

Report on Faculty Seminar in Turkey

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I would like to start my report by expressing my enthusiasm about the faculty seminar. The opportunities provided by this program was one of the reasons that made me choose the University of Richmond over other offers. I had great expectations about the seminar and I am glad to report that this experience was above and beyond what I imagined. This program provides a unique experience for the teacher and scholar of Comparative Economic Systems. The possibility of learning by direct observation the specifics of a country that I am discussing in the classroom is invaluable. In this report I would like to share with you my personal experience during the seminar and convey a sample of the knowledge I accumulated in Turkey.

During the seminar I had the chance to speak with Turkish scholars in economics and related fields, to attend to an informative presentation at the Ministry of Defense and see places that could help me understand the development of Turkey and by induction of the Middle-Eastern region. My discussion with one of the faculty at the Sabanci University revealed a conference on the economic systems that I was not aware. This conference was co-organized by Sabanci University in Turkey two weeks after the seminar was over. Dr. Pinar Bilgin facilitated my attendance to this conference where I met some of the leading scholars in the field.

One of the questions of great interest to a teacher and scholar of Comparative Economic Systems is the cohabitation of the Western economic organization and socio-economic values with the various traditional organization. Many scholars argue that globalization will lead to a convergence of economic and political systems toward a Western model, perhaps the Anglo-American system. Turkey provided a great case study for the assimilation and struggle among the Western influence, Islamic values and the traditional form of economy, such as the bazaar economy. I will explain my impressions on this topic into more details below.

At the same time, as a junior faculty at the end of my first year, this was a great chance to meet my colleagues from other departments. If you ask me how this interaction helped my professional development, I would answer to you by describing my wonderful

experience. I had delightful discussions on the various causes of the decline of the British Empire with my colleague John Gordon. The perspective of a seasoned historian on this issue brought up some insights that did not occur to me even during the class discussions with my students. Sharing the same room with the director of the Writing Center was a lucky circumstance. I discussed with Joe Essid about the various ways in which the Writing Center can help my students improve their writing skills. During this seminar, I had the chance to observe and learn the acute investigative questioning of a journalist from my colleague Mike Spear. At the same time my experience was enriched by the perspectives of a philosopher and anthropologist over the development of economic and political systems. My discussions with Gary Saphiro enlarged my horizons by connecting the economic thinking advancements to the development of main ideologies throughout history. These few examples are just instances of the overall beneficial experience of interacting with and learning from my colleagues.

In the remaining section of the report I would like to present a few of my impressions on the Turkish economic system and the current economic performance of Turkey.

The cohabitation of Western, Islamic and traditional economy in Turkey

My interest in the differences among economic systems led me to investigate the ideology of Islamic economics and the degree to which features of Islamic economic principles are present in the economy of modern Turkey. The term Islamic economics was first introduced by the Pakistan social thinker Sayyid Abdul A'la Maududi in the late 1940s. It stands for the economic theory built on the teachings of the Koran and from the Islamic practice. The theory of Islamic economics has been practiced since Middle Ages throughout the Muslim world. Its values were spread out by the Islamic merchants throughout the world. Iran and Pakistan have even legislated that their economies should run based on principles of Islamic practice. In Egypt, Indonesia, Malaysia, Sudan and the Gulf Cooperation Council countries, features of Islamic economics coexist alongside with features of western and traditional economic system.

I was pleased to learn that the faculty seminar organizers had scheduled a meeting with two non-governmental organizations (NGOs) that were promoting Islamic values. I seized the opportunity to inquire these gentlemen about how a perfect Islamic society and economy would look like. I was interested in learning the main socio-economic values of Islam. There are three basic undisputed principles of Islamic economics which are derived directly from the teachings of the Koran. They are the prohibition of interests, an income transfer system from the rich to the poor (the *zakat* system) and the use of Islamic moral norms in business conduct (so-called “green business”). My understanding of their discussions was that there is some disagreement on the definition of private property and the role of state.

