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# **FINANCIALISATION AND TURKISH PENSION REFORM**

**SERAP SARITAS ORAN**

Thesis submitted for the degree of PhD in Economics  
2016

Department of Economics  
School of Oriental and African Studies  
University of London

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## **Abstract**

This thesis aims to shed light on the relationship between financialisation and pension reform in Turkey. In the last two decades, more than thirty countries have replaced their pay-as-you-go pension schemes with fully-funded schemes. Although the increasing significance of financial conduits within pension provision has been evident within this reform trend, the corresponding literature has failed to address adequately the key role that financialisation has played. Therefore, it is argued here that the recent pension reform in Turkey, not least the Individual Pension System, cannot be understood without considering financialisation of the Turkish economy. Financialisation refers to both the extensive and intensive growth of finance, i.e. integration of financial activities into ever more aspects of economic production and social reproduction processes as well as the deepening of financial activities in line with the proliferation of more sophisticated financial operations/instruments. The expansion of finance within pension provision highlights the ability of finance as money capital to capitalise different forms of monetary streams. Thus, finance transforms the financial and non-financial sectors and is integrated into the everyday lives of households while financialisation of pension income is one of the overlooked financialisation practices. The private pension scheme in Turkey mostly serves the middle- and high-income earners revealing the generally adverse impact of financialisation on those in unfavourable labour market positions - women, informally employed and unemployed being the most vulnerable. The intensification of finance, on the other hand, is evident in the supply and demand side impacts of pension funds on capital markets. Accordingly, pension funds transfer massive flows to capital markets, thus pushing up asset prices. Moreover, pension funds, as they mature, demand more innovative investment instruments to meet their liabilities. In the Turkish capital markets' context, these impacts of pension funds are observable despite their recent origins.

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*“There is no royal road to science,  
and only those who do not dread the fatiguing climb of its steep paths  
have a chance of gaining its luminous summits.”*

*K. Marx*

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**Abbreviations**

ABSs Asset Backed Securities

BAT Banks Association of Turkey

BIS Bank for International Settlements

BIST Borsa Istanbul

BRSA Banking Regulation and Supervision Agency

CBRT Central Bank of the Republic of Turkey

CMB Capital Markets Board of Turkey

FDI Foreign Direct Investment

GNAT Grand National Assembly of Turkey

ICC Istanbul Chamber of Commerce

IBC Interest Bearing Capital

IFIs International Financial Institutions

IMF International Monetary Fund

IPS Individual Pension System

OECD Organisation for Economic Co-operation and Development

MoLSS Ministry of Labour and Social Security

PAYG Pay-as-you-go

PMC Pension Monitoring Centre

SDIF Saving Deposit Insurance Fund

SMEs Small and Medium Enterprises

WB World Bank

# **1. Introduction**

## **1.1. Introduction**

What we call the Turkish pension reform is the sum of series of reforms which have altered the pension system in Turkey over the period from 1999 to 2008. These reform series have decreased the significance of public pay-as-you-go (PAYG from now on) scheme while introducing a private scheme which is funded and invests pension contributions in financial markets, namely the Individual Pension System (IPS). The reform process is accompanied by a structural transformation in the economy strengthening and serving the interests of the financial sector. Moreover, international financial institutions, not least the World Bank (WB), has been involved in the pension reforms in a way which prioritises financial motives as opposed to traditional expectations from pension schemes. In this light, this study investigates the relation between financialisation and pension reforms, as well as financialised funded pensions' impacts on financialisation processes.

This thesis rests on three pillars. The first is Marxist finance theory. Our contribution is to argue that Marx's analysis of money capital (Marx, 1991) highlights the current tendency for extensive and intensive growth of finance, financialisation (Fine, 2013). More generally, neoliberal policies have played a substantial role in the emergence of financialisation in countries like the USA and the UK. With erosion of limits to the application of money capital, finance has grown both extensively and intensively in a way that increasingly shapes most if not all economic and social processes.

The second pillar of this study aims to locate pensions in relation to the generational social reproduction of labour power. Labour power, i.e. the capacity to labour, is a special commodity that is partially reproduced (Marx, 1990, 1996) through goods and services that are produced within capitalist relations and also attached to non-capitalist provision and processes such as state provisioning and household labour (Harvey, 1982). In this respect, the value of labour power is attached to a material standard of living which is necessary for the social reproduction of labourers outside the direct control, if not influence, of production relations (Fine, 2009). Thus, pensions are to be conceptualised as a key element in the social reproduction of the elderly.

The third pillar of the study is the character of financialisation in Turkey in particular and how this is reflected in the context of pensions. We build the argument that developing countries experience financialisation as a result of political imperatives. More specifically, pension reforms in capital-scarce developing countries mostly imply development of financial markets (Becker, Jäger, Leubolt, & Weissenbacher, 2010). In the era of financialisation, development of financial markets in relation to pension funds has significant implications. Hence, while pension reforms in Turkey place the elderly income of certain groups under stake, corresponding funds play a substantial role in contributing to the financialisation of the Turkish economy.

This argument is developed in five chapters after this introduction. This chapter continues with a brief overview of the motivation and background of the study. Then, we give an overview of the main arguments with summary of chapters. We conclude this introduction with a reading guidance for the rest of the study.

## **1.2. Motivation and background**

Our initial motivation in studying financialisation originated from the intention to develop an understanding of contemporary finance from a Marxist point of view. This curiosity was underpinned by discussions of the 2008 crisis which pointed to the role of finance in the emergence of global economic turmoil. While the crisis hit the countries with developed financial systems, Turkey and similar developing countries were already demonstrating analogy regarding the phenomenal growth of finance. Thus, the question of whether or not a similar crisis process was, and is, emerging in Turkey has become the primary issue that propelled this study. The background research has shown that financialisation is more complicated than being a component of the 2008 crisis and it has severe consequences those go beyond the developed countries. To this end, developing a theoretical analysis in depth with the purpose of conceptualising financialisation was a challenge to confront. Pointing at the peculiarities of financialisation in developing countries is important in analysing the phenomenon in the global context. Therefore, financialisation in general for a theoretical analysis, and financialisation in Turkey for a case study, was chosen as the initial focus.

As research progressed, it was recognised that financialisation in Turkey is a broad and multi-fold process in need of detailed analysis. The housing sector and

household debt with corresponding changes in the non-financial sector's financial engagements have been popular topics in this regard. However, through a literature review, we recognised that the recently introduced individual-funded pension scheme has not been evaluated in terms of financialisation at all. This was a crucial gap because the international literature on financialisation has put emphasis on pension funds' role in the emergence of financialisation whereas this aspect of financialisation was completely ignored in the context of Turkey. Therefore, we decided to shed light on this specific case study, reform of the pension system and the new private-funded scheme in order to outline the characteristics of financialisation in general and the peculiarities of financialisation in Turkey.

In the beginning, our focus was on capital markets regarding effects of the pension funds. This was a simple and standard approach to pensions and financialisation nexus as, within the literature, there are several examples of studies focusing on this relation. However, as the research evolved, we decided to enhance our analysis addressing the multidimensional relations between financialisation and pensions. For this purpose, conceptualising finance and pensions from a Marxist point of view was crucial. The basis for studying finance rests on the interest-bearing capital (IBC) discussion in the third volume of *Capital* (Marx, 1991). Therefore, it was comparatively easy to choose this as starting point. On the other hand, the literature has investigated pensions in different frames, such as social wage, welfare state and state/tax discussions (Gough, 1982). However, none of these approaches highlights the more abstract situation of pensions.

In this respect, Fine's argument on financialisation's impact on the value of labour power as reflecting alterations in the social reproduction processes was capturing (Fine, 2009). Moreover, this framework went beyond the simplistic analysis of exploitation, which posits pensions as component of the value of labour power and sees the abolition of pensions as a deepening in exploitation. Rather, combining value of labour power and pensions was crucial for positing pensions in relation with broader issues of social reproduction, highlighting the role of financialisation in terms of shaping social reproduction processes as well as economic production relations (Fine, 2010). Thus, while pension funds' impacts on capital markets and their role in contributing to financialisation of the economy are inevitably one side of the story, another side is financialisation's impact on pensions, not least on old-age income of different groups within the population. In this regard,

our purpose became to develop an alternative understanding of pension reforms which divorces from the cliché arguments on provision of ageing population as against budget deficits.

Our research questions focus on the three main aspects of financialisation, pensions and Turkey, alongside the reciprocal relations between them. We start by investigating the relation between finance and financialisation. Our main concern is to highlight the contribution of Marxist finance theory in understanding financialisation. Relevant issues are the role played by the underlying tendencies of capitalist relations in the emergence of financialisation. Moreover, incorporating political interferences and historical developments is crucial. After positing pensions in relation to the value of labour power, we aim to understand how financialisation shapes social reproduction process with special focus on the case of pensions.

Our research questions regarding our case study start with the peculiarities of financialisation in developing countries, more specifically in Turkey. For this purpose, we review the macroeconomic policies and developments in the financialised era. Then, we try to shed light on the underlying role played by financialisation in Turkey in shaping the way in which pensions are reformed. In this sense, we review the involvement of international financial institutions (IFIs) and investigate the veracity of arguments deriving from pension reform advocates. The question is whether or not pension reform arguments meet the needs of the Turkish pension system and whether they are underpinned by the motives of increasing significance of finance in old-age income provision. Moreover, we aim to analyse the impacts of pension reforms on financialisation in Turkey through investigating their capital markets-related effects. In other words, both financialisation's impacts on pension reforms, and reformed pension system's impacts on financialisation in Turkey issues are questioned.

### **1.3. Summary of the chapters**

This study is formed by five chapters and a conclusion in addition to this introduction. The second chapter is a literature review that aims to locate the contribution of this study. Almost all PhD theses have literature reviews and also there are several alternative ways of writing them. Our work engages with three different literatures; pension reforms literature which mainly derives from social policy discussions, financialisation literature which is both broad and proliferating in



subject matter, and literature on the recent transformation of the Turkish economy of which pension reforms are part and parcel of structural reforms advised by the IFIs. We only offer briefer reviews of the latter two literatures, with the main review being of the social policy literature. The main motivation is to point at the gap within this literature regarding the role played by financialisation in terms of pension reforms.

The chapter consists of three sections (in addition to its introduction and conclusion as in each chapter). Section 2.2 introduces the spread of pension reforms which resulted in more than thirty countries replacing or complementing their public PAYG pension schemes with private-funded ones. The pension reforms started with the experiment held in Chile where Chicago Boys managed to privatise the entirety of public pensions. After the success, the WB published the famous *Averting the Old Age Crisis* report (WB, 1994) and spread the reforms to other countries of two regions, *Latin America* and *Europe and Central Asia* (Madrid, 2003; Muller, 2003). According to the report, in order to avoid serious budgetary constraints due to an ageing population, i.e. increasing numbers of pensioners as opposed to decreasing numbers of active members (contributors to the system), existing pension systems were to be reformed. Two different mandatory pillars, one publicly-managed and tax-financed, the other privately managed and fully-funded, were to be established and supplemented by a voluntary third pillar. The first pillar would alleviate old age poverty by using the taxation power of government while the second pillar would perform the function of smoothing savings and boosting capital accumulation and capital market development. It is claimed in the Report that funded schemes would increase long-term saving and contribute to capital market deepening and growth (WB, 1994).

The following section (2.3.) reviews the interpretations of the pension reforms in light of their neglect of the role played by financialisation. In order to demonstrate this gap within the literature, we start by reviewing the Global Social Policy School (2.3.1) which stresses the role of international agencies' key function in pension reforms (Orenstein, 2008). Indeed, international actors, not least the WB, have played a fundamental role during the spread of the pension reforms as we show in detail in the Turkish context as well. We continue with the New Political Economy School (2.3.2) which is significant for pointing to the post-industrial era's characteristics as the main underlying reason for the transformation of pensions. Accordingly, the Keynesian period provided necessary conditions for PAYG

pensions which rely on high labour force participation and satisfactory wage levels. However, with decreasing fertility, low employment levels and stable (or decreasing) wages, these pension schemes were deemed to be unsustainable. Therefore, pension reforms are seen as a consequence of the new political economy of the neoliberal era (Myles & Pierson, 2001). Although rightly pointing to the post-industrial era's characteristics, this approach takes the transition in social provisions for granted while there are crucial policy interferences in this process, most importantly by IFIs.

The Welfare Regimes approach is the most popular strand of thought in the comparative analysis of social provisions and we review this approach's pension reform analysis in the subsection 2.3.3. The prominent author of this view is Esping-Andersen who clusters different welfare states suggesting three typologies of welfare regimes, liberal, conservative and social democratic regime (Esping-Andersen, 1990b). Each regime has different levels of protection against the insecurity that comes with the commodity form of labour and relies on family, state and the market to varying extents for this purpose. This approach suffers from being mostly descriptive in terms of analysing changing welfare practices. In other words, for the followers of this strand of thought, a pension reform which increases the significance of financial schemes, while shrinking PAYG pensions, is nothing but a convergence from social democratic regime to liberal welfare regime. Thus, the processes underlying this development, globalisation, neoliberalism or financialisation, are neglected.

We review the arguments and posit the absence of financialisation in the literature as the underlying process behind pension reforms in the following subsection (2.4) (Fine, 2014). Thus, we briefly explain what we mean by financialisation of pensions and prepare the theoretical framework on extensive and intensive growth of finance which is presented in the third chapter. Accordingly, it is not possible to describe all pension reforms simply as privatisation (Deken, 2013). We read this shift as financialisation of pensions rather than privatisation. By financialisation, we refer to two issues in the reformed pension systems: first, integration of financial institutions in the policymaking process during which they attribute financial missions to social provisions such as increasing savings and contributing to capital market development. The second point is that, even in countries where traditional pension schemes are preserved, rather than being replaced entirely by the private scheme, some sort of financial scheme has been

introduced. This signifies that public PAYG schemes are not the real target. The main purpose of the reforms is to strengthen the (private) financial component of the pension schemes.

The third chapter presents our theoretical framework which consists of three sections. The first section (3.2) scrutinises financialisation and neoliberalism in two subsections. We start with an abstract understanding of Marxist finance theory (3.2.1). Marx defines different forms of capital, and capital in the form of money undertakes the functions that we call finance in the modern world. Money capital has different appearances which vary in terms of their relations to surplus value production and appropriation. For instance, money dealing activities, which can be understood as banking and bookkeeping activities for circulating money as the means of exchange, are useful for the capitalist relations although not contributing to surplus value production directly. On the other hand, money capital in the form of interest-bearing capital is crucial for surplus value production for enabling the necessary funds for production and exchange of commodities (Marx, 1991). Moreover, IBC has a typical character of being fictitious with the capacity to capitalise every stream of money capital without a direct price or value relation with the underlying asset. This aspect of IBC, thus finance from a Marxist point of view, is important for highlighting the capacity of finance to overcome limits of value relations in terms of deepening and attaching to every aspect of life in fictitious forms (Fine, 2013).

The following subsection (3.2.2) focuses on the historical aspect of financialisation by emphasising the neoliberal era's certain characteristics that underpinned the emergence of financialisation. Without engaging in discussion on the definition of neoliberalism, we follow the view that neoliberalism is characterised by financialisation which paved the way for further rise in significance of finance (Saad-Filho, 2011). We posit shareholder value as the discourse of financialisation for prioritising the financial interests over all other motives. Thus, shareholder value has changed the way in which non-financial corporations are managed and altered capital accumulation by causing tepid economic growth (Lazonick & O'Sullivan, 2000). While shareholder value signifies the financialisation's influence on the non-financial sphere, securitisation points to transformation experienced in the financial sphere (Lavoie, 2012). Elimination of the rules that constrain the capitalisation of every sort of loan, financial actors have become capable of using every aspect of

economic and social life as an underlying asset for fictitious capital. Therefore, financialisation's impact on households has reflected itself in the phenomenal increase in indebtedness which feed back to the formation of securitised financial instruments.

Section 3.3 builds up the theoretical framework for the relation between extensive growth of finance and pensions. For this purpose, we abstract pensions from all its varying appearances and argue that pensions' essential function is related to social reproduction of labour power. Labour power is the capacity to labour and it is a special commodity (Marx, 1990). The value of labour power is determined by the material standards of living in relation with the social reproduction processes (Fine, 2002). Pensions are part and parcel of these standards and they are financed by the total social product and organised in association with the relations across workers, employers and the state (Marx, 1978). The reform of pensions with the involvement of financial actors and in line with financial motives, therefore, indicates the integration of finance into social reproduction by attaching the value of labour power to fictitious capital. Therefore, the state's role in mediating social reproduction by distributing social product through taxes has been undertaken by financial conduits. The implications of this development can be seen by observing the practices introduced with the pension reforms campaigns. Funded pensions signify the transition of pension provision from the non-financial arena of social reproduction to the financial sphere. Hence, pension provision has become a profit-making activity for financial actors as well as a source of income for fictitious capital owners. As a consequence, pensions became an individual investment rather than a social right over which class struggle was conducted in a collective manner (Lazzarato, 2012).

On this basis, we develop our theoretical framework on the intensification of finance and pension funds in section 3.4. We argue that pension funds play role in financialisation through three conduits. First, pension funds contribute to financialisation via their roles in capital markets as institutional investors influencing corporate governance through pursuit of shareholder value (Aglietta, 2000). As mentioned, pension funds affect the companies' investment decisions while pushing corporate managers to generate high shareholder returns which direct them to choose short-term lucrative financial activities over long-term real investments (Boyer, 2000). The second conduit is how the pension funds' supply-side impacts on capital

markets by transferring huge amounts of capital inflows at the beginning of their life cycle thus pushing up asset prices (Toporowski, 2000). As pension funds mature, i.e. their contributors' ratio over beneficiaries decreases, they become net sellers of the financial instruments in a way that contributes to the instability of the capital markets. Thirdly, pension funds' *logic of funding*, again in relation with their life cycle, shifts motivation from minimising risk to maximising returns (Engelen, 2003). Therefore, pension funds increasingly demand more sophisticated instruments which by-pass investment constraints and bring about lucrative returns.

Chapter 4 aims to give an overview of the financialisation in Turkey. In this regard, we start with background information about the last three decades of the Turkish economy. In a nutshell, Turkey liberalised the capital account in 1989 and the International Monetary Fund (IMF) approved the convertibility of the Turkish Lira (TL) in 1990 (Kazgan, 2013). Following this, the volume of capital inflows into Turkey, in particular in the form of foreign direct investments (FDIs), increased rapidly in the 1990s. Seeking to benefit from this favourable environment, the Turkish governments of the era implemented a state-driven growth policy which was based on high-indebtedness of the public sector. This process was marked by the involvement of the banking system in financing government debt through borrowing from abroad and lending to government at high interest rates. The lucrative returns from these operations and the difficulty of accessing funds resulted in the proliferation of banks that were founded by the big Turkish conglomerates (Gultekin Karakas, 2009). The first consequence of this development was the 1994 financial crisis which was underpinned by lack of liquidity due to sudden capital outflows alongside high public debt and inflation (Marois, 2012). As capital mobility due to financial account liberalisation induced a chain of reactions in developing countries, the instability of the 1990s resulted in subsequent crises in Mexico (1994) and Asia (1997) (Ergunes, 2012). In the second half of the 1990s, Turkey was severely affected by fears of contagion due to high public external debt, an ill-regulated financial sphere and extremely high inflation rate. Therefore, Turkey entered a structural transformation period in 1999 which started with a banking system reform and continued with disinflation programme signed with the IMF (Bedirhanoglu et al., 2013).

In light of these developments, in section 4.2, we argue that the Turkish economy was financialised in the post-2001 era as a result of restructuring

programmes advised by the IMF and other IFIs under the claim of solving high public indebtedness, financial fragility and prolonged inflation. We discuss that the decisive policy in terms of financialisation was inflation targeting policy which attracted capital inflows. Inflation targeting, first implemented in the New Zealand in 1990 before spreading around the world, is based on the neoliberal ideology of '*the only goal of the completely independent Central Bank should be sustaining price stability*'. Increasingly more countries started to implement inflation targeting as the main monetary policy (Epstein & Yeldan, 2006, 2010) and financialisation in developing countries has been characterised by this policy alongside other pro-financialisation policies (Becker et al., 2010). Another point we emphasise is that the Turkish economy was restructured in line with the putative shift from the Washington to the Post-Washington Consensus while the 'regulatory state', especially in the realm of finance, was created through measures and reforms promoted by the IFIs from 1999 onwards (Bakir & Onis, 2010; Erturk, 2003). The financial motive underlying these reforms is apparent in the consequences of structural reforms, including high unemployment despite accelerating economic growth. We also show that financialisation has had a socialised cost as international reserve accumulation to sustain capital inflows was added to the package of conditionality (Aybar & Dogru, 2013).

In the section 4.3, we take a close look at the implications of financialisation through three conduits of the economy, the financial sector, the non-financial sector and households. In 4.3.1, we demonstrate the transformation in the banking system which is the central institution for the financialisation process in Turkey. With the Banking Sector Restructuring Programme of the transition period, the Turkish banking system was reorganised such that the number of banks decreased due to insolvency leading them to be taken over by the state. These banks, then, were acquired by or merged with foreign banks, which resulted in a substantial increase in the significance of foreign banks in the Turkish banking system. Moreover, with the Twin Programme, which included fiscal control alongside inflation targeting, public indebtedness decreased substantially which caused banks to lose a lucrative source of profit, namely government debt securities. Therefore, banks in Turkey experienced a shift from purchasing public securities to lending more generally as we demonstrate with the data from banking system balance sheets.

In this light, we investigate the impact of this development in the banking system on the real sector in Turkey (4.3.2). The most remarkable implication of economic transformation has been the shift of the external debt from the public to the private sector. Across the latter, the non-financial sector has been the main debtor with, in particular, almost double of the external debt compared to that of the financial sector. However, this balance has changed since 2012 when the financial sector's foreign debt has caught up with the real sector and exceeded it in 2015. This development is related to the financial sector's crucial expansion as we show with data that banks are the main undertakers of this debt. Besides being indebted, we show that the Turkish real sector, including both manufacturing and non-manufacturing sectors, borrows mostly for the short term while the significance of bank loans decreased as opposed to financial liabilities in the real sector's balance sheet. More specifically, the manufacturing sector, which mostly consists of large-scale companies, relied on foreign resources for long-term borrowings. Then the question becomes, what do they do with the money they borrow? In order to see the implications of favourable financial circumstances on production levels, we examine fixed capital investment (Demir, 2009b; Ergunes, 2012). After reviewing relevant data available by the Central Bank of Republic of Turkey (CBRT), we draw the conclusion that the Turkish big corporations, which are the drivers of the manufacturing sector, have not reflected the availability of finance in their production levels. When it comes to small and medium enterprises, which comprise the majority of the non-manufacturing sector, the result is more disappointing as they could not even benefit from the expansion in loans. We bring evidence for this from bank loan allocations which show that the share of the small firms' loans has not changed even though loans expanded significantly. Finally, we specify that some of the non-manufacturing sector firms have been the winners in this process as is evident with the highest share of loans extended by banks to the construction sector, corresponding to the growth in the supply of and demand for housing.

In section 4.3.3, we evaluate the impacts of these developments on households. The structural transformations mentioned before has resulted in banks' increasing focus on consumer lending. As we show with data on loans and receivables of the banking system, the share of consumer loans has increased substantially. Moreover, we discuss that the main reason households seek bank loans is to buy a house, in response to the previously mentioned expansion in the

construction sector (Karacimen, 2014). What is more interesting is to see that the majority of the households that ask for consumer credit consists of those in low income groups. This is a challenging finding which needs to be explained. To that end, we address the issue of high unemployment and low labour force participation characteristic of the Turkish labour market. We refer to those authors who note that financialisation has exacerbated the existing problems of low-income households, inducing them to apply for bank loans in order to sustain their standards of living (Akçay & Gungen, 2014). In other words, we argue that the Turkish households have survived financialisation through bank loans.

Our fifth chapter develops an analysis in depth of Turkish pension reform. Here, we show the involvement of the WB which conditioned pension reform in return for a loan agreement in 1994 (5.2). Although, pension reforms began to be implemented after some time (in 1999), the way in which pensions were shaped was a perfect fit with WB advice: decreasing the significance of the PAYG scheme and introducing a private individual funded scheme (ILO, 1996). In order to reveal the financial motives underlying the pension reforms, we critically scrutinise the accuracy of pension reform advocates' arguments. In five subsections we deal with the arguments of ageing population, inadequacy of the pension system in protecting against poverty, deficits of the social security system institutions, coverage problems, and structural problems of the pension schemes originating from the fragmented organisation and technological shortcomings.

We show on the basis of comparative data that the population projections regarding Turkey's elderly population are exaggerated while the ageing *problem* is far from significant relative to the experience of other OECD countries (5.2.1). The argument of protection against poverty is discredited with the observation that social security systems have different functions than protecting those in extreme poverty, and there are alternative ways of addressing poverty than through social security schemes (5.3.2) (Guzel, 2005). We continue with the argument on the deficits of the social security system (5.2.3) which stem from previous policy implementations such as contribution breaks, misuse of pension schemes' surpluses, and last but not least, early retirement. We stress that the blueprint advice of increasing the retirement age would simply not solve this problem in Turkey. We provide further evidence in the form of the characteristics of the Turkish labour market pointing to the weight of the many young, educated unemployed as opposed to exhausted, uneducated elderly



workers (Turcan Ozsucu, 2006). In addition, we examine the so-called generosity of the Turkish pension system by comparing it with other OECD countries and illustrate that other OECD countries spend much more on old-age income than Turkey, and average income of the pensioner is much lower in Turkey (OECD, 2013).

Coverage of the Turkish social security system is a rightly observed issue as there are many elderly who are not covered by any kind of protection scheme (5.2.4). We show that the Turkish labour market's characteristics, such as high informality and low labour force participation, are what underpin the coverage problem. Moreover, due to very low social expenditure levels in Turkey, the social protection schemes' coverage falls behind the OECD average. Finally, we review the arguments regarding the structural problems of the Turkish social security system. These originated from the fragmented organisation of the three institutions providing pensions on the basis of different norms. In addition, the inadequate technical infrastructure available exacerbated the organisational problems of delivery within the system (5.2.5). Thus, we draw the conclusion that the Turkish social security system's problems have not been properly addressed by the advocates of reform and nor can they be resolved through the ways advised by the IFIs.

This fact did not stop the Turkish policymakers from implementing WB advice. They first changed the eligibility rules for entitlement to a pension in 1999. Then, they introduced the individual, private, funded scheme, namely the Individual Pension System (IPS) in 2001. Finally, they united all three social security institutions under one roof and further tightened the eligibility conditions for the public scheme. Thus, as of 2008, the Turkish pension system consisted of one pillar of the public PAYG scheme (with tightened eligibility conditions) and one pillar of financial scheme on the voluntary participation principle. After reviewing all the reform processes in detail in section 5.3, we demonstrate the impacts of the pension reforms in relation to the characteristics of the Turkish labour market. We argue that those unemployed, the informally employed and women in Turkey were worse off after the reforms. Accordingly, the increasing number of contribution days and higher eligibility ages for retirement contributed to the unemployment problem of the Turkish labour market as well as making it almost impossible to retire for those who were unemployed or informally employed casually. We also emphasise that women in Turkey, with their extremely low labour force participation and interrupted careers, were rendered even more disadvantaged after the reform process.

In section 5.4, we present our position on financialisation of pensions through the analysis of the IPS. Here we deal with two different arguments. First, we show that, despite the discrete process of the IPS and economic role attributed to it, it is part and parcel of the pension reform advised by the WB and consists of the motive of financialisation of pensions in relation to two other social security system reforms. This is so because those reforms decreased the significance of the public PAYG pensions while the IPS is presented as an implicit compensation mechanism for possible old-age income loss. The second argument, on the other hand, regards the capacity of the IPS in terms of providing solutions for the problems of the Turkish pension system. On the basis of data from the social security system and the IPS, we argue that the IPS mainly appeals to middle- and high-income earners. Therefore, it does not contribute to coverage of the social security system except from the self-employed which opted out from the public scheme and joined the IPS as expected by reform advocates. Moreover, we revisit the characteristic problems of the Turkish labour market and draw the same conclusion: the IPS does not solve unemployed or informally employed workers' pension problem as these people cannot contribute to the system to allow for reasonable old-age income. As a final point, we stress the disadvantaged position of the women as the kinship-pensions are decreased with the social security reforms and funded schemes lack any redistributive character.

As obvious from the literature and pension reform advocates' arguments, there is nothing new about saying pension funds contribute to capital markets' enhancement. In effect, the WB has suggested pension reforms to countries with undeveloped capital markets with the explicit promise of a more developed financial sphere. Not surprisingly, this promise held in the example of Chile whereas other advantages of pension reforms, regarding adequate pension income for instance, did not hold at all. Therefore, in our sixth chapter we state the obvious in a critical way, pension funds in Turkey have played a significant role in the development of capital markets. Nevertheless, our perspective can be regarded as novel for relating pension funds with the intensification of financialisation. We start by introducing general characteristics of pension funds in Turkey (6.2). We show that the Turkish pension funds were established in a cautious way with a lot of constraints on investment decisions and through rules to reassure participants in terms of transparency. This aspect of pension funds' regulation is understandable considering the novelty of this kind of investment for the Turkish population and suspicion originating from lack of

familiarity. What is surprising, on the other hand, is recent deregulation which has loosened the investment criteria with the promise of opening more space for interest-free IPS.

We continue by pointing to the growth of the pension funds' assets through quantitative data (6.2). The IPS funds' net asset value has shown rapid growth, not least after 2012, with the provision of lucrative state incentive. According to the Capital Markets Board of Turkey (CMB from now on) data, with TL37billions in value, the pension funds became the most important capital markets player in Turkey in 2014 by exceeding the mutual funds. Although Turkish pension funds represent one of the smallest pension funds across OECD countries, they are noted to be the fastest-growing pension funds in 2012. In this regard, it is not surprising to see the positive impacts of this rapid growth on capital markets in Turkey. Even so, Turkish capital markets have not experienced remarkable growth since the IPS was founded. Indeed, compared to G20 countries, Turkey exhibits the second lowest market capitalisation value (WB). We read this indicating that the IPS funds have contributed to capital market growth in a way that is more qualitative than quantitative. In order to support this argument, we move to the demand-side impacts of pension funds on capital markets in Turkey.

In 6.3, we demonstrate the transformation within the Turkish capital markets through data regarding the increasing significance of the private sector as opposed to the shrinking public sector securities. This development does not come as a surprise, in particular considering the overall restructuring of the financial system in Turkey which has decreased the weight of public sector in this regard. However, what is interesting is to see the change within the private sector financial instruments which signifies a shift from conventional financial instruments to those which can be deemed to be innovative instruments for Turkish capital markets. These instruments are bank bills, corporate bonds, asset-backed securities, real estate certificates and commercial papers.

In 6.3.1, we investigate the bank bills and corporate bonds in terms of what they represent for financialisation of the Turkish economy. We emphasise the point that increasing significance of bank bills as new instruments within the Turkish capital markets is in parallel with the significance of the banking system within the Turkish economy in general, and financialisation processes in particular. We provide evidence for this argument from the remarkable weight of the banking sector within

the most important base index of the Turkish capital markets, namely the top thirty companies of the Borsa Istanbul (BIST), i.e. BIST30. This point is important because pension funds in Turkey mostly invest in stocks that are listed in the BIST30 index. Thus, we highlight the internal feed-back mechanisms of financialisation through which pension funds provide funds for the expansion of the banking system which contributes to financialisation in an indirect manner. In the case of corporate bonds, on the other hand, the important point is to demonstrate that corporates started to issue bonds as sources of financing because they rely on the institutional investors, not least, pension funds in terms of serving its demands.

In section 6.3.2, we turn the coin and look at the pension funds' portfolio allocation in order to see the innovative instruments' rising significance in their investments. Unfortunately, the data on a detailed allocation of these sorts of instruments are not readily available. Rather, we only show that conventional instruments, such as government bonds, lose weight within the pension funds' portfolios while they consist of increasingly more innovative instruments (CMB, 2015a). However, we cannot fully see the allocation of these instruments in detail as they are all gathered under the label of 'others'. For this reason, we choose a different way. We take a specific instrument, lease certificates, and show how this instrument has become a remarkable component of pension funds' portfolios. Lease certificates are important because they in effect represent a major step towards securitisation in the Turkish capital markets. They work on the same principles with special purpose entities although in Turkey they are established in the form of joint-stock companies. What is dramatic in this context is that lease certificates are shaped with Islamic influences and marketed as interest-free pension funds as put by the Pension Monitoring Centre (PMC). Therefore, the intensification of finance through pension funds' demand for innovative instruments is experienced within an Islamic-finance context in Turkey. As we show, participation funds and alternative state contribution funds, which invest mainly in these instruments, are pushed by recent regulations with reference to interest-free pension income.

In the concluding chapter, we review the main arguments of each chapter and discuss the contribution of this study to the relevant literature. Moreover, we posit the limitations of the thesis in terms of unavailable data and arguments to be discussed in detail and enhanced further. We also recommend future research which can draw on the basis of the findings and framework of this study. Finally, we posit

the policy implications of the private-funded schemes especially the case they become mandatory. This point is important because at the time this introductory chapter is being written, legal arrangements to render the IPS mandatory for all workers are being accelerated (Boyacioglu, 2016).

#### **1.4. Concluding Remarks**

In this introductory chapter, we have given an overview of the thesis. There are a few more points in this regard. First of all, this thesis develops a macroeconomic analysis based on secondary data on economic indicators and sectoral developments. In this regard, there is no microanalysis drawing upon primary data at the firm level or individual interviews. Rather, we use the publicly available data from the government databases and Individual Pension System websites and reports in order to figure out the general tendencies regarding financialisation and its interaction with pension provision. Moreover, we also benefit from newspaper articles, not least those revealing the expectations of the capital market players and the intentions of government authorities. As mentioned before, there are five chapters apart from the conclusion (and this introductory chapter) and all these chapters have introduction and conclusion sections. Within the thesis, bold characters are used to emphasise the important points from direct quotations. On the other hand, italics are mainly used for the purpose of highlighting terms which are in common use or from a strand of thought or specific author (if it is a direct reference, the page number is provided).

## **2. A Gap in the Literature on Pension Reforms: Financialisation**

### **2.1. Introduction**

The last two decades have witnessed a contagion in pension reform which has resulted in the increasing significance of individually funded schemes. These accumulate pension contributions through funds then invest in financial markets. Therefore, returns on financial investments of funded schemes determine the old age income of participants. Moreover, these schemes gather a huge amount of capital under pension funds which are of paramount importance in terms of financial markets. On the basis of this reasoning, in this chapter, we associate the pension reform trend with the current economic phenomenon of financialisation that shapes economies in a way which prioritises finance. Analysing pension reforms in the context of financialisation is important because it points to the penetration of finance into pension provision in a way which reveals the extensive and intensive growth of finance (Fine, 2013). By extensive growth, we posit the influence of international financial institutions which shape pension provision according to the financial interests. By intensive growth, on the other hand, we refer to the influence of pension funds, which are founded in relation to the pension reforms, on financial markets through stimulating deepening of financial activities. Thus, we contribute to the literature on pension reforms by pointing to the key role financialisation plays in the transformation of the social provision, not least through pensions.

We develop our argument in three sections. In the next section, we cover pension reforms in several countries since the 1990s. The campaign for pension reform has been run by the World Bank (WB) with publications, foremost with the report called *Averting the Old Age Crisis* (WB, 1994), advisory relations and funding. The main argument of the reform campaigners has been the ‘ageing’ population. On the basis of this argument, the traditional national pension schemes are deemed to fail to cope with sustainability problems brought forward by demographic transition. As a result of the campaign, many countries in the *Latin America* and *Europe and Central Asia* have introduced new pension schemes where the individual savings accounts have become either the main provider of the pensions or complementary to the existing schemes. Most of these countries had young populations but they were experiencing similar economic problems, such as transition to the market economy (for post-socialist countries), capital scarcity and

fiscal deficits (Muller, 2003). Therefore, ageing-related arguments do not explain the reasons underlying pension reforms. This made it necessary to review other interpretations of transformation in social provision.

In the following section, we review the literature on pension reforms in three subsections with a focus on three main approaches: the Global Social Policy School, the New Political Economy approach and the Welfare Regimes Approach. The Global Social Policy School deals with global factors shaping national social policies, and it has the advantage of addressing the international actors conducting the pension reform campaign (as we show in 2.3.1). Adherents of this view do appropriately point to the key role of the WB in pension reforms (Orenstein, 2008). However, they fail to reveal the underlying agenda of promoting finance. Thus, this approach defines pension reforms as ‘pension privatisation’ which we challenge by putting forward the idea of ‘financialisation of pensions’ which emphasises the increasing significance of finance within provision of old age income. The New Political Economy approach (reviewed in the subsection 2.3.2), on the other hand, stresses the national factors regarding the production relations in a country which influence the way in which pensions are provided. This view places attention on the post-industrial structures in the developed countries which challenge the welfare services organised during industrialisation. On the basis of this idea, pension reforms are discussed as a matter of sustainability of pension schemes which are incompatible with the demographic transition. Consequently, this view analyses pension reforms in a way that is limited to the arguments of the campaigners for reform although their arguments are incapable of explaining the reforms in countries with young populations.

The last school we review is the Welfare Regimes Approach (in the subsection 2.3.3) which is a comparative analysis that clusters welfare regimes in different countries according to their commonalities (Esping-Andersen, 1990a, 1990b). Despite the dominance of this approach within the welfare state literature, it shows a complete failure in terms of describing the transformation of the welfare regimes (Fine, 2014). While the neoliberal era is characterised by alterations in welfare services, this view focuses on increasing or decreasing similarities across welfare regimes rather than revealing the underlying factors, financialisation in particular. Since this approach mostly analyses the welfare services as a totality rather than focusing on specific social provision, pension reforms have not been

subject to considerable attention. In the few analyses where pension reforms are investigated through welfare regimes, the argument does not go beyond analysis of the convergence (or divergence) of provision.

In the fourth section, on the basis of the gap within the literature on pension reforms, we analyse pension reforms in the context of financialisation. Here, we point, as mentioned, to the dual integration of finance with pensions. The first is related to the extensive growth of finance which refers to the expansion of the financial sphere in a way that involves non-financial elements being incorporated into the domain of finance. As a result, old age income has been provided through financial mechanisms and has become attached to financial market performance. Moreover, after reforms, pension systems have started to be evaluated on the basis of their contribution to capital market development. We argue that the financial mission attributed to the pension systems is a reflection of financialisation which shapes pension schemes in a way that favours financial markets.

The second aspect of the financialisation and pension relation is the impact of reformed pension schemes on financial markets' depth. In a nutshell, the WB prescribes a pension model which consists of a funded scheme as the substantial provider of old age income. Funded pension schemes accumulate savings of participants and invest them in financial markets through pension funds. Pension funds stimulate the supply of, and demand for, hybrid and more speculative financial instruments in a way which contributes to financialisation. Supply of financial instruments is increased by gathering huge amounts of capital inflows for application to financial markets (Toporowski, 2000). On the other hand, demand for sophisticated financial instruments is created as a result of the logic of funding which necessitates more liquid investments as funds mature (Engelen, 2003). This aspect of pension income providing funds is related to the intensive growth of finance which signifies ever increasing depth of financial activities (Fine, 2013).

By pointing to financialisation in the context of pension reforms, we contribute to the literature by carrying the discussion to a further level than the commonplace arguments regarding ageing. Indeed, we show that most of the countries that have reformed their pension systems have young populations. Moreover, when the only argument is related to the demographic transition, the funding method cannot be justified since financialised pension funds are not immune to ageing related problems.



Finally, we review recent publications on pension systems after reforms. Two issues deserve attention in the recent publications of the international financial institutions: the advocates of the pension reforms are still consistent with their previous position while they slightly modify their policy advice according to recent financial developments, not least the economic crisis (Whitehouse, Pallares-Miralles, & Romero, 2012). In addition, the reformed pension schemes are successful in terms of promoting financialisation in those countries but these schemes fail to meet projections in terms of adequacy of pension benefits.

We conclude by situating this chapter within the overall study in order to introduce both the theoretical and empirical aspects of our thesis. Theoretically, financialisation is applied to the understanding of pension reforms. Empirically, other country experiences provide grounds for the analysis of the Turkish pension reforms in its relation with financialisation. This enables us to show that financialisation underpins pension reforms in Turkey while pension funds contribute to the financialisation of the Turkish economy through their impact on financial markets.

## **2.2. Pension reforms**

Pension reforms go back to the early 1980s when the WB advised Chile to replace public pension schemes with private schemes. Pension policy advice was a part of a series of economic reforms put forward for Pinochet's government after the coup that elected leader Salvador Allende was overthrown. These economic reforms, including pension reforms, were advocated by the neoliberal economists, the so-called "Chicago boys" who were a group of young Chilean economists graduated from US universities. The reforms represented a neoliberal attack against social provision in Chile which became a laboratory for subsequent reforms (Orenstein, 2008).

In the 1990s, pension reforms spread around the world with more than thirty countries altering their pension systems. The WB ran the campaign advocating pension reforms. In this regard, the most important turning point was the publication of *"Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth"* (WB, 1994). The Report has become the flagship of a pension reform campaign run under the leadership of the WB with other international organisations including the IMF, the OECD, the Asian Development Bank (ADB), and United States Agency for International Development (USAID) (Beland & Orenstein, 2013).

The Report starts with a disaster scenario about old age income schemes and called upon developed and developing countries to take urgent measure against the approaching '*ageing crisis*':

“Systems providing financial security for the old are under increasing strain throughout the world. Rapid demographic transitions caused by rising life expectancy and declining fertility mean that the proportion of old people in the general population is growing rapidly. Extended families and other traditional ways of supporting the old are weakening. Meanwhile, formal systems, such as government-backed pensions, have proved both unsustainable and very difficult to reform. In some developing countries, these systems are nearing collapse. In others, governments preparing to establish formal systems risk repeating expensive mistakes. The result is a looming old age crisis that threatens not only the old but also their children and grandchildren, who must shoulder, directly or indirectly, much of the increasingly heavy burden of providing for the aged.” (WB, 1994, p. 13)

This claim was pursued with projections on ageing: the number of people of 60 years old or more was half billion in 1990 and was going to triple by 2030. Further, a significant part of ageing would be seen in developing countries, such as China, which have comparatively young populations for now.

“Because of the broad diffusion of medical knowledge and declining fertility, developing countries are aging much faster than the industrial countries did. In Belgium, it took more than 100 years for the share of the population over 60 to double from 9 to 18 percent. In China the same transition will take only 34 years and in Venezuela 22 years” (WB, 1994, p. 1)

One might ask, what is the problem with this? In effect, longevity must be celebrated since it is associated with the improvements made in human life. However, according to the WB this is a crisis for several reasons. First of all, across the world, the most dominant pension provision type is based on PAYG financing which means that current retirees are paid for by the contributions of current participants of the system. The benefits are earnings-related and they are financed through the payroll tax earmarked from current contributors' taxable earnings. Therefore, if the number of retirees is high (due to ageing), current participants have to pay proportionately more to the system. The Report argues that the number of new entrants to the system is incompatible with the rise in the number of pensioners. This

would result in unsustainable fiscal deficits of the social security systems all around the world. From this point of view, increasing payroll taxes, which is the usual way of collecting contributions to the PAYG pension schemes, aggravates the problem by inducing informality within the labour market. In a similar vein, subsidising pension systems through government spending exacerbates problems of countries with low growth rates.

“High payroll taxes distort labor markets and reduce growth. In Hungary, where more than one-quarter of the population are pensioners, the average effective retirement age has fallen to 54 and the payroll tax needed to pay the pensions is 33 percent, cutting the demand for labor, the supply of experienced labor, and national output. High government spending on old age security crowds out other important public goods and services. In 1989 Austria's pension fund cost 15 percent of GDP (gross domestic product), and old age benefits absorbed 40 percent of public spending. Without reform these already high percentages will increase further as the population ages.” (WB, 1994, p. 2)

On the basis of this reasoning, the WB asserts in the Report that pension systems have three functions, namely saving, redistribution and insurance which should be separated from each other through a multi-pillar pension system. The saving function of a pension refers to the ‘income smoothing over a person’s lifetime’ since people consume more during old age by spending less when they are young. On the other hand, pension systems also have a redistribution function which means that they transfer income between or within generations in order to prevent old age poverty. Finally, the insurance function protects the person against the risks related to old age. The report suggests that all these three functions should not be covered by a public PAYG scheme; rather **three pillars** should be founded in order to meet each function.

In more detail, the first pillar, which is publicly managed, prevents old age poverty and provides insurance against risks in this regard. Clearly, this pillar performs the redistribution function in order to alleviate poverty and can take three different forms: a means-tested programme, minimum pension guarantee to a mandatory saving pillar and, finally, it can be a flat rate benefit which is provided either universally or on an employment-related basis.

“But it should be modest in size, to allow ample room for other pillars, and pay-as-you- go, to avoid the problems frequently associated with public management of national provident funds. Having an unambiguous and limited objective for the public pillar should reduce the required tax rate substantially-and therefore evasion and misallocated labor-as well as pressures for overspending and perverse intra- and intergenerational transfers.”  
(WB, 1994, p. 16)

The second mandatory pillar suggested in the Report should be fully funded and privately managed as opposed to the first pillar (which would be a public PAYG scheme). There is a main difference between funded and PAYG schemes. Accordingly, funded schemes accumulate funds on the basis of savings, and those savings with returns on investments of funds determine retirement benefits. However, PAYG schemes work on the basis of intergenerational transfers which means that current participants pay in to finance current retirees’ benefits with the expectation that future participants will finance their retirement too. Thus, the second pillar functions for income-smoothing and saving; and it can take the forms of personal saving accounts or occupational plans. Finally, the voluntary personal savings account would constitute the third pillar and might take the form of occupational plans. Expectation from this pillar is to provide additional old age income and insurance. All three pillars provide insurance function whereas redistribution and saving functions are provided by the first and second pillars, respectively. Pension reforms advised by the WB refer to a decreased role of the state and inter-generational income transfer through the diminishing significance of public PAYG schemes. New expectations from PAYG scheme become providing a basic, modest income for the elderly in order to prevent poverty. Thus, the WB addresses the individual responsibility in order to ensure welfare during old age. This signifies a neoliberal paradigm shift within the pension provision from state to market and from social to individual.

In addition to these pillars, the Report recommends some parametric measures such as replacing defined benefit principle with defined contribution schemes, higher eligibility age for retirement with longer contribution periods, and introducing or altering indexation methods for pension benefits. In defined benefit schemes, which are traditional ways of calculating pension benefits, the latter are determined by a formula which consists of the years of contribution and the salary of

the employee. Therefore, the employee has an expectation of the approximate level of benefits she is going to be paid during retirement. However, in defined contribution schemes, only the contribution rate is fixed while the pensioner shoulders the risk of having lower benefits. The implication of higher retirement age and more contribution days is obvious: being eligible for a pension becomes more difficult. Last but not least, the indexation rules, although being suggested in order to protect the pensioner against the risk of inflation, targets less generous pension benefits which are required for lower replacement rates as advised by the WB. All these parametric measures strengthen the paradigmatic shift by diminishing the pension benefits paid by the public PAYG schemes while retirement becomes more difficult. Thus, the necessity of having a private funded saving pension plan increases.

After the publication of the Report in 1994, pension reforms have spread around the world. Two regions were significant in this regard, *Latin America* and *Europe and Central Asia*. Before the reform wave, pension systems in these regions were mostly public pension schemes with monolithic structures while private saving accounts were rare. After the reforms, however, almost all countries downsized or closed the public scheme and introduced private old age systems either on the basis of mandatory or voluntary participation principles (Madrid, 2003; Muller, 2003; Orenstein, 2008). In Latin America, following the Chilean example, Bolivia, Mexico and El Salvador also closed their public PAYG schemes either immediately or gradually after the reform (this means the existing PAYG scheme is closed to new entrants but valid for existing participants who prefer to stay in them). On the other hand, in Peru and Colombia, the public PAYG schemes were reserved as alternatives to the mandatory private scheme (second pillar). In Argentina, Uruguay and Costa Rica, the traditional PAYG schemes have been kept while private second pillars provide complementary pension income. Although the degree of applying private schemes varies across the countries, individual fully funded schemes have been founded in all of them (Muller, 2003, p. 20).

Another region spreading pension reforms is Europe and Central Asia. In this region, among 30 countries, 12 countries reformed their pension systems in the last two decades and introduced private saving accounts. Kazakhstan and Kosovo are two countries which have shifted their pension system to large funded pillars while they have downsized their public scheme to means-tested basic pension providers. In

Hungary, new entrants to the pension system are required to join the reformed scheme while the existing contributors of the system choose to opt out or not. In Poland, participants who are less than 30 years old have to join the private funded pension scheme. Latvia and Bulgaria have complemented their public pension schemes with small mandatory funded pillars to which workers need to contribute a 2 per cent of payroll tax. In a similar vein, in Lithuania the private pillar is small and percentage is a 2.5 of payroll tax. Croatia and Estonia introduced the private funded pillars and workers need to contribute, respectively, 5 and 6 per cent as a payroll tax. Slovakia, Macedonia and Romania are other countries in the region with private funded pillars. Russia started to accumulate funds for the private funded pension scheme in 2002 (Whitehouse et al., 2012).

China, Hong Kong, Uzbekistan, Taiwan, Nigeria, Sweden are countries from different regions which have introduced pension reforms. Moreover, Brazil, Kyrgyz Republic, Panama and Turkey adopted pension reforms which are consistent with the WB advice but they did not introduce mandatory saving accounts (Orenstein, 2008). Turkey has received the largest loan from the WB for reforming pension system among Europe and Central Asia countries without establishing a mandatory funded pillar (\$197.7 millions in three loans) (Andrews, 2006, p. 67)

To sum up, the WB started a pension campaign in 1994 with the publication of *Averting the Old Age Crisis* which “synthesized a neoliberal critique of existing welfare state arrangements” (Orenstein, 2008, p. 77). As a result of this campaign, several countries across the world have reformed their pension systems. In the next section, we discuss how reforms in pension systems are interpreted by the literature.

### **2.3. Is it the usual suspects or usual approaches?**

In order to explain all factors underlying the erosion of social protection, Schwartz (Schwartz, 2001) names his article as “Round up the Usual Suspects”. Here he highlights a wide range of global and national factors to address *who killed* the growth of the welfare state. However, within all those factors, one cannot find any hint of financialisation.<sup>1</sup> Indeed, this is a representative example of the general feature of the literature on the transformation of social provision. The literature is

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<sup>1</sup> After more than a decade that is characterised by financialisation, it is appropriate to point to the lack of financialisation within the literature. However, we are referring to Schwartz rather for illustrative purposes since he wrote his article in 2001 around when financialisation was just recognised (Engelen 2001).

very busy with focusing on the so-called *usual suspects*, novel factors like financialisation are notable for their absence. Therefore, we suggest a new approach, i.e. financialisation for the analysis of pension reforms. Financialisation is not independent from other factors that shape social policy such as neoliberalism, globalisation and post-industrialisation. Thus, it is useful to review the approaches on these factors with the purpose of revealing the absence and peculiarity of financialisation. Here, we review three main strands of thought regarding pension reforms: the Global Social Policy School, the New Political Economy School and the Welfare Regimes Approach.

### *2.3.1. Global Social Policy School*

With no doubt, the **Global Social Policy School** is the approach which puts most emphasis on pension reforms. The reason behind this is that the approach seeks international actors' practices within global social policy; and, pension reform is an excellent case study to reveal these actors' involvement in national policymaking. In more detail, this view posits that supranational organisations shape national social policies.<sup>2</sup> Therefore, social policy should be analysed in the context of globalisation (Yeates & Holden, 2009). As welfare states in mature economies have been undergoing a transformation process, globalisation is responsible in this regard as well as the neo-liberal drift (Ellison, 2006). On the basis of this reasoning, this strand of thought suggests a global social policy approach which considers the influence of supranational factors on national social policy.

“The collapse of the cold war, the consequent proliferation of little states, and the consequential increase in the importance of supranational, regional and global economic and political processes lead now to the need for social policy analysis to change gear from a focus solely on national and comparative social policy to a focus that gives equal weight to supranational and global social policy.” (Deacon, Hulse, & Stubbs, 2009, pp. 9–10)

The global social policy approach was developed in the late 1990s and, since then, its content and scope have diversified according to the strength attributed to supra-national factors influencing national policymaking. Adherents of the strong globalisation thesis argue that international institutions interfere in policymaking of

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<sup>2</sup> The adherents of the Global Social Policy approach use different concepts to refer to global actors such as supra-national, transnational and international actors etc. Here, we use all these concepts interchangeably although they might not have exactly the same meanings in the original texts.

national countries through direct or indirect mechanisms, and shift social policy trends. Moreover, growing global economic pressures related to trade openness and capital mobility put paramount pressure on national economies. Therefore, globalisation underlies neoliberal social policy. On the other hand, the weak globalisation thesis' adherents also point to the decisive role of national economic factors, such as unemployment, low growth rates and ageing population (these may or may not be related to globalisation). For weak globalizers, the impact of globalisation on welfare state services is unsurprisingly less than the impact argued by advocates of the strong thesis. Strength attributed to global factors and actors in determination of social policies at national levels differs widely between these two extreme positions (Ellison, 2006).

In this regard, neoliberal economic policy prescriptions advanced by Washington DC-based institutions, namely the IMF, the World Bank and the US Treasury have paramount importance (Orenstein, 2009). These policy prescriptions advocate 'free' trade, market liberalisation and deregulation, privatisation, and residual social provision. Hence, neoliberalism represents the ideology of these institutions.

“The primary archetypal indicators of a distinctively neo-liberal orientation are taken to be: a strong commitment to the primacy and superiority of systems for the organisation and coordination of productive activity based on principles of the “free market”; advocacy of the minimisation of the state's involvement in market-based productive activity in general, and of the operation of all aspects of the functioning of labour markets in particular; support for personal investment and entrepreneurship, and the cultural values of acquisitive individualism; the presumptions that individuals are key sources of enterprise, act in rational and self-interested ways and hold primary responsibility for their own conduct and their economic survival and well-being; and a consequential commitment to minimal residual state intervention in the provision of welfare for people whose individual conducts and abilities limit their capacities for rational, self-interested and responsible behaviour, economically and socially.” (Fergusson & Yeates, 2013, p. 67)

On the basis of this theoretical background, Orenstein investigates the pension reform trends with a focus on the WB's role (Beland & Orenstein, 2013; Orenstein, 2005, 2008, 2009, 2011). Orenstein explains that the spread of the pension



reform trend between 1981 and 2004 is a result of the campaign run by transnational actors, led by the WB, as a part of the broader neo-liberal agenda for global social policy (Orenstein, 2005).

“Transnational actors, including international organizations, transnational non-governmental organization (NGOs), expert networks, and individual policy entrepreneurs, have become leading sources of policy norms and ideas in countries worldwide in areas that often exceed their original mandate.” (Orenstein, 2009, p. 59)

The USAID, IMF, and regional development banks (such as ADB) have assisted the WB during the pension reform campaign. Moreover, these institutions funded the process through loans while in some cases pension reform was put forward as the condition for further loans. Finally, it should be noted that transnational actors are not only institutions but also policy advisors including individuals. For instance, Jose Pinera was individually involved within the pension reform campaign after his functioning as one of the Chicago Boys during the Chilean pension reform (Orenstein, 2008). In a similar vein, the manager of the largest insurance company in Bolivia contacted Jose Pinera to prepare a reform proposal for pension system (Muller, 2003).

All countries have had varying processes underlying pension reforms ranging from war's impact (Croatia) to economic crisis (Bulgaria) or high external debt (Hungary). All these different factors led governments to search for loans, to give signals of their commitment to a market economy and to endeavour to gain access to international capital markets (Muller, 2003). In other words, most of the middle-income developing countries accepted pension reforms on the ground of different economic and political factors such as capital scarcity where the pension reform signalled commitment to a free-market system (Brooks, 2005). Thus, it is obvious that transnational actors have played a significant role in pension reforms; however, every country applied the pension reforms on the basis of different processes. Focusing on agencies at the expense of processes results in neglecting factors such as financialisation.

Further, the scope of pension reform has varied across countries; thus it is mistaken to call all these reforms as *pension privatisation*. When reform regions are compared, we see that the size of private funded schemes in the post-socialist countries is much less than the size of private saving accounts in Latin America.

“When we review the pension reforms in the post-socialist countries, we see a slightly different trend. In the era of Central and Eastern Europe, only Kazakhstan closed down the traditional PAYG scheme while Hungary and Estonia did not alter their public PAYG schemes. Poland and Latvia founded a notional defined contribution scheme and Bulgaria and Croatia preferred PAYG scheme with pension points. In all these countries, except Kazakhstan, private tier has remained as complementary to public PAYG scheme.” (Muller, 2003, p. 68)

Moreover, the structures of the reformed pension systems differ significantly even within the region. For instance, in Latin America, it is argued that there are three different pension reform types.

“Second-pillar reforms can be classified into three categories. The first is the “Chilean model,” which made private accounts mandatory for all new workers; Bolivia, El Salvador, and Mexico also adopted this model. The second is what might be called the “Peruvian model,” which Colombia also adopted. Under this model, new workers are given a choice between a downsized pay-as-you-go pension and a private account. Under the third approach, which can be termed the “Argentine model,” new workers have a pay-as-you-go tier combined with a private account tier; Costa Rica and Uruguay also adopted this model.” (Gill, et al., 2008, p. 64)

To sum up, neoliberalism is taken as the central ideology of international institutions in social policy by the Global Social Policy literature. Yet, the financial agenda of these institutions and its impact on the way in which pension systems are restructured is not discussed in detail. This approach defines new pension systems, which are established on the basis of advice from the WB, as private pensions. In this sense, financialisation is the main aspect of neoliberalism and this strand of thought misses its implication by its narrow conceptualisation as privatisation.

