

HYMAN P. MINSKY’S “BIG GOVERNMENT” APPROACH IN SECURING ECONOMIC STABILITY AND ITS APPLICABILITY IN THE TURKISH ECONOMY



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ABSTRACT

The aim of this article is to discuss the applicability of Hyman P. Minsky’s “big government policy” proposal in the Turkish economy. According to Minsky, one of the main causes of economic cycles is the private sector’s decreasing investments and profits. The government is able to contribute to economic stability by reversing the decreasing investments and profits by means of big government policies. Turkish macroeconomic data verifies theoretical explanations of big government regarding total profits. Moreover, budget indicators show that the government can implement big government policies to secure financial and economic stability in Turkey.

Keywords: Big Government, Sectoral Financial Balances, Economic Stability

Jel codes: E42, E52, E58

Scope: Economics

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EKONOMİK İSTİKRARIN SAĞLANMASINDA HYMAN P. MINSKY’NİN BÜYÜK DEVLET YAKLAŞIMI VE TÜRKİYE EKONOMİSİ İÇİN UYGULANABİLİRLİĞİ



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ÖZ | Bu çalışmanın amacı Hyman Minsky’nin büyük devlet politika önerisinin Türkiye ekonomisi için geçerliliğini tartışmaktır. Hyman Minsky’ye göre, ekonomik dalgalanmaların temel nedenlerinden birisi özel kesim yatırımlarında ve karlarında meydana gelen düşüşlerdir. Büyük devlet uygulamalarıyla yatırımların ve karların düşüşü engellenebilir ve finansal ve ekonomik istikrar sağlanabilir. Türkiye ekonomisine ilişkin makroekonomik veriler büyük devletin toplam karlara ilişkin teorik açıklamalarını doğrulamaktadır. Ayrıca bütçe göstergeleri Türkiye’de finansal ve ekonomik istikrarın sağlanması için büyük devlet politikalarının uygulanabileceğini göstermektedir.

Anahtar Kelimeler: Büyük Devlet, Sektörel Finansal Dengeler, Ekonomik İstikrar

JEL Kodu: E42, E52, E58

Alanı: İktisat

Türü: Araştırma

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1. INTRODUCTION

The first huge crisis the capitalist system had ever encountered is the “Great Depression”, which was started in the US at the end of 1920s and brought about important consequences around the world. The Great Depression left millions of workers unemployed, caused a decrease in general prices and significant production losses. The policies proposed by Keynes, which are since called in the literature as demand-side macroeconomic policies, were applied to overcome the crisis. These policies involved the intensive use of fiscal policy to increase the aggregate demand in the economy. Public spending, transfer payments and taxes within the framework of fiscal policy would inevitably increase the share of the state in the economy. The involvement of the state in the economy in such a way is defined as “Big Government”.

Big Government implementations are seen in many countries under various forms and at different intensities from 1940s to 1980s. Such policies are replaced by many countries in the 1980s with the aim of restructuring economies in which the private sector plays a leading role. In parallel, the importance of fiscal policy has declined and monetary policy has become increasingly important in achieving economic stability. However, the increase in frequency of the occurrence of crises in the post-1980 era and monetary policy has become inadequate in preventing crises single-handedly. These policies were repeated during the 2007-2008 financial crisis; public spending and transfer payments were increased and taxes were decreased in many countries in order to recover decreasing aggregate demand.

In this study, theoretical information on the “Big Government” policy implementations, which constitutes an important part in Hyman P. Minsky’s studies, are given. Then, post-1980 period of the Turkish economy will be examined within this framework. In this context, the first two sections of the study give brief information on theoretical views of Minsky on the subject. Sectoral Financial Balances approach is introduced in the next chapter and current status of the Turkish economy is analyzed according to this approach. Lastly, policy recommendations for the Turkish economy are made in the light of Sectoral Financial Balances and Big Government approaches.

2. DEFINITION OF BIG GOVERNMENT?

The concept is Big Government is a product of the Great Depression experienced in the USA in 1930s. The Great Depression, which resulted in a hike in unemployment and sharp declines in production and general level of prices,

could only be eliminated by government interventions proposed by John Maynard Keynes. Share of the state in national incomes has increased due to increased public spending and transfer payments gradually and this increasing share gave way to the emergence of the concept of Big Government.

The gradual increase of the state in a capitalist system caused capitalist system to transform internally and resulted in development of different capitalist systems. In this respect, Minsky (1994, ss. 1-3) defines three main periods in the Twentieth Century capitalism. The first period, which approximately covers the first 30 years of the Twentieth Century, is the period in which the capitalist system based on the classical liberal thinking of the 1770s, emanating from the idea “*laissez faire, laissez passer*”, was failed. The second period is called as the “Golden Age of Capitalism”, and started in the 1940s and ended at the early 1970s. Big Government practices were quite intensive in the second period, and these were, in fact, the main reason in overcoming the Great Depression of the 1930s as already mentioned above. The third period is the neo-liberal period which was started at the late 1970s and continued into our day. The most successful period among these three is the second period in which Big Government policies proved that a capitalist economy involving the state is more successful than *laissez-faire* type capitalism. Practice of “Big Government” not only allowed the golden age of capitalism in the USA but also prevented another big depression at a time of recession in the 1970s and the early 1980s during which Keynesian policies were largely disfavored. While Big Government policies facilitated the stabilization of employment and income levels and cash flows (profits) of firms, the role of the FED as the ultimate lender has substantially provided for the liquidity need (Minsky, 2008, s. 17). The last period contains some failures in itself; however, a depression like the one experienced in the first period is not an issue¹. Being said that, recent developments are paving the way for financial instability.

