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WHAT CAN TURKEY LEARN FROM ARGENTINA?

Abstract

This paper compares the experiences of Turkey and Argentina in the face of the recent global economic meltdown. The historical and economic peculiarities of these two countries render them as perfect comparative case study. They both historically had acute macroeconomic instabilities with high inflation rates and internal and external disequilibrium. In both countries volatility in economic growth rates (stop-and-go cycles) have been associated with current account and fiscal deficits. They both adopted a number of stabilization policies guided by the IMF which were all unsuccessful. They both got into the new millennium with almost simultaneous (February 2001 in Turkey and December 2001 in Argentina) and the most severe economic crises in their histories. They both have experienced very rapid growth rates since their economic crises. Economic recovery in Argentina has been in a better shape and more sustainable than Turkey. Although both countries will inevitably face the negative impacts of the global crisis, the impact is likely to be more severe for Turkey.

JEL Classification Code: **E22, F3, G10, O16.**

Keywords: Argentina, Turkey, financial crisis, heterodox policies.

Introduction

This paper compares the experiences of Turkey and Argentina in the face of the recent global economic meltdown. The historical and economic peculiarities of these two countries render them as perfect comparative case study. They both historically had acute macroeconomic instabilities with high inflation rates and internal and external disequilibrium. In both countries volatility in economic growth rates (stop-and-go cycles) have been associated with current account and fiscal deficits. They both adopted a number of stabilization policies guided by the IMF which were

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all unsuccessful. They both got into the new millennium with almost simultaneous (February 2001 in Turkey and December 2001 in Argentina) and the most severe economic crises in their histories. They both have experienced very rapid growth rates since their economic crises.

After the crises, Argentina has implemented heterodox economic policies while Turkey under the auspices of the IMF has adhered to the orthodox approach. This paper argues that, in comparison to the Turkish case, Argentinean economic policy since 2003 is more successful in achieving economic recovery and stimulating sustainable development, and Argentina was better prepared for the world economic crisis of 2008-2009.

Until the world economic crisis of 2008-2009, Turkey faced the largest trade and current account deficits in its history whereas Argentina had trade and current account surpluses. Turkey had increasing rate of unemployment and external debt while Argentina managed to reduce them both visibly. Turkey had low and declining saving rates whereas Argentina substantially increased them. Turkey had one of the highest real interest rates in the world whereas in Argentina they were very low. Overall, the results are more encouraging for Argentina. This paper suggests that these simple facts imply a more sustainable recovery for Argentina. Turkish recovery however is a lot more vulnerable in the face of global economic crisis.

Argentina and Turkey before their Financial Crises

After decades of economic decline and instability with hyper inflation, Argentina adopted a very radical stabilization program in 1990. The convertibility plan was an extreme case of exchange rate based anti-inflation strategy which was designed with and supported by the IMF. To eliminate hyper-inflation, the plan fixed the Argentinean peso to the US dollar on a one to one basis. Inflation was reduced from over 3000 percent in 1989 and over 2000 percent in 1990 to 4 percent in 1994. Far-reaching trade and capital account liberalizations, macroeconomic stability, high real interest rates and a very ambitious privatization program generated large capital inflows which contributed to rapid economic growth rates. Per capita GDP (PPP constant 2005 international dollar) increased by 47 percent between 1990 and 1998. These achievements were presented to other developing countries as a successful model of IMF-induced reforms.

Onis (2004: 2), however, suggests that the "IMF prescription have contributed both to the early success and the subsequent collapse of the Argentine model". Overdependence of the economic performance to capital inflows and the accumulation of huge external debt highlighted the inbuilt vulnerability of the model. Controlling inflation and maintaining the fixed exchange rate required strict monetary and fiscal discipline which removed flexibility in their use and limited the ability of the government to respond to the economic recession in the late 1990s. Moreover the

rigidity of the plan increased the vulnerability of the economy to external shocks. The Argentinean currency became overvalued for at least three reasons: First, although inflation was brought under control successfully, it remained relatively high in 1991 (178 percent) and 1992 (25 percent) which caused significant overvaluation of the real exchange rate. Second, the US dollar appreciated against the other currencies. Finally, Argentina's main trade partner Brazil experienced a financial crisis in 1999 and devalued its currency. The real exchange rate overvaluation undermined Argentinean exports and led to an unsustainable and increasing current account deficit which was financed by increasing barrowing. Privatization was a source of foreign direct investment. The privatization revenues were used to finance fiscal and current account deficits and maintain the fixed exchange rate. Excessive reliance on such limited resources caused problems when the government had no more publicly owned firms to sell. The lack of privatization revenues caused not only a direct shortage in foreign currency and made it more difficult to finance fiscal and current account deficits but also increased the reliance on portfolio investment which created further vulnerability.

Although the economic growth rates remained over 5 percent between 1991 and 1997 (with an exception of 1995 where GDP fell due to the "tequila crisis"), they started to decline thereafter. After three years of negative growth rates between 1999 and 2001, the economy collapsed in 2002 which marked the end of Argentinean miracle with severe economic and social consequences. Per capita GDP (PPP constant 2005 international dollar) declined by 22 percent between 1998 and 2002. Unemployment increased from 6 percent in 1991 to 16.6 percent in 1996 and to 18.1 percent in 2001.

Turkey started its liberalization/stabilization policy under the military rule in 1980 in response to the debt and balance of payments crisis of the 1970s. The foreign exchange regime was liberalized in 1984 and public were allowed to hold foreign currency deposits and to engage in foreign exchange transactions. Initially the program looked successful with a reduction in inflation, current account deficit and public sector deficit; and increase in exports and respectable economic growth rates. However the public sector deficit and inflation increased significantly towards the end of the 1980s.

According to Akyuz and Boratav (2003) two factors played a significant role. First, the increase in exports and decline in inflation were achieved through significant reductions in real wages and support for agricultural sector. Return to democracy after 1987 led to an increased pressure on governments to compensate the losers. Second, the liberalization of the financial markets and the deregulation of interest rates before the introduction of fiscal discipline and effective control of inflation let to a significant increase in the cost of financing public sector deficits. A very rapid increase in the real interest rate resulted in a rapid accumulation of public debt and interest payments. The government responded to these problems by liberalizing the

capital account further in 1989 which removed all restrictions on capital flows. Full convertibility meant full exposure of the Turkish economy to the forces of financial globalization and economic performance became dependent on highly unpredictable short-term capital flows. The capital account liberalization aimed at financing the public sector deficit without crowding-out private investment but the fiscal problem was aggravated due to very high real interest rates which were mainly caused by inflation rate instability. The rapid increase in the public debt led the government to engage in Ponzi financing where mounting interest payments could only be paid by new barrowing. Interest payments to tax revenue ratio increased from 20 per cent in the 1980s to over 75 per cent in the 1990s (Akyuz and Boratav 2003). During the 1990s it became obvious that the full liberalization of the capital account was premature as the economy was unstable with large fiscal deficits and high inflation, and the financial markets were under regulated (Rodrik 1990, Onis and Bakir 2007).

Interest payments replaced the primary deficit as the most important component of the public sector deficit. Increased financial instability associated with large interest rate and exchange rate fluctuations, and capital in/out flows caused instability in investment and economic growth rates. The Mexican crisis in 1994, the Asian crisis in 1997, the Russian crisis in 1998 and a massive earthquake in 1999 pushed the Turkish economy into recession. Towards the end of the millennium, high inflation, unsustainable public debt and increasing financial fragility meant that Turkey desperately needed a stabilization program which was launched in December 1999 with a strong support from the IMF.

