

A COMPARATIVE STUDY OF
CHINESE AND TURKISH ECONOMIC REFORM POLICIES
IN THE AGE OF GLOBALIZATION

A Master's Thesis

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Ankara
September 2006

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I certify that I have read this thesis and have found that it is fully adequate, in scope and in quality, as a thesis for the degree of Masters of Arts in International Relations.

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ABSTRACT

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Though with different strategies and responses, yet all continue to share the same difficult task of development in this given conditions of globalizing world. My thesis compares and contrasts the reform history of China and Turkey under the overarching system of globalization as an attempt to find out better ways to achieve development. Although their socio-economic and political systems differ, China and Turkey have entered the world of globalization by launching the reform policies almost at the same time period and both faced the same elements of risks and opportunities generated by this system. My thesis utilizes the methodology of compare and contrast to examine China's dualistic strategy of state regulation within an open economy and Turkey's primary economic strategies based on the private enterprises to deduce that too much liberalization, especially in the field of financial market, could cause a slow-down to, if not harm, the economy. The thesis concludes with the speculation on how such success of Chinese economy could come to a halt if further liberalization especially in the form of capital account liberalization continues in the future.

Keywords: Turkish Economy, Chinese Economy, Development, Globalization, Economic Reform Policies, State Regulation, Liberalization, Financial Liberalization, Socialist Market System, Financial Reform.

ÖZET

KÜRESELLEŞME SÜRECİNDE ÇİN VE TÜRKİYE’NİN EKONOMİK REFORM POLİTİKASI

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Küreselleşme koşulları altında her ülke farklı tepkiler gösteriyor ve farklı stratejiler uyguluyor olsa da gelişmeyi devam ettirmek her biri için kaçınılmaz, zor bir görevdir. Bu tez, küreselleşme süreci içerisinde Çin ve Türkiye’nin ekonomik reform tarihlerini karşılaştırarak ileride gelişmeyi sağlayabilecek daha verimli yöntemler bulabilmeyi amaçlamıştır. Politik ve sosyo-ekonomik sistemleri birbirinden tamamen farklı olsa da, Çin ve Türkiye küreselleşme sürecine sistemin oluşturduğu benzer fırsat ve risk unsurları ile yüzleşerek aynı zaman diliminde ekonomik reformlar yaparak girmiştir. Bu tez, Çin’in açık ekonomi içinde devlet yönetmeliğinin ikilik stratejisini ve Türkiye’nin özel sektöre dayalı öncelikli ekonomik stratejilerini inceleyerek, özellikle finans sahasında fazla liberalleşmenin, bir ülkenin ekonomisinin yavaşlamasına neden olacağını ve hatta ekonominin zarar görebileceğini gösterir. Bu tez, kapital hesaplarının fazla liberalleşmesinin Çin’in ekonomik başarısını nasıl durma noktasına getirebileceği spekülasyonu ile sonuçlanır.

Anahtar Kelime: Türkiye Ekonomisi, Çin Ekonomisi, Gelişme, Küreselleşme, Ekonomik Reform Politikası, Devlet Yönetmeliği, Liberalleşme, Finansal Liberalleşme, Sosyal Piyasa Sistemi, Finansal Reformlar.

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This thesis is supposed to be a present I offer to my dearest family in South Korea. I dedicate this thesis to my grandfather whom I failed to deliver this thesis in time and to my beloved grandmother. I truly appreciate my parents for their patience and support which have been my greatest source of strength.

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CHAPTER 1

INTRODUCTION

Review the old and deducing the new makes a teacher.
--- Confucius

Examining different developmental paths of different countries allows us to make an analysis of better ways to development in this given conditions of globalizing world. My thesis would attempt to meet this goal by comparing and contrasting the reform history of China and Turkey. Although both have been influenced by the overarching system within which the process of globalization proceeds, the way they responded differ, both in their respective strategies to opening up to the world economy and in the degree of implementing such strategies in their own economies.

At first sight it may seem like a puzzle to try to compare the two countries organized around two different socio-economic and political systems – China being a socialist Marxist-Maoist system under one party rule and Turkey being organized around capitalist and basically liberal socio-economic concepts and institutions. Both, however, have entered the world of globalization emanating from their

fundamental respective economic system by launching the reform policies almost at the same time period—late 1970s and early 1980s. It was the time when the globalization process began to accelerate with full speed, disseminating the principles of liberalization around the world, and China and Turkey were given the same elements of risks and opportunities generated by this system. Though both responded by agreeing upon the necessity to reform the existing economic conditions, however the way how they coped with these risks and opportunities differed, and it is these very different strategies of the two countries that provide us with lessons to be learnt.¹ For both countries the main objective was how to achieve development from the underdeveloped situation.

China, just like many other countries facing the task of development, has faced similar pressures engendered by the post-World War II capitalist system, and thus has had to reorient itself toward the world economy. The initiation of the “open-door” policy under Deng Xiao Ping since late 1970s involved a shift away from central planning toward giving a greater role to market forces, expanding its foreign trade at the same time. Turkey also has begun to accelerate its reform process towards outward-oriented strategy since late 1970s, abandoning its mixed-economy strategy and trying to further liberalize its economy in the following years. However there exists a huge difference in the process, the difference marked by both the degree of stability and the specific structure of the political influence on the economic sphere, defining which would be one of the major tasks of this thesis.

¹ Some might argue that comparing the political economy of a socialist country with that of a country whose economy operates in the system of capitalist economy might not produce so a scientific results as expected. I would counter-argue that the case of Chinese economy is comparable to any other economies in the capitalist system since hereby we are talking about the forms and the consequences of the economic policies, not the ideologies behind them—the part which we will be dealing with in analyzing the comparison, not the comparison per se. As Gao argues, one shouldn't confuse the difference between market economy versus socialist market economy, and capitalism versus socialism (Gao, 1996, 6). Thus comparing the two different strategies under similar external pressure is more than valid.

The keyword of China's strategy, however, was state regulation whereas in Turkey the primary economic strategies put emphasis on the private enterprises. If both countries began their reform processes at the same time period, the effort of China was to save, not to dismantle socialism. Such dualistic characteristic of Chinese developmental history contrasts the Turkish case where full liberalization was the main motto throughout the decades of its reform history. These two different strategies implemented in the age of globalization and financial liberalization that make up the core of the process today have been the major reason behind the more success of one and the opposite of the other.

How about today? Would the success history of China with its praiseworthy strategies continue? China during last few years has been predicted to be the new leading power in the future, having truly astonished other countries also undergoing development. However as my thesis indicates, the further the globalization proceeds, the stronger the insistence on the requirements needed in order to intensify this process including the pressure for further financial liberalization, the less apparent such successful performance will be. Globalization has come to a stage where no more regulation is allowed. Therefore the tips of development that Chinese experience has offered to other developing countries, such as Turkey, will be weakened as the current advantage of domestic manipulation becomes no longer possible.

The research is divided into four parts. Following the Introduction, Chapter 1 examines the background history of development and globalization to give a brief idea on in what kind of system these economies function today. In Chapter 2, we will be examining the background of the reform history of China and Turkey including their different ideological background. This chapter allows us to understand how two

countries came to both enter the development process as globalization intensified. Chapter 3 compares the reform strategies of the two countries, putting emphasis on how regulative policies of China led to more success than the liberal policies of Turkey. An emphasis will be put especially on the different financial strategies of the two countries, and the recent changes. The research concludes with the speculation on how such success of Chinese economy could come to a halt if further liberalization especially in the form of capital account liberalization continues in the future –the lesson Turkey has been teaching since the beginning of their reform history.

CHAPTER 2

DEVELOPMENT AND GLOBALIZATION

*You can't catch a cub without going into tiger's den.
--- Ancient Chinese Proverb*

Development has been the task of all “developing” countries since the end of World War II, having gained its momentum with the beginning of decolonization, however the task still remains unfinished and yet unclear. The ambiguity of the task is evident when we consider that no countries start off on the equal footing nor do they share common pathways. Each country possess distinct political and economic structure of its own, thus creates its own path of development in accordance to its intrinsic footing. The task becomes even further confusing with the continuing change in the meaning of “development” *per se*, thus making it more difficult for the countries to define what it is that they are really pursuing. However it is in this complex but diverse development process of different countries that we may find a hint, although may not be the best model, to achieve better economic conditions of the developing countries.

Since the end of the World War II, the experiences of the developing countries revealed there exist several categories of development policies that we may

put as different development theories. 1950s and 1960s experienced the spreading of structuralist development theory which emphasized the importance of the role of the state in contrast to that of the market. Then re-emerged neoclassical development theory which refuted the role of the state, but firmly believed that development could be achieved only by giving the market full control of the economy. The commonness of such theories seemingly diametrical to each other, however, lies in the fact that both acknowledged that there exists a clear-cut dichotomy between the role of the state and the role of the market. They both understand them in relative terms that the increase in the role of state would mean the decrease in that of the market.

Institutionalist development theory, which emerged since late 1980s and the beginning of 1990s, emphasizes on the validity and availability of once-opposite two terms – strong state and market. That state intervention in order to direct the market economy is possible is the major theme of the institutionalist development theory. Based on the belief that the priorities of industrialization bypass that of market rationality, the “strategic industrial policies” of these countries of late industrialization required strong protection as well as the guidance of the state in order to achieve their aims within these market-oriented economies (Onis, 1998, 198). Chalmers Johnson’s concept of the “capitalist developmental state” reflects such an attempt to understand the development history of the Third World. His idea on the concept is based on the belief that economic development constitutes the foremost and single-minded priority of state action (Onis, 1998, 199). The state is well aware of the underlying commitment to the market, thus the market and the elite economic bureaucracy mutually coordinates its policies for the ultimate outcome (Onis, 1998, 199).

Robert Wade and Alice Amsden further develop Johnson's model. Wade's "governed market theory"² based on the importance of the role of government in setting the conditions for implementing its strategic industrial policy parallels Amsden's argument that the state instruments of control of investment and its high degree of selectivity brought the East Asian success.³ The institutionalist theorists interpreted the economic success of the developing countries during the 1980s and 1990s, such as East Asia, as the consequence of applying institutionalist policies, having strong belief in bureaucratic autonomy and the coexistence of public-private cooperation.

Recently the categorization of theories as aforementioned has been debated based on the argument that they only reflect economic aspects of development expressed narrowly in economic terms. The success of the failure is usually measured through the various numeric data indicating the status of their micro and macro economic frameworks, such as high GDP per capita, better trade, and high efficiency of FDI. Such a "traditional" understanding of development has been facing new challenges as the world became more and more complex, and so has its interactions. Such a complex and more intimate interactions often referred to as globalization have redirected our focus on the task of development of the "now-developing" countries.

One of the critics of such categorization of development theories is Joseph Stiglitz, who criticizes the traditional concept of development as too "economic" focusing narrowly on the capital stock and improving the allocation of resources, the view which embraces both the leftist economists who advocated the stronger role for

² Robert Wade. 1990. *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*. Princeton, New Jersey: Princeton University Press.

³ Alice H. Amsden. 1989. *Asia's Next Giant: South Korea's Late Industrialization*. New York: Oxford University Press.

governments in the 1960s and the rightist economists who favored market in the 1980s (Dunning, 2003, 79). Such strategies, according to Stiglitz, saw development as a technical problem requiring technical solutions, but did not take into consideration the societal dimension or the fact that the laws of economics were not universal (Dunning, 2003, 79). For Stiglitz, we should now understand development from a new paradigm. Development today represents change and transformation of society and embraces a social, moral and environmental dimensions as well as an economic one. He argues that development embraces a move from traditional to modern ways, such as acknowledging that change exists as a means to further control of individuals and societies to influence over their own destiny (Dunning, 2003, 77).

Though the examination of two countries that will be done in this thesis is based on such “traditional ways,” as to put according to Stiglitz, utilizing numerical data since they were the only sources available and credible, taking into consideration such an alternative vision of development offers us an opportunity to better understand to which direction the countries having passed through past development strategies should be directed in the future. Before I go on to examine China and Turkey as the two representing cases for my thesis, an introduction to the current politico-economic environment of the world would be necessary, since examining the development process would be meaningless without knowing within which framework such a process has taken place. This leads us to study the current trend of globalization which has offered the major playground for the countries with the task of development, whose norms and rules we would be examining in the following.

2.1 History of Globalization

Globalization is not a recent phenomena. International trade and financial openness has existed ever since late 19th century. According to some scholars, such as Hirst and Thompson, the concept of globalization *per se* is a wrong word to indicate today's world politico-economic trend (Hirst and Thompson, 1999). They argue that what we are witnessing today is not a process of globalization, but a deeper internationalization which has been continuing without any significant change since late 19th century. They maybe correct in a sense that globalization, in a literal sense, should involve supranational elements such as global system that subsume national economies and entities, which in the end would lead to established global governance. However I would ignore such a strict distinction of usage based on three arguments.

First, the public usage of the term should not be ignored especially if the term has become a widely understood norm incorporated within the professional works of that field. Such a view is also endorsed by Andreas Busch, that the distinguishing of 'inter-nation' and 'global' as in Hirst and Thompson manner only serves to different analytical purposes but in the end refer to the same thing (Hay, 2000, 45). Second, although the process of globalization has been continuing ever since the end of 19th centuries, the clear difference does exist between the process of late 19th century to early 20th century and the one today.⁴ Thus it would be too exaggerating to say, as in Hirst and Thompson manner, to round up the two periods as equal and to denote in consequent that Globalization is the wrong word of indication. This leads to my third argument to advocate the usage of globalization, that other terms to separate the "Second Globalization" as Daniel Yergin calls exist and has been widely used by the

⁴ See the transcript of the IMF Economic Forum, September 22, 2004. "Why Globalization Works," Washington, D.C.: IMF.

experts in the field. Thomas L. Friedman also offers another example of such classification of eras within the process of globalization that if the first era from the late 1800's to World War I could be classified as Globalization 1.0, and from the 1980's to 2000 as Globalization 2.0, then the era that we're now in is Globalization 3.0, based on the argument that the speeding of the technological development has resulted in shrinking of the size of the world (Friedman, March 04, 2004, New York Times). Whatever names scholars might give, the phenomenon surely reflect and is incorporated within the globalization process, rendering the usage of the term acceptable.

Though no exact definition of the term exists, various political and economic indicators suggest what and how the phenomenon consists of. The changes have been taking place mainly in economic sphere.⁵ Facilitated by development of technology, the mode of production became more international, limiting the role of national governments in manipulating the economy. The increasing amount and the mobility of capital that shapes and is shaped by a global capitalist system have become the pivot of the open and free market system. Various indicators should be examined in order to understand and measure the phenomenon of globalization, such as the rates of exports, world trade, foreign direct investment and corporate profiles, and other financial market indicators (Hay, 2000, 35).

