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Neoliberalism in Turkey: A Balance Sheet of Three Decades

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Title of paper: Financial Fragility on the Road: rising consumer credit and declining home ownership in Turkey

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Abstract

Turkey by and large avoided the financial meltdown thanks to its moderate level of household debt ratio and relatively sound public finance structure. The stylized fact is that the consumption loss as a percentage of GDP has been greater for the countries with higher growth rates of household debt-to-income ratios prior to the global crisis. Although Turkey also witnessed a surge in household debt levels, the starting point was so low that the general effect was not as destructive. We study two main factors that will make this dynamic more fragile and hence increase the likelihood of a financial crisis in the future. First, the share of consumer credit in household budgets increase steadily for the lower and middle income groups. Second, due to formalization of land and real estate markets, home ownership rates decline for the median group of households which constitute the backbone of the labor force. Both factors have the potential to induce dramatic rises in household debt-to-income ratios and create systemic financial risks.

Keywords

financial crisis, credit, housing market

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1. Introduction

Since capital account liberalization, Turkey has faced several crises leading to major income losses. In 2001, a major downturn occured in the financial markets and several reforms in the banking sector were adopted to prevent future collapses. The economic recovery was mostly consumption-led, and it has been received as a success story by the domestic and international institutions. Yet, the household sector dynamics and particularly the indebtedness of this sector is largely ignored in this analysis. For example in 2010 among 34 OECD members the household liabilities increased fastest by 12.1% and 10.8% in Greece and Turkey, respectively. Nevertheless, policy makers as well as the mainstream economists preferred to focus on public sector balance sheet dynamics in Turkey, which are in sound position in comparison to the EU and US economies. Even though the saving rate in Turkey declined to its historical lowest levels, public debt-to-GDP ratio continued to be the yardstick to judge the financial stability. We argue that underestimating the surging household debt can be a fatal mistake, particularly given that a new round of crisis could be triggered in a deregulated credit market.

There are important lessons to be learned from the Great Depression on the importance of household debt dynamics in both triggering the crisis and aggravating the duration and severity of the downturn (Eichengreen and Mitchener, 2003). The recent global crisis reminded us of these lessons and the mainstream economists as well as IMF, OECD and World Bank recently turn back to the question of why households debts rise and what the consequences would be (IMF, 2012). As Eggertsson and Krugman (2010) demonstrates gross debt matters as long as the lenders and debtors are two different groups. In various credit rationing models, households suffer from sudden stops or rapid decline in consumer credit. And the outcome is a volatile and lower consumption growth. In the Turkish case we also witness what Mason and Jayadev (2012) underline as the "Fisher Dynamics for the Household Sector". As the inflation rate declines in an environment of low household income growth and high or moderate levels of effective nominal interest rates, households are obliged to increase net borrowing.

Furthermore as we will discuss shortly in the following sections, increasing formalization in the housing market also put considerable burden on the indebted households. Lower home ownership rates decrease overall disposable income as the "imputed rental income" is foregone and squeeze the households in terms of interest payment capacity even with a given (non-increasing) debt level. Moreover, indebtedness in Turkey rises involuntarily due to the supply side of the credit market, and thes two factors combined would lead to long-run instability. This can be inferred from the divergence between the consumer credits and consumption patterns.

The structure of the paper is as follows. The next section presents a brief review of the existing studies on the links between financial stability and household debt. The third section discuses the rising volume and share of credit and whether this can be explained by consumption or savings in the household sector in Turkey. In the fourth section, we present the development in home ownership and relate it to the booming household debt in the post-2001 period. The last section concludes.

2. Literature Review

The relationship between slow income/wage growth and increasing debt burden is documented by various studies. Pollin (1990), for example, argues that the increase in household indebtedness beginning in the early 1970s was due to efforts to maintain past living standards in a period of low wage growth. Dynan (2012) uses household level data to examine the link between leverage and consumption and finds that highly leveraged home owners had larger declines in spending between 2007 and 2009 than other home owners, despite having smaller changes in net worth.