This was a typical exchange rate based stabilization program that was designed to cover a three-year period. Inflation would be reduced to 20 percent in year one, about to 10 percent in year two and to a single-digit level in the final year. A nominal fixed exchange rate against a Dollar-Euro basket was used to establish price stability. Turkish Lira would be devalued 20 percent in year one to keep the real exchange rate competitive. In year two Lira would be allowed to fluctuate within a band that would gradually be widened in year three. The proclaimed exit from the fixed exchange rate was considered a major strength but it was also a precarious strategy as a failure to meet inflation targets could risk a speculative attack on the currency at the time of the pre-announced exit date.

The program also encompassed fiscal policies and structural reforms. The fiscal policies aimed at achieving a public sector primary surplus through increase in income tax, VAT in alcohol and tobacco, education fees and a reduction in social security transfers as well as limited public sector salary increases. Structural reforms included the privatization of public firms, reforming the banking sector, eliminating subsidies to farmers and a pension reform.

The IMF (1999) considered the program "strong and well balanced" and supported it with financial assistance. In the first nine months some good results were achieved: the interest rates declined faster than inflation which brought relief to the

budget. A primarily surplus was achieved which was higher than planned. Positive net capital flows amounted to 12.5 billion dollars during the first 10 months of 2000 (Akyuz and Boratav 2003). Despite the full implementation and achievement of its monetary and fiscal policy targets, the program failed to achieve its inflation target by 35 percent in the first year (Onaran 2007). High inflation rate and the appreciation of dollar against euro (75 percent weight was given to dollar in the dollar-euro basket) resulted in real exchange rate overvaluation and caused major concerns regarding the sustainability of the fixed exchange rate and increased speculative expectations (Onaran 2007).

According to Akyuz and Boratav (2003) a number of factors contributed to the rigidity of inflation: First, fiscal adjustment required state owned enterprises to increase their prices to reduce their losses. Second, public sector salary increases exceeded the inflation target. Finally, some components of the consumer price index such as rents increased much faster than the inflation target.

The overvaluation of the real exchange rate combined with the worsening of the internal and external environment (oil price increase, delays in privatization, worsening relations with the EU, the economic situation in Argentina and a criminal investigation into several banks) brought the first shock in November 2000 with about 6 billion dollars capital outflows. The IMF support of 7.5 billion dollars kept the program on course for a short time but the second shock came in February 2001 with a larger capital outflows, towering interest rates and deteriorating reserves. The fixed exchange rate was abandoned and Lira was left to float. The real exchange rate (measured by the PPP conversion factor to market exchange rate ratio) depreciated by 23.1 percent in one year. According to Telli, Voyvoda and Yeldan (2008), the major flaw of the program was its excessive dependence on speculative short-term capital flows. Design problems as well as worsening external environment ended the stabilization policy with an unprecedented crisis. The political factors played a catalyst role in a frail economy where the investors have been waiting for a signal to move out (Onaran 2007). Per capita GDP (PPP constant 2005 international dollar) declined by 9.22 percent in 2001, total debt to GDP ratio increased from 61 percent in 1999 to 93.5 percent in 2001 and external debt to GDP ratio from 41 percent to 57.7 percent. The capital outflow in 2001 amounted to 11.3 percent of GNP (Onaran 2007).

Turkey and Argentina after their Financial Crises

Both countries have experienced neo-liberal reforms and ended up with their most severe financial crises. The Turkish neo-liberal reforms started earlier and had a gradualist character with slower pace. Argentinean reform process covered a shorter period but had much greater intensity. It certainly was one of the most radical experiments in neo-liberalism during the last three decades. In Argentina neo-liberalism caused a structural break with an economic boom that lasted for eight years which was fal-

lowed by a bust that started in 1999 and led to a massive financial crisis in 2002. Turkish neo-liberal experience did not cause a major change in the pattern of economic growth but the boom and bust cycles became augmented. Two decades of neo-liberal reforms which led to many small and large crises continued after the 2001 crisis.

Overall, between 1980 and 2008, Turkey looks relatively more successful. Turkish economy grew between 1980 and 1990 whereas Argentinean economy experienced a decline. During the 1990s the Argentinean economy grew a lot faster than the Turkish economy but the decline in the GDP during the financial crises of 2001 was more severe in Argentina. After the crises Argentinean economic recovery has been more pronounced with faster and sustained economic growth rates.

The crisis in Argentina and IMF's failure to support Argentina at the onset and during the crisis were taken as a complete failure of neo-liberalism to deliver stable economic growth. The pursuit of recovery, growth and social stability involved a more dynamic role for the state. The interim government of president Duhalde clearly had an anti-IMF rhetoric which marked a critical break from neo-liberalism and embedded heterodox policies based on a proactive state. In May 2003, Kirchner took over the presidency and continued with the policies where the state took on a central role in stimulating economic growth.

The abandonment of convertibility, the devaluation of currency and the following competitive exchange rate policy (managed or dirty float) significantly improved exports and helped to substitute importables. To keep the exchange rate competitive, the Central Bank buys and sells foreign currency by printing money which is then sterilized through issuing bond to keep money supply under control. The government converted most domestic debt contracted in dollar to pesos which neutralized the effect of exchange rate fluctuations on the debtor companies (Frenkela and Rapettib 2008). The export performance was aided by the improving terms of trade. International prices especially for agro-industrial goods (such as soybeans, wheat and oil), petroleum, gas and petrochemical products remained high.

Argentina's export structure is diversified away from primary commodities such as grains and beef to agro-industrial products, automobiles, steel, petrochemicals, tourism and engineering services (Lowenthal 2006). Taxes on traditional exports significantly increased primary fiscal budget surplus which in turn helped to make very substantial scheduled debt payments. Fiscal surplus was considerable due not only trade taxes but also increased economic activity and government's determinism to reduce tax evasion. Export taxes were instrumental to keep their domestic prices low which not only helped to control inflation but also helped their domestic consumers (many of the exportables such as beef and grains are heavily consumed in Argentina). This policy resolved the long lasting tension between the needs of exporters and the consumers.

The selected taxation of exports implies the introduction of multiple exchange rates in practice which does not offend the WTO rules. The WTO does not approve

selective protection of import substitutes or promotion of exportables but there is nothing in WTO rules that precludes a competitive exchange rate policy and taxing certain traditional exports which would indirectly promote non-traditional exports as well as create resources to promote selected non-tradables.

A 70 per cent reduction in the debt to private creditors and postponing the external debt payments until 2005 increased reserves and established confidence in the economy. After 2005, however, most new financial resources were spent in paying the external debt (Grugel and Riggirozzi 2007). An agreement with the IMF in 2003 secured a 3 billion dollars loan and debt repayments to the World Bank allowed new loans which were instrumental in the application of the social inclusion policies that guaranteed a minimum income to all citizens to tackle massive poverty and unemployment (Grugel and Riggirozzi 2007). The government finally cleared the account with the IMF by settling the 9.8 billion dollars debt in December 2005 which not only created more room for maneuver for policy making but also established confidence in the sovereignty of the state. Inflation was kept under control by 'voluntary' price controls through government-led negotiations with supermarkets and producers. A record level of current account surplus resulting from competitive exchange rate and the decision that export revenues exceeding one million dollar had to be sold to the central bank were instrumental in accumulating reserves to counter any financial problems without needing the IMF (Frenkela and Rapettib 2008).

The Argentinean economy grew vary rapidly after the crisis based on solid macroeconomic fundamentals (Frenkela and Rapettib 2008). The Argentinean experience challenges the myth that state-led development is tantamount with autarky and leads to inefficient results. Grugel and Riggirozzi (2007) suggest that the success has been primarily the result of a combination of prudent policy-making, favorable external environment and the fear of returning to the instability.