Big Government can take various forms in practice. A militarist-capitalist structure that prioritize military spending, a social capitalist structure promoting transfer payments or a capitalist structure adopted improvement of resource utilization as its priority objective are all examples of Big Government practice. In this respect, the state should not necessarily take upon a producing role in order to talk about Big Government. A structure in which public spending and transfer payments are high but the state does not hold the ownership of means of production can also be called as Big Government. Hence, Big Government can be seen in the US more than any country despite the state is not involved in the markets as a producer. However, transfer payments, military spending and payments related to national debt increased the size of the public within the

economy and this resulted in the state being termed as the Big Government (Minsky, 2008, s. 22).

Another point that should not be forgotten at this point is that all practices which can be called as interventionist and Big Government should not be considered the same. Populist practices may improve the status of the state in the economy, as it is shown that a politically oppressive interventionist state practice, such as in Nazi Germany, could well improve the status of the state in the economy (Minsky, 1994, s.7).

3. WHY THE PRACTICE OF BIG GOVERNMENT IS NEEDED IN CAPITALIST ECONOMIES?

According to Minsky, capitalist system is inherently instable and the own dynamics of the system have the potential of creating a financial or economic crisis. Thus, the basic justification of the practice of Big Government is to prevent tendencies that can create instability in a system that continuously creates instabilities. According to Minsky (2008, s. 7), in contrast to what mainstream economists claimed, the economy does not have a natural and automatically-operating order. As a social institution, economy is established by the law or through continuous development of inventions and innovations. Implemented policies can cause changes in the details and general characteristics of the economy.

Aside from the self-provision of stability in a capitalist market economy that is distant to intervention, the functioning of the market itself can be the main source of instability. Therefore, the system must be observed continuously and the state must intervene whenever convenient. Minsky (2008, s. 324) lists the following reasons as to why Big Government or interventionist state is needed:

- *Market mechanism can be an effective control tool for a number of insignificant decisions. In contrast, it does not perform as expected in issues of efficiency, equity and stability. Thus, it fails the test in macroeconomic issues.*
- *Financial system and its smooth operation is very important in a capitalist economy. Complex and sophisticated nature of the financial system has the potential of creating serious instabilities and, thus, interventions and regulations are necessary.*
- *Market mechanism is instable and inadequate in economies which capital investments occupy an important place and are expensive.*

- *Financial resources will not be invested into large-scale, long-term capital assets in a capitalist economy. If such investments are wanted to be made via private sector, the firms that are undertaking these investments should be given legal monopoly or oligopoly status in order to protect them against market forces. If there are monopolies or oligopolies, the state's control of these firms is inevitable.*
- *Big Government capitalism is more stable than "small government" capitalism. This proposition is well-proved in the golden age of capitalism. The basic reason of the relative success of Big Government capitalism is that it is a significant balancing element against the decrease in profits. In order for Big Government practice not to result in inflation, the budget should be adjusted to give surplus when inflation occurs and profits should be taken under control.*

Microeconomic analyzes on investments and on finance of investments are essential parts of the financial instability analyzed within the macro framework of the Minskian approach. Money and monetary relations are important in contrast to mainstream economics and the effects of changes in the amount of money on the real economy are quite strong (Fazzari, 1999, s. 8).

Investment is, in fact, the exchange of today's money with the money to-be-obtained in the future. The money earned today is used for the purchase of capital goods. Purchased capital goods are used in the production process and such utilization of capital goods facilitates earning of more money in the future. In brief, investment depends on the current situation of financial conditions and expectations of business people and bankers on the amount of future profits (Minsky, 1989a, s. 5). The amount of investments in the economy and the level of expected returns on the investments, and the quality of financial relations in financing of these investments are the main indicators of financial and economic stability. Big Government should be present in the capitalist system because a decrease in profits due to economic problems following investments may result in a gradual decrease in investments and interruptions in debt servicing. Big Government policies to-be-implemented prevents decrease of profits and facilitates the repayment of debts borrowed for financing the investments. Under what circumstances profits decrease or increase in a capitalist economy? Minsky (1989a, ss. 3-4; 1992, ss. 23-24; 2008, ss. 160-169) puts forth a very clear answer to this question with the following equation:

$$(\pi_C + \pi_I + \pi_G + \pi_X) = I + Df - BTDf \quad (1)$$

According to the equation, profits in an economy increase if investments and budget deficit increase and trade deficit decreases. In contrast, decrease of investments and budget deficit and increase of trade deficit would decrease total profits. Thus, if investments are falling and trade deficit is rising in an economy, the government can run a budget deficit to prevent a decline in total profits. In such an environment where investments are decreasing and trade deficit is increasing, if the debt level of the private sector is quite high as well, repayment of the debts will be problematic and fragility and crisis will be inevitable consequences.

Level of total profits in the economy thus will be determined by investments, budget deficit and current account deficit. While an increase in current account deficit will result in a drop in profits, increases in investments and budget deficit will increase total profits.

