This article critically evaluates the governance discourse that the Washington consensus has extended to the case of Turkey after the financial crisis there in 2001. In the United States and United Kingdom the debates on governance are ultimately about the rules of optimal managerial behaviour that will ensure the efficient use of capital. The political economy argument of financialisation, on the other hand, questions the achievability of the objectives set by the governance model and, instead, argues that the present day capitalism is characterised by a coupon pool system – where the capital markets are no longer simple vehicles of financial intermediation but instead regulate firm and household behaviour in a destabilising manner. This article argues that the financialisation framework can be successfully applied to the Turkish experience, a developing economy, where the financial intermediation process was corrupted and became the source of economic instability as a result of the International Monetary Fund led neo-liberal economic reforms since the early 1980s. The governance reforms are doomed to fail as long as the damages caused in the economy by financialisation – observable in the pyramid structure of domestic government bond market – are not understood and addressed.

Keywords: Financialisation; Governance; Turkey; IMF; Financial crisis; Emerging markets

Another important vehicle to enhance crisis prevention is the International Monetary Fund’s (IMF) work on the elaboration and dissemination of standards and codes for sound economic and financial policies and corporate governance. … We must continue to work patiently but persistently to convince developing and emerging market countries not to interpret these standards primarily as a ‘dictate’ by the industrialized countries but rather to see them as useful guide posts in their own efforts to strengthen institutions and gain greater access to international investment capital. We recently witnessed in Turkey how a public dispute between leading politicians can unleash a financial crisis.

(Köhler, IMF Managing Director, 2001)

INTRODUCTION

The stabilisation package that Turkey signed with the International Monetary Fund (IMF) in 2001, involving a stand-by credit of USD 18 billion – the highest IMF lending to any one country until the USD 30 billion package for Brazil in 2002 – included a new condition: Turkey should introduce ‘good governance’ into both public and private sectors. Since the Asian crisis of 1997, the conditionality package that is attached to the IMF lending to

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ISSN 1024-5294 print; ISSN 1477-2221 online © 2003 Taylor & Francis Ltd
DOI: 10.1080/1024529042000197068
the developing world includes ‘good governance’. According to its sister Washington organisation, the World Bank, in an evaluation in the aftermath of the string of crises in Mexico, South East Asia and Russia during the 1990s ‘countries that pursue privatisations without putting good governance structures in place experience worse economic growth’ (Monks and Minow, 2001: 259). In 1998, the President of the World Bank, James Wolfensohn, stated that:

> Good corporate governance can make a difference by broadening ownership and reducing concentration of power within societies. It bolsters capital markets and stimulates innovation. It fosters longer-term foreign direct investment, reduces volatility and deters capital flight.

(Monks and Minow, 2001: 259).

Following Turkey’s agreement on an economic reform programme with the IMF in 2001, the World Bank extended two loans, PFPSAL I and PFPSAL II (Programmatic Financial and Public Sector Adjustment Loans), worth USD 1.1 billion and USD 1.35 billion, respectively, with a view to help Turkey establish ‘good governance’. Prior to the release of the second tranche of these loans, at two conferences on February 14 and 15, 2002, in Ankara, Johannes Linn from the World Bank, Vice President of Europe and Central Asia Region, emphasised the role of good governance in economic development and attracting foreign investment.

Theoretical justification for the relationship between governance and economic performance, both at macro and firm levels, has its roots in Anglo-Saxon finance literature. The Washington consensus, promoting Anglo-Saxon financial markets in the developing world, is informed by this body of work and the practices that emanate from it. It is argued in this article that the competing view of financialisation gives us a better insight into the economic problems of Turkey than the governance argument. Optimal managerial behaviour prescribed by governance ignores the macro-economic environment, which is characterised by financialisation, and effects real decisions made by economic agents. Neo-liberal reforms that were promoted by the IMF and the World Bank in Turkey since the early 1980s have led to a domestic government securities market similar to the Ponzi scheme described by Froud et al. (2002) in their model of financialisation: coupon pool capitalism. Financialisation in Turkey, embedded in the government debt market, has reduced the intermediary role of banks in the economy to simply channelling savings, both domestic and international, into unproductive but high-yield debt obligations of the government. Consequently, productive investment activities in the economy are unable to compete for funds. This process then creates a balance sheet structure in the banking system, which becomes the cause of chronic instability in the economy and naturally, the conditions for financial crisis permanently set in. The evidence suggests that liberalised financial markets and free capital account encourage and deepen this financialisation process.

The article is organised as follows: the first part gives an overview of the mainstream corporate governance literature with a view to contextualise the World Bank and the Organisation for Economic Cooperation and Development’s (OECD) international governance initiatives in the 1990s. Then international political economists’ responses to mainstream corporate governance are considered. Two models of financialisation, Boyer’s (2000) finance-led growth regime and coupon pool capitalism of Froud et al. (2002), are contrasted. In reviewing both these approaches, Aglietta (2000) observes that they ‘contend that capital markets strongly shape corporate behaviour with definite real effects’. Coupon pool model of present day capitalism of Froud et al. with its emphasis on the role of any type of coupon-based financial system and not necessarily an equity-based one, is a very useful tool to apply to the current financial crises in the developing world. The second part of the article describes the 2001 financial crisis in Turkey and the consequent reform package that was agreed with the IMF where governance is promoted. In the third part of the article, it is argued how a coupon pool is created and works in the Turkish context by analysing the
dynamics of the public debt market and firm behaviour under financialisation. Finally, conclusions are drawn from the analysis to discuss the discrepancy between the prescribed behaviour by the governance model and real firm behaviour under financialisation.

CORPORATE GOVERNANCE, SHAREHOLDER VALUE AND EFFICIENT USE OF CAPITAL

Mainstream corporate governance literature is essentially concerned about the Anglo-Saxon economies of the United States and United Kingdom and can be possibly viewed in two distinct but not mutually exclusive ways: (i) a body of work that has its roots in Berle and Means (1932) and is primarily concerned with mechanisms of optimal corporate conduct when the ownership and control of capital are separated; and (ii) Jensen’s (1993) analysis and related work, where the implications of the ‘divergence between managers’ decisions and those that are optimal from society’s standpoint’ (Jensen, 1993: 850) are studied. The first category of work is essentially policy oriented and deals with issues regarding board structure in corporations, conflicts of interest between agents and principals, the appointment of executive and non-executive directors, appointment of committees, the role of auditors, etc. Shleifer and Vishny (1997) give a comprehensive account of this body of literature, and earlier in the 1990s, Prentice (1993) discusses corporate governance in the United Kingdom in the aftermath of the Cadbury Report.

