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## **RESURGENCE OF SELECTIVE INDUSTRIAL POLICY: WHAT TURKEY NEEDS**

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# Resurgence of Selective Industrial Policy: What Turkey Needs

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## Abstract

Three decades of Turkish experience with nonselective industrial policies (consistent with neoliberal policy) clearly demonstrates that structural transformation in Turkish economy could not be achieved. In this paper, we have three motivations. Our first motivation is to discuss overall industrial policy developments in Turkey since 1980s. Secondly, we aim to recommend feasible selective industrial policies for Turkey to support structural transformation. Thirdly, we comment on new Industrial Policy Strategy in Turkey. In that respect, our three basic research questions are, firstly, “is there still any meaningful space to implement industrial policy in developing countries such as Turkey?”, secondly, “which policies could be used?” and thirdly, “what are the main shortcomings of new Industrial Policy Strategy in Turkey?”. Our research demonstrates that there is still meaningful space to implement selective industrial policy in developing countries such as Turkey. Moreover, new Turkish Industrialization Strategy needs significant revisions if it genuinely aims at structural transformation in Turkey.

**Keywords:** *Turkey, Industrial Policy, Structural Transformation, Economic Growth.*

**JEL Classification:** *O10, O14 and O25.*

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## **Resurgence of Selective Industrial Policy: What Turkey Needs**

*“One powerful aspect of globalization is that those in developing countries can see the disparity between what is said and done in the North, and especially in the United States, and the policies which are recommended for, or imposed upon, them.”  
(Stiglitz, 2002, p.6)*

### **1. Introduction**

In the 21<sup>st</sup> century, changes in global business environment reinforced by advances in information and communication technologies, declines in transportation costs and modifications in international trade and investment rules yielded new challenges and opportunities for developing countries in their development paths.

At a first glance, developing countries today seem as locked by a highly restricted policy space to design their autonomous industrial policies. They are confined with increasing importance of foreign direct investment (FDI), great concentration at the tier of the global value chains and World Trade Organization (WTO) constraints. But as discussed by Chang (2010), mobility of FDI and hence feasibility of autonomous economic policies hinge on the related industry and the country. Moreover industry concentrations are highly volatile in the long run and WTO rules are not fixed. They could be redesigned in favor of less developed countries with the cooperative and coordinated initiatives of fast growing emerging economies.

In this dynamic context, mainstream neoliberal practice/approach is in support of *laissez faire* economics (free trade and free financial flows), which is regarded as capable of optimally allocating economic resources as necessary and sufficient condition for developing countries to industrialize, to prosper and to catch up with the developed world. This approach also asserts that, trusting free market economics (governments’ hands off approach), with improvements in information and communication technologies and declining transportation costs compared to past, will bear fruit earlier and enable poor countries to industrialize and to prosper more quickly.

The unorthodox economists are skeptical about just trusting in alleged success of governments’ hands off approach to make developing countries industrialized and prosperous. They identify that, with a quick glance at the history of industrialized economies, today’s

industrialized world did not get their high living standards by using free market apparatus. Conversely, the most loudly free market proponents in the world today, especially Great Britain and USA, have harnessed many interventionist industrial policies in the early and frequently in the later stages of their development (Shafaeddin, 1998; Chang and Grabel, 2004, p. 10-11).

Moreover, we can easily claim that the same advances in information and communication technologies and declining transportation costs plus trusting non-free market economics, usage of interventionist industrial policies, could also enable poor countries to industrialize and prosper faster today as can be seen by the experiences of China and India.

Unorthodox development economists give significant importance to industrial policy to increase living standards in poor countries. In the broadest definition, industrial policy means policy that affects industry but it is not any policy that affects industry, in fact it is a *selective* industrial policy that is designed to prefer or favor particular industries over others (Shafaeddin, 2008; Chang and Grabel, 2004; Chang, 2010). History of development economics demonstrates that *properly implemented selective industrial policies*, not (nonselective) neutral industrial policies, have succeeded in industrialization of many countries with very low industrial base (such as South Korea, Taiwan, Singapore, Brazil etc.) and they have become again successful in transforming countries into developed ones (such as Great Britain, USA, Japan, Germany, France, Finland etc.).

Again, readings from development economics, history is highly instructive for developing country policymakers to recognize that Robert Walpole, the first British Prime Minister, is the first person who established infant industry program (could be read as industrial policy) in 1721, and he affected the first US Treasury Secretary Alexander Hamilton who first developed the theory of infant industry protection (Chang, 2010). So we can easily conclude that Great Britain and US are both intellectual homes and first practitioners of industrial policies to develop their economies in history.

By coming about two centuries forward since implementation of industrial policies in Great Britain and US, we see the increasing importance of development topic after World War II. In those years, development was considered as synonymous with industrialization as a result of intellectual and geopolitical environment (Structuralism, Big Push Model, dominance and ascendancy of Keynesian Thought and split of world economy into two

blocs). Two related forces also boosted industrialization supporting environment. On the one hand, the western world faced up with rebuilding Europe, on the other hand newly independent countries aimed to change their economic structure with a more significant role of industry compared to traditional sectors (Rapley, Chp.2). Hence, during the interventionist era of 1950-1980, many countries have effectively and intensively implemented industrial policies as a part of their development programs.