By the early 1930s, the disintegration of world economy began with the collapse of world financial system, then based on Gold Standard which the United States abandoned in April 1933 (Gill, 1988, 133). The experience of Great

⁵ Not all share this view. Some view globalization as a newly emerging phenomena based on the spatial concept: that globalization indicates "deterritorialisation" and the globality should contain "supraterritorial quality" and should transcend geography (Scholte, in Shaw, 1999). However such an approach contains the danger of leaving out the parts and parcels of what the phenomena contains, but instead only focus on the external shape of the globalization. Thus such an approach is insufficient to explain either how such a phenomena came to take place, or to which direction it should be led.

Depression in the 1930s and the disaster of World War II brought in the notion of Keynesianism into play, which criticized the classical economics assumption of market based economy built upon the principle that the balance between supply and demand would ensure full employment. The government was to play a larger role in managing aggregate demand and ensure full employment, leading to the reformed capitalism or managed capitalism. An effort was put to bring back the Welfare State and the New Deal launched in the 1930s.⁶ As Daniel Yergin and Joseph Stanislaw phrases, the state was to control the “Commanding Heights” of its national economy (Yergin and Stanislaw, 2002). The notion of “mixed economy” emerged, characterized by strong, direct government involvement in the economy and an expansive welfare state which reached its peak in the 1970s. However the high inflation rate in the 1970s and the oil shock threatened the Keynesian assumption of positive government’s role.

With Margaret Thatcher coming to power in 1979, the notion of neoliberalism swept the world since 1980s. Under the theme of “TINA” (There Is No Alternative), Thatcher influenced by Friedrich von Hayek began preaching the notion of “competition.” (George, 1999). ‘Free market’ became the dominant ideology and privatization and liberalization became the major means to achieve the goal of development. The breakdown of Bretton Woods system in 1974 with the United States putting an end to the pegged exchange rate system to move towards floating exchange rate system only strengthened such a neoliberal movement. The IMF and the World Bank which themselves once have been the “brain-children” of Keynes (George, 1999) established at Bretton Woods in 1944 as a means to aid the countries with temporary balance of payments problems, now converted themselves under the

⁶ Such a shift from laissez-faire to a more direct interventionism implied, as indicated in Karl Polany’s *The Great Transformation*, “a historic change in the relationship between society and the market, and the state and capital in the major capitalist nations” (Gill, 1988, 132).

neoliberal doctrines and the advocacy of the United States. These institutions began to embrace opening the markets of developing countries, advising them to implement privatization, and reduce any forms of government subsidy or control etc.

In the mean time the term “Washington Consensus” emerged to represent the close cooperation among the US Treasury, the Wallstreet interest, and the IMF/World Bank in pursuing such neoliberal goals. The term “Washington Consensus” was first formulated by economist John Williamson in 1989 named after a list of 10 policy recommendations for economies of countries undergoing reform process (Naim, 2000, 1 of 10).⁷ Whether the usage of the term today is compatible to this original intention is a matter of dispute. Whatever evolution the term has passed through, the “Washington Consensus” after decades came to mean “a general set of policy recommendations” that embodied the views of the IMF, World Bank, U.S. Treasury and think tanks (Naim, 2000, 2 of 10).⁸ The negative experiences of developing countries only led to the deprivation of its reputation, as Naim calls it “Washington Confusion” (Naim, 2000, 8 of 10).

In terms of international economic environment, liberal international economic order has been continuously promoted by various international economic

⁷ These original ten propositions designed by John Williamson for Latin American Countries were:

1. Fiscal discipline
2. A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution
3. Tax reform
4. Interest rate liberalization
5. A competitive exchange rate
6. Trade liberalization
7. Liberalization of FDI inflows
8. Privatization
9. Deregulation
10. Secure property rights (Williamson, World Bank Research Observer, Vol.15, No.2 (August 2000), p. 252).

⁸ Naim indicates that the reason why the term Washington Consensus came to acquire “a life of its own” and came to be so frequently misused is due to the policy makers during the 1990s implementing an incomplete version of the model, in addition to the changes in both international and domestic economic and political environment (Naim, 2000, 2 of 10). Williamson strongly expresses his discontent toward the term being used today as the “synonym” for neoliberal market fundamentalism (Williamson, World Bank Research Observer, Vol.15, No.2 (August 2000), p. 256).

institutions since the World War II, or international finance institutions (IFIs), such as General Agreement on Tariffs and Trade (GATT, which was replaced by World Trade Organization since 1995), International Monetary Fund (IMF) and World Bank (WB). Such an attempt towards freer trade and exchange rate stability brought about huge increase in the world trade as well as real world GNP by 1980. Between 1950 and 1980, real world GNP increased four-fold and world exports as a percentage of global GNP rose from 11.7 percent to 21.2 percent (Gill, 1988, 145).

Amongst such a development, what play the major role in shaping today's globalization is the phenomena involved in the liberalization process of financial markets. As many contemporary scholars argue, the past developments in the sphere of financial markets have been "revolutionary" (Hay, 2000, 40). It is with this rapid change in the financial market that the debate on the impact of globalization has become more controversial. This notion of financial liberalization is especially important since, as my thesis would confirm, it is the major factor which has decided, and would decide, the course of many developing countries' developing status.

2.2 Financial Liberalization

The international economy since 1945 was based on the fixed exchange rate system in which other currencies were pegged to the US dollar which in turn was pegged to gold. Flow of financial capital was predictable through this way, thus rendering stability in the international finance flows. However, with the breakdown of the pegged exchange rate system in 1974, all restrictions on international capital movements were eliminated, triggering "the modern infrastructure of speculation" (Eatwell, 1996, 5). Thus began a rapid increase in the global flow of financial capital.

From \$10 billion⁹ and \$20 billion in 1973, the daily foreign exchange trading around the world exploded to \$1250 billion in the 1980's and 1990's (Eatwell, 1996, 1 and 3).

Financial liberalization has become the key-word for indicating today's globalization process.¹⁰ As Erol Balkan and Erinc Yeldan indicate, globalization accelerated with the improvement in technology during the 1970s has come to indicate the following two phenomena:

- 1) liberalization of the commodity and financial markets at the national scale
- 2) elimination of all the administrative and regulatory statues hindering the free movement of international capital flows (Balkan and Yeldan, 2002, 40).¹¹

The policies dominating the current process of globalization regarding this huge flow of financial capital have been to liberalize the financial markets, aiming to abolish the financial regulations that different countries used to impose on their own. Some of the major means through which the financial liberalization could be implemented include interest rate liberalization, enhancing market competition, privatization of major banks, and deregulation of foreign exchange control (Garnaut and Guoguang, 1992, 227-230). Such a shift to free capital mobility has often been criticized, however, for making the country's economy vulnerable to hot-money (or

⁹ Unless any additional notes are given, the unit of amount indicated by the \$ sign in the text represents the US\$.

¹⁰ Ziya Onis emphasizes the relations between globalization and financial liberalization that "globalization of the world economy finds its most complete form in financial markets" (Onis, 2000, 1).

¹¹ Elimination of any regulatory policies is mainly based on the view that economic intervention in any form leads to inefficient, thus slow economic growth, especially in the stage when industrial policy is under process, and when the development has passed its initiative process and is being achieved gradually (Garnaut and Guoguang, 1992, 226).

short-term loans) circulation, which consequently results in various financial crises.¹² Especially when considering the very nature of hot money flows which is preferred in a country less stable both economically and politically than the others who are more stable enough to attract long-term capital such as foreign direct investment, the potential crises from sudden huge outflow of capital is unprecedented.

It is in this very nature of international capital flow, motivated by the spectacular prospects of short-term capital gains, that renders close integration with the international financial market risky for late-developing countries (Onis, 1998, 515). To quote from the UNCTAD 1998 Trade and Development Report: “the ascendancy of finance over industry together with the globalization of finance has become underlying sources of instability and unpredictability in the world economy. ... In particular, financial deregulation and capital account liberalization appear to be the best predictor of crises in developing countries.” (UNCTAD, 1998; v, 55 in Balkan and Savran, 2002, 50). 10 developing countries had to undergo major financial crises between 1994 and 1999 alone, in some cases bringing about chained result of political turmoil (Naim, 2000, 4 of 10).

IMF has been the major target of criticism due to its active involvement in promoting financial openness in the developing countries.¹³ It has been argued that under the name of “Global Principles”, IMF together with the World Bank seek to

¹² Such huge amount of short-term capital flows based on speculation has been argued to be the major reason behind 1997 East Asian crisis. According to the World Bank, total private capital flows to the five crisis countries (Indonesia, South Korea, Malaysia, the Philippines and Thailand) were more than \$100 billion between 1996 and 1997 (World Bank. 1999. *Global Economic Prospects and the Developing Countries, 1998/99, Beyond Financial Crisis*. Washington: IMF, 55). It is even more surprising when considering the capital inflows to these countries in 1994 amounted to \$41 billion and the capital outflows in 1997 to \$12 billion (Bhagwati. 1998. “The Capital Myth: the Difference between Trade in Widgets and Dollars”, *Foreign Affairs* 77(3): 8).

¹³ IMF and the World Bank have acknowledged their role in shaping such policies in the world economy in the World Bank/IMF Development Committee’s Communique (April 28, 1999): “Ministers noted the important contributions of the Bank and the Fund in current efforts to strengthen the architecture of the international financial system through their participation in the formulation of international standards, principles and best practices.”

produce “uniformity of principles and practices” such as free trade, tighter budgets, high interest rates, liberalized financial flows, deregulation of business and privatization (Suzuki, 2001, 319). The main criticism lies on the fact that such uniform devices offered by the international financial institutions (IFIs) do not take into consideration the diverse conditions of the developing countries, ignoring the unique and different characteristics of each of them. Accused of pushing for financial liberalization in the countries who are not yet ready to adopt such a system, and once in crisis not offering anything but to force higher interest rate as the universal solution, IMF policies together with those of the other players taking part in the Washington Consensus have been the major concern for those aware of the danger behind financial liberalization.

How has IMF responded then? As expressed in the IMF Issues Brief published in April 12, 2000, they admit that in the short-term, volatile short-term capital flows may threaten macroeconomic stability.¹⁴ Admitting that the crises would not have developed if not for their exposure to global capital markets, they argue that nor could these countries have achieved such impressive growth without those financial flows. To quote Raghuram Rajam, the Economic Counsellor and Director of the Research Department at IMF:

“We do know that uncontrolled liberalization (...in particular capital accounts) without building appropriate institutions, at least some modicum of institutions, can be dangerous. But at the same time, you have to recognize the opposite problem, which is if you don’t liberalize,

¹⁴ “Globalization: Threat or Opportunity”, An IMF Issues Brief, April 12, 2000. (<http://imf.org/external/np/exr/ib/2000/041200>)

is there pressure to build those institutions, or do you have a permanent state of status in the institutional framework?”¹⁵

The similar view has been expressed by Kristin J. Forbes, a member of U.S. President’s Council of Economic Advisors during the same conference:

“...we do discuss movement toward free capital flows and opening up capital accounts, and our approach is that in the longer term it is certainly in the countries’ best interests to move towards the free movement of capital and open up their capital accounts. Getting there is obviously the tricky part. There are risks as you open up your capital account...But it’s a very important topic, and we certainly don’t have the last word, either.”¹⁶

As a reaction to such pressure to open up financially, some developing countries chose to close their economy and keep their state-controlled financial system under mono bank structure giving state the major power to control investment as was the case of China, at least until 2003, and some coped with such pressure by implementing full financial liberalization as was the case of Turkey.

As we would examine in the following chapters, this financial liberalization, along with other mechanisms of economic liberalization, and the way how these two countries responded play the major role in determining the development future of China and Turkey.

¹⁵ Transcript of an IMF Economic Forum, “Why Globalization Works”, Washington, D. C., September 22, 2004.

¹⁶ *Ibid.*

CHAPTER 3

THE BACKGROUND: PRE-REFORM COMPARISON

The strength of a nation derives from the integrity at home.
--- Confucius

Comparing any two countries' history of political economy with similar background of liberal economic framework is a task, though educative, not so distinct. In this sense, comparing China and Turkey is very important, that though both started their reform process in almost similar period, China's launch for reform was a very radical attempt due to its very different ideological background. China began its reform as a socialist system under one party rule whereas Turkish reform was organized around capitalist and basically liberal socioeconomic concepts and institutions. Examining the backgrounds of these two countries gives us an idea of what fundamental steps have been laid before that led to the reform process.

3.1 China

Just as all the other war torn countries during the 1950s, China and Turkey were striving to find ways to promote economic growth. In the beginning, Communist China under the leadership of Mao Ze Dong chose to adopt the basic

Stalinist political system and economic development model by nationalizing all economic, cultural, and social entities and had a “single party-state political-economic-social bureaucracy” run them (Hamrin, 1990, 11). The Maoist strategy was aimed to give priority to heavy and capital-intensive industry and give emphasis on over-centralized, top-down ruling system. However it didn’t take long for China to realize the difficulty of implementing such Stalinist mode of development. Among various reasons, extraction of resources from agriculture to support the growth of industry saw its limit due to China’s poverty. Lack of skilled personnel, poor communication and transportation links, and its geographic differences made central planning even more difficult (Hamrin, 1990, 12). The Stalinist mode has become the target for revision as the voice of complaints began to spread not only within the elite but also among the populace. Thus by the end of 1960s, it has been realized that the first initiation to reform was inevitable, the effort that still continues until today.

However, it is worth reconsidering some of the elements of Maoist strategy during this period as it is to a certain degree in concert with the major ideologies that lie beneath the recent development strategy of China today. Mao interpreted economic development as a matter of given task at the national level, that a country (possibly indicating the developing countries) should draw up its developmental policies making use of its own socioeconomic realities relatively independent from the outside world (Friedrich Wu, 1981, 451). Such a way of thinking is well reflected in one Chinese Community Party declaration:

In accordance with its own concrete conditions, China must rely
first of all on the diligent labor and talents of its own people,

utilize all its available resources fully and in a planned way, and bring all its potential into play in socialist construction. Only thus can it build socialism effectively and develop its economy speedily (Chinese Communist Party Central Committee, 1963, 368 in Friedrich Wu, 1981, 456).

What should be underlined is that the concept of self-reliance as understood by the policy-makers of China, at least since then until today, is clearly distinguishable from the concept of autarky. Mao himself emphasized self-reliance as the major guiding principle of China's economic development policies in the 1950s in the following manner: "The correct method is each country doing the utmost for itself as a means toward self-reliance for new growth, working independently to the greatest possible extent, making a principle out of not relying on others, and not doing something only when it really and truly cannot be done..." (Mao, 1977, 103 in Friedrich Wu, 1981, 456). It was important to find a reasonable mixture of independence and interdependence. However the percentage of the mixture kept changing especially with the rise of Deng Xiaoping and the continuing reform process since his period. As Mao puts: "the study of universal truth must be combined with...the concrete reality of China" (Mao, 1956, 82 in Friedrich, 1981, 457).