Jensen’s approach to corporate governance operates at a macro level studying the optimal governance structures that would create competitive firms reacting to secular changes in the global product markets, and it also prescribes shareholder value as the management objective. Jensen (1993) explicitly articulates the agency problem to the economic competitiveness of firms in a broader historical perspective, comparing the market for corporate control in the 1980s to the consolidation in the economy during the Industrial Revolution of the 19th century. Drawing on practices from the leveraged buy-out (LBO) era of the 1980s in the United States and invoking Schumpeter’s insights on creative destruction under capitalism, Jensen predicts a future for capitalism, both in the United States and world-wide, where corporate governance, the way control and ownership of capital are formally organised in capitalistic firms, would play a key role. Kaplan (1998) expands this line of thinking by arguing that LBOs in the late 1980s taught corporate America that boards and management have to take shareholder value as their prime objective if they wish to utilise the firm’s resources effectively and fully. Equity-based compensation schemes like stock options and performance evaluation methods like Stern Stewart’s Economic Value Added are the direct result of the LBO experience, where the financial interests of managers and shareholders converge to maximise the value of the firm and create competitive economic units. By opening up the market for corporate control, the take-over and LBO activities of the 1980s helped the efficient use of capital. As will be discussed below, the normative and positive aspects of this macro view of corporate governance are critically opposed by political economists like Froud et al. (2000, 2002), Boyer (2000) and Aglietta (2000).

GLOBALISATION OF CORPORATE GOVERNANCE: THE WASHINGTON CONSENSUS INTRODUCES CORPORATE GOVERNANCE TO DEVELOPING COUNTRIES

The themes of efficient use of capital and shareholder value were internationalised in the 1990s as private capital flew from core capitalist economies to the so-called emerging and
transition economies. After the Mexican financial crisis in 1994, major US and UK institutional investors – the California Public Employees Retirement System (CalPERS), the College Retirement Equities Fund (TIAA-CREF), the Council of Institutional Investors in the United States, the Association of British Insurers, the National Association of Pension Funds in the United Kingdom – led, in 1995, an initiative to form the International Corporate Governance Network (ICGN), with a view to promote international practices of corporate governance that would prioritise shareholder value. The institutional investors behind the ICGN had more than USD 6 trillion in assets (Monks and Minow, 2001: 253).

Official support for private capital’s global corporate governance agenda came after the big scale financial crises in East Asia and Russia in 1997 and 1998. The Group of Seven (G7) leaders at the Cologne summit in June 1999 welcomed the OECD Principles of Corporate Governance. The new international financial architecture required sound global corporate governance. The ICGN contributed to the OECD’s work on preparing the principles and amplified the principles by stating that:

The ICGN affirms – with the OECD Principles – that along with traditional financial criteria, the governance profile of a corporation is now an essential factor that investors take into consideration when deciding how to allocate their investment capital.

... The ICGN affirms that, to be effective, corporate governance practices should focus board attention on optimizing over time the returns to shareholders with a view to excel in comparison with the company’s equity sector peer group.

(ICGN, 1999)

The implementation of the OECD Principles in the developing world required active support from providers of both official and private capital, like the ICGD – representing international investors with more than USD 6 trillion in assets – and the World Bank, which had the capability and the power to implement the OECD Principles. The World Bank’s crisis loans to East Asian countries after 1997 included conditionalities regarding corporate governance reforms. The IMF loan agreements with countries that suffer financial crises carry conditions requiring institutional reforms in both the public and private sectors. Such reforms aim for observance of certain internationally recognised standards and codes in the countries that receive IMF credit. The IMF initially recognised 11 areas for international standards. They were accounting, auditing, banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditor rights, insurance supervision, monetary and financial policy transparency, payments systems and securities regulation. After September 11, 2001, a 12th area was added: anti-money laundering and countering the finance of terrorism. The IMF holds regular reviews with the recipient country before further release of tranches of the loans, to ensure that conditions in these 12 areas are being met. The World Bank usually provides soft loans and technical assistance to the recipient country to implement such conditions. This process was introduced in the wake of the Asian and Russian financial crises in the late 1990s. In May 1999, the IMF and the World Bank set up the Financial Sector Assessment Program ‘with a view to strengthen the monitoring of financial systems in the context of the Fund’s bilateral surveillance and the Bank’s financial sector development work’ (IMF, 2000). The IMF and the World Bank regularly publish Reports on the Observance of Standards and Codes on individual countries. In this context in 1999, the World Bank, in co-operation with the OECD, created the Global Corporate Governance Forum. The earlier work by the World Bank on governance, dating back to a 1994 workshop on corruption in Uganda, had a narrower definition, limited to state capture, which Hirst and Thompson (1999) interprets as meaning no more
than ‘good public administration’. The new programme of the World Bank on governance, however, is far more ambitious:

There is widespread recognition that sound corporate governance is an essential foundation for a well-functioning market economy and hence for long-term development. It is also critical in strengthening the international financial system.

(World Bank, 1999a)

This new programme is all about the efficient use of capital, the increasing role of private firms in the global economy, and how good corporate governance ‘helps to maintain the confidence of investors – both foreign and domestic – to attract more “patient”, long-term capital’ (OECD, 1999). At a more practical level, the World Bank, through the Forum, aims to provide assistance for developing transition economies on corporate governance by broadening the dialogue on corporate governance, exchanging experience and good practices, co-ordinating activities, and identifying and filling gaps in the provision of technical assistance.

The World Bank’s new corporate governance initiative has strong theoretical links to the Anglo-Saxon corporate governance literature of the 1990s. It also has affiliations with policy-oriented initiatives of the same period. The Forum’s launch document was baptised by Sir Adrian Cadbury, chairman of the committee, named after him, which in 1992 wrote the benchmark governance code for the United Kingdom, who announced that ‘corporate governance was now firmly on the world stage’ (World Bank, 1999b). The Global Corporate Governance Forum had support from the Private Sector Advisory Group (PSAG), which would provide effective links with the private sector players internationally. In conjunction with the PSAG, the Investor Responsibility Taskforce would help the Forum achieve its objectives in establishing good governance in developing countries. This would be done by rewarding countries and companies that make governance reforms. The taskforce’s first step was to write to equity research firms that cover emerging markets, calling on them to include governance considerations alongside their traditional financial analysis. They will also lobby emerging market indexers to include governance benchmarks (shareholders rights, board structure, audit process, etc.) in company ratings. This willingness of international fund managers to reward countries and companies with good corporate governance in the late 1990s echoes the findings of McKinsey in the LBO era in the late 1980s. Kaplan reports that a McKinsey survey of institutional investors found that they are willing to pay a premium of 10% for companies with good corporate governance (Kaplan, 1998: 408).

In his discursive analysis of the G7 and IMF’s international development discourse and policies over the last two decades, Dallaire (2001) sees the Cologne Summit of 1999, which endorsed the OECD governance code, as an important phase where the Washington consensus’ articulation of the social and the political to the economic arguments reached a pinnacle. The new discourse, although still based on the old discourse and policies that claim free markets are necessary for economic development, now emphasise the role of the ‘goodwill of capital markets’ (Dallaire, 2001: 104). The goodwill of capital markets now required globalised corporate governance. In the Kuhnian sense, a new academic research paradigm has emerged from this change as well. For example Khanna and Palepu (1999: 24), analysing Indian firms in the early 1990s, claim that ‘foreign institutional investors are a source of not only financing but also scarce monitoring skills in emerging markets like India’. And Johnson et al. (2000) studied financial crises in the emerging markets and found that the level of corporate governance can be a better predictor of financial crises than macro-economic variables.