Turkish Republic has also aimed to industrialize since its establishment in 1923. As discussed by Şenses (1994), Turkish governments till 1980 put special emphasis on industrial policies to get rapid growth and industrialization. Şenses (1994) argues that, except for the 1950-1953 and 1970-1973 periods, Turkish industrial policies in the period of 1923-1980 can be described as import substituting industrialization (ISI) with heavy protection. This ISI period has been ended with 1980 Structural Adjustment Program. The program has aimed export-oriented industrialization. Şenses (1994) claims that ISI in the period of 1965-1980 aimed to upgrade industrial productive capacity from light consumer goods to consumer, intermediate and capital goods respectively, and it enabled to get a large and diversified Turkish industrial base. Moreover, that increase in industrial capacity was basically relied on growth of domestic demand. In the last years of 1970s, ISI led industrialization was faced with some bottlenecks and it was ended because of highly inefficient industrial structure, mainly rooted from long term extensive protection, distorted relative factor prices along with low employment generation, ignoring resource constraint on industrialization and carrying out populist policies in case of external shocks (Şenses, 1994).

Our paper has three motivations. Our first motivation is to discuss overall industrial policy developments in Turkey especially in the neoliberal period (about last three decades). Secondly, we aim to propose feasible selective industrial policies for Turkey to support structural transformation in the economy. Our suggestions will be consistent with restricted policy space that stems from increasing importance of FDI; great concentration at the tier of the global value chains and WTO related constraints. Thirdly, we comment on recently announced Industrial Policy Strategy in Turkey.

Our three motivations are connected. Firstly, we identify unsatisfactory results of last three decades Turkish industrialization policies. We think that our experience with nonselective industrial policies clearly demonstrates that the need for upgrading of Turkish productive structure continues. In other words, nonselective industrial policies have not made

Turkey an industrialized country. Secondly, we highlight proven success of selective industrial policies. Those well-designed industrial policies have enabled industrialization of South Korea, Taiwan, and Singapore. Comparing those countries with Turkey makes clear that Turkey needs well designed selective industrial policies to upgrade its productive structure. But, unfortunately, recently announced Industrial Policy Strategy does not offer satisfactory selective industrial policies although a literature survey demonstrates there is still space to implement selective industrial policy. Moreover, the strategy has some serious shortcomings.

In that respect, three basic research questions gain prominence:

Is there still any meaningful space to implement industrial policy in less developed countries such as Turkey?

Which policies can be used to support industrialization in Turkey?

What are the main shortcomings of recently announced Industrial Policy Strategy in Turkey?

To do so, in the next section, a literature survey on industrialization and industrial policy will be presented. The third section will present historical industrial policy developments in Turkey. In the fourth section, we will start to answer our research questions. In that respect, we will mention about space for industrial policy in less developed countries, policy recommendations and our discussions on recently announced Turkish Industrial Strategy respectively. Section 5 concludes.

## **2. Literature Survey**

Economic development goes along with structural transformation that aims to increase the share of high productivity activities in the economy. Therefore, economic development policies are key to enrich people; increase aggregate saving that will be used to enhance capital accumulation of the economy. It should be admitted that high productivity activities could also include modern (nontraditional) agricultural activity as well as industry. In that respect, both of the sectors could be used to exploit high productivity gains. But it is known that welfare enhancing equitable economic growth occurs frequently in industrial activities. In the words of UNCTAD (2010):

“the importance of manufacturing for economic development relates, on the supply side, to its potential for strong productivity growth, and on the demand side, to the high income elasticity of demand for manufactures. The productivity growth potential in manufacturing activities derives from their growing tendency towards specialization, learning and agglomeration economies, as well as from static and dynamic economies of scale. As labour and capital move into these activities, average productivity in the economy climbs. This further enhances the demand for services and industrial products, which generates profitable new investment opportunities in these areas and growing demand for labour.”

In that respect, implementation of selective industrial policies to increase living standards becomes highly crucial. As discussed by Dicaprio and Gallagher (2006), belief about an economy that is based on manufacturing could yield productivity gains, stable export prices and more accessible externalities is the main motivation for implementation of industrial policies.

Although theoretical justification of need for industrial policy is clear, there are some skeptics. Due to Stiglitz (2002), negative attitude against industrial policy stems from naïve reading of economic theory and a misreading of economic history. He discusses that mainstream economic view of efficient competitive markets relies on unrealistic assumptions, even in most developed market economies, such as perfect information (nonexistence of asymmetric information) and complete markets (it is possible to get insurance for all risks in capital markets). Hence those unrealistic assumptions entail government intervention in market economies. He gives convincing reasons for the importance of selective industrial policies by discussing government originated innovations such as telegraph, the modern internet, high productive agricultural techniques in the United States and successful industrial policies enabled to close not just in capital but also a gap in knowledge in East Asian countries.

Some important stylized facts of development are neatly explained by Rodrik (2006): Economic development entails product diversification; fast growing countries have large manufacturing capacity; long term economic booms go along with structural transformation that support manufacturing; both economic policy and factor endowments determine production structure, in other words successful industrializers have always searched dynamic comparative advantage, have not simply confined themselves to static comparative advantage; economies that aim to export more sophisticated goods grow faster than the ones not aiming

at industrial upgrading; there exists unconditional convergence at the level of individual products; and manufacturing specialization is more convenient to promote industrial upgrading. Rodrik (2006) does not accept the neoliberal view that getting economic fundamentals (macroeconomic stability and well functioning markets) right ensures structural transformation and industrial development and asserts that industrial development entails robust industrial policy aimed at new exportables and a supportive exchange rate policy that advances production of tradables. Rodrik (2006) also warns inflation targeting countries by discussing inflation targeting monetary regimes have so far been evaluated in terms of consequences for inflation and output volatility but not in terms of long-term growth.