The prohibition of interest comes from the belief that lending is a riskless activity and it is immoral to earn money without risk taking. In this framework, profit is seen as legitimate since it is the payoff of the entrepreneur for risk taking. Lending can be allowed, however, in the form of financing with profit sharing as a reward. This can be justified on the grounds that the lender is actively involved in risk sharing. At first look there is an apparent contradiction between the rejection of interest and the so-called “rewards to the lender”. The profit sharing seems to be the same as the interest in the Western economies. In my opinion the main distinction comes from the perception of the degree of risk associated with lending. In Islamic economics profit sharing is not the same as interest because the lender is exposed to downside risk to the same degree as the entrepreneur. In Western economies the lender can earn interest even in the case of a failed project in the form of the execution of collateral or in some cases of personal assets. This however, is not the case in all situations. In modern banking theory, a bank is seen as a firm specialized in information about the various business risks. This does not assume that banks are not exposed to the risk facing the entrepreneurs but that they can neutralize risk by hedging. Using the same reasoning, the concept of interest on deposits is replaced with the “profit sharing” on deposits.

In Turkey, Islamic banks coexist with Western-style banks. My research led me to believe that depositors earn the same interest rates on deposits in the two types of banks.

Because of lack of data it was impossible to determine the revenues from loans in Turkey. However, I would dare to say that in practice, Islamic banking has proved to be flexible and has created financial instruments that allow profitable banking operations without calling the proceeds interest.

The second feature of the Islamic economics, the *zakat* system accumulates funds from wealthy donors or taxpayers in some countries to redistribute income to the poor. The *zakat* system applies both to businesses and individuals. Although this is not the main income redistribution system in Turkey, casual observation leads me to believe that this form of income redistribution is not as efficient as the welfare systems of Western Europe. This however, can be a result of the different levels of economic development. In other words, we cannot directly compare the sizes of the slices of economic pie of the two economic systems. When the economic pie is smaller, not only the slice will be smaller in absolute terms but it will be smaller in relative terms due to different priorities at that stage of development.

The third feature is the substitution of Islamic business ethics for capitalist business practices. Islam encourages profit making as a sign of successful entrepreneurship and creation of additional wealth. However, the speakers of the Islamic NGOs pointed out that the profits need to be “reasonable”. In achieving this goal, businesses should charge fair prices, provide accurate information and not engage in fraud or deceit. My understanding is that the methodology of profit determination in Islamic economics is cost mark-up. Firms would add up a margin over the cost to determine the price. I asked the speakers what would be a “reasonable” profit rate or mark-up. The answer was ten percent, although this rate may be just a personal opinion of the speaker.

The second major ideological feature of the Turkish economy that caught my attention was the concept of “bazaar economy”. My interest arose from a visit to the Grand Bazaar in Istanbul. Although we cannot label the Turkish economy as a bazaar economy, the coexistence of this form of exchange alongside with the traditional

Western-style stores and malls in Turkey raised some questions in my mind. Given that these stores sell seemingly identical products and face intense competition from many alike stores, how can they survive? How can they afford the high rent of a prime location such as the Grand Bazaar? Is it high margins on a few products sold? Is it the cultivation of a loyal clientele?

Before I start the analysis of the bazaar economy I would like to provide a short description of it. As you enter the Grand Bazaar you are approached by a store owner. The products seem identical but prices seem to be flexible and fluid. The merchants give the impression of experts on the product they sell and the sale becomes a personalized experience. Exchange skills are very elaborately developed, and are the primary determinant of who prospers in the bazaar and who does not. Trading involves a continual search for specific partners, not the mere offers of goods to the general public. In the absence of price quotations, the consumer can maximize his/her welfare only by being a shrewd negotiator. To summarize, the features of the “bazaar economy” are (1) high measurement costs to consumers since they are not specialized in determining the quality-price trade-off of the product, (2) continuous efforts at clientization and (3) intense bargaining at every margin. The store owner makes money by having better information than the buyer. In essence the name of the game is to raise the cost of information to the buyer so the consumer not knowing what the true (“fair”) price is will receive satisfaction from the apparent bargain obtained as a result of the negotiation.

Although this form of exchange may give pleasure to a tourist interested in the cultural experience, I believe that it is an inefficient form of exchange. The information asymmetry between the buyer and seller raise the transaction cost of exchange and therefore limit the amount of goods exchanged. One would anticipate that these types of exchanges will become obsolete and disappear in time. A modern market economy would provide some organization (firms) that will standardize quality and prices to build a brand reputation. Another option would be the creation of organizations to insure against the risks of information asymmetry. The question is if Turkey provides the institutional framework to make these organizations economically viable. Is the enforcement of

contracts through the court system sufficiently strong to allow these types of organizations to arise and prosper? These are questions still open for research.