Though China emphasized the importance of being as closed as possible, self-reliance was not self-isolationism (Friedrich Wu, 1981, 452).¹⁷ International

¹⁷ Though in theory the two were supposed to differ, the Maoist strategy in practice in the following years proved to have confused the two, whose policies reflected more autarkical characteristics as later considered to have been more of "self-isolation" than "self-reliance." The good example of such extremity could be the Great Proletarian Cultural Revolution launched in the mid 1960s by Mao, which now is often branded as an exercise of xenophobia (Friedrich Wu, 1981, 461). A more flexible way of interpreting the concept of self-reliance was to be revived under the new leadership of Deng in

exchanges were kept as well as the inflow of external assistance (Friedrich Wu, 1981, 452). What Chinese considered important, though whether it is being implemented in reality is a matter of dispute, was to draw a reasonable line between the two: keeping which form of international exchange, and to what degree would best keep China's domestic order of economy were the key issues to be dealt with. Such a way of thinking to a certain extent, extends until today. China's evolving open door policy always had in mind which sectors to keep under tight protection, such as financial market, and which sectors to widely open – the policy that is credited for the economic successes of the last two decades.

In 1958 the Great Leap Forward was implemented by Mao who began to accelerate collectivizing the urban and rural economy. The communes were created which allowed the bureaucracy to extend its hand to rural affairs, and decision-making power was decentralized to the provincial-level bureaucracies in pursuit of more rapid, localized development of China's internal resources (Hamrin, 1990, 12). Mao sought low-cost improvement in agricultural output through mass labor mobilization campaigns and local low-technology industries (Hamrin, 1990, 15). The basic idea behind such policies was “regional autarky and national isolationism” and as Hamrin puts, there was no change in “the monolithic mode of management by administrative command” (Hamrin, 1990, 13).

In the immediate post-World War II years, given the historical situation of Cold War era, it was tempting enough for China to lean towards the Soviet Union for economic aid and military protection. However the newly developed Maoist

the late 1970s. Under Deng's leadership, learning from foreign countries and self-reliance are not contradictory but complementary if done in a “principled and planned way” through the maxim of “first, use; second, criticize; third, convert; and fourth, create” (Beijing Ribao (Beijing Daily Newspaper), July 3, 1977, in Friedrich Wu, 1981, 465). Since mid-1979, the notion of “self-reliance” began to be replaced by a Chinese version of interdependence rhetoric decorated by such terms as “international cooperation,” “mutual benefit,” “equal exchanges,” “supplying each other's needs,” etc (Friedrich Wu, 1981, 468).

ideology of self-reliant developmental strategy convinced China to alter its policies. As Mao put it, again emphasizing the importance of ‘unique policies of Chinese characters’:

In those days [1949-1957]...we copied almost everything from the Soviet Union, and we had very little creativity of our own. At that time it was absolutely necessary to act thus, but at the same time it was also a weakness – a lack of creativity and lack of ability to stand on our own feet. Naturally this could not be our long-term strategy. From 1958 we decided to make self-reliance our major policy and striving for foreign aid a secondary aim (Mao, 1962, 178 in Friedrich, 1981, 459).

This move away from Soviet Union since late 1950s symbolizes China’s first step of radical departure which in the near future would develop into the form of what is called “Socialist Market System.”

While Mao’s version of the revision of Stalinist mode was being put into action, at the same time, more moderate reform programs have been planned by reformers such as Zhou Enlai and Chen Yun. They sought gradual organizational change through regular bureaucratic means and put emphasis on financial realism and overall coordination and balance among different economic sectors as well as geographic regions (Hamrin, 1990, 13). They favored agricultural and light industrial production, and creating export regions along the coast (Hamrin, 1990, 13). However these plans only remained as plans, never implemented until the death of Mao, partly due to the increasing tension between China and the United States

(which made it too risky for the economy to ignore military aspects), and mostly due to Mao's negative response to such proposals.

However several factors allow us to see that such yet-to-be-implemented-plans were destined to be revived, which we now know that they did after Mao's death. As White explains, the excessive concentration on heavy industry between 1950s and 1970s starved other sectors (White, 1993, 31). Recession after the Great Leap Forward killed 15 to 30 million people due to famine (White, 1993, 31). Slow rise in incomes, if not stagnating, fueled social discontent which began to pose serious political challenge to the Party leadership (White, 1993, 35). It was not only such internal conditions that began to seriously challenge the status-quo. The success of Japan and East Asia, including the success of Chinese communities in Taiwan, as they began to open themselves up to the international economy began to push Chinese Communist Party (CCP) regime to again reconsider Chinese concept of national 'self-reliance' (White, 1993, 35). It was not only these economic elements that provided motivation to support proposals of reform economists. The weakening of Chinese Communist Party especially during Mao's Cultural Revolution also played an important political role in the dismantling of the status-quo. As White argues, the Party split, lost its ideology as well as its authority, and thus lost the confidence of society (White, 1993, 38). Another step for further reform, thus, was inevitable.

3.2 Turkey

Turkish economic policies throughout history mirrored the pragmatic responses to both internal and external politico-economic impacts that came mostly in inconsistent and unstable manner. Turkey experienced a short period of

liberalization during the immediate post-World War II period, in the early 1950s. As Sevket Pamuk argues, the background for such liberalization was laid during the 1930s when the Etatism through its marketing monopolies benefited the nascent bourgeoisie.¹⁸ The private capital accumulation during the Second World War as the state reverted to deficit financing and taxation of the peasantry and non-Muslim bourgeoisie, gave the private fortunes to the hands of the Muslim bourgeoisie (Pamuk, 1981, 4).

It was also the international environment that enabled Turkey to depart from the principles of Etatism to those of liberalism. Turkey joined NATO in 1951, thus aligning with the Western alliance. Tightened ties with the United States also allowed high level of resource flows available in forms of extended military and economic aid to Turkey from the United States. Internally, the breakdown of the monopoly of Republican Party in 1946 brought in the multi-party system. Parliamentary democracy was introduced and the freedom of speech and publication expedited the circulation of Western ideas. Democrat Party which came to power in 1950 called for the transfer of the ownership of state economic enterprises to private capital, and promoted the agricultural sector.¹⁹ As a result of these developments, Turkey during the 1950s witnessed huge growth of private industrial enterprises. Such policies of Democrat Party was also sustained by opening up of new land, good weather conditions and expansion of demands for primary products such as wheat and chrome created by the Korean War (Pamuk, 1981, 11).

As the experiences of the two countries reveal, China and Turkey seemed to go towards two opposite directions during the 1950s. China under Mao was going as

¹⁸ See Sevket Pamuk, 1981. *The Political Economy of Industrialization in Turkey: 1947-1980*, Ankara: University of Ankara.

¹⁹ It is important to note that the huge expansion of agricultural output (45 percent increase in real terms) during this period is mainly due to the favorable weather condition between 1948 and 1953 (Okyar, 1979, 335).

inward as possible, closing its economy completely from the outside environment. The developmental plans of China, although many attempts have been made for the revision, were strongly influenced by Stalinist mode of development. Unlike Turkey who tried to adopt itself to the changing world politico-economic environment, China was firmly closed within.

Turkey, however, before moving on to further liberalization in 1980s, did experience a certain period of mixed economy. The sluggish growth and trade imbalances during the 1950s made agriculture based economy almost impossible to continue. By the mid-1950s, the decline in both world market demands for raw materials and in agricultural production led to the foreign exchange crisis²⁰, which in turn led to the deterioration in the external terms of trade and export earnings, putting an end to this short period of liberal trade policies (Pamuk, 1981, 11). During the 1960s and 1970s, Turkey witnessed the return of mixed economy.²¹

Giving back the power to the state with the rebirth of mixed economy embodies ample meanings. The belief in government's role reemerged, that using the government economic sector as an investment instrument could enhance the economy in general (Okyar, 1979, 333). The state economic enterprises could be used in policies of regional development and of spreading industries to various regions which private enterprises could not achieve (Okyar, 1979, 333). Based on such expectations, Turkish State Planning Organization (SPO) was established and absorbed in the 1961 constitution as one of the constitutional organs in the Republic. The first two Five Year Plan adopted by the organization emphasized on improving domestic savings performance and restricting imports through various measures as

²⁰ It is worth noting that the primary mode of accumulation was agriculture based.

²¹ For the detailed reasons behind such a return of the mixed economy framework, see Osman Okyar, 1979. "Development Background of the Turkish Economy, 1923-1973," *International Journal of the Middle East Studies* 10(3): 325-344.

quotas or licensing. The three five year plans were adopted for the period between 1963 and 1977, and the first two plans for the 1963-1973 period put emphasis on improving domestic savings performance. In terms of its trade policies, the restrictive characters prevailed, in the form of import and export licensing, quotas, and high customs duties, supplemented with numerous surcharges and advance import deposit requirements (Kopits, 1987, 2).

The return of such a mixed economy brought incredible economic growth to the Turkish economy, enjoying a vigorous economic recovery with high growth rates in GNP. From the 4.8 percent GNP growth rates in 1953-1963, the growth rates of GNP displayed gradual improvements: 6.4 percent in 1963-1967, 6.7 percent in 1968-1972 and 7.2 percent in 1973 to 1977 (Dogruel, 1994, 38). The emphasis on improving domestic savings performance during the first two Five Year Plans led to marginal savings ratios of 32 and 26 percent respectively, which in turn decreased the current account deficit of GNP (Celasun, 1983, 9).

Albeit its remarkable growth during the 1960s and the beginning of 1970s, Turkish economy faced a serious backsliding by the end of the 70s. We may attribute the 1978 crisis to both external and internal factors. Externally the first oil crisis in 1974 caused a sharp rise in imported oil prices. The oil crisis coincided with the reluctance of the government to adjust to the new international environment and to pass the deterioration in the terms of trade onto domestic prices of oil and other imported intermediate products led to significant internal and external imbalances (Dogruel, 1994, 44). Internally, during the process of what Dogruel appraises as the move from “easy” stage of import-substitution to the “complex” stage, Turkey failed to promote the domestic production of consumer durables and investment goods which required the implementation of high technology and the use of highly skilled

labor (Dogruel, 1994, 42).²² In order to preserve its growth momentum, and to finance the continuing expansionary policies, Turkey sought the solution in reserve decumulation and massive external borrowing (Togan, 1995, 5, Celasun, 1983, 11). We may conjecture the severity of the 1978-1989 crisis from the fact that annual growth declined from 4.0 percent in 1977 to 0.4 percent in 1979 (Celasun, 1983, 12), the current account of the balance of payments deteriorated from a surplus of US \$0.7 billion in 1973 to a deficit of US \$3.1 billion in 1977, and as a result, by the end of 1977 Turkey's external debt totaled US\$ 11.3 billion (more than three times the amount outstanding three years earlier) (Kopits, 1987, 3). Such serious drawbacks in Turkey's economic standing characterized by the amount of accumulated short-term debts was worsened by the international climate following the hike in oil prices in 1979 and 1980, leading to the domestic political and social instability (Togan, 1995, 6).

Turkey's choice as a reaction was to consult to the open neoliberal policies which have just begun to spread around the international economic arena. The government introduced a series of stabilization programs under the guidance of IMF and World Bank. The comprehensive policy package introduced on 24 January 1980 aimed at such factors as substantial increases in the prices of public enterprises; elimination of price controls for a wide range of industrial products; a major currency devaluation; improved incentives for exports; better conditions for foreign private capital; and a flexible policy for further exchange rate adjustment (Celasun,

²² Turkey experienced two stages of import substitution strategy during 1950 to 1979. The first stage was replacing the imports of non-durable consumer goods by domestic production, and the second of intermediate goods and consumer durables by domestic production. This second stage involved highly capital intensive goods which required skilled and technical labor, and the high protection that these relatively large sized industries required was costly. The state had to protect these industries through various means such as tariffs, quotas and over-valued exchange rates which made the maintenance of such a system more costly (Togan, 1995, 5). Given the conditions that Turkey was not yet mature enough to produce such capital intensive commodities, such a nature of import substitution process harmed Turkey's economy drastically.

1983, 13). The emphasis was on the “greater reliance on market forces” and outward-oriented economic policy, marking the turning point in Turkish economic history (Togan, 1995, 6).

3.3 Comparative Analysis

Few analyses could be made based on the two cases examined above. In both cases the international economic environment which these two countries had to cope with was only in its nascent stage of formation. Liberalization was the key word of the process but we do not see a strong external influence that makes these countries inevitable to take actions accordingly, at least not yet. Countries were busy trying to revive themselves economically from the war-torn conditions and building up their internal infrastructure.

Moreover, economies though had transactions amongst each other, were not that much connected as the money transactions were not as free as they are today. It was only with the breakdown of Bretton Woods pegged exchange rate system in 1977 that de facto (financial) transactions took place, spreading and enforcing further economic transactions, marking the beginning of how some scholars would term, the Second Age of Globalization. Until then, both China and Turkey, just as most of the other third world countries were, in a sense, free to decide what policies they intended to implement for their economic growth. One thing that is clear is that China, although pretty much wracked by Mao’s authoritarian policies during the Cultural Revolution, was in a more independent stance at the dawn of the reform age, whereas in Turkey with the involvement of IMF, it was in a much less independent stance, as could be seen in the following years.

CHAPTER 4

EXAMINING REFORM ERA

Once on a tiger's back, it's hard to get off.
---Ancient Chinese Proverb

This chapter focuses on comparing and contrasting the reform era of China and Turkey, including their different market systems, approach to the role of enterprises, agricultural reform, foreign direct investment, and their different reactions to the global trend of financial reform. The case of China and Turkey would be compared either in two different sub-sections or in accordance to the contents, would be described together without any sub-divisions.

4.1 The Initiation to Reform

China's Reform Policy since 1976

The initial stage of Chinese reform was taken in 1978 at the Third Plenum of the Central Committee of Chinese Communist Party which decided that it was time for China to depart from the previous Maoist strategies which seemed no longer viable to the backward economy of China. Although no strict plan was drawn as often been criticized by some scholars today, the advocates of reform in China

believed that the future would be brighter on the reform side than continuing the previous system. It was the continuous interaction between ideas, policies and practical results that was at the core of how the system functioned (White, 1993, 49). Though too ambiguous as it must have seemed at the beginning, such a mechanism functioned well: well enough as would be proven later on.