There are also many studies focusing on the relationship between consumer debt dynamics and economic performance, mainly output growth (Dutt, 2006; Barba and Pivetti, 2009; Hein, 2012; Basu, 2012; and Azad, 2012). In the simplest case as in Palley (1994), the household debt plays a contradictory role in aggregate demand and accumulation dynamics. On the one hand, additional debt enhances further consumption thus increases aggregate demand but on the other hand it causes higher interest payments to lenders thus decreases the overall aggregate demand. The various channels through which the fragility in balance sheets of households may affect the output are emphasized in recent studies. For example in Dutt (2012), the increase in indebtedness of the households would imply a transfer of income from the workers to capitalists/rentiers with lower propensity to consume, thus leading to lower output growth rates in the short-run. In the long-run the ultimate effect depends on mainly the relative levels of initial growth rates, savings behaviour of capitalists and the interest rate.

In Hein (2012), the rentier/capitalists decide how much of their savings should be allocated to consumer and corporate loans. The firms enjoy higher aggregate demand derived from increasing household borrowing but also suffer as the available funds to finance investment are declining in relative terms. The critical insight is that the creditors could decrease the availability of loans to households after a certain threshold of consumer debt is reached, thus negatively affecting the overall consumption and growth rate. Charpe et.al. (2012) argues that the credit demand of households and the profits of banks build a feedback loop and lead to instability. There is another loop in which prices rise at a slower rate than the real wages thus dampening accumulation due to declining profit rates. Finally, in a Fisher-dynamics accounting framework, Mason and Jayadev (2012) examine the household budget-debt developments in US and argue that due to the changes in nominal growth rates, effective interest rates on debt and inflation rates especially after 1980s a large part of the increase in leverage is involuntary.

Based on the insights from the studies discussed above, we mainly focus on the two trends we observe in Turkey. First, consumer loans are going up at a much faster rate than increase in disposable incomes or consumption expenditures. Second, home ownership rate in urban areas is declining significantly. The first trend points towards an involuntary built-up of household debt rather than keeping up with Jones -Veblen effect- which can also limit the likelihood of deleveraging even if household would like to do so. The second (exogenous) change implies that for workers/households the disposable income shrinks as "imputed rent" component is lost. As tenants they have to reserve a portion of their income to pay rents, thus the requirement to borrow increases even if they are willing to keep their consumption bundle constant.

3. Booming Consumer Credit

In Turkey, the dramatic rise in consumer credit both in terms of it volume and share is immediately visible. The aggregate consumer credit volume, covering consumer, mortgage and credit cards, increased from 111 billion TL to 250 billion TL within the period of 4 years, from June 2008 to June 2012. As can be seen, the total increase amounted to a staggering 125%. One of the crucial questions for the analysis of financial fragility is to what extent this credit boom was due to the new customers who use the new loans to extend consumption, rather than the refinancing the needs of the existing pool of credit customers. The Turkish case is more of an example of the second channel where refinancing and interest payments consist an important part of new credits.

According to Turkstat Survey (Income and Living Conditions Survey 2011) almost 60% of all households report that debt payments put a burden on the households on their budgets.

The median household income was around $6000 -about 7500TL- in mid 2000s. Supposing that the median household is the representative credit customer in the 2003-2008 period, the likelihood of being financially squeezed by debt services is high, which can be also seen from the actual interest rates and debt service. The average nominal interest rates on consumer credits in the 2003-2008 period was 20%, and the yearly total debt service was more than 25 billion TL as of June 2008. This picture bears certain similarities with the Greek case. According to Marsellou (2011) , for the poor households (annual income less than 7500 euros) the debt service burden as a share of disposable income had increased dramatically from 25.2 % in 2002 to 45.8% in 2007.

