Globalisation and deglobalisation

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Abstract

Globalisation has contributed positively to the global economy in terms of economic growth and welfare. However, especially amid rising global interdependence, closer synchronisation of business and financial cycles and stronger linkages across monetary, macroprudential and fiscal policies, as well as burgeoning protectionist sentiments, the changes it causes in the flow of goods, services, capital and people can also be disruptive, destabilising processes of production and funding. Future policies should aim to maintain stability while ensuring that efficient flows can be maintained.

Keywords: policy linkages, business cycles, financial cycles, capital movements, goods and services trade, migration, spillovers, emerging markets.

JEL classification: F10, F21, F22, F60, E3, E63.

Introduction

Globalisation contributes to economic growth through increased access to a larger pool of goods and services, financial saving and investment opportunities, flows of workers, the spread of technological progress and improved welfare. Following reforms in the early 1980s, Turkey increased its participation in the global economy by liberalising its trade regime followed by its financial sector and capital accounts. As a result, Turkey today has a globally integrated economy, the 15th largest in the world.

While capital is highly mobile, and trade in goods and services is ever more global, protectionist sentiments are starting to burgeon, especially in the advanced economies. As a result, the mobility of people, another factor of production, is facing even more constraints than before. Despite rising conservative attitudes elsewhere, we in Turkey see this as an opportunity to access a young and dynamic population that is eager to learn and contribute to our future growth prospects.

Increased globalisation has also resulted in a higher synchronisation of business and financial cycles, which calls for the need for greater policy cooperation both internally between monetary policy, fiscal policy and macroprudential policies, as well as internationally. Following the Great Financial Crisis (GFC), the Turkish financial sector has been able to swiftly substitute sources of external funding in response to changes in global liquidity, and is one of the many EMEs that extensively use macroprudential policies.

In sum, globalisation has positive contributions to make in terms of economic growth and welfare. However, especially in a new world setting of increased interdependence, the changes it causes in the flow of goods, services, capital, and people can also be disruptive in nature, destabilising production and funding processes. Future policies should aim to maintain stability while ensuring efficient flows can be maintained.

Capital

Following the liberalisation process that started in the 1980s, Turkey is well integrated into global capital markets and attracts cross-border investments and flows of funds into its domestic markets. Liberalisation efforts in this period were coupled with simultaneous financial innovation and technological progress globally, resulting in lower transaction costs and better payments systems, paving the way for faster, cheaper and more secure transactions, which further augmented the growth of cross-border flows.

Higher level of globalization in financial markets is championed for increasing saving and investment opportunities for both individuals and firms, and raising welfare for market participants through expanded possibilities for diversification. After the onset of the GFC, however, many countries started to discuss the relationship between heightened global integration and increased vulnerability to shocks from abroad. Market participants are concerned about contagion and the spillover of unstable external factors into their domestic financial markets, disrupting markets and causing an inefficient allocation of resources. In this setting, continued

access to foreign sources of funds becomes a concern of utmost importance to most EMEs.

Here Turkey stands out from the rest of its peers, as recent experience has shown that sources of liquidity can be substituted when there is a shortage in one particular region or resource. In addition to the risks raised by the GFC, recently certain regional risks to the traditional sources of global liquidity have increased. A large concentration of funding sourced from one particular region could therefore create a systemically significant potential for disruption if regionally specific risks were to increase. Thanks to their strong fundamentals, Turkish banks have shown resilience against a potential funding concentration risk by increasing their access to sources of liquidity from regions outside the traditional financial centres located in the euro zone, the United Kingdom and the United States.[1] As a result, the number of lender countries has increased from around 75 during the time of the crisis to about 110 at the beginning of 2017. The share claimed by the top 10 sources of funding has fallen from 85% to just below 70% in the same period, showing that the diversification consists not only in the number of countries, but also in the volume of funding accessed from the top sources. In the end, the share of non-traditional sources in total external debt has increased from about 15% to 35%.