Productivity is the main driver of a country's welfare and main determinant of catch up with more advanced countries (Haque, 2007). Hence differing productivity levels and growth rates among sectors imply that the catching up dynamics of an economy depends on in which sectors the economy could produce competitively. In that respect, importance of selective industrial policy becomes evident in the way of getting maximum benefit from scarce resources by directing them to most efficient usage areas to support development. Haque (2007) also thinks that authority of governments in designing industrial and trade policy has been transferred not to free markets but to global firms owned by rich countries. These firms' goals and strategies determine international trade, investment and service flows; they also affect economic policymaking in both home and host countries.

Moreover global trade patterns may limit export capability of domestic young firms since being a part of a trade network of a global firm seems at least as important as producing competitively (Haque, 2007). In other words, just producing efficiently in domestic market could not be sufficient for new firms to enter world markets. But achieving to be one of the competitive suppliers of a global firm may not be welfare enhancing and could result in "*a race to the bottom*" with the nicely packaged slogan of export led growth. In sum, being a competitive supplier of a global firm may not be welfare enhancing, and it could not help developmental objectives of a less developed country.

Shafaeddin (2008) argues that the need for trade and industrial policies depend on what poor countries want to do with trade liberalization. The paper claims that if the ultimate aim of trade liberalization (integration into the world economic system) is to prosper, then increasing necessity of tailor made trade and selective industrial policy becomes evident when concentration of international markets, increasing importance of global firms in production,

trade flows and technology, acceleration of technological changes and more knowledge nature of production are taken into consideration. Shafaeddin (2008) argues that current international rules and attributes of the world economy support globalization but they are not favorable for poor countries to achieve developmental goals.

### **3. A Brief History of Industrial Policy in Turkey**

The Turkish Republic has put significant efforts to enhance its industrial base since its establishment in 1923. The main heritage from the Ottoman Empire was a huge external debt stock and capital shortage along with low human capital and labor force were big obstacles in front of industrialization. Because of destructive wars, which continued for many decades through the end of the Empire, basic skills and craftsmanship to trigger growth cycle were also missing. Initial conditions were highly unfavorable; industrial base was almost non-existent and agriculture dominated economic structure. In such a discouraging state, there was an experiment with private sector led development until about 1929-1930. The public sector tried to lead industrial development with the expiration of the restrictive clauses of the Lausanne Treaty in 1929<sup>1</sup>, which imposed free trade regime on the Turkish economy, and significant industrial base has been settled as of 1950s with great efforts. These industrialization endeavors continued in 1960s-1970s with the establishment of State Planning Organization (1960) and implementation of development plans. In the last years of 1970s, foreign currency shortage and increasing political tension were instrumental in bringing industrialization attempts virtually to a halt. Turkey adopted neoliberal policies in close collaboration with the World Bank and the IMF at the beginning of 1980.

This new (neoliberal) economic experiment continued with the capital account liberalization in 1989. Şenses (1994) argues that industrialization endeavors, which have been pursued by all governments until 1980, have been largely ignored as of implementation of structural adjustment program. According to Şenses (1994), the program has envisaged the retreat of state from manufacturing activity, supported privatization, aimed retrenchment in public investment program and directed government expenditures to transport, energy and communications instead of manufacturing investment. He also argues that excessively liberal and nondiscriminatory nature of FDI policy and significant weakening of the State Planning

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<sup>1</sup> The convention of Balta Liman in 1838 restricted tariff autonomy in Ottoman Empire and Turkey had to wait nearly a century to dissolve “unequal treaty” and to implement tariff policy independently in 1929. The nonexistence of tariff autonomy in such a large empire and for such a long period make easy to grasp low industrial capacity inherited by the Turkish Republic.

Organization under the neoliberal experiment were among other examples of the neglect of industrialization.

Kepenek (1989) argues that industrialization endeavors in Turkey can be classified into two groups as ISI strategy in pre-1980 and export led growth strategy in post-1980 and although in the first period industrialization was aimed; in the second period industrialization has not been effectively pursued.

According to Türel (2007), Turkish industrial policy in the period of 1960-1970 and in post-1980 period has not included well designed performance criteria to judge effectiveness of implemented policies. Moreover, instead of selective industrial policies nonselective (neutral) ones have been used extensively in the post-1980 period.

As this short discussion on industrial policy in Turkey demonstrates, post-1980 economic policies were not prioritized in such a way to give sufficient consideration for long-term prosperity enhancing objectives of investment, sustainable, stable and equitable growth, employment, income distribution and industrialization (Şenses and Taymaz, 2003 and Türel, 2007). For about three decades, Turkey seems to have ignored fundamental developmental issues and was instead locked in and captured by a short-termist vision of financial markets.

There are some recent signs that some industrial policy related issues are resurfacing in both academic and policy-making circles. Before evaluating the newly announced Turkish Industrial Strategy of January 5, 2011 which arguably is the most significant step in this direction, declining industrial policy space and policy recommendations will be discussed in the next section.

#### **4. Some Discussions on Turkish Industrial Policy: Space, Recommendations and Shortcomings**

In this section of the paper, we will first discuss industrial policy space in less developed countries like Turkey. This will be followed by our selective industrial policy recommendations and our discussions on the recently announced Turkish Industrial Strategy.

**a. Is there still any meaningful space to implement industrial policy in developing countries such as Turkey?**

Both stylized facts of development discussed in Section two and history of development economics highlight importance of implementation of determined selective industrial policy for sustained growth and development. Although industrial policy is of crucial importance for the latter objective, policy space of developing countries has been narrowed considerably in recent years.