Just like the Asian crisis of 1997, the Enron scandal of 2001, when the corruption and informational efficiency of markets are found to be not unevenly distributed between the
North and the South, created a new wave of policy oriented and academic interest in governance. The OECD has launched a series of initiatives to revise and expand its 1999 code (Financial Times, 2002a), following the examples of the Sarbanes-Oxley Act in the United States and the activities of the Institutional Shareholders Committee of Britain, which started designing corporate governance codes (The Economist, 2002).

FINANCIALISATION IN A DEVELOPING ECONOMY CONTEXT

Corporate governance and shareholder value naturally attract a critical interest from political economists. Froud et al. (2000, 2002) and Boyer (2000) present two critical views on corporate governance and shareholder value. Both views identify financialisation as the dominant aspect of present day capitalism in the Anglo-Saxon economies of the United States and United Kingdom in particular. In a very useful taxonomy of the field about shareholder value and financialisation, Froud et al. (2002) distinguish theirs, British social accountants, and Boyer’s, French regulationist, from others by setting the unit of analysis at the macro-economic level, as opposed to the firm-level focus of mainstream corporate governance literature, and also by making the household a key variable in their analysis, in addition to the firm. Between the two models of financialisation that aim to explain the current state in the mature capitalist economies of the United States and United Kingdom, the one developed by Froud et al. (2000, 2002) is generalisable to the developing countries, which have adopted neo-liberal policies and liberalised their financial markets.

Coupon pool capitalism construct of Froud et al. rivals Boyer’s regulationist view of financialisation – which according to Boyer has replaced the earlier growth of Fordism – by pointing out the destructive instability that is embedded in financial markets. Coupon pool capitalism is not limited to the economies with Anglo-Saxon equity markets. It can exist in the economies with any form of coupon-based security markets. Froud et al. view the financialisation of the 1990s, which follows the productionism of the 1980s, as a possibly unrealisable project with the potential of fatal instability, rather than a Boyer type accumulation regime with a healthy medium-term life span. Following on from their earlier empirical work they claim that low profitability in globally competitive product markets would not allow the shareholder value driven managers of publicly traded firms to succeed in the rate of return competition in capital markets, unless they are lucky enough to be managing firms with advantages like intellectual property rights, brands and immateriality. Coupon pool construct of Froud et al. articulates well, by using the Ponzi scheme analogy, the gap between capital market expectations due to corporate governance, and investor psychology in bull markets, and the ultimate financial outcome. Financial engineering and restructuring cannot sustain the pyramid scheme forever.

Boyer’s model of the finance-led growth regime is based on actual and potential economic trends in mature capitalist economies. The relevance of this model for the emerging markets is invoked only when the role of central banks in financialised economies is discussed (Boyer, 2000: 131). Coupon pool capitalism model of Froud et al., on the other hand, is more explicit in its applicability to national capitalisms other than the United States and the United Kingdom. The concept of coupon pool capitalism aims to go beyond a mechanistic view and address ‘dynamic issues about changes in behaviour’ (Froud et al., 2002: 5). As such financialisation is not limited to the capitalist economies where shares issued by private corporations are the dominant form of financial assets, any form of financial asset with coupon type payment that is issued by, for example, the central or local state, can be the basis of a financialised economy. In their taxonomy of governance and financialisation
models, Froud et al. (2002: 22) also emphasise the ‘spreading global influence’ of coupon pool capitalism. The following definition of ‘coupon pool capitalism’, which problematises the intermediary role of financial markets, is also relevant for current national forms of capitalism in developing countries:

Instead, we hypothesise two generic types of capitalism: coupon pool capitalism and productionism. In a productionist type of capitalism, the capital market is an unproblematic intermediary between saving households and productionist firms, or between some firms such as banks or network leaders who own stakes in other firms. Coupon pool is a new generic type where the pool of new and issued coupons becomes a regulator of firm and household behaviour and a regulator of macro economic trajectory. (Froud et al., 2002: 5).

The Turkish economy that has been shaped since the early 1980s by the globally spreading neo-liberal policies, is characterised by financialisation similar to that described by Froud et al. Government debt market in Turkey, a bank-based economy (Sönmez, 2001: 245–292), is the source of coupon pool and acts as a “regulator of both macro-economic trajectory and firm and household behaviour”. The neo-liberal economic policies of privatisation, deregulation of capital markets, lifting of capital controls, etc. since the early 1980s in the West, as described for example in Helleiner (1994), have given rise to a system that is characterised by instability caused by stock markets. Froud et al. (2002) characterise this as ‘coupon pool capitalism’. Neo-liberal policies in the context of the developing world similarly emphasised the money markets where high-yield ‘coupons’ issued by governments dominated the macro-economic scene. However, as far as the product markets are concerned, the implications of ‘coupon pool capitalism’ are different between the mature capital market dominated economies and bank dominated developing economies. Under financialisation, capital markets in mature capitalist economies are still a conduit for productive activities but are not reliable valuation mechanisms for economic assets. Whereas in the Turkish case, a developing economy, coupons issued by the sovereign corrupt financial intermediation through the crowding-out effect and cause productive activities to be starved of funds. But in both instances ‘the pool of new and issued coupons becomes a regulator of firm and household behaviour and a regulator of macro-economic trajectory’ (Froud et al., 2002: 5). The following sections of this article will describe the ‘coupon pool’ nature of the Turkish economy in the aftermath of the neo-liberal economic policies that were advocated by the Washington consensus.

THE FINANCIAL CRISIS OF 2001 IN TURKEY

Turkey’s February 2001 financial crisis was the worst since the Second World War, causing shrinkage of the Gross National Product (GNP) by almost 10% in a year. Feeling the adverse global effects of the Asian crisis of 1997 and the Russian debt default of 1998, Turkey agreed to an exchange-rate-based stabilisation programme with the IMF in December 1999. The objective was to bring down the high double-digit inflation and interest rates in order for both to stimulate economic growth and reduce the burden of government debt. To protect its currency in the aftermath of the Asian crisis, Turkey had to increase the domestic interest rates. The nominal interest rate of short-term treasury bills jumped to a staggering 166% in 1998 when the inflation in the same year was 85%, and the following year both fell to 97% and 65%, respectively. In 1999 when the GDP shrank by almost 5% as a result of the global

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1 In Turkey, the bond market, which is exclusively a market for government bonds and treasury bills, is included in capital market activities and reported together with shares in stock exchange statistics. However, given the short maturity of government bonds and the nature of bond investors, who are primarily Turkish banks dealing in money markets, government bonds are technically money market instruments.
economic slowdown, the real interest rate paid on domestic public debt was 32% and this meant that 57% of budget revenues had to be allocated to the payment of the interest cost of the domestic debt as shown in Table I.

