

KOÇ UNIVERSITY
GRADUATE SCHOOL OF SOCIAL SCIENCES & HUMANITIES

REFORMING REACTIVE STATES: A COMPARATIVE POLITICAL ECONOMY
OF GREEK AND TURKISH CRISES

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A dissertation submitted for the degree of Doctor of Philosophy at Koç University

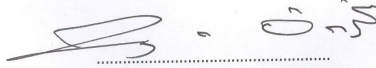
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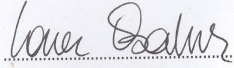
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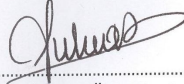
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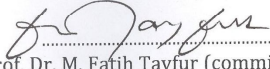
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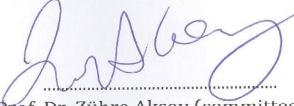
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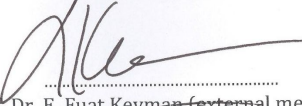
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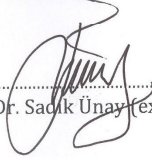
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Thesis abstract

The politics of major economic transformations is one of the controversial issues in international/comparative political economy literature. The institutionalist political economy literature suggests that ‘state capacity’ is a precondition, not an obstacle for reforming domestic political economy structures. However, states are not standardized commodities, whereby their capacity diverges remarkably. I will probe into the dynamics of fiscal and financial reforms in late-industrialized reactive states, defined with a low regulatory capacity to discipline their fisco-financial regimes as part and parcel of long-term economic transformations in the normal course of politics. My research questions are as follows: What are the dynamics of reform-inertia and reform-activism in reactive states? Under what conditions and through which mechanisms economic crises lead to paradigmatic economic reforms in these political economies?

In order to address these intricate and intriguing questions I offer a three-stage framework that is based on the epistemological tradition of ‘analytic eclecticism.’ Accordingly, I compared Greece and Turkey as most-similar cases. These two cases pose interesting research puzzles. First, both of these states approximate to ideal-typical configuration of reactive states in terms of fisco-financial regimes, characterized with a bloated public sector and ill-functioning financial system. Second, both have encountered a deep economic crisis that rocked the existing material and ideational equilibrium to its foundations in 2009 and 2001, respectively. Third, in both cases, external anchors, namely the IMF and the EU intervened into the process heavily. The post-crisis reform performance, however, demonstrated significant divergence in these two hitherto similar reactive states.

Based on thirty-six semi-structured in-depth elite interviews and complemented by various primary and secondary data sources my findings suggest that certain timing and context-dependent factors are in order for paradigmatic economic transformations in reactive states: (i) crises constitute critical junctures to introduce a nontrivial change in dominant fisco-financial paradigms, (ii) emergence of political will and policy entrepreneurs capable of linking the problems, policies, and politics to communicate a coherent crisis narrative becomes an imperative in times of crisis-induced uncertainty. The crisis narratives of state agents, however, must be matched with external anchors, and (iii) institutional structures, i.e., political context, state bureaucracy, and dominant policy coalitions, should play enabling roles at least to a certain extent in order to create supportive change-oriented coalitions assembled around a dominant crisis narrative.

Keywords: reactive states, regulatory state capacity, fisco-financial reforms, policy entrepreneurs, and crisis narratives.

Tez özeti

Ekonomik reformların siyasi iktisadı, uluslararası/karşılaştırmalı siyasi iktisat literatürünün tartışmalı konuları arasında yer almaktadır. Kurumsal siyasi iktisat ekolünün vurguladığı üzere, ‘devlet kapasitesi’ reform süreçlerinde bir engel değil, bir ön koşuldur. Ancak devletler kapasite bakımından farklılık sergileyen entitelerdir. Bu çalışma, geç-sanayileşmiş ‘reaktif devletler’ bağlamında mali-finansal reform dinamiklerini incelemektedir. Bu kapsamda cevap aranan temel araştırma soruları şunlardır: Reaktif devletlerde reform-durgunluğu ve reform-aktivizminin dinamikleri nasıl kavramsallaştırılabilir? Bilhassa ekonomik krizler, hangi şartlarda ve nedensellik mekanizmalarıyla kapsamlı mali-finansal reformlara imkan tanıyabilmektedir? Söz konusu karmaşık sorulara cevap verebilmek için bu çalışmada epistemolojik temeli ‘analitik eklektizme’ dayanan üç-aşamalı kavramsal model önerilmiştir. Bu çalışmada, Yunanistan ve Türkiye ‘en benzer vakalar’ olarak incelenmiştir. Birincisi, iki ülke de neoliberal küreselleşme döneminde disipline edilemeyen mali-finansal sistemleriyle ‘reaktif devlet’ kavramsallaştırmasına yakınsayan örneklerdir. İkincisi, iki ülke de düzenleyici devlet kapasitesinin eksikliğinden dolayı derin ekonomik kriz yaşamıştır. Söz konusu krizler (2009 Yunanistan ve 2001 Türkiye) mevcut güç dengelerini ve hakim paradigmatları temelinden sarsmıştır. Üçüncüsü, IMF-AB ‘dışsal çapası’ her iki ülkede de kriz sonrası yeniden yapılandırma süreçlerine doğrudan müdahil olmuştur. Ancak iki ülkenin kriz sonrası reform performansı karşılaştırıldığında çarpıcı bir farklılaşma görülmektedir.

Türkiye ve Yunanistan’ın karşılaştırmalı analizi reaktif devletlerde reform dinamiklerini anlayabilmek ve ‘sınırlı genellemeler’ önerebilmek için uygun vakalardır. Bu çalışmada kullanılan veriler, iki ülkedeki alan çalışmasında elde edilen otuz altı yarı-yapılandırılmış elit mülakatına dayanmaktadır. Ayrıca kapsamlı birincil ve ikincil veri ile alan araştırması bulguları desteklenmiştir. Çalışmanın bulgularına göre reaktif devletlerde reform dinamikleri bir dizi faktörün zaman ve konteks-bağımlı karmaşık etkileşiminin sonucunda ortaya çıkmaktadır: (i) krizler, reformların hayata geçirilmesi için fırsat penceresi açmaktadır; (ii) kriz sırasında siyasi irade ve ‘siyasi girişimciler’ sorunların, çözüm önerilerinin ve siyasi mekanizmaların birleştirilerek ‘bütüncül bir kriz okumasının’ oluşturulmasında kurucu önemdedir. Ancak reformist devlet aktörlerinin kriz okumasının ilgili dışsal çapaların kriz okumalarıyla örtüştürülmesi gerekmektedir; (iii) aktör düzeyinde oluşan hakim kriz okumasının reform-yanlısı koalisyonların desteği ile sürdürülebilir reformlara neden olabilmesi için kurumsal yapıların kritik eşiği aşmaya imkan tanıyacak ölçüde kolaylaştırıcı rol oynamaları gerekmektedir.

Anahtar kelimeler: reaktif devlet, devlet kapasitesi, mali-finansal reformlar, siyasi girişimci, kriz okuması.

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“I write from the midst of things and I cannot see their order as yet... I want to run but I can only drag along slowly.”

---Alexis de Tocqueville

I think writing a PhD dissertation very much resembles the situation described by Tocqueville. It is a long journey full of impediments, hopes, and frustrations. I am grateful to many people, scholars and colleagues, who helped me navigate my way in the midst of things during this PhD research. First and foremost, I struggle for sufficient words to express my deepest gratitude to my dissertation advisor, Professor Ziya Öniş. Professor Öniş guided me through all these years. I am more than thankful for his excellent guidance, insightful comments, encouraging feedback, and tireless support at all stages of my PhD education. More importantly, however, Professor Öniş instilled in me deeply the notion that cutting-edge scholarship does not only require ‘fair competition’ but also an open mind for cooperation, deliberation, genuine respect for pluralism, and academic modesty. I have always been and will remain honored and very proud of being his research assistant and PhD student. Second, I would like to thank my co-advisor Professor Caner Bakır for providing substantial comments and feedback at various stages of my research. His feedback helped me a lot in finding my way along the ‘messy center’ of comparative political economy.

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To my family

and

To the families of all those who lost their lives in the Soma mine explosion, Turkey's worst-ever mine disaster that resulted in the tragic deaths of 301 miners in May 2014.

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Chapter 1. Introduction

1.1. Problem statement and research questions

This study probes into the dynamics of economic reform processes in reactive states. The politics of major economic transformations is one of the controversial issues in international/comparative political economy literature.¹ There is no clear-cut and agreed-upon template for how successful reforms are initiated and consolidated. State's role in major economic transformations is an even more contested theme. The institutionalist political economy literature, which has made a strong comeback recently vis-à-vis orthodox neoclassical accounts, suggests that 'state capacity' is a precondition, not an obstacle for reforming the domestic political economy structures.² However, states are not standardized commodities whereby their capacity diverges substantially across

¹ For earlier political economy reviews, see Stephan Haggard and Robert R. Kaufman, ed., *The Politics of Economic Adjustment* (Princeton: Princeton University Press, 1992); Dani Rodrik, "Understanding Economic Policy Reform," *Journal of Economic Literature* XXXIV (1996): 9-41. For a recent review, see Hal Hill, "The Political Economy of Policy Reform: Insights from Southeast Asia," *Asian Development Review* 30, no. 1 (2013): 108-130.

² For an overview of institutional political economy framework, see Ha-Joon Chang, "Breaking the Mould: An Institutional Political Economy Alternative to the Neoliberal Theory of the Market and the State," *Cambridge Journal of Economics* 26, no. 5 (2002): 539-559; Ben Clift, *Comparative Political Economy: States, Markets, and Global Capitalism* (Basingstoke: Palgrave Macmillan, 2014). For the importance of 'state capacity' in international/comparative political economy, see Ha-Joon Chang, *Globalization, Economic Development and the Role of the State* (London and New York: Zed Books, 2004); Dennis A. Rondinelli and G. Shabbir Cheema, *Reinventing Government for the Twenty-First Century: State Capacity in a Globalizing Society* (Bloomfield: Kumarian Press, Inc., 2003); Peter Evans, "In the Search of the 21st Century Developmental State," *Center for Global Political Economy Working Paper* 4 (2008): 1-22; Peter Evans, "The Eclipse of the State? Reflections on Stateness in an Era of Globalization," *World Politics* 50, no. 1 (1997): 62-87.

cases. With respect to state capacity discussions, two main types of states are postulated in the literature: ‘proactive’ and ‘reactive’ ones.³

Proactive states tend to have the capacity to initiate economic reforms as part and parcel of a comprehensive political economy strategy. Thanks to the institutional complementarities in state-market relations, economic transformations in these states are commenced as part of prudently crafted and patiently implemented long-term strategies.⁴ Reactive states, on the other hand, tend to suffer from reform-biased institutional structures that underlie Olsonian collective action problems toward instigating virtuous reformist cycles.⁵ In these political economies, state remains at the center of the perennial who-gets-what struggle among different interest groups and its relative strength vis-à-vis other domestic/international centres of power tends to be weak.⁶ Furthermore, in these polities, rent-seeking exchange relationships and self-reinforcing clientelistic practices inform incremental deterioration of state capacity, which lead to the procrastination of crucial decisions in the normal course of politics.⁷ The postponement of urgently needed reform-decisions, in turn, paves the way for the

³ Linda Weiss, “Globalization and the Myth of the Powerless State,” *New Left Review* I, no. 225 (1997): 3-27; Linda Weiss, *The Myth of the Powerless State: Governing the Economy in a Global Era* (Cambridge: Polity Press, 1998); Ziya Öniş and Fikret Şenses, “Global Dynamics, Domestic Coalitions and Reactive State: Major Policy Shifts in Post-War Turkish Economic Development,” *METU Studies in Development*, no. 34 (2007): 251-286.

⁴ Chang, *Globalization, Economic Development and the Role of the State*, chapters 2 and 3.

⁵ Olson decades ago pointed out that well-organized minority interests are overrepresented and diffuse majority interests are sidelined due to ‘free rider’ problems. Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge: Harvard University Press, 1965).

⁶ I will offer a detailed literature survey and elaborate more on the conceptualization of ‘state capacity’ and ‘reactive states’ in chapter 2.

⁷ Given the technical and ideological dimensions surrounding the debate, one needs to clarify the very concept of ‘reform.’ In chapter 2, I will offer the definitions of ‘reform-inertia’ and ‘reform-activism’ in the conceptual vocabulary section of the three-stage framework adopted in this study.

accumulation of deep-seated fisco-financial problems. Öniş and Şenses demonstrate that, more often than not, reform processes in reactive states are set in motion in the wake of substantial exogenous shocks.⁸

“Reactive states tend to be more fragmented and enjoy a much lower degree of relative autonomy from key domestic constituencies... Hence, [reactive states’] ability to overcome sectional conflicts and concentrate their attention on longer-term strategic goals tends to be more limited... [In reactive states] in the absence of crises, the existing coalitions supporting a particular policy regime tend to display considerable resistance to change in spite of the fact that there might be clear signs indicating that the existing policy regime might no longer be viable or sustainable.”⁹

An economic crisis, in this context, is a forceful game-changer that may disturb ex ante equilibrium of domestic power relations and dominant ideational paradigms underlying intricate relationships between incumbent agents and structures.¹⁰ However, as the literature suggests, not all crises invite major policy changes.¹¹ In fact, exogenous shocks per se fall short of explaining post-crisis variations across cases in reactive states since crises with a similar magnitude lead to diverging post-crisis reform outcomes, as I will demonstrate in the empirical parts of this study. Yet the relevant literature has not paid much ado to explicate the causal mechanisms through which paradigmatic

⁸ Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*, 251-286.

⁹ *Ibid.*, 255, 261.

¹⁰ For an elaborate analysis in the Turkish context, see Ziya Öniş, “Beyond the 2001 Financial Crisis: The Political Economy of the New Phase of Neo-Liberal Restructuring in Turkey,” *Review of International Political Economy* 16, no. 3 (2009): 409-432.

¹¹ Arjen Boin Allan McConnell and Paul ‘t Hart, *Governing After Crisis: The Politics of Investigation, Accountability and Learning* (Cambridge: Cambridge University Press, 2008), 5; Jeffrey W. Legro, “The Transformation of Policy Ideas,” *American Journal of Political Science* 44, no. 3 (2000): 419-432; Fleur Alink, Arjen Boin and Paul ‘t Hart, “Institutional Crises and Reforms in Policy Sectors: The Case of Asylum Policy in Europe,” *Journal of European Public Policy* 8, no. 2 (2001): 286-306.

transformations take place in reactive states.¹² This leads to the main research questions posed in this study: What are the dynamics of reform-inertia and reform-activism in reactive states? Under what conditions and through which mechanisms economic crises lead to substantial reforms in these political economies?

1.2. Motivation of the study

These research questions are important for three main reasons, which also constitute the motivation and potential contributions of this study. First, current literature does not put adequate emphasis on the links between state capacity and reform dynamics in late-industrialized reactive states (see chapter 2). The ‘reactive state’ concept is mainly utilized by policy networks framework with an exclusive focus on advanced industrialized economies.¹³ The policy networks framework aims to reveal through which interest intermediation structures states are capable of steering non-state economic actors. Accordingly, reactive states are defined as the ones that are incapable of intervening in the industrial organization of the markets in cooperation with sectoral interest groups.¹⁴ Despite useful insights it provides, of which this study also benefits, the policy networks framework has a limited portability into the late-developers due to qualitative differences between advanced polities and late-industrialized reactive states

¹² For exceptions that concentrate on single-country studies see Caner Bakır, “Policy Entrepreneurship and Institutional Change: Multilevel Governance of Central Banking Reform,” *Governance: An International Journal of Policy, Administration and Institutions* 22, no. 4 (2009): 573; Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*, 251-286.

¹³ For an overview of ‘policy networks’ literature, see Tanja Börzel, “Networks: Reified Metaphor or Governance Panacea?”, *Public Administration* 89, no. 1 (2011): 49-63.

¹⁴ Michael M. Atkinson and William D. Coleman, “Strong States and Weak States: Sectoral Policy Networks in Advanced Capitalist Economies,” *British Journal of Political Science* 19, no. 1 (1989): 61.

in terms of domestic political setting, state bureaucracy, and dominant policy coalitions. The latter is defined with reference to (i) political systems imbued by political polarization and uncontrolled populism, (ii) state bureaucracies characterized by limited ‘embedded autonomy,’ and (iii) dominant policy coalitions —i.e., state’s relations with business elite and labour class— permeated by rent-seeking and clientelism. As Heper and Keyman highlight with reference to the Turkish case, the state in these political economies depicts a “double-faced” nature.¹⁵ On the one hand, it frequently intervenes into the functioning of the economic and political life. On the other hand, these interventions tend to be ad hoc, fragmented, and loop-sided that arbitrarily favours a narrow circle of privileged rentier coalitions against the overall welfare of the society. Moreover, in these polities, international dynamics play a much more pronounced role than the policy networks framework acknowledges in the context of advanced capitalist economies.

Having taken these points into consideration, this study claims that ‘state capacity’ debates and reform dynamics in late-industrialized reactive states are qualitatively different in comparison to the latter category (for details, see chapter 2). Therefore, we need to extend our gaze beyond domestic-oriented and sector-specific emphasis of the policy networks framework to better capture the deep causes and international dynamics of reform failures in the sub-set of states probed in this study. To this end, in the

¹⁵ Metin Heper and Fuat Keyman, “Double-faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies* 34, no. 4 (1998): 259-277. I should note, however, that Heper and Keyman do not use the concept of ‘reactive state.’

following chapter, I offer a three-stage framework that draws from three distinct but interrelated literatures: state capacity, policy entrepreneurship, and critical junctures.

In reactive states, institutional structures are set in a way that informs inward-looking myopic behaviour at the agency-level. Accordingly, state tends to be captured by special interests and, as a result, turns into an impediment to capacity-augmenting reforms rather than assuming a steering role. In this setting, institutional arrangements create various mechanisms for state agents to bandwagon the deeply entrenched rent-seeking coalitions. This tendency creates an interesting puzzle in terms of major policy transformations: those who are supposed to reform domestic political economies are usually the ones that are conditioned by and reap the benefits of the existing institutional arrangements. This problematiqué relates to the “paradox of embedded agency.”¹⁶ Then, how can it be possible to initiate a virtuous cycle of reform-activism in reactive states? And what accounts for diverging reform performance of reactive states with hitherto similar capacities? The policy entrepreneurship¹⁷ and critical junctures¹⁸ literatures provide fertile avenues to address the paradox of embedded agency.

The agent-structure problematiqué is one of the age-old debates in comparative political economy literature that much ink has been spilt on.¹⁹ Two methodologically and

¹⁶ For a discussion of the ‘paradox of embedded agency’ see, Julie Battilana, Bernard Leca, and Eva Boxenbaum, “How Actors Change Institutions: Towards a Theory of Institutional Entrepreneurship”, *The Academy of Management Annals* 3, no. 1 (2009): 65-107.

¹⁷ I offer a critical review of the ‘policy entrepreneurship’ literature in chapter 2.

¹⁸ I discussed the importance of ‘critical junctures’ within the context of this study in chapter 2.

¹⁹ For a comprehensive review, see Colin Hay, *Political Analysis* (Basingstoke: Palgrave Macmillan, 2002). For an overview for the purposes of this study, see chapter 2.

ontologically diverging perspectives have shaped the parameters of the agent-structure debate in political science for quite a long time.²⁰ On the one side, rational choice models take agents as the main unit of and focus for analysis. They assume that “political process and outcomes are completely determined by the actions of and interactions between these individuals.”²¹ Rational choice approaches are heavily criticized for being overly ahistorical and narrow-minded that concentrates only on trees “while the forest has grown.”²² Furthermore, they cannot address the embedded agency paradox in reactive states.

On the other side, structural approaches aim to account for the constraining/enabling impacts of social, economic, political, and cultural institutions on actors’ agency. These accounts seek to explicate how institutions define and defend interests and ideas of the agents, which Farrell and Newman call “the constitutive nature of institutional contexts.”²³ Dominant approaches in this stream of research, however, are generally criticized for placing too much emphasis on structures at the cost of agents. These accounts, while insightful at explaining status quo and stability, cannot address the issue of change and reform-activism in reactive states. In Thelen and Steinmo’s words, institutions tend to be operationalized in a way that they “explain everything until they

²⁰ Peter A. Hall and Rosemary C. R. Taylor, “Political Science and the Three New Institutionalisms,” *Political Studies* 44, no. 5 (1996): 936-957. Also see Hay, *Political Analysis*.

²¹ Andrew Hindmoor, *Rational Choice* (Basingstoke: Palgrave Macmillan, 2006), 1.

²² Benjamin J. Cohen, *International Political Economy: An Intellectual History* (Princeton: Princeton University Press, 2008), 131.

²³ Henry Farrell and Abraham L. Newman, “Making International Markets: Domestic Institutions in International Political Economy,” *Review of International Political Economy* 17, no. 4 (2010): 611.

explain nothing.”²⁴ As Gamble indicates, however, a proper analysis needs to give importance “to both structure and agency rather than concentrating on one to the exclusion of the other.”²⁵

In this context, burgeoning research on ‘policy entrepreneurship’ opened up new theoretical and empirical avenues by bringing the role of agency back into the analysis of major policy changes.²⁶ Kingdon, in his pioneering work, notes that policy entrepreneurs “could be in or out of government, in elected or appointed positions, in interest groups or research organizations. But their defining characteristic... is their willingness to invest their resources —time, energy, reputation, and sometimes money— in the hope of a future return.”²⁷ Policy entrepreneurs, however, do not operate in a vacuum. Kingdon offers ‘multiple-streams approach’ to place reformist change agents within the context of three kinds of processes: problems, policies, and politics.²⁸ The problems usually open up opportunity windows in the policy (solution) and political processes that enable policy entrepreneurs to promote alternative agendas toward instigating radical policy change. Thus paradigmatic transformations occur when change agents meticulously couple these three independent streams —problems, policies, and politics.²⁹ As Zahariadis documented, Kingdon’s multiple-streams approach triggered a wave of research that studied policy entrepreneurship with more explicit emphasis on

²⁴ Kathleen Thelen and Sven Steinmo, “Historical Institutionalism in Comparative Politics” in Sven Steinmo, Kathleen Thelen and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Analysis* (Cambridge: Cambridge University Press, 1992), 15.

²⁵ Andrew Gamble, “The New Political Economy,” *Political Studies* 43, no. 3 (1995): 522.

²⁶ For a literature review, see chapter 2.

²⁷ John W. Kingdon, *Agendas, Alternatives, and Public Policies* (New York: Longman, 1995), 122.

²⁸ *Ibid.*, 16.

²⁹ *Ibid.*, 172-184.

time and context-related factors.³⁰ In the words of Mintrom and Norman, subsequent studies “paid attention simultaneously to contextual factors, to individual actions within those contexts, and to how context shaped such actions.”³¹ Bakır underlines, however, that existing approaches suffer from certain pitfalls. Accordingly, the role of policy entrepreneurs is mainly studied within the framework of “governmental agenda setting,” which neglects the wider societal and political context.³² In order to rectify this gap, Bakır offers a broader analysis. First, in his work on central banking reform in Turkey, Bakır studied policy entrepreneurs within the context of domestic and transnational policy communities, linking the interactions between national and external dynamics.³³ Second, Bakır places policy entrepreneurs into a broader ‘institutional’ and ‘structural’ context.³⁴ In his study on bank behaviour, Bakır offers an eclectic model that places policy entrepreneurs into the enabling/constraining context of institutional and structural-level dynamics that inform persistence and change in bank behaviour in advanced political economies.³⁵

Taking the stock of extant research on policy entrepreneurship, this study aims to dig deeper to explicate better the limits of the reformist state agents in late-industrialized reactive states by adopting a comparative analysis of Greece and Turkey. The conviction

³⁰ Nikolaos Zahariadis, “The Multiple Streams Framework: Structures, Limitations, Prospects,” in Paul A. Sabatier, ed., *Theories of the Policy Process* (Boulder, Co: Westview Press, 2007), 65-92.

³¹ Michael Mintrom and Phillipa Norman, “Policy Entrepreneurship and Policy Change,” *The Policy Studies Journal* 37, no. 4 (2009): 651.

³² Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 573.

³³ *Ibid.*, 571-598.

³⁴ Caner Bakır, *Bank Behaviour and Resilience: The Effects of Structures, Institutions, and Agents* (New York: Palgrave Macmillan, 2013).

³⁵ *Ibid.*

of this study is that still there is room to consider the functions of policy entrepreneurs. In fact, the bulk of research on the subject matter concentrates on the dynamics of policy changes in developed countries. However, as I argued in the previous pages, the organization of domestic political economy setting and prevalence of non-domestic forces necessitates differentiated perspectives that apply for late-developed reactive states. In this regard, Bakır's research on central banking reform in Turkey that put emphasis on the interactions between domestic and transnational policy communities mediated by a policy entrepreneur is an important step to mitigate the gap in the literature.³⁶ The extant research, however, does not directly deal with the impacts of institutional structures on the performance of policy entrepreneurs in late-industrialized reactive states. When, why, and how domestic institutional structures play enabling/constraining roles in these polities and how diverging response of external anchors informs ultimate reform performance at crisis times? Under what conditions can policy entrepreneurs couple problems, policies, and politics around a dominant reformist narrative?

In search of these outstanding questions, this study intends to add a comparative dimension to the debate. First, it investigates two cases in which potential policy entrepreneurs could not achieve substantial transformations. In chapter 3, I will focus on Kostas Simitis as a policy entrepreneur in a non-crisis context. In chapter 4, I will examine another policy entrepreneur, Lucas Papademos, in a crisis context. In both

³⁶ Bakır, "Policy Entrepreneurship and Institutional Change," *Governance: An International Journal of Policy, Administration and Institutions*, 571-598.

cases, these two reformist state agents could not build momentum to reform Greece's ill-functioning fisco-financial regime, as their efforts came to almost nothing. Second, in addition to diachronic intra-case comparisons, this study compares Greece's Papademos experience with the Derviş case in Turkey (see chapter 7). By doing so I aim expand the debate on policy entrepreneurship by navigating the contextual limits and potentials of reformist change agents in crisis and non-crisis junctures.

Finally, this study hopes to make a third contribution to the complex dynamics of economic crises and reform outcomes in reactive states. The literature suggests that crises, as critical junctures, are rare tipping points in breaking down the dominant policy paradigms and 'levelling the playing field.'³⁷ Critical junctures are "relatively short periods of time during which there is substantially heightened probability that agents' choices will affect the outcome of interest."³⁸ Jolts and crises constitute points that are distinct from the 'normal' historical setting of interests and ideas.³⁹ The policy entrepreneurship literature also engages in an explicit and fruitful conversation with the critical junctures literature.⁴⁰ However, an adjustment is in order at this point as well. As

³⁷ Research stream affiliated with historical institutionalism puts special emphasis on 'critical junctures' or 'punctuated institutional equilibrium' model as the main engine of change. However, one should acknowledge that critical junctures do not exhaust all types of change in socio-political and economic life. The recent accounts of historical institutionalism aim to incorporate different ways of change into its conceptual toolkit. For instance, Streeck and Thelen seek to lurk beneath "conservative bias" by directing their attention to the "incremental and transformative change." See, Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Industrial Economies* (Oxford: Oxford University Press, 2005).

³⁸ Giovanni Capoccia and Daniel R. Klemen, "The Study of Junctures: Theory, Narrative, and Counterfactuals in Historical Institutionalism," *World Politics* 59, no. 3 (2007): 348.

³⁹ Ibid.

⁴⁰ John Hogan and Sharon Feeney, "Crisis and Policy Change: The Role of the Political Entrepreneur," *Risk, Hazards & Crisis in Public Policy* 3, no. 2 (2012): 1; Bakır, "Policy Entrepreneurship and Institutional Change," *Governance: An International Journal of Policy, Administration and Institutions*,

a follow up on my previous points, this study will claim that in crisis junctures the mode of interactions among domestic agents and institutional structures reflects just one side of the story. The dynamics of persistence and change in the fisco-financial regimes of reactive states necessitate an explicit recognition of the crucial roles played by external anchors. In this regard, regional organizations like the EU and international financial institutions such as the IMF and the World Bank tend to have considerable agenda-setting power over reactive states through various ‘conditionality’ mechanisms.⁴¹ Their impact, however, is also context-dependent and highly contingent. Using the comparative method both diachronically —analysing the same case at two points in time— and synchronically —analysing the processes of change across different cases, their context-specific leverage in reform processes can be revealed.

It is the conviction and premise of this study that instead of unidirectional inward-outward models, or vice versa, we need less parsimonious and more interactive frameworks that take dialectical interactions of the domestic-international nexus into consideration. The works of Öniş and Şenses,⁴² Bakır,⁴³ and Öniş⁴⁴ notably enlarged our horizons within the context of reactive states with their explicit recognition of the intricate relationships between domestic and external interactions during crisis junctures.

571-598. For a literature review, see Mintrom and Norman, “Policy Entrepreneurship and Policy Change,” *The Policy Studies Journal*, 656-657.

⁴¹ For a review of the relevant literature, see chapter 2.

⁴² Öniş and Şenses, in their pioneering study, applied ‘reactive state’ concept to the Turkish case with an explicit recognition of the role of external dynamics. See, Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*.

⁴³ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 571-598.

⁴⁴ Ziya Öniş, “Domestic Politics versus Global Dynamics: Toward a Political Economy of the 2000 and 2001 Financial Crises in Turkey,” *Turkish Studies* 4, no. 2 (2003): 1-30.

This study aims to take the debate one step further by offering *crisis narratives* as an organizing concept to better explore the circumstantial conditions under which a crisis induces paradigmatic policy regime changes. Boin, McConnell, and 't Hart,⁴⁵ and Boin, 't Hart, and McConnell⁴⁶ demonstrate that crises open up contentious episodes that invite 'frame contests,' which in turn pave the way for a political struggle of 'crisis exploitation.'⁴⁷ Accordingly, crisis exploitation refers to "the purposeful utilization of crisis-type rhetoric to significantly alter levels of political support for public office holders and public policies."⁴⁸ The policy and political outcomes of crisis-induced political blame games between change advocates and status quo players are determined by the capacity of various domestic players to exploit the crisis and the degree of their success in dominating post-crisis political landscape.⁴⁹

In this study, I inspired from 'frame contests' framework as it also calls for a nuanced perspective to study post-crisis politicking, despite popular notions to the contrary.⁵⁰ The crisis narratives approach offered in this study, however, diverges from this stream of research on important grounds. First, it acknowledges the crucial role of external anchors during critical junctures. The 'frame contests' approach, on the other hand, neglects the non-domestic sources of post-crisis framing contests. In late-industrialized reactive states, the external anchors decisively intervene in the design and

⁴⁵ Boin, McConnell and 't Hart, *Governing After Crisis*.

⁴⁶ Boin, 't Hart and McConnell, "Crisis Exploitation: Political and Policy Impacts of Framing Contests," *Journal of European Public Policy* 16, 81-106.

⁴⁷ *Ibid.*, 82-83.

⁴⁸ *Ibid.*, 83.

⁴⁹ Boin, McConnell and 't Hart, *Governing After Crisis*, 285-288.

⁵⁰ On this point, see Alink, Boin, and 't Hart, "Institutional Crises and Reforms in Policy Sectors: The Case of Refugee Policy in Europe," *Journal of European Public Policy*, 286-306.

implementation of post-crisis economic reform programs, which renders a careful analysis of their crisis narratives inescapable. Second, crisis narratives approach adopted here, by assigning ontological independence to external and domestic players simultaneously, enables us to explore the extent to which the narratives of external anchors and domestic stakeholders overlap each other and how diverging/converging crisis narratives inform reform outcomes in these polities. I will claim that the emergence of a form of a dominant narrative regarding the root-causes of and the steps to be taken to resolve the crisis determine ultimate reform performance. I will also argue that the degree of narrative matching is determined according the independent interests-ideas functions and power capacities of external anchors and domestic players, without neglecting the proposition that policy entrepreneurs can streamline matchmaking process.⁵¹ The question that I will seek to answer can be formulated as follows: How do crisis narratives of domestic agents and external anchors interact with each other, and what factors account for the emergence of fragmented or dominant crisis narratives in the wake of crisis-induced uncertainty episodes?

In summary, this study proposes that complex time and context-sensitive interactions of agents and institutional structures inform divergent reform outcomes in reactive states. I will offer a comparative political economy of Turkey and Greece as most-similar cases in the empirical chapters to substantiate my argument. As a matter of fact, these two

⁵¹ This also explains why I do not apply discursive institutionalism in this study. Although there are overlapping points, crisis narratives approach is more useful for the purposes of this study because it openly acknowledges the potential impacts of asymmetric power relations between external anchors and domestic players.

states demonstrate striking political economy similarities in terms of weak/weakening state capacity and sub-optimal state-market relations. Both of them were severely hit by economic shocks in 2001 and 2009, respectively. In both cases the external factors —the IMF-EU anchor— heavily intervened into the restructuring process following the economic shocks. Turkey’s post-crisis reform performance, however, substantially diverged from the Greek case. I will offer a three-stage framework in the following chapter to account for diverging fisco-financial reform performance of these two hitherto similar reactive states. I will also examine Kostas Simitis period in Greece and Turkey’s 1994 crisis as shadow cases to develop my conceptual framework in stages. However, before doing this, I shall set the outline of my research design, case selection method, sources of empirical data, and organization of chapters.

1.3. Research design: Case selection

This study places a central emphasis on the concept of ‘state capacity’ in its analysis of reform dynamics in Greece and Turkey. However, as Atkinson and Coleman,⁵² Weiss,⁵³ Painter and Pierre⁵⁴ aptly demonstrate, state capacity in the abstract does not have much analytical value. Weiss asserts this point as follows:

“Speaking of state-capacity in the abstract is of little use for understanding substantive issues. Whether or not state capacity exists in a given context can only be determined on the basis of specific issues that interest us. Accordingly

⁵² Atkinson and Coleman, “Strong States and Weak States,” *British Journal of Political Science*, 47-67.

⁵³ Weiss, “Globalization and the Myth,” *New Left Review* I, 3-27; Weiss, *The Myth of the Powerless State*; Linda Weiss, ed., *States in the Global Economy: Bringing Domestic Institutions Back In* (Cambridge: Cambridge University Press, 2003).

⁵⁴ Martin Painter and Jon Pierre, “Unpacking Policy Capacity: Issues and Themes,” in Martin Painter and John Pierre, eds., *Challenges to State Policy Capacity*, (Basingstoke: Palgrave Macmillan, 2005).

one must always ask: capacity for what? A state's capacity tends to vary across issue areas, some of which will be more far-reaching in their ramifications than others, depending on the larger environment."⁵⁵

This is because of state's polymorphousness. In his state theory, Mann argues that state is internally a *non-unitary entity* that is composed of various parts.⁵⁶ These parts are institutionalized at different junctures and linked to diverging domestic-international logics, which in turn generate multiple tendencies of state behaviour. This means that the same state may have diverging capacities across policy realms and sectors. For instance, à la Weiss, we can argue that regulatory state capacity in the fisco-financial regime may acquire it the status of a regulatory state whilst the same state may fall short of being neo-developmental in the industrial sphere.⁵⁷ Based on Mann's notion of polymorphous state and Weiss's elaboration on the concept, we can speak about three types of state capacity: regulatory capacity, transformative capacity, and distributive capacity.⁵⁸ In this study, I will discuss state capacity with reference to the regulation of fiscal and financial realms to explicate under what conditions and through which mechanisms substantial reforms —dependent variable— are initiated in the fisco-financial regimes in reactive states. State capacity literature suggests that reform initiatives generally emanate from the state agents rather than incumbent policy communities. However, the limits of the

⁵⁵ Weiss, *The Myth of the Powerless State*, 17.

⁵⁶ Michael Mann, *The Sources of Social Power: Volume II* (Cambridge: Cambridge University Press, 1993), 44-91.

⁵⁷ Linda Weiss, "The Myth of the Neoliberal State," in Chang Kyung-Sup, Ben Fine and Linda Weiss, eds., *Developmental Politics in Transition: The Neoliberal Era and Beyond* (New York: Palgrave Macmillan, 2012), 38. For the application of this perspective to the Spanish and Turkish cases in a comparative perspective, see Mustafa Kutlay, "Internationalization of Finance Capital in Spain and Turkey: Neoliberal Globalization and the Political Economy of State Strategies," *New Perspectives on Turkey*, no. 47 (2012): 115-137.

⁵⁸ Weiss, *The Myth of the Powerless State*, 7-12.

possible for reformist state agents —namely policy entrepreneurs— are conditioned by domestic and broader institutional structures. Therefore, as I suggested above, I place agency into a wider framework. Accordingly, two concepts are crucial for the purposes of this study: timing and context of reform initiatives. More often than not, crisis or jolt is a necessary factor —intervening variable— that opens up new opportunity structures and invites for an introduction of a virtuous reformist cycle. In these junctures, interactions among state agents, external anchors, and domestic institutional structures —independent variables— result in an emergence of either dominant or fragmented crisis narratives, which in turn inform reform outcomes.

My research design is based on the comparative method for two main reasons. First, as Eckstein,⁵⁹ Brady and Collier,⁶⁰ Mahoney and Rueschemeyer,⁶¹ Mahoney,⁶² King, Keohane and Verba,⁶³ Bennett and George,⁶⁴ and Tarrow⁶⁵ similarly argue, case studies are quite insightful in generating new hypotheses, revealing omitted variables and building new conceptual frameworks. Since this study offers a holistic framework that applies to late-developed reactive states, in-depth case study research is of particular value to test the single and combinative impacts of different causal mechanisms. As

⁵⁹ Harry Eckstein, “Case Study and Theory in Political Science,” in Freed Greenstein and Nelson Polsby, eds., *Handbook of Political Science* (Reading: Addison-Wesley, 1975), 79-138.

⁶⁰ Henry E. Brady and David Collier, *Rethinking Social Inquiry: Diverse Tools, Shared Standards* (Oxford: Rowman&Littlefield Publishers, 2004).

⁶¹ James Mahoney and Dietrich Rueschemeyer, *Comparative Historical Analysis in the Social Sciences* (Cambridge: Cambridge University Press, 2003).

⁶² James Mahoney, “Qualitative Methodology and Comparative Politics,” *Comparative Political Studies* 40, no. 2 (2007): 122-144.

⁶³ King, Keohane and Verba, *Designing Social Inquiry*.

⁶⁴ Alexander L. George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge: MIT Press, 2005).

⁶⁵ Sidney Tarrow, “Bridging the Quantitative-Qualitative Debate in Political Science,” *American Political Science Review* 89, no. 2 (1995): 471-474.

George and Bennett argue, case studies are beneficial in concept development.⁶⁶ By examining the causal mechanisms in detail, case studies may help researchers produce ‘contextualized knowledge.’ Tarrow argues that case studies are quite functional in determining tipping points, which, I think, are essential in producing contextualized knowledge about the mechanisms of persistence and change in reactive states.⁶⁷ Second, case studies enable researchers to develop bounded generalizations by way of producing contextualized knowledge. Bunce proposes in her research on comparative democratization that ‘bounded generalizations’ are those that apply to a range of states, rather than having universal application in all contexts and at all times.⁶⁸ Since the aim of this study is to propose a framework applicable to the late-industrialized reactive states that accounts for reform-inertia and reform-activism, the comparative historical method fits very well for the purposes of this study.

This study employs most-similar case design to offer bounded generalizations for research questions posed at the outset. In the most-similar case design, the researcher attempts to choose cases that are quite similar to each other in terms of dependent and major independent variables. Next step is to reveal critical changes in key independent variables that lead to a change in dependent variable.⁶⁹ For this purpose, in most-similar case design, a two-stage research strategy may be useful. At the first stage the researcher should acknowledge the similarity in key independent variables that lead to similar

⁶⁶ George and Bennett, *Case Studies and Theory Development*.

⁶⁷ Tarrow, “Bridging the Quantitative-Qualitative Debate,” *American Political Science Review*.

⁶⁸ Valerie Bunce, “Comparative Democratization Big and Bounded Generalizations,” *Comparative Political Studies* 33, no. 6-7 (2000): 703-734.

⁶⁹ George and Bennett, *Case Studies and Theory Development*, 50, 51, 59.

observable outcomes. At the second stage, the researcher should reveal the divergence in key independent variables that lead to variation in the observable outcome. Following this procedure I will study Greece and Turkey, which are quite similar cases in regard to regulatory state capacity and state-market relations in the pre-crisis era. A spate of research considers these two states as organic (Greece) and inorganic (Turkey) members of southern Europe. In fact, various but similar concepts such as “Napoleonic tradition,”⁷⁰ “state capitalism or state-influenced market economies,”⁷¹ “southern European capitalism,”⁷² and late development in the semi-periphery are utilized to denote different versions of state-led models in these political economies. It is astonishingly striking, however, that comparative political economy research on Greece and Turkey is a very under-studied area (for details, see chapter 7).

Greece and Turkey are reactive states. First, for idiosyncratic historical-sociological reasons, political context is imbued by intense and intentional polarization that hampers consensus-based reform activism whilst uncontrolled populism tends to lie in wait. The deep-seated patronage politics pursued in a polarized pluralist system—to use Sartori’s terminology—penetrated into the state apparatus.⁷³ A similar historical pattern is also

⁷⁰ Guy B. Peters, “The Napoleonic Tradition,” *The International Journal of Public Sector Management* 21, no. 2 (2008): 118-132.

⁷¹ Vivien A. Schmidt, *The Futures of the European Capitalism* (Oxford: Oxford University Press, 2002).

⁷² Bruno Amable, *The Diversity of Modern Capitalism* (Oxford: Oxford University Press, 2003). Turkey is not included in this study. Yet the characteristics attributed to southern model is applicable in Turkish context as well.

⁷³ Takis S. Pappas, “Why Greece Failed?” *Journal of Democracy* 24, no. 2 (2013): 31-45. Vassilis Monastiriotes and Andreas Antoniadis, “Reform That! Greece's Failing Reform Technology: Beyond ‘Vested Interests’ and ‘Political Exchange,’” in Stathis Kalyvas, George Pagoulatos and Haris Tsoukas, eds., *From Stagnation To Forced Adjustment: Reforms In Greece, 1974-2010* (London and New York: Hurst Co. and Columbia University Press, 2012), 31-47.

much pronounced in the Turkish case. Turkish political system is frequently defined with reference to polarized pluralism and an under-developed culture of consensus-based policy-making.⁷⁴ Second, not surprisingly, the state economic bureaucracy in both countries remains under heavy influence of patronage politics, which pave the way for weak institutional insulation and coherence. For instance, ‘embedded autonomy’ in economic bureaucracy remained a distant objective in Greece.⁷⁵ Similarly, the weak institutionalization of intra-bureaucratic cooperation and nascent institutional autonomy of state economic bureaucracy have dominated Turkish political economy.⁷⁶ Third, dominant policy coalitions used to be inward looking and rent-seeking in cases. Pappas notes that patron-client relations and political patronage are deeply entrenched in Greece to the extent that exclusive distribution of political rents to targeted interest groups have created *de facto* immunity from the law.⁷⁷ In terms of interest intermediation structures, Greece approximates to the model of ‘disjointed corporatism’ delineated by state-led, fragmented, and non-institutionalized state-business and state-labour relations.⁷⁸ The institutional context of interest intermediation in Turkey also fit into the reactive state category.⁷⁹ Non-state economic interest groups in Turkey suffer from ubiquitous inter-

⁷⁴ Ersin Kalaycıoğlu, “Turkish Democracy: Patronage versus Governance,” *Turkish Studies* 2, no. 1 (2001): 54-70; Heper and Keyman, “Double-faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies*, 259-277. For an in-depth debate, see chapter 5.

⁷⁵ Anastassios Chardas, “State Capacity and ‘Embeddedness’ in the Context of the European Union’s Regional Policy: The Case of Greece and the Third Community Support Framework (CSF),” *Southeast European and Black Sea Studies* 12, no. 2 (2012): 221-242.

⁷⁶ Heper and Keyman, “Double-faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies*, 259-277; Ziya Öniş, “Redemocratization and Economic Liberalization in Turkey: The Limits of State Autonomy,” *Studies in Comparative International Development* 27, no. 2 (1992): 3-23; Sadık Ünay, *Neoliberal Globalization and Institutional Reform: The Political Economy of Development Planning in Turkey* (New York: Nova Science Publishers, 2006), 109-111.

⁷⁷ Pappas, “Why Greece Failed?” *Journal of Democracy*, 37-38.

⁷⁸ For an in-depth debate, see chapter 3.

⁷⁹ For an in-depth debate, see chapter 5.

and intra-organizational failures; thereby, their mode of interaction with state tends to remain state-dependent, ad-hoc, and myopic.⁸⁰ Thus the existence of a strong yet coercive state apparatus accompanied by the monist conception of public interest paved the way for ‘double-faced’ states in both countries.⁸¹ Stated differently, Greece and Turkey have strong state traditions that can intervene in the functioning of the markets; however, the mode of intervention tends to remain arbitrary and short-term oriented, which in turn informs Olsonian collective action problems that fortifies many different forms of reform-inertia.⁸²

This brief comparison demonstrates that state’s reform capacity was similar in both countries in the pre-crisis contexts. Thus it provides a fertile ground for comparison in terms of the first-stage of most-similar case design. Divergence of post-crisis reform performance of these two cases is also striking. In 2001, Turkey experienced the deepest economic crisis of its modern history due to the culmination of structural problems in the form of a bloated public finance and a bankrupted financial system.⁸³ The crisis, however, opened up a window of opportunity in the sense that substantial fisco-financial reforms were initiated in the immediate aftermath of the crisis.⁸⁴ Thus economic crisis

⁸⁰ Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*.

⁸¹ Heper and Keyman, “Double-faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies*, 259-277

⁸² For Turkish case, see Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin: Walter de Gruyter, 1991). For Greek case, see Stella Zambarloukou, “Collective Bargaining and Social Pacts: Greece in Comparative Perspective,” *European Journal of Industrial Relations* 12, no. 2 (2006): 211-229.

⁸³ Ziya Öniş and Barry Rubin, eds., *Turkish Economy in Crisis* (London: Frank Cass, London, 2003); Yılmaz Akyüz and Korkut Boratav, “The Making of the Turkish Financial Crisis,” *World Development*, 31, no. 9, (2003): 1549–1566.

⁸⁴ For an in-depth debate, see chapter 6.

triggered a series of events that ultimately paved the way for the emergence of a ‘regulatory state’ backed by a consensus-driven dominant crisis narrative and accompanying supportive coalitions.⁸⁵ Greece also faced with —and still endures— a profound economic shock in 2009. The “weak state capacity,”⁸⁶ “the undisciplined public finance,”⁸⁷ “lack of competitiveness,”⁸⁸ and “unregulated financial system,”⁸⁹ jointly triggered the deepest economic turmoil in the recent history of Greece. The crisis, however, turned into a missed opportunity since pro-reform coalitions assembled around a dominant crisis narrative could not be generated despite the fact that the economic crisis was a true exogenous shock. As Ladi claims, “major paradigm shift has not taken place. [Instead] the reforms are either cut spending or incremental.”⁹⁰ Rather the crisis triggered a series of blame-games rather than consensus-based reform-activism, as a result of which Greece is still in the throes of deep political-economic instability.

The comparison of the Turkish and Greek cases poses interesting puzzles in addressing main research questions presented at the outset. Despite state’s weak reform capacity in both countries and despite similar depth of the economic crisis in these two countries, paradigmatic fisco-financial reforms were initiated in Turkey whilst an opposite trend

⁸⁵ Caner Bakır and Ziya Öniş, “The Regulatory State and Turkish Banking Reforms in the Age of Post-Washington Consensus,” *Development and Change* 41, no. 1 (2010): 77-106.

⁸⁶ Dimitris Tsarouhas, “The Political Origins of the Greek Crisis: Domestic Failures and the EU Factor,” *Insight Turkey* 14, no. 2 (2012): 83-98; Pantelis Sklias and Georgios Maris, “The Political Dimension of the Greek Financial Crisis,” *Perspectives on European Politics and Society* 14, no. 1 (2013): 144-164.

⁸⁷ Kevin Featherstone, “The Greek Sovereign Debt Crisis and EMU: A Failing State in a Skewed Regime,” *Journal of Common Market Studies* 49, no. 2 (2011): 193-217.

⁸⁸ Michael Mitsopoulos and Theodore Pelagidis, “Vikings in Greece: Kleptocratic Interest Groups in a Closed, Rent-Seeking Economy,” *Cato Journal* 29, no. 3 (2009): 399-416.

⁸⁹ Costas Lapavitsas et. al., “Eurozone Crisis: Beggar Thyself and Beggar Thy Neighbour,” *Journal of Balkan and Near Eastern Studies* 12, no. 4 (2010): 321-373.

⁹⁰ Stella Ladi, “Austerity Politics and Administrative Reform: The Eurozone Crisis and Its Impact upon Greek Public Administration,” *Comparative European Politics* 12, no. 2 (2014): 202.

turned out to be the case in Greece. How did Turkey succeed at breaking down reform inertia and why could the critical juncture not be exploited toward the creation of pro-reform coalitions in Greece? How can we explain the divergence of reform performance of these two hitherto similar polities? Finally, how do agents and institutional structures interact in the way that led to the emergence of a dominant crisis narrative in Turkey, whereas fragmented crisis narratives, blame-games and muddling through dominate the political agenda in the Greek case?

This study probes into the answers of these questions with reference to a three-stage conceptual framework offered in the following chapter. To test five main hypotheses derived from conceptual framework I will study four different cases. In this sense, I will delve into two junctures in Greece: (i) 1996-2000, which Kostas Simitis emerged as a policy entrepreneur and the EU-anchor played the role of an external anchor but no substantial and sustainable reform activism took place, and (ii) 2009 economic crisis in Greece. I will also examine (iii) Turkey's 1994 crisis, which did not lead to any substantial reforms, and (iv) 2001 Turkish economic crisis that was exploited as an opportunity window to instigate a paradigmatic change in Turkey's fisco-financial regime. It is the premise of this study that both cross-case variations —between Greece and Turkey— and within-case analyses —Greece and Turkey, respectively— enable us to propose some 'bounded generalizations' on reform dynamics in reactive states.

1.4. Methodology and data sources

This study relies on comparative historical methodology.⁹¹ I analyse how a reactive state has emerged and consolidated in Greece and Turkey in a neoliberal setting starting from early-1980s. I also explore how crises as critical junctures open up opportunity windows to alter the path dependent processes.⁹² By explaining the mechanisms of diverging reform outcomes in Greece and Turkey, I aim to demonstrate that path dependence is not a covering-law that imposes historical determinism.⁹³ Most-similar case design, however, is not sufficient per se to build conceptual frameworks and test hypotheses because it only demonstrates the correlation among some variables and may omit certain others. Therefore, I utilize process tracing to investigate the causal mechanisms proposed in my conceptual framework. According to George and Bennett, process tracing “identifies the intervening processes —the causal chain and causal mechanism— between independent variables and the outcome of the dependent variable.”⁹⁴ Thus process tracing enables researchers to assess whether hypothesized outcome occurs in the particular sequence and timing stated by the conceptual framework.⁹⁵ To this end, multiple data sources inform this study. First, this PhD dissertation primarily relies on in-depth semi-structured elite interviews. Elite interviews are particularly useful when the researcher seeks to gain a true understanding of “the inner workings of the political

⁹¹ For more on comparative historical methodology, see Mahoney and Rueschemeyer, *Comparative Historical Analysis*.

⁹² James Mahoney, “Path Dependence in Historical Sociology,” *Theory and Society* 29, no. 4 (2000): 507-548.

⁹³ On this point, I am inspired by Putnam’s pioneering work. See Robert D. Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton: Princeton University Press, 1993).

⁹⁴ George and Bennett, *Case Studies and Theory Development*, 206.

⁹⁵ Peter A. Hall, “Tracing the Progress of Process Tracing,” *European Political Science* 12, no. 1 (2012): 1-11.

process, the machinations between influential actors and how a sequence of events is viewed and responded to within the political machine.”⁹⁶ Elite interviews also enable the researcher to gain access to the crucial information that is very difficult, if not impossible, to gather through the review of other primary and secondary sources of data. Furthermore, elite interviews prove particularly beneficial when the researcher deals with contemporary issues that are still understudied and unrecorded.⁹⁷

For the purposes of this study, elite interviews are particularly useful due to two main reasons. First, the main aim of this research is to shed light on the post-crisis politicking by trying to reveal the complex interactions between influential domestic and external players, and how these complex, sequential interactions inform post-crisis reform performance. Second, this research deals with two contemporary crises in Greece and Turkey. The Greek economic crisis erupted in 2009 and still continues as of late-2014. Most of the details regarding the post-crisis developments are still understudied and unrecorded (see chapter 4). On the other side, more than a decade has passed over the 2001 economic crisis in Turkey. Thus, Turkish crisis is extensively studied in the literature (see chapter 6). However, there are still grey areas regarding how important actors articulated their responses and their approach informed the post-crisis reform outcomes, which is difficult to conduct a proper process tracing through an analysis of secondary sources. For these two main reasons, elite interviewing is considered as a useful method of gathering first-hand data.

⁹⁶ Darren G. Lilleker, “Interviewing the Political Elite: Navigating a Potential Minefield,” *Politics* 23, no. 3 (2003): 208.

⁹⁷ *Ibid.*, 213.

I conducted in-depth semi-structured elite interviews in Greece and Turkey. Researchers must acquire a good knowledge before they start interviewing about their research. Thus, it is advised for researchers to conduct interviews at later stages of their thesis after they extensively review the available second-hand materials and factual chronology of events.⁹⁸ I conducted field research in the fourth year of my PhD project. I visited Greece twice for field research on March 3-10, 2014 and on July 18-27, 2014. I also conducted field research in Turkey on August 29-September 16, 2014.

I utilized “purposive sampling”⁹⁹ to unravel and reflect the views of the main state actors who were directly involved in the design and implementation of the post-crisis reform packages and major interest groups that inform the post-crisis reform outcomes, either in a positive or negative manner. I also interviewed with third-party observers and opinion leaders to gain more information about the inner workings of the Greek and Turkish political economy systems. I selected my interviewees in line with the conceptual framework offered in chapter 2. Accordingly, I divided my sample into three categories: (i) representatives of main political parties and high-level bureaucrats, (ii) representatives of peak business and labour organizations (iii) informed third party observers who closely follow Greek and Turkish political economy, such as scholars, think tank experts, and financial journalists.

⁹⁸ Ibid., 212.

⁹⁹ Ariadne Vromen, “Debating Methods: Rediscovering Qualitative Approaches,” in David Marsh and Gerry Stoker, eds., *Theory and Methods in Political Science* (Basingstoke: Palgrave Macmillan, 2010), 259.

I conducted twenty-three semi-structured elite interviews in Greece. Seven of them are the representatives of the main political parties (PASOK, New Democracy, and SYRIZA) and the chief advisors of the key state agents (such as Lucas Papademos). Six of them are the top-level representatives of the major business (SEV and GSEVEE) and labour organizations (ADEDY and GSEE). Since I had the opportunity to interview with the chairmen and secretary-generals of the peak associations in question, they are in a position to speak on behalf of their institutions. I also interviewed with nine third-party observers, who are well-known experts and scholars on Greek political economy (see appendix 1). It turned out to be extremely difficult to contact with high-level officials in Greece since they did not respond to their e-mails. I therefore used intermediaries such as Turkish Embassy in Athens, senior Turkish diplomats, and scholars who have direct contacts with these figures (see acknowledgement). Further, in the final phase of my PhD research, I spent sixteen months in London. Thus I also had the opportunity to visit Hellenic Observatory at the London School of Economics and Political Science (LSE) several times to conduct in-depth interviews with pundits on Greek political economy. I also had conversations with leading Greek scholars working at various UK universities, which also informed the content of this study, apart from recorded semi-structured interviews.

I had thirteen semi-structured elite interviews in Turkey. I utilized similar selection criteria while conducting interviews in Turkey. Accordingly, I interviewed with representatives of the DSP-MHP-ANAP coalition government, which handled the crisis in 2001. I had the opportunity to talk to the high-level members from DSP and MHP, yet

I could not reach official representatives of ANAP. I tried to mitigate this gap by reviewing newspaper archives and by consulting to other data sources (see below). Second, I conducted an in-depth interview with Kemal Derviş who managed the post-crisis reform program in Turkey. Since Derviş and his economic team occupy a central place in my research, I also interviewed with the top-level economic bureaucrats from Undersecretariat of Treasury, Central Bank of the Republic of Turkey, and other state organizations taking part in Derviş's team. Third, I interviewed with the official representatives of peak associations on the business (TÜSİAD and MÜSİAD) and labour side (DİSK and TÜRK-İŞ) to reveal how they perceived the economic crisis and responded to the fiscal and financial reform measures as well as to explore the factors that shaped their preferences. In the Turkish case, the number of interviews conducted with third-party observers is fewer than the Greek case because I had the chance to review various published material in Turkish.

The interview questions are designed according to the conceptual framework. I particularly seek to test the research hypotheses proposed in chapter 2 (for the interview questions see appendix 2 and 3). In each interview, I directed 7-8 semi-structured open-ended questions. Asking open-ended questions are particularly useful as they enable the researcher to reveal “interviewee’s views, interpretations of events, understandings, experiences and opinions.”¹⁰⁰ Furthermore, as Aberbach and Rockman suggest, high-level policy makers “do not like being put in the straightjacket of close-ended

¹⁰⁰ Brigitte Byrne, “Qualitative Interviewing,” in Clive Seale, ed., *Researching Society and Culture* (London: Sage Publications, 2004), 182.

questions.”¹⁰¹ In this sense, semi-structured open-ended questions provide space to the respondents to think about their responses and frame their answers in line with their perspectives.¹⁰² Average duration of an interview was around 50 minutes. The interviews are recorded, coded, and stored in a computer file. The ethical considerations were properly addressed before, during, and after the interviews. Respondents were provided a formal letter outlining the aims and scope of the research. Koc University Committee on Human Research approved the content of the research design. The respondents allowed using their names and quoting their sentences in the text. The names, titles, affiliations of my interviewees, and the interview dates are reported in appendix 1. Few interviewees provided some ‘off the record’ information. I therefore did not use these parts, although they urged me to keep my critical faculty open regarding the points in the write-up stage of this dissertation. During the interviews, I tried not to give an impression that I took side either in favour or disfavour of the interviewees. I attempted to protect my neutrality by avoiding biased-questions.

The analysis of semi-structured interviews is a challenging task for the researchers due to the open-ended nature of the interviewees’ responses. Following Halperin and Heath, I analysed the interview data in three steps: data reduction, assignment, and drawing conclusions.¹⁰³ After reducing the data appeared in written up field notes or

¹⁰¹ Joel D. Aberbach and Bert A. Rockman, “Conducting and Coding Elite Interviews,” *PS: Political Science and Politics* 35, no. 4 (2002): 674.

¹⁰² *Ibid.*

¹⁰³ Sandra Halperin and Oliver Heath, *Political Research: Methods and Practical Skills* (Oxford: Oxford University Press, 2012), 278.

transcriptions,¹⁰⁴ I broke down the interview material and “assign them to different categories according to the variable to which they relate.”¹⁰⁵ Using the research questions and hypotheses as a guide, three broader categories are assigned in this study. First, the respondents are categorized whether they are supportive of the post-crisis reform measures or not. The positive responses were labelled as ‘pro-reformist’ and negative responses were labelled as ‘anti-reformist.’ Second, I strove to understand why they supported/rejected the reform packages. Thus, based on my conceptual framework, I categorized the interview data in three sub-categories according to the criteria of how they interpreted (i) the crisis, (ii) the role of state agents in charge of the post-crisis restructuration process, and (iii) the function of external anchors involved in the design and implementation of reform measures. Third, after analysing the interview data and crosschecking their validity, I drew general conclusions whether, why, and how a dominant (or fragmented) crisis narrative emerged in the wake of the crisis. The most striking responses are quoted in relevant parts throughout the text. More information on interview findings and the data sources is provided in appendix 4.

As Silverman underlines, interviews do not provide direct access to the facts and realities on the ground but enable researchers to have first-hand information about how interviewees have perceived the events.¹⁰⁶ Therefore, the reliability and validity of the information they provide needs to be crosschecked and substantiated with other sources

¹⁰⁴ Data reduction refers to “the process of selecting, focusing, simplifying, abstracting and transforming the data that appears in written up field notes and transcriptions.” Matthew B. Miles and A. Michael Huberman, *Qualitative Data Analysis: An Expanded Sourcebook* (Newbury Park: Sage Publications, 1994), 10. Quoted in Halperin and Heath, *Political Research*, 279.

¹⁰⁵ Halperin and Heath, *Political Research*, 280.

¹⁰⁶ David Silverman, *Interpreting Qualitative Data: A Guide to the Principles of Qualitative Research* (London: Sage Publications, 2011), 168.

of data.¹⁰⁷ To this end, I collected previously published materials, press statements, op-eds, and speeches of George Papandreou, Angela Merkel and Wolfgang Schäuble, and business and labour unions in Greece for chapter 4, in which I aimed to map out the crisis narratives developed by key agents involved in the management of 2009 Greek crisis. The documents supplemented my interviews to improve the validity of the process tracing.

In the Turkish case, in chapter 6, I collected similar materials for Kemal Derviş to supplement my semi-structured in-depth interview with him. I also collected printed materials about the political parties, domestic interest groups, and representatives of the IMF and the EU to assess how they approached Turkey's 2001 economic crisis (see appendix 4). I thematically analysed all documents in a chronological order. Third, I consulted to the official documents, reports, and descriptive statistics produced by international organizations. Accordingly, I reviewed OECD country surveys and various volumes of the European Commission and the IMF reports. Fourth, I extensively surveyed the secondary literature on Greek and Turkish political economy (see bibliography). Finally, I supplemented my data via thematic and ad-hoc review of a sample of newspapers in Greece and Turkey. I used newspapers as a data source for two main reasons. First, I seek to further penetrate into the details that my interviewees may eschew. Second, I double-checked the chronology of events so as to avoid any

¹⁰⁷ Angela Dale, "Quality in Social Research," *International Journal of Social Research Methodology* 9, no. 2 (2006): 81.

inaccuracy regarding the sequence and timing of developments. I reviewed *Athens News Agency* for Greece and *Milliyet Gazetesi* for Turkey.

1.5. Organization of chapters

The chapters of this study are organized according to two interwoven dimensions: historical evolution of events in regard to the selected cases and the stages that form the sequential formation of the conceptual framework. In chapter 2, I discuss at length the step-by-step construction of the conceptual framework. Accordingly, I review the literature on state capacity and reformulate the concept for the purposes of this study. Then, I concentrate on the dynamics of reform-activism and reform-inertia in reactive states with reference to the policy entrepreneurship and critical junctures literature. In the last part, I complete the parts of the jigsaw and offer a three-stage framework.

In chapter 3, I discuss the emergence and consolidation of a reactive Greek state during the neoliberal era, as part of the first-stage of my conceptual framework. The chapter starts from 1974, which constitutes a turning point in Greek political economy as democracy and rule of law restored in the country. I discuss the evolution of state capacity in Greece with reference to domestic and broader institutional structures that directly inform reform the procrastination of fiscal and financial reforms. In this chapter, I also explore the limits of the possible for pro-reform agents in reactive states in non-crisis junctures with reference to Kostas Simitis period.

Chapter 4 deals with the deepest economic crisis in Greece's post-war history. In this chapter, I provide a brief overview of the proximate causes of the Greek economic crisis and argue that the crisis could not be exploited as an opportunity window to reform the fiscal and financial calamities accumulated over the years. I then seek to explore why and how this opportunity was missed to a large extent with a particular reference to the crisis narratives approach I offered in the second and third stages of my conceptual framework.

In chapter 5, I discuss the emergence and consolidation of a reactive Turkish state in the neoliberal era, as part of the first-stage of my conceptual framework. The chapter starts with 1980, which constitutes a critical juncture in Turkey's economic and socio-political history due to the long-lasting effects of January 24 economic decisions and September 12 military coup, both of which jointly reshuffled country's political economy landscape in a range of ways. I discuss the evolution of state capacity in Turkey with reference to domestic and broader institutional structures, and reveal how the sub-optimal interaction led to the accumulation of fisco-financial profligacy. I then explore why the 1994 economic crisis in Turkey did not result in any paradigmatic changes and why state capacity continued to deteriorate in the aftermath.

Chapter 6 delves into Turkey's 2001 economic crisis. The crisis, which endured deep socio-political and economic costs, was exploited as an opportunity window. Thus substantial reforms were initiated in the fisco-financial regime that pave the way for the emergence of a regulatory state. In this chapter, I addressed the dynamics that led to a

new path in the wake of the economic turmoil. Accordingly, I will trace the process to explicate how agency-level dynamics interacted with institutional structures so that a dominant crisis narrative emerged toward the creation of new pro-reform coalitions and the implementation of a far-reaching reformist agenda.

Chapter 7 aims to put the parts of the jigsaw together. To this end, I offer a comparative analysis of Greek and Turkish cases. In this chapter, by revisiting the hypotheses developed in chapter 2, I aim to propose bounded generalizations applicable in other reactive state contexts. The chapter 8 concludes the thesis with a brief discussion on mainstream explanations, the limits of the thesis and new avenues for further research.

Chapter 2. Reforming the reactive states: A framework for analysis

2.1. Introduction

This chapter intends to develop a conceptual framework that explains persistence and change in reactive states with special reference to fisco-financial regimes. I stated in the introduction chapter that reform outcomes are the products of complex interplay between agents and institutional structures. Having relied on state capacity, critical junctures, and policy entrepreneurship literatures, in this chapter, I will propose a three-stage framework that tries to capture this intricacy. Accordingly, the first-stage of the framework aims to explore how state capacity is deteriorated in a gradual and path dependent way, and how sub-optimal equilibrium of state-market relations conditions reform-biased agency behaviour in reactive states. The procrastination of economic reforms in this stage is more likely to pave the way for the accumulation of fiscal and financial profligacy, which in turn buttress structural roots of the economic crises. In the second-stage, crisis opens up an opportunity window to initiate substantial reforms by reshuffling power balances within the system and providing leeway for the emergence of a new policy paradigm. However, crisis junctures are highly uncertain and contentious episodes, which invite massive fluidity. I would claim that the reform outcomes in this stage is informed by the type of emergent *crisis narratives* between state agents and external anchors, and the degree of penetration of these narratives into the domestic plane. Accordingly, two major trajectories may unfold in the third-stage: If a dominant

crisis narrative emerges at the agency-level and if institutional structures play enabling roles, collective action problems may be resolved and domestic ownership of reforms may be ensured. However, if fragmented crisis narratives transpire at the agency-level and institutional structures play constraining roles, blame-games dominate the political landscape, which in turn result in muddling through and the eventual restoration of status quo ante. This chapter probes into the time and context-specific interactions of these agency-level and institutional dynamics.

In the second part I will offer a critical review of state capacity literature. I will argue that the concept of state capacity suffers from concept stretching —to use Sartori’s terminology. Hence reclassification of the literature is in order to make the concept rather operationalizable for the purposes of this study. In the third part I will lay out the details of the conceptual framework that aims to explain the dynamics of reform-failures and paradigmatic changes in reactive states. In this part I will also propose *crisis narratives* approach as an organizing concept. In the fourth part I will summarize the stages that form the parts of the conceptual framework that is deployed in the empirical chapters of this study.

2.2. Unpacking ‘state capacity’: A reclassification of the literature

The conceptualization of ‘state capacity’ varies significantly in political science literature. The concept of state capacity is defined in a wide range to the extent that it

suffers from classical concept stretching problem in comparative politics.¹⁰⁸ Different approaches deploy a variety of concepts such as “strong states”, “weak states”, proactive states”, and “reactive states” based on their particular understanding of state capacity. The archipelago of definitions therefore requires a reclassification of the literature to make it operationalizable in reactive states. In this part I will first map out the literature and reformulate the concept. I would argue that an analytical distinction between ‘stateness’ and ‘state capacity’ is necessary to make the term rather manageable for comparative political economy studies.

2.2.1. Stateness: Strong vs. weak (or failed) states

We should first clarify what state capacity means within the context of stateness. State building, state failure, conflict, and international relations studies refer to the *stateness* of a state when they refer to state capacity concept. According to this line of research, strong states are the ones that have control over their territory and maintain government authority even at the scarcely populated and mountainous areas within the borders of a country.¹⁰⁹ The territorial control of a state includes its capability to avoid other states and non-state armed groups to claim authority across its borders. Furthermore, strong states are claimed to be resistant to the challenges of their legitimacy over the use of

¹⁰⁸ Sartori eloquently discusses the problem of “concept stretching” in comparative politics. See Giovanni Sartori, “Concept Misformation in Comparative Politics,” *American Political Science Review* 64, no. 4 (1970): 1033-1053.

¹⁰⁹ Robert I. Rotberg, *When States Fail: Causes and Consequences* (Princeton: Princeton University Press, 2003), 2-3.

force within its own territory.¹¹⁰ Thereby, core functions of a state, including security provision to their citizens against domestic and external threats, are also regarded as an indicator of state strength. Weak states or failed states, on the other hand, exhibit an absence of this capability.¹¹¹ State building and state failure literature in comparative politics concentrate on this particular aspect of the issue.¹¹² Migdal is one of the earliest comparativists who problematized and systematically evaluated state capacity/capabilities especially within the context of state building in third world countries. According to Migdal, state capabilities include the capacities to “penetrate society, regulate social relationships, and extract resources.”¹¹³ Weak states, lack territorial control, fail to avoid other states and non-state armed groups to claim authority over its own territory, and cannot extract resources. According to Tilly¹¹⁴ and Acemoğlu,¹¹⁵ resource extraction remains at the hearth of stateness. The states with high capabilities to proffer these functions are defined as strong states, whereas weak states

¹¹⁰ Ibid.

¹¹¹ James D. Fearon and David D. Laitin, “Ethnicity, Insurgency, and Civil War,” *American Political Science Review* 97, no. 1 (2003): 75, 80, 88; Ann Hironaka, *Neverending Wars: The International Community, Weak States, and the Perpetuation of Civil War* (Cambridge: Harvard University Press, 2005).

¹¹² After September 11, 2001, the academic research on weak and failed states skyrocketed partially due to the United States’ changing security strategy. The 2002 National Security Strategy of the United States underlined that “weak and failing states pose at great a danger to our national interest as strong states.” One of the indices for measuring the capacity of the states is developed by Brookings Institution, entitled *Index of State Weakness in the Developing World*. The index measures state weakness “as a function of its effectiveness, responsiveness, and legitimacy across a range of government activities.” The index measures state capacity in four main areas (economic, political, security, and social welfare) with 20 indicators in total. The study exemplifies the approaches developing a quantitative methodology to measure state capacity.

¹¹³ Joel S. Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton: Princeton University Press, 1988), 4-5.

¹¹⁴ Charles Tilly, *Coercion, Capital and European States: AD 990-1992* (Oxford: Blackwell Publisher, 1990).

¹¹⁵ Daron Acemoglu, “Politics and Economics in Weak and Strong States,” *Journal of Monetary Economics* 52, no. 7 (2005): 1199-1226.

are placed on the polar opposite of the spectrum.¹¹⁶ As Huntington succinctly puts the issue, the governments in most of the weak states, “simply do not govern.”¹¹⁷

Migdal offers a useful categorization by making distinction between the “image” and “practice” of the state.¹¹⁸ The image of the state refers to the ideal-typical configurations of a standard template that all states are supposed to possess in theory.¹¹⁹ On the other side of the coin, Migdal refers to the “practice of the state” to underline the diverging organizational capacities of the existing states in the world.¹²⁰ He urges researchers to concentrate on state capacity/capabilities to unravel this dual nature between the image and practice of the states.¹²¹ Following the footprints of Migdal, Fukuyama employs state capacity as the central organizing concept in recent state building and state failure literature.¹²² According to Fukuyama, “the essence of stateness is enforcement, [which is] the ultimate ability to send someone with a uniform and a gun to force people to comply with the state’s laws.”¹²³ Stateness has two dimensions: (1) scope of state activities, which refers to “different functions and goals taken on by governments,” and (2) strength of state power, which refers to the “ability of states to plan and execute policies and to enforce laws cleanly and transparently —commonly referred to as state

¹¹⁶ Fearon and Laitin, “Ethnicity, Insurgency, and Civil War,” *American Political Science Review*, 80, 81, 88.

¹¹⁷ Samuel Huntington, *Political Order in Changing Societies* (New Haven and London: Yale University Press, 1968), 2.

¹¹⁸ Joel S. Migdal, “Researching the State,” in Mark I. Lichbach, Alan S. Zuckerman, eds., *Comparative Politics, Rationality, Culture, and Structure* (Cambridge: Cambridge University Press, 2009), 165-176.

¹¹⁹ *Ibid.*, 165-166.

¹²⁰ *Ibid.*, 168.

¹²¹ Joel S. Migdal, *State in Society: Studying How States and Societies Transform and Constitute One Another* (Cambridge: Cambridge University Press, 2001), chapter 3.

¹²² Francis Fukuyama, *State Building: Governance and World Order in the 21st Century* (London: Profile Books, 2005), 7-19.

¹²³ *Ibid.*, 8.

or institutional capacity.”¹²⁴ In short, strong states/weak states in comparative politics ought be placed along a continuum with reference to their capacity, which is comprised of (i) ability to control their territory, (ii) capacity to provide core state functions, and (iii) legitimacy over domestic and external challengers.

In summary, the strong state/weak state categorization in comparative politics literature mainly concentrates on the basic capabilities and templates of the states. Therefore, I argue that the leitmotif of the debate in these fields is the *stateness* of a state. However, state capacity concept in comparative political economy focuses on a particular aspect of the issue, namely state’s capability to intervene, steer, and reform domestic economic structures and interest coalitions. Therefore, state capacity debate in comparative political economy, whether consciously or not, takes the *stateness of a state* for granted and deals with the sample of states that do not have substantial problems in maintaining territorial integrity and the supply of core public goods.

2.2.2. State capacity: Proactive vs. reactive states

The reactive/proactive state categorization refers to an advanced level of debate in state capacity literature vis-à-vis stateness because both “reactive” and “proactive” states meet the basic criteria of stateness. It does not mean that these two research streams have nothing in common. Quite the contrary, they have interwoven dimensions, yet they refer to analytically and categorically distinct levels, which deserve separate analysis.

¹²⁴ Ibid., 9.

Stated somewhat differently, in comparative political economy literature, both reactive and proactive states basically meet the Weberian state template as being the “monopoly of the legitimate use of physical force within a given territory.”¹²⁵ States in this category can provide core state functions and extract resources from their society while remaining loyal to rule-based institutional frameworks, despite the quality of rule of law and governance diverge across cases.

2.2.2.1. State capacity through autonomy: State-market dichotomy

The historical evolution of state capacity concept in this stream of research can be broken down in two major periods. The first-generation is dominated by historical comparative studies of Katzenstein,¹²⁶ and Krasner.¹²⁷ In his forceful critique of third image approaches to international politics, Katzenstein argued that the divergences and variations of foreign economic policies of advanced states are not derived from the “functional logic of different types of international effects but the constraints of domestic structures.”¹²⁸ Third image approaches to international politics posit that the main determinants of politics are ultimately derived not from the human nature —first image— or the internal structure of states —second image— but from the structure of

¹²⁵ Max Weber, “Politics as a Vocation,” in H. H. Gerth and C. Wright Mills, eds., *From Max Weber: Essays in Sociology* (London: Routledge, 1948), 78.

¹²⁶ Peter J. Katzenstein, “International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States,” *International Organization* 30, no.1 (1976): 1-45; Peter J. Katzenstein, ed., *Between Power and Plenty* (London: the University of Wisconsin Press, 1978).

¹²⁷ Stephen D. Krasner, *Defending the National Interest: Raw Materials Investment and U.S. Foreign Policy* (Princeton: Princeton University Press, 1978); Stephen Krasner, “US Commercial and Monetary Policy: Unravelling the Paradox of External Strength and Internal Weakness,” *International Organization* 31, no. 4 (1977): 635-671.

¹²⁸ Katzenstein, “International Relations and Domestic Structures,” *International Organization*, 15.

international system.¹²⁹ However, Katzenstein claimed that, not the dynamics of international system, but the nature of state-society relationship and the degree of centralization determine the type of economic policies pursued by nation-states. Strong state/weak society combination —i.e., state-centred polity, argues Katzenstein,¹³⁰ enables the state to intervene into the organization of economic relations and mobilize economic actors towards state-directed ends. Weak state/strong society combination — i.e., society-centred polity, on the other hand, paves the way for hands-off approach of the state towards initiating fiscal, financial, and industrial reforms.¹³¹ Adopting a similar typology, Krasner argues that the “American state is weak in relation to its own society” mainly because “power in [American political system] is fragmented and decentralized.”¹³²

The strong state/weak state debate in comparative political economy coincides with the rise of statist analysis in comparative politics during 1980s.¹³³ The statist approach argues that state is an independent and autonomous entity holding power that is distinct from sub-state level actors.¹³⁴ As a logical consequence of this reasoning, Skocpol derives state capacity from its autonomy.¹³⁵ In Skocpol’s approach, there is a tendency

¹²⁹ For more on third image approaches see, Kenneth Waltz, *Man, the State and War: A Theoretical Analysis* (New York: Columbia University Press, 1959).

¹³⁰ Katzenstein, *Between Power and Plenty*, 310, 324.

¹³¹ *Ibid.*

¹³² Krasner, “US Commercial and Monetary Policy,” *International Organization*, 637.

¹³³ Theda Skocpol, “Bringing the State Back in: Strategies of Analysis in Current Research,” in Peter Evans, Dietrich Rueschemeyer and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), 3-37.

¹³⁴ Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987); Krasner, *Defending the National Interest*.

¹³⁵ Skocpol, “Bringing the State Back in,” 5.

to equate state autonomy with state capacity in the sense that institutionally isolated states are labelled as “strong” whereas states that are captured by private interests conceived as “weak.” Strong state, the argument goes, is the one that “has the ability to implement official goals, especially *over* the actual or potential opposition of powerful social groups or in the face of recalcitrant socioeconomic circumstances.”¹³⁶ The first generation of state capacity discussions, therefore, develops a dichotomic/dualist understanding of state-market relations that formulate the concept in terms of state’s *coercive power over society*.

2.2.2.2. State capacity through embeddedness: Beyond state-market dichotomy

In his second-generation critique, Evans questions the unilateral statist approach by offering an alternative framework.¹³⁷ Evans argues that states must combine autonomy with some kind of “embeddedness” with economic interest groups.¹³⁸ According to Evans, the underlying analytical logic of state capacity revolves around a competent and meritocratic state bureaucracy that have high transformative capability and political entrepreneurship in building credibility across the state-private nexus so as to change the preference functions of economic elite towards a reform-oriented outlook.¹³⁹ For Evans, “embeddedness” provides networks for states to receive robust feedbacks from private

¹³⁶ Ibid., 9. Emphasis added.

¹³⁷ Peter B. Evans, “The State as Problem and Solution: Predation, Embedded Autonomy and Adjustment,” in Stephan Haggard and Robert Kaufman, eds., *The Politics of Economic Adjustment: International Constraints, Distributive Politics, and the State* (Princeton: Princeton University Press, 1992); Peter Evans, *Embedded Autonomy: State and Industrial Transformation* (Princeton: Princeton University Press, 1995).

¹³⁸ Peter Evans, “Transferable Lessons? Re-Examining the Institutional Prerequisites of East Asian Economic Policies,” *The Journal of Development Studies* 34, no. 6 (1998): 66-86.

¹³⁹ Evans, “Transferable Lessons?,” *The Journal of Development Studies*, 81.

interest groups and overcome Olsonian collective action and free riding problems during reform processes, whereas “autonomy” provides isolation for state agents to pursue coherent and long-term oriented reform strategies. An optimum admixture of these two aspects informs the overall capacity of the state:

“A state that was only autonomous would lack both sources of intelligence and the ability to rely on decentralized private implementation. Dense connecting networks without a robust internal structure would leave the state incapable of resolving ‘collective action’ problems of transcending the individual interest of its private counterparts.”¹⁴⁰

In her third-generation approach, Weiss further developed the embedded autonomy concept along the lines of state-market synergy.¹⁴¹ Weiss convincingly argues that the statist approaches —strong state/weak state portrayal— misconceived state’s reform capacity because “state power has been conceptualized in a way that makes it virtually impossible to apply to modern states.”¹⁴² She defines state capacity in the economic policy realm as “the ability of policy-making authorities to pursue domestic adjustment strategies *in cooperation with* organized economic interest groups.”¹⁴³ Therefore she offers an alternative conceptualization of state capacity, which she calls “governed interdependence” (GI):

“GI refers to a negotiated relationship, in which public and private participants maintain their autonomy, yet which is nevertheless governed by broader goals set and monitored by the state... GI intended to convey a reality in which both state

¹⁴⁰ Evans, *Embedded Autonomy*, 12.

