



Structural Adjustment Programs in Turkey in terms of Income Distribution (1980-2000)

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ABSTRACT

The major obstacle for the instable and developing economies of the developing countries were seen as government intervention in the economy. This led to debt crisis for emergency economies in the beginning of 1980s in which the amount of loans they borrowed with low interest rates increased very fast after rising interest rates. This problem gave new objectives to the IMF and the World Bank to stabilize those economies under deficit pressures with a more profound and comprehensive package of policy reforms which is known by its famed name, Structural Adjustment Programs. The philosophy was the minimalization of the state via trade and financial liberalizations. However, the last situation indicates that there is a certain income gap among different states and this seems like a big dilemma concerning the globalized world after SAPs. And this study tried to explain one of the transition periods of the globalization in Turkey under the World Bank-IMF co-operated structural adjustment program in the early 1980s and the effect of the program on income distribution in Turkey until 2001 crisis.

Key Words: Globalization, Income Distribution, Poverty Trap, Structural Adjustment Programs

INTRODUCTION

After the Industrial Revolution in the early 19th century, as we all know, the economy of the world grew enormously with the transitions from agrarian societies to industrial societies. Sachs (2005) states that the total economic activity in the world has increased 49% over the past 180 years. This magnitude economic growth, thanks to the intensifying idea of free market economies, supplied the conditions for globally integrated market of today's contemporary world. In an economic sense, Cornia and Court (2001) stress that the economic development and sustainability are the common and important ways to fight with poverty. In spite of the aforementioned economic growth, Sachs and McArthur (2005) estimate that approximately more than one billion people live in a dangerous poverty which is one sixth of the world population. In that sense, some nations succeeded in becoming relatively prosperous, while some of them failed in development suffering from the poverty trap¹. There are roughly 200 states in the world and approximately 160 of them are in the category of developing states (World Bank, 2015). The current situation shows that there is an obvious income gap among different nations as well as within nations and this income gap is one of the most controversial phenomena of the globalized world. This study will focus on one of the transition periods of the globalization in Turkey, the early 1980s, when the country was under the World Bank-IMF co-operated structural adjustment program in and it will examine the effect of the program on income distribution in Turkey until 2001 crisis. The study will also focus on the downsides and to a lesser extent, the advantages of the imposed structural adjustment policies on Turkey in terms of income distribution. The argument here aims not to trivialize or embroider the free market economy or state-oriented economy, however this study is a critical approach to the imposed policies by developed countries and cooperated national policymakers who causes distortion on income distribution in developing countries. For that reason, the findings of this study would suggest a reconsideration of external economic and social policies levied on a nation in an attempt to integrate a national economy to the functioning of globalization.

Infrastructuring of Global Post-War Economy

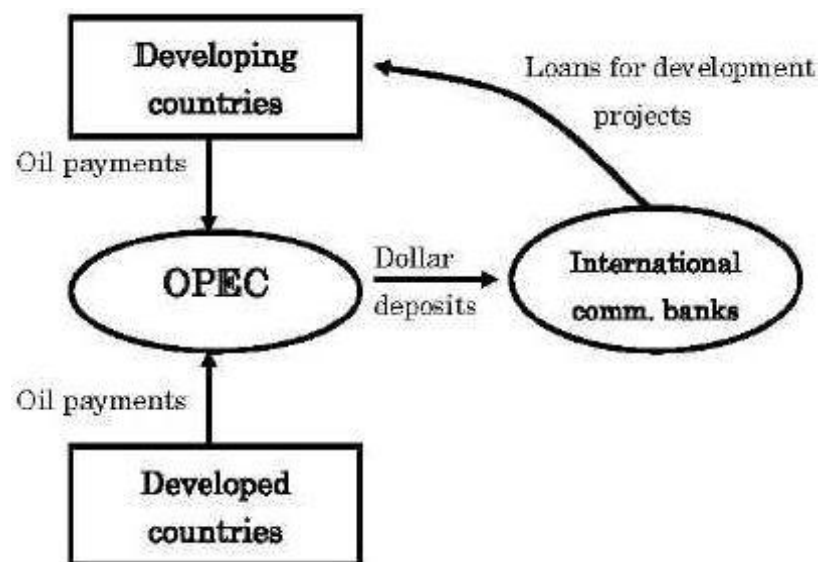
In July 1944, at a place called Bretton Woods close to New Hampshire, the new international monetary system was established in order to reconstruct the devastated global post-war economy. The main goal was to establish a cooperative monetary system to adjust the balance of payment problems (i.e. trade deficits: Export-Import). The principle tool of the system was fixed but adjustable foreign exchange rates were used in order to control the unrestricted fluctuations in currency devaluations to increase the exports in global markets which ultimately caused balance of payment problems for most of the economies. The creators of the Bretton Woods system tried to build monetary regulations that would mix the advantage of the classical gold standard (i.e., exchange rate stability) with positive sides of floating rates (i.e., independence to follow national full employment policies). They sought to avoid the defects of floating rates (destabilizing speculation and competitive beggar-thy-neighbour devaluations) and the defects of the fixed exchange rate gold standard (subordination of national monetary policies to the dictates of external balance and subjection of the economy to the international transmission of the business cycle). Eventually, they built an adjustable peg system of fixed parities that could be changed only in the case of a fundamental disequilibrium (Bordo, 1993:5).