During this highly volatile period, 8 banks, out of a total of 52 privately owned banks, became insolvent in 1999 and were taken over by the public Saving Deposit Insurance Fund (SDIF). The total number of banks in Turkey in 1999, including those taken over by the SDIF and those owned by the state and foreign banks, was 81 with 7691 branches. Since the earlier financial crisis of 1994, all bank deposits were fully insured by the state and bankruptcies were not allowed in the banking sector in order to prevent a run on banks with consequences of systemic risk.

Although the exchange-rate-based disinflation programme was at first successful in bringing down inflation and nominal interest rates, the crawling peg was causing two macro-economic imbalances: first, the trade deficit was increasing and second, international financial arbitrage was taking place due to the overvalued domestic currency. The latter further increased the fragility of the banking sector by deepening the maturity and currency mismatch risks on bank balance sheets. A storm similar to the one in East Asia in 1997 was brewing. Finally, the soaring current account deficit coupled with the government’s failure in privatisation were blamed for causing a deterioration in investors’ confidence in the government’s ability to sustain the exchange rate peg. Finally, in November 2002, overnight interbank interest rates went sky high, reaching 2000%, as a consequence of a liquidity crises in the banking sector. These high rates caused the failure of Demirbank, a medium sized bank which was market marker in government debt and had attracted Hong Kong Shanghai Bank Corporation’s interest as a takeover target. In the following panic selling of Turkish Lira, the abandonment of the currency peg could only be avoided by financial support from the IMF who had advised the peg in the first place.

However, the liquidity crisis of November 2000, although prevented from becoming a systemic financial crisis with IMF support, further weakened the banking system and caused a dangerous growth in public debt due to the sudden and large jumps in interest rates to protect the currency peg. It was not a surprise when, two months later in February 2001, a public row between the President and the Prime Minister on the regulation of banks, caused panic in financial markets, which in turn triggered a major financial crisis – like so many previous cases in the emerging economies in the 1990s – and forced the government to abandon the currency peg and float the currency. The Turkish Lira lost half of its value against major currencies and big corporate failures causing large scale redundancies, equally amongst white- and blue-collar workers, soon followed. Turkey experienced its worst economic crisis in its modern history. The shock was psychological as well as economic. An emerging economy witnessed its GNP per capita in US dollar terms being halved overnight due to price movements in financial markets.

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<tr>
<td>GDP*</td>
<td>6.0</td>
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<tr>
<td>Consumer price index†</td>
<td>70.1</td>
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<tr>
<td>Interest rates‡</td>
<td>97.8</td>
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<tr>
<td>Exchange rate§</td>
<td>64.6</td>
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* Growth rate.
† Percentage change.
‡ Compounded yield on Treasury bills.
§ Percentage change in USD/TL exchange rate.
Source: Akyüz and Borotav (2001).
On the policy front, just like the Asian crisis of 1997, the Turkish financial crisis started a debate on the optimum foreign exchange regimes and the crisis management in the developing economies in particular, and a new international financial structure in general. Eichengreen (2001) gives a comprehensive account of this debate by contrasting the spatially distant but temporally close Turkish and Argentinian crises. Debate, naturally, was not limited to the academic and policy circles. The pages of the Financial Times, too, reflected a debate on the wisdom of exchange-rate-based remedies in developing economies that took place between an ex-Turkish Central Banker and an IMF official (Deppler, 2001; Kumcu, 2001). An alternative view on the financial crisis in Turkey is based on the United Nations Conference on Trade and Development’s (UNCTAD) work on financial globalisation and the developing world (Khor, 2001). Following UNCTAD’s line of thinking on policy, Akyüz and Boratav (2001) recommend the temporary suspension of currency convertibility and a standoff on external debt payments for the management of the financial crisis in Turkey. The UNCTAD economists’ alternative approach, to resolve financial crises in the emerging economies by an orderly debt workout along the lines of US chapter 11, has been gaining some international support in attempts to mould a new international financial architecture (Haldane and Krueger, 2002; Krueger, 2002).

**INTRODUCTION OF GOVERNANCE TO TURKEY AS PART OF STABILISATION PACKAGE**

The policy response of the Washington consensus to the Turkish crisis, however, emphasised the governance practices as the quote from Köhler, the IMF Managing Director, at the beginning of this article shows. This was very much in line with the new thinking in the international financial circles that relates financial crises in the developing world to the lack of governance in private and public sectors. The USD 18 billion IMF rescue package for Turkey, which made Turkey the largest IMF debtor in 2001 until Brazil broke the record in 2002 with USD 30 billion, included governance conditionalities in addition to the usual ones that are of a macro-economic nature. When the new stand-by agreement came into effect in May 2001, Turkey promised improved governance to the IMF in its letter of intent (Government of Turkey, 2001). Soon after the Turkish government and the IMF had reached a stand-by agreement in spring 2001, the World Bank initiated in Ankara in September 2001 an ‘International Conference on Good Governance and Combating Corruption’. In July 2001 and April 2002, the two World Bank loans mentioned earlier were approved. These loans were intended to help Turkey implement its reform programme agreed with the IMF and ‘will support the Government’s macro-economic policy framework to create conditions for financial stability, renewed growth and disinflation; restore confidence in the banking system; lay the foundation for more effective government in line with international standards’ (World Bank, 2002, emphasis added).

Prior to the release of the second tranche of the loan at a conference in Ankara on February 14, 2002, organised jointly by the Foreign Investors Association of Turkey, the Turkish Chamber of Commerce, and the Turkish Treasury, Johannes Linn, Vice President Europe and Central Asia Region The World Bank, said that:

Market liberalization and privatization are creating new opportunities for private entrepreneurs, including in the strategically important agriculture sector. The tough measures to combat corruption and improve governance planned under the Government’s public sector reform program will remove hidden obstacles to investment and promote competition. Together with macroeconomic stabilization, these reforms can help Turkey restore sustainable growth and achieve its social objectives.

(Linn, 2002a)
At another conference on the following day Linn praised the national strategy of Turkey for ‘Enhancing Transparency and Good Governance in Turkey’s Public Service’, which had been drawn up by the Anti-corruption Steering Committee appointed by the Prime Ministry (Republic of Turkey Prime Ministry, 2002). She also added:

> It is very encouraging to see that the mobilization of civil society is being matched by vigorous efforts by the Government to develop a broad strategy to combat corruption and implement structural and institutional reforms to improve governance.