According to Chang (2005), decay in policy space started in the 1980s with increasing practice of Structural Adjustment Programmes of the IMF and the World Bank and then continued with conditions attached to financial assistance policies of developed countries. Chang (2005) argues that decline in room for policy space has covered also topics of multilateral trade politics such as patents (TRIPs), regulation of foreign investment (TRIMs) trade in services (GATS) with the establishment of WTO in 1995. The paper also argues that developed countries try to impose restrictions on policy space of developing countries by using free trade and bilateral investment agreements. Chang (2005) discusses threat of capital flight, obsessive free market ideologues<sup>2</sup> and domestic interest groups in developing countries as other influential factors that squeeze industrial policy space.

Although room for implementing industrial policy has declined, there is still space for implementing it in the WTO (Amsden, 2005). Historical evaluations demonstrate that policy space to implement industrial policy is not the smallest by historical standards (Chang, 2005). In that respect, the issue becomes what could be done to support development and how industrial policy should be implemented to yield most welfare enhancing results in developing countries. In other words, the issue is how less developed countries with limited industrial capacity move into more sophisticated and higher technology industries when mainstream economic view and international financial institutions with a leading role of WTO reduces space for infant industry protection and subsidization.

The WTO enables member countries to protect themselves from competition from aggregate imports that yield significant trade deficits and from the competition that threaten their individual industries (Amsden, 2005). Under the GATT regime, countries could use

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<sup>2</sup> In the words of Chang (2005, p.6) “These days many economists in developing countries are ideologically committed to free market and want the policy space of their governments to be restricted lest that their policies deviate from (what they think are) what the “science” of economic says.”

these measures to protect their industry without any time limit, but according to WTO rules, member countries can implement these measures for a limited period of eight years. She argues that there exists flexibility on application of WTO law by discussing non-existence of any action against free trade arrangements in Mexico. In Mexico, tariffs were increased significantly in 1995 with the argument of import threat. Amsden also argues usage of anti-dumping duties could be considered when competitors sell their products below their costs. Moreover, as a result of limited agreement on Trade Related Investment Measures (TRIMs), developing countries could harness local content requirements, trade balancing requirements and export requirements on firms in export processing zones to promote exports. In the words of Amsden (2005, p.220) “Thus, safeguards of various sorts enable countries to buttress their balance of payments and sustain an industry under siege. Safeguards can also be used to protect an infant industry, with eight years of protectionism virtually guaranteed.” She explains that subsidies for research and development, regional development and environment are not restricted by current WTO rules and these types of subsidies will continue to be operational since they have been used extensively in the United States and Europe. She also draws our attention to the importance of establishing proper reciprocal control mechanism and monitorable performance standards in allocating subsidies. She argues that industrial development efforts with control mechanism inclusive of science and technology subsidies yield fertile ground for less developed countries to industrialize.

Stiglitz (2002) thinks that industrial policy, with a private and public consensus on vision of economic development, could play a significant role in cases of coordination failures, large spillovers and significant problems of appropriability. He states that capital markets, with extensive asymmetric information problems especially for small and medium size enterprises (SMEs), require state intervention. In addition, state interventions in education and in research and development could be used as a tool to direct human capital formation and knowledge generating capacity of the economy into desired competitiveness enhancing levels. Undertaking complementary infrastructure investments also calls for state involvement. Stiglitz also suggests the use of tax policies, special tax treatment of real estate and energy to limit speculative real estate and encourage energy efficient technologies respectively, as a form of industrial policy. In addition to satisfying financing needs of SMEs, he also supports establishment of industrial and research parks and incubators and venture capital firms and argues that industrial policy should not ignore rural sector to reduce poverty and ensure social stability and justice.

Dicaprio and Gallagher (2006) analyze industrialization efforts of Newly Industrialized Countries in GATT and WTO regimes. They argue that although the WTO regime has narrowed the policy space of developing countries; there still exist policy options such as subsidies for R&D.

Rodrik (2008) discusses the controversy surrounding two views about design of industrial policy. One is the traditional model in which the state determines the sectors that deserve support and provides incentives for their growth while the second one considers industrial policy as a process that focuses on optimal institutional framework. He discusses how optimal industrial policy and its institutions could be designed by considering relevant market failures in the form of informational and political issues. He emphasizes three principles that should be considered in design of the policy as embeddedness, carrot and sticks and accountability.

Rodrik (2008) argues that uncertainty in the part of industrial policy makers about selection of support deserving sectors, intervention instruments and appropriate structure of cooperation and coordination mechanism among the state and the private sector requires an information flow from the private sector to the government. Hence, industrial policy should be designed as being aware of its information limitations and should function as a system of discovery. It should be embedded in private sector networks and bind the state to the society to extract required information to implement industrial policy as needed. Instead of just being autonomous, industrial policy should be based on “embedded autonomy”. The author also discusses that it should have well balanced structure in the form of incentives to encourage investments in non-traditional areas (the carrot) and discipline tools (the stick) to pick unsuccessful investments. Scarce resources should be used as efficiently as possible and some performance benchmarks should be set right at the outset. Rodrik further argues that design of industrial policy should also ensure accountability of policymakers to avoid corruption and enhance its legitimacy and to achieve that, a senior political profile could be held responsible for proper implementation of industrial policy, explicit goals could be given to individual agencies by holding them responsible to reach predetermined targets and transparency in the whole decision making processes could be increased.

