- Flexible labor markets
  - More business friendly policies (e.g. easier firing)
  - Weaker trade unions
  - Limited role for welfare policies
    - No more protection in the presence of market fluctuations.
  - Proliefration of non-standard jobs
  - Flexicurity (flexible security)
  - Wage/salary not anymore a source of income but only a production cost
  - How to be employable becomes a self-responsibility.
  - Employment is considered an opportunity rather than a social right.

- Neoliberal idea of “trickle-down”
  - We need to create first more wealth before we distribute it more widely.
  - Therefore policies resulting in unequal distribution of income would be tolerable
  - In reality, as a result of neo-liberal policies, income inequality has increased in most countries, but growth has actually slowed down significantly.

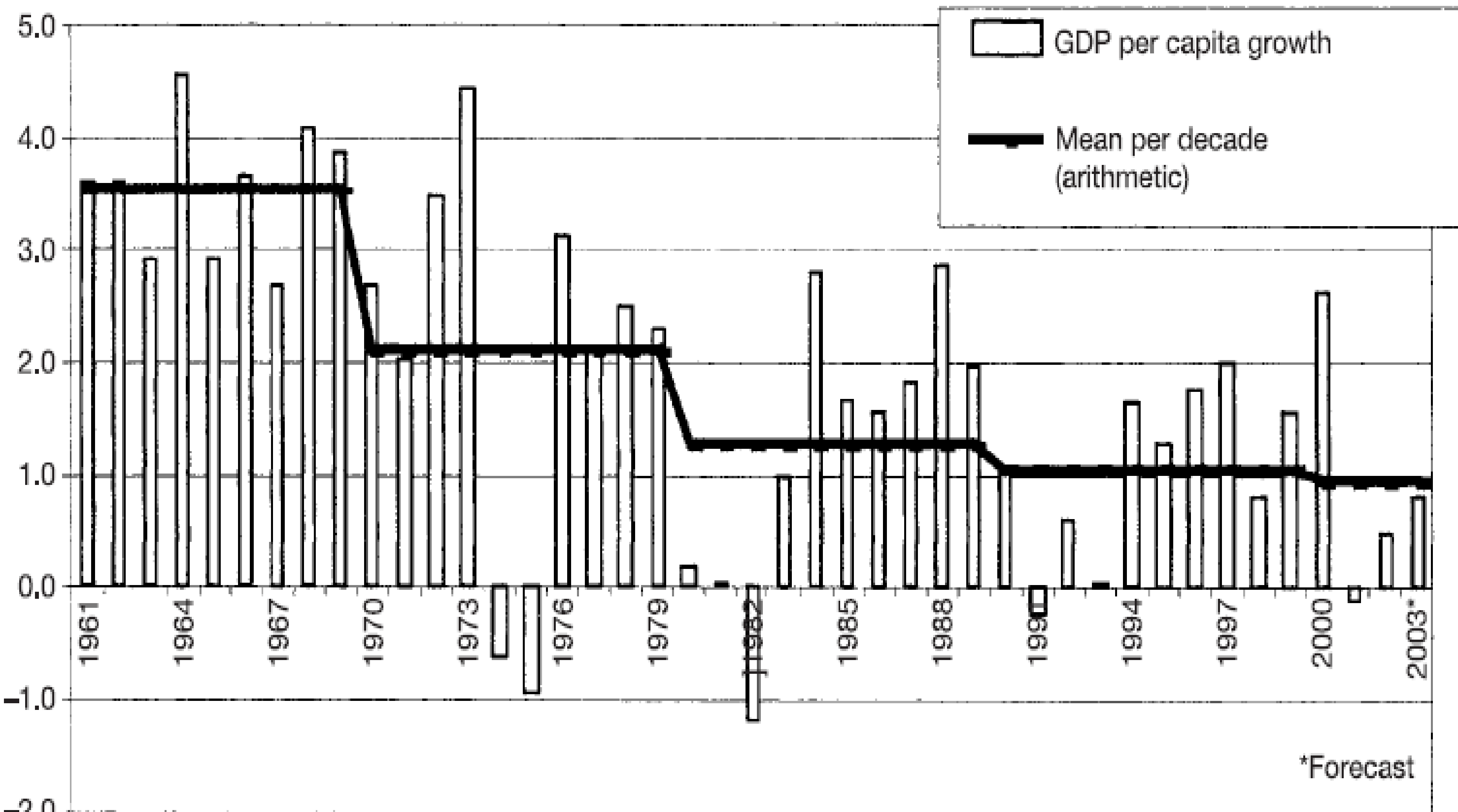
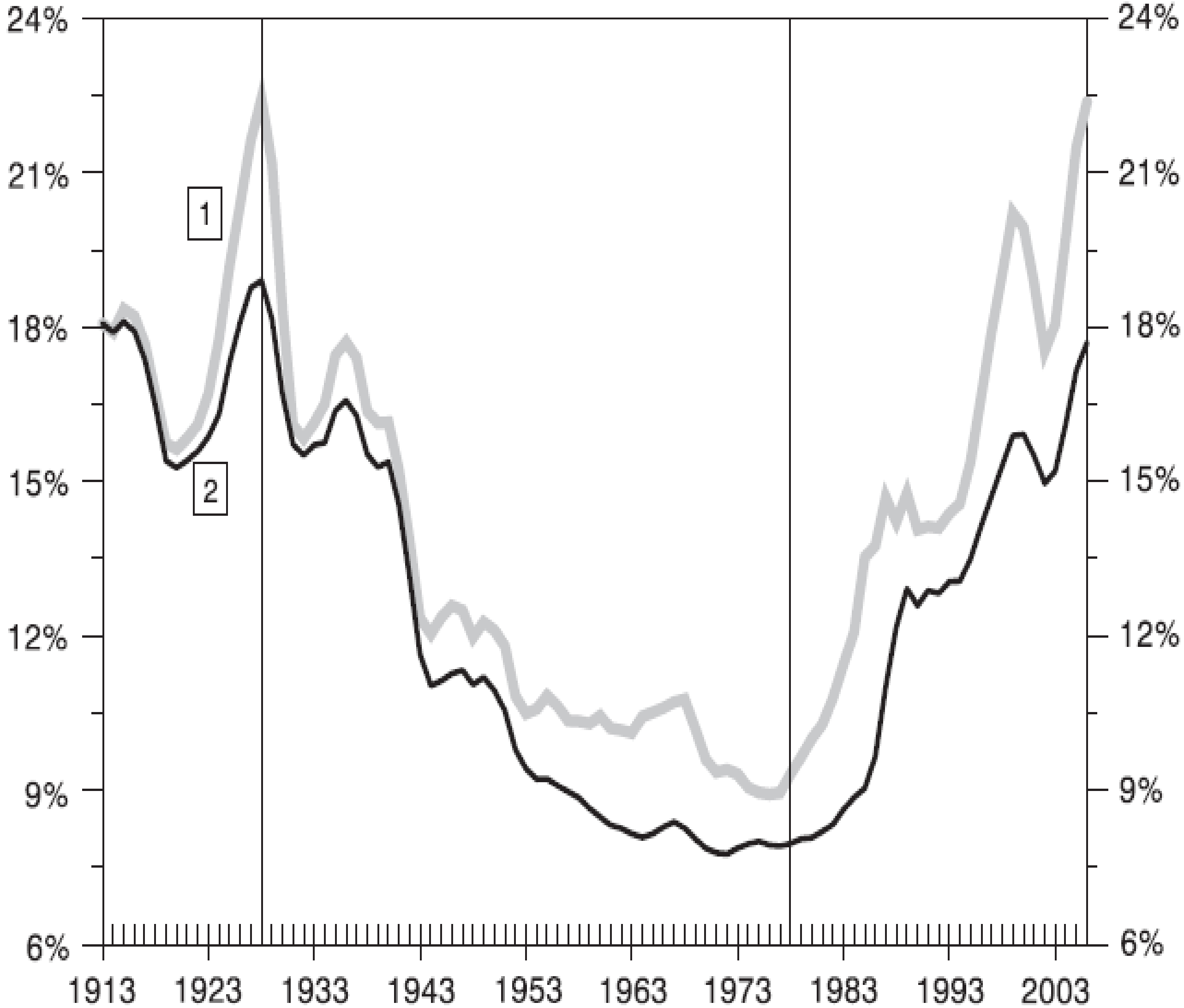