### *2.3.2. New Political Economy School*

The second strand of thought analysing social provision reforms is the **New Political Economy School** which focuses on the post-industrial changes that put budget pressures on welfare states and result in shift in social provision (Pierson, 2001). Accordingly, a reform trend in social provision originates from the inconsistency between the political economy of the past (when that social provision was designed

initially) and the contemporary policy environment (Myles & Pierson, 2001). In this regard, the main reason behind the spread of pension reform is that the PAYG schemes were organised under high rates of wage growth, fertility and labour force participation. When these rates have decreased, it has become necessary to replace the PAYG schemes with funded ones:

“The implicit ‘rate of return’ in schemes financed by payroll taxes is the annual percentage growth in total real wages (returns to labour). Total wages are the product of the average wage multiplies by the number of wage earners. The latter term is a function of population growth and the rate of labour force participation. Quite simply then, the financial soundness of old age pension financed from payroll taxes depends on high wage growth, high fertility, and high rates of labour force participation. The current wave of pension reform, then, is essentially a matter of adapting pension regimes designed for an ‘old’ political economy to one compatible with a new policy environment.”(Myles & Pierson, 2001) (Myles & Pierson, 2001, p. 311)

This strand of thought shows us that the pension reform trend needs to be analysed in the context of the bigger picture that covers the structural transformation of economies during the neoliberal era. Since the late 1970s, social provision practices have changed and more individualistic and private social provisions have replaced the social public schemes across the world. This trend of policy originated from the UK and the USA (with Thatcher and Reagan, respectively), then spread around the periphery (Walker & Foster, 2006).

“The neo-conservative position, which was gaining increasing strength in the core zone at this time, was hostile to taxation in general, in particular for welfare-state expenses. What was known as ‘welfare backlash’ had its earliest (and perhaps strongest) manifestations in the USA. In Europe, the political reaction varied. Just as Great Britain had set welfare-statism in Europe after 1945, Thatcher set the pace for its dismantling.” (Pelizzon & Casparis, 1998, p. 135)

Interpretations have differed considerably; some authors have called this the ‘transformation of the welfare state’, others preferred the term ‘welfare retrenchment’. Moreover, this shift is not only associated with post-industrialisation, but also with competition between countries brought about with globalisation. In this context, the term ‘race to the bottom’ indicates that as all countries try to reduce

costs of labour by decreasing social spending, every nation state would arrive at lower life standards as well as lower-qualified workforces. However, the 'race to the bottom' thesis is subject to many criticisms:

“‘The race to the bottom’ is a crisis myth rather than a crisis in reality. Despite cutbacks in a number of countries, our analysis demonstrates unequivocally that OECD average levels of social expenditure, whether measured as percentages of GDP as generosity ratios, or in real terms, either increased or remained constant between 1980 and 1998. Indeed, given that, during this period, social expenditure was increasing as a percentage of GDP and that non-social expenditure were declining, expenditure for welfare purposes was becoming appreciably more salient with the passing of time.” (Castles, 2006, p. 242)

Theoretically, the race to the bottom idea belongs to what is called convergence analysis within the literature. In this view, economic openness, which expanded dramatically from the 1980s, has compelled governments to cut social spending for competition purposes. Therefore, developing and industrialised nations have implemented welfare reforms which converge on a single, market-oriented social policy model (Brooks, 2005). On the other hand, the path-dependence view suggests that welfare states create expectations and dependency amongst the public. This prevents governments from reforming welfare systems without taking into account the electoral consequences (Achterberg & Yerkes, 2009).<sup>3</sup> However, when we review the example of the pension reforms, we see that electoral concerns have not been central to discussions at all. Rather, the agenda shift was swift on many occasions, and negotiations took place between international institutions and policymakers rather than national political parties (Muller 2003). Therefore, convergence analysis points at an important aspect of the pension reform in terms of increasing similarity in social provision practices of different countries.

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<sup>3</sup> There is also the path-convergence view which claims that more generous universal welfare states have adopted policies of retrenchment and neo-liberalisation, whereas, in the meantime, liberal welfare states have moved in the opposite direction and expanded their social expenditures. Therefore, two extremes converge at the 'middle of the road' which should be interpreted to be evidence of the idea that 'welfare states are not necessarily converging towards the most liberal end of the welfare spectrum'. This stream of thought argues that despite social democratic countries demonstrating less support for neoliberal policy, a trend towards neoliberal ideology is evident. However, in liberal welfare regimes where neoliberal policy is traditionally established, the support for neoliberal policy decreases. Thus, the convergence point appears to be in the middle, not at the neoliberal extreme (Achterberg & Yerkes, 2009).

Nevertheless, the reason provided by the convergence theorists, global competition, is not adequate. Rather, there is a fundamental economic phenomenon, financialisation, which shapes the economies in general and social provision in particular. Yet, in order to see the impact and significance of financialisation in this regard, it is not enough to look only at empirical data on government spending on social provision. This is because the quantitative data on public expenditure might not explain real trends in welfare standards (Castles, 2006).

“Today, governments of countries of the Organisation for Economic Co-operation and Development (OECD) typically spend 30-40% of their Gross Domestic Product (GDP) on welfare programmes and this level of expenditure has remained stable over the past 30 years or so. But this fact belies the transformations that have occurred within the welfare systems over that period. To begin with, mature welfare systems spend far more on pensions and healthcare than they have in the past. **They have also become more restrictive, more commodifying and more market-orientated.**” (Farnsworth & Irving, 2011, p. 4) [Emphases added]

To sum up, this school posits pension reforms and other market-oriented policies in relation with the broader transformation of the post-industrial era. Indeed, productivity, employment levels and political inclination towards welfare services are completely different than the circumstances at which pension systems were established in the post-war era. To point at these factors is crucial because financialisation as a phenomenon emerged in relation with them as well as shaping these trends as the underlying process associated with neoliberalism.

### *2.3.3. Welfare Regimes Approach*

The third approach we discuss is the Welfare Regimes Approach, which is the most influential comparative analysis within the social policy literature. Titmuss was the first author who classified welfare systems (Blakemore & Griggs, 2007). His distinction between ‘residual’, ‘industrial’ and ‘institutional’ welfare models of social policy posited a difference between countries according to the relations across the state, market and family in terms of providing social goods and services. The major breakthrough in comparative empirical analysis of welfare systems has been Esping-Andersen’s Welfare Regimes Approach (Esping-Andersen, 1990a, 1990b).

By drawing upon Titmuss' typology mentioned above, Esping-Andersen identifies three welfare regimes: liberal, conservative and social democratic welfare regimes.

“Welfare states vary considerably with respect to their principles of rights and stratification. This results in qualitatively different arrangements among state, market, and the family. The welfare state variation we find are therefore not linearly distributed, but clustered by regime types.”(Esping-Andersen, 1990a, p. 111)

The liberal welfare regime cluster is characterised by means-tested assistance, insignificant universal transfers and low replacement rates within state insurance mechanisms. As in this system the dependency on the market is high, the welfare state effect of the de-commodification of labour-power is minimal.<sup>4</sup> The archetypical examples of this model, accordingly, are seen in the United States, Canada, and Australia. By contrast, in the second regime type, a corporatist and statist structure of welfare provision is dominant and it is formed under traditional conservative institutions, such as the church. Therefore, under the conservative welfare regime cluster label we see countries such as France, Germany, and Italy. Lastly, under the social democratic welfare regimes, emancipation of the individual is exercised both from the market and the traditional family form. Under this regime, the costs of familial reproduction are socialised and in this way capacity of individual independence is generated. In this cluster we come across the Scandinavian countries, Norway, Sweden, Denmark and Finland as exemplified by Esping-Andersen (1990b).

Esping-Andersen has had a heavy influence on the social policy literature. While the need and utility of typologies for the comparative analysis of welfare state have recently started to be discussed, until now a considerable amount of intellectual effort has been invested in developing, testing, adjusting, expanding, and criticising the welfare regime typology (Van Kersbergen, 2013, p. 139). Following Esping-Andersen, several further typologies have been offered that can be gathered under three categories: approaches that claim three welfare regimes are not enough; attempts to reposition countries under different categories; and studies developing

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<sup>4</sup>The author develops the concept of de-commodification on the ground of Marxist view that posits labour-power as a commodity. De-commodification, therefore, refers to worker's diminishing commodity status through institutional arrangements those enable one to live without selling labour-power. In this context, services provided by the welfare state induce de-commodification by maintaining livelihood without relying on market (Esping-Andersen 1990).

alternative classificatory systems based on Esping-Andersen's theoretical approach (Ellison, 2006).<sup>5</sup>

After Esping-Andersen, comparative empirical analysis has become the dominant type of analysis in the social policy literature. Various typologies have emerged, such as the 'families of nations' approach by Castles (Castles, 1993) which examines similarities of different countries' public policies with reference to common cultural, historical and geographical features. On the other hand, the varieties of capitalism view, suggested by Hall and Soskice (Hall & Soskice, 2001), attempts to classify different welfare practices on the basis of a functionalist view rather than power resources approach which was initially applied by Esping-Andersen (Myles & Quadagno, 2002).<sup>6</sup> From this point of view, every social provision has a function within the economic structure, and differences across economies create certain welfare typologies (Hall & Soskice, 2001). For instance, a social democratic welfare state has a coordinated market economy which creates demand for active policies on childcare and education because these services support the specialisation and knowledge-based structure in those economies (Jensen, 2011, p. 127). On the basis of the varieties of capitalism approach, Huber and Stephens (Huber & Stephens, 2001) posited the production regimes approach as the institutionalized interaction between government, labour and employers. Thus, they link the study of welfare state regimes systematically to the study of production regimes.<sup>7</sup>

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<sup>5</sup> For a detailed review of the typologies suggested after Esping-Andersen see (Arts & Gelissen, 2006).

<sup>6</sup> The heterodox literature on the welfare state is divided into three main lines. First is 'the logic of industrialisation approach', which is also called the structural-functionalist school, and argues that the welfare states develop due to the underlying logic of industrialism. Therefore the key determinant is the changing forces of production. The second is the capitalist development approach which is also named as the neo-Marxist school, and the adherents of this school claim social policies to be the responses of state to the social reproduction requirements of capitalism. According to this, welfare state policies were imposed by the contradictory imperatives of the capitalist mode of production which, on the one hand, creates conditions for capital accumulation on the other hand, provides the social legitimization. Lastly, the democratisation approach, which is known as 'power-resource theory', emphasises the role of distribution in capitalist democracies. The adherents of this view see social policies as being driven and shaped by representative structures and electoral processes under the influence of social parties.

<sup>7</sup> "In the case of production regimes, the relevant institutions are private and public enterprises (industrial and financial), associations of capital interests (business associations and employers' organization) and of labour, labour market institutions, and governmental agencies involved in economic policy making, as well as the patterns of interaction among all of them; the relevant policies are labour market policy, macroeconomic policy, trade policy, industrial policy, and financial regulation." (Huber & Stephens, 2001, p. 108)

To sum up, comparative welfare regimes analyses claim that treating different regime types as broad, ideal, and typical systems allows grouping general institutional characteristics which enable researchers to see how countries within different clusters behave similarly under circumstances determined by global economic and institutional forces. At this point, the following question begs the answer: has the comparative analysis based on ideal types of welfare regimes been helpful in understanding the shift in social policy under neoliberal circumstances? The answer seems to be negative.

“[T]his paper examines critically what has been one of the most successful intellectual contributions to the neoliberal period, Esping-Andersen’s Welfare Regimes Approach (WRA) to comparative social policy. The paper shows that the WRA has deep roots within the conditions of the post-war boom and, as a consequence, was already well past its “use by date” when it emerged in the 1990s, let alone over the subsequent two decades of neoliberalism that have been underpinned by financialization. A close examination of the literature on the WRA shows how it has suffered from being unable to account for the differences between countries and programmes and has neglected both the changing conditions associated with neoliberalism and the causal factors underpinning it, and the closer determination of social policies themselves.” (Fine, 2014, p. 3)

Indeed, when the welfare regimes literature is reviewed with the aim of finding any analyses of pension reforms, the result is disappointing. Since, this approach focuses on the welfare state as a totality of different social provisions, pension provision as one aspect of it has not attracted much attention. Further, when pension reforms are analysed from this point of view, the factors underlying pension schemes, such as financialisation, neoliberalism or global actors, have been overlooked if not completely ignored. Rather, the attention was drawn on how transformations within the pension schemes fit into the typology of the welfare regime. Therefore, the welfare regime framework, while analysing reforms in social provisions under the neoliberal era, delivers two possible outcomes: either referring to reforms as developments which reinforce the position of the specific country within the typology to which it belongs; or situating transformation of the social provisions as a way of resembling a certain typology in which the country did not



belong prior to reforms. In other words, for this strand of thought, reforms are a matter of converging or diverging to certain ideal types of welfare regimes.

Aysan and Beaujot (Aysan & Beaujot, 2009), suggest in the context of pension reforms that every welfare regime produces its own way of struggling against the ageing problem - thus there is no single path for reforms. Interestingly enough, this approach does not discuss the necessity of pension reforms. Rather, pension campaigners' well-known arguments on 'ageing' are taken for granted without further analysis of whether or not these arguments are valid for different countries. Pension reforms' main policies, which are privatisation, decrease in pension spending, and tightening eligibility criteria for retirement, are conceptualised by this approach as re-commodification, cost containment and recalibration (cited in (Pierson, 2001) by (Aysan & Beaujot, 2009)).<sup>8</sup>

According to this analysis, privatisation and decreasing pension spending within pension systems in the Liberal welfare states are consistent with institutional structure of this regime. Moreover, pension reforms in the Scandinavian countries "are more concerned about cost containment, with moderate recalibration and little re-commodification" (p.713). The conservative welfare regime countries apply cost containment and recalibration of welfare policies in order to decrease the costs of ageing populations. Finally, the authors investigate the Southern European regime and draw the conclusion that recalibration is particularly significant in these countries because their welfare regimes are not fully developed and, thus, require adjustments to achieve welfare targets (Aysan & Beaujot, 2009).

Increasing sustainability of pension systems, decreasing pension spending, or tightening eligibility criteria in order to cope with ageing are familiar arguments from the pension reform campaigners. However, neither of them explains why the

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<sup>8</sup> "[W]e propose that cost containment has been more central to the retirement policies of Social Democratic countries and Continental Europe, while Liberal welfare states focus mainly on increasing the role of the individual in the market (re-commodification), and Southern European welfare states focus on changing regulations (recalibration)." (Aysan & Beaujot, 2009, p. 70)

Re-commodification can be understood as the reverse process of de-commodification suggested by Esping-Anderson. Thus, individuals become more vulnerable to the market as a result of policies bring e-commodification. Cost containment, on the other hand, can be thought of as the totality of the policy responses to budgetary concerns of governments. Thus, every decrease in expenditure on social provision can be gathered under this concept. Finally, recalibration, refers to reforms which are implemented to achieve certain welfare targets as well as adaptation to the changing economic and social structure.

pension reforms have started around the same time in several countries nor the increasing similarity of other regimes to Liberal countries.

“While the WRA [welfare regimes approach] has allowed an enormous amount of informative empirical work to be undertaken, it has led to increasingly serious deficiencies. It has been denuded of any explanatory or theoretical content. It is incapable of explaining change—if a regime is classified as a model of one sort, how does it become another? WRA fails to explain why different social policies should have the characteristics of different regimes within the same country, not least because it necessarily imposes undue homogeneity across ... or by country.” (Fine, 2014, p. 3)

To recap, the inadequacy of the approach in this regard is unfortunate especially when we consider that the welfare regimes approach is the dominant view within the social policy literature. Fine’s (2014) critique rightly suggests that rather than focusing on similarities within countries’ social policies, a theoretical approach should define varying structural features of each country, as well as agencies, processes, institutions and relations which make them peculiar. Indeed, only through this way, can one identify the production and reproduction relations underlying the social provisions within a country. Thus, it would be possible to explain the role of processes, like financialisation, in creating specific types of pension reform in more than thirty countries in a very short time interval. In effect, this is the most important gap within the pension reforms literature: the role of financialisation (Fine, 2014). We discuss this in detail in the next section.

#### **2.4. What they missed: financialisation**

Pension reform trends in the last two decades are underpinned by financialisation; and the current picture of reformed pension systems point to the financialisation of pensions. In this regard, financial components within pension provision have increased remarkably through funded, individual, savings accounts which invest in financial markets. Our position here is a contribution to the literature on social policy in general and pension reforms in particular because the absence of financialisation is crucial within the social policy literature as shown in the previous section.

“This absence of financialization is a devastating weakness both in terms of how it underpins other absences and in how it constrains understanding of what I have taken to be the key conundrum in addressing social policy: the

diversity of outcomes across countries and sectors despite common underlying determinants of which, of course, financialization is but one. Further, the absence of financialization from the social policy literature is indicative of weakness in understanding the relationship between it and globalization.” (Fine, 2014, p. 24)

Financialisation will be defined and discussed in detail in the next chapter. Before that in order to explain the key role it played in terms of pension reforms, we briefly introduce the concept and its relationship to pensions.

In a nutshell, financialisation stands for the extensive and intensive growth of finance. By extensive growth is meant that finance has engaged with activities and areas of social and economic life which were isolated from financial relations before the neoliberal era. By intensive growth, on the other hand, we refer to the proliferation of financial assets and hybrid forms which constitute financial operations at a deeper level while enabling higher financial returns (Fine, 2013). In this regard, the relationship between financialisation and pension reforms is a causal one in which the former results in the spread of the latter through three conduits. The first conduit is *structural* as financialisation alters the production and reproduction processes on which pension systems are established. The next chapter covers the theoretical discussion, through a detailed review of the accumulation of interest-bearing capital, on why and how this structural transformation has occurred. Thus, with the transformation of economic and social life under neoliberalism, finance has shaped the way in which pensions are provided alongside other aspects of extensive accumulation, as mentioned in the context of discussion on post-industrialism. However, this is not to say that pension reforms have been automatic in content for they are implemented by policymakers and could have taken various forms. Therefore, it is necessary to highlight the relations and actors as well as processes behind the abrupt trend in the spread of pension reform.

*Actors* responsible for financialisation of pension systems are discussed in the context of the WB as the main runner of the pension reform campaign, as rightly addressed by the Global Social Policy School. Not surprisingly, with neoliberalism, the WB, with other IFIs, has become more influential in terms of national and global policymaking processes through publications, advisory relations and even loan-agreement conditionalities. This explains how, during a standby agreement negotiation, the IMF puts forward the condition of pension reform that has been

promoted by the WB. This sort of an experience is exemplified in the context of Turkey where the IMF conditioned pension reform as part of a loan agreement although the pension reform advice was given by the WB, as further discussed in the 5<sup>th</sup> chapter in the context of Turkey's experience).

The third causal relation of financialisation with pension reforms is through the financial *motives* which shape old-age income provision in a way that creates profitmaking arenas or lucrative investment opportunities for financial market agencies. As mentioned in the context of welfare regimes, pension schemes have varying forms, functions and backgrounds in different countries which change according to those countries' peculiar economic, social and historical features. However, with the pension reform advocates' motivation of extending financial aspect of pension systems, the main, essential and fundamental missions attributed to pension schemes became contributing to economic growth through enabling capital market development as cited below from the famous *Averting Report* of the WB.

“Full funding should boost capital accumulation and financial market development. The economic growth this induces should make it easier to finance the public pillar.” (WB, 1994, P.16)

Hence, pension systems become an instrument to be used for the sake of financial profitability for the capitalist class while pension appears as a long-run investment for other classes. In other words, the ways in which pensions are understood, defined and discussed are configured with financial evaluations to the fore. On the basis of this definition, financialisation's engagement with pension systems through reforms has a twofold significance. The first is that, under financialisation, international institutions, like the WB, involve themselves in pension policymaking and attribute financial missions to the pension schemes.

“A dominant pay-as-you-go public pillar also misses an opportunity for **capital market development**. When the first old generations get pensions that exceed their savings, national consumption may rise and savings may decline. The next few cohorts pay their social security tax instead of saving for their own old age (since they now expect to get a pension from the government), so this loss in savings may never be made up. In contrast, the alternative, a mandatory funded plan, could increase capital accumulation-an important advantage in capital scarce countries. A mandatory saving plan that increases long-term saving beyond the voluntary point and requires it to flow

through financial institutions stimulates a demand for (and eventually supply of) long-term **financial instruments**-a boom to development.” (WB, 1994, p. 13) [Emphases added]

This signifies the expansion of finance into pension provision in a way which results in pension income being provided through financial mechanisms. Funded schemes provide benefits on the basis of returns to financial investments they make. Therefore, financialisation shapes the pension systems in a way which creates profitmaking opportunities for the financial market players.

“‘Financialization’ refers to the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operations of the economy and its governing institutions, both at the national and international levels” (Epstein, 2002, p. 2)

The second significance of this development is that the funded pension schemes play a substantial role in terms of financial market deepening in a way which enables the intensive growth of finance. Pension funds, which are established to control, manage and organise the investment of pension contributions in financial markets, engage with financial markets through two channels. The first channel is pension funds’ supply-side impact on capital markets. In a nutshell, pension funds gather a substantial amount of capital inflows and direct them to the capital markets. This impact creates asset inflation and financial instability within the capital markets (Toporowski, 2000). On the other hand, the second channel is pension funds’ demand-side influence on capital markets. This refers to the demand of pension funds for sophisticated financial instruments since when funds mature they need liquid assets to meet increasing liabilities (Engelen, 2003). As a totality of these effects, pension funds are involved in speculative activity which is one of the appearances of intensive growth of finance.

“[F]inancialization is closely associated with the formulation and implementation of social policy more directly. This is most obvious in terms of the pursuit of privatization in general and of pensions in particular, as well as in the broader ways in which finance has inserted itself into public forms of economic and social provision.” (Fine, 2014)

Pointing to the role of financialisation in pension reforms contributes to the literature through several ways. First of all, by revealing financialisation as an underlying factor, we move beyond the cliché arguments on pension reforms, such as

demographic transition, i.e. ageing. This is important because when we review the pension reforms in different countries, as mentioned before, we see that most of the countries which reformed their pension schemes have not confronted a crucial ageing problem. Rather, these were middle- and low-income countries which have had serious economic and fiscal problems other than ageing. Prior to pension reforms, the Latin American and Europe and Central Asian countries that reformed their pension schemes were struggling with economic problems such as crisis, fiscal deficit or external debt (Muller, 2003).

“[P]ension privatization has not been adopted by countries with oldest populations not by those countries with the largest pension burden as a proportion of GDP. Instead, pension privatization has been adopted by a wide range of countries with very different economic circumstances, some with large pension systems that pose a major burden on national budgets, some with relatively young populations.” (Orenstein, 2008, p. 28)

Countries with scarce capital, although having young populations, accepted reform of their pension schemes with the expectation of capital funds which would be available after reforms (Brooks, 2005). Moreover, the WB projections on ageing are based on certain assumptions about productivity, wage levels, and employment rates. These assumptions might hold for developed countries whereas they are not consistent with the circumstances in middle- and low-income countries (Engelen, 2003).

The second issue about ageing is that, although this aspect of pension reforms is not discussed very often, there is no general agreement that funded schemes are immune to ageing problem. In fact, in the Averting Report, the possible problems that a funded scheme would have under ageing population are indicated.

“In mandatory saving schemes, workers assume the investment, longevity, and inflation risks of their retirement funds. Retirement income will be lower if investment performance is poor. And if people live longer than expected, they may outlast their retirement savings. Some schemes require workers to purchase annuities when they retire-to insure against unexpected longevity. Investment risk is particularly high when accumulated assets are used to purchase the lifetime annuity, and the market interest rate on the date the annuity is purchased is critical.” (WB, 1994, p. 207)

In addition to the fact that funded pension schemes are not immune to demographic transition related problems, these schemes are liable to become involved in speculative activity when they fail to cope with ageing related issues. In a nutshell, there is a strong connection between ageing, maturation of pension funds and financialisation. This is so because in a funded scheme, pension benefits are dependent on the contributions to the pension fund as well as returns on financial investments made by the fund. And, when a pension fund is first established, the number of contributors to the system is higher than the number of retirees. Therefore, funds do not invest in high risky assets since the incoming capital flow is enough to confront the pay outs. However, when pension funds mature, the amount of capital outflows from the fund exceeds the inflows. For this reason, pension funds start investing in more risky, liquid and speculative assets (Engelen, 2003). Therefore, positing financialisation as the main process underlying pension reforms gives us the advantage of explaining the motives behind pension reforms.

Another contribution we make here in this study is to point to the financialised nature of pension schemes which is mostly missed by the literature which defines the reformed pension schemes as privatised. By all means, identifying the process as privatisation is not wrong. However, it is not enough for several reasons. First and foremost, despite the pension reform campaign, across 176 mandatory national schemes, the majority (82%) is still managed by the state while more than half of these schemes are financed on the basis of PAYG.

“About two thirds of pension schemes worldwide may be considered to be primarily defined benefit in their structure. About half of all the systems operate on an unfunded (or PAYG) basis with the other half about equally divided between partially and fully funded. The vast majority of systems are publically managed with less than one in four classified as primarily privately managed” (Whitehouse et al., 2012, p. 35)

However, this does not mean that pension reforms have not been influential in terms of spreading private schemes. They caused a dramatic increase in the number of mandatory privately managed defined contribution schemes from one in the 1980s to thirty in the 1990s. The argument we put forward is different: in most of the countries that reformed their pension schemes, PAYG schemes are protected to varying extents. They either remained as the main providers of pension provision, or they are kept with the purpose of providing basic income for the old age in order to

*alleviate old age poverty* (WB 1994). This means privatisation of the PAYG schemes is preferred but not necessarily essential for the advocates of reform. However, when it comes to establishing a financial component, none of the reformer countries could reject the advice (Andrews, 2006). Therefore, pension privatization does not explain the reforms in depth whereas financialisation of pensions accurately refers to the spread of individually funded schemes.

Last but not least, with this analysis of financialisation of pensions, we point to the class character of pension reforms which favour capitalists in general, and financial capitalists in particular. After the reforms, in most countries, employers do not contribute to funded pension schemes, not even to the mandatory ones (Muller, 2003). This means that the responsibility of the employer in terms of pension provision has been abolished through reforms.

“The private pension system lacks solidarity, eliminates income redistribution between generations and insured persons, and transfers the functions of solidarity and redistribution to the State, which therefore has to fund non-contributory and minimum pensions. Furthermore, the private system also incorporates a number of features that exacerbate inequalities in regard to funding, namely: (a) It abolished the employer's contribution and transferred it to the worker, who must pay 10 per cent of his/her wages or income; this fails to comply with the ILO's minimum standard that the worker's contribution should not amount to more than half of the total contribution” (Mesa-Lago, 2008, p. 301)

This argument goes beyond the literature which analyses pension reforms in the context of destruction of collective rights and their replacement by individual responsibilities.<sup>9</sup> Here, what is destroyed is the responsibility of the employer in terms of reproduction of labour. In our theoretical framework, in the next chapter, we show that this changing responsibility of employers originates from class struggle (as well as development of production relations). Thus, the capitalist class restores its class power under neoliberalism (Harvey, 2006). This aspect of pension reforms is consistent with the function of financialisation as a prominent feature of neoliberalism (Fine, 2013).

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<sup>9</sup> For a discussion on solidarity-decline thesis see (Trampusch, 2009).



On the basis of this analysis, when we look at the more recent publications evaluating pension reforms, we see two main points. The first is that the reform campaigners, led by the WB, have not changed their position on pension reforms. This finding contradicts the idea that the WB management has changed and the Bank has stopped advocating pension reforms (Beland & Orenstein, 2013). When we review recent publications from the Bank, however, we see that the Bank continues to advise pension reforms since reforms are consistent with the overall process of financialisation. Yet, it is true that the terminology on pensions used by the WB has slightly changed since 2005. The WB now recommends five pillars. The ‘zero pillar’ provides social pensions, i.e. non-contributory basic income for elderly. The first pillar is mandatory and earnings related while the second pillar is mandatory too but it is based on savings. The third pillar functions as complementary voluntary saving account, and the fourth pillar consists of other sources of old age income such as non-financial assets like home ownership as well as income from other social programmes (health and housing) (Whitehouse et al., 2012).

Moreover, the global financial crisis of 2008 has undermined the reliance on financial markets in particular due to significant losses of pension funds. As Cerami (Cerami, 2011) mentions, in 2008, the OECD countries’ private pension funds registered 20% losses worth approximately \$4.5 trillion (p.339).

“The recent global financial crisis has made the shortcomings of the current approach to ageing more clearly visible, highlighting not only the weaknesses of private pension funds but also of the excessive individualization of risks pursued in previous years.” (Cerami 2011, 339)

Thus, after the long-lasting economic crisis and financial turmoil, the WB modified its reform advice but without altering it in a way that challenges financial interests.

Another point on recent discussions of pensions reforms that deserves attention is the recognition of low performance of pension systems after the reforms. Coverage is one of the most important performance indicators.<sup>10</sup> When we look at the evaluation report by the WB, we see that reforms have not increased coverage at all.

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<sup>10</sup> Performance indicators of the pension systems includes coverage of both mandatory and voluntary pension schemes covering: adequacy of retirement benefits; financial sustainability and affordability of pensions (in terms of payroll taxes paid by participants of the mandatory pension systems); pension systems’ impact on labour market (informality); efficiency of administration (low costs); and insurance (secured benefits against crisis and other financial uncertainties).

“Bank-supported reforms have often contributed to fiscal sustainability. But, despite expectations, in many countries with multi-pillar systems, funded pensions remain poorly diversified and pension coverage has not increased. Also, the secondary objectives of funded pillars—to increase savings, develop capital markets, and improve labor flexibility—remain largely unrealized.” (Andrews, 2006, p.5)

We need to note that from our point of view this outcome cannot be regarded as a failure of the WB. Rather, in effect, decreasing adequacy of pensions should be read as the success of the IFIs which achieved to open more space for funded pension provision by necessitating individual savings accounts for old age income.

“The role of funded private pensions in the financing of retirement income may increase in the future as a result of reforms implemented in public pension systems...There is room in some countries to strengthen the role of private pensions in order to decrease the proportion of people that may have insufficient pension income.” (OECD, 2014, p. 86)

To recap, financialisation as an underlying phenomenon shapes the national economies by changing production and reproduction relations. Pension systems are tightly connected to these relations in constituting social reproduction and being attached to financialised economic production. Therefore, pension systems are influenced by financialisation as are other social provisions. With the reforms, pension contributions are invested in financial markets by pension funds. Thus, return on investments, i.e. financial market performance, determines old age income. Recent publications on pensions support our argument on financialisation of old age income since pensions are increasingly obtained through financial conduits after pension reforms.

## **2.5. Conclusion**

In this chapter, we introduce the idea of analysing recent pension reforms in the context of financialisation. Thus, we situate the change in pension systems within the bigger picture of transformation of economies under financialisation. We develop our analysis in three sections. First, we outline general characteristics of pension reforms since 1994. Here, we do not give too much technical detail on the way in which pension systems work. Rather, our main purpose is to ensure that reader has an accurate view on the direction of pension reforms which is from publicly

managed PAYG schemes to private, individual and funded schemes. Another issue observed in the first section concerns the role of the WB in these pension reforms. We emphasise this in order to reveal the function of international financial agents in pension reforms and to associate this function with the impact of financialisation that spreads around the world. Yet, this does not mean that there are countries which have reformed their pension systems without involvement of the WB. Further, we acknowledge that there are some countries which negotiated with the WB but have not reformed their pension schemes in accordance with the Bank's advice (Andrews, 2006). Thus, we are aware of varying influence of the WB in the pension reform trend. Nevertheless, the WB represents the connection between financialisation and agencies which defend and promote finance's interests during the policymaking of pension restructuring.

In this chapter, we focus on pension reforms in middle-income developing countries and, therefore, we do not give an overview of the transition of pension systems in developed countries. On the other hand, there is also a fundamental reform trend in high-income countries where pension systems already consist of a financial component. In the EU countries, for instance, financialisation reveals its impacts on policymaking through shifting calculation methods from defined benefit to defined contribution. As mentioned before, defined benefit schemes provide a certain level of secure old age income for participants of the pension scheme whereas defined contribution schemes only fix the contribution rate. Thus, this development is consistent with financialisation and neoliberalism for placing the financial risk of pension loss on the shoulders of participants in a way that renders individuals to be subject to financial risks (Saritas, 2014).

We continued by reviewing the interpretations of pension reforms across the literature. We had two motivations here: the first is to point to the gap within the literature on the role of financialisation as the underlying factor in pension reforms. Our second motivation is to point to other elements of pension reforms besides financialisation. These are globalisation, post-industrialisation and peculiarities of welfare arrangements in each country. Thus, we carry the discussion on pension reforms to a further point than demographic arguments provided by the reform advocates. We should note that it is impossible to deny ageing as a modern phenomenon. However, what we try to emphasise is that ageing is not necessarily a 'crisis'. "Living longer than ever before is of course an enormous achievement"

(European Commission, 2010, p. 4). The reason that the WB and OECD postulate ageing as a crisis is to justify the necessity of transforming pension systems into financial saving mechanisms. The strength of this rhetoric is more visible in countries where other policy options, such as increasing the fertility rate, opening border to migration and parametric measures to already existing schemes, are completely overlooked (Engelen, 2003).<sup>11</sup>

Challenging the ageing related arguments in terms of pension reform discussion is significant because most analysts take these and other popular arguments of pension reformers for granted. However, the idea that the ‘best way of solving demographic problems of pension systems is to entirely replace them with funded schemes’ is far from convincing. Moreover, the positive impacts of funded schemes on saving and development levels remain unproven macroeconomic arguments (Cesaratto, 2006). One might object to our position here by bringing forward different works falsifying us. Yet, what we are trying to do here is not pursuing a detailed macroeconomic analysis on funded pension schemes’ impacts on saving or development. Rather, we underline that the WB has persuaded many countries to introduce individual financial accounts with some mythical arguments which were later challenged by the World Bank’s own Chief Economist Stiglitz himself (Orszag & Stiglitz, 1999, 2001).<sup>12</sup>

After introducing pension reforms and discussing varying interpretations on them, we posit our own view on analysing pension reforms in the context of financialisation. We open the discussion on the nexus between financialisation and pensions from two perspectives. The first is to address financialisation’s role as the underlying process behind transformation of economies and pension reforms. The second perspective we introduce is to define reformed pension schemes as financialised pension provision since pension income is increasingly provided through financial(ised) conduits. Thus, pension provision, which traditionally used to be apart from the financial sphere, has been integrated into the domain of finance. This might not be surprising for those who are familiar with the financialisation literature which points to the increasing influence of finance on ever more aspects of social provisions. However, the peculiarity of pension reforms originates from them

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<sup>11</sup> Recently the EU countries have confronted a migration flow from Syria and other countries with civil wars. While this flow is discussed in varying contexts, the possible positive effect of migrants on the pension schemes in the ageing EU countries is ignored.

<sup>12</sup> Joseph Stiglitz served as the Chief Economist of the WB between 1997-2000.

creating pension funds which accelerate the financialisation of the economy through their impact on capital markets. This impact aggravates the speculation in the capital markets by creating demand for, and enabling supply of, sophisticated financial instruments. Therefore, we show the penetration of finance into pension provision (extensive growth of finance) and the deepening of financial relations through hybrid forms created as a result of the reformed pension schemes (intensive growth of finance), i.e. financialisation of pension provision (Fine, 2013).

Our analysis regarding pension reforms and financialisation can be found limited in the sense that it does not cover many implications of this shift in terms of poverty, redistribution, inequality and gender dimension. Although these aspects of financialisation of pensions are of paramount importance, we prefer to investigate them in the context of our case study on Turkey. Pension systems are diverse in structure, form and level of benefits. And, effects of reforms vary according to the economic, social and political environment within a country. For these reasons, the experience of Turkey in these regards is scrutinised in the fifth chapter. Thus, this chapter is linked to the rest of this study both theoretically and empirically in preparing the ground for investigating pension reforms and financialisation in Turkey.

Turkey is in particular an interesting case study for the investigation of financialisation in relation to pension reforms because it has entered a certain level of development at which transformation of pensions has come on the agenda but in a financialised way due to the increasing dominance of financial during the post-2001 era. In a nutshell, Turkey has never had a welfare state in a conventional way that is common in developed countries. The absence of class-based struggle (and/or demands for social rights) has enabled populist policies to destroy sustainability mechanisms of the pension system (through measures such as decreasing the retirement age as part of election promises). Thus, a substantial restructuring of the social security system, and pension provision as the major component of the former, became essential in the late 1990s. However, within this historical trajectory, this necessity of transformation coincided with the era of the IFIs financially-motivated imperatives that were preconditions for substantial support for those seeking and deploying economic and political power. Therefore, Turkey has become a perfect case study to illustrate how finance has penetrated into different policymaking

processes and created financialised structures which favour financial actors at the expense of social interests.<sup>13</sup>

As a final word, recently Argentina, Bolivia and Hungary have closed their privatised saving accounts for pensions (Whitehouse et al., 2012). These reversals from funded pension schemes show the limitations of blueprint pension reforms. And, this is not only because they are designed on the basis of high technical knowledge with little attention to the idiosyncratic features of each country but also because changing international economic circumstances force governments to adapt their pension systems to new conditions. Since the financial swing of 2008 crisis, countries in most regions, in the EU for instance, have shifted their reform structure from establishing financial schemes to rearranging parametric rules of existing PAYG schemes (European Commission, 2015). Financialisation, with other contemporary constraints such as development and climate change, has been effective in the formulation of social policy (Gough & Therborn, 2010). For this reason, financialisation should be scrutinized in order to analyse current trends in social provision in general and pensions in particular.

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<sup>13</sup> As a further note, the most self-evident data on financialisation in Turkey can be collected on the housing boom as briefly shown in the fourth chapter of this thesis. In spite of this, the pension system is selected as the main case study of this work because the housing boom has already been discussed by several authors in different studies ranging from a PhD thesis (Karacimen 2013) to detailed country reports (Bedirhanoglu (2013).

### **3. A Theoretical Framework for Financialisation and Pensions**

#### **3.1.Introduction**

The seeds for financialisation were planted during the neoliberal era beginning in the 1980s with continuing institutional transformations marking the 1990s. By the early 2000s, it was impossible to overlook the implications of financialisation. Pension reforms which began in the mid-1990s can only be analysed in light of financialisation for two reasons. First, financialisation has influenced economic production of which pension systems are a part. Second, financialisation directly intervenes in the formation of pension systems. Therefore, in this chapter, we elaborate an understanding of financialisation.

A theoretical framework on financialisation should first clarify what is meant by finance and how financialisation is distinctive from it. Then, the main factors underlying the emergence of financialisation need to be clarified in order to contextualise it historically. Once the common features and origins of financialisation process are highlighted, a framework can be applied to different financialised areas of economic and social life. To this end, we start with Marx's finance theory in the next section. We argue that, in his analysis, finance is the sphere where money capital circulates in relation with activities of money dealing and funding (Marx, 1991). Money capital has the underlying tendency of accumulating as '*capital in general*'. Moreover, money capital has the capability of expanding into different economic and social activities by attaching any revenue stream to finance through capitalisation. In addition, there is a strict relationship across accumulation of money capital, development of capitalist relations and more advanced forms of financial activity.

In this regard, our reference term is interest-bearing capital (IBC) through which Marx explains how financial relations are peculiar under capitalism, serving as the facilitator of surplus value production and exchange. Further, IBC also has a fictitious character to the extent that the stream of the surplus value (and not just revenue) to which it is attached can be capitalised and sold as a financial asset (Evans, 2004). On the basis of this theory, we draw on Fine's (Fine, 2013) approach and define financialisation as the phenomenal extension and intensification of IBC. By extensive growth of IBC is meant the diffusion of financial relations to areas to

which it did not previously apply. On the other hand, by the intensive growth, we refer to IBC accumulating in existing areas of application.

The second section addresses the historical developments and institutional transformations which underpin the emergence of financialisation. Investigating such historical specificity offers the opportunity to distinguish the nature of finance from financialisation. In this context, we point to neoliberalism as the mode of contemporary capitalism that incorporates elements providing the basis for financialisation (Saad-Filho, 2011). In this regard, market-oriented policies implemented since the 1980s have been reviewed in relation to financialisation (Dumenil & Levy, 2001). Instead of detailed analysis of the concept of neoliberalism and discussions evolving the term, we focus on the organic relations between financialisation and neoliberalism as characteristic of the current era (Fine, 2013).

Indeed, when we look at economic transformations under neoliberalism, we see market-oriented policies such as privatisation creating more space for financial actors, while equally paving the way for financial discourses in the sphere of scholarship, such as shareholder value (Erturk, Froud, Sukhdev, Leaver, & Williams, 2008; Lazonick & O'Sullivan, 2000). Moreover, financialisation can influence the structure of the economy by shifting corporate governance and priorities of non-financial firms from long-term investment to short-term strategies which slow down capital accumulation (Orhangazi, 2008; Stockhammer, 2004). Another structural change occurs within the financial sector where banks engage with financial markets in pursuit of lucrative returns through securitisation (Lapavitsas, 2013; Lavoie, 2012). Such structural shifts have varying impacts on different groups of households. For those which have middle or high incomes, financialisation and asset market inflation can result in wealth effects through pensions and other stockholdings (Boyer, 2000). On the other hand, low-income earners, subject to deteriorating wages and distortion in income inequality due to neoliberal policies, can experience increasing indebtedness (Harvey, 2006; Lapavitsas, 2013; Palley, 2007).

On this basis, in the third section, we develop a framework on the financialisation of pensions as extensive growth of finance, altering their levels and forms. To do so, we refer to Marx's concept of labour power and argue that pensions are crucial for social reproduction during old age (Marx, 1990). The value of labour power refers to workers' standards of living and pensions are deductions from the total social product. In this regard, pensions have been associated with



decommodification of labour power in terms of enabling generational reproduction without complete dependence on (labour) market relations. This allows for pensions to be located in terms of a (capital-labour) class context (Esping-Andersen, 1990b). A fraction of the total social product is appropriated by the state and distributed in the form of social insurance. Thus, the structure of pensions, although to varying extents, depends on the three parties of the employers, workers and the state (Gough, 1975; O'Connor, 1973). In this context, pensions appear in the form of a social right in the reproduction of labour power during retirement. This form derives from a collective logic, not least because pensions emerge in relation to the collective action of the working class (Blackburn, 2002, 2006).

We proceed the third section by showing that with financialisation pensions have been redefined in terms of individual savings and deemed to have the role of contributing to economic growth. This has been part of a campaign prioritising financial motives (WB, 1994). The structure of pensions has changed with the processes of social reproduction attached to IBC and financial markets serving as conduits for pension funds. This has created a new structure whereby the mechanism for social reproduction has become finance as opposed to, or at least alongside, the state. Privatisation, which preceded financialisation, of pensions, and increasing engagement of households with finance through stockholdings in the form of pension savings are other aspects of the financialised structure of pensions (Deken, 2013; Erturk, Froud, Johal, Leaver, & Williams, 2007). Finally, the form of pensions has changed with financialisation - from that of social right to individualised financial security (Lazzarato, 2012). Therefore, financialisation detaches pensions from collective provision and introduces self-responsibility (Frericks, 2014).

In the fourth section, we concentrate on the intensive accumulation of finance in relation to pension funds' key role in this regard. Thus, we review the literature on pension funds and their roles in financialisation. The Regulation school, which locates pension funds at a central position in their understanding of 'finance-led accumulation regime', provides insights in terms of pension funds' function in emergence of *shareholder value* and *corporate governance* approaches (Aglietta, 1998, 2000; Boyer, 2000; Lazonick & O'Sullivan, 2000). On the other hand, these approaches are criticised because of their roots in orthodox finance literature (Erturk, Froud, Johal, & Williams, 2004) and for failure in seeing the bigger picture of financialisation (Erturk, 2003). Then, we discuss the *Ponzi finance* nature of pension

funds which results in *asset market inflation* and unstable financial markets (Toporowski, 2000). Accordingly, large capital inflows brought by pension funds into capital markets induce **supply-side effects** on financial markets. In other words, pension funds create additional flows of capital which constitute a great potential source for financial instruments. In addition, we review Engelen's (Engelen, 2003) *logic of funding* approach which casts light on pension funds' **demand-side impacts** on financial markets for enhanced financial instruments. As pension funds mature, there is increased demand for speculative assets with higher returns to cover maturity-related deficits. Moreover, pension funds' portfolio managers, who are capable of dealing with sophisticated investment instruments, stimulate securitisation and proliferation of derivatives.

In the conclusion, we summarise the three sections' main points and contextualise this chapter in relation to the following empirical chapters. In this regard, the most significant aspect of this theoretical framework stems from each section's direct relation to a subsequent corresponding empirical chapter on financialisation and pensions in Turkey. The section on financialisation and neoliberalism (3.2.) provides the analytical basis for the review of economic and social processes which are shaped by financialisation and in turn underpin the financialisation of pensions in Turkey (chapter 4). Moreover, the extensive growth of finance (3.3.) is exemplified by the pension reforms in Turkey which have created funded schemes and financialised pension income (chapter 5). Finally, the intensive accumulation of finance (3.4.) reveals itself in the context of new pension funds' impacts on Turkish capital markets (chapter 6). In this way, we develop a theoretical framework that analytically supports the empirical investigation of financialisation and pensions in Turkey as developed in the rest of this study.

### **3.2. Financialisation and neoliberalism**

#### *3.2.1. From Marx's finance theory to financialisation*

Finance can be broadly defined as the activity of money management and providing and accessing necessary funds for multiple purposes. In Marx's analysis, at heart, finance is the sphere where *money capital* circulates. Since money capital is only one of the forms of *capital in general*, Marx does not deal with money capital until the second volume of *Capital* which includes an investigation of the circuit of money capital as one moment in the circuit of industrial capital (Marx, 1992). During its

circular movement, industrial capital passes through three stages and takes three different forms: as money capital, productive capital and commodity capital. Money capital is the stage in which the capitalist appears as buyer of means of production and labour power. Hence, money is transformed into commodities (M-C). The second stage is the productive consumption of the purchased goods and labour power through production of commodities where capital becomes productive capital. Finally, initiating the commodity capital circuit, the capitalist becomes seller of produced commodities which transforms them (and embodied surplus value) into money (and profit) in the circulation process (C'-M'). The formula for the circuit of money capital is: M-C...P...C'-M'. Here dots indicate that the process of circulation is interrupted by production, and C' and M' stand for C and M increased by surplus value.

Marx deals with more developed forms of money capital in the sixteenth chapter of the third volume of *Capital* (Marx, 1991). With the development of the capitalist mode of production and as a result of the division of labour amongst capitalists, a certain fraction of capitalists starts to specialise in the circulation of commodities and money capital. This is called merchant's capital and it consists in part of money-dealing capital. Money-dealing activities are technical functions such as collection of payments, bookkeeping and the settling of accounts. At this point, the analysis of money capital is confined to managing money as such.

But the most important aspect of finance for Marx is to be found in the analysis of interest-bearing capital (IBC), covered in the fifth part of the third volume of *Capital* (Marx, 1991). IBC is a specific form of money capital which as a commodity of a special kind through being borrowed by functioning industrial capitalists and lent by moneyed capitalists. IBC has the use-value of capital as self-expanding value, as a consequence of its use value as money as such with the context of capitalist relations of production.<sup>14</sup> The capital function of IBC brings a return, i.e. interest, which is a part of the surplus value produced. The movement of interest-bearing capital appears as M-M-C-M'-M' (Marx, 1991, p. 461). Thus, IBC

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<sup>14</sup> "On the basis of capitalist production, money can be transformed into capital, and through this transformation it is turned from a given, fixed value into a self-valorizing value capable of increasing itself. It produces profit, i.e., it enables the capitalist to extract and appropriate for himself a certain quantity of unpaid labour, surplus product and surplus-value. In this way the money receives, besides the use-value which it possesses as money, an additional use-value, namely the ability to function as capital. Its use-value here consists precisely in the profit that it produces when transformed into capital" (Marx, 1991, p. 459)

represents four important characteristics of borrowing and lending relations in capitalism as put by Fine (1985) as follows:

“(i) The use of borrowing and lending (i.e., credit relations) specifically for the purpose of advancing money capital for the appropriation of surplus value, (ii) The division of surplus value into profit of enterprise and interest in which the latter represents a rate of return over and above the normal rate of profit, (iii) The division of the capitalist class into two fractions, (iv) The power of IBC is derived from its centralizing the individualized hoards of money and making them available through the credit system as a powerful mechanism of competition (Fine, 1985, pp. 402–403).

As a result of the circulation of these different forms of money capital, credit relations emerge. According to Marx, credit relations under capitalism emerge from two different types of credit: the first type is the credit which is based on circulation of money capital and money-dealing activities, i.e. money-dealing capital (MDC). This commercial credit simply originates from the function of money as a means of payment. With the development of commerce and capitalist relations, the credit system is generalised, improved and commodities are sold for a written promise to pay on certain terms. Marx puts all the promissory notes under the general title of bills of exchange which themselves can circulate as means of payment.

The second type of credit, on the other hand, is a result of IBC's development. This type of credit originates from money's function as capital (Fine, 1985). The first type of credit relations, money as means of payment, exists in all historical periods of commodity exchange whereas credit relations attached to interest-bearing activities are characteristic of capitalist accumulation. Marx shows that credit relations which originate from money-dealing activities have the function of smoothing capitalist production by facilitating circulation of industrial capital and managing monetary relations. Credit relations that develop from interest-bearing activities, on the other hand, have the function of enabling expansion of capitalist production by providing necessary funds for accumulation. Hence, the difference between IBC and other financial activities have crucial importance in terms of whether creating surplus value or not.

Money-dealing activities contribute to capitalist accumulation through gathering reserve funds and idle money of all classes. Thus, with the development of capitalist relations, accumulation of funds and division of labour among capitalists,

credit relations form bank capital. Banks concentrate large amounts of loanable capital and confront borrowers as representative moneylenders. Bank capital consists of two parts: cash money and securities. The latter include commercial paper (or bills of exchange) and public securities, namely, government bonds, treasury notes and stocks of all kinds. Marx notes that these papers are interest-bearing papers and they are substantially different from bills of exchange.<sup>15</sup>

The most important feature of bank capital is in being fictitious and consisting of claims (bills of exchange), government securities (spent capital) and stocks (drafts on future revenue). There are three characteristics of Marx's analysis of fictitious capital. First, interest-bearing papers have a fictitious character because their prices are regulated separately from the value of the real capital they represent.

“It should not be forgotten here that this capital's money value, as represented by these papers in the banker's safe, is completely fictitious even in so far as they are drafts on certain assured revenues (as with government securities) or ownership titles to real capital (as with shares), their money value being **determined differently** from the value of actual capital that they at least partially represent: or, where they represent only a claim to revenue and not capital at all, the claim to the same revenue is expressed in a constantly changing fictitious money capital.”(Marx, 1991, p. 600) [Emphases added]

Second, Marx associates the increasing amount of fictitious forms of capital with the development of capitalist relations and the accumulation of huge amounts of IBC in particular. And the third characteristic of fictitious capital is that the return from these interest-bearing papers might not originate from surplus value. For instance, in the context of government bonds, Marx explains that interest paid for these do not derive directly from the production of surplus value. The key point here is that the amount loaned to the state no longer exists, as it is *spent capital*, and the intention behind loaning it has not been to expand it as capital.

“The basis of this [fictitious capital] is that, once the credit system has established a rate of interest, it is possible to look upon any stream of income as the return upon a notional amount of capital. The value of this notional

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<sup>15</sup> Banks' money creating function is deliberately not included as Marx's money theory is another vivid debate topic. We prefer to stay focused in this study by focusing on money as capital rather than money as means of payment as the main reference point of the financial relations.

capital will be the amount that, at the going rate of interest, would generate a return equal to the stream of income. Marx considers two forms of financial assets of this type. One is the shares of joint stock companies; the other is bonds issued by the government. In the case of shares, a sum of capital is advanced to a company and, in return, the former owner of the capital becomes entitled to receive a share of the profit subsequently produced. In such a situation, the company has acquired a productive asset, and the former owner of the money capital holds a financial instrument entitling them to a part of the future profits.” (Evans, 2004, p. 65)

To sum up, first, finance is a form of capital, i.e. money capital. Second, as opposed to other forms of (commodity and productive) capitals, money capital has the potential advantage of penetrating every aspect of economic and social life through capitalising different revenue streams in a fictitious way. Third, this framework shows the inherent tendency of accumulation of money capital as a result of capitalist development. For the current phenomenon of financialisation viewed through the lens of this framework, we see that financialisation involves the extensive and intensive accumulation of IBC at the heart of economic and social reproduction as a whole.

“More generally, it is apparent that any stream of potential revenue is not only open to being (fictitiously) capitalized as an asset but can then serve as the basis for further exchange as IBC. In this way, the reign of IBC can be expanded not just intensively in speculative booms ... It can also expand extensively, attaching itself to new activities from which it was previously absent or even absented by virtue of regulation or a form of provision (e.g., where income streams are not generated, as in social housing as opposed to mortgaged owner occupation). In this light, this author would **define financialization as the intensive and extensive accumulation of fictitious capital** or, in other words, the increasing scope and prevalence of IBC in the accumulation of capital.” (Fine, 2013, p. 55) [Emphases added]

Under financialisation, extensive accumulation of IBC is evident in the spread of financial relations to ever more aspects of economic and social life. The most important aspect of this development is the difference between finance before financialisation and under financialisation. We see that extensive growth of finance has the unique feature of differing from mere credit expansion by straddling the

borders between different forms of credit and IBC through capitalising them fictitiously under financialisation (Fine, 2013). Thus, finance expands the sphere of money management, funding activities in a way that integrates more aspects of economic and social life through financial conduits. Therefore, finance prioritises financial motives in these areas and transforms non-financial structures into profit-making arenas for financial actors. Hence, IBC expands and financial relations also become more sophisticated in depth, scope and complexity. None of this, however, is automatic in scale but is contingent upon historical developments that advantage the position of money capital and extend its structural boundaries (although finance ultimately depends upon the production and circulation of surplus value). This aspect of financialisation is elaborated through its relationship with neoliberalism.

### *3.2.2. From neoliberalism to financialisation*

Financialisation is associated with national and international neoliberal policies implemented since the 1980s. Thus, financialisation did not *directly* emerge from logical tendencies as such (IBC's extensive and intensive accumulation). Rather, financialisation is underpinned by historical, political and institutional factors in association with neoliberalism. Moreover, neoliberalism has had its distinctive character as a period of capitalism thanks to financialisation in general, not least IBC's fictitious character. Hence, the relation between financialisation and neoliberalism is key to contextualise contemporary forms of financial relations.

Neoliberalism is itself a fruitful subject enjoying several definitions with different emphases (Dumenil & Levy, 2001; Harvey, 2006; Saad-Filho & Johnston, 2005). Redefining the concept or reviewing relevant discussions, in particular in the context of financial crisis (McNally, 2009; Panitch & Gindin, 2011), is beyond the limits of this study. Therefore, we here only focus on aspects of neoliberalism that are closely related to the emergence of financialisation and the associated power of finance (although many see financialisation as an effect or parallel feature of neoliberalism as opposed to its defining characteristic – with concerted assault on the working class, possibly under the ideology of market forces, often taken as its preferred specification).

More specifically, neoliberal policies in relation to institutional transformations have contributed to the advantaged position of finance by releasing it from its boundaries and facilitating it to shape economic and social life. Neoliberal

ideas, which rise on the ground of free market adherents' frameworks of eliminating all boundaries to capital, have underpinned the emergence of financialisation.

“First, financialisation underpins neoliberalism analytically, economically, politically and ideologically, and it has been one of the main drivers of the restructuring of the global economy since the 1970s; financialisation is, then, the defining feature of accumulation today. Second, financialisation has been buttressed by institutional transformations expanding and intensifying the influence of finance over the economy, ideology, politics and the state. Third, contemporary financialisation derives both from the post-war boom and from its collapse into the stagflation of the 1970s. Fourth, financialisation has been closely associated with the increasing role of speculative finance in economic and social reproduction...” (Fine, Saad-Filho, Bayliss, & Robertson, 2015, pp. 14–16)

Thus, the development of financialisation is historically embedded within neoliberalism. While state power has been used to smooth capital accumulation under neoliberalism, finance has become the main instrument to overcome national and international limits to capital (Saad-Filho, 2011). Therefore, finance has facilitated global investment, production and commercial activities while allowing hedging and spreading of risks. In this regard, the fictitious character of IBC has played a key role which is evident in the context of derivative markets. These markets have been essential for insurance purposes and facilitated internationalisation of capital through trade and foreign direct investments (Panitch & Gindin, 2011). Thus, financialisation is the “*defining and or underlying aspect*” (Fine, 2014, p. 25) of neoliberalism.

The relation between neoliberal monetary policies and the emergence of financialisation deserves close attention. In this regard, it can be argued that the turning point for the emergence of finance's power was the US Federal Reserve's drastic policy moves for decreasing inflation in 1979. Under Volcker, the FED increased interest rates suddenly generating large flows of interest-income to lenders (Dumenil & Levy, 2001, 2012). Thus, the FED behaved like a global central bank with the main state motivation of defeating inflation in the US and continuing the dollar's dominant global position (Panitch & Gindin, 2011). Lower inflation was functional for financial markets in protecting lenders (Dumenil & Levy, 2002).



However, what is more important in terms of financialisation is the replacement of price inflation with asset inflation in capital markets after the Volcker policy.

“With more funds flowing into the US, this increased the competition among domestic lenders and tended to lower interest rates and financial profitability. In response, financial companies looked for new markets but also loaned more relative to their deposits and capital base. This in fact amounted to a vast increase in credit and the effective money supply, which however – given the defeat of labour, the low cost of imports, and the increased corporate ability to fund investments with internal funds – now produced **asset inflation** rather than price inflation.” (Panitch & Gindin, 2011, p. 11)[Emphasis added]

The asset inflation in financial markets accompanied by neoliberal policies contributed to the rising power of finance, equally creating a new discourse, i.e. of shareholder value. In a similar vein, the privatisation policies of the neoliberal era contributed to shareholder value becoming influential, going beyond corporate to individual financial arrangements:

“In this regard, the 1980s witnessed a highly successful neo-liberal governmental programme that featured the promotion of direct stock ownership: privatization. Framed by notions of ‘shareholder society’ and ‘popular capitalism’, the privatization programmes of the Thatcher and Reagan governments which de-nationalized a wide range of industries, services, and utilities created many first-time shareholders” (Langley, 2008, p. 55)

Shareholder value became the discourse of financialisation and popular in the US from the 1980s, suggesting that the main purpose of corporate governance to be creating the shareholder value, i.e. high returns for external investors. Under its influence, firms shifted their investment strategies from long-term investment to short-term strategies in order to increase their market value while distributing higher dividends (Lazonick & O’Sullivan, 2000). Thus, shareholder value affected corporate governance in a way that prioritised the interest of institutional investors such as pension funds and mutual funds. Therefore, shareholder value influenced “the volume, direction and mode of financing investment” (Boyer, 2000, p. 118). With the sophistication in financial markets, new financial instruments have emerged which have enabled hostile take-overs. Meanwhile, pay structures of managers have

been changed in a way that performance-related pay schemes and stock options are introduced. Thus, managers' income is tightly linked to the capital market value of their companies, i.e. shareholder returns (Lavoie, 2012).<sup>16</sup>

Financialisation, through pursuit of shareholder value, is also deemed to have slowed down capital accumulation by changing non-financial firms' investment strategies (Stockhammer, 2004). This aspect of financialisation explains tepid economic growth during the neoliberal era (Palley, 2007). It is important to note that the interrelation between financialisation and investment decisions of non-financial firms is twofold. While shareholder value requires high pay-outs, which results in less funds available for real investment, non-financial firms also prefer engaging with financial market activities over long-term investments with lower returns. In other words, lucrative financial returns result in more financial activity of non-financial companies in a way that crowds out real investment. However, this is very much related to the size of the firm considering the small and middle-size enterprises do not generally run financial market operations (Orhangazi, 2008).