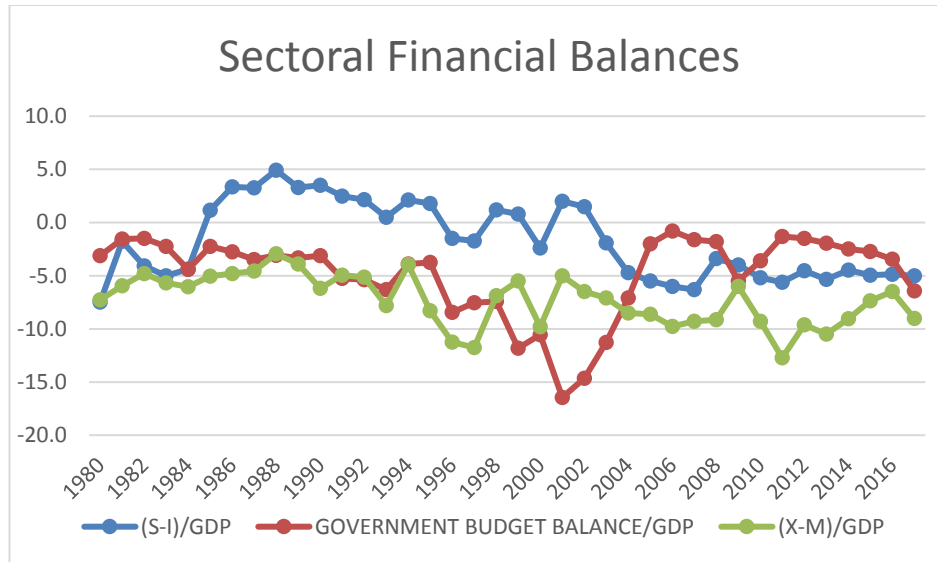
4. SECTORAL FINANCIAL BALANCES APPROACH AND BIG GOVERNMENT POLICIES FOR THE TURKISH ECONOMY

Capitalist system is unstable by its nature and the economy deteriorates during cyclical fluctuations, which in turn reflects negatively upon the level of welfare. Hence, Big Government policies become inevitable in order to prevent such losses in welfare and more damaging of the economy.

The analysis of current macroeconomic situation of the Turkish economy can be done by means of Sectoral Financial Balances Approach, and policy recommendations within the framework of Big Government approach for the solution of the problems of the Turkish economy can be formulated accordingly. Sectoral financial balances of the Turkish economy after 1980 are shown in Graph 1.

Looking at the government budget balance, it can be seen that the government started to run a budget deficit at the beginning of the 1980s. The budget deficit rapidly increased in the 1990s and reached to a peak in 2001, a year of severe crisis. The deficit started to decrease from 2002 onwards and dropped to the lowest level in 2006. The deficit began to rise again due to implementation of financial policies to curb the adverse effects of 2007-2008 global crisis on the Turkish economy and it reached to 5.5% of GDP in 2009. The budget deficit decreased again in 2010 and 2011 but this decrease was not sustained. The budget started to give a deficit again in 2012 and this deficit has increased significantly in the following three years. Contraction of the economy is one of the main

reasons of the budget deficit that Turkey has been experiencing in recent years. The government lowered such taxation items as value-added tax, private consumption tax etc. in order to prevent contraction in the economy and revitalize the market.



Graph 1. Sectoral Financial Balances.

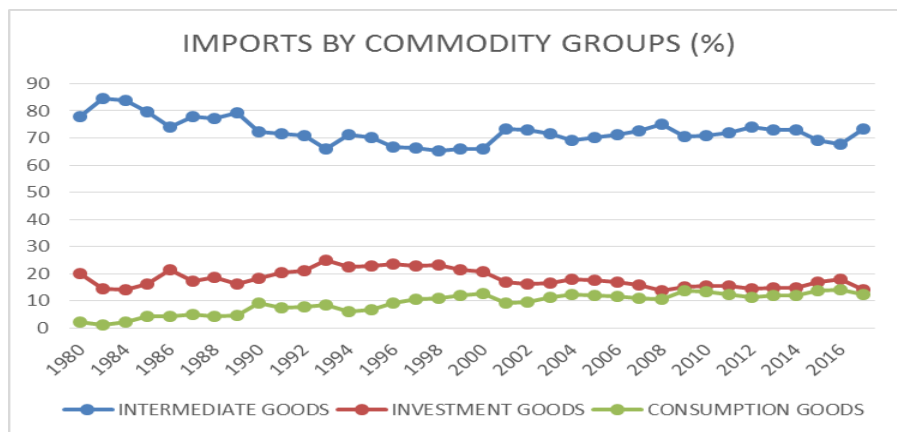
Sources: Presidency of the Republic of Turkey, Department of Strategy and Budget, <http://www.sbb.gov.tr/>
World Bank Database. www.worldbank.org

Savings-Investments (S-I) balance followed a course close to 0% level during years which the budget deficit is high. There is an improvement of S-I balance to positive numbers in years when budget deficit was increasing, however, it can also be seen that S-I balance deteriorates and rapidly moves to the negative area during years which the deficit is decreasing. Graph 1 shows that there is an inverse relationship between the budget deficit and S-I balance, which means that the budget deficit deteriorates Turkey's S-I balance.

Turkey has been running a trade deficit since 1980s. Such a state of the trade balance is a result of structural problems stemming from both imports and

exports. Looking at the exports side; there are no high value-added goods in exports from Turkey and the share of advanced technology products in total exports is very low. According to January 2019 records of the Turkish Statistical Institute the share of products containing high technology in all manufacturing industry products is 3% while the share of products containing medium technology is 35.1%. Competitiveness of Turkish products containing medium and high technology is low since there are a lot of countries producing the same products. Hence, Turkey should have to achieve a transition from low value-added, medium-technology products to high-technology, high value-added products in order to improve its competitiveness in the global market.

Imports present a different side to the trade balance problem. A great portion of the imports consists of intermediate goods. According to Turkish Statistical Institute data, the share of intermediate goods in total exports is approximately 70% in the post-1980 period, while the share of capital goods is about 20% and the share of consumption goods is 10% (Graph 2). Energy imports are also included in imports of intermediate goods and the share of energy imports in all imports of intermediate goods is 20-25%. However, even when energy imports are excluded, the imports of all other intermediate goods are still approximately 50% of the total imports. Therefore, this import structure implies an economy which is dependent on abroad in terms of energy and intermediate goods.

