey as other emerging economies (Kara, 2016).

As narrated in detail in the previous section, the central bank of Turkey and regulatory institutions enforced several macroprudential measures to address the risks Turkey faces due to the overheating in the economy. The macroprudential turn in Turkey was initiated by the CBRT in the first place by stating the risks of overheating in the economy which occurred because of the surge of capital flows into the country. These measures started in the late 2010 and notable macroprudential policies implemented between 2011 and 2014 by the relevant regulatory agencies. It is worth noting that there isn't any external impetus for the policy reform, on the contrary to the earlier crises. Turkey, in the economic realm, has always been known as a reactive state. This means that policy reform has been initiated following a crisis, and with key external actors playing a central role in the reform process (Öniş and Şenses, 2007). Therefore, the initiation of macroprudential policy is an outlier case in Turkey (Yağcı, 2017). The CBRT and its governor back then, Erdem Başçı, has played a key role for macroprudential ideational shift in Turkey. These actors initiated policy and institutional change for financial stability and they also were actively involved in all the policy stages of agenda setting, policy formulation, implementation and evolution via the FSC. Although the CBRT embraced its new mandate in the result of shifting external consensus, it has started to actively pursue financial stability goal without any legal amendments. In addition, the CBRT introduced new 'experimental', 'unconventional' or 'unorthodox' monetary policy tools by pointing out the increasing risks that Turkey faces due to overheating in the economy (Yağcı, 2017; CBRT, 2010). The CBRT has introduced two new policy instruments, interest rate corridor and reserve option mechanism (ROM) as unconventional monetary policy instruments (Yağcı, 2017).

A large amount of short-term capital inflows pose risks for many emerging economies. To illustrate the adverse impact of these hot money flows, the term 'fragile five' was used for Brazil, India, Indonesia, South Africa and Turkey due to having similar problems. These countries were dependent on foreign money inflows, had large current account deficits and lower economic growth prospects, and as a result they had higher risk of currency depreciation against the US dollar (Yağcı, 2017). Therefore, the CBRT and its governor initiated a policy and institutional change without any direct capital flow management measures in order to provide financial stability. However, macroprudential measures to mitigate the risks arising from hot money flows were mandated without an explicit and formal macroprudential policy framework. In order to prevent likely systemic risks and thereby to achieve financial stability, macroprudential measures were implemented through domestic institutions and officials in the regulatory agencies. Also, these policies were put into practice without any financial crisis originating domestically and without any external actors playing a central role in the reform process. As a former high level Turkish central bank official puts it, Turkish authorities have been thinking to take necessary measures in terms of volatile capital flows. Although this is not expressed publicly, an exchange of ideas on this issue was put into place among key policy makers (Interview 4). However, this would be difficult considering that Turkey has an open capital account regime, and requires capital inflows for its growing economy and is in a highly debted position. The global trend taken place in terms of macroprudential ideational shift in the post-GFC helped Turkey to implement these measures without any concern regarding capital inflows and debt position of the country (Interview 2; Interivew 4).

Therefore, the central bank of Turkey and its governor as internal actors played a key role in the macroprudential turn. In addition, the BRSA had a very key role in implementing macroprudential measures during this process considering that the agency has the responsibility of banking regulation and supervision in the Turkish financial sector. A high level official from the BRSA stated that the central bank has been the main actor in conducting macroprudential measures. However, it was stated that the CBRT would have been a missing hand without the BRSA in the implementing process. Because, Turkey is hosting a multiple regulatory system (Interview 7). Nevertheless, it is worth noting that the FSC, as an internal actor, played a key role in the implementation of macroprudential policies and also it served a formal mechanism helping the CBRT as the leading institution to policy formulation, policy implementation and evaluation of these policies (Interview 7). However, as Han (2016) states, the pursuit of financial stability of central banks in an explicit and active way in the post-global financial crisis era has significantly altered their relationships with financial markets and, particularly, governments.

The critical date is 2012 in terms of the macroprudential ideational shift in Turkey. The Turkish economy saw high annual GDP growth rates until the global crisis when GDP declined to 0.8 percent in 2008 and -4.8 percent in 2009. However, the economy recovered rapidly and saw high annual growth rates once again; 8.4 percent in 2010 and 11.2 percent in 2011. These exceptional growth rates didn't last long and declined to 4.7 percent in 2012 (World Bank Open Data, 2022). Afterwards, the political backlash within the ruling party to these measures started to surface and persisted thereafter.

Macroprudential policies, by their nature, have some costs for emerging economies in terms of economic growth. A high level CBRT official pointed out this issue and said that 'central banks and other regulatory institutions were aware of this risk for the Turkish economy, so these agencies were careful not to harm economic growth. In other words, we tried to keep the balance between these measures and economic growth' (Interview 1). Based on a high level central bank official, Yağcı (2017) also underlined the same issue that the CBRT provided a soft landing in the economy against the risks of overheating. However, a debate on the extent of these measures started in the political realm rather than the financial sector itself.

There was a prominent disagreement between Ali Babacan, who was the deputy prime minister in charge of economy, and Zafer Çağlayan, who was the minister of economic affairs then, on the speed of economic trajectory in 2012. Ali Babacan talked about the discussions on the macroprudential measures cooling of the economy and said that 'the driver, in the foggy weather, does not listen to people saying don't break, hit the gas'. Zafer Çağlayan repsonded this 'Of course there should be prudence but the car doesn't go with the handbreak on. No need to worry if the driver knows advanced driving techniques' (Star, 2012). Shortly afterwards, Recep Tayyip Erdoğan, who was the prime minister then and now the president, joined the discussion and said that Çağlayan is right (T24 Online Newspaper, 2012).

On the other hand, the regulatory agencies, established in the restructuring process following the 2001 crisis and the main characteristics of the post-Washington Consensus, were also in the beginning of the transformation due to the differentiating economic visions of the key political actors. Recep Tayyip Erdoğan has a more interventionist developmental paradigm. On the other hand, Ali Babacan was a strong supporter of macroprudential measures and financial stability orientation along with being a staunch supporter of the regulatory state paradigm at the time. These differences caused ideational differentiation in the economic policy-making process (Yağcı, 2018). This can be clearly followed from the discussions surrounding the status of the central bank, and its policy stance in terms of macroprudential measures along with monetary policy.

The idea of 'developmental central banking' has already been practiced in several emerging powers. Some key political actors were influenced by this idea such as Erdoğan and some of his close advisers. Ali Babacan clearly opposed political intervention in the regulatory agencies (Kutlay, 2019; Yağcı, 2018). His support was a key factor for macroprudential measures to be implemented smoothly, at least in the beginning. Erdem Başçı, who was the governor of the Central Bank between 2011-2016, resisted the reduction of interest rates in late 2013. In the words of a high level CBRT official, the Central Bank had a solid autonomy when Ali Babacan and Erdem Başçı were in the office (Interview 1). In addition, Başçı was harshly criticized by Çağlayan in 2013. The governor of the Central Bank, Başçı, expressed that the economy is slowing down because of macroprudential measures by saying that Turkish economy 'got off the plane and now advancing on the highway'. Çağlayan responded that the central bank Governor is just a civil servant serving the government, and the Governor alone can not determine the economic policy trajectory of Turkey. Çağlayan added that the only responsible for economic policy is the government itself (Vatan, 2013).

Although the political pressure and severe criticisms on the CBRT increased in time, macroprudential policies stayed intact and the CBRT maintained its tight monetary policy stance. For instance, an interest rate decision taken by the CBRT surprised. The bank had an emergency midnight meeting on 28 January 2014 due to the serious market pressure on the Turkish lira against the US dollar. The CBRT increased the policy interest rate from 4.5 per cent to 10 per cent. This was shocking considering that even many market players didn't expect it. Later on this interest rate decision was interpreted as the beginning of the end for both Ali Babacan and Erdem Başçı. The tone of criticisms went higher following this date. And the economic vision difference between Erdoğan and his close advisers, and Ali Babacan turned out clearly. In May 2014, the policy interest rate was reduced by 0.5 per cent and Erdoğan called the cut a 'joke'. Besides, Erdoğan severely criticized Başçı regarding high interest rates, and stated that he was the one elected and represented the will of the Turkish citizens; so he was feeling more responsibility towards those people, contrary to the governor and 'unelected' central bank bureaucrats. And Nihat Zeybekçi, Minister of Economy at the time, endorsed Erdoğan's statements by saying that his outcry was justified with these interest rate decisions (Yağcı, 2018). In March 2015, Erdoğan, the president at the time, addressed both Ali Babacan and Erdem Başçı with a threatening tone, '"[y]ou cannot make decisions because the interest lobby applauds them". He then stated that "those who pursue a high-interest-rate-policy are traitors"' (Özel, 2015, p. 242).

Not surprisingly, Ali Babacan, who has been in the cabinet with different titles in the consecutive AKP governments since 2002, was not reappointed as a minister following the November 2015 election. Similarly, Erdem Başçı was not reappointed as the CBRT Governor after his first term ended in 2016. Moreover, the powers of the deputy prime minister were curtailed after the formation of a new AKP government in May 2016. During Ali Babacan's tenure, the deputy prime minister was responsible for all regulatory institutions along with state banks. However, the new deputy prime minister, Mehmet Şimşek, supervisory authority over the regulatory institutions, CPM, BRSA, SDIF and Export Credit Bank of Turkey was given to other ministers.

Although macroprudential policies for financial stability and thereby preventing systemic shocks have not been revoked, the developments taken place in the post-2012 indicated how ideas and beliefs of political actors shape their approach and the reforms they enact in the Turkish case. In addition to this political backlash within the ruling AKP government against macroprudential measures, there are other critical factors which have influenced the macroprudential turn in Turkey. Some macroprudential policies implemented had complex structure along with their technical nature. This perplexed actors not only from reel sector but also from banking sector as well.

Trade and financial liberalization has several impacts on the relationship between the state and private sector by its nature. Similar to this, the adoption of a macroprudential regulatory approach will have different impacts on the relationship between the regulators and the banking sector itself along with the reel sector. As Yağcı (2018) states, referencing a representative of a big holding company, the central bank didn't provide a clear road map for macroprudential policy framework and this made policies unpredictable. In this sense, a high level official from the BRSA stated that the agency was not asking any advice from the banking sector representatives before any policy implementation. He stated that the agency was asking representatives to give their opinions and advice prior to any policy implementation in the pre-macroprudential policy period. However, it was not the case within the macroprudential policy framework (Interview 7). This was reflecting the nature of regulatory framework of macroprudential policies, which is "a system-wide top-down approach to regulation and financial stability that seeks to 'curb the credit cycle' through countercyclical regulatory interventions by directing, and sometimes directly constraining, the commercial activities of private institutions" (Baker, 2013b, p. 418). The FSC had an impact on this relationship. The foundation of the FSC along with the central bank in the driver seat diminished the influence of the banking sector in the regulatory policy making process (Interview 4, Interview 7).

On the other hand, the macroprudential turn uncovered the divergent preferences of reel sector actors. This can be exposed with the divergent preferences of two major business groups, namely TÜSİAD and MÜSİAD, in the Turkish context. These two business groups have different ideological backgrounds as well as different political orientations. While TÜSİAD (Türk Sanayicileri ve İş İnsanları Derneği—Turkish Industry and Business Association) is mostly composed of large holding companies based in İstanbul, MÜSİAD (Müstakil Sanayici ve İş Adamları Derneği—Independent Industrialists' and Businessmen's Association) is mostly composed of SMEs based in different cities in Turkey (Öniş and Türem, 2001). These two non-governmental business associations reflected their divergent preferences about the economy in public statements. In 2015, Cansen Başaran Symes, TÜSİAD chairwoman, stated that inflation rates were high and this harmed economic growth rates. Also, she stated that the fight against high inflation rates were not enough by implying an increase in the interest rate (Haberler, 2015). However, she was criticized by the president Erdoğan due to her comments on the economy a day later (Dünya, 2015). Two weeks later she was also condemned by the chairman of MÜSİAD for complaining about high interest rates in the economy. In addition, he argued that the members of TÜSİAD earn money mostly through non-operating ways rather than through production. According to him, MÜSİAD members earn money through production unlike TÜSİAD members (Türk, 2015). It can be stated that MÜSİAD prefers neo-developmentalist approach and policies of the AKP government. This also reflects developmentalist central banking preferences of the AKP government as stated above.

Moreover, the AKP government made a critical move that the idle credit guarantee scheme (CGS) was revived with special emphasis on assisting SME financing in 2017. Small and medium-sized enterprises (SMEs) are very important for the Turkish economy. They 'constitute the largest business segments in terms of their share of the economy and their contribution to employment and economic growth' (Yağcı, 2019, p. 337). Although the CGS was first founded in 1991 and became effective by granting its first guarentee in 1994, its activities were very limited until the revival in 2017 in terms of assisting the financing needs of micro, small, and medium-sized enterprises (MSMEs). The revision of the CGS reflects the changing context in terms of the macroprudential turn in Turkey with the transformation of the Turkish political economy following the beginning of 2017. Although macroprudential measures provided a soft landing for the Turkish economy in the face of large amounts of capital inflows and the resulting overheating economy. However, declining economic growth rates caused a political backlash within the AKP government in the post-2012 period. In addition, the failed coup attempt caused a sharp decline in economic growth rates. Therefore, the government decided to ease access to finance for SMEs in order to stimulate the economy despite macroprudential measures implemented. The CGS revived after a long period of time and played a key role in this.

The CGS played a very significant role for economic growth rates in the third quarter of 2017 that the Turkish economy grew by 11.1 percent. In the same quarter, while the imports of goods and services increased by 14.5 percent, the exports of goods and services increased by 17,2 percent. The AKP government implemented new measures for the CGS in order to provide easy finance for SMEs and to boost the economic growth rates further. Therefore, a new era started for the CGS in Turkey. According to a protocol signed between the Turkish Treasury and the CGS following the Council of Ministers Decree 2017/9969, the KGF was going to be supported by the Turkish Treasury in several respects. Moreover, the KGF replaced the credit approval committees by introducing an internal evaluation system and the 'Portfolio Guarantee System' in order to accelerate the credit utilization process. In this way, banks would directly assess the application and following the approval the CGS would only seek whether the application compliance with the beneficiary conditions. These changes shortened the loan application process from 35-40 days to 1 day. The CGS measures were considered permanent structural reforms rather than a cyclical tool for the Turkish economy by a CGS representative. Moreover, the CGS representative stated that the CGS surpassed the Republic of Korea's Credit Guarantee Fund (KODIT) by becoming the largest credit guarantee fund in the world with new measures implemented in 2017 (Yağcı, 2019; Para Analiz, 2017).

By the end of the third quarter in 2017, the annual corporate loan growth was 20 percent due to the CGS measures. The total loan provision of the Turkish banks had reached 529 billion US dollars by September 2017 (TCMB, 2017). Commercial and corporate loans comprised 51 per cent, SME loans 25 per cent and consumer loans and credit cards 24 percent of these loan provisions (BRSA, 2017). By the end of the third quarter in 2017, the annual corporate loan growth was 20 percent due to the CGS measures. The total loan provision of the Turkish banks had reached 529 billion US dollars by September 2017. Commercial and corporate loans comprised 51 percent, SME loans 25 percent and consumer loans and credit cards 24 percent of these loan provisions. 314.239 SMEs received authorized guarantees in 2017 only. The total amount of these guarantees reached 238 billion Turkish lira. The number of firms that received guarantees in 2017 only is six times higher than the number of firms that received guarantees between 1994 and 2016 in total. The result is the higher economic growth rates than in the last few years in the Turkish economy with the annual rate of 7.4 percent in 2017. So it can be stated that the CGS contributed to the economic growth rates significantly.