Financialisation, in relation with shareholder value, has witnessed a structural transformation in the financial sphere as well as the non-financial sector. Asset market inflation has caused disintermediation which means firms prefer capital markets instead of banks for borrowing (Toporowski, 2000). Thus, banks have focused on different income sources such as households, investment bank operations and sophisticated capital market operations through securitisation.

Securitisation is the process of issuing financial securities on the basis of flows of revenue, not least repayment of debts, such as mortgage, consumption or commercial loans (Lavoie, 2012). Since the mid-1980s, securitisation has taken a new form which enabled banks to remove mortgage loans out of their balance sheets in a way that decreases their liabilities. The most significant example of securitisation is no doubt with the mortgage loans which have been pooled and securitised as mortgage-backed securities since the 1970s in the USA. These securities were turned into collateralised mortgage obligations (CMOs), consisting of

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<sup>16</sup> "This was superseded by the idea that any manager should achieve at the minimum a 15 percent rate of return on equity (ROE)—the famous 15 percent ROE norm, notwithstanding the fact that such a norm was impossible to achieve consistently at a macroeconomic level under the usual conditions in developed economies. Second, this apparent shareholder revolution was steered by agency theory, based on the principal and agent problem—here, the shareholders and the corporate bureaucrats." (Lavoie, 2012, p. 222)

different tranches according groupings of income streams from mortgage repayments. Moreover, with the invention of CDOs in the 1990s, mortgage loans at different risk levels (low, middle and high-subprime) were mixed under tranches alongside different forms of debt. According to this, the risk of default characterises each tranche where the lowest absorbs possible defaults while the highest tranche is perceived as almost risk-free (Foster, 2008).

The structural shift in the financial sphere has had two main impacts on households. The first is known as the ‘wealth effect’ and the other as ‘indebtedness’. In more detail, US households with high- or middle-income have benefited from financial gains in the 1990s during capital market valuation through wealth effects which originated from increasing value of household’s financial assets in the form of pension and other savings (Aglietta, 1998, 2000; Boyer, 2000). Although Boyer (2000) argues that these wealth effects might induce finance-led growth, these effects cannot be generalised since wages are depressed during the neoliberal era, and most of the population is still heavily dependent on income from wages and salaries (Froud, Johal, & Williams, 2002). In effect, when we consider the exacerbating income inequality under the neoliberal era, wealth effects might be considered to contribute to the widening gap between high and low income groups (Harvey, 2006).

Indeed, the other impact of financialisation on households has been rising debt levels since 1979, not least in the form of mortgage loans (Palley, 2007). Due to neoliberal attacks against the working class, wage levels have been suppressed while income inequality has increased. Thus, while banks have enjoyed expanded capacity for issuing loans, with limitation of liability through securitisation, households have demanded these loans for reasons related to stagnant wage levels:

“First, non-financial enterprises have become broadly involved in the realm of finance, often undertaking financial transactions independently. Financialization represents the opening of more space between non-financial enterprises and banks, with a lessening of mutual dependence among the two. Second, banks have directed their activities toward trading in open financial markets and dealing with households. Third, individual and households have become heavily implicated in finance in terms of both borrowing (such as for housing and general consumption) and holding assets (such as for pensions and insurance).” (Lapavitsas, 2013, p. 15)

To sum up, financialisation's impacts on the economy at the macro level during the neoliberal era can be theorised across three different dimensions. The first is the influence of finance on capital accumulation through institutional transformation achieved by the pursuit of shareholder value that alters priorities of non-financial corporations in favour of financial activity. The second effect is the intensification and sophistication of financial activities through securitisation. The third effect is the shift in households' engagement with financial activities through holding financial assets and increasing indebtedness. In the next section, we elaborate the expansion of finance in the context of financialisation of pensions.

### **3.3. Extensive accumulation of IBC: financialisation of pensions**

Pensions have varying functions from generating social security during old age to preventing poverty amongst elderly as an aspect of social policy. These different understandings of pensions are accompanied by several management structures and ways of financing. Pension schemes can be financed by funding or intergenerational transfers (PAYG) (or a mixture of these two methods). Therefore, pensions are often discussed in the context of savings and taxation. Moreover, pension income appears in diverse forms as in the returns from individual or occupational savings or taxes earmarked from payrolls. In each case, although to varying extents, pensions are determined by factors associated with wages. However, pensions are dependent on elements which go far beyond wages as such. For pensions are situated in broader social reproduction processes that support certain standards of living (Fine, 2014).

Moreover, pensions are not enjoyed by all retirees as the same level of living standards. Rather, they vary across the population according to certain groups' positions within labour markets. For instance, in the case of a funded scheme, monthly contributions below a certain level might give insignificant financial returns which render low-income groups vulnerable in terms of pension income. Another example is the PAYG schemes which distribute pensions not only intra-generationally, but also inter-generationally. Therefore, pension levels vary across different income groups within a generation, as well as between different cohorts with changing economic and social factors, such as baby booms, and high or low productivity and employment. Further, future or current pension income can be altered with changing calculation of benefits and indexation methods. In a similar vein, under different schemes, pensions change according to the wage level, as well

as the contribution of employers, workers and the state. Thus, pensions differ on the basis of pension benefits' conditions in face of inflation and other monetary and real factors that change the standards of living irrespective of the wage level. And the impact of a pension, as an income stream supporting life in old age, is embedded within other aspects of social and economic reproduction such as provision for health and housing.

So, what is a pension in essence when we take account of, or strip away, all of these different considerations? Pensions are an element in the living standards of workers that are necessary to enable generational reproduction of labour power. Therefore, a pension is part and parcel of the value of labour power, the main form of social reproduction during retirement. The concept of labour power is introduced by Marx in order to distinguish between labour and the capacity to labour. In this regard, labour power is the special commodity that is sold by the worker and bought by the capitalist (Marx, 1990, 1996). The peculiarity of labour power originates from its being the source of surplus value, and with a dual structure of value: its use value is to produce (surplus) value which is separate from its (exchange) value which is the value of necessary goods and services for its reproduction (Fine, 2012). Therefore, capitalists can increase surplus value by reducing the value of labour power. Hence, the value of labour power is a concept which reveals the degree of exploitation under capitalism while allowing an understanding of the social reproduction processes (Harvey, 1982).

“Therefore the labour-time necessary for the production of labour-power is the value of the means of subsistence necessary for the maintenance of its owner. However, labour-power becomes a reality only by being expressed; it is activated only through labour. But in the course of this activity, i.e. labour, a definite quantity of human muscle, nerve, brain, etc. is expended, and these things have to be replaced. Since more is expended, more must be received. If the owner of labour-power works today, tomorrow he must again be able to repeat the same process in the same conditions as regards health and strength. His means of subsistence must therefore be sufficient to maintain him in his normal state as a working individual.” (Marx, 1990, pp. 274–275)

Marx posits that the value of labour power is determined, as in the case of other commodities, by the labour time necessary for its reproduction. Marx refers to two different ways to determine value of labour power: *labour time* necessary for

production of a given quantum of means of subsistence (so-called historical and moral elements) and a quantum of *value* as such without reference to the use values for which it provides. This dualism between use values and value has substantial significance in terms of highlighting the position of goods and services which are not produced through capitalist relations such as family/household labour, as well as state provisioning (which would enter as use values but not as values for the reproduction of labour power) (Harvey, 1982). For instance, in the case of pensions, neither the necessary labour time nor is the sum of values approach sufficient. This is because a pension is neither a commodity nor a service that designates itself as labour time or value. Rather, a pension is the old-age income that is necessary for the reproduction of the worker during retirement which, of course, like other elements in the value of labour power can vary across time and individuals. Thus, the question is how to understand the value of labour power in a way that incorporates in general use values that are not values, and this for pensions in particular.

In this regard, we follow Fine's (Fine, 2008, 2009) approach: the value of labour power as a 'material standard of living' which consists of goods and services that are produced through capitalist relations as well as this being attached to use values not provided as (exchange) value. Thus, means of social reproduction produced outside capitalist relations, within the household and by the state, are part and parcel of what makes for workers social reproduction and condition the value of labour power but are not part of the value of labour power itself.<sup>17</sup> In effect, Marx paves the way for this kind of interpretation of the value of labour power by pointing to the moral and historical element that is crucial in the formation of the value of labour power (Rosdolsky, 1977).<sup>18</sup> Thus, the value of labour power is determined as a result of historical development of capitalist relations (Harvey, 1982) and in

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<sup>17</sup> Although neo-Ricardian approaches tend to see the social and monetary wage as simply substitutable for one another. This is wrong both from the perspective of value relations as such, not least in provisioning being under capitalist relations of production or not. See below and debate between Gough (Gough, 1975) and Fine and Harris (Fine & Harris, 1976).

<sup>18</sup> "His natural needs, such as food, clothing, fuel and housing vary according to the climatic and other physical peculiarities of his country. On the other hand, the number and extent of his so-called necessary requirements, as also the manner in which they are satisfied, are themselves products of history, and depend therefore to a great extent on the level of civilization attained by a country; in particular they depend on the conditions in which, and consequently on the habits and expectations with which, the class of free workers has been formed. In contrast, therefore, with the case of other commodities, the determination of the value of labour-power contains a historical and moral element. Nevertheless, in a given country at a given period, the average amount of the means of subsistence necessary for the worker is a known datum." (Marx, 1990, p. 275)

relation to the class struggle for higher wages (Lebowitz, 1992) and for broader issues of social reproduction (Fine, 2009).

“The value of labour-power has most often been conceived of as a quantity, bundle or vector of goods for which a given amount of labour-time is required to produce them- with surplus labour left over to make up the profit and other revenues attached to exploitation. Such primarily economic analysis needs to be complemented by a second aspect of the value of labour-power: the notion that the consumption bundle so provided suffices for **social reproduction** of the work-force. The work-force does not depend solely upon a wage but is engaged in activity outside the place of employment, thereby involving the **state, the household and other social relations**, structures and processes more generally.” (Fine, 2002, pp. 8–9) [Emphases added]

Marx mentions that the reproduction of labour power includes a generational element with reference to future generations (children of workers to replace them) but not the previous workers (Marx, 1990). Nevertheless, there is one occasion where Marx mentions insurance in a way that can be associated with understanding of contemporary old-age pensions: in the *Critique of the Gotha Programme* (Marx, 1978) (Motta e Albuquerque, 2014). According to Marx, the total social product, which stems from the collective efforts of labour, can only be fairly distributed after deductions such as replacement of spent means of production, additional component for expanding production and, last but not least, “reserve or insurance funds to provide against accidents, dislocations caused by natural calamities, etc.” (Marx, 1978, p. 15). These funds are related to economic reproduction. On the other hand, the part of the total product which is used for means of consumption is related to the social reproduction.

“First, the general costs of administration not belonging to production. This part will, from the outset, be very considerably restricted in comparison with present-day society, and it diminishes in proportion as the new society develops. Secondly, that which is intended for the common satisfaction of needs, such as schools, health services, etc. From the outset, this part grows considerably in comparison with present-day society, and it grows in proportion as the new society develops. Thirdly, funds for those unable to

work, etc., in short, for what is included under so-called official poor relief today.” (Marx, 1978, p. 15)

In other words, pensions for those who are not able to work are part of means of consumption that is provided in order to sustain social reproduction during retirement. This relation between social reproduction and pensions is conceptualised by Esping-Andersen as decommodification which occurs “when a service is rendered as a matter of right, and when a person can maintain a livelihood without reliance on the market” (Esping-Andersen, 1990b, p. 22). Thus, he suggests pensions in part enable workers to live without this being contingent upon selling labour power, thus its being commodified. However, this understanding of pensions is more individualistic rather than positing pensions as a deduction from the total social product for reproduction during the old age, a collective expense of the capitalist that must be funded out of surplus value much like any other expenditure of the state. In this way, pensions are contextualised in terms of class analysis which acknowledges the levels and forms of exploitation and its situation within economic and social reproduction.

In relation to social reproduction and capitalist relations, pensions’ structures involve labour, capital and the state. As mentioned before, pensions are not related simply to individual wage levels. Rather they are deductions from the total social product. From a Marxist point of view, surplus value produced by workers is appropriated by capitalists, and the state appropriates some of this surplus value in order to fulfil services like pensions (O’Connor, 1973). This has been conceptualised as the ‘social wage’, a deferred payment made by the state on the behalf of capitalists. From this point of view, social services, including pensions, are viewed as an integral part of wages by the labour movement and defended in order to increase them similarly to wages (Gough, 1975, 1982). However, this concept of ‘social wage’ is criticised for implying the rejection of the law of value. Since values are exchanged as equivalents, pensions or other transfers or services cannot be posited as an integral part of the value of labour power (Fine & Harris, 1976). Again, here the problem arises in part from the perception of the value of labour power as an ‘individual’ concept rather than reflecting an abstract category related to workers’ standard of livings (as well as treating all use values as embodying more or less commensurable values even though some, such as state or household provision are not produced as values). This challenge can be overcome through referring to the



‘total social product’ understanding of Marx which indicates that the state serves to socialise the costs of reproduction of labour power for capitalists through taxes which are deductions from the total surplus value that is to be distributed as profit (Fine & Harris, 1976). Thus, due to class struggle for better standards of living and the development of the welfare state, pensions are formed as a social right (Townsend, 2007). Their greater or lesser attachment to differentiated wages and labour conditions can, however, create the appearance that pensions should be treated as part of the value of labour power as such, however conceived, whereas they are deeply embedded in a much more complex and concrete set of relations.

In this light, financialisation can be seen to have altered pensions through diffusion of finance into the old-age processes attached to social reproduction. During pension reform campaigns, countries with PAYG pension schemes have confronted advice to have funded pension schemes in order to contribute to the extent and depth of capital markets, saving levels and economic growth (WB, 1994). Hence, finance has penetrated pension systems, with the reproduction of labour power attached to IBC. Moreover, workers have been involved in financial market operations through holding pension assets. Finally, the role of the state is taken over by financial markets through privatisation preceding financialisation of pension systems. Thus, the structure of pension systems which consists of employers, workers and the state has been transformed into an individual saving and investment operation where financial markets are more involved in mediating social reproduction processes.

Pension reform campaigns have shifted the ground of pension provision from the non-financial to the financial sphere. With financialisation in addition, pension contributions are accumulated in pension funds and invested in financial markets. Thus, pension income becomes a source of money capital for financial operations. Indeed, financialisation of pensions and pension funds have played a substantial role in the financialisation process as a whole through their functioning for institutional investors within capital markets as discussed in detail in the next section (Deken, 2013; Engelen, 2003; Toporowski, 2000) – although the role of pensions as a source of finance long precedes the era of financialised neoliberalism. While financial actors’ integration into pension systems constitutes one part of the story, another part is households’ engagement with financial markets through their asset holdings within funded schemes (Erturk et al., 2008). The increasing

stockholdings of households in the form of pensions have been presented as the ‘democratisation’ of finance while the promised outcomes of financial democracy have been far from fulfilling (Erturk et al., 2007).

As a result of privatization preceding financialisation, the state’s role in socialising the costs of the reproduction of labour power in old age is increasingly attached to (private) financial markets. Privatisation of pensions can be accomplished in different ways and to different extents. For instance, in some cases, the state completely withdraws from provision of pensions and either individual or occupational forms are established. In other cases, the administration and management of pension system is reformatted in a way that becomes more market-based and competitive (Deken, 2013). In this regard, privatisation of pensions refers to individualisation of old-age income which significantly alters the role and responsibility of the state while raising self-responsibility. This aspect of financialisation of pensions becomes more relevant in the context of increasing flexibility within labour markets for which pension contributions are extremely variable. Thus, while pensions are reorganised in a way that individual responsibility and career aspects are strengthened, pension entitlement becomes reduced if not absented for others (Frericks, 2014).

This transformation is not confined to shift from PAYG to funded schemes, it is also valid for the trend in the US and UK pre-funded pension systems that is the closure of defined-benefit schemes on the basis of the so-called ‘final salary crisis’ (Langley, 2004).

“This shift from defined benefit to defined contribution public policy approaches – terms that come from the world of pensions which indicate the shift from a guaranteed annual income at retirement (which most pensions were at the end of the 1960s) to the advent of self-management through investment portfolios whose paltry returns for most are hardly a means of retirement. Now these once public goods of health, education and affordable housing, are themselves treated as investments, and citizenship is converted to a gambit of pay-to-play. (Martin, 2014, p. 198)

This development, by all means, cannot be separated from the dominance of an asset management discourse that has been considerably influential in the era of

financialisation (Langley, 2008; Martin, 2002).<sup>19</sup> Thus, defined contribution schemes put all the responsibility and risk of the value loss within the pension funds on the shoulders of the individual in a way that “*indicated that primary responsibility for saving for retirement lies not with the state or the employer, but with the individual*” (Langley 2004, p.550). In other words, beyond the destruction of the collectivity principle, this development eroded the class character of pensions and social reproduction during the old age.

“The individualisation of responsibility and risk for saving for retirement is, furthermore, closely bound up with financialisation as ‘both subjectivity and moral code’. As Foucauldian analyses of contemporary Anglo-American neoliberal welfare reform highlight, a discursive ‘responsibilization of the self’ is in the making. Central here is financial self-discipline, that is, a form of discipline ‘which has economic rationality, planning and foresight, prudence and social/moral responsibility among its cardinal virtues’. Put simply, good citizens do not rely on the state or their employer, but voluntarily insure against perceived risks, including those of the incapacity to work in old age, through the mechanisms of the financial markets. (Langley, 2004, p.552)

Financialisation undermines ‘*pension as a right*’ by turning it into ‘*pension as a security*’ (Lazzarato, 2012). When pensions become a security, not a right, in the extreme every worker has to negotiate privately for their contract whereas, in the past, these negotiations were held by unions on the basis of collective action.

“The company, then, is not a place of conflict between workers and bosses, nor are public services a place where highly asymmetrical powers are exercised between agents representing the administration and beneficiaries (the unemployed, the sick, welfare recipients). The private firm or public institution is a set of *individual contracts* linking different actors who, in the pursuit of their own individual interest, are all equal.” (Lazzarato, 2012, p. 102)

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<sup>19</sup> Although scholars of cultural political economy have rightly addressed the way in which financialisation has changed the **understanding** of pensions through discursive analyses, their approach does not fit with our framework which aims to highlight the variegated financialised neoliberalism of everyday life through attention to the structures, processes, relations and agencies rather than their effects in alterations at the level of everyday life.

As a consequence of financialisation, pensions are displaced from the arena of class struggle towards becoming an individual return rather than a class-related or – negotiated income for social reproduction. As already emphasised, as its counterpart, and even if pension contributions remain collective to some degree in form, financialisation of pensions represents the expansion of finance into more areas of economic and social life. In this regard, IBC is extended to social reproduction processes and attaches old-age income to financial conduits.

In the next section, we discuss financialisation as the intensive accumulation of IBC and pension funds' roles in this context through their impacts on capital markets. It starts with review of the literature on pension funds' function as institutional investors. They imposed the priorities of financial institutions and contributed to the deepening of financialisation processes more generally, especially in Anglo-Saxon countries with funded pension schemes. Moreover, we discuss pension funds' supply- and demand-side impacts on capital markets in order to show intensification of financial operations.

### **3.4. Intensive accumulation of IBC: pension funds and financialisation**

It has been a long time since Drucker (Drucker, 1976) published his breakthrough book on pension funds. His optimistic insights about the property relationships under 'pension fund socialism' and shared ownership by employers and employees (via pension funds' assets) do not seem to have been borne out. On the other hand, not everyone shared Drucker's optimism; Clark (Clark, 1998) disagreed with him while naming his own work 'pension fund capitalism'. According to Clark, pension funds' significance within the economy was nothing but a new stage of capitalism; pension funds, by using their power as investors, changed even the way in which corporations were managed (Clark & Hebb, 2004). Despite these contradictory approaches, there were some authors suggesting grey instead of black or white; Blackburn (Blackburn, 2002, 2006) claimed that the ownership relations created by pension funds were ambiguous, i.e. pension funds caused property rights to form a 'grey capital'. Now, when we look back to these discussions we surprisingly see that, despite many useful insights they provide, they fail to see a major function of pension funds: contributing to financialisation of the economy. So far, pension funds have not changed the property relations but rather they have shaped the capital markets in a way which has reinforced financialisation.

This has been realised by some authors with pension funds seen as central to some of the theoretical-historical explanations of financialisation. The Regulation School attributes pension funds a primary function in a finance-led accumulation regime which refers to finance being a key mediation mechanism in regulation of capital accumulation. As a result, an increasing percentage of aggregate saving, comprising retirement savings and pension accumulations, constitute a claim on future profits. Under Fordism, companies were controlled by ‘managerial capitalism’ whereas now the control is in the hands of institutional investors such as pension funds. These require a high level of financial returns. Thus, the nature of investments of the company changes from long- to short-term in order to meet the criterion. “In this way, individual savings patterns are becoming the main engine of the distribution of income via the institutional investors’ governance of company behaviour” (Aglietta, 1998, pp. 80–81). In other words, pension funds have been influential on investment decisions through their role as institutional investors. Since savings in the form of financial wealth have exceeded the savings in the form of bank deposits, institutional investors have become decisive in diversification of financial wealth.

“Institutional investors with holdings in a company, by contrast, insist on the performance criteria as evaluated by the financial markets. They compel firms to maximize their equity value in the short term, under the constant threat of hostile mergers and leveraged buy-outs. This form of company management breeds an obsession with cutting wage costs and shedding jobs to boost share prices without much thought for future development.” (Aglietta, 1998, p. 69)

Thus, on the basis of their shareholder value, institutional investors in general and pension funds in particular, have changed the way in which companies are governed. Accordingly, managers of the firms have to adjust their managerial decisions under the impact of shareholders who expect high and stable rates of return (Boyer, 2000, p. 120). Hence, the shareholder value argument has become popular in the 1980s in the United States with the evidence of institutional investors led by pension funds.

“The transfer of stockholding from individual households to institutions such as mutual funds, pension funds and life insurance companies made possible the takeovers advocated by agency theorists and gave shareholders much more collective power to influence the yields and market values of the

corporate stocks they held. During the 1950s and 1960s, there were legal restrictions on the extent to which life insurance companies and pension funds could include corporate equities in their investment portfolios, while mutual funds played only a limited, although growing, role in the mobilization of household savings. In the 1970s, however, a number of changes occurred in the financial sector that promoted the growth of equity-based institutional investing (Lazonick & O'Sullivan, 2000, pp. 16–17)

Approaches associating shareholder value and corporate governance concepts with pension funds as institutional investors are illuminating for our research which aims to highlight pension funds' role in financialisation. However, it is also true that these concepts have their roots in orthodox finance literature.

“The term corporate governance only passed into common usage in the early 1990s. The UK's Cadbury Report of 1992 was the first major public document that explicitly took corporate governance as its object. Better governance quickly became part of a powerful promise. By the late 1990s, proselytising World Bank and IMF reports implied that the whole world could be a better place if others adopted the techniques of Anglo American corporate governance. But by the early 2000s in the UK and US, corporate governance is increasingly associated with disappointment. In 2002 the American political classes registered the failure of multiple governance mechanisms to prevent or detect dishonest and irresponsible behaviour in companies like Enron or World Com; while in 2003 the British media protested the failure of such mechanisms to control top executive pay or limit ‘rewards for failure’.”(Erturk et al., 2004, p. 678)

Moreover, as argued by Erturk (Erturk, 2003), “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” (p.186). Accordingly, the corporate governance literature defines the ‘optimal managerial behaviour’ in a way which ignores the financialised economic environment. By financialised economy is meant that the capital markets have moved beyond the point of being simple intermediaries but rather have become forces determining firm and household decisions. Therefore, it is necessary to develop a more generic framework of financialisation which provides insights for macro problems of countries rather than

focusing on analysis of firm-level governance. On the basis of this view, Erturk suggests the notion of ‘coupon pool capitalism’ by following (Froud et al., 2002).

“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.” (Erturk, 2003, p. 190)[Emphasis added] Ponzi finance, referred to by the authors, is a financial structure which necessitates issuing of new liabilities in order to finance existing liabilities.<sup>20</sup>

Toporowski (Toporowski, 2000), in his influential work, depicts the way in which pension funds in the UK and USA have involved Ponzi finance because of the long-term securities they hold. “Most of the assets of UK and US pension funds consist of irredeemable shares” (Toporowski, 2000, p. 63). Pension funds bring huge capital inflows to capital markets through pension contributions and they need these inflows to continue and also expand in order to meet their liabilities to pensioners. These capital inflows are used to buy securities, such as stocks, shares and corporate and government bonds. In the beginning, funded schemes are immature which means contributions come in increasingly while the number of people who retire is very low. Therefore, as pension fund contributions flow into capital markets, they inflate them. Consequently, the price level of securities rises and their yield decreases. This means securities become cheaper and a more attractive way of financing companies. So companies start issuing securities to repay the bank debt and use it as a more convenient and cheaper way of financing which substitutes for bank borrowing. The impact of this development on the banking system is disintermediation, involving it in risky businesses, focusing on small- and medium-sized firms as well as engaging with financial derivatives.

In addition to this, pension funds eventually mature. Maturation involves larger pay-outs as opposed to smaller pay-ins.<sup>21</sup> As a result, in a ‘mature pension

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<sup>20</sup> “Financial structures are simply commitments to make payments in the future, against claims that result in incoming payments in the future. Three types of financial commitments: hedge finance; speculative finance; the Ponzi finance. “Ponzi finance, in Minsky’s view, is a situation in which both commitments and cash inflows are uncertain” (Toporowski, 2000, p. 60).

<sup>21</sup> “When a pension scheme is established it starts off with a relatively high inflow of contributions and current pensions liabilities which are small at first, because the few contributors that retire first of all have short contribution records, and therefore only small pension entitlements. In each successive year another cohort of retiring workers becomes entitled to a larger pension, by reason of their longer contribution record, than each previous year’s cohort. The excess of contributions over pensions is

fund' the pensions paid out exceeds the amount of contributions. The excess amount is paid through the investment income of the fund as well as selling the fund's securities. Therefore, pension funds become net sellers when they mature whereas they are net buyers when they are immature. The result is that pension funds contribute to the instability of the financial markets by inflating asset prices while they mature, as their liabilities become a potential strain once they are mature.

“These [Funded pension schemes] are the main impetus behind the inflation of capital markets in the main industrialized countries since the 1970s. Some of the consequences of the resulting extended capital market inflation for privatization and monetary policy are conserved. It is argued that funded pension schemes make the economy less efficient and weaken the financial system. **They do this by putting large irregular flows of contractual savings into capital markets, needing and ever-expanding contributing labour force to sustain those flows and prices in securities markets.** Contribution inflows are limited by the fall in rates of inflation in the advanced capitalist countries, the size of the well-paid labour force and by the trend towards the casualization of labour, which makes pension fund saving a less appropriate form of saving. The reduced financial inflows into pension funds will reduce the liquidity of capital markets and thwart the eventual disintermediation from securities markets.”(Toporowski, 2000, p. 49)  
[Emphases added]

Further, pension funds have been one of the main drivers of financialisation as the logic of their funding creates demand for enhanced financial products (Engelen, 2003). Accordingly, there are four main objectives of pension funds: *minimising risks, maximising returns, ensuring liquidity and minimising costs.*

“Pension funds are subject to a life cycle during which the ratio of contributors and beneficiaries changes gradually, effectuating radical transformations in the risk profile of the fund and hence in its investment strategies, turning formerly committed, long-term owners increasingly into speculative investors. Driving this process is an increasing need for liquidity, forcing pension funds to invest in the most liquid markets and within these

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therefore large at first, but rapidly falls and may even become negative as the scheme ‘matures’.” (Toporowski, 2000, p. 73)



markets to buy the stocks of those corporations that have the largest daily 'free float'."(Engelen, 2003, pp. 1364–1365)

Pension funds need to invest in liquid asset categories in order to trade quickly according to necessity. This has been a main reason for the development of the asset markets and liquid investment instruments while legal restrictions on investment decisions pushed the process even more. The logic of funding is not only limited to the investment instruments preferred by pension funds, but also the managerial structure is decisive. Engelen (2003) defines two management strategies: internal and external management. In internal management, funds employ their portfolio managers whereas in the external one, the portfolio management company is independent. Moreover, in external management, either intensive or extensive management strategy might be the case. In intensive management there are few external managers who manage a small number of asset categories and have long-term relations with the fund. However, extensive management means that there are many managers who compete and control a high number of limitless asset categories. External managers' relation to the fund is short-term. According to the logic of funding, pension funds tend to start with internal management and move to external management and extensive management strategy over time. The *extensive management*, in particular, refers to highly *sophisticated investment strategies* which push the development of *enhanced investment instruments*. At the beginning of the life of a pension fund, the focus is on risk minimisation, rather than return maximization, because the fund is immature and income inflow is much more than payouts. With the 1980s, maturation of several major pension funds caused a shift of priority to return maximization instead of risk minimisation. The increasing need for liquidity along with the maturity of pension funds, made them push the development of existing investment instruments in a way more speculative in nature.

"For as soon as pension funds mature, their need to push the envelope of existing investment norms and practices grows, resulting in increasingly speculative behaviour and a frantic search for financial innovations. Subsequently, ever more specialised and sophisticated asset categories are demanded and constructed, setting in motion a gradual externalisation of investment management, ultimately resulting in an elaborate and complex division of managerial labour."(Engelen, 2003, p. 1366)

Therefore, the investment instruments become ever more speculative as a result of the demand by investment managers, thereby contributing to investment innovation and the proliferation of derivative markets. Consequently, the finance industry grows in response to the push to meet pension funds' demands. Hence, this highlights the relationship between the maturation process of pension funds and the financialisation of the economy.

On the basis of this literature review, it can be argued that pension funds play a substantial role in financialisation of the economies through three channels:

- With their dominance in capital markets as institutional investors which promote shareholder value and changing the way in which corporations are governed.
- Through capital inflows to capital markets which causes asset market inflation and results in increasing financial market instability.
- As a consequence of their logic of funding which contributes to innovation in financial instruments and enhancing sophistication of capital markets.

By all means, the extent and degree of explanatory power of these theoretical approaches varies across countries on the basis of their own pension funds' experiences. Unsurprisingly, these approaches are frequently referred to in case studies in order to explain the key function of pension funds in intensification of financialisation. For instance, Macheda (Macheda, 2012) argues that pension funds played a decisive role in the financialisation of the Icelandic economy through two conduits. One is the money capital flow into national and international markets which resulted in inflation in asset prices thus causing asset values to rise significantly. The second conduit, on the other hand, is the increasing demand of pension funds for short-term yields as a consequence of maturity. Thus, pension funds became involved in more risky speculative circuits. Theurillat et al. (Theurillat, Corpataux, & Crevoisier, 2010) discuss the financialisation of the property sector in the context of Swiss pension funds which have been involved in property as financial players between 1992 and 2005. Decisions made by pension funds structured the property sector in a financialised way which the authors define as "the continuous assessment of economic activities by financial markets" (p.192). Belfrage (Belfrage, 2008) examines the impact of pension funds on workers in Sweden after the public pension reform in 1999. With the new pension system, decommodification and

solidarity principles were replaced with self responsibility for pension income. As a consequence of the increasing complexity of the financial products, the target of securing a high material living standard during retirement has become more volatile. Accordingly, risk management becomes situated at the core of financialisation while pension funds represent the “recommodification” of pensions, in financialised forms.

### **3.5. Conclusion**

Marxist authors have spent a lot of energy in theorising periods for which the financial sphere has been of significance. For Hilferding (Hilferding, 1981) finance capital gained supremacy at the beginning of the twentieth century through loanable capital’s advantageous position relative to industrial capital. For Arrighi (Arrighi, 1994), on the other hand, the movement of capital (M-C-M’) also summarised the historical development of capitalist economies from production to finance. Baran and Sweezy (Baran & Sweezy, 1973) put forward the ‘monopoly capital’ as characterising a new era where competition rules do not apply to the giant corporations in a way that enables them to overcome the law of tendency for falling rate of profits through focusing, ultimately and in part on financial activities. Following these strands of thought, contemporary authors such as Lapavistas (2013), Krippner (Krippner, 2005) and Foster (Foster, 2007), conceptualised financialisation with varying emphases on structural tendencies and financial capitalists’ roles.

From our point of view, financialisation is a phenomenon that emerges as the characteristic feature of the neoliberal period due to structural transformations within production and reproduction processes. These alterations occur in relation to inherent tendencies of money capital but they are also pushed by historical developments promoting finance’s increasing presence across every aspect of economic and social life. This brings to the fore the question of whether or not financialisation is a project that is run by certain actors? As mentioned before, the author of this study accepts the role of actors in pushing changes in political economic processes. Nevertheless, our view departs from approaches that argue that the financial character of neoliberalism was a project that is run through intervention, especially via monetary policy, i.e. a ‘coup’ (Dumenil and Levy, 2001). Rather, we follow the view that financialisation is the most significant feature of the neoliberal period (Fine, 2013) alongside other attributes of the period that reinforces capitalist class’ power against other classes (Harvey, 2006). Therefore, financialisation is neither a period nor a

project but it is a phenomenon of spread and condensation of financial accumulation. Thus, financialisation has three dominant features: deepening of financial operations through new techniques, such as securitisation; transformation of non-financial sector due to altering relations with the financial sphere; and, households' increasing exposure to financial activities.

This chapter develops a theoretical framework for the analysis of financialisation and pensions. To this end, we start by introducing general characteristics of financialisation as an underlying tendency that can be found in Marx's investigation of money capital. After defining financialisation as the phenomenal extensive and intensive growth of IBC, we give an overview of the historical developments underpinning financialisation. In this regard, our emphasis is on the neoliberalism which is the contemporary mode of capitalist relations which is characterised by the significance of finance.

In order to show the way in which finance engages with a new area and transforms it into a profit-making domain for financial actors, we scrutinise the reconfiguration of pensions. Pensions provide a good example of finance extending its reach to social reproduction, not least as an aspect the reproduction of labour power. Moreover, financialisation of pensions causes finance to displace the state in the socialisation mechanism of the costs of social reproduction of retirees. Thus, once state pensions are switched to funded saving mechanisms, the collective logic of pension as a social right is turned into an individual responsibility of pension as a security.

After revealing the general features of the extensive growth of finance and financialisation of pensions, we concentrate on the intensive growth of finance. Intensification of financial relations in association with pensions is theorised in the context of Anglo-Saxon countries where funded pension schemes have traditionally been prevalent. Therefore, we are able to see the substantial role played by pension funds as institutional investors in the emergence of shareholder value which is a key element of financialisation. In addition, pension funds have asset market inflation effects which are again shown to be important in the structural transformations of financial and non-financial sectors under financialisation. Finally, the logic of funding explains the function of pensions funds in fuelling demand for more sophisticated financial instruments which served as a contributory factor for the instability and speculation associated with financialisation.

Thus, we prepare the reader for the following three empirical chapters. The next (Chapter 4) covers the general characteristics of financialisation of the Turkish economy in order to show that finance changes pensions through changing the economic and social structures shaping pension systems. Then, we shed light on the pension reform process in Turkey which resulted in financialisation of pensions, with funded schemes becoming significant alongside the state PAYG system (Chapter 5). This points to the extensive growth finance, integrating pensions in Turkey into the financial domains. What follows after this is an account of the intensive growth of finance that can be observed through the recently established Turkish pension funds' impact on the country's capital markets (Chapter 6). Thereby, across the next three chapters, we reproduce our theoretical framework on financialisation and pensions presented here in three sections through the empirical evidence provided by the Turkish example of pension reform.

## **4. Financialisation of the Turkish economy in the post-2001 era**

### **4.1. Introduction**

Becker et al (Becker et al., 2010) seek to specify the characteristics of financialisation in periphery countries and argue that '*peripheral financialisation*' is marked by high reliance on capital inflows which are sustained by high interest rates and overvalued domestic currencies in order to attract capital flows. The pro-financialisation policies of fighting against inflation in general, not least exchange rate policies, have negative impacts on trade and current account deficits which result in high external debt. In addition, several restructuring measures are taken to integrate households into the financial sphere, i.e. mass-based financialisation. In this regard, privatisations of welfare services, in particular pension reforms, have a significant role in the emergence of financialisation in countries such as Chile. Financialisation in Turkey, indeed, has shown several similarities with this path, alongside its own peculiarities. Pension reform is one of the areas advised to developing countries by the IFIs (as Turkey's experience is discussed in detail in the next chapter) as part of what can be interpreted as pro-financialisation policies. Beyond that, the dependence on capital inflows, inflation targeting policy, financial sector restructuring programmes and many other developments are experienced in a similar way as framed by Becker et al.

In the next section, we trace the trajectory of the Turkish economy in order to show the historical developments and institutional transformations that have underpinned financialisation in Turkey in the post-2001 era. The implementation of inflation targeting policy and, in relation with that, massive capital inflows underpinned the expansion of the financial sector. Moreover, the restructuring of the banking system allowed foreign banks to be integrated into Turkish financial markets. Hence, foreign banks, experienced in consumer lending to households, have altered the focus of the banking sector alongside regulations that detached banks from lending to public sector. We also demonstrate the socialisation of the costs of the transformation process towards financialisation in terms of privatisations, fiscal contractions and accumulation of international reserves.

After showing how the Turkish economy has been financialised, in the third section we scrutinise financialisation through descriptive statistical evidence that is analysed on the basis of our theoretical framework on extensive and intensive growth

of finance. The section consists of three subsections, on banks, non-financial institutions and households. Although capital markets in Turkey have shown considerable development in terms of volume of capitalisation and innovation through new financial instruments, we leave that aside for now as Chapter 6 concentrates on that issue. Turkey has a financial system primarily based on banks and, as financial sector's significance within the economy has increased, most of this has originated from the banking sector. With the availability and accessibility of external funds, not least in the form of mergers and acquisitions with the reform process, banks have expanded their loans rapidly. Moreover, in the 2000s, the public sector borrowing requirement has decreased which directed banks' concentration from holding public securities to extending loans. However, what is more important than banks giving loans is to whom they were given and for what. All these issues are discussed in the section 4.3.1.

To investigate credit expansion's impact on the economy, in the following sub-section (4.3.2), we scrutinise the development of the non-financial sector's financial situation. Accordingly, we conclude that the real sector in Turkey has taken very different positions according to the scale of firms involved. In short, while big corporations have enjoyed the bonanza of both domestic and foreign financial sources, either in the form of direct investments or bank loans, the small and medium scale enterprises (SMEs) have not experienced improvement in their financial circumstances. This point explains why growth in fixed investment has not increased: banks have not intermediated to transfer, admittedly declining saving, sources from households to the SMEs that constitute the majority of the real sector in Turkey.

What did banks do then? They transferred these funds to other households as consumer lending. As we show in the last sub-section (4.3.3), household indebtedness has increased dramatically in the post-2001 era. When we look at the breakdown of consumer lending, we see that low and middle-low income households borrow in order to finance their housing mortgages, as well as other needs such as education, health, vacations and even weddings and so on.<sup>22</sup> This does not only explain the fast growth of the construction sector, for the expansion of consumer

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<sup>22</sup> Indeed there is a consumer loan which is extended purely for the purpose of wedding expenditure. For an example, please see the link. Available at: <http://www.yapikredi.com.tr/bireysel-bankacilik/krediler/kredi-urunlerimiz/bireysel-ihtiyac-kredileri/evlilik-kredisi.aspx> Access date: 09.03.2016

lending also signifies the integration of finance into the everyday lives of households. We conclude by highlighting this chapter's importance for our understanding of financialisation and its multidimensional impact transforms directly or indirectly all areas of the economy, policy and social life.

#### **4.2. Historical developments and institutional transformations leading to financialisation in the Turkish economy**

Turkey saw financial market liberalisation in 1989 as the main instrument for decreasing the role of state in the economy while contributing to the development of the private sector through financial market promotion. However, the outcome did not meet expectations. While the private sector was expected to take advantage of the newly established liberal capital account, the public sector became the main beneficiary of access to foreign capital. The public sector used financial markets for public borrowing due to high public sector indebtedness which constituted the main bone of the growth strategy of the early 1990s. Meanwhile, budget deficits were financed by issuing public bonds in the Istanbul Stock Exchange, founded in 1986, and exchanged the majority of public sector debt requirements (90%) by 1988. In the 1990s, the domestic borrowing by the Turkish state coincided with a favourable environment for financial globalisation, resulting in high reliance on short-term capital inflows and the potential for financial crises as a consequence (realised in 1994 and 1999) (Akkemik & Ozen, 2014).

“The underlying characteristic of the domestic debt management was its extreme short-termism. Net domestic borrowings, as a ratio of the stock of the existing debt, hovered around 50% before the 1990s. This ratio increased to 105% in 1993, indicating that each year the state had to resort to new borrowing exceeding the stock of debt already accumulated. In 1996, this ratio reached to 163.5%. Thus, the public sector has been trapped in a short-term rolling of debt, a phenomenon characterized as Ponzi-financing in the fiscal economics literature. For this scheme to work, however, domestic financial markets required the continued inflow of short-term capital inflows. Thus, the episode of hot money inflows should be interpreted, in the Turkish context, as the long arm of fiscal policy, overcoming credit restraints and monetary constraints of the monetary authority” (Boratav, Yeldan, & Kose, 2000, p. 25)



In order to attract the so-called ‘hot-money’, i.e. short-term foreign capital inflows, the interest rates for treasury bills were kept high and domestic currency was overvalued (Boratav et al., 2000). The consequence of this process was a ‘vicious circle’ of high interest rates, cheap foreign currency for those accessing foreign capital, but dangers of capital flight motivating further increases in real interest rates to stem potential outflows against the fear of devaluation (Balkan & Yeldan, 2002; Yeldan, 2006).

**Table 4.1 Public sector borrowing requirement as percentage of GDP (%)**

<b>Year</b>	<b>PSBR/GDP</b>	<b>Year</b>	<b>PSBR/GDP</b>
<b>1990</b>	5.5	<b>1995</b>	3.7
<b>1991</b>	7.5	<b>1996</b>	6.5
<b>1992</b>	7.9	<b>1997</b>	5.7
<b>1993</b>	7.7	<b>1998</b>	7.1
<b>1994</b>	4.6	<b>1999</b>	11.6

Source: (Ministry of Development, 2015a, pp. 131–132)

As seen from the table above, public sector debt requirements remained high during the 1990s at an average 6.9% of GDP. Banks took advantage of the financial arbitrage caused by high real interest rates while financing public deficit through borrowing from foreign banks and lending to government via public sector debt securities. This was known as ‘open position banking’ since banks took open foreign exchange positions in order to appropriate high profits (Gungen, 2014). Thus, banks concentrated on government debt which resulted in the share of government debt securities to double up in banks’ balance sheets (23% in 1999) (Bakir & Onis, 2010). Financing public debt was preferable as well as being lucrative for banks for several reasons.

“Government securities were granted tax exemptions and carried a stable and risk-free net yield higher than other types of securities. More importantly, the fact that they could be used as collateral in the interbank money market and be held against the liquidity (disponibility) requirements raised their attractiveness for the banking sector. Therefore, the increase in the disponibility ratio after 1985 led commercial banks to raise the share of government securities in their portfolios. Furthermore, only the banks were allowed to be primary dealers in the government bond market.” (Ganioglu, 2008, p. 369)

The Turkish private sector adapted to this phenomenon by establishing their own banks under the big conglomerates which previously served as non-financial corporations. In some cases the income gained by financial operations exceeded that from the non-financial operations of these big 'holdings' most of them containing the top 500 manufacturing firms of the country (Kazgan, 2013). Gultekin Karakas (Gultekin Karakas, 2009) names this process '*financial protection*' because she argues that, during the 1990s, a transition from import-substitution to an export-oriented growth model was in place, and the Turkish state smoothened the difficulties of this shift through transferring financial funds to non-financial firms via high interest rates on government debt securities.

Alongside indebtedness of the public sector and banks' pragmatic position in financing public debt, another important characteristic of the 1990s was high inflation. Therefore, by 1998, the picture of the Turkish economy was not very promising: high external debt, high interest rates and high inflation. After the Asian crisis, capital inflows to Turkey slowed down in 1998 while falling to 1.8% of GDP from 5.8% in 1997 (Akyuz & Boratav, 2002, p. 9). The Turkish government prepared a disinflation programme and put it into effect with the 17<sup>th</sup> Stand-by Agreement signed with the IMF in July 1998. The programme aimed to decrease the inflation rate below 50% through fiscal and monetary policies. In a nutshell, these measures included restricting the lending of CBRT to the Treasury, decreasing the banks' open position as a share of their assets and constraining the subsidies to the agricultural sector in order to decrease the sector's share within the economy. Moreover, fiscal measures such as increasing the primary surplus within the budget above 4% of the GDP, limiting the salary increases amongst the public sector employees in accordance with the inflation rate and reforming taxation, not least introducing a tax for income from rent which had not existed in Turkey until then. Finally, the exchange rate was aligned with the inflation rate, and privatisations were to be accelerated (Kazgan, 2013).

Meanwhile, the banking system was undergoing a transition period following the 1994 financial crisis. As mentioned before, the main function of banks in Turkey until 1999 was to finance the public sector debt through holding government securities. However, in the second half of the 1990s, due to changing international capital flows and instability spread through several financial crisis, not least the

Asian crisis, the Turkish banks became insolvent and were taken over by the government as a response to the IMF demands (Kazgan, 2013).

“While a currency crisis was averted over the turbulent years of 1998–1999, the banking sector felt the squeeze from tightened external financial conditions and contraction in economic activity. Eight insolvent banks had to be taken over by the public **Saving Deposit Insurance Fund (SDIF)**, in accordance with the full insurance granted to deposits after the 1994 crisis, thereby adding considerably to public debt and deficits.” (Akyuz & Boratav, 2002, pp. 9–10)[Emphases added]

In June 1999, the banking system reform was accelerated in order to show commitment to the financial policies advised by the IFIs. This involved in major part the rehabilitation of insolvent banks, introducing new banking laws in accordance with the Basel II principles, establishing a new independent regulation agency for the banking sector and rendering the Central Bank’s full independence (Bakir & Onis, 2010).

Thus, Turkey entered the new millennium with an IMF-advised disinflation programme and prolonged banking reform. Initially, the programme appeared to be successful attaining targets for the nominal exchange rate and primary budget deficits. However, the decrease in inflation was slower than intended:

“At the end of December 2000, the year-to-year change in the CPI was 39 per cent while the average inflation for the year as a whole reached 55 per cent compared to 65 per cent in the previous year. Given that the predetermined path for the nominal exchange rate had been followed, this resulted in a significant appreciation of the currency in real terms. This was also aggravated by the rise of the dollar against the euro.” (Akyuz & Boratav, 2002, p. 14)

Therefore, in November 2000, in light of massive capital outflows, Turkey experienced a serious liquidity crisis when the overnight borrowing interest rate reached 870% (Yaman Ozturk & Ercan, 2009). This crisis was delayed for a few months with IMF aid until the crisis erupted again and more severely in February 2001. Despite Turkey experiencing these crises during the implementation of an IMF programme, the institution continued to advise Turkey and provided financial assistance of USD 20.4 billion (net, between 1999 and 2003) (Yeldan, 2008). In

March 2001, Turkey appointed Kemal Dervis, who was an influential bureaucrat from the World Bank, as the minister responsible for the economic reforms.<sup>23</sup>

In May 2001, the Transition to a Strong Economy Programme (TSE) was introduced in parallel with the 18<sup>th</sup> Stand-by agreement signed with the IMF. The TSE consisted of three pillars: banking, public and private sectors. Accordingly, fifteen regulations were put in effect in fifteen days to reform four strategic sectors; *banking and finance, energy, telecommunication and transportation, and agriculture*. These regulations were implemented alongside policy measures for transparency, fiscal discipline and flexible public employment and change in wages policy (Gultekin Karakas, 2009). The solutions introduced for overcoming the economic crisis were a combination of mantras from the Washington and Post-Washington consensus. Accordingly, the fiscal reforms such as tax and fiscal restructuring, elimination of the extra-budgetary sources etc., were in line with the ideology of the ‘minimum state’ of the Washington Consensus. On the other hand, good governance, transparency and central bank independence were principles in accord with the Post-Washington Consensus alongside the regulation of banking system, such as international norms like Basel II and rehabilitation and restructuring of the banking sector (Erturk, 2003).

In relation with the programme, energy and telecommunication/transportation sectors underwent a severe privatisation process which attracted massive foreign capital inflows. Regulations regarding the agriculture sector aimed to phase out agricultural subsidies and supports; and the privatisation of the agricultural sales cooperatives (as promised to the IMF and the World Bank with the letters of intent to the IMF signed in 1999). This process later resulted in financialisation of agriculture through bank credits to small-scale farmers (Borlu, 2015). Moreover, the programme consisted of measures on the productive sector to push exports and support foreign direct investments. The financial restructuring programme, also known as the Istanbul approach, restructured the debts of the companies which would be able to pay them if they had enough time and opportunity. The supported firms were chosen from those with positive value added. In this context, their institutional managements

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<sup>23</sup> Erturk describes Dervis’ appointment in terms of a ‘pro-regulation coalition’ consisting of international financial institutions and domestic parties in order to reform the economy and restructure the economic institutions in a more regulated way in relation with the Post-Washington consensus (Erturk 2003).

were enhanced and their balance sheets were made compatible with the international accounting principles (Yaman Ozturk & Ercan, 2009).

While transforming the structure of the economy, the TSE programme introduced the Banking Sector Restructuring Program (BSRP) with the main motivation of reshaping the banking sector in Turkey (Marois, 2012, p. 165). The programme included a re-regulation of state banks, solving the problems of SDIF banks (those overtaken by the state due to insolvency) and private banks after the crisis while increasing regulation in the banking system. The feature of the Turkish banking system concentrating on financing the public debt was removed within the reform process. The Banking Regulation and Supervision Agency (BRSA) was established as one of the major steps to organise the banking sector framework through an independent supervisory authority (Ganioglu, 2008, p. 368).<sup>24</sup> The reforms included measures to detach the organic relations between banks and conglomerates (Gultekin Karakas, 2009).

The SDIF, as briefly mentioned before, played a key role in the transformation of the Turkish banking system. The SDIF was established as a response to the IMF demand after the 1994 financial to provide security for deposits in case of default. With the banking system reforms, the SDIF took over 11 banks before the 2001 crisis (one bank in 1997, one bank in 1998, six banks in 1999, three in 2000). In 2001, nine more banks were taken over by the SDIF and two more were added to this number in 2002 (Kazgan, 2013). The purpose of the SDIF was to ensure the rehabilitation of these banks through recapitalisation and debt consolidation.

One of the most important elements of the rehabilitation of the Turkish banking system was the elimination of the state banks' non-performing loans also known as 'state duty losses'. These were financed by the Treasury and used for funding public institutions deemed key activities for development. Indeed, state banks financed crucial developmental projects and provided subsidies, i.e. cushions, to those harmed by the neoliberal policies, such as farmers. However, when the loans to these institutions or individuals defaulted, the losses of the banks were recorded in the budget as duty losses (Marois, 2012; Marois & Gungen, 2013). At the same time, the state duty losses were used to hide budget deficits during the 1990s. Thus, the

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<sup>24</sup> Before this, the Central Bank of Republic of Turkey (CBRT) and the Treasury shared regulatory and supervisory power over banks.

state duty losses reached 13% of GDP in 1999 (USD19.2 billion). Therefore, in 2002, USD22 billion was used to cover duty losses of state banks alongside the USD25 billion that was used for private banks' bailout (in total 30% of GDP in 2002 was used for these bailouts) (Marois & Gungen, 2013, p. 9).

Finally, the reform process included signing 'Memorandums of Understanding' (MoUs) in order to meet the institutional criteria of foreign financial authorities. The MoUs aimed at the integration and penetration of international financial institutions into the Turkish banking system (Marois, 2012, p. 179). This was achieved through the contribution of several regulatory arrangements as mentioned below.

"One of the key winners of neoliberal restructuring in the banking sector has been foreign bank capital. There were several reasons why foreign bankers did not bear the cost of the crisis and were able to penetrate the banking market. First, major international banks had privileged access to the Central Bank's foreign exchange reserves immediately before the 2001 financial crisis ... Second, foreign banks which provided loans to Turkish banks did not have to face the losses when these domestic banks became insolvent, because of comprehensive Treasury guarantees which were part of the IMF conditionality... Third, foreign banks took the lion's share in the post-crisis consolidation of the banking sector by directly or indirectly acquiring domestic banks that were recapitalized by public money: bank consolidation included nationalization of failed banks and their subsequent sale to domestic banks, which were later taken over by foreign banks. Thus, the emergence of the regulatory state facilitated foreign bank penetration into the Turkish market." (Bakir & Onis, 2010, pp. 92–93)

After 2002, with the election of the AKP (Adalet ve Kalkinma Partisi, Justice and Development Party in English) as the ruling party and its strong commitment to the economic programme advised by the IFIs, the Turkish economy entered a distinctive period (Onis & Guven, 2011; Yorukoglu & Cufadar, 2008). The programme implemented was known as the 'twin-targeting programme' for consisting of two pillars, monetary policy designed as **inflation targeting** and a **fiscal austerity** pillar intended to create a budget surplus of 6.5% of GDP. With the purpose of creating a primary surplus to pay off external debt, budget expenditures were kept very low during the years the target was achieved (between 1999 and 2008). What is more

interesting is that fiscal expenditure remained low even after the budget deficit had been decreased and public indebtedness was considerably lowered (Arikboga, 2011).

The fiscal targets have had substantial impact on the living conditions of households in Turkey. However, what is more important in terms of our focus, financialisation, is the inflation-targeting policy which was adopted implicitly until 2006 and explicitly afterwards. In this regard, interest rates were raised and the exchange rate was overvalued as the government was seeking to give positive signals to international investors. According to the logic of the programme, the commitment to the reform process would induce capital inflows. Therefore, with the availability of funds, it would be possible to decrease the real interest rate. Thus, private consumption as well as fixed investment would increase (Telli, Voyvoda, & Yeldan, 2009).

In more detail, **the inflation targeting** policy was first implemented in New Zealand in 1990, then in England, Canada and Chile. This policy means that the central bank, which supposedly only has the mission of sustaining price stability, declares a certain level of targeted inflation (Yeldan, 2010a). In the beginning, the policy was more about sharing the central bank policies and expectations on inflation in a transparent way. However, in the late 1990s, the inflation targeting policy has become the main instrument suggested to developing countries for integration into the international financial markets. This policy generally brings about the legislative changes for independence of the central bank and it is underpinned with the understanding of price stability as the necessary condition for growth and employment. In this regard, high inflation, which refers to 5 or 6 per cent annual inflation or more, would destroy the economy in the long run (Epstein & Yeldan, 2006, 2008, 2010).

As a result of the implemented policies and in relation with the capital glut in the international environment, Turkey experienced an unprecedented capital inflow during the first decade of the 2000s. “Total net capital inflows between 2003 and 2012 amounted to \$400 billion, compared with a total of \$35 billion between 1980 and 2002” (Orhangazi, 2014, p. 2). This was because Turkey offered higher interest rates than many other countries although these interest rates were comparatively lower than the Turkish interest rates of the 1990s.

“More specifically, the Central Bank, preoccupied with price stability, kept interest rates artificially high in an effort to push inflation down to single

digits through cheap imports whilst allowing the Turkish lira to appreciate in real terms against major currencies. Although there has been a decline in the real interest rates, Turkey offered one of the highest real interest rates among emerging markets. For example, in mid-August 2008, the Central Bank's real policy rate of 4.7 per cent (i.e. the nominal rate deflated by inflation) was the second highest rate among a selected group of thirty-seven emerging countries." (Bakir & Onis, 2010, p. 98)

Amongst capital inflows, the most important type for the Turkish economy was foreign direct investment (FDI) inflows. The FDI inflows to Turkey showed an increase of eightfold (USD122 billion) between 2003 and 2012 whereas these only amounted to USD15 billion until 2002 (Ministry of Economy, 2013, p. 9). The highly significant influence of capital inflows in general, and FDI inflows in particular, has been on the foreign exchange rate. Since the CBRT implements a floating foreign exchange rate policy, the inflow of foreign capital to the country caused appreciation of the Turkish lira. As a result, the Turkish economy consumed more of relatively cheaper imported products which in turn caused an increase in the current account deficit (Yeldan, 2010b).

"During the 2000s, despite rapid growth and a significant surge in exports, Turkish economy could not generate jobs at the desired rate. Open unemployment rate which stood at 6.5% in 2000, has jumped to 10.3% in 2002 in the aftermath of the February 2001 financial crisis. Since then the Turkish gross domestic product has increased by a cumulative 30% in real terms until the contagion of the global crisis in October, 2008. Yet, employment generation capacity of this rapid growth had been dismal, and the open unemployment rate could not be brought down below 9%. Despite rapid expansion of production in many sectors, civilian employment increased sluggishly at best, and labour participation remained below its levels in the 1990s." (Yeldan, 2011, p. 9)

Thus, this phenomenon is called "jobless growth" (Bahçe & Memiş, 2014; Ercan, Taymaz, & Yeldan, 2010, p. 5; Ergunes, 2012). The average unemployment rate between 2005 and 2015 is recorded as 9.8% (TURKSTAT).