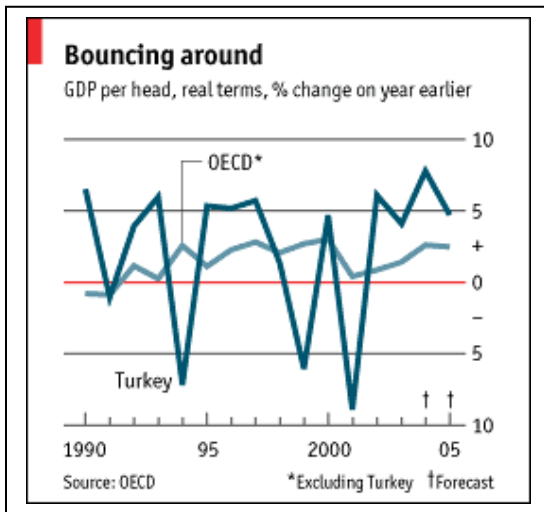
Recent economic performance of the Turkish economy¹

Turkey established an industrial base through state intervention and import protection in the post-war period. After the crises of the 1970s Turkey opted for an open economy. Liberalization of the domestic economy also began, but it remains mixed. Despite some privatization, infrastructure, utilities, many basic industries, some food-processing industries and about 30% of the banking sector are still owned by the state. Under pressure from the European Union, the International Monetary Fund and the World Bank, privatization and liberalization has begun or is imminent in most of these areas. Today, Turkey is at a crossroads. After hitting the most severe crisis of its recent history in 2000-2001, the economy bounced back and is now among the fastest growing economies in the OECD.

Turkish Economy for period 2000 – 2003. Comparisons with relevant countries.

| | Turkey | | | | Germany | Greece | Russia | Egypt |
|-----------------------------------|--------|-------|-------|-------|---------|--------|--------|--------|
| | 2000 | 2001 | 2002 | 2003 | 2003 | 2003 | 2003 | 2003 |
| GDP per head (\$ at PPP) | 6,668 | 6,220 | 6,713 | 7,050 | 27,060 | 18,730 | 8,350 | 3,710 |
| GDP (% real change pa) | 7.36 | -7.5 | 7.78 | 5 | -0.1 | 4.7 | 7.33 | 1.8 |
| Government consumption (% of GDP) | 14.08 | 14.24 | 14.03 | 12.8 | 19.7 | 15.6 | 16.89 | 11.49 |
| Budget balance (% of GDP) | - | -19.6 | - | -10.4 | -4 | -1.5 | 1.63 | -6.2 |
| Consumer prices (% change pa; av) | 54.92 | 54.4 | 44.96 | 25.3 | 1.07 | 3.6 | 13.63 | 4.3 |
| Public debt (% of GDP) | 51.19 | 99.88 | 86.33 | 74.4 | 63.9 | 101 | 34.8 | 101.81 |
| Labor costs per hour (USD) | 1.55 | 1.22 | 1.44 | 1.81 | 30.86 | 11.23 | 1 | 0.55 |
| Recorded unemployment (%) | 6.6 | 8.53 | 10.35 | 10.65 | 10.5 | 7.9 | 8.47 | 9.9 |
| Current-account balance/GDP | -4.93 | 2.33 | -0.81 | -2.4 | 1.7 | -6.8 | 9.02 | 5.1 |

¹ Sources: direct observation and data from The Economist



Structure of the economy - manufacturing & services are the major economic sectors:

- Industry accounts for about 25% of GDP and just under 20% of employment. Industry is dominated by the manufacturing industry; the private manufacture of consumer goods—led by textiles and clothing, motor vehicles and consumer electronics.