Currency movements in an environment of high interest rates and financial fluctuations may add to existing macroeconomic risks, especially for countries whose corporate sectors have incurred foreign currency-denominated debt. Compared to peer countries, the ratio of corporate financial debt-to-GDP in the Turkish corporate sector is at relatively moderate levels, and the pace of growth has slowed down in the past two years. While the high rollover rates and long maturity of corporate indebtedness help alleviate concerns over currency and liquidity risks, the currency composition of debt remains a potential concern, as the corporate sector has large FX loans, partly unhedged.

To this end, the CBRT, in coordination with other public entities, has initiated a coordinated study aimed at enhancing price and financial stability and improving the economy's resilience against FX volatility. As a first step, the Bank has collected granular data on firms to better assess corporate FX positions, cash flows and hedging behaviour. Following this assessment, the roadmap for a possible regulatory framework and a policy response for FX risk management and hedging instruments will be determined in line with the best market practices. Proactive regulation of this nature will certainly contribute not only to financial stability but to overall economic resilience.

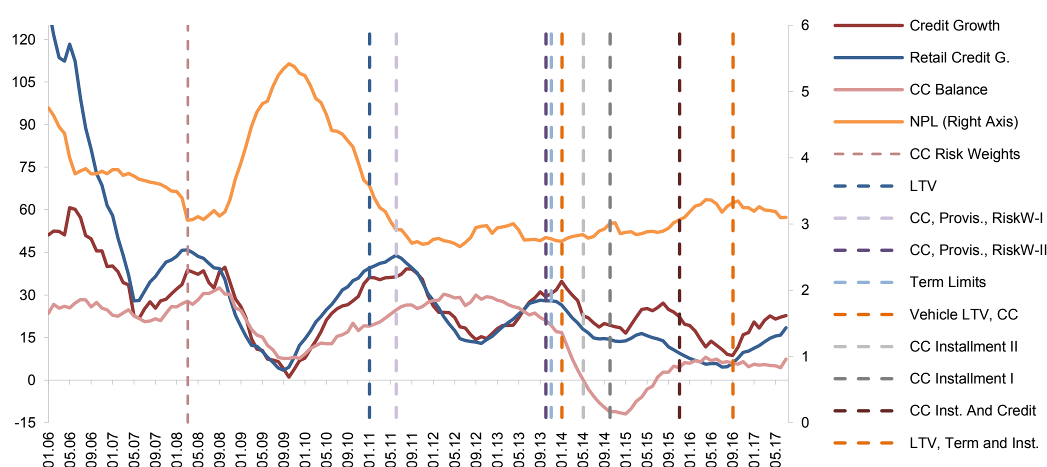
Spillovers and policy responses: Another concern raised over the effects of globalization is that heightened global interconnectedness has increased the synchronisation of both business and financial cycles, especially during downturns. In response, many countries have used macroprudential policies in efforts to counter transmission mechanisms and decouple the domestic cycles from the negative cycles seen in external markets. Following an overhaul of the banking sector in 2001, and active use of a wide variety of policies at different points in the cycle in response to varying needs of the market recently, Turkey weathered the GFC and its aftermath relatively well, showing that global integration does not necessarily translate into cycles of equal magnitudes across connected markets. The post-GFC monetary policy stance of advanced economies increased global liquidity and short-term capital flows

[1] T Çapacıoğlu (2017).

into EMEs, raising concerns about financial stability risks. Like many other EMEs, Turkey used macroprudential policies to limit fast credit growth. Turkey in particular approached the issue in a multi-faceted manner, and employed a number of measures that limited credit demand and credit supply by applying reserve requirements, general provisions, capital adequacy risk weights, and restrictions on consumer and commercial credit (Graph 1). In response to large fluctuations in some foreign currencies, households were prohibited from taking out FX-based or FX-linked loans, as they have no natural hedge against exchange rate movements. For the same reason, only firms with natural hedges, or large firms above a certain threshold, were allowed to continue borrowing in FX.

Credit growth and macroprudential policies

(Percent) Graph 1



Note: NPL is drawn scaled to the right-hand axis. Data are from the BRSA, latest data from August 2017.