Chinese reform process was different from that of most of other developing countries in the sense that the process not only meant means to improve the conditions of various economic indicators, but itself meant a huge total “restructuring” of the previous system as a whole. In order for the new system to work, China’s political structure had to be amended. The basic elements that once guided the politics of the previous planned economy system now had to undergo a fundamental change. As Deng reported to the Chinese Communist Party in 1988, the three fundamental changes achieved since 1978 were:

- 1) the concept of developing productivity as a new goal has replaced the previous concept of a class struggle;
- 2) China moved from isolation to open foreign policy to the outside world; and
- 3) reforms enabled China overcome various economic problems (Waters, 1997, 2).

Maoist emphasis on national economic ‘self-reliance’ was replaced by the strategy of ‘greater openness’ to the international economy through liberalization of domestic economy. The proportion of foreign trade in the economy began to increase, foreign credits from both governmental and private sources were accepted,

direct foreign investment was encouraged through wholly-owned or joint ventures, and “special economic zones’ (SEZs) and ‘open cities’ were established (White, 1993, 48, 49).

The commitments to the emerging ideas of reform by the politicians were also strong. As Hua Guofeng (the second premier of PRC who succeeded Mao after his death and the leader of the Communist Party of China until being ousted by Deng Xiaoping) addressed to the Second Session of the Fifth National People’s Congress in mid 1979:

Economic exchanges between countries and the import of technology are indispensable, major means by which countries develop their economy and technology. It is all the more necessary for developing countries to import advanced technology...in order to catch up with those economically developed...We hold that the development of economic, technological, scientific and cultural exchanges and cooperation among various countries on the basis of equality and mutual benefit will help to promote their friendly relations and preserve world peace (Hua Guofeng’s Report on the Work of the Government, June 18, 1979, in Friedrich Wu, 1981, 468).

Specialization, division of labor, interdependence and more liberal foreign economic policy were the major key words indicating the beginning of the new era of reform in China (Friedrich Wu, 1981, 469).

Thus began the long marathon of reform launched in rural sector during 1979-1984 (Phase One) and the following urban-industrial reform during 1984-1989 (Phase Two). It was with the government release of “On the Reform of Economic Structure” on October 20, 1984 when a significant step was taken from previous Soviet-style planned economy and a move towards opening China to the outside worlds was realized.

It is important to note that reform policies in China, however, did not tend to implement market-only principles as the ones in the capitalist market system. Instead it was decided to reduce the scope of mandatory planning and expand the scope of “guidance planning” which increased the powers of enterprise managers and allowed more liberated price system as was the case of the second phase (1984-1989). As more detailed examination of such reform periods would reveal, however, the state still remained as the major body to set the rules for the game.

Turkey’s Reform Policy Since 1980

The first step of Turkey towards reform era was made under the assistance of IMF, the World Bank, and OECD (Organization for Economic Co-operation and Development) with the introduction of stabilization and adjustment programs on 24 January 1980. Huge amount of financial assistance of these international institutions in return were to see Turkey break away from the previous import-substitution strategies to an open export-led and liberalized economy. The financial assistance from IMF amounted to \$1.7 billion in special drawing rights (SDR) under a series of stand-by arrangement, and from World Bank amounted to \$1.6 billion in the form of structural adjustment loans (Dogruel, 1994, 45). These stabilization programs in consistency with the “spirit of orthodox IMF” measures aimed at curbing inflation

and overcome the balance of payments difficulties (Hatiboglu, 2003, 119 and Dogruel, 1994, 45). The aim was to be achieved by cutting the Central Bank credits extended to the public sector which in turn resulted in immense decrease in public investment and spending (Dogruel, 1994, 45). The liberalization attempts included freeing of private sector prices, reducing agricultural subsidies, foreign trade liberalization and export promotion as well as move to a more flexible exchange rate regime.

Some of the major liberalization measures of Turkey since 1980 could briefly be listed as:

1. Devaluation of Money and the introduction of new exchange regime based on daily changes of the parity of TL vis-à-vis foreign currencies.
2. Abolishment of price control regulations.
3. A tight monetary policy based on IMF recommendations.
4. Liberalization of financial markets from regulations regarding deposit and credit rates which now operated in accordance to the markets.
5. The abolishment of individual bargains between unions and firms, causing the decrease in the power of unions in determining wages.
6. Liberalization of trade and freeing of international trade and foreign exchange operations (summarized from Hatiboglu, 2003, 120-122).

As a result during the 1980s, Turkey has become a model country of liberalization, shown as the “paragon of export-led growth” (Dogruel, 1994, 46).

4.2 Socialist Market System versus Market System

Uniqueness of Socialist Market System of China

Reforming previous old system required bringing fundamental changes to the existing economic concepts. Moving on from a command economy to socialist market economy was one of them. The previous system of government control of the enterprises has made economy prone to become lifeless, consequently necessitating a new method to enhance productivity (Gao, 1996, 3).

In the new system, the concept of ‘markets’ were no longer contradictory to ‘planning’, but was considered to be utilized in order to serve the aims of socialist development (White, 1993, 46). The notion of ‘profitability’ and the ‘demand-led system’ came into scene: the former gradually came to play the role of the best indicator of enterprise performance (White, 1993, 46). These were the new basic elements that Deng had in mind when announcing his Four Modernization in 1978 which embraced the modernization of industry, agriculture, national defense, and science and technology (Waters, 1997, 1).

By 1978, the idea of market economy prevailed over the previous system of planned economy. Such a step forward by Chinese policy makers is well reflected in their report to the Fourteenth Party Congress in 1977:

If we want to establish a socialist market economic system, we should allow the market to play the essential role of distributing resources under the macro-control and regulation of the state. We should make economic activities follow the law of value, and adapt to the change of demand and supply. We need to distribute resources to enterprises that have good economic benefit, and

provide enterprises pressure and motivation, in order to select the superior and eliminate the inferior. We need to take advantage of the sensitiveness of the market to various economic signals, and coordinate relations between production and demand (Guangyuan, CE2003, 21).

One should, however, keep in mind that the market economy that Deng Xiaoping had in mind was not the kind of market economy as Western model of capitalism. The notion of market economy in China that Deng had in mind was more of a “free market within a communist society” (Waters, 1997, 15). Such a way of thinking was possible since Deng in the very initial stage of reform denied that “the planned economy has a socialist nature...and that the market economy has a capitalist nature” (Guangyuan, CE2003, 20).²³

China’s successful economic development in the following years as the result of these reform policies are generally explained by reference to Deng’s ability to keep its socialist political structure while continuing to adopt the market system. Reform, thus in a sense, was limited to “economic” elements of both economy and politics. If general analysis is to be made, the basic ideology behind China’s socialist market system was, to put briefly, “progressive economy” but “conservative politics”; that is economic reform was to outrun political reform (White, 49). As many scholars would argue, the motivation behind China’s openness always has been to ‘preserve’, not to ‘dismantle’ socialism. There lies an important clue in this version of understanding Chinese socialist market system, as would be made clear in

²³ There is no strict economic formula that should match the system of politics. As discussed in the introduction, the belief in the dichotomy of market economy versus socialist economy and capitalism versus socialism should be corrected (Gao, 1996, 6).

comparison to the case of Turkey: such a dualist approach was what enabled China to achieve so much success that Turkey failed to.

Market System of Turkey (Trade Liberalization)

In comparison to the socialist market system of China, the similar concept also exists in Turkey –Social State. As incorporated into the Constitution of 1982, Social State does not necessarily take the form of socialist state nor does it imply being “statist.” This could be seen from the fact that whereas it was the “statist” principle that was included in the constitution early in 1937, the constitution of Turkey in 1982 clearly states the “Social State” as the main principle defining Turkey.

Article2 Characteristics of the Republic:

The Republic of Turkey is a democratic, secular and Social State governed by the rule of law; bearing in mind the concepts of public peace, national solidarity and justice; respecting human rights; loyal to the nationalism of Ataturk, and based on the fundamental tenets set forth in the Preamble.²⁴

Constitution of Turkey does not imply any specific form of economic system to be implemented. Thus the effectiveness of the Social State depends on the economic preference of the political authorities in power. Such notion of Social State in Turkey has been functioning in liberal economic system based on free competition and liberal market system. As elucidated in the constitution, the main aim of Social State is to safeguard the welfare of its citizen by protecting and recognizing their rights as: right to work, right to fair wage, right to social security, right to housing, right to medical care, and right to education.

²⁴ <http://www.tbmm.gov.tr/english/constitution.htm>.

Article 5 Fundamental Aims and Duties of the State:

The fundamental aims and duties of the State are; to safeguard the independence and integrity of the Turkish Nation, the indivisibility of the country, the Republic and democracy; to ensure the welfare, peace, and happiness of the individual and society; to strive for the removal of political, social and economic obstacles which restrict the fundamental rights and freedoms of the individual in a manner incompatible with the principles of justice and of the Social State governed by the rule of law; and to provide the conditions required for the development of the individual's material and spiritual existence.

In reality this has not been an easy task. Limited budget is one of the obstacles to full performance of these initiations.²⁵ However I must emphasize that the embedded character of “system-neutral” Social State of Turkey *per se* makes such initiations even more difficult to realize.

Turkey has integrated into the world economy since the early 1980s as could be understood from the trade liberalization history of Turkey. Previously, the import regime of Turkey during the 1960s and 1970s were regulated by annual import programmes. This annual import programmes consisted of three categories: the liberalization list, the quota list, and a list of commodities to be imported under bilateral trade arrangements. The liberalization list was separated into two: a free import list (liberalization list 1) and a restricted list (liberalization list 2). The liberalization list 1 usually contained commodities like raw materials and spare parts whereas the liberalization list 2 listed processed and semi-processed goods and raw materials. The commodities which were already domestically produced were in the

²⁵ The proportion of budget transferred to social security organs decreased from 62% to 56% in 1999 and 2000 respectively (http://www.turkhukuksitesi.com/makale_60.htm)

quota list. The system worked in such a way that the commodities once under the liberalization list could still be transferred to the quota list once the domestic production of the commodities begins. Even for those commodities listed in the liberalization lists, importing them involved complex bureaucratic procedures. Without any doubt it was more difficult for importing those in the quota list. In short, the domestic producers were given a complete protection under such a system. The system was under regulation during then.

It was in the beginning of 1980s that the trend began to show some change. In 1981, the quota list which implied a quantitative restriction on imports partly phased out, and the commodities in the liberalization list 2 began to submerge into liberalization list 1. The Table below shows the declining share of commodities in the ‘restricted list’ (liberalization list 2) in total imports.²⁶

Turkey

Share of ‘restricted list’ imports in total imports

	Restricted Imports (\$ Millions)	Total Imports (\$ Millions)	Share of Restricted Imports in Total Imports (%)
1970	192	948	20.3
1971	260	1,171	22.2
1972	413	1,563	26.4
1973	178	2,086	22.9
1974	697	3,778	18.4
1975	1,163	4,739	24.5
1976	1,143	5,129	22.3
1977	1,160	5,796	20.0
1978	784	4,599	17.0
1979	973	5,069	19.2
1980	947	7,909	12.0
1981	831	8,933	9.3
1982	272	8,843	3.1
1983	163	9,235	1.8
1984	17	10,757	0.2

Source: Various issues of the Annual Report, Central Bank of Turkey, in Togan, 1995, 12.

²⁶ Though no strict statistics of comparison is available for China, the continuing importance of import restrictions in China throughout 80s and 90s is discussed in the third section of this chapter, Decentralization versus Privatization.

In January 1984, all imports were classified into three lists: the ‘prohibited list’, ‘imports subject to permission’ and ‘liberalized list.’ The number of commodities in the ‘prohibited list’, which in the beginning contained some 500 commodities, decreased rapidly to three in the following year. Similarly, the share of commodities in the ‘import subject to permission’ also decreased; from 46.5 per cent of all imports in 1984 to 6.1 per cent in 1988 (Togan, 1995, 12). By 1990 both the ‘prohibited list’ and ‘imports subject to permission’ list phased out, leaving the ‘liberalized list’ as the only activator of the import regime.

In order to promote exports, government offered several incentives such as tax rebates, preferential credits, and tariff exemptions on imported inputs and packaging materials. In addition, in order to counteract the limits of foreign borrowing, Turkey rescheduled its foreign debts under the condition of accepting IMF’s structural adjustment programme which was implemented on 24 January 1980. As a result of such export-promotion policy through exchange rate policy, credit policy and fiscal policy, Turkey’s exports increased from \$2.9 billion in 1980 to \$13.6 billion in 1991 (Togan, 1995, 22). Increasing export was also the result of devaluation of Turkish Lira, which was achieved through the appropriate exchange-rate policy, which will be further dealt with in the following section.

In short, Turkey’s liberalization in trade was achieved both through welcoming more imports and promoting more exports. Restrictions on imports were gradually removed as exports were encouraged by government through exchange-rate policy, credit policy which extended credit at preferential rates of interest to both producers and exporters of selected products, and through fiscal incentives such as export rate rebates, exemption from the production tax (and later from value added

tax), and foreign exchange allocation (Togan, 1995, 22). One of the major steps taken toward Turkey's effort to liberalization was realized with the enforcement of Customs Union between Turkey and the EU in 1996 (World Bank, 2003, 102). As a result of its Customs Union with the EU, Turkey adopted most of EU's trade and competition rules including the abolition of all customs duties and charges on non-agricultural items from EU and European Free Trade Association (EFTA), prohibition of all quantitative restrictions and implementation of a common customs tariff to third-country (including the United States). The Customs Union is a part of the greater picture of Turkey's liberalization effort to integrate with the world economy, as have been with Turkey's participation in the World Trade Organization as a member since 1995.

4.3 Decentralization versus Privatization

Decentralization in China

Reform in China required decentralization in various dimensions of economy. Communist China ruled by a small central bureaucracy now had to undergo a significant change in dispersing its power to lower levels. This transfer of power from upper to lower level governments was based on the premise that allowing experience and knowledge-equipped local governments would enhance efficiency and productivity of the economy. The necessity for decentralization as initiated in the Third Plenary Session of the Eleventh Central Committee of the CCP which marked the beginning of the Chinese reform is well emphasized in the second paragraph of the Communiqué of the Third Plenary Session:

“Now, the serious shortcoming of our economic management system is the high centralization of power. We should dare to decentralize it according to the direction of leadership, allowing local governments and industrial and agricultural enterprises to have more power for their own operation and management under the direction of the unified plan of the state...We should implement the system of responsibilities according to a division of labor and individuals, giving more power and responsibility to management and management institutions, reducing meetings and documents, promoting work efficiency, and carefully implementing the system of examination, reward, punishment, and promotion...” (Yu Guangyuan, 2003, 11)

Three levels of decentralization were to include: administrative decentralization; fiscal decentralization; and industrial policy and infrastructure-supporting investment decentralization (Yusuf, 1994, 3). With the administrative decentralization, more power was diffused from central government to local governments, giving these local governments more room to adopt and implement new market-friendly reform policies (Yusuf, 1994, 3). Fiscal decentralization allowed the local governments to retain their tax revenues themselves instead of delivering them to the center (Yusuf, 1994, 3). These lower levels of government now were responsible for the prosperity of the local economy through the power to collect surcharges, fees and various duties, and to control the budgets of provincially-owned state enterprises (Yusuf, 1994, 3). Thirdly, decentralization of industrial policy and infrastructure-supporting investment dispersed central control over industrial decision-making to provincial bureaus (Yusuf, 1994, 3).