Turkey is one of the countries that made the most use of macroprudential policies among developing countries following the GFC between 2010 and 2016 due to large amounts of capital inflows (Boar et al., 2017). However, the macroprudential turn created a political backlash within the government that started to surface in 2012 and persisted thereafter. In addition, it was revealed that real and financial sector actors have divergent preferences in terms of the Turkish economy as indicated above in terms of the use of macroprudential measures and monetary policy. Moreover, the revival of the idle CGS by the government with the special emphasis on assisting SME financing in 2017 has been a critical move in terms of the future of macroprudential measures. An expert from the Ministry of Treasury and Finance stated that the CGS revival was a kind of announcement that macroprudential measures had largely lost its significance in terms of the Turkish economy. Because the government has prioritized higher economic growth rates rather than financial stability (Interview 6). The currency crisis in August 2018 has been an early indication on what comes next in terms of the future of the Turkish economy, and the priority of the AKP government and Erdoğan.

### 4.6. Conclusion

This chapter focuses on the macroprudential ideational shift between 2010 and 2017 period in Turkey. This chapter argues that there are several internal and external dynamics and drivers which influence the patterns of change in approach to financial governance in Turkey in the aftermath of the global financial crisis. The macroprudential turn in Turkey was significantly influenced by the GFC and the resulting ideational shift in international financial regulatory networks.

Due to the measures of advanced countries in the post-crisis period in line with the emergence of macroprudentialism, the increasing volatility in capital flows resulted in significant challenges for developing and emerging economies. In this sense, Turkey utilized macroprudential policies to mitigate the surge of short-term 'hot money' flows in the post-GFC period. With the bitter experience of the devastating 2001 crisis, bank regulation and supervision has been unambiguously prudent during the 2000s. However, external consensus on the use of macroprudential measures eased the central bank of Turkey to initiate and implement a new unconventional and experimental monetary policy in line with the macroprudential turn. In addition, the FSC was founded in 2011 with a key role in the implementation of macroprudential policies. Through the FSC, the CBRT and the BRSA, which is responsible for banking regulation and supervision, have implemented several macroprudential measures starting from the late 2010 in order to provide financial stability in the domestic financial system.

Although several internal actors such as the CBRT and its governor, the FSC, the BRSA and the deputy prime minister in charge of economy supported and defensed macroprudential measures against the risks arising from hot money inflows, the coherence and legitimacy of these policies was undermined in the post-2012 period. A political backlash started to surface within the AKP government against macroprudential measures with the claim of being harmful for economic growth in 2012. Structural features of the Turkish political economy combined with low interest rates in global markets, particularly in the post-GFC period, provided an environment that large holding companies easily attained foreign currency loans with low interest rates. However, SMEs could only attained Turkish lira credits with comparably high interest rates. While big holdings in the Turkish economy emerged as winners, SMEs emerged as losers from the macroprudential turn in Turkey. As representatives of SMEs, and a political and ideological ally of the ruling party, MÜSİAD criticized policies of the CBRT and the resulting high interest rates. On the other hand, TÜSİAD expressed concern about high inflation rates, as the representatives of big holding companies. In addition, the CBRT and its governor along with the deputy prime minister was harshly criticized by the president Erdogan due to high interest rates along with religious reasons. The revival of the idle credit guarantee scheme in the beginning of 2017 by the government damaged more the legitimacy and the coherence of the use of macroprudential measures implemented with the purpose of financial stability goal.

The political elites in the ruling party and, in particular, its leader, Erdogan, prioritized GDP growth at all costs. To this end, the independence of regulatory institutions has been another critical point about the macroprudential turn in Turkey. Executive control over domestic financial institutions, such as the CBRT and BRSA, was instrumentalized in order to provide proper environment for preferred policies. As Demiralp and Demiralp (2018) suggest rising populist pressures of political elites within the ruling party caused to decline of central bank independence. The government prioritized economic growth and the resulting low unemployment rates. Also, politicians within the AKP was afraid of losing its office, so some politicians, especially Erdogan, increased critics due to lower cost of applying pressure on the central bank. This happened because of political and economic developments in Turkey in the post-2012 period. The independence of the central bank, despite its guarantee by the Central Bank Law amended in 2001, is also related to broader political changes including the transition to a fully fledged presidential system with authoritarian and undemocratic features in the June elections of 2018.

# Chapter 5

# The Politics of Industrial Policy Formulation in Turkey in the 2000s

## 5.1. Introduction

The period starting with the 24th January Decisions led to a significant transformation process in Turkey not only in the financial sector but also in the Turkish industry. Therefore, this chapter deals with the economic and political developments taken place from the beginning of 1980 to the global financial crisis in the late 2000s with a focus on the Turkish industrial restructuring. The purpose of the chapter is to provide a detailed contextualisation of the contemporary industrial policy dynamics that are explored in Chapter Six.

This chapter states that neoliberal restructuring of the Turkish industrial sector had not been independent of the external and internal factors during this period. In line with the liberalization trend in the global markets, Turkey started to liberalize its foreign trade in the middle of 1980s gradually. In the beginning of 1990, capital account liberalization was also implemented despite the lack of proper regulatory mechanisms. Hence, Turkey faced successive crises over a short interval in 1994, 1999 and lastly in 2001. Following the 2001 crisis, neoliberal industrial restructuring had been identified as a critical turning point for the Turkish industry. Although it was witnessed a growing export and a transformation from low technology to medium and high technological industrial production in some sectors, new production and export lines became dependent on imported components.

In the next part, I will present the developments taken place in the pre-2001 crisis period of the industrialization efforts in Turkey. In the period between 1950 and 1980, Turkey implemented the Import Substitution Industrialization paradigm in order to build an industry with the help of the Planned Economy perspective as other developing countries during this period. However, the deterioration in the domestic economic and political situation starting with the oil crisis in the global markets forced Turkey to change its economic paradigm. In light of these developments, this chapter will argue that neoliberal industrialization in Turkey was not independent of the liberalization trend in international finance and the world commodity markets that Turkey embraced a new economic paradigm called the Washington Consensus or neoliberalism with the 24th January Decisions in 1980. In the third part of this chapter, I will argue that the Turkish economy was restructured by the key principles drawn up by the Post-Washington Consensus following the major crisis in 2001. In the aftermath of this devastating crisis, Turkey has benefited from the overvalued Turkish lira and a favorable global market to increase its export. However, import dependency started to be a major problem. In the fourth part, I will conclude that although the Turkish industry has achieved a substantial transformation in manufacturing output and exports in the 2000s, its mode of articulation with the global markets has not changed from low technology producer to medium and high technology producer during the same period.

### 5.2. Neoliberal Industrialization in the Pre-2001 Crisis Period in Turkey

Industrialization had been an important aim for Turkey since the beginning of the foundation of the republic in 1923 and a considerable industrialization effort was spent with the leading of the state until the beginning of the 1950s. Most of the established industrial enterprises were founded with the support of the state rather than private sector investments from 1933 to the beginning of the 1950s. Private investments with the foreign credits started to establish new industrial enterprises in the following years. Between 1960 and 1980, Turkey embraced the import substitution industrialization paradigm with the Planned Development perspective. However, this period ended with a major crisis at the end of the 1970s. A policy paradigm change was adopted in 1980 with the January 24th Decisions which were a radical institutional and policy change in the history of the Turkish economy. Accordingly, export orientation and integration with the global economy has been the overarching goal in line with the new policy paradigm namely the Washington Consensus prescribed by the international financial institutions for developing countries.

### 5.2.1. Industrialization in the Early Decades (1950-1980)

Turkey was largely a rural country in the post-Second World War years. The country was ruled by a single-party government system from the early 1920s to the late 1940s. In the 1930s, the government established a number of State Economic Enterprises (SEEs) in line with the 'étatism' ideology. This was the beginning of the industrialization efforts in the newly founded republic and also it was a reason for the lack of indigenous entrepreneurship in the private sector making such investments in the early years of modern Turkey. The country moved to a multi-party system in the late 1940s and the first election was held in 1950 in the new system. A new (Democratic Party) party having a tilt toward liberalism won the elections (Celasun, 2002).

The growth rates were high in the first half of the 1950s in Turkey due to the favourable external trade conditions and the post war Marshall Aid program of the United States. The agriculture sector largely dominated the economy during this period. State Economic Enterprises (SEEs) were producing most of the industrial products. However, the economy's performance worsened in the later years. In 1954, there was a massive crop failure. Therefore, the foreign exchange stringency caused sporadic import-substitution activity as well as facilitating the emergence of an entrepreneurial class in the country. The reason for this poor performance of the economy was largely a long term decline in international prices of agricultural commodities. In addition, chronic current account deficit was another major problem for Turkey. It was clear that this deficit was difficult to finance with foreign borrowing. In the given circumstances, Turkey's external imbalances widened and the government adopted an IMF-supported stabilization program involving a substantial devaluation of the Turkish lira in 1958 (Yılmaz, 2012; Celasun, 2002).

Worsening domestic political situation along with a period of economic decline ended with a military coup in May 1960. A new and more liberal leaning Constitution was prepared by the military-backed government in 1961. The Constitution embraced indicative planning as an essential instrument for economic development. In other words, the new Constitution institutionalized development planning. Within this framework, the State Planning Organization (SPO) was established with the task of preparing five-year plans covering all aspects of economic development in the whole country (Yılmaz, 2012).

The ISI policy paradigm was embraced by Turkey in 1963. Turkey, like many developing countries, saw the ISI paradigm as the only strategy in order to develop their domestic manufacturing industries. These countries were heavily dependent on intermediate and investment goods as well as consumption goods, and their export goods were largely raw materials and agricultural commodities. Five-year economic development plans were the main character for economic policymaking during the ISI paradigm period. These plans set the guidelines in a mixed economy framework in order to provide medium-term macro balances and sectoral expansions. There was an annual program for each year in five-year plans. These programs coordinated investment and public finance as well as specified policy measures. Yearly export regimes and import programs were the integral parts of the annual programs. Until the policy paradigm change in the beginning of 1980, Turkey heavily utilized financial repression and a restrictive trade regime in order to promote domestic industrialization. The main goal was to provide domestic demand and to produce imported goods domestically. The SEEs investment programs were also used as an additional tool for domestic industrial development in the overall context of the ISI policy paradigm period (Karluk, 2014; Yılmaz, 2012; Celasun, 2002).

The years in the ISI paradigm can be divided into two phases. In the first phase, from 1963 to 1970, the focal point was mainly to develop the domestic consumption goods industry. In the second phase, which ran from 1970 to 1980, the aim was to develop local productive capacity in durable consumer goods as well as intermediate goods industries. The state played an active role in the ISI policy paradigm years in order to develop different industries producing intermediate products. In addition, the state's role had been very significant for industries that produced machinery and equipment through SEEs in the 1970s. The share of SEEs in value added and manufacturing employment exceeded 40 and 35 percent in the late 1970s, respectively. Also, scale- and resource-intensive industries such as cement, iron and steel, chemicals, and paper were dominated by the SEEs that produced more than half of the value added of these sectors (Yılmaz, 2012; Kepenek and Yentürk, 2001).

The overall performance of the Turkish economy improved during the first phase of the ISI paradigm. The First (1963-7) and the Second (1968) five-year economic plans generated a substantial rise of GDP at 6.7 percent per year on average. Inflation rates were also low during these years, around 10 percent levels. Concessional capital inflows organized largely by the OECD Aid Consortium played an important role in this steady growth period. In addition, Western European countries, in particular Germany, accepted many Turkish workers. This eased the increasing unemployment problem due to the acceleration of rural-urban migration during these years in Turkey. Although the ISI paradigm carried out through five-year economic plans produced a substantial growth until the end of the first half of the 1970s, heavy reliance on investment and intermediate goods imports continued during this period, import dependence increased furthermore, and financing of the chronic trade deficit become more problematic (Yılmaz; 2012; Celasun, 2002).

In the mid-1970s, the oil prices went substantially higher in the global markets and the Turkish coalition governments decided not to reflect these high prices in the domestic market. Therefore, the demand for gasoline continued to remain strong and the trade deficit increased to a very high level. The budget deficit also increased for the reason that the governments decided to undertake the bill of oil import itself. Although the Turkish economy experienced a current account surplus in 1973 due to the active drive for export expansion of the governments along with the world economic boom in the early 1970s, chronic current account deficits became a destiny for Turkey in the second half of the 1970s for mainly two reasons, namely, the soaring cost of the oil bill and the increasing import needs throughout the capital deepening process. In the beginning, financing fiscal and current account deficits was not a difficulty due to the borrowing from international banks. However, access to external borrowing stopped being an option for Turkey no longer, because the governments failed to bring both deficits under control. Therefore, Turkey faced a massive balance of payment crisis in 1978 and 1979. At the same time, Turkey was going through the worst political instability resulting in a military coup in 1980 in its history. Budget deficits caused the inflation rate to go up to 64 percent in 1979, as well as a 2.8 percent in the GDP. In this setting, ‘a credible adjustment could not be launched in 1978–9, and the economy had to adjust to reductions in external resources via import compression, high inflation, output losses and disrupted markets’ (Celasun, 2002, p. 456). Hence, a policy paradigm change happened via the 24th January Decisions in 1980 (Yılmaz, 2012; Celasun, 2002).

### 5.2.2. The Post-1980 Industrialization Process

In the late 1970s, Turkey, as many other developing countries that adopted the import substitution industrialization paradigm, experienced a serious balance of payment crisis due mainly to a rapid rise in the oil prices and very costly foreign borrowing. In addition, capacity utilization rate in production decreased below 50 per cent due to the poor implementation of the ISI paradigm. The shortage of intermediate and investment goods production were the other reasons for the chronic balance of payment crisis in these years. Slowing economic growth, highly increasing external debt along with the political instability characterizing these years paved the way for the end of the ISI paradigm. As a consequence of all, the 24th January Decisions considered as a revolution in the history of the Turkish economy were implemented in 1980. This moment represented a rupture from the old import substitution industrialization paradigm to new neoliberal paradigm which the state is considered as a ‘problem’ for the efficient functioning of the markets (Karluk, 2014; Taymaz and Voyvoda, 2012).

Until 1980, Turkey implemented an economic policy paradigm which is generally known as import substitution industrialization (ISI) as many developing countries. This economic policy paradigm is characterized by a repressed financial system, dominance of state-owned enterprises in critical industries and also banking, very high protection from imports, and heavy controls on domestic prices. The ISI paradigm was implemented between 1960 and 1980 in Turkey. The macroeconomic performance of the Turkish economy deteriorated after 1976 and this period ended with a major crisis in the late 1970s. A radical economic program was launched in the aftermath of the crisis. Following the 24th January Decisions in 1980, the era of neoliberal restructuring shaped by internationalization and market-based orientation was started to be implemented in the Turkish economy (Atiyas and Bakis, 2015).

Turkey's experience of neoliberal paradigm in the industrial policy sphere can be divided into two phases: the 1980-2001 and post-2001 periods. The first phase was dominated by the principals of the Washington Consensus. This policy prescription supported by the international financial institutions such as the IMF and the World Bank is mainly characterized by opening up of the economy towards full integration with international finance and the world commodity. In Turkey, the 1980s were marked by a fundamental change from the ISI paradigm to trade liberalization, liberalization of domestic goods and financial markets, and liberalization of international finance. Foreign trade was liberalized first, during the early and mid-1980s. The decision of capital account liberalization was enacted in 1989 and implemented in 1990. In other words, the role of the state in economic affairs was aimed to be reduced during this period in line with the neoliberal policy paradigm (Atiyas and Bakis, 2015; Taymaz and Voyvoda, 2012).