Rodrik (2008) demonstrates that an industrial policy approach, which is aware of the potential problems in the design and implementation of industrial policy is possible and argues that those potential problems of information and rent seeking are not fixed; they could

be formed and made less binding. He also shows that, in different parts of economic policy making bodies of the state such as monetary policy, fiscal policy, or development banking, it could be already possible to design institutional arrangements that achieve social objectives by controlling informational and agency related problems.

Haque (2007) draws our attention to negative effects of bilateral trade agreements between industrial and developing countries on development and upgrading of productive structure in the latter. He supports usage of “*competition policy*” with a wider perspective that detects unfair practices of foreign firms on domestic ones. He argues that certain privileges of foreign firms (such as access to finance, advertising, political influence, hostile takeovers etc.) may hamper domestic firms’ capital accumulation endeavors. Hence, the low level of industrial activity in less developed country and being aware of harmful effects of global firms on domestic firms require more proactive competition policy in developing countries with greater emphasis on national interest<sup>3</sup> as in the case of industrialized countries.

Rodrik (2009) argues that structural change in an economy could retard and modern tradable sectors in developing countries could not thrive as expected as a result of sector specific problems related to access to finance and low sectoral private returns despite the existence of high social returns. The paper argues that developing countries suffer from both poor finance and poor returns curse and industrial policy could be used to fight against them by determining their strategic prioritization.

Shafaeddin (2008) argues that although a state can support infant industries mainly two ways by aiming at an economy with full of externalities (via investment in education, training, infrastructure etc.) and collective efficiencies (via industrial districts, clustering etc.) and by providing specific support to nascent industries, getting a mature industry entails more of the latter in the form of subsidies or tariff protections. He thinks that for less developed countries, just trusting foreign direct investment to enter global market could result in unfruitful specialization pattern that is based on static comparative cost advantage of relevant country. The author argues, even with WTO restrictions, there are some policy tools such as usage of subsidies for R&D activities, subsidies for agriculture, harnessing assistance to a

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<sup>3</sup> One should recall discussions on the takeover bid of American PepsiCo (one of the leading manufactures of carbonated and non-carbonated beverages, snacks and other foods) for the French dairy group of Danone in mid-2005. Reaction of French Government was noteworthy: French Prime Minister Dominique de Villepin said after the cabinet meeting “We plan to defend France’s interests and defend Danone as a national treasure”, French government prepared a law to protect companies in “strategic industries” such as Danone from takeover. ([http://en.wikipedia.org/wiki/Groupe\\_Danone](http://en.wikipedia.org/wiki/Groupe_Danone))

country's disadvantaged regions<sup>4</sup>, and subsidies for more environment friendly investments. The paper also mentions the possibility of relocating selected export industries in disadvantaged regions and nurture them with non-specific subsidies that are relevant for all industries in those regions.

The discussion so far clearly demonstrates that there is still some meaningful space to implement selective industrial policy in less developed countries such as Turkey. Which specific policies could be implemented will be discussed in the next section.

### **b. Policy Recommendations**

In Turkey, industrialization and developmental issues should have high priority on the economic agenda. All economic policies should be designed by considering prioritized developmental perspective. To do so, conventional economics paradigm, in the words of Stiglitz (2002) “the policies focusing on liberalization, privatization and stabilization which collectively have come to be called the Washington consensus policies”, among bureaucracy should be challenged by putting strong theoretical arguments in favor of failures of neoliberal policies implemented in last three decades.

In other words, as discussed by (Chang and Grabel, 2004) “there is no alternative to mainstream view” argument should be challenged, and awareness about alternative policies should be enhanced especially in the Turkish bureaucracy and academia. Although, how this could be achieved is beyond the scope of this paper, initially, curriculums of high school and university can be adjusted to include more compulsory developmental courses that discuss development experiences of industrialized countries. Moreover, getting closer relationships with other (more developmental vision bearing) institutions such as UNCTAD and UN etc. could be used to enrich developmental perspective in Turkish policy-making institutions.

After reaching a consensus on “need for industrialization” and on “there is alternative to mainstream view”, other countries' experiences could be utilized. Although, there is not one best industrial policy framework for all countries with different economic, cultural, social and political backgrounds, examining industrial policies in late industrializers (East Asian countries) could enable us to see and to integrate main determinants of industrial policy

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<sup>4</sup> According to Shafaeddin (2008, p.13) “The criteria should be based on development indicators, which should at least cover a measure of income or employment. Accordingly, the income per capita of the region should be lower than 85 per cent of the average for the country. The unemployment rate should be at least 110 per cent of the country average.”

successes into Turkish industrial strategy. These main determinants can be classified as five issues (Chang, 2006).

Firstly, it is quite important to determine realistically which sectors will be *selected* by considering country's technological capabilities and world market conditions. At the beginning, policymakers behave proactively and they should be aware of need to redesign goals and the forms of industrial policy as the economy reaches some predetermined technological capability and predetermined transformation of productive structure. In a retrospective manner, we observe that East Asian countries have promoted industries with high growth potential and widespread externalities.

Secondly, it is important to link industrial policy with export strategy. By doing so, the economy reaches scale economies earlier, gets export revenue to import foreign technology to internalize and export performance could be used to judge performance criteria for promoted industries.

Thirdly, the state should discipline promoted industries and limited resources should be used as efficiently as possible. Rodrik (2008) also discusses that industrial policy should have well balanced structure in the form of incentives to encourage investments in non-traditional areas and discipline tools to pick unsuccessful investments (carrot and stick approach).

Fourthly, competent bureaucracy and its autonomy from pressures of different segments of society are also important to implement industrial policy properly. But it should be kept in mind that nonexistence of qualified bureaucracy initially does not necessarily hinder countries to implement industrial policy properly and quality of bureaucracy could be improved with purposeful efforts as in the case of Korea.