Apart from transferring of power from central to local governments, decentralization also involved devolving power directly from any layer of government to the enterprise – the process which White differentiates into “administrative” and “economic” decentralization (White, 1993, 45).²⁷ The state played less direct role, giving more decision-making power to the enterprise (White, 1993, 46). The monopolistic character of state gradually began to be eliminated with the emergence of “multi-interests” in the economy (Wen Tiejun, 2003, 48).

Though decentralization as an attempt to cope with the changing environment since the reform began, bringing about more flexibility to the functioning of economy, the power still remained in the hands of the state. Strict policies under government plan existed in SOEs (State Owned Enterprises) in China, such as laying off their preexisting workers were not possible, nor could they leave the enterprises without permission (Lau, 2000, 135). Strong administrative interventions continued throughout the reform era of 1980s bringing about various success to the economy, as could be seen in a record trade surplus of US \$13.1 billion in 1990 (Lardy, 1992, 146). While pursuing the open-door strategies in accordance to the spirit of reform, it was the state which designed and implemented the policies as a way of protecting domestic market. They were realized through export subsidies and import curbing. The measures vary from direct quantitative limit to various product standards and inspection procedures on imported goods. As Lardy indicates:

For example in 1988 the state imposed curbs on imports of some 100 machinery products that were produced by enterprises under the Ministry of Aeronautics Industry. The state designed these

²⁷ The change in the system which White refers to was made from “vertical” relationships between enterprises and the supervisory state organs towards “horizontal” links between different enterprises (White, 1993, 46).

restrictions to protect the domestic production of a broad range of products, including buses, motorcycles and many types of machinery products (Liu, 1988). In mid-1989 there were further adjustments to the trade regime that provided the Ministry of Foreign Economic Relations and Trade with more control of the volume of imports, particularly at local levels (Yuan, 1989). By 1990 the state had imposed import bans on approximately 80 types of products and materials (Office of the US Trade Representative, 1991: 45) (Lardy, 1992, 147).

Privatization in Turkey

Turkey's state economic enterprises (SEEs) originate from the "Etatist" period of the 1930s. The SEEs have always played the central role in the industrialization process of Turkey since then, even during the post-1950 period when private business emerged as another important actor. The importance of the SEEs is reflected in their contribution to total industrial production and to overall capital formation. The SEEs accounted for about 40 percent of total value added in the manufacturing industry, and accounted for more than 50 percent of total fixed capital formation during the 1980s (Onis, 1991, 164).

However questions lingered about the performance of the public-enterprise sector as their operating losses grew, and so has the central government's budget to finance them, which resulted in accelerating inflation. Some of the apparent problems were: the absence of autonomy and managerial incentives; frequent interference from politicians and bureaucrats; and failure of the state-enterprise sector to provide incentives to the managerial elite (Onis, 1991, 164). It is highly

understandable that pressure to improve performance of the SEEs which have been operating under the highly monopolistic or oligopolistic market system during the 1960s and 1970s was very low, if not inexistent.

Since the second half of the 1970s, proposals and attempts to reform the SEEs began to gain momentum. However, although Turkey shifted toward more liberalized market-oriented system in the 1980s, privatization of the SEEs was slow to be realized. The reform attempt during 1980 and 1984 was led by the World Bank and the IMF from whom Turkey obtained structural adjustment loans (SALs). Under the SAL program, public-enterprise reform could be made through: “improving short-term financial structure; redirecting investment programs and financing them from non-budget sources; and changing the role of the SEEs to support the private sector” (Onis, 1991, 165).

It was with the Ozal government that pressure for reform was strengthened. Along with the introduction of trade and capital-account liberalization policies, privatization was put on the policy agenda in 1984. The State Planning Organization which was to be the leading organ commissioned the Morgan Guaranty Trust to organize the plan for the task of privatization. The report was submitted by the Morgan Bank in May 1986 whose main objective was to rank enterprises according to their suitability for divestiture. The enterprise was ranked according to the economic viability indicating the current operating profitability and market potential, which then decided its “saleability” (Onis, 1991, 166). The report implies foreign investors as the principal candidates for taking over the companies to be divested based on the tendency that investment from overseas would provide capital as well as technical know-how, and would promote the competitiveness of the companies divested.

An important point is worth made regarding the Turkish experiment of privatization. Privatization in Turkey did not necessarily mean a retreat of the state. As Ziya Onis argues, liberalization and privatization in Turkey did not automatically lead to a “retreat of the state,” but was followed by “reorganization” or “reconstitution” (Onis, 1991, 167). This could be understood when one examines the means through which privatization was implemented. Except for the direct sales of SEE assets, other instruments such as offers to sell management rights of an enterprise and offers of certificates entitling the public to a share in the operating income of the enterprise, as was the case of Teletas, a telecommunications company, whose shares were sold through 4,822 branch banks and completely transferred to the public, did not result in a total retreat of the state, but rather showed how government reorganized the structure of the economy.

That privatization did not necessarily mean a retreat of the state is also shown in the initiative aims behind privatization in Turkey. What privatization aimed at in the eyes of the Turkish policymakers was to establish a well-developed capital market. Government aimed at incorporating a large number of middle-income populations into the privatization process, which in turn would establish “popular capitalism” by extending property ownership to wider segments of the society (Onis, 1991, 168).

Turkey’s case of privatization process, however, cannot be said to have shown its full performance due to several reasons. First, Turkey’s macroeconomic environment was not suitable enough for political rationality to come true. Ozal’s post-1983 policies of tariff reform, the opening up of the capital account, and incentives to direct foreign investment coexisted with growing macroeconomic imbalances resulting from a public-sector based expansionist strategy, which

provided a hurdle for a full-scale privatization (Onis, 1991, 170). Secondly, institutional constraints blocked a more successful privatization drive in Turkey. The capital market was not developed enough to manage the privatization process. Weak capital market led to a weak financial base which in turn made large domestic corporations in Turkey who could have emerged as potential participants in the privatization process now depend on short-term bank financing (Onis, 1991, 171).

By the end of 1989, the process of privatization began to display certain deficiencies, such as the absence of regulatory framework, chronic inflation, high interest rates, and increasing external debts.

4.4 China's Reform Priority on Agriculture

One distinct contrasting point of the developmental history of China to that of Turkey is that China acknowledged the importance of reforming agriculture as the very base of further industrial reform. Whereas Turkey experienced an intensive development of agriculture during the period 1965-1979 with development plans and agricultural support policies, however with the beginning of the reform era since 1980, no special policies were included in regards to agricultural sector. Under the supervision of International Monetary Fund (IMF) and World Bank (WB), the agricultural support policies were to be reduced and so were the credit supported for the purchases of unions of agricultural sales cooperatives (UASCs) nor is any brighter future guaranteed by the continuing programs of structural adjustment as could be understood from the Letter of Intent submitted to the IMF on March 10, 2000:

In the agricultural sphere, the Government intends to break with the past once and for all in order to boost growth and reduce the burden

of agricultural support policies on the budget and the consumers. The medium-term objective is to substitute the existing system relying on support through government subsidized inputs and credit and price support for major commodities by a program of direct income support targeting ever more small farmers...In line with the medium-term objective of the withdrawal of the state from a direct part in agricultural production and agri-business, the agricultural reform program includes the commercialization and privatization of state assets in the sector (Oyan, 2002, 61)

Since the 1980 reform, one of the major contributing facts to systematic development of agriculture in Turkey began to fade slowly – the state power to initiate and implement.

On the contrast China's reform policies were initiated with agricultural reform and give the state major control over it in the continuing future. Reform Phase One (1979-1984) focused mainly on planning and implementing rural economic institutions in order to bring about changes in the existing agricultural system. The period coincided with the increasing number of pro-Deng reformists in the top posts which accelerated the speed of the reform process. The major change has been made to the previous system of commune based collective agricultural production system. It was transformed into more private-based 'responsibility system' where the production team made up of 30 families worked as the unit and was rewarded according to the unit's work effort (Perkins, 1988, 608). The reward to the work effort of farmers was received through "work points" which were calculated based on the amount of work each unit's farmers performed and were divided equally among the farmers of each unit and distributed in the form of incomes (Perkins, 1988,

608). The basic idea behind 'responsibility system' was based on the framework of socialist market system, which accentuated devolving responsibility from the collective unit to smallest unit possible, which in this case was represented by individual peasants (White, 1993, 54).

The agricultural decollectivisation launched in 1979 has transformed most of the collective forms of the 'responsibility system to individual household farming (Perkins, 1988, 609). By 1983, "rural people's commune" was abolished which epitomized the demise of team farming and de facto beginning of household agriculture based on 15 year contracts with the state to use the land (Perkins, 1994, 2). By 1984 the growth rate of agricultural value added grew five times that of 1957 (Perkins, 1994, 14). What enabled such a growth was not only the adoption of new 'responsibility system' but the changes in macro-economic policy which bolstered such attempts.

In terms of macro-economic policy, changes took place that would further support the move toward market-oriented agriculture within the context of socialist market system. Whereas the previous system depended mainly on the grain purchase quotas and subsidies by the government, the new reform policy allowed the state to increase the procurement prices (by an average of 31 per cent between 1978 and 1980 and 13 per cent between 1980 and 1983) (White, 1993, 54). The increase in the prices of agricultural goods narrowed the gap between the prices of agricultural and industrial goods. Incentive prices to certain crops by government were used in order to encourage agricultural diversification, such as cotton. Outside the state planned quotas, the amount of agricultural goods which the peasant households could sell was increased, and such encouragement of commercialization of agriculture was another step toward establishing socialist market system (White, 1993, 54).

4.5 Foreign Direct Investment

In the case of China

Foreign Direct Investment (FDI) in China has been the major driving force behind its successful economic growth. Both quantitatively and qualitatively, China's power to attract FDI has advanced that of any other developing countries. Apart from the cheap and skilled labor in China, the effort of Chinese government through designing necessary institutions also played an important role in China's success to attract ever increasing amount of FDI during the reform era.

The turning point of the Chinese reform history was marked by "The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment" which was promulgated and adopted in July 1979, marking the beginning of surging external contacts of China (Friedrich Wu, 1981, 474). The document became the foundation for the other laws on foreign investments that followed. China developed further its legal infrastructure for the foreign-invested enterprises (FIEs) with the passage of the "Wholly Foreign-Owned Enterprise Law" in 1986 and the "Sino-Foreign Cooperative Joint Venture Law" in 1988, laying the legal ground for the three main forms of FIEs—equity joint ventures, cooperative joint ventures, and wholly foreign-owned subsidiaries (Huang, CER, 2003, 405). With the decree of the "Regulations to Encourage Foreign Investments" by the State Council in 1986, China's FDI regulatory regime moved further from "permitting" to "encouraging" FDI (Huang, CER, 2003, 405). Such regulatory practices by the Chinese government continued in the 1990s with special effort to cope with international environment. With China's accession to the World Trade Organization

in 2001, China was obligated to allow foreign firms to own up to 50 percent of FIEs in the telecom and insurance industries (Huang, CER, 2003, 407).

As a result of FDI policies implemented by the government, FDI in China has grown enormously since early 1980s. From early 1980s to 1990s, annual contracted FDI inflow to China has grown from about \$ 1.5 billion to about \$ 40 billion in 1999, and actual FDI inflow from about \$ 0.5 billion to more than \$ 40 billion (Fung, 2002, 2 of 34). In 2001, FDI in China was \$45 billion, and in 2002 China outranked the US as the most attractive destination for FDI (Huang, Carnegie Endowment, 2003).²⁸ Today China accounts for 1/4 to 1/3 of total FDI inflow to the developing countries (Fung, 2002, 2 of 34).

The increasing importance of FDI in Chinese economy is apparent from the fact that the share of FDI in total annual investment in fixed assets grew from 3.8 percent in 1981 to 11-17 percent during the 1990s (Huang, Carnegie Endowment, 2003, and Fung, 2002, 2 of 34). FDI in China is also closely related with the exports as could be seen by the fact that the increase in exports in the pre-1997 period coincided with the increase in FDI in labor intensive industries (Huang, Carnegie Endowment, 2003, 1 of 3). China's export production could literally have been impossible without overflowing FDI. Apart from such tangible results, China benefited from FDI inflows through technological "know-how transfer" from these foreign-invested enterprises (FIEs) to the Chinese firms—what could be called spillover effect (Cheung, 2004, 26).

²⁸ It is important to note that the foreign capital China receives is mainly in the form of Foreign Direct Investment, the long-term capital providing China with stability in comparison to the short-term capital. More than two thirds of foreign capital that China received between 1979 and 2000 were in the form of direct investment (Fung, 2002, 5 of 34).

In the Case of Turkey

Turkey attracts relatively low volume of foreign direct investment compared to the other developing countries of comparable size. The amount of FDI Turkey attracted in 1971 was only \$300 million, and the average annual inflow of FDI up until 1980 was only \$90 million (Ogutcu, OECD Conference, 2002). It is true that with Turkey's shift from import substitute policy to export-oriented policy in the mid-1980s has increased the amount of FDI inflow, reaching \$1 billion in 1990.²⁹ However since then, FDI flows per annum remained static while global FDI flow was accelerating rapidly. How should one explain the still low level of FDI since Turkey's shift from a protectionist trade regime to a more liberalized export-oriented regime since mid-1980s? Apart from the criticism on the weak financial structures of medium-and small-scale domestic firms in Turkey which allowed foreign investors to take over these firms as a tool to increase their control over the internal market (Onis, 1998, 317), the main arguments lie in both unstable macro-economic character and in the "too liberal" policies of Turkey.

Although Turkey with its huge economic size and labour force might have attracted the foreign investors³⁰, its persistent political and economic instability renounced those advantageous economic potentials. What foreign firms take into consideration when determining their investment decisions, apart from low efficiency wage rates, natural resource endowments, or per capita income levels and growth performance which Turkey seems to possess, include political stability, and price and exchange rate stability, which could hardly be found in the case of

²⁹ That Turkey's highly protectionist import-substitution strategy led to such a low level of FDI is a widely shared point of view among scholars, which is in line with Bhagwati's thesis that "the magnitude of FDI inflows and their efficacy in promoting economic growth will be greater over the long haul in countries pursuing the export promotion strategy than in countries pursuing the import substitution strategy" (Bhagwati, 1978, 1985, in Togan and Balasubramanyam, 1995, 119).