In the late 1980s and during much of the 1990s, the main character of the Turkish economy was the culminating fiscal deficits and macroeconomic imbalances. During these years, Turkey suffered high inflation rates, high real interest rates, high budget deficits, and rapidly accumulating public debt. In order to overcome these issues, capital account liberalization was adopted in 1989 and implemented in 1990, in spite of opposition that it would be a premature decision due to the structure of the economy. Because there aren't proper and adequate regulatory institutions in the Turkish financial sector. The decision of capital account liberalization paved the way for the injection of liquidity into the domestic economy, in the form of short-term foreign capital flows. As a matter of fact, these hot money flows had favourable effects in the following few years in terms of economic growth. They, however, caused erratic movements in the current account balance and, therefore, the vulnerability of the Turkish economy to external shocks seriously increased. Another major step in the liberalization process in the first phase of the Turkish neoliberal restructuring was the

Customs Union agreement undertaken with the European Union in 1996. However, the liberalization process in the 1980s and 1990s was not accompanied by stabilization. Therefore, Turkey experienced serious economic and financial crises in 1994, 2000 and 2001. The 1990s are often regarded as the "lost decade" or "a decade to forget and this decade represents the unhappy face of the Washington Consensus in the neoliberal restructuring of the Turkish economy (Atiyas and Bakis, 2015; Taymaz and Voyvoda, 2012; Öniş and Şenses, 2007).

#### 5.2.2.1. The Early Decades of The Washington Consensus: 1980-1988 Trade Liberalization

The new neoliberal paradigm or 'rescue package' put into practice in response to the crisis in the late 1970s was designed and implemented with the heavy involvement of the IMF and the World Bank. The three primary objectives of the 'rescue package' was to bring inflation under control, to stabilize economic performance and more importantly, to solve the chronic balance of payments problems. Although the new economic program was delayed for at least a year due to the unstable political environment at the time, its long term objective was quite ambitious. According to the new policy paradigm called neoliberalism or the 'Washington Consensus', liberalization would allow markets to achieve efficient resource allocation under the principals of the relative price movements along with the outward orientation. When industry was exposed to the global markets in which there is competition and technological know-how, rapid gains in productivity would be converted into industrial restructuring via competence in the area of technology, increased human capital as well as an environment of comparative advantage. In this way, industry would be a sound ground for the growth of the rest of the economy as well (Taymaz and Voyvoda, 2012; Yılmaz, 2012).

The 24th January decisions as the beginning of a new era for the Turkish economy were not fully implemented until the military coup on 12 September 1980 when the ISI paradigm period ended for good. The year 1980 might be considered as the year of initial efforts to move to neoliberal paradigm, however, this was interrupted with the military coup. Following the announcement of the new policy package, the government focussed two primary objectives, namely export led output recovery and macroeconomic stabilization in spite of the severe import compression and high inflation. On the other hand, as part of its outward-oriented growth strategy, the government implemented various measures such as foreign exchange allocations, export tax rebates, preferential export credits, and duty-free access to imports (Yılmaz, 2012; Celasun, 2002).

The initial sharp adjustments in the exchange rate, interest rates and administered product prices was coupled with rapidly implemented unorthodox export incentive schemes. These measures helped in regaining confidence of international creditors such as the IMF and the World Bank. The adjustment loans coming from these institutions were quickly arranged and disbursed along with additional debt relief operations. These foreign credits eased the pressures on public finance as well as allowing the resumption of intermediate goods imports. Even though the industrial firms had low capacity utilization rates (45–50 percent levels), they showed a strong export response to altered incentive structure. During the first years of the new policy paradigm (1980-83), exporters of manufactured goods received around 20-23 percent subsidy. In addition, labor unions and civil society organizations were all banned by the military administration that ruled the country from September 1980 to November 1983. All strikes were declared illegal. Therefore, real wages declined by 45 percent from 1979 to 1987. As a result of export subsidies, real wage cuts, and the depreciation of the Turkish lira, manufacturing exports increased from 1.5 percent of GDP in 1980 to 8.8 percent in 1987. While the export/production ratio increased in the 1980-88 period, the post-1980 Turkish manufacturing industry had a low employment growth rate. The annual average rate of growth in output was 10.4 percent in the 1980-87 ‘trade liberalization’ period. However, the annual average rate of employment growth for the same period was just 2.7 percent, which is well below the output growth. To sum up, as a result of export subsidies, real wage cuts, and the depreciation of the Turkish lira, manufacturing exports increased from 1.5 percent of GDP in 1980 to 8.8 percent in 1987. The growth rates of the Turkish economy rose again to above 5 per cent in the first half of the 1980s (Yılmaz, 2012; Taymaz and Voyvoda, 2012; Celasun, 2002; Kepenek and Yentürk, 2001; Milanovic, 1986).

Gradual import liberalization was also started in 1984. This included substantial cuts in import tariffs and relaxation of quantitative restrictions on imports. Quantitative restrictions on imports were completely phased out by 1990. It was argued that changes realized in quantitative restrictions have resulted in elimination of trade barriers in a considerable way. Quantitative restrictions imposed a wedge between the international and domestic price of imports. And it was suggested that this was 50 percent in 1980. Then it declined 20 percent in 1984, 10 percent in 1985 and finally to zero by 1986 (Krueger and Aktan, 1992). For the manufacturing industry, the output weighted average nominal tariff rate declined to 40 percent in 1990 from 75.8 percent in 1983 (Togan, 1994). Following these measures, the total volume of exports (in US dollars) increased more than fourfold by 1989. In the 1980s, the annual average rate of economic growth was almost 6.5 percent due to the export boom and the easing of balance of payment problems. The manufacturing industry had a special role in this export boom that its share in total exports rose from 36 percent in 1980 to 80 percent in 1990 (Yılmaz, 2012).

In opposition to substantial increase in exports, production in the manufacturing industry grew less during the period. The share of the manufacturing industry in the value added increased 14 percent in the 1970s to 16.5 percent in the 1980s. This happened because of the slower manufacturing investment. The private sector had not enough incentive to take any cost reducing investment because the decline in real wages was a substantial 45 percent from 1980 to 1987. For this reason, manufacturing investment declined to below 5 percent of the GDP by 1985. This figure was above 8 percent in the 1970s. However, there was an important issue that real estate and service sector investments were booming during these years, while the share of the manufacturing industry investment in gross domestic product was declining from 6 percent in 1980 to 4 percent in 1987. Given this situation, the export-oriented growth strategy seemed not working well. The policies in the new paradigm promoted exports while they were exposing the Turkish products to world wide competition. In this way, the country would not run high current account deficits again. However, manufacturing investment and sustained productivity growth did not match with the increase in the exports of manufacturing products. Following the 1984 import liberalization, total factor productivity increased by 7.4 percent per year in 1984 and 1985. Then it declined by 5.4 percent per year from 1986 to 1988. Moreover, the policies implemented related to the export promotion were largely reversed. The administration of Turgut Özal, who was the prime minister of Turkey between 1983 to 1989, started to embrace an overvalued Turkish lira policy in order to keep the inflation in control. However, the high increase of real wages and salaries in the public sector soared the fiscal deficits which is already in the increasing trend (Karluk, 2014; Yılmaz, 2012; Özler and Yılmaz, 2009; Kepenek and Yentürk, 2001).

24 January 1980 was the beginning of a new era for the Turkish economy. The ISI paradigm was ended and a new paradigm called the ‘Washington Consensus’ or neoliberalism started to be embraced. As Taymaz and Voyvoda (2012) state, the heavy involvement of the IMF and the World Bank along with the military coup in September 1980 have influenced the gradual settlement of the neoliberal paradigm and its instruments. Prior to this, the ISI paradigm or domestic market-oriented growth model was advocated by the large industrialists, organized labor and economic bureaucracy. However, Turgut Özal and the new economy team of his achieved to lead an alliance between the state and export oriented capital, largely thanks to the generous export subsidization program and at expense of the working classes (Öniş and Şenses, 2007).

It was evident that the losers of the ‘trade liberalization’ period (1980-87) were the working classes with the severe restrictions in the Labor Code under the military rule. The industry integrated with the world markets through labor- and resource-intensive sectors in this period due to the suppressed wages, along with real devaluation and substantial export promotion. On the other hand, the poor performance of manufacturing investment did not generate sufficient contributions in productivity and employment. During these first years of the export-oriented neoliberal paradigm in the Turkish economy, export gains had reached their top limit based on the price incentives and subsidies in the lack of the necessary productivity investments for manufacturing exports. To sum up, the unbalanced structure of the economy failed to generate sustainable growth. It was obvious that generating economic growth by the way of price subsidies and wage suppression had reached its economic and also political limits by the end of 1988. Therefore, capital account liberalization in 1989 was a critical turning point for the fortune of the Turkish economy (Taymaz and Voyvoda, 2012; Kepenek and Yentürk, 2001).

#### 5.2.2.2. The Early Decades of The Washington Consensus: 1989-2000 Financial Liberalization

The financial liberalization period in the outward orientation of the Turkish economy is described with economic growth fueled by rising public expenditures and growing fiscal deficits. Domestic financial markets were insufficient to finance growing public expenditures and fiscal deficits. Therefore, capital account liberalization, which was adopted in August 1989 and implemented in 1990, paved the way for a substantial liquidity injection into the Turkish economy in the form of short-term foreign capital. These hot money inflows provided the necessary finance for the increasing public sector expenditures and also decreased the pressures of aggregate demand on the domestic markets by cheapening the costs of imported products. However, financial markets without an effective regulatory framework can be costly in a longer term as in the case of the Turkish economy in the 1990s. It became vulnerable to external shocks and sudden outflows of foreign capital became the main reason in the eruption of the crises of 1994,1999 and 2001 (Taymaz and Voyvoda, 2012).

This decision was another critical turning point for the integration of the Turkish economy with the global financial markets following the liberalization of trade. In a full open economy model, the annual GDP growth rates averaged 5.2 percent in 1989-1993. Also, the annual average rate of growth in manufacturing investments peaked with the figures of 15.9 percent. The decision of financial liberalization in 1989 was a move to a new exchange rate policy. Accordingly, the exchange rate became an implicit anchor for domestic prices. The old exchange rate policy had provided an anchor for promoting exports. The new function of the exchange rate led to an appreciation of the Turkish lira. The lira appreciated by 18 percent between 1989 and 1993. However, it reached its max appreciation level with the devaluation during the

1994 economic crisis. Due to the crisis, the GDP decreased by more than 6 percent and manufacturing investment contracted by almost 11 percent (Yılmaz, 2012).

The neoliberal paradigm implemented with the 24th January Decisions had another significant objective that the dominance of the state in the key industries and banking was to an end. In addition, the state intervention in the pricing and resource allocation process of the market economy would have been no longer an instrument to use. The SEEs had been an important instrument for production and also for employment in the post-war years in Turkey. However, their share had declined in the ISI paradigm years. The share of the SEEs in the total value added of the manufacturing industry and in employment had declined from 1963 to 1980. This decline continued in the post-1980 period. The employment and value added shares of the SEEs in the manufacturing industry had declined to 10 percent and 22 percent by the year of 2000, respectively. During the 1980s and 1990s, the private sector and the SEEs concentrated on different areas. In terms of value added, the private sector concentrated mainly in the consumer and investment goods, while the SEEs was focused primarily on the intermediate goods sectors (Yılmaz, 2012; Kepenek and Yentürk, 2001).

There were two important decisions that were in essence politically influenced the Turkish manufacturing industry hugely. First one was the rapid real wage hikes between 1988 and 1993. The reason for this was the significant increase in the real wages and salaries of government employees. Following the military coup in 1980, real wages had declined for several years due to the Labour Code stated above. However, the 1988-1993 period presented a rather different story. The competition between political parties intensified after the election of November 1987 that was considered the first proper democratic general elections in the post-1980 military period. And the promises to keep the inflation under control stated by the political party running the country since the 1983 election were forgotten. Agricultural support prices increased more than the actual inflation rate. Moreover, the employees in the public sector got a wage and salary increase at a rate close to 200 percent from 1988 to 1993. The result was the increasing public sector borrowing requirements that doubled in 1987 and reached 8.3 percent of GNP (Taymaz et al., 2021; Yılmaz, 2012).

In the Turkish manufacturing industry, the average real wage rate increased more than 130 percent from 1988 to 1993. During the same period, total factor and labor productivity growth rate reached unprecedented levels in the manufacturing industry. Taymaz et al. (2021) investigate whether real wages cause any productivity or not and state that real wages cause productivity. So, it is argued that real wage increases forced the Turkish firms in the manufacturing industry to increase their productivity in order to maintain their competitiveness. This evidence supports Dani Rodrik’s (1999) ’democracies pay higher wages’ hypothesis.

The second important decision was the formation of the Customs Union (CU) between the EU and Turkey in 1996. In the following years, the Turkish manufacturing industry was significantly influenced by this decision. Although it was not fulfilled of its potential, the CU has been positive on the Turkish manufacturing industry overall. The manufacturing industry had to increase its productivity due to the increased competition in the form of imports coming from the EU countries following the CU agreement. Before the CU agreement, some of the significant sectors such as durable home appliances, electrical machinery and automotive were protected by high tariff barriers in spite of the trade liberalization process. In these sectors, productivity increased substantially even though the total factor productivity as a whole didn't increase significantly in the manufacturing industry (Yılmaz, 2011; Taymaz and Yılmaz, 2007).

At this point, it is worth noting that the effects of the CU and the prospects of the integration of the Turkish economy with the production networks of the EU started to be identified following 1996. Although the CU agreement did not have much impact on the imports of the Turkish manufacturing industry in the first five years, the 2001 crisis generated a rather different impact. Following the 2001 crisis, the Turkish lira depreciated and domestic producers had to be forced to search for export markets due to the contraction in domestic demand. In 2001, export revenues increased by 12.6 percent. More importantly, however, exports achieved to grow more even after the domestic market resumed growth. Export revenues increased 15 percent in 2002, 31 percent in 2003 and 2004, and 16 percent in 2005 and 2006. This was an unprecedented export performance of the Turkish manufacturing industry considering the Turkish lira appreciation during this period (Yılmaz, 2011).

The financial liberalization period (1989-2000) along with the following two years were the political and economic instability years in Turkey. Therefore, the 1990s are described as the 'lost decade' in order to explain the severity of the situation. The growing public expenditures made the successive short term governments dependent on the financial markets. This contributed to the weakening of the regulatory capacities of the state. And it also undermined the state's ability to manage the distributional conflicts that arose as the result of the dependence on financial markets. During the 1990s, financial institutions became dominant within capital and thereby they had the ability to manipulate accumulation patterns in the Turkish economy (Öniş and Aysan, 2000). However, the 2001 crisis as the most devastating economic crisis in the history of modern Turkey has generated a rather different story in terms of the fortunes of Turkish politics and economy with the new reform movement.

### 5.3. Industrialization in the Post-Washington Consensus Period in Turkey: In the Aftermath of the 2001 Crisis

The post-2001 crisis period is the second phase of the Turkish experience of neoliberal industrialization. This period in the Turkish economy was restructured by the key principles drawn up by the Post-Washington Consensus. In order to achieve sustainable and equitable economic growth, good governance mechanisms through strong market-regulating institutions, especially in the banking sector, as well as consumer protection and competition regulation were put into practice. The Turkish banking sector was consolidated and recapitalized, and supervision and regulation of the banking sector was developed in line with the 'recovery program' launched in 2001. Also, legal and regulatory infrastructure necessary for the proper functioning of a modern market economy was strengthened with the improvements in institutions and economic policy making process in line with the mentioned recovery program designed by the IMF and the World Bank (Atiyas, 2012).