In Table 1, 2 and 3 we summarize the household budget dynamics. We gather the data from "Financial Stability Reports" of the Central Bank of Turkey. We report household liabilities and and interest payments both in terms of levels and in terms of ratios of household disposable income. As can be seen from Table 1, both the household debt and interest payments have risen significantly. While the disposable income went up by 31.7% over the period, the increase in the household debt was recorded as 45.7%. The interest payments to disposable income comprised 4.4% in 2010 and 4.9% in 2012. A similar rise was observed in terms of household debt to disposable income ratios for the same years. Table 2 shows that almost 75% of all borrowers have less than 2000 TL (1300 $) monthly income. Also this group has 46.5% of the total debt volume. In Table 3 we demonstrate annual growth rates of each item over the last decade. It can be immediately seen that the average growth in disposable income is 16% but the household debt went up by 43% between 2004 and 2012. Part of the rise in indebtedness is attributable to and the interest payments, which on average rose up by 27%.

Table 1. Household Budget Dynamics

	2010	**2011**	**2012 (3Q)**
Disposable Income (DI)	448.8	531.2	591.3
Household Debt (HD)	195.1	252	284.4
Interest Payment (IP)	20.4	23.1	29.3
IP/DI (%)	4.4	4.4.	4.9
HD/DI (%)	43.5	47.4	48.1

Table 2. Debtors across Income Groups

	Share in Volume	**Share in Numbers**
< 1000	25.4	38.8
1000-2000	21.1	25.5
2000-3000	16.8	12.3
3000-5000	11.2	5.9
> 5000	14.7	6.2
Other	10.8	11.8

Table 3. Annual Growth Rates in Household Budget Items

	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012 (3Q)**	**Average Growth**
Interest Payments (IP)	81%	40%	24%	29%	26%	7%	-3%	13%	27%	27%
Household Debt (HD)	110%	73%	51%	36%	30%	14%	33%	29%	13%	43%
Disposable Income (ID)	21%	7%	73%	15%	-24%	2%	25%	18%	11%	16%
IP/DI	52%	31%	-29%	10%	70%	5%	-24%	-2%	11%	14%
HD/DI	72%	62%	-13%	18%	71%	12%	6%	9%	1%	26.5%

We extend the analysis on the issue of whether households have used consumer loans to buy durable goods, thus increasing their implicit savings. According to Ceritoglu (2013) , the econometric results show that there are important differences in terms of effects of financial variables on various components of household consumption expenditures. Household expenditures on durable goods are more sensitive to changes in household expectations, the real interest rates and consumer credits than household expenditures on non-durable goods and services as expected. Moreover, the empirical analysis indicates that the credit channel is more important than the interest rate channel for household consumption expenditures. Household budget dynamics have a similar role in the housing market as thed demand for housing requires steady income growth, favourable conditions in the financial market, longterm planning and commitment. None of these factors appear to be existing in the Turkish case since the income growth especially for the households in the bottom earning groups. Hence, the credit boom is not attributable to durable consumption but rather is used to pay interest and cover losses from imputed rent.

In order to shed light on to the different consumption patterns of home owners and other households, we examine Household Budget Surveys from 2002 to 2011. We find that overall nominal increase in durable consumption is 430% in the ten-year period. However. while the home owners have increase their spending on the durable goods by 340% the tenants have increased their spending by 556%. The gap in relative growth in total spending is also striking. The increase in total spending from 2002 to 2011, reached 302% for the home owners and 452% for tenants. As the income growth for each group is not expected to be very different, the excessive spending of tenants should be sustained through debt.

In Figure 1, we underline the differences in growth rates of consumer borrowing and consumption expenditures, both in nominal and real terms. Note that especially after 2011, although real consumption growth drops to zero, households keep on borrowing at a rate of almost 20%. We argue that this is due to distress borrowing on behalf of financially squeezed households. And one of the main reasons for such a distress is the lack of income growth. Figure 2 displays the net increase in real wages in the public sector. As can be seen from the figıre below, the real wages are not sufficient to explain the growth of consumer borrowing. Moreover, average private sector wages as well as their growth are generally less than the public sector wages and growtj.