FDI inflows to Turkey, besides not contributing to employment increase, has had another feature of being concentrated on the financial sector. Between 2003 and 2013, the financial intermediation sector holds the top place for attracting USD38.6



billion of FDI inflows. On the other hand, manufacturing sector had only half of the amount that was attracted to finance (USD21.8 billion). These sectors are followed by the energy, telecommunications and whole and retail trade sectors with 12.1, 11.2 and 4.8 billion US dollars, respectively (Ministry of Economy, 2013, p. 11). The banking system, in particular, has been a magnet for FDI inflows during this period (Yorukoglu & Cufadar, 2008, p. 470). However, at the same time, Turkey has experienced a ‘puzzling’ phenomenon of increasing international reserves in line with the inflation targeting policy implemented by the Central Bank.

“This phenomenon is puzzling because the well-celebrated ‘flexibility’ of the exchange rate regimes were advocated precisely with the argument that, under the IT framework, the CBs would gain freedom in their monetary policies and would no longer need to hold reserves to defend a targeted rate of exchange. In the absence of any officially stated exchange rate target, the need for holding such sums of foreign reserves at the CBs should have been minimal. The proponents of the IT regimes argue that the CBs need to hold reserves to ‘maintain price stability against possible shocks’. Yet, the acclaimed ‘defense of price stability’ at the expense of such large and costly funds that are virtually kept idle at the IT central banks’ reserves is questionable in an era of prolonged unemployment and slow investment growth, and needs to be justified more fully.” (Epstein & Yeldan, 2008)

In more detail, international reserves are readily convertible financial assets that are held by central banks and used for international payments. Central banks hold these assets in order to “establish and maintain confidence in monetary and exchange rate policies, provide FX liquidity for the Treasury’s domestic and foreign debt services, reduce the economy’s susceptibility to endogenous and exogenous shocks, boost the confidence of international markets in the Turkish economy” (CBRT).

“It is widely recognized that these reserves have become much more significant for emerging capitalisms’ financial stability since the mid-1990s as a signal of creditworthiness for financial capital. Since 2001 the AKP has increased net foreign reserves nearly fourfold, or from about \$29 billion (in constant dollars) to over \$108 billion by late 2010. ... As analysts recognize, however, there is a ‘social cost’ tied to the current phase of financialization and recurrent crisis. Because Turkey is subordinate within the international

hierarchy of states, state agents are compelled to hold foreign reserves as a signal of stability and creditworthiness to globally mobile financial capital. Moreover, Turkish authorities must offer a higher rate of interest for Turkish state bonds than the rate of return earned by holding the bonds of states at the zenith of the hierarchy, such as US bonds. The difference between these rates is structural and is absorbed by the Turkish state as a fiscal loss (that is a **socialized loss**).” (Marois, 2012, p. 180) [Emphasis added]

Another form of the socialised loss emerges from the costs of ‘sterilisation’ which is applied in the countries with high levels of international reserves in order to prevent reserve accumulation from undermining targeted inflation (Acar Balaylar, 2011). Sterilisation means that monetary authorities’ interventions in the foreign exchange markets do not induce an expansion (or contraction) in the monetary base. However, in countries with high domestic interest rates, sterilisation results in considerable costs as with the total cost of sterilisation in Turkey between 2003 and 2010 at TL12 billion (p.32). Further, such operations prevent domestic interest rates from decreasing, raising the government’s borrowing costs.<sup>25</sup>

To sum up, the Turkish economy has experienced tremendous capital inflows, importing capital from 2002 (Erdem & Donmez Atbasi, 2011). Overvaluation of the Turkish lira is associated with these capital inflows, and this overvaluation of the currency has had an aggravating impact on the current account deficit. In 2008, as with the 1994 and 2001 crises, these capital inflows switch to capital outflows. After 2009, foreign capital inflows mostly consisted of so-called hot money, i.e. short-term investments. Thus, it can be argued that one of the most important characteristics of the financialisation in developing/periphery countries is the reliance on capital inflows (Becker et al., 2010).

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<sup>25</sup> Sterilisation means that the monetary authority buys or sells foreign assets in the case of an expansion or contraction. Thus, the monetary basis is adjusted through the opposite transaction. For this, CB buys foreign currency from banks, and then sells the assets in domestic currency from its portfolio. While selling bonds in the domestic markets, CB might prevent convergence of domestic interest rates to foreign interest rates, and high interest rates might induce even more capital inflows exacerbating the problem. Therefore, sterilisation has a financial cost which is the difference between the returns on international reserves and issued debt securities. If the domestic interest rates exceed international reserves’ returns, holding reserves would create a sort of ‘tax-effect’ so the monetary authority has to offer a high interest rate in order to suppress domestic demand (Acar Balaylar 2011).

**Table 4.2 Main indicators of the Turkish economy in the post-2001 era**

<b>Year</b>	<b>GDP (mil TL)</b>	<b>FDI (mil USD)</b>	<b>Exports (mil USD)</b>	<b>Imports (mil USD)</b>	<b>GDP Growth (%)</b>	<b>FDI Growth (%)</b>	<b>Unemployment rate (%)</b>
<b>2002</b>	72,519	1,082	36,059	51,553	6.2	-67.7	10.8
<b>2003</b>	76,338	1,702	47,252	69,339	5.3	31.0	11
<b>2004</b>	83,485	2,785	63,167	97,539	9.4	33.6	10.8
<b>2005</b>	90,499	10,031	73,476	116,774	8.4	16.3	10.6
<b>2006</b>	96,738	20,185	85,534	139,576	6.9	16.4	9
<b>2007</b>	101,254	22,047	107,271	170,062	4.7	25.4	9.2
<b>2008</b>	101,921	19,851	132,027	201,963	0.7	23.0	10
<b>2009</b>	97,003	8,585	102,142	140,928	-4.8	-22.6	13.1
<b>2010</b>	105,885	9,086	113,883	185,544	9.2	11.4	11.1
<b>2011</b>	115,174	16,136	134,906	240,841	8.8	18.4	9.1
<b>2012</b>	117,625	13,283	152,461	236,545	2.1	13.0	8.4
<b>2013</b>	122,556	12,357	151,802	251,661	4.2	-0.4	9
<b>2014</b>	126,127	12,146	157,610	242,177	2.9	3.8	9.9

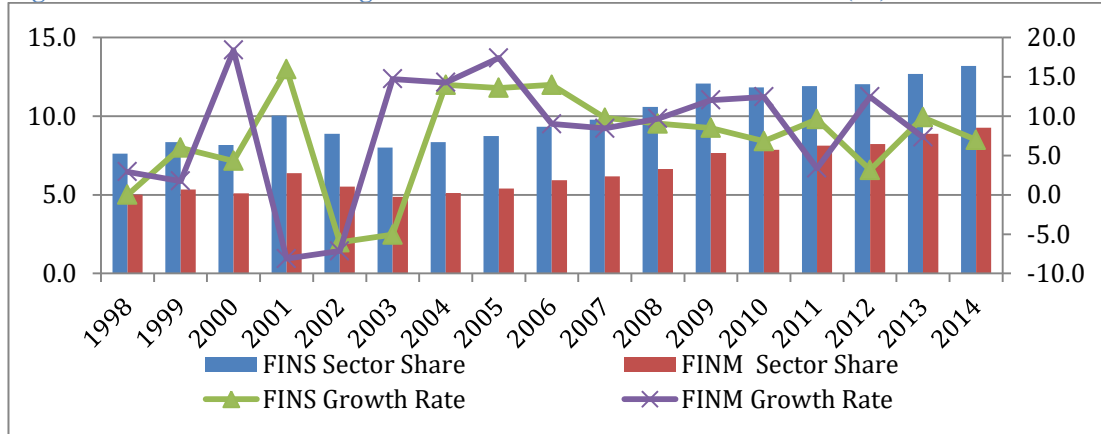
Source: (UNCTAD, 2016), (TURKSTAT, 2016), (Ministry of Development, 2015a)

In Turkey, in relation to capital inflows, the share of financial activities in GDP has grown more rapidly than all other sectors. The most important implication of this development has been change in banking system. While the number of banks has decreased as a result of banking reforms, the assets and liabilities of the banking system have grown significantly. The growth of balance sheet items of the banking system has been accompanied by a functional shift from financing government debt to extending loans as we show in detail in the next section.

#### **4.3. Extensive and intensive growth of finance**

The extensive growth of finance in relation to financialisation in Turkey can be traced through the sudden growth of the financial sector in general and the banking system in particular. Indeed, while finance has extended into several aspects of economic and social life, the significance of the financial sector within the economy has shown a considerable increase in a way that indicates intensification of financial relations. To start with, in the era of financialisation the financial activities have grown rapidly and occupied a larger share within GDP.

**Figure 4.1 Sectoral shares and growth rates of financial activities in GDP (%)**



Source: (TURKSTAT, 2016) Gross Domestic Product in Constant Prices by Kind of Economic Activity, NACE Rev. 2 - at 1998 Basic Prices. The left axis is sectoral share of Financial and Insurance activities (FINS) and Financial Intermediation Activities (FINM). The right axis is growth rate of FINS and FINM.

According to the figure 4.1, financial and insurance activities had a sectoral share of 7.6% and financial intermediation activities had a share of 5% of GDP in 1998. Both these activities have increased their shares with a consistent trend and were recorded as, respectively 13.2% and 9.3% in 2014. As a result of this trend, the Turkish financial sector has reached a total asset value of TL2,357 billion by 2015 (BAT, 2015b) from its value of TL185 billion in 2001 (BRSA, 2006). The Turkish financial system consists of three institutional components: banks, insurance companies and non-bank financial institutions, such as financial leasing companies, factoring companies and financing companies.<sup>26</sup> Banks are the most important financial institutions in Turkey with an asset value of TL1,994 billion in 2015. Banks have increased their assets more than six times since 2004. After banks, we have portfolio management companies and insurance companies with their total asset value around TL80 billion. Real estate investment partnerships and pension investment funds constitute the third layer of the Turkish financial system with their asset value at around TL40 billion by 2014. Non-bank financial institutions have shown a rapid increase in the last decade with their asset value totalling TL78.7 billion in 2014.

<sup>26</sup> Non-bank financial institutions of Turkey have recently established “The Association of Financial Leasing, Factoring and Financing Companies”. For further information see the link. Available at: <http://www.fkb.org.tr/home-page> Access date:10.03.2016

**Table 4.3. Asset size of financial sector in Turkey (in billion TL)**

	<b>2004</b>	<b>2010</b>	<b>2014</b>
<b>Banks</b>	306.4	1,007.0	1,994.1
<b>Portfolio Management Companies</b>	24.5	44.9	81.8
<b>Insurance companies</b>	9.8	31.0	79.0
<b>Real Estate investment partnerships</b>	1.4	5.1	41
<b>Pension investment funds</b>	4.2	17.8	37.7
<b>Financial leasing companies</b>	6.7	15.8	32
<b>Factoring companies</b>	4.1	14.5	26.5
<b>Financing companies</b>	1.5	6.1	20.2
<b>Total</b>	455.2	1,303.8	2,330.9

Source: (BAT, 2015b) (BRSA, 2006) (Bedirhanoglu et al., 2013)

The dominance of the banking sector within the total financial assets has even increased in the post-2001 era, while the financial assets of the Central Bank have decreased (Bedirhanoglu et al., 2013).

**Table 4.4 Capital market indicators, Turkey 2007-2014**

Years	Corporations Traded on Borsa Istanbul				Price/Earnings Ratio %	Turnover Ratio %
	Number of traded corporations	Total nominal capital Mil TL	Total Market capitalisation			
			Mil TL	Mil \$		
2007	327	51,685	335,948	289,986	11.9	129.7
2008	326	63,300	182,025	119,698	5.8	135.1
2009	325	70,061	350,761	235,996	16.8	178.7
2010	350	80,806	472,553	307,551	13.3	150.6
2011	373	89,724	381,152	201,924	11.9	115.8
2012	395	96,634	550,051	309,644	12.5	113.1
2013	405	103,179	503,668	236,586	10.2	161.8
2014	401	104,540	624,369	268,511	14.4	139.5

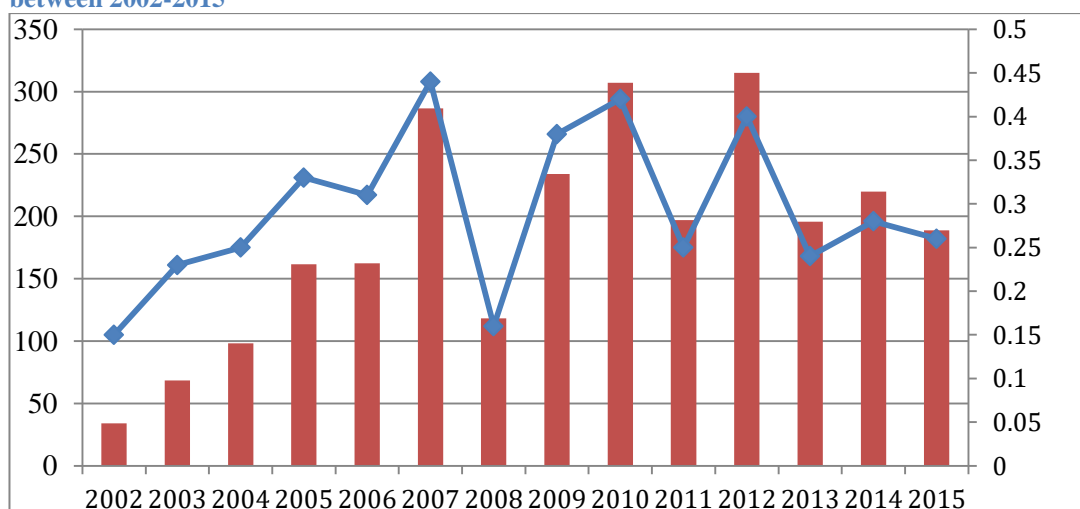
Source: (CMB, 2014a, p.66)

The significance of public securities has decreased while private sector securities have expanded within the Turkish capital markets. According to total financial assets data provided by the Ministry of Development (Ministry of Development, 2015a),

total public securities were more than ten times of private sector securities in 2001. However this ratio decreased to less than three by 2014.<sup>27</sup>

The number of traded corporations on Borsa Istanbul increased from 327 to 401 from 2007 to 2014. Moreover, the total nominal capital has doubled in 7 years and was recorded as TL104,520 million in 2014. Total market capitalisation has also doubled in domestic currency. However, due to the fall of the TL against the US dollar, market capitalisation value remained as low as 268 billion in terms of US dollars (by 2014).

**Figure 4.2 Market capitalisation in Turkey in billion USD and Market capitalisation/GDP (%) between 2002-2015**



Source: (CMB, 2015b) International Economic Financial Indicators December 2015. Market capitalisation in billion USD left axis, Market capitalisation/GDP right axis

After the price/earnings ratio peaked in 2009 at 16.85, it has decreased to 10.2 in 2013 and has shown a recent recovery of 4.2% in one year (14.4% in 2014). Finally, the turnover ratio of the Turkish capital market has not shown a considerable development as it was 129.7% in 2007 and is recorded as 139.5% in 2014.

Table 4.5 (below) shows the comparison of the financial sector in Turkey with developing countries and World averages. Accordingly, the ratio of financial sector/GDP in Turkey was recorded as (112%) which exceeded the developing countries' average (110%) in 2013. However, capital markets' ratio over GDP is as low as 58% whereas the world capital markets have a ratio of 217%. Again in terms of stocks, Turkey falls behind the developing countries' average with 32% as

<sup>27</sup> 2001: 122.930.009 Public sector securities vs. 10.517.096 private sector securities. 2014: 414.648.522 Public sector securities vs. 153.020.242 Private sector securities (Ministry of Development, 2015, p. 125).

opposed to 39% in 2013. Finally, the percentage of bills of exchange and bonds within GDP is below other developing countries.

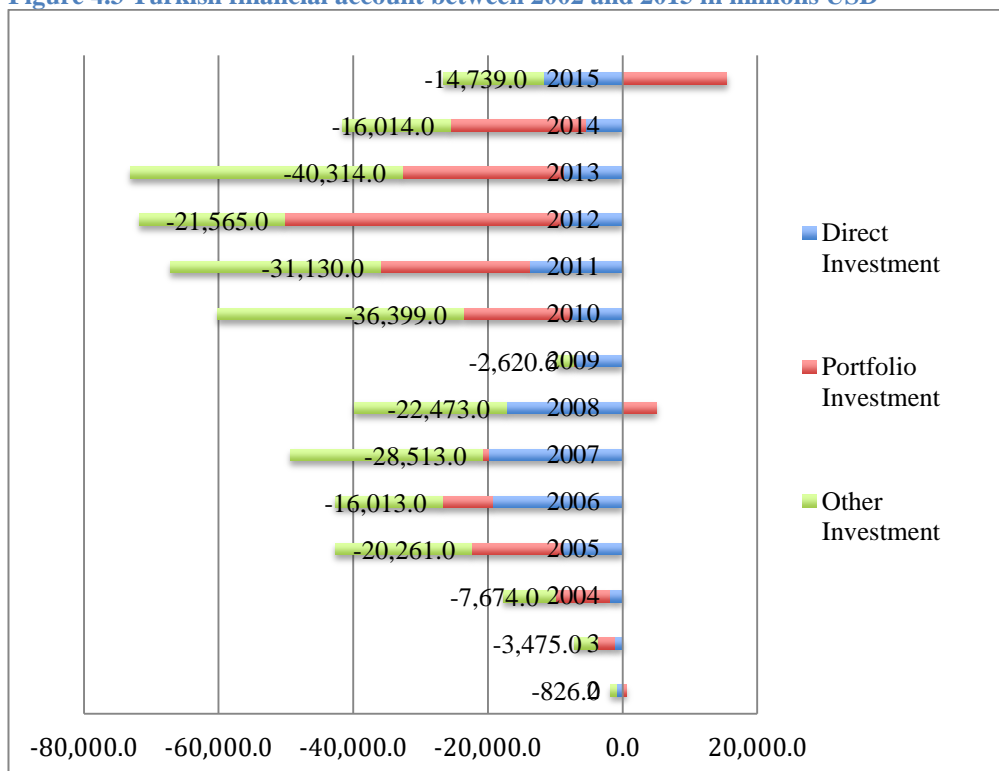
**Table 4.5 Financial sector/GDP (%) in Turkey, Developing countries and World in 2013**

	World	Developing countries	Turkey
Bank Assets	161	110	112
Capital Markets	217	78	58
Stocks	84	39	32
Bill of exchange/Bonds	134	39	26
Total	379	188	170

Source: (BAT, 2015b, p. 27)

Another issue on capital markets is the increasing integration of foreign capital in relation with the upward trend in international capital inflows to Turkey in the post-2001 era. In a nutshell, international capital flows are classified under three titles: direct investments, portfolio investments and others (definitions by both IMF and Turkish Central Bank). Foreign direct investments stand for financial activities such as buying a firm, providing initial capital for a new firm and capital increase for an existing firm. On the other hand, portfolio investments stand for capital owners to invest in foreign capital markets with the purpose of gaining interest or dividend yield alongside other financial returns on money market instruments and derivatives. Portfolio investments mostly consist of liquid instruments; thus they are referred to as ‘*hot money*’ which might leave the country in an unfavourable situation. Finally, ‘others’ include all the capital flows except direct and portfolio investments as well as reserves. The latter two, portfolio investments and others, mostly have a financial character, thus they are called financial capital flows. On the other hand, foreign direct investments are more likely to have non-financial character for investing in physical capital. As financial capital inflows are mostly short-term, they are associated with potential instability in the country. In the case of FDIs, however, the crucial point is whether or not these capital inflows increase long-term investments or simply take over an existing company without any contribution to development as such. In Turkey, the significance of the short-term speculative, i.e. hot money, capital inflows has always been higher than long-term investments. These capital inflows do not only have speculative character but also they are variable. This the liquidity character carried by the hot money increases Turkish economy’s vulnerability to crises (İpek & Karahan, 2013).

Figure 4.3 Turkish financial account between 2002 and 2015 in millions USD



Source: IMF<sup>28</sup>

As can be seen from the figure above, the Turkish financial account has attracted tremendous financial inflows. Amongst them, the significance of ‘other’ investments has been higher than direct and portfolio investments. In effect, a closer look at the data shows two diverse trends in relation with the balance between portfolio and direct investments. The first trend is seen between 2003 and 2009 when direct investments are at considerable levels and portfolio investments are comparatively low. On the other hand, the trend between 2009 and 2014 shows that direct investments lagged far behind portfolio investments. Thus, it can be argued that the significance of speculative activities has increased with the unfavourable environment for direct investments. As mentioned previously, these direct inflows mostly penetrated the Turkish markets through privatisations and restructuring of substantial sectors, such as banking. Moreover, with the consistent weight of other investments it can be interpreted that the foreign capital inflows to Turkey have

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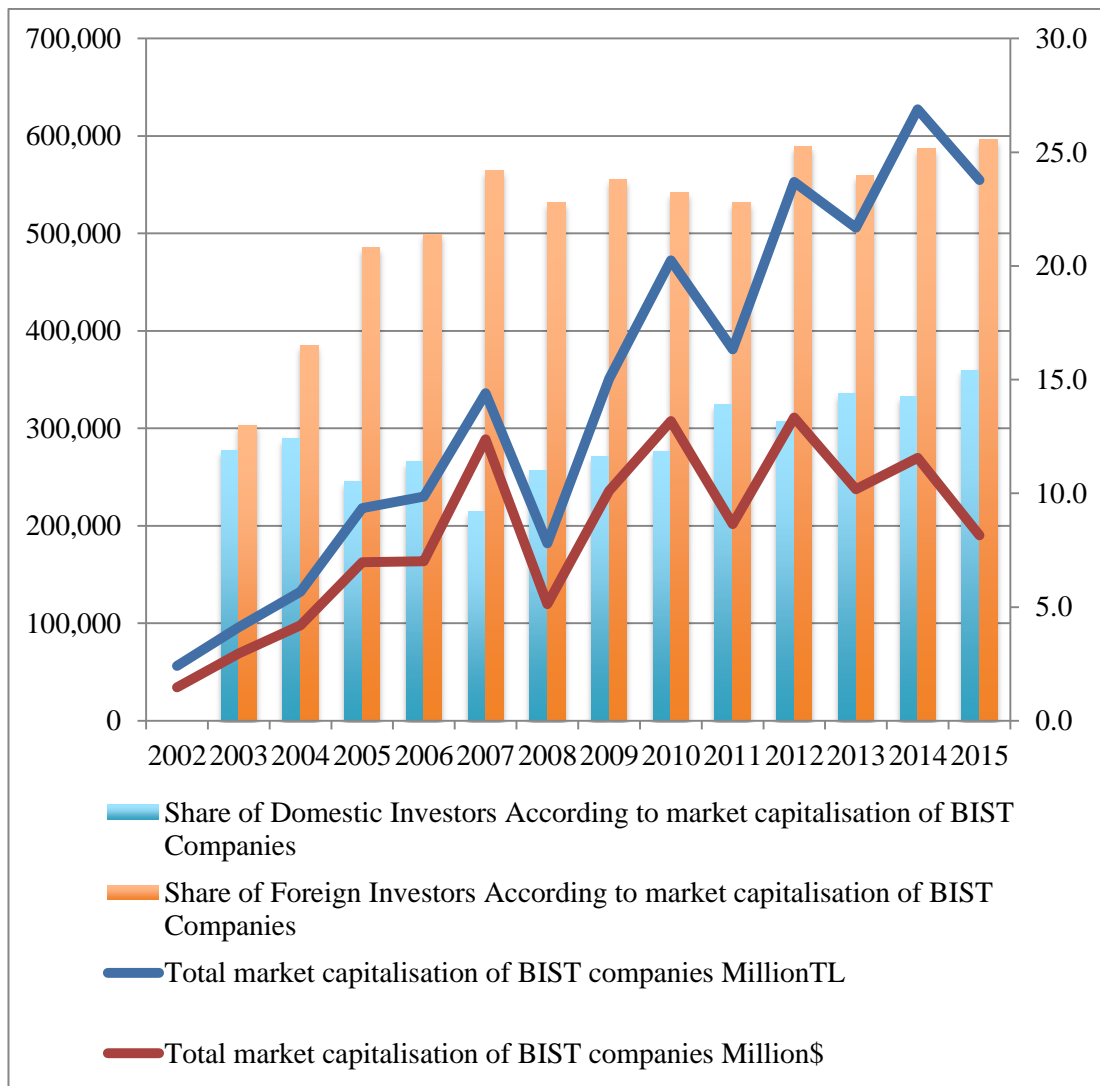
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mostly had financial character as other investments mostly consist of short-term liquid investment instruments.

This inflow has its reflection in the steady increase in significance of foreign capital in the Turkish capital market. As shown in the figure below, the share of foreign investors according to BIST market capitalisation has increased significantly since 2004.

**Figure 4.4 Share of foreign investors according to total market capitalisation of BIST btw 2002-2015**



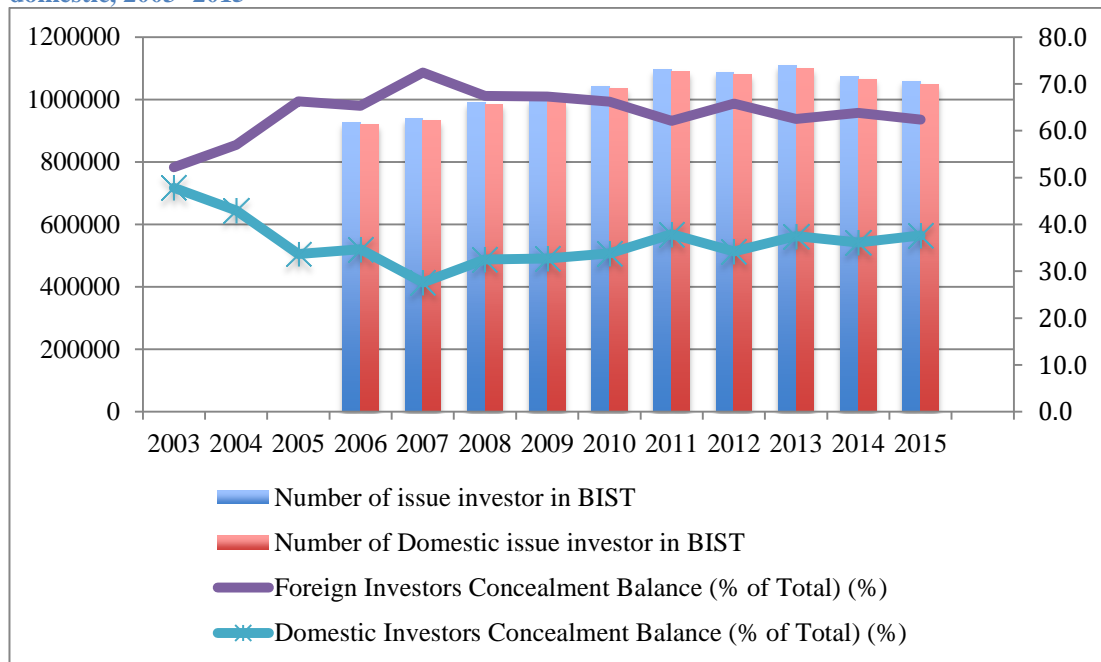
Source: (CMB, 2015a).

Note: Right axis: share of domestic and foreign investors in %. Left axis: total market capitalisation in million TL and \$.

This is important because, as shown below, within total issue investors, almost 99% of the Turkish capital market investors is domestic. In other words, despite their small numbers of foreign investors, foreign investors have higher concealment

balance<sup>29</sup> shares within total market capitalisation compared to the domestic investors' shares.

**Figure 4.5 Number of investors in BIST and investors' concealment balance, foreign versus domestic, 2003- 2015**



Source: (CMB, 2015a)

Note: Right axis % as of total concealment balance. Left axis number of issue investor.

In this sense, it can be argued that Turkey has mainly developed its financial system on the basis of banks which constitute the only element through which Turkey catches up with other developing countries. Nevertheless, the Turkish capital markets have shown qualitative transformations besides considerable quantitative development. The transformation of the Turkish financial system in general has stemmed from innovation through new instruments, such as asset-backed securities, derivatives, bank bills and Islamic-referenced 'sukuk' instruments which we do not explain here. However, all of these are investigated in detail in the last chapter where we discuss pension funds' impact on intensification of financial relations through their influence on capital markets in Turkey. Therefore, we continue here by focusing on banks which constitute the main component of financial relations in Turkey.

<sup>29</sup> Concealment balance stands for the stock transactions that are kept safe by the custody institution, i.e. Takasbank.

#### 4.3.1. Banks

By December 2015, the Turkish banking sector consisted of 47 banks comprising 34 deposit banks, 13 development and investment banks. There were also five participation banks.<sup>30</sup> Three of the deposit banks are owned by the state while nine are private with foreign ownership of 21 deposit banks. The total number of branches of deposit and development and investment banks was 11,193 while their employees' number is 201,205 at the end of 2015 (BAT, 2015c). As can be seen from the table below, the 2000s have witnessed a clear turning point within the development of the banking system. Since 1980, the total number of banks increased steadily until 2000 when it reached 79. As mentioned before, this increase was due to lucrative profits made by banks through financing public debt. Moreover, the loose financial regulations allowed big conglomerates to establish their own banks in order to finance their non-financial activities while taking advantage of access to capital (Gultekin Karakas, 2009). After the intense banking sector restructuring reforms, the number of banks decreased significantly. On the other hand, the number of foreign banks has increased across the banking system in the post-2001 era. This has been achieved through the integration of foreign capital into the Turkish banking system through mergers and acquisitions of foreign banks with the SDIF banks (the banks which were taken over by the state due to insolvency).

**Table 4.6 Development of the Turkish banking system 1980-2015**

	<b>1980</b>	<b>1990</b>	<b>2000</b>	<b>2005</b>	<b>2010</b>	<b>2015</b>
<b>Deposit banks</b>	40	56	61	34	32	<b>34</b>
Based on public capital	12	8	4	3	3	3
Based on private capital	24	25	28	17	11	9
Based on foreign capital	4	23	18	13	17	21
<b>Development and Investment banks</b>	3	10	18	13	13	<b>13</b>
<b>Participation banks</b>	0	0	0	4	4	<b>5</b>
<b>Total</b>	<b>43</b>	<b>66</b>	<b>79</b>	<b>51</b>	<b>49</b>	<b>52</b>

(BAT, 2014a, 2015a)

The consolidation of the banking system in Turkey has increased after the reforms, as the biggest five banks' share in total assets, deposits and loans is, respectively, 86%, 90% and 85% in 2014 (BAT, 2015a). After the 2008 crisis, the

<sup>30</sup> Data on participation banks are not included here, but will be given in detail in the following pages.

Turkish banking system continued to increase the number of branches despite a temporary slowdown during 2008-9. However, we should note that the job creation of the sector falls behind the growth of the banking system. Accordingly, the financial sector's share within total employment has decreased since 2005 while, as shown earlier, its share within GDP has increased (Karakas, 2015).

Another interesting point to note about banking sector's development during the financialised era is the significant presence of state-owned banks in Turkey. As can be seen from the table below, which consists of biggest banks with different capital structures, we see that the state-owned Ziraat, Halk and Vakif banks own 31% of the total assets of the banking sector. Moreover, the Ziraat Bank, which is the oldest bank (founded in 1863 to support agricultural sector (Marois & Güngen, 2016), has the second largest assets within the sector. IsBank, that is the leading actor of the sector, has also an interesting shareholder structure that consists of 28% Ataturk Shares that are controlled by the Republican People's Party (also 40.15% shares of this bank is owned by the bank's employees' occupational pension scheme- to be discussed further in the sixth chapter).

**Table 4.7 Assets of the banking sector banks by capital structure Million TL 2016 June**

<b>Banks</b>	<b>Total Assets</b>
<b>Banking Sector</b>	<b>2,374,699</b>
<b>Deposit Banks</b>	<b>2,343,255</b>
<b>State Owned Deposit Banks</b>	<b>736,888</b>
<i>T.C. Ziraat Bankası A.Ş.</i>	331,879
<i>Türkiye Halk Bankası A.Ş.</i>	204,814
<i>Türkiye Vakıflar Bankası T.A.O.</i>	200,195
<b>Private Banks</b>	<b>983,872</b>
<i>Akbank T.A.Ş.</i>	265,536
<i>Türkiye İş Bankası A.Ş.</i>	341,821
<i>Yapı ve Kredi Bankası A.Ş.</i>	245,820
<b>Foreign Banks</b>	<b>622,496</b>
<i>Denizbank A.Ş.</i>	117,864
<i>Türkiye Garanti Bankası A.Ş.</i>	287,248
<b>Development and Investment Banks</b>	<b>31,444</b>
<i>Türkiye Sınai Kalkınma Bankası A.Ş.</i>	22,549

Source: BAT <sup>31</sup>

There are two issues to discuss regarding state-owned banks: one is to explain how they survived the restructuring process without being privatised; and the other is to shed light on their role in financialisation process as the latter's answer is strongly related to the former's.

During the post-2001 era, state-owned deposit banks and development and investment banks based on public capital have been restructured alongside other measures regulating the banking sector as a whole. However, these banks have not been privatised in bulk despite initial plans. This can be analysed in the context of the fact that public banks are often attributed progressive roles regarding emerging countries' economies such as counter-cyclical loaning activities (as opposed to private banks which contract their loanable capital at the bust times in a way which exacerbates crises' impacts) and providing sources for developmental goals (Marois and Gungen 2016). Indeed, the history of public banks in Turkey signifies their key functions in capitalist development.<sup>32</sup> Nevertheless, the dominance of state within the banking sector has been diminished gradually at the neoliberal period of the 1990s through privatisation in small-scale and selling of public share in private banks. However, at the same time, state was instrumentalising public banks to cover fiscal deficits through duty losses (as mentioned at the section 4.1). Hence, it was not easy for authorities to privatise these huge public institutions for several reasons:

“First, it took time for the public banks to recover from the 2001 crisis and to establish a more marketable operational structure for privatization... Second, there remains ongoing and unresolved intra-state debate on the functional roles of the state banks... Third, the technical aspects of bank privatization were not easily resolved. The large size of the public banks militates against one-off block sales as the purchaser needs to be larger than the public banks ... There are also questions for the competition authority, as any buyer of a public bank would become an immediate market marker... Fourth, the public

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<sup>31</sup>

Available

at:

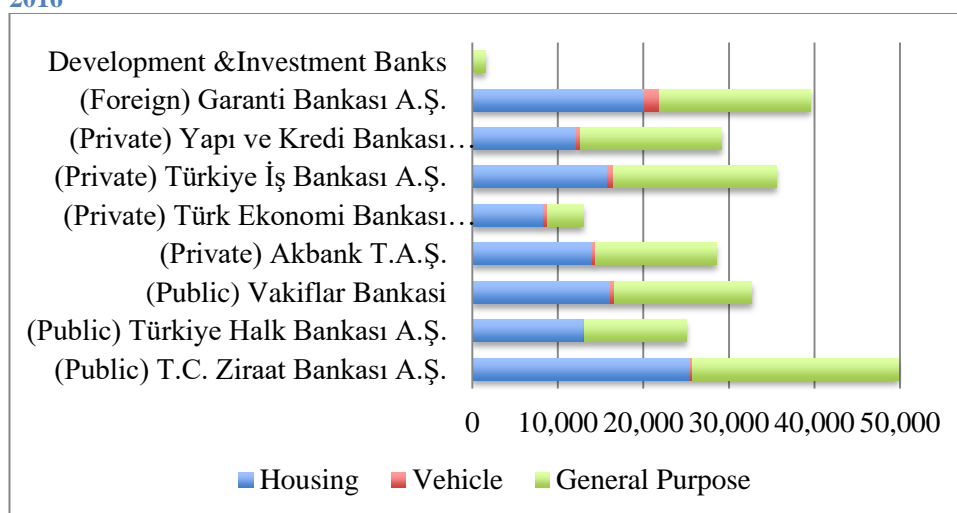
[https://www.tbb.org.tr/Content/Upload/istatistikraporlar/tumu/1050/Bankasecilmis\\_06-16-konsolide.zip](https://www.tbb.org.tr/Content/Upload/istatistikraporlar/tumu/1050/Bankasecilmis_06-16-konsolide.zip) Access date: 01.11.2016

<sup>32</sup> Ziraat Bank that is older than the republic was founded to finance the farmers/agricultural sector while Sümerbank targeted the industrial sector alongside many 'Halk banks' (People's banks) for addressing local necessities. In addition to state-owned deposit banks, there have been investment and development banks with state capital such as İller banks for municipalities which provided sources for financing infrastructure operations.

banks are becoming instrumental for emerging AKP plans to expand Islamic financial alternatives (dubbed ‘participation’ banks) in Turkey since the global financial crisis. For example, the AKP founded the **first publicly owned participation bank** as a subsidiary of Ziraat in 2015. Vakifbank and Halkbank are expected to follow suit in 2016. Fifth, empirical evidence also suggests that the public banks in Turkey may issue loans for political reasons, notably during election cycles, while at the same time playing an important role in mitigating economic shocks... (Marois and Gungen 2016, p.14)[Emphases added]

Thus, state-owned banks have remained as strong banking sector players even after the restructuring process. While acting so, public banks have not been divorced from the rest of the financialised banking system. As can be seen from the table below, state-owned deposit banks issued one-third of total consumer loans. Moreover, possibly due to their state’s long history regarding housing loans (Erol and Patek 2005), public banks exceeded both private and foreign capital banks in *housing loans*, in particular Ziraat Bank. While foreign banks pioneer the *vehicle loans*, private banks have become the leader in terms of *general purpose loans*.

**Figure 4.6 Consumer loans extended by banks with different capital structure, Million TL, June 2016**



Source: BAT<sup>33</sup>

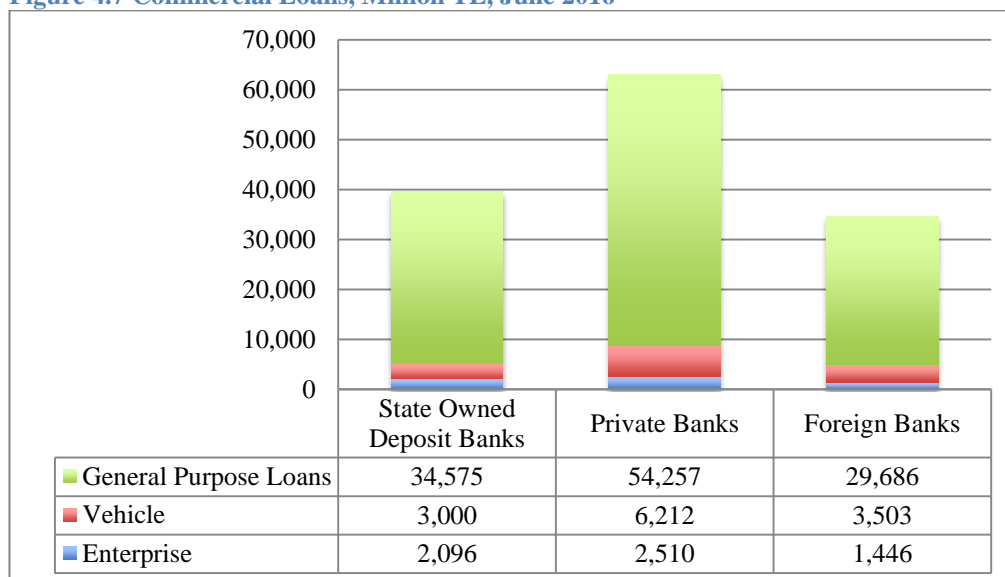
In more detail, amongst public banks Ziraat Bank pioneers individual lending while Vakifbank is the prominent bank in terms of commercial lending. It might be expected that public banks would focus on commercial lending (lending to

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Available at: [https://www.tbb.org.tr/Content/Upload/istatistikraporlar/tumu/1050/Bankasecilmis\\_06-16-konsolide.zip](https://www.tbb.org.tr/Content/Upload/istatistikraporlar/tumu/1050/Bankasecilmis_06-16-konsolide.zip) Access date: 01.11.2016.

corporates rather than individuals) rather than household lending. However, this is not the case as seen when comparing the two types of loans, with the private banks double the levels of public banks' commercial loans.

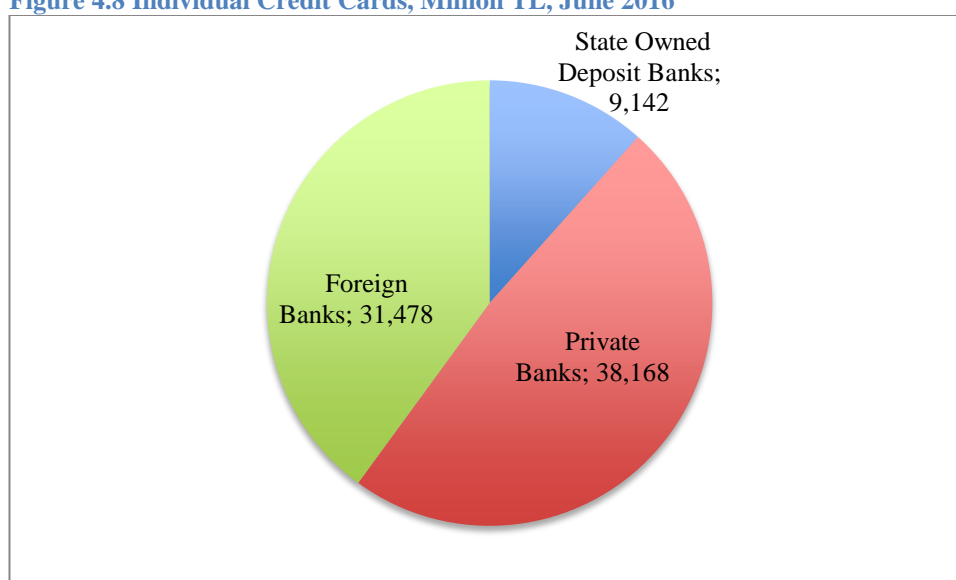
**Figure 4.7 Commercial Loans, Million TL, June 2016**



Source: BAT

This is not to say that public banks are financialised in exactly the same way as private and foreign banks. For instance, although state-owned deposit banks have been engaged with household lending, they do not show a presence in terms of individual credit card issuance.

**Figure 4.8 Individual Credit Cards, Million TL, June 2016**



Source: BAT

To sum up, due to country-specific features of the financial system, which comprises public banks as major actors of the banking system, the financialisation

process has affected banks with different capital structures in common ways by engaging with individual lending more than commercial lending. On the other hand, there have been certain differences between state-owned banks which fall behind the sector in terms of issuing individual credit cards or integrating with non-conventional banking activities such as derivative transactions.<sup>34</sup> This peculiarity of state-owned banks can be explained by their dual function in terms of both providing tools for government to implement neoliberal transformation policies and providing mechanisms to mitigate the negative affects of these transformations through developmental state banking roles (Marois and Gungen, 2016).

Another important development within the Turkish financial sector is the recent flourishing of Islamic banking. The participation banks are the frontiers of the Islamic-referenced banking activities. By 2014, there were four participation banks with 1001 domestic branches and 5.5% of total assets in the banking sector. These banks have been growing faster than the rest of the banking sector (Karakas, 2015).

“The emergence of these actors went hand in hand with the transformation of political Islam during this period, where politicians vehemently recruited pious businessmen into their support base via attractive incentives and investment benefit schemes. More recently, the AKP government – with strong roots in political Islam – incentivized the development of alternative banking instruments to facilitate capital accumulation while lowering associated risks. Especially after the 2008 crisis, the government closely works with major Islamic banks and assists them to attract domestic and international investors to maximize their profits. Proponents of Islamic banking suggest that the faith-based codes (Shari’a) on economic transactions such as mutual risk sharing, the ban on interest and contractual ambiguity serve as key barriers to protect ordinary individuals from the detrimental effects of liberal market capitalism.” (Apaydin, 2015, p. 2).

In a nutshell, the roots of faith-based finance in Turkey go back to the 1960s. In the 1980s, with the neoliberal era which was preceded by the military coup, the right-wing government initiated the Islamic banking legislation with the expectation of

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<sup>34</sup> State-owned banks integrate with derivate financial operations much less than other deposit banks. This is evident as state-owned banks’ income from derivate financial operations is TL4,268 million whereas private and foreign banks have gained TL21,500 and TL16,135 million, respectively, by June 2016 (BAT 2016).



attracting Gulf capital. The first Islamic banks, which were called finance houses, were established as joint ventures with Middle Eastern entrepreneurs with the motivation of channelling petrodollars into international finance through selling them as credits of their banks at the end of 1980s. Then, in the following years, Islamic banks and faith-based capital increased their significance in relation with the rise of political-Islam (Apaydin, 2015).

On the basis of this development, participation banking can be argued to be a peculiarity of the financialisation in Turkey. Participation banking consists of instruments called sukuk which commonly refer to the Islamic equivalent of bonds. The main difference between bonds and sukuk is that the former provides ownership of a debt whereas the latter gives a share of an asset to the investor (Islamic Development Bank).<sup>35</sup> The instruments based on ‘sukuk’ are not only used in the banking system, but also their influence extends to capital markets, more specifically pension funds’ investment (as shown in the sixth chapter in detail).

“In Muslim and non-Muslim countries, various organizations issue Sharī’ah-compliant participation certificates or securities, frequently referred to as Sukūk (plural of Sakk). According to the Islamic Financial Services Board (IFSB), Sukūk are defined as certificates with each sakk representing a proportional undivided ownership right in tangible assets or a pool of predominantly tangible assets, or a business venture (such as Mudārabah). These assets, which must be clearly identifiable, may be related to a specific project or investment activity in accordance with Sharī’ah rules and principles. Issuance of Sukūk, including the utilization of funds raised through such issuance, should not involve any elements of interest (Riba), excessive uncertainty (Gharar), or activities prohibited by Sharī’ah.” (IMF, BIS, & European Central Bank, 2015, p. 117)

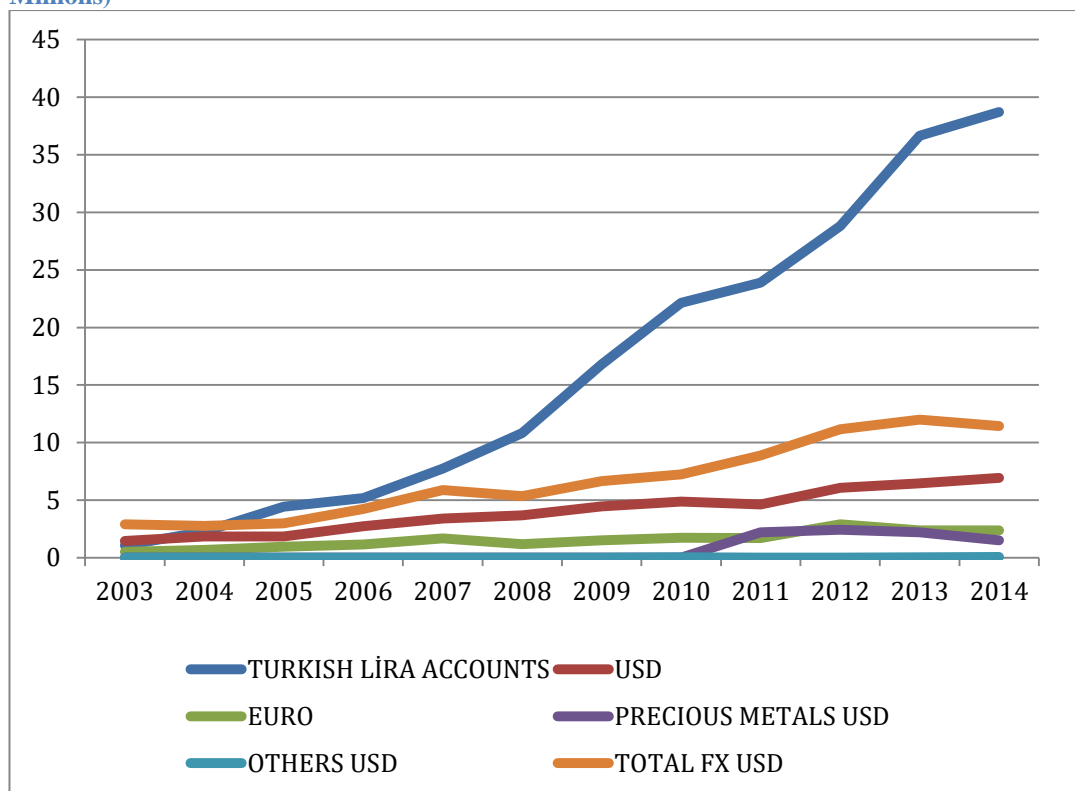
In this sense, participation banks collect savings and invest in industrial or commercial activities. Then, the bank shares the profit or loss with the owners of the savings. The interest-free principle refers to 1) not promising a pre-determined return; 2) not loaning in cash; but buying in once and selling in instalments. These

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<sup>35</sup> Islamic development bank. Access date: 10.03.2016 Available at: <http://thatswhy.isdb.org/irj/go/km/docs/documents/IDBDevelopments/Internet/thatswhy/en/sukuk/what-is-sukuk.html>

participation deposit accounts can be in TL as well as USD and Euro.<sup>36</sup> The rapid growth of interest-free deposit accounts in Turkey in the last ten years can be seen in the figure below.

**Figure 4.9 Breakdown of participation accounts in participation banks between 2003-2014 (in Millions)**



Source: Central Bank of Turkey. Available at: <http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+TR/TCMB+TR/Main+Menu/Istatistikler/Bankacilik+Verileri/Katilim+Bankalarindaki+Katilim+Fonlari> Access date 21.05.2015

Note: Since the Banking Regulation and Supervision Agency changed the deposit classification in 2011, the precious metals, which used to be classified under the ‘other’ label, are gathered under the relevant label. The decrease in the ‘other’ deposits is due to this change.

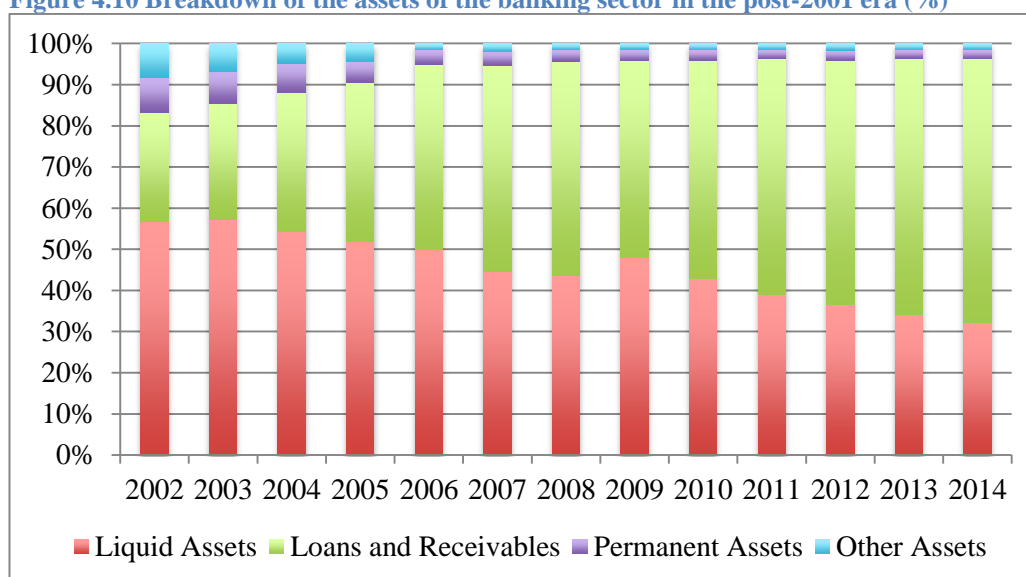
This is why the following quotation from Ernest Young’s ‘World Participation Banking Report’ points at the need for more reforms in this ‘big prize’ country.

<sup>36</sup> This definition is based on a booklet published by the Albarakaturk Participation bank which is the first participation bank established in Turkey. Available at: [http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0CCsQFjAB&url=http%3A%2F%2Fwww.albarakaturk.com.tr%2Fimages%2FPartDocuments%2FKatili m Bankaciligi Sistemi Nedir .pdf&ei=w-BcVbP\\_Acm17ga6tYD4Dg&usq=AFQjCNFu7GIaZ\\_aKXrrLdl1OJR07rjGRSA&sig2=CtiFBTopSGaHSOe36u\\_oUQ&bvm=bv.93756505,d.ZGU](http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0CCsQFjAB&url=http%3A%2F%2Fwww.albarakaturk.com.tr%2Fimages%2FPartDocuments%2FKatili m Bankaciligi Sistemi Nedir .pdf&ei=w-BcVbP_Acm17ga6tYD4Dg&usq=AFQjCNFu7GIaZ_aKXrrLdl1OJR07rjGRSA&sig2=CtiFBTopSGaHSOe36u_oUQ&bvm=bv.93756505,d.ZGU) Access date: 21.05.2015

“Given the size of its economy, Turkey is the big prize for the global Participation banking. However, meaningful growth in its national market share requires clarity in the regulatory requirement for Participation banking in Turkey. Regulatory reforms will encourage new market entrants, including some who might use technology-based market entry strategies, thereby enhancing the sophistication in the Turkish financial sector as a whole.” (Ernest Young, 2016, p. 58)

The rest of the banking system has experienced a functional shift in the post-2001 era since the share of government debt securities has decreased within the balance sheet. As mentioned before, the twin programme, which created a primary surplus of 5 per cent of GDP and fiscal measures taken after the crisis, has decreased the budget deficits with a reduction in public sector indebtedness. Therefore, public sector borrowing requirement has declined in a way that led banks to focus on credit activities while decreasing the share of securities in total assets (Bakir & Onis, 2010).

**Figure 4.10 Breakdown of the assets of the banking sector in the post-2001 era (%)**

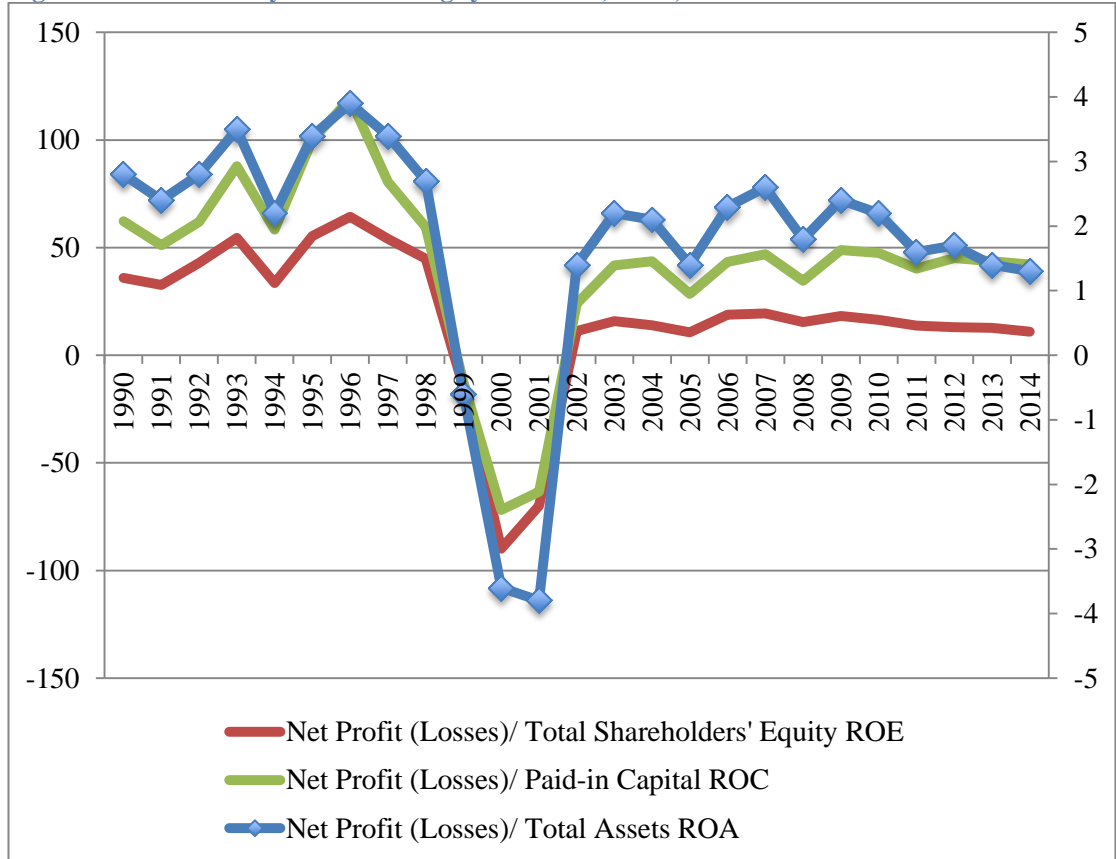


Source: (BAT, 2015a)

The decrease in government debt securities’ transactions has had a significant impact on the profitability level of the banking system because financing public debt was lucrative during the 1990s. The interest income from loans was TL7.8 million as opposed to interest income from securities which was TL5.1million in 1999. In other words, banks were making almost similar amounts of profits from securities transactions and extending loans. These rates have even intensified in 2002

when securities' returns were 2.5 times more profitable than interest income from loans. However, this trend changed until 2006 when loans became more profitable than securities. By 2014, the banking system's interest income from loans was recorded as TL104.7 million whereas interest income from securities was only TL26.4 million (BAT, 2015a).

**Figure 4.11 Profitability of the banking system ROE, ROC, ROA**



Source: (BAT, 2015a) Left axis: ROE, ROC; Right axis: ROA

In other words, banks started to run 'traditional' banking operations which decreased their profitability relatively. At the same time, in order to increase the sources for loans, banks have engaged in derivative transactions. In 2015, the banking sector bought TL793 billion in derivatives and sold TL791 billions. However, this should not deceive us about the motivation involved: banks do not engage in derivative activities in order to make profits. This is clear from income statements of the banks which show that banks' gained TL164 million interest-income whereas non-interest activities caused banks to lose TL28 billion (BRSA, 2015). Then, why do they buy and sell derivatives? According to Aybar and Dogru (Aybar & Dogru, 2013), the Turkish banks run derivative transactions in order to create cheap currency through currency swaps. Indeed, when we check the

components of the derivative transactions, we see that swaps constitute 45% of the total derivative transactions (BAT, 2015a). In other words, the Turkish banks increasingly appeal to derivative transactions in order to exchange foreign exchange deposits for cheap domestic currency. Within the **off-balance-sheet items** of the banking sector at the end of 2015, outstanding obligations reached the level of TL2.082 billion whereas 1.584 of this consisted of financial derivatives. Derivatives within the banking system as off-balance sheet items have grown 29.4% since the previous year.