Following the 24th January Decisions in 1980, the era of neoliberal restructuring shaped by internationalization and market-based orientation was started to be implemented in the Turkish economy. However, the macroeconomic environment deteriorated further in the late 1980 and in the first years of the 1990s due mainly to growing public expenditures and thereby public debt. This environment generated the economic crisis of 1994. With some quick responses from the government and financial support from the IMF, the Turkish economy recovered very quickly. The measures taken produced a positive environment just for a few years and moreover, these measures with the political instability within those years planted the seeds of the 2001 crisis. The 2001 crisis brought the country to the brink of collapse. Although the crisis primarily hit the financial sector very badly, the Turkish manufacturing sector suffered severely during the crisis year as well. Industrial production contracted by almost 10 percent in 2001 and thereby the industrial employment decreased about the same rate. In 2001, the loss in real earnings per production worker in the manufacturing industry was almost 18 percent (Taymaz and Voyvoda, 2007).

Turkey implemented the Transition to the Strong Economy Program with the direct impetus of the IMF and the World Bank following the 2001 crisis. The Turkish economy moved to a macroeconomic stability period by following a strict monetary and fiscal policy reform agenda. Therefore, the post-2001 crisis period has been described as one of the critical turning points for the fortunes of the Turkish economy. The growth rate of the GDP was -3.7 percent in 1999 and 6.8 percent in 2000. And it showed a harsh slowdown to -5.7 percent in 2001. In the following years, however, the GDP increased quite sharply that the average growth rate was 7.5 percent per annum from 2002 to 2006. The value of exports grew almost 25 percent on average per annum in the period of 2001-2006. In addition, the production index for the manufacturing industry increased by 57 percent from 2001 to 2008. The chronic inflation in the past forty years was finally brought under control via the post-crisis monetary and fiscal policies. It reached single-digit numbers by 2005. Public debt burden ratio was also reduced from a level of 66.3 percent of the GNP in 2001 to 34 percent in 2006 due to the clear mandate to generate primary budget surpluses (Yılmaz, 2012; Taymaz and Voyvoda, 2007; Kazgan, 2006).

The deteriorating post-1997 economic path in Turkey is reflected in the conduct of the manufacturing industry as well. The growth of industrial production lost its acceleration in 1998 with the 1.2 percent growth rate. Although the growth rate of industrial production dropped -3.7 percent in 1999, it had a short term revival in 2000 with 6.02 percent. However, it declined -8.7 percent in 2001 with the negative influence of the devastating crisis taken place in the beginning of the same year. While industrial production declines, there are observed reductions in the capacity utilization rates and more severe declines in the number of production workers. Between 1998 and 2001, industrial production decreased 7.3 percent cumulatively and capacity utilization rate declined 25.9 percent. The cumulative loss of jobs was 22.7 percent in industry in the same period (Yılmaz, 2012; Taymaz and Voyvoda, 2007).

Nevertheless, industrial recovery had been quite fast along with the sharp improving macroeconomic conditions in the period of 2002-2004. The annual average growth rate of industrial production was 9.3 percent during this period. Following the crisis, import growth decreased -24.80 percent in 2001. However, it escalated rapidly with an annual average rate of growth of 26.7 percent in the same period. These numbers negatively influenced the overall trade deficit in the Turkish manufacturing industry. The trade deficit in the manufacturing industry increased approximately to 3.5 billion in 2001, 7.8 billion in 2002, and 20.1 billion US dollars in 2004. On the other hand, the post-2001 crisis adjustment process in the manufacturing industry had positive impacts. The annual average growth rate was 5.5 percent in production, 11 percent in exports, and 11 percent in imports in the period of 2004-2007. The growth rate in production had been associated with the increasing levels of labor productivity during these years. While the average rate of productivity growth was 7.8 percent in 2002–2004 per annum, it was 5.3 percent in 2005–2007 per annum. However, the growth rates or employment was insignificant in the same period. The annual average growth rate in the level of production employment workers was only 1.5 percent between 2002-2004. This figure was -0.7 percent in 2005 and 2006 per annum. In 2007, it increased to only 2.1 percent (Taymaz and Voyvoda, 2007; Karluk, 2014).

The Turkish industry has gone through a serious transformation process in the aftermath of the 2001 crisis period. The Turkish manufacturing industry has primarily internationalized when considering the earlier period. Manufacturing exports as well as imports increased along with the increased trade with Asian countries. The new value of the Turkish lira, which appreciated by 44 percent from 2002 to 2008, led to an increase in the imported products in the manufacturing sectors. Even though the exports in the manufacturing industry have increased since the post-2001 period, imports have increased faster. Therefore, Turkish trade has been characterized by intra-industry trade during this period. The 'internationalization' period as described by Yükseler and Türkan (2006) has led to a substantial increase in export growth rates, while it didn't create a significant positive impact on employment as well as value added (Taymaz and Voyvoda, 2007).

The increasing total factor productivity in the manufacturing industry contributed to the positive performance of Turkish exports. However, another factor contributing significantly to Turkish exports in the post-2001 period is the appreciation of the euro against the US dollars. Turkish exporters imported raw materials from East Asian countries with the US dollars and exported half of these products to European countries with euros. Although the long-running real appreciation trend of the Turkish lira had some negative influences on the Turkish exporters, these manufacturers protected their competitiveness with this method. In total imports, the share of the EU decreased from 56 percent to 40 percent in 1996 and 2007, respectively. On the other hand, the share of East Asian countries doubled to reach 20 percent in 2007. Moreover, foreign trade deficit of Turkey against the EU decreased from 57.6 percent to 13 percent in 1996 and 2007, respectively. During the same period, foreign trade deficit of Turkey against East Asian countries increased from 13 percent in 1996 to 45 percent in 2008 (Yılmaz, 2012).

Following the 2001 crisis, neoliberal industrial restructuring of the Turkish production sector displays that the manufacturing industry transformed itself from primary and low technology production to more technology intensive manufacturing due to its articulation with the international markets. Herein, the high growth rates of industrial production with the growing high export demand played a significant role in emphasizing away from traditional sectors of the economy toward medium and high technology industries. Although the macroeconomic policy transformation taken place in the post-crisis era generated a critical environment for the production industries, the picture was not that quite bright due to some deficiencies. The real appreciation of the Turkish lira increased intermediate imports to substitute domestic production. Also new production and export lines became dependent on imported components. Therefore, the capacity of the economy was restrained to generate employment and value-added (Taymaz and Voyvoda, 2007).

### 5.4. Conclusion

The decisions taken on the 24th of January 1980 played a significant role in the transformation of the Turkish industry. This chapter argued that internal and external factors together played critical roles in the neoliberal restructuring process in the Turkish industrial sector as in the financial sector. Liberalization trend in the international financial sector started in the late 1970s in the UK and soon after, the trade liberalization was also embraced in an international fashion. Turkey was no exception. It started to liberalize its foreign trade in the middle of the 1980s.

This chapter states that neoliberal restructuring of the Turkish industrial sector had not been independent of external and internal factors during this period. In line with the liberalization trend in the global markets, Turkey started to liberalize its foreign trade gradually in the middle of 1980s. In the beginning of 1990, capital account liberalization was also implemented despite the lack of proper regulatory mechanisms. Hence, Turkey faced successive crises over a short interval in 1994, 1999 and lastly in 2001. Following the 2001 crisis, neoliberal industrial restructuring had been identified as a critical turning point for the Turkish industry. Although it witnessed a growing export and a transformation from low technology to medium and high technological industrial production in some sectors, new production and export lines became dependent on imported components. However, the global financial crisis of 2008 was a dramatic turning point for the fortune of industrial policies. In this sense, neo-developmentalist turn in the international political economy has been one of the lively debates, in particular regarding the role of the state in industrial policy. Therefore, the next chapter deals with the neo-developmentalist ideational shift in the Turkish political economy.

# Chapter 6

# The Neo-developmentalist Turn in Turkey in Industrial Policy Formulation in the Post-Global Financial Crisis Era

## 6.1. Introduction

As stated in chapter 2 of this thesis, the emergence of a neo-developmentalist turn in the international political economy has been one of the key elements regarding the role of the state in economic policy making in the post-GFC period. With the neo-developmentalist turn, a new form of state activism has been the main characteristic of the national capitalist development method. Due to the severity of the GFC, neoliberal ideas and narratives as the reigning ideology and conventional economic policy making have been deeply questioned not only in developing economies but also in developed economies. In this environment, Turkey has started to utilize neo-developmentalist policy guidance in its industrial policy making in an open-economy setting. In this sense, this chapter sheds light on the transition of Turkey, which has embraced the neoliberal paradigm since the early 1980s with a great reform template following the 2001 crisis, to neo-developmentalist policies.

The neo-developmentalist turn in Turkey was influenced by the GFC and, in particular, the resulting ideational shift in industrial policy making not only in developing countries but also in developed countries. Nevertheless, the emergence and the implementation of neo-developmentalist policies have been formed by domestic actors and dynamics as well as shifting external consensus and dynamics in the realm of economic policy making. In Turkey, some organizational changes and experimental policies have been carried out in line with new industrial policy making in the post-GFC period. In addition, new discourse utilized by politicians and policy makers influenced the ideational change at the domestic level in the alternative developmental paradigm, which is popular in emerging market economies.

The remainder of the chapter is organized as follows. The next section explains the emergence of neo-developmentalist turn in the international political economy with a focus on the comparison of neoliberal policy paradigm with the new developmentalist paradigm. The following section examines the emergence and the implementation of these policies in Turkey as an emerging middle power country. The fourth section explains the dynamics of policy (paradigm) change in terms of neo-developmentalist ideational shift in Turkey from the post-2011 to early 2018 in Turkey. The last section gives a brief summary of the chapter.

### 6.2. The External Context: The Rise of Neo-Developmentalism in the International Political Economy

In the aftermath of the GFC in 2008, the state is considered by many analysts to have made a strong comeback. While liberal economies have experienced severe turmoil in the subsequent years of the crisis, the ones which have state-led heterodox models seemed to survive more confidently. The future of the neoliberal policy paradigm, as the reigning economic policy framework over the last three decades, has been seriously questioned due to the severity of the crisis (Öniş and Güven, 2011; Gills, 2008). Neoliberalism is based on a critique of Keynesian and developmental state intervention along with the politicized nature of statism in economic policy making. This view is shaped with reference to main classical liberal assumptions, namely methodological individualism and rational utility maximization. Neoliberal paradigm advocates free trade as the key to industrial growth and technological advances. According to neoliberalism, global companies would put into practice new technological developments and investments in the most productive ways within fully integrated markets. Therefore, state-led industrial policy is invalid approach. Neoliberal policy framework suggests that setting the free market as the best way for the most efficient resource allocation would generate trickle-down effects in global as well as local markets. To this end, a new and reduced role for the state was devised that would ensure private entrepreneurship and competition into the global economy. In other words, the state is perceived as an obstacle for the efficient functioning of both global and local markets (Gezmiş, 2018; Payne and Phillips, 2010).

Neoclassical political economists argue that rational individual and corporate actors are more capable than states in improving national economies. These policies were considered as the most efficient instruments in order to achieve and sustain economic growth as well as human development not only for advanced countries but also for developing countries. The ideas of reduction of the state along with deregulation and privatization were promoted by the Washington Consensus (WC) coined by Williamson (1990). These three tenets of the WC recommended for developing countries were strongly supported by international organizations such as the IMF, the World Bank and the WTO through structural adjustment programs in different regions and a large number of countries (Stiglitz, 2002; Williamson, 1993). However, a comparative analysis suggests that countries that implemented heterodox economic policies rather than neoliberal orthodoxy outperformed their peers in terms of development and integration into the global economy over the last thirty years (Rodrik, 2007; Wade, 2003b).

The initial challenge to the neoliberal paradigm came from the scholars in East Asia. They demonstrated that newly industrialized countries of East Asia didn't solely rely on market forces for success, the state played a central role in regulating and coordinating the markets. This became a critical turning point for a lively debate, including the international financial institutions (IFIs) circles. Accordingly, the IFIs were criticized for their excessive focus on the free market as the motor of economic growth and, thereby, for ignoring the political and institutional aspects of economic development. Thus, a new agenda emerged, and the importance of the state along with its institutional capacity to guide economic growth was confirmed (Gezmiş, 2018). Joseph Stiglitz (2005), the former chief economist of the World Bank, suggested that the role of the state in the economy had to be considered once again. Accordingly, there was a need for a new paradigm named the Post-Washington Consensus (PWC) going beyond the Washington Consensus. The PWC was not an overhaul for the WC in terms of the view that macroeconomic fundamentals are significant for economic growth. Nevertheless, the PWC accepted the importance of regulatory institutions and social aspects into economic policy making, particularly for developing countries. Domestic institutions to regulate and to complement markets are in the center of the

PWC policy framework, so domestic reforms to overcome the challenges of integration into the global economy occupied the main concern (Gezmiş, 2018; Öniş and Şenses, 2005).

The global crisis in 2008, however, accelerated the debate regarding the role of the state in economic policy making in an environment, in which the pendulum is swinging away from the neoliberal policy paradigm or a free market and anti-statist ideology (Gills, 2008). Nevertheless, the current ideational shift in the modalities of the role of the state, or state intervention, goes beyond the 'governing the market' approaches, which emphasize on selective industrialization and protectionist foreign trade policies (Wade, 2003b). The state-led import substitution industrialization (ISI) policy paradigm, or old developmentalism, implemented in Asian and Latin American countries until the late 1970s demonstrate rich examples in terms of the potentials and limits of the role of the state in making and shaping markets. Also, the Northeast 'Asian Tigers' present different forms of developmental state practices that can be evaluated in terms of their limits and potentials (Kutlay, 2019). It is worth noting that Latin American ISI, particularly in the cases of Brazil and Mexico, was driven by nationalism as well as state activism, but the East Asian type of developmentalism differs significantly due to the features which are unique to the region. The East Asian developmental states created common objectives around their industrial projects because of the great level of state capacity that they enjoyed historically (Gezmiş, 2018). Similar to East Asia and Latin America, advanced countries practiced some sort of state intervention in their early development stages, through a Listian 'infant industry promotion' (Chang, 2002). Ban (2013) suggests that although the modalities of contemporary developmental state-market relations share some common characteristics with old developmentalism or the ISI, it has several distinctive features.

What is neo-developmentalism then? The term was firstly used in 2003 by Luiz Carlos Bresser-Pereira, who is a Brazilian economist and former policy-maker. That was an attempt to define an alternative policy framework to the Washington Consensus policy paradigm orthodoxy (Bresser-Pereira, 2009). It also began to appear in international development discourse in the late 2000s (Khan and Christiansen, 2010).

Neo-developmentalism differs from some main features of old developmentalism. It accommodates itself to the neoliberal acceptance regarding the importance of private entrepreneurship and markets as the engines of economic growth and development. This state-led development perspective embraces a selective type of state interventionism and integration into the global markets. Accordingly, local and foreign private investments must be stimulated, export-led growth must be encouraged and deficit-driven fiscal policies of the past must be abandoned (Gezmiş, 2018). This perspective is considered as a guide for the transition of all developing countries away from the Washington Consensus. Therefore, neo-developmentalism refers to a new form of state activism in which the main aim of this national capitalist development model is the achievement of full employment by being in line with the goals of price and financial stability. In other words, it is in a middle place between neoliberalism (liberal orthodoxy) and old developmentalism in which protectionism and export pessimism were the key characteristics (Ban, 2013, Bresser-Pereira and Theuer, 2012). Neo-developmentalism advocates that strong markets require strong states. This means that the relationship between markets and states is not a zero-sum game. Also, heavy-handed statism and protectionism of old developmentalism was abandoned in this perspective that the state is identified as an important, but not a principal, actor in investment and production in neo-developmentalism (Gezmiş, 2018).