³⁰ Turkey as a middle income developing country was considered to possess both well developed infrastructure such as transportation, finance and banking, and geographical advantages bordering Middle East and Europe (Togan and Balasubramanyam, 1995, 117).

Turkey.³¹ Endemic macroeconomic instability and chronically high rates of inflation, originating from the state's fiscal problems which emerged in the 1970s largely due to a high public sector borrowing, have offered the major obstacles for attracting foreign investors.

Another reason why Turkey has failed to attract expected amount of FDI lies in its liberalization policy *per se*. Study on Turkey's liberalization policy reveals that the policies of Turkey towards FDI are much more liberal than those of other developing countries of larger FDI inflows. Based on the principle of "equal treatment of domestic and foreign firms," Turkey "moved too far" in directing its liberalization policies (Onis, 1998, 311, and Togan and Balasubramanyam, 1995, 123). Reorganization of bureaucracy was realized in 1984 when Foreign Investment Department of the State Planning Organization was established to handle foreign investment approvals. With the creation of this single agency, the problems generated by the fragmented nature of the bureaucracy were eliminated (Onis, 1998, 185). Turkish law relating to foreign capital confers all the rights and obligations afforded to local nationals on foreign investors. This was made possible by making consistent the foreign investment Code with the OECD norms, the act which rendered foreign and domestic investors subject to equal treatment before the law (Onis, 1998, 185). Turkey provides a wide range of investment incentives to foreign firms, but does not implement any policies of regulations such as local content requirements and employment regulations, as is the case of other developing countries. The climax of such liberalization process was marked in 1986 when 100 percent foreign ownership became attainable for all foreign investors in all sectors (Onis, 1998, 311). No ceiling exists on the amount of equity foreign firms may own.

³¹ The importance of "policy environment" of the host country is well described in Ziya Onis, *State and Market: the Political Economy of Turkey in Comparative Perspective*, Istanbul: Bogazici Univ, 1998.

The law does not put any restrictions on the foreign investors who wish to transfer their profits abroad. It also has established Free Port Zones as an attempt to attract inward FDI, create more employment and transfer technology. However as Togan and Balasubramanyam argue, Turkish experience of FPZs only helps reiterate the fact that Turkey's framework of policies towards FDI were too generous to achieve their original goals.

Despite such liberal policies giving adamant power to the foreign firms operating in Turkey, it failed to derivate these gains to domestic economy. The following table compares the actual inflow of Turkey in comparison to that of China during the first decade since the reform policies of early 1980s.

China and Turkey

Actual FDI Inflow in Turkey and China 1980-1990 (in \$ Millions)

Year	*	1983	1984	1985	1986	1987	1988	1989	1990	1991
Turkey	18	46	113	99	125	115	354	663	684	810
China	1166	636	1258	1661	1874	2314	3194	3392	3487	4366
Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Turkey	844	636	608	885	722	805	940	783	982	3266
China	11007	27515	33767	37521	41725	45257	45463	40319	40715	37253

Source: for Turkey: SPO (State Planning Organization) based on Undersecretariat of Turkey and Central Bank , and for China: PRC National Bureau of Statistics (Yearly Data 2000, Chapter 17. Foreign Trade and Economic Cooperation, 17-13. Utilization of Foreign Capital).

*Due to availability of the data, this period indicates 1980 for Turkey and 1979-1982 for China.

4.6 Financial Reform

In the Case of China

In hew to the scope of socialist market system, the financial reform also reflected the basic element of the unique system of China – state control. Chinese financial market remaining closed does not necessarily implicate, however, that there

was no attempt at all towards reform policies within the field. As many would argue, especially emphasized by those who advocate the neo-liberal point of view, China did undergo several reform attempts since 1979.

One of them is the move from mono-banking system to a two-tiered banking system. On the contrary to the previous system where the only key institution was the People's Bank of China³² which alone handled most of the financial matters of the country, under the two-tiered banking system, the burden of the PBC was dispersed among several other institutions allowed.³³ Diversification was the major consequence of such a reform attempt which restored the credit of Agricultural Bank to handle funds for working capital in rural areas and established the Industrial and Commercial Bank to manage the urban industrial and commercial enterprises (McCormick and Unger, 1996, 161). A separate institution was also established to administer foreign exchange transactions (McCormick and Unger, 1996, 161). With all these institutions sharing the work, the PBC was now responsible for larger issues of government's finances, macro-financial economic issues, and for overseeing the loan activities of the specialized banks (McCormick and Unger, 1996, 161). As the result of the initial reform policies, local governments, enterprises and households now also became the recipients of the financial resources once under full control of central planning and financial authorities (McCormick and Unger, 1996, 162).

The reform policies in the late 1979 seem to show that China has, as many other developing countries of contemporary era including Turkey, embodied the

³² Two other specialized banks existed to assist the work of PBC: the Bank of China responsible for foreign exchange transactions; and the People's Construction Bank of China responsible for granting fixed capital grants from the state budget (McCormick and Unger, 1996, 159). The previous agency was under the supervision of the PBC, and the latter of the Ministry of Finance (*ibid*).

³³ As would be discussed later, such a dispersion of financial responsibilities and the diversification corollary to this policy cannot be judged on the absolute terms. Similar to today's phenomena, the rather centralized and even more closed financial system of China before 1979 was praised by today's scholars to have contributed to the maintenance of stability and high rates of other macro-economic indicators, such as growth rates and investment rates during then (McCormick and Unger, 1996, 160). The similar analysis is still applicable today.

popular move towards opening up. The reform attempt continued throughout 80s and 90s when new financial institutions emerged and further push towards two-tiered banking system continued. However, though not meaninglessly small, such a step was not huge enough to bring any crucial changes to the overall financial system of China.

China's financial market still remained closed and continued to function under tight state control. One recent example exists in the field of local equity market, two-thirds of which still is owned by the state and thus cannot be traded on stock exchanges (22 May, 2005, the New York Times). The reforms sponsored by the central government were problematic in four dimensions. First, the reform was directed mainly to the state-owned banking system and merely to anything else. Administering funds to public sector was delegated to the state banks that were functioning as administrative organs of the state (Bell (IMF), 1993, 31). Second, the scope of the reform was too narrow thus restricted. Third it lacked financial market since what operated the economy was not market but the central financial planners of the state which at the same time restricted the autonomy of the banks. Consequently, the banking system lacked any autonomy to set any policies of its own, having no independent monetary policy, but was a mere puppet of the huge strong central authorities (Lou Jiwei (WB), 1997, 38). Lastly, the fact that some elements of market system were allowed as the result of the reform led to the dualist tendency of the economy, where the economic actors such as enterprises now had to cope with increased chaos. In brief, the contents of the reform policies merely implied the move from "formal to informal methods of regulation and control" and what remained unchanged was the still strong influence of state in all dimensions of Chinese economy (McCormick and Unger, 1996, 156).

While reform policies were being designed and implemented, with state initiation being the pivot, the external pressure to further open up mainly continued in regards to its exchange rate regime. Chinese exchange regime, after having gone through several changes during the last two decades of reform history, established a de facto US dollar-pegged system since 1994 (Huang and Wang, 2004, 337). Though the regime was of a managed-float kind with a narrow band, it operated de facto pegged to the dollar. Such a regime which on the one hand allowed a certain degree of flexibility but delimiting the fluctuations within a narrow band, alongside the tight capital control by the state enabled China to witness high and stable economic growth since then (Huang and Wang, 2004, 338).³⁴

With China's further integration into the world economy, one example being the accession to the World Trade Organization in 2001³⁵, it has been speculated that the next step would take China to carry out capital account liberalization (Lin and Schramm, 2003, 247). Such a pressure, however, has long been encountered with Beijing's continuous confrontation. The logic behind such an encounter mainly is rooted in the acknowledged danger of what open financial/capital market would bring about. The distrust and the fear against the speculative market has been the major reason behind China's struggle. Fan Gang, director of the National Economic Research Institute China Reform Foundation, asserts, allowing greater fluctuation of exchange rate by appreciating the Yuan has been given a special attention by the

³⁴ The success could also be seen from China's current account and capital account surpluses with the implementation of the regime since 1994. China's story has been analyzed to owe its success to "the artificially low value of the Chinese currency against the dollar" which with further depreciation against other currencies allowed Chinese exports advantageous against not only United States but also other parts of the world including Europe (Barboza and Kahn, July 22, 2005, New York Times).

³⁵ The requirements for China's accession to WTO included liberalization of various economic spheres including trade and other investment areas including agriculture, telecommunications and financial services, which once actualized would threaten current foreign exchange regime and make capital account liberalization inevitable (Lin and Schramm, 2003, 263).

Chinese policy makers due to its sensitivity and risky character (Asia Times, 19/01/2005, “Beijing will hold the peg”). Having control over the currency was considered tantamount to “a matter of China’s sovereignty” as recently declared by Chinese Prime Minister Wen Jiabao (Barboza and Kahn, July 22, 2005, New York Times).

However, despite such a harsh struggle, China yielded to the global pressure finally. Marking another milestone in the Chinese history of reform, and as in line with this thesis of mine, China ended its previous regime of a de facto peg to the US dollar on 21 of July, 2005. This move representing a closer step towards liberal market system was launched with China’s Central Bank announcing that Yuan would rise to 8.11 from 8.28, a 2.1 percent increase, to US dollar, ending its decades-long policy of US dollar –peg regime (Goodman, July 21, 2005, Washington Post). The move was welcomed by the United States as reflected in the statement of John W. Snow, Treasury Secretary of United States: “I welcome China’s announcement today that it is adopting a more flexible exchange rate regime. As we have said, reform of China’s currency regime is important for China and the international financial system” (Barboza and Kahn, July 22, 2005, New York Times).

What makes the move more important, however, is the risk that it harbors. The gradual appreciation of the Yuan as the result of this first step is highly likely to attract huge inflow of speculative money into China, which would inevitably result in increase in inflation and asset bubbles in China (Barboza and Kahn, July 22, 2005, New York Times). In other words, once the capital inflow seems to increase, the speculative character of the market stimulates the expectation of the global financial market towards further inflow, which in the end results in uncontrollable and risky financial environment filled with short termed hot-money. As Nicholas R. Lardy, a

senior fellow at the Institute for International Economics in Washington indicates, “(such a move) creates the expectation of more moves so there could be even more speculative inflow” (Barboza and Kahn, July 22, 2005, New York Times).

The fact that such a move contains danger has been a long contested issue. The irrevocability of the negative impact of capital liberalization on the overall economy is well represented in the term “policy trilemma.” The term indicates the difficulty, if not impossibility, of the “trinity”: financial-market integration through controlling capital mobility, the exchange rate stability, and monetary independence (Lin and Schramm, 2003, 264 and Huang and Wang, 2004, 340). In this global economy, it is impossible to satisfy all three goals but must leave out one in order to satisfy the other two. To apply the theory to Chinese case, if China wishes to maintain its monetary independence, considering the pressure that joining to the globalization process would have upon Chinese economy, the tradeoff between capital mobility control and exchange rate stability is the cost that it would have to pay (Lin and Schramm, 2003, 264 and Huang and Wang, 2004, 340).

U.S. policymakers are still criticizing China for manipulating its currency claiming that it gives China an unfair competitive advantage in international trade (October 14, 2005, the Globalist). The charge for “currency manipulation” is grounded on the basic ideology of International Financial Institutions, such as IMF as written in IMF Article IV:

In particular, each member shall: ...avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” (IMF Article IV, Section 1)³⁶

³⁶ <http://www.imf.org/external/pubs/ft/aa/aa04.htm>

“To accord with the development of the international monetary system, the Fund, by an eighty-five percent majority of the total voting power, may make provision for general exchange arrangements without limiting the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund and the obligations under Section 1 of this Article... (IMF Article IV, Section 2)³⁷

Such a view is also supported by WTO, as clearly laid down in the Article XV (on Exchange Arrangements) of the GATT (the predecessor organization of today’s WTO):

1. The CONTRACTING PARTIES shall seek co-operation with the International Monetary Fund to the end that the CONTRACTING PARTIES and the Fund may pursue a co-ordinated policy with regard to exchange questions within the jurisdiction of the Fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the CONTRACTING PARTIES.
2. In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund...(Legal Texts of GATT, Article XV)³⁸

With its accession to the World Trade Organization (WTO) in 2001, China took another step toward global financial integration. As summarized in the words of Eswar Prasad, Chief of Asia and Pacific Department of IMF, the actors of pro-financial liberalization “think it is really in China’s own interest to move towards a

³⁷ *ibid.*

³⁸ http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm

more flexible exchange rate regime because it would give China an autonomous monetary policy and would help the economy adjust much better as its outward orientation increases.”³⁹

Not only the very nature of open financial market may bring harm to Chinese society, but also the consequential chaos that the coexistence of financial openness to the outside world and the traditional domestic financial institutions would bring also offer another reason behind gloomy Chinese future. Whatever the future speculation might be, it is an undoubted fact that China’s relatively closed financial policies did brought about further economic success by preventing the financial malaise, which often emerge in the form of crises, that other countries such as Turkey had to fight in the latter years.

In the Case of Turkey

Capital account liberalization in Turkey was launched in 1983, right after the decision to adopt a major stabilization-cum structural program as assisted by IMF and the World Bank in 1980.

Apart from the fact that Turkey’s early integration into the world market naturally accompanied opening up its financial market, its domestic political situation offers another explanation behind its early financial integration with the international market. After the end of the military rule in November 1983, and after experiencing a short period of absence of political competition until 1987, Turkey during late 1980s and early 1990s was undergoing an important period of “distributional conflict in a reconstituted democratic environment” (Onis, 1998, 517). For instance, the coalition government of DYP-SHP faced since their entering the

³⁹ Transcript of an IMF Economic Forum, October 19, 2004. “China in the Global Economy: Prospects and Challenges”, Washington DC.: IMF.

office in 1991 the dilemma of attempt to implement stabilization program in the situation where the constituents of the supporters prevented the government from doing so (Onis, 1998, 518). Having failed to implement the stabilization program of its own, the government turned instead to large amount of short-term capital which offered the politicians an alternative to solve the distributional dilemmas.

Turkey

Selected Balance of Payments Indicators (\$ Millions)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
1.Current Account Balance	-1265	-1413	-3408	-1936	-952	-1923	-1439	-1013	-1465	-806
2.Overall Balance of Capital Movements	-26	-112	90	-5	168	152	-66	124	790	969
Direct Investment	34	75	18	95	55	46	113	99	125	106
Portfolio Investment	0	0	0	0	0	0	0	0	146	282
Other Long-Term Capital	1681	1535	2029	998	1029	660	1614	163	1041	1453
Short-Term Capital	402	-1000	-2	121	98	798	-652	1479	812	50

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
1.Current Account Balance	1596	961	-2625	250	-974	-6433	2631	-2339	-2437	-2638
2.Overall Balance of Capital Movements	890	2762	1308	-1029	1484	308	206	4658	4545	3344
Direct Investment	354	663	700	783	779	622	559	772	612	554
Portfolio Investment	1178	1586	547	623	2411	3917	1158	237	570	1634
Other Long-Term Capital	209	885	-210	-783	-938	1370	-784	-79	1636	4788
Short-Term Capital	-2281	-554	3000	-3020	1396	3054	-5127	3713	5945	1761

Source: Various Issues of OECD Economic Surveys: Turkey.