**Table 4.8 Off-balance sheet items of the banking sector in Turkey 2006-2014 (in Thousands)**

	Guarantees and Warranties	Commitments	Derivative Financial Instruments
<b>2006</b>	77,019,710	81,493,635	106,125,271
<b>2007</b>	83,958,432	125,663,247	157,916,586
<b>2008</b>	105,976,500	149,749,550	192,575,682
<b>2009</b>	114,382,093	187,299,889	246,194,648
<b>2010</b>	142,070,342	361,507,973	384,521,033
<b>2011</b>	192,376,434	840,570,630	565,823,122
<b>2012</b>	214,395,960	1,066,803,109	<b>609,229,676</b>
<b>2013</b>	300,883,846	525,801,756	<b>1,066,840,798</b>
<b>2014</b>	350,127,644	481,423,733	<b>1,207,129,674</b>

Source: (BAT, 2015a)

Finally, when we look at the most recent picture, we see that the Turkish banking sector's assets over GDP ratio was 1.14 by the end of 2014 (BRSA, 2015). This share is close to the level of developing countries (BAT, 2015a).

**Table 4.9 Balance sheet of the banking sector in Turkey (as of 31.12.2015 billion TL)**

<b>Assets</b>		<b>Liabilities</b>	
Cash	151	Deposits	1,245
Required reserves	206	Loans to other banks	361
Non-performing loans	48	Issued securities	98
Securities	330	Repo	157
Loans	1,485	Equity	262
Other assets	186	Other liabilities	234
Total assets	2,357	Total liabilities	2,357

(BRSA, 2015, p. 2)

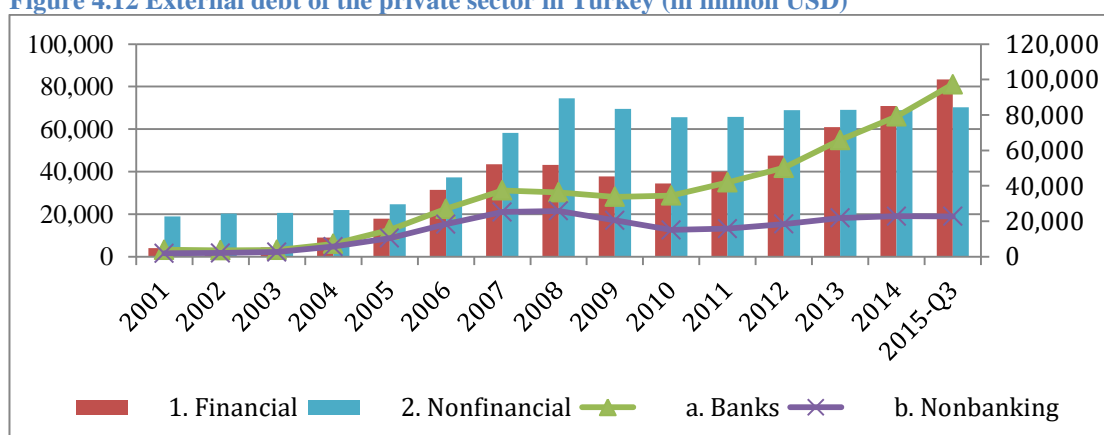
To sum up, the banking system has been restructured as the main component of the financial sector in a way that fits with main line of the reform process of the

Turkish economy. The changing distribution of balance sheet items from government debt securities to loans signify an alteration in the relations between banks and state, the non-financial sector and households. However, this is not a one-way relation where non-financial sector and households remain passive. Rather, these parties have also repositioned themselves according to the changing financial environment. In this regard, we trace the presence of the phenomenon that is known as financialisation of the non-financial sector.

#### 4.3.2. Non-financial sector

Financialisation of the non-financial sector can be understood in terms of financial institutions' changing attitude towards non-financial firms as well as non-financial firm's increasing involvement with financial activities. To start with, the most significant change within the financial relations of the non-financial sector in Turkey in the post-2001 era has been the increasing external debt of the private sector. As mentioned before, in the 1990s, the majority of external debt was with the public sector. However, with the shift in economic policies, public sector debt decreased and the debt burden shifted to the private sector (Ergunes, 2012). As mentioned before, during the 1990s, the average public sector borrowing requirement's share to GDP was recorded as 6.9%. However, in the 2000s, this average decreased to 2.9% between 2000 and 2013 (Ministry of Development, 2015a). Thus, public sector indebtedness has decreased significantly while private sector has become increasingly indebted.

**Figure 4.12 External debt of the private sector in Turkey (in million USD)**

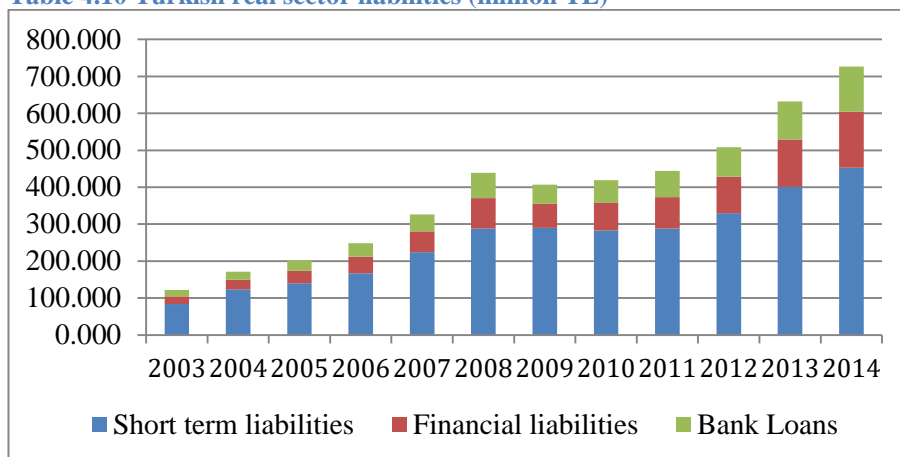


Source: (Ministry of Development, 2016c) Left axis Banks and Non-banking sector, Right axis: Financial and Non-financial sector.

The graph above tells us a lot about the characteristic of the private sector indebtedness. First of all, it is obvious that there is a changing allocation of

indebtedness between financial and non-financial sectors. Until 2013, non-financial sector borrowed the majority of the foreign loans with a peak in 2008 of USD90 billion. The financial sector's debt amounted USD50 billion by then. However, the financial sector has accelerated borrowing from outside since 2010 and exceeded the non-financial sector debt with USD100 billion in the third quarter of 2015. In other words, according to the most recent data, the financial sector in Turkey has become more indebted than the non-financial sector. Moreover, when we look at the breakdown of financial sector debt, we see that banks have always constituted the majority of external debt but the difference between banks and non-banking institutions has increased since 2010. By the third quarter of 2015, banks were responsible for USD80 billion of the total external debt of the financial sector. This is to say that, banks have enjoyed the available external debt to finance the loans that they have extended.

In order to understand the position of the non-financial sector, on the other hand, we need to look at sectoral balance sheets presented by the Central Bank. According to the balance sheet of the both manufacturing and non-manufacturing real sector firms, the short-term liabilities have been high with an average of 40% of their total liabilities since 2001. The rest of the liabilities are again around 40% equity and only 20% long-term liabilities. What is more interesting here is the changing dominance of financial liabilities as opposed to bank loans. There is a trend of financial liabilities' increasing weight within total liabilities. Therefore, it can be argued that the Turkish private sector, while concentrating increasingly on foreign markets, has increased its borrowings from non-bank resources (CBRT, 2016). This data do not tell us which real sector firms mostly engage with financial operations and for what purposes the real sector firms use these loans. Therefore, we need a closer investigation of the real sector in Turkey. In this regard, we can start from differentiating between manufacturing and non-manufacturing sectors of the real economy in Turkey.

**Table 4.10 Turkish real sector liabilities (million TL)**

(CBRT, 2016)

The manufacturing sector in Turkey mostly consists of large-scale companies with more than 500 employees (58.2% of the manufacturing sector). The share of mid-scale entities is 38.7% whereas only 3% of all 3803 companies in manufacturing sector are small in scale.<sup>37</sup> This indicates that the manufacturing sector is mainly comprised of big corporations with the majority of the manufacturing sector formed as joint stock companies (2259) while the number of limited companies is 1535 and only 1 holding company performs in this sector (CBRT, 2016).

**Table 4.11 Loans of the manufacturing firms according to currency and duration (In Millions TL by the end of 2014)**

	Short term	Long term	Total
<b>Cash loans</b>	<b>49,709</b>	<b>74,265</b>	<b>123,975</b>
Domestic Currency	26,321	21,277	47,599
Foreign Currency	23,387	52,988	76,375
<b>Non-cash loans</b>	<b>32,709</b>	<b>20,537</b>	<b>53,246</b>
Domestic Currency	10,197	4,828	15,025
Foreign Currency	22,512	15,709	38,221
<b>Total</b>	<b>85,086</b>	<b>97,801</b>	<b>182,887</b>

(CBRT, 2016)

The liabilities of the manufacturing sector at the end of 2014 gives a picture of its borrowing structure. As can be seen from the table above, the dominance of the foreign currency loans in total cash loans is clear with their value of 76 million out of

<sup>37</sup> The criteria for the SMEs according to employee number are as follow: less than 10 employees refer to micro firms, those have between 11 and 50 employees are small-firms and up to 250 employees are named as mid-scale. For more detail, see the link for the definition of the SMEs in Turkish. Available at: <http://www.kobi.org.tr/index.php/tanimi/layout> Access date: 10.03.2016.



123 billion Turkish Lira. Moreover, the cash loans used by the manufacturing sector in 2014 mostly consist of long-term loans in foreign currency. In terms of short-term cash loans, domestic and foreign currencies have similar weights. However, in long-term cash loans, foreign currency is 2.5 times more than domestic. In non-cash loans of the sector, the foreign currency has an absolute weight in both long- and short-term borrowings (CBRT, 2016). These data indicate that when it comes to cash borrowings for the short run, domestic or foreign currency does not make a difference for the manufacturing firms in Turkey. However, for the long-term cash borrowings, foreign currency is the first choice. On the other hand, for non-cash loans, which are guarantee letters from banks, foreign banks are mostly chosen for the short term.

To recap, the trend in terms of non-financial corporations' relation to financial activities has several features: first, non-financial companies took advantage of the strong Turkish Lira and low interest rates in the international markets and started to borrow from foreign sources which can be observed in the increasing external debt of the private sector. Second, the non-financial sector's loan maturity date was significantly short as is evident in the weight of short-term loans within total liabilities. Finally, the Turkish real sector firms became engaged with foreign banks in particular for the purpose of access to non-cash loans.

Now the question is what was the impact of this development on production levels in Turkey? There are two opposing views on this issue. One is comparatively optimistic and claims that the Turkish manufacturing companies have used external funds to invest in fixed capital investment. This is evident, accordingly, in the rising fixed capital formation and increasing labour productivity due to application of higher technologies. In this regard, Ergunes' (Ergunes, 2012) claim is that industrial production in Turkey has shifted more from consumer goods to intermediate goods with potential for a higher level of productivity. However, when we check the data on different capacity utilisation rates within the main industry groupings from the table below, we do not see clear evidence for rising capacity within intermediate and investment goods. This is not to deny that Turkey has moved to a higher level of development within industrial technology and this might be associated with the lucrative profits from financial activities of the 1990s in particular.

**Table 4.12 Capacity utilisation rates within the Turkish industry by main industry groupings (weighted average %)**

	Total Industry	Durable Consumer Goods	Non-durable Consumer Goods	Consumer Goods	Intermediate Goods	Investment Goods
2007	80.2	73.9	74.6	74.4	81.2	82.3
2008	76.7	67.9	72.7	71.8	77.1	79.6
2009	65.2	66.1	68.7	68.2	67.7	57.6
2010	72.6	70.7	71.9	71.7	75.9	68.8
2011	75.4	74.5	72.1	72.5	77.7	74.9
2012	74.2	73.6	72.9	73	76.1	72.3
2013	74.6	72.4	72.9	72.8	76.3	74.3
2014	74.4	72.2	73.1	72.9	76.3	72.7
2015	74.7	72.6	72.1	72.2	75.8	75.7

Source: (Ministry of Development, 2016b)

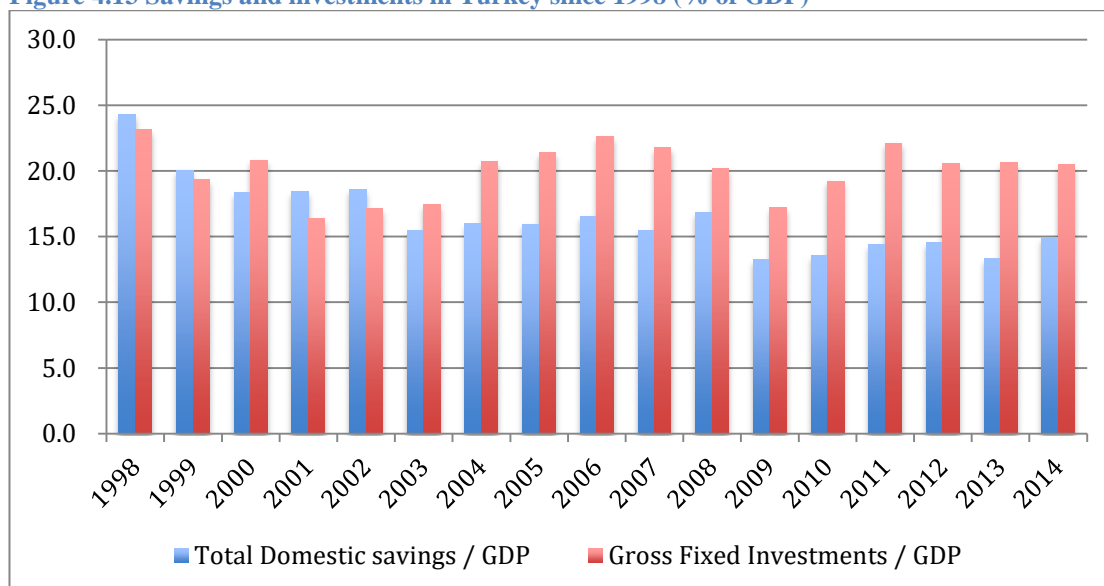
Nevertheless, it is hard to argue that a similar effect of the access to external funds has been evident in the era of financialisation.

The other view argues that the Turkish manufacturing sector has mostly used these funds to hedge against fluctuations, volatility and instability of the economy. Therefore, the fixed capital investments have not shown significant increase despite increasing availability and accessibility of external funds. According to Demir (Demir, 2009c, 2009a, 2009b) high real interest rates and volatility originating from capital flows pushes the Turkish non-financial firms to increase the share of liquid assets within their portfolios at the expense of fixed capital investments which decrease in proportion. This shift can be interpreted as a move away from industrialisation while the share of manufacturing value added in GDP kept decreasing in the 2000s as well as fixed capital formation (Akkemik & Ozen, 2014; Demir, 2009c).<sup>38</sup>

<sup>38</sup> Demir (2009a) investigates firm profitability for publicly traded manufacturing firms in Turkey between 1993 and 2003 in order to reveal the reasons firm engage in financial activities. He draws the conclusion that increasing availability and accessibility of investment opportunities in financial markets help real sector firm accrue high profits. In the context of a developing country, Turkey, where uncertainty and volatility of capital flows have negative impact on firms' profitability, manufacturing firms have preferred to increase the share of financial investments in total assets in order to sustain their profit margins. In particular during the 1990s, large financial gains were present due to government debt financing policy (as mentioned in the previous section). Therefore, although with a decrease in the 2000s, the share of financial returns in the form of interest derived from government debt securities, have been significant within the balance sheets of manufacturing firms.

Indeed, when we check the fixed capital investment data, we see that despite the decrease in total savings, fixed investment has not shown a considerable increase. As clear from the figure 4.13, the share of fixed investment within GDP has decreased compared to the percentage in 1998. Even the peak point of the 2000s (22.6% in 2006) is lower then the level in 1998 (23.1%). Domestic savings' share within GDP has decreased by four points since 1998 and is recorded as 20.5% in 2014.

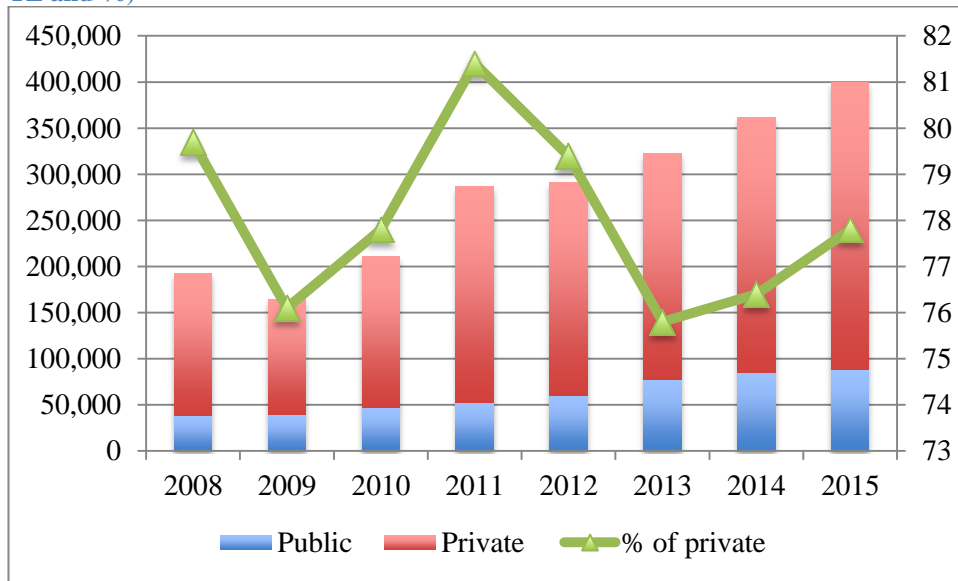
**Figure 4.13 Savings and investments in Turkey since 1998 (% of GDP)**



Source: (Ministry of Development, 2016a)

When we look closer at more recent data (figure 4.14), we see that the fixed capital investment has shown some improvement since 2009 but the share of private sector within total fixed investments has been extremely volatile. The dramatic drops in 2009 and 2013 can be associated with cyclical circumstances while a sudden rise is recorded in 2011. Therefore, it can be argued that the private sector in Turkey invests in fixed capital on the basis of the economic circumstances, rather than according to the source of the funds.

**Figure 4.14 Shares of public and private sectors within gross fixed capital investments (million TL and %)**

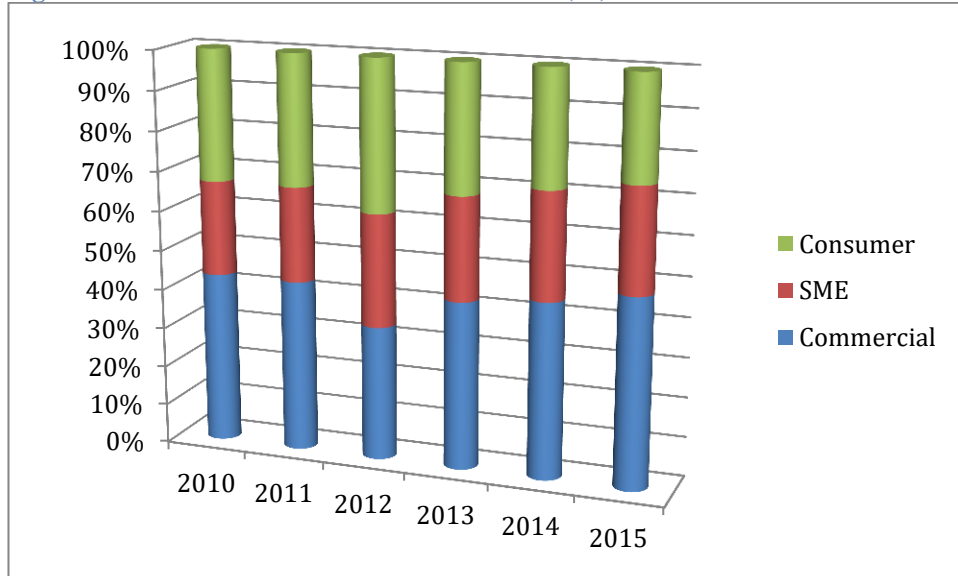


Source: (Ministry of Development, 2016a) Left axis: Private and Public sectors' gross fixed investments in million TL. Right axis: Percentage of private sector in gross fixed investments.

The evidence provided and the studies discussed mostly concentrate on big corporations in the country. However, it is crystal clear that the majority of the real sector in Turkey, not least the non-manufacturing firms, is comprised of small and medium enterprises (SMEs). This is an important point to note because the SMEs have a significantly different relation with banks as well as foreign funds. As data on these companies are not readily available, let us look at them from the banks' side in order to understand financial relations between them and non-manufacturing SMEs.

Loans are classified in the Turkish banking sector under three main titles: corporate/commercial loans; loans to small and medium Enterprises (SMEs); and consumer loans. The first type of loans is given to big corporate firms for commercial purposes. The second type of loans is divided into three subsections, respectively, micro, small and medium enterprises, whereas the consumer loans are given to individuals for consumption purposes. As can be seen from the figure below, commercial loans have a dominant share within total loans of the banking system.

Figure 4.15 Breakdown of bank loans 2010-2015 (%)



Source: (BRSA, 2015)

The total amount of credit given in 2015 is TL1,485 billion and TL711 billion is extended as commercial credit while the amount of consumer and SME loans are, respectively, 385 and 389 billion Turkish Liras (BRSA, 2015). Accordingly, commercial loans have increased their share within the total outstanding bank loans since 2012 reaching 48% by 2015. Interestingly, over the same period, the share of consumer loans has decreased. This signifies that banks have concentrated on commercial loans while relatively decreasing consumer loans since 2012. By 2015, the shares of loans to SMEs and consumer loans are the same (each 26%). However, even with the fluctuations in the shares of commercial loans and consumer loans, the share of SMEs has been stable within total bank loans. Middle-scale firms obtained TL157 billion, small firms had TL133 billion and micro scale firms only had TL99 billion of total bank loans given to SMEs. This is important to note because in Turkey the SME sector constitutes 99.9% of all enterprises, 76% of employment, 53% of wage and salary payments, 53.3% of added value, and 53.7% of gross investment in material goods (TURKSTAT).<sup>39</sup> This means that the SME sector has a different financing method than bank loans, however much the government has tried to increase their involvement. Ozlu and Yalcin (2010) explain that small firms mainly rely on trade credit rather than bank loans.<sup>40</sup> Trade credit refers to the credit

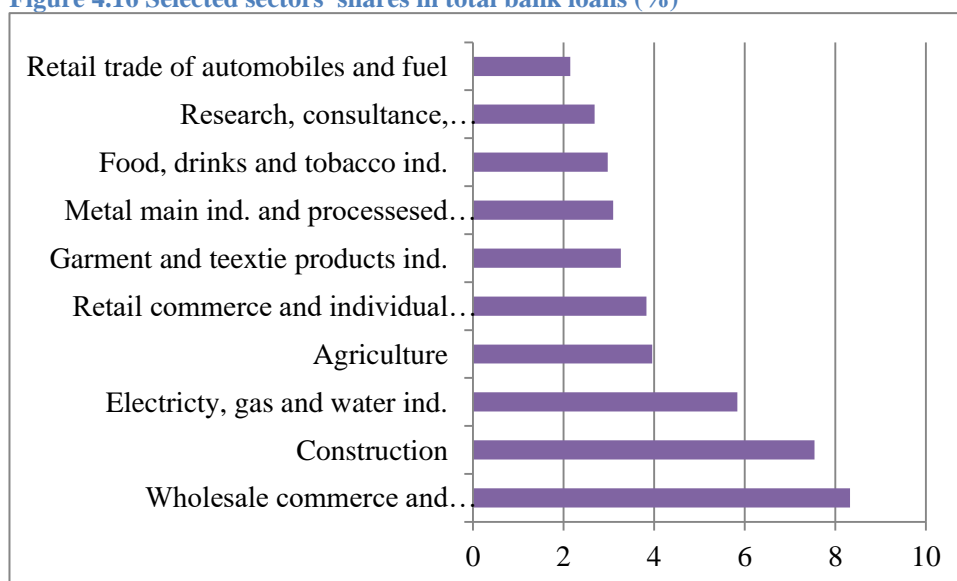
<sup>39</sup> <http://www.tuik.gov.tr/PreHaberBultenleri.do?id=15881>

<sup>40</sup> "Contrary to many other countries, trade credits constitute a large portion of corporate sector's external finance in Turkey, which should have implications for monetary policymaking. In general, small firms are more likely to rely on trade credits especially during the recessions while large firms tend to use more bank loans. In other words, large firms are financially less constrained and have

relations across suppliers and they are mostly used during tight periods. Moreover, according to Karakas (2015), an important reason for banks to choose individuals rather than firms for lending is that it is easier for banks to identify/detect individuals' financial conditions. On the other hand, firms require a detailed investigation and calculation period before granting loans. In this regard, SMEs are costly for banks in taking a long time to process loans. For this reason, some of the small firm owners apply for individual loans rather than commercial loans even though they need and use the credit for their business (Karakas, 2015).

Moreover, not all non-manufacturing sector's branches have similar relations with banks. Rather, there are some economic activities which have benefited from the expansion of bank loans more than the others. For instance, the construction sector is one of the lucky ones with a share of 7.54% of bank loans given to this sector in 2015. The construction sector has been growing rapidly since 2002 and it consists of a wide range of activities besides housing, such as construction of new highways, dams, power plants, etc.

**Figure 4.16 Selected sectors' shares in total bank loans (%)**



Source: (BRSA, 2015)

One of the main parts of the construction sector in Turkey has been dwelling construction. The absence of social housing in Turkey created severe need for supply

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access to bank finance during tight periods and behave as financially intermediary by extending trade credits to their financially constrained customers mainly small firms.” (Ozlu & Yalcin, 2010, p. 15)

of affordable dwellings. During the period of the AKP government, therefore, construction of dwellings has expanded dramatically under the control of the TOKI (abbreviation stands for Toplu Konut Idaresi Baskanligi, the Housing Development Administration in English). As can be seen from the table 4.13, demand and supply sides of the housing sector have expanded significantly with financialisation in Turkey. By 2013, the number of newly-built dwelling units, i.e. supply, has reached five times that of 2002. In a similar vein, demand increased considerably and the number of newly-built dwelling units was recorded at almost 700,000 by the end of 2013. The rapid growth of the sector has attracted both domestic and foreign investors, such as Gulf-based property investors (Bedirhanoglu et al., 2013). This development also underpinned the expansion of consumer loans for housing as investigated next alongside other forms of household credit.

**Table 4.13 Demand for, and supply of, housing since 2002**

	Supply: Building permits	Demand: Occupancy Permits	Supply: Building permits	Demand: Occupancy Permits
Year	Floor Area (thousand m <sup>2</sup> )	Floor Area (thousand m <sup>2</sup> )	Number of Dwelling Unit	Number of Dwelling Unit
2002	36,187	31,676	161,920	161,491
2003	45,516	30,936	202,854	162,908
2004	69,719	31,028	330,446	164,994
2005	106,424	50,324	546,618	249,816
2006	122,909	57,207	600,387	295,389
2007	125,067	63,403	584,955	326,484
2008	103,846	70,957	503,565	357,286
2009	100,726	94,567	518,475	469,981
2010	176,429	85,281	907,451	429,755
2011	123,621	105,650	650,127	556,769
2012	158,749	106,950	771,878	556,331
2013	175,807	138,495	839,630	726,339
2014	220,264	151,465	1,030,684	770,308
2015	184,050	141,441	870,515	724,331

Source: TURKSTAT Construction and Housing Statistics

#### *4.3.3. Households*

There are several factors addressing the rise consumer lending by banks in the Turkey in the post-2001 era. As mentioned before, the banking system restructuring increased the presence of foreign banks. These already had the experience, specialised knowledge and focus on household loans. Thus, they carried their practices from other countries to Turkey in a way that pushed competition in consumer lending. Moreover, the bonanza of capital inflows created alternative financing methods for non-financial corporations which relatively decreased their dependence on banks. Therefore, banks compensated for this trend by increasing lending to households. Further, banks also benefited from the external funding alternatives which made it easier to raise funds for lending to households. Finally, and presumably the most peculiar development in Turkey, was the changing relations of banks with public sector which was the main profit source of the 1990s as mentioned before. In other words, the decline of the public deficit through macroeconomic policies (the twin-targeting regime) has paved the way for banks' increasing focus on lending to households (Karacimen, 2014).

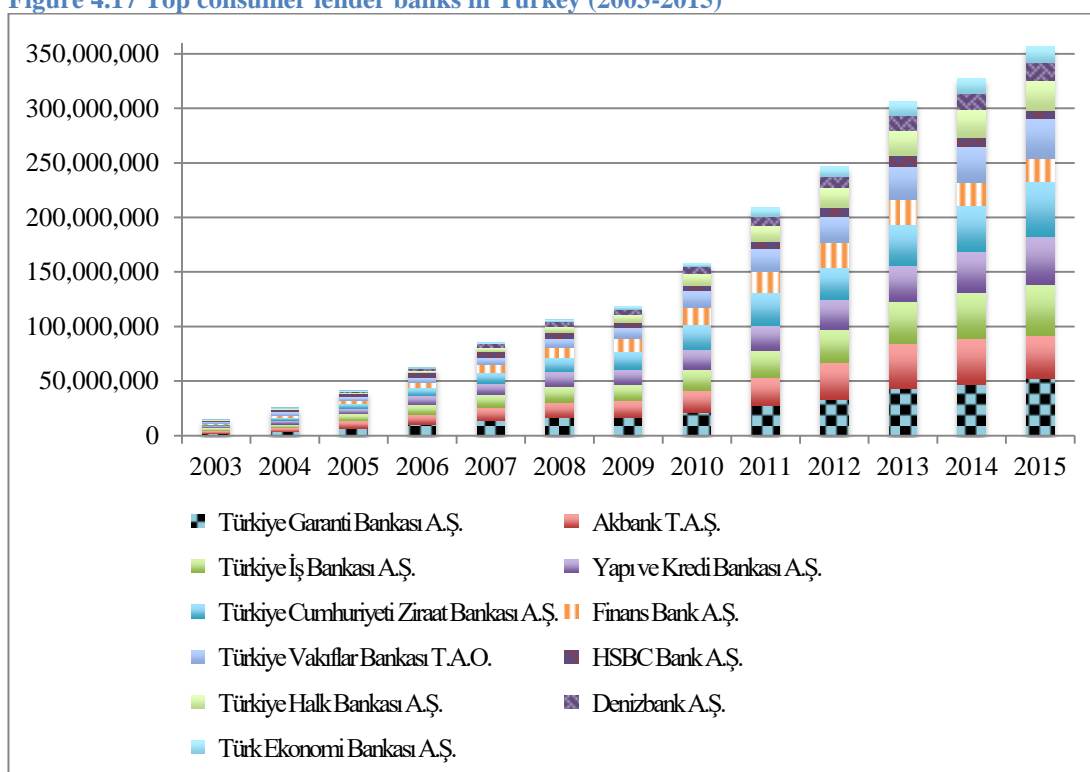
It is important to note that foreign banks have not introduced consumer lending not only because they did not have enough retail networks that would be necessary for this kind of breakthrough, but also because consumer lending, in the form of housing loans in particular, was already popular in Turkey from the late 1990s. However, what is meant here is that foreign banks altered the focus of the banking sector by showing how lucrative it was to lend to individuals on the basis of their previous experiences in other countries.

“Foreign bank entry was stimulated by: legislation implemented to upgrade the regulatory structure to the standards of the European Union; the opportunity that the crisis created for foreigners to take over Turkish banks cheaply; and the willingness of domestic capitalists to have foreign partners so as to more easily meet new regulations. According to statistics from the BAT, the share of foreign banks in total assets of the banking sector increased from 3.3 per cent in 2002 to 16.4 per cent in 2011. **Having already been specialized in lending to households in their home countries, foreign banks were motivated to take advantage of a rapidly growing consumer credit market in Turkey.** NBG, Dexia, HSBC and Citibank were among those banks which pursued an aggressive strategy to take part in the growing



Turkish consumer credit market, mainly by mergers and acquisitions. As a matter of fact, the average shares of consumer loans in total loans of Citibank, Finansbank (NBG) and HSBC were 38.5, 49.0 and 54.1 per cent, respectively, between 2004 and 2011 (BAT statistics). (Karacimen, 2014, p. 169)[Emphases added]

**Figure 4.17 Top consumer lender banks in Turkey (2003-2015)**



Source: (BAT, 2016). Available at:

<https://www.tbb.org.tr/Content/Upload/istatistikraporlar/tumu/1002/Bankasecilmis-09-15-konsolide.zip>

The eleven top consumer loan lender banks are shown above. These banks extend around 90% of total consumer loans in Turkey. HSBC, Denizbank and Finansbank are foreign banks which have minor significance in terms of amount of consumer lending. Therefore, it can be argued that foreign banks pioneered household lending in at most a qualitative way rather than showing quantitative significance. Finally, a recent development has abruptly increased the significance of foreign banks' in household lending since one of the major private banks, Garanti Bank, has been bought by a foreign company in 2014.

As a result of these developments, consumer loans' share has increased in total loans and receivables of the banking sector from 5.8% in 2002 to 14.9% in 2003 and 20.6% in 2004. After 2005, as can be seen from the table 4.14, the share of

consumer loans within total loans and receivables of the banking system has varied between 29% and 33%. Thus, the consumer loans of TL251,582 million occupied 28.5% of the total loans and receivables in 2014 (BAT, 2016b).

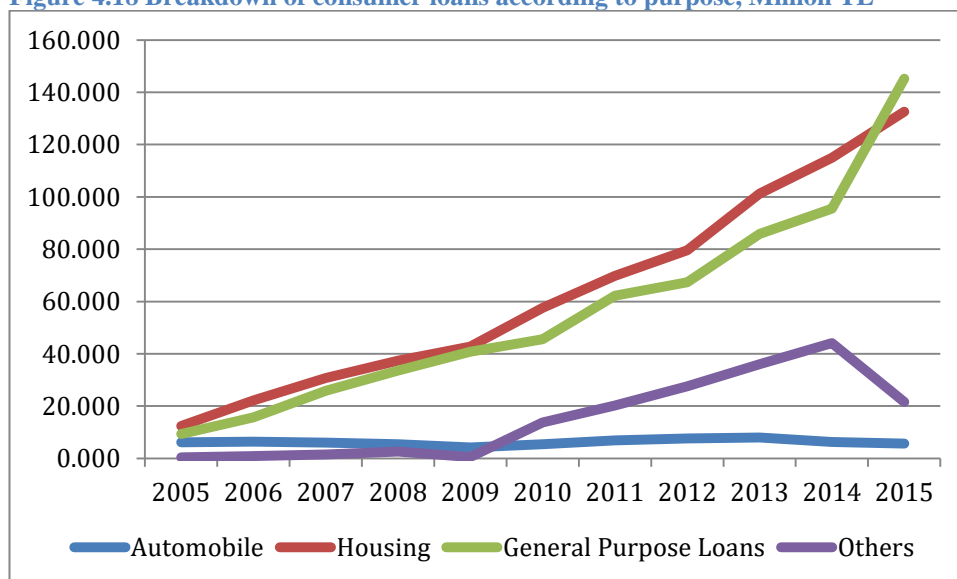
**Table 4.14 Volume of consumer loans and their share within total loans and receivables of the banking system (million TL and %)**

Year	Volume of consumer loans (million TL)	Share of consumer loans in total loans and receivables of banking sector (%)
2005	<b>28,265</b>	29.8
2006	<b>45,175</b>	31.2
2007	<b>64,002</b>	33.3
2008	<b>78,844</b>	31.7
2009	<b>88,320</b>	33.7
2010	<b>122,210</b>	33.3
2011	<b>159,224</b>	33.0
2012	<b>182,124</b>	33.7
2013	<b>231,181</b>	31.6
2014	<b>251,582</b>	28.5
2015	<b>283,562</b>	Not available

Source: (BAT, 2014b)

Now the question is for what purposes do the consumers in Turkey borrow from banks? Consumer loans are divided into three subsections: automobiles, housing, and general-purpose loans (loans for durable and semi-durable consumer goods, education, marriage and health purposes). Further, those not otherwise classified are designated ‘other consumer loans’.

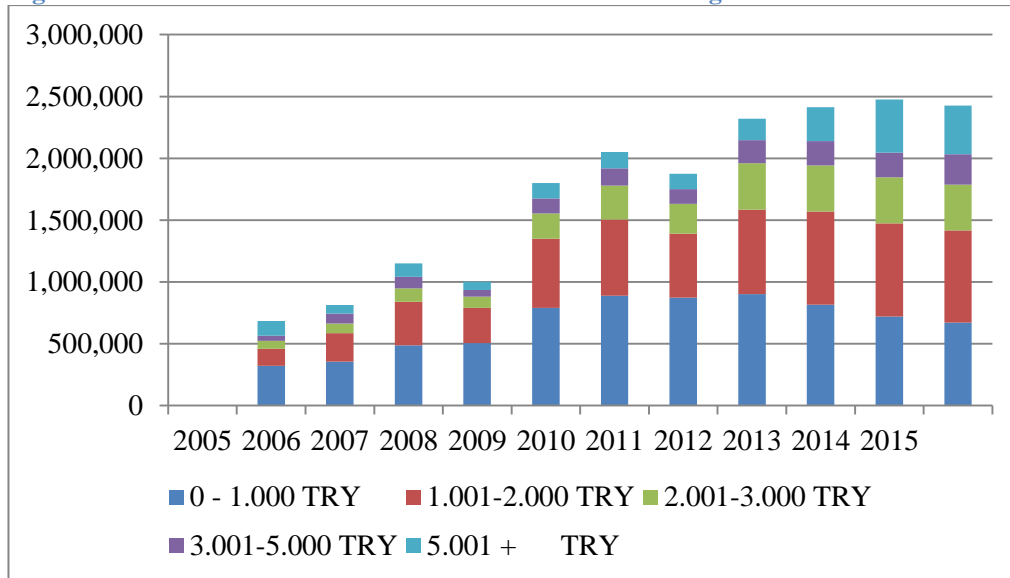
**Figure 4.18 Breakdown of consumer loans according to purpose, Million TL**



Source: (BAT, 2016b)

Amongst all kinds of consumer loans, the housing loans have shown the most significant development by growing from TL12,389 million in 2005 to TL132,620 million in 2015. With the fall of inflation and mortgage interest rates, banks have become the primary source of mortgages.<sup>41</sup> Research on the subject suggests that according to the Turkish population the best excuse for borrowing a bank loan is to buy a new house (Karacimen, 2013). In a similar vein, general purpose loans which amounted TL9,372 million in 2005, reached the level of TL145,248 million in 2015 and exceeded the level of housing loans for the first time in Turkish banking history. The loans which cannot be classified under any of these loan types, i.e. others, have increased rapidly to the level of a TL44,136 million peak in 2014 and then decreased to TL21,517 million in 2015. On the other hand, the volume of automobile loans has shown little change while remaining around its initial value of TL6 million over ten years (BAT, 2016b).

**Figure 4.19 Breakdown of consumer loan borrowers according to their income level**



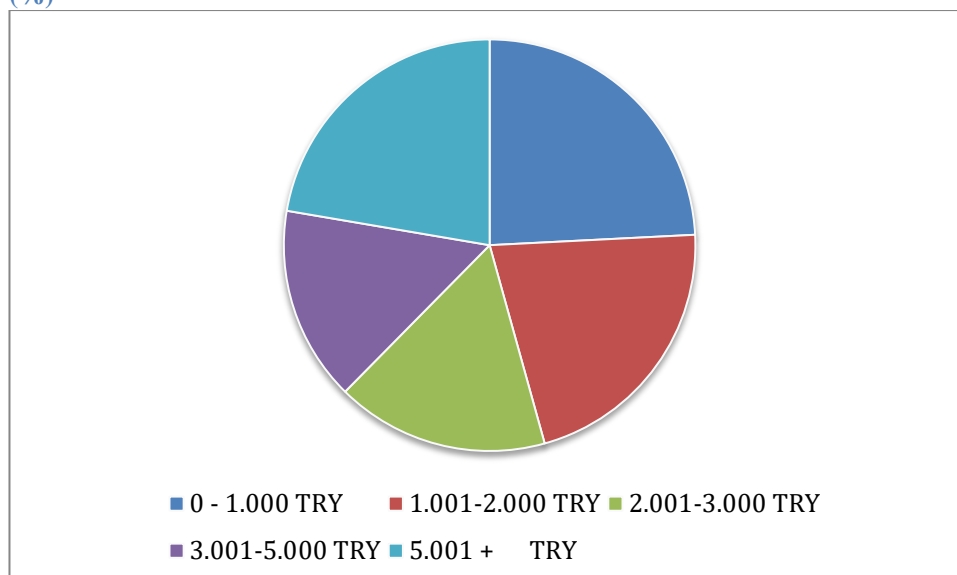
Source: (BAT, 2016b)

When we break down the profile of borrowers according to their income groups, we see that almost half of the borrowers have income between 0 and TL2000 per month (figure 4.19). This means that mostly low-income groups borrow from banks in order to sustain their consumption. What is even more interesting is that the amounts

<sup>41</sup> “Currently, annual mortgage interest rates of commercial banks are about twice as high as the rates applied by the HDA. There is not any subsidy to the households for the interest payment of the mortgage loans if they use the house for their own usage. However, for the houses purchased to earn rental income, interest paid for the mortgage loan can be deducted from that part of the rent that is subject to income tax.” (Bedirhanoglu et al. 2013, 310)

extended for these income groups also constitute almost half of the total outstanding loans (figure 4.13). According to data, 45% of total loans are lent to borrowers with income level between 0-TL2000 (BAT, 2016b).

**Figure 4.20 Extended consumer loans in September 2015 according to borrowers' income levels (%)**



Source: (BAT, 2016b)

The indebtedness amongst low-income groups can be explained in light of labour market policies of low wages, insecurity and flexibility (Karacimen, 2014, 2015).<sup>42</sup> As participation rates in the labour force, particularly for women, have remained chronically low, decline of real wage income has been a worsening factor in terms of the consequences of employment outcomes (Yeldan, 2010b). Despite high unemployment rates, consumption norms have been sustained through indebtedness of households, thus through consumer loans. Although some part of the consumption increase can be explained by cheap imports (as mentioned while foreign exchange rates were favourable) the rest of the consumption increase is associated with bank loans (Yeldan, 2006). In other words, the working class has sustained consumption through bank loans (Akçay & Gungen, 2014). Therefore, the

<sup>42</sup> An important example of this process can be seen in the tragic mine accident that occurred in Soma (Manisa, Turkey) which resulted in 301 miners losing their lives on the 13<sup>th</sup> May 2014. The Bogazici University Research Group on Soma published a fieldwork report after the incident. According to the report, 95% of the miners who lost their lives had consumer loans. Moreover, the interviewees frequently referred to their indebtedness in order to explain the reason for working in the mines although they were aware of inadequate workplace safety and risks originating from it. For more detail see the link of the report in Turkish. Available at: [https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=8&ved=0ahUKEwi6wJPurbjLAhWCZQ8KHddQBTQOFghUMAc&url=http%3A%2F%2Fwww.busomarastirmagrubu.boun.edu.tr%2Fsites%2Fdefault%2Ffiles%2Fcalismaraporu.pdf&usg=AFQjCNFpgdtGRceKJnF\\_CMQeWozYwuiN9g&bvm=bv.116573086.d.ZWU](https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=8&ved=0ahUKEwi6wJPurbjLAhWCZQ8KHddQBTQOFghUMAc&url=http%3A%2F%2Fwww.busomarastirmagrubu.boun.edu.tr%2Fsites%2Fdefault%2Ffiles%2Fcalismaraporu.pdf&usg=AFQjCNFpgdtGRceKJnF_CMQeWozYwuiN9g&bvm=bv.116573086.d.ZWU) Access date: 11.03.2016

number of consumer loan borrowers has quadrupled since 2005 when the number was around 5 million and is recorded as nearly twenty million in 2015 (BAT, 2016b).

Indebtedness becomes an economic problem in the case of default. That is why non-performing loans have increased rapidly such that regulations had to be introduced for restricting instalments on credit card. In other words, low-income households were sustaining their lives, prior to the introduction of the regulation, through use of several credit cards and with limitless instalments on corresponding expenditure (Aybar & Dogru, 2013). In 2015, non-performing loans' share in total loans and receivables was 3% (BAT, 2016a). Thus, we can draw the conclusion that when the non-performing loans reach unsustainable levels, the indebted households in Turkey will confront serious economic crises.

#### **4.4. Conclusion**

In this chapter, we argue that financialisation took off in Turkey in the aftermath of the 2001 crisis due to a substantial transformation wrought by the economic policies advised, encouraged and supported by the IFIs. These policies, especially inflation targeting and contractionary fiscal policy, served to restructure all areas of economic and social life from agriculture to social policy, from construction to labour markets, and so on. Moreover, this era witnessed a substantial restructuring of the financial institutions in Turkey, not least the banking system. In this sense, the expansion of the financial sector in relation to the massive capital inflows is important and is indicative of the contagious nature of financialisation. However, what is also important is the intensification of finance with and within the non-financial sector and with households. We began to demonstrate these latter processes through investigating these financial relations with the non-financial sphere as well as through banks' repositioning in terms of lending to households.

Even in developed countries, as is recognised in the literature, financialisation is uneven, complex and differentiated in incidence and impact. This applies equally to developing countries and that is why it is not easy to *prove* financialisation. Nevertheless, there are certain findings which point to the peculiarity of financialisation in developing countries which Turkey illustrates. First of all, in Turkey, the emergence of financialisation is related to the changing relations between the state and banks. In this regard, banks have not focused on consumers because non-financial corporations raised cheaper funds through involving

themselves in financial market operations. Rather, as we showed, big corporations always had access to funds from both foreign and domestic sources in the form of bank loans or through financial market activities. On the other hand, what has increased banks' focus on consumer lending has been the decrease in the public sector's borrowing requirement.

Second, despite the availability and accessibility of financial sources, the expansion of the financial sphere has not contributed substantively to real sector growth. This is evident in the decrease of fixed investment capital as well as the disadvantaged condition of the SMEs in terms of bank loans despite financial expansion. Banks have preferred not to lend to small firms, finding them too costly compared to big corporations and households. Some sectors have benefited from financialisation through greater availability of funds for both suppliers and demanders with the sector, as with (housing) construction.

Finally, integration of finance is not confined to the economic era. In effect, finance has become increasingly significant in the social lives of the Turkish population. Although within the literature mostly indebtedness is shown as the evidence of this development, as confirmed by our findings as well, in effect the impact of finance goes beyond this. Finance has created a phenomenon in which all the social life is reshaped including education, housing, health and pensions. As shown in the next chapter, the pension system in Turkey is part and parcel of the social security system, i.e. pay-as-you-go (PAYG), statutory, earnings related social insurance schemes whereas a private, funded, voluntary pension scheme, the Individual Pension System (IPS), has recently been introduced. This has been achieved through international financial organisations', not least the WB's, involvement in modelling the pension system. We argue that the IPS represents the financialisation of pensions for channelling pension contributions into financial markets and providing pension income through financial returns. In this regard, the transformation of the Turkish pension system has been subject to financialisation which functions as an underlying factor and official rationale that shapes the pension provision as elsewhere across the world.

## **5. Pension reforms in Turkey**

### **5.1. Introduction**

The transformation of the pension system in Turkey started after negotiations between the Turkish government and the WB with the latter insisting on putting pension reform on the agenda as a condition for the loan agreement signed in 1994. The WB's main argument was that the Turkish social security system in general, and pension provision in particular, was not sustainable and so needed to be reformed. As a result of the agreement with the WB in 1994, the Turkish authorities assigned the International Labour Organisation (ILO) experts to prepare a reform proposal for pension provision in Turkey. Subsequently, the ILO came up with a detailed report which consisted of four alternative pension systems ranging from a completely individual, funded system to a restructured PAYG social insurance system (ILO, 1996). The Turkish Government chose the two-pillar pension system, comprising a PAYG state scheme complemented by a funded, voluntary and individual system.

In the second section, we review the arguments put by the reform advocates. In the ILO Report, it was argued that the private schemes would decrease the burden of state through individual responsibility. Moreover, accordingly, coverage of pensions would expand for self-employed and agricultural workers as the private funded schemes are flexible in terms of participation and amounts contributed. The arguments for the necessity of pension reform in Turkey are further developed in a subsequent report which is also known as the White Book and published by the Ministry of Labour and Social Security (MoLSS) in Turkey (MoLSS, 2005). According to the report, a substantial pension reform is necessary because of high deficits of the Turkish social insurance institutions (main providers of pension income at that time), ageing population, inadequacy of existing social security system in terms of poverty alleviation, low coverage of the state scheme due to informality and structural problems of the existing social security system. We deal with all these arguments in detail and show that high government pension spending and ageing arguments do not fit the Turkish context where spending is low and there is a young population. On the other hand, deficits of the social insurance institutions and poor coverage of the pension schemes are undeniable facts for which the pension reforms do not provide a solution.

In third section, we discuss the Turkish pension reform which was undertaken in three stages. The first stage of the reform was held in 1999 and targeted the social insurance pensions. In a nutshell, the social security system of the time consisted of three social insurance institutions which were the main providers of statutory and earnings-related pensions for workers, self-employed people and civil servants. The 1999 reform determined the retirement age of 58 for women and 60 for men (before this reform there was not age constraint, only contribution days were required), changed the calculation methods for old age, disability and survivorship pension benefits, and introduced unemployment benefit. The second stage of the reform was the foundation of the IPS in 2001 which came into effect in 2003. The IPS represents the private pillar suggested by the ILO, and indirectly by the WB, complementing the social insurance institutions' PAYG schemes. It works on a voluntary basis, i.e. a person can join the IPS without joining or opting out from the state system. The IPS is based on the contract between the participant and the private pension company that invests the contributions made by the participant to the pension funds. Then pension funds invest in financial markets and the returns from these investments are paid to the participant as the pension benefit. The third stage of the pension reform was completed with Law 5510 that came into effect in 2008. With the law, three separate social insurance institutions have been gathered under one roof. Moreover, the retirement age is set at 65 from 2036, being gradually increased for the new entrants beginning in the system from 2008; the number of contribution days to be eligible for retirement were increased from 7000 to 7200 for private sector workers and to 9000 for civil servants and self-employed people. Further, the benefit calculation methods have been changed in a way in which current contributors to the system will draw lower pension benefits in the future and current retirees' pension income is increased by less than the previous incremental rate (the index was consisting the entire GDP growth whereas after the reform only 30% of the GDP growth is included in the valuation of pension benefits).

In the fourth section, we analyse the arguments of pension reform advocates and the pension reforms in Turkey in the context of financialisation. We argue that pension reforms have paved the way for financialisation of pension income by shrinking the state PAYG pensions in order to open space or create necessity for the private scheme. In this sense, increasing importance of the IPS within the pension system demonstrates the integration of finance in old-age income provision. As this



is another example of extension of finance into ever more areas of economic and social life, financialisation of pensions is observable in the Turkish context. Moreover, as financialisation transforms every area it penetrates, the IPS also has significant implications on pension system in Turkey. First, the IPS is a saving mechanism heavily skewed towards middle- and high-income earners. In other words, private funded schemes like the IPS, do not primarily play the role of enhancing the pensions of the majority, with some degree of choice over how much to contribute. Rather, they serve to cream off the pension funds of the better off and, in doing so, locating these funds within private financial markets and, thereby, immune from inter- and intra-generational redistribution (whilst simultaneously worsening the conditions attached to state pensions). This is the basis for the IPS serving to promote the financialisation of pension income, in association with the worsening impact of social security reforms on PAYG pensions.

Moreover, the IPS does not fulfil most of the functions those are attributed to it during the reform process by the pension reform advocates. Accordingly, it was argued that private schemes would increase the coverage by covering agricultural sector members and self-employed. We find that most of the self-employed people indeed responded to the pension reforms in an anticipated way and have joined the IPS while opting out from the state scheme. However, most rural workers cannot afford to join the IPS because they earn low incomes and the IPS is a system for high- or middle-income earners since contributions lower than a certain amount (although being allowed) do not give reasonable pension incomes. Thus, we argue that the IPS does not provide a solution to the coverage problem of the Turkish social security pensions because it only covers people from certain income levels (middle- or high-income) while excluding the rest.

Finally, we argue that the main problems for the social insurance pensions originate from the Turkish labour market which is characterised by high levels of unemployment and informal employment and the low rate of labour-force participation particularly amongst women. These features of the labour market underlie the inadequacies of the PAYG pensions as well as exacerbating the impact of pension reforms. In this way, we shed light on the impact of social security reforms and the IPS on these more marginalised groups (unemployed people, informally employed people and women who do not participate in the workforce). It is argued that the high unemployment rate, which is around 10% on average over the

last ten years, is one of the most important factors threatening the sustainability of the pension system through its increasing the pension-dependency ratio. The unemployed are much more vulnerable to social security reform, as it has tightened eligibility. The IPS does not provide an alternative because it is a system for professionals with regular payrolls rather than the low-income unemployed. Similar are the conditions of informally employed workers, corresponding to 36% of the labour force. Informal workers are mostly low-waged, employed for short periods without a contract that would provide them social security (including health and pension).

Low participation of women in the labour market is the Achille's heel of the social security system in Turkey. Only 30% of women participate in the workforce which is less than half of the men's rate (70%). This aspect of the labour market is important because it renders women dependent on men in terms of pensions while increasing the dependency rate thus threatening the sustainability of the social security pension system. It is shown that, after the social security reform, women have become even more vulnerable because of the increase in contributory days that makes it more difficult for them to qualify for a pension because of their interrupted careers with maternal breaks. Further, with the reform, the conditions to benefit from dependency pensions have been tightened while the level of benefit has been decreased.<sup>43</sup> In this regard, the impact of private-funded schemes on women is discussed in detail. At first glance, the IPS seems gender neutral because most of the participants are from similar socio-economic backgrounds. However, looking closer we see that the IPS is far from being a solution to women's social security problems which originate primarily from their lack of participation in the workforce due to the labour market's patriarchal structure. Moreover, if the IPS becomes the only source of pension income, gender-inequality (in terms of income) amongst the elderly is liable to increase because of the lack of redistribution within the pension system.

In the conclusion, we discuss both social security reform and the IPS together and emphasise that the relation between old-age income and financial market performance has become stronger than ever which indicates that pension provision in

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<sup>43</sup> The dependency pension is the benefit paid to the partner or the children of the social security system pensioner after s/he dies. It is shown in the fourth section of this chapter that the dependency pension is the main source of old-age income for most women because they do not have any pensions on which to draw from their working history.

Turkey is financialised.<sup>44</sup> In this regard, financialisation of pensions point at the social security and old-age income as new areas to which finance has extended. This analysis ties a summary of arguments made within the chapter to the broader and overall themes of our study.

## **5.2. Arguments put forward for the necessity of pension reform**

Before publishing the report of 'Averting the Old Age Crisis' (WB, 1994), the WB and IMF had meetings with policymakers from 39 countries. The logic of those meetings was to explain the arguments of the Report and convince them of the idea of privatisation of the social security systems (Guzel, 2006). The social security reforms in Turkey are shaped by this idea under the impact of WB and IMF. On the 5<sup>th</sup> of May 1994, the Turkish Republic and the WB signed a loan agreement which pre-conditioned pension reform. Consequently, the Turkish authorities appointed the ILO for the project on Pensions and Social Security Reform (ICC, 1999).<sup>45</sup> With the sponsorship of the WB, the ILO presented the Final Report on Social Security Reform in Turkey in 1996 (ILO, 1996). The ILO Report starts with a pessimistic evaluation of the pension system. According to it, the three social insurance institutions of the Turkish social security system then had deficits of 1.8% of the GDP. By taking the premium levels constant, the Report built actuarial model projections through which it projected a deficit of the social insurance institutions that would reach 10.1% of GDP by 2050.

In the Report, four different reform model alternatives are presented in order to avoid this consequence. The first is the PAYG model which only restructures the existing social insurances institutions and does not add any other schemes. The second is an extreme model of individual saving accounts which shows similarities with the reform implemented in Chile (Tuncay, 2000). The third alternative is a mixture of PAYG and individual saving accounts where the existing insurance institutions are kept and complemented with a mandatory funded scheme. The fourth proposal also suggests a mix of PAYG and funded system whereas this time the participation in the funded scheme is voluntary. Amongst all these different reform

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<sup>44</sup> It should be noted that the impact of the IPS funds on financial markets, and on the economy in general, is covered in the next chapter. In this chapter, the IPS is examined purely in terms of its relation to the financialisation of pensions.

<sup>45</sup> With the same agreement, the Commission on Australian Health Insurance was assigned to the project on Health Insurance Reform in Turkey. This Commission submitted a report in 1995 to the Turkish authorities.

scenarios, several issues are common: fixing the retirement age to a 58-60 age band (at that time there was not a retirement age floor, people who worked for a certain number of years were able to retire independently of their age); tightening the early retirement conditions; preserving the existing premium levels which already ranged between 20% to 35% of net income of the participant; and social insurance benefits would be adapted to developments in the economy in order to avoid income loss for some pensioners (Alpar, 2000).

Turkey chose the fourth alternative model which is called '*Alternative 4a and 4b: the multi-pillar system including voluntary complementary schemes*'. It includes a PAYG social insurance scheme providing a basic monthly income and a voluntary, private and funded individual scheme complementing the scheme. It is argued that this system would decrease the social expenditures significantly in ten years. With this system, it is projected that the deficit of the pension system would be 0.7% of GDP by 2050. The Report does not suggest any coordination between the social insurance pensions and the additional scheme for the reason that the latter would be completely voluntary and, presumably, would only cover a minority of the private sector employees.