The advocates of neo-developmentalism think that middle income-countries have overcome the infant industry stage. In other words, they think that the infant industry argument of old developmentalism has lost its relevance. Therefore, protectionist policies should be abandoned and the goal of an open economy should be acknowledged as a fundamental perspective. However, this acknowledgment is predicated on significant state interventionist qualifications. The goal of an open economy has to be complemented by the aim of using industrial and technological policies to increase the share of medium and high value added services and products. This is to be done through industrial and technological policies targeted at firms in the private sector which are judged to be able to compete globally (Ban, 2013, p. 4). On the contrary to old developmentalism, neo-developmentalism is not in favor of directly promoting deficit-driven industrialization; instead, the aim is providing macroeconomic stability to promote the global competitiveness of the private sector, and thereby, supporting industrialization. In doing so, it uses moderate interest rates, competitive exchange rate and fiscal discipline to ensure the private sector to access new technologies in the global markets (Gezmiş, 2018, p. 69). In other words, neo-developmentalists are on the same page with liberal orthodoxy that it has to be avoided from inflation, contrary to the old developmentalist complacency towards inflation. Nevertheless, the unwavering inflation aversion logic of orthodoxy should not come with high interest rates (Ban, 2013).

To sum up briefly, Kutlay (2019, p. 5) explains that, heterodox developmental states beginning to emerge in the late 1990s ‘target rapid economic ‘catch-up’ policies not *over* private actors, but *through* them by investing in research and development (R&D) through public–private partnerships, sovereign wealth funds and fiscal stability’. In that sense, the contemporary developmentalist project or neo-developmentalism, in its broader framework, can be described as ‘the adoption of a development strategy that allows domestic firms to seize global economies of scale and technological updating processes, but also innovation policy and an activist trade policy’ (Ban, 2013, p. 3).

### 6.3. The Emergence and the Adoption of Neo-Developmentalist Policies in Turkey

The political economy of Turkey has transformed seriously in the aftermath of the 2001 crisis. Following the devastating crisis, a bold and comprehensive reform package was put into implementation, the aim of which was to transform the functioning of the state. The reform program laid the groundwork for the enhancement of Turkey’s state capacity in the regulatory realm in line with the main principles of the Post-Washington Consensus. However, the regulatory state policies were not complemented by a profound industrial strategy. The reason is that ‘prudently crafted and patiently implemented capacity enhancing policies were not included in the policy mix to ensure the transformation of the production and trade structures’ (Kutlay and Karaoğuz, 2017, p. 6). The post-GFC environment in the international political economy triggered a reshuffling in the beliefs of Turkish politicians and policy-makers. In other words, the GFC and  the resulting ideational shift played a significant role as external dynamics in the process of new state-led developmentalist economic policy making processes.

Therefore, Turkey witnessed the emergence and the implementation of neo-developmentalist policies in the post-2011 period.

The neoliberal policy paradigm severely constrained developing countries' policy space in developmental aspects in the 1980s and the most of the 1990s (Gallagher, 2005; Wade, 2003; Chang, 2002). However, some developing countries, particularly large emerging powers, have enjoyed a less restrictive environment since the beginning of the 2000s. Such countries attempted to pursue state-led development policies along with their adoption of select parts of the Washington Consensus (Ban and Blyth, 2013). In this sense, BRIC countries are significant. The BRICs started just as a Goldman Sachs investment meme in the beginning of the 2000s, but they got much more attention during the global financial crisis due to their endurance. Although these countries formed even a governance mechanism for cooperation with a highly ambitious agenda in international economic institutions in the G20, a more interesting thing has been their approach to the neoliberal policy paradigm. These countries experienced impressive economic growth spurts despite the dominance of neoliberal economic ideas and narratives since the 1980s. However, it is necessary to emphasize that the role of the state in their developmental approach went far beyond the limits of the Washington Consensus. They also have a greater degree of policy autonomy from international organizations such as the IMF and the World Bank than other states in the developing world (Ban and Blyth, 2013). Moreover, near-BRIC countries or middle power countries have been influenced by these developments along with global context in which traditional dominance of established power countries and the endurance of their developmental policy paradigm, the Washington Consensus, are on the decline. For instance, Turkey, as a middle power country, is a case in point.

Turkey experienced the worst economic crisis in its modern history in 2001. In the post crisis period, a robust regulatory state in line with the augmented version of the Washington Consensus, namely the Post-Washington Consensus, was developed with the direct impetus of the IMF, the World Bank and the EU. Accordingly, the Turkish financial system, especially the banking sector, was restructured and nine independent regulatory institutions were established including Banking Regulation and Supervision

Agency (BRSA). Moreover, the Central Bank of Turkey was granted legal independence. The first Justice and Development Party (AKP) government took office following the 2002 general election and embraced the reform template with some minor edits that do not contradict neoliberal orthodoxy. The policies pursued in line with the regulatory state paradigm were quite effective in that Turkey was one of the rare countries that didn't have to bail out any domestic bank during the financial crisis in 2008 (Kutlay, 2019; Öniş and Kutlay, 2013).

The orientation of the early AKP governments was on the regulatory state aspect rather than developmentalist. In that sense, there was strong emphasis on the state's fiscal discipline and the strict surveillance framework for the financial system until the global financial crisis. The GFC was a dramatic turning point for the international political economic landscape due to the shifts in global context such as the weakening dominance of established powers and their neoliberal policy paradigm, and the increasing influence of BRICS countries. These are significant external dynamics which influenced the transformation of the Turkish political economy towards neo-developmentalism. Power shifts at the global level have accelerated in the aftermath of the global crisis. While emerging powers of the 'global South' are empowering, the established countries of the 'global North' are weakening (Haas, 2017; Stuenkel, 2015). The magnificent rise of China and the increasing importance of the China-Russia axis are considered as a striking phenomenon with economic as well as political implications (Kaczmarski, 2015). In addition, the transformative powers of the EU are gradually declining, in particular, in the broad spectrum of countries in Eastern Europe, the Balkans and, finally, Turkey (Öniş and Kutlay, 2019). Nevertheless, the growing influence of BRICS countries are more visible with the models of 'state capitalism' or 'state-permeated capitalism' popular in these countries (Yağcı, 2021; Nölke et al., 2019; Öniş, 2019).

There was another critical external dynamic which made Turkey consider a new approach regarding its industrial policy framework. The global crisis in 2008 clearly triggered a new industrial policy approach not only for Turkey and emerging powers but also for advanced countries (Interview 10). European countries such as the UK, Portugal and Greece were influenced by the crisis deeper than the countries such as Germany due to their dependence on service industry rather than manufacturing industry. Therefore, European countries started to modernize their manufacturing industries along with their strategic industry sectors. New protectionist policies considered harmful to the free market and anti-statist ideology have been implemented in European countries in order to ensure more manufacturing capacities and advantages against rival countries (Durusoy et al., 2015). Moreover, the Obama administration in the US established the President's Council of Advisors on Science and Technology (PCAST) with the responsibility of giving recommendations to the president and executive office of the president in the areas of science and technology in gaining strength for the American economy. Also, Advanced Manufacturing Partnership was founded for revival of the American manufacturing industry by the Obama administration in 2011 (Gür et al., 2017).

In this environment, the regulatory state paradigm in Turkey started to decline gradually (Öniş and Kutlay, 2013). For instance, some suspicions regarding the mainstream neoliberal ideas started to be surfaced by some government elites. As Kutlay (2019) points out, neo-developmentalist or state capitalist discourse started to take shape in a staggered manner. In the words of the chief adviser to Erdoğan, who was the prime minister until 2014 and now the president, 'state has to involve in the economy, regulates the economy, paves the way for entrepreneurs, considers the money and financial policies as national security and sees [money and financial policies] as means of national development' (Ertem, 2018).

Erdoğan declared an ambitious target for Turkey's industrial transformation strategy: he stated that 'we want Turkey to be one of the top ten economic areas of the world…Over the next 15 years we want to increase the per capita income from $10 500 to $25 000.' (Öniş and Kutlay, 2013, p. 1421). The Turkish policy makers became, in particular Erdoğan, more attuned to state-led economic policies of neo-developmentalist ideas in the post-GFC. However, before moving to introduction of these new policies reflecting the neo-developmentalist turn in the Turkish political economy, it is worth noting some state proactivism taken place in different AKP governments towards capacity-enhancing. These are several structural changes implemented to promote technological capacity of the economy. Although a robust regulatory state framework was formed following the 2001 crisis, Turkey didn't complete that with a pronounced industrial and technological transformation strategy. Therefore, Turkey continued to trace non-selective industrial policies in accordance with the neoliberal policy paradigm. Nevertheless, the AKP governments executed several organizational changes. In other words, neo-developmentalist ideational shift is associated with new institutional mechanisms.

First, the Ministry of Industry and Trade has been restructured and renamed as the Ministry of Science, Industry and Technology (MoSIT), in order to make explicit that the 'science' and 'technology' is an important aspect of the Turkish industrial transformation strategy. (This ministry has been renamed as the Ministry of Science and Technology (MoST) following the presidential elections in June 2018.) The ministry has been assigned for several tasks including preparing and implementing industrial policies and strategies along with technical and executive regulations of industrial products. Besides, the ministry has been in charge of designation, implementation and monitoring of science, technology and innovation policies in cooperation with the relevant institutions and organizations. In addition, the Scientific and Technological Research Council of Turkey (TÜBİTAK), the Small and Medium Sized Industry Development Organization (KOSGEB) and the Turkish Academy of Sciences (TÜBA), which are the main actors of the innovation system, has been connected to this newly established ministry. The TÜBİTAK has also been fully operationalized, which is the highest ranking institution in science, technology and innovation (STI) policy-making. Second, a new separate ministry, namely the Ministry of Development, was established and it was assigned with the coordination of Turkey's developmental policies in a more macro perspective. (This ministry has been restructured following the presidential election in June 2018 and it was named as the Presidency of Strategy and Budget.)

Third, in order to promote R&D, and to better monitor and increase the effectiveness of the policies implemented, a new important legislation has been enacted. Thus, in

2008, the ‘R&D law’ was enforced leading to the establishment of R&D centers by the private sector. The ‘Technopark Law’ was amended several times by the government to encourage more high-tech production. The creation of ‘Technology Transfer Offices’ is a requirement by the law, and their establishment is supported to ignite the university–industry collaboration, which is a common practice of developmental states. Fourth, in order to outline the principles and procedure to regulate the incentives given by the state in accordance with the EU acquis, a new regulation on the surveillance of state subsidies was enacted. Fifth, in order to impact analysis of the support allocated by the government, a new unit has been established within the MoSIT (Kutlay and Karaoğuz, 2017).

As stated above, the GFC carved out a significant space for neo-developmental policies. In this sense, there are various policies implemented in line with the neo-developmentalist ideational shift in Turkey in the post-GFC period. To start with, the Turkish Industrial Strategy Document was adopted in 2011 (and updated in 2015 and 2019) under the auspices of the MoSIT, along with the involvement of the relevant public and private bodies. The long-term goal of the industrial plan is set to position Turkey as ‘the production base of Eurasia in medium and high-tech products.’ Three basic strategic targets have been determined in line with this overall objective: (1) to increase the ratio of mid- and high-tech sectors in production and exports, (2) to transition to high value-added products in low-tech sectors, and (3) to increase the weight of companies that can continuously improve their skills. Thus, industrial policy objectives are designed to target Turkey’s unsustainable but long-standing current account deficit through high value-added products, which is expected to decrease the dependence of exports on imports. The main aim along with the goals stated above in the last strategy document published in 2019 is to gain technological independence. Because technological independence is considered as the major driving force for economic and political freedom. In addition, the strategy document refers to a ‘National Technology Move’ which should lead Turkey to local, national and original technologies (Tonkal and Daim, 2022). Moreover, as Evans (1995) suggests, the industrial strategy document accepts two important features of the state’s ‘embedded autonomy’ by underlining the internal coherence and synchronisation of state bureaucracies, as well as state–private business cooperation:

*To ensure the effectiveness of the industrial strategy, it is important to establish a high-level cooperation between the public and private sector... the cooperation and coordination among the public institutions is as important as the cooperation between the public and private sectors. (*Turkish Industrial Strategy Document, p. 134)

In this sense, investment stimulus packages were also put into practice for the private sector to improve investments in industrial sector targeting to reduce dependence on imported intermediate goods along with several subsidy schemes for other sectors such as tourism, health and export. In 2012, the AKP government announced a new package to encourage investments targeting to steer savings into high value added investments, boost production and employment, encourage large scale and strategic investments with high R&D content for increased international competitiveness, increase foreign direct investments, reduce regional development disparities, and promote investments for clustering and environment protection. The stimulus package, which divides Turkey into six regions according to their general development levels, enables each region to receive different amounts of incentives, proportionate to regional socioeconomic inequalities, including free land, cuts in social security premiums, corporate tax incentives and access to cheap credit. According to official figures, from June 2012 to the end of May 2018, 30.559 investment incentive certificates were issued. The total amount of fixed investment envisaged in all these documents issued to firms, including domestic firms along with firms with foreign capital, is 641 billion TL (approximately 100 billion dollar) (Ministry of Science and Technology, 2018).

Moreover, the Investment Incentive System of Turkey, which was applied in 2012 for the first time, has been redesigned and changed in line with the new requirements later on. Turkey has introduced one of the most competitive project-based investment incentive packages for 23 projects amounting to $33 billion in 2018 with an aim to boost industrial production (Daily Sabah, 2018). Accordingly, 23 projects including petrochemical, energy, metallurgy, health, manufacturing and agricultural industries will be supported. The incentive certificates do not distinguish between local and foreign investors, and it is the most comprehensive and competitive incentive scheme compared to other emerging market economies such as Indonesia, Mexico and India. The package covers several areas of investment expenditure items such as land allocation, various tax exemptions, support for staff insurance premiums, and several financial assistance for up to 10 years. There are two ways for application process to project-based investment incentive system, namely call on method and invitation method. Accordingly, firms can be invited for investment to projects decided by the ministry or selected firms can get an invitation to invest in a project. The process for call on or invitation method and the decision step is up to the ministry (The Ministry of Science and Industry, 2022).

On the other hand, the Investment Incentive Scheme of Turkey, in fact, complements already-existing R&D policies. The state investments in R&D sectors have increased considerably in the last decade. Gross domestic expenditure on R&D has crossed the 1 percent threshold in 2014, which was below 0.5 percent in the 1990s. The funds allocated to the private sector through innovation governance organizations, including TÜBİTAK, KOSGEB, MoSIT and newly established regional development agencies have increased. Despite the negative effect of the global financial crisis on the Turkish economy, the state funding increased in the R&D sector. Besides, the number of technoparks in Turkey over the 2000s have increased dramatically. Technoparks are usually established within or near a university campus to use the geographical proximity with the aim of advancing innovation. While there were only 2 technoparks in Turkey in 2001, the number increased to 74 in 2018 (Yılmaz, 2018). Moreover, R&D center numbers founded by the private sector via the ‘R&D law’ enacted in 2008 skyrocketed in Turkey to 1254 with more than 70.000 staff and more than 60.000 projects, while this number was only 300 in December 2016 (MoST, 2021).