¹ Poverty trap is a cycle which makes it very hard for people to enhance their personal economic conditions. When individuals lack of capital, they also can not find it so this financial inability creating a cycle of poverty (Gore:2002:1).

With the aim of multilateral cooperation and management of the system, International Monetary Fund (IMF) was established in 1945 to supply short-term loans to governments in order to overcome their deficit problems (Fridell, 2004). On the other hand, the World Bank was established to reconstruct the post-war economies of Europe with infrastructure project loans such as dam and road projects (primarily with the Marshall Plan). The other objective of the World Bank was to aid developing countries in their processes of industrialization (Braithwaite and Drahos, 2000: 99).

The main problem of the Bretton Woods system was the dependency of economies in their fiscal and monetary policies to the US dollar since the US dollar had become the international reserve currency. The monetary liquidity of the international system was supplied by the US dollar which in turn increased the balance of the payment deficits of the US, especially when the expenditures were high due to the Cold War era. As the US became incapable of controlling its deficit, the Bretton Woods system was abolished at the end of the 1960s and the foreign exchange rates began to fluctuate in the currency markets. However, WB and IMF remained as the influential multilateral economic establishments with changing objectives according to the international economic context throughout the last two decades. Through the 1970s, The Organization of the Petroleum Exporting Countries (OPEC)² enjoyed enormous oil profits as the oil was the primary necessity of the Cold War powers (US and Soviet Russia). Those petrodollars were invested in international banks and financial institutions which later flowed to developing countries as development loans with low interest rates. However, the excess supply of the US dollar in international circulation due to the efforts of closing the US trade deficits depreciated the value of the dollar and the US became incapable of financing its deficit. The reaction of the US was to increase interest rates to attract 'hot money' via financial markets as financial auxiliary. This led to a debt crisis for emergency economies in the beginning of 1980s in which the amount of loans they borrowed with low interest rates increased so fast after rising interest rates (Onho, 2015). This turning point gave new objectives to the IMF and the World Bank to stabilize those economies under deficit pressures with a more profound and comprehensive package of policy reforms which is known by its famed name, Structural Adjustment Programs (SAPs).

Figure 1: Petrodollar Recycling System



Source: (Onho, 2015).

Structural Adjustment Program Experiences from Turkey

Stiglitz (2002: 13) specifies that "the most dramatic changes in those institutions (the IMF and the World Bank) occurred in the 1980s, the era when Ronald Reagan and Margaret Thatcher preached free market ideology in the United States and in the United Kingdom". The major obstacle for the instable economies of the developing countries were seen as government intervention in the economy. Therefore, SAPs were designed to abolish government activity in the economy by encouraging a mostly unregulated free market system which was to be known as neoliberalism. Stiglitz has attempted to explain the transformation of the objectives. In the 1980s, World Bank was lending loans for public expenditure projects such as new roads and dams building to supply large extent support, in case of structural adjustment loans, but it did this

² At the end of 1950s, the amount of oil produced worldwide was larger than demand. The oil companies controlled the price of oil, and when the prices were diminished, the oil producer earned less money. OPEC tried to combat this low prices of market. Actually, OPEC clearly dominates world oil. OPEC member countries (Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela) produce 41% of the world's oil, and comprise 55% percent of the world's traded oil. For sure the most important data is the amount of the world's oil reserves that OPEC member countries control; they control over 78% of all crude oil reserves (Yang, 2015).



only when the IMF gave its confirmation- and with that confirmation came IMF enforced conditions on the state. (Stingliz, 2002:14)

Those SAPs implemented by the leadership of the World Bank not only diminished the level of fair income distribution but also increased poverty problems in developing countries such as Turkey. On the other hand, the legitimacy of international financial institutions began to be disputed. In 1990s, the World Bank increasingly started to address the social aspect of the development conflict and during the last quarter of 1990s it authorized the Comprehensive Development Framework (CDF)³. CDF was associated with the approach that indicated that economic growth without the social aspect of development could not be sustained. The Comprehensive Development Framework brought a very special deal to the development issue (Metin, 2013:212).