Fifthly, there should be high level of coordination and cooperation between the state and the private sector. This relation should be in the form of "embedded autonomy" in which the state has roots in society and it has its own will and autonomy to implement industrial policy properly (Chang, 2006; Rodrik, 2008).

Kepepek (1989) argues that Turkey needs an industrialization policy based on domestically produced technology and claims that an industrial policy should be evaluated not just focusing on economic criteria such as employment generation, foreign currency earnings

etc. but also caring on to what extent it supports improvement of human capital quality. He asserts that main determinant of industrialization is technology and hence technology should be real criteria to judge industrial policy.

Current development literature also supports Kepenek (1989) and it informs us that development level of any society is determined by *what they produce* and *how they produce*. This understanding makes an economy's production technology an important determinant of the level of sophistication in using production factors. Hence, the real difference between developed and less developed countries is technology-producing ability, the former group of countries has capability to generate new technology, and technology performs as a new way of capital accumulation by determining level of surplus over production costs. Moreover, technology may enable high skilled labor-intensive production, increasing productivity, growing real incomes and improving social welfare (Kepenek, 1989; Chang, 2009).

In that framework, we think that Turkey should aim at the production of new domestic technology and innovation in selected sectors. Those sectors should be ones with high externality disseminating and high growth potential industries, and policymakers should have a long-term perspective of gradually having global domestic players in the selected sectors. Presenting favorable working conditions to limit brain drain from sectors and improving the sectors related quality of science and technology education should also support this endeavor. But, while pursuing these objectives, industrial policy design should include three traits of "embedded autonomy", "carrot and stick" structure and "accountability of policymakers" (Rodrik, 2008). Moreover well-designed deliberation council should include all relevant socio-economic actors in the society. For Turkey as a less developed country, industrial development efforts with "control mechanism inclusive" science and technology subsidies can yield fertile ground to industrialize (Amsden, 2005).

As discussed in the earlier sections, there is still useful policy space to implement selective industrial policy. What Turkey can do in its policy space and which industrial policy actions could be utilized along with subsidization of production of new domestic technology and innovation in selected sectors will be argued in the next paragraphs<sup>5</sup>.

We think that, Turkey should try to use emergency tariff increases by considering its long term developmental goals. It should aim to nurture selected sectors (and hence firms) by

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<sup>5</sup> A more specific and detailed discussion can be found in Şenses and Taymaz (2003).

utilizing emergency tariff increases. Surely, it has to envisage convincing arguments to do so. We think that Turkey with a chronic trade deficit and large domestic market could easily convince its trading partners. Hence, a policy space to nurture selected industries for eight years could be obtained by invoking sectoral jumps in imports or overall balance of payments problem.

In addition, Turkey should try to perform a decisive role in WTO negotiations to resist decision taken against its development goals, to put pressure on main WTO decision makers to get benefit, and it should try to be more active to keep interests of less developed countries in multilateral organizations by cooperating and coordinating with other significant developing countries. For instance, Turkey and other countries should strongly resist international division of labor proposals that imply “industry-agriculture swap” among developed and less developed countries as discussed at the Doha Round (Chang, 2009) and should try to nurture selected sectors as much as possible.

Subsidies for agriculture, regional development, basic research and development, environment related technology upgrading is allowed (Chang, 2010) within current industrial policy domain. In that respect, Turkey should aim to focus on the most social benefit yielding usage of those allowed “domestic” subsidies when they are still permitted.

Moreover, in addition to domestic production of technology in selected sectors, agriculture and animal husbandry should also be treated strategically. These sectors are still vital for Turkey because of its roles in preventing deruralization and alleviating social tension in rural and urban. Furthermore, these sectors could affect other manufacturing sectors positively. For instance, organic output of agriculture (such as organic cotton) could be used in higher value added inclusive textile and clothing products. In other words, all industrial policy strategy, not just agriculture-related ones, should be designed by considering backward and forward linkages in the economy.

Chang (2010, p.34) also discusses that “countries can still impose conditions regarding the hiring of local labor (a good way to create technological spillover effects), technology transfer, and the conduct of R&D. They can also provide targeted subsidies, directed credits, and tailor-made infrastructure (measures that Singapore and Ireland have used, to attract FDI into “targeted” industries).” These purposeful, deliberately-guided FDI policies should also be relevant for Turkey. Turkey with large and unsaturated domestic market seems to attract

significant amount of foreign direct investment, and it should use its desirable characteristics to bargain with multinational companies to exploit them in a manner that is consistent with its long-term developmental perspective.

In addition, WTO rules do not hinder government policies that aim to reduce regional disequilibria and Turkey should promote sufficiently selected industries to convince them to relocate their production facilities into less developed regions in the country. For instance, Turkey can implement “flying geese pattern” of East and South-East Asian industrial development by utilizing state incentives. In this framework, infant industries are located in less developed regions of the country and they get considerable “nonactionable” state subsidies to grow up and after reaching sufficient competitiveness level they are replaced with another “infant” industry (or selected firms). We think that, selecting specific infant firms could be less eye catching (nonactionable), and by doing so the state could support occurrence of global firms.

We also think that, in addition to exports, Turkey has also potential to upgrade its productive structure by relying on its large and unsaturated domestic market. In that respect, any industrial policy should also consider possibility of productivity driven domestic led growth. Such a perspective could eliminate risk of “race to bottom” and “political pressures” that could exist in export led growth strategy (Unctad, 2010).