After the financial crises in November 2000 and in February 2001, Turkey adopted another orthodox stabilization policy under the supervision of the IMF which was based on high interest rates, substantial capital inflows, overvalued exchange rates, soaring imports, increased external debt, tight fiscal policies and jobless-growth. Therefore the Turkish post-crisis period has been "speculative-led" in nature which resembles the Argentinean growth experience between 1990 and 1998 except that Turkey has a flexible exchange rate policy.

The current program is based on the achievement of a significant fiscal primary surplus, tight monetary policies by the independent central bank to achieve price stability (inflation targeting) and the usual structural reforms such as privatization and the abolition of subsidies (Voyvoda and Yeldan 2005). The government aims to maintain two targets: inflation and primary surplus. The purpose of these targets is to reduce the country risk perception and reduce interest rates which is hoped to stimulate private investment and economic growth (Telli, Voyvoda and Yeldan 2008).

While primary surplus has been high (4.7 percent of the GDP) and inflation has been brought under control (about 18 percent) between 2002 and 2007, the real inter-

est rates remained relatively high. Therefore very rapid economic growth (on average 6.7 percent between 2002 and 2007) has been largely driven by massive capital inflows which has been motivated by high interest rates rather then increased investment.

Because growth, over the post-crisis period, has depended mainly on flows of "hot money", it has been speculative-led and volatile. Voyvoda and Yeldan (2005) calculated the net rate of return on financial arbitrage for Turkey and suggest that Turkey offeres arbitrage gains over 30 percent during the post-crisis period (up to 80 percent during the crisis of 2001) which is significantly higher than the OECD countries. Such high returns explain why Turkey receives very large sums of speculative money and investment in industrial activity remains low.

As opposed to the traditional stabilization policies, high interest rates aimed at attracting foreign capital rather than constraining the domestic demand. Capital inflows increased the availability of foreign exchange and caused overvaluation of the Turkish currency which, in turn, not only led to an import boom but also led exports to depend on cheaper capital goods imports. Increase in exports became depended largely on imports which are mostly assembled-part industries such as automotive parts and consumer durables (Voyvoda and Yeldan 2005). These are relatively low value added activities and create very few employment opportunities. Therefore, although exports increased very rapidly, the increase in imports surpassed exports and led to unprecedented levels of current account deficit and external indebtedness. The current account deficit was a massive 37.7 billion dollars in 2007 and 41.4 billion dollars in 2008. The average current account deficit between 2003 and 2008 (25.8 billion dollars) is about 20 times higher than the average current account deficit between 1980 and 2002 (1.33 billion dollars) which has caused serious concerns about its sustainability. External debt increased from 130.1 billion dollars at the end of 2002 to 247.5 billion dollars in 2008. The private sector took the lead in barrowing during this period while the contractionary policies led to very high primary fiscal surplus. The rapid growth of GDP failed to create jobs and unemployment remained high at about 10 percent. Therefore Turkish experience has been characterized as speculative and jobless growth (Voyvoda and Yeldan 2005).

The deregulation of the financial markets coupled with liberalization of international trade and prioritizing the control of inflation above any other macroeconomic consideration imply that interest rate and exchange rate become almost an exogenous variable determined by external factors which set them at undesirable levels, i.e. high interest rates and overvalued exchange rates.

Comparing Turkey and Argentina

As discussed earlier the economic revivals of both countries after their financial crises have been remarkable. However a simple examination of the macroeconomic variables suggests that Argentinean recovery appears more sustainable in the face of

global economic meltdown. After the crisis, Argentina detached itself from the IMF whereas Turkey established another stabilization program with the IMF. Argentina adopted heterodox policies whereas Turkey continued to follow orthodox policies with the support of IMF. This section compares Argentina and Turkey by focusing on a number of macroeconomic indicators to establish its claim that the post-crisis policies in Argentina have been more triumphant.

The GDP growth rates (figure 1) were lower and relatively more unstable for Argentine than Turkey between 1980 and 2008. Turkey grew 4.26 percent and Argentina grew 2.52 percent annually. The coefficient of variation is 99 percent for Turkey and 258 percent for Argentina for this period. The declines in GDP very often exceeded 5 per cent in Argentina. After the crises however Argentina appears more successful. Between 2002 and 2008, Turkey grew on average 5.95 percent with a coefficient of variation of 45.9 percent and Argentina grew 8.53 per cent with a coefficient of variation of 9.27 percent. During this period Argentina experienced positive growth in a row for six years for the first time since 1980.

Per capita GDP in current US dollar (figure 2) in Argentina shows a remarkable increase between 1990 and 1998 but an equally radical decline between 1998 and 2002. Per capita GDP in 2002 was lower than 1980. Per capita GDP in Argentina increased 145 percent between 2002 and 2007 but still remains 20 percent lower than its 1998 value. Per capita GDP in Turkey fluctuated between 1980 and 2001 but less radically compared to Argentina and increased rapidly after 2001. Per capita GDP in Turkey increased 95 percent in 22 years between 1980 and 2001, and it increased 210 percent in 7 years between 2001 and 2007.
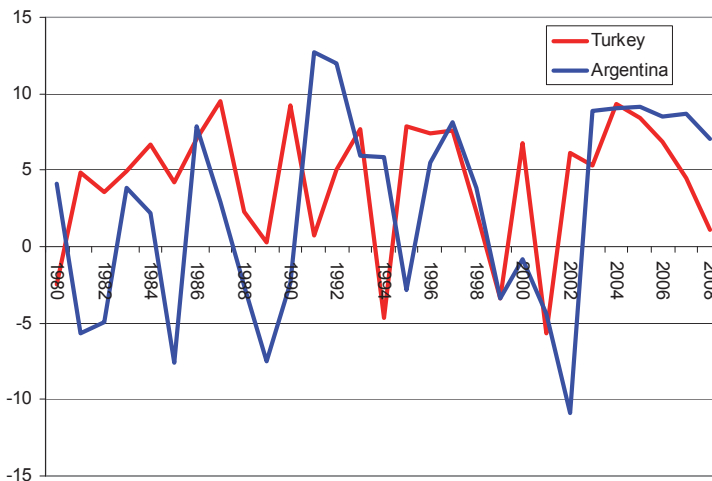
Figure 1. GDP growth (constant 2 000 US$)
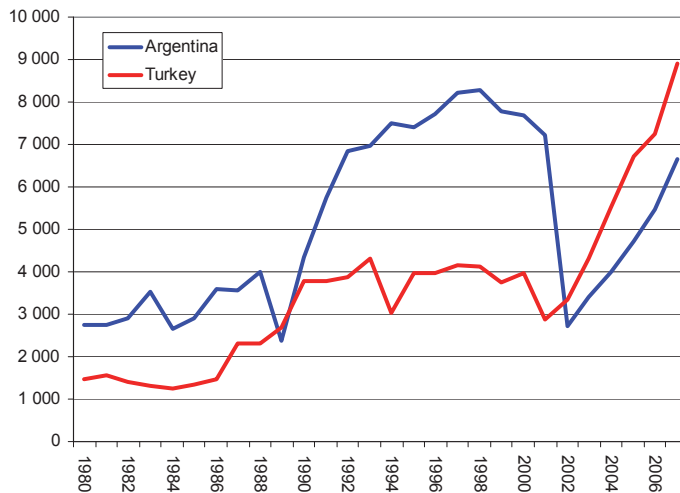Source: World Bank World Development Indicators

Figure 2. GDP Per Capita (current US$)
Source: World Bank World Development Indicators.

However, the above figures are misleading as they do not take domestic prices and rapid exchange rate changes into account. Increase and decline in GDP per capita is inflated by radical changes in the exchange rates. For Argentina, for example, the increase between 1990 and 1998 as well as the decline between 1998 and 2002 are both magnified by the radical changes in exchange rates. Equally important, the average prices in these two countries may substantially be different due to the 'Balassa and Samuelson effect'. This implies that even when the two countries have the same level of per capita income, purchasing power will be higher in the low price country.