- Construction contributed 5-6% of GDP in 1995-2001, down from 6-8% of GDP in the late 1980s and early 1990s. In 2002 the share of construction in GDP fell further to just over 4%.
- The share of agriculture in GDP declined steadily since 1960s. In 2001 and 2002, agriculture contributed only 12% of GDP. It accounts for about 1/4 of male employment and 60% of female employment

Four regions dominate industry and business

- The Marmara region, including Istanbul, Izmit and Bursa, in north-west Turkey, accounts for about 1/3 of GDP.
- The regions centring on Izmir in the west, the Adana-Mersin-Iskenderun triangle in the south and the capital, Ankara, are also significant areas of industrial and other business development.
- Outside these areas there are few large private-sector operations. However, several cities within relatively easy reach of these areas (for example, Denizli, Konya, Kayseri and Gaziantep near the Syrian border) have attracted significant investment in sectors such as textiles, food-processing and furniture. The lecture we attended at

the university in Denizli described the recent developments of the textile industry in the province of Denizli. The recent economic growth in the Denizli region was presented as the “economic miracle” of the region. However, considering that the growth of industrial production was coming mainly from the textile industry and the increasing competition from China, one can only wonder how sustainable such an “economic miracle” can be in the long run.

- The south and west enjoy the lion’s share of income from both tourism and agriculture. Antalya, on the south coast, is the leading tourist destination.

Foreign trade:

| Major exports 2003 | % of total | Major imports 2003 | % of total |
|-----------------------------|-------------------|-------------------------------|-------------------|
| Clothing&textiles | 30.4 | Machinery, appliances&parts | 22.8 |
| Road vehicles | 11.2 | Petroleum products | 16.6 |
| Electrical machinery | 7.4 | Iron&steel products | 6.8 |
| Iron&steel | 6.2 | Road vehicles | 7.8 |
| Fruits&vegetables | 3.9 | Plastics&products | 4.7 |
| Leading markets 2003 | % of total | Leading suppliers 2003 | % of total |
| Germany | 15.9 | Germany | 13.7 |
| US | 8.0 | Italy | 7.9 |
| UK | 7.8 | Russia | 7.9 |
| Italy | 6.8 | France | 6.0 |
| France | 6.0 | US | 5.0 |
| EU | 51.9 | EU | 45.8 |

SWOT Analysis of Turkish economy

| <i>Strengths</i> | <i>Weaknesses</i> |
|---|---|
| <ul style="list-style-type: none">- unprecedented political and economic stability that Turkey has enjoyed since PM Erdogan came to power in November 2002, after a decade of fractious coalition rule- GDP grew by 8% in 2004. Inflation was down to single digits (just over 9%) for the first time in 30 years.- The banking system, almost bust in 2001, has been restructured with a huge injection of public funds- on January 1st Turkey introduced a new lira, dropping six zeros from the old one- reached agreement with the IMF on a new three-year, \$10 billion economic program- In 2004 its budget achieved a primary surplus (before interest payments) of 6.5% of GDP | <ul style="list-style-type: none">- dodging taxes is a national sport- huge black economy—between 30% and 50% of GDP- The current-account deficit is 5% of GDP in 2004- Economic growth has not been historically consistent. Throughout the 1990s growth oscillated like an electrocardiogram recording a violent heart attack- Corruption, economic instability – Turkey has failed dismally to attract much-needed foreign direct investment. Its stock of such investment (as a percentage of GDP) is lower now than it was in the 1980s, and annual inflows have scarcely ever reached \$1 billion (whereas Ireland attracted over \$25 billion in 2003, as did Brazil in every year from 1998 to 2000). |
| <i>Opportunities</i> | <i>Threats</i> |
| <ul style="list-style-type: none">- overhauling the tax system is a top priority- budget surplus of 6.5% of GDP can help shrinking the foreign debt burden- income redistribution. The gap between the country's rich and poor is vast. Istanbul and Ankara alone account for about 30% of GDP. In the richest regions of the country, GDP per person is nearly six times what it is in the poorest—the region round the cities of Kars and Agri, towards Mount Ararat and the Iranian border. | <ul style="list-style-type: none">- The government's large debt, amounting to some 74% of GDP, most of it short-term and in foreign currency- High unemployment. The official rate of 10% is widely acknowledged to be unrealistically low. There is considerable underemployment in farming, for example. Unemployment among Kurdish migrants in Diyarbakir is as high as 60%, says the city's mayor. As the OECD puts it, "continuously high unemployment could undermine the social and political support for reforms." |