Competition policy could be used more effectively in Turkey with a wider perspective that detects unfair practices of foreign firms on domestic ones. As it is known, foreign firms have certain special privileges and they may hinder domestic firms’ growing up efforts. Hence, immature industrial capacity in developing country and being aware of inimical effects of global firms on domestic firms require proactive competition policy in developing countries with increased emphasis on national interest.

With regards to monetary and exchange rate policy, industrial development and measures directed at export structure upgrading should also get benefit from a more supportive exchange rate policy. As far as we know, there is no country which could industrialize with an overvalued domestic currency. Declining developmental policy space increases importance of appropriate monetary and exchange rate policies. We think that, although there are some important structural factors that determine export and trade balance developments (Aydın, Saygılı, Saygılı and Yılmaz, 2010; Saygılı, Cihan, Yalçın and Hamsici,

2010) in Turkey, real effective exchange rates are also important in competitiveness and hence export performance of Turkish exporters (Yılmaz, 2009; Gönenç and Yılmaz, 2007; Yılmaz and Gönenç, 2008). In sum, policymakers should not ignore developments in real effective exchange rates.

Last but not least, transformation of Turkish productive structure may even need to change valid policy space limiting factors. In that respect, we believe that, Turkey should be ready to consider enlarging “declining” industrial policy space by revising Customs Union (CU) related constraints on Turkish industrial policy design. If Turkey’s full EU membership will not be ensured in a foreseeable future, Turkey should envisage significant changes in CU agreement to have full rights to design its industrialization policy. Current CU structure is unfair, its unfairness can be neatly summarized by the words of Chang (2005, p.14) “needless to say, level playing field is the right principle to adopt when the players are equal. However, when the players are unequal, it is the wrong principle to apply. For example, if a team of 13-year-old children are playing football against the Brazilian national team, it is only fair that the playing field is not level and that children are allowed to attack from up the hill.”

### **c. Shortcomings of Newly Announced Turkish Industrial Strategy**

Turkish Ministry of Industry and Trade has published a new “Turkish Industrial Strategy<sup>6</sup>” document on January 5, 2011. Although, it is nice to see gaining importance of discussions about industrialization along with endeavors to make industrialization strategy a hot topic, we think that there are some shortcomings in the document. These shortcomings are related to preparation process of the document, participants in deliberation council, and policy suggestions in the document. Unfortunately, those factors can limit or hinder success of the strategy.

With regards to preparation of the document, we think that nonparticipation of labor side<sup>7</sup> in strategy preparation process decreases social adoption of the strategy and could inhibit reaching a consensus among different socio-economic actors. The current publicized document does not include views and demands of labor unions. In that respect, the designed industrial policy does not seem “embedded” as discussed by Rodrik (2008). In other words, publicized industrial policy strategy seems to be embedded in just one side (capitalist side) of

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<sup>6</sup> [http://www.sanayi.gov.tr/Files/Documents/sanayi\\_stratejisi\\_belgesi\\_2011\\_2014.pdf](http://www.sanayi.gov.tr/Files/Documents/sanayi_stratejisi_belgesi_2011_2014.pdf)

<sup>7</sup> <http://www.radikal.com.tr/Radikal.aspx?aType=RadikalDetayV3&ArticleID=1035653&Date=09.01.2011&CategoryID=80>

private sector networks, it ignores labor side, and hence it does not result in optimal information flow between the state and private agents.

Moreover, after reading the document and checking the listed references, we see the document has been dominated European Commission (EC) reports and it ignores unorthodox literature about industrialization. In fact, in the first clauses of the document, it becomes clear that the basic motivation to prepare the document is to close the chapter of “Enterprise and Industrial Policy” in Turkey's EU Accession Talks. In other words, it seems that it has been prepared with a routine chapter closing motivation not with a genuine aim of industrializing.

In addition, in the third clause of the document, it has been declared that EU officials have evaluated industrial policy implementations in Turkey and approved its consistency with EU standards. It should be questioned how a less developed country such as Turkey, with different economic, cultural, social and political backgrounds, can develop by implementing EU approved nonselective industrial policies. To the best of our knowledge, there is no developed country that has prospered by utilizing nonselective industrial policies similar to EU approved ones.

In that respect, designed industrial policy may not have optimum level of “autonomy”. It seems it is highly affected by EC regulations and views of their supporters in the domestic economy. It does not make us feel the report has been prepared autonomously by the state to ensure industrialization of Turkish economy. In sum, we have doubts about whether the publicized report satisfies “embedded autonomy” necessary condition of proper industrial policy design (Chang, 2006; Rodrik, 2008). Moreover, the report’s action plan to industrialize may face opposition from excluded actors in the economy.

Furthermore, the designed industrial policy does not mention discipline tools (sticks) to limit usage of resource inefficiently. There are many things in the form of to do list for the state, but it is not clear how the performance of the private sector will be evaluated and which actions will be taken for unsuccessful investments. Hence, we think that the report does not give enough importance of establishing proper reciprocal control mechanism and monitorable performance standards in allocating government funds.

In that respect, the report does not have well-balanced structure in the form of incentives and discipline tools. There are not any explicit goals to be given to private sector

agencies to make them responsible to reach predetermined targets. All these concerns also increase our suspicion about unilateral (noninclusive of all socio-economic partners) preparation of the report.