¹⁴¹ Weiss, “Globalization and the Myth of the Powerless State,” *New Left Review*, 3-27; Weiss, *The Myth of the Powerless State*.

¹⁴² Weiss, *The Myth of the Powerless State*, 27.

¹⁴³ *Ibid.*, 5. Emphasis added.

and dominant economic groups are ‘strong’, i.e. the state is well insulated and industry is highly organized and linked into the policy-making framework via a robust negotiating relationship.”¹⁴⁴

Interdependence is a generic characteristic in all modern states because of the complex nature of contemporary state-market relations. On the one hand, state needs the consent and cooperation of private interest groups to promote timely economic adjustments. The private actors, on the other hand, need constant support of state agencies in their economic activities. What differentiates GI from conventional interdependence is the more institutionally structured and negotiated nature of exchanges between state agents and organized interests toward the implementation of economic reforms. As Weiss argues “rather than leaving mutual dependence to chance, the state takes a proactive role, drawing business into a negotiating relationship in order to further its projects.”¹⁴⁵ However, GI approach rejects top-down management or unilateralism in the regulation of domestic economy. Accordingly, Weiss argues the joint contribution of state bureaucrats and social partners on an equal footing as necessary preconditions of the efficient and timely management of economic reform processes. Contrary to the statist first-generation arguments, which depict a zero-sum relationship between state and market, GI foresees regular and extensive cooperation as the institutional prerequisite of optimal policy change and sustainable reform-activism. This means that policy success over the medium and long-term horizon is determined by state capacity *through* market,

¹⁴⁴ Ibid., 38.

¹⁴⁵ Ibid.

not *over* it. In this ideal-typical typology, states are armoured to make timely economic decisions and rectify existing policy paradigms, if deemed necessary.

Governed interdependence concept opens up a productive avenue for understanding the underlying mechanisms of a state's reform capacity by incorporating the crucial role of "dense networks of relations that cross organizational boundaries and the interdependence of state and societal actors."¹⁴⁶ This qualification provides a functional link to policy networks framework.¹⁴⁷ As an integral aspect of state capacity debate, policy networks framework aims to reveal under what conditions and through which interest intermediation structures, states are capable of initiating major policy reforms in collaboration with private actors.¹⁴⁸ Atkinson and Coleman define two main types of policy networks with respect to state capacity: anticipatory and reactive.¹⁴⁹ Accordingly, "what distinguishes an anticipatory approach from a reactive one is the predisposition on the part of the state to intervene in the industrial organization of the sector."¹⁵⁰ Reactive states are defined with reference to insufficiently insulated bureaucracies against interest groups, ad hoc relationships between state and private elites, and fragmented nature of peak associations, which poses insurmountable challenges in the articulation of the

¹⁴⁶ Mark Robinson, "Hybrid States: Globalization and the Politics of State Capacity," *Political Studies* 56, no. 3 (2008): 566-583.

¹⁴⁷ *Ibid.*

¹⁴⁸ For an overview of 'policy networks' literature, see Börzel, "Networks: Reified Metaphor or Governance Panacea?", *Public Administration* 89, 49-63.

¹⁴⁹ Atkinson and Coleman, "Strong States and Weak States: Sectoral Policy Networks in Advanced Capitalist Economies," *British Journal of Political Science*, 47-67.

¹⁵⁰ *Ibid.*, 61.

organizational-level interests.¹⁵¹ Table 1 offers a stylized version of the reclassification of the existing literature on state capacity.

Table 1. Mapping out the 'state capacity': A reclassification of the literature

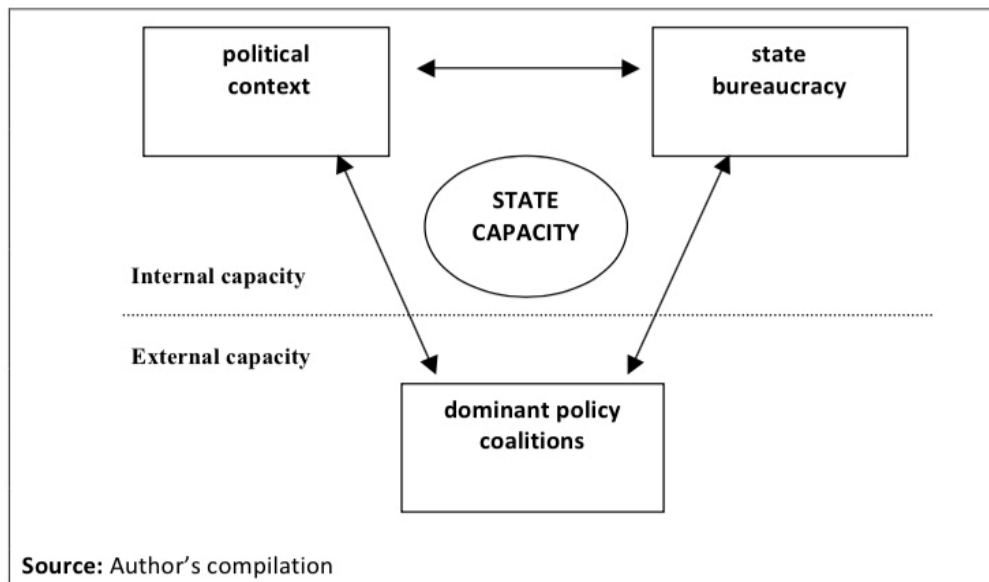
	Types of states	Assessment criteria
“Stateness”	Weak states	<ul style="list-style-type: none"> ● Control over territory ● Capacity to provide core functions ● Internal/external legitimacy
	Strong states	
“State capacity”	Reactive states	<ul style="list-style-type: none"> ● Political context ● State bureaucracy ● Mode of the relationship between state and dominant policy coalitions
	Proactive states	
Source: Author’s compilation		

There are two major caveats surrounding the use of state capacity literature as an analytic tool for analysis with respect to late-industrialized reactive states. First, dominant approaches to state capacity mainly concentrate either on developmental states or advanced industrialized countries. Thus they eschew the mechanisms of major policy shifts in late-developers. For instance, despite useful insights it provides, of which this study also benefits, policy networks framework has limited portability into the late-industrialized reactive states context due to qualitative differences in terms of the organization of domestic political setting, state bureaucracy, and dominant policy coalitions in the latter category. I previously claimed that state capacity emanates from state’s internal and external networks. Internal capacity stems from domestic political

¹⁵¹ Michael M. Atkinson and William D. Coleman, *The State, Business, and Industrial Change in Canada* (Toronto: University of Toronto Press, 1989), 80-93.

context and bureaucratic capabilities to craft coherent reform strategies. External capacity originates from state’s mode of interactions with the institutional representatives of organized capital and labour, which I call dominant policy coalitions (see figure 1).

Figure 1. Three pillars of state capacity



In these three respects, late-industrialized reactive states tend to suffer from both dimensions in a categorically different fashion vis-à-vis advanced political economies.¹⁵² In these polities, state remains at the centre of perennial who-gets-what struggle among different interest groups and state’s relative strength vis-à-vis other power centres — both internal and external forces— tend to be weak, which is partially conditioned by

¹⁵² Ziya Öniş, and Fikret Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*, 251-286.

their developmentalist timing.¹⁵³ First, the political context in reactive states tends to be polarized and conflict-prone due to the historically contingent configurations of state-society relations, which impedes consensus-based governance surrounded by an immature institutional environment. Political polarization, more often than not, underlies uncontrolled populism and patronage politics, which in turn inform gradual erosion of the fisco-financial discipline for the sake of short-term electoral purposes. Second, political patronage and pervasive clientelism are inclined to permeate into state bureaucracy as the latter is generally conceived as an arena to be captured by competing political and economic interest groups. Hence, bureaucracy remains fragmented and dependent on arbitrary protection of individual political elites that squanders both bureaucratic ‘autonomy’ and ‘embeddedness.’ Not surprisingly as a result, state bureaucracy cannot substantially contribute to the effective formulation and governance of economic reforms in a coordinated way with the executive authority and institutional non-state economic actors. Third, state-private interest groups —dominant policy coalitions— relationship is usually imbued by rampant rent-seeking and perverse incentives rather than a rule-based institutionalized relationship. The personalistic exchange relations and patronage-motivated interest intermediation structures, again, give ample way to the Olsonian collective action problems, which in turn underpin a sub-optimal equilibrium in terms of the credibility of commitment and societal trust

¹⁵³ Wallerstein’s modern world system approach provides important insights regarding the place and function of state in semi-peripheral countries. See Immanuel Wallerstein, *The Politics of the World Economy* (Cambridge: Cambridge University Press, 1984), 20. This study, though does not directly rely on the framework of modern world system approach, is inspired by Wallerstein’s formulation of political economy struggles between the state and different power groups and their possible impacts on state’s reform capacity in reactive states. Also see, M. Fatih Tayfur, *Semiperipheral Development and Foreign Policy: The Cases of Greece and Spain* (Aldershot: Ashgate, 2003), 6-7.

during normal periods of policy-making. In short, in reactive states, the institutional structures informing state's reform capacity are set in a way that foster reform-biased agency behaviour. That being said, one needs to make a categorical distinction between 'reactive' and 'predatory' states. Despite they suffer from political polarization, patronage politics, and rampant rent-seeking, reactive states should not be conflated with predatory states, which are defined as patrimonial and kinsmen regimes, "that extract large amount of otherwise investable surplus and provide so little in the way of 'collective goods' in return that they do impede economic transformation... Those who control state apparatus [in predatory states] seem to plunder without any more regard for the welfare of the citizenry than a predator has for the welfare of its prey."¹⁵⁴ Thus reactive states constitute distinct ideal-typical analytic category vis-à-vis predatory states as well as vis-à-vis the advanced polities and developmental states.

The second caveat of the existing approaches to 'reactive state' conceptualization relates to the mechanisms of paradigmatic policy changes in the sub-set of states scrutinized here. I would argue that dynamics of major economic transformations in late-industrialized reactive states are also qualitatively different. There are two strands to the argument. First, policy networks framework, apart from dealing with advanced capitalist polities with exclusive focus on sector-specific analysis, is better at explaining stability than change.¹⁵⁵ This conservative bias partially emanates from the unit of and emphasis for analysis. Accordingly, despite policy networks framework integrates 'state capacity'

¹⁵⁴ Peter Evans, "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State," *Sociological Forum* 4, no. 4 (1989): 562-563.

¹⁵⁵ Hanspeter Kriesi, Silke Adam, Margit Jochum, "Comparative Analysis of Policy Networks in Western Europe," *Journal of Public Policy* 13, no. 3 (2006): 346.

into its analytical toolkit and utilizes the concept of ‘reactive states,’ the leading role is attributed to the preferences of non-state actors. In fact, policy networks framework assumes the stability of relations so that the dominant network types and their preference functions tend to remain intact.¹⁵⁶ This situation creates a puzzle that deserves in-depth research: If substantial reforms are instigated through the internal transformation of policy networks and if incumbent policy communities tend to favour the status quo, how and under what conditions reforms are commenced in reactive states? As Börzel points out “policy network literature does not provide answers to questions, such as *how and why networks change*.”¹⁵⁷

Second, policy networks framework tends to prioritize micro-institutional and sector-specific domestic factors at the expense of international dynamics. Though it is understandable in the context of advanced political economies, it does not provide necessary conceptual tools to entirely grasp the sources of state weakness and dynamics of persistence and change in reactive states. I would argue in the next section that, international dynamics, both at the agency and institutional-level, play a much more decisive role in reactive states than current approaches acknowledge. Therefore, I would propose to extend our gaze beyond domestic-oriented and sector-specific analysis. In the following part, I will offer a three-stage conceptual framework that incorporates the complex interactions among state agents, external anchors, and institutional structures to account for time and context-dependent dynamics of persistence and change in the

¹⁵⁶ Richardson, “Government, Interest Groups and Policy Change,” *Political Studies*, 1007.

¹⁵⁷ Börzel, “Networks,” *Public Administration*, 51. Emphasis added.

economic policy paradigms of reactive states. Before setting up the parameters of this framework, however, some clarification on conceptual vocabulary is in order.

2.3. Conceptual vocabulary: The logic of analytic eclecticism

First, ‘analytic eclecticism’ underlies the epistemological presuppositions of this study. Following Sil and Katzenstein, I define any approach “eclectic” that seeks to “extricate, translate, and selectively integrate analytic elements —concepts, logics, mechanisms, and interpretations— of theories or narratives that have been developed within separate paradigms but that address related aspects of substantive problems that have both scholarly and practical significance.”¹⁵⁸ Analytic eclecticism fundamentally relies on Hirschman’s insightful observation that paradigm-bound research, because of its exclusive emphasis on certain variables, may ignore a “variety of [other] forces at work”, which usually paves the way for “a particularly high degree of error.”¹⁵⁹ Along these lines, the premise of analytic eclecticism is to overcome the enduring blind spots in paradigm-bound scholarship by addressing the complex causal mechanisms that lead to important policy outcomes:

“Analytic eclecticism generates complex causal stories that forgo parsimony in order to capture the interactions among different types of causal mechanisms normally analysed in isolation from each other within separate research traditions.”¹⁶⁰

¹⁵⁸ Rudra Sil and Peter Katzenstein, *Beyond Paradigms: Analytic Eclecticism in the Study of World Politics* (New York: Palgrave Macmillan, 2010), 10.

¹⁵⁹ Albert Hirschman, “The Search for Paradigms as a Hindrance to Understanding,” *World Politics* 22, no. 3 (1970): 341, 343.

¹⁶⁰ Rudra Sil and Peter Katzenstein, “Analytic Eclecticism in the Study of World Politics: Reconfiguring Problems and Mechanisms across Research Traditions,” *Perspectives on Politics* 8, no. 2 (2010): 412.

Analytic eclecticism is an epistemological approach that “guard against the risks of excessive reliance on single paradigm and the simplifying assumptions that come with it.”¹⁶¹ Sil and Katzenstein highlight three distinguishing features of analytic eclecticism: “its pragmatist ethos [that potentially speak to concrete issues of policy and practice], its open-ended approach to identifying problems, and their complex interactions in diverse contexts.”¹⁶² Furthermore, it draws attention to the way in which institutional structures influence agent’s capabilities, constraints, and opportunities.¹⁶³ Thus, analytic eclecticism is particularly insightful for the purposes of this study because dynamics of reform-inertia and reform-activism are complex and multidimensional phenomena emanating from the interactions of agents and institutional structures along domestic-international nexus. That being said, however, analytic eclecticism does not intend to create a shopping list of all imaginable causal factors. Its distinctiveness arises from its effort to determine how “elements of different causal stories [concentrating either on agency or institutional structures] might coexist as part of a more complex argument.”¹⁶⁴ Following the basic parameters of analytic eclecticism, this study draws from state capacity, critical junctures and policy entrepreneurship literatures to develop a coherent framework that accounts for the mechanisms of reform-inertia and reform-activism in reactive states with particular emphasis on state’s fisco-financial regulation capacity. A conscious dialogue among these distinct but interrelated literatures enables researchers to adopt a more holistic perspective on when, why, and how a virtuous cycle of reform-

¹⁶¹ Ibid., 414.

¹⁶² Ibid., 412.

¹⁶³ Sil and Katzenstein, *Beyond Paradigms*, 21.

¹⁶⁴ This effort therefore aims to engage and utilize the insights of different paradigms, not to replace them toward a grand ‘synthesis.’ See, Sil and Katzenstein, “Analytic Eclecticism in the Study of World Politics,” *Perspectives on Politics*, 414-415.

activism can be instigated in reactive states by turning the spotlight on the complex multi-level interplay between agents and institutional structures.

Second clarification is required on agent-structure problematiqué. As Jackson¹⁶⁵ and Hay¹⁶⁶ suggest agents' interaction with 'institutions' and 'structures' is one of the perennial controversies in political science literature. There are at least two aspects of the debate: ontological and semantic. From an ontological point of view, the crucial question is the divisibility of agents and institutional structures. The process-oriented constructivist accounts tend to assume that agents and structures *mutually constitute* each other.¹⁶⁷ Thus any attempt to separate them is futile since, in the words of Wendt, they are "ontologically co-determined."¹⁶⁸ On the other hand, scientific realism, a radically different philosophy of science that crosscuts theoretical paradigms, presupposes that "social structures have an existence independent of the agent's conception of them."¹⁶⁹ Accordingly, Bhaskar offers the concept of "ontological hiatus," which claims that agents and structures interact with each other, but this does not mean that they share the same ontology.¹⁷⁰ This study accepts the divisibility of agents and institutional structures because I admit the interaction between them and try to understand how they condition each other, whilst assuming that they have distinctive

¹⁶⁵ Gregory Jackson, "Actors and Institutions," in Glenn Morgan et. al., eds., *The Oxford Handbook of Comparative Institutional Analysis* (Oxford: Oxford University Press, 2010), 63-86.

¹⁶⁶ Hay, *Political Analysis*, chapter 2.

¹⁶⁷ For a detailed account, see Richard Ned Lebow, *Constructing Cause in International Relations* (Cambridge: Cambridge University Press, 2014).

¹⁶⁸ Alexander Wendt, "The Agent-Structure Problem in International Relations Theory," *International Organization* 41, no. 3 (1987): 339.

¹⁶⁹ Jonathan Joseph and Colin Wight, eds., *Scientific Realism and International Relations* (New York: Palgrave Macmillan, 2010), 21. Also see, Heikki Patomati and Colin Wight, "After Postpositivism: The Premises of Scientific Realism," *International Studies Quarterly* 44, no. 2 (2000): 230-232.

¹⁷⁰ Roy Bhaskar, *The Possibility of Naturalism* (Brighton: Harvester, 1979), 37.

ontologies, whose appearance does not presuppose the existence of the other. A related discussion, in this context, is the ontological primitivity of agents over structures, or *vice versa*. Different theoretical perspectives pursue an agent-centric or structure-based research strategy (see chapter 1).¹⁷¹ Analytic eclecticism approaches the debate from a conjuncture-specific angle and claims that the hierarchy depends on timing and context of the interactions between agents and institutional structures. This study draws from this particular insight as well. For instance, in reactive states, the deeply entrenched reform-biased institutional structures conditions and constrains agency behaviour in an adverse manner that the attempts of reformist state agents tend to result in failure in the normal course of politics. Yet the reform-oriented state agents tend to have more room to manoeuvre and make decisive impacts in altering the existing equilibrium of institutional relations at critical conjunctures opened up in the wake of deep exogenous shocks (for details, see below).

From a semantic point of view, a conceptual clarification is necessary on the conflation of ‘institutions’ and ‘structures.’ There is a confusion and controversy over these two concepts in the literature. Different variants of institutionalist scholars tend to use these two terms interchangeably and, more often than not, employ the concept of ‘institutional structures’ to refer to the factors that condition actor’s agency, either in a positive or a negative way. Thelen and Steinmo define “institutions as formal organizations and

¹⁷¹ William Roberts Clark, “Agents and Structures: Two Views of Preferences, Two Views of Institutions,” *International Studies Quarterly* 42, no. 2 (1998): 245-270.

informal rules and procedures that *structure* conduct.”¹⁷² Ikenberry’s definition also “ranges from specific characteristics of government institutions, to the more overarching *structures* of the state, to the nation’s normative social order.”¹⁷³ Hay and Wincott also coin the term “institutional structures” to define factors that inform agency behaviour.¹⁷⁴ However, certain other scholars challenge the conflation of institutions and structures. For instance, Bakır makes a distinction between “institutions” and “structures” in his “eclectic structures-institutions-agents framework,” which offers a typology of bank behaviour. Bakır treats structures “as broader contexts within which institutions and agents are embedded.”¹⁷⁵

The analytical premise of separating institutions and structures profoundly depends on the particular research question and researcher’s conceptual framework. For the purposes of this study, the main point is how we define these concepts, what they include, and through which mechanisms their interaction inform reform outcomes. I tend to agree with Thelen and Steinmo that structures are mostly useful as distinct analytical categories when the aim is to explicate how macro-level socio-economic factors such as capitalist class structure or the structure of interstate system affect the *explanandum*.¹⁷⁶ Since this study aims to develop a mid-level framework to explicate fiscal and financial reform dynamics in late-industrialized reactive states. Thus for the sake of practicality

¹⁷² Kathleen Thelen and Sven Steinmo, “Historical Institutionalism in Comparative Politics” in Sven Steinmo, Kathleen Thelen and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Analysis* (Cambridge: Cambridge University Press, 1992), 2.

¹⁷³ Quoted in *ibid.*, 2.

¹⁷⁴ Colin Hay and Daniel Wincott, “Structure, Agency and Historical Institutionalism,” *Political Studies* XLVI (1998): 951-957.

¹⁷⁵ Bakır, *Bank Behaviour and Resilience*, 13, 177.

¹⁷⁶ Thelen and Steinmo, “Historical Institutionalism in Comparative Politics,” 11.

and comparison, I will use ‘institutional structures’ to denote the *most* significant factors that constrain/enable the reform performance of the agency. In the relevant part below, I will specify domestic and broader institutional structures that inform regulatory state capacity and subsequent reform outcomes in reactive states.

Third, a clarification is also in order regarding the definition of ‘reform’ or ‘major policy change.’ The political economy literature suggests that reforms come in many forms and ways.¹⁷⁷ There is also a vast literature on the definition and types of policy reforms.¹⁷⁸ Similar to other forms of states, many economic changes are constantly engineered in reactive states as well, especially in the era of global neoliberalism. That being said, not all changes qualify the definition of ‘reform’ denoted in this study. The hastily crafted ad hoc policy changes and window dressing exercises are frequently put into practice in reactive states. In fact, these shallow and incomplete policy changes often lead to the further deterioration of state’s reform capacity. Thus insubstantial and non-sustainable policy changes are beyond the analytical scope of this study. Accordingly, by way of analogy from Hall, I identify three distinct types of reforms.¹⁷⁹ First order reform refers to minor policy adaptations in which just the settings of government’s policy

¹⁷⁷ For comprehensive reviews, see Haggard and Kaufman, ed., *The Politics of Economic Adjustment*; Rodrik, “Understanding Economic Policy Reform,” *Journal of Economic Literature*, 9-41. For recent reviews, see Hill, “The Political Economy of Policy Reform: Insights from Southeast Asia,” *Asian Development Review*, 108-130; Iberto Alesina, Silvia Ardagna, and Francesco Trebbi, “Who Adjusts and When? The Political Economy of Reforms,” *IMF Staff Papers* 53 (2006): 1-29; Dani Rodrik, “When Ideas Trump Interests: Preferences, Worldviews, and Policy Innovations,” *Journal of Economic Perspectives* 28, no. 1 (2014): 189-209.

¹⁷⁸ For an overview, see Mariano Tommasia and Andrés Velasco, “Where are we in the Political Economy of Reform,” *The Journal of Policy Reform* 1, no. 2 (1996): 187-238.

¹⁷⁹ Peter A. Hall, “Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain,” *Comparative Politics* 25, no. 3 (1993): 275-296.

instruments are altered. Second order reform refers to medium policy adaptations in which the instruments as well as the settings of the instruments are altered. Third order reform refers to a set of significant changes in policy that alter both the settings of the instruments; the policy instruments themselves and the ultimate goals and ideational paradigm behind the existing policies. I refer to third order reforms throughout this study, whilst I also frequently use ‘substantial and sustainable reforms,’ ‘major policy transformations,’ and ‘paradigmatic changes’ interchangeably to denote the same phenomenon. Consequently, I investigate a set of fiscal and structural reforms that inform state’s fisco-financial discipline and reform capacity.

2.4. Dynamics of reform processes in reactive states

What are the dynamics of reform-inertia and reform-activism in reactive states? This study assumes that states are still the most appropriate take-off point regarding the governance of state-market relations because setting common goals, steering policy communities, and promoting public-private partnerships are ultimately mediated by the state despite the emergence of alternative governance actors.¹⁸⁰ It is in this context that state capacity emerges as the single most important variable in understanding domestic reform dynamics. Per definitionem, the initiative to instigate a virtuous cycle of reform activism usually does not emanate from the concerted and consensus-based interactions of dominant policy coalitions in reactive states. Reformist state agents are expected to

¹⁸⁰ B. Guy Peters and Jon Pierre, “Governance, Government, and the State”, in Colin Hay, Michael Lister and David Marsh, eds., *The State: Theory and Issues* (London: Palgrave Macmillan, 2006). For the central role of state in comparative political economy analysis, see Vivien Schmidt, “Putting the Political Back into Political Economy by Bringing the State Back Yet Again,” *World Politics* 61, no. 3 (2009): 516-548.

set the policy agenda, steer incumbent policy communities toward the implementation of paradigmatic reforms.¹⁸¹ This leads to the first hypothesis of this study.

***H1:** It is more likely that the economic reforms emanate from reformist state agents' capacity to steer existing policy communities in reactive states.*

However, there appears a paradox here: As I stated above, institutional structures are set in a way in reactive states that existing arrangements create various mechanisms for state agents to bandwagon the deeply entrenched rent-seeking coalitions. The political polarization, clientelistic patronage politics, and underdeveloped culture of consensus-based policy-making create a sub-optimal environment for state agents to prioritize their short-term interests at the expense of long-term societal welfare. Stated somewhat differently, those who are supposed to reform the system are usually the ones that are 'captured by' and reap the benefits of the existing institutional equilibrium. This perennial problematique relates to the "paradox of embedded agency."¹⁸² Then, how can it be possible to initiate a virtuous cycle of reform-activism in reactive states? And what accounts for the diverging reform performance in states with similar capacities? The critical junctures and policy entrepreneurship literatures provide fertile avenues to address the paradox of embedded agency.¹⁸³ This brings us to a discussion on the timing and context of major policy changes in reactive states.

¹⁸¹ B. Guy Peters, "Shouldn't Row, Can't Steer: What's a Government to Do?," *Public Policy and Administration* 12, no. 2 (1997): 57.

¹⁸² Battilana, Leca, and Boxenbaum, "How Actors Change Institutions," *The Academy of Management Annals*, 65-107.

¹⁸³ For an overview, see chapter 1. For more debate on the issue, see the next section in this chapter.

2.3.1. Timing of reform processes: The logic of exogenous shocks

The analytical framework of this study is organized around two central concepts: *timing* and *context* of reform processes.¹⁸⁴ The first dimension concerns the timing of paradigmatic policy changes. I stated in the preceding paragraph that reform-biased institutional structures are more likely to constrain agency behaviour in the normal course of politics in a way that enforcement of capacity-augmenting fisco-financial reforms turns into an arduous task. I also highlighted that political context, state bureaucracy, and incumbent policy coalitions tend to favour deleterious policies and deterioration of state capacity rather than promoting long-term oriented reform strategies. This episode refers to the first-stage in my conceptual framework, which I call ‘stagnation and inertia.’ In this stage, urgently needed reforms are more likely to be delayed or watered down due to the sub-optimal interactions of agents and institutional structures. Thus the accumulation of structural problems, most of the time, lead to deep-seated economic crises. The literature suggests that external shocks are important tipping points that may open up opportunity windows to implement substantial reforms, especially in reform-resistant political economies.¹⁸⁵ Jolts and crises constitute critical

¹⁸⁴ For the importance of ‘temporality’ and ‘context’ in political science literature, especially for historical institutionalism, see Paul Pierson and Theda Skocpol, “Historical Institutionalism in Contemporary Political Science,” in Ira Katznelson and Helen V. Milner, eds., *Political Science: State of the Discipline* (New York: W.W. Norton, 2002): 693-721.

¹⁸⁵ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 571-598; Colin Hay, “Crisis and the Structural Transformation of the State: Interrogating the Process of Change,” *British Journal of Politics and International Relations* 1, no. 3 (1999): 317-344; Boin, ‘t Hart and McConnell, “Crisis Exploitation: Political and Policy Impacts of Framing Contests,” *Journal of European Public Policy*, 81-106; Boin, McConnell and ‘t Hart, *Governing After Crisis: The Politics of Investigation, Accountability and Learning*; Hogan and Feeney, “Crisis and Policy Change: The Role of the Political Entrepreneur,” *Risk, Hazards & Crisis in Public Policy*, 1-24; James I. Walsh, “Policy Failure and Policy Change: British Security Policy after the Cold War,” *Comparative Political Studies* 39, no. 4 (2006): 490-518; John Hogan, and Ana Hara, “Country at a

junctures that “make significant structural changes possible because they render politics highly fluid.”¹⁸⁶ Critical junctures are “relatively short periods of time during which there is substantially heightened probability that agents’ choices will affect the outcome of interest.”¹⁸⁷ This definition proffers that crisis junctures constitute a potential turning point that is distinct from the “normal” historical evolution of the “institutional setting of interests.”¹⁸⁸ Therefore, it opens up the second stage, i.e., ‘uncertainty and crisis narratives phase’ in the three-stage framework offered in this study. In this second-stage, ultimate reform outcomes are shaped according to the context-specific interactions of agency-level dynamics and institutional structures (see, below).

Jessop argues “that a crisis emerges when established patterns of dealing with structural contradictions, their crisis tendencies and dilemmas no longer work as expected and may even aggravate the situation.”¹⁸⁹ In this sense, a crisis is a reverberation of the unsustainable nature of prevailing policy paradigms. An economic crisis is a forceful game-changer in the institutional equilibrium of power balances because it delegitimizes existing policy paradigms and jeopardizes the relative power capacity of the deeply entrenched vested interests attached to these paradigms.¹⁹⁰ Thus the reshuffling of power balances among distributional coalitions disturbed by an economic crisis provides

Crossroads: An Insight into How an Economic Crisis Led to Dramatic Policy Change,” *Risk, Hazards & Crisis in Public Policy* 2, no. 3 (2011): 1-23.

¹⁸⁶ Geoffrey Garrett and Peter Lange “Internationalization, Institutions, and Political Change,” *International Organization* 49, no. 4 (1995): 522.

¹⁸⁷ Giovanni Capoccia and Daniel R. Klemen, “The Study of Junctures: Theory, Narrative, and Counterfactuals in Historical Institutionalism,” *World Politics* 59, no. 3 (2007): 348.

¹⁸⁸ *Ibid.*

¹⁸⁹ Bob Jessop, *The Future of the Capitalist State* (Cambridge: Polity Press, 2002), 92.

¹⁹⁰ Hall, “Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain,” *Comparative Politics*, 275-296; Sabatier, ed., *Theories of the Policy Process*.

opportunities in freeing the hands of the reform-oriented agents to initiate a new path that promote substantial and sustainable reforms.¹⁹¹ This leads to the second hypothesis of this research.

***H2:** Crises play constitutive roles as critical junctures that enable substantial reforms in reactive states. Not all crises, however, invite major policy change. The deeper the crisis, the more likely the change in dominant policy paradigms.*

Not all crises, however, invite substantial reforms. In fact, exogenous shocks per se fall short of explaining post-crisis variations across cases because crises with similar magnitude result in diverging post-crisis reform performance, a point I will demonstrate with reference to the Greek and Turkish cases in the empirical chapters. Hence, the current research underlines “that the exogenous explanations for sudden and dramatic shifts in policies tend to be crude.”¹⁹² In many cases status quo ante remained intact whatever the depth of the crisis is.¹⁹³ As Hogan and Feeney put the literature has not paid much ado to determine the causal mechanisms through which crises result in substantial reforms.¹⁹⁴

2.3.2. Context of reform processes: The logic of complex causality

Crises are the manifestations of policy failures that reverberate the ill-functioning aspects of state-market relations. That being said, crises are not as self-evident as they

¹⁹¹ Tommasia and Velasco, “Where are we in the Political Economy of Reform,” *The Journal of Policy Reform*, 187-238.

¹⁹² Hogan and Feeney, “Crisis and Policy Change,” *Risk, Hazards & Crisis in Public Policy*, 2.

¹⁹³ Legro, “The Transformation,” *American Journal of Political Science*, 424; Alink, Boin and ‘t Hart, “Institutional Crises and Reforms in Policy Sectors,” *Journal of European Public Policy*.

¹⁹⁴ Hogan and Feeney, “Crisis and Policy Change,” *Risk, Hazards & Crisis in Public Policy*, 1.

ostensibly appear at first glance.¹⁹⁵ In fact, the mere accumulation of structural contradictions is insufficient in explaining the emergence and consolidation of new policy paths in the wake of deep economic crises. Why are some economic crises exploited as opportunity windows and certain others lead to a further deterioration of state capacity? To address this question, critical junctures perspectives needs to be supplemented by a coherent framework that account for the complex interactions of agency-level dynamics and institutional structures.

2.3.2.1. Agency-level dynamics: Importance of narrative matching

Interest-based political economy accounts cogently demonstrate that deep crises are crucial tipping points for the redistribution of power balances among different interest coalitions.¹⁹⁶ If the analogy is apt an economic crisis in domestic politics resembles the functions of a war in international relations. As Gilpin suggested long ago, wars are likely to reshuffle the power relations in the interstate system in a rather dramatic way.¹⁹⁷ Similarly, a crisis denotes a punctuated equilibrium that renders pre-crisis power relations highly fluid at the domestic arena. The interest-based power transformations hypothesis, however, is too crude to explain the dynamics of new coalition formation in the wake of substantial economic shocks especially in polities that are arrested by

¹⁹⁵ Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (Cambridge: Cambridge University Press, 2002), 44-45.

¹⁹⁶ For an overview and empirical testing of this proposition, see Eduardo Lora and Mauricio Olivera, "What Makes Reforms Likely: Political Economy Determinants of Reforms in Latin America," *Journal of Applied Economics* 7, no. 1 (2004): 99-135.

¹⁹⁷ Robert Gilpin, *War and Change in International Politics* (Cambridge: Cambridge University Press, 1981).

inward-looking interest intermediation structures. Therefore, substantial reforms in reactive states would necessitate more than mechanical power transitions assumptions. I claimed previously that a crisis must to be narrated in particular ways to overcome collective action problems toward crafting new pro-reform coalitions. This leads us to put more emphasis on the role of ideas during critical junctures.¹⁹⁸ Ideational approaches suggest that crises are more likely to delegitimize existing paradigms. In fact, from a Kuhnian perspective, crises may unravel the perception that the dominant paradigms are the main reasons of the present problems.¹⁹⁹ According to Legro, policy change occurs at two distinct ideational realms in crisis junctures: ideational collapse and new ideational consolidation.²⁰⁰ Although deep crises pave the way for the de-legitimization and/or collapse of dominant policy paradigms, framing a particular narrative regarding the existing crisis²⁰¹ and bearing the ownership of new policy paradigms is sine qua non.²⁰² Therefore, in times of institutional fluidity and uncertainty, the absence/presence of reform-oriented state agents plays a crucial role in terms of developing a coherent crisis narrative. It is at this very point that the policy entrepreneurship literature engages into an explicit and fruitful conversation with critical junctures literature.

Kingdon, in his oft-cited study, offers ‘multiple-streams approach’ that places policy entrepreneurs within the context of three kinds of processes: problems, policies, and

¹⁹⁸ Blyth suggests that ideas may have five different causal effects during the periods of economic crisis: uncertainty reduction, coalition building, institutional contestation, institutional construction, and expectational coordination. Blyth, *Great Transformations*, 35.

¹⁹⁹ Thomas Kuhn, *The Structure of Scientific Revolutions* (Chicago: University of Chicago Press, 1962).

²⁰⁰ Legro, “The Transformation,” *American Journal of Political Science*.

²⁰¹ Boin, ‘t Hart and McConnell, “Crisis Exploitation,” *Journal of European Public Policy*, 95.

²⁰² Hay, “Crisis and the Structural Transformation,” *British Journal of Politics and International Relations*, 323, 333-338.

politics.²⁰³ Accordingly, paradigmatic transformations occur when change agents meticulously couple these three independent streams —problems, policies, and politics.²⁰⁴ There is a growing literature on policy entrepreneurs at different research fields including but not limited to foreign policy,²⁰⁵ central banking,²⁰⁶ macroeconomics,²⁰⁷ innovation²⁰⁸ and healthcare.²⁰⁹ However, there are certain pitfalls regarding the operationalization of policy entrepreneurship concept. First, as Bakır highlights, policy entrepreneurs are mainly studied within the framework of “governmental agenda setting,” which neglects the wider societal and political context.²¹⁰ In order to rectify this gap, Bakır offers a broader analysis that places policy entrepreneurs within the context of domestic and transnational policy communities.²¹¹ The current state of the literature suggests that Kingdon’s three-stream approach needs to be substantiated with more empirical research to better explicate wider ‘political’ context. Thus an explicit emphasis on the domestic and external political enabling/constraining factors might enable researchers to extrapolate how and under what conditions reformist state agents can couple problems, policies, and politics toward

²⁰³ Kingdon, *Agendas, Alternatives, and Public Policies*, 122.

²⁰⁴ *Ibid.*, 172-184.

²⁰⁵ Spyros Blavoukos and Dimitris Bourantonis, “Policy Entrepreneurship and Foreign Policy Change: The Greek-Turkish Rapprochement in the 1990s,” *Government and Opposition* 47, no. 4 (2012): 597-617.

²⁰⁶ Caner Bakır, *Merkezdeki Banka: Türkiye Cumhuriyet Merkez Bankası ve Uluslararası Bir Karşılaştırma* (İstanbul: İstanbul Bilgi Üniversitesi Yayınları, 2007); Bakır, “Policy Entrepreneurship and Institutional Change” *Governance: An International Journal of Policy, Administration and Institutions*.

²⁰⁷ Paul ‘t Hart and Jacob Gustavsson, “Foreign Economic Crisis, Reformist Leadership, and Policy Change: Lessons from Australia and Sweden,” *Administrative Theory and Praxis* 24, no. 1 (2002): 145-174.

²⁰⁸ Michael Mintrom, “Policy Entrepreneurs and the Diffusion of Innovation,” *American Journal of Political Science* 41 (1997): 738-770.

²⁰⁹ Thomas R. Oliver and Pamela Paul Shaheen, “Translating Ideas into Actions: Entrepreneurial Leadership in State Health Care Reforms,” *Journal of Health Politics, Policy and Law* 22 (1997): 721-788.

²¹⁰ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 573.

²¹¹ *Ibid.*, 571-598.

paradigmatic fisco-financial transformations in reactive states. In the empirical chapters on Greece and Turkey, I hope to shed fresh light on the debate by navigating both the successful and failed reform attempts of policy entrepreneurs at different times and contexts.

Second, the concept suffers from certain definitional problems.²¹² Hogan and Feeney make a distinction between a “policy entrepreneur” and “political entrepreneur.” They argue that the key agent of policy change is political entrepreneur, whose task is to “coordinate the policy entrepreneurs, encourage them to coalesce around a decipherable set of alternative reform ideas. They are the link between the innovations of the policy entrepreneurs and policy change.”²¹³ According to their conceptualization, political entrepreneurs have access to political decision-making echelons, whereas policy entrepreneurs have technocratic capabilities with a low public profile to trigger an ideational paradigm shift. Despite it makes an important point regarding the crucial game-changer role of political will, I think, for two reasons, this definition unnecessarily complicates the discussion. First, if it is likely to observe many policy entrepreneurs in a specific policy realm, speaking about ‘an entrepreneur’ is of little use because policy entrepreneurs are rarely emerging actors, per definitionem. Second, there is already a literature on ‘political leadership’ addressing the role of ‘political entrepreneurs’ proposed by Hogan and Feeney.²¹⁴ Therefore, following the useful principle of Occam’s

²¹² Hogan and Feeney, “Crisis and Policy Change,” *Risk, Hazards & Crisis in Public Policy*, 1-24.

²¹³ *Ibid.*, 6.

²¹⁴ For a succinct literature review on political leadership, see Jean Hartley and John Benington, “Political Leadership,” in Alan Bryman et. al., eds., *The Sage Handbook of Leadership* (London: Sage Publications, 2011), 203-214.

razor, which proposes that one should not increase the number of entries required to explain a given phenomenon beyond what is necessary, we should subsume policy entrepreneur and political entrepreneur concepts under ‘policy entrepreneur’ label and replace the second one with ‘political leadership.’ Accordingly, a policy entrepreneur refers to “an individual who mobilizes ideas, resolves conflicts, and steers their implementation for policy and institutional changes.”²¹⁵ In this study, I will take this definition as take-off point in the empirical chapters since it succinctly covers the qualifications attributed to a policy entrepreneur in the literature without falling into the trap of concept stretching. The discussion on political will and policy entrepreneurship leads to the third hypothesis.

***H3:** The presence of political will and policy entrepreneur is crucial in framing coherent narratives and generating public ownership to reform proposals. Policy entrepreneurs, however, are more likely to fail if the timing and context of their emergence are not conducive.*

The argument so far implies that despite rising popularity of the concept, there is still confusion in the literature regarding the definition and role of a policy entrepreneur and “it is yet to be broadly integrated within analysis of policy change.”²¹⁶ This is particularly the case for the sub-set of states addressed in this study, i.e., reactive states, as the concept is mostly operationalized within the context of advanced political economies. The scope conditions of the conduit role played by policy entrepreneurs, therefore, deserve further inquiry. In an early-account, Skocpol and Weir argue, “that we

²¹⁵ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 572.

²¹⁶ Mintrom and Norman, “Policy Entrepreneurship and Policy Change,” *The Policy Studies Journal*, 649.

must ask not about the presence of individual persons or ideas in the abstract, but whether key state agencies were open or closed to the use or development of innovative perspectives.²¹⁷ This proposition refers to the right direction in the debate. However, it is still incomplete because it only concentrates on state's internal capacity, which refers to just one side of the coin. As I propose in the preceding paragraphs, change-agents must to be embedded into a broader context of enabling/constraining factors. Their performance to link problems, policies, and politics toward paradigmatic economic reforms is conditioned by their interactions with external anchors and domestic institutional structures.

On the international side, external anchors play decisive roles in determining the scope conditions of post-crisis politicking in reactive states, as massive power asymmetry emerge in disfavour of the latter in the wake of a deep economic crisis.²¹⁸ Their role can be subsumed into two categories: supply of resources and supply of credibility. Accordingly, from an interest-based perspective, external anchors provide material support to state agents in their contest to frame a coherent narrative at the domestic realm.²¹⁹ The availability of financial resources proves crucial to alleviate distributional pressures emanated from post-crisis adjustment measures. The resources in question can be fiscal bailouts and technical expertise, generally attached to conditionality

²¹⁷ Theda Skocpol and Margaret Weir, "State Structures and Possibilities for Keynesian Responses to the Depression in Sweden, Britain, and the United States", in Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In*, 126.

²¹⁸ Öniş and Şenses, "Global Dynamics, Domestic Coalitions and Reactive State," *METU Studies in Development*, 251-286. For a broader discussion, see Barbara Stallings, "International Influence on Economic Policy: Debt, Stabilization, and Structural Reform," in Stephan Haggard and Robert R. Kaufman, eds., *The Politics of Economic Adjustment* (Princeton, Princeton University Press, 1992): 41-88.

²¹⁹ Anne O. Krueger and Sarath Rajapatirana, "The World Bank's Policies towards Trade and Trade Policy Reform," *World Economy* 22, no. 6 (1999): 717-740.

principles.²²⁰ Second, from an ideational perspective, external anchors can assume a practical role in the supply of credibility and legitimacy of certain reform ideas and tilt the balance in favour of the pro-reform coalitions during the early phases of crisis narration struggles. Therefore, the match in the *crisis narratives* of domestic change agents and external anchors will empower the former in establishing new policy coalitions and generating public ownership of their prescriptions. Chwieroth underlines this point as follows:

“When the perceived need for credibility is high, such as during an economic crisis, domestic norm entrepreneurs whose prescriptions resonate with the beliefs of relevant external actors will be empowered. In debates with their opponents, these domestic norm entrepreneurs can employ this resonance to present themselves and their policy blueprint as the only way to establish credibility and resolve the crisis.”²²¹

The mismatch between external actors’ perspectives and state agents’ reform prescriptions, on the other hand, may severely jeopardize the access to external resources and international credibility. As Acharya points out in a rather different context, the congruence between state agents and external anchors should be interpreted as a dynamic process rather than static “existential match.”²²² From a theoretical viewpoint, crisis narrative framework offered here takes the autonomous functions of

²²⁰ The financial support of external anchors and conditionality do not automatically facilitate policy reforms. On the IMF conditionality, see James Vreeland, *The IMF and Economic Development* (Cambridge: Cambridge University Press, 2003); on the EU conditionality, see Anna Mileta Vachudova, *Europe Undivided: Democracy, Leverage and Integration After Communism* (Oxford: Oxford University Press, 2005).

²²¹ Jeffrey M. Chwieroth, “How Do Crises Lead to Change? Liberalizing Capital Controls in the Early Years of New Order Indonesia,” *World Politics* 62, no. 3 (2010): 496-527.

²²² Amitav Acharya, “How Ideas Spread: Whose Norms Matter? Norm Localization and Institutional Change in Asian Regionalism,” *International Organization* 58, no. 1 (2004): 239-275.

state agents into consideration in localizing and domesticating the prescriptions of external players.²²³ The instigation of successful economic policy changes necessitates active participation and deliberation of external and domestic stakeholders assembled around a dominant crisis narrative. Stated differently, though the constraining role of external anchors and power asymmetries are too crucial to be neglected, narrative matching is rarely a one-way imposition process. The bargaining leverage of domestic agents, however, heavily depends on a set of complementary factors, which are informed by the interests and ideas of the most dominant external actors and enabling/constraining impacts of domestic institutional structures.

2.3.2.2. Institutional structures: Enabling/constraining conditions

Blyth convincingly argues that the root-causes and the nature of a crisis becomes *something to be explained* rather than *something with which to do the explaining* during post-crisis political tug-of-wars.²²⁴ In times of extreme uncertainty, the particular narrative about “what has gone wrong” and “what is to be done” makes crisis as “explicable, manageable, and indeed, actionable.”²²⁵ In this regard, the degree of narrative match between state agents and external actors do constitute necessary aspect of reform processes in reactive states. The balance sheet of reform outcomes, however, is drawn by institutional structures in which state agents are embedded. Domestic institutional structures, i.e., domestic political context, state bureaucracy, and dominant

²²³ Ibid.

²²⁴ Blyth, *Great Transformations*, 9.

²²⁵ Ibid., 10.

policy coalitions inform reform outcomes as the pillars of state's internal and external capacities. Since I have elaborated on these variables in the previous part, it suffices to state here that the degree of agents' penetration into these institutional structures and the enabling role played by political context, business and labour representatives is equally important for the initiation of a virtuous cycle of reform-activism in reactive states. Öniş and Şenses underline this point as follows: "External dynamics per se are insufficient to explain major policy shifts. The development of a supportive domestic policy coalition is [also] crucial."²²⁶

Based on the complex interactions between agents and institutional structures, in the third phase of my three-stage framework, dominant policy coalitions may redefine their interests and bandwagon the newly emerging winning coalitions if a dominant narrative articulated at the agency-level and if a sufficient number of institutional players are convinced that existing policy paradigms are totally exhausted. On the other hand, if fragmented/incoherent narratives dominate policy-making agenda at the agency-level, and if incumbent domestic coalitions do not own the reform agenda, they may align toward status quo and resistance to change. In this case, domestic ownership problems may precipitously amplify, which in turn result in the failure of the attempts of change-agents regardless of the depth of the economic shock. It may even turn out to be a case, which the crisis further informs the erosion of state capacity and prolongation of socio-economic and political chaos. This leads to the fourth hypothesis of this study:

²²⁶ Öniş and Şenses, "Global Dynamics, Domestic Coalitions and Reactive State," *METU Studies in Development*, 257.

H4: *The reform initiatives are more likely to remain incomplete or directly fail without enabling role played by domestic institutional structures. The wider the gap between the crisis narratives of state agents and external anchors, the more likely the failure is.*

Finally, broader institutional structures, in which national economies are placed, should be taken into consideration as they also inform long-term reform performance of reactive states in non-crisis episodes. The mechanisms and outcomes of the internationalization of domestic economies are old age discussions in comparative political economy literature.²²⁷ In an early account, for instance, Gourevitch urged comparativists to keep a sharp eye on the complex interactions between domestic and systemic-level phenomena to recognize how they condition each other.²²⁸ Accordingly, the changing aspects of international system —such as financial globalization— and/or regional integration projects —such as EU membership/candidacy processes —may impose new rules, regulations, and institutional change in the fisco-financial regimes of the nation-states. The impacts of broader institutional structures can be discussed with reference to two dimensions: constraining-impacts and reformist-impacts. The literature suggests that when highly specified set of rules is imposed on nation-states, reform mechanisms are more likely to have a high degree of convergence.²²⁹ By contrast, if broader structures only suggest tendencies with no binding rules and tight surveillance

²²⁷ Robert O. Keohane and Helen V. Milner, eds., *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996); Jeffrey Frieden and Lisa L. Martin, “International Political Economy: Global and Domestic Interactions” in Ira Katznelson and Helen V. Milner, eds., *Political Science: State of the Discipline* (New York: W. W. Norton, 2003), 118-146.

²²⁸ Peter Gourevitch, “The Second Image Reversed: The International Sources of Domestic Politics,” *International Organization* 32, no. 4 (1978): 881-911.

²²⁹ Weiss and her colleagues demonstrate that ‘constrained state’ thesis does not hold true in most cases. Weiss, ed., *States in the Global Economy*.

mechanisms, then states feel free to imitate or not depending on their preferences, policy legacies, domestic power balances, and distributional concerns. Thus we need to concentrate on domestic mediating factors to understand when, how, and why states alter prevalent policy paths.²³⁰ State's adjustment performance ultimately depends on the reorganization of domestic preference functions and reformulation of institutional arrangements underlying agency behaviour.²³¹

Another stream of research puts emphasis on the reform-encouraging impacts of broader institutional structures.²³² The integration into regional organizations and globalization trends may inform type and depth of change in fisco-financial regimes, as they impose a common set of standards and regulations upon nation-states. For instance, "EU conditionality" is proposed to have substantial reformist-impact on the fiscal and financial adjustment capacity of the member/candidate countries.²³³ However, the 'conditionality' impact is not standardized. Stated somewhat differently, they do not lead to a single unified political economy model in fiscal and financial policies of nation-

²³⁰ Linda Weiss, "Introduction: Bringing Domestic Institutions Back In" in Linda Weiss, ed., *States in the Global Economy* (Cambridge: Cambridge University Press, 2003), 1-37.

²³¹ For instance, varieties of capitalism scholars explain why convergence did not occur among countries over the last three decades characterized by neoliberal globalization. The different configuration of domestic institutions determines the diverging performance of national economies. See Peter Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001). For a similar discussion on the Europeanization context, see Vivien A. Schmidt, "Europeanization and the Mechanics of Economic Policy Adjustment," *Journal of European Public Policy* 9, no. 6 (2002): 894-912.

²³² Stephan Haggard and Sylvia Maxfield, "The Political Economy of Financial Internationalization in the Developing World," *International Organization* 50, no. 1 (1996): 35-68.

²³³ For an in-depth assessment, see Kenneth Dyson, *European States and the Euro: Europeanization, Variation, and Convergence* (Oxford: Oxford University Press, 2002).

states.²³⁴ I will demonstrate in the empirical chapters that broader institutional structures may even provide perverse incentives and moral hazard problems that lead to procrastination of reforms by leaving ample leeway thanks to lucrative fiscal subsidies and favourable borrowing opportunities. The impacts of broader institutional structures, whether constraining or reforming, heavily contingent upon how they are mediated, contested, and channelled within domestic contexts. The role of state capacity, at this point, emerges as a key independent variable. States with high capacity, i.e., proactive states, tend to exploit new opportunities provided by regional integration and globalization processes.²³⁵ States with low capacity, i.e., reactive states, tend to expose themselves to the side effects of regional and global transformations, which in turn exacerbates domestic reform failures. This leads to fifth hypothesis:

H5: The impact of broader institutional structures is heavily dependent on how they are mediated by state capacity at the domestic level. If the conditionality principles are lax and porous, it is more likely to lead to the procrastination of fisco-financial reforms in reactive states.

This study therefore acknowledges both the constraining and enabling roles of broader institutional structures by offering a qualified approach to understand the scope conditions, timing, and context of the feedbacks they provide. In the empirical parts, I will elaborate more on context-specific impacts of the ‘EU conditionality’ and financial globalization on the fisco-financial reform performance of reactive states with particular reference to the Greek and Turkish cases.

²³⁴ Schmidt, “Europeanization and the Mechanics of Economic Policy Adjustment,” *Journal of European Public Policy*, 894-912.

²³⁵ Linda Weiss, “State-augmenting Effects of Globalization,” *New Political Economy* 10, no. 3 (2005): 345-353.

2.4. Putting the jigsaw together

To sum up the argument so far, this study offers three-stage framework that explores political economy dynamics of reform processes in reactive states. This part offers a stylized summary of subsequent stages offered in this chapter. The figure below also provides an illustrated version of my conceptual framework.

Stage 1: Stagnation and inertia

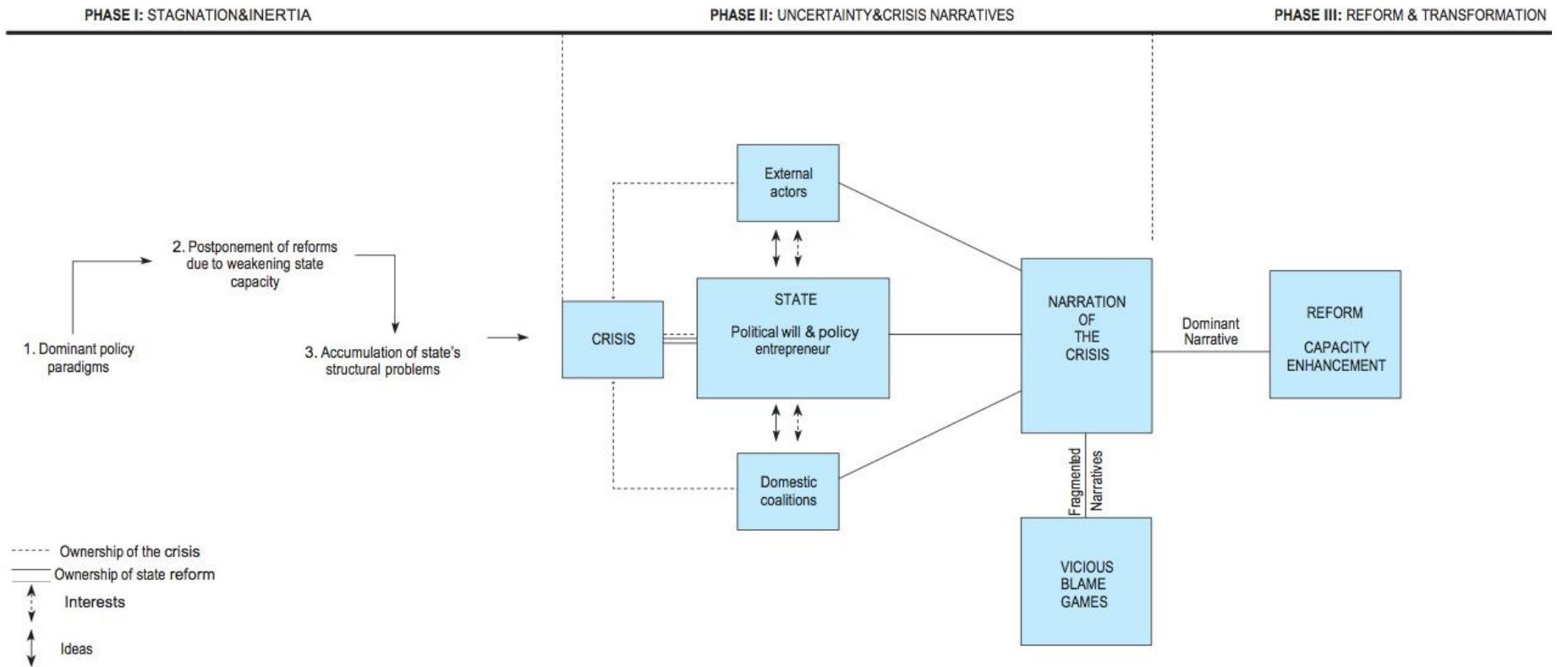
In the first stage, i.e., phase of stagnation and inertia, reform attempts are more likely to fail due to the path-dependent interactions among agents and institutional structures, which inform state's internal and external capacity. The weak state capacity to impose robust discipline often leads to a bloated fisco-financial regime in reactive states. Furthermore, in the absence of strong state capacity, this subset of states integrates are more likely to integrate into regionalization and globalization processes in a way that further inform economic moral hazard problems. In this sub-optimal equilibrium, agency behaviour is more likely to align toward status quo, and potential reformist agents are likely to fail in their attempts to generate ownership of their reformist agenda. Hence, the accumulation of structural problems, most of the time, deteriorates state's reform capacity, which in turn paves the wave for deep-seated economic turmoil.

Stage 2: Uncertainty and crisis narratives

Economic crises as a particular form of critical junctures tend to open an opportunity space to introduce new, and probably a high-level, equilibrium since exogenous shocks

lead to the weakening of reform-resistant domestic institutional arrangements and the ideational paradigms embedded therein. Thus exogenous shocks may invite the second stage in three-stage framework, i.e., phase of uncertainty and crisis narratives. In crisis junctures, the existence of reform-oriented state agents, possibly policy entrepreneurs, play instrumental role to couple problems, policies, and politics so as to introduce substantial reforms and generate ownership of their reform agenda. Their performance, however, is conditioned by two factors. First, a dominant crisis narrative must be ensured with external anchors, which are involved in the formulation and implementation of post-crisis reform policies. A high degree of narrative match between state agents and external anchors is more likely to facilitate a virtuous cycle of reform activism. Second, domestic institutional structures must play enabling role in terms of the ownership of the crisis and the subsequent reform measures. If the agency-level crisis narratives diverge substantially and reform recipes are unilaterally imposed, pro-status quo forces may weather the storm due to ubiquitous collective action and ownership problems at the domestic arena.

REFORM DYNAMICS IN REACTIVE STATES: A THREE-STAGE FRAMEWORK



Stage 3: Reform and transformation

Based on the complex interaction of state agents, external anchors, and domestic coalitions, two ideal-typical policy paths may arise in the third-stage. First trajectory is the emergence of a dominant narrative, which helps overcome the collective action problems toward a paradigmatic transformation in the existing fisco-financial regime. The narrative match between state agents and external actors, and the creation of new winning coalitions constitute the basic prerequisites to instigate a virtuous cycle of reform activism. Second trajectory is the emergence of multiple crisis narratives, which emanates from state agents' failure in framing coherent crisis narrative and matching it with those of external actors. The emergence of multiple crisis narratives creates enormous fragmentation and provides leeway for pro-status quo forces to reproduce their privileged positions. This sub-optimal equilibrium, in turn, triggers a vicious cycle of blame-games and muddling through. Not surprisingly, as a result, the crisis cannot be exploited as an opportunity to alter pre-crisis institutional arrangements. The following empirical chapters will apply three-stage framework to the Greek and Turkish cases.

Chapter 3. A reactive state in the making: Greece during 1974-2009

3.1. Introduction

This chapter delves into the institutionalization of a reactive Greek state in a neoliberal setting between 1974 and 2009. The post-authoritarian Greece poses striking political economy paradoxes in the sense that notable increase in material wealth accompanied by a secular decline in state capacity.²³⁶ As Triandafyllidou, Gropas, and Kouki put, “material prosperity improved, while painful structural reforms were always delayed or watered down.”²³⁷ Focusing on the mechanisms offered in the first-phase of three-stage framework proposed in chapter 2, I will discuss how reform-biased institutional structures were established and the already existing ones were consolidated in a path-dependent way, and how they, in turn, conditioned inward-looking agency behaviour. Based on my conceptual framework, I seek to provide time and context specific explanations to the main research questions posed in this study. In the following part, I will explicate the evolution of reactive Greek state with reference to three aspects of state capacity between 1974 and 1996. In the third part, turning to Kostas Simitis case, I will investigate why current policy paradigms prevailed despite the emergence of a

²³⁶ Dimitri A. Sotiropoulos, “The Paradox of Non-reform in a Reform-ripe Environment: Lessons from Post-authoritarian Greece,” in Stathis Kalyvas, George Pagoulatos and Haris Tsoukas, eds., *From Stagnation To Forced Adjustment: Reforms In Greece, 1974-2010* (London and New York: Hurst Co. and Columbia University Press, 2012), 9-29. Greece’s long-term GDP per capita performance is striking. According to Penn World Tables Database, (in purchasing power parity terms) per capita income of a Greek citizen was 35 per cent of an American citizen in 1960. This ratio increased to 61 per cent in 2010. Greece’s relative position is also improved in the EU. For instance, GDP per capita in purchasing power parity terms increased from 68 per cent of EU average in 1996 to 90 per cent in 2008.

²³⁷ Anna Triandafyllidou, Ruby Gropas, and Hara Kouki, “Introduction: Is Greece a Modern European Country?” in Anna Triandafyllidou, Ruby Gropas, and Hara Kouki, eds., *The Greek Crisis and European Modernity* (Hampshire: Palgrave Macmillan, 2013), 6.

capable policy entrepreneur and increasing external ‘conditionality.’ In the fourth part, I will discuss the consolidation of reactive Greek state in the post-2000 period with particular emphasis on the EU’s perverse role that further informed reform-inertia in Greece. Following the conceptual framework of this study, I will argue in the final part that existence of reform-oriented agents does not guarantee reform-activism in reactive states, if domestic policy coalitions are not disturbed by profound exogenous shocks and if agents are not informed by institutional-level enabling conditions. To this end, this chapter aims to shed light on the limits of the possible for policy entrepreneurs in non-crisis junctures.

3.2. Emergence of a reactive state (1974-1996)

This section provides a political economy account of the weakening of Greek state’s fisco-financial capacity in a neoliberal setting that gained momentum during post-authoritarian Greece.²³⁸ In reactive states, as I discussed in chapter 2, state remains at the center of perennial who-gets-what struggles among interest groups and state’s relative strength vis-à-vis other domestic/external centres of power tend to be weak. Accordingly, I offer an historical analysis as to why reform-biased equilibrium emerged and consolidated in the post-authoritarian Greece with a central emphasis on the Greek state. The reason for this study to concentrate on post-1974 is twofold. First, the post-1974 posed a new equilibrium as it demarcates the end of military regime and

²³⁸ In this chapter, I will mainly concentrate on third-order (what I call “substantial and sustainable”) fiscal and financial reforms in Greece. To this end, fiscal reforms are not restricted to narrow fiscal consolidation measures. It also includes structural reforms that make fiscal discipline sustainable.

restoration of democracy in Greece. Second, Greek political economy was gradually transformed toward a more neoliberal regime under the auspices of Europeanization and financial globalization imperatives. For these two main reasons, post-1974 period provides fertile avenues to understand the interplay of the agency and institutional-level dynamics that lead to the weakening of Greek state's capacity and subsequent failures of various reform attempts. Following the conceptual framework, this section discusses three major institutional structures that inform Greek state's capacity, i.e., domestic political context, state bureaucracy and dominant policy coalitions.

3.2.1. Domestic political context

First institutional structure that informed Greek state's reform capacity is domestic political context. The end of the Colonels regime in 1974, a military junta that had ruled the country for seven years, opened a new phase in the political economy of Greece.²³⁹ It posed a critical juncture to overhaul established state institutions and craft new ones in line with the changing power balances among political and economic interest groups. However, the new political context gradually underpinned an increasingly polarized and conflict-prone policy-making. The political setting also informed the state bureaucracy and dominant economic policy coalitions in a mutually reinforcing manner. As a matter of fact, Greece made a strikingly quick and peaceful transition to democracy with the

²³⁹ For the political economy of Greece between 1945 and 1974, see M. Fatih Tayfur, *Semiperipheral Development and Foreign Policy: The Case of Greece and Spain* (Aldershot: Ashgate, 2003), 39-72. For an analysis of the junta regime in Greece, see Richard Clogg, *A Concise History of Greece* (Cambridge: Cambridge University Press, 1997), 162-168.

collapse of the military regime.²⁴⁰ Following the fall of the junta, Konstantinos Karamanlis (1907–1998), a veteran statesman and former conservative prime minister from the days before the Colonels, returned from self-imposed exile in France and played maestro role during Greece’s transition to democracy. After being elected as prime minister in November 1974 with a landslide electoral majority around 54 percent of the total votes, Karamanlis demonstrated outstanding political leadership to reconstruct Greece’s institutional architecture. In this regard, three major developments are of particular importance. First, as a sign of clear rupture from the past, Karamanlis ensured the legalization of the Communist Party together with other once-banned leftist parties; threw his political support behind the courts to prosecute junta leaders; and abolished the monarchy in December 1974 plebiscite, with the backing of the 70 percent of population.²⁴¹ Second, Karamanlis secured the parliamentary majority to promulgate a new constitution in June 1975. Third, and most important, Greece became a full member of the then European Economic Community in January 1981, five years earlier in comparison to Spain and Portugal. Clogg argues that Karamanlis skilfully exploited “the feelings of guilt at Europe’s inertia during the dictatorship in Greece,” despite “the doubts [of the European Commission] as to whether [Greece was] yet ready to withstand the competitive rigors of the European market.”²⁴²

²⁴⁰ For Greece’s democratic transition in a comparative perspective with other Southern European countries see, Guillermo O’Donnell, Philippe C. Schmitter, and Laurence Whitehead, eds., *Transitions from Authoritarian Rule: Southern Europe*, (Baltimore: The Johns Hopkins University Press, 1986).

²⁴¹ Dimitri A. Sotiropoulos, “The Authoritarian Past and Contemporary Greek Democracy,” *South European Society and Politics* 15, no. 3, (2010): 450-452.

²⁴² Clogg, *A Concise History of Greece*, 177.

The immediate aftermath of 1974, therefore, provided a critical juncture for Greece to restructure the state-market relations and consolidate Greece's place in Europe. The historical opportunity window, however, could not be exploited to a significant extent in the economic realm.²⁴³ As Tayfur discusses in detail the reform-oriented virtuous cycle emerged during Karamanlis era gradually aligned toward reform-inertia starting from late 1970s,²⁴⁴ which increasingly jeopardized the first aspect of state capacity in Greece. In the post-authoritarian period, political context took the form of 'polarized pluralism' to use Sartori's well-known classification,²⁴⁵ in which two major parties, right-wing New Democracy (ND) and left-wing Panhellenic Socialist Movement (PASOK), dominated the political landscape.²⁴⁶ The two parties' share in total votes remained above 80 percent threshold between 1981 and 2009.²⁴⁷ Except a short interval of coalition governments formed during 1989-1990,²⁴⁸ ND and PASOK have alternated in power with strong one-party majorities in the parliament. In fact, the classical spatial model of party competition suggests that two party systems are more prone to ideological moderation and to the politics of compromise, as both parties tend to have an

²⁴³ In terms of democratization and human rights standards, however, Greece should be perceived as success story like Spain and Portugal.

²⁴⁴ Tayfur, *Semiperipheral Development and Foreign Policy*, 74-82.

²⁴⁵ Giovanni Sartori, *Parties and Party Systems: A Framework for Analysis* (Cambridge: Cambridge University Press, 1976).

²⁴⁶ George Th. Mavrogordatos, "The Greek Party System: A Case of 'Limited but Polarized Pluralism'?" in Stefano Bartolini and Peter Mair, eds., *Party Politics in Contemporary Europe* (London: Frank Cass, 1984), 156-169; Seraphim Seferiades, "Polarization and Non-proportionality: The Greek Party System in the Postwar Era," *Comparative Politics* 19, no.1 (1986): 69-93.

²⁴⁷ Author's calculations based on the official election results released by the Hellenic Parliament, available at <http://www.hellenicparliament.gr/en/Vouli-ton-Ellinon/To-Politevma/Ekloges/Eklogika-apotelesmata-New> (arrived on December 12, 2013).

²⁴⁸ In less than a year, two coalition governments were established: first the die-hard rivals, the Conservatives and Communists formed a coalition government, later a grand coalition was established including Conservatives, Communists (Left Alliance), and Socialists. In 1990, ND led by Constantine Mitsotakis put an end to the short coalition period by succeeding to form a majority government.

incentive to converge at the centre to capture the support of the median voter.²⁴⁹ Accordingly, the moderation of the political parties is potentially a rewarding strategy in bipartism since most of the voters are inclined to stand away from the ideological extremes. Given the fact that political stability and consensus-based policy making is a crucial enabling factor for enhancing state capacity and empowering accommodative state-market relations, two party systems arguably provide a suitable political framework for the institutionalization of a proactive state as well.

The consolidation of PASOK and ND in Greek political context, however, spawned an unusual pattern of cleavage politics that combined two-party competition with conflictual pluralism, which Pappas calls “polarized bipartism.”²⁵⁰ Accordingly, in the Greek case, constituency is kept at the polar opposites of the political spectrum and conflict-driven policy making has become the *modus operandi* of the domestic politics. It is argued that this was an “intentional polarization”²⁵¹ strategy deliberately pursued by the political elite to exploit the state’s fiscal resources single-handedly and distribute it to their supporters in a populist fashion in return for electoral loyalty. It is obvious that the root causes of political polarization and populism can be traced back to the early days of the Greek state.²⁵² Historically, Greece has suffered from multiple national

²⁴⁹ Anthony Downs, *An Economic Theory of Democracy* (New York: Harper, 1957).

²⁵⁰ Takis Pappas, “Why Greece Failed?” *Journal of Democracy* 24, no. 2 (2013): 40-41.

²⁵¹ Ibid. “Intentional polarization” is a frequently employed strategy by the political elites especially in deeply divided societies along sectarian, historical, cultural, and ideological lines. The politics of polarization is also a crucial issue in the Turkish context. The fifth chapter will deal with the impact of political polarization on state’s reform capacity.

²⁵² Clogg argues that patronage politics in Greece was inherited from Ottoman rule and permeated into institutional and political structures of Greek state from the very beginning of state-building process. Clogg, *A Concise History of Greece*, 63.

schisms: In the 19th century the major dividing lines were drawn between ‘traditionalists’ —the seminal political figure was Deliyannis— and ‘modernists’ —the seminal political figure was Trikoupis. In the first quarter of the 20th century, the struggle between liberals —gathered around Venizelos and the royalists —the supporters of monarchy— deeply polarized Greek society. The long-lasting wounds of the Greek Civil War (1946-1949) further polarized the country in the first two decades of the post-WWII period.²⁵³ Thus the historical evolution of cleavage politics in Greece provided fertile grounds for constant reproduction of polarization-induced patronage relations. After the restoration of democracy in 1974, however, political context took a new form in the sense that the post-1974 period exemplifies a qualitative transformation from traditional interpersonal patron-client relations to a group and institution, which is called ‘machine politics.’ Accordingly,

“A political party [becomes] a ‘collective patron’ [in] its relationship with voters... The party machine is fundamentally impersonal and its organizational core is a group, not an individual. Consequently, the political loyalty and identification of voters benefits the party as such, rather than individual politicians.”²⁵⁴

The PASOK period deserves particular attention in this regard. Under Andreas Papandreou’s charismatic leadership,²⁵⁵ PASOK governments (1981-1989) played

²⁵³ For a political and cultural history of modern Greece delineating multiple schisms, see John S. Koliopoulos and Thanos M. Veremis, *Modern Greece: A History Since 1821* (Oxford: Wiley-Blackwell, 2010).

²⁵⁴ George Th. Mavrogordatos, “From Traditional Clientelism to Machine Politics: the Impact of PASOK Populism in Greece,” *South European Society and Politics* 2, no. 3 (1997): 2.

²⁵⁵ For a detailed account of the “passions and prospects that incited Papandreou” before he rose to power as a charismatic political leader, see Stan Dreanos, *Andreas Papandreou: The Making of a Greek Democrat and Political Maverick* (London: I. B. Tauris, 2012).

instrumental role in the consolidation of a reactive Greek state over the 1980s. As Kalyvas argues, Papandreou opted for not mere polarizing rhetoric but an “instance of polarized politics” that has long-lasting implications on political context in Greece.²⁵⁶ PASOK positioned itself as the representative of middle and lower strata of society, which Papandreou himself called “the people” against “privileged” establishment, whose legitimate representation had been thwarted in the past. Exploiting the historical cleavages of the country, Papandreou championed the left-wing populist policies and portrayed the society “as being split by the fundamental division between an all-embracing ‘non-privileged’ majority, which he claimed to stand for, and a tiny ‘privileged’ oligarchy, representing foreign interests and domestic monopolies, which were identified as the enemy.”²⁵⁷ Along these lines, expansionary distributive outlook guided the social and economic policies of PASOK governments to consolidate party’s electoral base.

First, PASOK initiated new economic plans to underpin welfare state practices in the sectors such as healthcare, social security, and education to incorporate the previously excluded middle and lower strata of Greek society. In fact, by challenging the social base of the economic system that condition state-market relations, Papandreou aimed at changing the underlying power structures of and state’s position in the Greek political economy. What he had in mind was a radical reformation of the Greek economic

²⁵⁶ Stathis N. Kalyvas, “Polarization in Greek Politics: PASOK’s First Four Years, 1981-1985,” *Journal of the Hellenic Diaspora* 23, no. 1 (1997): 83-104.

²⁵⁷ Christos Lyrintzis, “PASOK in Power: From ‘Change’ to Disenchantment” in Richard Clogg, ed., *Greece, 1981-1989: The Populist Decade* (London: The Macmillan Press, 1993), 29.

structures. He unearthed this aim clearly in his speech when he first appeared in Greek Parliament as prime minister on November 22, 1981:

“Our basic target is a self-sufficient economic and social development, using all the productive forces in combination with a fairer distribution of the national income and wealth... We seek the gradual reform of the structures of the economy so that the basic economic choices are made by the society as a whole. The strategic sectors of the economy must come under substantial social control without overlooking the positive role of private initiative. The crisis in the capitalist system on a world scale, with ever-increasing unemployment and inflation, intensified international competition, the increase in the degree of concentration and the monopolistic structure of many branches, have made the traditional means of economic policy ineffective.”²⁵⁸

It was not coincidence that his election motto, *Allaghi* (change), touched a sensitive chord in the hearts and minds of ordinary Greek citizens. However, the uncontrolled expansion of state’s fiscal reach created widespread inefficiency and accumulation of new structural economic problems in the medium-term, despite expansionary welfare policies proved beneficial for the well being of society in the short-run.²⁵⁹ The accumulation of fiscal problems during the 1990s and 2000s mostly emanated from the bankrupted pension system, social security system, and inefficient public sector practices that were institutionalized in this period (see below). Second, as a respected Harvard trained heterodox economics professor,²⁶⁰ Papandreou pursued a rather

²⁵⁸ Quoted in Theodore C. Kariotis, “Andreas G. Papandreou: The Economist,” *Journal of the Hellenic Diaspora* 23, no. 1 (1997): 52.

²⁵⁹ Christos Lyrintzis, “PASOK in Power: From ‘Change’ to Disenchantment,” 27.

²⁶⁰ For a comprehensive review of Papandreou’s professional ideas on economics discipline with particular emphasis on his outlook on the Greek economy, see Theodore C. Kariotis, “Andreas G. Papandreou: The Economist,” *Journal of the Hellenic Diaspora*.

aggressive developmental strategy, especially in the first term of his premiership.²⁶¹ His economic narrative relied on the assumption that the weakness, short-term and speculative character of Greek big business, which based their performance on state-dependent subsidies and assistance lead to the rent seeking and underdevelopment of Greek economy.²⁶² Thus he targeted the small and medium sized entrepreneurs, cooperatives, and the public sector as the engines of Greece's economic development.

PASOK governments designed a set of supply-side initiatives by providing lucrative subsidies, incentives, and fiscal support to the targeted firms in the private and public sectors. A new piece of legislation (Law 1262/1982) was enacted that identified the policy instruments, incentives, and subsidies, according to which state support would be utilized.²⁶³ Yet, these reform initiatives hardly got off the ground as public money could not be channelled into the productive capacity-enhancing investments due to populist stimuli and resistance of inward looking economic policy communities. During the 1980s, state was controlling four-fifths of the total credits extended by the Greek financial system and, according to OECD reports, these credits were distributed without any particular attention to the banking and financial criteria.²⁶⁴ Since discretionary politics guided state's fiscal and financial behaviour, political privileges rather than efficiency became the main criterion in the distribution of state subsidies and bank

²⁶¹ Ten years before his premiership Papandreou published his magnum opus, in which he dealt with developmentalist planning in capitalist economies. See Andreas Papandreou, *Paternalistic Capitalism* (Minnesota: The University of Minnesota Press, 1972).

²⁶² Euclid Tsakalatos, "The Political Economy Of Social Democratic Economic Policies: The PASOK Experiment In Greece," *Oxford Review of Economic Policy* 14, no. 1 (1998): 117.

²⁶³ Kostas Lavdas, *The Europeanization of Greece* (London: Palgrave Macmillan, 1997), 151-152.

²⁶⁴ Quoted in Tayfur, *Semiperipheral Development and Foreign Policy*, 96-97.

credits. This paved the way for the gradual consolidation of a sub-optimal path that informed economic actors to opt for effortless gains. At the turn of the decade, therefore, state's fiscal balances were deteriorated substantially, a point I will discuss in detail below.

The alternation of two populist parties in power in the post-authoritarian Greece informed the main contours of political context in which the ruling party in each term has seized lucrative opportunities to control and distribute state rents to their supporters, as par excellence examples of machine politics. The voters, on the other side of the coin, have experienced and rationalized that “the state was up for grabs and that it was better to associate with the state through party contacts rather than venture into the market through competition.”²⁶⁵ They also internalized the rules of the game in the sense that their attachment to one of the two main parties would enable them to have rewarding opportunities when “their parties” would return to power.²⁶⁶ As Sotiropoulos put in his interview with the author, this mode of exchange relations between parties and their supporters nurtured a different kind of legitimacy culture in the eyes of domestic constituency that constantly undermined a rule-based and long-term oriented policy-making behaviour:

“In Greece, owing to polarized political system, political legitimacy is not limited to an understanding of parliamentary politics. It is understood as constant, unpredictable, and fluid day-to-day approval or disapproval of

²⁶⁵ Pappas, “Why Greece Failed?”, *Journal of Democracy*, 42.

²⁶⁶ *Ibid.*

governments... Legitimacy in the minds of Greeks [is] something daily contested [depending on the degree of favours they received from political elite] regardless of the strength of the governments.”²⁶⁷

In this institutional context, not surprisingly, politics was conceived as zero-sum-game so that the incumbent state agents did not prioritize issue-based consensus-seeking attempts. Instead, the political agenda was permeated by pervasive party factionalism. As a result, more often than not, the urgently needed economic reforms were pushed back.²⁶⁸ The political context also generated negative feedback mechanisms beyond political sphere, which in turn weakened Greek state’s internal and external capacities. On the internal aspect, uncontrolled populism permeated state administration in a way that jeopardized bureaucratic autonomy and meritocracy. On the external aspect, political setting and accompanied state policies motivated domestic policy coalitions to opt for a rentier mode of behaviour.

3.2.2. State bureaucracy

Second institutional structure that informed Greek state’s reform capacity is state bureaucracy. State capacity literature suggests that meritocratic and insulated bureaucracy characterized by embedded autonomy improves state’s reform credentials significantly. The Greek bureaucracy, however, did not approximate to these qualities during the period in question. In retrospect, Greek state’s internal capacity could not be

²⁶⁷ Interview with Dimitris Sotiropoulos, Advisor to Lucas Papademos, June 24, 2014.

²⁶⁸ Dimitri A. Sotiropoulos, “The Remains of Authoritarianism: Bureaucracy and Civil Society in Post-Authoritarian Greece”, *Cahiers d’Etudes sur la Méditerranée Orientale et le monde Turco-Iranien*, no. 20 (1995): 2.

empowered because state bureaucracy increasingly became “a focus of discord, an arena of intense political party competition.”²⁶⁹ All three dimensions of state’s bureaucratic capacity indicated secular decline in the Greek case. First, the public sector expanded in an uncontrolled and unplanned manner over the years. Since state was conceived as an arena to be captured by rival political parties, the governments approached the public bureaucracy through the lens of political patronage, which Lyrintzis called “bureaucratic clientelism.”²⁷⁰ In early 1980s, the Greek state was relatively small in size, employing about 510,000 people out of a population then numbering about ten-million. During PASOK governments (1981-1989) total public-sector employment reached 786,200 by 1990, an increase of more than 50 percent in a decade.²⁷¹ Between 1975 and 1990, the Greek public sector as a percentage of overall economy expanded from 35 per cent to almost 60 percent, four-fifths of which belongs to the 1980s,²⁷² a period frequently labelled as “populist decade” under the premiership of Andreas Papandreu (see above).²⁷³ Informed by long-lasting historical practices, governments used public sector and state bureaucracy for the allocation of spoils and favours to consolidate their electoral base. Lyrintzis puts the issue as follows:

“In a country where the state has always played a crucial social and economic role, it was relatively easy for a well organized party to become a collective

²⁶⁹ Dimitri A. Sotiropoulos, “A Description of the Greek Higher Civil Service,” in Edward C. Page and Vincent Wright, ed., *Bureaucratic Elites in Western European States* (Oxford: Oxford University Press, 1999), 28.