Per capita GDP in PPP (constant 2005 international dollar) addresses these problems and produces a more realistic picture. Once the impact of exchange rate changes is taken into account, a less radical increase and decrease in per capita GDP trends are observed (figure 3). Turkish per capita GDP (PPP) was 56 per cent of the Argentinean per capita GDP (PPP) in 1980. By 1990 they were almost equalized as per capita GDP declined in Argentina and increased in Turkey. Between 1990 and 1998 Argentina experienced a very rapid increase in per capita GDP (PPP) whereas Turkey experienced a modest increase. During the financial crises of 2001, the fall in GDP was a lot more radical in Argentina than Turkey and per capita GDP (PPP) in Turkey and Argentina were equalized again. Between 2002 and 2007 Argentina grew faster and took the lead yet again. In 2007 Turkish per capita GDP was about 90 per cent of the Argentinean per capita GDP. Therefore although Turkish per capita GDP (PPP) increased a lot faster than Argentina between 1980 and 2007, between 2002 and 2007 Argentina grew faster.
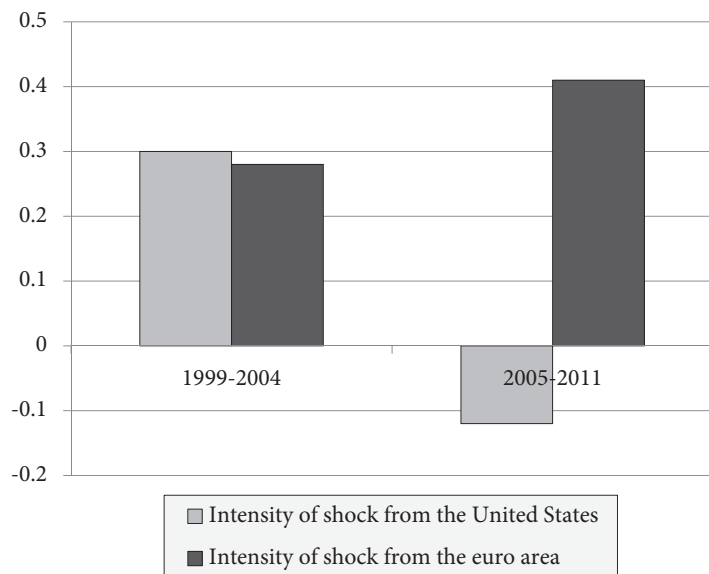
Figure 3. GDP Per Capita, PPP (constant 2005 international $)
Source: World Bank World Development Indicators.

The exchange rate policies played a pivotal role in the development pattern of both countries. We measure real exchange rate by the PPP conversion factor (GDP) to market exchange rate ratio which is taken from the World Development Indicators database. In Argentina (figure 4) the appreciation of the real exchange rate with the convertibility plan and depreciation in 2002 is very obvious. Although historically current account deficits are not unusual for Argentina, it became very high and persistent between 1990 and 2002. Current account deficits in Argentina were often caused by the income component of the current account and trade balance was almost always in surplus until 1990 (figure 5). Starting from 1990 the trade balance also experienced some large deficits. The recovery of the current account since 2002 has been largely due to a very high trade surplus. The adaptation of competitive exchange rate policy encouraged exports and import substitution. This exchange rate policy played not only a crucial role in stimulating rapid economic growth but also has been the main factor behind a healthy macroeconomic environment by contributing to external and fiscal account sustainability. Favorable external conditions (figure 6) vis-à-vis high international commodity prices, strong export demand (particularly from China and India) and low international interest rates contributed to the export boom. Therefore strong export and economic performance owe not only to economic policy making but also to circumstances and good luck (Grugel and Riggirozzi 2007).
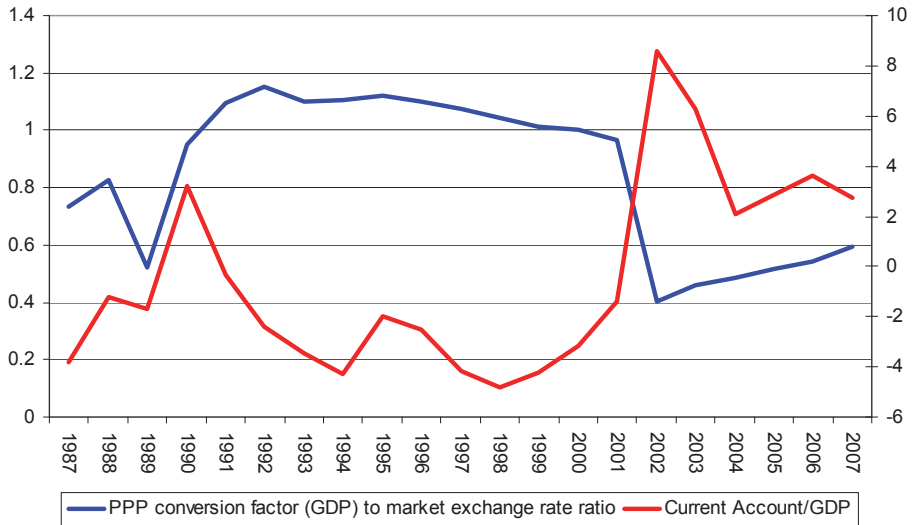
Figure 4. Argentina - Real Exchange Rate and Current Account to GDP Ratio
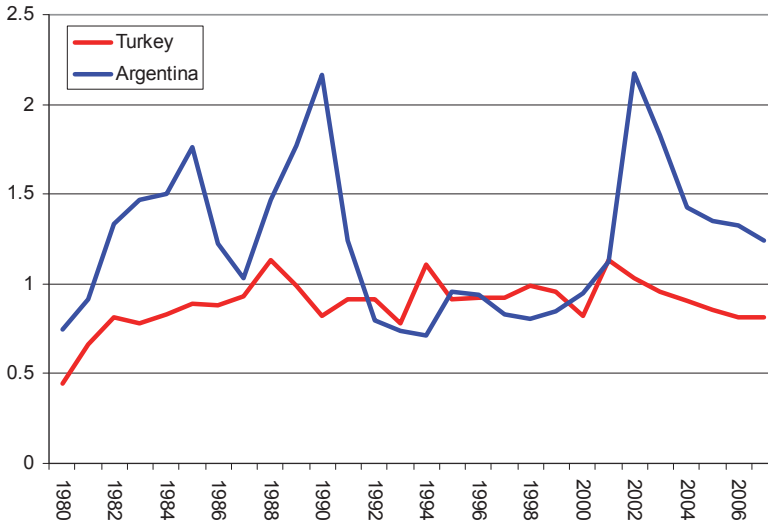Source: World Bank World Development Indicators

Figure 5. Exports to Imports Ratio
Source: World Bank World Development Indicators