We know that, in addition to those aforementioned main five determinants of successes of industrial policy in section 4.b, we see deliberation councils for policy making in key industries have also performed important roles in successful East Asian countries. In those countries, deliberation councils include government officials, real sector representatives and impartial opinion leaders such as eminent journalists and academics. Hence, in addition to nonexistence of labor side in the report preparation process, labor side seems not to exist in the deliberation council. It is also not clear whether the Turkish report has been prepared by considering views of impartial opinion leaders and whether they will exist in the deliberation council.

In brief, in terms of preparation of the report, and noninclusive nature of deliberation council, the report seems to fail to pass two out of three necessary conditions of well-designed industrial policy discussed by Rodrik (2008). In other words, the report seems to have been prepared in a way not paying sufficient attention to bring all economic actors to the table, hence it may not trigger economy wide cooperative, coordinated and sacrificed attitudes to industrialize. Moreover, uncertainties about nature (excluding labor side and impartial opinion leaders) of deliberation council may harm credibility and acceptability of the strategy in the society.

After discussing report preparation and deliberation council related issues (concerns about design of industrial policy), we turn to policy suggestions in the report.

We have doubt about value added generation capacity of Turkish industry could be increased by focusing mainly on neutral (nonselective) industrial policies. In fact, some influential economists on industrial policy literature do not accept a neutral industrial policy as a genuine industrial policy; they focus on “selective” industrial policy (Chang, 2006; Shafaeddin, 2008). In the words of Chang (2006, p.2) “...classifying every policy that affects industrial development as industrial policy is not a useful way to proceed. If we did that, virtually every policy could be classified as industrial policy, which would make the concept meaningless.”

It is highly skeptical to expect upgrading of productive structure by focusing excessively on EC approved policies and views of mainstream economics. We think that preference of nonselective industrial policies needs explanation when we consider unsuccessful results of more or less implemented nonselective industrial policies in Turkey since 1980 and proved success of selective industrial policies in all today's industrialized countries. We know that all countries in the world have developed with prior selective industrial policy and infant industry protection except for Hong Kong (Shafaeddin, 1998).

We think preference over neutral industrial policies may not trigger transformation of productive structure in Turkey. For instance, the report suggests that (as a neutral policy) financing conditions and credit availability of SMEs will be improved. But it is not clear how private financial sector will extend sufficient amount of long-term credit to finance SMEs' investments. In sum, Turkey needs selective industrial policies that are designed by all socio-economic actors.

## **5. Conclusion**

Our three decades experience with neoliberal policies clearly demonstrates that structural transformation in Turkish economy could not be achieved, traditional agriculture and high labor-intensive sector still accounts for large share of employment and need for upgrading of productive structure continues.

Neoliberal orthodoxy assumes a "static" comparative advantage trade theory, and in the Turkish case, it has limited the country to upgrade its industrial base. Hence current orthodoxy, which directs Turkey to labor intensive (low value added-low income) sectors, can't help Turkey to prosper. Contrary to that, Turkey needs to behave as having an East Asian style "dynamic" comparative advantage trade vision. With that perspective, it should design overall development goals and support it with selective industrial policies that will bring comparative advantage in high value added and high wage income manufacturing activities. To increase living standards and improve income distribution, Turkey needs to focus on high value added and high wage income manufacturing activities (Şenses and Taymaz, 2003).

To ensure and assist structural transformation, Turkey should envisage using emergency tariff increases and performing a decisive role in WTO negotiations. Moreover,

subsidies for agriculture, animal husbandry, and regional development should be used more effectively with a long term vision of preventing deruralization and alleviating social tension in rural and urban sectors/areas. With a large, unsaturated and dynamic domestic market, purposeful, deliberately guided FDI policy should be implemented strategically to bargain with multinational companies and to exploit them in a manner that is consistent with the country's long-term developmental perspective.

In addition, policymakers should promote industries sufficiently to convince enterprises to relocate their production facilities into less developed regions in the country with the argument of reducing regional inequalities. For instance, Turkey can implement “flying geese pattern” of East and South-East Asian industrial development by utilizing state incentives.

With regards to monetary policy, industrial development and struggles on export structure upgrading should also get benefit from a more supportive exchange rate policy. As far as we know, there is no country that could industrialize with an overvalued domestic currency. Declining developmental policy space increases importance of appropriate monetary and exchange rate policies.

Last but not least, Turkey should be ready to consider enlarging “declining” industrial policy space by revising Customs Union related constraints on Turkish industrial policy design to have full right to say in its industrialization policy.

We think that new Turkish Industrialization Strategy needs significant revisions if it genuinely aims at structural transformation in Turkey. A fair reading of history makes us sure about success of properly implemented selective industrial policies. But, the new strategy in its current form with excessive reliance on neutral industrial policies is highly unlikely to upgrade Turkish manufacturing and hence Turkey seems to be fighting a losing battle. Furthermore, current strategy does not include all socio-economic partners, it does not satisfy embedded autonomy and existence of well-balanced incentive and punishment conditions of properly designed industrial policy.

The ultimate aim of any Turkish industrial policy should be production of new domestic technology and innovation in selected sectors. Hence, all endeavors and resources should be put on those selected sectors. Those sectors should be high externality

disseminating and high growth potential industries and policymakers should have a long-term perspective of gradually having global domestic players in those selected sectors. This process should be envisaged as reaching the ultimate objective of becoming an industrialized country. Fortunately, relative magnitude of Turkish domestic market is sufficient to succeed structural transformation along with domestically produced new technologies (Kepenek, 1989). Productivity driven domestic led growth perspective could eliminate risk of “race to bottom” and “political pressures” that could exist in export led growth strategy (Unctad, 2010). Hence, policymakers should also be aware of this elusive option.

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