²⁷⁰ Christos Lyrintzis, “Political Parties in Post - junta Greece: A Case of ‘Bureaucratic Clientelism?’,” *West European Politics* 7, no. 2 (1984): 99-118.

²⁷¹ Pappas, “Why Greece Failed?,” *Journal of Democracy*, 38.

²⁷² Quoted in George Pagoulatos, “Economic Adjustment and Financial Reform: Greece’s Europeanization and the Emergence of a Stabilization State,” *South European Society and Politics* 5, no. 2 (2000): 193.

²⁷³ Richard Clogg, ed., *Greece, 1981-1989: The Populist Decade* (London: The Macmillan Press, 1993).

patron by using an intricate combination of party mechanisms and state structures. Needless to say, the overlapping of party and state structure is at the expense of the efficiency, modernization, and rationalization of the public sector [and state bureaucracy]. The proliferation of parasitic jobs and the creation of numerous state-controlled agencies exemplify the logic of organized and bureaucratic patronage.”²⁷⁴

The expansionary practices exercised during the 1980s remained intact in the aftermath. As a result, except a short anti-populist interval in the late-1990, the total number of public employment finally reached to around 984,000 before 2009 economic crisis, a point I will revisit below.²⁷⁵ The reallocation of resources to inefficient public sector and the political motivations behind public sector appointments not only jeopardized public finances but also deteriorated the public-private balance that business community frequently criticized. Hellenic Federation of Enterprises (SEV) president, Theodore Fessas, indicated this point as follows:

“The generous employment terms offered by a public sector led to a massive reallocation of the workforce from productive activities to the increasingly inefficient public sector. Over decades this public sector kept increasingly complex bureaucracy, legal ambiguity and institutional instability. The resulting corruption also kept increasing even while the balance between the financing needs of the public sector, and private sector that catered the public sector, kept deteriorating.”²⁷⁶

²⁷⁴ Lyrintzis, “PASOK in Power: From ‘Change’ to Disenchantment,” 32-33.

²⁷⁵ OECD, *Greece: Review of the Central Administration* (Paris: OECD Publications Service, 2012), 71.

²⁷⁶ Interview with Theodore Fessas, President of SEV, June 24, 2014.

In fact, contrary to the popular arguments, the size of the Greek state per se does not pose a problem.²⁷⁷ One may even argue that the size of Greek state has always been reasonable in comparison to other OECD members.²⁷⁸ The state capacity literature also suggests that sizeable public sector may even be an advantage for state's transformative, regulatory, and distributive credentials as it turns out to be the case in Nordic countries.²⁷⁹ Greece, however, suffers from the lack of bureaucratic meritocracy and embedded autonomy, which brings us to the second aspect of Greece's internal state capacity. The single most important variable that informed the degree of meritocratic credentials in state bureaucracy has been the political context that paved the way for politically motivated discretionary recruitments. More often than not, "political friends looking-for-jobs" have been appointed to key managerial positions at the fiscal and financial echelons.²⁸⁰ As documented in comparative studies, over-politicized recruitments and appointments have taken place both "at the bottom" and "at the top" of the Greek state bureaucracy.²⁸¹ First, the absorption of new personnel was actualized through bypassing the competitive meritocracy-based entrance systems.²⁸² Therefore, loyalty, rather than meritocracy and technical capacity had become the main selection

²⁷⁷ For an example to this line of explanation, see Christopher Humphrys, "A Tragedy Long in the Making," *The Telegraph*, June 24, 2011.

²⁷⁸ According to OECD data, Greece has the 10th largest state measured in terms of the employment in public sector in comparison to total labour force in 2008. Author's calculation based on the data obtained from OECD databases.

²⁷⁹ According to the OECD data, employment in general government and public corporations as a percentage of the labour force is more than 30 per cent in Norway and Denmark, and it is more than 23 per cent in Finland.

²⁸⁰ Tayfur, *Semiperipheral Development and Foreign Policy*, 105.

²⁸¹ Dimitri A. Sotiropoulos, "Southern European Public Bureaucracies in Comparative Perspective," *West European Politics* 27, no. 3 (2004): 411.

²⁸² Dimitri A. Sotiropoulos, "The Two Faces of Politicization of the Greek Civil Service: The Case of Contemporary Greece," in Guy Peters and John Pierre, ed., *Politicization of the Civil Service in Comparative Perspective: The Quest for Control* (London: Routledge, 2004): 256-265.

criterion. Second, key bureaucratic posts were dominated by ‘top down’ clientelism.²⁸³ Thus the higher echelons of fiscal bureaucracy had virtually no autonomy to impose budget discipline or challenge policy makers if they perceived the political requests deleterious for state’s fiscal performance. Various OECD reports assert “that political criteria have tended to weight heavily on promotions, [which in turn] discouraged the recruitment of talented personnel.”²⁸⁴ In short, both the higher echelons and entry-level positions are predominantly linked with political parties that lead to the gradual deterioration of the bureaucratic autonomy at all levels and policy realms. Sotiropoulos bluntly puts “that the Greek public administration render service, for the most part [...] to its elected political masters, to the governing political party, and to favoured clienteles among prospective voters.”²⁸⁵ The lack of autonomy impeded state’s internal capacity to initiate and supervise economic reform measures in corporation with political executive and non-state economic interest groups. In one of my interviewees’ words, as a result, Greece could not develop an “institutional memory” to initiate and supervise competitiveness-enhancing reforms:

“Fiscal and financial bureaucracy in Greece remained quite weak. State bureaucracy does not have an institutional memory because all of the [economic] ministerial positions are replaced with the change of the governments and there is very little in-house expertise. So it is impossible for the administration itself to

²⁸³ Ibid.

²⁸⁴ OECD, *Economic Surveys, Greece: 1990-1991* (Paris: OECD Publications Service, 1991), 63. It is interesting to note that OECD report in 2011 underlines almost the same point regarding fiscal bureaucracy in Greece. OECD, *Economic Surveys, Greece: 2011* (Paris: OECD Publications Service, 2011), 90. The report also makes references to the previous reports proposing the same recommendations.

²⁸⁵ Sotiropoulos, “A Description of the Greek Higher Civil Service,” 29.

produce reform ideas and to respond to [adjustment necessities in conjunction with societal actors].²⁸⁶

Third, Greek state's internal capacity was also severely constrained due to policy fragmentation and incoherence. This is mainly because of the frequent changes in policy competencies with the alternation of governments and inter-ministerial rivalries even within the same governments. Bureaucratic positions were reshuffled, deactivated and/or new ones were created with not respect to organizational coherence and insulation.

George Pagoulatos, chief advisor to Lucas Papademos, underlined this point as follows:

“At the top-level [there is] intra-governmental disputes, feudalization, and departmental patriotism. Most of the time, reforms promoted by finance ministry and opposed by other ministries [and bureaucratic circles]. The intra-bureaucratic fragmentation also played a very important role [in reform-failures]... The lack of state capacity, in this sense, created a tendency to the procrastination of painful reforms [due to] incoherence and inter-ministerial discontinuity.”²⁸⁷

OECD surveys also reveal that the inter-ministerial cooperation in Greek economic bureaucracy remained very low and subject to ad hoc mechanisms.²⁸⁸ Thus bureaucratic feudalization posed considerable stumbling blocks in terms of meticulous formulation and cogent implementation of long-term oriented economic reforms.²⁸⁹ Literature suggests that a significant number of reform initiatives constantly failed because the relevant public bureaucracy was incapable of coordinating and steering reform proposals

²⁸⁶ Interview with Dimitris Papadimitriou, Professor of Political Science, University of Manchester, June 18, 2014.

²⁸⁷ Interview with George Pagoulatos, Senior Advisor to Lucas Papademos, June 24, 2014.

²⁸⁸ OECD, *Greece: Review of Central Administration*, 51.

²⁸⁹ For example, for the ministry of finance alone, 2,890 competency changes through laws, 11,018 changes through presidential decrees, and 3,191 changes through ministerial decrees have taken place between 1996 and 2011. It refers to 1,140 changes of government competencies per year. Ibid.

prepared by expert committees. Monastiriotes and Antoniadis demonstrate that fiscal bureaucracy in Greece remained fragmented and parochial so that it could not overcome coordination problems in its relations with expert communities despite the fact that countless reform initiatives had taken place in the post-authoritarian era.²⁹⁰ In his interview with the author, Monastiriotes underscored this problem as follow:

“Weak public administration is one of the obstacles for effective design and implementation of economic reforms... It is not only reform-resistant vested interests, [but Greece] also has a problem of ‘reform technology’ in the sense of identifying, coordinating and implementing [feasible] reforms [in the Greek context]. The expertise could not be sufficiently cultivated and used by Greek economic bureaucracy.”²⁹¹

Similarly, Greek state —i.e., the executive authority— lacks competence and capacity to pose common policy-making vision to the relevant ministries, including fiscal and financial issues. Featherstone and Papadimitriou define this fragmentation as “solitary centres amid a segmented government.”²⁹² OECD surveys also underscore “that information sharing, co-ordination and integrated approach to policymaking are seriously remained deficient in the Greek fiscal administration.”²⁹³ In short, the evidence suggests that all three aspects of Greek state’s internal capacity suffered certain deficiencies and setbacks in a downward trend between 1980 and 1996, which further jeopardized in the post-2000 period.

²⁹⁰ Monastiriotes and Antoniadis, “Reform That! Greece's Failing Reform Technology,” 31-47.

²⁹¹ Interview with Vassilis Monastiriotes, Professor of Political Economy, LSE, May 20, 2014.

²⁹² Kevin Featherstone and Dimitris Papadimitriou, “The Emperor Has no Clothes: Power and Resources within the Greek Core Executive,” *Governance* 26, no. 3 (2013): 523-545.

²⁹³ OECD, *Greece: Review of Central Administration*, 54.

3.2.3. Dominant policy coalitions

Third institutional structure that informed Greek state's reform capacity is dominant policy coalitions. State capacity literature proposes that state's mode of relations with major economic interest groups is crucial in informing state's reform performance. I proposed in chapter 2 that dominant policy coalitions and their interaction patterns with the state constitute the external aspect of state capacity. In the Greek case, the political context not only undermined reformist outlook of the state bureaucracy but also informed the main features of the interest intermediation structures. Lavdas asserts that the mode of relationship between state, trade unions, and business associations reflect "disjointed corporatism"—lacking compromise, trust, and rule-based dialogue.²⁹⁴ Accordingly, disjointed corporatism denotes "the combination of a set of corporatist features and a prevailing political modality that lacks diffuse reciprocity and remains incapable of brokering social pacts."²⁹⁵

There are two strands to the argument. On the one hand, the 'corporatist' element indicates strong state tradition capable of influencing the market dynamics thanks to buoyant fisco-financial resources and lucrative arrangements at the disposal of the state. Historically, Greece's semi-peripheral integration to world economy provided institutional and ideational background for the state to possess a dominant role in Greek

²⁹⁴ Lavdas, *The Europeanization of Greece*, passim.

²⁹⁵ Ibid., 17.

political economy.²⁹⁶ Yet, Greek state's mode of economic intervention significantly diverged from the corporatist models of the western European states. Similar to other reactive states, Greek state's market interventions reflect an incoherent, spasmodic, and discretionary tendency mostly resulted in unproductive outcomes; thereby fell short of steering sustainable reform-activism.²⁹⁷ On the other hand, state's relations with economic interest groups reflect a 'disjointed' nature due to the lack of institutionalized negotiated relationship ('governed interdependence' in state capacity terminology) and limited ability of peak economic organizations to commit and ensure the compliance of their members. For the purposes of this study main peak associations on the labour side are the General Confederation of Labour (GSEE), the Confederation of Public Servants (ADEDY); on the capital (employers) side is the Hellenic Federation of Enterprises (SEV).

In the Greek case, similar to other reactive states, main interest groups' interactions with the state have traditionally been adversarial, fragmented and loop-sided. The literature suggests that weak civil society and low social capital has been the main aspects of state-society relations starting from the very commencement of the Greek state.²⁹⁸ Thus interest groups remained relatively weak vis-à-vis the state so that non-state actors suffer

²⁹⁶ Tayfur discusses the central importance of state in semi-peripheral political economies with special reference to Greek and Spanish cases. See Tayfur, *Semiperipheral Development and Foreign Policy*, 6-7, 39-40, and passim. Also see Nicos Mouzelis, *Modern Greece: Facets of Underdevelopment* (London: Palgrave Macmillan, 1978).

²⁹⁷ Chardas, "State Capacity and 'Embeddedness' in the Context of the European Union's Regional Policy: The Case of Greece and the Third Community Support Framework (CSF)," *Southeast European and Black Sea Studies*, 226-228.

²⁹⁸ Nikiiforos P. Diamandouros, "Cultural Dualism and Political Change in Postauthoritarian Greece," Working Paper no. 1994-50, Centro de Estudios Avanzados en Ciencias Sociales, Instituto Juan March de Estudios e Investigaciones, 1994.

from Olsonian collective action problems in articulating, promoting and defending their autonomous interest through interactive intermediation structures. They also suffer from internal fractionalization, norms of reciprocity and commitment problems due to the lack of social capital and general trust.²⁹⁹ This historical and socio-political background —once informed by polarized political context— magnified power asymmetries in state-labour and state-capital relations during neoliberal globalization.³⁰⁰ I stated previously that, in the post-authoritarian democratic environment, the political parties replaced the traditional interpersonal patron-client linkages with machine politics. Accordingly, similar to the patronage-induced politics-bureaucracy interactions, unidirectional and top-down imposition of policy decisions permeated state-labour and state-capital relationships. In terms of the labour unions, an almost entirely state-dependent relationship dominated the policy-making processes during post-1974. Accordingly, the labour unions were subject to party control and patronage politics, as a result of which institutional reciprocity was jeopardized during 1980s. Therefore, as Mavrogordatos deciphers:

“Unions in Greece have served as Trojan Horses of PASOK populism and clientelism. This is due primarily to their complete penetration or even substitution by the corresponding specialized party organizations. The process was spearheaded by PASOK’s own organization (PASKE) and perpetuated by

²⁹⁹ Greece is reported to be one of the worst performing EU countries hardly better than Lithuania Romania, Bulgaria, and Poland. For a review, see Nikoleta Jones, Chrisovaladis Malesios, Theodoros Iosifides & Kostas M. Sophoulis, “Social Capital in Greece: Measurement and Comparative Perspectives,” *South European Society and Politics* 13, no. 2 (2008): 175-193.

³⁰⁰ In addition to various attempts in the first half of the 20th century, the two military coups (1936-1941, 1967-1974) and the bloody civil war (1946-1949) significantly deteriorated the social fabric with long-lasting divisions and trust problems in civil society.

PASOK legislation imposing proportional representation as the compulsory electoral system in trade union elections.”³⁰¹

Historical records suggest that trade unions have suffered from frequent and direct state interventions mainly thanks to strong state tradition in Greece.³⁰² Labour union activity had been subject to state control through a series of supervisory laws that constrained unions’ financial independence, decision-making autonomy, and bargaining capacities.³⁰³ However, post-authoritarian period brought a qualitative transformation in state-labour relations as machine politics became much more pervasive. In this context, Tsarouhas underscores that the imposition of ‘proportional representation’ in the elections of the GSEE and ADEDY presidencies as a clear illustration of Greek state’s patronage motivations during 1980s.³⁰⁴ Proportional representation provided new tools to resurrect and perpetuate populist practices of the past in a more radical fashion since it enabled PASOK governments to control unions by “thinly-disguised party lists.”³⁰⁵ Schmitter, in his comparative study of state-labour relations in southern Europe underlines the over-politicized nature of union activity in Greece: “Parties, especially PASOK after it took over in 1981, have made concerted efforts to penetrate and capture

³⁰¹ Mavrogordatos, “From Traditional Clientelism to Machine Politics,” *South European Society and Politics*, 21.

³⁰² For a detailed historical account see Christos Ioannou, *Trade Unions in Greece: Development, Structures and Prospects* (Athens: Friedrich Ebert Foundation, 1999).

³⁰³ Christos Ioannou, “From Divided ‘Quangos’ to Fragmented ‘Social Partners’: Explaining the Absence of Mergers”, in Waddington Jeremy, ed., *Restructuring Representation: The Merger Process and Trade Union Structural Development in Ten Countries* (Brussels: P.I.E-Peter Lang, 2005), 150-151.

³⁰⁴ Dimitris Tsarouhas, “Social Partnership in Greece: Is There a Europeanization Effect?”, *European Journal of Industrial Relations* 14, no. 3 (2008): 358.

³⁰⁵ For a detailed examination of proportional representation, and its role in furthering patronage politics in the unions, see George Th. Mavrogordatos, “Civil Society under Populism,” in Richard Clogg, ed., *Greece, 1981-1989: The Populist Decade* (New York: St. Martin’s Press, 1993), 47-64.

leadership positions [in labour unions].”³⁰⁶ The party competition inside the unions further aggravated in time as the alternating ND and PASOK governments followed the suit, a point I will return below. Thus labour unions turned into inefficient actors that help the formulation and implementation of concerted economic reforms. In addition to the over-politicization problematique, the fragmented internal organization of peak labour organizations also hampered reform-activism. At first glance, as Secretary General of GSEE argued during the interview that labour unions appear unitary at the peak level since two unions represent the entire working class in Greece:

“Opposite to many other European countries, there is no ideological and organizational fragmentation among trade unions in Greece. The main organizational [and functional] division is between two peak associations, namely, ADEDY and GSEE, which represent the civil servants and private sector workers, respectively.”³⁰⁷

Greek trade unions, however, are characterized by intra-fractionalization that tends to underpin collective action and credibility of commitment problems as highlighted by the state capacity framework. The GSEE, for example, accompanied by more than 7,000 primary (individual organizations and local branches) and more than 100 secondary (federations and labour centres) level units, which “operate independently of any links with the higher levels.”³⁰⁸ ADEDY also depicts very similar characteristics. Accordingly, ADEDY includes a total of 1,264 primary-level units, organized in 52

³⁰⁶ Philippe C. Schmitter, “Organized Interests and Democratic Consolidation in Southern Europe,” in Richard Gunther, Nikiforos P. Diamandouros, Hans-Jürgen Puhle, eds., *The Politics of Democratic Consolidation: Southern Europe in Comparative Perspective* (Baltimore: Johns Hopkins University Press, 1995), 293.

³⁰⁷ Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014.

³⁰⁸ Kostas Lavdas, “Interest Groups in Disjointed Corporatism: Social Dialogue in Greece and European ‘Competitive Corporatism’”, *West European Politics* 28, no. 2 (2005): 302.

federations³⁰⁹ As a result, as one of my respondents, the Greek Deputy Ombudsman, underlined the over-politicized, fragmented and state-dependent nature of labour unions create insurmountable challenges to any kind of substantive social dialogue and cooperation-based economic policy-making.³¹⁰

On the capital side, Lavdas argues that the Greek business presents a contrast to labour unions because major business organization, Hellenic Federation of Enterprises (SEV), enjoyed relative autonomy vis-à-vis the Greek state. However, the dominant mode of the relationship between the state and SEV had generally been antagonistic and conflictual.³¹¹ In the post-1974 period, Andreas Papandreou's anti-capitalist and anti-European rhetoric, aggressive nationalization attempts, and expansionary fiscal policies pushed state-business relations into a slippery slope, particularly during the first half of 1980s. SEV overtly condemned the government's economic policies whilst Papandreou "responded publicly [and] accused businessmen of making use of semi-legal methods, manipulating public work contracts, defrauding public funds, and misusing investment loans."³¹² In the 1990s, PASOK's changing discourse toward the EU and its softened tone regarding the economic liberalization demands paved the way for relative normalization in state-business relations during the Simitis leadership (see below).

³⁰⁹ Ioannou, "From Divided 'Quangos' to Fragmented 'Social Partners': Explaining the Absence of Mergers," 146.

³¹⁰ Interview with Christos A. Ioannou, Greek Deputy Ombudsman and Mediator and Arbitrator with the Organization for Mediation and Arbitration in Greece, June 26, 2014. Also see Christos Ioannou, "Odysseus or Sisyphus Revisited: Failed Attempts to conclude Social-liberal Pacts in Greece", in Philippe Pochet, Maarten Keune, and David Natali, eds., *After the Euro and Enlargement: Social Pacts in the European Union* (Brussels: Observatoire Social Européen & ETUI, 2010), 83-108.

³¹¹ Lavdas, "Interest Groups in Disjointed Corporatism," *West European Politics*, 302-303, 307.

³¹² Tayfur, *Semiperipheral Development and Foreign Policy*, 95.

However, the ‘disjointed’ nature of state-business relations remained almost intact because reciprocal policy-making mechanisms could not be established.³¹³ In author’s interview, honorary president of the SEV, Dimitris Daskalopoulos, underlined this point rather bluntly:

“Most Greek governments [did not consult to business elite in Greece] and never established institutional consultation of the period after 1974: they were reluctant to consult with the top employers’ organization of Greece lest they be accused of promoting the interests of business!”³¹⁴

On the other side of the coin, business elites associated with SEV also exploited state lucrative funds and subsidies rather than pushing for competition-enhancing reforms. Furthermore, SEV failed to encompass individual firms and local associations so that it also suffered from collective action problems despite the fact that it was more successful in terms of the organizational coherence and interest representation in comparison to the labour class.³¹⁵ The limited representative capacity of the SEV provided ample room for various small rent-seeking interest groups (‘pockets of inefficiency’ in state capacity terminology), which “draw a significant advantage from their small size, as they do not contain free riders that could undermine their agenda or fail to contribute actively to their interests.”³¹⁶ More than 130 professions, for instance, were shielded from real

³¹³ Orazio Lanza and Kostas Lavdas, “The Disentanglement of Interest Politics: Business Associability, the Parties, and Policy in Italy and Greece,” *European Journal of Political Research* 37, no. 2 (2000): 203-235.

³¹⁴ Interview with Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014.

³¹⁵ Dimitris Tsarouhas, “Social Partnership in Greece: Is There a Europeanization Effect?,” *European Journal of Industrial Relations* 14, no. 3 (2008): 359.

³¹⁶ Theodore Pelagidis and Michael Mitsopoulos, *Understanding the Economic Crisis in Greece: From Boom to Bust* (Hampshire: Palgrave Macmillan, 2011), 8.

external and domestic competition.³¹⁷ Nevertheless, state-business relations were not always confrontational. The initial antagonistic relationship between PASOK government and Greek business elite in early 1980s was gradually transformed into a kind of mutual dependence in the second half of the decade.³¹⁸ The emergent relationship, however, did not empower the capacity of the state to steer business communities. During 1980s, Greek state extended almost half of all grants and subsidies to uncompetitive rent-seeking finance capital mainly for political patronage motivations.³¹⁹ In this sense, financial system played crucial intermediary role in cementing the sub-optimal equilibrium in state-business relations. Tridimas reports that Greek financial sector funded three-quarters of the bloating public sector borrowing requirements during the Papandreou period.³²⁰ Greek governments forced oligopolistic banking system to invest more than half of their assets in treasury bonds issued by the state, which in turn was used to shore up state's fiscal profligacy.³²¹

In the 1990s, rising tide of neoliberal globalization and the EU's single market regulations created external pressures to liberalize Greek financial system. Accordingly, Greece removed all short- and long-term restrictions on the capital movement as of 1994 along with the introduction of a more flexible and simplified regulatory framework (see

³¹⁷ Pappas, "Why Greece Failed?", *Journal of Democracy*, 38.

³¹⁸ Lavdas, *Europeanization of Greece*, 170-185.

³¹⁹ Tayfur, *Semiperipheral Development and Foreign Policy*, 96.

³²⁰ George Tridimas, "Greek Fiscal Policy and the European Union," in Kevin Featherstone and Kostas Ifantis, eds., *Greece in a Changing Europe: Between European Integration and Balkan Disintegration* (Manchester: Manchester University Press, 1996), 63.

³²¹ *Ibid.*

below).³²² The financial liberalization, however, materialized in an unfavourable institutional context; thereby further informed the fisco-financial profligacy due to two main reasons. First, oligopolistic structure of the Greek banking system was not overhauled before liberalization took place. Thus the share of state-controlled banks (SCB) remained relatively high in the financial system. In a clientelistic political economy structure devoid of regulatory checks-and-balance mechanisms, ‘bad credits to good friends’ turned into business-as-usual practices. As Pagoulatos points out, “the SCB acted like a second state budget and excessive ambiguity and lack of transparency surrounded the financial give-and-take between governments and state-controlled banks.”³²³ The SCB also served as political elites’ backyards for patronage appointments and electoral purposes. Starting from early 1980s, the competitive entrance exams to the state banks, similar to fiscal bureaucracy, were de facto abolished by the ruling political elite.³²⁴ Not surprisingly, as a result, the SCB bloated with non-qualified personnel. Mavrogordatos reports that state banks could operate with only half of their personnel in this period.³²⁵

Second, increasing public debt ratios generated crowding out effects by encouraging rent-seeking motivations of the private finance capital. The combination of state’s fiscal profligacy and uncontrolled liberalization of the state-dominated financial system created a dangerous policy mix: On the one hand, Greek governments increasingly relied

³²² OECD, *Economic Surveys, Greece: 1992-1993* (Paris: OECD Publications Service 1993), 36-39.

³²³ Pagoulatos, *Greece’s New Political Economy*, 114.

³²⁴ Mavrogordatos, “From Traditional Clientelism to Machine Politics,” *South European Society and Politics*, 9-12.

³²⁵ *Ibid.*, 10.

on treasury bills yielding attractive real interest rates to finance swelling public deficits. On the other hand, financing Greek treasury opened up ample opportunities private finance capital because of the risk-free gains extracted through treasury bills and high intermediation commissions.³²⁶ Moreover, close connections between industrial and financial elite and their deeply entrenched give-and-take relationships with the state exacerbated the problems in the fisco-financial system. In exchange for funding the governments, major Greek banks received privileges to enter into profitable public sector projects in very favourable terms and conditions during 1980-1996.³²⁷ It is true that the state's share in the financial system substantially reduced after a series of privatization waves during the EMU process under intense pressures of the European Commission to adapt EU Banking Directives.³²⁸ However, the ominous give-and-take relationship between the state and private interest groups reproduced itself by other means, a point to which I will turn back later.

3.3. Summing up: A self-reinforcing vicious cycle

The discussion so far illustrates that state's reform capacity has been jeopardized in a path-dependent and self-reinforcing pattern in all three aspects between 1980 and 1996. First, domestic political context, based on polarized bipartite competition, posed insurmountable barriers to foster sustainable reform-activism. As Spanou and Sotiropoulos succinctly underline:

³²⁶ Pagoulatos, *Greece's New Political Economy*, 147.

³²⁷ *Ibid.*, 147-148.

³²⁸ For a detailed list of the EU Banking Directives, see Ralph C. Bryant, Nicholas C. Garganas and George S. Tavlas, eds., *Greece's Economic Performance and Prospects* (Athens: Bank of Greece Printing Works, 2001): 85-91.

“The features of the political system have influenced state reform that was systematically conducted in a conflictual environment, failing to achieve consensus and falling victim to party competition. While state reform has constantly been on the political agenda, policies and measures taken by one government would be discontinued or dismantled by the next one in power.”³²⁹

The political context, imbued with uncontrolled populism and intentional polarization, weakened both internal and external aspects of the state capacity. On the internal side, loyalty to political parties rather than meritocracy had become the main currency in state bureaucracy. Not surprisingly as a result, public administration became “colossus with feet of clay” entangled by vested interests.³³⁰ Similarly, autonomy and embeddedness of the state bureaucracy also jeopardized over time. In this perverse institutional-setting, reform-oriented bureaucratic agents did have neither power nor resources to resist the deleterious economic policies of the succeeding governments.³³¹ On the external side, the governments constantly endeavoured to expand their reach to dominate non-state economic actors. Thus the Greek state’s relationship with major policy coalitions institutionalized in a way that aligned toward stagnation and inertia. Also, fragmented exchange mechanisms encouraged dominant policy coalitions to pursue disjointed strategies rather than seeking for a rule-based and reform-oriented outlook.

³²⁹ Calliope Spanou and Dimitri A. Sotiropoulos, “The Odyssey of Administrative Reforms in Greece, 1981-2009: A Tale of Two Reform Paths,” *Public Administration* 89, no. 3 (2011): 724.

³³⁰ Dimitri A. Sotiropoulos, “A Colossus with Feet of Clay: The State in Post-Authoritarian Greece,” in Harry Psomiades and Stavros B. Thomadakis, eds., *Greece, the New Europe and the Changing International Order* (New York: Pella, 1993), 43-56.

³³¹ Interview with Dimitris Sotiropoulos, Advisor to Lucas Papademos, June 24, 2014; interview with Dimitris Katsikas, Head of Crisis Observatory, ELIAMEP, June 24, 2014.

“In GSEE and ADEDY disproportionate strength has been enjoyed by employees of the public sector, affecting the stance of the leadership on key economic and social issues. At the same time, SEV has displayed the predominance of the few very large firms (some ex-state monopolies). This has favoured the distinctive interests of those who have benefited from the prevailing market regulations, barriers to entry, and stable product demand.”³³²

The inward-looking mode of relations between the Greek state and major interest groups gradually reinforced reform-inertia in a circular logic. In the initial phases, relevant institutional structures were crafted—or the already established ones were consolidated—in a way that served the immediate interests of the incumbent agents. The ‘locked-in’ institutional structures, in turn, increasingly motivated agents to pursue rent-seeking economic strategies. The interaction between agents and institutional structures triggered a self-reinforcing vicious cycle that constantly hampered reform possibilities. As a result, badly needed fiscal reforms were constantly delayed or watered down.

Two particular comprehensive reform attempts in the pre-1996 period are illuminating in this regard. First, Papandreou launched a stabilization program at the beginning of his second term to curb the rising fiscal profligacy of the Greek state. As neoliberalism started to bite national economies and the EU became an increasingly important actor for the organization of the Greek economy within the context of single market regulations, a stabilization program (1986-1987) turned out to be an urgent necessity to keep competitive at the European level. The program aimed at curbing the exorbitant inflation, cutting down public sector expenditures and wages, and reducing the public

³³² Featherstone and Papadimitriou, *The Limits of Europeanization*, 48.

sector borrowing requirements. The reform program was also underwritten by an EC loan of 1.75 billion ecus.³³³ Despite a quick start, however, the program was halted abruptly, since Papandreou believed that PASOK was unlikely to keep its hold in power without a U-turn to distributive policies. Thus, in comparison to its first term, PASOK pursued even more populist and expansionary fiscal policies in the wake of 1989 elections.³³⁴

The ambitious pro-reformist turn of Constantine Mitsotakis, Greek prime minister during 1991-1993, is another illuminating case that demonstrates how reform-oriented agents are constrained by institutional structures. A pro-European political rhetoric that advocated fiscal consolidation, massive privatizations, and financial reforms entered into Greek political agenda in early 1990s after ND's Mitsotakis assumed premiership. Representing the ND's progressive wing vis-à-vis the more traditional and conservative clique, Mitsotakis prepared a "Medium-Term Adjustment Programme" in 1991 targeting economic convergence with the core European countries.³³⁵ Mitsotakis, however, could not succeed in achieving any of the program targets due to the multiple constraints highlighted in this study.

First, Mitsotakis could not overcome the resistance of vested interests within ND and subsequently failed to achieve much-needed political consensus to deepen his reformist agenda even within his own party. Second, certain segments of the private business,

³³³ Sarantis E. G. Lolos, "Success and Failure of Economic Reforms: The Experience of Greece and Portugal," *Comparative Economic Studies* 40, no. 1 (1998): 79-81.

³³⁴ Tsakalatos, "The Political Economy of Social Democratic Economic Policies: The PASOK Experiment In Greece," *Oxford Review of Economic Policy*, 118.

³³⁵ Theodore Pelagidis and Michael Mitsopoulos, *Greece: From Exit to Recovery* (Washington, D.C.: Brookings Institution Press, 2014), 7-10, 13-15.

labour unions, and state bureaucracy severely resisted to the modernization and privatization objectives of the Adjustment Programme. Third, the EC did not play a strong anchor role because the monetary union was still seemed a distant objective in early 1990s. Tranditis portrays the besiegement of Mitsotakis in a rather stark manner: “The Mitsotakis agenda soon came under fire from both the opposition and the unions en bloc as well as from segments of the ND party associated with the employees of the public sector.”³³⁶ As a result, the targets of the Adjustment Programme were abandoned in 1992 and Papandreou’s PASOK replaced Mitsotakis government in 1993 elections.

The costs of reform-inertia and uncontrolled fiscal expansion reverberated through state’s fiscal indicators in this period: General public expenditure increased from 27.6 percent of GDP in 1980 to 46 percent in 1995. Government revenue, on the other hand, increased from 25 percent to just 36 percent of GDP. Greek state’s public debt also skyrocketed from 22.5 per cent to almost 97 percent of economic output in the same period.³³⁷ Likewise, Greece’s average budget deficit floated around 10 percent of GDP between 1980 and 1995.³³⁸ Attached to weak conditionality, the EC assistance, in the same period, bolstered reform failures in Greece though in an unintended way. In fact, the EC provided an opportunity window to initiate a reformist cycle in Greece in late-1980s via two major channels. First, the establishment of single market and gradual liberalization of domestic economies crafted incentives for the Greek political elite to emulate and domesticate fisco-financial reforms initiated at the European-level. Second,

³³⁶ Aris Tranditis, “Reforms and Collective Action in a Clientelist System: Greece during the Mitsotakis Administration (1990–93),” *South European Society and Politics*, ifirst version (2014): 5.

³³⁷ I retrieved the data from IMF World Economic Outlook Database.

³³⁸ Bryant, Garganas and Tavlas, eds., *Greece’s Economic Performance and Prospects*, 4.

lucrative EC funds provided opportunities for Greek governments to ease the burdens of the adjustment process. The potential cushioning impact of the EC funds was crucial for Greece because inflows reached more than 20 billion dollars during Papandreou era.³³⁹ In relative terms net receipts from the EC increased from 0.5 percent to more than 5.5 of GDP annually.³⁴⁰ That being said, however, PASOK governments followed the least-resistant path so that EC funds were used to shore up budget deficits and appease electoral constituency. As Verney puts “Greek government appeared unable to absorb the financial support it was offered or to coordinate its use in a way that would help the country to adjust to the challenge of Community competition.”³⁴¹ Hence, paradoxically, the EC became the sponsor of the reactive Greek state in this period. All in all, thanks to agency and institutional-level self-reinforcing processes, Greece has gradually become *une société bloquée*, thwarting state’s capacity to prudently craft and coherently implement economic adjustment policies in the normal course of politics.³⁴² Reform attempts, even if emboldened by reformist state agents, fell upon infertile ground.³⁴³ In this regard, Kostas Simitis experience is an illustrative case in point.

³³⁹ Tayfur, *Semiperipheral Development and Foreign Policy*, 98.

³⁴⁰ Tridimas, “Greek Fiscal Policy and the European Union,” 55.

³⁴¹ Susannah Verney, “From the ‘Special Relationship’ to Europeanism: PASOK and the European Community, 1981-1989,” in Richard Clogg, ed., *Greece, 1981-1989: The Populist Decade* (London: The Macmillan Press, 1993), 150.

³⁴² Kevin Featherstone, “The Greek Sovereign Debt Crisis and EMU: A Failing State in a Skewed Regime,” *Journal of Common Market Studies* 49, no. 2 (2011): 197-198.

³⁴³ Antigone Lyberaki and Euclid Tsakalotos, “Reforming the Economy without Society: Social and Institutional Constraints to Economic Reform in post-1974 Greece,” *New Political Economy* 7, no. 1 (2002): 110.

3.4. Kostas Simitis case (1996-2004): A break with the past?

In the previous chapter I argued that paradigmatic reform initiatives are not likely to emanate from dominant policy coalitions in reactive states. On the contrary, domestic institutional structures tend to foster a bias toward the persistence of status quo. Thus reformist state agents are expected to disturb extant equilibrium and lead the debate in terms of initiating a new policy path. The timing and context of the rise of reformist state agents are decisively critical to inform reform outcomes in reactive states. In this sense, an important window of opportunity was opened in Greek political economy with the election of Kostas Simitis as prime minister in 1996. Simitis was a dedicated reformist agent and potential policy entrepreneur, whose aim was to overhaul Greek political economy comprehensively. His technocratic background, non-populist personality and conciliatory leadership style also signified a clear divergence from his predecessor, Andreas Papandreou.³⁴⁴

Simitis was a potential policy entrepreneur due to three main reasons. First, Simitis had a strong technocratic and professional background. He was a law and economics professor, studied at University of Malburg in Germany and London School of Economics in the UK. Thanks to his education and intellectual competencies Simitis appeared as a key figure keen on offering issue-based technical solutions to specific

³⁴⁴ For an analysis on the transformation of PASOK's leadership style, party structure, values, orientation, and policy priorities, see Michalis Spourdalakis & Chrisanthos Tassis, "Party Change in Greece and the Vanguard Role of PASOK," *South European Society and Politics* 11, no. 3-4 (2006): 497-512.

problems; it is not coincidental that his nickname was “accountant.”³⁴⁵ Second, he was a respected figure among different segments of Greek society and politics. Simitis was known as “an individual without a spot of corruption” on his past,³⁴⁶ and enjoyed high level of popularity hovering around 60 per cent of the population when he assumed premiership, according to public surveys.³⁴⁷ Third, he was a respected figure among international epistemic communities. Simitis represented Greece in the European Commission for many years at different posts and became an esteemed and well-known person among his colleagues due to his compatible technical and diplomatic credentials. He was acknowledged in the European circles as “a safe pair of hands.”³⁴⁸ As Ludrow asserts, Simitis was seen as a skilful statesman, and “one of the most senior members of the European Council with a quiet authority that his colleagues respect.”³⁴⁹ Fluent in English, German, and French, he established close personnel connections at the European level and capitalized on high degree of international legitimacy (see below). His personal qualifications placed Simitis as a capable policy entrepreneur to mediate between international and domestic policy communities to instigate a virtuous cycle of reform activism in Greece. In terms of policies (i.e., solutions) Simitis had a sound understanding of the major problems Greece encountered at the time. He was aware of the fact that ‘state capture’ was at the heart of Greece’s persistent economic reform failures. In one of his earliest speeches, for instance, he self-reflectively acknowledged the very problems created by his own party in the post-authoritarian period:

³⁴⁵ The Economist, “Kostas Simitis, Greece’s Cautious Helmsman,” April 13, 2000.

³⁴⁶ Koliopoulos and Veremis, *Modern Greece: A History since 1821*, 190.

³⁴⁷ Athens News Agency, “Polls Favour New Simitis Government,” January 29, 1996.

³⁴⁸ Dionyssi G. Dimitrakopoulos and Argyris G. Passas, “The Greek Presidency: In the Shadow of War,” *Journal of Common Market Studies* 42, Annual Review (2004): 43.

³⁴⁹ Peter Ludlow, “The Greek Presidency,” Briefing note no. 9 (Brussels: Euro Comment), 2.

“Our political practice followed the same track as that of the right-wing governments; many times we implemented ad hoc policies; we maintained clientelistic relations between the government and the voters; we made selective allocation of funds and we introduced measures benefitting specific groups. The principle governing our political practice [*sic*] was that the party and the government were always right and that their actions had to be justified... We do not need attractive slogans that create rising expectations but systematic programming and well planned action.”³⁵⁰

Simitis, therefore, openly denounced irresponsible populist policies and targeted the transformation of state-market relations. He underlined this point in one of his speeches as follows:

“Populism transfers the social problem from the plain of ideology to a level that does not disturb the status quo of social relations. The assistance of the state and the benefits derived from it is the sole objective of political struggles in Greece.”³⁵¹

Rather than opting for expansionary fiscal policies, uncontrolled populism and conflictual zero-sum politics, Simitis framed an avowedly reformist rhetoric with repeated emphasis on the concepts of ‘modernization’ and ‘Europeanization’ to “prepare Greece for the 21st century.”³⁵² Along these lines, first, he tried to overcome the collective action problems and internal fractionalization in PASOK. His first cabinet (1996-2000) included leading pro-European figures such as Yiannos Papantoniou responsible for national economy and finance, and George Papandreou responsible for

³⁵⁰ Quoted in Lyrantzis, “PASOK in Power: From ‘Change’ to Disenchantment,” 41-42.

³⁵¹ Quoted in Koliopoulos and Veremis, *Modern Greece*, 189.

³⁵² Athens News Agency, “Hard Work the Recipe for Success, Simitis Tells New Government,” January 23, 1996.

EU affairs as deputy foreign minister.³⁵³ The highly technocratic character of Simitis government launched an ambitious economic modernization project to position Greece as a core European country in the Balkans, rather than an inferior Balkans state at the periphery of Europe. The guiding logic of his government program, which was entitled “Building a Strong Greece,” was to launch a new national development and reform strategy in order to construct a sustainable fisco-financial regime.³⁵⁴

The timing of Simitis’ advent into premiership was also ripe because the EU possessed strong legitimizing role to empower Simitis’ domestic policy entrepreneurship in the second half of 1990s. Simitis’ first term coincided with intense Europeanization period in the wider European politics due to the final stage of European Monetary Union (EMU). In the 1990s, creation of a single currency regime turned out to be one of the most ambitious projects had ever experienced in the history of European integration. In addition to the expected economic benefits of a common currency such as the elimination of transaction costs and exchange rate fluctuations,³⁵⁵ there were two more reasons rendering EMU a path-breaking turning point. First, the single currency was interpreted as an achievement beyond its economic benefits and enthusiastically embraced by europhiles as a great leap forward toward common European identity. Euro

³⁵³ Simitis also kept these figures in their positions in his second cabinet. Athens News Agency, “Simitis Unveils New Government,” April 13, 2000.

³⁵⁴ Athens News Agency, “Simitis Presents New Government Programme: ‘Building a Strong Greece,’” January 30, 1996; also see Calliope Spanou, “State Reform in Greece: Responding to Old and New Challenges,” *International Journal of Public Sector Management* 21, no. 2 (2008): 155.

³⁵⁵ Paul De Grauwe, *Economics of Monetary Union* (Oxford: Oxford University Press, 2003), 60-77.

played a functional and symbolic role in the making of an ‘ever closer union.’³⁵⁶ Second, euro was presumed to improve the position of member states in the international system by challenging the reserve currency status of the US dollar. Robert Mundell, for instance, argued “the introduction of the euro will be the most important change in the international monetary system since the transition, achieved during World War I, from the pound to the dollar as the dominant international currency.”³⁵⁷ It is in this context that Simitis narrated and communicated his reformist agenda as a compulsory recipe for integrating Greece into the grand European project. In PASOK’s official program, he claimed, “that the unshakable target of the government’s economic policy is Greece’s participation in EU developments and the final stage of Economic and Monetary Union.”³⁵⁸ Accordingly, adopting euro was narrated not only as the most efficient way of improving state’s fiscal discipline but also as the only way to have a voice in the emerging architecture of European political economy. Simitis stated this point clearly in an interview with *Kathimerini*, a widely circulated Greek newspaper:

“By all means we must succeed to be part of the core EU member states in the EMU. Only then will we be able to have an influential role in the decisions that will be affecting us. Therefore EMU membership is not only an economic issue, but also mostly a political one. In fact the economic policy that we have decided

³⁵⁶ For a comprehensive account of EMU and the role of ideas in this process see, Kathleen R. McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Ithaca and London: Cornell University Press, 1998).

³⁵⁷ Robert Mundell, “What the Euro Means for the Dollar and the International Monetary System,” *Atlantic Economic Journal* 26, no. 3 (1998): 227-228.

³⁵⁸ Athens News Agency, “Simitis Presents New Government Programme: ‘Building a Strong Greece,’” January 30, 1996.

to apply is part of an entire development plan which aims to restructure all of the public sector.”³⁵⁹

Simitis also reframed the EU’s role in the domestic consumption of Greek politics. This reshuffling refers to a clear departure from PASOK’s antagonizing tradition with the EU during the Papandreou era. In that sense, the EU factor strengthened Simitis’ hands to foster his reformist agenda, which further informed the normalization of Greek politics to initiate consensus-based economic reforms with private interest groups and enabled to overcome the old age left-right cleavages in the country.³⁶⁰ Accordingly, the main opposition party, ND, supported Greece’s single currency membership and backed the fisco-financial reforms framed and advocated by Simitis.³⁶¹ Since conservative political elite rendered the cost of non-compliance with the Maastricht criteria and the eventual exclusion of Greece from the monetary union unbearable. Thus an ostensibly broad-based coalition at the political level assembled around a reformist narrative.³⁶² Hence, the change in PASOK’s rhetoric regarding the EU factor enhanced the capacity of Simitis to build a larger winning coalition that encompasses certain interest groups aligned with the main opposition party.

³⁵⁹ Quoted in Christos Dimas, “Privatization in the Name of ‘Europe’: Analysing the Telecoms Privatization in Greece from a ‘Discursive Institutional’ Perspective,” GreeSE Paper No. 41 (Hellenic Observatory Papers on Greece and Southeast Europe, 2010), http://eprints.lse.ac.uk/31089/1/GreeSE_No41.pdf (accessed on December 3, 2013), 34.

³⁶⁰ Tayfur, *Semiperipheral Development and Foreign Policy*, 123-128.

³⁶¹ Athens News Agency, “Karamanlis Hails Greece’s Entry into EMU,” June 20, 2000. Also see, European Parliament Task Force on Economic and Monetary Union, “EMU and Greece,” prepared by the Directorate General for Research Economic Affairs Division, 1998, http://www.europarl.europa.eu/euro/country/general/gr_en.pdf (accessed on January 15, 2014), 14.

³⁶² Panos Kazakos, “Europeanization, Public Goals and Group Interests: Convergence Policy in Greece, 1990-2003,” *West European Politics* 27, no. 5 (2004): 906.

The ideological convergence among the rival political camps in Greece also informed the preference functions of dominant interest groups including labour and business unions. Greek financial and industrial capital increasingly threw support behind the fiscal convergence reforms. The first and foremost supporter, in this context, was financial elite. As Frieden and Jones point out, financial elite is supposed to be the supporter of economic integration projects due to the assumed benefits of the elimination of transaction costs and economies of scale opportunities.³⁶³ The industrial elite also welcomed the membership decision since they perceived it as an opportunity to integrate with core European production structures. In my interviews representatives of the business associations argued that their decision to support Greece's entrance into euro was appropriate and well deserved.³⁶⁴

The Greek labour unions also softened their stance toward euro membership. As one of my interviewees' from GSEE/ADEDY underscored "[labour unions] thought that euro membership would help consolidating welfare state policies in Greece and foster economic convergence at the European level."³⁶⁵ Thus they accepted to shoulder the burden of fiscal conservatism superimposed by convergence criteria. However, as I will discuss in the incoming pages and in chapter 4, the euro project paved the way for the

³⁶³ Jeffrey Frieden and Erik Jones, "The Political Economy of European Monetary Union: A Conceptual Overview," in Jeffrey Frieden, Daniel Gros and E. Jones, eds., *The New Political Economy of EMU* (Lanham: Rowman and Littlefield, 1998).

³⁶⁴ Interview with Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014; also interview with Theodore Fessas, President of SEV, June 24, 2014.

³⁶⁵ Interview with Savas Robolis, Scientific Director of Labour Institute (INE)/GSEE-ADEDY, June 24, 2014.

financialization of European economies, which in turn hollowed out the ‘social Europe project’ that also accelerated the fiscal crisis of the Greek state.³⁶⁶

On the external side, Simitis succeeded garnering the support of other member states partially thanks to his connections at the European epistemic communities. Simitis directly contacted with European leaders at the personnel level. For instance, he got Hans Tietmeyer, the then head of Germany’s central bank, and Theo Waigel, the then finance minister of Germany to support Greece’s entry into the exchange rate mechanism in 1998. It is ironic in retrospect that Germany’s political backing proved crucial for Greece’s acceptance into single currency regime.³⁶⁷ In fact, initially, Greece was excluded from participating in final stage of the EMU. The European Commission and European Monetary Institute gauged in their 1998 report that Greece could not sustain high degree of convergence in none of the fiscal and financial the criteria.³⁶⁸ Following the political support threw behind Simitis government at the European-level, however, the atmosphere changed dramatically. In 2000, European Commission report concluded “Greece has achieved striking progress towards convergence” and gave its positive opinion regarding Greece’s entry despite the same Commission highlighted just two years ago that none of the convergence criteria were fulfilled by Greece.³⁶⁹ Having taken the membership process into consideration, it seems reasonable to argue at this

³⁶⁶ For an analysis of the rise of ‘consolidation state’ in Europe, see Wolfgang Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism* (London: Verso, 2014).

³⁶⁷ The Economist, “Greece: The Painful Road to Modernity,” March 19, 1998.

³⁶⁸ European Monetary Institute, *Convergence Report* (Frankfurt: Kern & Birner GmbH + Co., March 1998), 16.

³⁶⁹ European Commission, *Report from the Commission: Convergence Report 2000*, COM (2000), 277 final (Brussels: European Commission, May 2000), 10.

point that Greece's adhesion into the euro area was primarily the outcome of the country's geopolitical importance for the core EU member states and for the reputation of the entire euro project, rather than its fisco-financial performance. Thus the fiscal discipline imposed on Greece was dressed up in a dangerous euphemism that opened up Greek political and economic elites to synthesize accession rules with their traditional political modus operandi.³⁷⁰

3.4.1. Persistence of reform-inertia: An assessment of Simitis period

Simitis' ambitious reform-activism produced some initial results at the fiscal realm. Between 1996 and 2000, Greek economy grew 3.5 percent annually, higher than the EU averages (2.9 percent), the budget deficit decreased to 1.7 percent, and the government revenue/expenditure ratio improved from 0.8 to 0.92. Inflation, a historically recalcitrant problem for the Greek economy, was also reduced to 3 percent from double-digit numbers. Greek government's initial reform attempts impressed the markets that the interest rate differential had fallen dramatically: In 1992, long-term interest rates in Greece were about 16 percentage points higher than the EU average; by 2000 the difference was less than 1 percentage points.³⁷¹ The record on public debt remained poor, however. The public debt was far from being close to the relevant Maastricht criterion (60 percent of GDP), nevertheless it was stabilized around 100 percent of the GDP.

³⁷⁰ For a comparative historical analysis of southern Europe's geopolitical importance for the core European countries and its impact on Greece's intricate encounter with neoliberal experiment in Europe, see M. Fatih Tayfur, "Tarihsel Süreç İçinde Güney Avrupa'nın Borç Krizi" in Fikret Şenses, Ziya Öniş, Caner Bakır, *Ülke Deneyimleri Işığında Küresel Kriz ve Yeni Ekonomik Düzen* (İstanbul: İletişim Yayınları, 2013), 195-202.

³⁷¹ I retrieved the data from European Central Bank Data Warehouse.

Simitis also embarked on a set of reforms in the financial realm to comply with the European Commission directives. Lucas Papademos, a close advisor of Simitis and the future prime minister of Greece, played a crucial role in the pre-EMU process as the governor of the Greek Central Bank, namely the Bank of Greece (BoG). In this regard, the independence of the BoG and the establishment of new financial regulatory institutions were proved as significant changes.³⁷² In 1997, BoG was granted institutional independence, i.e., the legal status to operate independently from the instructions and advices of the government, in line with the single currency program that established the European System of Central Banks. In pursuant of the pertaining legal framework, ‘price stability’ became the first and foremost objective of the BoG. After 2001, the monetary policy was transferred to the discretion of the independent European Central Bank (ECB).³⁷³

Having taken the fiscal and financial developments into consideration, how should we approach Simitis’ reform performance and to what extent Greece succeeded to overcome path-dependent reform-inertia during his reign? I argue that Simitis was successful in ensuring nominal convergence in the first term of his premiership and building pro-reform coalitions toward common currency membership, during which the EU as a positively informed the fiscal discipline and facilitated the implementation of certain financial reforms. However, Simitis failed to initiate a virtuous and sustainable cycle of

³⁷² OECD, *Economic Surveys: Greece, 1997-1998* (Paris: OECD Publication Service, 1999), 42-48.

³⁷³ Official Journal of the European Union, *Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union* C 326, no. 55 (2012).

reform-activism that improved regulatory state capacity. Therefore, medium-term implications of Simitis' policy entrepreneurship remained ephemeral. There are two strands to this argument. First, fiscal reforms initially targeted one-off convergence toward Maastricht criteria rather than structural transformation in state's fisco-financial regime. In this sense, it is not possible to refer to a paradigm shift in state's role in the economy because the supposedly reformist policy coalitions, which backed Simitis in the initial phases, approached the reform processes through the lens of nominal convergence.³⁷⁴ Accordingly, achieving the technical criteria on budget deficit, inflation, and long-term interest rates were perceived as a goal in itself. The underlying structural problems that inform fisco-financial profligacy were not addressed in this period (see below).

Second, in the absence of an exogenous shock that alters power balances and dominant ideational paradigms, the reform-biased institutional structures remained almost intact. Although Simitis himself deemed structural fiscal reforms necessary to ensure Greek state's fiscal sustainability he could not overcome the resistance of dominant policy coalitions.³⁷⁵ Thus reform-inertia perpetuated in the major structural problem areas of the Greek economy, the seeds of which were planted during PASOK governments in the 1980s, including labour markets, pension system, privatizations, tax regime, and public administration.³⁷⁶ The empirical evidence supports the argument proposed above. For

³⁷⁴ Pagoulatos, "Economic Adjustment and Financial Reform," *South European Society and Politics*, 199.

³⁷⁵ Kevin Featherstone, "Introduction: 'Modernisation' and the Structural Constraints of Greek Politics," *West European Politics* 28, no. 2 (2005): 237.

³⁷⁶ *Ibid.*

instance, Simitis aimed to reform the labour markets to underpin fiscal consolidation and competitiveness of the Greek economy. In 1997, he launched social dialogue with employers and labour unions, entitled “Confidence Pact between the Government and Social Partners towards the Year 2000.” The aim of the Pact was to set a reform agenda including labour market flexibility and openness to ensure Greece’s competitiveness in the euro area. The negotiations, however, plunged into deadlock as GSEE abstained from social dialogue. The government, in turn, introduced a far too limited Labour Reform in 1998 (Law 2639/98), leaving all burning problems on the flexibility and efficiency of labour markets untouched. OECD report pointed, “that an opportunity to address key rigidities was missed in Greece.”³⁷⁷

In 2000, following the introduction of the Lisbon agenda at the European Council Helsinki Summit (1999, see below) Simitis government reintroduced the reform bills on labour markets. The domestic policy coalitions, however, harshly reacted. GSEE, once again, opposed the reform bill because most of its members were enjoying secure and stable employment opportunities.³⁷⁸ ADEDY, the union of public servants, also joined the anti-reform coalitions since it did not have interest in labour market flexibility. Featherstone notes that “in effect, [labour unions] are protected from job insecurity, have little interest in job creation, and seek to protect their privileges. Their interests are also short-term and defensive.”³⁷⁹

³⁷⁷ OECD, *Economic Surveys: Greece, 1997-1998* (Paris: OECD Publication Service, 1999), 10, 69-78.

³⁷⁸ Kazakos, “Europeanization, Public Goals and Group Interests,” *West European Politics*, 906.

³⁷⁹ Kevin Featherstone, “Greece and EMU: Between External Empowerment and Domestic Vulnerability,” *Journal of Common Market Studies* 41, no. 5 (2003): 935.

The institutional representatives of the Greek finance capital also did not demonstrate a genuine willingness to support reform initiatives promoted by Simitis beyond the nominal convergence targets. SEV, for instance, did not back the labour reform proposals because its membership base, which was dominated by traditional state-protected elite “has found the transition to market competition difficult.”³⁸⁰ The attempts to reform the parlous state of pension system, which was acting like a black hole in Greece’s fiscal accounts, also shared alike destiny. Despite a quasi-certain consensus emerged that pension system was one of the main problems increasingly “threatening the fiscal sustainability” of state budget as highlighted in various OECD reports,³⁸¹ the well-entrenched pro-status quo forces succeeded blocking the process by a series of strikes and street demonstrations as never before since the end of the military dictatorship.³⁸² In our interview, Greek Deputy Ombudsman and Head of the Organization for Mediation and Arbitration in Greece, Christos Ioannou, also expressed that that resistance of domestic institutional structures to the proposed reforms in labour markets, social security system, and public administration at the time placed Greece into a path the laid the groundwork for Greece’s fiscal crisis in 2009.³⁸³ Simitis relented and shelved the implementation of labour markets and pension system reforms. He similarly

³⁸⁰ Ibid., 934.

³⁸¹ OECD, *Economic Surveys: 2000-2001* (Paris: OECD Publication Service, 2001), 45-48.

³⁸² Athens News Agency, “GSEE Calls New Strike despite Government Freeze of Proposed Social Security Reforms,” April 28, 2001.

³⁸³ Interview with Christos A. Ioannou, Greek Deputy Ombudsman and Mediator and Arbitrator with the Organization for Mediation and Arbitration in Greece, June 26, 2014.

pursued an incremental stop-go strategy regarding privatizations, tax reforms, and public administration reforms “in fear of the sizeable political cost.”³⁸⁴

In summary, Simitis was a potential policy entrepreneur dedicated to break down the recalcitrant reform-inertia in Greek political economy. In the first term of his premiership, Simitis succeeded to achieve nominal convergence at the fiscal realm and enact certain financial regulations thanks to the euro membership goal and external empowerment of the EU. However, the EU ceased to possess a reformist-impact in Greece; thereby badly needed structural fiscal reforms remained untouched. In the absence of a credible external anchor and increasing resistance of domestic institutional structures, his reform attempts led to the creation of a short-lived *stabilization state* rather than a paradigm change in state-market relations. For all these reasons, Simitis case enables us to make some inferences on the ‘limits of the possible’ for reformist state agents under unfavourable institutional contexts in reactive states (see chapter 7).

3.5. Consolidation of a reactive state (2004-2009)

The post-Simitis period refers to the consolidation period of the reactive Greek state. In fact, the empowerment capacity of the EU as the single most important broader institutional structure ceased to exist after Greece adopted euro in 2001. The ‘hard’ conditionality of convergence criteria was replaced by ‘soft’ conditionality principles

³⁸⁴ Pagoulatos, “Economic Adjustment and Financial Reform,” *South European Society and Politics*, 200.

after the membership.³⁸⁵ At Helsinki in December 1999, the European Council established a process to review progress on structural fiscal reforms across member states. One year later, Lisbon Strategy was launched. The common focus included the improvement of member states' competitiveness through a set of structural reforms. Open Method of Coordination, an intergovernmental voluntary cooperation mechanism based on benchmarking and sharing best practices among EU member countries, was determined as the ultimate driver of the reform processes.³⁸⁶ However, the 'soft' conditionality of Lisbon agenda proved inadequate to provide economic discipline in member states, including Greece.³⁸⁷ During 2000-2009, agency-level dynamics and institutional structures, both domestic and broader ones, interacted in a way that reactive Greek state practises amplified, whereby economic reforms came to a complete halt in the strict sense of the word.

With the rise of ND's Kostas Karamanlis as the new prime minister in 2004, traditional petty-politicking made a strong come back in Greek political context. Despite

³⁸⁵ Kevin Featherstone, "'Soft' Co-ordination Meets 'Hard' Politics: the European Union and Pension Reform in Greece," *Journal of European Public Policy* 12, no. 4 (2005): 733-750.

³⁸⁶ For the evaluation and functioning of Open Method of Coordination, see Caroline de la Porte, "Principal-Agent Theory and the Open Method of Co-ordination: The Case of the European Employment Strategy," in Susana Borrás and Claudio M. Radaelli, ed., *The Politics of the Lisbon Agenda* (London: Routledge), 23-41.

³⁸⁷ Lisbon Strategy had an ambitious goal: "to become the most dynamic and competitive knowledge-based economy in the world by 2010 capable of sustainable economic growth with more and better jobs and greater social cohesion and respect for the environment." However, the targets of the Strategy could not be reached as of 2010. The EU employment rate reached 66 per cent in 2008 (the target was 70 per cent) and dropped back after the euro crisis. Also, total R&D expenditure in the EU expressed as a percentage of GDP improved marginally from 1.82 per cent in 2000 to 1.9 per cent in 2008 (the target was 3 per cent). Thus the European Commission had to revise the targets for 2020. European Commission, Commission Staff Working Document: Lisbon Strategy Evaluation Document, Brussels, 2.2.2010, SEC(2010) 114 final, (Brussels: European Commission, 2010), 2.

Karamanlis' main election motto was the "re-foundation of the state"³⁸⁸ and then the finance minister Alogoskoufis promised "efficiency, moderation and economic reforms based on consensus,"³⁸⁹ Greek state's poor governance performance perpetuated during the ND governments (2004-2009). From political leadership point of view, Kostas Karamanlis had neither incentives nor capabilities to challenge the existing equilibrium of state-market relations. On the fiscal side, mainly thanks to populist political concerns, Karamanlis government overlooked the uncontrolled expansion of the state. Despite he labelled the public sector as "great invalid" lacking meritocracy and efficiency,³⁹⁰ he still followed the reform-biased path mainly for electoral calculations. The OECD survey reports that the number of public employees continued to increase about 61,000 during 2002-2008, which was just 6,000 in 1997-2002.³⁹¹ Contrary to its pre-election promises and party program, the Karamanlis government, in coordination with its trade union faction in GSEE, by-passed the independent regulatory agency, Supreme Council for Civil Personnel Selection (ASEP) that was established to recruit public servants. Karamanlis frequently reappointed part-time positions that need not go through ASEP for furthering his political patronage.³⁹² According to the OECD data, the wider public

³⁸⁸ Athens News Agency, "New Interior Minister Says 'State to be Re-established with Spirit of Unity,'" March 11, 2004. Also see, Christos Lyrintzis, "Greek Politics in the Era of Economic Crisis: Reassessing Causes and Effects," GreeSE Paper No. 45 (Hellenic Observatory Papers on Greece and Southeast Europe, 2011), http://eprints.lse.ac.uk/33826/1/GreeSE_No45.pdf (accessed on December 13, 2013), 9.

³⁸⁹ Athens News Agency, "Government to Seek Balanced Economic Growth, FinMin Says", March 30, 2004.

³⁹⁰ Nikos Konstandaras, "Kostas Karamanlis's Deafening Silence," *Kathimerini*, September 5, 2013.

³⁹¹ OECD, *Greece: Review of the Central Administration, 2011* (Paris: OECD Publishing, 2012), 71.

³⁹² Athens News Agency, "Prime Minister Vows to Keep Election Pledges," March 22, 2004.

sector employment, including general government and public corporations, increased from 19.3 percent of total employment in 2000 to 20.7 in 2008.³⁹³

The wages in the public sector also increased spectacularly during his terms in office. According to the European Central Bank report, the cumulative wage increase in the state sector per employee was 108.7 per cent in 1998-2009 period, well above the euro area average (34.9) with the highest rate after Ireland (110.8).³⁹⁴ According to OECD, just before the economic crisis, public sector wages were 30-40 percent above the private sector averages.³⁹⁵ As a result, the total government expenditure in 2000-2008 increased from 46.7 per cent to 50.6 per cent of GDP. The government revenue, on the other hand, declined from 43 per cent to 40.7 due to massive tax evasion.³⁹⁶

Similar to the Simitis period, Greek economy grew at relatively high rates during Karamanlis government, around 3.1 percent annually in 2004-2008. The fundamentals of economic growth, however, were somewhat superficial and absolutely fragile. It was a debt-driven growth model heavily relied on foreign inflows in the form of foreign loans extended to Greek government bonds and domestic banking system mainly for consumption and housing credits (see below).³⁹⁷ In fact, in the post-EMU process, Greek state played a shock-absorber role because the Greek firms could not keep pace with

³⁹³ OECD, *Greece: Review of the Central Administration*, 71.

³⁹⁴ Frédéric Holm-Hadulla et. al., "Public Sector Wages in the Euro Area: Towards Securing Stability and Competitiveness," *European Central Bank Occasional Paper Series*, no. 112 (2010): 14.

³⁹⁵ OECD, *Economic Surveys, Greece: 2011* (Paris: OECD Publication Service, 2011), 89.

³⁹⁶ Georgia Kaplanoglou and Vassilis T. Rapanos "Tax and Trust: Fiscal Crisis in Greece," *South European Society and Politics* 18, no. 3 (2013): 283-304.

³⁹⁷ Evangelia Desli and Theodore Pelagidis, "Greece's Sudden Faltering Economy: From Boom to Bust with Special Reference to the Debt Problem," in Philip Arestis and Malcolm Sawyer, eds., *The Euro Crisis* (Basingstoke: Palgrave Macmillan, 2012), 121, 129.

breath-taking competition in the euro area. I argued in the previous part that Greece became a member of the currency union without initiating urgently needed reforms, especially in the fiscal realm of the economy. Therefore, Greek firms increasingly lost their competitive edge vis-à-vis their European counterparts.

The divergence in the competitive performance of the Greek economy triggered new fault-lines in the euro area, which further obliged Greek state to pursue an expansionary fiscal outlook. Greece, in the post-2000 entrapped in a vicious cycle again. The expansion of public sector due to uncontrolled populism, the deterioration of the private sector competitiveness due to postponement of structural reforms, and the continuance of reform-biased relations between state and social partners created a dangerous policy mix, which is aptly summarized by Katsimi and Moutos as follows:

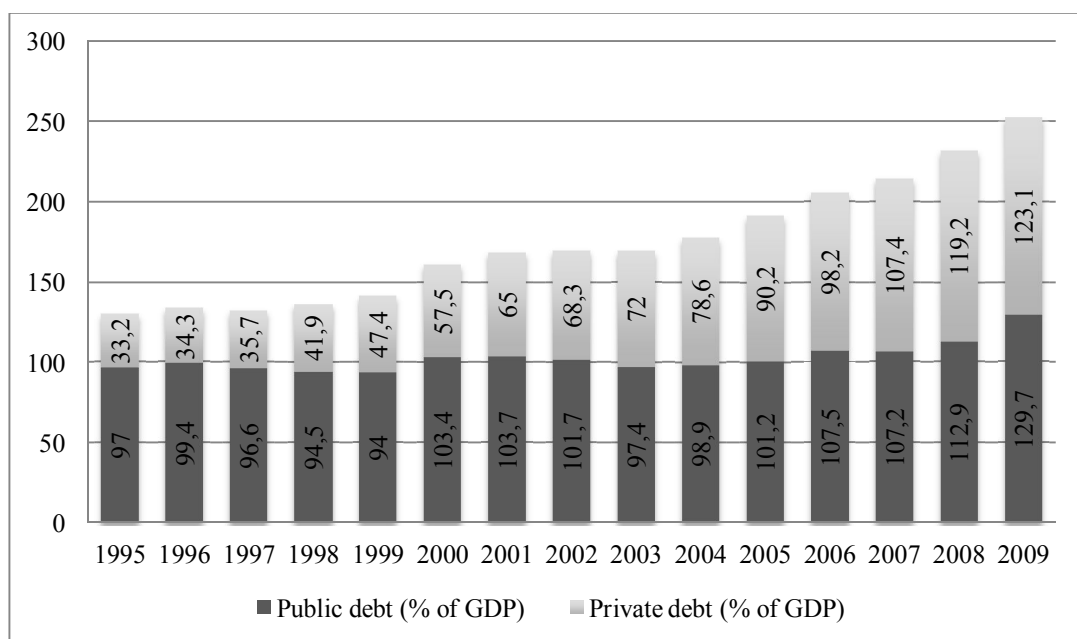
“Increases in public employment and tax rates, without attendant increases in publicly provided goods and in tax revenue, along with the shouldering of the financial obligations of inefficient private-sector firms, led to both public debt accumulation and increased wage demands by private-sector workers and a weakening of private-sector performance and employment opportunities, which in turn induced the ‘nanny’ state to intervene (as an employer and lender of last resort) in order to alleviate what it was co-responsible for creating in the first place, thus leading to further debt accumulation and providing new impetus to the vicious circle.”³⁹⁸

The cost of ‘nanny state’ was unbearable for Greece: Budget deficit increased from 3.7 per cent in 2000 to 15.7 percent of GDP in 2009. Public debt jumped from 104.4 percent

³⁹⁸ Margarita Katsimi and Thomas Moutos, “EMU and the Greek Crisis: The Political Economy Perspective,” *European Journal of Political Economy* 26, no. 4 (2010): 572.

to 130 percent of the GDP. The accumulation of the public debt went hand in hand with the skyrocketed private debt in this period. The ample credit opportunities encouraged the private sector borrowing in an unprecedented fashion that private debt over GDP ratio increased from 57.5 to 123.1 percent (see figure 2).

Figure 2. Greece's public and private debt (1995-2009)



Available data suggest that the traditional mode of interactions between agents and domestic institutional structures remained intact under the leadership of Karamanlis.³⁹⁹ Thus an unsustainable path prevailed, which in turn further eroded Greek state's capacity to govern domestic economy. Given the scope of fiscal and financial problems, a puzzling question emerges at this point: How did it become possible to make the 'unsustainable sustainable' in the Greek case? How did the Greek state perpetuate a debt-ridden model for such a long period? Based on the conceptual framework offered in

³⁹⁹ My interviewees also confirmed this point. For the full list see appendix 1.

the previous chapter, I would propose that the EU, as a broader institutional structure, planted the seeds of grave moral hazard problems that reinforced ‘state capture’ in Greece during the post-Simitis era. Stated somewhat differently, Greece’s integration into wider institutional setting of the monetary union without adequate state capacity exacerbated ubiquitous fisco-financial reform failures. Thus this study claims that Greece’s reform-inertia in the post-2000 is closely linked to the perverse incentive structures and moral hazard problems emanated from the reversal of the EU’s anchor role. There are two strands to the argument.

The first dimension relates to the architecture of the currency union. The intellectual forebears of the euro area acknowledged that, for a sustainable monetary union, fiscal discipline was sine quo non. However, having realized the political impossibility of the creation of a federal state, Stability and Growth Pact (hereinafter, SGP) was designed in 1997 to provide a benchmark for fiscal discipline among euro countries. The SGP set upper limits for member states so as to keep their budget deficit and public debt within acceptable thresholds —60 percent of GDP for public debt and 3 percent of GDP for budget deficits.⁴⁰⁰ The SGP, however, proved insufficient to ensure fiscal prudence since

⁴⁰⁰ SGP has two dimensions: preventive and corrective arms. The preventive arm seeks to ensure the fiscal prudence in member states over a specific cycle. The corrective arm determines specific measures to put the member states’ fiscal houses in order in the case of an excessive deficit. The preventive arm is the medium-term budgetary objective. Member states determine their medium-term budgetary plans and submit them to the European Commission, which is the legally responsible institution to oversee the member states’ fiscal performance. The corrective arm includes the Excessive Deficit Procedure, a step-by-step procedure for correcting excessive deficits defined in the Treaty on the Functioning of the EU (Articles 121 and 126).

the core countries, primarily Germany and France, breached the Pact many times.⁴⁰¹ Even Romano Prodi, the then president of the European Commission denounced the SGP as a “stupid idea.”⁴⁰² The Council of Economic and Finance Ministers (Ecofin) decided to suspend the Excessive Deficit Procedure component of the SGP on 25 November 2003 due to the insistence of Franco-German axis.⁴⁰³ In a rather paradoxical way, by doing so, Germany undermined the foundations of the very fiscal regime it had created in the first instance. Crawford underlines this point as follows:

“Germany had weakened the very regime it had created. It would now be difficult to ask other euro zone members with chronic deficits to curb their spending, and what the Commission called ‘fiscal irresponsibility’ in one country could very possibly damage others.”⁴⁰⁴

Once the fiscal discipline was hollowed out by Germany, the hands of the peripheral states were released. This created escape avenues to prolong reform-inertia by new means. Hence, peripheral states, especially Greece, compensated external competitiveness losses with increasing state borrowing rather than initiating supply-side reforms. Accordingly, Greek state continued to expose lucrative and non-transparent subsidies to privileged private sector firms and inflated public employment. Not surprisingly as a result, in 2000-2008, Greece overshot both the budget deficit and public

⁴⁰¹ Jacques Le Cacheux and Florence Touya, “The Dismal Record of the Stability and Growth Pact,” in Ingo Linsenmann, Christoph O. Meyer and Wolfgang T. Wessels, eds., *Economic Government of the EU: A Balance Sheet of New Modes of Policy Coordination* (London: Palgrave Macmillan, 2007), 73-90.

⁴⁰² His exact sentence was as follows: “I know very well that the Stability Pact is stupid because all the decisions made under it are so rigid.” David Haworth and George Trefgarne, “Euro Stability Pact is Stupid, Says Prodi,” *The Telegraph*, October 18, 2002.

⁴⁰³ Patrick Lebrond, “The Political Stability and Growth Pact is Dead: Long Live the Economic Stability and Growth Pact,” *Journal of Common Market Studies* 44, no. 5 (2006): 969-970.

⁴⁰⁴ Beverly Crawford, *Power and German Foreign Policy* (Basingstoke: Palgrave Macmillan, 2007), 139-140.

debt thresholds nine times, which means that it had never complied with the criteria (see table 2).

Table 2. The widening gap between 'north' and 'south' in the EU

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Government deficit (% of GDP)												
Greece	-4.5	-4.8	-5.6	-7.5	-5.2	-5.7	-6.5	-9.8	-15.7	-10.7	-9.5	-9
Spain	-0.5	-0.3	-0.3	-0.1	1.3	2.4	2	-4.5	-11.1	-9.6	-9.6	-10.6
Ireland	0.9	-0.4	0.4	1.4	1.6	2.9	0.2	-7.4	-13.7	-30.6	-13.1	-8.2
Portugal	-4.8	-3.4	-3.7	-4	-6.5	-4.6	-3.1	-3.6	-10.2	-9.8	-4.3	-6.4
Germany	-3.1	-3.8	-4.2	-3.8	-3.3	-1.6	0.2	-0.1	-3.1	-4.2	-0.8	0.1
Italy	-3.1	-3.1	-3.6	-3.5	-4.4	-3.4	-1.6	-2.7	-5.5	-4.5	-3.8	-3
France	-1.5	-3.1	-4.1	-3.6	-2.9	-2.3	-2.7	-3.3	-7.5	-7.1	-5.3	-4.8
EU average	-1.5	-2.6	-3.2	-2.9	-2.5	-1.5	-0.9	-2.4	-6.9	-6.5	-4.4	-3.9
Gross public debt (% of GDP)												
Greece	104.7	102.6	98.3	99.8	110	107.8	107.3	112.9	129.7	148.3	170.3	156.9
Spain	55.6	52.6	48.8	46.3	43.2	39.7	36.3	40.2	54	61.7	70.5	86
Ireland	34.5	31.8	31	29.5	27.2	24.6	24.9	44.2	64.4	91.2	104.1	117.4
Portugal	53.8	56.8	59.4	61.9	67.7	69.4	68.4	71.7	83.7	94	108.2	124.1
Germany	59.1	60.7	64.4	66.2	68.5	68	65.2	66.8	74.5	82.5	80	81
Italy	108.3	105.4	104.1	103.7	105.7	106.3	103.3	106.1	116.4	119.3	120.7	127
France	57.1	59.1	63.3	65.2	66.8	64.1	64.2	68.2	79.2	82.4	85.8	90.2
EU average	83	80.1	74.5	62.2	58.9	61.6	62.9	62.3	61.9	60.4	61	61.8
Current account deficit (%of GDP)												
Greece	-7.2	-6.5	-6.5	-5.8	-7.6	-11.4	-14.6	-14.9	-11.2	-10.1	-9.9	-2.4
Spain	-3.9	-3.3	-3.5	-5.2	-7.4	-9.0	-10.0	-9.6	-4.8	-4.5	-3.8	-1.1
Ireland	-0.6	-1.0	0.0	-0.6	-3.5	-3.6	-5.3	-5.6	-2.3	1.1	1.2	4.4
Portugal	-10.3	-8.2	-6.4	-8.3	-10.3	-10.7	-10.1	-12.6	-10.9	-10.6	-7.0	-2.0
Germany	0.0	2.0	1.9	4.7	5.1	6.3	7.4	6.2	6.0	6.3	6.2	7.0
Italy	0.3	-0.4	-0.8	-0.3	-0.9	-1.5	-1.3	-2.9	-2.0	-3.5	-3.1	-0.4
France	1.7	1.0	0.4	0.5	-0.5	-0.6	-1.0	-1.7	-1.3	-1.3	-1.8	-2.2
Source: Eurostat												

Similar to the 1980s and early-1990s, the EU, once again, turned into the ‘sponsor’ of Greece’s fiscal profligacy, albeit this time easy-money also channelled thorough the private markets in addition to the structural EU funds. The perverse broader institutional setting, i.e., the abundance of ponzi-cum-funding-opportunities, enabled state agents and dominant policy coalitions to postpone necessary reform measures in an already reform-biased domestic institutional equilibrium. In the post-membership era, the Greek state had an exclusive opportunity to borrow through very low interest rates as credit rating agencies and the international investors perceived Greece as another Germany. EMU membership, in this sense, provided de facto bail out guarantee to the Greek state and private business.

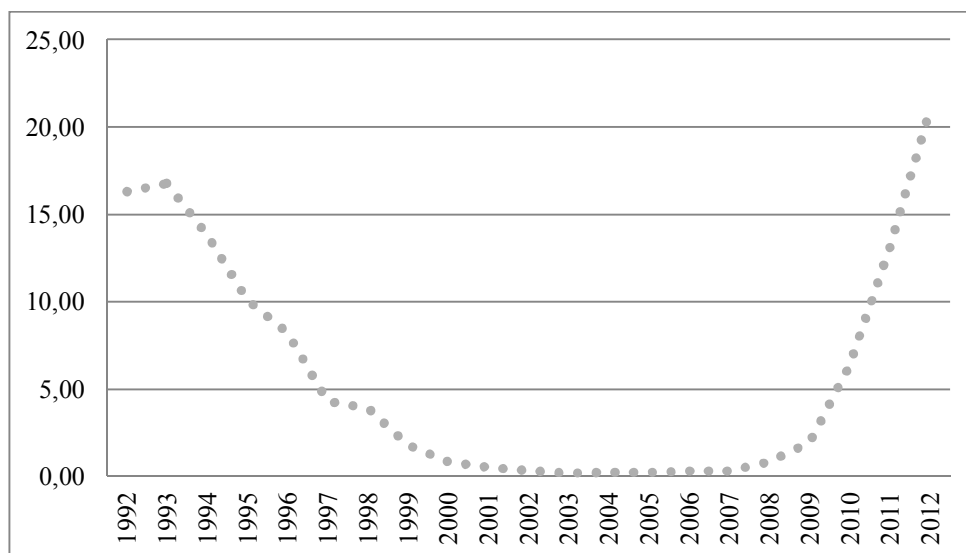
“Greek accession was perceived to convey an implicit bailout guarantee to holders of Greek bonds, with Germany in the role of the guarantor. As a result, markets stopped pricing Greek bonds on the basis of expected fundamentals and started pricing them exclusively on the basis of the best-case scenario, i.e., achievement of full real convergence to German fundamentals.”⁴⁰⁵

Benign expectations of the markets, which were in fact unrelated to the fundamentals of the Greek economy, put a downward structural break in Greek real interest rates.⁴⁰⁶ The long-term rates fell to 6.1 percent in 2000 from 14.4 percent in 1996; government bond yields further slumped to 3.6 percent in mid-2005 and remained less than 5 percent in the pre-crisis period. The difference between German and Greek sovereign spreads, for instance, fell precipitously between 2001 and 2008 (see figure 3).

⁴⁰⁵ Michael G. Arghyrou and John D. Tsoukalas, “The Greek Debt Crisis: Likely Causes, Mechanics and Outcomes,” *The World Economy* 34, no. 2 (2011): 180.