It is important to understand the design of the SAPs and the logic behind the program. In a very broad sense, SAPs were mainly policy reform packages which aimed to substantially establish the conditions for stabilized free market economy and to promote the free market economy with minimum role of the state. From that approach, the mentality of the SAPs is deemed to be uniform for those economies which all have differential complexities in their economic contexts. In the context of the 1980s, SAPs aimed to transform the inward looking and self-directed models of national development economies based on domestic demand (import-substitution model) into outward looking, export oriented and globally integrated economies. The main components of the SAPs were fiscal and monetary tightness (reduction in public expenditures such as in health and education to control budget deficits, elimination of agricultural subsidies), greater openness to foreign trade and capital (promoting exports, lowering tariffs), privatization (transferring State Economic Enterprises-SEEs to private sides, encouraging foreign direct investment), and deregulation (removal of restrictions on business and individuals to encourage free market intensity). Consequently, the philosophy was the minimalization of the state via trade and financial liberalizations (Akdemir, 2001:46-48).

During 1970s, import-substitution development model was widespread among developing countries. Turkey was one of those countries which had inward-looking economy until the beginning of the 1980s. The state was at the centre of economic development in which dynamic public investments were implemented in order to expand the domestic production capacity in heavy manufacturing and capital goods, such as machinery. There were government regulations on foreign trade which restricted import and export activities via protectionist tariffs. State Economic Enterprises were the tools of industrialization with activities of both investment and production. Under the import-substitution development model strategy, there was national consensus between different players of the economy. The industrial capitalists enjoyed oligopolistic profits where the economy was not integrated to competitive global markets. The State Economic Enterprises produced cheaper intermediary goods for those private enterprises that decreased their production costs. On the other hand, unionized industrial workers held the bargaining power for sustainable rises in their wages as a condition against the profit satisfaction of the industrialists. Moreover, the agriculture sector was being subsidized by the government in which the bureaucratic elites were the determinant players in the social consensus (Voyvoda and Yeldan, 2001).

However, at this point, the key point is that the national economy was still dependent on external markets in terms of capital and technology incentive goods although the economy was not fully integrated to the global market. Through the end of the 1970s, the state was not anymore capable to finance the current deficits (i.e. negative Export-Import account) accompanied with international foreign exchange crisis and increasing political tensions within the country that ended with military coup and neoliberal reorientation of the economy in the beginning of the 1980s. According to the official SAP report of the World Bank in 1980, the amount of loan was determined as US\$200 million equivalent in various currencies with a term of 17 years including four years grace, at 8.25 per annum. The description of the World Bank for the SAP loan is as follows:

The loan will be in support of structural adjustment policies adopted, and to be adopted, by Turkey. These policies are aimed at promoting: greater reliance on market forces and less on direct state intervention and control; increased export orientation; increased mobilization of domestic resources; and a self-reliant SEE sector having higher productivity and better management and which sets own prices sufficient to cover operation costs and investment needs (World Bank, 2011:163). Moreover, the World Bank also explains the causes of economic crisis of Turkey in the 1980 report. According to that explanation, although the national economy was deteriorated by the external effects of the global economy, the political mismanagement and unsuccessful economic administration of the governments in response to external vulnerabilities deepened the crisis that began in mid-1977 and continued in the early 1980s.

Applied signs of SAP in the Post 1980 Economy

There are two phases of liberalization under the SAP. First phase (1980-89) was trade liberalization with the aim of promoting exports. In this period, export oriented growth was the main objective. Due to the balance of payment deficits,

³ "The CDF advocates: a holistic long-term vision; the country in the lead, both "owning" and directing the development agenda, with the Bank and other partners each defining their support in their respective business plans; stronger partnerships among governments, donors, civil society, the private sector, and other development stakeholders in implementing the country strategy; and a transparent focus on development outcomes to ensure better practical success in reducing poverty" (Worldbank, 2016).



foreign exchange revenues became vital to finance the deficit. One of the instruments was the depreciation of the Turkish Lira in order to decrease the Turkish commodity prices in external markets in order to encourage the demand for Turkish commodities, and thus increased exports were aimed. In January 1980, the exchange rate was devalued by 48.6% (Ersel, 1991:3). concern in supporting exporting capacity of Turkey's Economy. Moreover, the government subsidized private sector to promote exports via tax rebate system in order to decrease the production costs. Domestic demand was reduced by increasing the domestic prices which led to a decline in real wages (i.e. wage/prices). Labour cost is basically the main input in determining the prices in competitive markets. Therefore, wage repression was one of the policies. Another area was tariff regulations. For instance, in 1981 the stamp duty was lowered from 25% to 1% (Ersel, 1991: 6). Eventually, the share of exports increased from 6.4% of GNP in 1980 to 20.3% in 1990 and the share of imports increased from 13.9% of GNP in 1980 to 26.8% in 1990 (Ersel, 1991).