Figure 1. Consumer Credits and Private Consumption

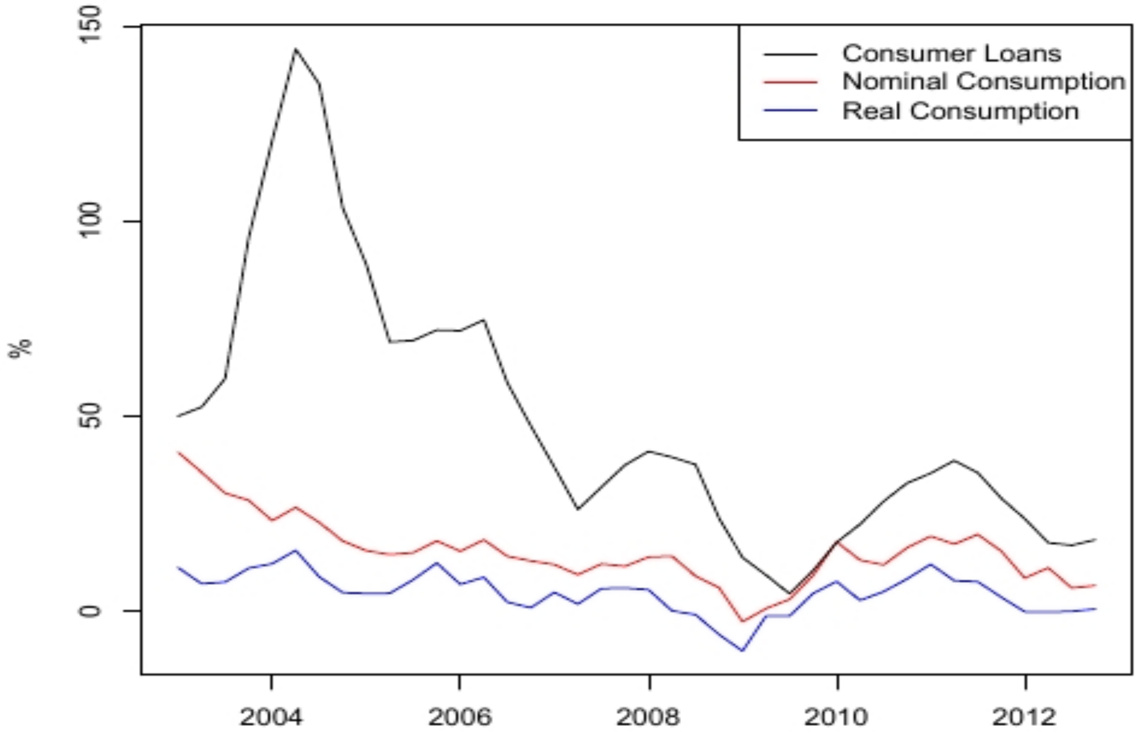
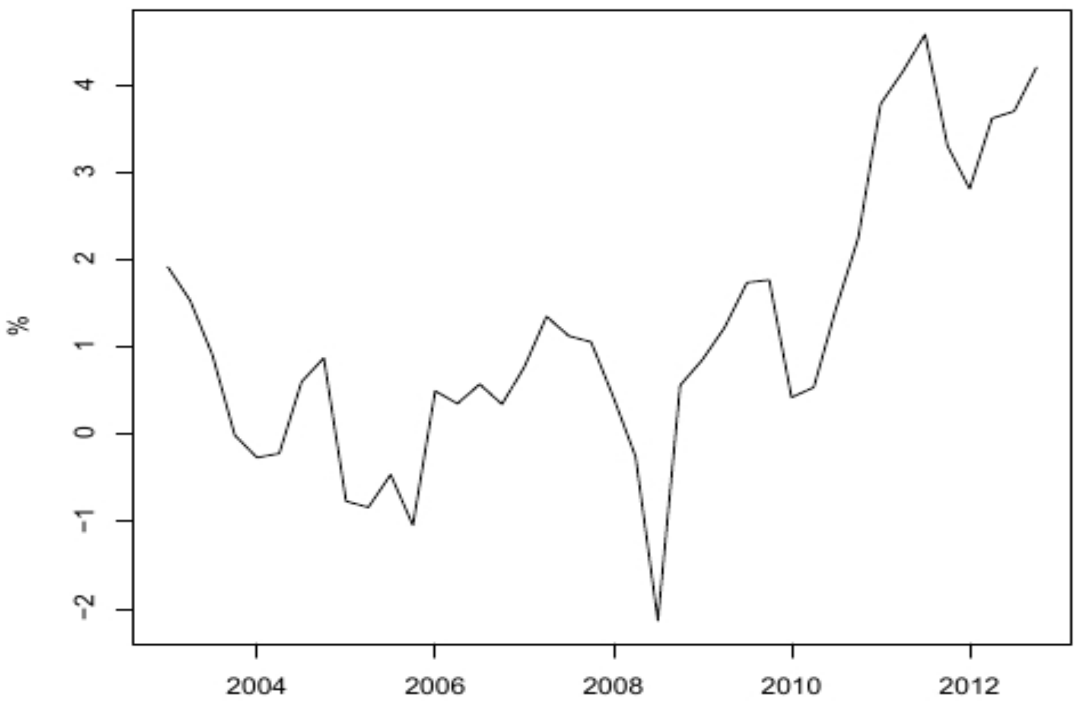