(Linn, 2002b)

In the wake of the financial crisis in Turkey, there were big corporate and banking failures, and the true losses of state banks – that control almost a 50% share of the banking sector – equalling nearly 10% of GNP were revealed. Surrounding these failures were a long list of accounts detailing corruption and mismanagement in both the private and public sectors that filled newspaper pages and television airtime. Management behaviour was put under the spotlight by both official and private providers of international capital. The response to the latter’s concerns came from the Capital Markets Board of Turkey in December 2002, when its President announced that the Board would create a new index of listed companies that adhere to the international corporate governance standards. The objective of the initiative is to attract international private capital (Hürriyet, 2002: 11). Although malfeasance existed in both the private and public sectors, it would be rather naïve to think that it was the primary cause of the economic ills and financial crisis. Such behaviour can be best understood within the context of the economic structure that was in operation, and codes of corporate governance are unfortunately aimed at the resultant behaviour but ignore the financialised nature of the economy that influences behaviour.

The IMF stabilisation package gives priority to the governance problem in the banking sector, which is identified as the ‘most urgent problem that the economic programme needs to address’ (Turkish Treasury, 2001a: 3). It is also one of the key priorities of the World Bank’s initiative in supporting the ‘Turkish government’s ‘multi-year financial and public sector reform program’ (World Bank, 2002). The IMF and World Bank see Turkey’s weak financial sector and the banking in particular as the cause of Turkey’s economic problems and urge the restructuring of banks both in private and public hands. According to the reform package of 2001 Turkey’s weak banking system caused ‘serious fluctuations and instability’ in the financial markets (Turkish Treasury, 2001b).

**A MACRO PROFILE OF THE TURKISH ECONOMY**

Turkey, like many developing economies, is a bank-based economy. Although the IMF-designed macro-economic stabilisation and financial liberalisation programme of January 1980 led to the creation of a modern exchange in 1986 and the stock market has gradually become an obsession, a casino-like lure, for public and media, it plays a significantly lesser role in financial intermediation. In 2000, there were 315 companies listed in Istanbul Stock Exchange and only less than 2% of the Turkish population owned shares. In 2002, before the financial crisis, market capitalisation of the stock market as a percentage of GNP was 34.4%, whereas total bank assets to GNP was 78% (Central Bank of the Republic of Turkey, 2000; Istanbul Stock Exchange, 2001). Bank deposits were 57% of all financial assets in 1979, immediately before liberalisation, and 70% in 1986, soon after liberalisation (Sancak, 2002: 5). Although the banking system in Turkey dominates the intermediation process, the percentage of loans to the private sector in their total assets is relatively small compared to both bank-based and capital markets-based economies. In Turkey this ratio
has averaged 13% over the 1990–1995 period, compared to 64% in the United States, 94% in Germany, 75% in South Korea and 46% in Indonesia (Sönmez, 2001: 167). Although private sector banks have more than a 50% of the market share and are primarily part of a bigger family owned commercial conglomerates, they find financing the public deficit, which will be argued below is the source of financialisation in the Turkish context, more profitable than investing in riskier private projects.\(^2\) Even the publicly owned banks that control 34.6\% of the total banking assets and 40\% of the total banking deposits in 2000, had only 26.2\% of the total banking loans to the private sector (Central Bank of the Republic of Turkey, 2000). Savings are pooled in the banking system in Turkey but they are not necessarily transformed into funds for private projects.

Banking has increasingly dominated the economy in Turkey as a result of liberalisation policies. The focus of neo-liberal policies of the early 1980s, which followed the current account crisis of 1978 and aimed to convert Turkey from an import-substitution economy to an export-led economy, was the banking system. Deregulation of interest rates and entry to the banking sector was followed by creation of money markets with the interbank market and government bond market taking the lead. In 1984, the foreign exchange regime was liberalised, allowing current account convertibility and ownership of foreign currency deposits in domestic banks. Full capital account liberalisation came in 1989. Like other countries in the developing world that had current account deficits in the late 1970s and the early 1980s, and had reached stand-by agreements with the IMF, Turkey had gradually become familiar with neo-liberal discourse and practices. Under various structural adjustment programmes, liberalisation and privatisation practices in the 1980s have introduced initial public offerings, stock market investments and foreign exchange deposit accounts into the daily economic life in Turkey. In some sectors of the society, new economic institutions and practices were heralded as modernisation and catching-up with the ‘advanced’ world. In a book that critically discusses globalisation and its impact on Turkey by tracing the projectile of Turkey’s interaction with the world economy from the 19th to the 21st century, Kazgan (2002) observes, in the context of the market reforms of the late 1980s, that:

\[\text{While the (Turkish) economy was in a roller coaster ride because of volatile foreign exchange, money and stock markets... the popular media overwhelmingly were in full praise of the virtues of liberalisation, and believed that currency convertibility would advance Turkey to the level of the developed world.} \]

(My translation from Kazgan, 2002: 149)

Liberalisation programmes of the 1980s deregulated interest rates and shifted the financing of public sector deficit from the central bank to direct security issues by the treasury. Banks became the primary investors in these coupon paying securities. Rational financial risk and return calculations and the regulatory regime were the prime reasons behind these bank portfolio decisions in post-liberalisation Turkey. The bank regulation required that Turkish banks invested nearly 40\% of their funds in treasury securities for liquidity purposes. This was a direct intervention by the government in the intermediation process to make sure that savings were channelled to deficit financing. However, banks were willing investors anyway, as the return on these risk-free assets was very attractive. Instead of lending to risky private companies, banks invested in financial obligations of the least risky entity in the economy, the state. Liberalised interest rates and capital account allowed banks to raise funds domestically

\(^2\) Post-liberalisation ownership structure of private banks in Turkey has been a subject of intense political and public debate. Family owned holding companies needed banks to have direct access to government debt market for high returns and also to finance their industrial investments at low cost. Therefore granting of new banking licences and sale of banks through privatisation became highly politicised processes. Kazgan (2002: 223–335) discusses income distribution effects of this relationship between the political power and the business in Turkey, and Alper and Onis (2002) explore it from a wider political economy perspective.
and internationally at very attractive rates. These funds then were invested in high-yield sovereign obligations. As a result, as observed above when discussing Turkey as a bank-based economy, the banking system was getting bigger as a percentage of GNP, but at the same time the ratio of private loans to bank assets, even in those banks owned by commercial conglomerates, was declining. Consequently the banking system has transformed into a mechanism to finance public deficit that itself, over the years, became a Ponzi scheme. Between 1990 and 1999, the share of government bonds in the total assets of banks has increased from 10% to 23%, whereas the share of loans to the private sector has declined from 36% to 24% (Turkish Treasury, 2001b).

COUPON POOL CAPITALISM IN THE TURKISH CONTEXT

It is argued in the rest of this article that the IMF and World Bank led neo-liberal discourse that emphasises governance in the restructuring of Turkish financial markets and banking is not convincing in addressing Turkey’s economic problems. The governance initiative of the Washington consensus, inspired by the theoretical recipes for the Anglo-Saxon economies, is about prescribed optimum managerial behaviour both in the public and private sectors in the developing world. The coupon pool model of present day capitalism, however, problematises the possibility of such behaviour when the economy is dominated by financial debt and the high yield on such debt. In the Turkish context, too, the effect on managerial decisions of the public domestic debt market that consists of high-yield securities and its macro-economic consequences need to be assessed.