According to the Report, the major positive impact of the multi-pillar system on income distribution across pensioners would be through the social assistance expenditures for people more than 65 years old and the coverage of agricultural workers and self-employed people in the rural sector. However, it is admitted that the funded scheme would increase income inequality within the elderly because some people would not be able to participate in the complementary schemes. Projected positive impacts of the system were as follows:

- Social protection expenditures and the subsidies to the social security system would be reduced in the mid-run.
- In the long run, the social insurance programmes would give smaller deficits.
- In the long run, the pension system would give a lower cumulative deficit and the decrease in the social protection system subsidies would enhance the government budget.
- More options would be open to the employers and employees to establish alternative schemes for retirement.
- Contribution would be made to development of the financial markets.

Negative impacts of the system are summarised as follows:

- Because all of the workers would not be able to benefit from the additional schemes, the pension income inequality would be aggravated.
- Civil servants between 30 to 50 years old would not have enough time to accumulate within the complementary scheme and would be negatively affected.

Moreover, it is indicated that all the reform scenarios would cause lower replacement ratios for almost each group of participants. People who are entirely excluded from the system are covered with the social protection (non-contributory social assistance) expenditures because decreasing the subsidies to the insurance schemes would increase the resources devoted into the social assistance for people who do not have any old-age income (ILO, 1996).

Although the programme suggests that the deficit of the social insurance institutions would decrease, there is no measure within the programme that decreases the deficit of the social insurance without decreasing the pension benefits. In other words, the programme is based on the measures decreasing the replacement ratios within the PAYG social insurance pensions while establishing the additional individual schemes in order to compensate the income loss originating from the state pension scheme. On the other hand, this system excludes the self-employed people from the PAYG scheme and incentivises them (through tax relief) to join the complementary individual schemes. This is presented as a way of increasing coverage particularly amongst self-employed people. To sum up, the additional scheme has two functions: one is providing an option for people to compensate for their losses, thus enabling the contraction within the PAYG benefits. The other one is increasing the coverage of the pension system by covering self-employed people under a private scheme.

What this report tells us is that although the pension system in Turkey required an urgent reform in the mid-1990s, the way in which this reform proposal is introduced indicates the dominance of neoliberal ideology rather than the needs of the system. In order to correct a problem within a system, the reasons underlying the problem should be clarified. Then the question is what were the reasons resulting in high deficits of the insurance institutions providing pensions in the 1990s? There were several premium holidays, early retirement opportunities and legislative interventions that decrease the contributions to the social security system those are

known as ‘populist policies’. Moreover, during the years social security system were giving surpluses, these funds were being used to finance the budget deficit which was the substantial problem of the 1990s as mentioned in the previous chapter (4.2). In addition, pension system of the time was suffering from institutional limitations, such as lack of auditors who would detect the corruption at the administrative level or in individual workplaces. In relation with this, the informality within the labour market was growing while people were employed either without any security or with fake payroll cheques which hide the real amount of the wage in order to contribute to the pension system less (Yasar, 2013). None of these structural inadequacies are addressed within the reform proposal.

Moreover, there is another shortcoming of the reform proposal which has been clearer in more recent publications of the IFIs, that is the idea that social security and social assistance schemes are opponents of each other. Thus, state has to prefer between choosing to contribute to old-age income of employed and providing a basic income for those who are in need. That is why in the ILO report, despite not establishing any organic relations between private scheme and the PAYG system, the private schemes are deemed to be solving the problem of deficits. Accordingly, when the government starts to pay less in the PAYG scheme, it would then be able to increase the social policy assistance. In this context, the employed and unemployed or informally employed people are suggested to be opponents of each other within a zero-sum game (Turcan Ozsucu, 2006). However, this approach, which suggests a trade-off to exist between social security and social protection, is disputable. Rather, these two are different issues in which the state has different roles to play. Therefore, state should contribute to employed people’s pensions as well as providing a minimum income for those who are not able to work (Guzel, 2006).

Despite all these shortcomings, the Turkish government of the time committed to transform the pension system in line with the reform proposal of the ILO report. Thus, the government started the preparations for the individual private scheme while restructuring the PAYG component through social security reform in 1999. Nonetheless, after the reform in 1999, the Turkish social security system continued to have deficit which reached 4% of GDP by 2003. Therefore, the WB took the opportunity to publish a Turkish pension system reform report in May 2003. In relation with that, the IMF included social security reform into the other structural reform pre-conditions for the 19<sup>th</sup> standby agreement in 2005 (for more detail see

3.2.) (Egeli & Ozen, 2009). As a result, the Ministry of Labour and Social Security (MoLSS) started to prepare a report to present the necessity of social security reform with three representatives from social security institution and four delegates from Treasury and Central Bank of Turkey. This indicates that the perspective on social security reform was from a budgetary concern rather than improving the adequacy of the pensions (Celik, 2006).

The report is published in 2005 with the name of the “Social Security System, Reform and Suggestions” which is also known as the White Book (MoLSS, 2005). The arguments put forward within the White Book, those underlying the reform for social security in general, and social insurance pensions in particular, can be gathered under five points:

- Ageing population,
- Existing social security system’s insufficient protection against poverty,
- Deficits of social insurance institutions that cause financial burdens on the state budget and macroeconomic instabilities,
- Low coverage of the social security system,
- Structural problems of the existing social insurance institutions and social assistance expenditures.

#### *5.2.1. Ageing population*

Within the pension reform literature, the ‘ageing population’ is a well-known argument that is put forward by the WB to push pension reform (WB, 1994). In line with the WB argument, the White Book claims that Turkey gets older rapidly. The rate of number of people older than 65 years old within the number of people between 0-64 years old would increase from 7% to 14% in 27 years. This transition in the weight of elderly within the population has been experienced in developed countries in much longer periods (ranging across 26 years in Japan to 115 years in France). Moreover, the dependency ratio, which stands for the number of people 65 years old and more plus the population between 0-14 years old over total population, would increase after 2025 with acceleration after 2035. This means that the number of people who are not able to work will increase more rapidly than the number of people who work. Hence, the next 20 years represent the ‘window of opportunity’ for Turkey to restructure the pension scheme in order to enable its sustainability (MoLSS, 2005).

The argument of ageing appears to be convincing at the first glance. However, it can be argued that it is pushed too much in the Turkish context where the problem is presented in a more exaggerated way than it is in effect. Ageing population refers to an increase in the median age of the population. According to this, in the world the share of elderly people to the total and working-age population has increased around 10% to 15% in every country since the 1950s. This is associated with the baby-boom generation of the post-war era getting older, as well as other factors such as decreasing fertility rates and increasing health-technology. Indeed, when we look at the data for OECD high-income countries, the average proportion of population more than 65 years old to working-age population reached 24% by 2010. In a similar vein, the elderly population is 16% of the overall population on average in all high-income OECD countries (OECD, 2014).

Nevertheless, when we examine whether or not Turkey is ageing, the findings indicate that the demographic development is different in Turkey than high-income countries. In effect, the share of people older than 65 years old was 4.4 in 1970 and increased to 7.6% in 2013.

**Table 5.1 Share of population over 65 years old within working age and total population between 2001-2010 (%)**

%/Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Working age population	8.3	8.4	8.5	8.5	8.6	8.6	8.7	8.7	8.7	8.8
Population	5.4	5.4	5.5	5.6	5.7	5.7	5.8	5.8	5.9	6

Source:WB<sup>46</sup>

In other words, the WB and other advocates of pension reforms rely on projections which are produced on the basis of high-income level countries' experiences. Thus, they do not address the real problems specific to each country.

### *5.2.2. Protection against poverty*

The other argument within the White Book regards the inadequacy of social security system in terms of alleviating poverty. According to this, "the main purpose of social security is to protect people against poverty" (MoLSS, 2005, p. 9). When the government brought this issue to a meeting with interest groups and trade unions in

<sup>46</sup>Available at:

[http://www.worldbank.org/content/dam/Worldbank/Brief/Social%20Protection%20and%20Labor/1.1\\_Env\\_OA\\_Dependency\\_Ratio&Population+65\\_2Q2012.xlsx](http://www.worldbank.org/content/dam/Worldbank/Brief/Social%20Protection%20and%20Labor/1.1_Env_OA_Dependency_Ratio&Population+65_2Q2012.xlsx) Access date:13.02.2015



July 2004, the left-wing trade union DISK (Confederation of Progressive Trade Unions of Turkey, Devrimci Isci Sendikaları Konfederasyonu in Turkish) declared their opposition on this point (DISK, 2004).<sup>47</sup> According to DISK, associating the social security system with impoverishment is not appropriate. Rather, social security provides income for temporary or permanent incapacity to work.

“First of all, the goal of social security is to provide an economic security to an individual who confronts a social risk. If this security is adequate, that prevents the individual to fall in poverty. However, except this indirect influence, the social security does not have an aim to protect against poverty or abolish the inequalities. Moreover, with the proposed model, it is not clear how this goal would be achieved. Hence, yet at the beginning, the social security system is restructured with a reform that is based on a wrong target and mission.”(Guzel, 2005, p. 72)

Government authorities reject this objection by arguing that the poverty reduction is related to the economic growth which is negatively influenced by the deficits of the social security institutions. Moreover, the resources devoted to cover the deficits of these institutions mean subsidising people who are in least need. In other words, while the poverty amongst the employed and self-employed people is already low, the social security expenses are transferred to these people through government contributions to cover the deficits of the social insurance institutions. Therefore, people, who are in absolute poverty, do not benefit from the subsidies whereas the social security system should have covered them (MoLSS, 2005).

It is indeed true that the narrow definition of social security needs to be broadened as its definition as the income security (restoring income to some extent in the case of the inability to work, including old age) does not meet the realities of the neoliberal era (van Ginneken, 2003, p. 4). This is so because in the past, social security covered most of the population and those marginal groups who were out of the umbrella were taken care of through social assistance schemes. And, the costs of these schemes were insignificant thus easily financed by the state. On the other hand, now, the number of those not covered because of the informality of employment is extremely high. Therefore, the cost of social assistance schemes is paramount.

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<sup>47</sup> DISK’s statement against the social security reform, November 2004. Accessed on 06.04.2015. Available at: <http://www.antimai.org/cy/disksosguv.htm>

However, this is not to say that the expansion of social security definition and practices, in a way that covers social protection, need to be done at the expense of those employed. The idea of state should cover those who are in poverty while the employed should take individual responsibility for their income security destroys the link between production relations and social security. In other words, social security becomes poverty-related instead of being related to contributions to social production. In effect, social security is established as result of struggles of workers through the historical process. Thus, social security is a right and the transfers made to the social insurance institutions are not subsidies but rather government's mission to accomplish its role as a social state (DISK, 2004). Therefore, it can be argued that positing social insurance as an opposite of the social assistance expenditure is not a good way of analysing social security deficits. This is because these two schemes (social insurance and social assistance) are not complements of one another. Each is contributed by different parties and has different budgetary constraints.

#### *5.2.3. Deficits of the social security system*

The third main argument put forward in the White Book is related to the deficits of social insurance institutions those provide pensions. According to the White Book, the financing problem of the social security system has negative impacts on inflation and some other essential economic indicators because of the pressure it causes on state finances. The transfer made from the state budget to cover the deficits of the social security system has reached 4.5% of GNP while the total resources devoted to cover the deficits of the social security system in the last ten years equal total national income in 2004. The deficit of the social security system increases the public sector debt requirement which causes the interest rates to increase. Hence, investment and economic growth are influenced badly which stimulates unemployment and aggravates income distribution. To sum up, the system, which is meant to provide social security creates completely reverse consequences. (MoLSS, 2005, pp. 12–13).

With this argument, as Celik (2006) rightly puts it, the deficits of social security institutions are pointed at as the '*scapegoat*' of all the problems within the economy such as unemployment, macroeconomic instability and income inequality. Moreover, the share of interest payments within the budget over the same period (1994-2004) is four times the share of transfers made to cover the social security

deficit. Finally, with incomprehensible reasoning, the White Book calculates the resources devoted to the social security over 10 years in comparison with only one year's GNP and debt stock. Thus, draws a chaotic picture (Celik, 2006).

**Table 5.2 Non-interest Balance of Social Security System as % of GDP (IMF Definition)**

<b>Year</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>%</b>	-0.19	0.01	0.06	-0.03	-0.03	-0.04	-0.02	0.12
<b>Year</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>%</b>	0.09	-0.01	0.06	0.03	0.02	-0.01	-0.33	-0.36

Source: Ministry of Development Public Sector Debt Requirement Indicators (%GDP) (Ministry of Development, 2015b)

In the Book, the deficits of the social insurance institutions originate from 'income decreasing factors' and 'cost increasing factors'. Income decreasing factors are early retirement, difference between declared income (for premium calculation) and real income, informality and contribution holidays. Cost increasing factors, on the other hand, are early retirement, high benefit levels, long benefit periods due to ageing (health costs due to ageing although we do not cover this issue here)(MoLSS, 2005). Amongst these the most emphasised is early retirement.

Accordingly, Turkey is the country with longest pension payment period. When the retirement age is too low, the actuarial balance of the pension system is distorted because the number of active workers is much lower than the number of passive participants of the system. Thus, dependency ratio decreases in a way which threatens the sustainability of the social security system. In order to have a sustainable system, the dependency ratio should be around four (Egeli & Ozen, 2009). However, increasing retirement age is an arguable measure because features of the Turkish labour market are very specific:

“Turkey has a relatively young labour force with average age of 36. The average age of workers in the industrial sector is 32.7 and in service sector this average is 34.7. The average age of unemployed people for starting to work is 29.6. In other words, people who are not employed but ready to be employed are 6 years younger than the already working population average. Finally, the average education year of already employed people is 7 whereas people who are not employed but ready to be employed have an average 8 years of study. Thus, Turkey has a young working population and even

younger and more educated unemployed people who are ready to work.”(Turcan Ozsucu, 2006, p. 52)

As the author rightly puts it, the young working population is a challenge for the increase in the retirement age in Turkey. Moreover, there is a generation in Turkey that started working at very young ages and are more exhausted due to longer working hours, difficult working conditions and less working place security etc. therefore have shorter life expectation. In particular, when we consider the high unemployment rate, increasing retirement age to higher levels while there are many young and educated people who are ready to work does not seem reasonable.

In addition to this fact, despite all these wrong implementations of early retirement and long benefit payments, Turkey still has a comparatively low rate of pension spending compare to other OECD countries. The OECD defines the data on pension spending as all cash expenditures (including lump-sum payments) on old-age and survivor pensions that provide an income for persons retired from the labour market or guarantee incomes when a person has reached a 'standard' pensionable age or fulfilled the necessary contributory requirements. Pension spending in Turkey, by 2009, is 6.8% of GDP whereas the OECD total average is 7.8%.<sup>48</sup> Since the Turkish pension system does not require government contribution to the earnings-related social security system, pension spending is related to the means-tested pension income (for people more than 65 years old and in need). When we check the key indicators in the table below to see whether or not the Turkish pension system is generous, it can be easily seen that the average worker earning level is very low compared to the OECD standards. Therefore, in terms of deficits of the social security system and generosity of the Turkish pensions, the arguments of the White Book are discredited with data.

**Table 5.3 Key indicators of the Turkish pension system compare to OECD averages**

	Turkey	OECD
Average worker earnings (USD)	15400	42700
Public pension spending % GDP	6.8	7.8
Population over 65% working age	12.5	25.5
Life expectancy at birth	75.1	79.9

Source: (OECD, 2013, p. 354)

<sup>48</sup> OECD (2015), Pension spending (indicator). doi: 10.1787/a041f4ef-en (Accessed on 10 February 2015) <http://data.oecd.org/socialexp/pension-spending.htm>

These contradictions between the reality in Turkey and reform proposals prepared on the basis of other countries' experiences show the failure of ready-made policies in fitting specific circumstances. Another example of this approach is the persistence about decreasing the replacement rates in the Turkish pension systems. In a nutshell, the net replacement rate is defined as the individual net pension entitlement divided by net pre-retirement earnings (taking into account personal income taxes and social security contributions paid by workers and pensioners). This rate measures how effectively a pension system provides a retirement income to replace earnings before retirement. In other words, replacement rates indicate the success of the pension system in a country. Thus, suggesting Turkey to decrease this rate is incomprehensible in this sense. Nevertheless, the average gross replacement rate is 54.5% and the average net replacement rate is 64.5% by 2012 for all OECD countries. However, in Turkey, the gross replacement rate is 66.8% and the net replacement rate is 94.9% (OECD).<sup>49</sup> On the basis of these data, the official rationale argues that the replacement rates in Turkey, which are higher than OECD standards, should be decreased (Karadeniz, 2009). However, the high levels of replacement rates can be explained by very low wage levels which are replaced by the pension benefits even though the benefits are not high at all. Although this deserves a more detailed investigation which we cannot cover within the limits of this study, this is an important point to see in terms of peculiarities of each country.

In addition, budget deficits of the social security institutions are not only about expenditures but also related to the income of the institutions. In this regard, in Turkey the individuals' contributions to the social security system have increased from 4.5% GDP to 8% of GDP between 2000 and 2013. On the contrary, the average social security contributions' rate has increased only slightly across the OECD countries, i.e., from 8.6% to 9% of GDP over the same period.<sup>50</sup>

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<sup>49</sup> OECD (2015), Gross pension replacement rates (indicator). doi: 10.1787/3d1afeb1-en (Accessed on 10 February 2015) <http://data.oecd.org/pension/gross-pension-replacement-rates.htm>

<sup>50</sup> Social security contributions are compulsory payments paid to general government that confer entitlement to receive a (contingent) future social benefit. They include: unemployment insurance benefits and supplements, accident, injury and sickness benefits, old-age, disability and survivors' pensions, family allowances, reimbursements for medical and hospital expenses or provision of hospital or medical services. Contributions may be levied on both employees and employers. Such payments are usually earmarked to finance social benefits and are often paid to those institutions of general government that provide such benefits. This indicator relates to government as a whole (all government levels) and is measured in percentages of both GDP and of total taxation. OECD (2015), Social security contributions (indicator). doi: 10.1787/3ebfe901-en (Accessed on 12 February 2015) <http://data.oecd.org/tax/social-security-contributions.htm>

#### 5.2.4. Coverage

Fourthly, the coverage problem is approached within the White Book mostly in terms of informality and social protection. Accordingly, there are 11 million people who are working unregistered and this number corresponds to 52% of the workforce (data for 2004). It is also mentioned that, although more than 21 million people appeal to social assistance, the expenditure on this constitutes only 0.8% of GDP (MoLSS, 2005, p. 16). The coverage problem of the Turkish social security is rightly pointed at despite the confusion of terminology: the coverage of the social security system is different than the coverage of social expenditure. *One form of coverage is related to the social security system* and the OECD compares countries according to two different pension coverage definitions for the active members of the pension systems: the first one is the total number of active contributors over labour force; whereas the second one is the total active contributors over all population of working age. In this regard, in 2008, Turkey had 58.6% and 30.5% coverage, respectively. These rates are very low compared to the high-income OECD countries which have an average of 90.0% and 78.6%, respectively. In effect, the coverage of the Turkish pension system is low even compared to the average of the country group of *Europe and Central Asia* under which Turkey is classified. The Europe and Central Asia country group has an average of 68.6% of coverage for the first definition and 46.0% of coverage for the second.

**Table 5.4 Coverage of the pension system in Turkey between 2008 and 2013 (in Thousands)**

Year	Working-age population (1)	Labour-force (2)	Active contributors (3)	1st Coverage (3/2)	2nd Coverage (3/1)
2008	50,772	23,805	15,041	0.63	0.3
2009	51,686	24,748	15,967	0.65	0.31
2010	52,541	25,641	16,196	0.63	0.31
2011	53,593	26,725	17,375	0.65	0.32
2012	54,724	27,339	18,353	0.67	0.34
2013	55,608	28,271	18,887	0.67	0.34

Source: Ministry of Labour and Social Security Labour Statistics and Social Security Institution (MoLSS, 2014)

The table above is drawn through application of the OECD method to the data available since 2008. Despite the improvements within the coverage of the pension system, Turkey is still far below the average coverage rates of other OECD

countries. As can be seen from the table, 34% of working age population is not actively covered by the system which means that around 18 million people are excluded (working-age population in 2013 is 55.608 million).<sup>51</sup> The main reason of the coverage inadequacy is the informality within the labour market. However, informality does not only refer people who work without registering in the social security system, rather it also covers those declare their income much lower than their real income in order to pay lower social security contributions (Egeli & Ozen, 2009).

*The other form of coverage is related to the social expenditure* which is, in Turkey, the flat-rate old age income granted to people who are excluded from the social insurance schemes. Social expenditure comprises cash benefits, direct in-kind provision of goods and services, and tax breaks with social purposes to low-income households, the elderly, disabled, sick, unemployed, or young persons. According to the OECD data, total net social spending, by 2011, is second lowest in Turkey with 11.1% of GDP whereas the OECD average is 20.8%.<sup>52</sup> Hence, public expenditure is very low compared to other OECD countries which explains the shortcoming of the social expenditure coverage.

#### *5.2.5. Structural problems*

The final point brought forward by the White Book is related to the structural problems of the social security system in Turkey. When the structural problems of the social security system in Turkey are analysed, it is seen that they are not demographically related, such as ageing or increasing life expectations, as suggested for developed countries (Egeli & Ozen, 2009). Turkey has a young population but despite that because of distorted actuarial balances and institutional inadequacies, the social security system has become unsustainable.

In this regard, the fragmented structure of the social security system which consisted three insurance institutions is addressed to be problematic. Indeed, switching between institutions, due to employment status change, was very slow and inefficient. However, this can be associated with the insufficient technical infrastructure which required a lot of paperwork for social security issues. According to the White Book, all these structural problems of the social security system would

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<sup>51</sup> Labour Statistics Reports by Ministry of Labour and Social Security (MoLSS, 2014).

<sup>52</sup> OECD (2015), Social spending (indicator). doi: 10.1787/7497563b-en (Accessed on 10 February 2015) <http://data.oecd.org/socialexp/social-spending.htm>

be solved through unifying three social insurance institutions under one roof, supporting this new organization with a well-established internet based technical infrastructure and generating commonality of the norms while simplifying the chaotic legislation.

Despite the shortcomings of the reform proposals' arguments in terms of reflecting the real problems of the pension system, Turkey reformed pensions in line with these arguments. In the next section, we investigate the development of pension reforms in detail.

### **5.3. Pension System Reforms and Their Impacts**

The main structure of the social security system in Turkey is established on the basis of social insurance schemes which classify participants according to their employment status. Accordingly, public sector workers have a different scheme than private sector workers and across the private sector, self-employed people have a scheme that is separated from those serving to an employer through a contract (ICC, 1999). On the basis of this frame, as can be seen from the figure below, the Turkish social security system in 1999 comprised three parts: the first and main component consisted of the social insurance institutions which provided defined-benefit and PAYG-based state pensions. For workers in the private sector the *Social Insurances Institution* (Sosyal Sigortalar Kurumu in Turkish); for public employees and civil servants the *Superannuation Fund* (Emekli Sandigi in Turkish); and for independent workers the *Social Insurance Organization of Craftsmen, Tradesmen and Other Self-Employed* (Bag-Kur in Turkish) provided pension (and health) insurance services. The second component consisted of the social assistance under the name of social relief either in kind or money. These included aid from the Social Cooperation and Solidarity Institution, a modest old-age income for people who do not have any other pension, and the Green Card for free health services. The third part of the system is comprised of supplementary occupational funds for certain group of employees. The fund OYAK was organised for military service pensioners. The Workers' Union which is a fund under the Ministry of Labour and Social Security, and private insurance schemes under the life insurance companies, were also of minor importance in terms of additional coverage (Uralcan, 2005).

In more detail, certain institutions, organisation and companies have been providing additional pension income alongside some social rights and aids in case of



need, under collective schemes those are called ‘foundation’ (‘sandik’ in Turkish). According to Banksen’s report (BANKSEN, 2012), there are 18 active foundations, twelve of them are provided by banks, five by insurance companies and one by a profession union.<sup>53</sup> The total number of members of these foundations is around 360.000. There are also ‘friendly societies’ (vakıf) which allegedly control funds that amount to TL7 billion (in 2013).<sup>54</sup> These funds are required to be transferred to the Individual Pension System by 2017.<sup>55</sup> According to the Central Bank’s Institutional Sector list, there are four institutions founded with the special law to provide additional income for pensions<sup>56</sup> alongside eighty institutions which provide additional pension income for their members and employees. These institutions consist of government agencies, private companies, financial intermediaries and banks.<sup>57</sup>

Amongst these foundations, one of the most important is the Isbank pension foundation which was established in 1933 and had 25.000 active members and 26.000 passive members by 2015.<sup>58</sup> This foundation invests in Isbank as it owns 40.15% of the biggest private bank in the country. Thus, the additional pension income is provided through financial activities while making the bank’s employees

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<sup>53</sup> 1-) Yapı ve Kredi Bankası A.Ş. Memur ve Hizmetlileri Yardım ve Emekli Sandığı Vakfı 2-) T.C. Ziraat Bankası A.Ş. ve T. Halk Bankası A.Ş. Mensupları ve Yardım ve Emekli Sandığı Vakfı 3-) Türkiye Garanti Bankası A.Ş. Memur ve Hizmetlileri Emekli Sandığı Vakfı 4-) Akbank T.A.Ş. Mensupları Tekaüt Sandığı Vakfı 5-) Türkiye Sınai Kalkınma Bankası T.A.Ş. Memur ve Hizmetlileri Emekli Sandığı Vakfı 6-) Şekerbank T.A.Ş. Memur ve Hizmetlileri Sigorta ve Emekli Sandığı Vakfı 7-) Türkiye Vakıflar Bankası T.A.O. Memur ve Hizmetlileri Emekli Sandığı Vakfı 8-) Türkiye İş Bankası A.Ş. Mensupları Emekli Sandığı Vakfı 9-) Türkiye İmar Bankası A.Ş. Mensupları Yardım ve Emekli Sandığı Vakfı 10-) Fortis Bank A.Ş. Mensupları Emekli Sandığı Vakfı 11-) Türkiye Halk Bankası A.Ş. Mensupları Yardım ve Emekli Sandığı Vakfı (Pamukbank Sandığı) 12-) Esbank Eskişehir Bankası T.A.Ş. Mensupları Emekli Sandığı Tesisi 13-) Milli Reasürans Mensupları Emekli Sandığı Vakfı 14-) Anadolu Anonim Türk Sigorta Şirketi Mensupları Emekli Sandığı Vakfı 15-) Türkiye Genel Sigorta A.Ş. Memur ve Hizmetlileri Emekli Sandığı Vakfı 16-) Ankara Anonim Türk Sigorta Şirketi Memur ve Hizmetlileri Emekli Sandığı Vakfı 17-) Liberty Sigorta A.Ş. (Şeker Sigorta) Personeli Sigorta Ve Yardım Sandığı Vakfı 18-) Türkiye Odalar ve Borsalar ve Birlik Personeli Sigorta ve Emekli Sandığı Vakfı

<sup>54</sup> For the newspaper article in Turkish see the link available online <http://www.milliyet.com.tr/devlet-katkisi-tatli-geldi/ekonomi/detay/1727426/default.htm>. Access date: 06.10.2016.

<sup>55</sup> Pension monitoring centre announcement. Available online: <http://www.egm.org.tr/?sid=93>. Access date: 06.10.2016.

<sup>56</sup> Ordu Yardımlaşma Kurumu (OYAK), İlkokul Öğretmenleri Sağlık ve Sosyal Yardım Sandığı (İLKSAN), Ereğli Kömür Havzası Amele Birliği Biriktirme ve Yardımlaşma Sandığı, Polis Bakım ve Yardım Sandığı (POLSAN).

<sup>57</sup> Turkish Republic Central Bank Institutional Sector List, 2015. Available at: [http://www.tcmb.gov.tr/wps/wcm/connect/310de748-8047-4615-aa38-f8989c607faa/KurumsalSektör\\_2015.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE310de748-8047-4615-aa38-f8989c607faa](http://www.tcmb.gov.tr/wps/wcm/connect/310de748-8047-4615-aa38-f8989c607faa/KurumsalSektör_2015.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE310de748-8047-4615-aa38-f8989c607faa) In Turkish. Access date: 07.10.2016.

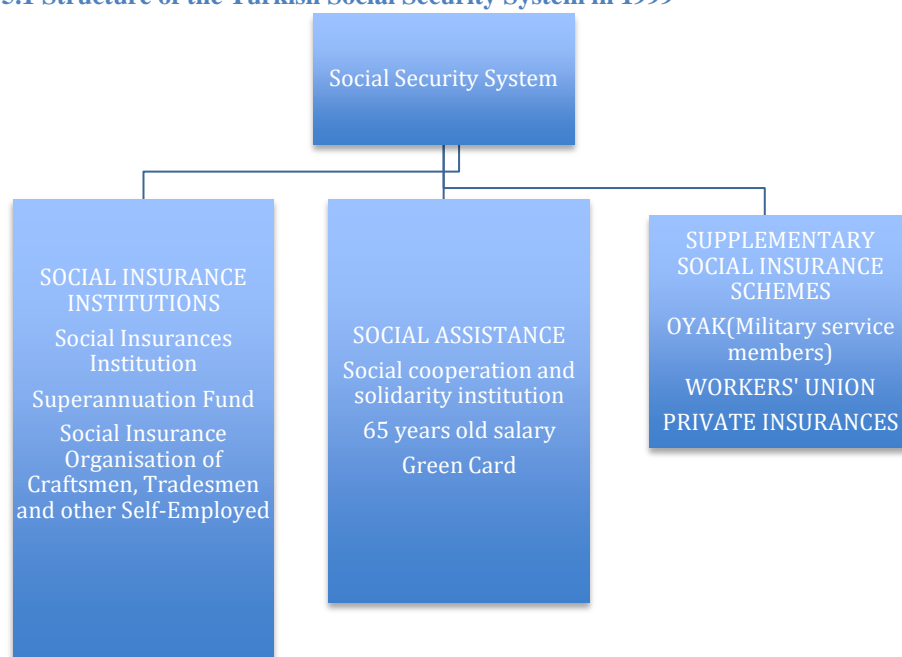
<sup>58</sup> Available at: <https://www.tibasvakfi.org.tr/icerik/EsTarihce.aspx> in Turkish. Access date: 06.10.2016

and staff the major shareowner of the company. However, this is not to say that this investment model is common for other foundations providing pension income. Rather, there is another strategy implemented by the OYAK pension foundation which does not exclusively buy shares rather than becoming direct partners of companies or founding its own companies. OYAK was founded in 1961 with 65.000 participants in order to provide additional social security coverage for social and physical risks confronted by its members, i.e. military forces and their families.<sup>59</sup> What is significant for OYAK's case is that this foundation benefited from and contributed to the developmental state idea of the 1960s through establishing industrial factories and directly involving itself in productive activities. Thus, while OYAK has become one of the biggest conglomerates (holdings) in the country, it provided a remarkable additional pension income for its members while operating in industrial, service and finance sectors through activities including housing, automotive and investment trusts. To sum up, prior to the IPS, the Turkish pension system consisted of archaic forms of, mostly occupational, pension funds with country-specific features both in terms of coverage and investment strategies. With the IPS, most of these funds were transferred to the system but there are still some foundations which are to be transferred to the system by 2017 according to the IPS code.

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<sup>59</sup> For history of OYAK see in Turkish. Available online: <http://www.oyak.com.tr/TR/kurumsal/tarihce/1981---1990.html> Access date: 07.10.2016

**Figure 5.1 Structure of the Turkish Social Security System in 1999**



Source: Adopted from (Uralcan, 2005, p. 22)

The first stage of the pension reform process in Turkey started following the advice in the ILO Report (ILO, 1996), the Turkish government prepared the social security reform with Law No: 4447 which was legislated and came into effect in September, 1999 (Alpar, 2000). This Law implemented measures to decrease informal employment (re-organising a mandatory registration process at the beginning of the employment for the social insurance institutions). It also increased the premium levels, and pension benefits were tied to the inflation rate. The retirement age was also determined as 58 for women and 60 for men at this point. Unemployment insurance, which was a missing element in the social security system in Turkey until then, was introduced alongside other regulations changing old-age pension eligibility criteria and benefit calculations (ICC, 1999).

The second stage of the reform was the foundation of the Individual Pension System (IPS) (Egeli & Ozen, 2009). The IPS is a private, funded pension scheme, which works on a defined contribution principle, and participation in the system is voluntary. The IPS does not abolish the PAYG pensions provided by the Social Security Institution; rather it goes along with them. The IPS was accepted on the 28<sup>th</sup> of March, 2001, with Law No. 4632 and the system officially commenced on the 27<sup>th</sup> of October, 2003 (PMC, 2004). The preliminaries of the IPS go back far beyond 2003 as a Commission was established on the IPS in August 1999. The representatives of the Ministry of Labour and Social Security, the Institutions of

Social Security, the Under-Secretariat for the Treasury, and the relevant sectors attended that Commission. In May 2000, the draft of the law of “the Individual Pension Saving and Investment System” was presented to the Cabinet and, was accepted by the “Grand National Assembly of Turkey” on 28<sup>th</sup> March of 2001 (GNAT, 2001). Furthermore, in order to organise the tax incentives for the Individual Pension System, the Turkish Government accepted another Law to change some of the tax rules on 28<sup>th</sup> of June 2001. With this Law (GNAT, 2001), some tax incentives are provided for the participants in the system at different stages in their participation. The Law defines the IPS as follows:

- The IPS is an individual pension system that is based on defined contributions and voluntary-participation principles.
- The IPS is complementary to the public social security system.
- The IPS aims to direct individuals’ pension savings into investment.
- The IPS aims to provide additional income during retirement, thereby increasing welfare levels.
- The IPS enables creation of long-term resources for the economy thus increasing employment and contributing to the development.<sup>60</sup>

The organisational structure of the IPS includes the participant, the pension company, the portfolio manager and the regulatory bodies. The Under-Secretariat of the Treasury and the Capital Market Board (CMB) are the key institutions because they regulate the IPS and supervise the coherence between the separate elements of the system. The Pension Advisory Board is established to determine the individual pension policies and to make recommendations about the measures to be taken for the implementation of such policies. This Board consists of the Under-Secretariat of the Treasury as the President, and representatives (at least at the general manager level) of the Ministries of Finance and Labour and Social Security, as well as the representatives from the CMB (PMC, 2004).

The Takasbank is the custodian of the system which is established under the Istanbul Stock Exchange (ISE) and assigned by the CMB of Turkey. Assets of pension mutual funds are safe-kept by Takasbank. The Takasbank’s major purpose is to provide clearing, settlement and custody services for the pension fund for buying and selling of assets. Procedurally, pension companies have to open an account at

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<sup>60</sup> The Law is available at: [www.mevzuat.gov.tr/MevzuatMetin/1.5.4632.pdf](http://www.mevzuat.gov.tr/MevzuatMetin/1.5.4632.pdf) (In Turkish) Access Date: 03.12.2014

Takasbank for each participant and they are required to present to the custodian the participant's identity and communication information. Thus, the assets of the portfolio fund are kept in these accounts and they are under the assurance of Takasbank. The Pension Monitoring Centre (PMC), on the other hand, is a checkpoint where operations of pension companies are monitored on a daily basis and reported to the public authorities, as well as generating and providing information to the public and the participants. The PMC is founded by the Under-Secretariat of the Treasury and eleven pension companies in July 2003 as a requirement of Law no. 4632 (GNAT, 2001). The Under-Secretariat of the Treasury authorises the PMC to produce accurate information.<sup>61</sup>

In the IPS, private pension companies collect contributions of participants and invest these contributions in financial markets. The returns on the investment are paid to the pensioner in the case of retirement or exit from the system. Entrance to the system is based on the pension contract made between the participant and the pension company. On the basis of the retirement plan the participant chooses, the pension company signs a contract with the portfolio management company which manages the pension funds (PMC, 2004). A participant over 56 years old can be retired from the IPS if s/he has contributed to the system for at least 10 years (Gokbayrak, 2010b). Account holders are able to transfer their savings and accumulated rights to another pension company after fulfilling one year in the pension company (Korkmaz & Uygunturk, 2006). If the participant dies, the beneficiary of the participant can apply to the pension company for payment of the amount accumulated in the system. In a similar vein, if the participant suffers a permanent disability, s/he can apply for refund without being retired. However, in both circumstances, the payments are calculated on the basis of not-retired condition; which means that the participant cannot benefit from incentives and subsidies provided by the state. Finally, if the participant dies when s/he is retired from the

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<sup>61</sup> The PMC is founded by the shareholders with 1.7 million USD paid-in capital. One of the shareholders is the Under-Secretariat of the Treasury with a privileged share in capital, other shareholders are 17 pension companies (Aegon Emeklilik Hayat, Allianz Hayat & Emeklilik, Anadolu Hayat Emeklilik, Asya Emeklilik & Hayat, Avivasa Emeklilik & Hayat, Axa Hayat & Emeklilik, BNP Paribas Cardif Emeklilik, Metlife Emeklilik & Hayat, Ergo Emeklilik & Hayat, Finans Emeklilik & Hayat, Garanti Emeklilik & Hayat, Groupama Emeklilik, Halk Hayat & Emeklilik, ING Emeklilik, Vakıf Emeklilik, Yapı Kredi Emeklilik, Ziraat Hayat & Emeklilik). These companies have licences to operate in the pension branch with an equal share in the capital. Available at: <http://www.egm.org.tr/?sid=13> Access date: 03.12.2014

system, the benefits from the system and accumulated amount cannot be transferred to a spouse.

The third stage of the reform has been wrought through the implementation of Law No: 5510, which was legislated in 2006, fundamentally changed the social security system (GNAT, 2006). The Law is known as the Social Insurance and General Health Insurance Law. On the basis of legal objections, the Law was amended and only came into effect in October 2008.<sup>62</sup> With this reform, the three social insurance institutions are gathered under one roof and named as the Social Security Institution (SSI) (In Turkish Sosyal Guvenlik Kurumu SGK). Thus, the fragmented structure of the social insurance institutions has been changed alongside parametric adjustments explained below.

**Table 5.5 Pension eligibility criteria before and after the reform**

For entrants to the system	Age of eligibility for retirement	Contribution days	Alternative eligibility condition
Between September 1999 and October 2008	58 for women 60 for men	7000	25 Years of insurance with 4500 days of contribution
After October 2008	58-65 for women 60-65 for men	9000 for civil servants and self employed; 7200 for private sector workers	65 Years old with 5400 days of contribution

Source: Law No: 5510 (GNAT, 2006) and Pensions at a Glance (OECD, 2013)

According to the Law, entrants to the system after October 2008 can draw a pension at the age of 65 and with 7200 contribution days for workers whereas for civil servants and self-employed people the criterion is 9000 contribution days. The eligibility age will increase gradually between 2036 and 2048 when the age requirement will be 65 years for both women and men.<sup>63</sup> The age of retirement is determined according to the year in which the contribution day requirement is fulfilled. The alternative eligibility condition (for entrants to the system after October

<sup>62</sup> Some of the articles of the Law were brought to the Constitutional Court by the President at the time, arguing that they were against the equality principle of the Constitution. Thus, the Constitution cancelled those articles and government legislated new laws to fill the gaps.

<sup>63</sup> The eligibility age was implemented as following: between 1/1/2036 and 31/12/2037 for women 59, for men 61, between 1/1/2038 and 31/12/2039 for women 60, for men 62, between 1/1/2040 and 31/12/2041 for women 61, for men 63, between 1/1/2042 and 31/12/2043 for women 62, for men 64, between 1/1/2044 and 31/12/2045 for women 63, for men 65, between 1/1/2046 and 31/12/2047 for women 64, for men 65, and as of 1/1/2048 for both women and men 65.

2008) is 65 years of age with 5400 days of contributions. The minimum pensions are granted to those who are at or older than 65 years without any other income or insurance to be detected by a means test. Moreover, miners can draw a pension when they are 55 years old with a 20-year contribution record.

With Law No: 5510, the calculation methods of pension entitlements and benefits are also changed. There are two main calculations for defined-benefit pension schemes; the first one is the indexation of the monthly benefits which are being paid to current retirees. The purpose is to prevent any purchasing power loss of retired people because of price movements. The second one is the calculation of future benefits that is based on the actuarial rate (expected value of future loss), i.e. the multiplier of current salary and service duration of the worker. The reform has changed both calculation methods in a way which results in lower pension benefits. The indexation used to include the whole of economic growth whereas it is modified to reflect only 30%. The actuarial rate was 2.6% under the non-linear formula whereas now it is linear and 2% (Karadeniz, 2009).

“The pension under the scheme [for participants between 1999-2008] is based on average lifetime earnings revalued in line with real GDP growth and the change of CPI  $[(1 + \text{GDP}) \times (1 + \text{CPI})]$ . The pension has a non-linear formula with years of coverage. The first ten years earn a pension of 35% of pay, with 2% per year extra for the next 15 years and 1.5% per year thereafter. The pension under the new scheme [for participants after 2008] is based on average lifetime earnings revalued in line with real GDP growth and the change of CPI  $[(1 + \text{CPI} + 30\% \text{ GDP})]$ . The accrual rate is 2% for one year of coverage and it cannot exceed 90% of pension.”(OECD, 2013, pp. 354–355)

The last measure regarding the pension level within the reform is the change of premium rates. The social security system in Turkey is financed through contributions of employees and employers, namely premium which is a certain percentage of the wage. In the Turkish system, premium is collected under two different names. The first is defined as the long-term premium and it includes the disability, old age and death categories. This premium equals to 20% of the wage and the employee contributes 9% while the employer contributes 11%. The second type of premium is called short-term and it consists of contributions for occupational disease, occupational accident, sickness and maternity. This premium is 2% of the wage and is paid by the employer only. Until very recently, the premium for the

short-term insurances was determined gradually according to the jeopardy of the work, ranging between 1% and 6.5%. However, with a regulation in September, 2013, the risk classification has been abandoned and the contribution is fixed at 2%. Besides long- and short-term insurances, there are two other categories of premia for general health insurance and unemployment fund. The total contribution to the general health insurance, which is required for benefiting public health services, is 12.5% of the wage (contributed 5% by employee, 7.5% by employer). Finally, the unemployment fund contribution is 1% for the employee and 2% for the employer while government also contributes with 1% of the wage.

**Table 5.6 Premium rates in the Turkish Social Security System after the Reform (%)**

Type of insurance	Employee	Employer	Government
Occupational accident, disease, sickness and maternity	-	2	-
Disability, Old-age, invalidity	9	11 [6 by employer] [5 by government]	-
General Health Insurance	5	7.5	-
Unemployment insurance	1	2	1

Source: Law No: 5510 (GNAT, 2006) (Social Security Institution, 2013)

Premium incentives are introduced for the first time with Law No: 5084 in 2004. The aim of the incentive is to increase investment and employment as well as encouraging regular premium payments by the employers. According to this, the Law No: 5510 implemented 5% of the premium of the employer to be paid by the government. This means the Treasury directly subsidises employers by paying almost half of their long-term premium payments (5% over 11%). The only requirement to benefit from this incentive is that the employer is to pay all of the remaining social security contributions on time and regularly. As a result of this incentive, the new premium rates are as follows: the employee pays 9% of the net wage to the state PAYG pension scheme, whereas the employer pays 6% and government pays the 5% of employee's net wage (Social Security Institution, 2013).

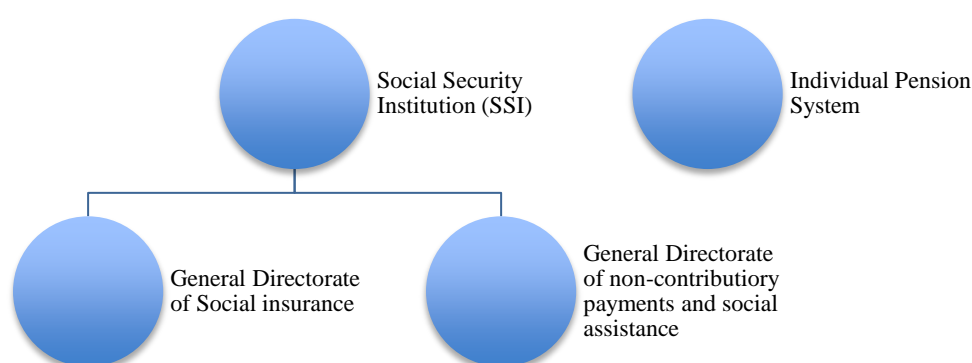
As a result of all these measures within the reform, the Turkish pension system has changed in a way that:

- Getting a pension is more difficult, needing to be older and work for longer periods;



- Already entitled pension benefits will be increased less after the pension reform and for entrants to the system after 2008 - the pension benefits they draw will be lower than the level before the reform;
- The premium burden of employers decreases within the system whereas the burden of employees remains the same and is highest amongst other parties contributing to the system.

**Figure 5.2 Structure of the social security system after 2008**



In other words, these reforms have managed to achieve the initial goal of decreasing state-scheme's weight within the pensions while rendering retirement difficult from the PAYG system as well as decreasing the benefits. However, these reforms also have adverse impacts on certain groups within the population which occupy a vulnerable position in the labour market. In effect, the Turkish labour market consists of a considerable amount of people that would be deemed to be in fragile conditions. These people are those unemployed (temporarily or permanently), those employed informally and women whose labour force participation rate is dramatically low in Turkey (Dedeoglu, 2012). Unemployment is very high at 10.7% on average between 2004 and 2013 despite the relatively low labour force participation rate (50.8% in 2013).

**Table 5.7 Main indicators of the Turkish labour market 2004-2013 (in 000s)**

Year	Non-institutional population	Working-age population	Labour-force	Employment	Unemployed	Informal employment
2004	66,379	47,544	22,017	19,632	2,385	9,843
2005	67,227	48,359	22,455	20,067	2,388	9,666
2006	68,066	49,174	22,751	20,423	2,328	9,593
2007	68,901	49,994	23,114	20,738	2,376	9,423
2008	69,721	50,772	23,805	21,194	2,611	9,220
2009	70,542	51,686	24,748	21,277	3,471	9,238
2010	71,343	52,541	25,641	22,594	3,046	9,772
2011	72,376	53,593	26,725	24,110	2,615	10,139
2012	73,604	54,724	27,339	24,821	2,518	9,686
2013	74,457	55,608	28,271	25,524	2,747	9,379

Source: Labour Statistics Reports by Ministry of Labour and Social Security, (MoLSS, 2014) Note: Non-institutional population comprises all the population excluding the residents of dormitories of universities, orphanages, rest homes for elderly persons, special hospitals, prisons and military barracks. (MoLSS, 2014)

As a result of the high unemployment and low labour force participation rate characteristics of the Turkish labour market, the rate of insured over pensioners decreases. This means that while there were more people paying into the system to support one pensioner, this number has decreased in a way that increases the burden of each insured individual. Therefore, the contribution rates are high as frequently complained about the Turkish social security system. The purpose of the pension reforms increasing the eligibility age for retirement is to increase this rate by decreasing the number of pensioners. However, what is always missed, or neglected, is the fact that there is another way to intervene in this rate; that is to increase the number of insured by pushing up the employment rates. Indeed, as can be seen from the table below, the measures taken by the pension reforms have not resulted in quick improvements at the environment of high chronic unemployment rates in Turkey.

Moreover, with the latest reforms, the unemployment feature of the Turkish labour market has become more crucial because (private sector) workers have to contribute 7200 days (and civil servants and self-employed people 9000 days) for retirement. Therefore, any interruption within working life would cause severe problems in drawing a pension. In a similar vein, the low rate of labour force

participation has become even more problematic since the dependency pensions are significantly restricted with reforms.

**Table 5.8 Coverage of the Turkish social security system**

Years	Insured	Pensioners	Dependents	Coverage of Social Security	Rate of Insured over Pensioner
2003	12,289,808	6,848,022	28,661,079	48,094,450	1.99
2004	12,553,265	7,174,632	30,109,280	50,138,617	1.93
2005	13,156,439	7,504,453	31,423,261	54,667,326	1.95
2006	14,124,935	7,913,724	32,330,398	56,423,907	1.95
2007	14,763,075	8,279,444	33,070,537	56,423,907	1.95
2008	15,041,268	8,746,703	33,227,265	57,338,454	1.87
2009	15,096,728	9,173,750	33,989,891	58,591,574	1.78
2010	16,196,304	9,518,648	35,470,436	61,506,194	1.84
2011	17,374,631	10,014,982	36,348,316	64,088,819	1.87
2012	18,352,859	10,382,419	33,807,725	62,899,043	1.90
2013	18,886,989	10,607,263	32,944,917	62,806,374	1.90
2014 (July)	19,482,604	10,795,051	33,557,833	64,209,254	1.91

Source: Social Security Institution Insurance Statistics, Monthly Basic Indicators 2014 July (Social Security Institution, 2014)

In addition to high unemployment rates, the Turkish labour market is also characterised by the high informality problem. It is often argued that the reason underlying the informality is that social security institutions require high contribution levels, i.e. high premiums. In order to decrease the social security related labour costs, employers hire workers without formal contracts. However, when these workers are not registered, the rate of insured over pensioners decreases. In turn, social security institutions have to increase contribution premiums in order to finance pensioners. As a result of this vicious circle, informality is high within labour market in Turkey (Gokbayrak, 2010b) (Balci Izgi, 2008).

That is why some authors have opposed the pension reform by arguing that the underlying reason behind the social security deficit is the structural ‘informality’ and, since the reform cannot solve this problem, it is inappropriate to change the system as proposed (Guzel, 2005). Nevertheless, informality within the Turkish labour market has shown a declining trend from 50.1% in 2004 to 36.7% in 2013 according to the Ministry of Labour and Social Security data (see the table 5.9).

**Table 5.9 Informality within the Turkish labour market (in 000s and %)**

Year	Informal employment	Non-agricultural informal employment	Informal employment rate	Informal employment rate in non-agricultural workers
2004	9,843	4,707	50.1	33.8
2005	9,666	5,119	48.2	34.3
2006	9,593	5,285	47.0	34.1
2007	9,423	5,132	45.4	32.3
2008	9,220	4,814	43.5	29.8
2009	9,238	4,818	43.8	30.1
2010	9,772	4,195	43.3	29.1
2011	10,139	4,988	42.1	27.8
2012	9,686	4,589	39.0	24.5
2013	9,379	4,369	36.7	22.4

Source: Labour Statistics report for the years 2009, 2011 and 2013 by the Ministry of Labour and Social Security (MoLSS, 2014) (MoLSS, 2012) (MoLSS, 2010).

The third characteristic of the Turkish labour market regarding the varying impacts of reformed pension system is the low participation rate of women in the workforce (Gokbayrak, 2010a). This is extremely low, only 30.8% whereas it is 71.5% for men in 2013. This low rate, by some authors, is associated with the transition from agricultural to industrial production because, under the former, women are included in the labour force statistics as non-paid family workers whereas in the latter they are dropped from employment as a result of difficulties in adapting to the urban labour market (Gokbayrak, 2011). Further, on average women earn less than half as much as men, and institutional services for childcare are inadequate which causes women to stay out of professional life. Also, there are labour market regulations those strengthen the patriarchal structure of the labour market, such as enabling women to receive severance pay if they quit a job after marriage (Dedeoglu, 2012). Given the interrupted careers of women due to time spent out of working life for giving birth and taking care of the children, the social security reform, which extended the contributory periods to 9000 days, makes it difficult for women to fulfil the *lifelong career* target.

**Table 5.10 Participation to the labour force according to gender 2004-2013 (%)**

Year	Labour force participation rate	Male	Female
2004	46.3	70.3	23.3
2005	46.4	70.6	23.3
2006	46.3	69.9	23.6
2007	46.2	69.8	23.6
2008	46.9	70.1	24.5
2009	47.9	70.5	26
2010	48.8	70.8	27.6
2011	49.9	71.7	28.8
2012	50	71	29.5
2013	50.8	71.5	30.8

Source: (MoLSS, 2014) (MoLSS, 2012) (MoLSS, 2010)

Even if women work for a while, they mainly get pension income as dependants (on the basis of a family member's working period) as they do not work until their retirement. As a result, most women have dependency pensions whereas for men it is the opposite (men mostly have pensions as a result of their working history not their family members'). In this regard, the new social security system decreases the level of benefit from dependency pensions. In the previous system, women who lost their husbands were able to get 75% of their husbands' pension benefit, whereas now, if they start working, they will be paid 50% (M. Sahin, 2012). In this regard, the social security reform by tightening eligibility conditions for dependent pensions aims to push women's labour force participation rate. However, this does not imply increasing gender equality within the social security system because the causality is from the labour market to the social security system, not the other way around (Ş. Sahin, Elveren, Dedeoglu, & Elveren, 2012).

To sum up, pension reforms in Turkey has fundamentally transformed the old-age income provision with arguments of solving social security system's ageing, deficit, coverage, and institutional management related problems while strengthening its power to alleviate poverty. However, through a detailed investigation of the reform process and the implications of reforms we have shown that some of the problems, such as ageing and deficits related to ageing population, do not exist in the Turkish context (at least not in the way which is proposed by the WB or because of the reasons suggested by reform advocates). Moreover, the problems which are addressed correctly by the reform advocates, such as low coverage and structural

problems of the system, are not solved by any measures taken with the reforms. Therefore, there is a serious problem-resolution mismatch within the reform process of the Turkish pensions.

What is even more interesting is to see that the latest pension reforms have exacerbating impacts on characteristic problems of the Turkish labour market, such as unemployment, informality and low female participation rate to the labour force. On the basis of this reasoning it can be argued that the main motivation of the pension reforms has been to increase the finance's integration to the old-age income provision rather than solving the problems of the Turkish pension system. This is why the IPS has been suggested to solve structural problems of the Turkish pension system while there is no chance it can have the slightest influence on issues such as unemployment, informality or women's disadvantaged position within the labour market. By discrediting these arguments regarding the IPS, we show its essential role to prevail financialisation of pensions in the next section.

#### **5.4. IPS, financialisation and the pension reforms**

The social security reforms and the IPS seem completely independent of one another at first glance. This is because they were enacted under different laws with arguments that they would solve different problems in terms of old-age income. In this regard, the social security reform is argued to stand for solving the social security budget deficits by decreasing the replacement ratio and enhancing the sustainability of the system through the change of eligibility criteria. On the other hand, missions attributed to the IPS are considerably different for being mostly economic goals, such as increasing employment, creating long-term resources and reinforcing economic development (Korkmaz & Uygunturk, 2006). Accordingly, the pension funds within the IPS will achieve these goals by transforming capital markets. This will occur as a result of the transformation of the individual into institutional investment through pension funds. Moreover, pension funds will deepen capital markets with the supply of long-term funds for accumulation (Sener & Akin, 2010). Finally, the system is claimed to provide the optimum use of resources because the participants in the IPS would desire their savings to be applied in the best way and competition between the pension companies for the highest performance would lead to higher returns (Avci, 2011).

Any of these missions attributed to the IPS are related to the social security system's problems. However, as we recall from the discussions on the individual pillar that is suggested by the WB, the private funded scheme is argued to have the implicit advantage of being independent from the structural problems of labour markets. This implies that whatever the eligibility requirements of the PAYG state scheme, such as the retirement age, contribution days or low benefits, the participants of the individual scheme are able to engage in the private scheme more easily. Moreover, the return of the funded scheme is not limited to the actuarial regulations or low indexation rates; rather, the pensioner gets what s/he contributes, on the basis of financial performance of investments. This flexibility argument, along with the additional income provided by the private scheme, provides a discourse of justification for the financialised pension schemes. Thus, pension reforms should be considered alongside the introduction of the individual schemes as an element of financialisation of pension provision. In other words, the IPS is only another stage of the pension reform advised by the WB (Guzel, 2005).

For that reason we argue here that despite the independent appearance of social security reform and the IPS, both serve for the financialisation of pensions while the former shrinks the state pensions and paves the way for the latter for those able to participate. The argument of financialisation of pensions is based on three assertions. First, it is aimed to change the main source of the pension income from state schemes to individual savings with the reforms. Second, the main factor determining the level of pension income is changed from tax and contribution premiums to financial market performance. Third, the perception of pension as a right for social security is changed into pension as an individual investment under the shadow of the IFIs. These three features of financialised pension provision are demonstrated by investigating the experience of the pension system in Turkey.

The role of the IPS in terms of financialisation is even more explicit when we investigate the way in which it has developed and general characteristics of its participants. As illustrated in the table below, the IPS started its journey in 2004 with 330 thousand participants' funds of TL300 million which is invested by 10 companies. However, these modest numbers have increased substantially when in 2013 the number of participants were more than four millions and the value of funds within the system amounted TL25 billion.

**Table 5.11 Development of the Individual Pension System between 2004 and 2013**

Year	Number of Participant	Funds (TL)	Number of intermediaries	Number of pension companies
2004	334,557	296,133,224	5,597	10
2005	714,146	1,227,661,174	10,029	11
2006	1,073,650	2,821,487,474	12,135	11
2007	1,457,704	4,570,924,599	12,422	11
2008	1,745,354	6,372,756,623	13,735	12
2009	1,987,940	9,097,436,467	15,666	13
2010	2,281,478	12,011,986,651	16,716	13
2011	2,641,843	14,329,771,986	17,868	15
2012	3,128,130	20,346,290,278	20,176	17
2013	4,153,055	25,145,718,418	26,639	18

Source: Data are collected from several Pension Monitoring Centre Reports available at: <http://www.egm.org.tr/?pid=360> Access date: 12.Dec.2014

In line with the ILO Report (1996) the IPS has been supported by tax incentives from the beginning. Before 2013 the incentive was implemented as tax exemptions, i.e. the contributions to the IPS and a certain percentage of the benefit gained from the IPS was excluded from income tax. The form of incentive was changed in 2013 from tax exemption to direct contribution of 25%, i.e. for participant's every TL100 contribution government contributes TL25.<sup>64</sup> This lucrative incentive doubled the increase in the number of new participants and caused one million new people to join the IPS in 2013. Moreover, the average contribution paid by new participants in the system increased by around 30%. As a result, at the end of 2013, the fund value of the system rose beyond 25 billion Turkish Liras with an increase of 24% in one year.<sup>65</sup> But not all contributions accumulated within the system are invested because the administrative expense fees are deducted. As the IPS came into effect in 2003 and those entering the system needed to stay within the system at least ten years, by 2013 the system rewarded its first pensioners who turned 56 years old. The number of participants entitled to pensions in 2013 was 7,577.<sup>66</sup>

<sup>64</sup> State contributions are subject to certain contribution ceilings and they are invested separately from individual's contributions. This is elaborated in the next chapter.