The huge inflow of short-term capital into Turkey accompanied with its full liberalization of capital account since 1989 led to an unstable and inconsistent economic growth (Balkan and Savran, 2002, 41). The sudden decrease of the annual growth from 1993 to 1994 which fell from 8.0 percent to -5.5 percent is only a partial

example of how an economy open to hot money could be affected. The same pattern of unstable fluctuation applies to other indicators of the economy such as balance on current account.

The Turkish economy with an open financial system experienced a vicious circle that brought the cyclical financial crises to the economy in the late 1990s and early 2000s. As Ziya Onis summarizes, the inflows of foreign capital results in sharp appreciation of the real exchange rate in a country like Turkey where it lacks adequate filtering mechanisms, which in turn offers the authorities a good alternative of short-term anti-inflationary instrument (Onis, 1998, 525). This overvaluation of the domestic currency, leading to an import boom due to cheapening of imports and export stagnation results in increase in trade deficit and large current account deficit leading to the distorted and fragile balance of payments structure (Onis, 1998, 525, Balkan and Savran, 2002, 43). As Boratav, Turel and Yeldan summarizes:

...the post-1990 Turkish experience shows the serious problems confronting a developing economy which decides to move into full external and internal deregulation in the financial system under conditions of high inflation. The specter of capital flight becomes the dominant motive in policy-making and creates commitment to high interest rates and expectations for cheap foreign exchange. The links of these two policy variables with the real sphere of the economy, i.e. investment on physical capital and the current account balance of payments, are deeply severed. Instability in the rates of foreign exchange and interest rates creates feedbacks which lead the economy

into further instability (Boratav, Turel and Yeldan, 1995 in Balkan and Savran, 2002, 43).

Examining the budget deficit of years between 1980 and 1989 supports the negative impact of financial liberalization on the government to raise funds at market-related interest rates.

Turkey
Central Government Budget (1980-1990)(TL billions)

Year	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Budget balance	-166.2	-123.6	-157.3	-312.6	-978.7	-798.2	-1411.5	-2607.4	-3990.2	-7672	-14202
Transfers	397.9	571.6	548.1	1071.4	1602.8	2187.7	3490.1	5863.5	10420.8	16377.9	25363
Of which interest payments	31.5	75.3	87.4	211.4	440.8	675.0	1331.1	2266.4	4977.8	8259.5	14600

Source: OECD Economic Survey: Turkey 1990-91.

Towards the end of the 1980s we can see that the interest payments by government itself make up the most part of the budget deficit.

By 1999 the gross inflow of short-term capital (or hot money) to Turkey reached \$108.6 billion which makes up 2/3 of the overall Turkish GNP (Balkan and Savran, 2002, 48). This indicator only reiterates the declining, if not nonexistent, power of domestic system to control its own financial policies from international speculative centers, which themselves are accused of provoking financial fragility and thus leading to distorted distribution of income (Balkan and Yeldan, 1998; Yenturk, 1999 in Balkan and Savran, 2002, 48).

The hazards that Turkey witnessed from its early opening up of financial market could be briefly listed as the following:

- 1) With short-term capital flowing into the domestic economy, the previous role of Central Bank (controlling the rates of interest and of foreign exchange) is now handed over to the “exclusive directives of external centers” resulting in a continuous high real interest rates and an overvalued domestic currency.
- 2) Disassociation of the financial and real sectors due to unpredictable inflows and outflows of hot money creates bubbles in the stock exchange market.
- 3) Continuous speculative capital flows reflect the unstable economic environment in Turkey, thus lowering the creditworthiness of Turkey by foreign investors (Balkan and Savran, 2002, 49).

Turkish experience shows the danger behind fully liberalizing one’s financial system under conditions of high inflation. Public sector lost the capacity to generate savings and the state sought to finance domestic debt by issuing new debt instrument which only triggered further domestic debt. Turkey’s domestic debt stock increased from near zero in 1987 to 25-30 percent of GDP by 2000 (Onis, 2003, 7). A vicious circle of increase in real interest rates as a result of government’s demand for funds caused an increase in interest payments which in turn only contributed to increased budget deficits (Onis, 2003, 7). Such a short-sighted government decision to rely on the exchange rate and short-term capital inflows as the means of financial liberalization only proved how ‘short-termed’ such prescriptions could be.⁴⁰

⁴⁰ As Saracoglu indicates, “policy makers believed that structural adjustment policies could not be implemented successfully unless financial markets were deep and mature enough to meet the financing needs of an outward oriented economy.” (Saracoglu, 1996 in The Central Bank of Turkey, 2002, 58).

4.7 The Results

In China Structural Change in the Economy Becomes Reality

During the 1980s China's annual GDP rose by about 10 per cent (White, 1993, 72). Exports also grew rapidly at an average annual growth rate amounting to 16.7 per cent between 1979 and 1990, enabling China to maintain its current account surpluses in all but four years between 1978 and 1992 (White, 1993, 72 and Yusuf, 1994, 2??). Such improvement of China's relationship with the international economy could be also seen from its performance in its share of global trade which increased from 0.8 per cent in 1978 to 1.7 per cent in 1987.⁴¹

China

China's Foreign Trade 1978-2000 (\$ billions)

Year	Total	Exports	Imports	Balance
1978	20.64	9.75	10.89	-1.14
1979	29.34	13.66	15.68	-2.02
1980	38.14	18.12	20.02	-1.90
1981	44.03	22.01	22.02	-0.01
1982	41.61	22.32	19.29	3.03
1983	43.62	22.23	21.39	0.84
1984	53.55	26.14	27.41	-1.27
1985	69.60	27.35	42.25	-14.90
1986	72.85	30.94	42.91	-11.97
1987	82.65	39.44	43.21	-3.77
1988	102.79	47.52	55.27	-7.75
1989	111.68	52.54	59.14	-6.60
1990	115.44	62.09	53.35	8.75
1991	135.63	71.84	63.79	8.05
1992	165.53	84.94	80.59	4.35
1993	195.70	91.74	10.396	-12.22
1994	236.62	121.01	115.61	5.4
1995	280.86	148.78	132.08	16.7
1996	289.88	151.05	138.83	12.22
1997	325.16	182.79	142.37	40.42
1998	324.05	183.81	140.24	43.57
1999	360.63	194.93	165.70	29.23
2000	474.3	249.2	225.1	24.1

Source: PRC National Bureau of Statistics (Yearly Data 2000, Chapter 17. Foreign Trade and Economic Cooperation, 17-3. Total Imports and Exports).

⁴¹ Peter Nolan. 1990. 'Introduction', in Peter Nolan and Fureng Dong (eds.) 1990. *The Chinese Economy and its Future*. Cambridge: Polity Press. 1-38, in Gordon White. 1993. *Riding the Tiger: the Politics of Economic Reform in Post-Mao China*. London: Macmillan. 73.

Today, China remains world's third largest trader, its exports amounting to \$ 772 billion and imports to \$ 660.1 billion, and its total amount of trade reaching \$ 1.42 trillion in 2005 (Wei, January 12, 2006, China Daily). Such numeric data contains ample meaning to Chinese economy when one considers that China's trade surplus in 2005 reached a record of US\$ 102 billion, the amount triple that of 2004.

Ever increasing GDP of China also supports such success of China as indicated in the following table:

China

China's GDP and GDP per capita

Year	1978	1979	1980	1981	1982	1983	1984	1985
GDP	3624.1	4038.2	4517.8	4862.4	5294.7	5934.5	7171.0	8964.4
GDP per capita (100 million Yuan)	379	417	460	489	525	580	692	853
Year	1986	1987	1988	1989	1990	1991	1992	1993
GDP	10202.2	11962.5	14928.3	16909.2	18547.9	21617.8	26638.1	34634.4
GDP per capita (100 million Yuan)	956	1104	1355	1512	1634	1879	2287	2939
Year	1994	1995	1996	1997	1998	1999	2000	2001
GDP	46759.4	58478.1	67884.6	74462.6	78345.2	81910.9	99215	109656
GDP per capita (100 million Yuan)	3923	4854	5576	6053	6392	6506	7880	8709
Year	2002	2003	2004	2005				
GDP	120333	135823	159878	182820				
GDP per capita (yuan)	9557	10787	12698	14520				

Sources: For years 1978-1999, PRC National Bureau of Statistics (Yearly Data 2000, Chapter 3. National Accounts, 3-1. Gross Domestic Product), and for years 2000-2005, The US-China Business Council, "PRC Economic Statistics," <http://www.uschina.org/statistics/economy.html>

The reform process of China since 1978 also influenced the relationship between the state and the economy. Diversification of the ownership system and greater autonomy for enterprises in the public sector enhanced the balance of power between state economic organs and other productive units including enterprises, households and firms, the phenomenon which White argues to have triggered the rise of a 'second economy' which gave these productive units right to ownership (White, 1993, 73-75). However one should notice that state still kept full control in regards to certain major issues such as investment projects, key raw materials and energy inputs (White, 1993, 74).

State regulation was the key word to indicate such a huge success in China's developmental history. Apart from the banking system of China as examined above in regards to the financial reform process which gave de facto control to the hands of the state, China's legislation provides state with various means to initiate and control, especially in regards to the foreign trade. The Foreign Trade Law of People's Republic of China clearly states in Chapter Three:⁴²

Article 18 The authority responsible for foreign trade and economic relations under the State Council shall, in collaboration with the relevant authorities under the State Council and in accordance with the provision of Article 16, Article 17⁴³ of this Law, formulate, adjust and publish the list of goods and technologies whose import or export are subject to restrictions or prohibitions.

Upon the approval of the State Council the authority responsible for foreign trade and economic relations under the State Council may, within the framework of Article 16 and Article 17, independently or in

⁴² See Appendix 2.

⁴³ See Appendix 2.

collaboration with the relevant authorities under the State Council determine, on a temporary basis, to impose restriction or prohibition on the import or export of particular goods or technologies not included in the list mentioned in the preceding paragraph.⁴⁴

Turkey: Results of the Reform Policies since 1980s

As statistics reveal, Turkey did seem to have come close to achieving some of those goals in the first years as shown by the growth in exports and reduction in inflation, and most importantly the restoration of positive growth rates (Dogruel, 1994, 46). However it is very important to note that, in overall, as the growth rates of GNP indicates, the average annual growth rate only reached 4.61 percent, much below that achieved between the years 1963 and 1977 when it reached 6.9 percent (Dogruel, 1994, 46).

⁴⁴ <http://www.chinatoday.com/law/a07.htm>

Turkey

Turkey's Foreign Trade (\$ millions)

Year	Total	Exports	Imports	Balance
1970	1537	589	948	-359
1980	10819	2,910	7,909	-4999
1983	14963	5,728	9,235	-3507
1984	17891	7,134	10,757	-3443
1985	19301	7,958	11,343	-3385
1986	18562	7,457	11,105	-3648
1987	24348	10,190	14,158	-3968
1988	25997	11,662	14,335	-2673
1989	27417	11,625	15,792	-4167
1990	35261	12,959	22,302	-9343
1991	34641	13,594	21,047	-7453
1992	37586	14,715	22,871	-8156
1993	44773	15,345	29,428	-14083
1994	41379	18,109	23,270	-5161
1995	57345	21,636	35,709	-14073
1996	66852	23,225	43,627	-20402
1997	74820	26,261	48,559	-22298
1998	72894	26,973	45,921	-18948
1999	67259	26,588	40,671	-14083
2000	82278	27,775	54,503	-26728
2001	71744	31,334	40,410	-9076
2002	86205	36,059	50,146	-14087
2003	113995	47,253	66,742	-19489
2004	157163	63,121	94,042	-30921

Source: SPO

Turkey

Turkey's GDP and GDP per capita (billion TL)

Year	1980	1981	1982	1983	1984	1985	1986	1987
GDP	5.231	7.901	10.492	13.906	21.997	35.095	51.079	74.722
GDP per capita	116.9	176.6	234.5	310.8	491.6	692.6	1008.1	1474.8
Year	1988	1989	1990	1991	1992	1993	1994	1995
GDP	129.223	227.325	393.060	630.117	1.093.368	1.981.867	3.868.429	7.762.456
GDP per capita	2550.5	4486.8	6960.1	11578.5	19360.8	35094.0	68500.4	125699.6
Year	1996	1997	1998	1999	2000	2001	2002	2003
GDP	14.772.110	28.835.883	52.224.945	77.415.272	124.583.458	178.412.439	277.574.057	359.762.926
GDP per capita	239208.9	466947.6	845693.3	1253607.4	1836297.9	2629710.2	4091303.0	5302725.9

Source: Selected Data from Turkish Treasury

Even for the growth that Turkey did achieve, it is worth noted that it is the role of the government that de facto contributed the most. As Cecen and Dogruel argue, it was the government strategy to reduce the public consumption and increase the public investment that enabled the economy to perform strong growth (Dogruel, 1994, 48). On the contrary, the stabilization and liberalization policies have brought various negative impacts to the economy especially in terms of income distribution (Dogruel, 1994, 51).⁴⁵ It is often argued that the inequality in Turkish society owes to the embedded dilemma of globalization process *per se*, that the pressure for further populist redistribution has been clashing with the neoliberal goals of integrating into the global economy and achieve high growth rate (Onis, 2000, 4).

⁴⁵ From 1978 to 1988, the share of wages and salaries declined from 35.19 percent to 14.00 percent (Dogruel, 1994, 51).

Turkey's reform policies did help Turkey integrate into the world economy. However did such integration allow Turkey to achieve its primary goal of economic development? The answer is quite negative. Especially after the capital account liberalization, the growth rate of Turkey has been growing in volatile and unstable manner, as we would be examining in the later part. As summarized by the Central Bank of Turkey, major features of Turkish economic policy environment in the 1980s were "volatile growth rates, high public sector deficits, a chronically high and persistent inflation, a deteriorating income distribution, a poorly regulated financial system, and high expectations and confidence in the immediate and positive impacts of the direct implementation of free market policies." (Central Bank of Turkey, 2002, 53)

4.8 Comparison: Turkey versus China during the Reform Era

Turkey was open to the external influence as a consequence of her early interaction with the international society, whereas China remained closed, thus refraining itself from any interaction with the outside world, at least during their initial phase of reform. Several reasons rendered Turkey to so closely interact with the international system since 1980. First, in 1980 Turkey emerged as the test-case for the World Bank-IMF joint programme. Second, Turkey was part of the NATO alliance and was of strategic importance to the West in regards to its proximity to then Soviet Union. Such factor has led Turkey to follow the path of West, or at least more easily influenced by them.