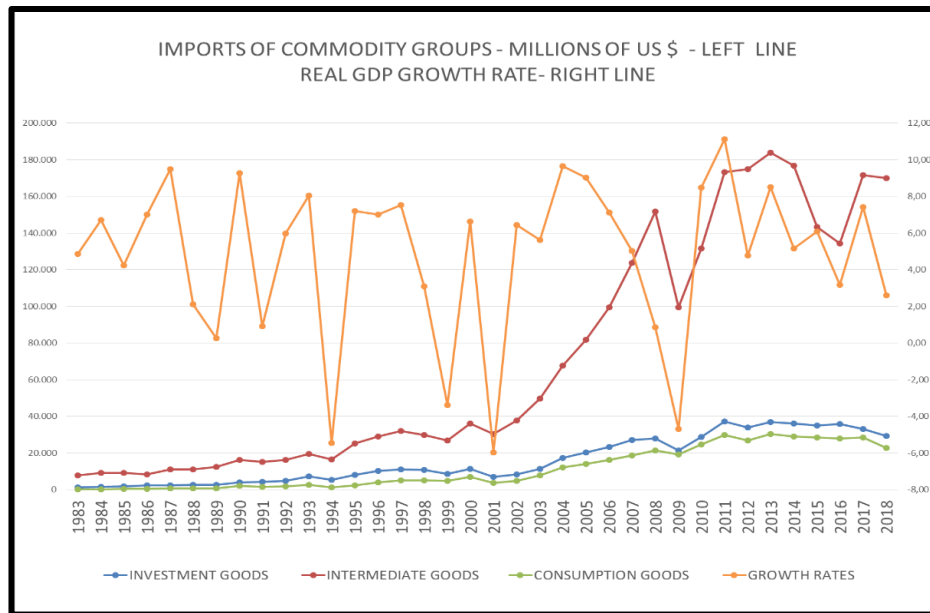


Graph 2. Imports by Commodity Groups (%).

Source: Turkish Statistical Institute, www.turkstat.gov.tr

Graph 3 shows imports by commodity groups and growth rates. As it can

be seen clearly from Graph 3, there are no significant increases in imports of intermediate goods until the beginning of 2000s and there is a very sharp upward trend thereof. Moreover, there is also a relationship between the imports of intermediate goods and growth since 2000s; the imports of intermediate goods increase during high-growth years while, in contrast, the imports of intermediate goods decrease when growth slows down. Thus, it can be said that production and growth in the economy had become highly dependent on the imports of intermediate goods from 2000s onwards.



Graph 3. Imports of Commodity Groups.

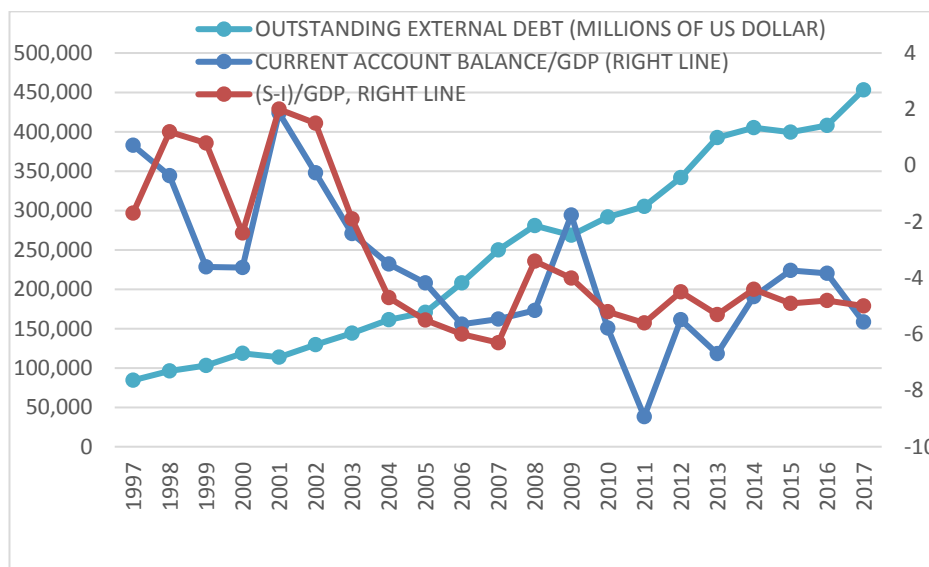
4.1. Results of Sectoral Financial Imbalances

4.1.1. Increasing External Debts

As it can be seen clearly from the graphs above, savings-investment imbalance increased gradually as public budget deficit became smaller. Moreover, dependency on the imports of intermediate goods resulted in an increasing trade deficit and current account deficit. Upon this background, external debt has been rapidly increasing through two channels: On the one hand, a tendency towards foreign savings in order to overcome a lack of domestic savings led to a rapid increase in external debt. On the other hand, a tendency to finance the current account deficit with external resources accelerated the