⁴⁰⁶ Michael G. Arghyrou, A. Gregoriou and A. Kontonikas, “Do Real Interest Rates Converge? Evidence from the European Union,” *Journal of International Financial Markets, Institutions and Money* 19, no. 3 (2009): 447–460.

Figure 3. The interest rate differentials between Greece and Germany



The unprecedentedly cheap credit opportunities and lax fiscal and financial regulatory mechanisms motivated the Greek elites to opt for ponzi strategies. Thus the post-2000 period exhibits par excellence exemplars of pervasive moral hazard problems. In our interview, Dimitris Katsikas, underlined this point as follows:

“The economic growth model in Greece was very problematic. Two developments helped us [Greece] to cover these problems [lack of growth model and state’s fiscal profligacy]: first, the irrationality of markets. We used to borrow 20-30 basis points above Germany, [which was nothing to do] with Greece’s economic fundamentals. Effectively [markets] perceived Greece and Germany as single country. This allowed Greece to borrow cheaply. This also allowed public and private sectors to continue wrong growth model based on consumption and imports. Second, euro area governance structure was incomplete. Countries were allowed to follow very different policies. There were more than thirty violations of SGP in this period. This was also a facilitating factor for Greece to be a bad boy.”⁴⁰⁷

⁴⁰⁷ Interview with Dimitris Katsikas, Head of Crisis Observatory, ELIAMEP, June 24, 2014.

Second factor that informed fiscal profligacy and reform-inertia in Greece was rapid financialization of European economies.⁴⁰⁸ The abolition of capital controls in the 1990s and the complete external liberalization of financial markets set the foundations for full-fledged financialization in Europe, including Greece.⁴⁰⁹ The single currency regime amplified the moral hazard problems thanks to the emergence of complex financial interdependence devoid of robust prudential regulatory mechanisms.⁴¹⁰ During 2000-2008, parallel to other European economies, Greek financial sector unprecedentedly bloated (see table 3). For instance, credit institutions' assets over GDP increased from 107 percent to 190 percent in 2008. In this period, the Greek banks extended huge volumes of credits to the Greek state and private business. Furthermore, the banks in core European countries willingly exposed massive credits to the Greek state and households.⁴¹¹ As Crouch argues in a rather more general context, 'privatised Keynesianism' laid the groundwork for lucrative opportunities to satisfy consuming aspirations of the society.⁴¹² Private sector borrowing, primarily the banking system, played intermediary role to sustain the debt-ridden economic model (see figure 2). The

⁴⁰⁸ Krippner defines financialization as "a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production." 'Financial' in Krippner's definition refers to the "activities relating to the provision (or transfer) of liquid capital in expectation of future interests, dividends, or capital gains." Greta R. Krippner, "The Financialization of the American Economy," *Socio-Economic Review* 3, no. 2 (2005): 174-175. Also see Gerald Epstein, ed., *Financialization and the World Economy* (Massachusetts: Edward Elgar Publishing Limited, 2005), 17-46.

⁴⁰⁹ George Pagoulatos, "State-driven in Boom and in Bust: Structural Limitations of Financial Power in Greece," *Government and Opposition* 49, no. 3 (2014): 452-482.

⁴¹⁰ Heikki Patomaki, *The Great Eurozone Disaster: From Crisis to Global New Deal* (London: Zed Books, 2013).

⁴¹¹ For example, German banks' exposure totalled around 420 billion euros; French banks pursued the most aggressive credit policies in the southern periphery with 550 billion euros (almost 30 per cent of the French GDP) as of 2008. I retrieved the data from European Central Bank and Eurostat databases.

⁴¹² Colin Crouch, "Privatized Keynesianism: An Unacknowledged Policy Regime," *The British Journal of Politics and International Relations* 11, no. 3 (2009): 382-399.

ECB data reveals that annual bank lending for housing purchases increased from 15 per cent to 35 per cent of total bank lending during 1998-2007. Similarly, consumer credit increased from 6.5 percent to 16 percent in the same period.⁴¹³ Hence the Greek state had another privilege to sustain economic growth and satisfy popular demands via mounting debts rather than structural fiscal reforms. As Pagoulatos puts “credit-driven, demand-led growth was politically popular, and the high growth rates achieved up to 2008, combined with the low interest rates, generated the kind of complacency that allowed governments to eschew necessary supply-side structural reforms.”⁴¹⁴

Table 3. Credit institutions' assets over GDP

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Greece	107	123	142	156	155	142	124	124	142	147	167	190
Ireland	262	304	240	404	461	364	413	487	583	674	7115	760
Italy	156	143	147	152	152	161	159	164	176	189	217	231
Portugal	237	286	281	274	287	263	252	240	242	255	270	290
Spain	170	173	178	185	193	184	192	204	237	256	281	309
Germany	256	275	287	299	304	297	295	298	304	307	312	316

Source: European Commission AMECO database

The analysis so far suggests that broader institutional structure of the EU, which was underpinned by neoliberal globalization, also informed fiscal profligacy and ubiquitous moral hazard problems already existing in the ill-functioning fisco-financial regime of the Greek state. In short, during the period in question, Greece enjoyed high investment

⁴¹³ European Central Bank, *Structural Indicators for the EU Banking Sector* (Frankfurt: European Central Bank Publications, 2008), Table 4, Table 5, and Table 6; European Central Bank, *Structural Analysis of the EU Banking Sector* (Frankfurt: European Central Bank Publications, 2003), Table 7, Table 8, and Table 9.

⁴¹⁴ Pagoulatos, “State-driven in Boom and in Bust,” *Government and Opposition*, 463.

grades from ratings agencies,⁴¹⁵ attracted ample foreign capital, exploited lucrative credit opportunities accompanied with very low interest-rates, and continued to receive generous structural funds from the EU. In my interviews, the emergent vicious cycle is acknowledged by business and political elites alike:

“The main flaws stemming essentially from the incompleteness of the European project, helped to lock the internal politics on a path that allowed imbalances to persist over time and to become entrenched rather than face soon the inevitable limits to their sustainability. These flaws are (i) the inability to enforce a level regulatory playing field across the single market and accepting the ability of member states to introduce or maintain national legislation and administrative practices that effectively undermine the single market, (ii) that markets were allowed to believe for over a decade that all sovereigns within the euro area had similar risks regardless of their fundamentals and (iii) it was accepted for decades that huge sums of money of European structural funds can be managed and dispensed by inefficient national governments. Thus, the clientelistic politics of Greece were provided with the necessary funds and allowed to trade votes against generous public sector employment and privileges [to the private sector].”⁴¹⁶

The perverse institutional environment amplified reform-inertia and perpetuated economic mismanagement. As Zahariadis puts, “whereas Europeanization is [generally] viewed as national adaptation to European norms, the Greek case shows it also

⁴¹⁵ The role of credit agencies is a controversial issue in the Greek case in particular. They are heavily criticized for magnifying Greek crisis both in the pre- and post-crisis periods. Paul De Grauwe calls this a typical error of credit rating agencies: “The rating agencies make systematic ‘type I’ errors during periods of euphoria, i.e. they fail to cry wolf, when there are wolves in the forest. During periods of depression they make systematic ‘type II’ errors, i.e. they cry wolf all the time, when most of the wolves have left the forest. As a result, they amplify the destabilising movements in the financial markets.” Paul De Grauwe, “Crisis in the Eurozone and How to Deal with It?” *CEPS Policy Brief*, No. 204 (2010), 1.

⁴¹⁶ Interview with Theodore Fessas, President of SEV, June 24, 2014; also interview with Christos Dimas, Member of Parliament, New Democracy, June 24, 2014.

reinforces national idiosyncrasies.”⁴¹⁷ The evidence suggests that Greece’s integration into the euro area without a robust state capacity to discipline and reform its fiscal and financial sectors invited subsequent reform failures. Given the weak state capacity, domestic policy coalitions pursued the least resistant path rather than pushing for substantial competitiveness-enhancing reforms. A careful review of the European Commission reports between 2002 and 2007 demonstrates that Greece was criticized in an increasingly sterner tone regarding the “urgent problems” accumulating in the fiscal balances.⁴¹⁸ It is therefore not surprising that Greece had constantly been one of the “laggards” and “worst performers” in terms of economic reform performance among the EU members.⁴¹⁹ Similarly, according to recent studies, Greece had the lowest reform capacity among OECD member states, which catapulted into a devastating economic crisis in 2009.⁴²⁰

3.6. Conclusion

In this chapter, based on the first phase of three-stage framework, I discussed the emergence and consolidation of a reactive state in Greece during post-authoritarian period. Accordingly, weakening capacity of the Greek state was informed through path-dependent interactions between agents and institutional structures along the domestic-

⁴¹⁷ Nikolaos Zahariadis, “National Fiscal Profligacy and European Institutional Adolescence: The Greek Trigger to Europe’s Sovereign Debt Crisis,” *Government and Opposition* 48, no. 1 (2013): 51.

⁴¹⁸ Especially see European Commission, *Communication from the Commission on the Implementation of the 2003-05 Broad Economic Policy Guidelines*, SEC(2004), 20 final (Brussels: European Commission, January 2004); European Commission, *Greece: Assessment of National Reform Program, 2005-2008* (Brussels: European Commission, 2006), 58-64.

⁴¹⁹ Katinka Barysch, Simon Tilford and Philip Whyte, *The Lisbon Scorecard-VIII: Is Europe Ready For An Economic Storm?* (London: Centre for European Reform, 2008), 10-11.

⁴²⁰ Bertelsmann Shiftung, *Sustainable Governance Indicators* (Berlin: Bertelsmann Shiftung, 2009).

international nexus. All three aspects of Greece's state capacity declined over the years. First, in the post-authoritarian period, Greek political context took a shape of polarized bi-party competition. Thus conflict prone and uncontrolled populism occupied political sphere. Similar to other reactive states, the Greek state was perceived as an arena to be captured —rather than governed— by competing interest groups. Second, state bureaucracy remained fragmented and dependent on patronage politics. Deterioration of the Greek state's internal capacity, in turn, influenced the organization of the interest intermediation structures. Economic and political opportunities, which were structured by the state, led to self-reinforcing processes for further entrenchment of inward-looking rentier coalitions. During the long-lasting PASOK governments under Andreas Papandreou leadership, albeit ebb and flow, reform-inertia prevailed.

An opportunity window was opened up in the Greek political economy with the rise of Simitis to the premiership in 1996. In fact, Simitis was a potential policy entrepreneur with strong professional credentials. His reform attempts, however, did have limited long-term impacts. The Simitis case provides fertile avenues to understand how policy entrepreneurs' reform performance is conditioned by institutional structures in time and context-specific ways. Despite his attempts, Simitis could not alter prevailing fisco-financial paradigm. In the absence of an exogenous shock that would delegitimize the dominant paradigms and redistribute domestic power balances, Simitis could not initiate a new reform-oriented path supported by new winning coalitions. To state somewhat differently, without a trenchant 'game changer,' entrenched coalitions did not experience any ambiguity and uncertainty in regard to their interests. For all these reasons, Simitis

era should be labelled as “path stabilization: marginal adaptation to the environmental changes without changing core principles.”⁴²¹ I will revisit Simitis case in a comparative perspective in chapter 7.

Finally, broader institutional structures that informed Greek state’s reform performance should also be taken into consideration. The Greek case demonstrates that the EU factor is also context-specific. There are three major episodes with regard to the EU factor in the Greek case. In the first episode, Greece’s early membership to the Community retarded state reform capacity during the 1980s. The EU, even in an unintended manner, financed reactive state practices thanks to massive influx of various fiscal transfers. In the second episode, the EU’s role changed during mid-1990s thanks to the acceleration of the EMU project. However, the flawed design of convergence reforms and the poor implementation of Maastricht criteria enabled Greece to become single currency member without instigating a compatible fisco-financial regime. In the third episode, the EU totally ceased to be a reform-encouraging factor for Greece. Perverse incentive structures informed state agents’ behaviour in a way that structural reforms were constantly watered down. Karamanlis governments enjoyed moral hazard problems emanated from the structure of the monetary union and financialization of European economies.

⁴²¹ Bernhard Ebbinghouse, “Can Path Dependence Explain Institutional Change,” *MPIfG Discussion Papers*, no. 2 (2005): 17.

In summary, post-2000 period exacerbated the capacity problems of the Greek state that lead to the accumulation of massive economic problems. This sub-optimal equilibrium paved the way for the 2009 Greek debacle. The crisis ultimately opened up the second phase in three-stage framework proposed in the previous chapter.

Chapter 4. The political economy of 2009 crisis in Greece

4.1. Introduction

The postponement of fiscal reforms and the accumulation of economic problems abruptly surfaced with the eruption of the economic crisis in October 2009, which George Papandreou, the then prime minister, described as the “deepest”, “most tragic” and “hardest times in [Greece’s] post-war history.”⁴²² The crisis endured deep social, political and economic pains. The cumulative decline in GDP reached 30 percent with an astonishing unemployment rate hovering around 28 percent as of the end of 2014. As one observer put eloquently, after four tortuous years, “seen from Greece, Great Depression looks good.”⁴²³ From the perspective of this study, the crisis also disturbed the power balances in the Greek political economy by creating extensive institutional fluidity. The 2009 Greek crisis, by opening up the second-phase of the three-stage framework offered in this study, provided historical opportunity window to implement a new fisco-financial regime via the creation of domestic pro-reform coalitions. However, this opportunity could not be exploited to a significant extent. In fact, the opposite turned out to be the case: Greece decisively plunged into a deadlock and multi-level blame games that have dominated the policy-making agenda over the last five years. Even the most optimistic accounts on Greece’s reform performance acknowledge that there are considerable lags and notable failures.

⁴²² Athens News Agency, “PM Papandreou: The Crisis will be Overcome”, November 28, 2009.

⁴²³ Floyd Norris, “Seen From Greece, Great Depression Looks Good,” *The New York Times*, March 15, 2013.

Why crisis did not lead to the creation of new pro-reform coalitions and give leeway to reform-oriented paradigm change? How agency-level dynamics and institutional structures were interacted that fragmented crisis narratives and blame games dominated the political agenda in the post-2009 period? This chapter offers answers to these questions in line with the conceptual framework offered in chapter 2. To this end, second part provides a brief history of the Greek crisis. Third part discusses the agency and institutional-level dynamics that paved the way for fragmented crisis narratives and multiple blames games, which refers to the third-stage in my conceptual framework. The final part concludes the chapter.

4.2. Greek economic crisis and bailouts: A brief overview

The structural causes of the Greek economic crisis,⁴²⁴ which were discussed in detail in chapter 3, are accumulated incrementally over the years. The proximate causes, however, surfaced after the election of George Papandreou as the new prime minister on October 4, 2009 with 44 percent of the total votes in the elections. Just two days after his ascendance to the premiership, in a private meeting with George Provopoulos, the then governor of the Central Bank of Greece, Papandreou cognized that the budget deficit was heading towards double digit figures instead of 3.7 percent of the GDP as

⁴²⁴ In order to reflect the full dynamics of the crisis in Greece, one should use the term ‘fiscal and financial crisis’ because 2009 Greek crisis has both fiscal dimensions stemming from the public sector profligacy and financial dimensions emanated from the poorly regulated banking system. For the sake of simplicity, however, ‘fiscal and financial crisis’ will be used interchangeably with ‘economic crisis’ throughout the chapter.

previously declared by the outgoing centre-right ND government.⁴²⁵ On 18 October 2009, Papandreou admitted that the previous government covered up the real budget deficits and declared the “true” figures to be around 12.5 percent of the GDP, more than tripling the previous projections.⁴²⁶ As the new government’s spokesperson put, the “unrealistic data” published by the ND government created “exceptionally negative reaction” among European circles.⁴²⁷

Combined with Greece’s very high government debt ratio —around 115 percent of GDP and net external debt almost 100 percent of GDP— and skyrocketed current account deficit —around 13,1 percent of GDP, the revision in budget figures triggered an unprecedented economic crisis. Since it became apparent that Greece was in fact suffering from triple deficits —budget, current account, and credibility— the markets and credit ratings agencies punitively reacted. Fitch Ratings downgraded Greece’s credit notch sharply, which was followed by other leading agencies, first such downgrading in ten years.⁴²⁸ In early 2010, market sentiments vis-à-vis Greece deteriorated precipitously that Papandreou had to announce an anti-crisis plan on March 4, 2010. The government package introduced increase in taxes, freeze on pensions, and cap on civil servants’ pay, bonuses, and recruitments, which targeted to reduce the country’s fiscal deficit by a total

⁴²⁵ Carlo Bastasin, *Saving Europe: How National Politics Nearly Destroyed the Euro* (Washington, D.C.: Brookings Institution Press, 2012), 135.

⁴²⁶ Athens News Agency, “Government Submits New Deficit Figure”, 22 October 2009, Issue no. 3329.

⁴²⁷ Athens News Agency, “Government Blames ND for ‘Credibility Deficit’ at EU”, 22 October 2009, Issue no. 3329.

⁴²⁸ Fitch stated that “the downgrade reflects concerns over the medium-term outlook for public finances given the weak credibility of fiscal institutions and the policy framework in Greece, exacerbated by uncertainty over the prospects for a balanced and sustained economic recovery.” Athens News Agency, “Fitch Downgrades Greek Credit Rating, Government Recasts”, 9 December 2009, Issue no. 3370.

of 4 percent in 2010.⁴²⁹ However, the plan was perceived neither comprehensive nor bold enough to decisively arrest the expansion of the crisis. In fact, Papandreou's initial policy response was fragmented and unsystematic (see below). Following the initial measures, Prime Minister announced a new small set of cost-cutting measures totalling 0,5 percent of GDP. Further revenue-increasing and cost-cutting measures totalling 2 percent of GDP was also introduced in the third wave.⁴³⁰ Despite counter-crisis policy responses, Greece's economic outlook worsened as the European Commission revealed another statistical manipulation in April 2010.

The spasmodic and stop-go nature of the counter-crisis measures injected further uncertainty. The increasing credibility gap of the government pushed the Greek economy into a virtual deadlock and Greek state's bonds were downgraded to "junk" status. Bond yields surged to almost 15 percent, which resulted in Greece's cut-off from the markets in the first quarter of 2010. With no other viable policy options at hand, Papandreou officially requested the EU-IMF support as a 'lender of last resort' on April 23 after a turbulent period of informal negotiations behind the curtain, which spawned subverting speculations.⁴³¹ A joint EC-ECB-IMF mission, called 'troika,' was sent to Athens to negotiate the scope of the bailout package and the conditionality measures

⁴²⁹ Hellenic Republic Ministry of Finance, "Announcement on New Economic and Fiscal Measures," available at <http://www.minfin.gr/portal/> (arrived on February 15, 2014).

⁴³⁰ Ibid.

⁴³¹ I will discuss this point in the next part.

attached to the program. Agreement at the technical level was reached on 2 May 2010 on a comprehensive multi-year program covering three years between 2010 and 2013.⁴³²

Table 4. Troika's assistance to Greece: first bailout package

	DATE	EU	DATE	IMF	TOTAL
1st disbursement	18-May-10	14.5	12-May-10	5.5	20
2nd disbursement	13-Sep-10	6.5	15-Sep-10	2.5	9
3rd disbursement	19-Jan-11	6.5	21-Dec-10	2.5	9
4th disbursement	16-Mar-11	10.9	16-Mar-11	4.1	15
5th disbursement	15-Jul-11	8.7	13-Jul-11	3.3	12
6th disbursement	14-Dec-11	5.8	7-Dec-11	2.2	8
TOTAL		52.9		20.1	73

Source: European Commission Reviews, IMF

The bailout pledged a total of 110 billion euros, unprecedented in the history of the IMF and the EU (see table 4).⁴³³ The then IMF director, Dominique Strauss-Kahn, pointed out that Greece retained “an exceptional level of access” to the IMF resources, “largest access granted to a member country.”⁴³⁴ The bailout package was attached to strict conditionality principles documented in two official documents: Memorandum of Economic and Financial Policies (MEFP) and a more detailed Memorandum of Understanding (MoU) providing a roadmap to reform Greece’s domestic economic landscape.⁴³⁵ The Greek Parliament ratified the Memorandum with the law

⁴³² International Monetary Fund, “IMF Reaches Staff-level Agreement with Greece on €30 Billion Stand-By Arrangement,” *Press Release*, no. 10/176, May 2, 2010.

⁴³³ 80 billion euros was pledged by bilateral loans of euro area member states. IMF funded the remaining 30 billion euros.

⁴³⁴ International Monetary Fund, “IMF Reaches Staff-level Agreement with Greece on €30 Billion Stand-By Arrangement.”

⁴³⁵ European Commission, *The Economic Adjustment Programme for Greece* (Brussels: European Commission Directorate-General for Economic and Financial Affairs Publications, 2010).

3845/2010.⁴³⁶ Hence, a very strict conditionality anchor arose with an “unprecedented combination of expertise and capacity to formulate a detailed plan to stabilize the finances of the Greek government and the macroeconomic fundamentals of Greek economy.”⁴³⁷ Similarly, Ladi argues that the memoranda constitute “the most coercive phase of Greece’s Europeanization since its entry in the EU.”⁴³⁸

The program was an ambitious document standing on three pillars: Fiscal reforms, financial reforms, and structural reforms that fortify the sustainability of fiscal consolidation. On top of the measures already taken by the Papandreou government, MEFP targeted fiscal adjustment amounting to 11 percent of the GDP as of 2013, which was pointed out as the “cornerstone of the program.”⁴³⁹ Accordingly, expenditures should be cut by 7 percent and revenues should be increased by 4 percent to reduce the budget deficit “well below” 3 percent of GDP by 2014.⁴⁴⁰ The program urged the commitment of the Greek government to strengthen the national fiscal policy framework and fiscal institutions by keeping primary balance in a sizeable surplus —minimum 5 percent of GDP— after 2013. The fiscal strategy targeted the decline of the debt-GDP ratio starting from 2013. For achieving program targets, a frontloaded fiscal adjustment was prioritized by the Troika to “avoid reform fatigue.”⁴⁴¹ The fiscal reforms outlined in

⁴³⁶ Henceforth, “MEFP”, “MoU”, “Memorandum”, and “program” would be used interchangeably in this study unless I refer to technical differences.

⁴³⁷ Desli and Pelagidis, “Greece’s Sudden Faltering Economy,” 140.

⁴³⁸ Ladi, “Austerity Politics and Administrative Reform,” *Comparative European Politics*, 202.

⁴³⁹ European Commission, *The Economic Adjustment Programme for Greece*, 40.

⁴⁴⁰ Ibid. Also see International Monetary Fund, *Greece: Staff Report on Request for Stand-by Agreement* (Washington D.C.: IMF Publication Services, May 2010), 10-11.

⁴⁴¹ European Commission, *The Economic Adjustment Programme for Greece*, 42.

the program also covered a wide range of items including tax reform, pension reform, health sector reform, debt management framework, and public administration.

In the financial pillar, the program envisaged two major adjustments.⁴⁴² The immediate concern was to provide liquidity to the financial sector since Greek banks lost wholesale market access in the first quarter of 2010. In 2008, Karamanlis government extended bank assistance package around 28 billion euros to intercept the shocks waves of global financial turmoil.⁴⁴³ However, the amount proved inadequate. The financial sector, which was not in fact the primary problem in the initial phases, was drawn into the Greek debacle following the fiscal insolvency of the Greek state. The non-performing loans reached at 7.7 percent of the total loans disbursed in 2009.⁴⁴⁴ In this environment, Greece's cut-off from the markets further exacerbated the financial woes in the banking system. Hence, the MEFP envisioned liquidity mechanisms for the financial sector via the European Central Bank and the Central Bank of Greece. Second, the medium term concern was to provide stability in the financial system. To this end, the program requested the Greek government to establish a fully independent Hellenic Financial Stability Fund (HFSF) through specific legislation in consultation with the IMF, the European Commission, and the ECB. The HFSF was endowed with 10 billion euros from the bailout package to recapitalize the Greek banks, "if and when such needs

⁴⁴² Since the monetary policy was transferred to supranational level, most of the onus was transferred to the shoulders of the ECB officials and European Commission in regard to financial regulations and new surveillance mechanisms.

⁴⁴³ Papandreou as the leader of main opposition party at the time voted against the plan on the ground that "it constituted a 'blank cheque' to the banks, which was given following negotiations that took place under the table." Athens News Agency, "Parliament Ratifies Bill on Bank Liquidity," November 21, 2008.

⁴⁴⁴ I retrieved the data from the European Central Bank Statistical Data Warehouse.

arouse.”⁴⁴⁵ The Bank of Greece committed itself to “implement intensified supervision and increase the resources dedicated to banking supervision.”⁴⁴⁶

In the structural pillar, the MEFP specified ambitious reform targets to transform the fundamentals of the reactive Greek state. The structural reforms were deemed necessary to ensure ‘internal devaluation’ in the absence of an exchange rate lever. According to the program, the ultimate medium-term goal of the structural reforms was to construct a competitive Greek state by way of arresting state’s fiscal profligacy and ensuring fiscal sustainability:

“[The aim was to] enhance the flexibility and productive capacity of the economy, ensure that wage and price developments restore and then sustain international competitiveness, and progressively alter the economy’s structure towards a more investment and export-led growth model.”⁴⁴⁷

The structural impediments that weakened Greek state’s capacity that was specifically addressed in the plan can be broken down into three titles. First, public administration was to be overhauled through thorough reorganization of the recruitment procedures, establishment of the independent external institutions to review the public administration, and the reduction of the number of civil servants. Second, state-owned enterprises were to be reformed and divested within the context of a comprehensive privatization program. Third, labour and production markets were to be liberalized by

⁴⁴⁵ IMF, *Greece: Ex-Post Evaluation Of Exceptional Access Under The 2010 Stand-By Arrangement* (Washington DC: IMF Publication Services, 2013), 11.

⁴⁴⁶ European Commission, *The Economic Adjustment Programme for Greece*, 24, 47.

⁴⁴⁷ *Ibid.*, 48.

introducing further flexibility in employment and wage policies.⁴⁴⁸ The appendix at the back of this study provides a detailed list of fiscal, financial, and structural reforms. Given the scope of reforms listed in the program, it appears that Greece faced with the most coercive shock over the previous three decades. A Technical Memorandum of Understanding (TMoU) was attached to the program that specified the quantitative performance criteria, indicative targets, structural benchmarks, quarterly program reviews (to be published by European Commission) and consultation clauses.⁴⁴⁹

4.3. A failed reform program: What went wrong in Greece?

In retrospect, five years over the crisis, it is now apparent that Greece is far from being a ‘success story.’ The hard data suggests that bailout programs did not yield the expected/targeted results (see below). During my interviews, all of my respondents also shared the strong opinion that the troika program mostly failed, despite the views of the respondents significantly diverged regarding the reasons that lead to the failure of the program.⁴⁵⁰ The first bailout program aimed at correcting the fiscal and structural deficits of Greek economy, boosting competitiveness and ensuring financial stability. Accordingly, Greece was projected to return to positive growth path by 2012 and to access capital markets as of 2013. The program also projected that unemployment would peak at 14.8 percent in 2012, the debt ratio would start decreasing from 149 percent of

⁴⁴⁸ Ibid., 48-49.

⁴⁴⁹ Ibid., Attachment III, 85-90.

⁴⁵⁰ I conducted 23 semi-structured elite interviews in Greece and in the UK. My sample is composed of political elite from PASOK, New Democracy, SYRIZA, representatives from SEV, GSEE, ADEDY, scholars working on Greek political economy, and think tank experts. For details see the research design and methodology part in chapter 1. Also see appendix 1 and appendix 4.

GDP in 2013, and no debt restructuring was in question.⁴⁵¹ The actual results, however, were far from the program targets: Unemployment reached 28 percent; real GDP shrank around 25 percent; the debt ratio skyrocketed to 175 percent of the GDP and real domestic demand declined around 30 percent (see table 5).

Table 5. Troika program's projections vs. actual figures

	2010	2011	2012	2013	2014*
GDP growth (percent)					
Program Projections	-4	-2.6	1.1	2.1	2.1
Actual ratios	-4.9	-7.1	-6.4	-4.2	0.6
Deviation	0.9	4.5	7.5	6.3	1.5
Gross Public Debt (percent of GDP)					
Program Projections	133.2	145.2	148.9	149.7	148.4
Actual ratios	148.3	170	156**	175.7	174
Deviation	-15.1	-24.8	-7.1	-26	-25.6
Unemployment (percent)					
Program projections	12	14.7	15.2	14.8	...
Actual ratios	11.1	15.9	22.2	25.2	28
Deviation	0.9	-1.2	-7	-10.4	...

Sources: I retrieved program projections from the May 2010 Adjustment Programme. I retrieved actual ratios from the IMF World Economic Outlook Database.

* Actual ratios for 2014 are IMF Projections

** The sharp decline in 2012 was due to debt restructuring including private sector actors, entitled “Private Sector Involvement” (see below).

Greece could not return to economic recovery path and failed to access capital markets despite a total of 210 billion euros disbursed as of June 2013 in addition to a sizeable debt restructuring involving private sector.⁴⁵² Furthermore, non-performing over total

⁴⁵¹ International Monetary Fund, *Greece: Staff Report on Request for Stand-by Agreement*, 1, 35.

⁴⁵² European Commission, *The Second Economic Adjustment Programme for Greece: Third Review* (Brussels: European Commission Directorate-General for Economic and Financial Affairs Publications, 2013), 47.

loans ratio skyrocketed in 2012 to 36.6 percent in consumer loans and 24.5 percent in corporate loans.⁴⁵³ I will discuss in the following section that new supportive coalitions also could not be created so that ownership of the fisco-financial reforms remained at best ephemeral. Thus the failure of the first program necessitated a second bailout package around 130 billion euros.⁴⁵⁴ However, the second adjustment program also suffered from significant reform failures and implementation gaps. The third troika review, for instance, asserted that “several important reform actions being delayed”, “fiscal outlook remains subject to high uncertainty”, “concerns remain about the willingness and capacity of the Greek administration to implement [scheduled] public finance reforms,” and “limited progress [achieved] in privatization.”⁴⁵⁵

The Greek case poses interesting research puzzles. An unprecedented economic crisis levelled the socio-political and economic landscape for the implementation of substantial reforms by delegitimizing and exhausting the prevailing policy paradigms. The IMF-EU anchor also emerged as crucial disciplinary factors in the wake of the crisis. Attached to strict conditionality measures, the bailout programs offered huge amounts of financial assistance, which can alleviate the distributional pressures. Hence, the both the ‘carrots’ and the ‘sticks’ were available to ensure the fiscal and financial reforms. Then, what went wrong in Greece? Why reform program did not generate the expected results? And why domestic ownership could not be generated toward the

⁴⁵³ I retrieved the data from the European Central Bank Statistical Data Warehouse.

⁴⁵⁴ European Commission, *The Second Economic Adjustment Programme for Greece* (Brussels: European Commission Directorate-General for Economic and Financial Affairs Publications, 2012).

⁴⁵⁵ European Commission, *The Second Economic Adjustment Programme for Greece: Third Review*, 1-8.

initiation of a virtuous cycle of reform-activism in Greece? In order to provide answers to these questions, I will refer to the mechanisms offered in the second-stage of my conceptual framework. To this end, I will delve into the crisis narratives of the state agents and external anchors, and try to elucidate how the responses of domestic institutional structures informed post-crisis reform dynamics. This requires a nuanced process tracing uncovering the interactions between agents and institutional structures in a sequential manner during the crisis juncture in Greece. For a proper process tracing, I will use the data I gathered via twenty-three semi-structured elite interviews in my field research, the primary documents such as speeches, press statements, interviews, op-eds, and the secondary materials collected from a variety of sources (see chapter 1 and appendix 4).

4.3.1. Agency-level dynamics: Diverging crisis narratives

One of the important factors that explain Greece's weak reform performance is related to the commitment and domestic ownership problems. The literature suggests that reformist state agents and strong political will play crucial role in reactive states during crisis junctures to steer new policy coalitions throwing their full support to the reform-oriented paradigms. Based on my field research and review of the speeches of relevant agents, I will argue that the commitment problems mainly emanated from the diverging crisis narratives. At the agency-level, Papandreou's crisis narrative diverged from those of German leadership and the troika. In fact, unbridgeable gaps emerged between the parties regarding the sources of the Greek economic turmoil and the measures to be

taken to overcome it. With the deepening of the economic crisis, the agency-level mismatch further widened. As fragmented crisis narratives occupied the policy-making agenda, the proposed reform program suffered from substantial ownership and legitimacy gaps in the eyes of domestic constituency.

Newly elected Prime Minister, George Papandreou, emerged as the key state agent to handle the Greek economic crisis. Papandreou period (October 2009-November 2011) deserves particular attention because the basic parameters of the bailout programs and the dominant mode of relations among key stakeholders were set up during his term in office, which in turn created a path dependent process for the incoming governments. Therefore, this part discusses Papandreou's crisis narrative in an interactive perspective with external anchors and domestic policy coalitions that are entrenched in institutional structures.⁴⁵⁶ There are two distinct phases in this regard: In the first phase, Papandreou could not reveal the true depth of the crisis and could not develop a coherent crisis narrative. Othon Anastasakis pointed out this problem as follows:

“The problem with Papandreou in the initial phases was that at the beginning he did not appreciate the severity of the situation. He continued to promise that ‘there was money,’ and he probably believed in this. He acted as if there wasn't a problem with state finances.”⁴⁵⁷

⁴⁵⁶ In this chapter, I thematically analysed Papandreou's speeches, interviews and op-eds (all in English) between October 2009 and January 2013. All documents are reviewed in a chronological order. I also conducted semi-structured elite interviews with PASOK officials and third party observers closely following the Greek political economy.

⁴⁵⁷ Interview with Othon Anastasakis, Director of European Studies Centre, Oxford University, June 13, 2014.

Thus up to March 2010, Papandreou could not send credible signals to the domestic audience and international players. The Papandreou government did almost nothing even to arrest the expansion of the public debt and budget deficits, let alone instigating paradigm-changing reforms. As one of my interviewees' indicated:

“Papandreou’s earlier response to the crisis was inconsistent, confusing and uncertain. He sent out mixed signals using a different language towards the international audience and a different one towards the domestic constituency.”⁴⁵⁸

In this first phase, Papandreou acted in a paradoxical and contradictory manner: On the one hand, he continued to remain loyal to his pre-election promises regarding government spending and subsidy guarantees. On the other hand, he promised to reduce hefty budget deficits and public debt.⁴⁵⁹ Papandreou repeatedly denied that Greece was on the brink of insolvency. In our interview, Greek deputy ombudsman, Christos Ioannou, defined Papandreou’s crisis management strategy as “romantic”: “Papandreou government’s approach was romantic [because] there was weak understanding of the situation and the real issues at stake [in the initial phases].”⁴⁶⁰

Papandreou’s underestimation of the gravity of the situation and his apparent denial, however, received harsh response from the markets so that government spreads

⁴⁵⁸ Interview with Dimitris Tsarouhas, Professor of European and Greek Politics, Bilkent University, June 10, 2014.

⁴⁵⁹ Ibid. Also interview with Vassilis Monastiriotis, Professor of Political Economy, LSE, May 20, 2014.

⁴⁶⁰ Interview with Christos A. Ioannou, Greek Deputy Ombudsman and Mediator and Arbitrator with the Organization for Mediation and Arbitration in Greece, June 26, 2014.

skyrocketed in early 2010.⁴⁶¹ He reckoned the severity of the situation when the markets harshly responded to the hazy messages of the Greek government. From this point onwards, a second phase started in Papandreou's approach to the crisis. In this stage, he tried to narrate the Greek crisis as "a test case for Europe," composed of domestic, but especially international dimensions. On the domestic side, in most of his speeches, Papandreou accepted that the Greek state had structural problems that necessitate substantial economic reforms:

"[We have a] political system built on clientelism, patronage, inequality and injustice, captive to special interest groups with special privileges, and along with it a huge, over-centralized, inefficient and bureaucratic state, lacking transparency, meritocracy and accountability."⁴⁶²

Papandreou became aware of the fact that Greece was suffering from serious credibility and commitment problems; thereby he tried to send strong signals to his European counterparts and financial markets. Along these lines, he argued that his government was dedicated to offset Greece's credibility problems. Papandreou underlined Greece's credibility gap in almost all of his interviews and speeches during 2010 and early 2011. He constantly argued, however, that his government was not part of the problems accumulated over the years.⁴⁶³ Hence he based his credibility-building strategy on a dichotomic portrayal of the 'old and new Greece.' He blamed the previous government

⁴⁶¹ Dimitris Tsarouhas, "The Political Origins of the Greek Crisis: Domestic Failures and the EU Factor," *Insight Turkey* 14, no. 2 (2012): 92.

⁴⁶² George Papandreou, "Re-inventing Greece: A Leadership Vision", Speech at the Economist Conference <http://papandreou.gr/en/speech-at-the-economist-conference/> (arrived on February 27, 2014).

⁴⁶³ For a crystal clear example of this narrative, see Christiane Amanpour, "Interview with George Papandreou", <http://www.primeminister.gov.gr/english/2010/02/15/prime-ministers-george-a-papandreou-interview-on-cnn/> (arrived on February 27, 2014).

due to “the lack of transparency/accountability in governance and mismanagement of the Greek economy.”⁴⁶⁴ The underlying motivation was to convince the international markets and the European political elite that his government was “different” from the previous ones:

“We had truly a mismanagement of the economy from the previous government... We have had a credibility deficit much more than a financial deficit [but] what I am saying to my counterparts in the European Union is *this is a different government*.”⁴⁶⁵

On the external side, Papandreou blamed international speculators. He narrated the Greek crisis, at least partially, as a product of the unfettered international financial speculators. PASOK leader tried to place Greek turmoil into a structural context to counterbalance financial panic and speculative attacks. He later argued “Greece was only a symptom of much deeper structural problems in the euro zone and vulnerabilities in the wider global economic system.”⁴⁶⁶ In this sense, Papandreou criticized unleashed financial speculation and claimed that his government’s ‘radical reforms’ were not appreciated:

“Our [Greek] crisis has exposed deep flaws in the international economic system, flaws that savage cuts to salaries will not cure. Despite the radical reforms my government has launched, opportunistic traders have forced interest rates on Greek bonds to record highs. Some of these speculators are making a fortune by betting on our nation’s misfortune.”⁴⁶⁷

⁴⁶⁴ Ibid.

⁴⁶⁵ Andrew Marr, “Interview with George Papandreou,” http://news.bbc.co.uk/1/hi/uk_politics/8526880.stm (arrived on February 27, 2014), emphasis added.

⁴⁶⁶ George Papandreou, “Imagine a European Democracy without Borders,” TED Speech, http://www.ted.com/talks/george_papandreou_imagine_a_european_democracy_without_borders/transcript (arrived on February 27, 2014).

⁴⁶⁷ George Papandreou, “Greece is not an Island,” *The New York Times*, March 9, 2010.

He similarly underlined the self-fulfilling effects of the financial speculation and frequently pointed out that Greece's reform endeavour was shadowed by speculators due to the lack of a coordinated and proactive European-level response against overzealous speculative attacks. For instance, in one of his speeches in April 2010, Papandreou put this point as follows:

“Unjust inaccuracies [i.e., financial speculations] undermine the situation and distract people from those real, effective and brave changes, reforms and sacrifices we pledged to proceed with so as to put our house in order.”⁴⁶⁸

Papandreou, therefore, asked for the establishment of European-level fiscal cohesion and solidarity mechanisms to “protect European democracies and people against unfettered financial speculators.”⁴⁶⁹ He tried to convince his European counterparts in the first quarter of 2010 to act in a coordinated way to avoid “Greece's scapegoating” by the markets as the weakest chain in Europe. Papandreou's advisor, Harvard professor Richard Parker, argued in March 2010 that “Athens desperately needs the manoeuvring room that visible European support would provide by driving off the speculators and letting Papandreou's government focus on domestic restructuring.”⁴⁷⁰ The materials cited here and others in the appendix 4 suggest that Papandreou's ad hoc and hastily crafted crisis narrative, which was tried to be articulated in the later phases, based on the

⁴⁶⁸ George Papandreou, “In the Face of a Crisis for Greece and the EU,” Speech at the Economist Conference, <http://papandreou.gr/en/in-the-face-of-a-crisis-for-greece-and-the-eu/> (arrived on February 27, 2014)

⁴⁶⁹ Ibid.

⁴⁷⁰ Richard Parker, “Athens: The First Domino,” *The National Interest*, March 8, 2010.

argument that the real problem was bigger than one country, and Greece was nothing more than a preview of what might still be to come. Thus, Papandreou tried to depict the Greek crisis as a “test case” for European unity:

“We’re in a laboratory right now and let us hope that this test case is a successful one for Europe by in fact putting to the test the unity of Europe in a positive way. Europe has a lot of strength. We need to pool that strength...”⁴⁷¹

As the Greek crisis evolved, however, it became apparent that Papandreou’s perspective diverged from his European counterparts, notably from Germany’s approach to the Greek crisis. For two main reasons this study concentrates on Merkel’s crisis narrative as the main reference point. First, Germany consolidated its regional hegemonic power position thanks to high export performance and current account surplus that outperformed other euro area countries in the post-2000 period. Germany’s trade surplus quadrupled in the decade after the introduction of single currency. Its total current account surplus —977 billion dollars— *alone* was as large as the southern European countries’ *combined* current account deficits —1.16 trillion dollars— over the first eight years of the single currency.⁴⁷² One should note that all southern European countries, without any exception, suffered from chronic current account deficits after their membership to the euro area and none of them had current account surplus even in a single year in the post-2000 period. Hence, Germany stood out as the most resourceful state capable of providing public goods in crisis-torn Europe. Second, the euro crisis

⁴⁷¹ Marr, “Interview with George Papandreou.”

⁴⁷² I retrieved the data from Eurostat.

catapulted Germany into a “reluctant hegemonic position.”⁴⁷³ Accordingly, Angela Merkel occupied the key external actor role in the management of Greek crisis. One should acknowledge at the outset that Germany was not the only important external actor involved in Greek economic crisis.⁴⁷⁴ It is however obvious that Germany single-handedly shaped the basic parameters of the bailout and conditionality programs implemented by the IMF-EU anchor. Therefore, this study attributes a central role to Germany. However, it also takes other actors into consideration and cites wherever they inform the post-crisis management strategies. Based on my interviews and the review of Merkel’s interviews, speeches, and op-eds along with those of her influential finance minister Wolfgang Schäuble, I will claim that Germany’s crisis narrative strikingly diverged from the dominant perspective in Greece.⁴⁷⁵

4.3.2. Diverging interests and ideas: the logic of extreme austerity

Germany’s response to the Greek crisis requires a multi-dimensional analysis along the interests-ideas nexus because neither ‘interests’ nor ‘ideas’ per se explicate the dominant crisis narrative emerged in Germany. In the initial phases, Merkel interpreted the Greek problem as an outcome of Greece’s fiscal profligacy; thereby perceived Greece as a “special” and “exceptional case.” Moreover, Papandreou’s initial fragmented and lax response to the crisis exacerbated Greece’s already grave credibility problems in the

⁴⁷³ William E. Paterson, “The Reluctant Hegemon? Germany Moves Centre Stage in the European Union,” *Journal of Common Market Studies* 49, Annual Review (2011): 57-75.

⁴⁷⁴ European Commission, IMF, and European Central Bank, namely troika, also took part in negotiations.

⁴⁷⁵ In this chapter, I thematically analysed Angela Merkel and her finance minister Wolfgang Schäuble’s speeches, interviews and op-eds (all in English) between October 2009 and January 2013. All documents are reviewed in chronological order.

eyes of the German policy-makers. Based on this background, German Chancellor backed the anti-crisis measures taken by the Greek government but denied any kind of European rescue in the first place on the ground of moral hazard problems. Merkel claimed, in early 2010, “that financial help [to Greece] is not on the agenda. I don’t think it’s advisable to upset the markets by raising false expectations.”⁴⁷⁶ However, Greece completely failed to ensure the trust of the markets as of April 2010. Thus a disorderly default became inescapable in the absence of a bailout package. A possible Greek default was against Germany’s interests for two main reasons.

First, the German and French banks’ exposure to Greece and neighbouring markets were large enough to spark a wave of instability in the German financial system. German and French banks at the time carried a combined 119 billion dollars in exposure to the Greek borrowers, including government bonds, corporate debts, and consumer loans.⁴⁷⁷ If Athens were to default, it was possible for markets to question whether French and German banks could withstand the potential losses, sparking a panic that could reverberate throughout the euro system. Second, and more importantly, Merkel reckoned that a possible Greek default would create negative spillover and domino effects in other southern European economies, mainly Spain and Italy, which were also sitting on the sharp edge of the knife due to the dense interconnectedness of the financial markets in

⁴⁷⁶ Ambrose Evans-Prichard, “Greece Accuses Germany of ‘Squalid Game’ in Debt Crisis,” *The Telegraph*, March 22, 2010. This was also the official policy pursued by Greek government. Both Prime Minister George Papandreou and Finance Minister George Papaconstantinou denied in the initial phases that Greece was in need of fiscal support from the IMF and/or EU.

⁴⁷⁷ Data is gathered from Bank of International Settlement (BIS) database. Also see Vanessa Fuhrmans and Sebastian Moffett, “Exposure to Greece Weighs On French, German Banks,” *The Wall Street Journal*, February 17, 2010.

the euro area. According to Bank of International Settlements (BIS) data, the German and French banks' exposure to southern European countries were around 970 billion dollars at the time.⁴⁷⁸ Given the precariousness of the situation, Merkel had to change her position in April 2010 as the contagion risk turned into a real possibility. Hence, for Merkel, bailing out Greece was perceived "as a necessary evil."⁴⁷⁹

The negotiations over the first bailout package took place in a very tense environment. Germany insisted on a strict conditionality program including harsh austerity measures to overcome Greece's infamous credibility of commitment and moral hazard problems. Papandreou, on the other hand, asked for a "united European response" with a probably more flexible bailout package spanning a longer time horizon while he also accepted that Greece was in need of substantial fiscal reforms. Just before the bailout agreement, Papandreou asked for "time, patience, and calmness":

"We [as Greek government] show determination while making painful decisions and changes. [From Germany and troika] we are asking for time, patience, calmness; to be given a chance to put things in order and get back on the path of normality and sustainable development."⁴⁸⁰

Papandreou, as the leader of social democrat PASOK and the president of Socialist International, did not agree with the spirit of the austerity program because he later admitted that the "people who were not responsible for the crisis [in Greece] were

⁴⁷⁸ Ibid.

⁴⁷⁹ Sebastian Dullien and Ulrike Guerot, *The Long Shadow of Ordoliberalism: Germany's Approach to the Euro Crisis* (London: European Council of Foreign Relations, 2012), 4. This point is important because it demonstrates the guiding motivations behind Germany's decisions during the management of the crisis.

⁴⁸⁰ Papandreou, "In the Face of a Crisis for Greece and the EU."

paying the price for [extreme austerity]. There was a sense of injustice [in the bailout program].”⁴⁸¹ However, Germany stood firm on a very strict austerity program from the initial phases. Consequently, since he had no other policy option Papandreou signed the memorandum, the major elements of which were discussed in the previous part. Merkel’s crisis narrative was quite rigid and matchmaking was beyond the possibility frontier.⁴⁸² In fact, the balance was incomparably asymmetric between the parties that Greece had little bargaining leverage vis-à-vis Germany.⁴⁸³ In my interviews, even the most ardent critics of Papandreou, such as labour unions⁴⁸⁴ and opposition parties⁴⁸⁵ also admitted that Papandreou was in a very difficult situation. The following excerpt eloquently captures how difficult the situation was for the Greek Prime Minister during the April 2010 negotiations in Brussels:

“[When Greek army launched a coup in 1967], military trucks drive up to our house. Soldiers storm the door. They find me up on the top terrace. A sergeant comes up to me with a machine gun, puts it to my head, and says, ‘tell me where your father is or I will kill you.’ [Years later in] Brussels, in April 2010, this time it was not the military, but the markets, that put a gun to our collective heads. What followed were the most difficult decisions in my life, painful to me, painful to my countrymen.”⁴⁸⁶

⁴⁸¹ Neil Macdonald, “Papandreou Talks Greece’s Debt”, <http://www.cbc.ca/news/papandreou-talks-greece-s-debt-1.954851> (arrived on February 27, 2014).

⁴⁸² Interview with Kostas Triantafyllos, Member of Parliament, PASOK, June 19, 2014.

⁴⁸³ Interview with Kevin Featherstone, Director of Hellenic Observatory, LSE, June 11, 2014.

⁴⁸⁴ Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014; interview with Ellie Varchalama, Legal Advisor to GSEE/ADEDY, June 26, 2014.

⁴⁸⁵ Interview with Christos Dimas, Member of Parliament, New Democracy, June 24, 2014;

⁴⁸⁶ Papandreou, “Imagine a European Democracy without Borders.”

The austerity program was exceptional in the post-war OECD history.⁴⁸⁷ As I pointed out in the previous section (also see table 5), MEFP put overambitious targets: 11 percent of fiscal adjustment through 2013, reduction of the budget deficit “well below” 3 percent of GDP by 2014, the stabilization of public debt around 145 percent of GDP in 2014, the implementation of comprehensive structural reforms, public sector lay-offs, and large-scale privatization around 50 billion euros. In fact, most of the commentators warned against the negative effects of excessive austerity measures, which was likely to push Greece in a prolonged slump. For instance, Wolf argued that Greece was asked to do what Latin American countries did in the 1980s, “a lost decade —the beneficiaries being foreign creditors.”⁴⁸⁸ Many analysts also contended that this was a “crisis of design” rather than a mere fiscal profligacy crisis sparked by irresponsible Greek state, as narrated by Germany.⁴⁸⁹ Therefore, as the argument went, disproportionate imposition of austerity measures would not relieve the pressure over the Greek economy and would not strengthen the hands of pro-reform coalitions in Greece.⁴⁹⁰

Even the IMF staffs were sceptical about the success of the program. As a matter of fact, serious concerns were raised about the fragility of the situation stemmed from overoptimistic and ambitious targets that were set in the first place. An internal IMF

⁴⁸⁷ Silvia Ardagna and Francesco Caselli, “The Political Economy of the Greek Debt Crisis: A Tale of Two Bailouts,” *American Economic Journal: Macroeconomics* (forthcoming).

⁴⁸⁸ Martin Wolf, “A Bail-out for Greece is just the Beginning,” *Financial Times*, May 4, 2010.

⁴⁸⁹ See, inter alia, Paul De Grauwe, “The Governance of a Fragile Eurozone,” CEPS Working Paper, no. 346, 2011; Andrew Moravcsik, “Europe After the Crisis: How to Sustain a Common Currency,” *Foreign Affairs* 91, no. 3 (2012): 54-68; Lapavistas et. al., “Eurozone Crisis: Beggar Thyself and Thy Neighbour,” *Journal of Balkan and Near Eastern Studies*, 321-373; Paul Krugman, *End This Depression Now* (New York: W.W. Norton and Company, 2012); Vassilis Faouskas and Constantine Dimoulas, *Greece, Financialization, and the EU* (New York: Palgrave Macmillan, 2013).

⁴⁹⁰ Wolfgang Münchau, “Greece’s Bail-out only Delays the Inevitable,” *Financial Times*, April 18, 2010.

document, highlighting the extreme austerity imposed on Greece, was leaked on May 9, 2010. According to ‘strictly confidential’ Office Memorandum, “the exceptionally high risks of the program were recognized by [the IMF] staff itself, in particular in its assessment of debt sustainability.”⁴⁹¹ Finally, the IMF report published in June 2013 accepted the flawed logic of the bailout program in an unusually direct language:

“Staff made it clear that the program [...] was an ambitious program that was subject to considerable risks. The adjustment needs were huge, reforms would be socially painful, and commitment might flag. Debt was not judged to be sustainable with high probability and it would take little in the way of a deviation from program assumptions or an external shock to generate a less favourable debt trajectory.”⁴⁹²

German Chancellor, however, argued that “the austerity program is sustainable [and] there is no other way.”⁴⁹³ At this point, one should question the motivations that inform Germany to develop a crisis narrative that put exclusive emphasis on very strict austerity measures. I will suggest that Germany’s excessive response couldn’t be explained with reference to German interests per se. In a rather paradoxical way, a possible deepening of the economic recession in Greece and contraction in the wider euro area was also against the immediate interests of export-oriented German economy. Therefore, deflationist risks associated with the memorandum were posing considerable risks for Germany. There was also an imminent risk that front-loaded harsh austerity measures

⁴⁹¹ IMF, *Office Memorandum: Board Meeting on Greece’s Request for an SBA*, May 9, 2010. Available at <http://online.wsj.com/public/resources/documents/Greece-IMF-2010-Bailout-Minutes.pdf> (arrived on February 1, 2014), 2

⁴⁹² IMF, *Greece: Ex-Post Evaluation Of Exceptional Access Under The 2010 Stand-By Arrangement*, 26.

⁴⁹³ Angela Merkel, “Greece’s Austerity Programme ‘Ambitious and Sustainable,’” May 2, 2010, http://www.bundestkanzlerin.de/Content/EN/Artikel/2010/05/2010-05-02-griechenland-hilfen_en.html (arrived on February 27, 2014).

may hamper the creation of pro-reform coalitions by diverting the attention of the Greek constituency. Then, why did Merkel and her team insist on extreme measures, possibly to the detriment of a possible reformist path in Greece? In order to address this puzzle, we need to refer to the constitutive roles of ideas at crisis moments, characterized by intense uncertainty. In chapter 2, I discussed that ideas play crucial enabling/constraining roles in shaping, guiding, and conditioning agency behaviour at critical junctures. Thus, along with interests, ideas also shape the main parameters of crisis narratives developed by agents in times of massive fluidity.

The ideational political economy paradigm that informed the parameters of Germany's crisis narrative was ordoliberalism. Ordoliberalism has historical roots in the German economic thinking and reflects a cross-party compromise in Germany.⁴⁹⁴ Bonefeld defines ordoliberalism as “the theory behind the German social market economy [which argues] that free economy presupposes the exercise of strong state authority.”⁴⁹⁵ The central tenet of ordoliberalism is that the state should regulate the markets in such a way that economic outcomes approximates to perfectly competitive markets. To that end, it calls for a state-centric approach to provide a constitutional-legal framework, an *ordo*, “which obliges countries to adhere to strict fiscal discipline and for automatic sanctions

⁴⁹⁴ Ordoliberalism emerged toward the end of Weimar Republic (1919-1933). This period is characterized with hyperinflation, mass unemployment, and depression. For the history of ordoliberalism, see Razeen Sally, “Ordoliberalism and the Social Market: Classical Political Economy from Germany”, *New Political Economy* 1, no. 2 (1996): 233-256; also see Werner Bonefeld, “German Ordo-liberalism and the Politics of Vitality,” *Renewal* 20, no. 4 (2013): 35-39.

⁴⁹⁵ Werner Bonefeld, “Freedom and the Strong State: On German Ordoliberalism,” *New Political Economy* 17, no. 5 (2012): 633.

if the constitutional framework is violated.”⁴⁹⁶ Apart from state’s legal-based regulatory function, however, ordoliberalism rejects the Keynesian demand-side expansionary fiscal and monetary policies to stabilize the economy even during recessions on the ground that it would create moral hazard problems and lack of will to implement necessary economic reforms.

There are three main aspects of ordoliberal paradigm that conditioned the main contours of Germany’s crisis narrative.⁴⁹⁷ First, ordoliberal paradigm considers government deficits and public debts as the only area that rule-based cooperation is required. The coordination on the supply-side policies such as wages, social security policies, and labour market reforms are the not the primary concerns of the ordoliberal paradigm.⁴⁹⁸ In this respect, Germany insisted that euro area countries should emulate and follow the best model rather than asking for supply-side coordination and financial assistance to mitigate transnational economic imbalances. In her speech at the World Economic Forum, Merkel put this point as follows:

“I’ve heard the claims that Germany is the cause of economic imbalances. If this is about imbalances due to different levels of competitiveness, we have come to a very interesting point in Europe. Do we want coherence without ambition? Then

⁴⁹⁶ Volker Berghahn and Brigiette Young, “Reflections on Werner Bonefeld’s ‘Freedom and the Strong State: On German Ordoliberalism’ and the Continuing Importance of the Ideas of Ordoliberalism to Understand Germany’s (Contested) Role in Resolving the Eurozone Crisis,” *New Political Economy* 18, no. 5 (2013): 775.

⁴⁹⁷ For a similar discussion on Germany’s contested role in euro area crisis, see Sebastian Dullien and Ulrike Guerot, *The Long Shadow of Ordoliberalism*.

⁴⁹⁸ As Lapavitsas et. al. argue “Germany has been unrelenting in squeezing its own workers throughout this period” and German political elite did not implement these policies in a coordinated way with other euro area economies. This unilateral approach evoked kind of “beggar thy neighbour” policies in the euro area. For comprehensive review, see Lapavitsas et. al., “Eurozone Crisis: Beggar Thyself and Thy Neighbour,” *Journal of Balkan and Near Eastern Studies*, 336-241.

we'll meet somewhere in the middle. Or do we want to look and see *who does what best and try to emulate the best in Europe?*"⁴⁹⁹

In a similar view, the worsening current account balances of the peripheral countries are interpreted as their own faults because they did not avoid a loss of competitiveness and excessive consumption.⁵⁰⁰ Hence, the recipes that Merkel eagerly proposed to Greece was outright wage cuts, reduction in expenditures, and increases in taxes. Second, German ordoliberal paradigm argues that harsh austerity measures do not necessarily lead to depression and negative growth prospects. On the contrary, it would mitigate moral hazard problems and credibility gaps, which in turn positively inform debt dynamics and growth projections. Accordingly, the fiscal discipline and extreme austerity is the most cogent way to improve debt dynamics because it would send strong signals to the markets by increasing the credibility of debtor countries' commitments and thereby boosting private sector confidence. It is because of this reasoning that Merkel indirectly sidelined Papandreou's "financial speculation" thesis and primarily approached the bailout issue from a moral hazard perspective.

Third, Germany challenged the idea of debt mutualisation and the introduction of eurobonds from the very beginning of the crisis due to the same ordoliberal perspective.

⁴⁹⁹ Angela Merkel, "Speech by Dr. Angela Merkel, Chancellor of the Federal Republic of Germany, at the World Economic Forum Annual Meeting, January 25, 2012," <http://www.bundestkanzlerin.de/ContentArchiv/EN/Archiv17/Reden/2012/2012-01-25-bkin-rede-davos.html> (arrived on March 1, 2014).

Emphasis added.

⁵⁰⁰ In her speech at European Parliament on November 7, 2012, German Chancellor argued "if all the member states had stuck to the agreed thresholds and engaged in reform to increase their competitiveness, economic and monetary union would never have been embroiled in such a crisis." Angela Merkel, "Speech by Federal Chancellor Angela Merkel in the European Parliament in Brussels", <http://www.bundestkanzlerin.de/ContentArchiv/EN/Archiv17/Reden/2012/2012-11-07-merkel-eu.html> (arrived on March 2, 2014)

Merkel's determined rejection of Papandreou's —and other European leaders— solidarity requests is a clear reflection of Germany's adherence to a system of rule-based fiscal and monetary prudence. Based on this logic, rather than mutualisation of member states' public debt to demonstrate "European solidarity," Germany proposed a fiscal compact to promote "culture of stability." Along these lines, Merkel stipulated a constitutionally mandated debt brake "with which the member states cannot simply run up debts but rather must strive for economic strength and financial stability."⁵⁰¹

The debate so far reflects that not only conflicting interests but also the incommensurability of diverging ideas informed the mismatch of the two sides' crisis narratives. Social democrat and Keynesian Papandreou and his team asked for more time, more flexible bailout package, more EU-level coordination, and more accommodative fiscal and monetary policies. Christian democrat and ordoliberal Merkel and her team, in return, proposed a bailout package attached to excessively austere conditionality measures.⁵⁰² It appears that German leadership was very clear about the accuracy of ordoliberalist principles and had no suspicion whether or not they would work in the Greek context. Papandreou, on the other hand, experienced difficulties in developing a coherent crisis narrative in the initial phases. As Tsoukalis puts,

⁵⁰¹ Angela Merkel, "Speech by Federal Chancellor Angela Merkel at the Opening Ceremony of the College of Europe on November, 2, 2010," <http://www.bruessel.diplo.de/contentblob/2959854/Daten/> (arrived on February 10, 2014).

⁵⁰² Immediately after his resignation, Papandreou openly accused conservative politicians, first and foremost Merkel, for dividing the European nations and scapegoating southern Europe including Greece. For instance in one of his speeches on 25 November 2011, he argued, "the conservatives, while talking about a strong Europe, have divided us, have created new fissures, new fears, new nationalisms and new scapegoats." See George Papandreou, "Speech at the Progressive Convention of the PES," <http://papandreou.gr/en/speech-at-the-progressive-convention-of-the-pes/> (arrived on February 27, 2014).

“Papandreou failed to develop and articulate a coherent and consistent strategy for economic reform and adjustment.”⁵⁰³ Therefore, May 2010 bailout program emerged as a sub-optimal deal in the first place.⁵⁰⁴ Papandreou admitted latter that Greece was “punished by Germany” in Brussels in May 2010. “Merkel said very clearly to me,” claimed Papandreou, “someone has to be seen to be punished, so others don’t do this in the future.”⁵⁰⁵ Three years later, Papandreou expressed his disappointment in Brussels summit in April 2010:

“Instead of reaching out to the collective wisdom in our societies, investing in it to find more creative solutions, we have reverted to political posturing [during the May 2010 bailout summit in Brussels]... Those profligate, idle, ouzo-swilling, Zorba-dancing Greeks... They are the problem! Punish them!”⁵⁰⁶

In summary, the narrative mismatch at the agency-level created insurmountable obstacles in terms of the ownership of the reform program.⁵⁰⁷ In one of my interviewees’ words, this triggered “a vicious cycle of multiple blame games.”⁵⁰⁸ Papandreou found himself in a position to implement a reform package whilst denouncing it at the same time. Not surprisingly, as a result, Papandreou government started to depict serious

⁵⁰³ Loukas Tsoukalis, “Greece in the Euro Area: Odd Man Out, or Precursor of Things to Come?” in William Cline and Guntram B. Wolff, eds, *Resolving the European Debt Crisis* (Washington DC: Peterson Institute for International Economics, 2012), 32.

⁵⁰⁴ For the sub-optimal nature of the bailout packages, see Silvia Ardagna and Francesco Caselli, “The Political Economy of the Greek Debt Crisis: A Tale of Two Bailouts,” *American Economic Journal: Macroeconomics* (forthcoming).

⁵⁰⁵ Gavin Hewitt, *The Lost Continent: Europe’s Darkest Hour Since World War Two* (London: Hodder & Stoughton, 2013), 84.

⁵⁰⁶ Papandreou, “Imagine a European Democracy without Borders.”

⁵⁰⁷ Interview with Kostas Triantafyllos, Member of Parliament, PASOK, June 19, 2014; interview with Dimitris Sotiropoulos, Advisor to Lucas Papademos, June 24, 2014; interview with Dimitri Papadimitriou, Professor of Political Science, University of Manchester, June 18, 2014; interview with Sotirios Zartaloudis, Lecturer, Loughborough University, June 16, 2014.

⁵⁰⁸ Interview with Kevin Featherstone, Director of Hellenic Observatory, LSE, June 11, 2014.

deviations in terms of the ‘ownership of the program’ and the ‘ownership of the reforms.’⁵⁰⁹ Troika’s third review, in a much sterner tone of warning, highlighted many crucial “delays” and “disappointing” reform performance in the fiscal and structural realms envisioned in May 2010 program.⁵¹⁰ The narrative mismatch at the agency-level, however, constitutes just one side of the coin. Institutional structures at the Greek domestic plane further constrained the instigation of a virtuous cycle of reform-activism in the post-2010 period.

4.3.3. Institutional structures: Constraining factors at work

The institutional structures also exacerbated the collective action problems and constrained proper implementation of the reform program in the Greek context. In fact, the institutional structures and agents mutually contributed to the emergence of a vicious cycle in the Greek case, as a result of which blame games and muddling thorough triumphed the consensus-based policy-making. I argued in chapter 2 that new supportive coalitions need to be created and entrenched ones to be dismantled in order to craft a high-level equilibrium in reactive states. The responses of the institutional structures and their mode of interactions with the agents are decisive in this regard. To this end, political context, state bureaucracy, trade unions, and business associations play key roles. In the following part I will discuss constraining roles of these institutional structures and try to elucidate how complex interactions between agency and

⁵⁰⁹ European Commission, *The Economic Adjustment Programme for Greece: Third Review* (Brussels: European Commission Directorate-General for Economic and Financial Affairs Publications, 2011).

⁵¹⁰ *Ibid.*

institutional-level dynamics informed muddling through in the third phase of the three-stage framework.

4.3.3.1. Political context

First, domestic political context turned out to be an important factor that adversely informed Greece's reform performance. The conflictual and polarized political culture, which has historically been an integral aspect of reactive Greek state, continued to play a constraining role in the post-2009 period. The main opposition party, ND, questioned the logic and legitimacy of the reform program in the first instance. As discussed in the previous part, blaming the previous ND government as the main architect of Greece's economic havoc constituted the backbone of Papandreou's credibility-building strategy. However, this policy backlashed in the post-memorandum process because, as Papandreou burned all bridges with ND, he lost a critical opportunity to implement the reforms in a consensus-based political environment. On the other side of the coin, ND opted for traditional intentional polarization strategy for the sake of short-term political calculations. As a result, ND voted against the reform program in the Parliament on May 6, 2010. Antonis Samaras, the leader of the ND, declared that they would not show "tolerance" for PASOK's policies during the implementation of the MEFP:

"We vote against it not because we refuse the financing support, which (the ruling) PASOK rendered indispensable now, but because we disagree with the policies that led us up to here as well as with the government's economic strategy for handling the crisis. The government does not need our vote to pass

the relevant bill. It simply wants a ‘vote of tolerance’ for its policies.”⁵¹¹

In fact, ND took a very ambivalent stance vis-à-vis the MEFP. On the one hand, Samaras assured the troika, European Parliament, German and French leadership that his party would “commit itself to the agreements that are signed by the Greek state, because the Greek state has continuity;”⁵¹² on the other hand, Samaras severely criticized the harsh austerity measures attached to the MEFP and Papandreou’s handling of the crisis. One of my interviewees, a member of parliament representing ND, put the issue as follows:

“We needed more realistic program, something which could actually be implemented and have successful results. The problem with 2010 memorandum was that it did force the Greek state to cut down wages, pensions, and salaries [but failed to promote] new employment opportunities, growth, and development. That was the main reason for ND to oppose the memorandum. ND believed that first memorandum would not help the country get out of the crisis... That’s why we did not support and voted in favour of the memorandum at the time.”⁵¹³

Aware of the potential popular backlash against the memorandum, Samaras exploited the fragile political context to consolidate its own electoral base via confrontational political manoeuvres rather than interpreting the crisis as an opportunity window to reform Greece’s wrecked economic system within the framework of a consensus-based national strategy.⁵¹⁴ Other critical political stakeholder at the time, which even became

⁵¹¹ Athens News Agency, “ND to Vote against Greece’s EU-IMF Financing,” May 5, 2010.

⁵¹² Athens News Agency, “ND Leader Phone Contacts with Commission, EPP Chiefs,” May 6, 2010.

⁵¹³ Interview with Christos Dimas, Member of Parliament, New Democracy, June 25, 2014.

⁵¹⁴ Dora Bakoyannis, the daughter of Konstantine Mitsotakis, voted in favour of the memorandum. Samaras immediately expelled her from the party.

more important thereafter, SYRIZA, categorically rejected the memorandum, burned all bridges with the Papandreou government, and adopted a full-fledged anti-austerity rhetoric. In our interview, SYRIZA representative put the issue in a rather blunt way:

“Papandreou was executing what he was ordered to... He was like the puppet of the markets [and the troika]. Thus we [SYRIZA] became the main agent of anti-austerity movement in Greece. And we did a good job.”⁵¹⁵

Papandreou also experienced insurmountable difficulties in ensuring intra-party discipline. During the election campaign, PASOK’s motto was ‘there is money’ (*lefta uparxoun*). PASOK promised to expand state expenditure through a rationalized and better-governed social welfare services. Consistent with its pre-election promises, Papandreou government pursued expansionary policies in the initial months. The necessity to implement severe cuts after May 2010, however, disturbed the balances within PASOK. Some members of Papandreou’s party, primarily traditionalist wing, staunchly opposed to the drastic cuts and reform proposals of the troika program. This created fractions and collective action problems within PASOK:

“Within the cabinet of Papandreou government, there was a high degree of non-coordination. His first government included a mix of technocrats such as the finance minister but the cabinet also included some so-called PASOK traditionalists. And they were placed in key positions like the ministry of national economy. What they [PASOK traditionalists] were communicating was MoU was external imposition that PASOK should not commit to its full implementation. In other words, there was a lack of coordination in the cabinet of Papandreou.”⁵¹⁶

⁵¹⁵ Interview with Lefteris Kretsos, Representative of SYRIZA, June 7, 2014.

⁵¹⁶ Interview with Dimitris Tsarouhas, Professor of European and Greek Politics, Bilkent University, June 10, 2014.

Gradually intensifying political tug-of-wars, lack of effective political leadership, and intra and inter-party coordination failures jointly hampered the coherent supply and consistent implementation of counter measures in the wake of the crisis.⁵¹⁷ My findings are also compatible with other studies in the literature. In their research, Vasilopoulou, Halikiopoulou, and Exadaktylos report that more than one third of Samaras' speeches and more than half of SYRIZA leader's speeches had a direct blaming tone towards other political parties, IMF, troika, and Germany during 2009-2011.⁵¹⁸ Greek political landscape took a turn for the worse and depicted an entirely fragile equilibrium in the post-Papandreou period, a point I will turn back in the following section.

4.3.3.2. Dominant policy coalitions

Second, dominant policy coalitions played a crucial role that informed Greece's reform performance in the post-memorandum process. As discussed in chapter 3, trade unions, business associations, and other small but deeply entrenched rent-seeking interest coalitions have been integral aspects of reactive Greek state. Hence, their response to the MEFP was as critical as the reactions of the political parties. I hypothesized in the conceptual framework that the creation of new winning coalitions is necessary to ensure domestic ownership of the proposed reform agenda and its proper implementation. In the Greek case, however, an opposite trend occurred. The major trade unions and small

⁵¹⁷ Interview with Dimitris A. Sotiropoulos, Advisor to Lucas Papademos, June 24, 2013; interview with Dimitris Katsikas, Head of Crisis Observatory, ELIAMEP, June 24, 2014.

⁵¹⁸ Sophia Vasilopoulou, Dafne Halikiopoulou, and Theofanis Exadaktylos, "Greece in Crisis: Austerity, Populism and the Politics of Blame," *Journal of Common Market Studies* 52, no. 2 (2014): 395-396.

interest groups categorically rejected the policy mix of the adjustment program. The two leading peak associations ADEDY, the public servants trade union, and GSEE, the umbrella organization of the Greek labour class, organized mass strikes and public demonstrations. One of the cornerstones of the troika program was to overhaul the public administration to improve state's fiscal capacity. In his Parliament speech, on May 7, 2010, Papandreou also expressed his tenacity to abolish "the second public sector that was set up over the last five years."⁵¹⁹ However, the reaction of the ADEDY was severe. The public bureaucracy immediately rejected the reform proposals and public servants' institutional representative ADEDY dismissed the bailout program due to "the lack of proper dialogue and consultation." ADEDY in cooperation with GSEE asked for "renegotiating the [austerity program] to alleviate the negative impacts and social tensions."⁵²⁰ The GSEE's initial reaction was also identical. GSEE challenged the austerity measures on the ground that MEFP was unilaterally imposed on Greek people without any prior consultation to the social partners. ADEDY and GSEE severely criticized the Papandreou government and troika because of "top-down imposition of reform program." Secretary General of GSEE, Zoe Lanara, claimed during the interview "that necessary coordination and consensus toward the implementation of the fiscal

⁵¹⁹ According to Papandreou, "since 2004 there were 60,000 new employees appointed to the public sector... New contract workers exceeded 100,000 and 50,000 young people were in fake stage programmes. A second public sector was set up in five years." See, Athens News Agency, "Parliament OK's Bailout Scheme," May 7, 2010.

⁵²⁰ Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014. Also see, Zoe Lanara, *The Impact of Anti-crisis Measures and the Social and Employment Situation: Greece* (Brussels: European Economic and Social Committee, 2012), 9.

reforms was not launched.”⁵²¹ Legal adviser to GSEE, Ellie Varchalama emphasized a similar point:

“The program was implemented in such a rapid way/procedure that no consultation and dialogue took place with social partners. There was no time for social dialogue. Who cares about social partners? Even the parliament [was sidelined] in 2010, it was a huge blow to democracy in Greece. We signed papers with employers underlining that we did not agree with the measures. [They would lead to] irreversible anarchy.”⁵²²

The GSEE president, Yannis Panagopoulos, immediately published a declaration, which claimed that Germany’s unilateral imposition of the austerity measures would cause irrevocable harm on working classes and social fabric in Greece:

“These are the most socially unjust and harsh measures of the modern history of the country. It is not only socially unjust and economically cyclonic. They will lead the economy into a deep freeze and the world of work in very difficult times... Labour and social rights are delivered prey to the appetites.”⁵²³

The labour unions categorically rejected the troika program on the ground that the proposed reforms would deepen the economic crisis in Greece and lead the collapse of domestic consumption. In the initial phases, according to union representatives, their proposals to craft a better program were taken into account neither by troika nor by the government:

⁵²¹ Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014.

⁵²² Interview with Ellie Varchalama, Legal Advisor to GSEE/ADEDY, June 26, 2014.

⁵²³ The General Confederation of the Greek Workers, “Declaration: President of GSEE Yannis Panagopoulos” available at http://www.ucbf.org/modules/news/article.php?storyid=129&sel_lang=english (arrived on February 10, 2014).

“It was clear that the program would lead to recession and unemployment. [The program was to] lead an increasingly larger part of the population to a dramatic reduction in wages, pensions, and incomes. By May 2010, the GSEE submitted its proposals and unfavourable forecasts regarding the implementation of internal devaluation program. None of our proposals were taken into consideration by troika and the government.”⁵²⁴

On the business side, SEV, Hellenic Federation of Enterprises, initially supported the reform program. SEV Chairman, Dimitris Daskalopoulos challenged the trade unions in SEV annual meeting on May 11, 2010 by arguing, “painful measures we are called to undergo are not some international conspiracy for the oppression of our country [...] they are a much-needed therapy” to overhaul profligate state structures, fiscal irresponsibility, and pervasive vested interests.⁵²⁵ Nevertheless, SEV also took a cautionary tone on the sub-optimal nature of policy-mix proposed by the program. In fact, in a short time period, SEV also raised its criticism to the troika program because of its “anti-growth bias.” In our interview, Daskalopoulos highlighted this point:

“SEV supported the reforms proposed by the troika because these were the very same reforms that SEV had been clamouring for during the last 15 years at least. However, this does not mean that we approached the MoU uncritically. As early as June 2010 we came out with a public statement pointing out the mistakes in the troika’s policies, especially regarding the violence of the fiscal austerity measures. A bit later in November of the same year we handed to the EU (to the president of the EU, to the president of the Commission and to the Commissioner for Economic and Monetary Affairs) a detailed memorandum detailing the

⁵²⁴ Interview with Savas Robolis, Scientific Director of Labour Institute (INE)/GSEE-ADEDY, June 24, 2014.

⁵²⁵ Dimitris Daskalopoulos, “Hellenic Federation of Enterprises Annual General Assembly, May 11, 2010”, Speech of the Chairman, <http://www.sev.org.gr/online/viewNews.aspx?id=1721&mid=8&lang=en> (arrived on February 20, 2014).

problems with the economic policy demanded by troika. In the same document we suggested specific remedial action.”⁵²⁶

As the austerity measures started to bite the private sector and contracted the economic output and private consumption, SEV sent a memo with an accompanying report to the Papandreou government and troika representatives, which suggested amendments on the program. However, according to SEV officials, “their suggestions fall on deaf ears.”⁵²⁷ Therefore, SEV became a critic of the program as well, a point I will revisit in the next part. The absence of a coherent crisis narrative at the agency-level and the unilateral imposition of the harsh austerity measures exacerbated the ownership problems because it became very difficult for Papandreou to create new distributional coalitions vis-à-vis the entrenched rent-seeking policy communities. Christos Ioannou, from the Organization for Mediation and Arbitration in Greece, underlines the “failures to build coalitions for reforms” as follows:

“The troika appeared primarily the initiator of cuts and reforms, but their aims neglected the benefits of consultation and led to a complete break-up with the public sector employees, their representatives and with large segments of the state bureaucracy.”⁵²⁸

On May 5, 2010, ADEDY and GSEE called for “strong social struggles” against austerity measures and organized a general strike in Athens. In response to Papandreou

⁵²⁶ Interview with Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014.

⁵²⁷ Interview with Michael Mitsopoulos, Senior Advisor to the President of SEV, June 23, 2014.

⁵²⁸ Interview with Christos A. Ioannou, Greek Deputy Ombudsman and Mediator and Arbitrator with the Organization for Mediation and Arbitration in Greece, June 26, 2014. Also see Christos A. Ioannou, “Greek Public Service Employment Relations: A Gordian Knot in the Era of Sovereign Default,” *European Journal of Industrial Relations* 19, no. 4 (2013): 302.

government's approval of the spending-cuts, public sector layoffs and tax increases, more than 100,000 people marched through the Parliament building in Athens, which was the largest public protest since the restoration of democracy in Greece.⁵²⁹ The protestors were coming from different political and sociological backgrounds but they all believed that they were treated unfairly and were not themselves to blame for their situation. The two targets in their blame attribution were the 'corrupt' Greek political establishment and German leadership as the chief architect of the unjust and unfair measures imposed on Greek people.⁵³⁰ The sense of widespread injustice and relative deprivation,⁵³¹ combined with a strong protest culture,⁵³² triggered a series of demonstrations that paralyzed the economic and socio-political life during Papandreou's premiership. 14 general strikes took place between 2010 and 2011, a number far beyond the south European averages (see table 6). In addition to general strikes, a total of 7,123 demonstrations organized just in 2010, in which "about 30 per cent of the entire population engaged."⁵³³

⁵²⁹ Interview with Savas Robolis, Scientific Director of Labour Institute (INE)/GSEE-ADEDY, June 24, 2014; Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014.

⁵³⁰ The protests turned into violent attacks as three people, one of them a pregnant woman, were killed when some of the protestors threw petrol bombs at a bank branch.

⁵³¹ In his seminal study, Ted Gurr offers a theoretical explanation on the relationship between wide sense of injustice, relative deprivation, and rioting practices. Ted Gurr, *Why Men Rebel* (Princeton, NJ: Princeton University Press, 1970).

⁵³² There is an established body of research on the "institutionalization of protest culture in Greece." For a critical analysis, see Aikaterini Andronikidou & Iosif Kovras, "Cultures of Rioting and Anti-Systemic Politics in Southern Europe," *West European Politics* 35, no. 4 (2012): 707-725.

⁵³³ Wolfgang Rüdiger and Georgios Karyotis, "Who Protests in Greece? Mass Opposition to Austerity," *British Journal of Political Science*, ifirst version (2013): 11, 23.

Table 6. Number of general strikes in southern Europe (2002-2011)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Greece	1	0	1	3	2	1	1	1	7	7
Spain	1	0	0	0	0	0	0	0	1	0
Portugal	1	0	0	0	0	1	0	0	1	0
Italy	2	2	2	1	0	0	1	1	1	2

Source: Wolfgang Rüdig and Georgios Karyotis, “Who Protests in Greece? Mass Opposition to Austerity,” *British Journal of Political Science*, ifirst version (2013): 11.