The centre of financial instability in Turkey, like other emerging economies – for example Brazil and Argentina – is the public domestic debt market. Market reforms in Turkey since the early 1980s have led to the growth of the public domestic debt market that ended up in the late 1990s with what the coupon pool model describes as a giant Ponzi scheme.3 In order to be able to service domestic debt, the Turkish government has to issue new bonds and keep rolling over maturing obligations. Table II shows that the interest burden of government debt was less than 1% of GNP in 1980 and went up to 3.5% in 1990. By 2001, the year of the financial crisis, it reached an unsustainable level of 23%. By then interest payments on government debt consumed half of budget expenditure and 79% of all budget revenues, and exceeded the tax revenues. The actual figures for 2002 up to May show that reducing the coupon cost on the economy proves very difficult.

The data in Tables III and IV demonstrate very clearly the Ponzi scheme created by the coupon paying domestic treasury bills and bonds. Table III shows that the public budget deficit in Turkey in the 1990s was due to the interest burden of debt issued by the government. The primary budget (budget excluding interest payments) has been in surplus since 1994. In line with the neo-liberal policies adopted in the 1980s and 1990s, government has retreated from productive activities. The increase in the consolidated budget deficit was not due to fiscal expansionism at all. The increasing share of transfer payments in budgetary expenditures was at the expense of public investment. As Table III shows, the share of interest payments in consolidated budget revenues increased between 1991 and 2001 from 25% to a peak of 80.4%. Hence, new debt was issued to pay rising interest payments. In 2000, interest payments as a percentage of gross borrowing reached 64%.

3 Froud et al. (2002) describe the similarities between the US fraudster Ponzi’s investment scheme and the role of capital markets in present day capitalism. This scheme, also referred as ‘pyramid scheme’, has been regularly observed in the liberalised financial markets of the developing world.
Between 1992, when the Turkish financial markets were fully liberalised, and 1999, the real interest paid on government domestic debt averaged 32% per annum, while the real annual growth rate of GNP averaged 4% (Turkish Treasury, 2001b: 3). A combination of increasing debt stock and international financial instability after the Mexican peso crisis in 1994 and the Asian crisis of 1997 meant increased real risk premium on domestic public debt instruments (bonds and bills) with short maturities.

Table IV shows that, in 1990, Turkey’s domestic debt stock as a percentage of GNP was 14.4% and the interest paid on this stock was 3.5%. In the same year, foreign debt stock was twice the size of domestic debt at 32.2% but the interest burden was only 2.14% of GNP. By 2001, although domestic debt stock was still less than the foreign debt stock, 68.1% compared to 78.5%, the interest cost was almost five times more. However, the domestic debt market was not limited to residents only. Fully liberalised capital account allowed the so-called fleet footed international capital to play a considerable role. Between 1990 and 2000, the cumulative net capital inflow was USD 75 billion, about 42% of average GNP during the same period. (Akyüz and Boratav, 2001: 7). However, gross foreign direct investment totalled only USD 7.2 billion between 1992 and 2000 (Alper and Onis, 2001: 11). This sharp contrast between the values of capital flow and foreign direct investment is another evidence for the financialisation process in Turkey. International capital was attracted by the high-real returns offered through the coupons of government debt issues and the projects in the real economy could not compete with such returns.

### Table III: Government debt dynamics in Turkey.

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</thead>
<tbody>
<tr>
<td>Consolidated budget deficit*</td>
<td>-5.3</td>
<td>-4.3</td>
<td>-6.7</td>
<td>-3.9</td>
<td>-4.0</td>
<td>-8.3</td>
<td>-7.6</td>
<td>-7.3</td>
<td>-11.9</td>
<td>-10.9</td>
<td>-16.0</td>
</tr>
<tr>
<td>Primary surplus (deficit)†</td>
<td>-1.5</td>
<td>-0.6</td>
<td>-0.9</td>
<td>3.8</td>
<td>3.3</td>
<td>1.7</td>
<td>0.1</td>
<td>4.3</td>
<td>1.8</td>
<td>5.3</td>
<td>6.9</td>
</tr>
<tr>
<td>Interest payments:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>(a) As percentage of net borrowing</td>
<td>72.0</td>
<td>67.8</td>
<td>92.4</td>
<td>196.3</td>
<td>195.8</td>
<td>118.1</td>
<td>110.6</td>
<td>168.7</td>
<td>103.7</td>
<td>163.7</td>
<td>219.0</td>
</tr>
<tr>
<td>(b) As percentage of gross borrowing</td>
<td>35.7</td>
<td>27.1</td>
<td>41.3</td>
<td>43.0</td>
<td>37.7</td>
<td>36.3</td>
<td>43.0</td>
<td>47.9</td>
<td>40.2</td>
<td>63.9</td>
<td>57.3</td>
</tr>
<tr>
<td>(c) As percentage consolidated budget revenues</td>
<td>24.9</td>
<td>23.1</td>
<td>33.1</td>
<td>40.0</td>
<td>41.3</td>
<td>55.4</td>
<td>39.6</td>
<td>52.8</td>
<td>57.0</td>
<td>61.5</td>
<td>80.4</td>
</tr>
</tbody>
</table>

*Percentage of GNP.
†When interest on government debt is excluded from the budget.

This high cost of the coupon paying financial instruments issued by the government adversely affected the investment in health, education and justice. Table V shows that in 1991, 42% of government expenditure was for the payment of the salaries of state employees. Privatisation and other similar measures reduced this figure to 19% in 2001. Public investment is reduced from 9% to 5%, and subsidies to state owned economic enterprises were reduced from 9.4% to 1.5%.

In their coupon pool capitalism model, Froud et al. (2002) observe that in Western economies, governance models set unrealisable rate of return targets for companies by using the stock market performance as a benchmark, and as a result there is an intensification of the risk of financial bubbles and instability. The government domestic bond market plays a similar role in Turkey. Managerial behaviour needs to be assessed within the absurdly enlarged government debt market. Since Turkish companies cannot achieve rate of return figures even approaching, let alone surpassing, 32% per annum in real terms from their product market activities, they instead invest in the ‘coupon’ paying financial assets generated by the government. A survey carried out by the Istanbul Chamber of Industry revealed that the largest 500 non-financial companies by sales have earned more in interest income from government bonds than from their ordinary activities since 1998. This investment behaviour of Turkish companies has dominated discussions in the economic press in Turkey in the post-mortem of the crisis in 2001 (see, for example, Tuncer, 2002). The data in Table VI demonstrates well the effect of coupon pool capitalism in the Turkish context on firm behaviour. In a bank-based economy like Turkey, coupon pool capitalism increases the interest burden of private companies due to very high real interest rates, which eventually leads to bankruptcies. It also encourages companies to improve their financial performances by investing funds in short-term coupons rather than employment generating long-term projects. The net interest burden of the largest 500 non-financial companies increased to 8.1% of nominal sales in 2001 from 6% in 1996. The same group of companies could achieve positive pre-tax income since 1998 not from their ordinary activities but from extra-ordinary activities that include interest income on coupon paying financial instruments. Table VI shows that the interest income