The second phase was financial liberalization after 1988. In this phase, financial markets were deregulated. The control over foreign capital transactions were eliminated and the convertibility of Turkish Lira in foreign exchange markets were announced. Thus, in 1989 Turkey opened up its domestic asset markets to the international financial competition. This allowed «hot money» inflows to the national economy in which liquidity helped to finance the public expenditures. However, the economy also became vulnerable to external financial shocks in which that 'hot money' could immediately outflow from the domestic asset markets. On the other hand, the deeper financial markets changed the forms of income. In other words, the financial 'portfolio' earnings increased among private corporations rather than direct investments (tends to create deployment). The slide from production activity earnings to financial rentiers (interest income) decreased the ratio of wage income. For instance, interest income share in GDP increased from 0% in 1980 to around 15% in 1995. On the contrary, wage income share in GDP fell from around 35% in mid 1970s to around 25% in 1995 (Yeldan, 2002).

Income Distribution Trend in Turkey after SAP

SAP is mainly a macroeconomic stability program which prepares the structural background for economic growth. Economic growth is one of the essential objective of a national economy as it tends to increase productivity, investment and employment. Thus, poverty is possible to decrease. However, economic growth does not necessarily mean economic development, because the fair distribution of that growth is the primary factor in order to sustain the growth. The main criticisms against the SAP based economic growth approaches are the neglect of just distribution of income, social safety nets (i.e. education, health etc.) and environmental conservation. The latter two are also effective in the unequal distribution of the income.

Cornia and Court (2001) define income inequality as the inequality of the distribution of household income among the population of one country. They also identify that the level of income depends primarily on the distribution of wages and assets as well as on government policy. In terms of measurement of the inequality, Gini Index is one of the most common scales in which zero represents perfect inequality and one or hundred represents perfect equality. However, Gini Index itself might be insufficient to understand the depth of income trend. Therefore, it is beneficial to additionally analyse and consider some other distributional indicators such as the distribution of functional income (wage income, interest income and agricultural income). Moreover, as Cornia and Court describe, Gini Index above 40 is assumed to be high. According to Joint Poverty Assessment Report on Turkey by the World Bank (2005), it is stated that although Turkey is a middle income country, its income inequality is relatively high in which Gini Index is 43.6. Moreover, the highest 20% quantile of the population has 49.7% share of the total income of Turkey according to the 2003 World Bank Development Report. Almost half of the total income is held by only the highest 20% of the population. The Gini index was around 50 in the last quarter of 1970s and in the first quarter of 1980s. If only Gini index is to be considered, there is a slightly decrease in terms of inequality. However, the data shows that there is no stable decline (1983-52, 1987-43, 1994-49, 2002-44, 2005-41, 2009-39, 2012-40) which makes it hard to say that the SAP in the post-1980 period was healthy in terms of income distribution (World Bank, 2016).

The export-oriented economy that SAP prepared the infrastructure for globalization process had direct and systematic causes on income distribution (Cizre and Yeldan, 2002). In Turkey, the population at the lowest proportion in terms of income have higher shares of wage, agricultural income and pensions than the average household. Therefore, interest income and non-wage earnings (e.g. rents) are rare for those 'poor' strata of the population. In that sense, as it was mentioned earlier, the share of interest income in GDP enormously increased after the structural adjustment, especially with financial liberalization. On the other hand, the share of wage earnings was systematically decreased in the aim of promoting exports. Labour costs are important in competitive global markets. Moreover, after 1980s the unions were fragmented with the approval of the bureaucratic elites and industrialists. However, there was a social consensus in the import substitution era in which the labour unions were part of the consensus that stabilized the rise of wages. This trend was also negatively effective on social security protection of the wage earners, because unions had bargaining power with industrialists in terms of labour insurance of workers and wages (Karadag, 2010). Furthermore, agricultural earnings of the peasantry decreased as the percentage of employment in agriculture decreased from 50% in 1980 to 34% in 2004. Those who became out of the agricultural employment caused migration from rural areas especially from east to urban areas in the west side of the country. This trend also caused marginal sectors in urban areas (Ozturk, 2012).