In the aftermath of May 2010, Papandreou government was stuck between a rock and a hard place. Papandreou found himself in a position to implement an extremely austere package despite he disagreed with many aspects of it. Lack of a coherent crisis narrative in the initial phases and Papandreou’s inability to negotiate a more flexible bailout scheme also jeopardized his reputation and credibility at home. Moreover, major political parties entered into a vicious cycle of conventional tug-of-wars and short-sighted blame games, which dominated the third-stage in my conceptual framework.⁵³⁴

4.3.4. Third-stage: Olsonian deadlock and blame games

The narrative mismatch at the agency-level, troika’s insistence on harsh front-loaded austerity measures, Papandreou’s leadership failures, and the resistance of domestic institutional structures paved the way for a sub-optimal equilibrium, i.e., Olsonian deadlock and blame games in the third-phase of the three-stage framework offered in this study. In this phase, worsening macroeconomic conditions and deepening recession due to austerity measures informed domestic reform dynamics in a spiralling way that

⁵³⁴ Interview with Othon Anastasakis, Director of European Studies Centre, Oxford University, June 13, 2014.

plunged Greek political economy into an ultimate deadlock. In fact, growth-biased reform program had rather unintended consequences for the Greek economy: The costs of domestic adjustment in Greece unexpectedly but exorbitantly aggravated. Since internal devaluation was imposed as the only acceptable strategy for Greece to stay in the euro area, the adjustment burden solely remained on the shoulders of the Greek people, which further undermined the legitimacy and credibility of the reform agenda. Front-loaded strict fiscal consolidation created a strong deflationary bias starting from 2011. Greece's growth performance gradually worsened, which in turn, diverted attention from structural reforms and strengthened the hands of anti-memorandum coalitions.⁵³⁵ In 2011, Greek economy shrank 7.1 percent, which was projected to be just 2.6 in the May 2010 program. The contraction in GDP also derailed other program targets. For instance, public debt to GDP ratio, which was a crucial indicator in the eyes of international investors, increased to 170 percent rather than 145.2 percent as projected in the adjustment program. The failure in achieving the program targets, however, did not lead to a revision and compromise because Merkel did not deviate from the ordoliberalist crisis narrative that she developed in the first place. On the contrary, Germany insisted on the implementation of a new wave of austerity measures. As a result, Papandreou government approved the Medium Term Fiscal Strategy 2012-2015 (MTFS). The MTFS outlined new measures that worth 28.3 billion euros, including 6.4

⁵³⁵ In fact, Greece's reform performance was broadly on track in 2010, despite widespread political and social opposition. The program kicked off to a strong start in early stages. The first review (July 2010) of the troika acknowledged an "impressive progress." The second review (December 2010) acknowledged that the "policy implementation has become more difficult", nevertheless assessed the "country broadly on track." European Commission, *The Economic Adjustment Programme for Greece: Second Review*, (Brussels: European Commission Directorate-General for Economic and Financial Affairs Publications, 2010), 1, 41.

billion euros to make up for the deviations in 2011. Of these, 13.5 billion euros come from the revenue side, while the remaining 14.8 billion euros come from the expenditure side. It included the dismissal of 30,000 public sector workers and cuts of 20 percent on pensions.⁵³⁶ The MTF5 also included an ambitious privatization program designed to bring 50 billion euros by 2015.⁵³⁷

The European Commission and the IMF reports in 2011 revealed that the program suffered from severe delays. Thereby, international markets convinced that the program had already failed in its first year. The deterioration of the macroeconomic situation and the declining credibility of the reform program in the eyes of market actors sparked a new round of blame games between Greece and its European partners. Dominant policy coalitions, including SEV, claimed that the failure of the program was due to the deflationary effects of the austerity measures and the policy inaction of the EU and the ECB, which was unacceptable in a monetary union. In our interview, the then president of SEV, Dimitris Daskalopoulos expressed their disappointment and alienation as follows:

“We pointed out that in a full monetary union all members are responsible for all debts. And we also underlined the fact that the crisis had been foreseen since the inception of the euro. Without a real central bank ready to act as a lender of last resort the monetary union was by definition incomplete –and thus unable to deal with sovereign debt crises. In effect our point was that true monetary union members do not and cannot face a sovereign debt crisis. If they do then there is no single currency and the monetary union is seriously lacking.”⁵³⁸

⁵³⁶ Hellenic Republic Ministry of Finance, *Medium Term Fiscal Strategy, 2012-2015*, June 2011.

⁵³⁷ *Ibid.*, 29.

⁵³⁸ Interview with Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014.

Germany, on the other hand, blamed Greek government for delaying the reforms and for failing to ensure the political credibility vis-à-vis international investors. Monastiriotis argued that Greek political and economic elites' prolonged denial of the domestic responsibility in the initial phases exacerbated Greece's reputation problems in an irreversible way. It also provided solid reasons for the German elite to remain very sceptical vis-à-vis Greece.⁵³⁹ Similarly, in the absence of a coherent response to the crisis, markets convinced that there was no substantial progress in Greece's reform process and a default was an increasingly likely option. The failure of the first bailout program necessitated another rescue package amidst infamous "Grexit" debates in mid-2011.⁵⁴⁰ Hence, a new round of bargaining was kicked-off for the second bailout package. The new package was "estimated 109 billion euros with lower interest rates and extended maturities [which were] very closely [attached to] the strict implementation of the program based on the regular assessment by the Commission in liaison with the ECB and the IMF."⁵⁴¹ The program also envisioned Private Sector Involvement around 37 billion euros to restructure the Greek debt. Furthermore, in order to meet the conditionality criteria, Papandreou government was asked to implement more austerity measures in addition to the ones that were already specified but

⁵³⁹ Interview with Vassilis Monastiriotis, Professor of Political Economy, LSE, May 20, 2014.

⁵⁴⁰ Timothy F. Geithner, then the secretary of the U.S. Department of the Treasury, writes in his memoirs that "Grexit" turned out to be a serious policy discussion in their meetings with European leaders in late 2011 and early 2012. He portrays one of his conversations with German Finance Minister as follows: "He told me there were many in Europe who still thought kicking the Greeks out of the eurozone was a plausible—even desirable—strategy. The idea was that with Greece out, Germany would be more likely to provide the financial support the eurozone needed, because the German people would no longer perceive aid to Europe as a bailout for the Greeks." See, Timothy F. Geithner, *Stress Test: Reflections on Financial Crises* (New York: Random House Large Print, 2014), 797.

⁵⁴¹ The Council of the European Union, "Statement By the Heads of State or Government of the Euro Area and EU Institutions," Brussels, 21 July 2011, 2.

postponed in the original program. Not surprisingly, as a result, the public outrage against further austerity measures and the political tug-of-war between Merkel and Papandreou exponentially intensified in 2011.

On the domestic side, Papandreou blamed dominant coalitions on the ground that they did not own the reform program. He argued that business associations, trade unions, and opposition parties categorically rejected his cooperation attempts. Squeezed between troika's relentless austerity demands and the increasing opposition of domestic institutional structures, Papandreou called for an unexpected referendum. He argued that the critical situation that Greece had reached necessitated all domestic stakeholders to place their support behind the program. However, he also conceded that pro-reform coalitions could not be established "consisting broad support of the Greek people, of the conscientious civil servant, the trade unionist with a new creative role, the productive entrepreneur who does not seek to evade taxes."⁵⁴² In his parliament speech on November, 3rd Papandreou put the issue as follows:

"If there were consensus we would not [ask for] a referendum. If the opposition comes to the table to agree on the reform agreement we do not need a referendum."⁵⁴³

Papandreou's surprising decision increased the fever of the markets and aroused severe reaction of the Franco-German leadership. Under intense pressure from Merkel and

⁵⁴² George Papandreou, "Speech at the Cabinet Meeting, October 1, 2011," <http://papandreou.gr/en/speech-at-the-cabinet-meeting-2/> (arrived on February 27, 2014).

⁵⁴³ George Papandreou, "Speech in the Cabinet Meeting, October 3, 2011," <http://papandreou.gr/en/speech-at-the-cabinet-meeting/> (arrived on February 27, 2014).

Sarkozy, on October 6, 2011, Papandreou revoked his referendum decision and submitted his resignation to the President. His final step demarked the Olsonian deadlock in Greek political economy, which could not be overcome in the post-Papandreou period.

4.4. Post-Papandreou period: Consolidation of anti-memorandum coalitions

Lucas Papademos, the former BoG governor (1994-2002) and vice president of the ECB (2002-2010), was appointed as the new prime minister to lead the ‘national unity government’ three days after Papandreou’s resignation on November 11, 2011. PASOK, New Democracy, and small right wing party, LAOS, supported Papademos government. Papademos was a policy entrepreneur in the strict sense of the term. He was a respected above-the-party figure in Greece. Graduated from MIT, he was also a renowned professor of economics with European-wide recognition. He had a sound understanding of the root causes of the Greek and euro area crisis.⁵⁴⁴ Thanks to his BoG and ECB duties, he had close connections in domestic and international epistemic communities. He had personal comradeships with leading policy-making figures in the EU posts, including the ECB governor, Mario Draghi.⁵⁴⁵ As Kouvelakis asserts, “Papademos government was the natural incarnation of a ruling bloc that is entirely dominated by the

⁵⁴⁴ See, inter alia, Lucas Papademos, “The Sovereign Debt Crisis, Financial Stability and Fiscal Policy in the Euro Area,” *Ekonomia* 14, no. 2 (2011): 108-118.

⁵⁴⁵ Suzanne Daley, “Economist Named to Lead Greek Unity Government,” *The New York Times*, November 10, 2011.

interests of European finance.”⁵⁴⁶ Merkel also placed her full support behind Papademos. Given the strong support he received from European circles, Papademos succeeded to secure the second bailout package in February 2012, which was around 137 billion euros (see table 7).⁵⁴⁷

Table 7. Troika's assistance to Greece: Second bailout package

		DATE	EU	IMF	TOTAL
1st disbursement	1st tranche	12 March, 10 and 25 Apr. 2012	29.7	1.6	
	2nd tranche	12 March, 10 and 25 Apr. 2012	4.9		
	3rd tranche	19-Mar-12	5.9		
	4th tranche	10-Apr-12	3.3		
	5th tranche	19-Apr-12	25		
	6th tranche	10-May-12	4.2		
	7th tranche	28-Jun-12	1		
2nd disbursement	1st tranche	17 and 19 December 2013	34.3	3.24	
	2nd tranche	28 and 31 January 2013	9.2		
	3rd tranche	28-Feb-13	2.8		
	4th tranche	3-May-13	2.8		
3rd disbursement	1st tranche	17-May-13	4.2	1.73	
	2nd tranche	25-Jun-13	3.3		
TOTAL			130.6	6.62	137.2
1st and 2nd PROGRAMS TOTAL			183.5	26.7	210.2
Source: European Commission Reviews, IMF					

He also successfully managed the largest debt restructuring in the history of modern Greece that involved private sector actors in a very delicate equilibrium. In our interview, senior advisor to Papademos delved into the delicacy of the situation as follows:

⁵⁴⁶ Stathis Kouvelakis, “The Greek Cauldron,” *New Left Review*, no. 72 (2011): 26.

⁵⁴⁷ European Commission, *The Second Economic Adjustment Programme for Greece*.

“Papademos took over at most acute moment of Greek crisis. It was a time of chaos [emerged] about the possibility of [Grexit]. There was panic on the part of the depositors; there was bad publicity for Greece. The objective of the government was to stabilize the situation, to conclude PSI, and to negotiate the second economic program... In a very [negative] environment, Papademos managed to stabilize the political situation, to manage and pass a very difficult program, and PSI, which lifted part of the debt burden on the shoulders of the country... This was achieved in a time when German Finance Minister [described Greece] as ‘hopeless’ and ‘bottomless pit.’”⁵⁴⁸

Beyond the implementation of pre-determined policy targets, however, Papademos could not fulfil the expectations to instigate a new reformist cycle and develop domestic ownership of the reform program. Having considered the timing and context of Papademos’ rise, there were several constraining factors at work. First, Papademos lacked the political cloud to push the reform process in the parliament due to the perverse political context. This was mainly because of the half-hearted support demonstrated by coalition partners. Samaras, for instance, called for early elections in a short period after the formation of the new government rather than seeking for a much needed cross-party compromise. In one of my interviews, Dimitris Sotiropoulos, advisor to Papademos, put the issue as follows:

“There were high expectations from Papademos. His government was the first in two decades, in which prime minister was relying on the coalition of parties. The ND forcefully believed that if elections would take place, then it would come first. Thus Samaras was more than anxious and eager to call early elections. During the premiership of Papademos, the ND delayed, postponed and even undermined all reform proposals coming from the prime minister’s office.”⁵⁴⁹

⁵⁴⁸ Interview with George Pagoulatos, Senior Advisor to Lucas Papademos, June 24, 2014.

⁵⁴⁹ Interview with Dimitris Sotiropoulos, Advisor to Lucas Papademos, June 24, 2014.

Second, Papademos government lacked the popular democratic legitimacy in the eyes of domestic constituency. The public outrage against Germany and austerity program restricted his mandate significantly. He was conceived as the representative of troika and therefore suffered from extensive credibility deficits:

“Greek public did not really see Papademos as a figure to unite pro-reform coalitions. By that time, the frustration and anger to the creditors was so high that Papademos’ credibility was immediately destroyed as somebody ‘selected by the creditors.’ Merkel insisted Papademos to become the prime minister of Greece. She invited him to European Council meetings when he had no relevant official post at the time. In the eyes of Greek electorates, Papademos was Germany’s choice. He, therefore, was not seen as a remedy to malaise, rather a consequence of it.”⁵⁵⁰

The Papademos case, similar to Simitis example, enables us to make some inferences regarding the ‘limits of the possible’ for policy entrepreneurs in reactive states. The available evidence suggests that neither timing nor context was suitable for Papademos to develop a coherent crisis narrative and mobilize the pro-reform coalitions toward a particular direction because a path-dependent process had already been set in motion before his ascendance to premiership. Thus not only crisis times, but also the phase in which policy entrepreneurs emerges during crisis junctures matter for the ultimate reform outcomes. Furthermore, the strict imposition of Germany-led IMF-EU conditionality left no virtual space for Papademos to manoeuvre. In a rather sub-optimal context, Papademos fell short of making a lasting impact on Greece’s reform

⁵⁵⁰ Interview with Dimitris Papadimitriou, Professor of Political Science, University of Manchester, June 18, 2014; also interview with Tryfon Bampilis, Research Fellow at European Studies Centre, University of Oxford, June 13, 2014.

performance. As a result, a new coalition government replaced Papademos under the premiership of ND's Samaras in June 17, 2012, after two elections in one-month time.

Greek political economy plunged into a vicious cycle in the post-Papandreou period. On the one hand, certain fiscal and financial reforms were materialized—at least on paper—to secure bailout tranches. According to OECD report published in 2013 the implementation of the pension reform, certain improvements in tax system and expansion in tax base and the partial restructuring of labour markets stand out as some notable transformations.⁵⁵¹ Euro Plus Monitor also reports that Greece achieved substantial fiscal adjustment for 2009-2012 among euro area countries with a decline in general government deficit by 9.3 percent and a reduction in the primary budget deficit by 9.1 percent.⁵⁵² On the other hand, the deflationary impact of the austerity packages worsened growth prospects and debt dynamics. Despite all efforts, the targets of the reform program failed substantially. First, GDP growth projections of the first memorandum deviated 20.7 percent. In 2008-2013, Greece's GDP contracted almost 25 percent. Second, all debt reduction attempts and 50 percent haircut of private sector debt notwithstanding, debt-to-GDP ratio increased to 174 percent, more than 25 percent deviation of the program projections. Third, unemployment ratio skyrocketed to 28 percent as of 2013. In this adverse environment, the social havoc created by the economic crisis and harsh austerity measures imposed by troika hollowed out any substantial reform possibility.

⁵⁵¹ OECD, *Economic Policy Reforms, 2013: Going for Growth* (Paris: OECD Publishing, 2013), 155-159.

⁵⁵² Euro Plus Monitor, *The 2013-Euro plus Monitor: From Pain to Gain*, The Lisbon Council Policy Brief, 2013.

“The troika and Germany were interested in receiving their money back and concentrated on short-term austerity measures... [Thus] after a certain point the very notion of ‘reform’ became irrelevant.”⁵⁵³

As Konstandaras rightly puts “instead of reforms being seen as something good that would offset some of the difficulties that citizens faced, they were presented as further punishment.”⁵⁵⁴ One of the interviewees eloquently featured how the conflation of ‘reforms’ with senseless ‘austerity’ diverted the attention from the real recognition of long-term oriented reforms:

“The troika’s instinct to have early horizontal cuts was in fact mistaken partly because of the deflationary aspects but also because *it diverted the attention from the real recognition of domestic institutional [fiscal and financial] reforms*. What Greece needed above all was the empowerment of a reform agenda to prioritize certain types of reforms that could have been much more engaging, connected with domestic reform coalitions. Instead austerity came to impose equal misery that stimulated domestic coalitions to oppose the misery. For example, troika was saying that Greek public administration should lose 150,000 posts, which was not the result of any serious review of how many public servants Greece needs. It was simply a fiscal saving target. It encouraged the domestic governments [and coalitions] to defend every one of these 150,000 jobs. So it diverted the attention from real, meaningful, structural reforms.”⁵⁵⁵

The disenchantment of domestic audience, as a result, led to a virtual deadlock in the third-stage of my conceptual framework. The overwhelming majority of the population started to draw analogies between the protectorates of foreign powers established on different occasions during country’s debt-ridden history and Greece’s present misery. As

⁵⁵³ Interview with Othon Anastasakis, Director of European Studies Centre, University of Oxford, June 14, 2014.

⁵⁵⁴ Nikos Konstandaras, “The Placebo Effect and the Economy,” *Kathimerini*, April 24, 2014.

⁵⁵⁵ Interview with Kevin Featherstone, Director of Hellenic Observatory, LSE, June 11, 2014.

Tayfur points out, the Greek state bankrupted several times during its modern history and each time major western powers stepped in to ensure the rollover of the Greek sovereign debt via lucrative loans due to the geopolitical importance of the country, but they also established strict surveillance mechanisms in return.⁵⁵⁶ Germany, after 1890s in particular, turned out to be the “most uncompromising creditor” among the great powers that bailed out Greece.⁵⁵⁷ In addition to the tormented historical memories of the Greek people in regard to their country’s troubled fiscal relations with the foreign creditors, the Greek people interpreted the post-crisis intervention of the troika as “a new German occupation by other means,” revitalized the memoirs of the Weimar Republic during the inter-war period.⁵⁵⁸ Hence, in the post-2011, frequent street protests against Germany and the troika dominated the political agenda. According to Ministry of Public Order, 20,201 legal demonstrations took place in Greece between May 2010 and March 2014.⁵⁵⁹ ADEDY and GSEE organized 34 general strikes in the same period.⁵⁶⁰ The strikingly high number of protests indicates that the established political parties, conventional approaches and the reform program lost credibility and legitimacy. According to European Commission surveys, the Greeks’ trust in national government declined to 8 percent, trust in the national parliament to 17 percent, and trust in political parties to 5 percent as of 2013.⁵⁶¹

⁵⁵⁶ M. Fatih Tayfur, “Yunanistan’ın Mali-Finansal Krizi: Tarih Kaç Kez Tekerrür Eder?,” *Mülkiye Dergisi* XXXVI, no. 274 (2012): 183-190.

⁵⁵⁷ *Ibid.*, 187.

⁵⁵⁸ Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014.

⁵⁵⁹ “More than 20,000 Protests since 2010 Bailout,” *Kathimerini*, April 24, 2014.

⁵⁶⁰ Interview with Zoe Lanara, Secretary General of GSEE, June 26, 2014.

⁵⁶¹ Data gathered from European Commission, Eurobarometer Interactive Search System, available at http://ec.europa.eu/public_opinion/cf/index_en.cfm (arrived on December 14, 2013).

In the third-stage, therefore, the Greek economic crisis brought about massive socio-political and economic uncertainty. First, the political context radically aligned toward anti-memorandum parties. The two-party system collapsed as the electorates expressed their alienation and detachment from ND and PASOK in the first post-crisis elections. As discussed in chapter 3, these two parties monopolized the political landscape with more than 80 percent of the total votes since the restoration of democracy in Greece. However, in May 2012 elections, ND and PASOK recorded their worst electoral performance with only 32 percent of the total votes. On the other hand, the anti-memorandum party, Coalition of the Radical Left, SYRIZA received 16.8 percent of the votes in May 2012, and 27 percent in June 2012 elections, which was just 3 percent in the pre-crisis elections. The racist and xenophobic neo-Nazi party Golden Dawn's electoral base also expanded dramatically from less than 1 percent to 7 percent of the total votes. The opinion polls in 2014 demonstrate that SYRIZA is now the leading party (with 26 percent) in Greece ahead of ND (with 20 percent) and PASOK (with 5.5 percent). Far-right neo-Nazi party, Golden Dawn, occupies the third place in the polls with 11 percent of the total votes.⁵⁶² The surge of anti-systemic SYRIZA and Golden Dawn reflects Greek voters' deep dissatisfaction and alienation of the political system in Greece.⁵⁶³ It also demonstrates that the legitimacy and credibility of the reform program utterly failed because SYRIZA is renowned with its anti-austerity and anti-memorandum

⁵⁶² Athens News Agency, "SYRIZA Leads over ND, Says Opinion Poll," February 13, 2014.

⁵⁶³ For an analysis of the striking meltdown of the Greek party system see Susannah Verney, "Broken and can't be Fixed': The Impact of the Economic Crisis on the Greek Party System," *The International Spectator* 49, no. 1 (2014): 18-35; for an analysis of the rise of Golden Dawn see Antonis Ellinas, "The Rise of Golden Dawn: The New Face of the Far Right in Greece," *South European Society and Politics* 18, no. 4 (2013): 543-565; for an analysis of SYRIZA phenomenon, see Myrto Tsakatika and Costas Eleftheriou, "The Radical Left's Turn towards Civil Society in Greece: One Strategy, Two Paths," *South European Society and Politics* 18, no. 1 (2013): 81-99.

stance. Right from the very beginning, SYRIZA leader Alexis Tsipras lamented that the “reform program itself is the crisis, not the solution” and blamed Germany for creating a “humanitarian crisis” in Greece.⁵⁶⁴ In fact, SYRIZA gained its popularity by denouncing the ‘Greek exceptionalism’ argument. For instance, Laskos and Tsakalotos, two SYRIZA members and economic advisors to Tsipras, dismissed ‘Greek exceptionalism’ narrative as “Merkel’s Calvinist fable.”⁵⁶⁵ Their critical approach to neoliberalism as-the-main-cause of the Greek debacle was in fact reflecting the feelings of thousands of demonstrators poured into the streets:

“To be sure, the Greek economy and its polity had various special features, but in no way do these make the case exceptionalism. The Greek neoliberal settlement shares many of the characteristics of similar experiments elsewhere as well as many of the failings of such experiments. In other words, the Greek crisis is better to understood as a crisis of a particular neoliberal settlement rather than in terms of a failure to accept and implement the main tenets of neoliberalism.”⁵⁶⁶

Second, anti-memorandum policy coalitions gradually consolidated their positions. The declining legitimacy of the reform program and the emerging political chaos evaporated any meaningful possibility of a paradigmatic change in Greece’s fisco-financial regime.⁵⁶⁷ The shifting position of the SEV, Hellenic Federation of Enterprises, is an illustrative case in point. SEV, which was a supporter of the reform program in the initial phases, developed an increasingly critical and cynic tone starting from 2011. There were two strands to SEV’s blame attribution. First, Greek big business blamed the

⁵⁶⁴ Interview with Lefteris Kretsos, SYRIZA Representative, June 7, 2014. Also see Alexis Tsipras, “Sleepwalker of Austerity”, *Le Monde*, January 17, 2014.

⁵⁶⁵ Christos Laskos and Euclid Tsakalotos, *Crucible of Resistance: Greece, the Eurozone, and World Economic Crisis* (London: Pluto Press, 2013), 3.

⁵⁶⁶ *Ibid.*

⁵⁶⁷ Interview with Kevin Featherstone, Director of Hellenic Observatory, LSE, June 11, 2014.

political elite due to their insistence on ‘party-politicking’ rather than developing a consensus-based approach.⁵⁶⁸ The then president of SEV, Dimitris Daskalopoulos, argued that the government and opposition parties did not develop a conciliatory approach to overhaul the “anachronistic and symbiotic party-state relationship.”⁵⁶⁹ Thus, reform proposals were not internalized and a sense of domestic ownership of the reform program could not be established. The current president of SEV, Theodore Fessas complained about the lack of supportive domestic coalitions:

“Greek administration has not been able to build an endogenous culture of reforms and of focusing on growth enhancing measures. To make matters worse, whatever progress has been achieved so far is now more than compensated by the fragmentation of the political landscape and the deterioration of social coherence as a result of the depression of the Greek economy. One has also to add that the MOU was never going to work unless the Greek people felt a sense of ownership to the reform effort. In this respect, *the Memorandum’s biggest failure was that it did not create the critical mass of stakeholders who would support in particular the part of the growth enhancing reforms.*”⁵⁷⁰

Second, SEV blamed troika and Germany due to their insistence on self-defeating austerity policies, which “led [Greece] into a complete economic and social deadlock.”⁵⁷¹ SEV representatives underlined in almost all speeches after November

⁵⁶⁸ Interview with Theodore Fessas, President of SEV, June 24, 2014.

⁵⁶⁹ Dimitris Daskalopoulos, “Hellenic Federation of Enterprises Annual General Assembly, May 24, 2011, <http://sev.org.gr/online/viewNews.aspx?id=1918&mid=&lang=en> (arrived on April 20, 2014).

⁵⁷⁰ Interview with Theodore Fessas, President of SEV, June 24, 2014.

⁵⁷¹ Dimitris Daskalopoulos, “Hellenic Federation of Enterprises Annual General Assembly, 13 May, 2013”, Speech of the Chairman, http://admin.sev.org.gr/Uploads/pdf/Speech_dda_english%20version.pdf 3 (arrived on April 20, 2014). Also see, Dimitris Daskalopoulos, “Next Steps towards the Social Dimension of the EMU/EU,” Speech at the Tripartite Social Summit for Growth and Employment, October 24, 2013, <http://www.sev.org.gr/online/viewNews.aspx?id=2368&mid=8&lang=en> (arrived on April 20, 2014).

2010 that single-mindedly imposed austerity politics advocated by Germany was creating havoc in Greek political economy:

“The priorities established by the first MoU were wrong. The program demanded a big and socially extremely painful fiscal adjustment. It was a grave misreading of Greek political and social realities.... Fiscal adjustment should be slower, in exchange for faster and more intensive reforms. This would have had several benefits: less social pain and hence greater acceptance of the program by the people, a sounder base for fiscal reform, the timely creation of the prerequisites for export and investment-led growth.”⁵⁷²

In summary, Greek crisis sparked a wave of domestic and external blame-games, which paved the way for muddling through in the third-stage of my conceptual framework. Blame games occupied the political agenda, rather than the consolidation of a dominant crisis narrative backed by supportive domestic coalitions. The agency-level controversies, constraining feedback of the institutional structures, and the mutually disparaging interplay of these multi-level dynamics created a vicious cycle that eradicated substantial reform possibilities in a gradual yet decisive way. In the field research, I asked whether pro-reform coalitions could be created over the last five years in support of a new paradigm regarding the state-market relations. None of them replied in a positive tone. Their responses were either pessimistic or very pessimistic (see appendix 4).

⁵⁷² Interview with Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014. Also see, Dimitris Daskalopoulos, “Can Greece Get Out of the Crisis?”

4.5. Conclusion

The 2009 Greek crisis should be considered as a critical juncture. The crisis created an opportunity window to reform the deeply flawed fisco-financial regime of the reactive Greek state. The depth of the crisis disturbed domestic power balances and delegitimized existing paradigms. It therefore opened up a potential room to manoeuvre for reformist state agents, which was absent in the pre-crisis period. However, this opportunity could not be exploited. I argued in this chapter that the economic crisis did not lead to consensus-based reform-activism due to the interplay of the agency-level dynamics and institutional structures, which resulted in fragmented crisis narratives.

At the agency-level, the crisis narratives of domestic state agents and external anchors diverged substantially. In the initial phases, Papandreou government's reaction to the crisis was fragmented, inconsistent and ad hoc. Papandreou also failed to develop necessary coordination and communication mechanisms to handle the crisis properly. Only after four months, Papandreou tried to portray Greece as 'a test case' for European integration. Accordingly, he asked for more European-level solidarity, more generous funding with lower interest rates, and more flexible reform program putting principal emphasis on growth-generating reforms rather than harsh front-loaded fiscal consolidation. Germany and troika's crisis narrative, however, was radically different. Merkel portrayed Greece as a 'special case,' and claimed that the root causes of the crisis was stemming from the fiscal profligacy of the Greek state and people, who were accustomed to live high off the hog. The political economy paradigm that guided

Germany's approach to the crisis was ordoliberalism, which put central weight on the fiscal discipline and austerity politics even at depression-prone crisis times. This study argued that the *agency-level narrative mismatch* created an unhealthy environment to implement substantial reforms from the very beginning of the Greek economic crisis. Since the crisis narratives of the domestic agents and external actors were gradually diverged and Germany was uncompromising, necessary coordination mechanisms organizing the domestic-external linkages could not be crafted. Furthermore, Papandreou government failed to overcome the infamous collective action problems at the domestic scene toward proper negotiation and implementation of the reform program. In fact, Papandreou found himself in a peculiar position to defend an austerity package whilst he obliquely condemned at the same time.

The institutional structures also adversely informed the reform performance. Dominant policy coalitions that were entrenched in the political system, state bureaucracy, private sector, and trade unions challenged the troika program on the ground that it incorporated extremely unjust measures and was unilaterally imposed without any prior consultation. Even SEV, leading business association that initially supported fiscal reforms, gradually increased its critical tone toward the Greek government and Germany. Therefore, the reform program had suffered from serious domestic ownership problems. The initial sub-optimal response to the Greek crisis created a path-dependent process, which resulted in the triumph of blame games and muddling through in the third-stage of the conceptual framework developed in this study. The following national unity government led by technocratic Papademos (October 2011-May 2012) also could not disturb this

path-dependent process so that the bailout programs turned into slow motion accident. Papademos is an illuminating case in point because it sheds light under which conditions policy entrepreneurs can steer new policy communities toward a change in dominant policy paradigms. Papademos case implies that not only crisis times, but also the phases of the crisis in which policy entrepreneurs emerge determine the limits of the possible for their reform performance. The later phases of the Greek crisis reflected a very unfavourable context for reversing the already established reform-biased equilibrium. It also demonstrated that if external anchors did not provide a certain degree of flexibility, the policy entrepreneurs couldn't link problems, policies, and politics at crisis junctures. In this adverse environment, Papademos could not succeed in establishing new pro-reform coalitions toward the commencement of substantial reforms (see chapter 7), though Greece was kept in the euro area over the last four years. In the final analysis, I argued that it is not because of the isolated impacts of the agency—whether domestic or external— or institutional-level variables that resulted in reform-failures in Greece, but because of the complex interactions of these dynamics. As one of my interviewees put meticulously, “there was not good or bad guy in the Greek crisis, there was a bad game.”

Chapter 5. A reactive state in the making: Turkey during 1980-2001

5.1. Introduction

This chapter deals with the institutionalization of a reactive Turkish state in a neoliberal setting between 1980 and 2001. The governance paradigm that guided the Turkish economy passed through sea change thanks to the major liberalization reforms following 1980. The initial reform-activism, however, were gradually replaced by stagnation and inertia during 1990s. In fact, during the period in question, Turkey's state capacity gradually deteriorated in a way that exacerbated the problems in the Turkish fiscal and financial system. Focusing on the mechanisms offered in the first-phase of the conceptual framework proposed in chapter 2, I will discuss how institutional structures underlying state capacity were set out in a path-dependent way along domestic-international nexus, and how they, in turn, conditioned rent-seeking agency behaviour during the internationalization of the Turkish economy.

In the following part I will concentrate on three pillars of state's reform capacity during 1980-1994. In the fourth part I will investigate why reform-inertia prevailed despite an exogenous shock, i.e., 1994 economic crisis, knocked on Turkey's door. Despite Turkey experienced an economic crisis in 1994, no significant paradigm change took place in the aftermath concerning the dominant fisco-financial regime. Rather, the sub-optimal mode of state-market relations deepened and widened. Based on the conceptual

framework this part would address the scope conditions under which crises alter or reproduce status quo and inertia. In the fifth part I will discuss the consolidation of a reform-biased vicious cycle in the post-1994 period with reference to the entrenchment of rent-seeking capital accumulation model, which came to an abrupt end with the devastating economic turmoil in 2001. In the final analysis I will argue that economic crisis does not squarely lead to a new path in reactive states in the absence of reformist agents, credible external anchors, and complementary institutional-level enabling conditions.

5.2. Emergence of a reactive state (1980-1994)

This section aims to reveal how Turkish state's internal and external capacity deteriorated over the period in question and how weakened state capacity, intermingled with neoliberal globalization, led to the accumulation of fisco-financial problems. To this end, I will discuss the interaction of three major institutional structures, i.e., domestic political context, state bureaucracy and dominant policy coalitions, and their conditioning impact on the agency behaviour. Similar to the Greek case state remained at the very center of the who-gets-what struggles in Turkey. The political elites and economic interest groups constantly tussled to capture the commanding heights of the state apparatus in order to advance their short-term interests and exploit lucrative resources at the disposal of the state. As Heper and Keyman coined the term, Turkish

state depicts a ‘double-faced’ nature.⁵⁷³ On the one hand, Turkey inherited a strong state tradition that enabled the state agents to frequently intervene into the domestic organization of the economy and society.⁵⁷⁴ On the other hand, Turkish state suffered from weak capacity in the sense that it failed to steer successful economic transformations in institutionalized concertation with private interest groups — ‘governed interdependence’ in state capacity terminology. As a result, as Öniş and Şenses⁵⁷⁵ and Keyman and Öniş⁵⁷⁶ demonstrate paradigmatic economic policy changes were triggered by deep crises and subsequent stabilization programs crafted under the auspices of international financial institutions rather than carefully designed and patiently implemented in-house reform processes.

The political economy shift from an import-substituted industrialization (ISI) model to export-oriented neoliberal paradigm should also be interpreted in this context. During 1960-1980, Turkey pursued state-led economic development strategy, following a balance of payments crisis in late 1950s and a coup d’état in May 1960. Accordingly, state heavily involved in the organization of the industrial production, closely governed trade and foreign exchange regimes, and controlled the resource allocation mechanisms through an active planning bureaucracy under the auspices of the State Planning

⁵⁷³ Heper and Keyman, “Double-Faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies*, 259-277.

⁵⁷⁴ This also relates to the ‘transcendental state tradition’ in Turkey. See Metin Heper, *State Tradition in Turkey* (Northgate: The Eothen Press, 1985).

⁵⁷⁵ Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*, 251-286.

⁵⁷⁶ E. Fuat Keyman and Ziya Öniş, *Turkish Politics in a Changing World: Global Dynamics and Domestic Transformations* (İstanbul: İstanbul Bilgi University Press, 2007), 103.

Organization (SPO).⁵⁷⁷ In the financial realm, state-led developmental policies were supplemented by repressive measures such as ceilings on deposit and lending rates, credit rationing and subsidized credits to priority sectors through state banks, overwhelming taxation of financial transactions, entry and exit barriers to foreign banks, and the frequent use of the Central Bank as the ultimate creditor of the public finance.⁵⁷⁸ Despite certain achievements in terms of rapid industrialization and rather respected growth rates,⁵⁷⁹ the ISI regime was subject to high degrees of rent-seeking since the governments' arbitrary discretion over the instruments of economic policies increased gradually. Ünay,⁵⁸⁰ Krueger,⁵⁸¹ Boratav,⁵⁸² and Öniş,⁵⁸³ inter alia, demonstrate that state-led regime paved the way for an inflationary bias and non-transparent exchange relationships between the state and well-entrenched interest groups thanks to the generously dispersed but loosely monitored subsidies, randomly imposed quotas, tariffs, and import licenses. In this period, state resources were increasingly diverted to 'directly unproductive activities' in Bhagwati's conceptualization,⁵⁸⁴ which in turn paved the way for export-pessimism towards the end of 1970s. Thus Turkey mired into a severe

⁵⁷⁷ Çağlar Keyder, "Economic Development and Crisis, 1950-1980," in Irvin C. Schick and Ertuğrul Ahmet Tonak, *Turkey in Transition: New Perspectives* (Oxford: Oxford University Press, 1987), 293-305.

⁵⁷⁸ Güven Sak, *Public Policies towards Financial Liberalization: A General Framework and an Evaluation of the Turkish Experience in the 1980's* (Ankara: Capital Markets Board Publications), 96.

⁵⁷⁹ The annual GNP growth was 6.8 percent and industrial growth was 9.6 per cent during 1962-1976. The annual GNP growth declined to less than 2 percent over 1977-1980. Korkut Boratav, *Türkiye İktisat Tarihi, 1908-2002* (Ankara: İmge Kitabevi, 2005), 130.

⁵⁸⁰ For a comprehensive political economy survey on the ISI period, see Ünay, *Neoliberal Globalization and Institutional Reform*, 53-65.

⁵⁸¹ Anne Krueger, *Foreign Trade Regimes and Economic Development: Turkey* (New York: Columbia University Press, 1974).

⁵⁸² Boratav, *Türkiye İktisat Tarihi*, 117-144.

⁵⁸³ Ziya Öniş, "Inflation and Import-Substituting Industrialization: An Interpretation of the Turkish Case," *Journal of Economic and Administrative Studies* 1, no. 1 (1987): 25-43.

⁵⁸⁴ Jagdish N. Bhagwati, "Directly Unproductive Profit-seeking (DUP) Activities," *Journal of Political Economy* 90, no. 5 (1982): 988-1002.

economic and political regime crisis in 1980 with the accumulation of state's fiscal imbalances, balance of payment deficits, and external debt.⁵⁸⁵

1980 therefore posed a critical juncture in Turkish political economy. The ISI regime resulted in a punctuated equilibrium and a new path in state-market relations emerged. Turkey adopted a new economic paradigm stamped by neoliberal-oriented January 24, 1980 decisions.⁵⁸⁶ The reform program was radical and far-reaching in the sense that it incorporated both short-term fiscal stabilization measures and long-term structural reforms. The crisis was a genuine exogenous shock that delegitimized the prevailing policy paradigms and eroded the material power of the dominant policy coalitions flourished during the ISI regime. The strong external anchors also informed the direction of change in Turkey. The program, which was underwritten by the 'cross-conditionality' of the IMF-World Bank double anchor, tipped the material and ideational balance decisively in favour of the free market model. Turkey received five consecutive loans from the World Bank to implement the reform program. IMF also involved in with a three-year standby agreement in June 1980. The amount and duration of the IMF-World Bank support, which Taylor dubbed as "a long leash," was unmatched in the credit history of these institutions.⁵⁸⁷ According to Celasun's calculations, cumulative net

⁵⁸⁵ Ünay, *Neoliberal Globalization and Institutional Reform*, 53-65; also see Çağlar Keyder, *State and Class in Turkey: A Study in Capitalist Development* (London: Verso, 1987).

⁵⁸⁶ For a comprehensive overview of January 24, 1980 decisions, see OECD, *OECD Economic Surveys, Turkey: 1980* (Paris: OECD Publication Service, 1980), annex I and annex II.

⁵⁸⁷ Lance Taylor, "The Turkish Experience: Summary and Comparative Notes," in Tosun Arıcanlı and Dani Rodrik, *The Political Economy of Turkey: Debt, Adjustment, and Sustainability* (London: Macmillan, 1990), 269. The amount and duration of support was closely related to Turkey's geopolitical significance at the time. The Iranian revolution, Soviet Army's invasion of Afghanistan, and the

financial support amounted to some 3 billion dollars during 1980-1983.⁵⁸⁸ There were various aspects of the program, but two of them stand out.⁵⁸⁹ First, major trade liberalization took place in the post-1980 period. The average tariffs and non-tariff barriers were reduced considerably so that anti-export bias was removed. State also actively offered export-subsidies and other forms of investment incentives to promote an export-oriented growth model.⁵⁹⁰ Second, all market prices, capital account and financial transactions liberalized in a step-by-step fashion. The leitmotif of the liberalization reforms was to reduce the role of the state in the economy, which was expected to eliminate rent-seeking opportunities at the disposal of the state and the connected interest groups. Thus, post-1980 was conceived as an opportunity window to craft reform-oriented institutional setting to impose a disciplined fisco-financial regime.⁵⁹¹ In retrospect, however, it became apparent that new policy path produced adverse incentives that underlined the gradual eradication of regulatory state capacity. Turkey's transformation in the post-1980 took place within the context of sub-optimal interactions of the domestic and broader institutional structures, which informed rent-seeking behaviour at the agency-level.

intensification of Cold War between the two hegemonic power blocks dramatically increased the importance of Turkey's domestic stability for the capitalist economies of the Western world.

⁵⁸⁸ Merih Celasun, "Fiscal Aspects of Adjustment in the 1980s," in Tosun Arıcanlı and Dani Rodrik, *The Political Economy of Turkey: Debt, Adjustment, and Sustainability* (London: Macmillan, 1990), 37.

⁵⁸⁹ For a comprehensive review see Ziya Öniş and Steven B. Webb, *The Political Economy of Policy Reform in the 1980s*, World Bank Working Papers, Paper no. 1059 (1992).

⁵⁹⁰ Amry Adly, "Unorthodox Liberalism, Democracy, and Post-Liberal Distributional Coalitions: The Case of Turkey," *Turkish Studies* 11, no. 2 (2010): 274.

⁵⁹¹ For a typical example, see Anne O. Krueger, "The Importance of Economic Policy in Development: Contrasts between Korea and Turkey," *NBER Working Paper Series*, Working Paper no. 2195.

5.2.1. Domestic political context

First institutional structure that informed state's reform capacity is domestic political context. The neoliberal reforms were coupled with radical political transformations in the post-1980. The military coup that took place on September 12th, 1980 reshuffled the political arena, depoliticized social life, and rendered the civil society docile.⁵⁹² The military monopolized the political arena during 1980-1983 as it banned all political parties and their leaders along with civil society organizations; thereby, liberalization reforms were implemented under intense suppression over distributional coalitions. Kenan Evren, the chief of the general staff who headed the military coup and became Turkey's seventh president in the aftermath, later admitted that "if 24 January decisions were not followed by 12 September military coup, I have no doubt that the reform program would have resulted in fiasco."⁵⁹³ Following the restoration of multi-party democracy in 1983, therefore, the pendulum had swung in the opposite direction and populism made a strong callback in domestic political scene to capture the support of the hitherto excluded distributional coalitions. In this new institutional setting, similar to Greece, domestic political context in Turkey depicted major tenets of conflictual tendencies⁵⁹⁴ imbued by "strong legacy of populism [with an] overriding faith in

⁵⁹² The humanitarian costs of military intervention were heart breaking: 650,000 people were arrested after the coup. 23,700 civil society associations were suspended and 927 publications banned. 30,000 people were sent into exile. 50 people were executed and 300 were died in "suspicious" ways. See TBMM, *Meclis Araştırması Komisyonu Raporu*, cilt 1 (Ankara: TBMM Basımevi, 2012): xiv-xv.

⁵⁹³ Milliyet Gazetesi, "12 Eylül Olmasaydı, 24 Ocak Kararları Fiyasko ile Sonuçlanırdı," January 7, 1991.

⁵⁹⁴ For the definition of 'conflictual pluralism,' see chapter 3.

charismatic leadership and a personalistic mode of governance characterized by a weak civil society.”⁵⁹⁵

Turkey’s post-1980 political context can be bracketed under two major episodes in order to better explicate the underlying political dynamics that inform state’s weakening capacity. The first episode refers to the ‘Özal decade’ that covered the period from early 1980s up to 1989. Turgut Özal, a former undersecretary of the SPO, emerged as the key state agent in the design and implementation of the post-crisis liberalization reforms. Özal continued to play a key role after September 12, 1980 as deputy prime minister in charge of economic affairs in the interim military government. With the restoration of the multi-party democracy in late 1983, as the charismatic leader of the newly founded Motherland Party —ANAP in Turkish acronym, Özal reappeared as a key figure again, this time with a before-the-scenes role. He succeeded to outperform his political rivals in the first pseudo-democratic elections following the military coup, and formed a single party government with a landslide electoral victory on November 6, 1983.⁵⁹⁶ Özal was a capable reformist state agent with strong leadership capabilities. Since he spent his lifetime at the highest echelons of the state bureaucracy, private sector, and acquired more experience at the World Bank, he established good connections with international and domestic policy communities. At the domestic realm, Özal enjoyed widespread legitimacy in the eyes of different segments of Turkish society. His hybrid ideology,

⁵⁹⁵ Ziya Öniş, *State and Market: The Political Economy of Turkey in a Comparative Perspective* (İstanbul: Boğaziçi University Press, 1998), 514.

⁵⁹⁶ The elections were pseudo democratic because it was a three-party poll with two parties established by the military regime. ANAP received more than 45 per cent of total votes. In fact, Özal’s electoral victory was totally unexpected because the leader of the military junta and his co-conspirators openly threw their support behind another candidate, Turgut Sunalp, instead of Turgut Özal.

which he called ‘four strands,’ combined elements of liberalism, political conservatism with Islamist connotations, welfarism and nationalism helped him transcend the traditional centre-periphery divide in Turkish politics to a certain extent.⁵⁹⁷ In addition, Özal had a clear-cut economic reform program, the core elements of which were the elimination of all price controls, liberalization of trade and foreign direct investment, privatization of state economic enterprises, and restructuring of the banking system.⁵⁹⁸ It is fair to argue that during his time in the World Bank, Özal internalized the neoliberal model rising in the Anglo-Saxon world and strongly convinced that Turkey’s deep-seated economic problems can only be resolved through a market-oriented paradigm.⁵⁹⁹

The Özal government demonstrated strong commitment to its target-oriented reform program until mid-1980s. In the aftermath, alas, state’s fiscal discipline waxed and waned gradually mainly due to the distributional pressures emanated from the structural adjustment policies and emergent populist cycle. The principal losers of the January 24, 1980 decisions were fixed wage earners, civil servants, and farmers. Since adjustment program was implemented under severe authoritarian conditions, the military government coercively suppressed the aforementioned distributive concerns. Thus, in a post-democratic setting, ANAP government faced with two conflicting rationalities and an apparent paradox: how to create broad-based support coalitions in a democratic polity

⁵⁹⁷ For the leadership, ideology, and organization of the Motherland Party, see Ersin Kalaycıoğlu, “The Motherland Party: The Challenge of Institutionalization in a Charismatic Leader Party,” in Barry Rubin and Metin Heper, eds., *Political Parties in Turkey* (London: Frank Cass, 2002), 41-61.

⁵⁹⁸ Anavatan Partisi, “Anavatan Partisi Programı ve 6 Kasım 1983 Seçim Beyannamesi” (1983): 23-28, http://www.tbmm.gov.tr/develop/owa/e_yayin.giris_q (arrived on June 1, 2014).

⁵⁹⁹ Turgut Özal, *Turgut Özal’ın Anıları*, compiled by Mehmet Barlas (İstanbul: Birey Yayıncılık, 2001), 120.

and promote adjustment policies, simultaneously?⁶⁰⁰ Özal's response to this dilemma was to opt for a highly uncoordinated policy mix of expansionary fiscal policies, discretionary use of resources at the disposal of the state, and wink at corruption to form ad hoc electoral coalitions,⁶⁰¹ what Waterbury called "coalition maintenance through state patronage."⁶⁰² Accordingly, this expansionary logic informed gradual detachment from institution-based procedures in the management of economy. Özal, in order to implement economic decisions in a swift way, recurrently inclined to sidestep the bureaucratic and legal procedures, which planted the seeds of uncontrolled populism in the years to come.⁶⁰³ Accordingly, as Heper and Keyman pointed out, cabinet decrees rather than acts of parliament constituted the essence of economic policy-making.⁶⁰⁴ Many of the key economic decisions regarding privatizations, state economic enterprises, trade and financial liberalization were taken within narrow inner circles instead of consultation with relevant bureaucracy and private interest groups (see below). The fiscal spending decisions were also conducted along the same logic, mostly starting from mid-1980s onwards. In this regard, the frequent use of extra-budgetary

⁶⁰⁰ Ziya Öniş, "Political Economy of Turkey in the 1980s: Anatomy of Unorthodox Liberalism" in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 35.

⁶⁰¹ Mine Eder, "Populism as a Barrier to Integration with the EU," in Nergis Canefe and Mehmet Ugur, eds., *Turkey and European Integration: Accession Prospects and Issues* (London: Routledge, 2004), 57; also see, Ziya Öniş, "Turgut Özal and His Economic Legacy: Turkish Neo-Liberalism in Critical Perspective," *Middle Eastern Studies* 40, no. 4 (2004): 117.

⁶⁰² John Waterbury, "Export-Led Growth and the Center-Right Coalition in Turkey," *Comparative Politics* 24, no. 2 (1992): 133.

⁶⁰³ Literature suggests that clientelism has deep roots in Turkish politics dating back to the formation of the modern Turkish state. For instance see Ayşe Güneş-Ayata, "Roots and Trends of Clientelism in Turkey," in Luis Roniger and Ayşe Güneş-Ayata, eds., *Democracy, Clientelism, and Civil Society*, (London: Lynne Rienner Publishers, 1994), 49-63; Sabri Sayarı, "Political Patronage in Turkey," in Ernest Gellner and John Waterbury, eds., *Patrons and Clients in Mediterranean Societies* (London: Duckworth Publishers, 1977), 103-30.

⁶⁰⁴ Keyman and Heper, "Double-Faced State: Political Patronage and the Consolidation of Democracy in Turkey," *Middle Eastern Studies*, 267.

funds (EBFs) constitutes a novel fiscal policy related innovation.⁶⁰⁵ Özal preferred to spend state's fiscal resources in a flexible manner, as it was the case in the creation of sizeable EBFs such as Mass Housing and Public Transportation Funds. EBFs proved to be useful instruments to disburse state's fiscal resources in a rather discretionary fashion beyond the purview of the parliament. The number of EBFs ranged from 96 to 134 with total assets estimated to be around 3.5 to 5.7 billion dollars in 1988.⁶⁰⁶ Their share in the budget gradually expanded and reached to a quarter of the total budget revenues in 1989.⁶⁰⁷ The discretionary spending of the EBFs underpinned patronage politics in the economy with deteriorating impacts on the fiscal discipline of the state.⁶⁰⁸ Similarly, Özal's lukewarm approach to economic crimes —such as fictitious exports, see below— as well as his tendency to wink at bribery and corruption, once again, reincarnated rent-seeking agency behaviour, yet this time via different means:

“Even though Özal's strategies worsened the income levels of workers and farmers, the rapid rise of the informal economy and the willingness of the government to overlook bribery (hence the famous motto of Turgut Özal: ‘My civil servant knows what to do’) created alternative avenues to mediate increasing inequality. So instead of attracting those from the lower middle classes and the workers (as the ISI populists often did), neoliberal populists sought support in the new urban para-classes that depended on informal sectors as well as new small to medium-sized entrepreneurs who were eager to exploit

⁶⁰⁵ For an analysis of the EBFs, see Oğuz Oyan, “Fonlar, İstikrar Programı ve Özelleştirme,” *Mülkiye Dergisi*, no. 91 (1988): 19-26; also see Oğuz Oyan, “An Overall Evaluation of the Causes of the Use of Special Funds in Turkey and Their Place in the Economy,” *Yapı Kredi Economic Review* 1, no. 4 (1987): 96.

⁶⁰⁶ Dani Rodrik, “Premature Liberalization, Incomplete Stabilization: The Özal Decade in Turkey,” *NBER Working Paper Series*, working paper no. 3300 (1990): 24.

⁶⁰⁷ *Ibid.*

⁶⁰⁸ Öniş and Webb, *The Political Economy of Policy Reform in the 1980s*, World Bank Working Papers, Paper no. 1059 (1992), 36.

market opportunities but highly reluctant to pay taxes or social insurance contributions.”⁶⁰⁹

One of the striking manifestations of the rampant populism was growing informal economy, which resulted in state’s inability to implement an efficient and fair taxation system to improve its revenue base. Similar to Papandreou case in Greece, state’s unwillingness, and to some extent, incapacity to extract resources from wealthier segments of society limited its taxation capacity. The data suggest that in the post-liberalization period, state’s tax base could not be improved: The tax revenue over GNP declined from 16.8 percent in 1980 to 15 percent in 1989.⁶¹⁰ It is rather paradoxical that Özal’s initial reform-activism invited subsequent deterioration of state capacity; thereby, put Turkish political economy into a reform-biased path during 1990s. Informed by perverse fisco-financial practices of the previous decade, underpinned by destabilizing impacts of neoliberal globalization (see section 5.3), and permeated by increasingly instable and polarized political context, the 1990s turned into a lost decade for the Turkish political economy.⁶¹¹ The second phase of Turkish political context in the post-1980, therefore, refers to a string of ‘weak coalition governments’ that covered the period from 1991 to 2002.

⁶⁰⁹ Eder, “Populism as a Barrier to Integration with the EU,” 61. Also see, Oktay Yenal, *Cumhuriyet’in İktisat Tarihi* (İstanbul: İş Bankası Kültür Yayınları, 2010), 131, 140-146.

⁶¹⁰ Öniş and Webb, *The Political Economy of Policy Reform in the 1980s*, World Bank Working Papers, Paper no. 1059 (1992).

⁶¹¹ For a vivid portrayal of the 1990s, see Kerem Öktem, *Angry Nation: Turkey since 1989* (London: Zed Books, 2011), 84-121.

In 1989, Özal had himself elected to the presidency. Despite the fact that Özal continued to manage ANAP behind the scenes through a loyal caretaker Prime Minister, Yıldırım Akbulut, the political competition exponentially intensified with the return of once banned veteran political figures. In September 1987 referendum, just over 50 per cent of the citizens had voted in favour of lifting bans on more than 200 politicians imposed by military regime.⁶¹² These included two former Prime Ministers, Süleyman Demirel and Bülent Ecevit, and leading nationalist politician, Alparslan Türkeş. In an increasingly competitive political environment, the general elections in October 1991 brought a new era of weak coalition governments during 1990s. In this phase, political context in Turkey fits quite well into the category of what Sartori calls “polarized pluralism.”⁶¹³ Accordingly, consensus-based policy-making was sidelined, as a result of which political system gradually became dysfunctional. In that sense, Turkish political context resembles the Greek case as increasing polarization dominated the political agenda; the only difference was instable multiparty system in Turkey instead of two-party system established in the latter. In this decade, eleven coalition governments were established with an average lifespan of 449 days (see the next section below). The politics was perceived as a zero-sum game divided according to the ethnic and ideological cleavages that legitimized ‘we vs. others’ mentality. In the first half of the decade, three highly uncoordinated and incoherent coalition governments were formed with an average duration of 479 days (see figure).

⁶¹² Milliyet Gazetesi, “Halk ‘Evet’ Dedi,” September 8, 1987.

⁶¹³ For definition of polarized pluralism see chapter 3.

Table 8. Governments' lifespan in Turkey (1989-1995)

Government	Prime minister	Rise	Fall	Duration (days)
ANAP	Turgut Özal	December 1987	November 1989	688
ANAP	Yıldırım Akbulut	November 1989	June 1991	590
ANAP	Mesut Yılmaz	June 1991	November 1991	150
DYP-SHP	Süleyman Demirel	November 1991	April 1993	581
DYP-SHP	Tansu Çiller	June 1993	October 1995	831
DYP-SHP (M)	Tansu Çiller	October 1995	October 1995	24
DYP-CHP (C)	Tansu Çiller	November 1995	December 1995	127
1980-1995 average				557.37
1991-1995 average				478.67
1995-2002 average				376.29
1991-2002 average				449.56

Source: Author's calculations based on Turkish Grand National Assembly (TBMM) data
(M): Minority government
(C): Caretaker government

True Path Party (DYP) and Social Democrat Populist Party (SHP) formed three successive coalition governments in the first half of the 1990s (see table 8). The electoral base of the DYP-SHP coalitions was composed of the main losers of structural adjustment reforms of the previous decade. DYP was representing the centre-right tradition in Turkey and its main support base was composed of the farming community, middle-classes, and small and medium-sized enterprises. On the other hand, SHP emerged as the representative of the weakening labour class. Both of these groups were the principal losers of regressive fiscal policies, which were put into implementation as part liberalization reforms: During 1980s, the share of agriculture in national income declined from 24 per cent to 16 per cent. Similarly, the share of wages and salaries also

decreased from 27 per cent to 14 per cent, whereas rents, profits, and interest income jumped from 49 per cent to 70 per cent at the turn of the decade.⁶¹⁴

Both DYP and SHP inclined to pursue high wage policies to please their respective electorates. The emergent populist cycle that was triggered in the second half of the 1980s turned into a full-fledged neo-populism during DYP-SHP coalitions in the first half of 1990s.⁶¹⁵ Farmers were supported through generous subsidies, labour class was compensated by high wage increases, and industrial elite was backed by low tax burdens, low input prices provided via state economic enterprises, and clientelistic policy networks. During 1989-1993, just before 1994 economic crisis, the real wages were almost doubled, whereby the mark-up ratios of the industrial elite remained unchanged around 40 percent, which demonstrates that state turned out to be the major loser of the populist expansion cycle.⁶¹⁶ In the first half of 1990s, the logic of short-lived coalition governments thus hampered coherent supply and consistent implementation of even the basic economic policies, let alone fostering state capacity to effectively reform domestic economy in line with the changing global dynamics:

“Instead of dealing with painful, long-term reforms with uncertain political outcomes, politicians have continued with the existing patronage patterns [during 1990s]. Growing political fragmentation within Parliament and the logic of

⁶¹⁴ Dani Rodrik, “Premature Liberalization, Incomplete Stabilization: The Özal Decade in Turkey,” *NBER Working Paper Series*, working paper no. 3300 (1990): 24. For the changing dynamics of income distribution in this period also see, Korkut Boratav, *Türkiye İktisat Tarihi* (Ankara: İmge Kitabevi, 2005), 163-169.

⁶¹⁵ Eder, “Populism as a Barrier to Integration with the EU,” 62.

⁶¹⁶ Erinç Yeldan, *Küreselleşme Sürecinde Türkiye Ekonomisi* (İstanbul: İletişim Yayınları, 2011), 76.

coalition governments combined to generate populist policies as each party tried to use state resources for its own constituencies.”⁶¹⁷

In summary, the discretionary policy making in the 1980s and collective action problems associated with weak coalition governments in the first half of 1990s as well as the contradictory logic of the DYP-SHP coalitions lead to insurmountable governance problems. Domestic political context also informed the structure of state bureaucracy and shaped the main contours of the interaction between the state and dominant policy coalitions, as a result of which their contribution to reform processes remained extremely limited. Along these lines, next section will discuss the transformation of state’s bureaucratic capacity during the period in question.

5.2.2. State bureaucracy

Second institutional structure that informed state’s reform capacity is economic bureaucracy. State capacity literature suggests that bureaucracy plays a central role in terms of the production and dissemination of high quality information so as to overcome collective action problems not only within state mechanisms but also between state actors and dominant policy coalitions toward the implementation of substantial and sustainable reforms. However, the existence of an insulated but highly coordinated and meritocratic core economic bureaucracy deemed a distant objective in the Turkish case.⁶¹⁸ In the post-1980 period, the domestic political context also underpinned the main features of state bureaucracy. Thus state economic bureaucracy acquired neither

⁶¹⁷ Eder, “Populism as a Barrier to Integration with the EU,” 62.

⁶¹⁸ Ünay, *Neoliberal Globalization and Institutional Reform*, 71-73, 143-144.

‘autonomy’ nor ‘embeddedness.’⁶¹⁹

First, the public sector in general and state bureaucracy in particular gradually expanded in the post-liberalization process. As Yeldan and Çizre-Sakallıoğlu point out, in a state-dominated economic structure, “politics was understood and defined as a strategy to build and sustain power by distributing material benefits generated by the state through clientelistic channels.”⁶²⁰ Similar to other reactive states such as Greece, public sector in general and state bureaucracy in particular became the battleground for political elite to capture the state and ‘distribute material benefits’ through patronage networks in Turkey. In retrospect, one of the stated aims of the market-oriented reforms was to cure the haemorrhaging public sector through downsizing, which was perceived as pockets of rent-seeking and inefficiency. The post-1980 developments, however, hollowed out these expectations. I stated in the previous section that restoration of democratic politics aggravated the distributional concerns of the political parties. In this context, state employment provided rewarding opportunities for political elite to satisfy the middle classes as well as to expand their political reach especially at the election episodes. The data corroborates the existence of such a kind of upward trend: In the early years of post-liberalization period, the number of staff positions in the public sector remained almost stable around 1.2 million. The Özal government pursued austere policies in compliance with ANAP’s party program and the recommendations of the IMF and the

⁶¹⁹ Ibid.

⁶²⁰ Erinç Yeldan and Ümit Cizre-Sakallıoğlu, “Politics, Society, and Financial Liberalization: Turkey in the 1990s,” *Development and Change* 31, no. 2 (2000): 498-499.

World Bank.⁶²¹ However, during the local election year in 1984, the number of staff rose to 1.29 million by 7.5 percent increase. In the general election year in 1987, the numbers made a big jump again with almost 10 percent increase and hit 1.49 million. Finally, the number of staff positions reached a new plateau with 1.81 million in the wake of 1994 economic crisis, 55 percent higher than the positions in 1980.⁶²² The state economic enterprises (SEEs) reflect another important dimension that disturbed fiscal discipline in this period. The SEEs continued to be a major source of fiscal instability in the post-liberalization process, despite the frequent articulation of an entirely opposite rhetoric. The contribution of the SEEs to GNP expanded from 11 percent of GNP to more than 16 percent at constant prices during 1980s, and no substantial divestiture took place until 1988 (for details see section 5.3.1).⁶²³

The expansion of the public sector, however, should not be conflated with the increasing impact of the state bureaucracy on economic decision-making processes. This ostensible paradox brings us to the second aspect of state's internal capacity. Özal targeted the centralization of the economic governance. Therefore he deliberately excluded traditional state bureaucracy from key decision-making processes. There were historical reasons for Özal to keep economic bureaucracy at arm's length: During the ISI period, economic bureaucracy adopted an inward-looking *étatiste* mind-set and enjoyed excessive autonomy vis-à-vis the political elite.⁶²⁴ The traditional bureaucracy in Turkey

⁶²¹ İzak Atiyas, "Uneven Governance and Fiscal Failure: The Adjustment Experience in Turkey," *The World Bank Private Sector Development Department Occasional Paper*, no. 17 (1995): 16-17.

⁶²² Ibid.

⁶²³ Ziya Öniş, "The Evolution of Privatization in Turkey: The Institutional Context of Public-Enterprise Reform," *International Journal of Middle East Studies* 23, no. 2 (1991): 170.

⁶²⁴ Öniş, "Turgut Özal and His Economic Legacy," *Middle Eastern Studies*, 121.

was therefore imbued by “pathological bureaucratization” in the words of Heper that favoured frequent state intervention and procedural maze.⁶²⁵ I stated in the previous part that Özal’s utmost priority was to accelerate the decision-making processes and implement market-oriented reforms in a rather swift way. Accordingly, one of his catchwords was to put an “end to the protectionist and paternalistic state,”⁶²⁶ and obviously, he conceived state bureaucracy as the guardian of this “the paternalistic state.” In his memoirs, he openly expresses his deep antipathy against the behavioural codes of the bureaucratic tradition in Turkey:

“...We [in Turkey] do not make a distinction between politicians and bureaucrats. In the legal code it is written that the authority is in the hands of ‘ministries.’ In fact, discretion should be in the hands of ‘ministers.’ We need to demonstrate the power and superiority of elected political elite [vis-à-vis bureaucracy]. As an unfortunate outcome of the 1960 coup, politicians were insulted. It was argued that politicians always made the things worse. It was again argued that bureaucracy fixed the things broken by political elite.”⁶²⁷

Özal therefore aimed at reducing the power of economic bureaucracy. He frequently stated that his aim was to circumvent the red tape and vested interests entrenched at the bureaucratic circles.⁶²⁸ To this end, as Ünay stated, traditional bureaucratic institutions were increasingly sidelined whereas “brand-new institutions” were set up under the auspices of the Prime Ministry.⁶²⁹ For instance, the power of the Ministry of Finance and the power of the Ministry of Commerce were dramatically curtailed. Instead, an

⁶²⁵ Metin Heper, “Negative Bureaucratic Politics in a Modernizing Context: The Turkish Case”, *Journal of South Asian and Middle Eastern Studies* 1, no.1 (1977): 80.

⁶²⁶ Feride Acar, “Turgut Özal: Pious Agent of Liberal Transformation” in Metin Heper and Sabri Sayarı, eds., *Political Leaders and Democracy in Turkey* (Oxford: Lexington Books, 2002), 172.

⁶²⁷ Özal, *Turgut Özal’ın Anıları*, 120.

⁶²⁸ Ibid. Also see Acar, “Turgut Özal: Pious Agent of Liberal Transformation.”

⁶²⁹ Ünay, *Neoliberal Globalization and Institutional Reform*, 122.

Undersecretariat of Treasury and Foreign Trade was created in the Prime Minister's office with extensive discretionary rights on state's fiscal decisions.⁶³⁰ As Ekrem Pakdemirli, the first undersecretary of Treasury and Foreign Trade underlines in his memoirs, what Özal had in mind was to streamline economic decision making processes under his leadership.⁶³¹ Along the same logic, Department of Foreign Investment, Department of Investment, Export Promotion and Implementation, and Privatization Administration were created. All these new economic institutions were directly responsible to the Prime Minister and his office. The other key institutions of economic bureaucracy from the previous decades, namely SPO and Central Bank were already at Prime Minister's disposal so that "Özal came to have direct control over appointments to all top [bureaucratic] executive positions."⁶³²

The Public Personnel Law was also modified (see below), which enabled the appointment of non-bureaucratic figures to the key posts of state economic bureaucracy. Özal appointed young, well-educated, and outward-oriented figures to the commanding heights of the economic bureaucracy. Most of these people, popularized as 'Özal's princess' in the media, were US-educated, high calibre figures with good connections at the international financial institutions such as the IMF and the World Bank. Özal's aim was to integrate Turkey with the Western economies. Accordingly, he conceived that the dynamism and vision of the newly appointed elite as valuable assets to achieve this

⁶³⁰ For a detailed survey of institutional change in economic bureaucracy see OECD, *Economic Surveys, Turkey: 1983-1984* (Paris: OECD Publication Service, 1984), 42-43.

⁶³¹ Ekrem Pakdemirli, *Özal'ın Mirası*, compiled by Turgay Yavuz (İstanbul: Ufuk Yayınları, 2013), 105-106.

⁶³² Ayşe Öncü and Deniz Gökçe, "Macro-Politics of De-Regulation and Micro-Politics of Banks," in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 104.

goal.⁶³³ Despite new bureaucratic elite injected reform euphoria in the initial phases thanks to the high degree of insulation they enjoyed vis-à-vis the statist economic bureaucracy and economic interest groups, the top-down and discretionary style of policy-making opened up a slippery slope that “associated with a weakening of the bureaucratic apparatus with costly consequences that became evident with recurring episodes of corruption, notably in the ensuing 1990s.”⁶³⁴ The economic bureaucracy lost its corporate identity that rendered core institutions’ capacity to control widespread corruption and rent-seeking agency behaviour in the private sector. Öniş deciphers how the curtailment of state’s internal capacity invited the deterioration of bureaucratic surveillance capacity during 1990s:

“A weakened bureaucratic apparatus, subject to frequent changes of its personnel through political appointments, lost a sense of common vision. Economic bureaucracy [became] unable to act as a barrier against ‘populist expansionism’ and the misuse or misallocation of public funds that accompanied this process in the context of the full-blown electoral contests of the post-1987 era.”⁶³⁵

Third, state’s internal capacity suffered from extensive policy fragmentation and incoherence, which was mostly emanated from frequent reshuffling of bureaucratic posts in the post-liberalization period. State capacity literature suggests that an organizationally coherent economic bureaucracy facilitates reform-activism by undertaking coordinative and communicative roles, enhancing high quality information flows, fostering trust and credibility of commitments and reciprocity among societal

⁶³³ Metin Heper and M. Selçuk Sancar, “Is Legal-Rational Bureaucracy a Prerequisite For a Rational-Productive Bureaucracy? The Case Of Turkey”, *Administration and Society* 30, no (1998): 152.

⁶³⁴ Öniş, “Turgut Özal and His Economic Legacy,” *Middle Eastern Studies*, 121-122.

⁶³⁵ Öniş, *State and Market*, 502.

actors and state elites.⁶³⁶ The literature also proffers that bureaucratic insulation precedes policy coherence, which means that lack of insulation may easily pave the way for political patronage and arbitrary reshuffling of bureaucratic corps.⁶³⁷ In the Turkish context, from an historical point of view, economic bureaucracy succeeded to protect its turf and enjoyed a high level of insulation vis-à-vis political and economic elite during the ISI period, partially thanks to the lingering legacy of monist state tradition. However, ‘autonomy’ of the Turkish bureaucracy was not accompanied by ‘embeddedness.’ In the post-liberalization period, increasing politicization and fragmentation of state bureaucracy eroded its autonomy whilst lack of embeddedness prevailed. The overemphasis on the self-adjustment capacity of the markets and politically motivated appointments put bureaucratic coherence and coordination into serious jeopardy.⁶³⁸ As a result, the overwhelming majority of the key economic bureaucrats started to come and go with governments, which in turn exacerbated bureaucratic balkanization, policy fragmentation and incoherence:

“Governments [in Turkey] heavily engaged in unrestrained patronage and nepotism. The resulting arbitrary reshuffling of bureaucrats involved all ranks politicized the bureaucracy and undermined esprit de corps.”⁶³⁹

⁶³⁶ Sylvia Maxfield and Ben Ross Schneider, eds., *Business and the State in Developing Countries* (Ithaca: Cornell University Press, 1997), 16-18.

⁶³⁷ Ibid.

⁶³⁸ A. Ümit Berkman and Metin Heper, “Political Dynamics and Administrative Reform in Turkey,” in Ali Farazmand, ed., *Administrative Reform in Developing Nations* (London: Praeger, 2002), 159.

⁶³⁹ Jesse Biddle and Vedat Milor, “Economic Governance in Turkey: Bureaucratic Capacity, Policy Networks, and Business Associations” in Sylvia Maxfield and Ben Ross Schneider, eds., *Business and the State in Developing Countries* (Ithaca: Cornell University Press, 1997), 286.

In 1984, with Act 3046, ANAP government bypassed the restrictions of Public Personnel Law No 657. With this law, the governments obtained the right to recruit contract-based personnel in key institutions of economic bureaucracy through bypassing the written and oral exams.⁶⁴⁰ Following the Act 3046, the conversion of the public service managers to contract status significantly increased. For instance, the number of contract-based administrators was 674 in 1984, which rose to 26,578 in 1986.⁶⁴¹ For instance, the directorate of incentives and implementation, one of the most crucial bureaus of the SPO dealing with state subsidies to private sector, turned into a backyard for patronage-based appointments. Literally, 69 percent of bureaucrats were appointed on contract basis in this department.⁶⁴²

The data, despite somewhat anecdotal and preliminary, hint that political elite found new ways to permeate into the functioning of the economic bureaucracy.⁶⁴³ Nevertheless, the worst was yet to come. In the 1990s, as I discussed in the preceding paragraphs, weak coalition administrations replaced the single party governments of the previous decade. In this new political context, the state bureaucracy turned into a real battlefield of the rival political parties struggling for power in a polarized and populist political setting. In the words of Heper and Keyman:

⁶⁴⁰ Ibid., 295.

⁶⁴¹ Waterbury, "Export-Led Growth and the Center-Right Coalition in Turkey," *Comparative Politics*, 138.

⁶⁴² Biddle and Milor, "Economic Governance in Turkey: Bureaucratic Capacity, Policy Networks, and Business Associations," 296.

⁶⁴³ For a detailed review with special reference to the case of SPO, see Onur Ender Aslan, "Devlet Planlama Teşkilatı: 1980 Sonrası Dönüşüm," *Amme İdaresi Dergisi* 31, no. 1 (1998): 103-123.

“Bureaucracy has been increasingly politicized. Political parties were not interested in positive contributions the bureaucracy could make to the formulation of policies. Rather, they tried to curb the power of the bureaucracy for their own purposes -being able to pursue their particular aims without any interference from the bureaucracy.”⁶⁴⁴

In summary, during 1980s and in the first half of 1990s, all three aspects of state’s internal capacity suffered from administrative weaknesses due to the reasons endemic to the reactive states. Thus, similar to the Greek case, in Turkey, economic bureaucracy could not play an active role in the economic decision-making processes.⁶⁴⁵ As Boratav, Türel, and Yeldan unearth “decision making and implementation on rent-allocating activities definitely shifted into the prerogative of the political layer of the state structure as the upper bureaucracy was pushed increasingly into a passive position.”⁶⁴⁶

5.2.3. Dominant policy coalitions

Third institutional structure that informed state’s reform capacity is dominant policy coalitions. State capacity literature proposes that state’s mode of relations with major economic interest groups play a crucial role in terms of state’s reform-activism. I therefore maintained in chapter 2 that dominant policy coalitions and their interaction patterns with the state constitute the external aspect of state capacity. Similar to the Greek case, Turkish state’s relations with domestic policy communities reflect typical

⁶⁴⁴ Metin Heper and Fuat Keyman, “Double-Faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies*, 263.

⁶⁴⁵ Biddle and Milor, “Economic Governance in Turkey: Bureaucratic Capacity, Policy Networks, and Business Associations,” 297.

⁶⁴⁶ Korkut Boratav, Oktar Türel, and Erinç Yeldan, “Dilemmas of Structural Adjustment and Environmental Policies under Instability: Post-1980 Turkey,” *World Development* 24, no. 2 (1996): 378.

features of ‘disjointed corporatism.’⁶⁴⁷ Historically informed analysis suggests that transcendental state tradition, which precipitated ruling from above, thwarted the development of civil society and social trust in Turkey.⁶⁴⁸ OECD data indicates that along with Greece, Turkey has the lowest levels of general trust, barely higher than Chile.⁶⁴⁹ Keyman and İçduygu demonstrate that civil society still remains weak in Turkey, despite the fact that multiple-transformations took place concerning the state-centred Turkish modernity.⁶⁵⁰ Given the unfavourable historical-institutional background and weak social capital, the bilateral relations between state and major economic interest groups remained state-dependent, ad hoc and loop-sided —lacking rule based and institutionalized reciprocal mechanisms, i.e., ‘governed interdependence’ in state capacity literature.

In the same vein, peak associations in the labour and business sides fell short of expanding their reach, ensuring the commitment of their members, and overcoming the collective action problems vis-à-vis the state bureaucracy and political elite. Thus, dominant policy coalitions contributed little to the economic reform processes. Instead, fragmented exchange relationships between state and private interest groups informed

⁶⁴⁷ For main features of disjointed corporatism, see chapter 3.

⁶⁴⁸ Heper, *State Tradition in Turkey*; Şerif Mardin, “Center-Periphery Relations: A Key To Turkish Politics?” *Daedalus* 102, no. 1 (1973): 169-190; Metin Heper, “The ‘Strong State’ and Democracy: The Turkish Case in Comparative and Historical Perspective,” in Samuel N. Eisenstadt, ed., *Democracy and Modernity* (Leiden: E. J. Brill, 1992), 142-164.

⁶⁴⁹ OECD, *Society at A Glance, 2011: OECD Social Indicators* (Paris: OECD Publication Service, 2011). Also see İlkay Sunar, *State, Society, and Democracy in Turkey* (İstanbul: Bahçeşehir University Publications, 2004).

⁶⁵⁰ For an in-depth theoretical-analytical analysis that accounts for the transformation of civil society in Turkey during globalization processes, see E. Fuat Keyman and Ahmet İçduygu, “Globalization, Civil Society and Citizenship in Turkey: Actors, Boundaries and Discourses,” *Citizenship Studies* 7, no. 2 (2003): 219-234.

rent-seeking patronage politics. There are four primary-level peak associations, which I will take into account in this study: the Confederation of Turkish Trade Unions (TÜRK-İŞ) and Confederation of Progressive Trade Unions (DİSK) on the labour side; and the Union of Chambers and Commodity Exchanges of Turkey (TOBB) and Turkish Industry and Business Association (TÜSİAD) on the business side.⁶⁵¹

On the labour side, state played a crucial role in the organization of labour markets. However, state-labour relations in Turkey pose marked contrasts to the corporatist models of advanced western economies. The weak power capacity of the labour class vis-à-vis the political and business elite also distinguishes the Turkish case from the Greek one. Trade unions in Turkey remained at the margins of the economic policy-making with little opportunity and capacity to influence reform processes noticeably, either in positive or negative ways. During 1960-1980, thanks to the relatively progressive elements of the 1961 Constitution and ensuing labour legislation enacted in 1963, labour unions progressively increased their voice at the political echelons.⁶⁵² The tripartite corporatist arrangements, however, could not be crafted during the ISI period. On the contrary, mounting political polarization in the 1970s underpinned the radicalization of the Turkish labour movement. Despite TÜRK-İŞ, the only peak labour organization up to late 1960s, remained state-dependent, new and more autonomous trade unions were established along the lines of ideological cleavages. Accordingly,

⁶⁵¹ Independent Industrialists and Businessmen's Association (MÜSİAD in Turkish acronym) should also be taken into consideration as the representative of conservative business elite in Turkey. However, MÜSİAD was established in 1990 and emerged as an important business association in mid-1990s, especially during 2000s with the rise of Justice and Development Party (AKP in Turkish acronym) governments. Therefore I will discuss the role of MÜSİAD in chapter 6.

⁶⁵² Yıldırım Koç, *Türkiye'de İşçi Sınıfı ve Sendikacılık Hareketi Tarihi* (İstanbul: Kaynak Yayınları, 2003).

DİSK, which was founded in 1967, was clearly the most radical one.⁶⁵³ The vortex of political and social violence that intensified in late-1970s spawned a destructive pattern of conflict and antagonism between the state and labour unions. Parallel to the economic bottlenecks associated with the ISI regime and accompanying political instability, the number of strikes skyrocketed in late 1970s. Accordingly, 39,901 workers joined strikes during 1979, which resulted in a total loss of 2.2 million working days.⁶⁵⁴ The announcement of the 24 January decisions struck a nerve with the labour class so much so that 84,432 workers poured into the streets in the first eight months of 1980 with a total loss of 7.7 million working days.⁶⁵⁵

Following the September 12, 1980 intervention, military junta pursued very aggressive suppression policies to enervate the labour movement. All trade organizations, except TÜRK-İŞ,⁶⁵⁶ were banned. 1,955 trade union administrators were jailed, strikes were outlawed, and collective bargaining over wages was suspended.⁶⁵⁷ Article 51 of the 1982 constitution, which was crafted by interim military regime and the ensuing labour code (Trade Unions Act No. 2821 dated March 5, 1983), institutionalized the peripheral status

⁶⁵³ Fikret Adaman, Ayşe Buğra, Ahmet İnel, "Social Context of Labour Union Activity: The Case of Turkey," *Labour Studies Journal* 34, no. 2 (2009): 173.

⁶⁵⁴ Yıldırım Koç, "30. Yıl Dönümünde 12 Eylül Darbesi ve İşçi Sınıfı," *Mülkiye Dergisi* 43, no. 268 (2010): 57.

⁶⁵⁵ *Ibid.*

⁶⁵⁶ TÜRK-İŞ openly supported the 12 September 1980 military coup. TÜRK-İŞ President İbrahim Denizci released a press statement after the military coup, saying that "TÜRK-İŞ respects Turkish army's decision intervene [into politics], which we hope that would bring peace and security to our citizens and country." Quoted in TBMM, *Meclis Araştırması Komisyonu Raporu*, 605.

⁶⁵⁷ Koç, "30. Yıl Dönümünde 12 Eylül Darbesi ve İşçi Sınıfı," *Mülkiye Dergisi*, 51.

of labour unions.⁶⁵⁸ Accordingly, labour unions were not allowed to form any connections with political parties and their activities were strictly restricted to their own strictly defined sectoral interests. In the absence of institutionalized social dialogue and tripartite corporatist agreements, labour unions were almost entirely excluded from economic policy-making processes in the post-1980 context. In Cizre-Sakallıoğlu's words:

“The new system sought to erase the ‘unionist malaise’ of the 1960s and 1970s, which had manifested itself as proliferation of unions, the infiltration of ideological unionism, at the leadership level and lack of trade union leadership capable of restraining the membership. Accordingly, trade unions were prohibited from pursuing a political cause and engaging in political [and economic] activity.”⁶⁵⁹

The incoming civil governments did not instil any substantial attempt to empower the legal status of the labour class. Özbudun documented in detail that the legal framework for labour associations remained almost intact despite some marginal improvements achieved after 1987.⁶⁶⁰ In the short-term, the governments perceived weak labour as an opportunity to engineer real devaluations of the exchange rates and depressed wages to stimulate export-oriented growth model in an era characterized by post-Fordist flexible production structures. In the medium-term, however, it paved the way for a precarious legacy with long-lasting adverse impacts on the institutional relations of social dialogue

⁶⁵⁸ Ergun Özbudun, “The Post-1980 Legal Framework for Interest Group Associations,” in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 49-50.

