The Crisis Dynamics in the Developing Countries: The Case of Turkey

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Abstract

This paper discusses the dynamics and tendencies leading the developing countries to the economic crisis in the current situation. In the neoliberal era, the developing countries adopted tight monetary policies (together with inflation targeting) and fiscal discipline by following the instructions of the IMF and World Bank. Otherwise the international financial system would punish these countries. This challenge was especially critical for Turkey, which has been highly dependent on the international capital inflows. Relatively high interest rates facilitated capital inflows. In the presence of global excess liquidity, high interest rates were not disturbing for the manufacturing industry dependent on the cheap imports. However, in an environment where US interest rates are increasing and capital inflows to Turkey are stagnating, these two policies (tight monetary policies and fiscal discipline) have constituted the basic dynamics of the economic crisis. The pressures on monetary policy and fiscal policy arose as crucial dilemmas. On the one hand, relatively high interest rates are required to sustain capital inflows and control inflation, and on the other hand, the manufacturing and construction industries need lower interest rates to maintain their profitability. Under these circumstances, the government intervenes by giving several incentives, which may trigger a public finance crisis. This paves the way for the second dilemma: As the economic crisis intensifies the government needs to apply expansionary fiscal policies to deal with the crisis; however, this not only poses the risk of a public finance crisis but also may lead to capital outflows as a result of abandoning the fiscal discipline.

Keywords: Turkish economy, economic crisis, international capital flows, tight monetary policy, fiscal discipline

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