Not surprisingly, one of the initial post-crisis measures was loan-to-value (LTV) caps of 75% for retail housing loans and 50% for corporate real estate loans, which were introduced in 2011. A ladder system for LTV caps on vehicle loans was introduced later, which also helped to soften demand for credit and ease the pressure on the currency and current accounts. On the consumer side, further measures to curb demand were taken: as individuals were using credit cards with large number of payment instalments, credit cards were functioning as a short-term credit mechanism rather than a means of payment. To counter this, a cap of nine months on the number of credit card instalments was introduced, credit card minimum payments were tied to credit card limits, and limits were linked to income. The maximum maturity allowed on general purpose loans was restricted to 36 months, and on vehicle loans to 48 months. Non-bank financing companies were also included in the reserve requirement system. The measures were successful in curbing credit growth in the aftermath of the GFC.

More recently, signs of economic recovery in advanced economies have helped slow capital flows into EMEs. Turkey's credit growth rate has slowed, which was also in part due to the success of the macroprudential policies. In 2016, in a setting of slowing down credit growth in both commercial and retail side, a number of easing measures were implemented. On the consumer side, the LTV ratio for housing loans was increased, the maximum maturity of general purpose loans was increased from

36 months to 48, the number of payment instalments allowed on credit cards was increased from nine to 12, and a restructuring facility for existing balances in credit cards and general purpose loans was implemented with maturities as high as 72 months.[2] On the supply side, general provisions for commercial loans were reduced, and the incremental provisioning applied to consumer loans was abolished. As a result, credit growth started to pick up again in the fourth quarter of 2016.

Another outcome of this period was the decoupling of the relationship between credit growth and the NPL rates seen in the economy. NPL rates usually rise as credit growth slows, as seen in the case of the Turkish economy during the GFC. However, following the introduction of macroprudential policies, in the post-2011 era we see that the relationship is much more gradual, with moderate changes in NPL ratio in response to the general slow-down in credit growth.

Migration

As mentioned above, and in parallel with rising protectionist sentiment relating to trade in goods and services, the movement of people – seen as a factor of production that has historically not enjoyed the same level of mobility as capital – has come under even greater scrutiny than before. In Turkey, we have approached the subject of migration first and foremost as a humanitarian matter. While migration does raise various predicaments relating to social adjustment, infrastructural capacity and economic costs; we see the presence of migrants in Turkey as a welcome development that will undoubtedly invigorate the labour market and contribute to our existing multicultural richness.

In a recent paper, CBRT researchers have found the effects of the inflow of Syrian refugees on the local labour force to have been limited, with rather favourable effects on the informal labour sector while having no significantly depressive effect on the wages of local labourers.[3] On the other hand, the influx of job seekers has added to the unemployment rate, especially among women and low-skilled workers as well as the informally employed whom they have replaced. The population of migrants has also contributed positively to domestic demand and therefore to GDP growth by some 0.2–0.3 percentage points while the substitution of local informal workers with migrants is calculated to have depressive effect of around 2.5 percentages on CPI.[4] And to tie the issue with mobility of capital, there has been an increase in the number of enterprises operating with Syrian capital, which have further contributed to the growth in domestic economic activity.

Further, migrants may elect to return to their countries of origin in the future. But even if they did decide to stay, it would not be accurate to evaluate their presence in the labour market as an inflow of permanently less-skilled labourers. Most migrants are young. Together with future generations, they will have an easier time integrating into society and are expected to be more flexible in closing any skills gap. A similar kind of movement was seen among the Turkish guest labourers in Germany, who started migrating there in the early 1960s. The influx of low skilled-workers, who were

[2] S Baziki (2017).

[3] Ceritoğlu et al (2017).

[4] Konuk and Tümen (2016).

thought to be temporary, proved to be rather permanent. Currently the third generation of migrants has moved up the production ladder, and became an indispensable part of society and the economy, as well as the political sphere with their presence in academia, the sciences, the arts, and representation in both local and federal level politics.

Ultimately we think this issue is best approached with a long-term humane outlook rather than a focus on the short-term economic costs. And if the Turkish migrant experience in Germany is any indication, then we expect the migrant population to contribute to our economic growth and welfare in the long run, which will outweigh any short-term costs.