In addition, the Turkish government kicked off mega-sized infrastructure projects through public-private partnerships (PPP), an investment model based on state guaranteeing loans and revenue for participating companies. These projects include many investments such as airports, city hospitals, railways, highways, and a giant canal bisecting the country for a new trade route (Gal, 2018). The construction industry's contribution to economic growth has started to increase clearly in the post-global financial crisis era in Turkey. The country's construction sector contribution to GDP has been one of the highest in the whole world. However, the important part of this construction sector growth is the increasing share of the public-private partnership model in it. While the ratio of both private and public construction in GDP increased between the years of 2002 and 2007, the global crisis caused a setback of this ratio. In the aftermath of the global crisis, the ratio of public construction in GDP peaked in 2013. The construction sector as a whole has significantly grown in the post-2008 period in Turkey with the increasing role of the state as an investor in the sector (Tuğal, 2022). In terms of the total investment of PPPs, Turkey is ranked the 4th country among all low- and middle-income countries, following Brazil, India, and China. Also, Turkey is ranked the 5th in terms of the number of projects in 1990-2021. Turkey has become the largest PPP market in Europe between 2014 and 2018, followed by the UK and France. This model of investment has contributed construction-led economic growth rather than industrial sector growth as stated with the state-led developmentalist policies. Also, resources have been distributed to pro-government capital groups and political power has been reproduced through these investments (Ayhan and Üstüner, 2022).

Moreover, there is another important initiative reflecting the ambition of Turkish policy makers in line with the state-led developmentalist ideas. The government established a Joint Enterprise Group to produce a domestic automobile brand. The initiative has been implemented after the repeated calls of the President Erdoğan and it is a joint project of the MoST and the Union of Chambers and Commodity Exchanges (TOBB). Five local suppliers - Anadolu Group, BMC, Kıraça Holding, Turkcell, and Zorlu Holding - will jointly manufacture Turkey's first domestic car and each has 19 percent share along with five percent share of the TOBB. The joint venture established a company, namely, ‘Joint Venture for Turkey's Car Industry and Commerce Co." (Türkiye'nin Otomobili Girişim Grubu Sanayi ve Ticaret AŞ)’ and hired a former Bosch manager as the CEO. The first prototype was completed in 2019 and released to the public by Erdoğan in December 2019. First prototypes are produced and introduced to the public and the mass production will start in 2023. Besides, the total investment for the first phase in the indigenous car project is estimated at $3 billion (Hürriyet Daily News, 2017a and 2018). The plans for a Turkish-designed and -built electric car is a right move for transition to manufacturing high-value added industries. Considering the middle-income trap of Turkey in the post-2008 period as newly industrialized countries such as Brazil, Thailand and South Africa, the domestic car initiative come after the repeated calls of President Erdoğan is a good starting point for Turkey to have a sustained growth and development trajectory (Başbay, 2018).

Erdoğan declared his intention to develop ‘native and national technologies’ several times, in particular in the post-GFC period. In this sense, the progress taken place in the Turkish defense industry is significant and domestic technology development and production is strongly emphasized. Turkey has become one of the growing exporters of military equipment, including heavy weapons, arms, artillery, missiles, ships, aircrafts and armored vehicles to the countries in the region such as Saudi Arabia, the UAE, Azerbaijan, Malaysia, Pakistan, Qatar and Turkmenistan. Exporting domestically manufactured arms led to an acceleration of the Turkish defense industry in the global market. According to Stockholm International Peace Research Institute's (SIPRI), Turkey substantially increased arms export by 145 percent between 2013-2017, having the highest percentage increase in the world (Tekingunduz, 2018). Moreover, it is announced that Turkey and Pakistan have reached a deal on the sole of a load of 30 Turkish-made helicopters which is the largest-ever defense contract between the two countries (Kurubas, 2018).

As Ban (2013) states, achievement of full employment in price and financial stability is the main element within the neo-developmentalist paradigm. Therefore, the other important development related to changing the mind-set of Turkish policy makers is the strong support for President Erdoğan’s call for employment mobilization. He invited the private sector to take part in employment mobilization and added that the government would reward the companies (Hürriyet Daily News, 2017b). The president Erdoğan renewed the employment mobilization and shared the results that 1.5 million new jobs had been created in the ten month period after the first call. While renewing his call to companies to add more jobs, the president also elaborated on new incentives to support the country's employment. Accordingly, the government will provide an insurance premium contribution for salaries and also premium and tax support for all employees with insurance will continue for 12 months. Additionally, the president stated that this incentive program for employment mobilization would continue until 2020 (Daily Sabah, 2017a).

The establishment of a sovereign wealth fund is another significant indicator for the ideational shift in the mind-set of the Turkish policy makers. Although there was opposition, it was created in August 2016 to provide funds for large scale and strategic investments. Ali Babacan, who is the former deputy prime minister in charge of economy and now an opposition political party leader, stated that there was a lot of pressure on the establishment of the Wealth Fund when he was a minister. Therefore, the foundation of the Wealth Fund waited until he left the office (Kaya, 2020). It has been announced that the Treasury's shares in state-run lender Ziraat Bankası, the country's stock exchange market Borsa Istanbul, the General Directorate of Post and Telegraph Organization (PTT), the Petroleum Pipeline Corporation (BOTAS), the national petroleum producer TP, communication services and satellite technologies company TURKSAT, and 6.88 percent treasury shares in telecommunication company TurkTelekom plus Turkey's official mining company Eti Maden and the General Directorate of Tea Enterprises (CAYKUR) were all transferred to the sovereign wealth fund. These companies are the most valuable and profitable firms which play a locomotive role in their sectors. The main aim for establishing the fund is to increase growth rate and investments, thereby providing further employment and to ensure budget allocation to R&D investments for high-tech products in the national defense industry (Daily Sabah, 2017b). However, the Wealth Fund allowed the government to pump money into the economy in crisis situations (Akçay, 2021). Following the victory of the 2018 presidential election, Erdoğan, himself, became the chairman of the Fund.

As Blyth (2002) suggests, in times of increasing uncertainty and anxiety, a new ideational paradigm can emerge. Accordingly, ideas play a significant role that they can elucidate ‘what has gone wrong’ and also ‘what is to be done’, in particular, following the critical junctures (Blyth, 2002). In this sense, the neoliberal policy paradigm as the reigning ideology and conventional economic policy making have been deeply criticized following the global financial crisis not only in developing economies but also in developed countries. Therefore, the state has made a strong come back in the aftermath of the crisis, in particular, in carving out industrial policies. As detailed above, Turkey has implemented several institutional and policy changes in line with new industrial policy making ideas and narratives. Although the neo-developmentalist turn in Turkey is influenced by the global financial crisis and the resulting ideational external shift in industrial policy making, several internal actors and dynamics have also been influential in the emergence and policy adoption process.

### 6.4. The Dynamics of Policy (Paradigm) Change in Turkey

The global financial crisis in 2008 has triggered a lively debate on the modalities of market governance. While neoliberal economic thinking considering the state as a problem for the efficient functioning of the markets have been questioned, state intervention or state-led developmentalist economic policy making has started to be seen as vital for emerging economies. Several institutional changes in addition to new experimental and unorthodox policies have been implemented in Turkey, in particular, in the post-2011 period despite its long term ties with neoliberal policy paradigm. Several strong neoliberal policy paradigm features, namely liberal trade regime, capital account openness and pro-privatization stance, have been largely intact in the period between 2008 and early 2018. However, some alternative authoritarian developmental paradigm features, namely developmental interventionism related to the independence of central bank and regulatory agencies, have been adopted by the government during this period and, in particular, in the post-2018 presidential election period.

There have been several internal and external dynamics and drivers which influence the patterns of change in approach to carving out industrial policy in Turkey in the aftermath of the GFC. One of the external dynamics has been the global financial crisis and the resulting ideational shift at the global level. As mentioned above, ideas become more important in times of increasing uncertainty and anxiety as experienced. An ideational or transformative shift eventuates in two different ways or in other words, in two distinct realms. One is the collapse of old ideas and the other one is the consolidation of new ideas. These are also called as push-and-pull factors (Kutlay, 2019; Öniş and Kutlay, 2019). The Neoliberal paradigm is based on some certain ideas such as disapproval of state intervention, liberalization and privatization. This ideational framework, also known as the 'Washington Consensus', was supported by the US and the US led international institutions and recommended to the developing world as the prescription of economic problems since the beginning of the 1990s. However, the legitimacy crisis of neoliberal ideas emerged mainly because of income inequalities and financial fragilities in developing countries as well as advanced countries constitutes 'push' factors. In terms of push factors, the financial crisis in 2007-08 marked a critical turning point in which the developed world embraced the neoliberal paradigm and were severely influenced by the crisis. Particularly the US and Europe faced the collapse of giant financial companies called 'too big to fail', growing debt burden on households and increasing unemployment. These caused neoliberal ideas to be seriously questioned not only by ordinary citizens but also by politicians and policy makers. Moreover, the ideational framework of neoliberal paradigm, once known as the best route to prosperity, is severely discredited even in the countries in the periphery of Europe (Öniş and Kutlay, 2019).

On the other hand, the 'pull' side of the equilibrium helps the consolidation of new developmental ideas. The significant factor in the ideational shift, particularly in the post-GFC era, is the rising Non-Western powers such as China, Russia, India and Brazil. An important feature of the current transformation of the international system is the power diffusion in favor of emerging countries. It is a very examined and expressed issue that the US is no longer a hegemon state, as it used to be. It doesn't have enough power and lacks the ability to single-handedly shape the world in terms of political and economic governance structures. Therefore, the world is defined as in the era of regional orders or, in other words, regionalization is an important new trend that the world is witnessing (Öniş and Kutlay, 2013; Kupchan, 2012; Katzenstein, 2005). This means that the coming era can be defined as a 'multi-order world'. In other words, there are some new alternative international orders emerging that the new world order will likely witness a questioning of liberal hegemony not only in political spectrum but also in political economic realm (Flockhart, 2016; Nölke et al., 2014; Bremmer, 2010).

In this sense, the old developmental paradigm based on conventional neoliberal ideas is being sidelined by alternative new developmental ideas gaining predominance among non-Western emerging powers. It can be stated that the role of the state is redefined or rediscovered in terms of making and shaping markets in the current new developmental ideational framework. As discussed in the earlier section, neo-develomentalism introduces a new way of relationship between state and market. Despite the fact that the Chinese form of capitalism is different from the East Asian developmental state experiences, it is clear that China's approach to developmental states still sits in the tradition of developmental states in terms of the role of the state in promoting industrial transformation. In this sense, Beijing Consensus is significant because it gives an ideational developmental paradigm alternative for emerging and middle power countries to utilize their own approaches (Öniş, 2019; Yağcı, 2016). On the other hand, the European Union, which was a significant external direct impetus for Turkey to reform its devastated economy, suffered a deep economic and identity crisis in the post-GFC period. This caused the EU to start to lose its soft power over Turkey. Hence, the EU was less attractive than before, this was followed by discourse on the pronunciation of being a member of the Shanghai Cooperation Organization. This is a clear mark for the beginning of Turkey's shift in its orientation and this reflects that ideas and beliefs of political actors were very significant in pursuing alternative models (Berberoğlu, 2013). In short, the diffusion of power from West to East can be considered as an external dynamic and a driver for Turkey to choose a different path. In addition, a new alternative development paradigm taken shape by the Beijing Consensus provides a new path to other emerging and developing countries. And lastly, the EU and European countries have lost their transformative power on Turkey that the EU had played a significant external anchor for earlier reform periods.

Another critical external actor and driver for Turkey's new trajectory towards state-led development policy has been the Russia-China axis. In line with the ideational shift in the Turkish political economy, the Russia-China axis has strengthened in a steady manner in the post-GFC period. For example, Turkey's trading volume with Russia and China has increased significantly and these countries have become major trading partners. Total trading volume with these two countries of Turkey reached around USD 50 billion in 2020. However, it is worth noting that this is an asymmetric relationship because the trade deficit with these two countries of Turkey is increasing every year (Ministry of Trade, 2021a; 2021b). The growing dependence on imports from these two non-Western countries is a sign of new direction regarding the EU as the biggest trading partner for Turkey for a long time. Besides, Turkey has strong tourism ties with Russia. Russian tourists number has been the largest amount in total visitor numbers to Turkey. Once German visitors were the leaders, now Russians are taking their place. Erdoğan thanked Russian leader Putin for the increasing number of tourists coming from Russia (DW Türkçe, 2021). Although, there was a dramatic crisis between Turkey and Russia due to a Russian SU-24 fighter sent down near Turkish-Syrian border in November 2015 by Turkish Air Force, bilateral cooperation between countries are recovered rather swiftly over the last years that this is clear in the words of Putin 'relations between Russia and Turkey are taking on an increasingly more profound and substantive character in the economy' (Tass, 2018).

As stated above, Turkey has a long lasting history with Western countries since the end of the Second World War. Turkey is a member country of NATO, is represented in the Council of Europe and also is one of the EU candidates. Moreover, Turkey has embraced the neoliberal policy paradigm since the beginning of 1980. In 2017, 70 percent of the inward direct investment came from Western countries and 54 percent of its total trade volume was accounted for with the West. In this context, it is seen less likely that Turkey will be influenced non-Western great powers. However, non-Western great powers shape developmental ideational shifts in Turkey. This is seen in the words and acts of government elites. These are internal actors and drivers for the neo-developmentalist turn in Turkey. Yiğit Bulut (2017), who is the chief economic advisor of the president Erdoğan since 2013, says that 'a new world, a new Turkey and a new economic paradigm for Turkey'. Accordingly, Turkey is defining a new paradigm that it is trying to benefit from the 'shifting centers of economic gravity' in the East. In this sense, the Russian and Chinese companies are more eager to invest in mega-sized construction and infrastructure projects in Turkey. For example, Turkey's first nuclear power plant factory, Akkuyu, worth USD 20 billion is beind established by Russia. In 2018, the sovereign wealth funds of two countries signed an agreement for a joint investment fund worth USD 1 billion. Accordingly, both parties would pay USD 500 million to the fund. This money will be directed towards attractive investment projects that will promote trade, economic and investment cooperation between Russia and Turkey. Also, Yiğit Bulut in his statement in the ceremony, told that they were happy for this bridge between countries. He added that the global economy was shifting from the West to the East and the Russia-Turkey cooperation was a significant element of the new world order (Sputniknews, 2018). Moreover, Turkish policymakers have developed a strong interest in China's One Belt One Road (OBOR) project following its launch. The Erdoğan administration even formed 'a working group specially dealing with Turkey's engagement with OBOR [BRI] by the Turkish ministry of foreign affairs with inputs from the ministries of transportation, energy, economy and customs' (Atlı, 2017).

As stated above, the relationship between Turkey and the EU reflects the transformation of Turkey, too. The first years of AK Party ruling has witnessed a close ties with the EU in formation of Turkish political liberalization, democratization along with the transition to a rule-based liberal market economy. The state-market relations were restructured in line with the neoliberal policy paradigm due to the EU conditionality in the post-2001 crisis period. During the first years of AK Party, Turkey has benefited from a large sum of foreign direct investment that the ongoing EU negotiation process had a significant influence on (World Bank Open Data, 2022). However, the EU Ministry established in 2011 was closed in June 2018 as a reflection of the ideational shift of policy makers in Turkey. It was reorganized as a directorate under the ministry of foreign affairs (Habertürk, 2018).