Figure 6.1 Global growth rates, annually and by decade, 1960–2003

- Annual growth rate of per capita income
  - 1960-1980 3%
  - 1980-2000 1.7% (including China and India)
  - The same figures are 3.2% and 2.1% for developed countries.
- Growth failure has been particularly noticeable in Latin America and Africa, where neo-liberal programs were implemented more thoroughly than in other regions. (in Africa there has been even a real decline in per capita income)
- Turkey

Period	Growth rate
1960-1977	6.8
1980-1988	4.9
1989-1997	4.3
1998-2007	3.6



. *Income share of the top 1% in the USA, 1913–2006. Three-year moving averages: [1] including realised capital gains; [2] excluding capital gains.*

Financial Liberalization

- Reading by Yılmaz Akyüz on the website
- Domestic
  - Reduction or removal of interest rate controls
  - Privatization of public banks
- External
  - Residents can hold foreign financial assets
  - Removal of restrictions on capital movements and foreign exchange(FDI, portfolio investment and debt flows)
  - Opening up domestic banking system to international competition

- Theoretical arguments
  - Efficient allocation of resources
    - In domestic markets
    - In international markets
  - Elimination of financial repression
  - What is financial repression?
    - Low real interest rates
    - Low savings
    - Low growth
  - International capital flows would reduce financial constraints on investment

- High liquidity in developed countries in the late 1980s
    - Low interest rates in developed economies in the late 1980s
- Removal of strict regulations in the banking system in developed countries
    - Financial innovations to get around the regulations (e.g. hedge funds)
- Low profitability in manufacturing industries
    - Short-term and risky investments in developing countries became attractive
- New profitable opportunities in developing countries as a result of financial liberalization

- Increasing access by developing countries to international savings
    - Assumption: saving-constrained developing countries
- "For western finance, emerging markets were a hedge, and for developing countries, international finance was an opportunity. A cozy relationship seemed easy to build. It appeared that all that was needed was the liberalization of finance and a monetary policy that ensured interest rates high enough to make capital inflows attractive, even after adjusting for risk."