⁶⁵⁹ Ümit Cizre Sakallıoğlu, “Labour: The Battered Community” in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 61.

⁶⁶⁰ Özbudun, “The Post-1980 Legal Framework for Interest Group Associations,” 41-53.

and sustainable reform-activism.⁶⁶¹ The differences and similarities with the Greek case are worth noting at this point. In the Greek case, labour extensively politicized and was asymmetrically included into the political processes whilst labour movement was marginalized and almost completely excluded in the Turkish case. Both Papandreou's social democratic model and Özal's neoliberal paradigm, however, lead to similar outcomes in terms of labour's role in reform processes since the mode of inclusion and exclusion paved the way for pervasive populism and fragmentation in the absence of institutionalized deliberation mechanisms that undermined consensus-based reform activism.

State's relations with business elite also reflected loop-sided and state-centred equilibrium. Buğra,⁶⁶² Atlı,⁶⁶³ Keyder,⁶⁶⁴ Yalman,⁶⁶⁵ and Heper,⁶⁶⁶ inter alia, documented that state intervention remained the single most important variable that determined the fortunes and misfortunes of the business community in Turkey. In fact, similar to other late-industrialized economies, the very creation of capitalist class was state's pet project.⁶⁶⁷ From the commencement of the modern Turkish Republic, state

⁶⁶¹ Adaman, Buğra, and İnel, "Social Context of Labour Union Activity," *Labour Studies Journal*, 168-188.

⁶⁶² Ayşe Buğra, *State and Business in Modern Turkey: A Comparative Study* (New York: State University of New York Press, 1994).

⁶⁶³ Altay Atlı, *Business Associations and Foreign Policy: Revisiting State-Business Relations in Turkey*, Unpublished PhD Dissertation submitted to the Institute for Graduate Studies in the Social Sciences, Boğaziçi University, September 2013.

⁶⁶⁴ Keyder, *State and Class in Turkey*.

⁶⁶⁵ Galip L. Yalman, *Transition to Neoliberalism: The Case of Turkey in the 1980s* (İstanbul: İstanbul Bilgi University Press, 2009).

⁶⁶⁶ Metin Heper, "Interest-Group Politics in post-1980 Turkey: Lingering Monism" in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 163-176.

⁶⁶⁷ Keyder, *State and Class in Turkey*.

assumed a market-making role for the capital holders. Especially during the ISI period, roughly spanned from 1960 to 1980, Turkish state provided lucrative subsidies, legal privileges, import licenses, and arbitrary protection mechanisms to the business elite. Thanks to the buoyant state support, big business expanded its activities: There were very few conglomerates in Turkey before 1963 whereas the number of the newly established ones increased by 19 in the 1960s; and by 106 in the second half of 1970s.⁶⁶⁸

The ISI period, however, underpinned the disjointed nature of corporatist state-business relations because overdependence on state resources lacked regularized forms of consultation and reciprocal deliberation mechanisms. Thus Buğra labels state-business relations in the pre-1980 period as “market repressive,”⁶⁶⁹ which not only limited the role of business elite in the formulation and implementation of reform processes in a concerted and timely manner, but also rasped the capacity of the state as it encouraged pervasive rent-seeking at the agency-level. From this viewpoint the critical juncture emerged in 1980 created a new window of opportunity to reverse the past practices in state-business relations. As a matter of fact Turkish business elite strongly supported Özal government in the initial phases.⁶⁷⁰ Ali Koçman, the then president of TÜSİAD,

⁶⁶⁸ Öztürk, *Türkiye’de Büyük Sermaye Grupları*, 92.

⁶⁶⁹ Ayşe Buğra, “Political Sources of Uncertainty in Business Life,” in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 152.

⁶⁷⁰ In 1979, by placing an advertisement campaign on major Turkish newspapers, TÜSİAD publicly criticized center-left Bülent Ecevit government on the ground that the government was incapable of managing Turkish economy and “controlling labour militancy.” In the advertisements, excessive state intervention singled out the major problem of Turkish economy. Thus big business strongly supported Özal’s neoliberal agenda after the military intervention. For the advertisements, see Cumhuriyet Gazetesi,

threw full support behind the economic liberalization program to the extent that he even glorified the 24 January decisions as nothing short of “miraculous.”

“24 January decisions were [the most important decisions] taken over the last 1,000 years of Turkish history and lead to great success. [Therefore] 24 January decisions were miraculous.”⁶⁷¹

Özal was a former member of TÜSİAD and a top-executive in Sabancı Holding, one of Turkey’s largest corporations. Thus he was well attuned to the priorities of the business elite. Furthermore, as I have discussed in the previous section, he was a staunch supporter of free entrepreneurship. In the first Özal government, for instance, 75 percent of the cabinet was composed of politicians who had worked in the private sector in their previous careers.⁶⁷² In his 20-seated cabinet, there were five economists and 11 engineers with some experience in economics.⁶⁷³ Özal reflected his business-minded perspective in his foreign policy making style as well. He did place central importance on economic interdependence with neighbouring countries as a practical hand in Turkish foreign policy. Accordingly, Turkish business elite became an integral part of the official state visits Özal paid to foreign countries.⁶⁷⁴ The developments in the first half of mid-1980s indicate that burgeoning interaction channels provided new avenues for state-business cooperation and reciprocal deliberation. Despite this enabling background the

“Gerçekçi Çıkış Yolu” [Realistic Exit], May 16, 1979 and Cumhuriyet Gazetesi, “Ulus Bekliyor” [The Nation is Waiting], May 23, 1979.

⁶⁷¹ Milliyet Gazetesi, “Koçman: ‘24 Ocak Kararları Mucizevi Bir Karardır,’” April 20, 1983.

⁶⁷² Yeşim Arat, “Politics and Big Business: Janus-Faced Link to the State,” in Metin Heper, ed., *Strong State and Economic Interest Groups: The Post-1980 Turkish Experience* (Berlin and New York: Walter de Gruyter, 1991), 144.

⁶⁷³ Milliyet Gazetesi, “Mühendisler Hükümeti,” December 14, 1983.

⁶⁷⁴ Altay Atlı, “Businessmen as Diplomats: The Role of Business Associations in Turkey’s Foreign Economic Policy,” *Insight Turkey* 13, no. 1 (2011): 112.

institutional basis of state-business relations could not be institutionalized in a way that would contribute to concerted economic policy-making and reform-activism. In order to account for the factors that underlie asymmetric and fragmented nature of interest intermediation structures, we should first and foremost concentrate on the organizational characteristics of peak associations.

The first business association in Turkey was established at the behest of the state in 1950. The Union of Chamber and Commodity Exchanges of Turkey (TOBB) assumed a quasi-public role, since membership to TOBB was compulsory for all enterprises in the country. The over politicization of the union activities in the 1970s and TOBB's exclusive emphasis on the interests of the merchants and small-scale entrepreneurs, disenfranchised the big-scale business in the 1970s.⁶⁷⁵ Thus twelve largest industrialists established their own association in 1971, named Turkish Industry and Business Association (TÜSİAD), which became the first voluntary business association in Turkey.⁶⁷⁶ TÜSİAD increased its economic and political might over the years. However, inter and intra-organizational factors crippled its capacity to stand out as an independent power block vis-à-vis the state. First, various circles denounced TÜSİAD for "being a club of the rich" with a narrow membership base.⁶⁷⁷ Similarly it received a lukewarm

⁶⁷⁵ Atila Eralp, "The Politics of Turkish Development Strategies," in Andrew Finkel and Nükhet Sirman, eds., *Turkish State, Turkish Society* (London: Routledge, 1990), 229-232.

⁶⁷⁶ Ayşe Öncü, "Chambers of Industry in Turkey: An Inquiry into State-Industry Relations as a Distributive Domain," in Ergun Özbudun and Aydın Ulusan, eds., *The Political Economy of Income Distribution in Turkey* (New York: Holmes and Meier Publishers, 1980), 474.

⁶⁷⁷ Eylem Türk, *TÜSİAD: Patronlar Kulübü* (İstanbul: Alfa, 2009), 19; Asım Kocabıyık, *Tazlar Köyü'nden Borusan'a* (İstanbul: Doğan Kitap, 2007), 222.

response from the TOBB.⁶⁷⁸ In fact, TOBB perceived itself as the sole legitimate representative of the business class in Turkey and rejected any proposal dispatched from TÜSİAD regarding the improvement of inter-organizational cooperation to overcome collective action problems the side of the capital holders.⁶⁷⁹ Second, TÜSİAD suffered from intra-organizational problems that hampered even the compliance of its own members. Buğra⁶⁸⁰ and Gülfidan⁶⁸¹ assiduously documented that TÜSİAD members frequently bypassed their own organization and established personnel contracts with political elite to solve their problems.

“Rather than informing the government of their demands through the Association they belong to, TÜSİAD members developed ‘particularistic’ ties with the party elites, which in turn meant clientelism, pure and simple.”⁶⁸²

Inter and intra-organizational cooperation failures and fragmented interest intermediation structures, therefore, provided ample room for clientelistic exchange relations between state and interest groups. The heterodox elements of the post-1980 economic policies amplified rent-seeking in state-business relations. Two policy instruments were frequently utilized during 1980s. First, investment-incentive regimes, incorporating various elements like exemptions from financial tax and stamp duty, foreign-exchange allocation scheme, and favourable credits to business elite were

⁶⁷⁸ Robert Bianchi, *Interest Groups and Political Development in Turkey* (Princeton: Princeton University Press, 1984), 260-261.

⁶⁷⁹ The conflict further escalated during 1990s. For instance, see, Milliyet Gazetesi, “TOBB-TÜSİAD Çekişmesi,” October 23, 1992; Yavuz Donat, “TOBB’dan TÜSİAD’a: ‘Şov Yapma,’” *Milliyet Gazetesi*, October 13, 1993. Also see Milliyet Gazetesi, “TOBB ile TÜSİAD’ın Savaşı Büyüyor,” April 30, 1995.

⁶⁸⁰ Buğra, *State and Business in Modern Turkey*, 164.

⁶⁸¹ Şebnem Gülfidan, *Big Business and the State in Turkey: The Case of TÜSİAD* (İstanbul: Boğaziçi University Press, 1993).

⁶⁸² *Ibid.*, 73.

implemented regularly. The incentive regime mostly targeted manufacturing industry to transform production structures and prioritized less developed regions, mostly the eastern parts of the country to overcome loop-sided and unequal regional development of Turkish economy.⁶⁸³ The Turkish incentive regime, however, significantly diverged from the developmental state practices in one crucial aspect. Biddle and Milor demonstrate in their detailed survey that the incentives were mostly delivered inefficiently as incentive contracts routinely violated, incentive schemes frequently changed, and the ratio of reciprocal fulfilment of contract obligations remained extremely low given the absence of an insulated economic bureaucracy capable of screening/monitoring projects, and fragmented nature of peak associations incapable of ensuring the compliance of their members.⁶⁸⁴ During 1980s, the fiscal costs of incentive supports amounted to 4-5 percent of GNP in annual terms,⁶⁸⁵ which, in a path dependent way, contributed to perverse exchange relationship between state and dominant policy coalitions and the subsequent fiscal crisis of the state in the incoming years:

“Throughout the 1980s, the incentives tended to become more widespread rather than restricted, primarily because modifications to the system were resisted by the beneficiaries and the maximization of the discretionary powers of the state

⁶⁸³ Biddle and Milor, “Economic Governance in Turkey: Bureaucratic Capacity, Policy Networks, and Business Associations,” 289.

⁶⁸⁴ Jesse Biddle and Vedat Milor, “Institutional Influences on Economic Policy in Turkey: A Three Industry Comparison,” *World Bank Private Sector Development Department*, Occasional Paper no. 3, 1995.

⁶⁸⁵ İsmail Arslan, *A Review of Turkish Incentive Systems* (Washington D.C.: World Bank Publications, 1993); also see İsmail Arslan and Sweder van Wijnbergen, “Export Incentives, Exchange Rate Policy and Export Growth in Turkey,” *The Review of Economics and Statistics* 75, no. 1 (1993): 128-133.

proved expedient for policy generated rents that could be selectively allocated to reward friends and punish foes.”⁶⁸⁶

Second, export-incentive regime was put into implementation in the post-liberalization process. Özal governments placed utmost emphasis on export-promotion strategies to achieve high and rapid economic growth. Export growth was also deemed crucial to mitigate the side effects of distributional conflicts, compensate the depressed domestic demand, and improve Turkey’s international creditworthiness. Accordingly, a variety of export incentive schemes were crafted, including tax rebates, cheap credits, and foreign exchange allocations. Baysan and Blitzer report that state subsidies allocated to manufactured-exports amounted to 20 percent of total exports in the first half of 1980s.⁶⁸⁷ In fact, state’s extensive fiscal support had some initial positive impacts. In the reports of international organizations, the striking increase in Turkey’s export performance that helped to overcome the dismal export-pessimism of the ISI period was appreciated as the most salient feature of post-liberalization reforms.⁶⁸⁸ According to Turkish Statistical Institute, commodity exports increased 15.8 per cent annually and reached 10.8 per cent of GNP from just 4.2 per cent during 1980-1989.⁶⁸⁹ Based on a government decree in July 1980 (amended in January 1984) twenty-four foreign trade companies, all of which except the two were affiliates of the Turkish big business, were

⁶⁸⁶ Biddle and Milor, “Economic Governance in Turkey: Bureaucratic Capacity, Policy Networks, and Business Associations,” 288.

⁶⁸⁷ Tercan Baysan and Charles Blitzer, “Turkey’s Trade Liberalization in the 1980s and Prospects for its Sustainability” in in Tosun Arıcanlı and Dani Rodrik, *The Political Economy of Turkey: Debt, Adjustment, and Sustainability* (London: Macmillan, 1990), 13 and Table 1.2.

⁶⁸⁸ OECD, *Economic Surveys, Turkey: 1991-1992* (Paris: OECD Publication Service, 1992).

⁶⁸⁹ Turkish Statistical Institute, *Statistical Indicators: 1923-2011* (Ankara: Turkish Statistical Institute), 481.

established.⁶⁹⁰ Those qualified for foreign trade companies benefitted from a multitude of incentives in the form of tax rebates, duty free imports, and favourable credits from the state banks. The export-promotion strategies were designed explicitly to replicate the East Asian developmental model. Since the investment and export-promotion strategies were implemented without a proper emphasis on state's monitoring capabilities, however, rent-seeking policy networks among political elites, state banks, and industrial capital were persevered. In a rather stark contrast to East Asian developmental experiences, arbitrarily designed and poorly implemented incentive and export-promotion schemes lead to perverse incentive structures and subsequent fiscal imbalances.⁶⁹¹ It became public with infamous over-invoicing and 'fictitious export' incidents that economic governance strategies informed rent-seeking behaviour. According to the SPO calculations, 'fictitious export' activities composed 15 percent of total exports in the 1980s.⁶⁹² Öztürk reports however that SPO estimations prove rather conservative in comparison to other credible accounts, which hover around 30-35 percent.⁶⁹³ The data suggest that Turkish state, rather than steering new policy coalitions to promote growth-enhancing reform activism in this period, turned into major source of instability and uncertainty thanks to excessive political discretion that result in frequently changing and arbitrarily implemented economic policies.⁶⁹⁴

⁶⁹⁰ Ziya Öniş, "Organization of Export-Oriented Industrialization: The Turkish Foreign Trade Companies in a Comparative Perspective" in Tefik Nas and Mehmet Odekon, eds., *The Economics and Politics of Turkish Liberalization* (Bethlehem: Lehigh University Press, 1992), 73-100.

⁶⁹¹ Ibid. Also see Ünay, *Neoliberal Globalization and Institutional Reform*, 111.

⁶⁹² Quoted in Özgür Öztürk, *Türkiye'de Büyük Sermaye Grupları: Finans Kapitalin Oluşumu ve Gelişimi* (İstanbul: SAV Yayınları, 2010), 140.

⁶⁹³ Ibid.

⁶⁹⁴ Işık Özel, "Beyond the Orthodox Paradox: The Breakup of State-Business Coalitions in 1980s Turkey," *Journal of International Affairs*, vol. 57, no. 1 (2003): 97-110; for a comparison of Turkish and

In summary, all three aspects adversely informed Turkey's state capacity in the post-liberalization juncture. First, political context was imbued by uncontrolled populism and increasing polarization. Second, the state bureaucracy suffered from "embeddedness" and "autonomy", which in turn, expanded the reach of discretionary and fragmented economic policy-making. Third, major policy coalitions' mode of relationship with the state resembled disjointed corporatism so that labour unions and business elite could not contribute to the reform processes in a reciprocal and institutionalized manner. Thus broader political, bureaucratic, and economic institutional settings informed inward-looking and fragmented agency behaviour. Thus, conditioned by sub-optimal institutional equilibrium, bureaucratic and economic actors gradually adjusted their preference functions "in such a way to influence the government's discretionary meddling in the economy, and the ability to make profits through quick responses to changes in the rules of the game."⁶⁹⁵ Consequently, "seizing and saving the day"⁶⁹⁶ has become modus operandi of dominant policy coalitions.

5.3. 1994 economic crisis: An opportunity missed?

The analysis so far suggests that internal and external capacity of the Turkish state remained weak during 1980-1994. Accordingly, the interactions of agents and domestic institutional structures informed myopic behaviour, rather than reform-oriented outlook.

East Asian cases in terms of the importance of state's strategic vision and policy stability, see Öniş, "Redemocratization and Economic Liberalization in Turkey: The Limits of State Autonomy," *Studies in Comparative International Development* 27, 3-23.

⁶⁹⁵ Buğra, "Political Sources of Uncertainty in Business Life," 159.

⁶⁹⁶ Ibid.

However, the picture would remain incomplete if we just focus on the domestic phenomena. As I proposed in chapter 2, we should also take broader institutional structures into consideration in order to understand how the interactions of domestic and international dynamics reinforced reactive state practices. In this context, the rise of financial globalization and Turkey's sub-optimal integration into the liberalization processes played an adverse role on state capacity, especially during 1990s. The mode of Turkey's exposition to financial globalization exacerbated fisco-financial problems because it was materialized before the rules of the game, namely robust institutions in charge of fiscal and financial regulation were introduced. In fact, full capital account liberalization in August 1989 was a personnel decision of Özal, which he took despite the contrary advice of economic bureaucracy.⁶⁹⁷ The decision, once combined with instable macroeconomic fundamentals, populist political context, inept bureaucracy, and inward-looking state-business relations, a dangerous policy mix and a self-reinforcing vicious cycle were precipitated in the 1990s.

The public sector borrowing requirement (PSBR) rose steadily up to 1993 due to populist expansionary cycle that started in late-1980s. The PSBR reached almost 12 percent of GNP in 1993 up from 3.5 percent in 1986. The budget deficit widened substantially as state's revenue base could not be improved. Accordingly, the budget deficit over GNP ratio, which used to be around 3 percent before 1989 reached at 6.7

⁶⁹⁷ There is evidence that Central Bank bureaucrats challenged the idea. See, Hasan Ersel, "The Timing of Capital Account Liberalization: The Turkish Experience," *New Perspectives on Turkey* 15 (1996): 45-64.

percent as of 1993.⁶⁹⁸ The public debt also increased to more than 50 percent in 1994. The share of short-term debt over total debt rose from 12 percent in 1989 to more than 28 percent in 1993.⁶⁹⁹ In the post-liberalization period, the governments deliberately kept interest rates very high to attract short-term capital for rolling over the public debt. State interest payments over GNP therefore rose from 1.4 percent during 1981-1985 to 7.7 percent in 1994. High interest rates led to the overvaluation of domestic currency, which in turn disturbed current account performance. Thus current account deficit skyrocketed to 3.9 percent of GNP in 1993. Similarly, inflation remained very high (around 65 percent) over the same period partially due to the monetization of public debt (see table 9).⁷⁰⁰

Table 9. Basic fiscal indicators of Turkish economy (1980-1994)

	Real growth*	Budget balance**	Inflation*	Public debt**	Interest payments**
1981-1985	4.7	-2.6	40	36.3	1.4
1986-1990	5.8	-3.2	54.4	49.1	3.3
1991	0.3	-5.3	59.2	38.8	3.8
1992	6.4	-4.3	63.5	38.9	3.7
1993	8.1	-6.7	67.4	38.8	5.8
1994	-6.1	-3.9	107.3	51.2	7.7

Source: Central Bank of the Republic of Turkey, TUIK, and IMF.
*Percentage change
**Percentage of GNP

⁶⁹⁸ Ibid.

⁶⁹⁹ OECD, *Economic Surveys, Turkey: 1994-1995* (Paris: OECD Publication Service, 1995), 1-3.

⁷⁰⁰ Ibid.

Turkish economy faced an early test in 1994 due to worsening macroeconomic imbalances in a neoliberal broader structural setting. It is interesting to note at this point that Turkey's exposition to the periodic crises was earlier than the Greek case, despite similar dynamics were at work in both countries. The most plausible explanation of this paradox lies in the broader institutional structure in which these two economies were operating at the time. Since Turkey was not a member of the EU, it was not cushioned against fiscal shocks because it did not enjoy the lucrative EU funds. Furthermore, Turkey heavily suffered from credibility problems and widespread uncertainty given the lack of the EU's shock absorbing role. As a result, accumulation of the fisco-financial problems accompanied by an increasingly instable political arena led to an economic crisis in April 1994. In fact, all structural indicators hint that a crisis risk appeared on the horizons in early-1990s. The timing of the crisis, however, was determined by the reactions of international financial agents. In January 1994, two credit rating agencies, first Moody's and then Standard & Poor's, decreased Turkey's ratings. This decision triggered a crisis of confidence resulting in substantial outflows of short-term capital. Hence the balance of payments crisis triggered a rapid depreciation of the exchange rate, which forced the government to implement an IMF-backed stabilization program on April 5, 1994.⁷⁰¹

⁷⁰¹ For a comparative political economy of the 1994 crisis in Turkey with reference to the interaction of international dynamics and domestic weaknesses, see Ziya Öniş and Ahmet Faruk Aysan, "Neoliberal Globalization, the Nation State and the Financial Crises in the Semi-Periphery: A Comparative Analysis," *Third World Quarterly* 21, no. 1 (2000): 129-130; also see, Gülten Kazgan, *Tanzimattan 21. Yüzyıla Türkiye Ekonomisi* (İstanbul: İstanbul Bilgi Üniversitesi Yayınları, 2002).

5.3.1. Persistence of reform-inertia: An assessment

The literature suggests that economic crises pose critical junctures to initiate paradigmatic fisco-financial reforms. In retrospect, however, the 1994 economic crisis did not pave the way for Turkey to reverse the vicious cycle that the Turkish economy was entrapped in. On the contrary, as I will elucidate in the following part, post-1994 period witnessed further entrenchment of the rent-seeking relations, culminating with a devastating February 2001 crisis. In this sense, an analysis of 1994 crisis may provide insights to better explicate the complex relationship between crises and reform outcomes in reactive states. Why 1994 crisis could not be exploited as an opportunity window to address the fiscal and financial profligacy of the state? How did reform-inertia endure in the post-1994 period? Based on the conceptual framework, I will address this question with reference to the interaction of agency-level dynamics and institutional structures.

At the agency-level, one should concentrate on Tansu Çiller as the main state agent responsible for the management of the economy. Tansu Çiller was an economy professor, who spent years in academia before she was appointed as the minister of state in charge of economic affairs in the DYP-SHP coalition headed by Süleyman Demirel. After President Özal unexpectedly passed away in March 1993, Demirel became the new president. Çiller succeeded him as the leader of the DYP and starting from June 25, 1993, she served as the prime minister for almost three years. Therefore, Çiller was one of the major architects of the economic policies of the DYP-SHP coalition governments. She was also the chief planner and executor of the economic stabilization program after

the crisis in 1994. It is interesting to note at this point that Çiller's technocratic and professional background partially resembles Simitis case in Greece. Despite her technical credentials, however, Çiller was not a reformist state agent (or policy entrepreneur) because she did not enjoy necessary legitimacy in the eyes of broader segments of the society and failed to inject adequate confidence to the policy communities during her position in the previous Demirel government. She also had weak interpersonal connections with the financial epistemic communities at the international level. This study therefore argues that, at the agency-level, Çiller could not develop a coherent and credible narrative to address the underlying structural problems both in the pre- and post-crisis intervals.

In the pre-crisis context, starting from the second half of 1993, Çiller made a substantial change in fiscal policies in order to reverse the rising tide of the public debt. Çiller aimed at reducing high interest rates in a rather swift way. In the government program, which was announced in June 1993, the government promised to “reduce real interest rates [as soon as possible] so as to alleviate the debt and interest burden on the public and private sector budgets, which in turn expected to curtail high inflation.”⁷⁰² The electoral base of the coalition government, mainly small and medium-sized entrepreneurs were also suffering from exorbitant interest rates and high inflation. The method Çiller pursued, however, was far from being credible and convincing. In the last quarter of 1993, Çiller artificially tried to suppress the interest rates. Accordingly, the

⁷⁰² I. Çiller Hükümeti Programı, <http://www.tbmm.gov.tr/hukumetler/HP50.htm> (arrived on August 9, 2014).

government cancelled short maturity domestic debt auctions and started to rely on Central Bank resources for the service of the public debt. The idea was to force private financial elite to lend the government over more favourable interest rates. Over the last three months of 1993, Treasury used almost two billion dollars, 30 percent equivalent of Central Bank's foreign exchange reserves. In the first three weeks of 1994, the government used 53 percent of its Central Bank borrowing limit for that year.⁷⁰³ What was worse than direct monetization the public debt was the attitude of financial elite. The hazy messages Çiller sent to the investors, the successive economic policy mistakes, and the decreasing political credibility at the agency-level triggered a vicious cycle starting from the beginning of 1994. Private investors showed no interest in government securities and rushed for foreign currency; thereby, the Treasury could not finance its debt up to the end of March, which eventually led to a crisis in April 1994. The Turkish lira depreciated by almost 70 percent and overnight interest rates jumped to 700 percent, an unprecedented level in Turkey's economic history. Inflation also reached three-digit plateau with 106,3 percent for the first time. Having taken all these factors into consideration, the evidence suggests that Çiller's pre-crisis performance was far from being convincing in the eyes of the market players. On top of her economic policy mistakes, Çiller also had to shoulder the previous DYP-SHP government's unfulfilled reform promises under Demirel's leadership. The first DYP-SHP government program, which was announced on November 20, 1991 promised to "fix state's fiscal problems

⁷⁰³ Fatih Özatay, "The 1994 Currency Crisis in Turkey," *The Journal of Policy Reform* 3, no. 4 (2000): 346-348.

and structural imbalances in the economy within 500 days.”⁷⁰⁴ Thus, Çiller was also perceived as the successor of failed economic policies of the DYP-SHP coalition government.

Çiller’s policy mistakes in the pre-crisis period, not surprisingly, adversely informed her post-crisis reform performance. In the aftermath of the crisis, as Yenal points out, Çiller government announced an ambitious reform program, called 5th of April Decisions (5 Nisan Kararları).⁷⁰⁵ The program, which Çiller declared as Turkey’s “economic war of independence”⁷⁰⁶ was composed of two main components: fiscal consolidation to mitigate public finance deficits and structural reforms to address the sustainability of fiscal balances in the medium term. First, the government adopted front-loaded correction measures to regain the confidence of the financial community. The short-term aim was to achieve primary public sector balance—which was a deficit of some 6.2 percent of GNP in 1993—and reduce public sector borrowing requirement to 6.2 percent of GNP—which was around 12.5 percent of GNP in 1993. To attain these goals, program foresaw immediate price increases in the products of state economic enterprises around 70-100 percent, introduction of a number of one-off tax measures—composing 1.6 percent of GNP, significant reduction in public sector real wages, and reduction of budgetary transfers to state economic enterprises around TL16 trillion.⁷⁰⁷ Also, it was declared to dismiss 18,000 public sector workers, to freeze all on-going public

⁷⁰⁴ 7. Demirel Hükümeti Programı, <http://www.tbmm.gov.tr/hukümetler/HP49.htm> (arrived on August 10, 2014).

⁷⁰⁵ Yenal, *Cumhuriyet’in İktisat Tarihi*, 151-152.

⁷⁰⁶ Milliyet Gazetesi, “İktidarın Son Şansı,” April 5, 1994.

⁷⁰⁷ All figures from OECD, *Economic Surveys, Turkey: 1994-1995* (Paris: OECD Publication Service, 1995), 24-27.

investments, and cancel the on-going public procurements.⁷⁰⁸ Second, 5th of April Decisions set ambitious aims for structural reforms. These included measures to downsize state economic enterprises in line with a comprehensive liberalization scheme, labour market reforms, and extensive supply and demand side reforms to improve efficiency and equality in the taxation system, restructuring of the bankrupted social security system, and introduction of new competition regulations to cope with the European firms in the post-Customs Union period.⁷⁰⁹

The program achieved some degree of initial success in terms of fiscal consolidation. The public sector borrowing requirement was reduced to 6.5 percent of GNP and budget deficit was curtailed to 4 percent of GNP. Thanks to fiscal consolidation and high economic recovery, the public debt-GNP ratio declined from 58 percent to 48 percent in one year.⁷¹⁰ The data suggest that the swift recovery of the economy, the surge in exports, and the increasing capital inflows ensured the short-term stability (see below). The reform program also covered certain measures that laid the foundations of a nascent regulatory state in the medium-term. In 1994, the government enacted a privatization law (law 4046), as a result of which high privatization council, privatization administration and privatization fund were established. Similarly, initial steps were also taken toward the autonomy of the Central Bank in its relations with the Treasury and

⁷⁰⁸ Milliyet Gazetesi, "Ekonomide Sıkıyönetim," April 4, 1994.

⁷⁰⁹ For details, see OECD, *Economic Surveys, Turkey: 1994-1995*, 34-54.

⁷¹⁰ OECD, *Economic Surveys, Turkey: 1995-1996* (Paris: OECD Publication Service, 1996), 20-22.

other state enterprises.⁷¹¹ Some partial amendments were introduced in the banking law (law 3182) that targeted the regulation of ill-functioning financial sector.⁷¹² That being said, Çiller government mostly satisfied with short-term oriented stabilization measures and did not put most of the structural reforms into implementation. The proper realization of the privatization law, for instance, was constantly delayed up until the elections in October 1995. The privatization implementations remained very low around 572 million dollars in 1995, which was barely above the term average during 1991-1995.⁷¹³ OECD reports hint that all other important structural reforms highlighted in the program, like tax reform, social security reform, agricultural reforms, reform of the SEEs shared the same destiny.⁷¹⁴ Thus Çiller's weak commitment to the implementation of reform program created significant ownership problems at the agency-level. However, the lack of a reformist agent capable of developing coherent reformist narrative, demonstrating the political will, and overcoming credibility of commitment problems constitutes just one side of the story. We should also concentrate on the enabling/constraining institutional-level factors that were at work at a crisis juncture to better explicate the relationship between crisis and potential reform outcomes. Following our conceptual framework, four aspects are of particular importance.

⁷¹¹ Devlet Planlama Teşkilatı, *Yedinci Beş Yıllık Kalkınma Planı, 1996-2000* (Ankara: DPT Yayınları, 1997), 6.

⁷¹² Ekrem Erdem, Ömer Şanlıoğlu, M. Fatih İlgün, *Türkiye'de Hükümetlerin Makroekonomik Performansı, 1950-2007* (Ankara: Detay Yayıncılık, 2009), 242.

⁷¹³ Özelleştirme İdaresi Başkanlığı, *Rakamlarla Özelleştirme* (Ankara: T.C. Başbakanlık Özelleştirme İdaresi Başkanlığı Basımevi, 2012), 24.

⁷¹⁴ OECD reports document the little progress that was achieved in the subsequent years. Especially see, OECD, *Economic Surveys, Turkey: 1995-1996*, 53-54; OECD, *Economic Surveys, Turkey: 1996-1997* (Paris: OECD Publication Service, 1997).

First, the literature suggests that the depth of the crisis plays important role in dismantling reform-biased equilibrium. A deep economic crisis redistributes the power balances within the domestic system and opens up opportunity windows to put a decisive end to the populist policy cycles. It also tends to delegitimize the existing paradigms that inform extant equilibrium of state-market relations. From these two particular points of view, 1994 crisis was not deep enough to disturb the established patterns in the post-liberalization period and the dominant policy paradigm backing the existing mode of relations. The quick recovery in 1995 and the relatively high, but certainly unsustainable, growth rates in the subsequent years underpinned the sense of complacency. Despite economic output decreased by 6.1 percent and capital outflow reached around 4.2 billion dollars in 1994, growth rates bounced back in the immediate aftermath. Turkish economy registered a swift recovery of 4.8 percent in 1995, 8.5 in 1996, and 8.4 in 1997.⁷¹⁵ It is true that three banks, TYT Bank, Marmarabank, Impexbank declared bankruptcy in the wake of the crisis. However they were too small to engender systemic risks in the financial sector. Furthermore, public confidence was restored steadily as the government provided full insurance on May 6, 1994 that covered all savings deposits denominated in domestic and foreign currency.⁷¹⁶ In summary, the data hint that 1994 economic crisis, despite revealed the fragility of the existing fisco-financial regime, nevertheless, not deep enough to alter the perceptions of state elites and private interest groups. Öniş puts this point as follows: “The evidence suggests that

⁷¹⁵ Turkish Statistical Institute, *Statistical Indicators: 1923-2011* (Ankara: Turkish Statistical Institute), 754.

⁷¹⁶ OECD, *Economic Surveys, Turkey: 1995-1996*, 50.

the crisis was not deep enough to disturb or dismantle the underlying mechanics of the populist cycle.”⁷¹⁷

Second, in the wake of the crisis, domestic political context played a very constraining role. The coalition government was on the knife’s sharp edge due to serious corruption allegations. Çiller was under cross fire for hiding the true size of her wealth. It was publicized in the media that Çiller acquired several properties in the US including a villa, shopping mall, hotel, and a flat, which she did not declare previously.⁷¹⁸ Therefore, though indirectly, question marks aroused regarding government’s willingness to arrest the deterioration of the fiscal imbalances and misutilization of public funds. The divergence in the preferences of the coalition partners was also inescapably intensified the credibility of commitment problems. The government partners were struggling hard to control state resources in order to broaden their own electoral base. In this regard, the timing of the reform program was telling that reveals the degree of ownership and commitment problems. On January 31, 1994, the then Governor of the Central Bank of Republic of Turkey, Bülent Gültekin resigned since, according to him, “Çiller government had not [genuine] political will to effectively implement [necessary] economic reform measures.”⁷¹⁹ His successor, Yaman Törüner, also admitted later that

⁷¹⁷ Öniş, *State and Market*, 527.

⁷¹⁸ Milliyet Gazetesi, “Çiller’in ABD’deki Serveti,” June 17, 1994; also see, Milliyet Gazetesi, “Neden Amerika? Nereden Bu Para?” June 18, 1994.

⁷¹⁹ Milliyet Gazetesi, “Çiller’i Şok Eden İstifa,” February 1, 1994.

the implementation of the reform measures was deliberately postponed due to the March 30, 1994 local elections.⁷²⁰

Furthermore, the reform package was not a product of consensus reached among coalition members. Murat Karayalçın later admitted the high level of non-coordination within the government at the time by saying that he “was not informed by Çiller about the full content of the reform package before the press conference on 5th of April decisions.”⁷²¹ He, in fact, learned the many details of the program during the press statement. Not surprisingly, therefore, implementation phase was subject to insurmountable collective action and credibility of commitment problems as privatization, tax regulation, and pension reforms were first delayed and then entirely shelved.⁷²² Whereas the evaluation of whether the reform program was desirable is beyond the scope of this study, one should acknowledge that the leaders of the DYP-SHP coalition government failed to maintain commitment to the very program they crafted in the first instance. For instance, debate over privatizations was an illuminating case in point: Divestiture of the SEEs occupied the cornerstone of the reform program because the worsening balance sheets of public enterprises turned out to be one of the recurrent factors that exploded state fiscal expenditures. Özal governments also could and, to a certain extent, was not willing to privatize any of the major SEEs.⁷²³ Thus only

⁷²⁰ Yaman Törüner, “5 Nisan Kararları,” *Milliyet Gazetesi*, April 7, 2014.

⁷²¹ Mehmet Ali Birand, *Son Darbe 28 Şubat* (İstanbul: Doğan Kitap, 2012).

⁷²² OECD reports, which I cited in 716, emphasize reform failures in these areas.

⁷²³ Özal was still complaining about SEEs and their burden on fiscal balances in his speeches during early 1990s. For an illustrative example, see *Milliyet Gazetesi*, “Özal’dan Ekonomik Salvo,” December 6, 1991. For the history of privatizations in Turkey, see Cevat Karataş and Metin Ercan, “The Privatisation Experience In Turkey And Argentina: A Comparative Study, 1986-2007,” *METU Studies in Development*

a very small subset had been privatized before 1994 crisis.⁷²⁴ The Çiller government, therefore, faced with uneasy choices. The coalition partner, SHP, was a social democratic party, whose main support base was composed of urban wage earners, traditional bureaucracy, and labour class. As a natural successor of the Republican People's Party, which prompted etatism in Turkish economy, SHP also positioned itself on a neo-statist political spectrum starting from late-1980s.⁷²⁵ Therefore, the spirit and letter of the economic adjustment package was incongruous with SHP's ideological stance. Despite Murat Karayalçın, the leader of the SHP at the time placed his support behind the 5th of April 1994 decisions in the initial phases,⁷²⁶ it did not take too long to observe fatal coordination failures and lack of political will.⁷²⁷ The opposition parties also declined to support the reform program. The main opposition party, ANAP categorically rejected the reform measures. ANAP leader, Mesut Yılmaz, criticized the policy mix of the reform program on the ground that it would lead to "social upheavals."

"[We will not support the government's counter-crisis measures because] the decisions are composed of only austerity measures and price increases. We think that the sacrifice is not distributed among societal classes in a just manner, which may pave the way for social upheavals in the incoming days."⁷²⁸

35, no. 2 (2008): 345-384. For a full list of privatization implementations during the period in question, see Özelleştirme İdaresi Başkanlığı, *Rakamlarla Özelleştirme*.

⁷²⁴ For a comprehensive discussion in a comparative perspective, see Ziya Öniş, "Privatization and the Logic of Coalition Building: A Comparative Analysis of State Divestiture in Turkey and the United Kingdom," *Comparative Political Studies*, 24, no. 1 (1991): 231-253.

⁷²⁵ During late 1980s, SHP strongly resisted the privatization of PETKİM, a petrochemical complex, Sümerbank, a textile company, and Teletaş, telecommunication giant.

⁷²⁶ Milliyet Gazetesi, "Ekonomide Sıkıyönetim," April 4, 1994.

⁷²⁷ Milliyet Gazetesi, "Koalisyon Bıçak Sırtında," July 14, 1994. Also see, Erdem, Şanlıoğlu, and İlgün, *Türkiye'de Hükümetlerin Makroekonomik Performansı*, 254.

⁷²⁸ Milliyet Gazetesi, "Yılmaz: 'Paket Kötü Bir Kopya,'" April 6, 1994.

The junior opposition party, the Welfare Party (RP in Turkish acronym) also categorically rejected the stabilization measures. Necmettin Erbakan, the leader of the RP, argued that single-mindedly imposed harsh austerity measures would further “impoverish middle-classes and exacerbate inflationary pressures.”⁷²⁹ Erbakan put emphasis on industrialization and argued that decisions include virtually nothing to achieve this goal. It is therefore apparent that not only the coalition partners but also the opposition parties opted for myopic and polarizing political manoeuvres rather than prioritizing consensus-based policy-making, which in turn resulted in infamous collective action and ownership problems to introduce a paradigm change in state-market relations. Furthermore, the political context was overloaded with non-economic problems at the time. Accordingly, the escalation of the military conflicts in the southeastern provinces of the country adversely informed the public agenda and diverted government’s attention from the economic reforms. The fight against the PKK (Kurdish Workers Party) terrorism, in this sense, exacerbated the already delicate fiscal balances. The military expenditure was officially estimated to be almost around 4.0 percent of GNP in this period.⁷³⁰ In an increasingly unstable political setting, therefore, urgently needed structural reforms were delayed.

Third, labour unions and business elite also did not play enabling roles regarding the implementation of the economic reform program, albeit for different reasons. The crisis

⁷²⁹ Milliyet Gazetesi, “Yılmaz Dinledi, Erbakan Uyardı,” April 5, 1994.

⁷³⁰ Data is extracted from SIPRI Military Expenditure Database; see http://www.sipri.org/research/armaments/milex/milex_database (arrived on August 1, 2014). Experts believe that even these high figures were a true understatement.

could not be transformed into an opportunity window to initiate major policy changes through the creation of new winning coalitions, not only because of the political leadership and ownership problems but also because of the asymmetric distribution of austerity burdens. In fact, 5th of April 1994 decisions put the onus squarely on the shoulders of labour class and fixed-wage earners. The government accommodated the fiscal disequilibrium by the downward flexibility of the wage labour. In a sense, labour bore the brunt of the adjustment burden almost single-handedly. Concurrently, the manufacturing real wages declined by 30.1 per cent in the private sector and 18.1 per cent in the public side of the economy.⁷³¹ Not surprisingly as a result, major representatives of the labour unions, i.e., DİSK and TÜRK-İŞ, and various sectoral-level unions launched uncoordinated and local-level ad hoc rallies to avert deterioration in the real wages, dismissal of public sector workers, and reverse privatization decisions.⁷³² TÜRK-İŞ president, Bayram Meral, for instance, dismissed the program: “the government did not consult to TÜRK-İŞ and our recommendations were not taken into consideration. It was designed according to the IMF and the World Bank prescriptions.”⁷³³ Despite labour unions in the Turkish context were relatively less powerful than their counterparts in Greece, the disjointed relationships between state and labour created various collective action problems to instigate a coherent reformist paradigm.

⁷³¹ Erinç Yeldan, “Neoliberal Global Remedies: From Speculative-Led Growth to IMF-Led Crisis in Turkey,” *Review of Radical Political Economics* 38, no. 2 (2006): 199.

⁷³² Milliyet Gazetesi, “İşçiler Sokağa Döküldü,” April 7, 1994.

⁷³³ Milliyet Gazetesi, “Ekonomik Pakete Tepki Yağdı,” April 6, 1994.

Evidence suggests that business elite also showed little genuine interest in reforming the fisco-financial fault lines in the economy. In the first instance, TÜSİAD developed an increasingly sceptical stance toward Çiller government before the crisis due to Çiller's "frequently changing and uncertain economic policies."⁷³⁴ Big business even considered the reform package as "the last chance of Çiller government" and declared "conditional support" to the economic program.⁷³⁵ The reluctant initial support rapidly turned into severe criticisms. TÜSİAD chairman, Halis Komili, argued just one month after the program that "there are two keys to overcome this crisis: flawless implementation [of the program] and trust environment. The government lost both of these keys."⁷³⁶ As a matter of fact, finance capital did not display genuine will for a paradigm change in state-market relations. According to Öniş, two particular mechanisms were at work that helped big business to shield itself from the negative repercussions of the crisis, which in turn underpinned complacency and reform-biased behaviour.⁷³⁷ First, big conglomerates, once again, veered to export activities because of the currency depreciation and contraction in domestic demand. Yeldan calculates that mark-up ratios of private capital remained very high around 40 percent during 1989-1993 and reached to a new plateau of 47 percent in 1994.⁷³⁸

⁷³⁴ Milliyet Gazetesi, "TÜSİAD Çiller'e Bir Şans Daha Verdi," February 12, 1994.

⁷³⁵ Milliyet Gazetesi, "TÜSİAD'tan Hükümete Zorunlu Destek," April 8, 1994.

⁷³⁶ Milliyet Gazetesi, "TÜSİAD Çiller'e Savaş Açtı," May 5, 1994.

⁷³⁷ Ziya Öniş, "Globalization and Financial Blow-ups in the Semi-periphery: Turkey's Financial Crisis of 1994 in Retrospect" in *State and Market: The Political Economy of Turkey in a Comparative Perspective* (İstanbul: Boğaziçi University Press, 1998), 522-523.

⁷³⁸ Yeldan, *Küreselleşme Sürecinde Türkiye Ekonomisi*, 76.

Second, financial and industrial firms continued to exploit rent-seeking opportunities in the aftermath of the crisis because the reform package involved no substantial measures to alter inward-looking and sub-optimal state-market equilibrium. I stated in the previous section that state's weak/weakening capacity in the post-liberalization process created ample room for Turkish finance capital to exploit state resources. In the pre-crisis period, a significant part of industrial and financial community continued to heavily engage in non-productive activities. In fact, the financial elite implicitly backed reactive state policies in order to secure lucrative profit opportunities extracted from treasury bills that yielded very high rates of returns in real terms. Thus financial liberalization not only provided perverse incentive structures for political elite to prolong populist cycles, but also dramatically altered the way through which state's fiscal profligacy is financed.

“...The incoming speculative money was used for the expansion of public expenditure through the state bonds. This provided the state with funds, which led to complacency about any serious attempt to increase the public income.”⁷³⁹

In this perverse institutional setting, rather than expanding the tax base, the public deficits were increasingly financed through domestic financial agents, who in turn borrowed from international markets with reasonable interest rates and extended these credits to the state at mind-blowingly high profit margins (for details see below).⁷⁴⁰ According to Özatay, credits extended by commercial banks increased by 8.3 percent

⁷³⁹ Aydın, *The Political Economy of Turkey*, 116.

⁷⁴⁰ For the logic and mechanisms of this process, see İzzettin Önder, “Kapitalist İlişkiler Bağlamında ve Türkiye’de Devletin Yeri ve İşlevi,” in Ahmet H. Köse, Fikret Şenses and Erinç Yeldan, *Küresel Düzen: Birikim, Devlet ve Sınıflar* (İstanbul: İletişim Yayınları, 2003), 272-277.

annually in the period preceding the crisis. Similarly, the share of foreign liabilities to non-residents over total liabilities sharply increased from 7 percent (1990) to 14.1 percent (1993) of the domestic financial sector.⁷⁴¹ Even the industrial elite took advantage of state's fiscal profligacy not only by extracting poorly regulated subsidies and taking part in public procurement contracts, but also by heavily investing in government bonds through affiliated banks. For instance, the share of profits from non-manufacturing activities in total operating profits rose from 15.3 percent (1982) to 54.6 percent (1994) of the largest industrial firms.⁷⁴² Therefore, big business was able to shield itself from the side-effects of the crisis and ensure profits through rentier activities, which explains why dominant policy networks showed no genuine interest in changing established fisco-financial paradigm in the aftermath of the 1994 crisis.

Finally, the absence of a strong external anchor also hindered effective formulation and consistent implementation of a credible reform program. The 5th of April decisions were supplemented by a standard IMF stand-by agreement. However, the IMF anchor ceased to exist after a short period as swift economic recovery invited complacency effects. Apart from the lack of political commitment and domestic ownership problems the reform program was in fact reflecting the main postulates of the Washington consensus that advocated financial liberalization, privatization, and deregulation.⁷⁴³ However, as I discussed in the previous section, part of Turkey's fiscal and financial problems were

⁷⁴¹ Fatih Özatay, "The 1994 Currency Crisis in Turkey," *The Journal of Policy Reform*, 337-339.

⁷⁴² İstanbul Sanayi Odası, *Türkiye'nin 500 Büyük Sanayi Kuruluşu* (İstanbul: İSO Yayınları, 1995), 70.

⁷⁴³ I will offer an in-depth discussion on Washington consensus and its modified version (post-Washington consensus) in chapter 6.

emanated from its integration into financial globalization with weak state capacity, which underestimated the crucial intervening role of the institutional regulatory mechanisms. Thus in the post-1989, state capacity to regulate domestic financial system was significantly jeopardized. Moreover, similar to the EU factor in the Greek case, financial globalization opened up escape avenues for the political elite to postpone economic reform processes because it provided new opportunities and perverse incentives to roll-over the state deficits. The economic stability program addressed none of these problems because it was designed according to the dominant ideational paradigm that reflected all weak spots of the Washington consensus. The EU anchor that could offer a set of incentives and conditionality to encourage substantial reforms was also absent in the Turkish context during 1990s. Despite Turkey launched Customs Union with the EU in 1995 that paved the way for the elimination of tariffs and quotas and the promulgation of a regulation law, the Customs Union fell short of fixing the fiscal mismanagement.

5.4. Consolidation of a reactive state (1995-2001)

The discussion so far demonstrates that 1994 economic crisis did not invite a new fisco-financial regime due to adverse interaction of agency and institutional-level dynamics. None of Turkey's major economic problems were addressed in the wake of the crisis. On the contrary, the post-1994 period witnessed the consolidation of a reactive Turkish state, characterized by recalcitrant reform-inertia. In the previous section I argued that Turkey's exposure to the vagaries of financial globalization was not an optimal policy-

decision because it undermined regulatory state power vis-à-vis the erratic market dynamics. Along the same lines, I would argue in this section that during 1994-2001, agency-level dynamics and institutional structures, both domestic and broader ones, interacted in a way that reactive Turkish state further consolidated, whereby state's reform capacity came to a complete halt.

First of all, the lack of an imaginative leap of statecraft and of political leadership constituted the single most delineating characteristic of the domestic political context in the post-1994 period. The political plane took a turn for the worse in the second half of 1990s due to acute political polarization, political regime concerns, and serious corruption allegations. In fact, the period in question refers to one of the most instable and polarized episodes in Turkish politics. During 1995-2002, six coalition governments were formed with an average lifespan of 376.3 days. Three of them were minority governments that were backed by other political parties in the parliament, which exposed the governments vulnerable to all kind of political engineering and short-term oriented tug-of-wars (see table 10).

Table 10. Governments' lifespan in Turkey (1996-2002)

Government	Prime minister	Rise	Fall	Duration (days)
ANAP-DYP (M)	A. Mesut Yılmaz	March 1996	June 1996	113
RP-DYP	Necmettin Erbakan	June 1996	June 1997	366
ANAP-DSP-DTP (M)	A. Mesut Yılmaz	June 1997	January 1999	599
ANAP-DSP-DYP (M)	M. Bülent Ecevit	January 1999	May 1999	136
DSP-ANAP-MHP	M. Bülent Ecevit	May 1999	November 2002	1269
1995-2002 average				376.29
1991-1995 average				478.67
1991-2002 average				449.56

Source: Author's calculations based on Turkish Grand National Assembly (TBMM) data.

(M): Minority government.

The coalition governments were highly fragile and ideologically incommensurable that consensus-based reform-activism proved to be beyond the possibility frontier. The coalition governments reflected uneasy political combinations: Islamist and centre-right parties (DYP-RP government), centre-right and centre-left parties (ANAP-DSP-DTP and ANAP-DSP-DYP governments) and centre-right, centre-left and ultra-nationalist parties (DSP-MHP-ANAP). Thus ideological rifts among coalition partners emerged as ubiquitous impediments for a coherent supply and consistent implementation of economic policies. In addition to the intra-governmental collective action problems, two main political cleavages polarized the political agenda during the period in question.

The first one was the intensification of ethnic tensions. The armed conflict between the state security forces and the PKK escalated in the second half of the 1990s with devastating impacts on political, social, and economic life. The annual number of deaths reached 4,570 during 1995-1999. In the midst of a severe political regime crisis in 1997,

the death toll increased to 8,234, an unprecedented number over the history of the conflict.⁷⁴⁴ Around 30 per cent of the population living in the southeastern provinces was forced to move into the western and southern metropolitan areas.⁷⁴⁵ Yüksekser reports that more than one million people had migrated from the region, overwhelming majority of which was informally employed in the precarious job market.⁷⁴⁶ The massive human mobilization led to acute polarization with devastating impacts on political, social, and economic stability. As Keyman perspicuously points out:

“The ‘Kurdish question’ has been most politically troublesome and challenging. The Kurdish question has placed ethnicity at the center of Turkish politics, while also causing a very bloody and violent ethnic conflict, or ‘low-intensity war’ between government forces and the PKK —a war that has left almost 40,000 people dead; more than 1,000,000 people displaced; and a society highly polarized, intolerant, and facing a serious risk of segregation.”⁷⁴⁷

Second political cleavage that aggravated political polarization in the post-Cold War context was the revitalization of traditional schism between secular establishment and the rising tide of political Islam. In fact, “the resurgence of Islam has been one of the defining and constitutive elements of the changing nature and formation of Turkish modernity since the 1980s, and this has had a significant impact on Turkish secularism by causing its recent crisis.”⁷⁴⁸ The ineptitude of mainstream political parties in

⁷⁴⁴ Milliyet Gazetesi, “26 Yıllın Kanlı Bilançosu,” June 26, 2010.

⁷⁴⁵ Quoted in Yeldan and Cizre-Sakallıoğlu, “Politics, Society, and Financial Liberalization: Turkey in the 1990s,” *Development and Change*, 492-493.

⁷⁴⁶ Deniz Yüksekser, “Neoliberal Restructuring and Social Exclusion in Turkey,” in Ziya Öniş and Fikret Şenses, eds., *Turkey and the Global Economy: Neo-liberal Restructuring and Integration in the Post-crisis Era* (Oxon: Routledge, 2009), 266-267.

⁷⁴⁷ E. Fuat Keyman, “Rethinking the ‘Kurdish question’ in Turkey: Modernity, Citizenship and Democracy,” *Philosophy and Social Criticism* 38, no. 4-5 (2012): 467-476.

⁷⁴⁸ E. Fuat Keyman, “Modernity, Secularism and Islam: The Case of Turkey,” *Theory, Culture & Society* 24, no. 2 (2007): 223.

governing distributional conflicts disenchanted masses, which in turn set a fertile background for the spectacular rise of the RP under the populist leadership of Necmettin Erbakan.⁷⁴⁹ RP distinguished itself from the mainstream right and left wing political parties by adopting an explicit Islamist agenda. In 1995 general elections, RP increased its share of the national vote to 21.4 per cent, which catapulted it into the leading political party in the country. After a series unsuccessful coalition formation attempts among major parties, RP-DYP coalition emerged as the only alternative under the premiership of Erbakan. RP-DYP government was unmatched in Turkey's political history since for the first time an Islamist party obtained mandate to rule the country.⁷⁵⁰ The rise of the RP hit a raw nerve, especially among the circles in the military, which perceived itself as the sole guardian of the secular foundations of the Republic.⁷⁵¹ RP was heavily critical of the traditional notion of secularism that was staunchly advocated by mainstream political and bureaucratic establishment. On the other side of the coin, according to military, the danger was imminent. Admiral Güven Erkaya even stated, "irtica [religious reactionary] had become a more dangerous threat than PKK terrorism

⁷⁴⁹ The party put its mark on Turkish politics in March 27, 1994 local elections. The party succeeded to win metropolitan municipalities, including İstanbul and Ankara. See Milliyet Gazetesi, "İstanbul Refah'a Kaydı," March 29, 1994; Milliyet Gazetesi, "Başkent 11 Bin Oyla Refah'ın," March 30, 1994.

⁷⁵⁰ Political Islam has deep-seated roots in Turkish political history. Accordingly, the Islamist parties, which appeared under different names, had their own voice in Turkish politics starting from early 1970s. However, they remained marginal and parochial up until RP's successive triumphs in the local and general elections in 1994 and 1995, respectively. For a sociological-historical overview accounting for the dynamics of confrontation and cooperation between political Islam and secular Turkish state, see Berna Turam, *Between Islam and the State: the Politics of Engagement* (Stanford University Press, 2007). Also see Keyman, "Modernity, Secularism and Islam: The Case of Turkey," *Theory, Culture & Society*, 215-234.

⁷⁵¹ During the period in question, military frequently made the headlines of the newspapers as a very outspoken critic of RP in particular and political Islam in general. It became apparent later that a clandestine group within the military was set up to "monitor religious reactionary" and was alleged to organize the process after military intervention on February 28, 1997. For an assiduous journalistic account, see Mehmet Ali Birand, *Son Darbe 28 Şubat*.

[during the RP government].”⁷⁵² After almost one year of political tug-of-war, the military finally flexed its muscles by intervening into the political plane on February 28, 1997, for the fourth time since 1946.⁷⁵³ The “post-modern coup”, as the Secretary General of Turkish General Staff then coined the term,⁷⁵⁴ initiated a process that precipitated resignation of the RP-DYP coalition government but proved unable to check the rising tide of instant political polarization and instability.

Since the aim of this section is not to enter into a detailed political economy analysis of the rise of Islamist political movements in contemporary Turkey, we should again turn our attention to the way in which political context conditioned interest functions of political and economic agency in mid-1990s.⁷⁵⁵ Two strands stand out. First, it created imperatives for weak coalition governments to opt for non-transparent and non-accountable ways of utilizing state largesse to prolong their terms in power. Alper and Öniş demonstrate that political parties’ lacklustre record of democratic accountability and legitimacy markedly weakened state capacity to impose fisco-financial discipline and steer pro-reform coalitions toward this direction.⁷⁵⁶ Second, the rise of identity-

⁷⁵² Milliyet Gazetesi, “İrtica PKK’dan Tehlikeli,” February 25, 1997.

⁷⁵³ The intervention was a coup in the classical sense of the word because the government was forced out without dissolving the parliament and suspending constitution. The National Security Council issued a memorandum on February 28, 1997 after a meeting lasted more than nine hours, which underlined the secular pillars of the Republic and declared measures against “irtica” (religious reactionary). See, Milliyet Gazetesi, “Rejime MGK Güvencesi,” March 1, 1997. Also see, Milliyet Gazetesi, “İşte MGK’nın Tarihi Bildirisi,” March 1, 1997.

⁷⁵⁴ Milliyet Gazetesi, “28 Şubat Darbe mi, Müdahale mi?” January 16, 2001.

⁷⁵⁵ For a political economy of the RP within the context of Turkish neoliberalism, see Ziya Öniş, “The Political Economy of Islamic Resurgence in Turkey: The Rise of the Welfare Party in Perspective,” *Third World Quarterly* 18, no. 4 (1997): 743-766.

⁷⁵⁶ Emre Alper and Ziya Öniş, “Financial Globalization, the Democratic Deficit, and Recurrent Crises in Emerging Markets: The Turkish Experience in the Aftermath of Capital Account Liberalization,” *Emerging Markets Finance and Trade* 39, no. 3 (2003): 5-26.

dominated zero-sum political outlook legitimized favouritism and non-economic use of state resources along the lines of political ‘we vs. the rest’ divisions, pure and simple. Thus fierce political competition and conflict-prone policy-making motivated the political elite to capture the state so as to control rent distribution channels.

“Agreements among the political parties in Turkey were almost always based on short-term and tactical matters; the parties were preoccupied with trying to prevent other political parties from making electoral gains through exercising patronage powers and not with attempting to convince the electorate about the merits of their policies and programs.”⁷⁵⁷

In summary, due to the imminent fault lines highlighted above, the political structure was not conducive to the formation of “a social pact or a more corporatist formal pact designed to build a consensus around anti-inflationary strategy [and reform-oriented outlook].”⁷⁵⁸ Thus, similar to the Greek case, uncontrolled public expenditures turned into the predominant electoral survival strategy that led to a self-defeating debt trap (see below). How did it become possible to sustain this low-level equilibrium? To address this question, similar to the Greek case, I will revisit the conceptual framework to investigate the interactions between broader and domestic dynamics that jointly informed reform-biased agency behaviour.

At the intersection of international and domestic dynamics, I should cast light on the ominous give and take relationships between the state and domestic policy coalitions,

⁷⁵⁷ Heper and Keyman, “Double-Faced State: Political Patronage and the Consolidation of Democracy in Turkey,” *Middle Eastern Studies*, 263.

⁷⁵⁸ Ziya Öniş, “Democracy, Populism, and Chronic Inflation in Turkey: The Post Liberalization Experience,” *Yapı Kredi Economic Review* 8 (1997): 37.

since the latter played a conduit role that linked Turkish economy to the financial globalization processes. Turkey's integration into international markets was mediated by bank-based domestic financial system.⁷⁵⁹ The banking system became increasingly critical for Turkish political economy in this period. Two major mechanisms linked the state to the dominant policy networks along domestic-global nexus. First, public banks had become the main outlets of state's fiscal profligacy. Given the lack of regulatory state capacity, two largest public banks were totally exposed to the disposal of the governments. Ziraat Bankası, the largest public bank at the time, extended heavily subsidized credits to the farming community whereas Halk Bank served the small and medium-sized entrepreneurs.⁷⁶⁰ As highlighted in OECD reports, credit allocation and entry-exit mechanisms of the banking system was "highly politicized" in this period.⁷⁶¹ State banks, which controlled more than 45 per cent of total assets in the sector in 1990 and 35 per cent in 1999, operated in line with 'bad credits to good friends' principle.⁷⁶² The evidence confirms that the rent-seeking coalitions formed among corrupt politicians, state bureaucrats including military elite, and major private financial and industrial groups siphoned-off the state banks so that 'duty losses' increased dramatically to 13.3

⁷⁵⁹ For the typology of banking systems and details of "bank-based financial system", see John Zysman, *Governments, Markets and Growth: Finance and the Politics of Industrial Change* (Ithaca, NY: Cornell University Press, 1983). For an application of Zysman's typology to the Turkish case, see Caner Bakır, "Governance by Supranational Interdependence: Domestic Policy Change in the Turkish Financial Services Industry," in Jonathan Batten and Colm Kearney, eds., *Emerging European Financial Markets: Independence and Integration Post-Enlargement* (London: Elsevier, 2006), 179-211.

⁷⁶⁰ Emre Alper and Ziya Öniş, "Soft Budget Constraints, Government Ownership of Banks and Regulatory Failure: The Political Economy of the Turkish Banking System in the Post-Capital Account Liberalization Era," Boğaziçi University Department of Economics Research Papers, ISS/EC-2002-02, 2002.

⁷⁶¹ OECD, *Economic Surveys, Turkey: 2002* (Paris: OECD Publication Service, 2002), 80.

⁷⁶² OECD, *Economic Surveys, Turkey: 2001* (Paris: OECD Publication Service, 2001), 17-18. For a critical analysis of this low level equilibrium with particular reference to military as an interest group and its impact on state's fiscal crisis, see Fırat Demir, "Militarization of the Market and Rent-Seeking Coalitions in Turkey," *Development and Change* 36, no. 4 (2005): 667-690.

percent of GNP in 1999 up from 2.2 per cent in 1995.⁷⁶³ In the wake of 2001 economic crisis the duty losses of the public banks skyrocketed to 25 billion dollars, accounting for 16 per cent of GNP.⁷⁶⁴

Second, private banks ceased to play an intermediary role between investors and savers. The financialization of the domestic economy under extremely lax prudential regulations and ever-expanding fiscal profligacy had profound effects on the behaviour and expectations of private financial agents. The private banks heavily borrowed from the foreign markets with dollar-denominated, mostly short-term, debt instruments and directed these credits to the state sector. Since state turned into an unsinkable customer paying high real interest rates, “an enormous and unsustainable network of some 80 private banks with no connection with the real sector emerged to take advantage of quick returns from public debt.”⁷⁶⁵ The pace of rupture between the financial and industrial aspects of the economy was striking: During 1990s, the real gross domestic product grew just by 3.4 per cent per annum, whereby the real rate of growth in banking assets was more than 13 per cent.⁷⁶⁶ The misutilization of the existing funds and perverse functioning of the financial system eroded the intermediary function of the banking system: The credits’ share in total bank assets declined from 47 per cent in 1990 to 32.8 per cent in 2000. In the same period, the credit over deposit ratio declined from

⁷⁶³ Fatih Özatay and Güven Sak, “Banking Sector Fragility and Turkey’s 2000-01 Financial Crisis,” *Brookings Trade Forum* (Washington D.C.: Brookings Institution Publications, 2002), table 2.

⁷⁶⁴ *Ibid.*

⁷⁶⁵ Ümit Cizre and Erinç Yeldan, “The Turkish Encounter with Neo-Liberalism: Economics and Politics in the 2000/2001 Crisis,” *Review of International Political Economy* 12, no. 3 (2005): 391.

⁷⁶⁶ Erol Balkan and Erinç Yeldan, “Peripheral Development under Financial Liberalization: The Turkish Experience,” in Neşecan Balkan and Sungur Savran, eds., *The Ravages of Neoliberalism: Economy, Society and Gender in Turkey* (New York: Nova Science Publishers, 2002), 40-43.

84 per cent to 51 per cent.⁷⁶⁷ Similarly, the share of government bills and bonds in total bank deposits increased from 10 to 23 per cent during 1990-1999.⁷⁶⁸

Industrial capital had also partaken in the directly unproductive rent-reeking cycle. In the previous section, I argued that business elite demonstrated no genuine interest in reforming the Turkish financial and fiscal system because it captured the lion's share of the rents created by reactive state practices. This low level equilibrium reached its zenith in the second half of 1990s.⁷⁶⁹ In this period, the widespread corruption allegations linking political parties, state bureaucrats, business elite, and media moguls dominated the headlines of the newspapers. Thus the state-business relations in the second half of 1990s fully approximated to reform-biased rent-seeking policy networks. Accordingly, fiscal resources were misallocated via “political credits” —to quote a leading Turkish businessman— channelled to the ‘good friends’ in the private sector,⁷⁷⁰ the mafia-mediated non-transparent privatization implementations,⁷⁷¹ and ineffective tax

⁷⁶⁷ Bankacılık Düzenleme ve Denetleme Kurumu, *Bankacılık Sektörü Yeniden Yapılandırma Programı*, May 2001, https://www.bddk.org.tr/WebSitesi/turkce/Raporlar/Diger_Raporlar/15279C8914BD.pdf (arrived on August 1, 2014), 6.

⁷⁶⁸ Ibid. Also see Güzin G. Akın, Ahmet F. Aysan, and Levent Yıldırım, “Transformation of the Turkish Financial Sector in the Aftermath of the 2001 Crisis”, in Ziya Öniş and Fikret Şenses, eds., *Turkey and the Global Economy: Neo-liberal Restructuring and Integration in the Post-crisis Era*, (Oxon: Routledge, 2009), 74

⁷⁶⁹ OECD, *Economic Surveys, Turkey: 2002* (Paris: OECD Publication Service, 2002), 78-80.

⁷⁷⁰ This phrase belongs to Mehmet Emin Karamehmet, a leading Turkish businessman, who actively involved into the privatization and public procurement activities in the second half of 1990s. See, *Milliyet Gazetesi*, “Politik Kredi Vardır, Bakanın Emriyle Verilir,” June 7, 2004.

⁷⁷¹ The privatization of Türkbank was a clear example that demonstrated the corrupt linkages among political elites, top economic actors, and the mafia. Korkmaz Yiğit, a wealthy constructor, owned the bank on August 4, 1998 for 600 million dollars after eight rounds of bids among competitors. However, it became apparent with the leakage of a type recording that Alaattin Çakıcı, a well-known Turkish mafia leader, illegally involved into process in favor of Korkmaz Yiğit. The bid was cancelled on October 22. Yiğit confessed that the “government was fully aware of the developments and supporting him” right from the very beginning. The corruption scandal culminated into the fall of ANAP-DSP-DTP government. See, *Milliyet Gazetesi*, “Yiğit’ten İtiraf,” October 11, 1998.

management and public procurement mechanisms.⁷⁷² Mehmet Küçükaşık, a member of the parliamentary commission formed under the auspices of the Turkish Grand National Assembly to investigate Türkbank corruption claims (see footnote 771), portrayed the ominous exchange networks as follows:

“We [as the members of the commission] have unearthed that state ministers and prime ministers had non-transparent relationships with business circles, so that these businessmen had easily met with political elite without any reservation in hotel lobbies and private places (at politicians’ houses)... Prime ministers [and state ministers frequently] rigged the public tenders. State bureaucracy, political elite, and media remained silent while all these developments were taking place.”⁷⁷³

In addition to the traditional mode of rent extraction mechanisms financialization tendency also diverted industrial actors’ attention from fixed investments to financial arbitrage gains through treasury bills. Since governments opted for foreign capital to finance public deficits, real interest rates remained significantly high during 1990s, which in turn emerged as one of the risk-free income sources for industrial capital. It is no coincidence that almost all large-scale holding companies acquired their own banks in 1990s. Accordingly, fourteen new banks, which were directly affiliated with industrial conglomerates, were established during 1990s.⁷⁷⁴ Yeldan reports that the ratio of

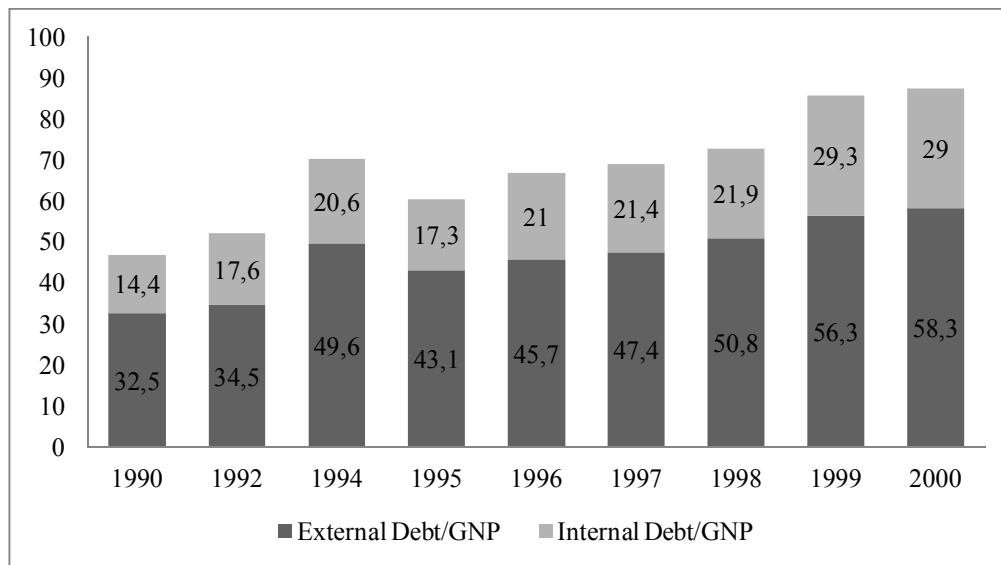
⁷⁷² For an extensive review of corrupt give-and-take practices, see Nuray Ergüneş, *Bankalar, Birikim, Yolsuzluk: 1980 Sonrası Türkiye’de Bankacılık Sektörü* (İstanbul: SAV Yayınları, 2008).

⁷⁷³ TBMM Tutanak Dergisi, cilt 56, 114. bileşim, 13 Temmuz 2004, 32.

⁷⁷⁴ The number of banks in the financial system increased from 62 to 81 during 1989-1999.

financial revenues to net profits before tax increased from 24 percent in 1985 to 219 percent in 1999 of the biggest 500 manufacturing firms in Turkey.⁷⁷⁵

Figure 4. Turkey's internal and external debt (1990-2000)



The perverse broader institutional environment amplified reform-inertia and perpetuated fiscal profligacy during the period in question. At the turn of the century, total internal and external debt stock increased to almost 90 percent of GNP, which was just 47 percent in 1990 and 60 percent in 1995 (see figure 4). Uncontrolled populism and ineptitude of weak governments in governing distributional conflicts transformed the state budget into a lucrative rent transfer mechanism. Accordingly, budget deficit increased from 4 percent of GNP to 10.2 percent in 2000, public debt rose to almost 60 percent of GNP, and interest payments over state debt rose steeply to unbearable levels

⁷⁷⁵ Yeldan, *Küreselleşme Sürecinde Türkiye Ekonomisi*, 156. Also see, Yakup Kepenek and Nurhan Yentürk, *Türkiye Ekonomisi* (İstanbul: Remzi Kitabevi, 2007), 251.

with 16.2 percent of GNP in 2000 (see table 11). According to Yenal, the annual interest payments of public debt devoured more than 75 percent of state's total tax revenue.⁷⁷⁶ Similarly, public sector borrowing requirement jumped to 15.5 percent in 1999 and then declined to 12.5 percent of GNP.

Table 11. Basic fiscal indicators of Turkish economy (1995-2000)

	PSBR*	Budget balance**	Inflation***	Public debt**	Interest payments**
1995	5	-4.0	87.2	44.1	7.3
1996	8.6	-8.3	78	47.1	10
1997	7.7	-7.6	81.2	46.6	7.7
1998	9.4	-6.9	75.3	47.9	11.5
1999	15.5	-11.6	55.8	58.7	13.7
2000	11.8	-10.2	51.6	59.9	16.2

Source: Central Bank of the Republic of Turkey, TUIK, and IMF.

* Public Sector Borrowing Requirement (percentage of GNP)

** Percentage of GNP

*** Annual percentage change

5.5. Conclusion

In this chapter, based on the first phase of three-stage framework, I explicated the emergence and consolidation of a reactive state in Turkey during 1980-2001. The January 24, 1980 decisions constitute a historical threshold that embarked on sea change in Turkish political economy under the leadership of Turgut Özal. For better or worse, Turkey accomplished major economic transformation from an ISI-led regime to export-oriented neoliberal model. As proposed by reactive state framework, the paradigm

⁷⁷⁶ Yenal, *Cumhuriyet'in İktisat Tarihi*, 153.

change was precipitated after a deep economic crisis. The post-liberalization process, however, was accompanied by gradual deterioration of state capacity. First, political context aligned toward new forms of populism in late-1980s and took a shape of polarized multiparty competition during 1990s, which informed exclusionary policy-making. Similar to the Greek case, state was perceived as an arena to be captured — rather than governed— by competing interest groups. Second, state bureaucracy was sidelined as discretionary decision-making infiltrated into the political context. Third, the path dependent historical configuration of state-business and state-labour relations informed fragmented and rent-seeking exchange patterns. Thus economic and political opportunities, which were structured by the state, led to self-reinforcing processes for the entrenchment of inward-looking policy coalitions.

Turkey's integration into vagaries of financial globalization in 1989 without robust institutional capacity aggravated fisco-financial problems. In fact, ponzi-cum-funding-opportunities enabled state agents to postpone necessary reforms so that Turkey faced an early test in 1994. The economic crisis, however, did not invite substantial reforms in Turkish fiscal and financial system. Based on conceptual framework, I argued that status quo ante was reproduced because (i) crisis was not deep enough to deteriorate the legitimacy of dominant policy paradigms and disturb the existing mode of state-market relations, and (ii) agency and institutional-level dynamics were unfavourable to initiate any paradigmatic change in the aftermath of the crisis. Çiller was not a capable reformist agent to narrate new ideas, steer pro-reform coalitions, and generate public ownership of her reformist agenda. The institutional-level dynamics also played constraining role. The

political context was very instable due to the shaky fundamentals of the coalition government and myopic opposition parties. In retrospect, the 1994 crisis did not exhaust the rent-seeking mode of relations so that dominant policy coalitions did show no genuine interest to the change-oriented narratives. Finally, IMF did not appear as a credible external anchor to superimpose conditionality measures. In fact, the approach of the IMF was reflecting all weak spots of the Washington consensus, which was more likely to exacerbate the already precarious equilibrium in Turkish economic system.

In his magnum opus, Keynes warns “that speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.”⁷⁷⁷ If we draw inspiration from Keynes, in the long history of Turkish economy, the 1990s turned into one of the intervals during which “the job was to be ill-done.” The country decisively plunged into a vicious reform-biased cycle. The financialization of Turkish economy and the ineptitude of a string of weak coalition governments during 1990s resulted in the constant procrastination of fisco-financial reforms. Not surprisingly, as a result, Turkey’s ‘lost decade’ terminated with a devastating economic crisis at the turn of the century.

⁷⁷⁷ John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (London: St. Martin’s Press, 1960), 159.

Chapter 6. The political economy of 2001 crisis in Turkey

6.1. Introduction

The accumulation of fiscal and financial problems during the 1990s left Turkey on the brink of an economic collapse at the turn of the century. The postponement of necessary reforms under endemic political instability invited twin crises in November 2000 and February 2001. The latter one, in particular, was by far the deepest shock of the republican era that hit the Turkish economy unprecedentedly. Gross national product in real terms declined by 9.4 percent; the immediate capital exodus amounted to 7 billion dollars; and the interest rates jumped to unmatched historical levels. The rate of inflation rose by a massive 68.5 percent. As of the end of 2001, the public sector borrowing requirement increased to 15.5 percent; budget deficit skyrocketed to 17.4 percent; and public debt jumped to 97.8 percent of GNP. As OECD report indicates, the distributive consequences of the economic crisis were nothing short of a social catastrophe: the number of unemployed persons reached a level of 2.2 million, as a result of which unemployment ratio hovered up to 10.7 percent.⁷⁷⁸ The crisis also sparked a surge in poverty as it led to a major increase in the number of people living below the poverty and subsistence lines.⁷⁷⁹ On the financial side, the banking system, which was operating in line with the infamous principle of ‘banking on the government,’ came very close to the brink of a total collapse following the insolvency of many banks. The total cost of

⁷⁷⁸ OECD, *Economic Surveys, Turkey: 2001-2002* (Paris: OECD Publications Service, 2002), 34.

⁷⁷⁹ For an in depth analysis of the economic havoc, see Fikret Şenses, “Economic Crisis as an Instigator of Distributional Conflict: The Turkish Case in 2001,” *Turkish Studies* 4, no. 2 (2003): 92-119.

the restructuration of the banking system amounted to 47.2 billion dollars, some 32 percent of GNP in 2001. The state directly shouldered the 39,4 billion of this amount, which accounted for the 26,6 percent of GNP.⁷⁸⁰

The crisis reshuffled the power balances in terms of both the state's position vis-à-vis the dominant domestic policy coalitions and external players. It also delegitimized the prevailing ideational paradigms that had informed reactive state practices for years. As Öniş states, the crisis helped “highlight the total exhaustion of a model of development based on clientelistic ties and patronage networks.”⁷⁸¹ However, in the Turkish context, in a stark contrast to Greece, the critical juncture was exploited as a window of opportunity. Accordingly, Turkey's fisco-financial regime was substantially overhauled along with a creation of new pro-reform coalitions. The transformation strongly showed a quality of a paradigm change since the state's fiscal profligacy and lax financial supervision were replaced with a regulatory state paradigm that precipitates strong macroprudential regulation. How did the crisis invite the creation of new pro-reform coalitions and give leeway to the rise of a new paradigm in Turkey? How did agency-level dynamics and institutional structures interact in a way that a change-oriented dominant crisis narrative, in complete contrast to the Greek case, triumphed in the post-2001 period? This chapter offers time and context specific answers to these questions in line with the conceptual framework offered in chapter 2. Accordingly, the second part

⁷⁸⁰ DPT, *Dokuzuncu Kalkınma Planı (2007-2013): Finansal Hizmetler Özel İhtisas Komisyonu Raporu* (Ankara: Devlet Planlama Teşkilatı, 2007), 4.

⁷⁸¹ Ziya Öniş, “Domestic Politics versus Global Dynamics: Toward a Political Economy of the 2000 and 2001 Financial Crises in Turkey,” in Ziya Öniş and Barry Rubin, *The Turkish Economy in Crisis* (London: Frank Cass, 2003), 15.

provides a concise history of the February 2001 economic crisis in Turkey. The third part delves into the agency and institutional-level dynamics that enabled the emergence of a dominant crisis narrative. The fourth part deals with the consolidation of the pro-reform coalitions and the increase of Turkey's regulatory state capacity, which refers to the third-phase in my conceptual framework. The final part concludes the chapter.

6.2. 2001 Turkish economic crisis: A brief overview

A new coalition government was formed on May 28, 1999 incorporating centre-left Democratic Left Party (DSP in Turkish acronym) under the leadership of Bülent Ecevit, Motherland Party (ANAP in Turkish acronym) under the leadership of Mesut Yılmaz, and Nationalist Movement Party (MHP in Turkish acronym) under the leadership of Devlet Bahçeli.⁷⁸² Aware of the fiscal and financial problems accumulated over the years, the coalition government signed a three-year stand-by agreement with the IMF in the amount of SDR 2,892 million (300 percent of quota) in December 1999 to address structural causes of fiscal imbalances, high and chronic inflation, and financial profligacy. The agreement, similar to the reform package announced following the 1994 crisis, was rather ambitious. In the Letter of Intent submitted to the IMF, the government declared its goal as “freeing Turkey from inflation and enhancing the prospects for growth and for a better standard of living for all parts of society.”⁷⁸³ The three-year

⁷⁸² In April 1999 elections, DSP outperformed its rivals by acquiring 22.2 percent of the total votes. MHP followed DSP with 18 percent and ANAP became the fourth party with 13.2 percent. The coalition government enjoyed a comfortable majority in the parliament with 53.4 per cent of the total votes and 64 percent of total seats.