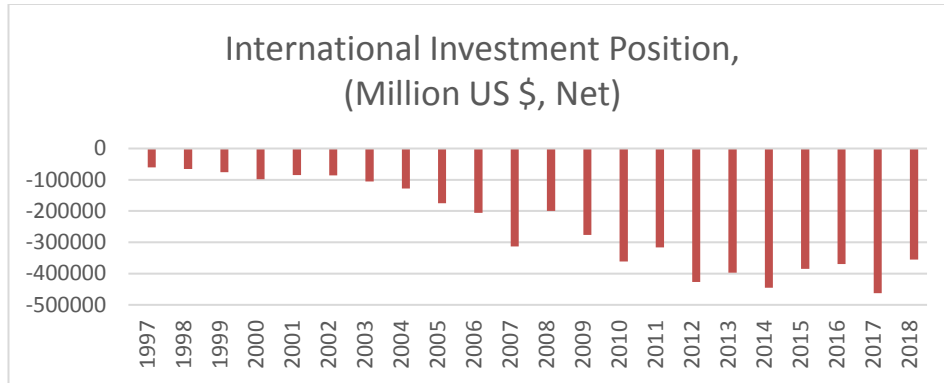
increase in external debt. The increase in liquidity in international markets due to expansionary monetary policies implemented by both the US Federal Reserve (FED) and the European Central Bank (ECB) following the financial crisis of 2007-2008, has also contributed to the rising tendency of seeking external finance. As in many other developing countries, domestic economic actors in Turkey sought to utilize this excess and cheap liquidity and looked for borrowing from abroad. This resulted in significant increases in the external debts of both financial and other market entities.

Graph 4 shows the relationship between current account deficit, S-I balance and external debt in the Turkish economy. While there is not a sharp increase in external debt until the beginning of 2000s, it started to increase rapidly from the beginning of 2000s in parallel to the deteriorations in both S-I balance and current account. The reason for this is the increase in investments and in imports of intermediate goods with the entry of the economy into a fast growth cycle (Graph 3). Under these circumstances, seeking of external resources rapidly increased with the aims of both financing current account deficit and covering the lack of savings with external resources and, thus, external debt has increased rapidly.



Graph 4. Current Account Deficit, Saving Gaps and External Debt (Turkey)

Continuous increase of the external debt stock has also affected the international net investment position of the economy as the net investment position reached almost 50% of the GDP. As Graph 5 shows, while net investment position remained at low levels up until the beginning of 2000s, it started to increase rapidly thereof. Net investment position, as known, shows the net relationship between a country and the rest of the world. Increasing indebtedness means that the Turkish economy is a net debtor against abroad or foreigners are net creditors in the Turkish economy.



Graph 5. International Investment Position (Million US \$, Net)

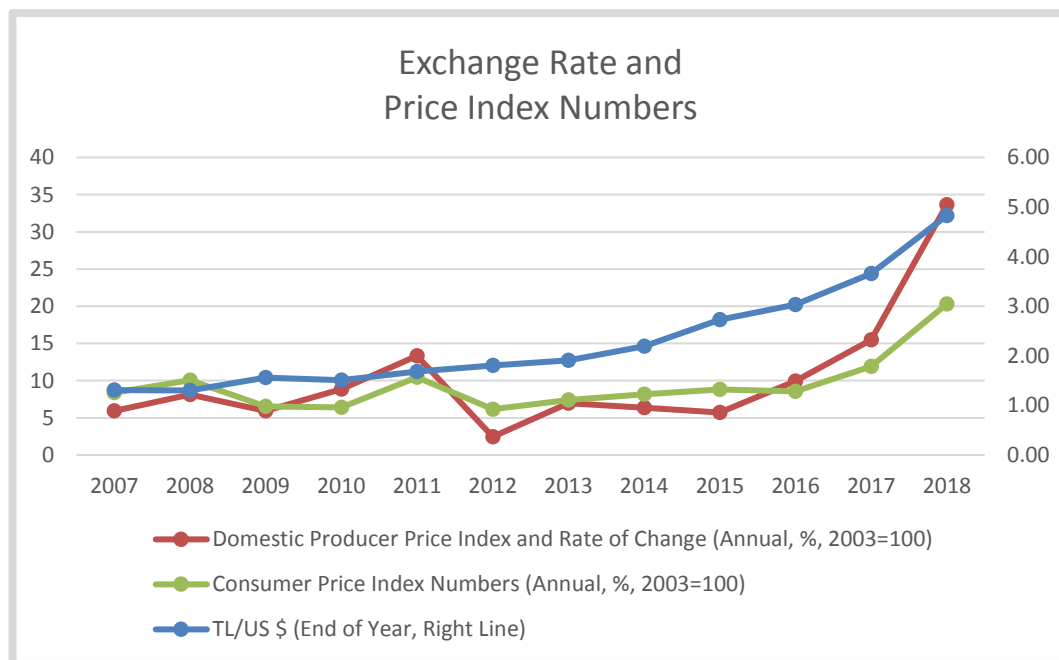
As can be seen in Graph 5, the deterioration in net investment position started at the beginning of 2000s. As the external debt stock increased, the net investment position became increasingly deteriorated.

4.1.2. Increasing Foreign Exchange Rates, Interest Rates and Inflation

Indeed, as all the graphs above show, the decrease in the public budget deficit, the increase in the investment-savings imbalance and the increase in foreign trade deficit are all experienced after the rapid growth period started at the beginning of the 2000s. Both the increase in investment- savings imbalance and the external debt due to the current account deficit heightened the exchange rate risk and increased the financial fragility in the economy and opened the door for a possible financial crisis.