### Table V: Components of government expenditure (in per cent).

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Payments</td>
<td>18.5</td>
<td>18.2</td>
<td>24.0</td>
<td>33.2</td>
<td>33.7</td>
<td>38.0</td>
<td>28.5</td>
<td>39.6</td>
<td>38.2</td>
<td>43.5</td>
<td>51.4</td>
</tr>
<tr>
<td>Domestic debt</td>
<td>13.0</td>
<td>13.8</td>
<td>19.1</td>
<td>26.0</td>
<td>27.8</td>
<td>33.7</td>
<td>24.8</td>
<td>36.1</td>
<td>35.0</td>
<td>40.0</td>
<td>47.0</td>
</tr>
<tr>
<td>Foreign debt</td>
<td>5.5</td>
<td>4.4</td>
<td>4.9</td>
<td>7.3</td>
<td>5.9</td>
<td>4.3</td>
<td>3.8</td>
<td>3.5</td>
<td>3.2</td>
<td>3.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Transfers to state economic enterprises</td>
<td>9.4</td>
<td>3.7</td>
<td>5.3</td>
<td>2.3</td>
<td>2.7</td>
<td>1.3</td>
<td>1.5</td>
<td>1.0</td>
<td>1.5</td>
<td>1.9</td>
<td>1.5</td>
</tr>
<tr>
<td>Personnel</td>
<td>42.0</td>
<td>47.1</td>
<td>38.4</td>
<td>32.9</td>
<td>29.4</td>
<td>24.7</td>
<td>25.9</td>
<td>24.8</td>
<td>24.6</td>
<td>21.2</td>
<td>19.0</td>
</tr>
<tr>
<td>Investment</td>
<td>9.0</td>
<td>8.6</td>
<td>7.5</td>
<td>5.6</td>
<td>5.4</td>
<td>6.0</td>
<td>7.4</td>
<td>6.4</td>
<td>5.6</td>
<td>5.9</td>
<td>4.9</td>
</tr>
</tbody>
</table>

*Source: State Planning Organisation of the Republic of Turkey Prime Ministry (2002).*
of the largest 500 non-financial Turkish companies has been greater than the net income from ordinary activities. This kind of company behaviour looks similar to the one described by Froud et al. (2000, 2002) when the management of companies in mature economies resort to financial-engineering methods to achieve unrealistic returns dictated by capital markets that are driven by shareholder value.

Not only does the financialisation caused by the huge public debt market discourage firms from investment activities, but it also deprives them of funds through the well-known crowding out effect. Private sector investments are crowded out by gigantic government borrowing, which is possible and is at the same time sustained by long periods because the interest rates and capital account are dogmatically liberalised. As well as regulatory obligations, rational risk and return calculations make banks invest, through their treasury operations, in high yielding public debt rather than invest in riskier commercial loans. Hence financialisation in Turkey affects management behaviour in the banking sector, which as a result has become the source of the instability that is very familiar in crisis ridden emerging economies and documented very extensively in the literature (see, for example, Allen, et al., 2002). The objective correlation in this instance though is a financial sector in Turkey where intermediation in the true economic sense of the term, channelling savings into productive investments, is not economically viable. In the context of developing economies this can be described as the coupon pool crowding out productionist capital and causing financial instability and poor economic performance.

Between 1990 and 1999, the share of government bonds in the total assets of banks has increased from 10% to 23%, whereas the share of loans to the private sector has declined from 36% to 24% (Turkish Treasury, 2001b). Even after the reform package that followed the financial crisis in 2001, Turkish banks continue to invest in government debt because of the continuing high coupons paid rather than improve their economic role of financial intermediation. At the end of the first half of 2002, Turkish banks held TL 74,000 trillion of domestic public bonds, increased from TL 59,000 trillion at the end of 2001 (Yildirim, 2002). This means that banks hold 58% of the outstanding coupon paying public debt. In 2000, total deposits in the banking sector were equal to 50% of GNP, whereas total loans were only 23%. Turkish banks channel only 45% of the savings they collect from households and firms into private sector loans (Turkish Banks Association, 2001: 28). The liberalisation of financial markets and creation of money and capital markets in Turkey did not create an efficient market system where savings are channelled into profitable production. Instead, they gave rise to a giant Ponzi scheme where the government paid real interest rates in the region of 30% per annum, not to invest in the economy but to service its domestic debt. This form of

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**TABLE VI** Impact of financialisation on largest 500 non-financial companies by sales in Turkey.

<table>
<thead>
<tr>
<th>Percentage of nominal sales</th>
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</thead>
<tbody>
<tr>
<td>----------------------------------</td>
</tr>
<tr>
<td>1. Net interest paid</td>
</tr>
<tr>
<td>2. Non-operating income</td>
</tr>
<tr>
<td>a) Interest income</td>
</tr>
<tr>
<td>b) Other non-operating income</td>
</tr>
<tr>
<td>3. Operating income (loss)</td>
</tr>
</tbody>
</table>

Pre-tax Income (2 + 3) | 9.7  | 10.0 | 6.5  | 3.8  | 4.6  | 1.3  |

**Source:** Istanbul Chamber of Industry (2002). 4

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4 The data on Table VI is kindly provided to me by Dr E. Özütün, the Economist of Istanbul Chamber of Industry (ISO).
financialisation seems to characterise the recent problems of Argentina and Brazil, too. Coupon paying government debt obligations in domestic currency dominate the economic landscape (Financial Times, 2002b: 10). Household savings are channelled into these debt instruments through the banking system. Banks pool small savings and invest them primarily in coupon paying government debt instruments. In 1990, the share of government securities in total financial assets was 19%, Turkish lira denominated financial assets including money in circulation 54%, and foreign currency deposits in domestic banks 15%. In 2000, the share of government securities jumped to 35%, equalling two-thirds of combined TL and foreign currency financial assets in domestic markets. The anticipation of a devaluation due to the government debt market dynamics led households to reallocate financial assets in their portfolios, and by the year 2000, 44% of all bank deposits were in foreign currency, an increase from 24% in 1990. This portfolio decision by households has further increased the risks in the banking sector as the level of currency mismatch became higher. High real yields on Turkish lira denominated government bonds encouraged Turkish banks to borrow both domestically and internationally in foreign currencies at short maturities and invest in Turkish lira denominated government financial paper at relatively longer maturities. Currency and maturity mismatch in bank assets and liabilities are normal as long as banks are well capitalised to absorb unexpected losses from unfavourable currency and interest rate movements. According to Belli (2002), the logic of financialisation, the Ponzi scheme created by the government debt market, created a regulator behaviour that allowed under-capitalised and weak banks to continue to invest in government securities. Banks financed their investments in government securities by borrowing abroad in foreign currencies and raising foreign exchange deposits from residents. The following banking statistics show how the banking system in Turkey has gradually become riskier and hence increased financial instability in the economy: in 2000, the average maturity of government bonds was 429 days but the banks financed these assets through deposits with an average maturity of 78 days. In 2000, Turkish banks had more foreign currency liabilities than foreign currency assets, the gap being USD 17.3 billion, 11% of the total assets of banks. Fourteen per cent of Turkish commercial banks’ total liabilities in 2000, USD 22 billion, was borrowing from abroad in foreign currency (Turkish Banks Association, 2001). The high-yield coupons of government securities encouraged banks to carry out arbitrage activities between international markets and the domestic debt market. When the banks’ assets and liabilities are mismatched in maturity and currency to such a high degree without a proper hedge, a sudden increase in interest and foreign exchange rates naturally destabilises such financial systems.