⁷⁸³ Letter of Intent of the Government of Turkey, December 9, 1999, <https://www.imf.org/external/np/loi/1999/120999.htm> (arrived on September 12, 2014)

disinflation program was very assertive in terms of its inflation targets: lowering the inflation rate to 25 percent by late December 2000 to 10-12 percent by the end of 2001, and to single digits (about 5-7 percent) at the end of 2002.⁷⁸⁴ A pre-announced exchange rate strategy was adopted to ensure credibility of the disinflation scheme. In order to reduce inflation and arrest state's exacerbating fiscal crisis, the program also targeted structural reforms to make an up-front fiscal adjustment sustainable. The structural reforms included the introduction of a tax package incorporating personnel income and corporate tax regulations, an increase in motor vehicle and property taxes, and other ad hoc measures which were expected to raise state revenues by 2 per cent of GNP in 2000. Furthermore, 21 SEEs were included into the privatization scheme of the government as part of the stand-by program.⁷⁸⁵ Accordingly, the stand-by agreement targeted privatization revenues by 3.5 per cent of GNP in 2000 (about 7.6 billion dollars), 3.25 per cent in 2001 (6 billion dollars), and 2 per cent in 2002 (4 billion dollars).⁷⁸⁶ The program also envisioned a social security reform, restructuring of agricultural subsidies, and improvements in public administration to ensure fiscal discipline in public finances.

The coalition government demonstrated high level of commitment to the reform agenda in the initial phases. A close examination of the government program in fact reveals that coalition partners promised to initiate substantial fiscal and financial reforms before the

⁷⁸⁴ Ibid., Article 6.

⁷⁸⁵ Ibid., Annex B.

⁷⁸⁶ Ibid., Articles 23, 28, 29.

stand-by arrangement.⁷⁸⁷ In June 1999, the parliament approved a new Banking Law (No. 4398) that delegated supervision and regulation authority to a new independent institution, named Banking Regulation and Supervision Agency (BRSA). Following the stand-by agreement, the government committed itself to make further amendments in the banking law so as to “increase transparency and independence in the operation of the Agency [BRSA], strengthen key prudential regulations, and to provide all of the tools needed for the improved resolution of problem banks.”⁷⁸⁸ The BSRA started to operate in August 2000. The amendments in the banking law also designed precise takeover mechanisms for the insolvent banks. Accordingly, the government pledged to transfer further authority to the Savings Deposits Insurance Fund (SDIF), the public body created after the 1994 crisis to back up state’s guarantee of bank deposits, in the stand-by agreement. The prudential regulations foreseen in the Letter of Intent were nothing short of a paradigmatic shift in the governance of Turkish financial system.

“We [the government] will take important additional steps in the area of prudential regulation and supervision. Appropriate prudential requirements in line with international standards and best practices will be taken in the areas of: (i) accounting standards applicable to banks for prudential reporting and financial disclosure purposes, (ii) capital adequacy, including market risk, and (iii) improved internal risk management procedures.”⁷⁸⁹

⁷⁸⁷ V. Ecevit Hükümeti Programı, <http://www.tbmm.gov.tr/hukumetler/HP57.htm> (arrived on September 13, 2014). In our interview, Masum Türker, member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002), also underlined this point by stating that most of the fiscal and financial reform proposals were in fact prepared before February 2001 crisis.

⁷⁸⁸ Letter of Intent of the Government of Turkey, December 9, 1999, Article 53.

⁷⁸⁹ Ibid., Article 61.

The strong support of the government for the stabilization program and commitment to the reform agenda, however, started to disappear in the second half of 2000. In the initial phases, the coalition government was perceived as an opportunity for Turkey since it unified different ideological stances around a reformist agenda. The diverse ideological commitments of the coalition partners, however, turned into important stumbling stones in terms of a consistent and sturdy implementation of the promised reforms. The increasing incoherence among the coalition partners and particularly the resistance of the nationalist MHP to the banking regulations, agricultural reforms, and controversy over privatization of key state organizations such as Türk Telekom, gradually eroded the confidence of investors toward the program starting from mid-2000s.⁷⁹⁰ It shortly became apparent that the stabilization package failed to generate credibility on the part of the market actors. As Akçay put it, starting from mid-2000, “foreign capital became quite timid, due to the particularly discouraging signals being given by the government on the fiscal front and regarding the reform package.”⁷⁹¹ Furthermore, the real appreciation of the Turkish lira, a swift recovery in domestic demand and surge in energy prices led to an increasing current account deficit. The combination of a series of domestic and external untoward events,⁷⁹² as a result, raised serious questions regarding the sustainability of the exchange rate regime, which left Turkish economy almost

⁷⁹⁰ Kepenek and Yentürk, *Türkiye Ekonomisi*, 590-592; Ziya Öniş, “Conclusion: Broader Ramifications of Turkey’s Financial Crisis,” in Ziya Öniş and Barry Rubin, *The Turkish Economy in Crisis* (London: Frank Cass, 2003), 190.

⁷⁹¹ Cevdet Akçay, “The Turkish Banking Sector Two Years after the Crisis: A Snapshot of the Sector and Current Risks,” in Ziya Öniş and Barry Rubin, *The Turkish Economy in Crisis* (London: Frank Cass, 2003), 177.

⁷⁹² The uncertainties and instability in Argentina, a country which was implementing currency board regime similar to Turkey’s pegged exchange rate program at the time, appeared as an important development that increased the risk perception of international investors in regard to emerging markets, inter alia, Turkey.

entirely vulnerable vis-à-vis the speculative attacks of erratic capital flows.⁷⁹³ The instability triggered a surge in interest rates and a sharp decline in the price of treasury bills with an increasing demand on short-term liquidity. In this deteriorating environment, the first shock wave hit the economy in November 2000, when a mid-sized private bank, Demirbank, holding a large amount of government securities, declared bankruptcy following the rapid deterioration of its capital base. The Central Bank intervened in the markets by selling some 6 billion dollars in addition to the extra credit line opened by the IMF, which temporarily tranquilized and subdued the markets.

The snowball however had continued to roll, as the structural problems were not tackled meticulously due to the timid approach of the government and sub-optimal policy mix and sequencing of the IMF program.⁷⁹⁴ The real shock knocked on Turkey's door in February 21, 2001. In a context of diminishing confidence to the political authority, the expectations of the market players turned for the worse after November 2000. This time, the triggering factor that pinpointed the timing of the crisis was political in nature. On February 19, 2001, at an ill-tempered meeting of National Security Council, Prime Minister Bülent Ecevit and President Ahmet Necdet Sezer had a serious dispute

⁷⁹³ November 2000 crisis is a well-researched theme in the literature. For illustrative reviews, see Emre Alper, "The Turkish Liquidity Crisis of 2000: What Went Wrong?" *Russian and East European Finance and Trade* 37, no. 6 (2001): 51-71; Akyüz and Boratav, "The Making of Turkish Financial Crises," *World Development*; Nur Keyder, "The Aftermath of the Exchange Rate-Based Program and the November 2000 Financial Crisis in Turkey," *Russian and East European Finance and Trade* 37, no. 6 (2001): 22-44; Ahmet Ertuğrul and Erinç Yeldan, "On the Structural Weaknesses of the post-1999 Turkish Disinflation Program," *Turkish Studies* 4, no. 2 (2003): 53-66.

⁷⁹⁴ The policy mistakes of the IMF in 2000 played a crucial role in the failure of Turkey's stabilization program. IMF's policy mistakes also had ramifications in terms of the bargaining positions of Turkish policy makers and the IMF following February 2001 crisis. I will discuss this point in detail in the following section.

regarding the status and implementations of the BRSA. The Prime Minister stormed out of the meeting. During the press conference, which he arranged immediately after the dispute, Ecevit defined the incident as a “big [political] crisis.”⁷⁹⁵ The disclosure of the public argument increased the jitters immensely within the markets, which in turn, precipitated a series of events that culminated in by far the deepest peacetime turmoil in the history of the country.

Gross national product in real terms declined by 9.4 percent; the immediate capital exodus amounted to 7.6 billion dollars; the interest rates jumped to unprecedented levels.⁷⁹⁶ This was also the final call to pull the plug of the IMF-sponsored exchange rate-based stabilization program. As the exchange rate was left free to float, domestic currency lost its value by 65.9 percent in total in two months. The massive devaluation in domestic currency also severely jeopardized the balance sheets of financial and non-financial firms due to high levels of open foreign exchange positions they were exposed to. As I discussed in chapter 5, the banks during 1990s borrowed in foreign denominated currencies and directed these funds to Turkish lira denominated funds.⁷⁹⁷ Not surprisingly, as a result, the accumulation of foreign exchange liabilities left Turkish banks defenceless against currency mismatch problems in the wake of the crisis.⁷⁹⁸ In

⁷⁹⁵ Milliyet Gazetesi, “Ecevit Konuştuğu Piyasa Dalgalandı,” February 20, 2001.

⁷⁹⁶ The overnight interest rates had hiked to 2,000 percent on February 21, following the public argument between Prime Minister and President, and skyrocketed to more than 4,000 percent on February 21.

⁷⁹⁷ The government securities were equivalent of 10 per cent of total assets of deposit banks in 1990. The figure increased to 23 percent of total assets in 2000. In the same period, the share of loans to the private sector over total assets decreased from 36 percent to 24 percent.

⁷⁹⁸ The foreign exchange deposits were composing 58.6 percent of total deposits in Turkish banks in 2000, which was just 25 percent in 1990. The ratio, in itself, demonstrates that “dollarization” became an increasing trend in Turkish economy during 1990s. Following the 2001 economic crisis, the devaluation in

addition to the widespread bankruptcies in the banking sector, which resulted in a massive cost of 47.2 billion dollars,⁷⁹⁹ thousands of small and medium-sized enterprises went out of business during 2001 and 2002. As of the end of 2001, the public sector borrowing requirement increased to 15.5 percent; budget deficit skyrocketed to 17.4 percent; and public debt jumped to 97.8 percent of GNP. The distributive consequences of the economic crisis were also significant: almost 1 million people lost their jobs, which resulted in an unemployment ratio hovering around 10.7 percent in a year.⁸⁰⁰ The rate of inflation rose immensely, by 68.5 percent in comparison to the previous year. As Adaman and Çarkoğlu demonstrated, the crisis also led to an erosion of Turkey's already nascent social capital, which in turn, triggered widespread corruption.⁸⁰¹

6.3. Post-crisis reform program: Getting things right

The February 2001 crisis represents a real turning point in Turkish political economy not only because it was the deepest crisis in the history of the country but also due to the paradigmatic changes that took place during the post-crisis period. In the fiscal and financial realms, the crisis was exploited as an opportunity window to initiate substantial and sustainable reforms that informed fundamental restructuring of state-market relations. Following the crisis, Turkey prepared a bold and comprehensive reform

the currency severely hit banking sector accustomed to holding balance sheets with large share of domestic currency denominated treasury bills on the asset side, which was mainly financed by foreign currency denominated liabilities.

⁷⁹⁹ DPT, *Dokuzuncu Kalkınma Planı (2007-2013): Finansal Hizmetler Özel İhtisas Komisyonu Raporu*, 4.

⁸⁰⁰ For an in-depth analysis of the distributional consequences of Turkish economic crisis, see Şenses, "Economic Crisis as an Instigator of Distributional Conflict," *Turkish Studies*, 92-119.

⁸⁰¹ Fikret Adaman and Ali Çarkoğlu, "Social Capital and Corruption in during Times of Times of Crisis: A Look at Turkish Firms during the Economic Crisis of 2001," in Ziya Öniş and Barry Rubin, *The Turkish Economy in Crisis* (London: Frank Cass, 2003), 120-145.

package entitled *Strengthening the Turkish Economy: Turkey's Transition Program*, the aim of which was declared as to “fundamentally [transform] the functioning of the state.”⁸⁰² The details of the program were crafted under the auspices of the IMF in a Letter of Intent sent to the Fund by the coalition government on May 3, 2001.⁸⁰³ The reform program was attached to strict quantitative and structural conditionality benchmarks in return for the financial and technical assistance of the IMF (see table 12). The program offered a three-pronged approach: fiscal consolidation, financial restructuring, and structural reforms to ensure fiscal and financial sustainability of the Turkish economy in the medium-term.⁸⁰⁴ On the fiscal front, similar to other post-crisis reform programs, the government adopted a set of fiscal consolidation measures. The public sector primary balance was targeted to be 5.5 percent of GNP in 2001 and 6.5 percent in 2002. On the expenditure side, the state budget was cut by 9 percent in real terms in 2001.⁸⁰⁵ A Public Savings Communiqué was released to discipline the state expenditures. In addition to the already closed ones, the government further closed 36 budgetary funds and six EBFs, which were considered as the black holes in state budget.⁸⁰⁶ Recruitment of new civil servants to the public sector was also frozen during the crisis years in addition to the cancellation of the public sector investment projects.

⁸⁰² Undersecretariat of Treasury, *Strengthening the Turkish Economy: Turkey's Transition Program*, <http://imb.tcmb.gov.tr/wps/wcm/connect/tcmb+en/tcmb+en/main+menu/publications/basic+policy+readings> (arrived on September 14, 2014), 34.

⁸⁰³ Letter of Intent of the Government of Turkey, May 3, 2001, <https://www.imf.org/external/NP/LOI/2001/tur/02/INDEX.HTM> (arrived on September 14, 2014).

⁸⁰⁴ In the program, the pillars of three-pronged approach are classified as (1) fiscal and monetary reforms, (2) structural reforms in the real sector and banking system, and (3) a strengthened social dialogue. For the purposes of this study I slightly reformulated the presentation of the program.

⁸⁰⁵ Letter of Intent of the Government of Turkey, May 3, 2001, 13.

⁸⁰⁶ *Ibid.*, 9.

Second cornerstone of the program was the restructuring of the financial system. As part of *Turkey's Transition Program*, a detailed roadmap entitled *Banking Sector Restructuring and Rehabilitation Program* was released in May 2001 that outlined the “underlying strategy of the BRSA towards establishing a sound banking sector and the action plan for the restructuring of the banking sector.”⁸⁰⁷ First, a costly financial restructuring plan was put into practice to recapitalize the two largest state banks (Ziraat and Halkbank).⁸⁰⁸ The insolvent private banks were also taken over by SDIF. As a result, 22 insolvent banks were transferred to SDIF as of 2003.⁸⁰⁹ The SDIF-owned banks were merged, sold, or liquidated after financial streamlining took place. Second, BSRA, which started its operations in mid-2000 in pursuant to a new banking law of 1999, was granted completely independent operational capacity following the 2001 crisis to adequately supervise the banking sector. Thanks to the substantial amendments in the banking law, all banks were required to fully comply with the BSRA regulations.

The strict prudential regulations adopted in the banking law were put into implementation. Accordingly, an independent governing board, reporting to the Treasury, was appointed in state banks “to apply commercial criteria to operations and pricing policies that ensure profitability.”⁸¹⁰ The private banks were also required to

⁸⁰⁷ BDDK, *Towards a Sound Turkish Banking Sector*, http://www.bddk.org.tr/WebSites/english/Reports/Other_Reports/2642annex_report_towards_a_sound_turkish_banking_sector.pdf (arrived on September 14, 2014), 8.

⁸⁰⁸ Emlak Bank, the third largest state bank at the time, was closed and assets were transferred to Ziraat Bank.

⁸⁰⁹ This number covers the period between 1997 and 2003. 14 of them were taken over during 2000-2003. See, SDIF, *Annual Report-2003*, http://www.tmsf.org.tr/yillik_rapor.en (arrived on September 14, 2014), 9-10.

⁸¹⁰ Letter of Intent of the Government of Turkey, May 3, 2001, 6.

restore their capital adequacy ratios and capital deficient banks were forced by BSRA to present capital strengthening plans. All banks were obliged to develop internal prudential mechanisms in addition to strong BSRA-led external supervision. In July 2004, blanket deposit guarantee, which was introduced following the 1994 crisis, was abolished in order to mitigate moral hazard risks. Finally, monetary policy moved toward inflation targeting as the Central Bank of the Republic of Turkey was given “full operational independence in pursuing its primary mandate of maintaining price stability.”⁸¹¹

The structural fiscal reforms constituted the third pillar of the program. I discussed in the previous chapter that non-transparent management of public finance and a fragmented structure of the central budget provided ample room for political rent-seeking and patronage in the absence of parliamentary purview. The worsening public fiscal balances, in turn, jeopardized economic efficiency and competitiveness. Therefore, the reforms in this category were claimed to put a clear break with the past habits of state behaviour:

“Successful implementation of the structural reforms envisaged in the program will increase the economy’s efficiency, thus facilitating sustainable growth with current resources. Structural reforms will also transform fundamentally the functioning of the state. This way, the state will be prevented from returning to the old habits that deteriorate public finances and reduce the efficiency of resource utilization.”⁸¹²

⁸¹¹ Ibid., 18.

⁸¹² Undersecretariat of Treasury, *Strengthening the Turkish Economy: Turkey’s Transition Program*, 34.

Similar to the financial reforms, a new regulatory framework was also crafted in the fiscal system. First, a new public borrowing law was promulgated in order to streamline state's fiscal accounts. The new regulations concerning the public borrowing practices brought transparency and clarity to the state borrowing limits, which used to be quite opaque and arbitrary. Keeping the Turkish parliament informed regarding public debt dynamics through quarterly published debt management reports also became legally binding. Second, existing budget law was also amended so as to make budgetary spending more accountable and tractable.⁸¹³ As I stated in the preceding paragraphs, the EBFs were closed and the creation of new ones was banned. Third, the Turkish parliament promulgated a new public tender/procurement law. Fourth, in pursuant to the stand-by agreement with the IMF, the government also accelerated privatization implementations, primarily in the telecommunication, banking, aviation, sugar, tobacco, steel, and natural gas industries.⁸¹⁴ The Turkish parliament passed 19 vital structural reform laws or regulations, more than half of which were approved in the first four months preceding the economic crisis (see below). In summary, the unified thread of fiscal, financial, and structural reforms were declared as “[to improve] the economic environment through enhanced transparency, better governance, and a strengthened regulatory environment.”⁸¹⁵

⁸¹³ Letter of Intent of the Government of Turkey, May 3, 2001, 9.

⁸¹⁴ The details of privatization plans were outlined in Article 21 of the Letter of Intent submitted to the IMF. See, *ibid.*, 10-12.

⁸¹⁵ *Ibid.*, 5.

The February 2001 crisis was distinct from the previous ones not only in terms of its magnitude but it also laid the groundwork for a virtuous cycle of reform-activism that informed a new equilibrium in state-market relations. I have demonstrated in the preceding pages that occasional attempts were made to put ambitious reform programs into implementation in the post-crisis episodes to arrest state's fiscal profligacy and discipline ill-functioning financial system. These attempts, however, did not lead to a paradigm change because they were either utterly failed or ultimately watered down, as a result of which, status quo ante restored. The February 2001 crisis, in this context, points to a completely new phase in Turkish neoliberalism because, for the first time over years, Turkish policy-makers embarked on a set of substantial and sustainable reforms that underpinned regulatory state capacity. In retrospect, the state succeeded in putting its fiscal house into order so that the budget deficit and public debt were brought under control —to levels consistent with the Maastricht criteria. The financial system was also overhauled significantly so that 'banking on government' and 'bad credits to good friends' ceased to be policy options for private and public banks.⁸¹⁶ As Akçay and Alper rightly point out the reforms "were revolutionary steps in the economic history of the Turkish Republic and did correspond to a strong shift in public and fiscal policy."⁸¹⁷ Therefore, the 2001 crisis paved the way for a new and arguably a high level equilibrium in comparison to the pre-crisis period (for details see part 6.4). How did it become possible to reform the suboptimal financial system and discipline state's profligate fiscal

⁸¹⁶ Interview with Doğan Cansızlar, Chairman of Capital Markets Board of Turkey, September 11, 2014.

⁸¹⁷ O. Cevdet Akçay and C. Emre Alper, "Towards a Sustainable Debt Burden: Challenges Facing Turkey at the Turn of the New Millennium," in Ziya Öniş and Barry Rubin, *The Turkish Economy in Crisis* (London: Frank Cass, 2003), 149.

behaviour? Also, how could it become possible to overcome the resistance of the rent-seeking incumbent policy coalitions so that the introduction and consolidation of substantial reforms became possible? What factors accounted for the paradigmatic change in Turkey's fisco-financial regime?

Based on the conceptual framework offered in chapter 2, I will argue in the following section that the spotlight should be turned on the agency-level dynamics and institutional structures to reveal whether the interaction between domestic agents and external anchors resulted in the emergence of a dominant crisis narrative and to what extent this narrative penetrated into the domestic institutional structures toward the creation of pro-reform coalitions backing the proposed reforms. This requires a nuanced process tracing uncovering the interactions between agents and institutional structures during the crisis juncture. For a proper process tracing, I will use the data I gathered via thirteen semi-structured elite interviews in my field research, the primary documents (speeches, press statements, interviews, op-eds) produced by the relevant actors involved in the process, a thematic survey of newspaper articles, and ample secondary material collected from a variety of sources (for details see chapter 1, appendix 1, and appendix 4).

6.3.1. Agency-level dynamics: Converging crisis narratives

Following the public argument between the Prime Minister and the President on February 19, 2001 that sent domestic currency crashing by more than a third and eventually plunged the economy into a devastating crisis in a few days, Prime Minister

Bülent Ecevit invited Kemal Derviş, the World Bank's vice-president for poverty reduction and economic management, to handle the economic crisis. The motivation behind the government's appointment of Derviş was twofold. The first and immediate concern was to extinguish the fire of the markets by ensuring credibility and trust at the top level of economic management. The second and long-term aim was to ensure the assistance of international financial institutions while restructuring the domestic economy.⁸¹⁸ Ecevit's initial intention was to appoint Derviş as the governor of the Central Bank. However, Derviş insisted on a more powerful post since he cognized that the crisis was too deep to counteract via monetary policy instruments per se.⁸¹⁹ He stated this point to the Prime Minister:

“The governorship of the Central Bank was not the right authority to handle the crisis. In order to manage the departure from the crisis successfully, I need a more senior post with wide-ranging powers. It is by no means possible to overcome this crisis by just relying on monetary policy instruments. We need a state minister to coordinate the implementation of structural reforms and supervise macroeconomic balances, simultaneously.”⁸²⁰

After the coalition leaders consulted among themselves, the government positively responded to his request. As a result, Derviş was appointed as the ‘minister of state for economic affairs.’ In his words, Derviş was “offered the position of minister of the treasury, as well as coordinating responsibilities for the Central Bank and Banking Sector Regulation Agency, and the responsibility for negotiations with the IMF and

⁸¹⁸ Interview with Masum Türker, member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002), September 10, 2014.

⁸¹⁹ Interview with Kemal Derviş, Minister of Economic Affairs and Treasury, September 11, 2014.

⁸²⁰ Kemal Derviş, Serhan Asker, Yusuf Işık, *Kemal Derviş Anlatıyor: Krizden Çıkış ve Çağdaş Sosyal Demokrasi* (İstanbul: Doğan Kitapçılık, 2006), 63.

World Banks.”⁸²¹ From that point onwards, Derviş had become the key state agent regarding the management of the economic crisis and coordination of the reform processes. Stated somewhat differently, he turned out to be the main architect of the crisis narrative developed at the domestic agency level. Therefore, I will mainly concentrate on the crisis narrative developed by Derviş in an interactive manner with other important domestic and external players that were involved in the process. In this section, I will primarily rely on my semi-structured in-depth interview with Derviş, yet I will frequently refer to his speeches, interviews, and press statements as well.

Bakır pointed out that Derviş was a policy entrepreneur “operat[ing] in different ideational realms as decision maker (e.g., politician and bureaucrat), theorist (e.g., academic and intellectual), and framer (e.g., spin doctor publicizing favourable interpretation of some of the neoliberal ideas), as well as a mediator.”⁸²² First, he was a capable technocratic figure with widespread expertise knowledge in the theory and practice of economic crises and reform processes. He graduated from the Department of Economics at London School of Economics. He then received a PhD degree in economics from Princeton University, USA. Following three years work experience in two Turkish universities as a professor of economics during 1973-1976,⁸²³ he joined the

⁸²¹ Kemal Derviş, “Returning From the Brink: Turkey’s Efforts at Systemic Change and Structural Reform,” in Tim Besley and Roberto Zagha, eds., *Development Challenges in the 1990s: Leading Policymakers Speak from Experience* (Oxford: Oxford University Press, 2005), 65.

⁸²² Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 587.

⁸²³ After Derviş completed his PhD, he turned back to Turkey and worked in Hacettepe University and Middle East Technical University in Ankara. In the same episode, he also served as a consultant to Bülent Ecevit, who at the time was the leader of the centre-left Republican People’s Party. In his memoirs, Derviş admits that he was very interested and keen to enter into politics in CHP since he appreciated Ecevit as a

World Bank, where he spent 24 years until he returned back to Turkey in 2001. In addition to his academic credentials and professional expertise on the theory of economics, Derviş also gained ample technical and policy-related experience at the World Bank across a range of departments.⁸²⁴ Second, Derviş had established good connections with international epistemic communities. Similar to Lucas Papademos in the Greek case, as he socialized within the international financial institutions, Derviş, in fact, incarnated mainstream ideas developed in these circles. Third, the timing and context were also quite right as he entered into Turkish politics at a critical juncture when the domestic and external trust in established parties and political actors had deteriorated significantly. Derviş, therefore, emerged as an outsider and non-partisan figure.

When he accepted Ecevit's offer to become a state minister in charge of economic affairs, the business elite, civil society organizations, and domestic media offered him a warm welcome (see below). Derviş also enjoyed a high level of popularity within Turkish society, 66 percent of which supported him according to the surveys.⁸²⁵ Since the coalition government granted extraordinary discretion authority to Derviş, he was even labelled as “the fourth partner of the coalition government”⁸²⁶ or “super-minister

true social democrat. See, Derviş, Asker, Işık, *Kemal Derviş Anlatıyor: Krizden Çıkış ve Çağdaş Sosyal Demokrasi*, 31-39. Also see, Sefa Kaplan, *Kemal Derviş: Bir 'Kurtarıcı' Öyküsü* (İstanbul: Metis Yayınları, 2001), 32-33.

⁸²⁴ Derviş assumed different duties at the World Bank during his long career at the World Bank.

⁸²⁵ Milliyet Gazetesi, “Metropoller ‘Derviş’ Dedi,” July 13, 2001.

⁸²⁶ Interview with Şevket Bülend Yahnici, Deputy Leader of MHP, September 4, 2014.

with wide-ranging powers.”⁸²⁷ For all these reasons, Derviş occupied a central position as the key state agent, who developed the government’s crisis narrative, conducted negotiations with external actors, and coordinated reform packages at the domestic level so as to steer new pro-reform coalitions.

Following his appointment of significant authority, in a short period, Derviş formed his economic team. A coincidence facilitated his work in this regard. Just days before he assumed his new post, the governor of the Central Bank, Gazi Erçel, and the undersecretary of the treasury, Selçuk Demiralp resigned from their posts. The following day after he was appointed as a minister of state, the chairman of the BSRA, Zekeriya Temizel, also left his office. These three posts were strategically important to coordinate economic bureaucracy and supervise post-crisis transformation. Since Derviş appointed his teammates as of the end of March, high-level of coordination was ensured in the fiscal, monetary, and financial pillars of economic bureaucracy in a very short period, which in turn, helped the development of a coherent and credible crisis narrative. Derviş framed Turkey’s economic crisis mainly as a ‘domestic problem,’ root causes of which emanated from reactive state practices accumulated over the years.⁸²⁸ Accordingly, he narrated the crisis as an outcome of deleterious policies pursued by rent-seeking vested interest coalitions:

⁸²⁷ BBC News, “World Bank Man to Turkish ‘Rescue’”, <http://news.bbc.co.uk/1/hi/business/1198790.stm> (arrived on September 6, 2014).

⁸²⁸ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

“At the heart of Turkey’s difficulties was a rent-seeking socioeconomic system where governments had for decades promised and attempted to distribute more resources than they could raise. The private sector encouraged by the political class, spent enormous effort capturing rents in exchange for support to various political groups.”⁸²⁹

His interpretation based itself on a fundamental assumption that Turkey’s task was not “one of achieving stabilization or restoring liquidity.”⁸³⁰ Derviş’s diagnosis of the crisis as an inescapable consequence of the reactive state practices is worth accentuating at this point because, in the wake of the crisis, some pundits claimed that the Central Bank could have avoided the crisis had it provided liquidity for the economy in the critical episodes during November 2000 and February 2001.⁸³¹ According to Derviş and his economic team, however, a simple liquidity problem emerged from the mismanagement of the Central Bank was not the right approach in interpreting the root causes of Turkey’s economic crisis. What Turkey had to achieve, as his argument went, was “a systemic economic change: shifting from a rent-seeking society to a modern, competitive economy with much greater autonomy in the economic sphere, greater separation of politics and markets, greater transparency, and less privilege and therefore a better distribution of income, which would also lead to a greater legitimacy of

⁸²⁹ Derviş, “Returning From the Brink,” 66.

⁸³⁰ Ibid.

⁸³¹ A series of articles published by Turkish experts in the pages of the *Financial Times* include illustrative examples of this approach. For instance see, Ercan Kumcu, “The IMF’s Blunder in Turkey,” *Financial Times*, March 13, 2001; Korkut Boratav, “Blaming Turkey for the crisis preserves IMF’s reputation,” *Financial Times*, May 30, 2001; Oktay Yenal, “The Irresponsible Monetary Fund,” *Financial Times*, July 12, 2001.

governance and decision-making.”⁸³² To this end, according to Derviş, restructuring the financial system was an issue of primary importance.

“...The most immediate concern is to fix the structural weaknesses in the banking sector... The main lesson to be drawn [from the crisis] is the necessity to simultaneously restructure the banking system along with the fiscal and monetary policies. We have to be determined and take irreversible reformist steps regarding the banking sector.”⁸³³

Derviş’s initial approach suggests that domestic ownership of the crisis was ensured at the agency level in a consistent way starting from the early stages of the crisis. The major domestic agents responsible for the crisis management openly accepted and acknowledged that the crisis was in fact ‘made in Turkey’ so that fundamental reforms were in place in order so as to overcome it. The guiding logic of the reform program, as Süreyya Serdengeçti, the then governor of the Central Bank, stressed in our interview was to introduce a “new paradigm in state-market relations that ensures arms-length distance between day-to-day politics and the functioning of the fiscal and financial system.”⁸³⁴ The crisis narrative developed by Derviş and Turkish economic bureaucracy substantially coincided with the perspective of the IMF. This is in fact an expected development due to two main reasons. First, the IMF was a strong advocate of structural reforms in Turkey for quite a long time. For instance, the most important titles of the reform proposals such as privatizations, public borrowing regulations, regulation of the financial sector, and the Central Bank independence were already included in the

⁸³² Derviş, “Returning From the Brink,” 66.

⁸³³ Milliyet Gazetesi, “Sorun Siyasetçilerde,” March 10, 2001.

⁸³⁴ Interview with Süreyya Serdengeçti, Governor of the Central Bank of the Republic of Turkey, September 15, 2014.

December 1999 stand-by agreement, but failed to be implemented properly (see above). Thus the IMF welcomed Derviş's approach to the crisis. Stanley Fischer, first deputy managing director of the IMF and the major actor responsible for the management of the crisis on behalf of the Fund, stated this point in one of his speeches as follows:

“The Turkish authorities in the negotiations we have been conducting with Minister Derviş and his colleagues have demonstrated their determination to continue on the path of stabilization and reform on which they started at the end of 1999, and to take all the measures, including very tough ones to restructure the banking system and fiscal measures that will ensure a rapid turnaround in the debt situation necessary to restore stability and continue the process of disinflation... [Thus] Turkey deserves the support of the international community, and it will get it.”⁸³⁵

Second, Derviş used to work for the World Bank for more than two-decades; thereby, it is quite plausible to suggest that he had incorporated the mainstream ideas of the international financial institutions. As a matter of fact, the critical accounts of Turkish political economy tend to approach Derviş as the organic representative of the hegemonic capitalist ruling bloc.⁸³⁶ By doing so, they incline to overlook reformist actors' agency by attributing them an epiphenomenal role, whose actions are preordained by the interests and ideas of international financial institutions. This study tends to diverge from these unidirectional and somehow reductionist interpretations. As suggested, policy entrepreneurs are expected to domesticate international interests and

⁸³⁵ Stanley Fischer, “Remarks by Stanley Fischer, First Deputy Managing Director of the IMF, April 25, 2001,” <https://www.imf.org/external/np/speeches/2001/042501.htm> (arrived on September 12, 2014), 7.

⁸³⁶ For a crystal clear example of this stream of arguments, see Yücel Demirel and Özgür Orhangazi, “Kemal Derviş Mit(leştirilmes)ini Tersinden Okumak,” *Praksis*, no. 9 (2003): 337-356.

mainstream ideas while transposing them into the domestic field.⁸³⁷ Nevertheless, per definitionem, policy entrepreneurs are transnationalized agents that are supposed to have strong linkages with international epistemic communities. From this vantage point, their outlook resonates with international conventional wisdom regarding the fundamentals. This makes narrative matching a relatively easy task at the agency-level, which obviously turned out to be the case in Turkey's relations with the IMF under the stewardship of Kemal Derviş. It is therefore hardly surprising that the IMF endorsed its confidence to Derviş from the very beginning:

“We have a great deal of confidence in him [Kemal Derviş] and his team... Derviş is certainly well known, not only in the kind of sort of the IMF/World Bank sense of the world, but he is someone of international stature... We would be happy to be of assistance in whatever way we can.”⁸³⁸

Looking from this angle, Derviş adopted a crisis narrative that was fundamentally agreed and backed by the IMF and the World Bank. In our interview, Derviş himself implied this point as follows:

“We were on the same page with the IMF, especially regarding the root causes of Turkey's economic problems and structural reform measures [to be taken in the fiscal and financial realms]. The World Bank also played a crucial role in energy sector reform, agricultural reforms, and social assistance. A consensus emerged on the creation of a flexible social market economy... [In short] we did not have any substantial divergence in terms of the main framework of the reform program.”⁸³⁹

⁸³⁷ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 591.

⁸³⁸ IMF, “Transcripts of a Press Briefing by Thomas Dawson, Director of External Relations Department of the IMF, March 12, 2001,” <https://www.imf.org/external/np/tr/2001/tr010312.htm> (arrived on September 12, 2014), 6-7.

⁸³⁹ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

That being said, the perspectives of the parties were not entirely overlapping in the initial phases. Although the parties were of the same opinion regarding fundamentals and therefore adopted similar crisis narratives, there were certain points of disagreement especially on the speed and scope of fiscal adjustment. In general, the Turkish side opposed the IMF's insistence on a rapid macroeconomic adjustment and strict austerity measures since, according to Derviş and his team, this move would delegitimize the reform program in the eyes of domestic constituency. My interviews revealed that two major points created a fevered environment between the parties. The first controversy erupted on the inflation rate targets for 2002. Stanley Fischer insisted on a 20 percent inflation rate target for 2002. Derviş and his economic team, however, challenged this idea as they considered the proposed target unattainable and unrealistic. Derviş attributed high importance to macroeconomic targets, because he thought that the credibility of the program might be put in jeopardy in case the program targets were perceived unrealistic. Derviş stated this point as follows:

“Our inflation rate target for 2002 was 40 percent. The IMF insisted on 20 percent. Then, we agreed on the 35 percent inflation target for 2002. I ordered our Central Bank governor [Süreyya Serdengeçti] to negotiate an attainable target. Finally, we succeeded [in both terms]: The IMF accepted our offer and the 2002 inflation realized as 30 percent.”⁸⁴⁰

The second important controversy emerged in regard to the increase in the public sector wages. Fischer insisted on freezing the wages of the civil servants in order to comply with fiscal consolidation measures. According to Fischer, an increase in labour wages

⁸⁴⁰ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

might pave the way for the deterioration of public finances and the derailment of the entire program.⁸⁴¹ Derviş, on the other hand, opposed Fischer's demands since he thought that freezing public servants' wages might asymmetrically increase domestic audience costs, which in turn, might weaken the credibility and support-base of the entire reform program.

Regarding the inflation target, Fischer and the IMF team abandoned their initial ideas and accepted the proposal of Derviş and his negotiation team.⁸⁴² The controversy over public wages however proved a more difficult issue. The IMF in the first place resisted any increase in public sector wages. According to Derviş, "the entire program come close to the point of collapse" as the Turkish team also refused to change its initial stance.⁸⁴³ However, it became possible to cut a deal, partially, "thanks to a close personal relationship between Fischer and Derviş."⁸⁴⁴ As a result, Turkey secured almost 20 billion dollars of financial assistance within the context of a three-year stand-by agreement (in total, around 30 billion dollars, see table 12), which in the words of Fischer "demonstrates [IMF's] backing... by providing exceptional financing in its support."⁸⁴⁵

⁸⁴¹ Interview with Yusuf Işık, Chief Advisor to Kemal Derviş, 26 September 2014.

⁸⁴² Also see, Bakır, "Policy Entrepreneurship and Institutional Change," *Governance: An International Journal of Policy, Administration and Institutions*, 591.

⁸⁴³ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

⁸⁴⁴ Interview with Süreyya Serdengeçti, Governor of the Central Bank of the Republic of Turkey, September 16, 2014.

⁸⁴⁵ IMF, "IMF Approves Augmentation of Turkey's Stand-By Credit to US\$19 Billion", *Press Release no. 01/23*, May 15, 2001.

Table 12. IMF financial assistance to Turkey (1999-2003)

July-December 1999	Staff monitored follow up
2000-2002	Standby
November-December 2000	Extra reserve facility after the November 2000 crisis
February-March 2001	Extra financing after February 2001 crisis
2002-2004	Standby
11 September, 2001	Extra financing after 9/11 crisis
Total approval	31.85 billion dollars
1999	288 million dollars
2000	3.44 billion dollars
2001	11.32 billion dollars
2002	12.5 billion dollars
2003	1.6 billion dollars
Total disposition	29.23 billion dollars

Source: Adapted from Yeldan (2005) and IMF data

How did it become possible for Turkey to ensure the flow of such a large amount of financial assistance? And what factors accounted for the emergence of a consensus on a “more sophisticated, internally coherent and attainable reform program in comparison to previous orthodox stabilization measures”?⁸⁴⁶ I discussed in chapter 2 that policy entrepreneurs play instrumental roles in framing coherent narratives regarding the root-causes of the crisis and the measures to be taken. They also assume an instrumental role in ensuring the trust of external anchors to put their reformist agendas into implementation. The credibility-effect, in turn, increases the likelihood of receiving much more financial assistance from international financial institutions and bilateral loans from core states of the international system. In this sense, the findings of my field

⁸⁴⁶ For a discussion on these aspects of the program, see Refet Gürkaynak and Selin Sayek-Böke, “AKP Döneminde Türkiye Ekonomisi,” *Birikim*, no. 296, (2013): 64.

research confirm Bakır's previous study that 'the Derviş factor' turned out to be an instrumental variable that facilitated fisco-financial restructuring in Turkey.⁸⁴⁷ As a capable policy entrepreneur Derviş succeeded to generate urgently needed credibility and trust toward *Turkey's Transition Program* in the eyes of international epistemic circles thanks to his extensive networks and professional reputation. In our interview, Faik Öztırak, the undersecretary of treasury at the time and one the core members of Derviş's negotiation team, stated this point cogently:

“By pursuing a radical reformist agenda, Turkey succeeded in positively altering expectations in the eyes of international actors and the IMF. Turkey conveyed the message that ‘the rules of the game are changing radically; the old game has come to a clear end.’ Kemal Derviş played an important role to give this message to international financial institutions... Derviş had credibility and gravity in the eyes of the IMF and [World Bank] so that Turkey's reform program was approved and endorsed by these institutions.”⁸⁴⁸

Derviş's connections with the senior members of the IMF Board of Executive Directors and a close friendship with Stanley Fischer also facilitated settlement on a mutually acceptable reform program.

“We were speaking the same language with Fischer. We experimented with the Asia crisis together and we [personally] discussed many aspects of the crisis. Thanks to our joint experiences, we developed a common language and framework [regarding the crisis and reform measures to be taken].”⁸⁴⁹

⁸⁴⁷ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 587-588.

⁸⁴⁸ Interview with Faik Öztırak, Undersecretary of Treasury, September 10, 2014.

⁸⁴⁹ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

6.3.2. Converging interests and ideas: Turkey's bargaining space

'The Derviş factor,' however, needs to be placed into its proper context in order not to exaggerate the role of agency. The qualifications of Derviş do explain only some part of the degree of flexibility demonstrated by the IMF toward Turkey and the relatively generous financial assistance it was willing to provide. We need to extend our gaze toward the interests-ideas nexus, to fully grasp the factors that informed the convergence of the outlooks of agents in question and facilitated the emergence of a dominant narrative at the agency-level in a crisis juncture. Two major interest-related intervening variables increased Turkey's bargaining power and helped her to receive a large amount of financial support.

First, as I discussed in section 6.2, Turkey witnessed the most severe economic crisis in the midst of an IMF-sponsored stabilization program. The exchange rate-based stabilization program was the idea of the IMF staff, which was implemented despite serious objections of the Turkish economic team at the time. Furthermore, IMF did not provide necessary financial support to the introduced substantial structural reforms. Apart from these logistical problems, the December 1999 stabilization program also failed to offer an appropriate sequencing of reforms.⁸⁵⁰ The IMF placed prior emphasis on the elimination of macroeconomic disequilibrium, rather than the restructuring of wobbly financial system. It became apparent that the IMF did not have required

⁸⁵⁰ For a severely critical account of the IMF's role in Turkey's economic turmoil, see Yılmaz Akyüz and Korkut Boratav, "The Making of the Turkish Financial Crisis," *World Development* 31, no. 9 (2003): 1549-1566.

information concerning the true depth of fiscal and financial disequilibrium in Turkey. The February 2001 crisis, in this sense, clearly revealed “the insufficient investment on the part of the IMF, in terms of acquainting itself with the specific characteristics of individual countries and acquiring the relevant information.”⁸⁵¹ The apparent failures of the IMF, in a paradoxical way, turned out to be valuable assets for Turkey as it enlarged its bargaining space. In our interview, Faik Öztırak, an experienced Turkish bureaucrat who played major roles in negotiations with the IMF, underscored this point as follows:

“[There was another crucial factor] that strengthened Turkey’s bargaining position: One of the reasons that pushed Turkey into a crisis was the exchange rate-based stabilization program. The IMF staunchly advocated this strategy. [From the very beginning] we [the representatives of Turkish negotiation team] argued that this strategy would not work in the Turkish context. [After the 2001 crisis] this provided us significant bargaining advantage because we have said this previously. Therefore, the IMF was inclined to accept our suggestions in the post-2001 crisis in comparison to the pre-crisis context... Otherwise, it would not have been possible to receive such a large amount of financial support.”⁸⁵²

Second, Turkey’s geopolitical importance for the US played a considerable role in the post-crisis context. Woods,⁸⁵³ Stone,⁸⁵⁴ and Oatley and Yackee⁸⁵⁵ demonstrate that IMF assistance to emerging markets is not a politically neutral practice since engagement with the IMF provides a conduit of other political and geopolitical goals for the US over the debtor countries. Turkey’s political stability and economic durability appeared as an

⁸⁵¹ Öniş, “Domestic Politics versus Global Dynamics,” 12.

⁸⁵² Interview with Faik Öztırak, Undersecretary of Treasury, September 10, 2014.

⁸⁵³ Ngarie Woods, “Understanding Pathways Through Financial Crises and the Impact of the IMF: An Introduction,” *Global Governance* 12, no. 4 (2006): 379, 384.

⁸⁵⁴ Randal W. Stone, *Controlling Institutions: International Organizations and the Global Economy* (Cambridge: Cambridge University Press, 2011).

⁸⁵⁵ Thomas Oatley and Jason Yackee, “American Interests and IMF Lending,” *International Politics* 41, no. 3 (2004): 415-429.

important concern for the US foreign policy makers. It was therefore not surprising that just two days after the crisis outbreak, the then US president George W. Bush called Turkish prime minister in order to state “the readiness of the US to support Turkey.”⁸⁵⁶ As Miller points out “the US foreign policy interest in maintaining strong relations with Turkey, [provided] the freedom to the IMF to accommodate Derviş’s revisions than in other crisis packages.”⁸⁵⁷ Thus it is fair to argue in the Turkish case that the foreign policy priorities of the US toward the Middle East and Turkey’s geostrategic position as a spearhead in the region proved beneficial for Turkey to receive a considerably larger amount of financial assistance from the IMF.⁸⁵⁸ In the final analysis, the IMF bailed out Turkey, whilst rejecting Argentina’s request, a country also experiencing a deep economic crisis like Turkey but located at the periphery of the US foreign policy interests.⁸⁵⁹

Turkey’s geopolitical significance for the US became even more pronounced in the aftermath of the September 11, 2001 terrorist attacks.⁸⁶⁰ As the US government prepared to launch military operations in Turkey’s neighbouring states, its position in the western alliance appeared more critical than ever for the US foreign policy objectives. It is in this

⁸⁵⁶ Milliyet Gazetesi, “Bush’tan Ecevit’e Telefon,” February 24, 2001.

⁸⁵⁷ Calum Miller, “Pathways Through Financial Crisis: Turkey,” *Global Governance* 12, no. 4 (2006): 458.

⁸⁵⁸ Akyüz and Boratav, “The Making of the Turkish Financial Crisis,” *World Development*, 1550. Also see, Ziya Öniş, “Beyond the 2001 Financial Crisis: The Political Economy of the New Phase of Neo-Liberal Restructuring in Turkey,” *Review of International Political Economy* 16, no. 3 (2009): 417.

⁸⁵⁹ For the details of Argentina’s troubled relations with the Fund, see Pamela Starr, “Argentina: Anatomy of a Crisis Foretold,” *Current History*, no. 661 (2003): 65-71. For a comparative analysis with reference to diverging geopolitical significance of Turkey and Argentina, inter alia, see Ziya Öniş, “Varieties and Crises of Neoliberal Globalization: Argentina, Turkey and the IMF,” *Third World Quarterly* 27, no. 2 (2006): 252.

⁸⁶⁰ Cizre and Yeldan, “The Turkish Encounter with Neo-Liberalism: Economics and Politics in the 2000/2001 Crises,” *Review of International Political Economy*, 402.

context that Turkey applied to the IMF for an extra reserve facility in order to armour itself vis-à-vis the side effects of a reversal in capital flows to Middle Eastern economies and emerging markets. The IMF, in the words of Derviş, “immediately promised to open a new credit line of 10 billion dollars.”⁸⁶¹ One may claim that Turkey’s commitment to the reform program underpinned the credibility of Turkish policy-makers in the eyes of IMF officials. Yet, this would be a grave underestimation to evaluate IMF support in isolation from the concerns of the US government in the post-9/11 security environment. For instance, on December 14, 2001, President Bush personally reiterated his administration’s willingness to help Turkey in a meeting with Turkey’s ambassador in Washington.⁸⁶² In February 2002, the IMF renewed its commitment to Turkey with a revised agreement with new capital. As Woods suggests:

“The permissive support of the IMF reflected both the stake (in terms of advice and resources) the institution had in Turkey’s existing arrangements and the significant pressure from the United States, which was concerned about fallout in its relations with a key strategic ally.”⁸⁶³

The interview findings also confirm that the US closely monitored the implementation of Turkey’s restructuring program. The US embassy to Turkey, particularly ambassador Robert Pierson and deputy chief of mission in Ankara James Jeffrey, frequently met with government representatives. For instance, Jeffrey visited Şevket

⁸⁶¹ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014. Derviş stated to the author that the quick approval of the IMF was closely related to the trust-based relationship between the Turkish team and the IMF built after the post-2001 crisis. Turkey’s adherence to the reform program, Derviş claimed, increased Turkey’s credibility and trustworthiness.

⁸⁶² Cizre and Yeldan, “The Turkish Encounter with Neo-Liberalism,” *Review of International Political Economy*, footnote 16.

⁸⁶³ Woods, “Understanding Pathways Through Financial Crises and the Impact of the IMF: An Introduction,” *Global Governance*, 384.

Bülend Yahnici, the spokesperson of the government, during the most intense episode of the crisis in order to remind the Turkish government “that the US is responsible to ‘control’ how the US taxpayers’ money [extended to Turkey via the IMF credits] is spent and distributed.”⁸⁶⁴ One of the top officials of the DSP at the time also stated that the US ambassador frequently visited deputy prime minister, Hüsametdin Özkan, to supervise the progress in reform measures, with a particular interest in the privatization of the energy sector.⁸⁶⁵

The preceding debate suggests that the two driving interest-related developments helped Turkey receive relatively timely and large amount of financial assistance. However, these factors do not explain the content and design of the reform program, which bring about the importance of ideas at critical junctures. The major ideational factor that facilitated the emergence of a dominant crisis narrative at the agency-level, prioritizing the establishment of robust regulatory institutions rather than single-minded strict fiscal austerity was related to the rising economic policy paradigm at the time, namely post-Washington Consensus (PWC). The dominant crisis narrative emerged at the agency-level put a significant emphasis on the regulatory credentials of the Turkish state in the fisco-financial regime. From this perspective, the reform program went beyond the neoliberal orthodoxy of the Washington Consensus (WC) that increasingly dominated the outlook of the IMF and the World Bank in the post-1980 era. The WC advocated a political economy model revolving around the standard templates of ‘market

⁸⁶⁴ Interview with Şevket Bülend Yahnici, Deputy Leader of MHP, September 4, 2014.

⁸⁶⁵ Interview with Masum Türker, Member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002), September 10, 2014.

liberalization' and 'minimal state.'⁸⁶⁶ The organizing ideational notion of the WC was the unshakable trust placed in the self-adjustment capacity of the markets.⁸⁶⁷ Accordingly, it was assumed that "getting prices right... through trade liberalization, privatization, reduced public spending, freeing key relative prices such as interest rates, and lifting exchange controls" would address major problems regarding the proper functioning of the markets.⁸⁶⁸ The WC also advocated a minimalist and non-interventionist state. Accordingly, state was perceived as a problem that undermines the proper functioning of the markets, rather than being conceived as a benign agent that facilitates better regulation and more efficient functioning of the markets. Staunchly supported by the hegemonic power centres of international political economy, the basic premises of the WC formed the main policy focus of the IMF and World Bank.

The weak spots and deeply flawed logic of the WC, however, surfaced rather quickly. Two interrelated developments proved crucial in this regard. First, the WC failed to live up to its initial promises. Mounting empirical evidence from Mexico (1994), Asia (1997), Russia (1998), and Argentina (2001) crises, inter alia, clearly demonstrated the flawed intellectual foundations of the Washington Consensus.⁸⁶⁹ These crises also revealed that IMF-sponsored financial liberalization reforms and premature abolition of

⁸⁶⁶ For an early account and a set of policy proposals in line with the logic of the WC, see John Williamson, "What Washington Means by Policy Reform?" in John Williamson, ed., *Latin American Adjustment: How Much Has Happened?* (Washington DC: Institute for International Economics, 1990), chapter 2.

⁸⁶⁷ For an in-depth analysis of this badly flawed logic, see Dani Rodrik, *Has Globalization Gone Too Far?* (Washington D.C.: Institute of International Economics, 1997).

⁸⁶⁸ Ziya Öniş and Fikret Şenses, "Rethinking the Emerging Post-Washington Consensus," *Development and Change* 36, no. 2 (2005): 264.

⁸⁶⁹ For an extensive critique with reference to the economic crises during the 1990s, see Joseph Stiglitz, *Globalisation and Its Discontents* (New York: W.W. Norton, 2002).

capital account regimes eventually failed in a variety of country cases. As Stiglitz points out, it was understood that “redesigning the regulatory system, not financial liberalization, should be the issue.”⁸⁷⁰ Second, the ‘star globalizers’ of the post-1980 era were the countries that pursued heterodox policies. As Rodrik puts “globalization’s chief beneficiaries are not necessarily those with the most open economic policies.”⁸⁷¹ The states known for their heterodox fiscal and financial policies—including active state guidance and intervention—like China, India, and Vietnam protected themselves against the side-effects of global financial crises better than the ones pursued orthodox neoliberal dictums.⁸⁷² The poor record of the latter increasingly jeopardized the legitimacy and credibility of the Bretton Woods institutions advocating the Washington Consensus. The spectacular failure of the WC, as a result, laid the groundwork for a kind of self-criticism from within dominant establishment.⁸⁷³ Accordingly the concept of conditionality started to be redefined “with greater attention being paid to institutional and regulatory reforms moving beyond a simple-minded pre-occupation with trying to impose short-term macroeconomic discipline at all cost.”⁸⁷⁴ The IMF also found itself amidst an identity crisis and faced with severe criticisms not only from external

⁸⁷⁰ Joseph Stiglitz, “More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus,” *Revista de Economia Politica* 19, no. 1 (1999): 106.

⁸⁷¹ Dani Rodrik, “How to Save Globalization From its Cheerleaders,” *The Journal of Trade and Diplomacy* 1, no. 2 (2007): 3.

⁸⁷² *Ibid.*

⁸⁷³ World Bank was faster than the IMF in terms of self-evaluation and intra-organizational critique. The oft-cited and widely debated World Bank report that underlined the importance of regulatory institutions and state’s steering role, in this sense, published in 1997. See World Bank, *The State in a Changing World* (New York: Oxford University Press, 1997).

⁸⁷⁴ Öniş, “Beyond the 2001 Financial Crisis: The Political Economy of the New Phase of Neo-Liberal Restructuring in Turkey,” *Review of International Political Economy*, 412.

intellectual echelons but also from within circles.⁸⁷⁵ Particularly relevant for the purposes of this study is the significant role Stanley Fischer played as first deputy managing director of the IMF. As a well-known economist and an influential intellectual figure in the World Bank and the IMF networks, Fischer openly discerned that “[one of the lessons] learned by the IMF [is the necessity of] better supervision by industrial country regulators over the financial institutions active in international markets, and more provision of information by those institutions.”⁸⁷⁶ It is plausible to argue that this paradigmatic shift also had ramifications on the design and policy mix of Turkey’s post-crisis reform program. Derviş stated this point as follows:

“[At that time] the IMF was in need of a major change. The IMF revised its ideas substantially regarding the economic crisis in Asia. Therefore the IMF in 2001-2002 was significantly different from the IMF in 1990s. [I had the impression that] the IMF took lessons from its policy mistakes regarding the Asian crisis [and Washington consensus] that helped us agree on a common reform program.”⁸⁷⁷

In summary, the policy entrepreneurship of Kemal Derviş played its role in sending coherent, credible, and strong signals to the external anchors involved in the management of the Turkish economic crisis. It also helped Turkey to ensure the flow of

⁸⁷⁵ For a lucid analysis see Ben Thirkell-White, *The IMF and the Politics of Financial Globalization: From the Asian Crisis to a New International Financial Architecture* (Basingstoke: Palgrave Macmillan, 2005).

⁸⁷⁶ Stanley Fischer, “Financial Crises and Reform of the International Financial System,” *Review of World Economics* 139, no. 1 (2003): 33. For a critical reflection on the IMF’s role in the crises during 1990s and the lessons learned by the IMF, see Stanley Fischer, “The International Financial System: Crisis and Reform,” The Robbins Lectures, October 29-31, 2001, http://cep.lse.ac.uk/conference_papers/29_10_2001a.pdf (arrived on September 15, 2014). Also see, Stanley Fischer, “On the Need for an International Lender of Last Resort,” Speech delivered at American Economic Association and the American Finance Association New York, January 3, 1999, <http://www.imf.org/external/np/speeches/1999/010399.HTM> (arrived on September 17, 2014).

⁸⁷⁷ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

large amounts of financial assistance in a timely manner. However, the ‘Derviş factor’ needs to be placed into a proper context: The combined effects of the interest-based factors that highlighted Turkey’s geopolitical advantages and ideational factors that brought important changes in the mind-set of the IMF staff—once combined with the failure of the December 1999 IMF-imposed program—noticeably enlarged Turkey’s bargaining space and facilitated the emergence of a common crisis narrative, relying on the logic of regulatory state at the agency-level.

6.3.3. Institutional structures: Enabling factors at work

The domestic institutional structures also facilitated the proper implementation of the reform program in the Turkish context. In fact, the institutional structures and agents mutually contributed to the emergence of a virtuous cycle in the Turkish case, as a result of which consensus-based policy-making prevailed. I argued in chapter 2 that new supportive coalitions need to be created along with the dismantlement of the entrenched ones in order to craft a new equilibrium in reactive states. The responses of the institutional structures and their mode of interactions with reformist state agents and external anchors are decisive in this regard. To this end, political context, state bureaucracy, trade unions, and business associations informed Turkey’s post-crisis reform performance as major aspects of reactive state. In the following part, I will discuss enabling roles played by institutional structures and try to elucidate how complex interactions between agency and institutional-level dynamics informed the

emergence and consolidation of pro-reform coalitions in the third phase of my conceptual framework.

6.3.3.1. Political context

First, domestic political context aroused as an important factor in Turkey's post-crisis political economy equilibrium. I demonstrated in the previous chapter that the Turkish political context, more often than not, tended to inform polarized and conflictual mode of governance, which in turn, exacerbated collective action problems toward instigating virtuous reformist cycles. Thus, similar to other reactive states, political context used to play an adverse role in terms of reform activism. The post-crisis political equilibrium, however, paints a different picture in the Turkish context. The crisis empowered the reformist segments of economic bureaucracy relative to political elites. I revealed in my field research that Turkey's preparedness at the bureaucratic level was relatively high in the wake of February 2001 crisis. Thanks to the experiences derived from past economic crises, Turkish economic bureaucracy was aware of the underlying fiscal and financial fragilities. Accordingly, a series of reforms were already in progress for a while to streamline the fiscal and financial system in Turkey.

“Turkish economic bureaucracy had been working on economic fragilities for a long time period. Thus they accumulated significant degree of expertise on what needs to be done. Despite certain political resistance, for instance, Turkey succeeded in establishing BSRA and SDIF before the crisis. More or less, the

other vital fiscal and financial reforms were also more or less prepared by economic bureaucracy.⁸⁷⁸

Derviş also underlined this point as a crucial factor for the speed and ultimate success of the reform program in our interview:

“In fact, technical studies on most of the reform proposals, such as the establishment of BSRA and Central Bank independence law, had already been conducted by economic bureaucracy before the 2001 economic crisis hit the economy. What was required was the political will to put these reform proposals into practice.”⁸⁷⁹

The domestic political economy context and international dynamics, however, were not conducive to put these reformist ideas into implementation in a coordinated and determined way assembled around political will and ownership. In this sense, Turkey’s final economic jolt posed a true critical juncture and levelled the playing field as it exhausted dominant mode of relations and rendered existing institutional arrangements highly fluid. It became apparent that Turkey was in need of deep paradigmatic changes in state-market relations. Thus the sense of complacency, which used to be defining characteristics of the political modus operandi during 1990s, was replaced by a sense of urgency.⁸⁸⁰ Accordingly, broad-based consensus emerged among different segments of society, which seized rare context-specific opportunities for reform oriented change agents to step smartly through it. As Faik Öztürk stated to the author;

⁸⁷⁸ Interview with Faik Öztürk, Undersecretary of Treasury, September 10, 2014; also interview with Süreyya Serdengeçti, Governor of the Central Bank of the Republic of Turkey, September 16, 2014.

⁸⁷⁹ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

⁸⁸⁰ Interview with Doğan Cansızlar, Chairman of Capital Markets Board of Turkey, September 11, 2014.

“[In 2001] Turkey experienced the deepest crisis in recent economic history. The crisis created a wave of anxiety and concern among people [different segments of society]. We were also under high pressure from international markets. The overwhelming majority of the population [and interest groups] accepted that structural reforms must be implemented quickly in order to restore economic growth, create new jobs, and mitigate the destructive effects of crisis. It is in this context that we took courageous reformist steps in financial and fiscal areas.”⁸⁸¹

The crisis was a profound exogenous shock for the coalition government in every sense. A wave of panic spread through the coalition partners following the collapse of the banking system and the bankruptcy of state’s fiscal accounts. The coalition partners reckoned that stakes were very high because their credibility drastically eroded in the eyes of domestic constituency and international investors.⁸⁸² Thus the depth of the crisis altered the perceptions of political elite as they cognized that they had to bite the bullet and streamline themselves since “there was no alternative but to reform” the public finances and financial system.⁸⁸³ In the words of Derviş, “the coalition leaders were on the same page regarding the urgency and necessity of comprehensive structural reforms.”⁸⁸⁴ It became apparent that “economic catastrophe showed all but the most incorrigibly obtuse that to try and carry on with ‘business as usual’ would be tantamount to embracing national self-destruction.”⁸⁸⁵ It is in this context that Derviş was invited to

⁸⁸¹ Interview with Faik Öztürk, Undersecretary of Treasury, September 10, 2014.

⁸⁸² The credibility of the entire political system collapsed in the wake of the crisis. The majority of the public was in the opinion that political parties were corrupt and inept. In our interview, Şevket Bülend Yahniçi, the deputy leader of the MHP, also admitted that the economy was “taken hostage by widespread corruption” at the time.

⁸⁸³ Interview with Hasan Ersel, Chief Economist and Senior Executive Vice President of Yapı Kredi Bank, September 28, 2014.

⁸⁸⁴ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

⁸⁸⁵ Soli Özel, “After the Tsunami,” *Journal of Democracy* 14, no. 2 (2003): 90. Also see, İlder Turan, “Short-Term Pains for Long-Term Pleasures,” *Private View* 11 (2002): 16.

the country as a joint decision of the coalition partners.⁸⁸⁶ Thanks to the fragile equilibrium in crisis juncture and because he was considered as the only ‘exit strategy,’ the coalition government, in the initial phases, placed unequivocal support behind Derviş. The leader of ANAP and the deputy prime minister at the time, Mesut Yılmaz, stated this point in a lucid manner:

“The political context at the time was not conducive to implement such [reform] program because we were three-partite coalition and would eventually go to elections. All coalition partners had electoral concerns. The implementation of this [ambitious] program was only possible if we made real sacrifices, overcame our immediate interests and put them aside for the future of the country. In order to achieve this, we needed a non-political figure with no political expectations to lead the program. The candidate was also expected to have required experience and expertise to implement the program in a determined and non-compromising way.”⁸⁸⁷

The coalition leaders’ strong political will opened a large manoeuvre space for Derviş to couple problems, policies (i.e., solutions) and politics. Thanks to the autonomy and strong mandate provided by the government, Derviş could circumvent tricky political calculations and succeeded to appoint his own economic team, which was desperately absent in Greece’s Papademos (see chapters 4 and 7). Despite the modus operandi of the coalition government was relying on the principle of ‘share-and-respect,’ a tacit agreement according to which state ministries and key bureaucratic posts were

⁸⁸⁶ During my interviews, I was told two different stories about the invitation process. First, some high level technocrats and political elites argued that Stanley Fischer of the IMF advised Prime Minister Ecevit to appoint Kemal Derviş. Second, I was also told that Ecevit did not receive any “advice” from external actors. He decided to call Derviş himself based on their previous connections. Derviş, himself, argued that the second explanation was the true one.

⁸⁸⁷ Interview with Mesut Yılmaz quoted in Mehmet Ali Birand, *Son Darbe 28 Şubat* (İstanbul: Doğan Kitap, 2012), 336-337.

distributed among coalition partners proportionately and then left the entire discretion to the party in question without any major external intervention, Derviş, to a significant extent, transcended collective action and coordination problems at the bureaucratic and political fields.⁸⁸⁸

6.3.3.2. Dominant policy coalitions

Second, dominant policy coalitions played crucial role that informed Turkey's reform performance in the post-crisis period. In chapter 5, I demonstrated that the major policy coalitions approximated reform-biased rent-seeking networks, which contributed to the procrastination of reform processes and the subsequent fiscal crisis of the state. Thus the challenge for reformist agents at the domestic level was to steer new pro-reform coalitions to ensure domestic ownership of the crisis and the reform packages. I will argue in the following section that domestic institutional structures also played an enabling role in the post-crisis context.

Before flying to Turkey, Derviş talked to Guillerma Ortiz, the then finance minister who played a major role in the 1994 Mexican crisis hoping to receive some useful advice. Ortiz advised Derviş to “spend half of his day to inform the public and try to obtain the active support of different interest groups.”⁸⁸⁹ In retrospect, it seems that Derviş followed this crucial advice. In the Letter of Intent submitted to the IMF on May 3,

⁸⁸⁸ Interview with Şevket Bülend Yahnici, Deputy Leader of MHP, September 4, 2014; Interview with Masum Türker, Member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002), September 10, 2014.

⁸⁸⁹ Interview with Kemal Derviş quoted in Işın Çelebi, *Türkiye'nin Dönüşüm Yılları: Yeniden Öğrenme Zamanı* (İstanbul: Alfa, 2012), 372.

2001, Turkish policy-makers promised to develop a strategy “aimed at explaining major policies and actions to market participants through regular press conferences, newsletters, seminars, and other events.”⁸⁹⁰ Derviş stated to the author that he placed central emphasis to proper dialogue with social partners:

“I placed an utmost emphasis on communication [with social partners] and did my best to explain the driving logic and necessity of our reform program. I regularly informed labour unions, business associations, media, and scholars.”⁸⁹¹

The regular communication with domestic policy coalitions yielded concrete results to overcome collective action problems toward creating new pro-reform coalitions. On the business side, TÜSİAD threw unequivocal support behind the IMF-sponsored reform program.⁸⁹² In fact, TÜSİAD’s policy stance needs to be interpreted within the context of changing power equilibrium in the Turkish finance capital. Turkish business passed through intra-capital bifurcation during the second half of the 1990s.⁸⁹³ I stated in chapter 5 that dominant business coalitions in Turkey mainly relied on a rentier-oriented capital accumulation model, flourished under the auspices of arbitrary state protection. As Keyman and Koyuncu point out, however, “strong state tradition [and accompanying state-centred Turkish modernization]... faced a serious legitimacy problem in

⁸⁹⁰ Letter of Intent of the Government of Turkey, May 3, 2001, 4.

⁸⁹¹ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

⁸⁹² Interview with Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD, September 13, 2014; interview with Yusuf Işık, Chief Advisor to Kemal Derviş, September 26, 2014.

⁸⁹³ Derya Gültekin-Karakaş, *Hem Hasımız Hem Hısımız: Türkiye’de Finans Kapitalin Dönüşümü ve Banka Reformu* (İstanbul: İletişim Yayınları, 2009); also see, Derya Gültekin-Karakaş, “Sermayenin Uluslararasılaşması Sürecinde Türkiye Banka Reformu ve Finans Kapital-içi Yeniden Yapılanma,” *Praksis*, no. 19 (2009): 95-131.

maintaining its position as the primary context for politics.”⁸⁹⁴ The exhaustion of prevalent model in state-market relations fully reverberated following the devastating economic havoc in 2001. Accordingly, as a testament to the collapse of reactive policy networks, overwhelming majority of state-dependent firms declared bankruptcy.⁸⁹⁵ The natural elimination of otherwise well-entrenched distributional coalitions strengthened the hands of more integrationist and growth-oriented segments of capital holders, which embraced an increasingly critical rhetoric toward state’s arbitrary and ambiguous interventions in the functioning of the markets.⁸⁹⁶ Represented by TÜSİAD at the institutional level, these firms backed regulatory state paradigm in the aftermath of the crisis. As a matter of fact, TÜSİAD raised its voice in favour of the restructuration of state-market relations from mid-1990s onwards, asking for more transparent and rule-based interactions in state-business relations. In a report published in 1995, which was entitled “Optimal State: Towards a New State Model in the 21st Century,” TÜSİAD avowedly asked for “the reorganization and restructuration of the state” in line with the principles of “limited,” “responsible,” and “rule-based regulatory state.”⁸⁹⁷ Along the same logic, immediately after the deep exogenous shock in 2001, TÜSİAD president Tuncay Özilhan claimed that the crisis opened up an opportunity space to address

⁸⁹⁴ E. Fuat Keyman and Berrin Koyuncu, “Globalization, Alternative Modernities, and the Political Economy of Turkey,” *Review of International Political Economy* 12, no. 1 (2005): 109.

⁸⁹⁵ Gültekin-Karakaş, *Hem Hasımız Hem Hısımız*, 211.

⁸⁹⁶ For instance see, Sabah Gazetesi, “Derviş Son Ümidimiz,” March 21, 2001. For an illustrative example of this approach, also see TÜSİAD, “Bağımsız Düzenleyici Kurumlar ve Türkiye Örneği,” Yayın No. TÜSİAD-T/2002-12/349 (2002).

⁸⁹⁷ TÜSİAD, “Optimal Devlet: 21. Yüzyılda Yeni Bir Devlet Modeline Doğru,” Yayın no. TÜSİAD-T/95, 2 174 (1995).

Turkey's long-awaited structural economic problems.⁸⁹⁸ According to TÜSİAD, "state [...] with its inefficient bureaucracy and profligate fiscal policies, constituted Turkey's most important structural economic problem."⁸⁹⁹ Thus, the crisis narrative framed at the agency-level perfectly resonated with TÜSİAD's interests and outlook in the post-crisis context. Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD, put this point very clearly in our interview:

"The content of the reform program was significantly overlapping with the arguments and proposals that TÜSİAD advocated for years. Thus TÜSİAD strongly supported the program."⁹⁰⁰

The leading members of TÜSİAD also welcomed the IMF-induced reform package promoted by Derviş. After the announcement of the reform package, Rahmi Koç, the CEO of the Koç Holding, Turkey's largest conglomerate, for instance, expressed his support, noting the "program as Turkey's last chance."⁹⁰¹ TOBB's approach toward the reform program needs to be analysed in two distinct phases. The first phase, which lasted until June 2001 under the chairmanship of Fuat Miras, refers to a period of 'cautious support.' TOBB, in this period, did not categorically reject the reform program. However, Miras criticized Derviş and his economic team on several occasions since, according to Miras, they declined to consult to TOBB representatives regarding the policy mix of the reform program.

⁸⁹⁸ TÜSİAD, "TÜSİAD Yönetim Kurulu Başkanı Tuncay Özilhan'ın 5. SİAD Zirvesi Konuşması," May 9, 2001, http://www.tusiad.org/_rsc/shared/file/2001-05-09-TOzilhanin5SIADZirvesiKonusmasi.pdf (arrived on September 25, 2014), 4-5.

⁸⁹⁹ Ibid., 5.

⁹⁰⁰ Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD, September 24, 2014.

⁹⁰¹ Milliyet Gazetesi, "Koç: Program Son Şansımız," May 18, 2001; Sabah Gazetesi, "Derviş Son Ümidimiz," March 21, 2001.

“Our opposition is not directed at Derviş or the reform program itself. We are against the methods he pursues. Derviş prefers to work with a narrow team... He did not contact us [to explain the program], except one meeting.”⁹⁰²

Miras adopted a sterner tone in his speech delivered at TOBB’s 56th general council meeting on May 26, 2001. He argued that the “reform program concentrated only on the fiscal and financial discipline” and “did not take any concrete measure to recover the industrial sector.”⁹⁰³ It appears that TOBB, in the first phase, hesitated to give much credit to Derviş and the reform program. This reluctant stance, however, started to change gradually after June 2001 with the election of Rifat Hisarcıklioğlu as the new chairman. Hisarcıklioğlu claimed that the responsibility of the crisis lays on the shoulders of all segments of the society, in particular the political elite and businessmen. He also interpreted the crisis as “a golden opportunity” to restructure the Turkish economy.⁹⁰⁴ In this second phase, therefore, TOBB also became part of the emergent pro-reform coalitions:

“In all my speeches I delivered across Anatolia, I tried to gain the support of the industrialists. I strove to explain the state we are in in all details. In fact, I received extraordinary support from Rifat Hisarcıklioğlu and his colleagues. Hisarcıklioğlu succeeded to transform the TOBB from a short-sighted rent seeking institution to a long-sighted growth-oriented one.”⁹⁰⁵

⁹⁰² Sabah Gazetesi, “Derviş’in Yöntemine Karşıyız,” May 24, 2001. Also see, Hürriyet Gazetesi, “Miras: Kalp Krizi Geçirmek Üzereyiz,” May 26, 2001.

⁹⁰³ Fuat Miras, “56. Genel Kurul Konuşması, 26 Mayıs 2001” in Nart Bozkurt, *Başkanların Genel Kurul Konuşmaları*, Volume 2 (Ankara: TOBB Yayınları, 2011), 626-627, 629.

⁹⁰⁴ Rifat Hisarcıklioğlu, “57. Genel Kurul Konuşması, 2 Mayıs 2002” in Nart Bozkurt, *Başkanların Genel Kurul Konuşmaları*, Volume 3 (Ankara: TOBB Yayınları, 2011), 645-646.

⁹⁰⁵ Derviş, Asker, and Işık, *Krizden Çıkış ve Çağdaş Sosyal Demokrasi*, 119.

TOBB occupied a crucial position in the post-crisis context because, as I discussed in chapter 5, it represents all small and medium-sized enterprises in Turkey, which composes more than 65 percent of total employment.⁹⁰⁶ TOBB's role became more important in a context that another important representative of Anatolian capital, MÜSİAD, categorically rejected the program.⁹⁰⁷ According to MÜSİAD representatives, the program was biased toward big business and international financial capital, thus offering no concrete benefits to the productive classes. MÜSİAD representatives also targeted Derviş since, according to them, Derviş refrained from informing them at the formulation and implementation stages of the program.⁹⁰⁸ TOBB's institutional support increased the legitimacy of the reform measures in the eyes of its members, which in turn, decreased the risks of untoward social incidents. Derviş acknowledged TOBB's contributions to the author as follows:

“TOBB especially played a very constructive role. We organized meetings at the local level with TOBB members in Denizli, Gaziantep, Bursa, Çorum etc. [We explained to them that] a stronger economy [following the reforms] would boost their export performance. Their support proved very beneficial for us.”⁹⁰⁹

⁹⁰⁶ Hasan Ersel, “Politico-Economic Development in Turkey (1950-2010), unpublished manuscript, 22.

⁹⁰⁷ Interview with Ömer Bolat, President of MÜSİAD, September 16, 2014. Also see, MÜSİAD, *Türkiye Ekonomisi 2001* (İstanbul: Seçil Ofset, 2001): ix-xx.

⁹⁰⁸ Interview with Ömer Bolat, President of MÜSİAD, September 16, 2014. In our interview I was also told that MÜSİAD was isolated from mainstream policy-making platforms due to the lingering impact of the “28 February process,” known as a post-modern coup in Turkish politics (see chapter 5). Due to its close relations with the Islamist Welfare Party, MÜSİAD was stigmatized and isolated in the aftermath. It is astonishing to note however that MÜSİAD fundamentally changed its position vis-à-vis the reform program with the rise of the AKP, which further contributed to the consolidation of a broad-based reformist coalition in the third-stage of my framework (see below). For an in-depth study on the transformation of MÜSİAD see Dilek Yankaya, *Yeni İslami Burjuvazi: Türk Modeli* (İstanbul: İletişim Yayınları, 2014).

⁹⁰⁹ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

The major institutional structures that ensure social control in crisis juncture were labour organizations. On the labour side, trade unions, in a stark contrast to the Greek case, did not categorically reject the reform program. Therefore, the labour class did not poured into the streets, though occasional and spasmodic protests took place.⁹¹⁰ It is also important to note at this point that trade unions' reactions were much weaker than their resistance to the stabilization measures put into implementation following the 1994 economic crisis. As Şenses points out “while there had been a very sharp increase in the number of strikes, the number of workers taking part in strikes, and the number of working days lost through strikes in 1995, there has been a marked decline in all three of these indicators during 2001 and the first nine months of 2002.”⁹¹¹ In fact, I revealed in my interviews that the two major trade unions developed a relatively consensus-prone approach in terms of the ownership of the reform program. As anticipated, trade unions claimed no responsibility in the emergence of the crisis. Bayram Meral, the then president of TÜRK-İŞ, Turkey's peak labour association, stated that the crisis was the outcome of “corrupt banking system,” “greedy political behaviour,” and “misguided IMF policies imposed on Turkey.”⁹¹² Similarly, the then president of DİSK, Rıdvan Budak argued that the main responsibility lies on the shoulders of the financial elite and owners of capital that performed irresponsibly to maximize their short-term interests at the expense of society, which was encouraged by uncontrolled neoliberal economic

⁹¹⁰ Interview with Bayram Meral, President of TÜRK-İŞ, September 10, 2014; interview with Rıdvan Budak, President of DİSK, September 9, 2014.

⁹¹¹ Şenses, “Economic Crisis as an Instigator of Distributional Conflict,” *Turkish Studies*, 111-112.

⁹¹² Interview with Bayram Meral, President of TÜRK-İŞ, September 10, 2014.

model imposed on Turkish economy.⁹¹³ That being said, trade unions seemed to be convinced that reform program was the only way to get out of the economic havoc in 2001.

“The crisis was a financial crisis, which emanated from the lax legal regulations, loopholes in the regulatory mechanisms, and political [short-sidedness]. Yet, the crisis pushed the entire country into difficulty. Thus we decided to do whatever it takes in order to overcome it.”⁹¹⁴

DİSK, for obvious reasons, was not a fan of the IMF policies. Historical record also suggests that DİSK representatives denounced the previous stand-by agreements. The debt of the 2001 crisis, however, forced DİSK to adopt a tolerant approach to the economic reform program as they deemed it the only way to restore economic recovery and avoid further job losses.

“DİSK was aware that public finances bankrupted. Thus DİSK adopted a consensus-seeking and solution-based approach [to restore quick economic recovery]. We, of course, put primary emphasis on the wages and rights of the labour class.”⁹¹⁵

TÜRK-İŞ, Turkey’s largest trade union and the major representative of civil servants adopted a more critical stance in the first instance.⁹¹⁶ As I stated previously, the cuts in public expenditures and privatization of the SEEs constituted one of the cornerstones of the IMF-led reform program. Similar to all other stand-by agreements, the IMF officials requested sharp decline in public sector wages (see above). Therefore, TÜRK-İŞ

⁹¹³ Interview with Rıdvan Budak, President of DİSK, September 9, 2014.

⁹¹⁴ Interview with Rıdvan Budak, President of DİSK, September 9, 2014.

⁹¹⁵ Interview with Rıdvan Budak, President of DİSK, September 9, 2014.

⁹¹⁶ Interview with Bayram Meral, President of TÜRK-İŞ, September 10, 2014.

strongly resisted the demands of the IMF on the wage issue. The resistance of TÜRK-İŞ, and to a certain degree DİSK, forced Derviş to renegotiate the policy mix of the program in regard to public sector wages. Following the softening stance of the IMF, a wage deal was cut off with labour unions, as a result of which they also softened their resistance.

Derviş stated the enabling role that trade unions played as follows:

“[Business associations, trade unions, and society in general] owned the reform program to a surprising degree for me. Trade unions showed us significant support. They rightly claimed that they were not responsible for the crisis. Yet, they did not reject reform measures in order to avoid further job losses. The wage deal we concluded with TÜRK-İŞ was a very successful example of a consensus-based adjustment.”⁹¹⁷

The regulation of the financial sector and tough measures taken against ailing banks increased the credibility of the reform program in the eyes of the labour unions because they perceived these measures as ‘sincere’ steps in the right direction to overcome Turkey’s deep-rooted fiscal and financial profligacy.

“Derviş promised [and succeeded] to create a rule-based financial system in Turkey. The lax and arbitrary credit policies of the banks were brought under strict regulation thanks to independent regulatory agencies. All these measures [that we also supported] disciplined Turkish economy.”⁹¹⁸

The credibility effect of the policy entrepreneurs was discernible in government’s relations with labour unions in the post-crisis process. In my interviews, the union representatives acknowledged that Derviş approached them with convincing and

⁹¹⁷ Interview with Kemal Derviş, Minister of State for Economic Affairs, September 11, 2014.