Goods and services trade

The economic reforms integrating the Turkish economy with global trade began in the early 1980s in the form of growth policies geared towards promoting exports, similar to the experience of many other EMEs. Today, Turkey is well integrated into global trade in goods and services as a liberalised open economy. As the world's 15th largest economy and the 28th largest export economy, Turkey is a not only an affiliate of multilateral trade agreements through its membership in the European Customs Union, World Trade Organisation and EFTA but it is also a partner in many bilateral trade agreements.[5] The EU is Turkey's largest trading partner in both imports and exports, while Turkey itself ranks fourth among the EU's export destinations and fifth among its sources of imports.

Turkish exports have moved away from agricultural goods to mostly value added exports, such as machinery, textiles, transport materials, and manufactured goods and metal products.[6] A study of export destinations shows that Turkey is well integrated into global markets, selling goods to both EMEs and advanced economies.[7] Turkey also benefits from access to other EMEs and advanced economies as sources of intermediate goods.[8] This outcome is further supported by the establishment of subsidiaries and other direct investments of foreign firms. China, Russia, Korea and Iran are among the top five sources of intermediate goods, after the EU, and provide the economy with access to machinery and its intermediates, semi-processed metals, plastic goods and resources.

Increased globalisation has seen the development of a more complex bundle of Turkish exports. Productivity fuels economic growth, and a more productive and competitive business environment will yield to a larger global presence through a higher share of global trade. In this regard, it is of utmost importance to analyse the

5 Bilateral trade agreements were signed with Albania, Bosnia-Herzegovina, Chile, Croatia, Egypt, Georgia, Israel, Jordan, Lebanon, the Republic of Macedonia, Montenegro, Morocco, the Palestinian Authority, Syria, Serbia and Tunisia.

6 Aydın et al (2007) find that the 2001–04 period saw an upward trend in specialisation in high technology-intensive exports compared with the previous six years.

7 The top five export destinations reveal a similar picture: the EU, the United States, Switzerland, Iran and Iraq.

8 Yükseler and Türkan (2006) find that the Turkish export sector is increasingly integrated with imports.

country's export mix to assess how its firms fare in terms of global competition. In a global study of economic complexity, researchers measure the relative concentration and intensity of knowledge in a country by looking at the range of exported goods.[9] Using this measure Turkey's level of diversity in complex products has placed it as the 40th most complex exporting country in 2015, up from a ranking of 50th in 2000, well above its other EME peers. This indicator has been shown to be a powerful indicator for future growth and shows potential for Turkey to positively diverge from the rest of its peers in the future.[10] Turkey has also outperformed its potential in terms of economic size and product range in global comparative advantage: in the latest data available for 2015, Turkey had a global comparative advantage in about 400 products.[11]

The distributional effects of trade are much discussed both in academia and by policymakers. Trade liberalisation in the 1980s is often championed for having raised per capita incomes in that period. However, the process has also contributed to a widening of the skills gap in many comparable economies. A related question is whether a country's export composition has influenced its income inequality or if product diversification has been beneficial for various groups within the country. In a study that links the export bundle of countries to the potential level of income inequality relating to products in the export bundle, Turkey's largest trade volumes are concentrated in the medium range of inequality relating to products.[12] Finally, the concentration of firms in the economy shows that the Herfindahl index for the secondary sector is down from an already low score of 0.1 in the early 1992s to about 0.05 at the end of 2016.[13] The market share of firms in the top decile also reflects the positive effects of competition and the enlargement of the market base, as the share declined from around 0.45 in the early 1990s to less than 0.3 at end-2016.

Conclusion

Globalisation has made a positive contribution in terms of economic growth and welfare. However, especially in a setting of increased global interdependence, the changes it causes in the flow of goods, services, capital and people can also be disruptive, destabilising processes of production and funding. Future policies should be coordinated with the aim of maintaining stability while ensuring that efficient flows can be maintained.

[9] Simoes and Hidalgo (2011).

[10] Hidalgo and Hausmann (2009).

[11] Simoes and Hidalgo (2011).

[12] Simoes and Hidalgo, op cit.

[13] The calculations use only firms on the Borsa Istanbul that report net sales in their income statements.

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