The fact that the production structure of the economy became dependent on imports of intermediate goods caused the exchange rate risk to increase during the production process. As a matter of fact, the rapid rise in the exchange rate in

2018 led to higher production costs and inflation. As it can be seen from Graph 6, while 1 dollar was about 3 TL in 2016, the dollar/TL exchange rate was increased to 5.30 in the last two years. In fact, in August 2018, dollar/TL exchange rate exceeded the level of 7 TL, albeit briefly. The rapid appreciation of the dollar or the rapid depreciation of TL led to a sharp increase in domestic producer prices in the economy, which largely depends on imports of intermediate goods, followed by a rise in the consumer price index. The exchange rate started to rise rapidly, particularly in 2017, the year during when the domestic producer price index increased rapidly. The increase in producer prices led to a 20% increase in the consumer price index in a very short period of time. It seems that it will not be easy to reduce inflation in consumer prices without lowering inflation in producer prices.



Graph 6. Exchange Rate and Price Index Numbers.

Source: - Turkish Statistical Institute, www.turkstat.gov.tr

- Central Bank of Republic of Turkey, <https://www.tcmb.gov.tr>

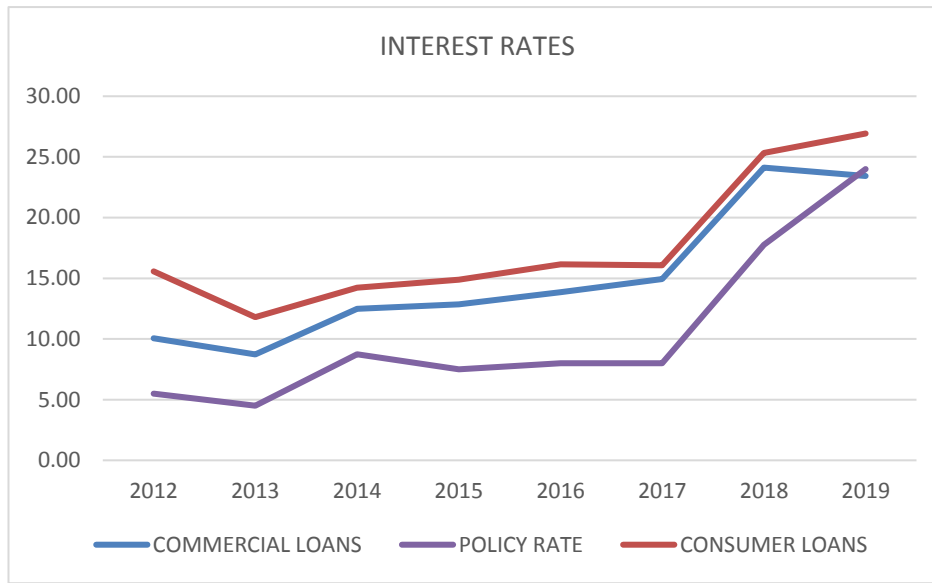
The increase in production costs due to increases in exchange rates resulted in a decrease in investments as well as in real production. This is evident from the last two-year data on growth. While the economy grew by 7.4% in real

terms in 2017, 7.4% growth was recorded in the first quarter of 2018, 5.3% in the second quarter and 1.8% in the third quarter, however, but the economy shrunk by 3% in the fourth quarter of 2018. Although an average growth rate of 2.6% was achieved throughout 2018, a significant decrease was observed in comparison with the average growth rate of 7.4% in 2017.

Increased production costs due to the exchange rate risk also adversely affected the gross fixed capital formation in the economy in 2018. Gross fixed capital formation, which was increased by 8.8% and 4.8% in the first and the second quarters of 2018, respectively, began to shrink in the third quarter. The gross fixed capital formation shrank by 4.7% in the third quarter of 2018 and 12.9% in the fourth quarter. This decrease in investments indicates that there will be both a contraction in the economy and a decline in the profitability of the private sector (Equation 1) in 2019. The private sector has a high amount of debt, yet the decrease in investments and profitability may push the private sector into an even worse situation. In order to curb this decrease in investments and profits, expansionary fiscal policies in the context of Big Government seem inevitable.

The increase in exchange rates is not the only reason for the rapid decline in investments in recent years. The Central Bank was forced to raise interest rates due to the increase in external resource dependency with the aims of repaying high external debt and financing the current account deficit. Therefore, the Central Bank increased the one-week repo auction interest rate, which is an indicative policy rate. The increase in the policy rate also triggered an increase in the loan and deposit rates, and such increases in interest rates had a negative impact on investments.

As it can be seen in Graph 7, interest rates, which followed a rather steady course until 2017, have increased with the increase of exchange rates in 2017. In particular, the rapid increase in the policy rate of the Central Bank led to increased funding costs for banks, and both consumer and commercial loan interest rates increased. This increase in interest rates adversely affected both investments and retail sales.



Graph 7. Interest Rates.

Source: CBRT, Electronic Data Delivery System, <https://evds2.tcmb.gov.tr/>

Similar to investments, volume of retail sales in the economy has also decreased significantly in recent months. Volume of retail sales, measured in constant 2015 prices, decreased by 6.7% in January 2019, compared to the same month of the previous year. In line with the decrease in investments and sales volume, unemployment rates in the economy also increased. According to Turkey Statistical Institute data the unemployment rate has increased from 10.4% in 2017 to 13.5% in 2018. The unemployment rate is higher among the young population: the youth unemployment rate was 19.5% in 2017 and while it was 24.5% in 2018.

5. BIG GOVERNMENT POLICIES REQUIRED TO ACHIEVE STABILITY IN THE ECONOMY

Turkey is currently facing a vicious cycle, and as long as this vicious cycle is not broken, it seems impossible for economic problems to be solved permanently. On the one hand, while trying to achieve economic growth, trade deficit and current account deficit are increasing and foreign resources need to be used to finance the current account deficit. On the other hand, since production is highly dependent on intermediate goods imports, the policies to be applied to reduce the trade deficit and the current account deficit impede the growth of the

economy. The consequences of this vicious cycle are high external debt, high cost inflation, declining investments and declining profits.