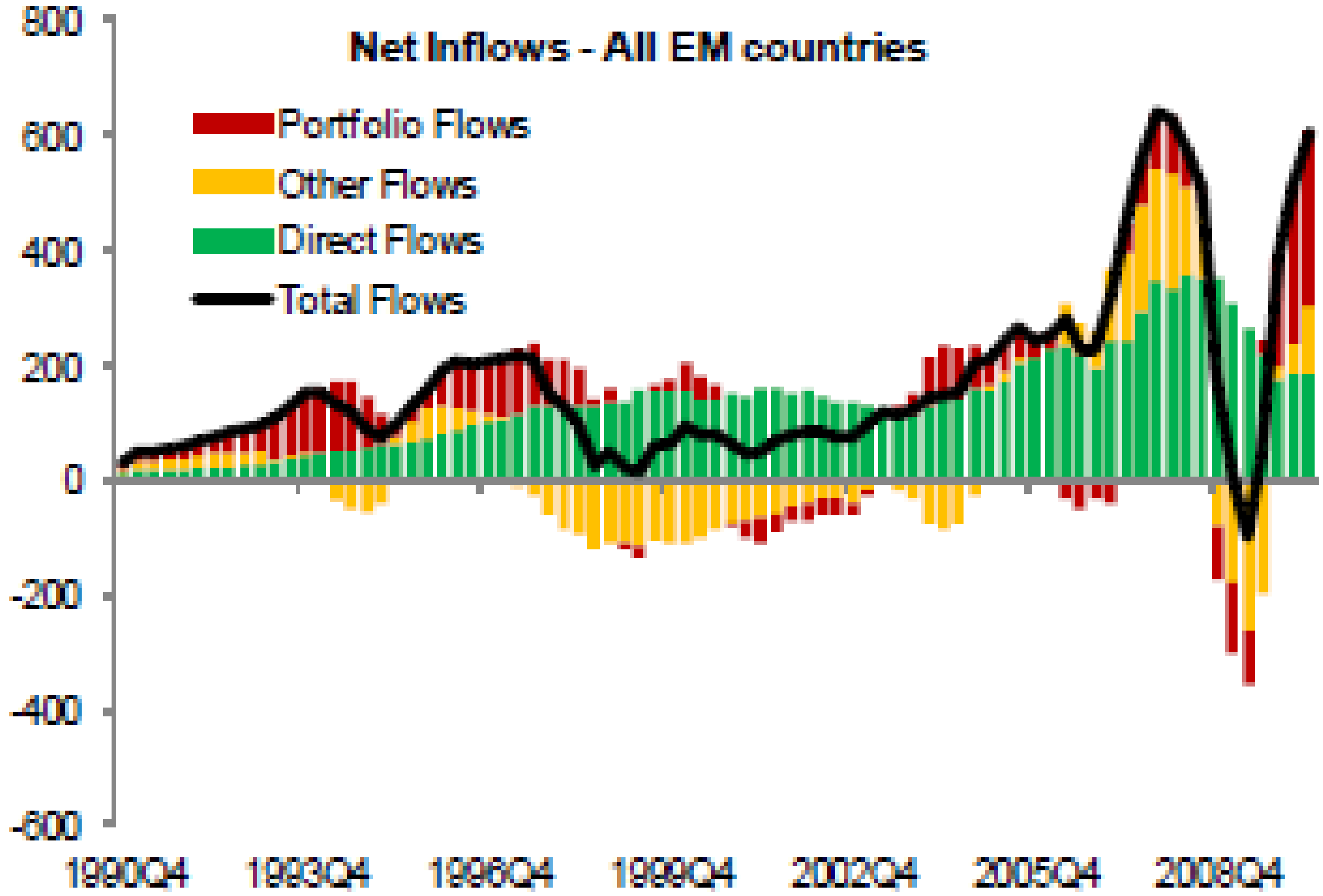
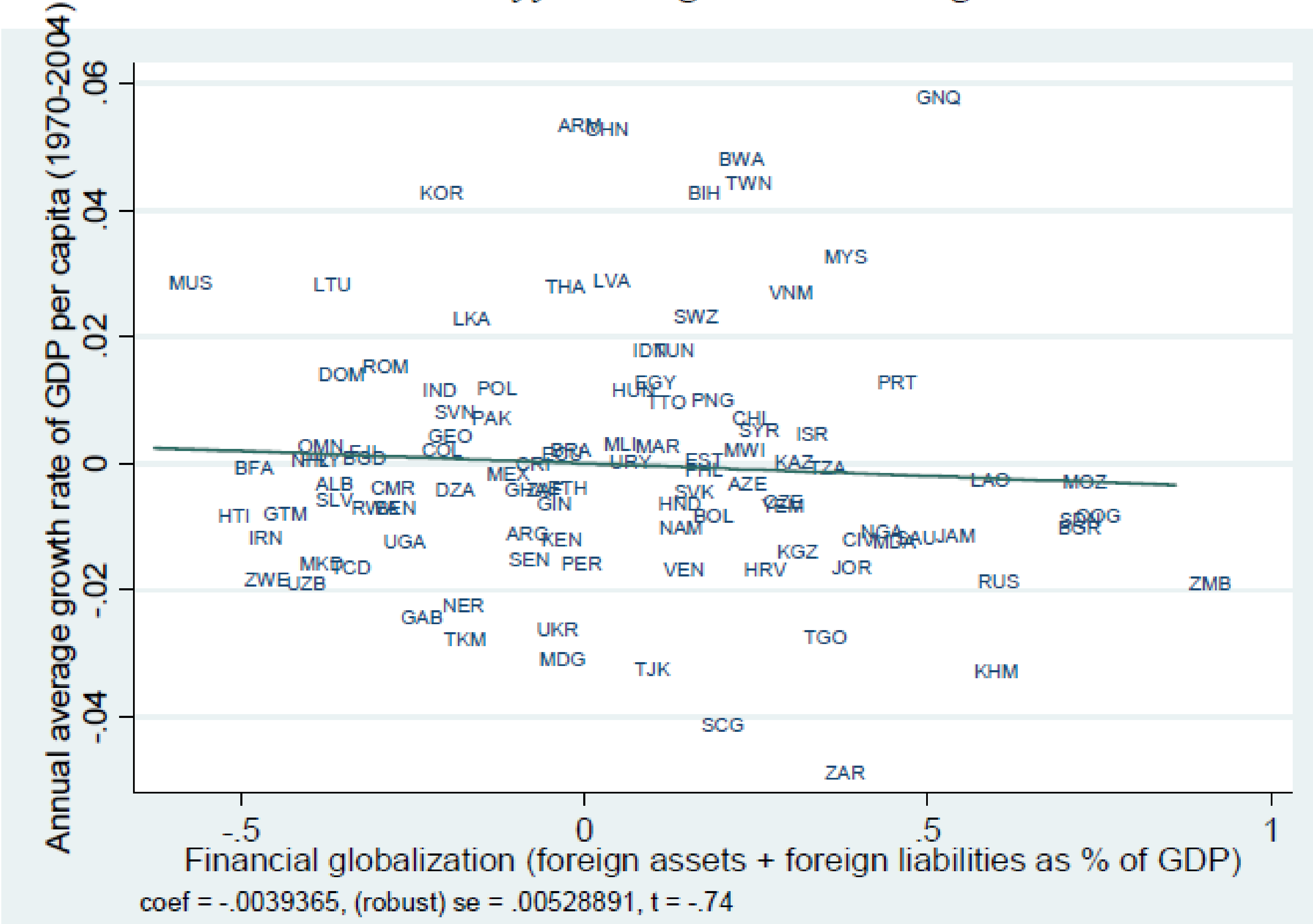