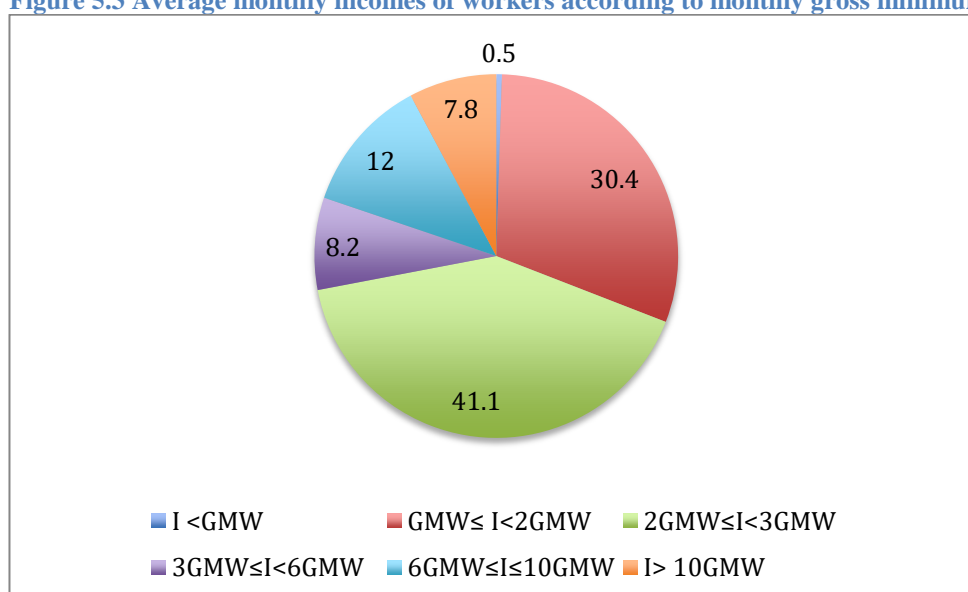
<sup>65</sup> Although the Turkish lira value of the funds increased in 2013, because of the depreciation of the Turkish lira against US\$ the value of funds contracted in US\$ terms (PMC, 2014).

<sup>66</sup> By the end of 2013, TL 21,455,900,238 was invested after deduction of TL 465,959,876 fees for administrative expenses from the total amount collected from contracts in force. Apart from contributions, an amount of TL 188,221,931 was paid as entrance fee.



The participants in the IPS are mostly middle- or high-income earners who see IPS as an external saving mechanism that is supported by lucrative tax incentives rather than additional old-age income. This argument is supported by the data on participants of the IPS. Most of the IPS participants have monthly income that is higher than the gross minimum wage (GMW). More than 70% of participants' net income ranges between one and three times monthly GMW.<sup>67</sup> On the other hand, participants with net monthly income more than six times of GMW (but less than 10 times of GMW) make up 12% of total participants (they own 33.8% of total accumulation). The number of participants with monthly income equal or less than the GMW is only 0.5% of total participants while they accumulate only 0.2% of total funds. On the other hand, participants with income level higher than 10 times of GMW (7.8% of participants) accumulated 43% of total funds (PMC, 2013, p.24). It is transparent that people with low-income levels do not have a place in the IPS whereas high-income participants mostly benefit from the system.

**Figure 5.3 Average monthly incomes of workers according to monthly gross minimum wage**



Source: (PMC, 2013)<sup>68</sup>

By 2013, the average age of the IPS participants is recorded as 38 while the weighted average age in terms of accumulation owned is 44.8. This means most of the participants are young or middle-aged whereas older participants own more assets. According to the profession data in 2013, the dominant share of the

<sup>67</sup> The share of this income group within the total accumulation of the funds is 53.2%

<sup>68</sup> The data on net income of participants are collected on the basis of information they give during registration to the pension company. The figure is drawn on the basis of the information given by 21.5% of participants. Not all participants give accurate information on their income level.

participants is the self-employed with 28.9% of all the IPS participants. Further, 16.1% of participants are housewives and the share of doctor/pharmacist is 8.2% while 8% of the participants are workers.<sup>69</sup> The shares of participants with professions of bank personnel, engineer and civil servant are all around 6%. Finally, a mixture of teacher, academician, lawyer, architect and retired people consist of 20% of participants.

There are other researches supporting our argument. For instance, research by Sener and Akin (2010) shows that almost 75% of the participants have income more than 1000 Turkish Liras per month (which is more than the minimum wage of the time); and the willingness for participating in the system is less with people who have income lower than 1500 TL per month. This reveals that the system is popular amongst people who are from the middle-income range. In a similar vein, Onal (2001) argues that lower income-groups would not participate in the system because modest contributions would draw insignificant returns as shown by Ergenekon (2001) with a simulation (lower income groups get a pension from the IPS with a replacement rate of 53%).

What all these findings tell us is that the IPS is a system which mainly comprises of young, middle- and high-income earners with high-education levels. However, this participant profile is not exactly what was suggested within the ILO Report (1996). Accordingly, the IPS was supposed to increase the coverage of pension system by including self-employed and agricultural workers. This argument was underpinned by the reasoning that people from these employment statutes have very unsteady income flow thus they are not able to fit in PAYG scheme. However, the flexible nature of private schemes would suit their conditions.

Indeed, agricultural workers in Turkey are excluded from the social security system through high premium floors (Gokbayrak, 2011). The agricultural workers who constitute the lowest income group (ILO, 1996) are not covered by the IPS as revealed by the income characteristics of members above.<sup>70</sup> Thus, most of the agricultural workers is compelled to survive with a means-tested social assistance pension, which is given to people who are more than 65 years old and is very low

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<sup>69</sup> Only 35% of the participants give accurate information of profession.

<sup>70</sup> As mentioned before, the share of people who have less income than minimum wage is only 0.5%. Thus, it can be argued that rural area workers could not have participated in the IPS. Even if they did so, their returns would not be satisfactory since the studies show that the IPS can only provide reasonable pension income if the contributions are higher than a certain threshold which is beyond the limits of what farmers can afford.

(around 35% of monthly minimum wage and paid in every three months). Thus, the IPS is far from providing solutions for the coverage problem of the reformed pension system in terms of agricultural workers.

On the other hand, self-employed people participate in the IPS as the most dominant group of professionals as mentioned above. The number of participants in the IPS is 4.1 million as of 2013. This means there were around 1.2 million self-employed in the IPS by 2013.<sup>71</sup> The decreasing number of self-employed people in the social security system can be seen from the table below. We read this as self-employed people who opt out from the state system, due to lower pension benefits and higher premium contributions, participate instead in the IPS.

**Table 5.12 Active members of the Turkish social security system**

Coverage	4a Private sector workers	4b Self-employed	4c Civil Servants	Total Insured
2008	9,574,873	3,260,719	2,205,676	15,041,268
2009	9,618,438	3,236,872	2,241,418	15,096,728
2010	10,575,935	3,337,858	2,282,511	16,196,304
2011	11,547,134	3,273,297	2,554,200	17,374,631
2012	12,527,337	3,162,914	2,662,608	18,352,859
2013	13,136,339	2,927,250	2,823,400	18,886,989
2014 July	13,609,439	3,008,365	2,864,800	19,482,604

Source: Social Security Institution Insurance Statistics, Monthly Basic Indicators 2014 July (Social Security Institution, 2014)

The second column of the table 5.12 shows the number of self-employed people in the PAYG pension scheme (with the official code of 4b). This number has decreased whereas the numbers of workers in the private sector (4a) and civil servants (4c) have increased. When we calculate the percentage of self-employed people with active membership of the social security system, we see that their share decreased from 21% to 15% between 2008 and 2013.<sup>72</sup> On the other hand, at the same period, the total number of self-employed people in the IPS increased from 815.000 to 1.162.000. Thus, we draw the conclusion that self-employed people have responded to the social security reform, exactly in the way the authorities expected: replacing the state pension with the individual scheme.

<sup>71</sup> 28.9% of 41530055 equals to 1.200.232.

<sup>72</sup>  $3261/15041 = 0.21$  and  $2927/11887 = 0.15$ . We take the social insurance systems' data for 2013 because the data on IPS are available for that year.

**Table 5.13 Passive members of the Turkish social security system (in 000s)**

<b>SSI Coverage</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014*</b>
<b>4a</b>	5,024	5,290	5,535	5,777	6,026	6,260	6,409
-Old Age	3,467	3,665	3,850	4,041	4,235	4,412	4,534
-Survivors	1,362	1,426	1,483	1,531	1,582	1,635	1,659
<b>4b</b>	1,965	2,088	2,160	2,381	2,469	2,422	2,444
-Old-age	1,252	1,341	1,383	1,515	1,553	1,575	1,587
-Survivors	698	731	760	847	896	828	836
<b>4c</b>	1,756	1,795	1,822	1,856	1,886	1,923	1,941
-Old-age	1,252	1,341	1,383	1,515	1,553	1,575	1,587
-Survivors	528	543	552	566	578	592	603
<b>Total pensioners</b>	8,746	9,173	9,518	10,014	10,382	10,607	10,795

Source: Social Security Institution Insurance Statistics, Monthly Basic Indicators 2014\*:July (Social Security Institution, 2014)

Another projection of the ILO report was that the establishment of the IPS would decrease the burden of state in terms of pension spending while assigning individual responsibility within the pension system. Meanwhile, the government would devote the resources previously used to subsidise the PAYG scheme into the social assistance scheme. Thus, the pension spending, which is high but not adequate to cover low income groups who do not have any other pension benefits, would be less but much more effective (covering more people in poverty). However, this projection proved to be wrong because the IPS does not decrease the state's burden since it is subsidised by incentives. By the end of 2013, the total amount paid in this regard was TL1,369,932,116 for 2,800,129 participants which equals to TL489 per person for contributing to the IPS (PMC, 2013).

It is clear that the IPS cannot provide solutions to problems of the Turkish pension system as long as it does not mitigate the structural problems of the labour market. There is no need to show for what reasons unemployed and informally employed people are not able to join the IPS. However, there is an interesting point worth to be discussed. That is the female participation in the IPS which is considerably high in a way that supports the argument that the private scheme is gender-equal for being independent from employment status. Indeed, female participants own 42% of the total accumulations. Moreover, 16.1% of participants define themselves as housewives, i.e. unpaid house worker. Some authors explain

this outcome, the IPS being equal in gender terms and gives similar results for women and men, with the fact that most of the participants in the IPS belong to similar socio-economic backgrounds (Ş. Sahin et al., 2012). Moreover, it is argued that as much as social security system becomes commercialised in Turkey, gender disparity within the IPS would reflect those in labour markets in particular and society in general (A. Y. Elveren, 2008) (Bozkus & Elveren, 2008).<sup>73</sup>

There are several reasons for private pension schemes to not provide the gender equality that is attributed to them. First of all, although contributions are flexible, it is still a crystal clear fact that the wage levels are different for men and women. Moreover, starting with lower wages and having lesser increases in wages cause another significant difference between men and women. Further, since women's funds are smaller than men's, the management expenses' share is higher for women than men. Finally, women live longer than men with a smaller pension pot (Ş. Sahin & Elveren, 2014).

“Since women have a higher life expectancy even if they have the same capital accumulation through their working years compared to men, women's retirement income will be lower because the total amount is distributed during a longer time period. Gender inequality is perpetuated and deepened in the private pension scheme with overall gender-biased regulations in social security. Our results show that women are disadvantaged from the outset, receiving a lower wage than men, and therefore contributing less to their private pension scheme than men, on the whole. This discrimination is worsened when we account for the fact that women work fewer fulltime years than men”. (A. Elveren Y. & Hsu, 2007, p. 8)

Thus, projections show that the pension income difference of women and men from the IPS would range around 20% to 79% on the basis of age and education (Ş. Sahin et al., 2012).

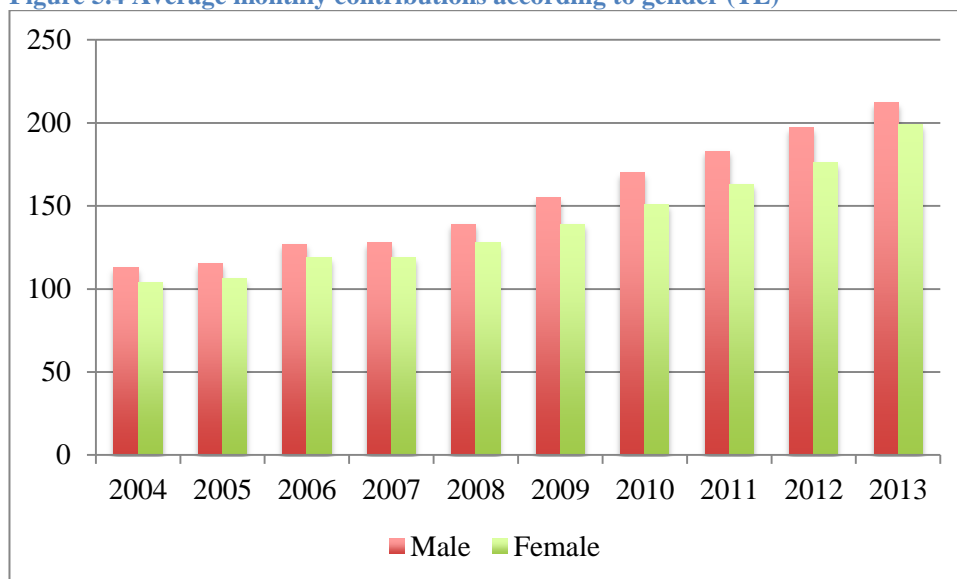
Indeed, when we look closer at the monthly contributions according to gender, we see that women's contributions are always lower than men. Since the

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<sup>73</sup> According to Bozkus and Elveren (2008), when the income effect is eliminated, women and men differ significantly in terms of their contributions to the system which change according to the age, education level and the cities in which they live. Second, although the regular contribution rates seem similar for both genders, the influences of other social factors (age, education level and the city in which they live) make considerably different impacts on women and men. This finding is reached as a result of a simulation which assumes that all working people join the system, and the state system is completely privatised to show how women and men's pension income would vary.

return from the contributions determines future pension income, it can be argued that women would draw lower pension benefits from the IPS.<sup>74</sup>

**Figure 5.4 Average monthly contributions according to gender (TL)**



Source: (PMC, 2013, p. 33)

To sum up, pension reform and the IPS do not address the problems with the Turkish pension system which originate from structural distortions within the labour market, such as high unemployment, high informality and low labour participation rates particularly across women. This invalidates the arguments of the WB and other defenders of pension reforms who bring forward the ageing population and high pension spending of governments to justify reforms. In particular, in developing countries where the income level is low, not least amongst the elderly, destroying the state schemes exacerbates the inter-generational redistribution of income. The private schemes, like the IPS, do not compensate for the backlash within the social security system pensions because private pensions are mostly preferred by, and benefit, middle- and high-income earners. Moreover, the pension returns from these schemes are completely dependent on financial market performance. This feature of private schemes puts old-age income under threat particularly in countries with unstable financial markets.

<sup>74</sup> The regional dimension of the IPS also shows expected features. The monthly regular contributions paid for the contracts in force in 2013 is 205 TL whereas this amount is 219 for participants who reside in the Marmara region which is the most developed, industrialised and urban region of the country. Moreover, there are 18,159 contracts with participants who are living abroad.

## 5.5. Conclusion

In this chapter, the idea of financialisation of pension provision is discussed in the context of the Turkish social security reforms and the private funded scheme, the IPS. In 1999, the transformation of the pension system has started through several reforms including a Social Security Reform reorganising the social security pensions and the Individual Pension System reform which introduced the private component to the pension system.

We argue that pension reform trends in Turkey display significant similarities with pension reforms across the world. These themselves can be dated from the second half of the 1990s, following the WB's "Averting the Old-Age Crisis" Report (WB, 1994). In common with elsewhere in the world, pension reform in Turkey has involved: tightening eligibility rules for getting a pension, such as higher retirement age and longer contribution periods; lower pension benefits through changing the benefit calculation and indexation methods; and introducing, or strengthening, the existing (private) financial component of the pension system.

The WB's pension model posits the state as basic income provider for the elderly in need whereas the main source of pension income is the accumulated funds of individuals. In this regard, the WB points at the involvement of the IFIs in policymaking on pensions while representing the interests of finance. Thus, the pension income has increasingly become financialised by being channelled through financial conduits, as well as, being dependent on financial market performance. This does not only put the elderly income at risk, but also changes the perception of pension income from 'right to social security' to 'individual responsibility'.

The pension reform in Turkey has been accomplished in three stages and, with the new model, the PAYG state scheme pays less (basic) pension benefits and with more difficult eligibility criteria, while the private funded scheme, the IPS, functions as a complement to the state scheme. As showed earlier, this model fits entirely with the advice of the WB for decreasing the state PAYG scheme's share in the pension income and increasing the role of the financial element, the IPS in the case of Turkey. The IPS is attributed overwhelming functions to solve the problems of the social security system, such as coverage and state burden. In effect, this is not surprising because the argument of 'ageing population', which holds for the high-income countries, does not address the problems of the social security system in Turkey, a country with a very young population. By illustrating through empirical

data it is shown that addressing funded schemes for problems they are incapable of solving is a way of concealing the real logic underlying pension reforms, i.e. financialisation. Analysing the social security reform in association with the IPS is crucial in providing evidence for the financialisation of pensions.

This three-staged reform process has a rationale behind it: financialisation. For, pensions provided by the state should be lowered to a minimum, basic level; thus, the private schemes are designed to allow for desirable living conditions in old age. Since these, heavily propagated, individual schemes invest in financial markets, pension income is contingent on financial market returns and performance. This can be read as the financialisation of pension provision while financial markets fill the gap created from the withdrawal of state from the provision of pension income. In other words, financialisation plays a dual role here: first, it underlies the reform process by shaping the pension provision through involvement of the IFIs in policymaking. Second, it renders pension income to be provided through a financial conduit.

Moreover, financialisation of pensions has had several impacts by being justified through ill-defined problems of the pension system while exacerbating the real problems. The main social security problems in Turkey are high employment, informality and low participation of women in the workforce. These problems originate from labour market structures and have been aggravating social security budgets by increasing the number of people who are benefiting from the system while the number of people contributing to the system decreases. None of the reforms of social security system has provided solutions to these problems, nor has the IPS. In effect, the eligibility rules are tightened in a way which excludes vulnerable people from the social security system. Therefore, the impact of financialisation of pensions, as an element of social security reform and the IPS, has been crucial particularly for vulnerable groups.

To sum up, social security reform and the Individual Pension System represent the financialisation of pension income by decreasing the pension income from the state PAYG system and linking elderly-income to financial market performance through pension funds. Financialisation of pensions refers to the individual saving mechanisms the state promotes as the main source of pension income for the better off, through which the level of pension income is determined by the financial market performance. At the same time, financialisation of pensions



resides within a bigger picture where finance increasingly integrates into social areas which were partially or entirely immune to finance in the past.

## **6. Financialisation and Pension Funds In Turkey**

### **6.1. Introduction**

The relationship between financialisation and pensions is discussed in two contexts in this study. In the previous chapter, we scrutinised the impact of the financialisation of pension provision which changes the way in which people receive pensions. On the other hand, now, we put forward a different side of the analysis: pension funds' role in financialisation of the economy. In this chapter we argue that pension funds, that were established in 2003 as a component of the private pension scheme, namely the IPS, contribute to financialisation of the economy in Turkey. Pension funds' function in terms of financialisation is visible in their impacts on the formation of capital markets in Turkey.

In a nutshell, financialisation is the extensive and intensive growth of finance into ever more areas of the economic and social processes (Fine, 2013). In this regard, capital markets play a substantial role through enabling the production and exchange of sophisticated securities which cover assets that were out of financial conduits in the past. For instance, a person's mortgage debt has become a financial instrument while this was not the case previously. Moreover, through securitisation, the relationship between the underlying asset and the security produced on the basis of the asset becomes weaker and ambiguous. This results in an increasingly speculative character of capital markets, an attribute of financialisation. Therefore, it can be argued that capital market formation is crucial in order to understand financialisation.

Regarding financialisation, we define two impacts of pension funds on the development of capital markets: first, the supply impact, which is characterised by rapid growth of pension funds which provide new capital inflows to financial markets, thus enabling the quantitative growth of capital markets; second, the demand impact of pension funds that stimulates the innovation of new investment instruments in general, and securitisation in particular. This argument that pension funds contribute to financialisation in Turkey, through transforming capital markets via supply and demand impacts, is developed in two sections.

In the first section, we introduce the general characteristics of pension funds in Turkey by reviewing the relevant regulations. According to these, a person can join a private pension scheme by signing a contract with a pension company. The

pension company establishes at least three pension funds and assigns portfolio managers (at least one for each fund) to manage the portfolio of pension funds on the basis of *fiduciary and risk diversification principles*. A participant, on the other hand, chooses amongst different pension plans in which his/her contributions are invested. In order to clarify the risk and return features of a pension fund, the system consists of pension fund types.

Since the beginning, there have been six pension types which vary according to investment instruments, strategies or both. These are: *income, growth, money market, precious metals, specialised and other* types of pension funds (PMC, 2016). After identifying each type's peculiarity, we bring in two more pension fund types which have been introduced recently: state contribution type of pension funds and participation/alternative type of pension funds. State contribution funds were established after the 2013 regulation which introduced state contribution incentive of 25% matching contributions for each participant.<sup>75</sup> On the other hand, participation funds (also known as alternative pension funds) are *interest-free* pension funds which only invest in non-interest securities in order to attract participants with religion-related concerns (Islam prohibits interest income).

Then, we review the development of figures on pension funds in Turkey. According to the data, the total value of *pension funds' assets* have grown from TL42 millions in 2003 to TL37 billions in 2014 while the number of the IPS participants exceeded 5 million. Pension funds' portfolio value had exceeded the portfolio value of mutual funds by 2014 (CMB, 2015a). We emphasise that the breakthrough in terms of the growth of pension funds dates from after 2013 regulation which introduced state contribution incentives (CMB, 2014a). As a result, the share of pension funds' assets in GDP has grown from 0.39% in 2003 to 4.86% by 2014. This absolute growth of pension funds is supported with relatively rapid growth of pension funds compared to other institutional investors in Turkey (OECD, 2016).

Moreover, across OECD countries, Turkey stands as a *newcomer* which has a very small, but also one of the *most rapidly growing*, pension funds' portfolio value. Although having one of the smallest capital markets in the G20 countries with *market capitalisation value* of USD309 billions in 2012, Turkey has shown the most

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<sup>75</sup> Available at: [http://web2.egm.org.tr/webegm2/yeni\\_web/devlet\\_katki\\_main.asp](http://web2.egm.org.tr/webegm2/yeni_web/devlet_katki_main.asp) Access date:31.05.2015

rapid growth in one year with a 53% increase in 2012.<sup>76</sup> The most recent data indicate that this growth has slowed down in the last two years.

In the third section, we deal with demand side impacts of pension funds on capital markets which significantly alter the qualitative character of capital markets in Turkey. Accordingly, the share of public securities within the total outstanding securities has been declining whereas the share of private sector securities has increased from 8.4% in 2003 to 26.9% in 2014 (CMB, 2015a). Moreover, within the private sector securities, the dominance of shares has decreased while other instruments have been introduced such as *bank bills*, *corporate bonds*, *asset backed securities (ABSs)* and *warrants*. The percentage of bank bills within the total outstanding securities has been recorded as 4.6 by 2014. Similarly, corporate bonds have constituted 3.3% of total outstanding securities in 2014. ABSs and warrants are still insignificant in terms of their shares within the capital markets (less than 1%). While issuing these instruments, or changing regulations in a way which enables these instruments to be issued, the authorities acknowledge pension funds as the initial source of demand for them.

Then, we scrutinise the pension funds' demand effects for innovation in capital markets in Turkey through a concrete case: *lease certificates* and their relations with *participation accounts*. With these, pension funds' portfolio allocation has changed significantly, while the share of government debt securities has decreased from 80% in 2005 to 57% in 2014. Meanwhile, the share of assets gathered under the label of 'other' has increased from its initial value of less than 1% (in 2003) to 21% in 2014 (CMB, 2015a). We associate this shift from government debt securities to other assets with the proliferation of new instruments such as bank bills, corporate bonds, ABSs and warrants, and lease certificates in particular.

Lease certificates, in a nutshell, are new capital market instruments which work on transfer-lease-take over principle which is a form of *securitisation* known as special purpose entities in the international markets (Treasury, 2015). In Turkey, lease certificates are packaged with Islamic references and advertised as '*interest-free bills*' that are appropriate for religious investors who want to avoid interest income. In this regard, government established interest-free state contribution

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<sup>76</sup> Available at: <https://www.quandl.com/c/economics/stock-market-capitalization-by-country> Access date: 28.05.2015

pension funds which had invested 93% of their portfolios in lease certificates by 2014. In a similar vein, participation/alternative pension funds established by pension companies invest 63% of their portfolios in lease certificates in 2014 (PMC, 2014).

In other words, securitisation in Turkey is packaged with religious references while the demand for these securities is provided by pension funds. This feature of intensification of finance indicates a peculiarity of financialisation in Turkey. We conclude with a summary of the main arguments made within the chapter and point out the contribution of this chapter in terms of analysing diverse impacts of financialisation of pensions in the context of capital markets.

## **6.2. Pension funds in Turkey and supply side developments**

Pension funds in Turkey were founded in 2003 as a component of the private pension scheme, the IPS. In the IPS, participants get pension income according to the contributions made and the returns on contributions from investments in pension funds. The fund is managed by the portfolio managers while the participant chooses across different fund types those are available within the plans of the pension company. There are no upper or lower restrictions in terms of investment amounts and participants are able to check the profitability of the fund by accessing information through Takasbank.<sup>77</sup> Pension funds invest pension contributions of the participant on the basis of two principles; *fiduciary principle of property* and *diversification of risk*. Fiduciary principle stands for the responsibility of the fund manager in terms of protecting the interests of the investors who gave them the right to decide for them. Fund expenses are covered through fee cuts on the fund while the total cut cannot exceed the percentage determined by rule. The total management fees include the operation fees. Management expense fees can be charged on the contributions at the maximum rate of 2%. Since 2012, in every three months, the company board implements a registration fee that is 1/100,000 of the fund's asset value (PMC, 2016).

The minimum number of funds that a pension company has to found is three and each fund needs to sign contract with at least one portfolio manager in order to start performing. Independent portfolio management companies undertake the

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<sup>77</sup> Takasbank is the custodial institution mentioned in the previous chapter. The website of Takasbank enables participants to control their savings' distribution across different fund groups. A participant is allowed to change the distribution of the accumulations in their accounts amongst different fund groups at most 6 times a year.

allocation of pension fund portfolios. If a pension company is associated with a bank, the bank's fund managers undertake the management of the pension funds. 5% of the issued capital of the company is registered and fund portfolios are established with the amounts that correspond to this level (for each of three funds separately). If the value of shares exceeds the amount indicated within the directory of the fund, the number of shares is increased. Pension funds do not have a legal entity. Thus if the pension company goes bankruptcy, the funds and their returns cannot be appropriated as collateral to the company's debt. In other words, pension funds' assets cannot be hypothecated, shown as collateral to any other transaction except portfolio-related ones, or included in bankruptcy arrangements.

There are some restrictions on investment decisions of pension funds: no more than 10% of pension funds can be invested in the same issuer's money and capital market instruments. For asset leasing companies, this restriction is applied at 25% rather than 10%. Moreover, the government debt securities both in TL and in foreign exchange (known as 'Eurobonds') are exempted from this restriction. Finally, the stocks issued by companies treated in BIST30 index are exempted from this constraint as well. Pension funds' portfolios have to consist of assets treated in the stock exchange. Securities other than those on the stock exchange market can only be included up to 10% of the portfolio value. Deposit and participation accounts can be included to the portfolio maximum of 25%.<sup>78</sup> However, the deposit or participation accounts held in one bank cannot exceed 6% of the portfolio. Debt securities and lease certificates issued by banks cannot exceed the 25% of the fund portfolio. And, share of one company cannot be invested in more than 10% of the portfolio. A maximum 10% of the portfolio can be invested in money market transactions. Maximum 20% of pension funds' portfolios can be invested in mutual funds but one mutual fund's share cannot exceed 4% of the portfolio. Warrants cannot be invested in more than 15% of the pension fund's portfolio.

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<sup>78</sup>Participation account is an interest-free deposit account established in the participation banks for people who want to avoid interest-income which is regarded to be sinful in Islam. Return of participation account is based on capital participation of the bank from the investments of the borrowers.

**Table 6.1 Constraints on pension funds' portfolio investments**

Asset type	Maximum %
Deposit / Participation Bank Accounts	25
Takasbank Money Market Transactions	10
Mutual Fund Shares	20
Asset backed securities	20
Warrants	15

There are different types of funds which are classified according to the dominant security in which they are mostly invested, by investment strategy or both. The Capital Markets Board determined six types on the 10<sup>th</sup> of May 2002: *income*, *growth*, *money market*, *precious metals*, *specialised* and *other funds*.<sup>79</sup> When a participant joins the system and needs to choose from different funds, the type of fund becomes a sort of indicator in terms of risk and return expectations. For instance, an 'income type' pension fund, with a name such as 'Public debt securities income fund (TL)', implies that the dominant share (at least 80%) of the fund's portfolio consists of public domestic debt securities as well as reverse repos for bonds and T-bills.<sup>80</sup> There are also income type pension funds which mostly consist of government foreign debt securities issued by the Treasury of Turkey in US\$ or Euro, i.e. *Eurobonds*. Eurobond is an internationally listed investment instrument which is issued in the foreign exchange and suitable for long-run investment. All types of funds, in order to maintain the risk aversion principle, might consist of other assets such as gold and similar precious metals, and derivatives and other money market transactions such as options, forwards, warrants, future contracts.<sup>81</sup>

<sup>79</sup> The IPS regulation is available at the capital markets board website: <http://www.spk.gov.tr/apps/Mevzuat/PrinterFriendly.aspx?nid=13455&submenuheader=null> Access date: 01.05.2015

<sup>80</sup> Reverse repos, in length 'reverse repurchase agreement', indicates the purchase of securities with the agreement to sell them at a higher price at a specific future date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement. Repos are classified as a money-market instrument. They are usually used to raise short-term capital. Available at: <http://www.investopedia.com/terms/r/reverserepurchaseagreement.asp#ixzz3YagfOiTw> Access date: 02.05.2015

<sup>81</sup> A warrant is a derivative security that gives the holder the right to purchase securities (usually equity) from the issuer at a specific price within a certain time frame. Warrants are often included in a new debt issue as a "sweetener" to entice investors. The main difference between warrants and call options is that warrants are issued and guaranteed by the company, whereas options are exchange instruments and are not issued by the company. Also, the lifetime of a warrant is often measured in years, while the lifetime of a typical option is measured in months. Available at: <http://www.investopedia.com/terms/w/warrant.asp#ixzz3YaxI6MzW> Access date: 02.05.2015

In comparison with the income funds, the growth type pension funds direct more investment in stocks of private sector companies. The most preferred stocks belong to the companies those are listed in the BIST 30 index.<sup>82</sup> However, in the case of some growth funds, the portfolio mainly consists of foreign companies' stocks. Money market type pension funds mostly invest in money market transactions such as options, forwards, warrants and future contracts. Precious metal type pension fund, on the other hand, mainly comprise gold and other precious metals related assets. Specialised type pension funds are more focused than both income and growth funds. For instance, a '*developing-countries investment*' pension fund might consist of Brazil, China, India and Russian companies' stocks as 80% of its portfolio. In a similar vein, a specialised fund might predominantly invest in stocks of one particular company. However, in order to stay within the investment restrictions of the pension funds regulations, the name of the fund has to clearly express this specific company. In other words, if a pension fund invests in a particular asset type more than 80% of the portfolio, the fund name has to indicate this. Finally, 'other' types of pension funds are those which only include standard investment instruments in order to give time to the new participants until they decide their investment strategy. Until now, we have summarized the general characteristics of income, growth, money-market, precious metals, specialized and other types of pension funds. However, after 2013, a new type of fund is established as a result of the state contribution incentive: the state contribution fund.

In more detail, state contribution incentives came into effect on 1<sup>st</sup> of January 2013 in order to promote participation in the IPS. For this, the state contributes to participant's account at the amount of 25% of the contribution made by the participant. The participant does not need to fulfil any other requirements to benefit from this incentive; contributing to the IPS is sufficient. Although the contributions to the IPS are not limited, the amount of the contribution which is subject to incentive is limited. The state contribution cannot be applied to amounts more than the annual gross minimum wage. In other words, the annual state contribution cannot exceed 25% of annual gross minimum wage.

The Pension Monitoring Centre tracks the contribution amount and informs the state about it. Then, the state transfers 25% of that amount to the participant's

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<sup>82</sup> BIST stands for the abbreviation of Borsa Istanbul which is the name for stock exchange market.



state contribution account. There is an important nuance here: the **participant's own account is different and separated from the participant's state contribution account**. For instance, a participant who makes TL200 contributions every month has a state contribution of TL50 in her state contribution account. Thus, participant's accumulation increases to TL250. If the participant opts out from the IPS, the state contribution and corresponding returns on these contributions are paid to the participant on the basis of time spent by participant at the IPS. In order to be entitled to the state contribution fund and its returns in full, a participant has to stay within the system until retirement, death or disability.

“Percentage of entitlement to state contribution, based on the period of time spent within the system as from January 1, 2013, shall be 15% from 3 to 6 years, 35% from 6 to 10 years, 60% for 10 years and over and 100% for retirement, death and disability. On the basis of the returns of the entitled portion of the state contribution, a withholding tax of 15% shall be imposed for those who pay contributions for less than 10 years, 10% for those who pay contributions for at least 10 years but opt out before they are entitled to retirement, and 5% for those who opt out due to reasons such as retirement, death and disability.” (PMC, 2013, p. 50)

State Contribution Funds can invest in certain instruments, as shown in the table below, according to portfolio limitations introduced by law.

**Table 6.2 Investment restrictions of state contribution funds**

<b>Instruments</b>	<b>Minimum%</b>	<b>Maximum%</b>
Government Bonds (TL), Revenue Sharing Bonds or Lease Certificate issued by Undersecretaries of Treasury	75	100
Turkish Lira Denominated; Deposit, Participation Account, traded in the stock market with the proviso bonds issued by banks or Lease Certificate issued by the bank's subsidiary leasing companies	0	15
BIST 100 Index or BIST Participation Index Shares	0	15
Reverse Repo and Takasbank Money Market Operations	0	1

Source: Adapted from (PMC, 2013, p.82).

Finally, there is one more type of pension funds which is either called participation or alternative type of pension fund. The portfolio of this type of funds consists of *interest-free* securities such as lease certificates, participation bank accounts, gold, capital markets instruments based on gold and other precious metals,

interest-free debt securities of private or public sector, and shares of companies listed in the BIST participation index. This type of funds is established for participants who do not want to get interest-income because of religious concerns.

In addition to these ‘types’, pension companies label their funds with different names such as ‘liquid’, ‘flexible’, ‘balanced’ etc. Hence, a ‘liquid-flexible fund’, for instance, might mostly consist of reverse repo and short-term Takasbank money transactions, for which the average maturity of the portfolio does not exceed 45 days. Lease certificates might also be heavily included within the portfolio. On the other hand, ‘mixed’ income type pension fund might invest in corporate bonds in order to provide long-term interest income. Fund type called ‘flexible-balanced’ might be a mixture of public debt securities, stocks and reverse repo (stocks of companies treated in BIST). On the other hand, there are ‘flexible-growth’ funds with high-risk strategies. These funds consist of government and private sector debt securities, national firms’ shares, USA’s and EU countries’ debt securities, international (foreign) companies’ shares and reverse repo of national companies are selected from those listed on the BIST. These examples can be proliferated but the reasoning is clear: pension fund title signifies the investment strategy and implies a certain kind of risk-return expectation.

**Table 6.3 Development of the Pension Funds in Turkey between 2003-2014**

Year	Number of Funds	Net Asset Value (Thousand TL)	Number of Investors
2003	68	42,779.00	15,245
2004	81	296,124.83	314,257
2005	96	1,219,049.10	672,696
2006	102	2,821,384.52	1,073,650
2007	104	4,558,886.00	1,457,704
2008	121	6,041,612.07	1,745,354
2009	130	9,105,097.38	1,987,940
2010	140	12,017,953.46	2,281,478
2011	165	14,345,204.85	6,569,933
2012	176	20,357,692.13	3,128,130
2013	237	26,186,322.64	4,126,956
2014	246	37,771,442.17	5,062,659

Source: Capital Markets Board Monthly Statistical Bulletin March 2015 (CMB, 2015a).

On the basis of this structure, the Turkish pension funds have grown rapidly in both number and portfolio value since 2003 when the IPS was founded. As can be seen from the table below, the initial number of pension funds was 68 in 2003 and it has been recorded as 246 by the end of 2014. Between 2003 and 2014, the net asset value of funds has increased from TL42 millions to TL37 billions. The number of investors has risen from 15 thousand in 2003 to 5 million in 2014.

As the table 6.3 reveals, the most significant increase within the value of assets and number of investors has been recorded after 2012. The reason behind that is the new regulation introduced in January 2013. As mentioned before, the incentive of 25% of state contribution has been implemented since the beginning of 2013. In addition, with the same regulation change, the instruments that could be included in pension mutual funds' portfolios have been diversified. In this context, gold funds, lease certificate funds and basket-funds are new types of funds introduced. Moreover, participation funds, which only include non-interest instruments, are founded as well. The board fee, which is taken to improve and support the individual pension system, is decreased by 40% for pension funds and is abolished entirely for participation type pension funds (CMB, 2014b, pp. 52–3). Finally, with the new regulation it is clarified that if the fund name refers to a certain asset or sector, the fund needs to deploy at least 80% of the assets into that particular asset or sector. As a result of this regulation, the number of investors has increased by almost 2 millions and reached 5 millions at the end of 2014. Thus, the net asset value of the pension funds has almost doubled between 2012 and 2014, and recorded as TL 37 billions in 2014.

It is possible to show the rapid growth of pension funds in comparison with other financial market players such as mutual funds. As can be seen from the table below, between 2004 and 2014, the development of pension funds in Turkey is much more rapid than the development of mutual funds. First of all, the number of mutual funds has grown two times in the last ten years whereas number of pension mutual funds has grown three times at the same period. Secondly, the portfolio value of mutual funds has increased from TL24 billions in 2004 to TL33 billions in 2014. The trend of increase has not always been consistent, i.e. it is interrupted a few times. On the other hand, pension funds' portfolio value has increased from TL296 millions to TL37 billions in ten years. Moreover, the trend of increase in pension funds is

consistent and has not been interrupted except in 2011 when the portfolio value of pension funds decreased slightly in terms of USD.

**Table 6.4 Development of mutual funds and pension funds in Turkey between 2004-2014**

Year	Number of Mutual funds	Portfolio value of Mutual funds in Millions		Number of Pension funds	Portfolio value of Pension funds in Millions	
		TL	\$		TL	\$
<b>2004</b>	253	24,444	18,213	81	296	219
<b>2005</b>	275	29,374	21,872	96	1,219	902
<b>2006</b>	289	22,012	15,577	102	2,821	1,984
<b>2007</b>	297	26,381	22,508	104	4,559	3,890
<b>2008</b>	340	23,979	15,768	121	6,042	3,973
<b>2009</b>	316	29,608	19,921	130	9,105	6,126
<b>2010</b>	486	33,220	21,620	140	12,018	7,822
<b>2011</b>	595	30,219	15,905	165	14,345	7,550
<b>2012</b>	592	30,688	17,155	176	20,358	11,380
<b>2013</b>	522	30,083	14,131	237	26,186	12,300
<b>2014</b>	482	33,315	14,327	246	37,771	16,244

Source: (CMB, 2015a)

The growth of the pension funds in Turkey can be also shown through international comparison. For this purpose we use OECD data both in terms of absolute value of pension funds and the share of pension funds' assets value as percentage of GDP. The OECD defines pension funds' assets as those bought with the contributions to a pension plan for the exclusive purpose of financing pension plan benefits (OECD, 2016). According to the OECD data, by 2014, the amount of pension funds' assets of the United States has reached USD14 trillion. The leading example, United States, is followed by the United Kingdom with USD2.6 trillion pension funds' assets value. And other OECD countries with high values of pension funds include Australia, Netherlands and Canada as shown in the table below. There are two other countries which have big pension funds markets compared to their GDPs in 2014: Iceland with a pension fund value of 146.3% of the country's GDP and for Switzerland the share of pension funds is 125.6%.

**Table 6.5 OECD countries with highest and lowest pension funds value (Millions \$ and % GDP)**

COUNTRY	Value of pension funds in millions USD	Value of pension funds as % of GDP
United States	14,733,958	84.6
United Kingdom	2,685,370	96.0
Australia	1,685,992	113.1
Canada	1,304,264	74.7
Netherlands	1,282,009	161.1
<b>Turkey</b>	<b>14,292</b>	<b>2</b>
Hungary	5,043	4.1
Estonia	2,676	11.3
Slovenia	1,912	4.2
Luxembourg	1,813	3.2

Source: Source: OECD, 2015<sup>83</sup>

On the other hand, not all OECD countries have developed pension funds markets. For instance, Luxembourg has the smallest pension funds value with USD3.2 billion and is followed by Slovenia with USD1.9 billion of pension funds. These countries' pension funds are also small in terms of share of GDP, respectively 3.2% and 4.2%.

On the basis of this data we can posit Turkey as a newcomer but the growth of the pension funds is relatively rapid. The pension funds assets in Turkey increased from TL1.6 billion in 2004 to TL35 billion in 2013. The biggest increase is recorded in 2010 according to the OECD data. Moreover, we know on the basis of data provided by the Turkish authorities (CMB, 2015a), the jump between 2013 and 2014 is significant as well, with the rapid growth of pension funds continuing. As a result of this rapid growth, the share of pension funds relative to GDP has grown from 0.39% to 4.86% in Turkey between 2003 and 2014.<sup>84</sup> This growth trend has been steady except between 2011 and 2012 when the share of pension funds within GDP has decreased from 4.12% to 3.79%. In order to explain this contraction, we need to go to data provided by the CMB. Accordingly, between 2012 and 2013 pension funds assets have only grown by 0.8% of the growth rate whereas the GDP has

<sup>83</sup> OECD data for 2014. Available at: <https://www.oecd.org/finance/Pension-funds-pre-data-2015.pdf> Access date: 02.11.2016

<sup>84</sup> OECD Dataset Funded Pension Statistics OECD (2015) Available at: <http://data.oecd.org/pension/pension-funds-assets.htm> Access date: 18.04.2015

grown 4.2% (CMB, 2015a)(TURKSTAT, 2016). The growth of the share of pension funds within the GDP has continued after this temporary decline and reached the level of 4.86% in 2014.

In relation with the supply-side impacts of pension funds, the capital markets in Turkey have developed considerably. Market capitalisation (or market cap) is the total market value of the shares outstanding for public trade. It is calculated through multiplying the price of shares with the number of shares outstanding. The market capitalisation value in Turkey has increased rapidly after 2004 as can be seen from the table above. This rapid growth is evident when we compare it with the other countries. For instance, the biggest increase in stock market capitalisation in one year was recorded in Turkey in 2012 with a 53% rise. At the same year, the increase of stock market capitalisation has been recorded as 19% in the USA, 5% in the UK and 4% in Japan which are the leading countries in stock market capitalisation.

**Table 6.6 Market Capitalisation in Turkey between 2001-2012 in US\$ Millions**

<b>Year</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Market Capitalisation</b>	47,149	33,957	68,379	98,298	161,537	162,398
<b>Year</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Market Capitalisation</b>	266,572	117,229	225,735	306,662	201,817	308,774

Source: The World Bank Market Capitalisation Data (WB, 2015)

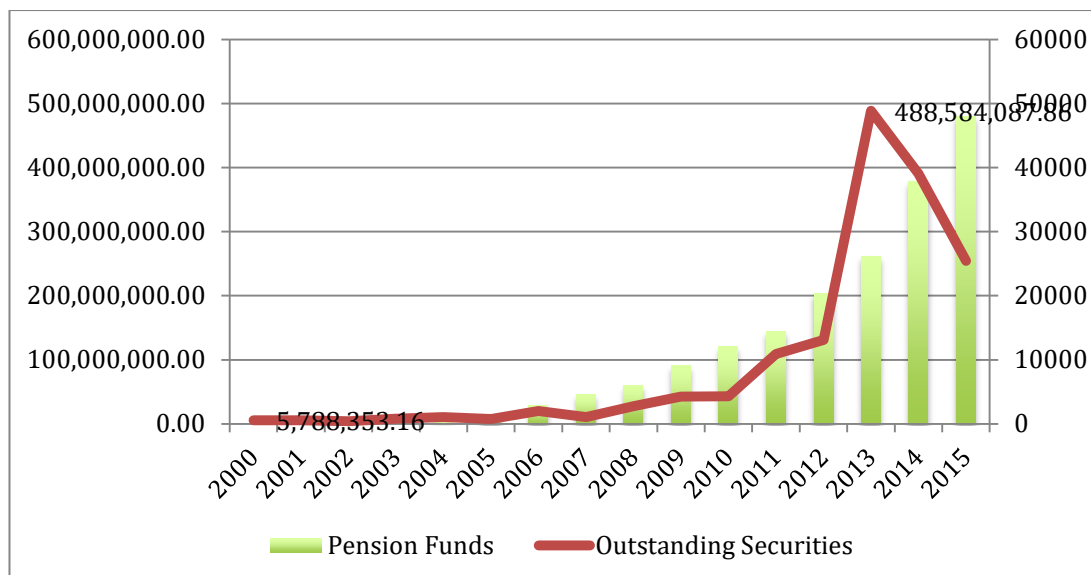
However, by 2012, Turkey still has one of the lowest stock market cap values amongst G20 countries. As we show in the table 6.7, Argentina has the lowest stock market capitalisation value with USD34 billion whereas Turkey is the second lowest with USD309 billion. By 2012, the highest market capitalisation value belongs to USA with USD18.6 trillion.<sup>85</sup> The recent data indicate that the rapid growth of market capitalisation has slowed down in 2013 and 2014, USD 273 and USD269 billion, respectively. Nevertheless, it can be argued that capital markets in Turkey have expanded significantly since 2004 (CMB, 2015b).

To sum up, on the basis of available evidence, it can be argued that, despite the relatively short history of the pension funds in Turkey, they now occupy a significant position in the Turkish capital markets along with other investment

<sup>85</sup> Available at: <https://www.quandl.com/c/economics/stock-market-capitalization-by-country> Access date: 28.05.2015

opportunities. Growth of the pension funds provides a supply of capital inflows for new capital market instruments.

**Figure 6.1 Pension funds' portfolio values and outstanding securities in the Turkish capital markets, Million TL, 2004-2015**



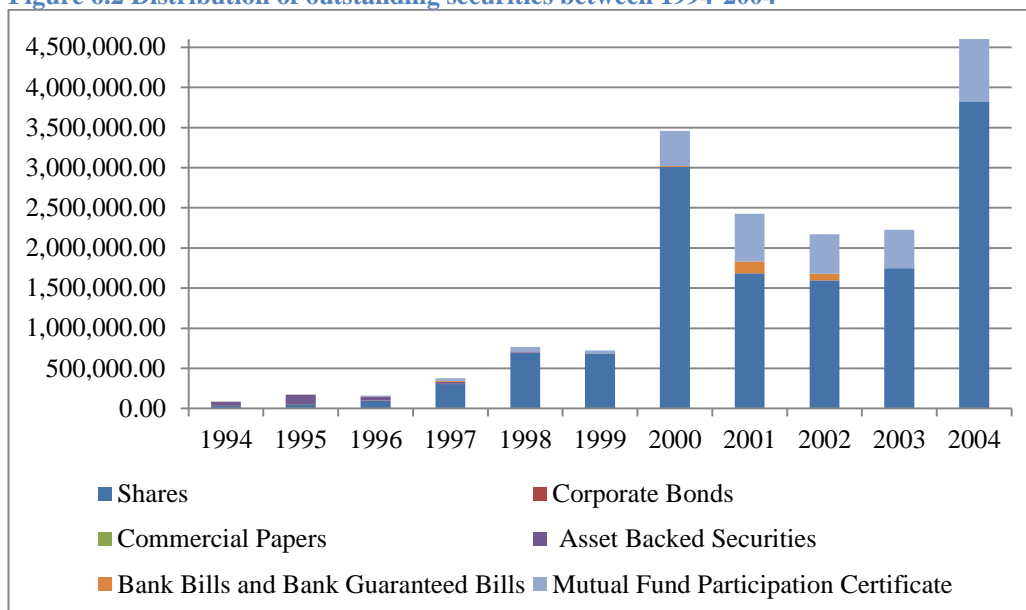
Source: CMB.

Note: Right axis pension funds, left axis outstanding securities.

The figure above can be interpreted as representing a conjunction of several factors which include establishment of pension funds but also other developments contributing to financialisation. In this regard, it does not come as a surprise that the moment when outstanding securities climb up drastically is also the moment when pension funds' portfolio value has exploded. These two developments are not irrelevant as they are both related to the financialisation phenomenon. However, this is not to say that the only reason capital markets in Turkey accelerated growth in the post-2001 era is because of pension funds. Rather, it is related to general transformations during the financialised era of which pension funds' establishment and growth is part and parcel. Moreover, privatisation of several public institutions and transformation of the banking sector are other factors which contribute to the growth of outstanding securities; in a way that resembles the US and UK experience where the privatisation process of the 1980s resulted in shareholder discourse in a way that is associated with financialisation (Langley, 2008).

Moreover, when we make a comparison between two different periods, the first between 1994 and 2004, and the second period being 2005 and 2015, we see that the components of outstanding securities have changed as well.

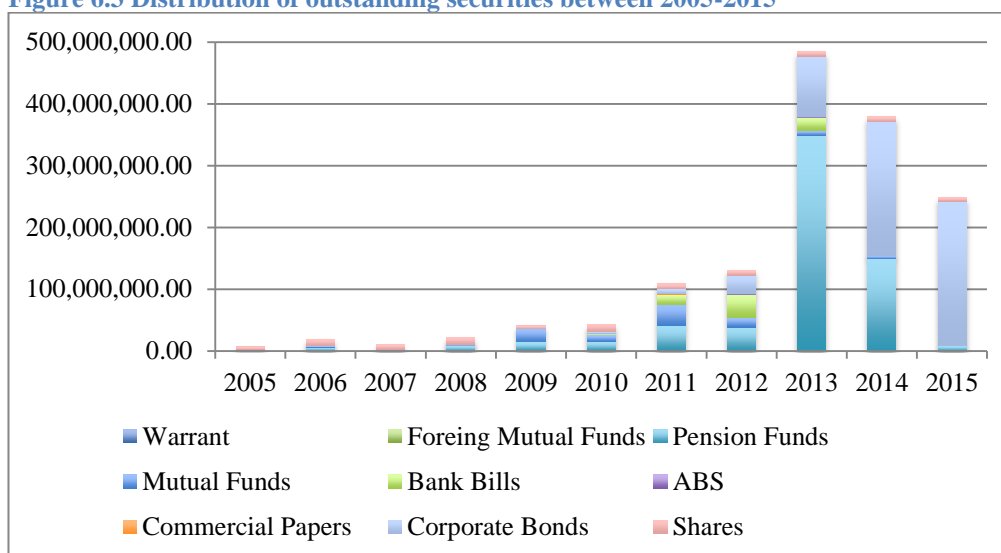
**Figure 6.2 Distribution of outstanding securities between 1994-2004**



Source: CMB

These two periods are diverse in terms of the variety of investment instruments as is evident from the figure below which is much colourful than the figure above. In the first period, except for a few years between 1994 and 1998, the dominant securities in the Turkish capital markets are shares while mutual fund certificates exist in considerable levels.

**Figure 6.3 Distribution of outstanding securities between 2005-2015**



Source: CMB 2015

On the other hand, the second term 2005 and 2015 is characterised by a rich colour range which signifies the newly-introduced investment instruments within the Turkish capital markets. On the basis of this information and other evidence collected from capital market investors' announcements, we associate this



enrichment in financial instruments with the establishment of pension funds in relation to the expansion and deepening of the financial sphere.

This quantitative growth has been accompanied by a qualitative transformation. Since 2003, the share of public securities has decreased against the increasing percentage of private sector securities within the total outstanding securities in the capital markets in Turkey. Meanwhile, within the private sector securities, the shares of recently introduced securities, i.e. corporate bonds, commercial papers and bank bills, have increased. At the same time, the asset backed securities and warrants have become prevalent. These impacts of pension funds on capital markets in Turkey are investigated in the next section.

**Table 6.7 Highest and lowest market capitalisation values in G20 Countries by 2012 (in billions USD)**

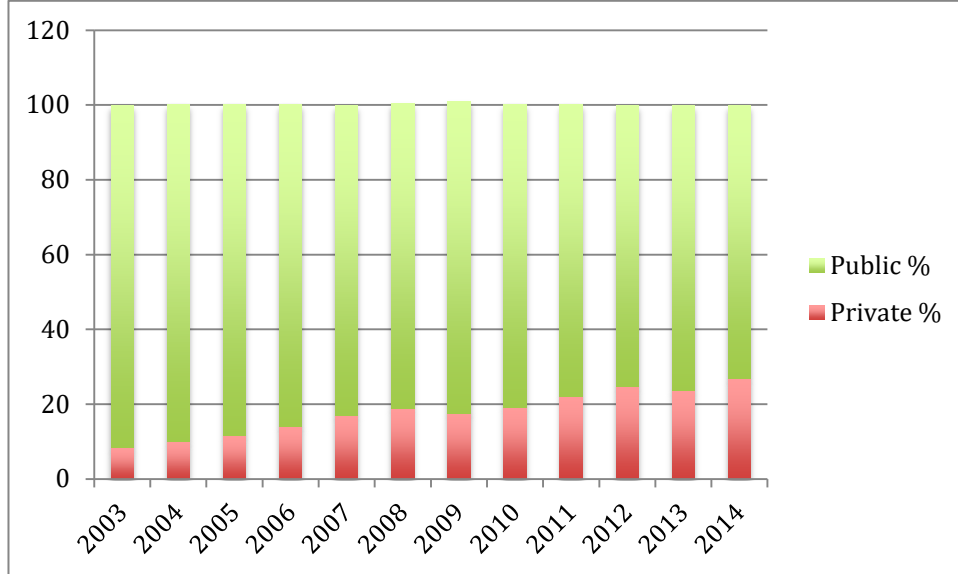
<b>Highest</b>		<b>Lowest</b>	
<b>Country</b>	<b>Value</b>	<b>Country</b>	<b>Value</b>
USA	18,668	Argentina	34
China	3,697	Turkey	309
Japan	3,681	Indonesia	397
Germany	1,486	Italy	480
France	1,823	Mexico	525

Source: Available at: <https://www.quandl.com/c/economics/stock-market-capitalization-by-country> Access date: 28.05.2015

### **6.3. Capital Market Innovation: Demand side developments**

As can be seen from the figure below, the structure of the Turkish capital market has changed as the share of the private sector has increased from 8.4% in 2003 to 26.9% in 2014. This increase has been interrupted in 2009 and 2013, but the figures have recovered rapidly afterwards.

**Figure 6.4 Increasing share of private sector securities within the Turkish capital market**



Source: (CMB, 2015a)

While private sector securities within the capital markets in Turkey have become more significant than before, the allocation of securities within the private sector has changed as well. Until 2008, shares constituted the whole private sector securities in the financial markets. In other words, the private sector only issued securities in the form of shares. However, after 2008, new forms of securities have been issued by the private sector. Shares are still the most dominant asset type but their significance has gradually decreased. The table below shows the share of different private sector securities amongst the overall outstanding securities traded in the capital market in Turkey after 2008. In 2008, the percentage of shares was recorded as 18.7% whereas there were two more private sector securities: corporate bonds (0.1%) and commercial papers (0.1%). In 2010, the percentage of shares was recorded as 18.5 while corporate bonds constituted 0.3% of all securities in the capital markets. In the same year, there was a new security in the private sector: bank bills, which started at 0.3% and have grown rapidly to 4.5% in 2014. Meanwhile, the growth of corporate bonds continued and was recorded as 3.3% in 2014. Asset backed securities also appeared in the financial picture in Turkey in 2011 and have grown to 0.4% in 2014.

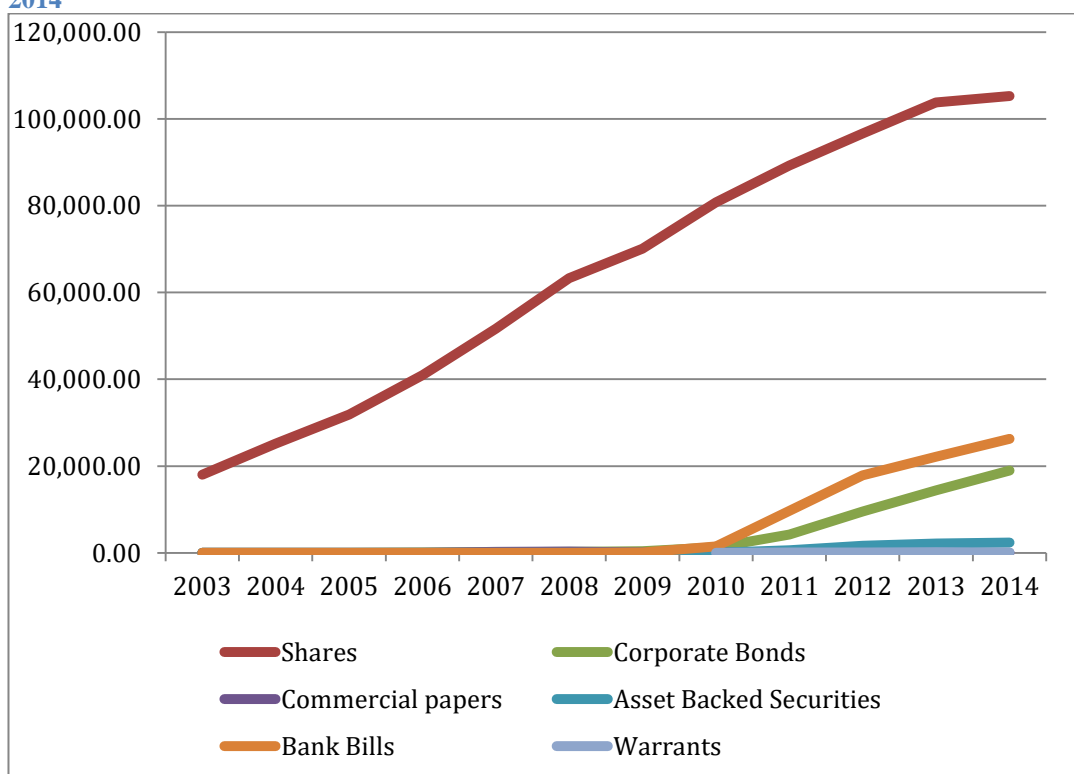
**Table 6.8 Private sector securities' shares as % of total outstanding securities**

<b>Securities</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Shares	18.7	17.5	18.5	18.9	18.8	19.7	18.5
Corporate bonds	0.1	0.1	0.3	0.9	1.9	2.7	3.3
Commercial papers	0.1	0	0	0	0.1	0	0
Asset backed securities	0	0	0	0.1	0.3	0	0.4
Bank bills	0	0	0.3	2	3.5	0.7	4.6
Real estate certificates	0	0	0	0	0	0.4	0
Total private sector securities as % of total outstanding securities	18.9	17.6	19.2	22	24.6	23.5	26.9

Source: (CMB, 2015a)

As a result of these developments, the total value of shares has been recorded as TL105 billions by 2014, a rise from TL18 billions in 2003. Corporate bonds have increased rapidly after 2010 and recorded at TL18 billions by 2014. The most significant rise has been experienced by bank bills, which appeared in 2009 for the first time with the value of TL55 thousands and have increased to TL26 billions by 2014. Finally, in 2014, the total value of asset backed securities has been TL2 billions whereas warrants' value has only been TL114 millions (CMB, 2015a). Thus, in the most recent picture of the Turkish financial markets, bank bills and corporate bonds follow shares as increasingly important private sector assets. We explain the implications of all these products in the order of their significance: bank bills, corporate bonds, asset backed securities and warrants.