For Turkey the real exchange rate appreciation and the significant deterioration in the current account since 2001 is very obvious (figure 7). The current account deficit reaches a new record level every year since 2004. As argued earlier, the aver-

age current account deficit between 2003 and 2008 is about 20 times higher than the average current account deficit between 1980 and 2002. Such a rapid growth in current account deficit weakens investor confidence, causes vulnerability to radical capital outflows and causes serious concerns regarding its sustainability. The terms of trade (figure 6) for Turkey have not been favorable due particularly to the strong challenge from China to Turkish exports.
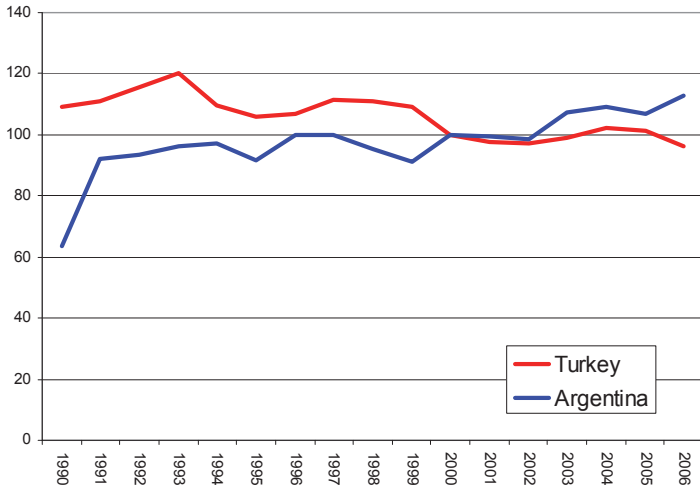
Figure 6. Net barter terms of trade (2000 = 100)
Source: World Bank World Development Indicators
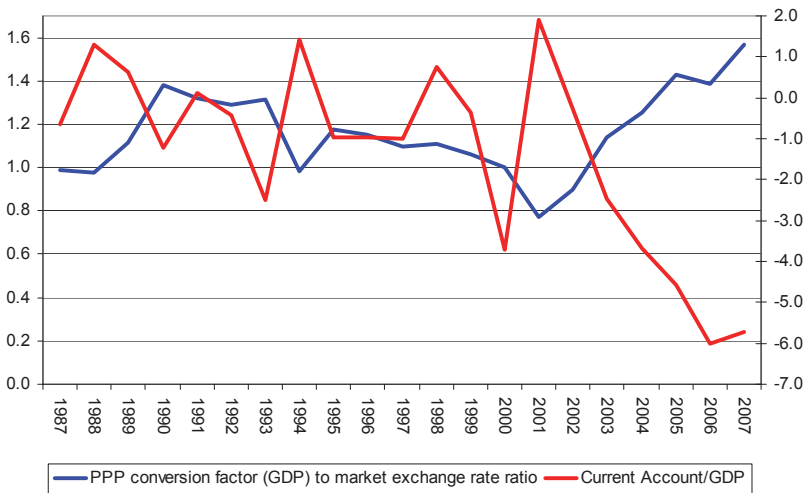
Figure 7. Turkey - Real Exchange Rate and Current Account to GDP Ratio
Source: World Bank World Development Indicators

How current account is financed is as important as its size (figures 8 and 9). Current account can be financed by foreign direct investment (FDI), portfolio investment and external barrowing. FDI is thought to be relatively less problematical way of financing current account deficit as portfolio investment and short-term barrowing can be very volatile. In Argentina portfolio investment increased very rapidly between 1991 and 1998 (figure 8) and it became negative between 1999 and 2005. Although in 2005 Argentina introduced controls on short-term and speculative types of capital flows through a 30 percent unpaid reserve requirement for at least a year, in practice this policy was ineffective as it allowed ways to avoid the reserve requirements (Frenkela and Rapettib 2008). After 2005 portfolio investment has an increasing trend. According to Frenkela and Rapettib (2008) controls were introduced more as an indication of the commitment to maintain the competitive exchange rate policy rather than as an effective control mechanism. FDI played an important role in the financing of current account primarily via privatization revenues during the 1990s.
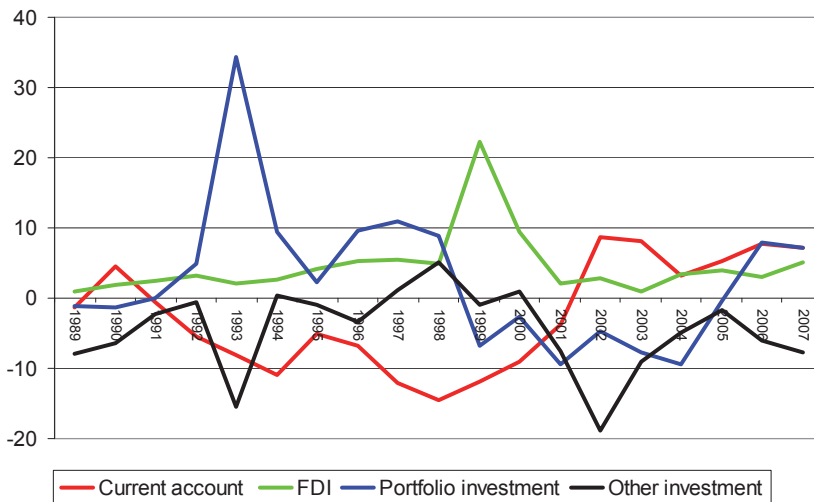
Figure 8. Argentina (Billions of US$)
Source: IMF Balance of Payments Statistics

In Turkey the rapid increase in FDI since 2005 led some economists to believe that the rapid increase in current account was no longer a serious problem (figure 9). This optimism however is unjustified as increase in FDI is largely led by privatization policies as well as mergers and accusations (rather than greenfield investment) particularly in the financial sector. As argued earlier and supported by Argentina's experience, relying on such limited revenues can be problematical in the long term. In Turkey foreign debt plays the most important role in financing current account deficit. Portfolio investment declined in 2007 but still remains an important source of finance.

The debt-led development attempt in Argentina increased the debt and debt to GDP ratio particularly after 1993 (figure 10 and 11). Debt to GDP ratio in 2004 was above 200 percent. The debt restructuring in 2005 reduced the total nominal debt by 67 billion dollar, an almost 40 percent in total. The decision to delay external debt payments until 2005 allowed the accumulation of reserves which increased confidence in the economy (figure 12).
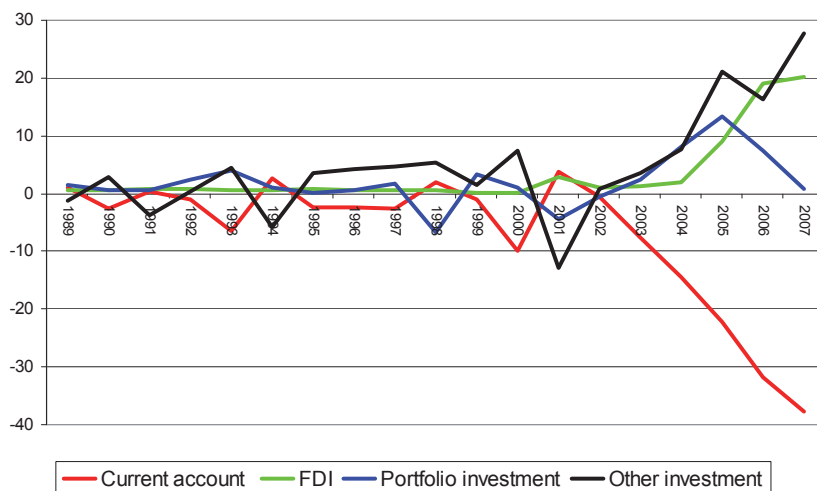