Although the high yield on these bonds is the primary reason, the government also introduced regulations whereby banks have to hold short-term government securities to meet the required high-liquidity ratios. The high ratio of bank assets in government debt was both voluntary and forced. The international financial community and commentators, including official agencies like the World Bank and IMF, tend to explain this observed bank behaviour by lack of governance and ‘crony capitalism’. However, such bank behaviour is not inconsistent with rational economic behaviour. For example, in explaining the intermediary role of banks in the economy, Fama (1980) states that banks exist to provide portfolios against which depositors are willing to hold claims. Banks provide this portfolio management service to earn a competitively determined management fee, which is the difference between

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5 In Brazil, the total debt stock of the public sector is USD 250 billion. Of this, only USD 75 billion is owed to the foreign lenders. Brazilian public debt constitutes 30% of Brazilian banks’ assets. In Turkey, this figure is 23%. In emerging markets, the uncertainty about governments’ ability to roll over and pay interest on maturing debt, read sustainability of the Ponzi scheme, is a source of near-permanent financial instability.
the returns on their portfolios and what they pay to their depositors. In this context, banks are concerned with the fees they earn rather than with the types of portfolios they provide.

The form of financialisation described above is not peculiar to Turkey but also characterises other developing economies. In discussing the current Brazilian financial crisis, the leader writer of the Financial Times stated that:

If Brazil restructured its domestically held debt, it would crush the banking system, which holds about 30 per cent of its assets in government securities.

(Financial Times, 2002b: 10)

The developing world version of ‘coupon capitalism’ creates a macro-economic environment very similar to the one in advanced capitalist countries. In both instances:

... financial paper traded in the capital markets and coupon pool capitalism exists where the financial markets are no longer simple intermediaries between household savers and investing firms but act dynamically to shape the behaviour of both firms and households.

(Froud et al., 2002: 2)

**CONCLUSION**

A key policy response from the Washington consensus to the financial crises in the emerging economies in the 1990s has been the introduction of good public and private governance as part of the stabilisation packages. Public and managerial behaviour, especially in the banking sector, was believed to have contributed significantly to the fiscal deficits and weak banking system, with large credit, and asset and liability risks. In this context, the key parameters of the debate have been the suitability of pegged exchange rate systems, the role of liberalised capital account and the supervision of banks. However, the financialisation of the emerging market economies through the ever growing domestic debt market and its effect on the behaviour of economic agents are not problematised.

In Turkey, the government debt market plays the role of ‘coupon pool’ as a source of the benchmark unrealistic rate of return on capital, and consequently the financial instability. The deepest financial crisis in Turkey, which occurred in 2001 and made Turkey the largest IMF borrower until the recent USD 30 billion rescue package for Brazil, has its roots in the government debt market. In November 2000, the tenth largest Turkish bank, Demirbank’s – since acquired by HSBC of the United Kingdom – exposure to risks in this market triggered the crisis. The financial liberalisation process, promoted by the IMF and the World Bank, led to the creation of a domestic public debt market with high-yield coupons, which gradually determined the economic behaviour of investing firms, household savers and financial intermediaries.

The liberalisation project in Turkey advocated by the Washington consensus as in other developing economies since the early 1980s, did not lead to the creation of an efficient and rational financial intermediation either domestically or internationally. The international aspect has been the subject of discussions on globalisation questioning the destabilising role of short-term capital flows. The domestic aspect, on the other hand, gave rise to debates on the sustainability of fiscal deficits, the macro-economic consequences of fiscal deficits and public debt dynamics under fixed or floating exchange rate regimes. In this context, a debate on crisis intervention was inevitable as well. However, all these debates, within the developmental economics framework, seem to ignore the fundamental financial question: the relationship between the return on financial assets and firm and managerial behaviour. The latter has become the main pre-occupation of the international official and private providers of finance and is articulated in the efficient use of capital arguments within the
governance debate. But this view ignores the effect on managerial behaviour in the developing world of the financial return dynamics created by financial liberalisation. The model advocated by the Washington consensus for the developing economies is the Anglo-Saxon example where firms are pressurised through governance demands to achieve unrealistic returns on capital set by capital markets. The management of publicly listed corporations have to play a dangerous balancing act between what is achievable in today’s competitive product markets and what is expected in capital markets. The coupon pool capitalism construct explains this present day contradiction in mature capitalist economies and relates it to the instability and crisis observed in financial markets. In the core of this analysis is the rate of return dynamics, which the author thinks, similarly applies to the developing world’s finance-led economic crises. In the case of Turkey, the effect of governance on managerial behaviour is far less significant compared to the rate of return dynamics that has resulted from financial liberalisation, which is the cause of financialisation. The neo-liberally designed money markets in the developing economies lead to the trading of treasury coupons with yields that are impossible to achieve in today’s global product markets. The governance initiatives of the IMF and the World Bank do not address this fundamental relationship between the cost of capital and the return on investments in a globalised economy where over-capacity and outsourcing make it very difficult for private firms in the developing world to achieve returns superior to the ones that exist in domestic financial markets. Hence, the economic policies that are promoted by the Washington consensus, wrapped up in a rhetoric of governance – and within the context of competition for international capital and sustainable public debt dynamics – fail to acknowledge the effect of yield dynamics in financial markets on the behaviour of private firms and are themselves doomed to fail. From the policy point of view, in a world where product markets are internationally very competitive, the implications of the dynamics of financialisation in the developing world deserve more attention than governance. Kaplinsky (2000), for example, argues how, under globalisation, the value chain in product markets is transformed with significant income distribution and competitive implications for the developing economies. The emphasis on governance in the developing world distracts policy makers from such crucial structural issues with grave economic consequences.

Acknowledgements

The author is grateful to Karel Williams for his encouragement and suggestions. The author also likes to thank the anonymous referees for their comments on the first draft of this article.

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