It would be beneficial to adapt Sectoral Financial Balances approach for the Turkish economy in order to better explain the policies proposed within the framework of the Big Government implementations for solution of the problems faced by the Turkish economy. Sectoral Financial Balances approach and its graphical representation were used by Post-Keynesian economists (Zezza 2009; Parenteau 2010; Kregel 2011; Papadimitriou, Nikiforos and Zezza 2018) to illustrate the sectoral macroeconomic situations of various countries.

The starting point of sectoral financial balances is the national income equation:

$$Y = C + I + (G - T) + (X - M) \quad \text{and} \quad C = Y - S, \text{ then}$$

$$(S - I) = (G - T) + (X - M) \quad (2)$$

Left-hand side of the Equation 2 represents the private sector balance while the right-hand side represents the balance of the public sector and the rest of the world. Figure 1 is derived from equation 2 and is called as “Sectoral Balances Map”. According to the available data, the Turkish economy currently falls within area V: Current account is in deficit, the public budget is also running a deficit and the private sector is also in deficit due to investment-saving imbalance.

Sectoral Balances Map is a guiding tool in choosing which economic policy pack to implement. It can be argued that, in the first place, the government should not implement policies that would lead to a surplus of budget under current conditions in the short-term. Because under the current conditions, this would result in a budget surplus which will move the economy to area IV, which is where Minskian crises are experienced. In an economy where aggregate demand and investment are declining, the government must cut public spending on while increasing taxes, which may lead to decreasing private sector profitability ($\pi = I + DF - Btdf$). Such a decline in profitability may result in deficiencies in debt servicing. This may increase the contraction in the economy and can cause quick bankruptcies.

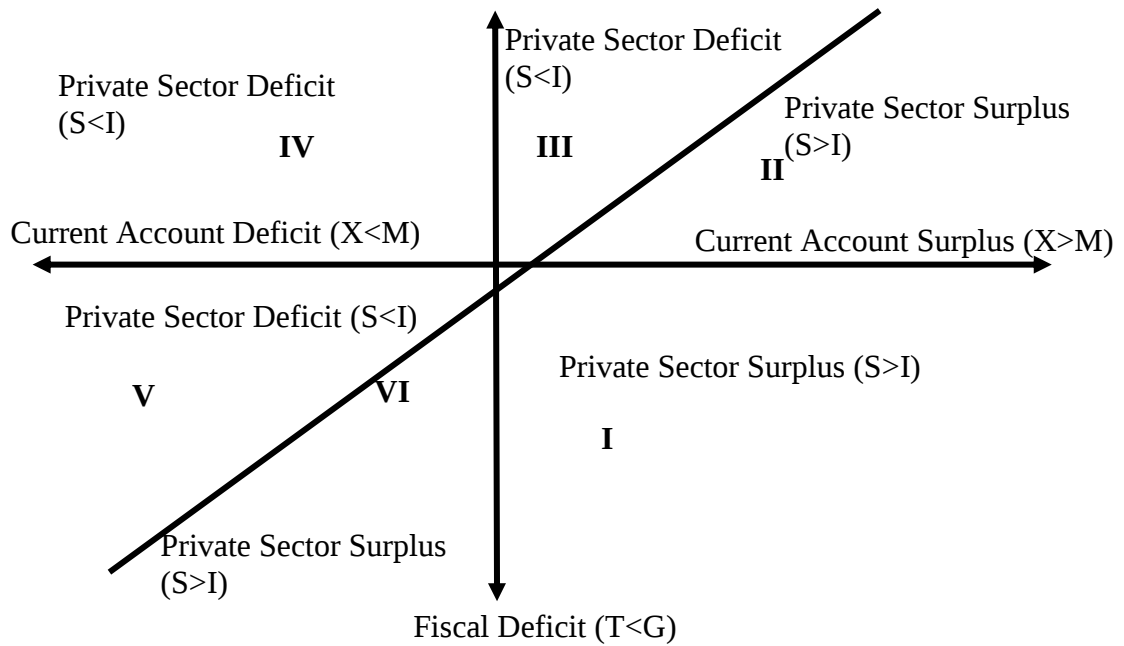


Figure 1. Sectoral Balances Map.

Sources: Parenteau R. (2010). On Fiscal Correctness and Animal Sacrifices (Leading the PIIGS to Slaughter, Part 1), <http://www.nakedcapitalism.com/2010/03/parenteau-on-fiscal-correctness-and-animal-sacrifices-leading-the-piigs-to-slaughter-part-1.html>. Kregel J. (2011). Debtors' Crisis or Creditors' Crisis? Who Pay For The European Sovereign and Subprime Mortgage Losses?, *The Jerome Levy Economics Institute of Bard College, Public Policy Brief*, No.121.

The current situation of the economy made state intervention inevitable, but this intervention should be an intervention with **strategic priorities**. The priority intervention area should be the structure of the trade. Policies should be implemented to reduce dependency on imports of intermediate goods. Within this framework, domestic production of those imported intermediary goods that can be produced domestically should be encouraged through various incentives. These incentives may include tax reductions and exceptions for firms that will invest in these areas, assuming of the burden of employment taxes by the state, and such policies as employment of public employees within the framework of public benefit programs of İŞKUR (Turkish Employment Agency) in import-substitution sectors. Employing workers in import-substituting firms within

public benefit programs will not load an additional burden for the public sector since the state reserves a certain amount of budget from the unemployment fund for their employment in the public. The changing of the employment area from the public sector to the private sector will be just enough.