Figure 9. Turkey (Billions of US$)
Source: IMF Balance of Payments Statistics
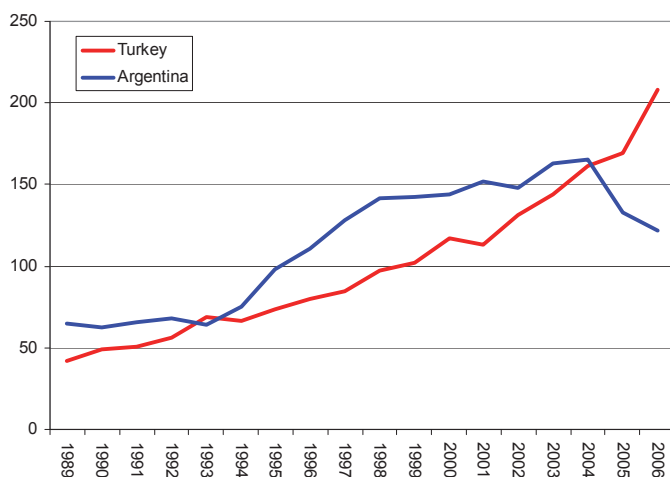
Figure 10. External debt (current billion of US$)
Source: World Bank World Development Indicators
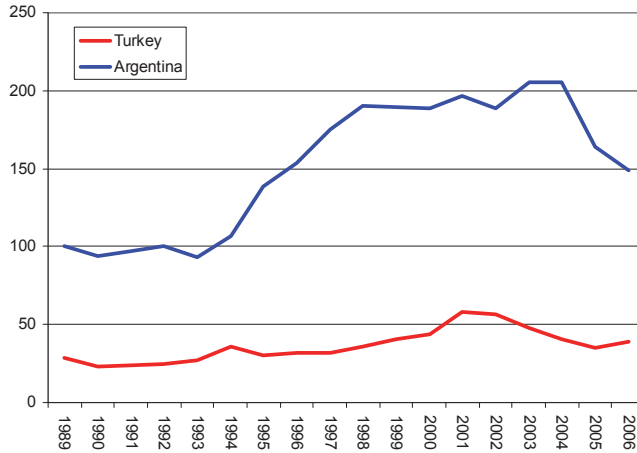
Figure 11. External debt to GDP Ratio (current US$)
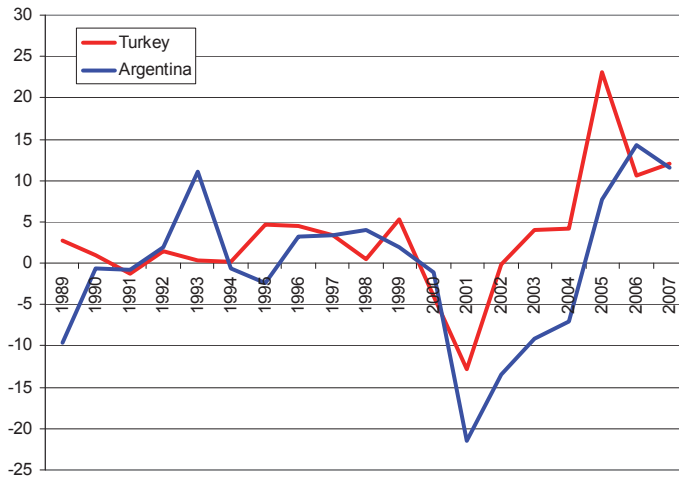Source: World Bank World Development Indicators

Figure 12. International reserves (Billions of US$)
Source: World Bank World Development Indicators

The total debt in Turkey has been growing since 2001 very rapidly (figure 10). However because the increase in GDP exceeded the increase in debt, the debt to GDP ratio has been declining which has produced a positive atmosphere in Turkey (figure 11). Such optimism however can be misleading as the increase in GDP has been magnified by the overvalued exchange rates. As argued earlier, GDP calculations are influenced by changes in exchange rates and overvalued exchange rates in-

flate the GDP. Therefore rather than using GDP in current US dollars, it makes more sense to use GDP in PPP (figure 13). Once the influence of exchange rates on GDP is taken into account the increase in debt to GDP ratio in Turkey and the decline in Argentina become more pronounced.
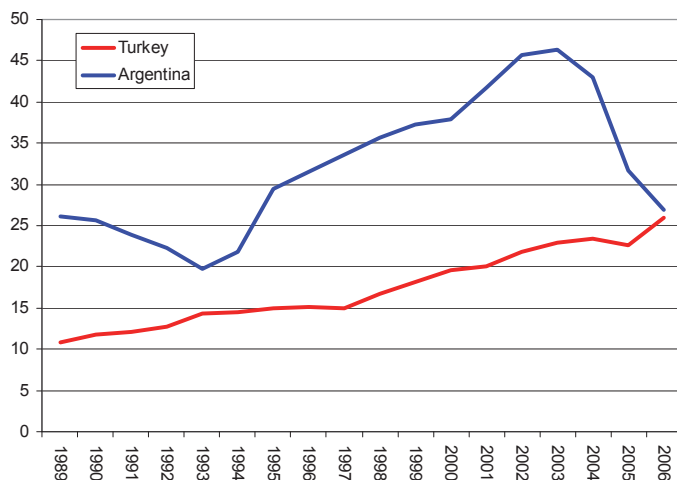

Figure 13. External debt to GDP Ratio (PPP constant 2005 international $)
Source: World Bank World Development Indicators

An important part of Argentina's macroeconomic policy since 2003 has been the historically very high primary budget surplus which allowed the country to have a budget surplus (figure 14). While primary surplus is not unusual for Argentina the budget balance remained negative during most of the 1990s due to high interest payments. Since 2003 the primary surplus has become significantly larger due to taxes on exports, high economic growth rates which increased taxable income and government's determinism to reduce tax evasion (Cibils 2008). According to Frenkela and Rapettib (2008), in 2006 taxes on export accounted for 63 percent of the primary surplus and 122 percent of the total surplus. Large primary surplus allowed substantial debt payments. Fiscal surplus has become larger due to increase in primary surplus and a decline in interest payments.

In Turkey, apart from 1997, the primary balance has been in surplus but due to very large interest payments the budget remained in deficit (figure 15). The budget deficit reached to more than 12 percent of the GDP in 2001 and due to contractionary fiscal policies it steadily declined to less than 1 percent in 2006. An increase in primary surplus as well as a decline in interest payments contributed to declining budget deficit. Turkey has also been able to reduce the public debt substantially. Figures 16 and 17 show that the public sector revenues and primary expenditure as percentage of GDP increased much faster in Argentina than Turkey since their crises.
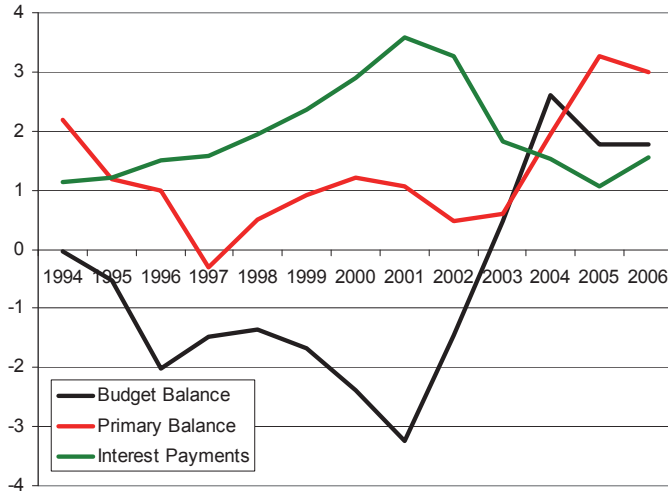
Figure 14. Budget Balance – Argentina
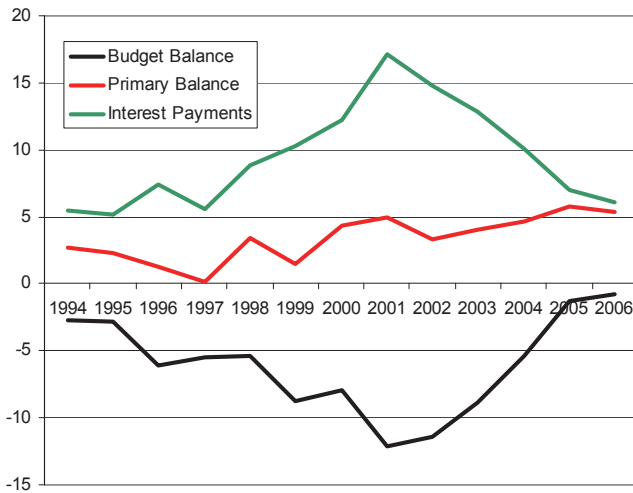Source: The Ministry of Economy of Argentina