The five structural adjustment loans (SALs) that Turkey received from the World Bank became the stepping stones for Turkey's future economic path. However it seemed that Ozal and his government was the one leading the economy,

there consistently was World Bank in the background. The direct influence of World Bank and the international financial community seemed to have come to an end by the end of 1984, when the institutional limit of five SALs was reached. However the indirect control of these external institutions still remained since 1984.

China on the contrary remained relatively closed, still implementing restrictive policies on imports and foreign capitals. As the very nature of Socialist Market Economy implies, state still holds a high degree of autonomy in both designing and implementing economic policies. It is evident from the fact that “in China 90 per cent of industrial capital is in state hands, and most land is still collectively owned.” (Hirst and Thompson, 1999, 156) The similar case could be seen in both the enterprises in China mostly of which still remain state-enterprises, and in the equity market where two-thirds of the equity in 1,377 listed companies in China are owned by the state (The NYT, “Beijing rules out any role in reforming market,” May 22, 2005). The role of government has been compared to that of a “parent,” with the ability to combine the roles of government and enterprises, managing the economy of the country in a uniform and unified planned manner (Gao, 2003, 39).

An explanation from the political dimension is worth noted here. Ziya Onis owes it to the very nature of democratic politics.⁴⁶ Countries of late-industrializing, such as Turkey, typically are “in the process of establishing, reestablishing, and consolidating their democratic regimes” and “the nature of democratic politics in such countries is generally fragile” usually reflected through fragmented party system and “a strong legacy of “populism.”” In such a system, politicians tend to adopt relatively short time horizons due to obstacles posed by the fragile and

⁴⁶ For details see Ziya Onis, 1998. *State and Market*. Istanbul: Bogazici Universitesi, 514.

fragmented party system.⁴⁷ In this short time horizon, it is likely that the type of capital politicians utilize is usually “short-term financial capital of a speculative nature motivated primarily by interest rate differentials.” Given the nature of such capital, or hot-money, any economy built upon such weak and unstable basis is doomed to break down.

What probably might be the most important departure from each other between the case of Turkey and China would be in the attitude with regard to financial liberalization. Turkey’s adoption of structural program in 1980 and the following attempt to liberalize its economy throughout 1980s involved capital account liberalization which started in 1983 and which by 1989 reached its climax with extremely liberal capital accounts regime. China however, always kept its financial market closed though actively participating in other economic activities, at least until today. One might say the major reason behind such difference lies in their politics based on different ideological regime. However more could be attributed to such phenomena.

The nineteenth-century economist Friedrich List warned in 1841, “the result of general free trade would not be a universal republic, but, on the contrary, a universal subjection of the less advanced nations to the supremacy of the predominant manufacturing, commercial, and naval power...”⁴⁸ Reckless opening to the global economy is too risky especially when considering the volatile and

⁴⁷ Gunduz Aktan makes the similar argument that a country adopting democracy at a stage when its economy has not achieved its full development has the risk of basing its political competence on the legacy of populism (Gunduz Aktan, “Turkiye’ nin Gelecegi (3).” 05 July, 2005. Radikal Gazetesi.). He warns Turkey that if the notion of “development within democracy” is not being separated from the notion of populism, (which unfortunately has been the case of Turkey since post war period, author) then the firm solution to today’s economic problems would not be possible (*ibid.*)

⁴⁸ Friedrich List, *The National System of Political Economy* (Sampson S. Lloyd trans., August M. Kelley Publishers 1966), originally published in 1841, in Eisuke Suzuki.2001. “The Fallacy of Globalism and the Protection of National Economies,” *The Yale Journal of International Law* 26(2):319-322.

speculative characteristics of global financial flow.⁴⁹ For “future national economy” to succeed, some kind of supportive measures should be ready before adopting global financial policy, both at the domestic and global level (Suzuki, 2001, 322). Or else, as the cases of Turkey in the earlier period and China in the later period show, once accessed to the global capital movement, any power of governments to command and regulate also begins to diminish.

Could countries choose on their own which type of capital they will attract? According to some scholars, yes, and this explains the reason why China was able to choose the different path from that of Turkey. Whether a country would utilize short-term capital (that contains the potential to generate huge economic crises) or long-term capital (usually in the form of foreign direct investment which is argued to be of most benefit to economic growth) depends on “the type of policies or strategies adopted by the nation state” (Onis, 1998, 515). The live example of such a statement could be China who refused to adopt the international norm of the period regarding financial market but kept implementing its own policies to attract foreign direct investment.

⁴⁹ The volatility of the global financial capital could be seen clearly from the fact that while the private capital flows into emerging markets peaked \$213 billion in 1996, it suddenly collapsed to \$60 billion in 1998 (A Council on Foreign Relations Task Force. 1999. “The Future of the International Financial Architecture,” *Foreign Affairs* 78(6): 174).

CHAPTER 5

CONCLUSION

To know the road ahead, ask those coming back.
--- Ancient Chinese Proverb

In the beginning, the two countries did start with two different socio-economic and political systems. China with its one party rule adhered to the socialist Marxist-Maoist system and Turkey with its capitalist and liberal socio-economic pattern, however, have joined the process of globalization almost simultaneously since late 1970s (in the case of China) and early 1980s (in the case of Turkey). With principles of globalization spreading at its full speed, the pressures the two countries had to receive were in resemblance to each others. Both had to cope with whether or not, or how to adopt the principles of neoliberalization, the most undeniable fundamentals that make up the process of globalization *per se*. With the aim of achieving development from the underdeveloped situation, both responded with launching reform policies, considering the risks and opportunities embedded in the process.

However, the way how they did it differed, China mainly relying on the power of state and Turkey on that of market. Especially in regards to their different

attitudes toward financial liberalization, rather closed China was able to make further progress, blocked from various financial crises that Turkey had to face as a result of full liberalization. Could such difference as a result of different strategies to common external threat and opportunities continue? In other words, will China continue to exhibit its success once achieved as a result of different strategies to that Turkey, when considering that the history today is experiencing weakening of China's stance against financial liberalization?

China is growing not only faster enough but also well enough in quality to leave the once-dragons-of-Asia behind. However the international stage in which China is performing now is not the same as the one in two decades ago, when the revival of globalization (or the second age of globalization) began to show its real face. International push to liberalize financial market is becoming stronger than ever, especially since China's joining of WTO in 2001. The United States has been continuously pushing China to shift its exchange rate to a floating one. This not only means that China must slow its growth to avoid an inflationary boom-and-bust cycle, but it also means that it needs to create jobs for hundreds of millions of people (International Herald Tribune, January 25, 2005). This, however, is not the only aspect of current Chinese reform policies that lead to a negative speculation on Chinese future.

The basic idea behind Deng's socialist market system was 'to let the economy grow but politics stay.' Until today the idea was accepted and implemented without any serious hurdles, since economy was always under political control. However as the process of globalization proceeds, or in different terms, as the push from U.S. and international financial institutions such as IMF on China to open its financial market gets stronger, the consequence would be the reversal of the

previous system. Economy would no longer be controllable! How could an economy no longer controllable continue in the name of ‘socialist market system?’ Having lost its guiding map, further growth would not be possible, especially under a system of no title.

The other possible reason that leads to the negative speculation of Chinese future growth would be the possibility of political uprising due to increasing inequality and corruption as the result of lost balance between ‘liberal economy’ and ‘conservative politics’. Further financial liberalization would result in a more uncontrollable economy, which in turn would lead to a more vulnerable economic system. The issue of the possible political uprising has gained its importance especially with the death of Zhao Zhi Yang in January 17, 2005, the former Communist Party leader who supported students during the 1989 pro-democracy Tiananmen Square protests and strongly advocated liberal economic reforms. This very recent incident has become the reminder to the public of the Tiananmen incident. As Philip Bowring argues in International Herald Tribune, January 18, 2005, although China’s economy is growing at a rapid rate, the leadership should notice that several of the conditions that led to Tiananmen are present today—corruption, inflation and increasing public disturbances that follow. In a more general sense, no development strategies would succeed in this system of globalization if designed from the old point of view. It is high time to urgently seek alternative ways of development strategy.

The example of Turkey proves the fact that capital account liberalization generates vulnerability in the economies under process of development. The underlying characteristics of capital account liberalization such as unstable exchange rates and interest rates narrow planning horizons of policy makers, as was the case of

Turkey, thus lead to boom and bust cycles in the economy making it dependent on foreign financing based on short-term capital (Central Bank, 2002, 56).

As was the case of Turkey, globalization also tends to restrict the state's ability to render welfare provision for the citizens, resulting in an increase in dissatisfaction and lack of trust in politics among its citizens (Onis, 2000, 9). It is the general expectation that the state conducts its task of guaranteeing social rights of its citizens especially in the given condition of unstable and speculative economic environment. Undoubtedly the discontent is to continue in the future.

When examining the pre-reform era of Turkey during the 1960s and 1970s, it was the domestic demand-based state initiation that became the major source of growth. Though returning back to such a system might be impossible, if not irrational, however, more efficient long-term plans through designing necessary internal adjustment could be made when taking these "repercussions of external economic conditions" in mind (Dogruel, 1994, 52).

Examining the experiments of the reform efforts of developing countries, two of which has been done in this work of mine, accentuates the important role of state in designing and implementing policies to deal with ever stronger push toward market-based economies. In other words, the key factor that causes *de facto* difference is the role of national policy options. As Hirst and Thompson indicate, the major side-effects to liberalization of economy especially in financial sector could be prevented through "active macroeconomic management and prudential domestic financial regulation" (Hirst and Thompson, 1999, 154). And from this point of view, it was China's "suspicion in the market forces" that gave power to the state not to the market. It was this centralization of power that facilitated major changes to the economy once the leaders recognized the necessity for reform (Perkins, 1988, 626).

“Globalization is an inherently inequalitarian process” generating a group of losers and winners simultaneously (Onis, 2000, 9). That free-market oriented globalization process seems to bring hazards to the economies of developing countries especially through means of financial liberalization does not mean that we should deny the process and start closing their economies from each other. As Moises Naim indicates, the solution to prevent reforming economies from powerful international shocks lies neither in the whole new “global financial architecture” nor in the isolation of the economy through implementing quasi-protectionist obstacles to trade and investment flows (Naim, 2000, 5 of 10). The solution rather lies in designing and strengthening a set of institutions and policies that could absorb such shocks internally, with the help of strong and efficient public sector (Naim, 2000, 7 of 10). It is important to keep in mind that such policies only could success when the uniqueness of each country is taken into consideration.

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APPENDIX A

The sources of growth of China as divided in the two phases as Reform

Phase One (1979-1984) and Reform Phase Two (1984-1989) in the text:

Sources of Growth in China

	Agriculture	Industry	
		State	Collective
1978-84			
Sector growth	8.0	8.49	14.03
TFP*	5.9	3.45	5.2
1984-88			
Sector growth	4.0	10.22	19.86
TFP	3.0	3.01	5.86

Source: (Jefferson, 1992 in Yusuf, 1994, 13??)⁵⁰

* indicates Total Factor Productivity

⁵⁰ Gary H. Jefferson, Tom G. Rawski, and Yuxin X. Zheng, "Growth, Efficiency and Convergence in China's State and Collective Industry," Economic Development and Cultural Change, January 1992, 40:2, 239-66 in Shahid Yusuf, "China's Macroeconomic Performance and Management during Transition," Journal of Economic Perspectives, Spring 1994, 8:2, 71-93.

APPENDIX B

Foreign Trade Law of the People's Republic of China (Adopted at the Seventh Session of the Standing Committee of the Eighth National People's Congress on May 12, 1994)

Chapter III Import and Export of Goods and Technologies

Article 15 The State allows free import and export of goods and technologies except where laws or administrative regulations provided otherwise.

Article 16 The State may impose restrictions on the import or export of goods and technologies in any of the following circumstances:

1. where the import or export shall be restricted in order to safeguard the national security or public interest;
2. where the export shall be restricted on account of domestic shortage in supply or effective protection of exhaustible domestic resources;
3. where the export shall be restricted due to the limited market capacity of the importing country or region;
4. where the import shall be restricted in order to establish or accelerate the establishment of a particular domestic industry;
5. where the restriction on the import of agricultural, animal husbandry or fishery products in any form is necessary;
6. where the import shall be restricted in order to maintain the State's international financial status and the balance of international payments;
7. where, as the international treaties or agreements to which the People's Republic

of China is a contracting party or a participating party require, the import or export shall be restricted.

Article 17 The States prohibits the import or export of any goods or technologies in any of the following circumstances;

1. where such goods or technologies will endanger national security or public interest;
2. where the import or export of such goods or technologies must be prohibited in order to protect human life or health;
3. where such goods or technologies will disrupt the ecological environment;
4. where the import or export of such goods or technologies shall be prohibited in accordance with the provisions of international treaties or agreements to which the People's Republic of China is a contracting party or a participating party.

Article 18 The authority responsible for foreign trade and economic relations under the State Council shall, in collaboration with the relevant authorities under the State Council and in accordance with the provision of Article 16, Article 17 of this Law, formulate, adjust and publish the list of goods and technologies whose import or export are subject to restrictions or prohibitions.

Upon the approval of the State Council the authority responsible for foreign trade and economic relations under the State Council may, within the framework of Article 16 and Article 17, independently or in collaboration with the relevant authorities under the State Council determine, on a temporary basis, to impose restriction or prohibition on the import or export of particular goods or technologies not included in the list mentioned in the preceding paragraph.

Article 19 Goods whose import or export is restricted shall be subject to quota and /or licensing control; technologies whose import or export is restricted shall be subject to licensing control.

Import or export of any goods and technologies subject to quota and /or licensing control will be effected only with the approval of the authority responsible for foreign trade and economic relations under the State Council or the joint approval of the preceding authorities and other authorities concerned under the State Council in compliance with the provisions of the State Council.

Article 20 Import and export quotas of goods shall be distributed on the basis of the conditions including but not limited to the actual import or export performance and capability of the applicants in foreign trade dealings and on the basis of the principles of efficiency, impartiality, transparency and fair competition by the authority responsible for foreign trade and economic relations under the State Council or the relevant authorities under the State Council within their respective responsibilities. The ways and means of the distribution of quotas are to be regulated by the State Council.

Article 21 Where the import or export of goods, articles such as cultural relics, wildlife animals, plants and the products there of are prohibited or restricted by other laws or administrative regulations, the provisions of the laws and regulations in question shall be observed.