Moreover, the chief advisor to the president of Turkey claimed that the 'EU is destined to break up' and said that Turkey must question the ties with European countries and the EU itself. According to him, emerging powers must be seen as an alternative to Western alliance for Turkey (Bulut, 2014). In this context, Turkish politicians and policy makers stated their interest on non-Western cooperation organizations as a means of deepening institutional linkages with emerging power countries. The BRICS was seen as a significant alternative. Mehmet Şimşek, former minister in charge of economy and deputy prime minister, said that they were 'seriously considering becoming a member of the bank' established by the BRICS. The New Development Bank established by the

BRICS requires being a member for its benefits. Therefore, Şimşek said that ‘Membership is required in order to benefit from the projects they will provide. We are seriously considering becoming a member…’ of the bank to benefit from its ample investment opportunities and projects at the meeting of contractors association (Daily Sabah, 2017c). Besides, the president Erdoğan voiced his eagerness to join the BRICS as the sixth member at the 10th BRICS Summit in Johannesburg in July 2018 just a month after the elections in June. He even proposed ‘BRICST’ as a modified name for the grouping if Turkey joins the group (Munyar, 2018).

In addition, increasing political pressure on the central bank and regulatory agencies can be considered as an internal dynamic reflecting the ideational shift in some of the government elites from regulatory neoliberal paradigm to more developmental central banking understanding. The Turkish central bank and regulatory agencies had been the key institutions in terms of the recovery and restructuring process in the post-2001 crisis period. However, scholars point out a process of institutional weakening in the post-2011 period in Turkey (Acemoğlu and Murat, 2015). The autonomy of the central bank tested with the developmantalist discourse utilized by the president Erdoğan and the AKP government elites. The idea of autonomy and independence of the central bank was harshly criticized by high level officials from the AKP government. As stated in chapter 4, the macroprudential measures implemented in the post-global crisis era were undermined through this discourse. Therefore, the central bank has been the central for ideational contestation between 'financial stabilizers' (Ali Babacan, Mehmet Şimşek and Erdem Başçı) and 'developmentalists' (Recep Tayyip Erdoğan, Zafer Çağlayan, Nihat Zeybekçi and, in the post-2018 period, Berat Albayrak) supporting low interest rates (Öniş, 2019). Central bank governors are replaced with new ones by the president Erdoğan following the 2018 presidential election with the words of 'didn't listen to us’ (Şen, 2021).

There is another critical internal dynamic within the neo-developmentalist turn in Turkey in the post-2011 period. Erdoğan and some government elites started to utilize a neo-developmentalist discourse with the focus on the idea of building a national industrial base (Kutlay and Karaoğuz, 2018). Ambitious targets in terms of growth and industrial production such as producing a 'national car' or building a 'national defense' industry with the strong reference to 'local and national' have been set.

As an external dynamic, the rise of non-Western powers such as China clearly exerts influence on the economic development models of emerging economies. However, internal political economic drivers also have significant influence on the path chosen or likely success (Waldner, 1999; Chibber, 2003). In this sense, mutually dependent state-business ties are another critical internal dynamic in terms of ideational shift within the neo-developmentalist turn in Turkey. Business associations are very key in terms of being representatives of particular social cleavages. Therefore, they influence the form that state-business relations take. As Buğra and Savaşkan (2014) states, there is a 'new capitalism' in Turkey with the emergence of powerful actors in sectors such as construction, media and energy. Also, these actors have close links to the party or party state. On the other hand, low-tech sectors such as textile, chemicals and glass are the main sectors for Turkey's export oriented industries and exporters are still dependent on imported goods to make exports. Moreover, low-tech sectors such as construction, mining and energy are still very key sectors for the overall growth strategy. Government elites have strong and close familial and personal connections with SMEs and big business families in these sectors (Buğra and Savaşkan, 2014).

Political Islam in Turkish politics started to advance in the 1990s and, so interests and preferences diverged between large, secular, Western-oriented conglomerates and other big businesses in terms of business. As stated in chapter 4, while TÜSİAD represents secular and Western oriented business groups, MÜSİAD represents conservative and Muslim-oriented business groups mostly composed of small and medium enterprises (SMEs) (Özel, 2010). As Yagci (2021) states, these two business associations accommodate enterprises with different sizes and political views. However, it could be argued that organizational views in their public statements reflect the positions of most of their members. The AKP government created a 'pro-growth' alliance with the private sector during its rule. These private sector actors are composed of different fractions of the domestic business world. However, as Buğra and Savaşkan (2014) aptly point out pro-government MÜSİAD members and SMEs became the leading beneficiaries in this period. Because, to a large extent, SMEs constitute the main political and economic base of AKP support. SMEs have been actively involved in housing and other construction projects. Many changes have been done in the public procurement system, mega-sized infrastructure projects have been conducted through public-private partnership methods and SMEs have been very key actors in these processes (Çeviker-Gürakar, 2016).

As stated above and in chapter 4, TÜSİAD and MÜSİAD have conflicting interests and preferences. While MÜSİAD representatives and leading politicians in the AKP government were criticizing macroprudential policies of the central bank for the resulting low economic growth and high inflation rates in the post-2010 period, TÜSİAD stated the importance of the central bank independence and fighting against inflation. As mentioned in chapter 4, the AKP government made a critical move for reviving the CGS in 2017. This was significant for easing credit to SMEs. As a result of this, the number of SMEs granted authorized guaranteed loans in 2017 were 314,239, with the total amount guaranteed reaching 238 billion liras (about 63 billion US dollars). These two business associations have also divergent preferences in terms of political front in addition to economic front. A constitutional referendum was set in 2017 for a shift to the presidential system in Turkey. The AKP and Erdoğan pushed this comprehensive shift to executive presidency in which the president would be head of both the state and the executive and also could maintain the leadership of a political party. While TÜSİAD stated that the presidential system was not appropriate for Turkey, MÜSİAD expressed its support for the presidential system. Following Erdoğan's election as the president under the new presidential system in 2018, MÜSİAD Chairman Abdurrahman Kaan asserted that 'New Turkey' with the election of Erdoğan as the president would enable rapid decision making. Also he argued that the new presidency system with Erdoğan elected accelerated Turkey's development course by minimising bureaucracy and would overcome all the challenges ahead to a “Strong Turkey” (Yagci, 2021).

However, the overall economic performance in the post-2011 period was not shiny as it was in the 2000s. While GDP growth rates had been unstable, high in 2013 and 2017, low in 2014, 2015 and 2016, GDP per capita had been decreasing between 2013 and 2018. While inflation rates in the post-2015 period have been increasing, gross external debt and gross external debt in terms of the percentage of GDP has been increasing since 2011. Turkey's ability to attract FDI is weakening in recent years. Public expenditures massively increased due to a populist cycle (CBRT, 2022; Öniş, 2019; TÜİK, 2022). A policy of low interest rate as Erdoğan supports could make sense in terms of stimulating the construction sector and allowing households to access finance in easy terms, however, this policy choice tends to backfire in a globalized economy. This is what happened following the 2018 presidential election in Turkey. Short term capital outflows caused a weakening of the Turkish lira against the US dollar.

On the other hand, Turkey has so far industrialized on the back of imported equipment. In other words, the country has still depended on imported goods. And it still manufactures goods by using this equipment. The products produced in the country are mostly standard undifferentiated ones with medium level technology. The level of industrialization in the country is still behind the top manufacturers of the world and it is experiencing a middle-income trap. Turkey suffers from low sophistication and therefore, low value of exports (Yülek, 2018).

### 6.5. Conclusion

This chapter focuses on the neo-developmentalist ideational shift from the post-2011 to early 2018 in Turkey. This chapter argues that there are several internal and external dynamics and drivers which influence the patterns of change in approach to industrial policy in Turkey in the aftermath of the global financial crisis. The neo-developmentalist turn in Turkey was influenced by the GFC and, in particular, the resulting ideational shift in industrial policy making not only in developing countries but also in developed countries.

The global crisis in 2008 accelerated the debate regarding the role of the state in economic policy making in an environment, in which the pendulum is swinging away from neoliberal policy paradigm or a free market and anti-statist ideology. Therefore, the state was considered by many analysts to have made a strong comeback. In this sense, state-led developmentalist policies in carving out industrial policy in a more open economy setting started to be more famous across the world. The post-GFC environment in the international and comparative political economy triggered a reshuffling in Turkish political economy in line with the neo-developmentalist turn.

The emergence and the implementation of neo-developmentalist policies have been formed by domestic actors and dynamics as well as shifting external consensus and dynamics in the realm of economic policy making. In Turkey, some organizational changes and experimental policies have been carried out in line with new industrial policy making in the post-GFC period. In addition, new discourse utilized by politicians and policy makers influenced the ideational change at the domestic level in the alternative developmental paradigm, which is popular in emerging countries.

When it is assessed in terms of ‘learning’, human capital, and infrastructure, Turkey has established a threshold following a decade of industrial policies supporting advanced technology investments. In addition, there have been some success stories in the defence industry and automobile sector. However, there is more to do rather than just focusing on supportive industrial policy in order to ensure economy-wide productivity gains.In order to translate these developments into economy-wide productivity gains, the problems related to market uncertainty, macro-instability, weak institutions and dependent business elite must be solved. Moreover, these problems have reached new heigths in the late AKP period. The party has responded to a defensive and authoritarian reaction to global and domestic political challenges that this process was resulted with a presidential system with weak check and balance mechanism after the 2017 referendum. This has, in turn, undermined transparency, public sector accountability and finally bureaucratic autonomy (Toksoz, 2023; Gür, 2022).

# Chapter 7

# Conclusion

## 7.1. Research Summary and Findings

The aim of this thesis is to understand the transformation of the Turkish political economy with the focus on external and internal dynamics and drivers within the realms of financial and industrial sector policies in the period between the late 2010 and the early 2018. The thesis particularly strove to understand the relationship between the global financial crisis in 2008 and ideational shifts within a rising middle power country case. This thesis argues that although external dynamics and actors have been very influential, internal dynamics and actors have also played a significant role in bringing about these ideational shifts in the realms of financial governance and the real economy. Through this concluding chapter, I first provide a summary of headline findings on the extent and drivers of change in financial sector governance and industrial policy. Then, I provide a section including avenues for future research on policy paradigm change.

### 7.1.1. Contemporary Financial Sector Governance in Turkey: Headline Findings

In the aftermath of the global financial crisis in 2008, there has been an ideational shift in the realms of both financial and industrial policy making on a global level. In terms of financial governance, significant consensus among policymakers across the globe has emerged to adopt a macroprudential policy framework. Macroprudential ideas embrace a quite different conception of market relations and behavior that it asserts the contrary of efficient market theories. Accordingly, the role of public authorities is redefined and their power is increased in order to intervene and set limits to activities in the financial system (Baker, 2013a). In line with the macroprudential turn, central banks of advanced countries accommodated unconventional monetary policy measures. However, this caused short-term hot money flows to emerging and developing economies. These capital flows resulted in an increasing volatility and risks in managing them (Ahmet and Zlate, 2014).

In this sense, private credit growth rate climbed to 40% in Turkey and the Turkish lira appreciated rapidly due to the QE policies of the central banks of advanced countries. Moreover, the current account balance deteriorated and the current account deficit widened and was substantially financed by short-term portfolio flows in this period (Kara, 2016). Economic growth is very high in the periods of increasing capital inflows in a country like Turkey. However, this could lead to an overheating in the economy resulting in the increase in the debt burden of firms and individuals. Nevertheless, Turkey, as an emerging middle power country, has differed from other emerging economies' capital flow management measures in the post-GFC era. Turkey is the only emerging market economy where unconventional, experimental monetary policy measures used for macroprudential purposes and no direct capital flow management measures have been imposed (Yağcı, 2017). In other words, Turkey continued the open capital account regime despite the risks of short-term hot money flows into the country in the post-GFC period. The central bank of Turkey, however, implemented asymmetric interest rate corridor and reserve option mechanisms as 'unconventional', 'experimental' and 'unorthodox' monetary policy measures to mitigate the risks stemming from large capital inflows and to provide financial stability in the late 2010.

Financial stability emerged as a key pillar for policy making in the aftermath of the GFC across all central banks in the world. It was the case for the Turkish central bank as well. The CBRT has introduced two new policy instruments, interest rate corridor and reserve option mechanism as unconventional monetary policy tools in the pursuit of financial stability in line with the macroprudential turn (Yağcı, 2017). This was a rather significant step for the CBRT, which has started to actively pursue financial stability goal without any legal amendments with monetary policy tools. In addition, the Financial Stability Committee (FSC) was established by the Turkish Treasury in 2011 as a formal institutional mechanism in the governance of macroprudential measures in Turkey. The FSC was established, defining the deputy prime minister, who is in charge of economy, as chairman of the committee. The FSC included all the major relevant institutions for financial stability approach, namely, Banking Regulation and Supervision Agency (BRSA), Treasury, Capital Markets Board (CMB), Saving Deposit Insurance Fund (SDIF), and the central bank of Turkey.

As it is discussed in chapter 4, external and internal dynamics have both influenced the macroprudential ideational shift in Turkey. The global financial crisis has created a new orientation towards financial stability and the resulting macroprudential ideational shift in financial governance (Baker, 2013). With the macroprudential turn, central banks around the world have embraced precautionary measures against systemic risks and implemented unconventional policy instruments in order to provide financial stability. In this sense, central banks of advanced countries increased their monetary bases with massive asset purchases and lending programs. As a result of this, emerging economies encountered a surge of short-term hot money flows. As this thesis argues, the financial crisis in 2008 and the resulting macroprudential ideational shift in financial governance have played a significant role within the macroprudential turn in Turkey. Nevertheless, the surge of short-term hot money inflows stemming from central banks of advanced countries' macroprudential policies has been the key driver for Turkey's macroprudential turn. While the global crisis, the resulting ideational shift in global financial networks and large amount of capital inflows have played an influential role as an external dynamic, there have been several significant internal dynamics contributing factors for both continuity and change within the macroprudential turn in Turkey.

One of the internal dynamics has roots in the bitter experience of an earlier crisis. Following the devastating February 2001 crisis, Turkey restructured its economy in line with the dominant neoliberal paradigm. Bank regulation and supervision has been unambiguously prudent during the 2000s. The central bank of Turkey and the BRSA as the responsible institution for supervision and regulation of the banking system had a greater degree of independence, in particular, in the 2000s. This was the case due to the reform program embraced with the ideational and material support of the Bretton Woods institution and the EU in the post-2001 domestic crisis period. Therefore, the CBRT could have taken the leading role in the post-GFC period.

As Kara (2016) and Yağcı (2017) assert, the Turkish central bank was the leading internal actor in designing and implementing macroprudential measures. The CBRT (2010), as the first institution, drew attention to global imbalances stemming from capital flows and macro-financial risks facing the Turkish economy. In this sense, the CBRT initiated a policy and an informal institutional change regarding active financial stability goal in Turkey starting from the late 2010. It is worth noting that central banks assumed their leading role in pursuing financial stability in line with changing international consensus regarding macroprudential shift in global level. However, the Turkish central bank started to use unconventional monetary policy tools in pursuing financial stability goal as a new mandate without legal amendments. It is important to state that the CBRT as an institution and its Governor, Erdem Başçı, as an individual played a very key role in the macroprudential turn in Turkey. These internal drivers initiated divergent change for financial stability and they also were actively involved in all the policy stages of agenda setting, policy formulation, implementation and evolution.