Figure 15. Budget Balance – Turkey
Source: Turkish Statistical Institute

Due to the alternative development strategies adopted by these two countries, the real deposit interest rates in Argentina declined very radically and became negative since 2003 whereas in Turkey they increased and remained above 10 percent (figure 18). The Turkish strategy requires high real interest rates to attract more foreign capital. Argentinean strategy however requires low interest rates to stimulate

domestic investment by using domestic savings. In Argentina the gross fixed capital formation increased from 12 percent in 2002 to 24.2 percent in 2007 (figure 19). Gross domestic savings increased from 15.5 percent in 2001 to 26.9 percent in 2002 and 29 percent in 2007 (figure 20). In Turkey the gross fixed capital formation increased from 15.9 percent in 2001 to 21.5 percent in 2007 but saving rates declined 23.3 percent in 1998 to 17.1 percent in 2007. The investment rate in Turkey in 2007 was lower than what it was in 1998.
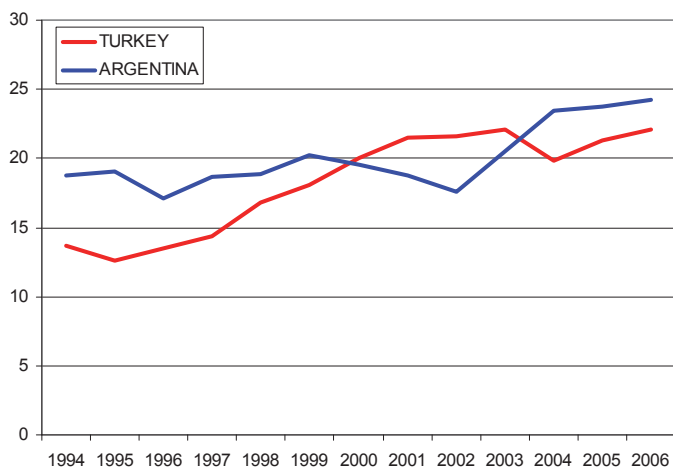
Figure 16. Public Sector Revenues (% of GDP)
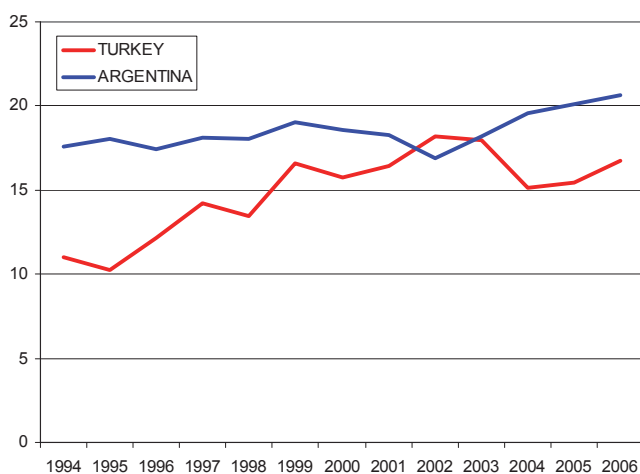Source: Turkish Statistical Institute and The Ministry of Economy of Argentina

Figure 17. Public Sector Primary Expenditure (% of GDP)
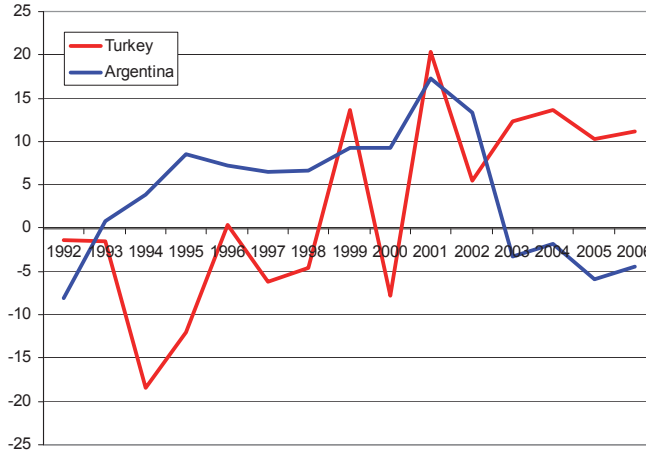Source: Turkish Statistical Institute and The Ministry of Economy of Argentina

Figure 18. Real Deposit Interest Rate (%)
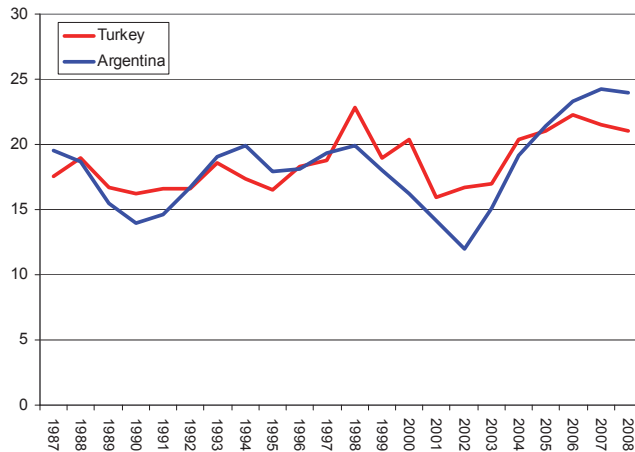Source: World Bank World Development Indicators

Figure 19. Gross Fixed Capital Formation (% of GDP)
Source: World Bank World Development Indicators

Unemployment in Argentina increased very rapidly from 6 percent in 1991 to 18.1 percent in 2001 but it declined to 8.5 percent in 2007 (figure 21). In Turkey unemployment increased from 6.6 percent in 2000 to 10.5 in 2003 and slightly declined to 9.8 percent in 2007. Therefore rapid economic growth in Turkey after 2001 has failed to create jobs and therefore considered as "jobless growth". The failure to recover from high unemployment after the financial crisis was unusual for the Turkish economy which puts the burden of the crisis unevenly on unskilled workers or wage earners (Onis and Bakir 2007). In 1996 unemployment rate was almost 11 percent

higher in Argentina than Turkey. In 2007, however, unemployment is 1.4 percent higher in Turkey than Argentina.
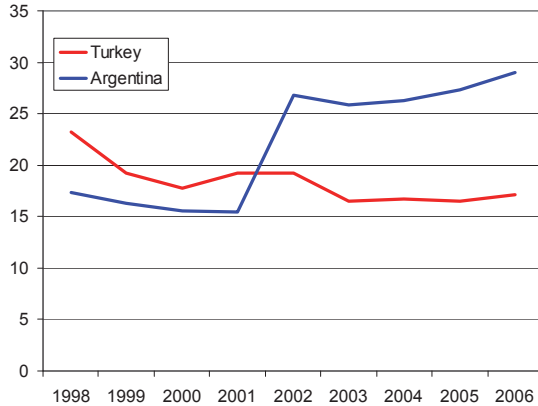