Transformation of exports, which is the other active cause of the trade deficit, is inevitable as well. The share of high-technology products in exported products is very small, whereas the share of medium-high technology products is very high. According to January 2019 data of the Turkish Statistical Institute, the share of high-technology products in manufacturing industry exports is 3% while the share of medium-high technology products is 35.1%. Turkey's competitiveness in medium- and- high-tech products is low because the number of countries producing these products is quite high. Therefore, Turkey needs to accomplish a transition towards high-tech exportable which carry a competitive advantage, and the incentives to be granted within the framework of Big Government implementations should be shifted towards this area. In this context, companies that produce or want to produce high-tech products may be provided with cost-effective and long-term loans, tax reductions and employment support on the one hand, while offering logistics supports to these firms to improve their outreach to more foreign markets on the other. Increased inclusion of high-tech and high-value-added products in total exports will also contribute to decreasing trade deficit and current account deficit by increasing the import coverage of exports. Implementation of policies that reduce intermediate goods imports and increase the export of high-tech products within the scope of the Big Government implementations will reduce the dependence of domestic production on intermediate goods imports and will also significantly lower the problem of financing the current account deficit and the risk of exchange rate.

In order to lower the trade deficit and finance the current account deficit, policies to increase tourism revenues should also be implemented. Exchange rates which have been increasing in Turkey in the last two years resulted in the formation of a price advantage for foreign visitors in tourism services. If the quality of the tourism services offered can be improved to a certain extent and the prices are not increased in months during which tourism activity is intensive, the capital inflow due to the tourism services will be very high and this capital inflow will make a significant contribution to the financing of the current account deficit and refinancing of foreign debts.

How will the private sector pay its outstanding external debt back? One

way to do this is to implement austerity policies proposed by rather mainstream economists. Within the framework of the austerity policies, private sector consumption and investment spending will be reduced and savings will be increased and, accordingly, a resource will be created for the payment of debts. However, implementation of this policy in a shrinking economy will lead to a decrease in investments in the economy, a decrease in profits and an increase in unemployment. Thus, traditional policies or mainstream policies will have no effect except exacerbating the contraction in the economy.

Profits are the main source that the private sector can use to pay its debts; therefore, policies that will increase the profits of the private sector should be formulated. In order to achieve this in a shrinking economy, expansionary fiscal policies should be sustained and, if necessary, deficit spending should be increased. It is possible to encourage investments by lowering interest rates in order to increase profits; however, it seems unlikely to reduce interest rates to encourage investments at this stage, since a decrease in domestic interest rates may trigger capital outflow, leading to an increase in exchange rate and cost inflation. For this reason, it can be said that there is a need for expansionary fiscal policies and the increase of the budget deficit in order to prevent decreasing private sector profits and easy refinancing of private sector debts.

6. CONCLUDING REMARKS

As an emerging economy, the Turkish economy is facing some fundamental problems. Investment savings imbalance; strong dependence of production on imports of intermediate goods; concentration of exports on low and medium technology products; the current account deficit and the financing problem of this deficit are the main problems of the country. As a consequence of these problems, external debt dependency and private sector-based external debts are increased. The increasing foreign debts heightened the exchange rate risk and the country risk, and the increasing foreign exchange rates in the last two years lifted the production costs up and caused an increase in both producer and consumer inflation and a decrease in investments. After all, Turkey's economy is now encountering high external debt, high inflation in consumer and producer prices and falling investment and production.

Austerity policies proposed by the mainstream economists for the solution of these problems will lead to a further contraction in an already shrinking economy and to a deepening of the crisis. Inflation can be reduced to a

certain extent with austerity policies but the costs arising from the increase in the exchange rates cannot be reduced with such policies. Therefore, mainstream economic policies or austerity policies will not have an effect other than to worsen the current situation and reduce public welfare. In fact, these will further reduce investments and profits and make serviceability of the private sector debts a tough task.

Under the current circumstances, we think that the economic policies proposed within the framework of the Big Government approach will be more effective in solving the problems of the Turkish economy. The priority policy to be implemented is to curb intermediate goods dependency in trade and upgrading of export goods to high-tech and high value-added products. This requires incentives provided by the government such as tax reductions, employment support, low-cost and long-term financing for firms in the import substitution and exporting sectors.

In order to increase investments and profits, expansionary fiscal policies and open budget expenditures should be implemented. Open budget policies will increase private sector sales, which in turn will increase investments. The increase in the private sector profitability as a result of open budget policies will allow smooth repayment of private sector debts.

As shown by Sectoral Balances Map (Figure 1), the private sector, which has a heavy debt burden, has to generate a financial surplus to pay its debts, which is only possible in areas I, II and VI. In order to move to Area II, trade balance surplus and balance of payments surplus needs to be quite high, and that does not seem possible for the Turkish economy in the short term. The policies that enable the transition from the current state (area V) to area VI and from there to areas I and II are the policies that need to be implemented. For this purpose, import substitution and exporting sectors should be supported by a budget deficit to a certain extent. By this way, the balance of payments deficit can be reduced and the balance of payments surplus can be achieved in the medium and long term. Tourism revenues would also be important in the transition from area V to area VI and consequently to areas I and II. In this context, tourism enterprises should be supported by various incentives. Tourism revenues will contribute significantly to the short-and medium-term financing of the current account deficit.

The policies to be implemented within the framework of Big Government approach will ensure the serviceability of the debts and eliminate the pressure

generated by the balance of payments on growth. Increasing growth rates will contribute to the increase of social welfare.

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