In addition, the FSC, as a formal institutional mechanism in the governance of macroprudential measures, was established in June 2011. This institution has also played a key role in the implementation of macroprudential measures. Therefore, it was the other key internal actor within the macroprudential turn in Turkey. The BRSA, also, had a very key role in implementing macroprudential measures considering that the agency has the responsibility of banking regulation and supervision in the Turkish financial sector. The BRSA took several measures in line with the recommendations of the FSC. As this thesis argues, however, Ali Babacan as the chairman of the committee has played a vital role for the relatively smooth implementation of relevant policies until his term as a minister ended in 2015. An official from the CBRT described this inclusion as a significant thing that the existence of the politician in the committee accelerated the implementation process as well as easing the implementation (Interview 4). With this support, the CBRT maintained its autonomy and was enabled to utilize experimental measures for financial stability purposes in line with macroprudential ideational shift.

However, as Han (2016) states, the pursuit of financial stability of central banks in an explicit and active way in the post-global financial crisis era has significantly altered their relationships with financial markets and, particularly, governments. Macroprudential measures, by their nature, have some costs for emerging economies in terms of economic growth. The critical date is 2012 in terms of the macroprudential ideational shift in Turkey. While the Turkish economy saw high annual GDP growth rates until the GFC, GDP sharply declined in 2008 and 2009. Afterwards, the economy recovered rapidly and saw high growth rates in 2010 and 2011. However, GDP growth rate declined in 2012 and then the political backlash within the ruling party to these measures started to surface and persisted thereafter.

Recep Tayyip Erdoğan, who was the prime minister then and now the president, has a more interventionist developmental paradigm. On the other hand, Ali Babacan was a strong supporter of macroprudential measures and financial stability orientation along with being a staunch supporter of the regulatory state paradigm. These differences caused ideational differentiation in the economic policy-making process (Yağcı, 2018). This can be clearly followed from the discussions surrounding the status of the central bank, and its policy stance in terms of macroprudential measures along with monetary policy. Ali Babacan clearly opposed political intervention in the regulatory agencies despite the increasing political pressure on himself and these independent institutions (Kutlay, 2019; Yağcı, 2018). However, macroprudential measures stayed intact and the CBRT maintained its tight monetary policy stance for a while, at least.

In addition to this political backlash, this thesis argues that there are other critical factors which have influenced the fortunes of the macroprudential ideational shift in Turkey. The adoption of a macroprudential regulatory approach had different impacts on the relationship between the regulators and the banking sector itself along with the reel sector. As Yağcı (2018) states, referencing a representative of a big holding company, the central bank didn't provide a clear road map for macroprudential policy framework and this made policies unpredictable. In this sense, a high level official from the BRSA stated that the agency was not asking any advice from the banking sector representatives before any policy implementation. He stated that the agency was asking representatives to give their opinions and advice prior to any policy implementation in the pre-macroprudential policy period. However, it was not the case within the macroprudential policy framework (Interview 7). The foundation of the FSC, also, along with the central bank in the driver seat diminished the influence of the banking sector in the regulatory policy making process (Interview 4, Interview 7).

As well as divergent preferences in the realm of financial sector governance, the macroprudential turn also uncovered the divergent preferences of real sector actors. This can be exposed with the divergent preferences of two major business groups, namely TÜSİAD and MÜSİAD, in the Turkish context. While TÜSİAD criticizes the government for the high inflation rates by implying an increase in the interest rate, MÜSİAD supported neo-developmentalist approach and policies of the AKP government. This also reflected developmentalist central banking preferences of some of the government elites as stated in chapter 4.

Although macroprudential policies for financial stability and thereby preventing systemic shocks have not been revoked, the developments taken place in the post-2012 indicated how ideas and beliefs of political actors shape their approach and the reforms they enact in the Turkish case. In this sense, the AKP government made a critical move that the idle credit guarantee scheme (CGS) was revived with special emphasis on assisting SME financing in 2017. While the CGS contributed to the economic growth rates significantly in 2017, as this thesis argues, this was a kind of announcement that macroprudential measures had largely lost their significance in terms of the Turkish economy despite the relevant macroprudential measures not revoked.

### 7.1.2. Contemporary Industrial Policy in Turkey: Headline Findings

The future of neoliberal policy paradigm, as the reigning economic policy framework over the last three decades, has been seriously questioned due to the severity of the global crisis in 2008. The crisis accelerated the debate regarding the role of the state in economic policy making in an environment, in which the pendulum is swinging away from the neoliberal policy paradigm or a free market and anti-statist ideology. In this context, the state is considered by many analysts to have made a strong comeback. While liberal economies have experienced severe turmoil in the subsequent years of the crisis, the ones which have state-led heterodox models seemed to survive more confidently (Kutlay and Karaoğuz, 2018). This state-led development perspective or neo-developmentalism embraces a selective type of state interventionism and integration into the global markets. Neo-developmentalism accommodates itself to the neoliberal acceptance regarding the importance of private entrepreneurship and markets as the engines of economic growth and development (Gezmiş, 2018).

Following the 2001 crisis, a bold and comprehensive reform package was put into implementation for the enhancement of Turkey's state capacity in the regulatory realm in line with the main principles of the Post-Washington Consensus, while this was not complemented by a profound industrial strategy. However, the post-GFC environment triggered a reshuffling in the beliefs of Turkish politicians and policy-makers. In other words, the GFC and the resulting ideational shift in carving out industrial policy played a significant role as external dynamics in adopting and implementing state-led developmentalist policies in Turkey.

The GFC was a dramatic turning point for the international political economic landscape due to the shifts in global context such as the weakening dominance of established powers and their neoliberal policy paradigm, and the increasing influence of BRICS countries on near-BRIC countries or middle power countries. This thesis argues that Turkey, as an emerging middle power country, is a case in point. These are significant external dynamics which influenced the transformation of the Turkish political economy towards neo-developmentalism. The established countries of the 'global North' are weakening. Also, the influence of the US on Turkey has declined due to the growing disagreements between them. Moreover, it was witnessed that the transformative powers of the EU on Turkey has lost its influence. These were the main external impetus in the reform process in the aftermath of the 2001 domestic crisis.

While the Western countries' influence on emerging market economies and, in particular, Turkey is decreasing, the growing influence of BRICS countries are more visible with the models of 'state capitalism' or 'state-permeated capitalism' popular in these countries (Yağcı, 2021; Nölke et al., 2019; Öniş, 2019). The magnificent rise of China and the increasing importance of the China-Russia axis are considered as a striking phenomenon with economic as well as political implications (Kaczmarski, 2015). The China-Russia axis is particularly significant in terms of the Turkish political economic transformation.

The global crisis clearly triggered a new development approach not only for Turkey and emerging powers but also for advanced countries. The Neoliberal paradigm is based on some certain ideas such as disapproval of state intervention, liberalization and privatization. This ideational framework, also known as the 'Washington Consensus', was supported by the US and the US led international institutions and recommended to the developing world as the prescription of economic problems since the beginning of the 1990s. However, the legitimacy crisis of neoliberal ideas has been clearly indicated not only by ordinary citizens but also by politicians and policy makers. Moreover, the ideational framework of neoliberal paradigm, once known as the best route to prosperity, is severely discredited even in the countries in the periphery of Europe (Öniş and Kutlay, 2019). In short, the diffusion of power from the West to the East can be considered as an external dynamic and a driver for Turkey to choose a different path. In addition, the EU and European countries have lost their transformative power on Turkey that the EU had played a significant external anchor for earlier reform periods. And lastly, a new alternative development paradigm taken shape by the Beijing Consensus provides a new path to other emerging and developing countries.

As this thesis argues, the regulatory state paradigm in Turkey started to decline gradually in this environment. The Ministry of Science, Industry and Technology (MoSIT) was established in order to make explicit that the 'science' and 'technology' is an important aspect of the Turkish industrial transformation strategy. In addition, a new separate ministry, namely the Ministry of Development, was established and it was assigned with the coordination of Turkey's developmental policies in a more macro perspective. They were assigned with carving out proper developmentalist policies in this new political and economic paradigm. Moreover, the establishment of a sovereign wealth fund is another significant indicator for the ideational shift in the mind-set of Turkish policy makers. Although there was opposition, it was created in August 2016 to provide funds for large scale and strategic investments. These were the main internal organizational manifestations of a new ideational shift in the Turkish political economy.

Within the neo-developmentalist turn in Turkey in the post-GFC period, Erdoğan and some government elites started to utilize a neo-developmentalist discourse with the focus on the idea of building a national industrial base (Kutlay and Karaoğuz, 2018). Erdoğan declared his intention to develop 'native and national technologies' several times. Ambitious targets in terms of growth and industrial production such as producing a 'national car' or building a 'national defense' industry with the strong reference to 'local and national' have been set (Kutlay, 2019; Öniş, 2019). In addition, increasing political pressure on the central bank and regulatory agencies can be considered as an internal dynamic reflecting the ideational shift in some of the government elites from the regulatory neoliberal paradigm to a more developmental central banking understanding. The autonomy of the central bank tested with the developmentalist discourse utilized by the president Erdoğan and the AKP government elites. The idea of autonomy and independence of the central bank was harshly criticized by high level officials from the AKP government. This thesis argues that these developments reflected the neo-developmentalist ideational shift in internal actors.

This thesis has shown that mutually dependent state-business ties are another critical internal dynamic in terms of ideational shift within the neo-developmentalist turn in Turkey. Business associations are very key in terms of being representatives of particular social cleavages. Therefore, they influence the form that state-business relations take (Yagci, 2021). The AKP government created a 'pro-growth' alliance with the private sector during its rule. These private sector actors are composed of different fractions of the domestic business world. However, as Buğra and Savaşkan (2014) aptly point out pro-government MÜSİAD members and SMEs became the leading beneficiaries in this period. While TÜSİAD represents secular and Western oriented business groups, MÜSİAD represents conservative and Muslim-oriented business groups mostly composed of SMEs (Özel, 2010). SMEs have been actively involved in housing and other construction projects, in particular, in the post-GFC period. Many changes have been done in the public procurement system, mega-sized infrastructure projects have been conducted through public-private partnership methods and SMEs have been very key actors in these processes (Çeviker-Gürakar, 2016).

To sum up, this thesis analyses dynamics of financial governance and industrial policy in Turkey in the period between the late 2010 and the early 2018. This thesis specifically seeks to identify patterns of continuity and change in these policy realms with the focus on the balance between internal and external dynamics in shaping outcomes in the post-GFC international political economic environment. As well as agreeing with prominent analyses that post-GFC change should be characterized as incremental, I suggest that different balances between external and internal dynamics have shaped the patterns of change within the financial and industrial policy spheres in Turkey. Overall I argue that a variegated agency, which is an agency understanding contributing both continuity and change, displayed across the spheres of industrial policy and financial regulation in Turkey's contemporary political economy. I find that ideational change taken place in the global political economy along with the agency of domestic actors and domestic institutions have divergent influences on adopting and implementing policies in both spheres. In other words, both external and internal dynamics shaped the outcomes without obvious pre-empinence of either external or internal factors. Driven by these dynamics, we have seen the movement toward hybrid policy paradigms in the Turkish political economy with financial governance remaining characterized by key neoliberal principles, and the state's role in the real economy characterized by aspects of neo-developmentalism.

### 7.2. Avenues for Future Research

This thesis investigated the Turkish political economy within the period between the late 2010 and the early 2018. Accordingly, the Turkish political economy shows a hybrid model with financial governance remaining characterized by key neoliberal principles, and the state's role in the real economy characterized by aspects of neo-developmentalism. However, Turkey's transition to a fully fledged presidential system in the June elections of 2018 and the crisis of 2018-2019 deserves further attention and investigation with the focus on the balance between internal and external dynamics in terms of the fortunes of the Turkish political economy. Because, on the contrary to the earlier period with the balance of divergent external and internal dynamics, the president Erdoğan, with its expanded presidential powers and with weak checks-and-balances mechanism in the system, has consolidated his position as the central driving force in the modes of governance of neo-developmentalist or state capitalist.

Turkey experienced a new economic crisis and the resulting lengthy recession period by the end of 2018. In the financial crisis that happened in 1994, 2001 and 2009, the Turkish economy shrank rapidly with a collapse of asset values and a contraction of output. However, the 2018 economic crisis was characterized by a prolonged recession with persistent low rates of growth, reduction in investment performance, debt repayment problems, rising unemployment, rapid currency depreciation and high inflation (Orhangazi and Yeldan, 2021). Moreover, this crisis displays significant elements that 'allow us to draw attention to the critical role of domestic politics in the face of substantive shifts in the liberal international order' (Öniş and Kutlay, 2021, p.2).

Turkish contemporary political economy under the subsequent governments of the Justice and Development Party (AKP) has been characterized as 'populist' (Aytaç and Öniş, 2014), 'social neoliberal' (Dorlach, 2015), 'authoritarian neoliberal' (Tansel, 2018), and 'competitive authoritarian' (Esen and Gümüşçü, 2018). Moreover, Özel (2013) defines the Turkish variety of 'illiberal capitalism' with the prevailing statist and patrimonial features showing market economy characteristics. However, I suggest that state capitalist (Öniş, 2019; Kutlay, 2019) or state-permeated capitalist (Yagci, 2021) features demonstrate itself in the Turkish political economy, in particular, in the post-2018 crisis period.

The shifts in international political economic order has provided alternative developmental paradigms and opened up new policy space for emerging market economies in carving out their financial and industrial policy making. In particular, the China-Russia axis has created a new framework with their authoritarian and undemocratic features of their state-market relations. In this sense, Turkey's contemporary political economy needs to be studied with the transition of a full-fledged presidential system, which gives a hyper-central and consolidated driving force authority with a weak checks-and-balances mechanism to the elected president. Following the footstep of Öniş and Kutlay (2021), it is worth noting that the Turkish economy has structural problems, origins of which lie in the earlier period, such as capital inflow dependency, low saving rates, failure to develop high industrial and technology export goods. However, the ongoing economic problems cannot be seen as a mere crisis of regulatory neoliberalism implemented in the post-2001 crisis period. I argue that the origins of the ongoing economic crisis is related to the hyper-presidential system with state-capitalism or neo-developmentalism with certain features of neoliberal practices in an increasingly de-institutionalized domestic political economic governance mechanism. Turkey has been deeply influenced with the ideational shift in the international political economic order in the post-GFC period and its associated political and economic domestic dislocations.

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## Appendix: List of Interviews

1- Former High Level Official, Central Bank of Republic of Turkey, (11.12.2018)

2- High Level Official, Banking Regulation and Supervision Agency, (14.12.2018)

3- Expert, Ministry of Treasury and Finance, (27.11.2018)

4- High Level Official, Central Bank of Republic of Turkey, (05.12.2018)

5- Expert, Ministry of Treasury and Finance, (22.11.2018)

6- Expert, Ministry of Treasury and Finance, (29.11.2018)

7- High Level Official, Banking Regulation and Supervision Agency, (14.12.2018)

8- Academic and Official at the Central Bank of Republic of Turkey, (12.12.2018).

9- Academic, (12.12.2018)

10- Academic and Director in a Think Tank, (12.12.2018).

11- Senior Expert, Presidency of Strategy and Budget, (24.11.2018)

12- Senior Expert, Presidency of Strategy and Budget, (24.11.2018)

13- Senior Expert, Presidency of Strategy and Budget, (24.11.2018)

14- Expert, Ministry of Industry and Technology, (28.11.2018)

15- Senior Expert, Ministry of Industry and Technology, (04.12.2018)

16- Senior Expert, Ministry of Industry and Technology, (06.12.2018)

17- Expert, Ministry of Industry and Technology, (28.11.2018)