Net Inflows - All EM countries
Portfolio Flows
Other Flows
Direct Flows
Total Flows
800
600
400
200
0
-200
-400
-600
1990Q4
1993Q4
1996Q4
1999Q4
2002Q4
2005Q4
2008Q4

Figure 1: Financial globalization and growth (1970-2004)

Panel A: Level of financial globalization and growth



liberalization

Boom and Bust cycles

- How does a financial boom emerge?
  - Financial liberalization and higher interest rates
  - Rise in capital inflows (debt or portfolio)
  - Credit expansion
  - Higher consumption (sometimes even higher investment)
  - And higher growth
- Any bad news can trigger capital outflow
- Even higher interest rates are required to avoid capital outflow
- Insolvent firms, banks and households

- Other Problems
  - Currency mismatch in private sector
    - Banks borrow in foreign currency
    - Loan out money to domestic sector
    - Domestic sector's earnings in domestic currency
    - Even the non financial firms can borrow in foreign currency
    - Financial fragility emerges
  - Appreciation of the domestic currency
    - Cheap imports
      - Trade deficits and unsustainable current account deficits
      - Domestic companies can be competed away by cheap imports

- Appreciation of the currency
  - Shift of investment from tradable to non-tradable sectors due to lower relative profitability (e.g. construction industry versus machinery industry)
  - Low competitiveness as a result of appreciation
  - low investment in export sectors, low productivity, low growth
  - Higher import dependency in many industries
  - Unsustainable current account deficits

		Banking Sector Foreign Credits		
	Return on Hot Money[a]	Gross inflows	Gross Outflows	Net Hot Money Inflows
1988	-0.073			-126
1989	0.236			233
1990	0.293			3139
1991	-0.038	43,186	42,523	-392
1992	0.154	64,767	62,363	2439
1993	0.045	122,053	118,271	4478
1994	-0.315	75,439	82,040	-5913
1995	0.197	76,427	75,626	2341
1996	0.329	8,824	8,055	2198
1997	0.278	19,110	18,386	1166
1998	0.254	19,288	19,225	2267
1999	0.298	122,673	120,603	2907
2000	0.133	209,432	204,691	4863