**Figure 6.5 Private sector securities' shares within the Turkish capital markets between 2003-2014**



Source: Capital Market Board Monthly Statistical Bulletin, March 2015<sup>86</sup>

### 6.3.1 New capital market instruments: Evidence for innovation

Bank bills have been issued by the development and investment banks since 1992 in order to raise finance through capital markets. In October 2010, the CMB has allowed deposit banks to issue bills (CMB, n.a.). Banks bills are very similar to T-bills but they are generally issued with higher interest-rates. Therefore, the return on bank bills is higher than similar debt securities. The underlying factor of issuing bills is the low interest rates on deposits which leads banks to seek alternatives for raising finance.<sup>87</sup> Without doubt, the rise of bank bills is also related to the increasing significance of the banking sector in the Turkish capital markets. Indeed, when we review the size of banks in the stock exchange market this growth is even more obvious. Borsa Istanbul, BIST, is founded in 2012 with the merger of the Istanbul

<sup>86</sup> Report has an error at the value of 2014 in annual section, we applied the correct value of 2014 December instead. Available at: <http://www.spk.gov.tr/apps/aylikbulten/index.aspx?submenuheader=0> Access date: 19.05.2015

<sup>87</sup> Denizbank guide for bank bills. Available at: [https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=6&cad=rja&uact=8&ved=0CE8QFjAF&url=https%3A%2F%2Fwww.denizbank.com%2Fkisa-kisa%2Fpdf%2Fbono\\_faq.pdf&ei=i-FgVbr-MInXUaytgMAL&usg=AFQjCNGfo-s5Ujtzk7dpGMXts01b\\_j-mA&sig2=MKNGTBv\\_CO0wyhfJwYRpIlg&bvm=bv.93990622,d.d24](https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=6&cad=rja&uact=8&ved=0CE8QFjAF&url=https%3A%2F%2Fwww.denizbank.com%2Fkisa-kisa%2Fpdf%2Fbono_faq.pdf&ei=i-FgVbr-MInXUaytgMAL&usg=AFQjCNGfo-s5Ujtzk7dpGMXts01b_j-mA&sig2=MKNGTBv_CO0wyhfJwYRpIlg&bvm=bv.93990622,d.d24) Access date: 23.05.2015

Exchange Market (IMKB, Istanbul Menkul Kiymetler Borsasi in Turkish) with Derivatives Market (Vadeli Islem ve Opsiyon Borsasi) and Istanbul Precious Metals (Istanbul Altin Borsasi). The secondary exchange of stocks is performed in the BIST. BIST100 is the base index and includes selected stocks of 100 companies (Egilmez, 2013). BIST 100 Index covers BIST 30 (and BIST 50) stocks.<sup>88</sup> When we review the companies which constitute the BIST 30 index, we see that the dominance belongs to the banking sector. For instance, the table below shows the ten companies with the biggest weight in the BIST30 index. As it is clear from the table, the two most dominant companies are banks and four of the first ten companies are banks.

**Table 6.9 Ten most weighted companies within BIST30 index**

Company based allocation	Sector	Weight %
T. GARANTI BANKASI A.S.	Banking	11.90
AKBANK T. A.S.	Banking	11.46
HACI OMER SABANCI HOLDING A.S.	Holding	6.20
TURKCELL ILETISIM HIZMETLERI A.S.	Telecommunication	6.19
BIM BIRLESIK MAGAZALAR A.S.	Retail	6.13
T. HALK BANKASI A.S.	Banking	5.75
T. IS BANKASI A.S.	Banking	5.59
EREGLI DEMIR CELIK FABRIKLARI A.S.	Iron-steel	5.44
TUPRAS-TURKIYE PETROL RAFINELERI A.S.	Petro chemistry	5.34
KOC HOLDING A.S.	Holding	4.69

Source: Calculation date: 20.05.2015 Access date: 23.05.2015 Available at: <http://www.ist30.com/sayfa/ist30-bist-30-endeks-kapsami>

When we look at the sectoral breakdown of the BIST 30 index, it is easier to see the dominance of the banking sector as shown with the table 6.10. It is the most important sector within the BIST30 index. This is important in terms of pension funds' investment decisions because they choose stocks from BIST 30 index. Therefore, it can be argued that pension funds contribute to financialisation of the economy by providing finance for the banking sector which is already a rapidly growing sector of the country. Moreover, when we review the characteristics of bills issued by banks, we see that *“the most important feature of these securities is that they are suitable for institutional investors such as pension funds”* (Bekar, 2011).

<sup>88</sup> “BIST 30 Index consists of 30 stocks selected among the stocks of companies traded on the National Market and the stocks of real estate investment trusts and venture capital investment trusts traded on the Collective Products Market”. BIST Stock Indices Ground Rules, available at: <http://www.borsaistanbul.com/en/indices/bist-stock-indices> access date: 21.04.2015

The reason that funds in general, pension funds in particular, prefer bank bills is that their maturity rests between 3-6-12 months which causes them to be considered as liquid assets by funds (Uras, 2011). Thus, financialisation has an internal mechanism that enables financial institutions (pension funds) to feed other financial institutions (banks) through capital market instruments (bank bills).

**Table 6.10 Sectoral breakdown of the BIST30 index**

<b>Sector</b>	<b>Weight (%)</b>	<b>Sector</b>	<b>Weight (%)</b>
Banking	38.95	Petro chemistry	6.19
Holding	13.15	Real estate partnership	4.07
Telecommunication	8.50	Automotive	3.36
Iron-steel	7.05	Food	1.75
Transportation	7	Construction	1.69
Retail	6.64	Durable consumer goods	1.65

Source: Calculation date: 20.05.2015 Access date: 23.05.2015 Available at: <http://www.ist30.com/sayfa/ist30-bist30-endeks-kapsami>

Another private sector security that has gained importance recently is corporate bond. In Turkey, corporate bonds are first issued in 2006 after a long time and have increased rapidly and reached the 3.3% of the total outstanding securities. Previously, corporate bonds used to be issued in the Turkish capital markets until the mid-1990s. However, for a long time corporate bonds were not preferred by the capital market investors because the interest rates of government bonds were higher as a consequence of the high public debt during the 1990s. With the reform in taxation in 2006, which equalised the tax on corporate bonds' returns and the returns of government bonds, the former became popular again. Moreover, corporate bonds are seen as appropriate alternatives by companies seeking to diversify the debt instruments and create new ways of raising finance. Therefore, corporate bonds recorded 3.3% of the total outstanding securities by 2014 (CMB).

In similar vein with bank bills, when corporate bonds reappeared after a long absence, the demand for these instruments were expected to arise from institutional investors, not least pension funds. This is not to say that corporate bonds are not suitable for individual investors. Rather, the general idea was that individual investors might be more hesitant initially to invest in corporate bonds (as for bank bills). Therefore, until the supply of corporate bonds diversify as a response to the

demand by the portfolio managers, the target buyer for them would remain the institutional investor, i.e. mutual and pension funds.<sup>89</sup> To sum up, both bank bills and corporate bonds are introduced with the motivation of deepening financial markets by diversifying alternative securities while relying on the institutional investors, most importantly pension funds, to provide the initial demand for these securities.

There are two more types of securities which have recently been visible in the Turkish capital markets: asset backed securities and warrants. Asset backed securities (ABSs) were regulated in 1992 as a form of securitisation based on liabilities (debt). ABSs, however, have only recently become one of the most remarkable securities in the Turkish capital markets (0.4% of total outstanding securities by 2014). Securitisation enables the exchange of liabilities with several creditors and long-term maturations by transforming them into securities. Finance-partnerships, banks, financing companies, financial leasing institutions and real estate investment partnerships issue ABSs. ABSs can be issued on the basis of several liabilities such as banks' consumer loans, financing firms' loans, mortgage loans, financial leasing companies' loans originating from leasing agreements, banks' and private financial institutions' export-purposed loans and other loans (CMB, n.a.).<sup>90</sup> Warrants, on the other hand, are capital market instruments which give the owners the right to buy the shares of a partnership. Warrants are similar to options which do not give the ownership of a share but rather the right to buy or sell the share. There are also warrants and certificates for investment institutions which give the right to buy or sell an asset issued by an investment institution. Banks and intermediary institutions are required to have an approval from CMB or rating agencies in order to issue warrants. Moreover, BIST 30 index stocks, public debt securities, foreign exchange, precious metals can be the underlying asset for warrants (CMB, n.a.). Warrants still have an insignificant share in the Turkish capital markets. However, what is interesting about them and important for our study is the way in

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<sup>89</sup> Available at: <http://www.finansgundem.com/para-piyasa/sirketlere-kaynak-yatirimciya-enstruman-219523.htm> Access date: 28.05.2015

<sup>90</sup> ABSs are issued through two different financing institutions: asset financing funds and mortgage financing funds. These funds take over the assets and issue securities on the basis of them. Leasing companies and financing firms are only allowed to issue securities based on liabilities in their founders' balance sheet. On the other hand, those funds established by banks are allowed to take over liabilities of other institutions and issue ABSs based on them. For detailed information on the ABSs see the communiqué announced on 09.01.2014. Available at: <http://www.resmigazete.gov.tr/eskiler/2014/01/20140109-11.htm> Access date: 25.05.2015

which they are introduced by the authorities. ABSs and warrants are introduced in a way that emphasises they are investment instruments which are more suitable for institutional investors. They are complicated and sophisticated in terms of conditions; as a consequence, individual investors might be confused and lose their investments while using them.<sup>91</sup> Therefore, according to the Turkish Capital Market Association, institutional investors such as pension funds are expected to include these instruments in their portfolio while providing demand for them (TCMA, 2016).

To sum up, while the financial markets in Turkey have developed, pension funds have been important for two reasons: firstly, pension funds have grown rapidly in recent years and have become one of the most important agencies in the Turkish capital markets. This has meant that pension funds provide capital inflows to buy the newly introduced instruments. Secondly, pension funds are managed by professional portfolio managers who formed the initial demand for sophisticated investment instruments such as bank bills, corporate bonds, ABSs and warrants. The share of each of these instruments within the portfolio of pension funds is not clear because they are gathered under the label of ‘other’ instruments. However, it is still very clear that the significance of these instruments has increased within the pension funds’ investment strategies. In order to demonstrate this, we look at the other side of the coin: pension funds’ asset allocation.

### *6.3.2 Origin of the demand for innovation: Pension funds’ asset allocation*

Although, the Turkish pension funds have been established only for a decade, we can already find evidence in their assets allocation that signifies the shift from traditional investment instruments to recently innovated securities. In this regard, the table below shows the development of the asset allocation of pension funds’ portfolios between 2003 and 2014. Since the beginning of the IPS, the majority share of assets has belonged to the government debt securities (TB in the table). In 2003 the government bonds and bills constituted the 69% of the total assets of pension funds. This percentage has increased until 2005 when it reached 80% and since then it has been declining. Although there have been recoveries from time to time, the share of government debt securities within the portfolio of pension funds has continued

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<sup>91</sup> Turkish Capital Markets Association website introduces capital market investment instruments. Available at: <https://www.tspakb.org.tr/tr/Yat%C4%B1r%C4%B1mc%C4%B1K%C3%B6C5%9Fesi.aspx> Access date: 28.05.2015



falling and it was recorded as 57% in 2014. Stocks, on the other hand, constitute 13% of the total assets of pension funds. This percentage was 11 in 2003 but has fluctuated meanwhile, as can be seen from the table. The percentage of the repos has decreased almost in half from 13% in 2003 to 6% in 2014. The money market transactions have occupied a minor percentage (less than 1%) since the establishment of the pension funds (0.92% in 2014). Foreign exchange securities are also another insignificant asset type within the portfolio of pension funds with 1.1% in 2014. Finally, the most impressive growth has been in the percentage of ‘other’ instruments within the pension funds’ portfolios. The percentage of ‘other’ assets has increased from 0.57% in 2003 to 21% in 2014. When we look closer, we recognise two jumps, one in 2007 when the percentage increases from 0.75% in 2006 to 5% by the end of 2007. The second jump is recorded in 2010 when the 5% of 2009 share of ‘other’ assets reached 16% by the end of 2010. It is transparent that the 20% increase in the ‘other’ instruments is related to the newly introduced capital market instruments, corporate bonds, bank bills, ABSs and warrants in general, and lease certificates in particular.

**Table 6.11 Asset allocation of PMFs between 2003 and 2014 (%)**

Year	Stocks	T-Bills	Reverse Repo	Money market Securities	Foreign Securities	Other
2003	11.18	69.46	13.76	0.82	4.20	0.57
2004	13.32	72.44	9.07	3.33	1.84	0.00
2005	11.12	80.41	5.35	0.91	0.76	1.45
2006	8.59	73.03	14.43	2.50	0.69	0.75
2007	11.60	68.87	13.66	0.42	0.51	4.94
2008	7.68	69.74	15.68	0.01	0.53	6.36
2009	10.01	68.68	15.26	0.42	0.32	5.31
2010	11.99	57.78	13.40	0.03	0.14	16.66
2011	12.09	60.19	11.88	0.49	0.84	14.51
2012	15.96	58.04	8.15	0.72	0.56	16.57
2013	14.04	58.88	6.83	1.24	0.92	18.09
2014	13.52	56.95	6.55	0.92	1.10	20.96

Source: Capital Markets Board Monthly Statistical Bulletin (CMB, 2015a)

Across ‘other’ instruments, the most remarkable development has been experienced with lease certificates which were introduced in 2010. Lease certificates, are ‘*interest-free bills*’ which enable companies (originator) to raise finance by using

the ‘transfer-lease-take over’ method through an Asset Lease Company (ALC). ALCs in Turkey are founded in the form of joint-stock companies.<sup>92</sup> Lease certificates can be based on ownership, management agreement, buy-sell, partnership, and contract of construction those are issued by ALCs. According to this, ALCs take over a certain asset from the original company in order to lease the asset to the original company, or to third parties, in order to raise finance for the asset through issuing certificates based on the asset. Lease certificates are issued by the public and private sector. ALCs can be founded by banks, intermediary institutions such as portfolio, safekeeping and underwriting institutions, mortgage financing institutions, real estate partnerships (whose shares are traded in the stock market), partnerships who are graded by the ratings agencies and by the partnerships whose majority share is owned by the Treasury (CMB, 2013). Treasury published an investor guide for lease certificates and explained how the Treasury Asset Leasing Company (TALC) raises finance for public sector on the basis of real estates (Treasury, 2015). The initial interpretation has been that the CMB of Turkey introduces this instrument in order to attract the so-called Gulf Capital since it is appropriate for investors with religious concerns (Gumus, n.a.).

**Table 6.12 Lease certificates (in 000s TL)**

VALUE DATE	MATURITY DATE	MATURITY	RENTAL RATE	RENTAL PAYMENT PERIOD	SALE AMOUNT
03/10/12	01/10/14	2 Years	3.7	6 Months	1,624,483
20/02/13	18/02/15	2 Years	2.85	6 Months	1,515,327
21/08/13	19/08/15	2 Years	4.5	6 Months	1,817,300
19/02/14	17/02/16	2 Years	5.3	6 Months	1,332,820
01/10/14	28/09/16	2 Years	4.84	6 Months	1,839,964
18/02/15	15/02/17	2 Years	3.9	6 Months	1,801,515

Source: Republic of Turkey Prime Ministry Undersecretariat of Treasury. Available at: <https://www.hazine.gov.tr/File/?path=ROOT%2f1%2fDocuments%2fKamu+Finansman%c4%b1+%c4%b0statisti%c4%9fi%2fKira+Sert.+Internet+Tablosu.xlsx> Access date:21.05.2015

It is clear that, despite packaging with Islamic references, the most important implication of the lease certificates is prevailing ‘securitisation’ across Turkish

<sup>92</sup>

Capital markets board announcement  
<http://www.spk.gov.tr/duyurugoster.aspx?aid=201041&subid=0&ct=c>

capital markets. Lease certificates work on the same principle with ‘special purpose entity’ (SPE from now on). The SPE is an external company which takes over the assets of the originator company in a way which secures the obligations in the case of bankruptcy. SPEs produce derivatives on the basis of assets of the originator company. However, what made SPEs popular is their role in hiding debt, for which Enron is remembered as the source of a major scandal.<sup>93</sup> What is more interesting is that in the Turkish context these companies are formed as joint-stock companies and their products, i.e. derivatives, are packaged with Islamic references.

The main involvement of pension funds with lease certificates (interest-free bills) has been through foundation of participation pension funds which, in principle, work like interest-free deposit accounts established in participation banks (see 4.3.1). The interest-free pension funds can be founded in different types, such as flexible, stocks or precious metals. The IPS has become more convenient for interest-free services since 2008 when the constraint of devoting at least 30% of the fund in government debt securities was abolished. This made it possible to establish completely interest-free pension funds.<sup>94</sup> Moreover, the state contribution funds, which were introduced in 2013, were established in two different forms: one, conventional fund, which invests in interest bearing securities; the other one, on the other hand, invests only in interest-free assets. Hence, particularly with the recent regulation changes, participation pension funds have stimulated a huge attraction for the interest-free individual pension system.<sup>95</sup>

After their announcement in 2010 and subsequent progress in regulation, lease certificates have become substantial investment instruments for the participation pension funds. The Individual Pension System Progress Report indicates that by December 2014, there were 24 pension mutual funds formed on the basis of participation principle, and their portfolios are heavily invested in lease certificates (PMC, 2014). As can be seen from the figure 6.3, 63% of portfolios of these pension funds consist of lease certificates.

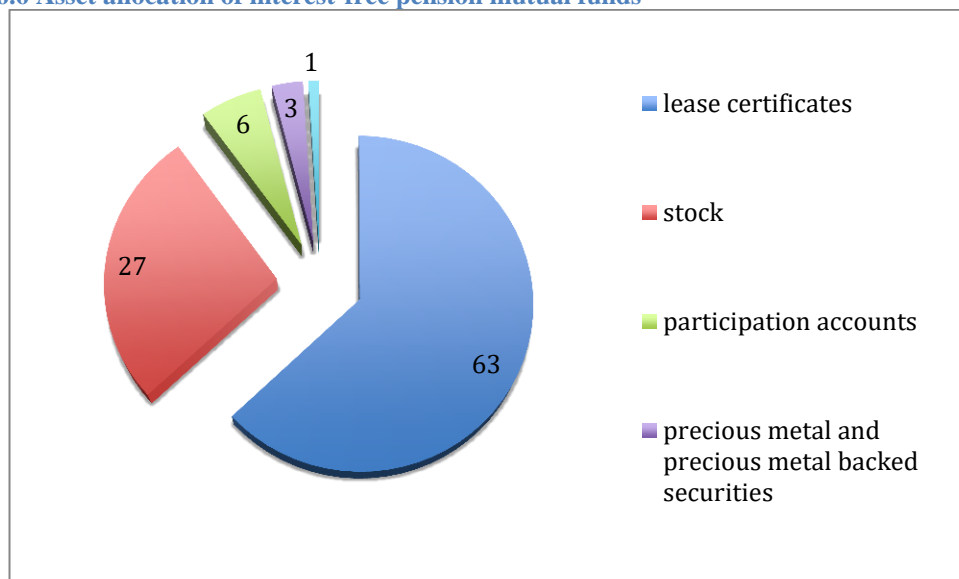
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<sup>93</sup> <http://www.investopedia.com/terms/s/spv.asp#ixzz3ahyH5Im2>

<sup>94</sup> [http://www.zaman.com.tr/yorum\\_bireysel-emeklilik-sistemi-ve-islam-hukuku\\_2066123.html](http://www.zaman.com.tr/yorum_bireysel-emeklilik-sistemi-ve-islam-hukuku_2066123.html)

<sup>95</sup> In a newspaper interview, a manager from an interest-free individual pension company declares that they decided to enter the system as a result of the 2013 regulations. Moreover, they expect the total sectoral value of the IPS to be 400 billions while they hope to get 15% of sector share as participation pension funds. The interview is dated on 18.10.2014. Available at: <http://www.haber7.com/guncel/haber/1211385-dini-kurallara-uygun-6-yeni-faizsiz-fon> Access date: 21.05.2015

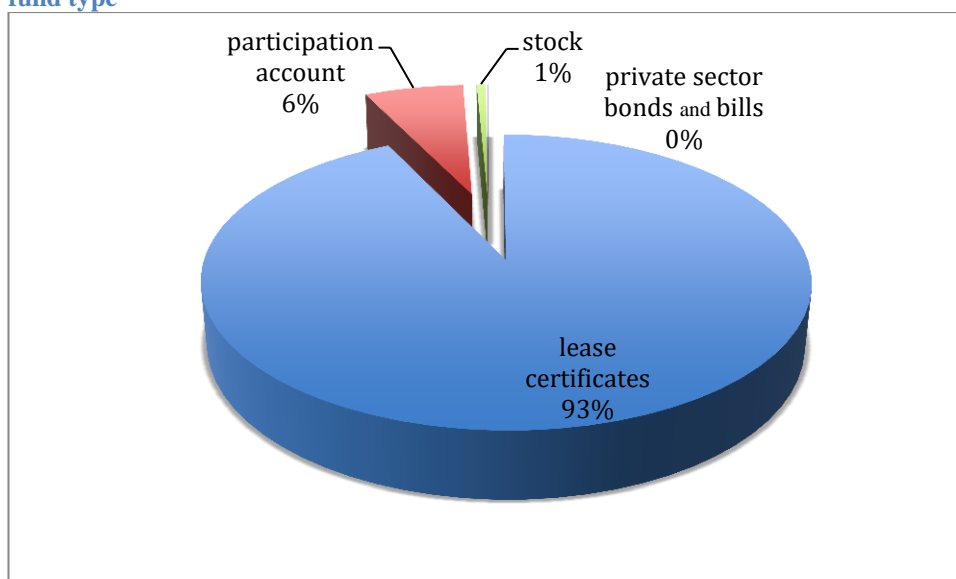
**Figure 6.6 Asset allocation of interest-free pension mutual funds**



Source: Adapted from Individual Pension System Progress Report (PMC, 2014, p. 63)

The dominance of lease certificates is stronger when it comes to the state contribution funds. As mentioned before, the state contribution funds are established in the form of ‘interest-free’ pension funds as well as conventional funds. There are nine interest-free state contribution funds which have ‘alternative’ or ‘participation’ in their titles. The figure 6.4 shows the asset allocation of these funds. Accordingly, interest-free state contribution funds invest 93% of their portfolios in lease certificates.

**Figure 6.7 Asset allocation of state contribution funds formed as alternative or participation fund type**



Source: Adapted from Individual Pension System Progress Report (PMC, 2014, p. 81)

To sum up, the complete structure of derivatives produced by SPEs refer to securitisation which increases intensification of financial operations. In other words, lease certificates, in which participation pension funds heavily invest, associate the old-age additional income of participants with speculation in financial markets. Therefore, it can be argued that IPS provides demand for innovation in financial markets by establishing certain types of pension funds. In the case of participation pension funds, the securitisation dimension of lease certificates is concealed behind the argument that *'people should be able to save for their retirement without involving in interest-bearing activities that are banned by their religion'*.

#### **6.4. Conclusion**

On the basis of the theoretical framework on financialisation and pension funds, we demonstrate pension funds' supply and demand effects on capital markets in the Turkish context. When we review all the regulations regarding funded pension schemes we see that, although the IPS has been founded with tight regulation in the beginning, the system has been re-regulated recently. In particular, the loosening of the investment criteria, through abolishing the rule of investing 30% of the portfolio in government debt securities and enabling foundation of participation pension funds, shows the flexibility of the authorities in terms of the function of pension funds. It is possible to associate the expansion of capital markets with establishment of the pension funds in a direct manner because the pension funds' portfolio assets signify a certain increase in the capital market activity. This relation is crystallised in the supply-side effect of the pension funds through providing new capital resource to enhance capital market instruments. Note that this argument significantly differs from the orthodox view which attributes positive functions to pension funds in terms of contributing to the improvement of capital markets. On the contrary, our position here has its roots in heterodox financial instability approaches which show how pension funds' additional inflows create speculation in capital markets (Toporowski, 2000). The decreasing dominance of public securities and increasing significance of recently introduced instruments, such as bank bills, corporate bonds and ABSs, signify the trend from long-term less risky securities to short-term more speculative securities.

The extraordinary amounts of capital inflows, which are brought by pension funds, stimulate a strong innovation wave. As mentioned in the theoretical

framework chapter on financialisation and pension funds relations, new financial instruments are introduced to increase returns when pension funds are mature. Indeed, the logic of funding approach, on which we draw our analysis, provides remarkable insights in terms of speculative assets' proliferation as a result of changing risk-return balances as pension funds mature (Engelen, 2003). When we compare the recent asset allocation data with that at the beginning of the establishment of pension funds, we see the shift in the Turkish capital markets from government debt to 'other' securities. This shift cannot be explained only with the maturation of pension funds particularly because they have been founded very recently (in 2003). Therefore, we associate the shift in pension funds' portfolios with the financial deepening motivation of the Turkish capital market authorities and the new investment instruments introduced in this regard (bank bills, corporate bonds and ABSs). This is the characteristic feature of the Turkish pension funds in terms of financialisation of the economy through their impacts on capital markets.

In this regard, what deserves most attention is the development of lease certificates in relation with participation pension funds. The underlying motivation behind lease certificates is to increase the depth of financial markets in Turkey through prevailing securitisation. However, the way in which they are presented is entirely different: they are presented with religious references while the financial depth agenda seems of secondary importance, if not hidden. Lease certificate is a breakthrough in terms of securitisation in Turkey for the reason that they introduce a certainly different level of financial depth which did not exist in the Turkish financial markets before. However, what is more interesting is that this securitisation is packaged with Islamic references of interest-free finance. Participation pension funds, which are established to attract religiously sensitive people to the IPS, invest heavily in lease certificates. Thus, pension funds' role is clearly observed in the case of lease certificates and participation pension funds. Moreover, this implies the prevailing securitisation, speculation and financialisation in the Turkish capital markets supported by the pension funds through creating demand for these instruments. Therefore, we clearly see the role of pension funds in financialisation in Turkey by examining the capital market's transformation in the last decade.

To sum up, this chapter fulfils a key role by revealing the multi-fold relations between pension funds, capital markets and financialisation. Pension funds' establishment itself is a part of financial growth agenda of the Turkish authorities.

We mentioned this while reviewing the institutionalisation of financialisation in Turkey as well as reform process which attributed economic growth missions to the private pension scheme. Therefore, we emphasise that the pension funds' relation to capital market growth is more than the absolute contribution of their portfolio assets. Rather, they have an internal and mutual association with each other in relation to the financialisation of the economy.

## **7. Conclusion**

### **7.1. Introduction**

In this thesis, our main argument is to associate the way in which pensions are restructured in Turkey with the phenomenal spread and condensation of financial relations, namely financialisation (Fine, 2013). What is distinctive about pensions under financialisation is that they are restructured, reformed and reorganised with financial motives of creating pension funds especially in those countries lack depth in capital markets. Encouraged by varieties of international pressures and inducements, pension funds contribute to financialisation through accumulating massive amounts of money capital which create both supply-side and demand-side effects on capital markets, resulting in increasing speculation that manifests itself in the corresponding spread and sophistication of financial instruments.

Our position is significant for pointing to financialisation as the main underlying tendency behind pension reforms across the world, while also associating the phenomenon with neoliberalism and acknowledging the roles of globalisation and post-industrialisation in this regard. As discussed in our literature review, globalisation and political and economic factors of the post-industrial era have been effective in the process of transformation of pensions as well as in the peculiarities of different countries' "welfare regimes". We should bear in mind that all countries' social policies are established on the basis of country-specific social reproduction relations which depend on global developments within capitalism, and state and class relations.

On this basis, we suggest that it is not appropriate to draw clear-cut conclusions such as 'race to the bottom' or other sorts of convergence (or divergence) in social provisions whether for pensions or otherwise. Thus, detection of financialisation as the trend shaping social reproduction in varying places, and its implications, require a more in-depth analysis than simply looking at the level of social expenditure or budget deficits due to pension payments. It is not sufficient to point at demographic trajectory, employment or wage levels, as the underlying factors behind the pension reforms.

Indeed, financialised pension schemes have spread around developing countries from the time of the involvement of agencies such as the Chicago Boys in Chile and, in the case of Turkey, through the role of the WB and the IMF. Indeed,



the increasing power of IFIs in social policy making is crucial in this regard, but this is not to say that national governments are passive and ineffective in terms of deciding or implementing social policy. Rather, IFIs desperately need state power to fulfil their targets of financialising the pensions for the bulk of the population while providing safety nets for those who cannot be covered by such financial schemes. What is different with financialisation is the motivation of the national authorities behind the reforms: pension income is perceived as a way to feed capital markets rather than the elderly. Moreover, pension systems are structured in the financial sphere as opposed to targeting social rights as previously. Hence, pension income is related to financial market returns rather than mechanisms established between the state, workers and employers.

With the purpose of analysing the pension reforms in Turkey in this context, we draw a theoretical framework through a discussion on the interrelations across finance, social reproduction and pensions. The main theoretical conclusions we draw can be summarised as follows.

- Financialisation is the distinctive feature of neoliberalism, i.e. current mode of capitalism, which demonstrates itself in the increasing integration of finance into economic and social reproduction alongside the rising sophistication of financial operations.
- Financialisation of pensions perfectly illustrates the capability of finance to enter several areas of social reproduction of labour power through involvement of IFIs in policymaking processes while attaching old-age income provision to fictitious capital and extending finance's profit-making domain.
- An essential nexus of financialisation and pension reforms is found in the key role played by pension funds in terms of sophistication of financial operations through supply- and demand-side effects of the money capital accumulated by these funds on capital markets.

In more detail, our initial motivation for building our theoretical framework on the basis of Marxist finance theory arose from the idea that Marx's approach had the advantage of positing finance in relation with economic and social reproduction. Thus, as we demonstrate by the analysis of money capital as a moment within the industrial circuit, finance is inevitable for surplus value production. Moreover, specialisation in financial activities grows in parallel with the development of surplus

value production as is obvious from discussion of money-dealing capital's emergence. As suggested from our overview of IBC, financial income has its roots in produced/appropriated surplus value and, due to its fictitious character, can develop an increasingly "distant" dependence on the underlying production of surplus value. This increasing distance between financial operations and surplus value production creates a systemic aspect of financialised capitalism.

While the transformation of the financial sphere and its influence on "real" sectors places new relations on the forms taken by capital accumulation, finance also influences the value of labour power through its interaction with the social reproduction processes, mostly clearly captured in the literature by its reference to household indebtedness. Financialisation of social reproduction processes goes beyond (consumer credit) indebtedness and signifies a more substantial economic and social transformation of which pensions is a part in relation to the reproduction of labour power. The value of labour power (as the wage in concrete form) is attached to a more general standard of living that includes the reproduction of the elderly as part of the means of consumption that is funded from the total social product.

A straightforward conclusion to draw in this context would be that financialisation's impact is one of decreasing the value of labour power through changing structures of pensions. This point deserves closer scrutiny. From an abstract point of view, financialisation of pensions might not make any difference to the value of labour power as long as the material standard of living is preserved. This is so because the value of labour power cannot permanently fall below a certain level that is determined under the circumstances of contemporary capitalist relations. Marx explains in detail the tendencies and countertendencies that keep the value of labour power at a certain level. In this regard, the main countertendency would be class struggle of workers who would not sacrifice their 'given' living conditions. On the other hand, capitalists would always pursue efforts for suppressing labour costs even though this might harm their profits in the long run.

On the basis of this understanding, it can be argued that the transformation in the pension systems can indeed be posited as in part the result of the capitalists' motivation of decreasing the value of labour power by squeezing the funds devoted for social reproduction, not least elderly income, especially in times of crisis and recession when the balance of class struggle can favour capital. However, the

suppression of class struggle might facilitate a backlash in material standards of living from certain groups of people within the working class. That is why our position here is more nuanced than simply arriving at the conclusion that financialisation of pensions signifies reduction in the value of labour power. Rather, the potential impacts of this development in pension systems needs to be illuminated through investigation of historical evidence in light of class struggle for better living conditions during old age, and how such provision is made.

Our investigation of the case study on the basis of this framework starts with a macro analysis of the Turkish economy in order to show how financialisation has changed the production and reproduction relations in Turkey in the post-2001 era. Although financialisation is mostly perceived as a developed country phenomenon, we pursued the idea that financialisation is contagious and experienced in developing countries with certain peculiarities that divorce their experiences from those of developed countries. In this context, the conclusions we draw from Turkey's experience are as follows:

- Financialisation in Turkey is mainly driven by the IFIs with the argument of solving the economic problems of high public indebtedness, high inflation and financial fragility through implementing policies such as inflation targeting, fiscal discipline and banking reforms.
- These structural transformations resulted in acceleration of privatisation, socialised costs such as international reserves accumulation and low employment levels despite the volatile economic growth that is driven by the massive capital inflows to the country.
- It is possible to observe the transformation brought forward by financialisation in the post-2001 era through investigating the expansion and restructuring of the financial sector, altering relations of the non-financial sector with financial activities – with limited contribution to production levels, and banks' concentration on consumer lending which gives rise to the household indebtedness.

Our inquiry into the Turkish economy supports our theoretical approach which posits financialisation as involving the reconfiguration of finance in several aspects of economic and social life. In this sense, pension reforms are not independent from the rest of Turkish fiscal policy in seeking a contraction in state expenditure, not least in social provision. Moreover, the introduction of the IPS is not discrete from other

privatisations that accelerated with the motivation of freeing markets by abolishing state involvement. This is why the decrease in public indebtedness and changed relations of financial agencies with government borrowing fit with the plan for withdrawing the state from the market, including financial markets. However, expectations concerning “crowding out” have not held. Even though public securities’ weight diminished within the financial markets, not least banks’ portfolios, the private sector did not benefit from this development in a growth of productive capital.

Therefore, our analysis of IBC and fictitious capital, which demonstrates that finance does not necessarily serve capitalists’ interests in the sense of boosting production, proves apposite possibly more so than at any other time. As long as finance finds its way to profit, which it does in the Turkish context either through consumer lending to households or generating relations with big corporations or certain sectors (such as construction) while using external debt in foreign currency to finance these loans, the more progressive role of contributing to real investment is not fulfilled.

In this light, it comes as no surprise that the pension system in Turkey, which was advised by the WB in 1994, has been altered to open more space for finance. We investigate the historical development of the reform process and the corresponding institutional transformation of the pension systems and draw the following conclusions:

- The implementation of the pension reform, as with other developing countries, is closely related to efforts to access capital which demonstrates itself in the Turkish case with the conditionality of pension reform for the loan and standby agreements with the WB and the IMF, respectively.
- During the reform process, the budgetary constraints of the Turkish social security system are wrongly explained by appeal to an ageing population whereas the deficits of the social security system of this youth-populated country originated from labour market characteristics of high unemployment, low wages and informality in addition to the chronic low labour force participation, in particular amongst women.
- Although undertaken as a multi-staged process, the Turkish pension reform serves and is underpinned by financialisation of the economy

which is evident in the rising significance of financial conduits in pension provision via the IPS and tightening eligibility conditions and lowering pension benefits from the public PAYG scheme.

- The scrutinised investigation of data confirms the weakness of pension reform advocates' suggestions of ageing population, unsustainable budget deficits and so on while it is also evident that none of the measures in reformed pension schemes is capable of satisfactorily meeting the correctly observed shortcomings of the pension system, such as coverage.

There is some room for clarification on the role of the IFIs in implementation of pension reforms in Turkey – that is whether or not they pushed financialisation while the Turkish authorities and society resisted the process. First and foremost, it has to be admitted that it was not an easy financialisation process in Turkey as both in general economic restructuring measures and in particular pension system transformation, the WB and IMF had to use some carrot and stick methods for pushing implementation of its advice. However, it would be an overstatement to argue that these efforts were due to strong opposition of local parties as the spread of financialisation was mostly consented to, if not very welcome as in the case of the housing boom and abrupt increased demand for mortgage loans. Rather, what we could make out of this endeavour is that the Turkish economy with very preliminary financial markets required a direct intervention by local and global forces to enable the emergence of financialisation.

The best hinge for this interpretation is the *25% matching contributions* for participation in the IPS. This incentive originates from the fact that the majority of the society had very little familiarity with funds and capital markets as an investment option. Therefore, they were sceptical about joining the IPS. In addition to this well-known obstacle, the authorities were aware of potential participants with Islamic reservations. Further, a middle-income country like Turkey necessitates much more encouragement than higher-income countries when it comes to saving due to low earning levels. On top of all of these, when it is also considered that the IPS is not the best available investment option, an endorsement becomes vital. Therefore, the whole process of IFIs' intervention and local governments' excessive diligence for promoting the private funded scheme can be understood as a facilitator for

financialisation in a relatively less convenient context, i.e. Turkey, rather than struggle against an organised and mobilised defiance.

Further implications of the pension reform process are traced in the potential impacts of financialised pension provision on vulnerable groups of the population. One might think that, as those unemployed and informally employed do not have a pension either from the PAYG or the IPS, they would be no better nor worse off after the reforms. Yet, this is only formally so. Before the reforms, there were alternative eligibility opportunities thanks to the redistributive mechanisms of the PAYG scheme. These and other sources of modest pension income were abolished alongside tightening rules of the pension system in response to budgetary concerns. The IPS, on the other hand, does not allow for this kind of mitigating mechanisms with the only return from a pension pot being determined by financial market performance. Therefore, the position of disadvantaged groups in the labour market is aggravated by the reforms. What is especially problematic is the case of women as they are expected to participate in the labour force in lieu of state-funded pension benefits which constitute their main income source in old age, with the “neutral” IPS discriminating against women given their multiple disadvantages in labour markets. Another interesting point to stress is the approach of the IFIs to Turkey’s middle-class in a slightly different way than other developing countries as, in the former case, the middle class (with upper classes) is seen as an object of saving (through retirement funds) whereas in the latter, such as Asian countries, China in particular, a rising middle class is expected to contribute to consumption, i.e. ‘the consumer class’ (OECD, 2010, p. 10).

As a final false point on the WB’s ageing population arguments and its far-reaching implications, it has been 22 years since the WB first presented living longer as a curse rather than a celebration (WB, 1994). Since then, many things have changed in the world and most of the WB’s projections have proven to be wrong. Despite that, the WB has not modified this argument in a way that shows us the *only thing that does not get old is the argument of ageing*. Moreover, with the underlying fear of losing the window of opportunity in terms of being the youngest population in Europe, the Turkish authorities have recently accelerated religious references

towards abolishing use of contraception.<sup>96</sup> By all means, the political transformation in the country is not directly the result of, nor response to, WB reports. However, demographic arguments should be discussed more carefully by considering women's rights for contraception rather than positing them as disordered fertility machines of the neoliberal era. None of the economic arguments can and should be more powerful than women's prolonged fights for the right to choose giving birth or not.

This is especially so given the impact of pension funds interactions with capital markets. As we show in the theoretical framework on intensification of finance in relation with pension funds, three conduits highlight the function of pension funds in financialisation: their institutional investor role in terms of prevailing shareholder value and influencing corporate governance; asset market inflation and other supply side-effects of massive capital accumulated in pension funds; and the logic of funding and other demand-side effects of pension funds which stimulate innovation in new capital market instruments. The review of financialisation literature sheds light on the first conduit of pension funds serving as an institutional transformation favouring the ascendance of financial motives in big corporations' investment decisions in Anglo-Saxon countries where pension funds have a long history. However, this sort of function of pension funds in financialisation in Turkey is weak as they are recent and their relations to the real sector is still limited and indirect. Nevertheless, the other two conduits of pension funds' in relation to financialisation are observable in Turkey which enable us to present the following findings:

- Capital markets in Turkey, despite being one of the smallest across OECD countries, have shown a rapid transformation as the structure of capital markets has changed with the increasing role of private sector securities as opposed to diminishing public sector's financial instruments. At the same time, private sector securities' composition has changed while shares of conventional instruments, such as stocks, remain stable and recent innovations gain more weight as a result of the introduction of novel financial instruments such as bank bills, corporate bonds, ABSs and warrants.

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<sup>96</sup>For the newspaper article on the issue, see in English. Access date: 02.06.2016 Available at: <http://www.independent.co.uk/news/world/europe/turkish-president-recep-tayyip-erdogan-says-no-muslim-family-should-use-contraception-a7056816.html>

- The organic relation between pension funds' supply-side impacts and capital markets' development is evident in the growth of pension funds which have been accelerated with the state contribution incentives and loosening of investment criteria to enable pension funds to be the most important institutional investors on the Turkish capital markets, recently exceeding mutual funds.
- The significance of pension funds in issuing novel financial instruments is clear in the approaches of capital market authorities and players towards pension funds, as pension funds have been the origin of the demand for unconventional financial instruments such as bank bills and corporate bonds, alongside the increasing presence of lease certificates in participation funds that signifies securitisation is prevalent in Turkey through instrumentalising religious concerns.

Further, in order to avoid companies founding pension funds to invest in their own securities, there are restrictions on pension fund portfolios as they cannot include more than 10% of their portfolios in the same sort of shares. However, this restriction does not apply to big corporations that have stocks listed on the BIST30. Moreover, stocks of the companies that are not listed on the stock exchange are not permitted to be included in the portfolio above a certain amount, 10%. Thus, the idea behind this is to prevent small companies using pension funds as a self-financing accumulation mechanism. This might be justified by the risk of default while, at the same time, it results in pension funds not contributing into development of the real sector mostly consisting mainly of small-scale companies.

In a similar vein, banks' involvement with pension funds is aimed to be restricted through constraints on allocation of pension funds' investments in deposit and participation accounts. Despite that, however, banks benefited from the IPS and pension funds significantly both in terms of supply for new funds and resources for profits, as well as demand for new financial instruments established by banks, i.e. bank bills. They approached pension funds as a new profit-making domain while many banks established their own pension companies. Moreover, this is a costless and comparatively less risky business especially considering banks' portfolio managers control pension funds' portfolios. Thus, the winner in terms of pension funds in the Turkish financialisation process is the banking system too. This



character of pension funds' development in Turkey originates from the fact that banks are the most powerful organisations in the Turkish financial sphere.

Thus, the developments in Turkey fit with the financialisation literature that suggests the key function of pension funds is in the emergence of capital market movements associated with financialisation. Although it is too early to observe asset market inflation impacts and institutional investor effects of pension funds in Turkey, their key function in capital markets is crystal clear. The important point is that pension funds' performance contributes to financialisation with an increasingly fictitious character attached to capital market instruments, not least in the form of securitisation. Interestingly, the securitisation process in Turkey is packaged with Islamic references in a way that conceals its financialisation-related functions. This can be seen as a peculiarity of financialisation and pension funds in Turkey.

In the next section, we discuss the contributions of this study and its limitations. We also address areas of future research which can potentially draw on our analysis. The significance of this study is enhanced as the Turkish government has been preparing legislation that requires all workers to be registered in the IPS automatically, with the possibility of opting out after a certain time. We conclude with final remarks on the potential implications of IPS especially in case it becomes mandatory starting from 2017.

## **7.2. Contributions, limitations and further research**

Not surprisingly each social provision, education, health or housing, has its own characteristics in relation to their function within economic and social reproduction. Unsurprisingly, pensions have been differentiated by finance in the era of financialisation and, in this light, this thesis contributes to social policy literature (Fine, 2014). In doing so, the theoretical framework of this thesis draws on existing literature on Marxist understanding of financialisation as the extensive and intensive accumulation of finance (Fine, 2013). In terms of the expansion of finance in pensions, we highlight the relation between finance and social reproduction. This aspect of our study is significant for engaging with value of labour power and social wage discussions (Fine & Harris, 1976; Gough, 1975, 1982). In more detail, if value of labour power is seen as an individual relation rather than as underpinned by standards determined through class relation, any loss in social provisions is seen as a way of increasing exploitation at the individual level (Gough, 1975). We disagree

with this approach and follow the argument that the value of labour power is a living standard determined in relation with broader processes of social reproduction (Fine, 2009). Thus, changes in social provision, such as pensions, affect the value of labour to the extent they affect the standards of living for the working class. Therefore, rather than drawing shallow conclusions regarding exploitation (up or down with what is provided as opposed to whom and how), we focus on differentiating the impacts of financialisation on social reproduction through varying processes, with uneven effects across different layers of the proletariat.

The other half of our theoretical framework, the intensive growth of finance and pension funds, on the other hand, addresses a different gap within the Marxist literature. Although having a substantial foundation, Marxist theory of finance lacks analyses that explain the practical implications of fictitious capital. In other words, the surplus value related functions of different forms of fictitious capital are highlighted whereas the way in which capital markets undertake these functions is neglected. Therefore, we benefited from critical approaches that highlight capital markets' workings (Toporowski, 2000) and pension funds' function in this regard (Engelen, 2003). This is an attempt to combine the abstract understanding of finance in capitalist relations to observable mechanisms of the modern financial sphere and pension funds.

The contribution of this thesis in terms of our case study is threefold. First, we uncover the role of the IFIs, not least the WB, in Turkish pension reforms by tracing back the evidence from more than two decades ago. It is wrong to say that pointing to the inaccuracy of pension reform advocates' arguments is an original contribution here as this aspect of pension reforms is stressed many times before (Guzel, 2005; Turcan Ozsucu, 2006). Nevertheless, revealing the financial motives behind the pension reforms is novel in the Turkish context where these tend to be analysed simply as privatisation of pensions. However, as we demonstrate with a detailed analysis of capital markets since the establishment of pension funds, we are able to emphasise the financial implications of pension reforms which go beyond privatisation to indicate financialisation of pensions.

Second, investigating the IPS in detail is a fundamental contribution considering that it is becoming mandatory for all workers (Boyacioglu, 2016). According to the legislation currently in progress, all workers starting a new job will be automatically registered within the IPS for six months. After this period, the

worker will have the choice of opting out. Nonetheless, this implementation can be seen as a transition period to render the IPS completely mandatory. Thus, by addressing the potential negative impacts of the IPS on vulnerable groups of the population, those unemployed, informally employed, low waged, and, last but not least women, we highlight a crucial consequence of the financial pension schemes: exacerbating the inequality within the labour market and across the elderly.

Finally, we contribute to the literature on the IPS and pension funds' capital markets-related effects from a critical point of view. Most of the analysis of IPS serves as a tribute to capital market development while neglecting the enhanced speculative character of such activities in this regard (Avci, 2011). On the other hand, we analyse the macroeconomic variables in the era of financialisation and draw the conclusion that not all kinds of expansion in financial activities contribute to surplus value production. Rather, increasingly fictitious activities detach finance from a functional relation to production. Therefore, capital market development itself is not inevitably beneficial for economic growth. Indeed, in the Turkish case, the increasing securitisation with Islamic packaging shows that pension funds might only contribute to rising speculation.

One limitation of our study stems from its exclusive preoccupation with pensions and Turkey. In this regard, financialisation of pensions is not only a transnational project run by the WB with an explicit target (Orenstein, 2008), it is also a reflection of underlying tendencies of financialisation in the global context as countries reform their pensions systems. Such financialisation (of pensions) is not necessarily going to be common across different countries. Moreover, it is beyond the scope of this study to discuss other aspects of financialisation of social reproduction, such as health (Sumaria, 2010).

Another limitation of this thesis stems from pension reforms in Turkey being too recent to confirm our longer-term theoretical insights. For instance, it is hard to show how pension funds' institutional investors function in the Turkish capital markets regarding their influence on corporate governance. Rather, their character as institutional investor is only observable as a source of more skilled dealing, due to reliance upon expert portfolio managers. In a similar vein, their impact on asset market inflation or shift in management activities due to logic of funding (Engelen, 2003) is not as yet well-supported due to their immature nature. Finally, because of the absence of data, we are not able to provide a detailed review of the internal

workings of pension funds in Turkey in terms of investigating extensive versus intensive management strategies. The only information we have is that every pension fund has to sign a contract with a portfolio manager. In this sense, pension funds seem to have an external management. However, it is also known that pension funds, which are mostly established by banks, generally appeal to banks' portfolio investors. In this regard, pension funds' management seems to be not only internal to pension funds themselves but also integrated into the banking system. This peculiar character of pension funds in Turkey requires more research.

What, then, can be contributed to further research is to suggest a **mapping of financialisation** across different areas by bringing out common and peculiar characters of each sector. In other words, what is similar between financialisation of food (Salerno, 2014; Williams, 2014) and financialisation of water provision (Bayliss, 2014)? Or, what can be used from the research on carbon derivatives (Layfield, 2013) to analyse the securities based on mortgages (Walks, 2014)? Another question might seek to analyse whether or not financialisation shapes development policy (Carroll & Jarvis, 2014; Weber, 2014) in a way that prioritises financial motives within social policies (Fine, 2014)? Hence, a broad sketch of financialisation of almost everything highlights the main spines of financialisation and the relations across different examples of financialised domains instead of drawing independent analyses of financialisation often based on varying conceptual framings. Inspired by Leyshon and Thrift (Leyshon & Thrift, 2007) who suggested "*the capitalization of almost everything*", we call this process '**financialisation of almost everything**'. With agreement on the point that some of the research on financialisation is not conceptually justified (Christophers, 2015), we support proliferation of analyses of financialisation is the means to gauge the variety of domains with which it has exhibited different degrees and characteristics.

The second domain that has potential for research is the IPS. If this funded scheme becomes mandatory for millions of workers in Turkey, as planned, nothing will remain the same for the Turkish social security system and capital markets. Prospective research might focus on vulnerable income groups within the labour market in a way that develops the insights provided here. This can be a more qualitative research that is based on interviews as well as macro data that shows how unemployed, informally employed, the low-waged and women will be affected. Already, , there are studies that project outcomes for women of the IPS when it

becomes mandatory (Bozkus & Elveren, 2008; A. Y. Elveren, 2008; A. Elveren Y. & Hsu, 2007).

On the other hand, those employed temporarily are liable to be affected severely from the planned policy on the IPS. This is because for those who occasionally work with a very low wage, joining the IPS will directly decrease the wage level and claiming it back will require extra effort and time with every job change. This can be seen as an implicit *financial premium* and, as in the case of a high social security premium, workers and employers might go for the informality option. However, what is even more dramatic is that in the case of social security premiums, those not claimed back due to impossibility of retirement, are included in the redistributive social security budget. In the case of the IPS, on the other hand, what will happen to these small amounts of contributions is ambiguous. Will the unclaimed contributions remain in the pension funds? If so, is this not a direct support for financial actors while aggravating the existing informality problem?

Moreover, if this regulation does not meet with any opposition and the IPS becomes mandatory, the development of pension funds will be even faster and enable future researchers to investigate their impacts on capital markets. In this regard, a close analysis of pension funds, possibly on the basis of primary data collection from funds themselves, can enable observing the shift in their asset allocation as well as investment strategies. Thus, our insights on the logic of funding, and pension funds' contribution in increasing the speculative character of capital markets, will likely to be able to be examined with more data.

### **7.3. Concluding remarks**

To sum up, the IPS is not a simple saving mechanism for additional retirement income as suggested by the authorities. Rather, it represents a substantial restructuring in pension provision in terms of integration of pension income into the financial sphere, while old age income provision becomes a field for financial activity and actors. Funded pension schemes have traditionally been common in Anglo-Saxon countries with developed capitalist relations alongside sophisticated financial sectors. However, the reason behind this sort of pension financing to become more prevalent across the developing world is the pension reform campaign run by the WB since the 1994 Averting the Old Age Crisis report (WB, 1994). Presenting ageing population as a challenge that could be confronted only by

financialised pension provision is a reflection of the ascendance of power and significance of finance which extends its reach across varying moments of economy and society.

More immediately, jumping to Turkey in the contemporary period, there are two strands of conclusions to draw about the potential implementation of the proposal for rendering the IPS mandatory for every worker below 45 years old with an opt-out option after six months. The first implication regards the pension funds and the second concerns this policy's impact on living standards of workers.

Four of eighteen millions workers have already joined the IPS. Within the rest, twelve million who are below 45 years old will join the IPS automatically through paying TL100 per month for six months starting from January 2017. Thus, in the first half of 2017, the IPS will have TL7.2 billion additional funds. If nobody opts out at the end of the first year, the pension funds will increase by TL14.4 billion and this amount will be TL10.8 billion even if only half of the participants remain in the system.<sup>97</sup> In this regard, several issues are open to discussion.

The first thing is whether or not pension fund management fees, entrance fees and operational costs will be refunded to the participants who choose to opt out after the obligatory period. This is important because the Turkish pension funds' total operational management-related fees are already criticised for being above average due to lack of competition and the short history of the sector. While this is the case, expecting low-income workers to pay for these fees mandatorily for six months will cause a transfer of income from workers' wages to pension funds, particularly if the return of funds is deducts management fees.

The second issue is whether or not employers will contribute to the system. In the case of absence of employer contribution, the burden of pension income will be only on employees' shoulders which signals the individualised nature of pension provision. On the other hand, there is an option of introducing employer contributions with a tax incentive for the employer. However, according to the pilot scheme that started recently, the employee has to work for a certain number of years in order to benefit from employer's contribution to the IPS. What will happen to this contribution in the case of changing jobs or temporary breaks to career seems to be

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<sup>97</sup> For the newspaper article in Turkish please see the link below. Available at: [http://www.cumhuriyet.com.tr/haber/ekonomi/534249/Hukumetten\\_yeni\\_adim\\_45\\_yasin\\_altindaki\\_herkesin\\_maasindan\\_600\\_lira\\_kesinti\\_.html](http://www.cumhuriyet.com.tr/haber/ekonomi/534249/Hukumetten_yeni_adim_45_yasin_altindaki_herkesin_maasindan_600_lira_kesinti_.html) Access date: 09.06.2016

urgent questions to answer as, in the case of rendering the IPS participation mandatory, this kind of scheme will put additional constraints on workers' job contracts. In other words, worker will have to choose between current earnings and potential future income for old age in the case of a wage dispute with an employer.

The third issue is whether or not a state contribution will be granted to these twelve million workers. As mentioned before, the state contribution incentive is 25% and, according to the official announcement, the cost of this incentive is already around one billion Turkish liras. This aspect of the IPS is severely criticised for subsidising those who are already middle- or high-income earners. If this is abolished for those who join to the system mandatorily, there will be loss of support for those who are most in need as half of these twelve million workers earn only the minimum wage. In case this incentive is preserved and granted to the new participants, the total cost for the first six months will be TL1.8 billion for the Turkish Treasury. However, we should note that this is a fictitious cost as they will only be paid to the worker in the future and if staying in the system for a certain time period before retiring. Then, the question is, what will happen to those state contribution incentives not claimed by the participants but invested in funds of the IPS? According to the regulation, state contribution incentives are paid back to the Treasury in a way that it is noted down as general budget income.<sup>98</sup> This is important because the government invests in capital markets and acts like a financial market investor that seeks financial returns. The neoliberal ideology of taking the state out of market is upside down in the case of the IPS and financial markets. Finally, the IPS is still not the best investment option in Turkey while precious metals (gold) and the stock exchange offer higher returns. Therefore, pushing the IPS as the additional and mandatory saving mechanism is not the best option for workers.

However, the previous paragraph operates at a superficial and polemical level, looking distributionally at what the worker receives and is taken away again. Real take home wages are determined by a host of factors as are the benefits and costs in monetary and kind forms that accompany them. By the same token, the actual pension to be received in the future, in light of contributions now to the IPS, will be determined in ways that at most loosely reflect those contributions. This

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<sup>98</sup> <http://www.egm.org.tr/?pid=771>

points to the need to discuss the details of such schemes in a broader theoretical and historical framing.

By way of illustration, consider the implications of the making of the IPS mandatory in light of discussion of the value of labour power. In more detail, by 2016, the minimum wage in Turkey after taxes has been increased by 30% from TL1000 to TL1300. This policy has previously been debated across several aspects but recently two new points for discussion have emerged. According to the tax law, the minimum wage earner will be grouped in higher tax group and will pay 20% income tax rather than the previous 15% starting from October 2016. As a result of this development, the substantial amount of the wage increase will be repaid to the state as income tax. In addition to this development, the IPS contribution will be perceived by the minimum wage earner as a further cut from the wage increase. Thus, most of the TL300 wage increase will be taken back in the form of tax and *finance premium*. This point is important because it confirms our approach on value of labour power which is a living standard rather than welfare payments or cuts for social security. It shows that whatever the amount paid to workers, the living standard of workers only increases in relation to broader processes of social reproduction. This demonstrates the significance of class struggle for workers to increase their living conditions. In the absence of that, the value of labour power will be altered explicitly or implicitly by financial or non-financial interventions as in the case of the IPS.



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