

## Chapter 20

# The Relationship between Current Account Deficits and Unemployment in Turkey

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### ABSTRACT

*In this chapter, we test the nature of the variety of empirical relationships between current account deficits and unemployment in Turkey over 2000Q1–2012Q1. Our working hypothesis in this paper is that the meager job creation in Turkey over 2000s is the direct symptom of a speculative-led growth environment (Grabel, 1995) together with an excessively open and unregulated capital account in the age of relatively cheap and abundant global finance. Based on the vector error correction model (VECM), we found that there is a unidirectional causality running from current account deficits to unemployment. Both Impulse Response and Variance Decomposition analyses are quite consistent with results of VECM. We interpret these findings as evidence of the structural characteristics of unemployment, reflected in output elasticities, being embedded under the deepening external fragility of the Turkish economy over the 2000s.*

### INTRODUCTION

A major enigma of the Turkish macroeconomic path over the 2000s was the relatively high and persistent rate of open unemployment. This observation came at odds against rapid growth and a significant surge in exports over the decade. The rate of open unemployment which stood at 6.5% in 2000 has jumped to 10.3% in 2002 in the after-

math of the February, 2001 financial crisis. Since then, the Turkish Gross Domestic Product (GDP) has increased by a cumulative 40% in real terms. Nonetheless, employment generation capacity of this rapid growth had been rather dismal, and the open unemployment rate could not be brought down below 9% by the end-of 2007, just before the eruption of the current global economic crisis. Despite rapid expansion of production in many

DOI: 10.4018/978-1-4666-9548-1.ch020

sectors, civilian employment increased sluggishly at best, and labor participation remained below its levels as observed during the 1990s.

The *medium term economic program, 2013-2015*, chartered by the Turkish State Planning Organization (SPO) as well documents that unemployment is expected to remain at the plateau of 10% over the programming horizon. A further caution is that Turkish labor market is suffering from informalization and marginalization, with low labor participation rates, lack of health and social safety nets, and increased fragmentation. These assessments are also shared by many other national and international agencies and researchers of the Turkish economy.

According to some interpretations, the meager job creation of the economy is due to the excessive regulatory framework and the imposed tax burden. Turkey indeed has one of the highest tax burdens in its labor markets in comparison to the OECD averages. Tunali (2003), for instance, reports that the social security contributions of the employers reach to 22%, and together with other taxes on labor employment, create an additional cost burden for employers reaching as much as 35% over net wages. Tunali further argues that employment protection laws may have increased the insecurity faced by the workers as employees try to avoid severance payments by shifting their labor demand to workers mostly from the informal market. This undoubtedly has adverse consequences for tax revenues and also on the formal industrial relations.

Ercan and Tansel (2007), on the other hand, report that it is the Labor Act introduced in 2003 which was the main source of the problem. The Law is criticized (mostly by the employers' wing) on the grounds that the job security clauses that had been introduced in 2003 led the employers to be more reluctant in expanding formal employment. Ercan and Tansel also summarize the workers' unions' opposition to this argument stating that it is the first time with the new act, "flexi-time" and "flexible work" *de*-regulations entered the

Turkish labor scene. Yet despite conducive policies towards the desired "flexibilities", still not enough jobs have been created. In fact, existing studies claim in this regard that labor market regulations and other "distortions" in the *formal* economy may actually not binding for the larger segment of the labor market (Agénor et al, 2007; Onaran, 2009). Onaran (2013), for instance, argue that wages actually exhibit a high degree of flexibility as the power of trade unions has eroded significantly in the past two decades.

An alternative hypothesis is that the jobless growth problem ought to be regarded as a direct symptom of the current *macroeconomic framework* together with an excessively open capital account and widespread financial speculation. According to this line of thought, due to virtually an unregulated capital account and the relatively high real rates of interest prevalent in the Turkish financial markets, Turkey is observed to receive massive inflows of short term finance capital. As a result, the domestic currency, *TL* (Turkish Lira), appreciates and Turkey suffers from a widening current account deficit. Appreciated currency brings forth a surge in imports together with a contraction of labor intensive, traditional export industries such as textiles, clothing, and food processing. This leads to contraction of formal jobs and increased informalization of economic activities (see Yeldan, 2006, 2011; Onaran, 2008).

In fact, a further key distinguishing feature of the Turkish economy over the 2000s was the eruption of the current account deficits in almost a structurally permanent manner. Traditionally Turkey used to display a fair balance in its current account. However, starting 2003 annualized current account deficit, as a ratio to the gross domestic product, increased to the 3 – 4% band, and then jumped above 6% after 2006 to reach a record high 9.7% in 2011.

Our working hypothesis in this chapter is that the meager job creation in Turkey over the 2000s is the direct symptom of a speculative-led growth environment (*a la* Grabel, 1995) together with an

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