Figure 4: Overvaluation and Capital Flows, 1970-2004

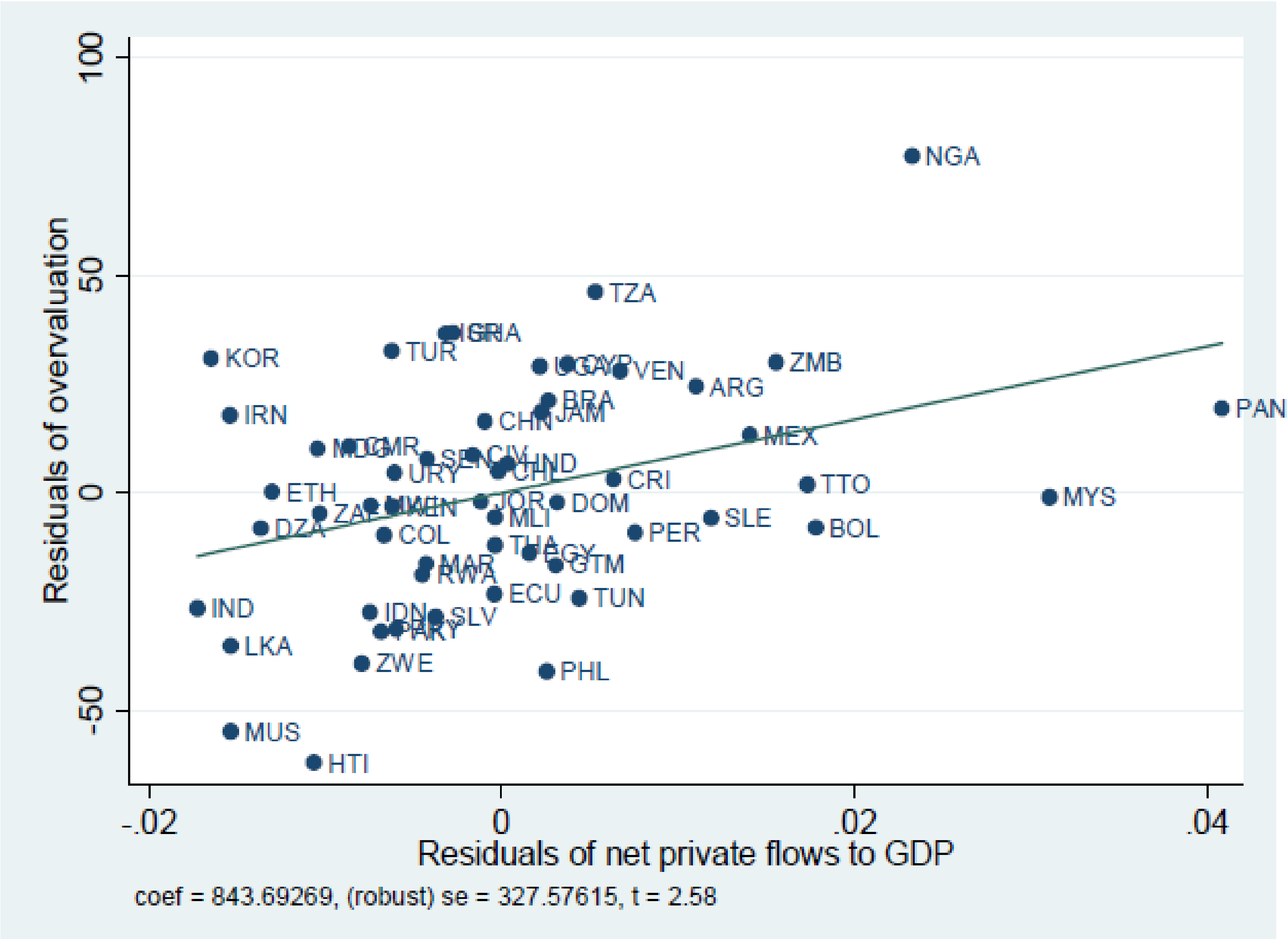
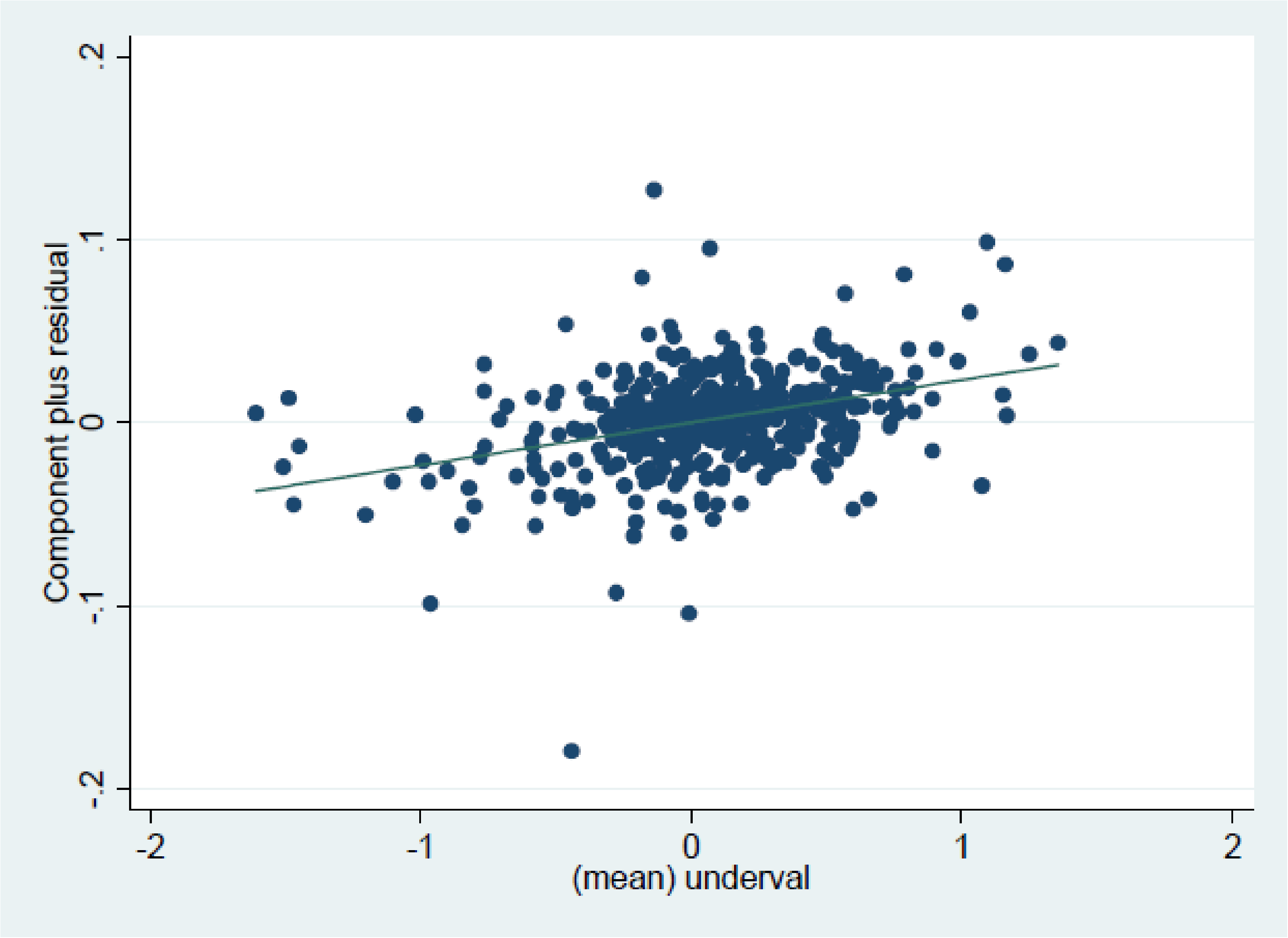
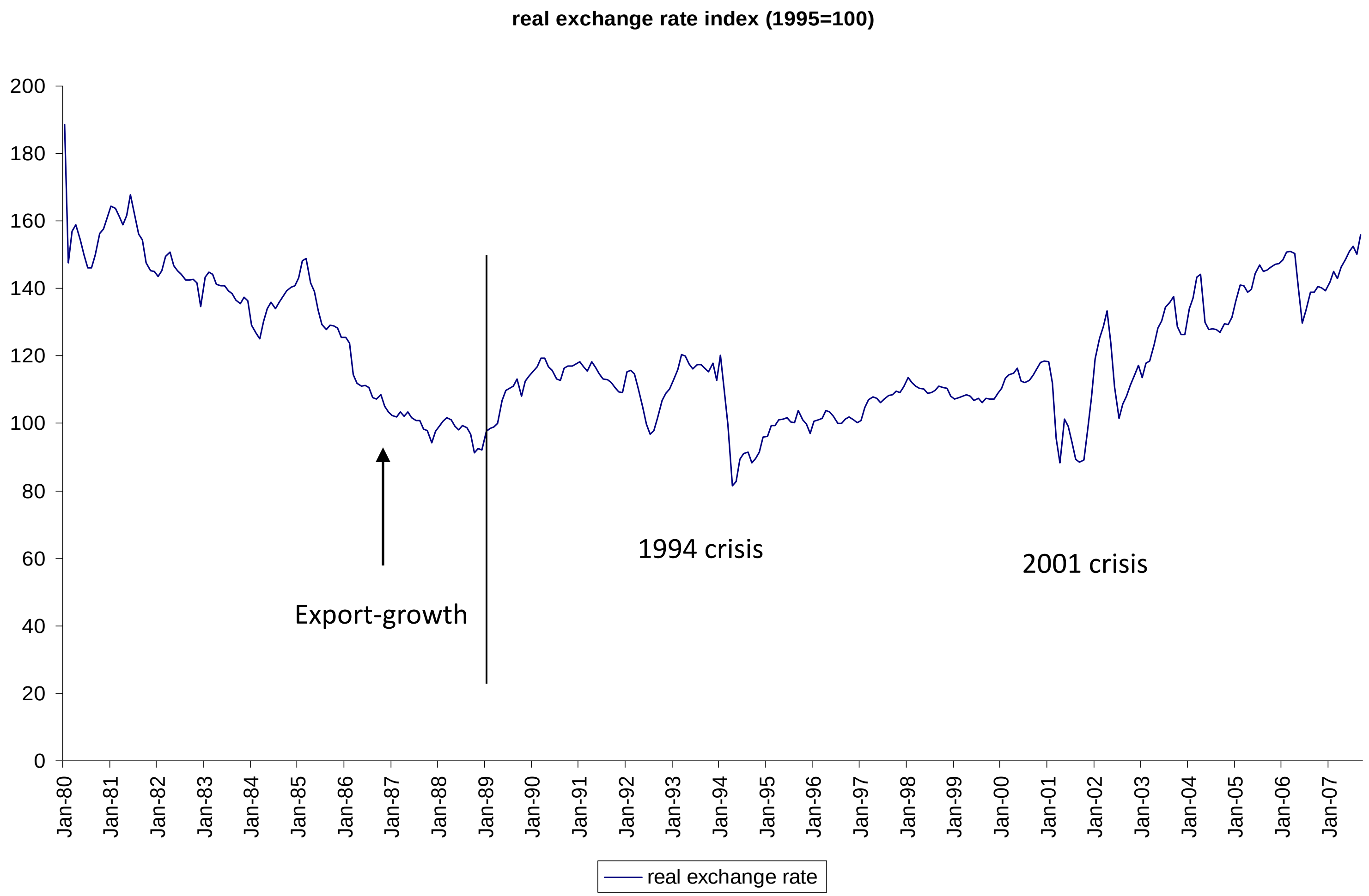


Figure 5: Economic Growth and Undervaluation of the Real Exchange Rate



Real exchange rate in Turkey

An increase indicates real appreciation



Foreign capital and economic growth

	Foreign Capital/GDP	GDP growth rate
1984-1988	2.2	6.2
1989-1993	3.3	5
1995-1997	3.4	7.7
2000	8.1	6.3
2002-2007	9.8	7.2