Figure 20. Gross domestic savings (% of GDP)
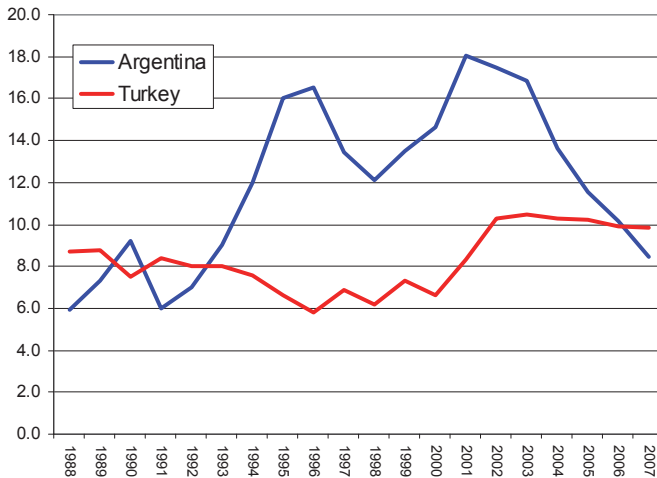Source: World Bank World Development Indicators

Figure 21. Unemployment rate (%)
Source: World Bank World Development Indicators

Although inflation in Argentina is moderate, it is considerably higher than those of the 1990s (figure 22). Inflation increased from 4 percent in 2004 to 11 percent in 2006 and was 9 percent in 2007. There is a debate between orthodox and heterodox economists over whether current level of inflation constitutes a problem. The orthodox approach promotes a monetary policy known as "inflation targeting" and keen to keep inflation as low as possible regardless of what happens to production and

employment. The heterodox approach suggest that a moderate level of inflation is in fact preferable because it allows relative prices to adjust more easily when prices are sluggish downward. So far inflation has been kept under control by ad hoc policies such as price controls of basic goods, export taxes (to reduce the domestic price of exportables) and arbitration in wage negotiations. Wage demands and profits are contained due to fear of unemployment and return to instability. However managing industrial relations between business and labor is not an easy task in the long run (Grugel and Riggirozzi 2007). Keeping inflation under control may not be so easy without a long-term strategy. Perhaps a more worrying aspect of inflation debate in Argentina is the alleged manipulation of the inflation figures by altering the statistical methodology in January 2007 to mask relatively high inflation figures. Cibils (2008) suggests that while the official inflation rate for 2007 is 8.5 percent alternative estimations suggest that it could be between 12 to 24 percent. The manipulation of inflation also makes it difficult to know the current levels of poverty as poverty calculations are sensitive to the level of inflation. If inflation is higher that the government figure, it is reasonable to assume that poverty must also be higher. The underestimation of inflation also has relevance to public debt as "41 percent of public debt has interest payments indexed to the official CPI" (Weisbrot 2008).
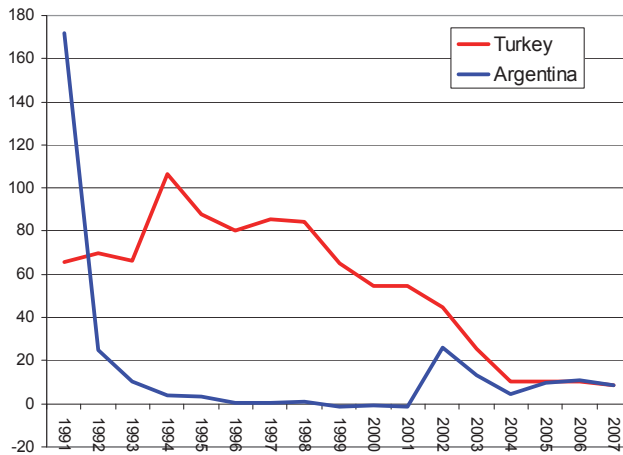

Figure 22. Inflation, consumer prices (annual %)
Source: World Bank World Development Indicators

Inflation in Turkey has been successfully brought under control due to tight monetary policies adopted by the independent central bank and inflation targeting policies. Inflation went down from 54.4 percent in 2001 to 8.8 percent in 2007. Although controlling inflation has clearly been the most successful aspect of the post-2001 crisis adjustment period, the cost of this achievement and whether inflation will remain low in the long run is still subject to a debate.

Conclusion

It is clear from the above evidence that economic recovery in Argentina has been in a better shape and more sustainable than Turkey. Although both countries will inevitably face the negative impacts of the global crisis, the impact is likely to be more severe for Turkey. The early signs support this prediction. During the May-June 2006 turbulences Turkey was amongst the hardest hit middle income countries (Onaran 2007). The IMF estimates that Turkish economy will shrink by 5.1 percent in 2009 and this fallows the dismal 1.1 percent growth rate in 2008. The decline in the Argentinean economy will be limited to 1.5 percent in 2009 and this follows from a much superior growth rate of 7 percent in 2008. In terms of growth rates in 2008 the CIA World Fact Book ranks Turkey as the 175th out of 217 countries and ranks Argentina as the 30th.

The current economic policies in Turkey resemble Argentina's policies during the 1990s. Although Turkey has adopted flexible exchange rate policies and reformed its financial sector during the post-2001 crisis period, high interest rates, large capital inflows, overvalued exchange rates, soaring imports, increased external debt, tight fiscal policies, privatization policies and jobless-growth are familiar characteristics of the Turkish economy to pre-2001 crisis characteristics of Argentina. Therefore such flawed policies could not have been sustained in the long run with or without the world economic crisis. Many economists expected Turkey to experience another financial crisis before the world financial crisis.

For sure not everything is seamless in Argentina and flawed in Turkey. Despite all the positive signs, Argentina's heterodox experience has been ad hoc and there is not consensus over what has or should replace neo-liberalism. Although a more proactive role for the state has been envisaged, there is a lack of clarity over the precise role of the state and a lack of development program. There appears no clear long term strategy to deal with issues such as inflation, energy, and income distribution (Cibils 2008). Inflation figures are likely to be manipulated, thus may not show the true poverty levels. Despite Argentina is rich in oil and natural gas, it is facing an acute energy shortage due to the underinvestment in the energy sector resulting from privatization policies during the 1990s (Lowenthal 2006). Argentina also faced a devastating drought in 2008 and 2009 which killed millions of livestock and hit the agricultural sector and exports severely. The favorable terms of trade due to high export prices are unlikely to continue perpetually. Although unemployment fell from 18 percent in 2001 to 8.5 percent in 2007, many new jobs are in non-unionized, low-paid and temporary without standard benefits of full time jobs. Grugel and Riggirozzi (2007) note that almost half of total employees have no social insurance and unemployment amongst young people remains very high.

The banking sector reforms and the creation of the Independent Banking Supervision Institution in Turkey after the 2001 crisis helped the Turkish banks to face the world crisis in favorable conditions. Although the financial sector in Turkey remains

lucrative, the problems in the real sector are likely to influence the financial sector. The impact of the global financial crisis on Turkey economy will likely to come from its impact on the real sector rather than the financial sector. Turkey has been able to attract foreign capital due to high interest rates and policies such as the law on repatriation of capital that relaxed the foreign exchange shortage. However such temporary emergency measures are unlikely to keep the economy above water interminably.

In conclusion there can be very little doubt that Argentina's heterodox policies have been a lot more successful compared to Turkey's orthodox policies. Policies in Argentina have been experimental but very imaginative. It may not be possible or even desirable for Turkey to imitate Argentinean experience single-mindedly but Argentinean experience provides some valuable lessons. Turkey must now look beyond the failed policies of the orthodoxy and adopt more pragmatic policies to address its structural and long lasting problems. Turkey must reject the straitjacket imposed by the IMF and adopt new strategies according to its specific circumstances. The Argentinean experience as well as a large literature on developing countries show that no pre-determined set of policies will serve all countries equally well, be it orthodox or heterodox. The development process is a non-linear and complex process and no simple rules can be advised to developing countries.

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