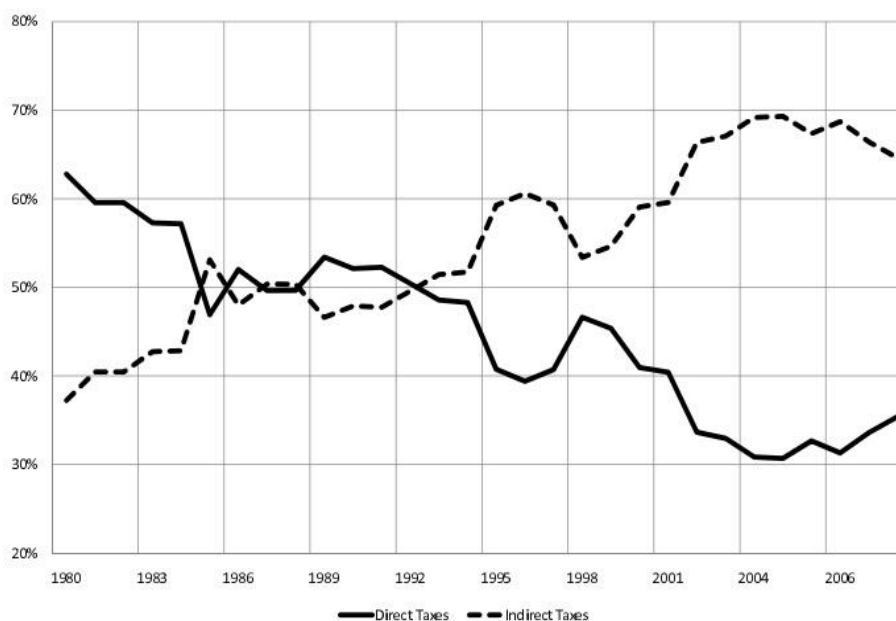
Another aspect which should be analysed is the relative prices. Food Price Index which is more influential on the poor grew 18.3% annually from 1980 and 1990. The index also grew 31.8% annually between 1990 and 2002 (World Bank, 2004). Even the income remains unchanged, the increase in relative prices puts more pressure on the poor population than those who have higher incomes. Thus, overall impact of relative price movements has been in the direction of rising inequality and exacerbated poverty (Yeldan, 2001).

Distributional Efficiency of Direct and Indirect Taxes

Tax system of a country can easily affect the quality of life and living conditions in varied forms for varied social layers of the countries' population. Therefore, the impacts of direct and indirect taxes on the quality of life and living conditions is a significant issue in public finance and national economy and concern in income distribution.

The size of indirect taxes in total tax revenues, especially consumption taxes, is quite high in Turkey when compared to other OECD countries. Indirect taxes are the source of nearly two third of the public tax revenue, and have considerable effects on the income distribution and living conditions in Turkey. This importance on indirect taxes in Turkey, as well as other developing economies, is argued to be emerging from the inability of the government in collecting direct taxes because of the existence of a large informal sector that is not easily taxable. It has been offered that the current increase in the indirect taxes puts the burden on mostly the low income layers, raising concerns of inequality (Pinar, Erus and Soydan, 2003:1).

Figure 2: Share of Direct Taxes and Indirect Taxes in Tax Revenues: 1923 - 2009



Source: Revenue Administration (www.gib.gov.tr)

Tax policies after structural adjustment are also effective in allocation of the income. For instance, the first establishment of Value Added Tax (VAT) in the mid-1980s reflected on the consumer goods which was objective (reflection to every strata of the society). On the other hand, the government decreased the direct tax burden (tax from income) on the industrial sector to encourage export-oriented production and growth. The increase share of indirect taxes (VAT) meant increases in relative prices which negatively harmed the poor than the upper-level income population of the country. Income distribution was damaged by means of increased indirect tax burden mostly paid by low income social layers while direct taxes as corporate tax rates diminishing for attract foreign investments and also encourage export-oriented production.

CONCLUSION

There are roughly 200 states in the world and around 160 of them are in the category of developing states. The major obstacle for the instable economies of the developing countries were seen as government intervention in the economy. This led to debt crisis for emergency economies in the beginning of 1980s in which the amount of loans they borrowed with low interest rates increased very fast after rising interest rates. This problem gave new objectives to the IMF and the World Bank to stabilize those economies under deficit pressures with a more profound and comprehensive package of policy reforms which is known by its famed name, Structural Adjustment Programs.

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As a result, it is important to emphasize that economic development in the way of operational definition includes sustainable economic growth accompanied by fair distributional patterns and social diligence. The main criticisms against the SAP based economic growth approaches are the neglect of just distribution of income, social safety nets (i.e. education, health etc.) and environmental conservation. The latter two are also effective in the unequal distribution of the income.

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