Figure 2. Public Sector Wage Growth



4. Home Ownership

We argue that one of the main driving factors behind the rapid growth in consumer credits in Turkey is the decline in home ownership. As Erdogdu (2010) demonstrates in the absence of strong state support for formal housing especially for the lower and middle income groups in Turkey the solution was informality (i.e. gecekondus) till the early 2000s. Nevertheless this trend came to an end with the neoliberal policies of Justice and Development Party in the last decade. Home ownership rates have declined significantly especially in urban settings. Despite the booming consumer loans in general and mortgages in particular, we observe a dramatic drop in home ownership rates in urban areas. Apparently, the declining home ownership rates and declining saving rates in the last decade move in tandem. We calculate home ownership rates in urban areas based on the data from the Turkstat. In Figure 3, the decline from 65% in early 2000s to 54% in 2011 is illustrated. As the wage earners in the urban areas are more likely to be constrained in the housing market, they become indebted. The falling home ownership rates imply worsening household balance sheet dynamics since tenants have to pay monthly rents which constraint their consumption spending and debt service capabilities if they are in debt.

Figure 3. Home Ownership Rates

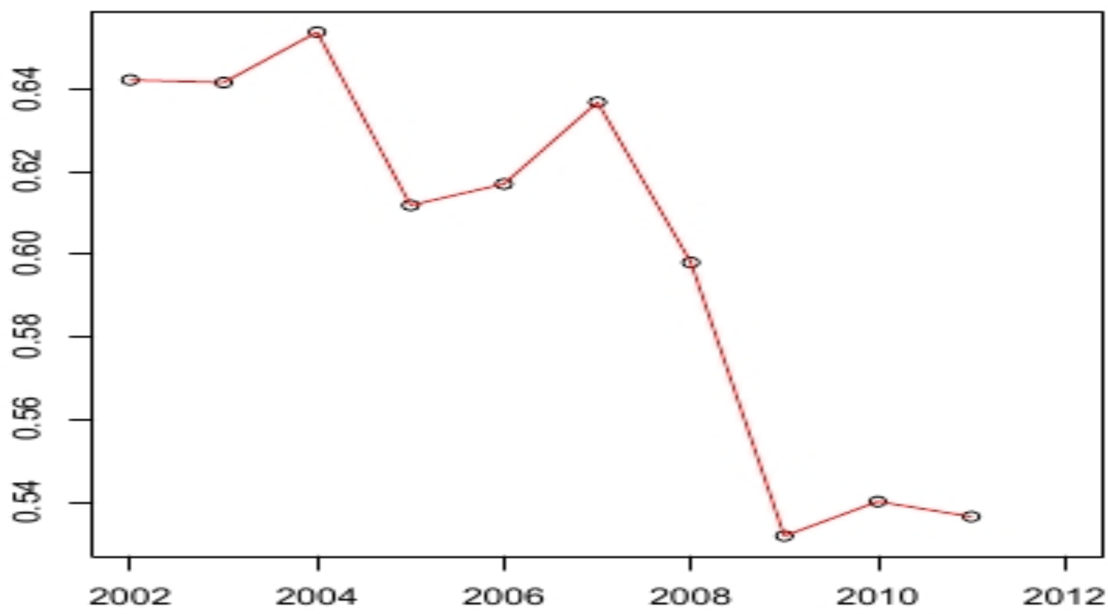
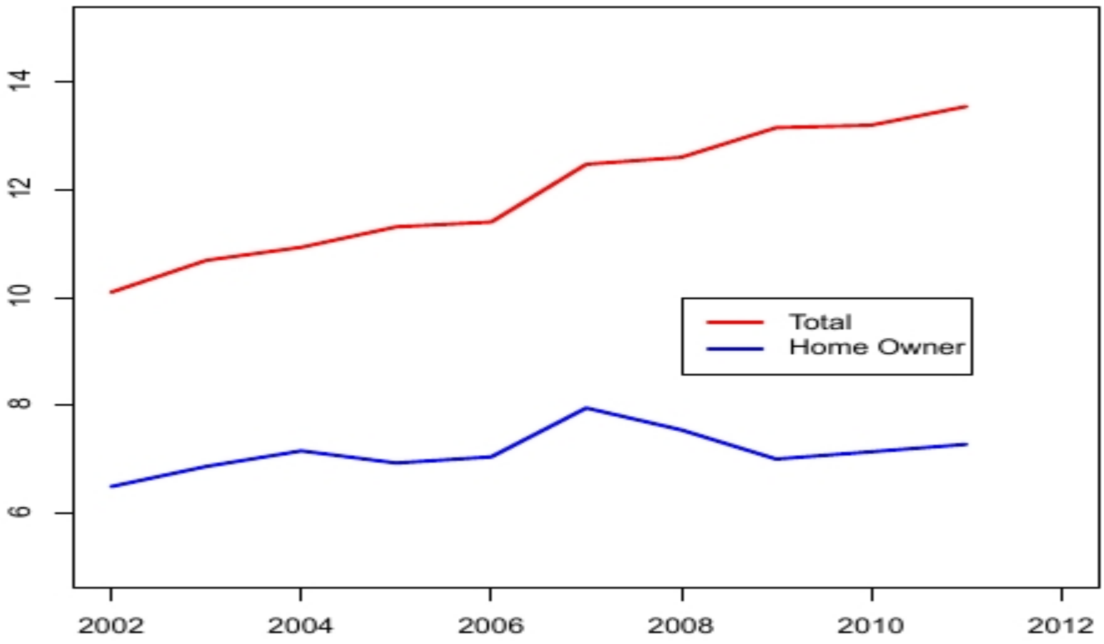


Figure 4. Household in Urban Areas



We also examine the home ownership trends among the entire set of urban households from 2002 to 2011. Although the total number of urban households has a cumulative increase of 34%, the number of home-owner households went up only by 12%. Put it differently, out of the total newcomer urban households, which amounts to 3.45 million, only 22% (780 thousand) could own a house. The gap between the urban settlers and those who can be home-owners widened steadily over the period as can be seen from Figure 4. Table 4 emphasizes the relatively disadvantageous status of middle and low income families in urban areas in 2006. Among the people who earn the median income and below, the home ownership rate is around 50.58% while it is almost 20% more for the wealthier groups. The substantial gap also exists for rentals where 22% of the people with more than median income pay rent whereas for lower income households, the ratio is around 39%.

Table 4. Home Ownership in Urban Areas in 2006 (%)

	Median Income and Below	Above Median Income
Home ownership	50.58	69.86
Rent	39.06	22.1
Subsidized Rental	0.64	1.67
Other (inc. free residency)	9.72	6.85

5. Conclusion

Apart from casual warnings appearing in newspapers and journals, the dramatically increasing household debt-to-income ratio in Turkey has been largely ignored both by the economists and the policy makers. In the paper we argued that this view is mistaken. Formalization of the housing market, hence declining home ownership rates as well as slow growth of nominal incomes are structural patterns that make the household debt dynamics in Turkey rather fragile. The neoliberal economic policies in Turkey are not expected to increase the wages substantially in the near future. Besides, the housing policy of the governments is not conducive to help the households to meet their debt payments. Therefore, we argue that the financial risks in Turkey are higher than the conventional measures only looking at the public sector debt dynamics.

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