⁹¹⁸ Interview with Rıdvan Budak, President of DİSK, September 9, 2014. Also, interview with Bayram Meral, President of TÜRK-İŞ, September 10, 2014.

coherent arguments, and consensus-seeking behaviour, which in turn, reinforced reciprocal trust. The almost perfect match with his and external anchors' crisis narratives and the strong international support Derviş received also underpinned his reputation at the domestic level. On the other side of the coin, I also argued in chapter 2 that domestic institutional structures should play enabling roles to provide adequate space for reformist state agents to communicate their reformist rhetoric. In this sense, in the Turkish context, social partners facilitated the emergence of a consensus-based environment to initiate major policy changes.⁹¹⁹ Öztırak admitted the positive feedback of social partners that informed the ultimate success of the reform program:

“I must admit frankly that both business associations and labour unions owned the reform program and placed their support behind it. This support was crucial. In addition to their occasional contributions to the content of the program, they also complied with the reform targets.”⁹²⁰

What changed the preference functions of major policy coalitions in Turkey and how are they convinced to bear the immediate costs of massive economic adjustment? It appears that the depth of the economic crisis, the almost perfect narrative match at the agency-level, and the policy entrepreneurship effects mutually interacted so that a new fisco-financial equilibrium was deemed inescapable. In addition to the factors highlighted above, one should also underline that Turkey took advantage of the double external anchor in the post-crisis context, which unprecedentedly cemented the domestic ownership of reform program. The IMF was in fact not strong enough to play a permanent anchor role for Turkey. The previous IMF programs were failed not only

⁹¹⁹ For instance, see Fikret Bila, “İşçiden Fedakarlık,” *Milliyet Gazetesi*, April 19, 2001.

⁹²⁰ Interview with Faik Öztırak, Undersecretary of Treasury, September 10, 2014.

because of the weak domestic ownership and crucial design failures but also because the IMF proved to be a relatively weak external anchor to ensure state's fiscal and financial prudence. In this sense, the EU further strengthened the hands of pro-reform coalitions and helped overcoming collective action problems toward implementation of the deep-seated reforms in the wake of economic crisis.⁹²¹ In other words, the idea of EU-membership had profound effects on the consolidation of dominant crisis narrative framed at the agency-level.

The EU declared Turkey a candidate country in December 1999 Helsinki summit. The decision invited a series of political and economic reverberations because, for the first time in Turkey's long-lasting "awkward" relationship with the EU,⁹²² "the ball was placed in Turkey's court, meaning that the door to Europe is open to Turkey if it can meet the criteria for membership... including economic transparency and competitiveness."⁹²³ Turkey was asked to instigate a set of comprehensive political and economic reforms so as to obtain a date to start negotiations with the EU. The incentive structures offered by the EU reinforced a virtuous cycle of reform activism unmatched in Turkey's recent history. The coalition partners, particularly DSP and ANAP, and the recently established future ruling party, the Justice and Development Party (AKP),

⁹²¹ Öniş and Bakır, "Turkey's Political Economy in the Age of Financial Globalization," *South European Society and Politics*, 155.

⁹²² For the idiosyncratic history of Turkey-EU relations, see Hakan Arıkan, *Turkey and the EU: An Awkward Candidate for EU Membership?* (Aldershot: Ashgate, 2003); Meltem Müftüler-Bac, "The Never-Ending Story: Turkey and the European Union," *Middle Eastern Studies* 34, no. 4 (1998): 240-258.

⁹²³ Paul Kubicek, "The Earthquake, the European Union, and Political Reform in Turkey," *Mediterranean Politics* 7, no. 1 (2002): 2.

adopted a “euro-enthusiastic” stance.⁹²⁴ In addition, the most active economic interest groups, such as TÜSİAD, TOBB, TÜRK-İŞ, and DİSK exhibited strong interest in Turkey’s EU vocation.⁹²⁵ TOBB defined the EU membership goal as “a social [and economic] transformation project.”⁹²⁶ TÜSİAD, which had backed the 1980 military coup, started to raise its voice in favour of the EU membership since being part of the Union would boost “Turkey’s economic welfare, foreign direct investment, and growth performance,” noting particularly that the creation of a regulatory state was sine qua non of the EU accession process.⁹²⁷ In the words of TÜSİAD president:

“By achieving structural reforms in the way we govern our state [and economy], and to integrate with the EU, we have to prove the entire world that we are determined not to be ‘a country of crises’ anymore.”⁹²⁸

The popular support was also fairly high, as some 75 percent of the public had had a positive perception on Turkey’s EU bid.⁹²⁹ In this context, as membership seemed a real possibility, the EU-leverage appeared as a strong asset to legitimize the reform

⁹²⁴ Filiz Başkan and Selin Bengi Gümrükçü, “Positions of Turkish Political Parties on European Integration,” *Southeast European and Black Sea Studies* 12, no. 1 (2012): 31-33.

⁹²⁵ A cautionary note is in order here: Although it also backed Turkey’s membership to the EU, TÜRK-İŞ adopted a more nationalistic and less enthusiastic outlook. In a report published in 2001 and submitted to the President of Turkey, it is stated “TÜRK-İŞ supports Turkey’s EU bid, yet it has serious doubts about the goodwill [and sincerity] of the EU toward Turkey.” See, TÜRK-İŞ, *Avrupa Birliği Türkiye’den Ne İstiyor?* (Ankara: TÜRK-İŞ Yayınları, 2001), 7.

⁹²⁶ Rifat Hisarcıklıoğlu, “57. Genel Kurul Konuşması, 2 Mayıs 2002,” 655.

⁹²⁷ TÜSİAD, “Türkiye’nin AB Üyeliği: Doğrudan Yatırımlar ve Ekonomik Büyüme,” *TÜSİAD Görüşler Dizisi*, no. 8 (2002).

⁹²⁸ TÜSİAD, “TÜSİAD Yönetim Kurulu Başkanı Tuncay Özilhan’ın 5. SİAD Zirvesi Konuşması,” 2; also see TÜSİAD, “Türkiye’nin Geleceği Avrupa Birliği’ndedir,” *TÜSİAD Basın Bülteni*, TS/BAS/02-41, May 29, 2002.

⁹²⁹ Quoted in Kubicek, “The Earthquake, the European Union, and Political Reform in Turkey,” *Mediterranean Politics*, 11.

packages. It is in this appropriate context that fiscal and financial reforms were linked to the membership process as “necessary steps to converge with the EU and EMU.”⁹³⁰

“Derviş narrated the reform agenda as the [only] way for Turkish economy to converge with the EU members in the fields of financial [and fiscal] regulations. It was possible to promulgate these reform bills only in such a context [i.e., in the heydays of EU membership process].”⁹³¹

The EU-factor reinforced many aspects of Turkey’s post-crisis reform agenda because the prerequisites for EU membership overlapped with the IMF-sponsored reform program. A close examination of the EU progress reports reveals that state’s fiscal discipline, independence of the Central Bank for an effective control of inflation,⁹³² the enforcement of a set of laws and institutions in charge of effective financial regulation, and massive privatizations,⁹³³ inter alia, were recommended for Turkey to convergence with the EU standards. Thus the EU endorsed the IMF-sponsored reform program, mentioning that the proper implementation of the measures would help Turkey comply with the accession criteria:

“[Following the economic crisis] a substantial number of laws, implementing aspects of the new economic plan, were adopted swiftly in the second quarter of 2001. *These reforms are intended to overcome the crisis, and to help meet the economic criteria for EU membership.*”⁹³⁴

⁹³⁰ Undersecretariat of Treasury, *Strengthening the Turkish Economy: Turkey’s Transition Program*, 34.

⁹³¹ Interview with Rıdvan Budak, President of DİSK, September 9, 2014.

⁹³² European Commission, *1999 Regular Report on Turkey’s Progress Toward Accession* (Brussels: European Commission, October 1999): 26, 39.

⁹³³ European Commission, *2000 Regular Report on Turkey’s Progress Toward Accession* (Brussels: European Commission, November, 2000): 31, 47.

⁹³⁴ European Commission, *2001 Regular Report on Turkey’s Progress Toward Accession*, SEC(2001) 1756 (Brussels: European Commission, November 2001): 14, emphasis added.

It is therefore fair to argue that the EU-anchor sturdily altered the interest functions and outlook of dominant policy coalitions and provided considerable leeway in the circulation of reform-oriented ideas at the domestic political economy landscape. Derviş skilfully exploited the EU-factor as a complementary anchor in order to broaden the scope of pro-reform coalitions and enfeeble the resistance points. In this sense, it is not coincidental that *Turkey's Transition Program* made explicit references to the Maastricht criteria and EU membership:

“Through structural reforms, Turkey will permanently reduce inflation to single digits, maintain public deficit at sustainable levels and satisfy other criteria for membership in the EU and EMU.”⁹³⁵

The double IMF-EU anchor synergistically tilted the balance in disfavour of anti-reformist domestic coalitions so that the Turkish parliament swiftly adopted the laws and regulations envisaged in *Turkey's Transition Program* and *Banking Sector Restructuring Program* in the summer of 2001. That being said, certain difficulties were also encountered due to the fragility and knife-edge equilibrium of the coalition government. The two most controversial reforms were related to the tobacco law and the restructuration of Türk Telekom, Turkey's telecommunications giant. The minister of state in charge of privatization implementations, Yüksel Yalova, expressed his objection to the tobacco law mainly because of electoral concerns. He therefore refused sending the draft law to the parliament. The postponement laid the groundwork for a clash between Yalova and Derviş, since the latter thought that this step might put the entire

⁹³⁵ Undersecretariat of Treasury, *Strengthening the Turkish Economy: Turkey's Transition Program*, 34.

credibility of the reform program into jeopardy. As a result of the intense pressures of Derviş, Deputy Prime Minister, Mesut Yılmaz, asked Yalova to leave his post.⁹³⁶ The tobacco law was then passed by the parliament just few days after the resignation of the minister. The second incident, the Türk Telekom case, was even more critical. Derviş had a public argument with the minister of transportation, Enis Öksüz, backed by the MHP leader Devlet Bahçeli, over the appointments to the governing board of Türk Telekom.⁹³⁷ Derviş claimed that the candidates proposed by the transportation minister did not comply with the criteria highlighted in the Letter of Intent, thus he opposed their appointments.⁹³⁸ The eventual political stalemate paved the way for a tacit crisis in the coalition government, which in turn, led to the postponement of the second tranche of the IMF credit support because of IMF's insistence "to verify that the newly appointed board of Türk Telekom meets the requirements set out in the [May 3 memorandum]."⁹³⁹ The IMF's adamant stance and Derviş's pressures forced the MHP leader to ask for the resignation of the minister of transportation on July 17, 2001.⁹⁴⁰ Just ten days after the debate, Stanley Fischer paid a visit to Turkey to discuss the state of the program and to underscore IMF's strong support to Turkey's on-going reform agenda. Fischer and Derviş, in their joint press statement, declared that they are in full agreement regarding the design of the package and the progress so far achieved.⁹⁴¹ On the other side of the

⁹³⁶ Milliyet Gazetesi, "Bedelini Ödettiler," June 1, 2001.

⁹³⁷ MHP leader vociferously criticized Kemal Derviş by stating, "it is by no means acceptable that Derviş threatens the government in every bottleneck with his resignation and cut-off of the IMF support."

Milliyet Gazetesi, "MHP: İstifa Etse Hiçbir Şey Olmaz," June 29, 2001.

⁹³⁸ Milliyet Gazetesi, "'Derviş: Partiye Bağlı İnsanlar Atayacaksak Bu İş Yürümez,'" June 28, 2001.

⁹³⁹ IMF, "IMF Postpones Board Meeting on Turkey," *News Brief no. 01/51*, July 2, 2001.

⁹⁴⁰ Milliyet Gazetesi, "IMF'ye En Somut Güvence," July 18, 2001.

⁹⁴¹ IMF, "Statement on Turkey by IMF First Deputy Managing Director Stanley Fischer," *News Brief no. 01/66*, July 28, 2001; also see Milliyet Gazetesi, "Fischer: Bu Program Desteğe Layık," July 28, 2001.

coin, domestic policy coalitions also reiterated their support to the reform package. TÜSİAD, for instance, warned the government “not to plant the seeds of a third crisis”⁹⁴² and criticized the MHP leadership by urging to refrain from “hazy statements and irresponsible behaviours” in order not to undermine the credibility of the program.

“...The coalition partners, who worked in close coordination and consensus to implement the reform program until now, must not veer to political rent seeking in the present crisis context. Such behaviour would do the utmost harm to our country.”⁹⁴³

Sakıp Sabancı, the CEO of Turkey’s second largest conglomerate, for instance, cautioned the political parties in order not to “decrease the performance of Derviş” with vicious political tug-of-wars.⁹⁴⁴ In a similar vein, TOBB chairman Rifat Hisarcıkıoğlu also expressed small and medium-sized entrepreneurs’ support to Derviş in his stroke.⁹⁴⁵ In retrospect, it is fair to argue that Türk Telekom case constituted a critical test for reformist state agents to mobilize supportive domestic coalitions to advance policy change. As a result, the resignations led to the elimination of the potential veto points within the government, which in turn, further buttressed the dominant narrative. It also demonstrated that Derviş, as a policy entrepreneur, succeeded to penetrate into domestic institutional structures to tilt the balance in favour of the IMF-sponsored reform package.

⁹⁴² Milliyet Gazetesi, “Üçüncü Krizin Temelini Atıyorlar,” July 1, 2001.

⁹⁴³ Milliyet Gazetesi, “Pürüz Bir Haftada Aşılır,” July 5, 2001. Also see, TÜSİAD, “TÜSİAD Yönetim Kurulu Başkanı Tuncay Özilhan’ın Türkiye SİAD Platformu Kayseri Başkanlar Kurulu Konuşması,” June 14, 2001, http://www.tusiad.org/_rsc/shared/file/2002-06-14-TOzilhaninSIADPlatformuKayseriKonusmasi.pdf (arrived at September 28, 2014).

⁹⁴⁴ Milliyet Gazetesi, “Sabancı: ‘Derviş’in Performansını İndirsek Fatura Halka Çıkar,” June 28, 2001.

⁹⁴⁵ Milliyet Gazetesi, “Derviş: Gelecek Kredinin 200 Milyon Doları Eximbank’a Aktarılacak,” June 29, 2001.

Despite the most intense phase of the crisis was left behind as of late-2001, the reform agenda remained on knife-edge equilibrium since the consensus among pro-reform coalitions was still paper-thin. Furthermore, the political context took a turn for the worse starting from the second quarter of 2002 as the coalition government entered into deep turbulence. First, the Prime Minister Bülent Ecevit experienced serious health problems that impeded the proper functioning of the government. The imminent political instability and economic uncertainty adversely informed the expectations of the market actors. In such a parlous state of political environment, the coordination failures regarding the economic affairs amplified to such an extent that Derviş had to send a letter to the coalition leaders on April 4, 2002, seriously warning about a train wreck in the economy.⁹⁴⁶ Second, Derviş appeared as a potential leader in Turkish politics, which in turn, stroke a sensitive nerve among coalition partners.⁹⁴⁷ On May 10, Derviş overtly complained about the political instability and fingered out the early elections as an exit strategy.⁹⁴⁸ His decision to abandon his nonpartisan position laid the groundwork for an unexpected challenge from within DSP ranks to Ecevit's leadership. Half of the parliamentarians, headed by Ecevit's close aid Hüsametdin Özkan, resigned from DSP to found a new political party. Upon the insistence of the MHP leader, the coalition government called for early elections scheduled for November 3, 2002. Not surprisingly, as a result, the limping macroeconomic balances turned upside down again, whilst the IMF decided to postpone the next trench of financial support.

⁹⁴⁶ Derviş, Asker and Işık, *Krizden Çıkış ve Çağdaş Sosyal Demokrasi*, 156-159.

⁹⁴⁷ Interview with Şevket Bülend Yahniçi, Deputy Leader of MHP, September 4, 2014; Interview with Masum Türker, Member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002), September 10, 2014.

⁹⁴⁸ Milliyet Gazetesi, "Derviş Kızdırdı," May 11, 2002.

6.4. Third phase: The consolidation of Turkish regulatory state

The third phase refers to the consolidation of the reform program through the fortification of the pro-reform coalitions. The Greek case verifies that enactment of reform packages is one thing, implementing them is entirely another. Stated somewhat differently, change in legal codes need not mean a real change in substance. What translates the former into the latter is the consolidation of pro-reform coalitions inspired by a strong political will. Thus the difference is only discernible through a thorough analysis of the third phase of the three-stage framework offered in chapter 2, which concentrates on whether a new equilibrium could be established in line with a dominant narrative and supportive domestic coalitions. From this point of view, Turkey entered into a stable consolidation phase only after the elections held on November 3, 2002.

On October 3, 2002, in the first national elections following the economic crisis, Turkish voters swept aside established parties. The election results were historic for a number of reasons. First, the whole cohort of political establishment was severely punished by the public. All three members of the coalition government (DSP, MHP, and ANAP) failed to pass the election threshold. Astonishingly, their combined vote share decreased from 53.4 per cent in 1999 to 14.6 per cent in 2002 elections. The opposition parties also fared very poorly as none of them succeeded to pass the election threshold. The election results reflected “electorate’s anxious search for new options” as they got disenchanted

with the corruption-tainted parties and clientelism-prone old spoils system.⁹⁴⁹ Second, the Justice and Development Party (AKP), a successor of previously banned Islamist parties, gained a triumphant victory that generated “earthquake-like political impacts,” to use Keyman’s terminology.⁹⁵⁰ The AKP wound up two-thirds of the parliament (363 of the 541 elected seats), which put a decisive end to the long-lasting interlude of shaky coalition governments. Third, the election results posed a new critical juncture on the fortune of the fiscal and financial reforms enacted in the aftermath of the economic crisis. As a matter of fact, in its pre-election party program, the AKP framed an avowedly pro-EU and pro-market rhetoric, clearly stated in AKP’s election manifesto: “To achieve economic development and democratic consolidation, the EU membership constitutes our primary target. We will support the economic and democratic standards, legal, and institutional regulations advocated by the EU.”⁹⁵¹ Yet, the “party’s questionable provenance” was still a source of anxiety for many, both at home and abroad, as there were grave doubts about the sincerity of AKP’s conversion.⁹⁵² A sharp reversal of the reform processes and the reincarnation of the Islamist-cum-uncontrolled populism was still not-a-too-distant possibility in the context of late-2002 and early-2003. The AKP leadership, however, owned the IMF-induced reform program along with a zealous quest for EU-membership, which in turn, paved the way for the

⁹⁴⁹ Özel, “After the Tsunami,” *Journal of Democracy*, 81.

⁹⁵⁰ For a succinct “historical-sociological and political-economic” analysis of the AKP case, see E. Fuat Keyman, “Modernization, Globalization and Democratization in Turkey: The AKP Experience and its Limits,” *Constellations* 17, no. 2 (2010): 312-327.

⁹⁵¹ Adalet ve Kalkınma Partisi, *AK Parti Seçim Beyannamesi* (Ankara: AK Parti, 2002), 44.

⁹⁵² Ziya Öniş and E. Fuat Keyman, “Turkey at the Polls: A New Path Emerges,” *Journal of Democracy* 14, no. 2 (2003): 96.

consolidation of reformist equilibrium.⁹⁵³ This point was underlined by one of my interviewees as follows:

“Starting from May 2002, the risk of derailment in the economic reform program turned into a real possibility due to the worsening health of the prime minister and the tug-of-wars among coalition members. These risks were reflected on the macroeconomic indicators. The global liquidity was still so tight that any political instability had non-negligible potential to push Turkish economy into a new crisis. [Following 2002 election] the adherence of the AKP government to the reform program played crucial role in the consolidation of the post-crisis reform agenda.”⁹⁵⁴

The AKP’s adherence to the main contours of the regulatory state laid the groundwork for the enhancement of Turkey’s state capacity in its first term in office. First, political context approximated to consensus-based policy-making under intense pressure of the double IMF-EU anchor. The successive weak coalition governments that lacked political will and capacity to impose fisco-financial discipline were replaced by single party governments functioning in line with the basic parameters of a regulatory state.⁹⁵⁵ Second, state economic bureaucracy benefitted from better coordination and increasing autonomy vis-à-vis the rent seeking interest coalitions. The regulatory institutions performed their functions without major political interventions from the non-market

⁹⁵³ I should note at this point that the leading economic figures of the AKP government do argue that they made substantial revisions in the IMF-sponsored reform program. Ali Coşkun stated in our interview that AKP government added strong social and industrial policy components to the existing program during its first term in office. Interview with Ali Coşkun, Minister of Industry and Trade (2002-2007), September 12, 2014.

⁹⁵⁴ Interview with Faik Öztırak, Undersecretary of Treasury, September 10, 2014. Öztırak, however, underlined in our interview that the AKP government failed to sustain the reform momentum in the post-2007 process.

⁹⁵⁵ Sadık Ünay, *Kalkınmacı Modernlik: Küresel Ekonomi Politik ve Türkiye* (İstanbul: Küre Yayınları, 2013), 327-333. The recent reversals and institutional setbacks concerning the regulatory state paradigm in Turkey will be addressed in the conclusion chapter.

forces, which in turn informed rule-based agency behaviour.⁹⁵⁶ Third, dominant policy coalitions approximated to proactive policy networks in comparison to the pre-crisis period. The intra-capital restructuring, especially in the banking sector, dismantled the reactive policy networks that rely on rentier-type of accumulation strategies. The fiscal discipline of the state, in this sense, forced capital holders to adopt more growth-oriented internationalization strategies. During 2002-2007, a broad-based reformist coalition emerged in the sense that, in addition to the pro-reform coalitions of the immediate post-crisis period, hitherto isolated economic interest groups, primarily MÜSİAD and related capital circles, was also taken on board by the AKP government that further legitimized the new policy paradigm in the eyes of the conservative entrepreneurs spread across the Anatolia.⁹⁵⁷ As Ünay suggests “this productive synergy... motivated Turkey’s success in instituting political and macroeconomic stability,”⁹⁵⁸ which also had deep-seated ramifications on Turkey’s democratization experience and foreign policy performance.⁹⁵⁹

⁹⁵⁶ Independent regulatory institutions also brought a new set of controversial questions concerning the legitimacy and quality of democratic governance in Turkey. This point, however, is beyond the scope of this study. For more on the issue, see Ümit Sönmez, “The Political Economy of Market and Regulatory Reforms in Turkey: The Logic and Unintended Consequences of Ad Hoc Strategies,” *New Political Economy* 16, no. 1 (2011): 101-130.

⁹⁵⁷ Interview with Ömer Bolat, President of MÜSİAD, September 16, 2014.

⁹⁵⁸ Sadık Ünay, “Economic Diplomacy for Competitiveness: Globalization and Turkey’s New Foreign Policy,” *Perceptions* XV, no. 3-4 (2010): 33.

⁹⁵⁹ For a comprehensive historical analysis of the multi-dimensional interactions among economic, political, and foreign policy transformations in the last decade see E. Fuat Keyman and Şebnem Gümüüşçü, *Democracy, Identity, and Foreign Policy in Turkey: Hegemony Through Transformation* (Basingstoke: Palgrave Macmillan, 2014).

Table 13. The fiscal and financial performance of Turkish economy (2002-2007)

	2002	2003	2004	2005	2006	2007
Fiscal indicators						
Real GDP growth (percent)	6.2	5.3	9.4	8.4	6.9	4.6
Budget deficit (percent of GDP)	-11.5	-8.8	-5.22	-1.3	-0.61	-1.62
Public debt (percent of GDP)	74	67.7	59.6	52.7	46.5	40
Privatizations (US \$ billions)	0.5	0.2	1.3	8.2	8	4.3
FDI (US \$ billions)	1.08	1.75	2.79	8.97	19.26	19.94
Inflation (percent)	45.1	25.3	8.5	8.1	9.6	8.7
PSBR (percent of GDP)	10	7.3	3.6	-0.1	-1.9	0.1
Financial indicators						
Total assets/GDP	76.5	69.4	71.2	81.5	86.7	87.3
Total loans/total assets	23.3	27.3	33.3	38.3	43.8	49.1
Total loans/total total deposits	36.0	43.9	53.1	62.0	71.1	80
Capital adequacy ratio	25.1	30.9	28.8	23.7	22.3	18.9
Non-performing loans	17.6	11.5	6.0	4.8	3.8	3.5
Source: Central Bank of the Republic of Turkey, Electronic Data Delivery System						

The empirical outcomes of the virtuous cycle Turkey entered in the post-2002 period are reflected in basic indicators: The state's fiscal house was put into order as the budget deficit and public debt complied with the Maastricht criteria. Turkey also overcame the stubborn inflation problem as the inflation rates declined to single-digits. The strict regulation of the financial sector also laid the groundwork for the banks to perform their true intermediary roles between the savers and the investors, rather than 'banking on the government' (see, table 13). Though Turkey failed to augment the transformative state capacity, a point I will discuss in chapter 8, a regulatory state was consolidated thanks to

the enabling roles played by external anchors and new supportive domestic coalitions coordinated by political will and leadership.⁹⁶⁰

6.5. Conclusion

This chapter set out to explore the reform dynamics in the post-2001 crisis. Turkey entered the new century with twin crises. The February 2001 turmoil, in particular, was a real turning point in the political economy history of the country as it put the socio-political and economic life into severe disarray. Thus the 2001 crisis in Turkey should be considered as a critical juncture. Despite its long-lasting hazardous impacts, the crisis also created an opportunity window to reform the deeply flawed fiscal and financial aspects of the reactive Turkish state. The depth of the crisis disturbed power balances in Turkish political economy and denounced well-entrenched reactive policy networks. It, therefore, opened up ample room for reformist state agents to step through it, which was capitalized on to a significant extent. As a result, in the fiscal and financial realm, Turkey's regulatory state capacity was improved substantially. Based on the three-stage framework offered in this study, I argued in this chapter that the economic crisis did invite a paradigmatic change in state's fiscal and financial capacity due to the complex mutual interplay of agency-level dynamics and institutional structures, which informed a virtuous cycle of reform activism.

⁹⁶⁰ A cautionary note is in order here. The AKP government started to change its approach toward the regulatory state institutions, especially after 2011. The reasons of the AKP's changing approach and institutional erosion in regulatory state paradigm are discussed in chapter 8. The structural problems of the Turkish economy and weak transformative state capacity are also highlighted in the same chapter.

At the agency-level, as Bakır suggested, Kemal Derviş emerged as a capable policy entrepreneur to mediate external dynamics and domestic coalitions.⁹⁶¹ Derviş narrated that the crisis emerged from reactive state policies accumulated over the years and claimed that comprehensive reforms were in order to arrest state's fiscal and financial profligacy. He coordinated economic bureaucracy and steered new pro-reform coalitions in support of the reform program. Derviş also succeeded in securing the urgently needed trust and credibility in the eyes of international community, thanks to which Turkey received an extraordinarily large amount of IMF assistance. Further, I demonstrated that the contextual factors played enabling role in the Turkish case as Derviş was backed by international power centres thanks to three developments along interests-ideas nexus, which are the IMF's reputation crisis at the time, Turkey's increasing geopolitical importance for the US foreign policy, and the rising Post-Washington Consensus.

I also found out that institutional structures played enabling roles in the crisis context. The business associations, except MÜSİAD, threw their support behind the dominant crisis narrative emerged at the agency-level. On the capital side, the economic crisis crystallized intra-capital bifurcation in Turkish political economy. As the main representative of a more integrationist segment among capital holders, TÜSİAD had been asking for a redefinition of state's role in the economy, by putting particular attention to the augmentation of regulatory functions. Thus, the content of the reform

⁹⁶¹ Bakır, "Policy Entrepreneurship and Institutional Change," *Governance: An International Journal of Policy, Administration and Institutions*, 591-592.

package resonated well with the changing interests of big business in Turkey. TOBB, as the main representative of small and medium-sized entrepreneurs also adopted a positive tone since its members also cognized that the existing model of development totally exhausted itself. On the labour side, it is fair to argue that the enabling roles played by the trade unions point to a stark contrast to the Greek case. In addition to their relatively weaker position in domestic power configuration, my field research reveals that they also did not categorically reject the proposed package, which in turn, decreased the audience costs of reform measures. Finally, the EU-anchor turned into a crucial factor that complemented the IMF conditionality. The assumed benefits of a potential EU membership asymmetrically tilted the balance in favour of pro-reform coalitions. In this institutional context, the IMF-induced reform program was narrated as part of a broader economic strategy to converge with the EU standards. It seems that the IMF anchor alone would not have been adequate, if the EU did not offer strong incentive structures for domestic political and economic interest groups.

In the third phase of my framework, the logic of regulatory state was consolidated during the first term of the AKP government. The outlook of the AKP was crucial in the sense that Turkey was still walking through a tight rope as of 2002. The AKP leadership, however, followed the main framework of the transition program without any major deviation along with an explicit emphasis and much ado on the EU membership goal. Thus a reversal to the pre-crisis populist cycle ceased to be a substantial risk anymore. In conclusion, I argued in this chapter that the crisis was exploited as a window of opportunity due to a high degree of narrative match at the agency-level, not only because

of Derviş's policy entrepreneurship capabilities but also because of a set of other non-domestic factors, and the enabling roles played by institutional structures, which in turn, ensured domestic ownership of the reform program and the emergence of a new equilibrium.

Chapter 7. Towards a comparative political economy of reactive states

7.1. Introduction

This study probed into the dynamics of paradigmatic changes in the fisco-financial regimes of late-industrialized reactive states, i.e., states with low capacity to impose fiscal discipline and financial surveillance. I particularly concentrated on economic crises as critical junctures to better explicate the underlying mechanisms that inform substantial divergences in terms of reform performance in these political economies. To this end, I offered a three-stage framework and tested it in the Greek and Turkish cases, respectively. These two cases pose interesting research puzzles. First, both of these states approximate to the ideal-typical configuration of reactive states during the neoliberal globalization period. Second, both states have encountered a deep economic crisis that rocked the existing material and ideational equilibrium to its foundations. Third, external anchors, the IMF-EU duo, heavily intervened in the post-crisis restructuring phase. The post-crisis reform performance, however, demonstrated a significant degree of divergence in these two hitherto similar reactive states. To address this puzzle I adopted a holistic framework based on the epistemological tradition of ‘analytic eclecticism’ that aims to incorporate time and context-specific interactions between agents and institutional structures with an explicit reference to the interplay of external and domestic phenomena.⁹⁶² In this study, I benefitted from state capacity,

⁹⁶² In addition to the works of Rudra Sil and Peter Katzenstein, which I cited in chapter 2, I also heavily borrowed from leading British political economist, Susan Strange on the issue of eclecticism. In her

critical junctures, and policy entrepreneurship as organizing concepts. I constructed my framework with an explicit reference to the complex multi-causal explanations and thick approaches in comparative political economy,⁹⁶³ which forsake the principle of parsimony in order to overcome the “mono-causal mania” in contemporary literature.⁹⁶⁴ Accordingly, in the following part, I will revisit the hypotheses set out in chapter 2 in line with my findings and draw some conclusions. In the third part, I will discuss potential contributions to the literature. The final part will conclude the chapter.

7.2. Main findings and revisiting the hypotheses

In this section I will report the main findings of this study and revisit the research hypotheses. I will first concentrate on the first-stage of my conceptual framework that covers the background chapters. In the second part I will address the second and third-stages, which form the main chapters in this research.

magnum opus, Strange maintained that mainstream approaches to the international political economy “are like toy trains on separate tracks, travelling from different starting points and ending at different destinations.” Thus in this study I try to adopt a mutually inclusive approach by borrowing from different streams of research. See, Susan Strange, *States and Markets* (London: Pinter Publishers, 1988), 16.

⁹⁶³ The controversy between ‘thin’ and ‘thick’ approaches in comparative politics is a strenuous topic. In this study I followed the long-standing tradition that perceive the field as “eclectic, messy center.” Accordingly, my aim is to link agents with institutional structures on the one hand and domestic phenomena with external dynamics, on the other. For more on the issue, see Atul Kohli et. al., “The Role of Theory in Comparative Politics: A Symposium,” *World Politics* 48, no. 1 (1995): 1-49. For a critical review, see Mark I. Lichbach, “Thinking and Working in the Midst of Things: Discovery, Explanation, and Evidence in Comparative Politics,” in Mark I. Lichbach, Alan S. Zuckerman, eds., *Comparative Politics, Rationality, Culture, and Structure* (Cambridge: Cambridge University Press, 2009), 18-71.

⁹⁶⁴ This phrase belongs to John Gerard Ruggie. Quoted in Jeffrey W. Legro and Andrew Moravcsik, “Is Anybody Still a Realist?” *International Security* 24, no. 2 (1999): 50.

7.2.1. First-stage: Stability, inertia and procrastination of reforms

My background chapters on Greece (chapter 3) and Turkey (chapter 5) dealt with the first phase of the three-stage framework. Accordingly, I strove to understand how the sub-optimal interaction of agents and institutional structures —i.e., political context, state bureaucracy, and dominant policy coalitions— informed reactive state practises, which in turn exacerbated state’s fiscal profligacy and financial indiscipline. The polarized political system in Greece that undermined consensus-based policy-making culture informed the political agents to deepen patronage networks in state bureaucracy and dominant policy communities —i.e., state’s relations with business and labour. In this institutional setting, state was conceived as an arena to be captured by rival political and economic actors for rent-seeking purposes rather than conceived as an autonomous player to govern the economy and steer sustainable reform-activism. The procrastination of reform measures, in turn, bloated the public sector and deteriorated financial discipline. The ultimate outcome was the devastating economic crisis that Greece experienced in 2009.

Turkey also experienced similar ebbs and flows during its troubled encounters with neoliberal globalization. Turkish policy-makers launched an entirely new economic paradigm after the 1980 military coup that relied on export-promotion and financial liberalization. The transformation, however, did take place within the context of immature institutional setting that paved the way for a strikingly perverse fisco-financial regime. As a result, Turkey entered a long-lasting turbulence during 1990s, which

resulted in a severe economic turmoil in 2001. On the external side of the equilibrium, broader institutional structures also played adverse roles in the Greek and Turkish cases. I discussed in chapter 2 that membership/candidacy to regional/multilateral organizations and integration to financial globalization trends informs the fisco-financial performance of national economies, as they tend to impose common standards, rules, and regulations. I, however, hypothesized that the impact of external anchors, whether disciplining or reforming, are heavily contingent upon how they are mediated, contested, and channelled by domestic intervening mechanisms. The state capacity, at this point, emerges as a key independent variable. Reactive states tend to expose themselves to the side effects of global and regional transformations, which in turn amplify domestic reform failures. Stated differently, in the absence of adequate state capacity, external anchors might exacerbate moral hazard problems through a set of perverse incentive mechanisms.

This is precisely what happened in Greece and Turkey. In the Greek case, the early membership to the then European Economic Community in 1981 and the adhesion of Greece to the euro area in 2000 further informed rent-seeking agency behaviour. Since Greece had a chance to exploit the lucrative EU funds and extremely favourable borrowing opportunities, state agents were encouraged to postpone urgently needed capacity-enhancing institutional reforms. The EU was unwilling and/or failed to impose strict conditionality on the regulation of fisco-financial regime in Greece as well. The “undersupply of fiscal and financial stability,” in turn, created demonstration effects for

the Greek state agents and non-state economic players to maintain ample rent positions.⁹⁶⁵

In the Turkish case, the EU did not play a significant anchor-role until the turn of the century, though Turkey formed a customs union with the EU in 1996 that planted the seeds of a nascent regulatory state. Thus, it is plausible to argue that Turkey encountered the erratic flows of global finance earlier than Greece. Since Turkish economy was exposed to the vagaries of financial globalization in the absence of robust domestic regulatory institutions and a shock-absorbing external EU-anchor, state's capacity to arrest fiscal profligacy and financial misbehaviour quickly eroded. In this sub-optimal equilibrium, non-state economic players seized new borrowing opportunities to finance the ever-expanding state sector at the behest of corrupt political elite. Not surprisingly, as a result, Turkey plunged into a devastating crisis in 2001. The analysis of the first-stage of my framework enables us to reveal the limited, and even adverse, role of external anchors to impose fisco-financial discipline when they hit reactive state structures. Thus the findings of this study confirm the fifth hypothesis proposed in chapter 2: "The impact of broader institutional structures is heavily dependent on how they are mediated by state capacity at the domestic level. If the conditionality principles are lax and porous, it is more likely that they lead to the procrastination of fisco-financial reforms in reactive states."

⁹⁶⁵ Shawn Donnelly, "Power Politics and the Undersupply of Financial Stability in Europe," *Review of International Political Economy* 21, no. 4 (2014): 980-1005.

7.2.2. Second and third-stages: Uncertainty, crisis narratives, and reform outcomes

I claimed in chapter 2 that institutional structures tend to inform rent-seeking agency behaviour in reactive states. The interests of domestic players are constructed in a way that the state in these political economies is entrapped in a vicious cycle, which brings about an inherent paradox: if political context, state bureaucracy, and dominant policy coalitions are inclined to inform massive rent-seeking and if state autonomy vis-à-vis the non-state players tends to decline in a gradual manner, how are paradigmatic transformations took place in these political economies? And what accounts for the divergence of reform performance in reactive states? Policy entrepreneurship and critical junctures literatures offer fertile avenues to address these challenging questions. Toward this end, the second-stage of my conceptual framework quests for the favourable contexts that enable change agents to couple the problems, policies, and politics. I also strove to delineate the scope conditions under which critical junctures, particularly economic crises, invite paradigmatic changes in reactive states.

In the Chinese language it is claimed that the word ‘crisis’ is composed of two characters: one represents danger and the other implies opportunity. This is arguably more appropriate for reactive states since critical junctures, mostly triggered by an economic turmoil, open up interregnum episodes to reverse the existing sub-optimal patterns of power relations and ideational paradigms that guide state-market relations. However, as Nehru once claimed in a rather different context, “every little thing counts

in a crisis.”⁹⁶⁶ Thus, in order to better understand under which conditions the opportunity windows are exploited in uncertainty episodes, we need to turn the microscope on the timing, sequencing, and mode of interactions among a number of variables. First, policy entrepreneurs could play their ‘change-agent role’ in reactive states if they emerge as key agents in crisis junctures. Second, in crisis junctures, the crisis narratives of state agents need to be matched with those of most influential external anchors, which involve in the post-crisis restructuring process. The degree of narrative match between domestic state agents and external anchors inform the level of domestic ownership of the crisis and the reform measures to be taken at the agency-level. The degree of match and the bargaining scope of state agents are determined by the conjunctural interests and ideas of the parties involved. A possible mismatch —or a failure of narrative matching— might invite serious credibility and trust problems on the side of the state agents, which in turn, put the entire reform program into a serious jeopardy.

Third, the responses of institutional structures constitute the final independent variable that informs the ultimate reform performance. I hypothesized in chapter 2 that state agents must steer new supportive coalitions at the domestic plane assembled around a dominant crisis narrative in order to ensure the ownership of the crisis and legitimize the logic of economic reform measures. Based on the complex interactions among state agents, external anchors, and relevant institutional structures, either a dominant crisis narrative or fragmented narratives emerge in the third phase of my three-stage

⁹⁶⁶ Jawaharlal Nehru, *Jawaharlal Nehru's Speeches 1949-1953* (New Delhi: The Publications Division, Ministry of Information and Broadcasting, Government of India, 1954), 144.

framework. If a dominant crisis narrative prevails, coherent paradigmatic reforms are likely to be swiftly enacted and resolutely implemented; otherwise, mutual blame-games and muddling through dominate the policy-making agenda in the post-crisis context, which result in incomplete and shallow reforms at best. The empirical findings of this study provide useful answers to test different aspects of the second and third-stages of the analytic framework proposed above. Accordingly, I examined four cases to test the different constellations of the key explanatory factors identified above. I think that these cases help us better explicate the timing, direction, and mechanisms of fisco-financial paradigm change in reactive states.

The first —shadow— case I studied was the reform attempts promoted by Kostas Simitis in Greece. Simitis was a policy entrepreneur who dedicated himself to the modernization of the Greek economy. First, as a professor of economics and law, he had strong technocratic credentials and technical expertise on the functioning of the economic and political systems in Greece and across Europe. Second, he had solid networks in European epistemic communities as he served as a member of the European Commission for many years. In fact, he was known among the European circles as “a respected figure” and “safe pair of hands.” Third, he established trust-based relationship with domestic policy communities in Greece thanks to his transparent and compelling political career. His ascendance to power was also ripe since he assumed premiership at a turning point in the history of European integration —the final phase of the launch of the euro. In this environment, strongly backed by the EU, in particular by Germany, Simitis framed a reformist agenda to put the state’s fiscal house into order and

restructure reform the financial sector in order to compel the banks to finance growth-oriented sectors rather than swelling state deficits. Simitis was in a perfect position to couple the problems, policies (i.e., solutions), and the politics to address Greece's fiscal and financial calamities. Simitis appointed reform-oriented economic bureaucrats as members of his team to set the governmental reform agenda; Lucas Papademos, the governor of the Greek Central Bank and Simitis' chief-advisor being the most popular one. Simitis, however, could achieve only very limited success due to two main reasons. First, despite the fact that Simitis assumed his post in a critical juncture, the EU-factor failed to play a genuine trigger role in instigating a virtuous cycle of reform activism because the criteria to be admitted to the euro membership were far from having long-lasting transformative impacts on candidate states, including Greece. The criteria only concentrated on one-off budget discipline, nominal convergence of the fiscal debt targets, and some light-touch institutional reforms concerning the status of national central banks, without putting any attention to the competitiveness indicators, such as labour productivity, effective regulation of financial sector, and current account performance. Furthermore, even the declared technical performance criteria, i.e., Stability and Growth Pact, were not implemented consistently. The European Council, for instance, dismissed the warnings of the European Commission highlighting the ineligibility of Greece to adopt euro due to the geopolitical significance of Greece in the eyes of the core EU member states and political symbolism attached to being in/out of the euro area. As a result, Greece became a member with a very high public debt figures, loosely regulated financial system, and burning competitiveness problems.

The second reason that explains Simitis' failure to accomplish his reformist agenda is related to the adverse role played by domestic institutional structures. Simitis was aware of the deep-seated problems associated with the Greek economy at the time, thus proposed comprehensive reform measures to ensure state's fiscal sustainability and competitiveness in the euro area. Accordingly, he pushed for labour market regulations, pension system reform, budgetary discipline measures, and massive privatizations. These measures, however, could not be implemented in a coherent and decisive fashion because Simitis failed to receive a genuine support from the political parties, trade unions, and business associations to steer pro-reform coalitions. Despite the emergence of a consensus on Greece's membership in the euro area, the scope of necessary reforms to achieve this goal was limited to the nominal convergence criteria.

In retrospect, it would be fair to argue that in the absence of a strong exogenous shock that would exhaust dominant policy paradigms and redistribute domestic power balances, pro-status quo forces triumphed over tenuous pro-change coalitions. Simitis could not have enough political space to implement his comprehensive reform proposals because the privileged status of the incumbent rent-seeking coalitions was not fundamentally questioned in the absence of a paradigm-exhausting economic shock. Thus Simitis could not succeed in penetrating into dominant policy communities to generate ownership of his reformist agenda. Greece, as a result, entered into the euro area with a short-lived stabilization state, which further eroded regulatory state capacity in the post-2000 period. My findings, therefore, confirm the third hypothesis proposed in chapter 2: "The presence of political will and policy entrepreneur is crucial in framing

substantial reforms and generating public ownership to reform proposals. Policy entrepreneurs, however, are more likely to fail if the timing and context of their reform initiatives are not conducive.”

The second —shadow— case I studied was Turkey’s 1994 economic crisis and the failed reform package adopted in the aftermath. As I offered a detailed analysis in chapter 5, Turkey integrated into financial globalization before the rules of the game, namely fiscal and financial regulatory institutions, was set out properly. Furthermore, Turkey could not benefit from the EU cushion vis-à-vis predatory market sentiments as Greece enjoyed during the same period. Not surprisingly, as a result, Turkish economy plunged into an early economic turbulence in the first quarter of 1994. From the perspective of this study, the crisis opened up an opportunity window to address the weaknesses of the limping fiscal and financial pillars of the economy. However, this opportunity could not be exploited due to three main reasons. First, Tansu Çiller, the prime minister and the major architect of the post-crisis reform package, was not a reformist change agent in any sense of the term. Though Çiller was an economy professor, whose professional expertise concentrated on Turkish economy, she failed to ensure the credibility and trust of the market players because of the infamous legacy of her pre-crisis populist economic policies. Also, the high level of non-coordination among the coalition government and the lack of a genuine political will further hindered the proper implementation of reform measures. Second, the external context was quite unfavourable. In fact, the reform package, 5th of April Decisions, that was put into practice following the crisis was supplemented by a stand-by agreement signed with the

IMF. Yet, the IMF failed to play a permanent anchor role to ensure a fisco-financial paradigm change in the Turkish economy for two main reasons.

First, the design and policy mix of the reform package were flawed as it put exclusive emphasis on the fiscal consolidation measures with very scant attention paid to the underlying causes of Turkey's fiscal and financial woes. Crafted in line with the erroneous logic of the Washington Consensus, the reform package did not address the accumulating moral hazard problems in a loosely regulated financial system. On the contrary, the government introduced blanket deposit guarantee to the savings held in commercial banks, which opened up ample room for extra moral hazard problems. Second, the IMF could not act as a long-term stabilizing anchor because the stand-by agreement was cancelled just one year after the crisis, following the collapse of the shaky coalition government. In the absence of a proper mix of financial incentives and reform conditionality, the credibility of the IMF-backed reform package quickly eroded in the eyes of market players. The third reason as to why crisis did not invite any substantial change in dominant fisco-financial paradigm was related to the constraining role of domestic institutional structures. A combination of weak external pressures and poor display of domestic leadership helped pro-status quo coalitions to weather the economic storm without any significant deterioration in their power positions. In the wake of the 1994 economic crisis business associations and trade unions did not play enabling roles. The quick but obviously non-sustainable economic recovery just one year after the crisis informed a sense of complacency on the business side. Furthermore, the established finance capital took advantage of the reactive state practices in the fiscal

and financial realms by investing in government bills through affiliated banks and exploiting connected lending practices in a poorly regulated institutional environment. On the labour side, harsh austerity measures triggered the resistance of the trade unions. Having combined with poor coordination and communication of the reform package at the agency-level and the extremely weak conditionality of external anchors, the 1994 economic crisis could not be seized as a turning point to launch a new fisco-financial paradigm, backed by new reformist coalitions that are assembled around a dominant crisis narrative. My findings, therefore, confirm the second hypothesis proposed in chapter 2: “Crises play constitutive roles as critical junctures that enable substantial reforms in reactive states. Not all crises, however, invite major policy change. The deeper the crisis, the more likely the change in the dominant policy paradigms.”

In addition to the shadow cases I studied in the background chapters, I focused on Greece’s 2009 crisis and Turkey’s 2001 turmoil in chapters 4 and 6. The intra- and inter-case comparisons would better explicate different constellations of the proposed causal mechanisms in my framework as well as their differentiated impacts on reform outcomes in diverging contexts. Starting from late-2009, Greece plunged into the worst economic turmoil that the country had ever experienced throughout its peacetime history. The unexpectedly devastating crisis was the product of structural economic problems accumulated over the years (see chapter 4). Moreover, the asymmetric architecture of the euro area, which paved the way for further “peripheralization of southern countries” within the European single market, amplified the magnitude of the

financialization and speculation-led growth in southern European economies.⁹⁶⁷ On the other side of the coin, the crisis turned into a potential tipping point to introduce paradigmatic transformations by way of a virtuous cycle of reform-activism. In fact, the Memorandum of Economic and Financial Policies, underwritten by the “troika’s super sovereign status,”⁹⁶⁸ constituted the most coercive phase of reform conditionality that Greece had confronted since its candidacy to the then European Economic Community. In retrospect, however, even the most optimistic accounts acknowledge the existence of notable reform failures and shallow implementation of the troika program. Based on the conceptual framework, I argued that the interaction modes of agency-level dynamics and institutional structures informed fragmented crisis narratives, which in turn, enfeebled pro-reform coalitions and empowered anti-memorandum forces in the post-crisis period.

At the domestic agency-level, in the initial phase, Papandreou could not assume the role of a credible change agent, capable of developing a coherent crisis narrative and generating domestic ownership toward reformist rhetoric. In fact, Papandreou sent hazy messages and contradictory signals due to the very low level of preparedness and intense fear of domestic audience costs in the initial phases. In the second phase, Papandreou strove to frame the Greek crisis as a ‘test case’ for the European integration, particularly asking for more generous EU support attached to more favourable lending conditions to protect his country against the ruthless zeal of international speculators, who, in the

⁹⁶⁷ Francesca Gambarotto and Stefano Solari, “The Peripheralization of Southern European Capitalism within the EMU,” *Review of International Political Economy*, ifirst version (2014): 1-25. Also see Fouskas and Dimoulas, *Greece, Financialization, and the EU* (Basingstoke: Palgrave Macmillan, 2013).

⁹⁶⁸ Susan Watkins, “Another Turn of the Screw,” *New Left Review*, no. 75 (2012): 12.

words of Papandreou, were trying to make fortunes on the misfortune of Greece. The crisis narrative of Germany, the hegemonic actor that single-handedly shaped the parameters of the troika program, however, spectacularly diverged from Papandreou's perspective. German chancellor Angela Merkel narrated the Greek crisis as 'exceptional case,' stemming from the profligate behaviour of Greek political elite and people alike. According to the German leadership, Greeks were recklessly living high off the hog, accustomed to retire too early, borrow too irresponsibly and pay too little taxes.⁹⁶⁹ German finance minister, Wolfgang Schäuble, even lamented Greece as "a bottomless pit."⁹⁷⁰ Germany's overly moralistic crisis narrative led to overestimating the domestic causes of the Greek problem and underestimating the failures arising from the flawed design of the euro area. Thus, German myopia overlooked the crucial point that the havoc was also a crisis of the European financial system, thereby deserving a determined European-level response beyond draconian fiscal cuts and self-defeating austerity measures.⁹⁷¹

A set of factors along interest-ideas nexus conditioned the character of Germany's divergent narrative toward the Greek crisis. From an interest-based perspective, keeping Greece in the euro area served the interests of the core European states, first and foremost Germany, due to high volume of financial exposure and increasing risks of a potential domino effect triggered by Greece's eventual default. This approach resonated with the interests of Greek policy-makers since they also considered remaining in the

⁹⁶⁹ Valentina Pop, "Merkel Under Fire for 'Lazy Greeks' Comment," *EUobserver*, May 19, 2011.

⁹⁷⁰ Quoted in Nick Malkoutzis, "Is Greece a Failed State?" *Foreign Policy*, March 1, 2012.

⁹⁷¹ Peter A. Hall, "The Economics and Politics of the Euro Crisis," *German Politics* 21, no. 4 (2012): 365.

euro area as the least of all possible evils. In terms of ideas, however, Germany's narrative radically diverged from the perspective of Papandreou government. Having been informed by uncompromising ordoliberal paradigm, Germany imposed an extremely austere reform package dressed up in antagonizing moralistic rhetoric. As a result, the troika program asked for very harsh front-loaded fiscal measures rather than structural reforms congruent with the priorities of the Greek economy and the principle of social solidarity in Europe. In fact, as Tayfur underscores, the Germany-led package was a blueprint of a radical change in Greece's political economy regime in line with the interests and ideas of the European core.⁹⁷² Social democrat and Keynesian Papandreou, however, felt squeezed between a rock and a hard place since he considered the harsh austerity package as nothing but a set of unjust measures to punish the Greeks.

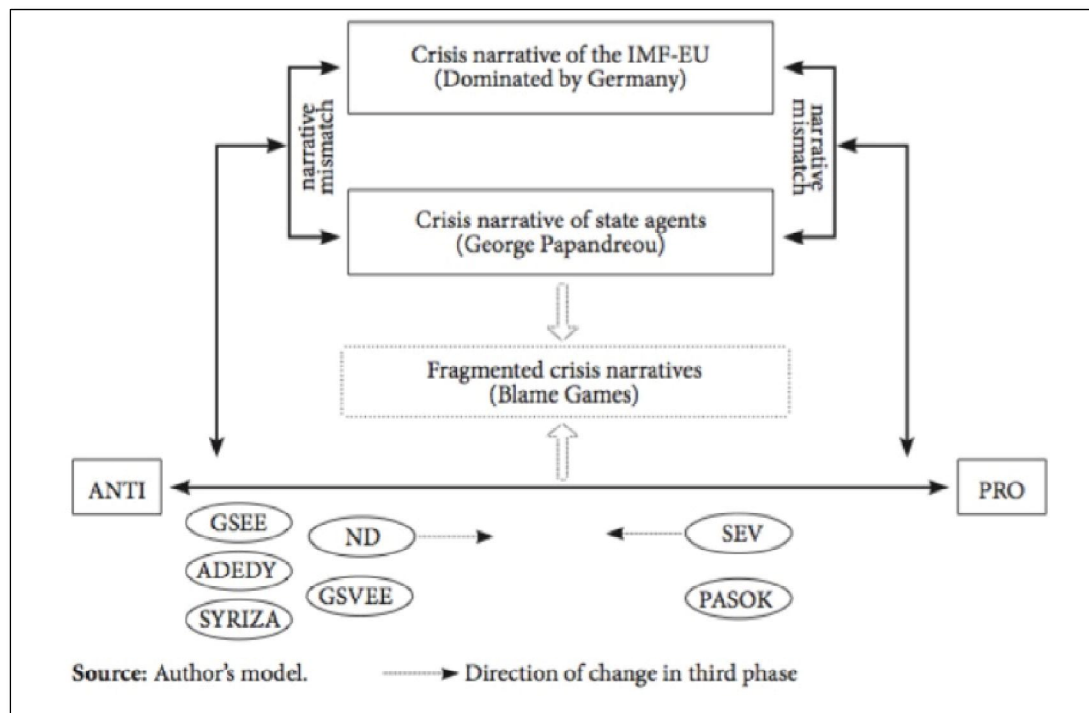
Furthermore, I revealed during the semi-structured in-depth interviews that Greek political and economic elite had grave doubts about the logic of the bailout packages. In fact, they were not mistaken, given that more than two-thirds of the bailout funds were immediately transferred to service existing debts, which meant that core members, Germany in particular, bailed out their own banks.⁹⁷³ The narrative mismatch at the agency-level, therefore, created a sub-optimal equilibrium in the first place and forced Papandreou to implement a reform program whilst denouncing it simultaneously. Not

⁹⁷² Tayfur, "Tarihsel Süreç İçinde Güney Avrupa'nın Borç Krizi," 214-215.

⁹⁷³ For the full list of my interviews with the representatives of Greek political parties, trade unions, business associations, and third-party observers see Appendix 1. Also see, Liz Alderman and Jack Ewing, "Most Aid to Athens Circles Back to Europe," *New York Times*, May 29, 2012.

surprisingly, as a result, this narrative mismatch intensified ownership problems of the reform program at the domestic plane (see figure 5 below).

Figure 5. The logic of anti-reform equilibrium in Greece



The ownership problems further exacerbated as domestic institutional structures bitterly contested the troika memoranda, which in turn, adversely informed Greece’s post-crisis reform performance. I revealed in my in-depth interviews that the opposition parties (mainly ND and SYRIZA), the well-entrenched cliques within Papandreou government (PASOK), trade unions (ADEDY, GSEE), and the major institutional representative of small and medium-sized enterprises (GSVEE) categorically rejected the policy mix of

the reform program. The only institutional player that supported the troika memorandum in the early phases was SEV, Greece's most influential business association (see figure 5). Even SEV changed its initial institutional position in the later months, as the chairman and senior advisors of SEV raised harsh criticisms to the memoranda during my interviews.⁹⁷⁴ The fragmented crisis narratives and pervasive collective action problems led to the multi-level blame games and muddling through in the third-stage of the three-stage framework. The appointment of Lucas Papademos as the leader of 'national unity government' in November 2011 also could not disturb this sub-optimal equilibrium.

In theory, Papademos was a competent policy entrepreneur capable of coupling the problems and policies (i.e., solutions) to initiate a consensus-based credible reformist agenda. He was a well-respected and influential transnational technocrat mastering the theory and practice of economic crises and subsequent reform processes. In addition to a stupendous academic background, his 16 years of experience as the governor of the Central Bank of Greece and the vice-president of the European Central Bank catapulted Papademos into a position to play a mediation role between the transnational and domestic policy communities. The troika, in particular German leadership, also threw full support behind Papademos to assume premiership. However, Papademos government failed to reverse the vicious policy path that Greece plunged in the post-

⁹⁷⁴ Interview with Theodore Fessas, President of SEV, June 24, 2014; interview with Michael Mitsopoulos, Senior Advisor to the President of SEV, June 23, 2014; interview with Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014.

2009 period due to the adverse ‘politics’ stream. Despite his efforts, Papademos could not soften the stance of the Germany-led IMF-EU anchor and could not create new supportive coalitions in favour of the troika memoranda. The Papademos case clearly demonstrates that the degree of flexibility provided by external anchors and the enabling role of domestic institutional structures are crucially important for policy entrepreneurs to succeed, which also confirms the third hypothesis proposed in chapter 2. All in all, the complex mutual interactions that informed narrative mismatch and blame games at the agency and institutional-levels (see figure 5) laid the groundwork for the deepening of the Greek economic debacle; an almost total collapse of Greece’s socio-political fabric epitomised by violent mass demonstrations; and a spectacular rise of anti-memorandum parties, championed by radical-left SYRIZA coalition and far-right Golden Dawn party. My findings in chapter 4, therefore, also confirm the fourth hypothesis proposed in this study: “The reform initiatives are more likely to be unsuccessful without enabling role played by domestic institutional structures. The wider the gap between the crisis narratives of domestic agents and external actors, the more likely the failure is.”

The fourth case was Turkey’s 2001 economic crisis, which constituted by far the deepest economic shock in the contemporary history of the country. The long-term collateral damage of the crisis on Turkey’s socio-political order notwithstanding, the year 2001 represented a real turning point in the fisco-financial regulation capacity of the Turkish state. Following the abysmal shock, Turkey launched a bold reform program to discipline the public finances and overhaul the financial system, underwritten by the IMF and complemented by the EU. The Turkish case poses interesting puzzles for the

purposes of this study, especially compared to Greece, as it demonstrates the diverging reform performance of reactive states in the post-crisis contexts. As I demonstrated in chapter 6 *Turkey's Transition Program* was “carefully designed [and] reforms were well-sequenced.”⁹⁷⁵ I revealed in my interviews that the emergence of pro-reform coalitions in the aftermath of the crisis was the outcome of complex interplay between agency-level factors and enabling roles played by institutional structures. The crisis exhausted the rent-seeking development paradigm and weakened the material and ideational superiority of reform-biased incumbent policy coalitions. In all my interviews, the respondents highlighted that the crisis was exceptionally devastating so that it opened up a rare window of opportunity to introduce substantial paradigmatic changes,⁹⁷⁶ which also confirm the second hypothesis in chapter 2.

Kemal Derviş, a policy entrepreneur in the strict sense of the term, exploited the crisis-induced opportunity window to link problems, policies, and politics toward introducing substantial fisco-financial reforms. The coalition government led by Bülent Ecevit also demonstrated a strong ownership of the crisis. As a result, Derviş was provided a large political room to manoeuvre and to implement his reformist ideas effectively, which was strikingly absent in the Greek case (see section 7.3). Thanks to his professional background as a prominent scholar and transnational technocrat, Derviş adopted a coherent crisis narrative from the early phases of the crisis. Derviş also positioned as credible mediator linking transnational and domestic policy communities that ensured

⁹⁷⁵ Hasan Ersel, “Politico-Economic Developments in Turkey and the Transformation of Political Islam,” *Middle East Development Journal* 5, no. 1 (2013): 14.

⁹⁷⁶ For details see, chapter 6 and appendix 4.

the trust of the external anchors. Derviş narrated the crisis as an outcome of the reactive state practises that informed pervasive rent-seeking and widespread corruption, which reached its zenith in the ill-functioning financial sector.

The crisis narrative put forth by Derviş and Turkish economic team significantly overlapped with the IMF's approach, in particular with that of Stanley Fischer, the first deputy-managing director of the Fund. Having taken the fact that Derviş had worked for the World Bank for more than two-decades, it is not surprising that he internalized the mainstream policy paradigms prevalent among the Bretton Woods institutions. However, the IMF-sponsored reform program was a more sophisticated and tailor-made package in comparison to the previous ones. In addition, the reform program was also backed by a large amount of financial assistance unmatched in the history of the Fund. Apart from the instrumental role performed by Derviş, a set of other crucial factors along the lines of interest-ideas nexus expanded Turkey's bargaining space and facilitated the emergence of a more domesticized reform package that was backed by generous financial support.

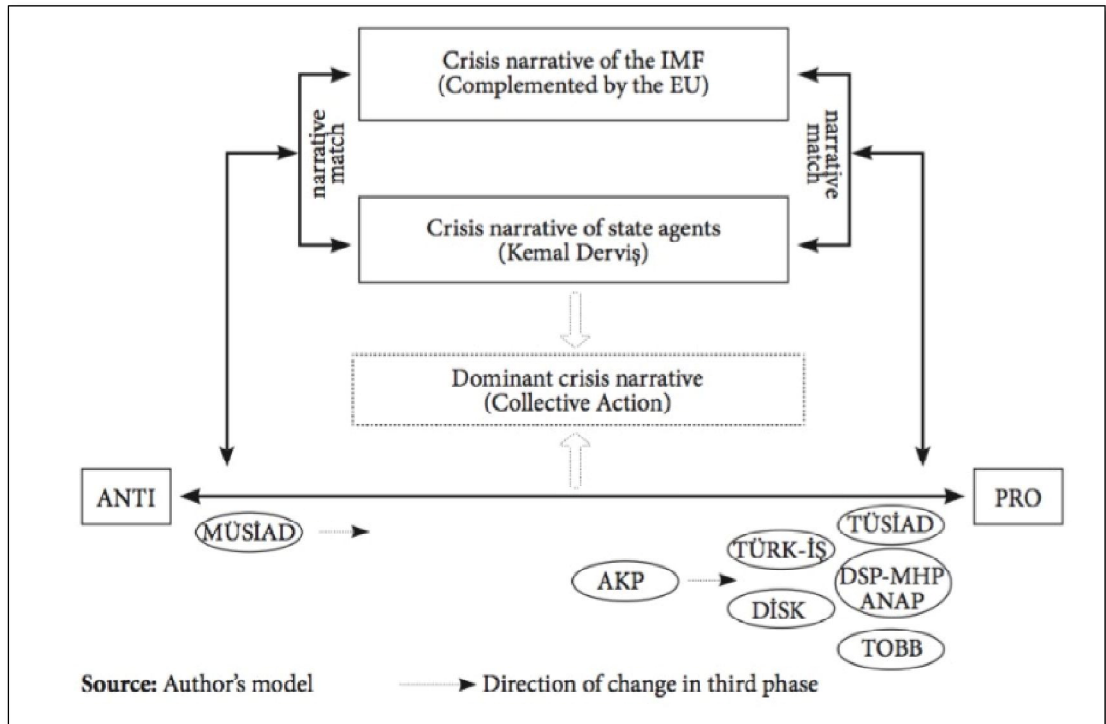
First, the IMF suffered from credibility and reputation problems at the time due to the spectacular failure of the previous stand-by agreements implemented in Turkey. My thorough interviews with Kemal Derviş, Süreyya Serdengeçti, and Faik Öztırak revealed that this situation empowered the hands of the Turkish economic bureaucracy vis-à-vis

the IMF staff.⁹⁷⁷ I also revealed that the preparedness of the Turkish economic bureaucracy proved a crucial factor for effective formulation of the post-crisis reform package. In a rather stark contrast to Greek case, Turkish bureaucracy, spearheaded by Derviş, actively contributed to the content and implementation of the fisco-financial reforms, which in turn, improved domestic ownership. Second, Turkey's geopolitical importance for the US foreign policy interests became increasingly important at the time as the neo-conservative US administration was in the midst of reformulating its policies toward the Middle East. The spearhead role attributed to Turkey in the Middle East by the US administration also partially explains the large amount of the IMF support. Third, the rise of the Post-Washington Consensus at the turn of the century played considerable role in terms of the policy mix of the post-crisis reform program. The emphasis on the efficient regulation of the banking sector, rather than single-minded insistence on orthodox fiscal austerity measures, turned out to be an important element in the policy agenda of the IMF staff as well, which in turn increased the legitimacy of the reform measures in the eyes of relevant stakeholders (see figure 6 below).

The combined effects of the conjunctural developments highlighted above led the external anchors to provide more space to the Turkish state agents. The degree of flexibility, in turn, informed the emergence of a more applicable and attainable reform program. The dominant crisis narrative emerged at the agency-level also penetrated into domestic institutional structures.

⁹⁷⁷ See chapter 6.

Figure 6. The logic of pro-reform equilibrium in Turkey



In a stark contrast to the Greek case, domestic institutional structures also played an enabling role in the Turkish context. On the business side, the crisis was instrumental not only in discrediting the inherent fragilities of rent-seeking reactive state practices, but also functional in eliminating the inward-looking policy communities since many related conglomerates and their affiliated banks declared bankruptcy during the crisis. Stated somewhat differently, the crisis crystallized the intra-capital bifurcation in Turkish political economy in the sense that relatively more integrationist and growth-oriented segments of the business class, which were in favour of a regulatory state paradigm, gained the upper hand. TÜSİAD, as the main institutional representative of the integrationist segments of Turkish finance capital, threw full support behind the

reform program. I was repeatedly told during the field research that the IMF-backed crisis narrative communicated by Derviş coincided with the changing interests of TÜSİAD. TOBB, the main representative of the small and medium-sized enterprises, also backed *Turkey's Transition Program* starting from mid-2001 because TOBB representatives perceived the existing mode of state-market relations unsustainable. On the labour side, the major trade unions (DİSK and TÜRK-İŞ) did not categorically reject the reform program as their counterparts did in the Greek context. Though, labour unions were not sympathetic to the IMF policies for understandable reasons, their critical stance did not turn into well-organized street demonstrations not only because the labour movement was in a weak position in terms of domestic power constellations but also because the leaders of the labour movement deliberately avoided this happening. In my interviews, I revealed that Derviş and the coalition government regularly informed the leaders of the labour unions and business representatives, which in turn, improved the legitimacy and ownership of the reform program in the eyes of domestic stakeholders.⁹⁷⁸ The Turkish case, therefore, confirms the first hypothesis proposed in chapter 2: “It is more likely that the economic reforms emanate from reformist state agents’ capacity to steer existing policy communities in reactive states.” It also demonstrates, however, that the enabling roles played by institutional structures are equally crucial as I proposed in hypothesis four.

⁹⁷⁸ Interview with Bayram Meral, President of TÜRK-İŞ, September 10, 2014; interview with Rıdvan Budak, President of DİSK, September 9, 2014; interview with Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD, September 13, 2014; interview with Yusuf Işık, Chief Advisor to Kemal Derviş, September 26, 2014.

Finally, one should add the complementary enabling function of the EU-anchor that underpinned the emergence and consolidation of a dominant crisis narrative. The European Council Helsinki Summit in 1999 was a “turning point”⁹⁷⁹ that invited “profound”⁹⁸⁰ changes in the EU’s transformative role over Turkey, since “Turkey’s long association with the EU has finally produced a certain level of certainty.”⁹⁸¹ Along these lines, the EU membership goal emerged as a crucial facilitating factor in terms of the consolidation of a dominant crisis narrative and ownership of the reforms in the post-crisis period. The reform program is framed as an integral and inseparable aspect of Turkey’s EU bid. Thus the double IMF-EU anchor unprecedentedly tilted the material and ideational power equilibrium in favour of a pro-reformist narrative assembled around a new paradigm that promoted fiscal discipline and financial prudence (see figure 6).

In the third-stage of my conceptual framework, the new fisco-financial regime entered into a consolidation phase, which dispersed the fears about a possible return to the pre-crisis populist and short-sided institutional equilibrium. As Ünay suggested “the AKP government promptly declared its unequivocal commitment to the on-going economic

⁹⁷⁹ Mehmet Uğur, “Testing Times in EU-Turkey Relations: The Road to Copenhagen and Beyond,” *Journal of Southern Europe and the Balkans* 5, no. 2 (2003): 174.

⁹⁸⁰ Ziya Öniş, “Domestic Politics, International Norms and Challenges to the State: Turkey-EU Relations in the Post-Helsinki Era,” *Turkish Studies* 4, no. 1 (2003): 13. Also see Nathalie Tocci, “Europeanization in Turkey: Trigger or Anchor for Reform?” *South European Society and Politics* 10, no. 1 (2005): 73-83.

⁹⁸¹ E. Fuat Keyman and Ahmet İçduygu, “Introduction: Citizenship, Identity, and the Question of Democracy in Turkey,” in E. Fuat Keyman and Ahmet İçduygu, *Citizenship in a Global World: European Questions and Turkish Experiences* (London: Routledge), 11. Also see, Şuhnaz Yılmaz, “The Torny Path: Turkey-EU Relations in Perspective,” *Journal of Cyprus Studies* 8-9, special issue (2002/2003): 126-135.

restructuring program under the aegis of the IMF, while declaring its willingness to discover new ways of financing economic recovery and cease dependence on IMF funds at the earliest possible opportunity.”⁹⁸² The AKP government’s tenacious commitment to the reform program led to the enhancement of regulatory state capacity during 2002-2007 that led to the eye-catching improvements in the main fiscal and financial indicators.

Table 14. Reform dynamics in reactive states: putting the jigsaw together

	Crisis	Policy entrepreneur	Enabling impact of institutional structures	Reform outcomes
1996-Greece	No	Yes	Weak	No substantial reforms
1994-Turkey	Yes	No	Weak	No substantial reforms
2009-Greece	Yes	Yes*	Mixed**	Conflict-led fragmented reforms
2001-Turkey	Yes	Yes	Strong	Consensus-led substantial reforms
<p>* A potential policy entrepreneur, Lucas Papademos, emerged in the later phases, not at earlier stages of the crisis.</p> <p>** The EU-IMF emerged as strong external anchors that impose strict reform conditionality along with ample financial resources. Yet, diverging crisis narratives at the agency-level adversely informed domestic institutional structures, which in turn, played a constraining role for the creation of pro-reform coalitions.</p>				

Having compared and contrasted the four cases and revisited research hypotheses, it is now time to put the parts of the jigsaw together. It seems that reform outcomes in reactive states are informed by time and context specific interactions of agency and institutional-level dynamics along the domestic-external nexus. I tabulated my findings

⁹⁸² Ünay, *Neoliberal Globalization and Institutional Reform*, 170.

in table 14. Accordingly, certain factors are in order for successful and sustainable economic transformations in reactive states: (i) crises constitute critical junctures in reactive states to introduce a nontrivial change in existing fisco-financial paradigms, (ii) emergence of political will and policy entrepreneurs capable of linking the problems, policies, and politics in order to communicate a coherent crisis narrative becomes an imperative in times of crisis-induced uncertainty. However, the crisis narratives of state agents must be matched with external anchors or the narratives of external actors need to be internalized at the domestic-level, and (iii) institutional structures, i.e., political context, state bureaucracy, and dominant policy coalitions, should play enabling roles at least to a certain extent in order to create supportive change-demanding coalitions assembled around a dominant crisis narrative.

7.3. Contributions to the literature

In this section I will discuss the broader implications of my findings. This study makes potential contributions to the relevant literature on three strands. First, I applied the ‘state capacity’ concept to the late-industrialized reactive states in a comparative perspective. Following the trailblazing research program advanced by Weiss⁹⁸³ and other institutionalist political economists,⁹⁸⁴ I started from the main assumption and argument that state capacity appears as the single most important intervening variable that calibrates the reform performance of national economies operating within international

⁹⁸³ Linda Weiss, “The State in the Economy: Neoliberal or Neoactivist?” in Glenn Morgan et. al., eds., *The Oxford Handbook of Comparative Institutional Analysis* (Oxford: Oxford University Press, 2010), 183-209.

⁹⁸⁴ See chapter 1 and chapter 2.

political economy system. The state capacity, however, is a much used, and to a certain extent, an abused concept in political science. Having taken this challenge into consideration, I reclassified the relevant literature around two central concepts: ‘stateness’ and ‘state capacity.’ The first term refers to the extent to which a state is capable of providing core functions such as control over territory, internal/external legitimacy, and basic collective goods —e.g. security, education, and healthcare. This definition of the concept, in my categorization, is associated with the research agenda on ‘failed states.’⁹⁸⁵ The second term, on the other hand, takes certain level of stateness for granted. Accordingly, state capacity literature ponders the sources and implications of diverging capacities of modern states to govern economic reform processes in coordination with relevant policy communities. In this sense of the term, the policy networks framework utilized the ‘reactive state’ concept within the context of advanced industrialized countries.⁹⁸⁶ In this study, following Öniş and Şenses,⁹⁸⁷ I employed the term to the late-industrialized context in a comparative perspective, which remains a relatively neglected aspect of state capacity debates.⁹⁸⁸ The term, I argued, needs to be

⁹⁸⁵ For a critical analysis see Shahar Hameiri, “Failed States or a Failed Paradigm? State Capacity and the Limits of Institutionalism,” *Journal of Development and International Relations* 10, no. 2 (2007): 122-149. For an extensive literature review from a critical viewpoint, see Jonathan Di John, “Conceptualizing the Causes and Consequences of Failed States: A Critical Review of the Literature,” LSE Development Studies Institute Working Paper Series, no. 2 (2008).

⁹⁸⁶ This stream of research is affiliated with policy networks literature. See chapter 1 and chapter 2.

⁹⁸⁷ Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*.

⁹⁸⁸ There are certain studies that explicitly refer the concept of ‘state capacity,’ albeit with different conceptualizations and operationalization of the term. For illustrative works on Turkey see Öniş, “Redemocratization and Economic Liberalization in Turkey: The Limits of State Autonomy,” *Studies in Comparative International Development*, 3-23; Ünay, *Neoliberal Globalization and Institutional Reform*; For studies on Greece see Featherstone and Papadimitriou, *The Limits of Europeanization*; Chardas, “State Capacity and ‘Embeddedness’ in the Context of the European Union’s Regional Policy: The Case of Greece and the Third Community Support Framework (CSF),” *Southeast European and Black Sea Studies*, 221-242.

reconceptualised and placed in a broader political economy setting since the dynamics of fisco-financial reform processes are qualitatively different in these political economies due to two main qualifications. First, institutional arrangement of domestic political context in late-developers paints a distinct pattern. Accordingly, the ideal-typical institutional configuration of state capacity relies on three pillars: political context, state bureaucracy, and dominant policy communities. In late industrialized reactive states, the idiosyncratic historical set-up of political systems tends to be subjugated by an underdeveloped culture of consensus-based policy-making. State economic bureaucracy also suffers from polarizing patronage politics and high degree of politicisation, which put bureaucratic autonomy and embeddedness into serious jeopardy. Furthermore, state-business and state-labour relations reflect a non-institutionalized and fragmented pattern of interest intermediation so that coordinated reform-activism turns into an arduous task in the normal course of politics.⁹⁸⁹ Therefore, the polities in question tend to suffer from pervasive rent-seeking, patronage politics, and clientelistic exchange relationship that hamper state's fiscal discipline and financial prudence.

Second, external anchors play a much more pronounced role in the sub-set of states investigated in this research, either enabling or constraining, in comparison to the advanced capitalist economies. The late-industrialized reactive states do not only suffer from 'state capture' at the domestic scene, but also tend to enjoy a low degree of autonomy vis-à-vis the hegemonic power centres and international financial institutions

⁹⁸⁹ That being said, I should underline that the long-term causes of political polarization, political patronage, clientelism, and loop-sided state-business and state-labor relations are beyond the scope of this study.

as a result of which they are inclined to pursue undifferentiated implementation of the mainstream fisco-financial paradigms. Also, in crisis junctures, external anchors play crucial roles by intervening in the economic restructuring processes via a set of conditionality measures attached to bailout packages. This necessitates a thorough analysis of the role of external anchors in relation to the positions of domestic state agents.

That being said, reactive states also depict significant divergence in terms of their post-crisis reform performance. In this sense, a comparative analysis of Greece and Turkey with reference to the three-stage framework enables us to offer certain ‘bounded generalizations’ regarding the dynamics of persistence and change in the fisco-financial regimes of late-industrialized reactive states. The approach adopted here also has ramifications for the literature on southern European studies in general and Greece-Turkey comparisons in particular. Even though these two countries depict significant similarities in terms of the organization of state-market relations and state capacity, scant attention is paid to this dimension of the debate.⁹⁹⁰ More often than not ‘high politics’ dominated Turkey-Greece comparisons in the literature thanks to the fragile security

⁹⁹⁰ For notable exceptions, which also adopt a political economy perspective see Ziya Öniş and Şuhnaz Yılmaz, “Greek-Turkish Rapprochement: Rhetoric or Reality?” *Political Science Quarterly* 123, no. 1 (2008): 123-149; M. Fatih Tayfur, “Yunanistan ve İspanya’nın Avrupalılaşıma Serüveni ve Türkiye: İki Nikah Bir Cenaze” in Atilla Eralp, ed., *Türkiye ve Avrupa* (Ankara: İmge Kitabevi, 1997), 177-239; M. Fatih Tayfur, “Susan Strange Goes to the Eastern Mediterranean: An alternative Approach to an Explanation of the International Political Economy of Turkish-Greek Relations in the Eastern Mediterranean,” *Perceptions* VIII, no. 2 (2003): 111-143. For a discussion on comparative political economy of labor markets in Greece and Turkey, see Özgün Sarımeşmet Duman, “The Rise and Consolidation of Neoliberalism in the European Union: A Comparative Analysis of Social and Employment Policies in Greece and Turkey,” *European Journal of Industrial Relations*, ifirst version, 2014.

environment in which these two states socialize and interact with each other. Furthermore, it is quite interesting that Turkey is often neglected in the discussions clustered around the ‘models of capitalism’ approach advanced by Amable⁹⁹¹ and ‘varieties of capitalism’ approach pioneered by Hall and Soskice.⁹⁹² Despite these studies’ acknowledgement of the existence of a kind of ‘southern model of capitalism,’ Turkey is excluded from these debates. The empirical findings of this study suggest that Turkey and Greece are similar cases in terms of the organisation of domestic markets. Thus a comparative analysis of these two countries through the lens of state capacity might offer new avenues to advance research programs on the political economy of and economic transformations in the southern European region. Moreover, to the best knowledge of the author, this research is the first attempt that compares Greece and Turkey within the context of economic crises and post-crisis reform outcomes.

Second, as part of my framework, I seek to join the debate and add on the literature that deals with the intricate and intriguing relationship between economic crisis and major policy changes. The idea that crisis triggers paradigmatic changes turns out to be a conventional wisdom in the mainstream accounts.⁹⁹³ If one considers that a crisis is in fact an obvious case of a paradigm failure, “that reform should follow crisis, then, is no more surprising than smoke following fire.”⁹⁹⁴ However, as ‘crisis exploitation’ or

⁹⁹¹ Amable, *The Diversity of Modern Capitalism*.

⁹⁹² Hall and Soskice, *The Institutional Foundations of Comparative Advantage*.

⁹⁹³ For an early review, see Tommasia and Velasco, “Where are we in the Political Economy of Reform,” *The Journal of Policy Reform*. For a quantitative review, see Allan Drazen and William Easterly, “Do Crises Induce Reform? Simple Empirical Tests of Conventional Wisdom,” *Economics and Politics* 13, no. 2 (2001): 129-157.

⁹⁹⁴ Rodrik, “Understanding Economic Policy Reform,” *Journal of Economic Literature*, 27.

'frame contests' literature underlines the relationship between crisis and major policy change is not as straightforward as it appears. According to Boin, McConnell and 't Hart, crises or natural disasters open up contentious periods epitomized by frame contexts and blame games.⁹⁹⁵ In the midst of post-crisis politicking, major policy reforms are initiated when the rhetoric of pro-change coalitions crowd out pro-status quo forces. Therefore, a careful process tracing is needed to open the black box of the complex relationships between a crisis and major economic changes. The framework adopted in this study has certain commonalities with political crisis exploitation literature. However, I diverged from the perspective of Boin, McConnell, and 't Hart in the sense that their approach perceives framing contests as one-level game that is played at the domestic arena. Since crisis exploitation literature exclusively concentrates on advanced political economies and mostly deals with the politics of investigation and accountability in the aftermath of extraordinary incidents such as natural disasters,⁹⁹⁶ or terrorist attacks,⁹⁹⁷ it is not surprising that it does not account for the decisive impact of non-domestic factors in post-crisis reform processes.

In fact, as I indicated previously, in a punctuated equilibrium the leverage of external anchors tends to increase precipitously vis-à-vis the domestic stakeholders in reactive

⁹⁹⁵ Boin, McConnell and 't Hart, eds., *Governing After Crisis*.

⁹⁹⁶ Thomas Preston, "Weathering the Politics of Responsibility and Blame: The Bush Administration and its Response to Hurricane Katrina," in Arjen Boin Allan McConnell and Paul 't Hart, eds., *Governing After Crisis: The Politics of Investigation, Accountability and Learning* (Cambridge: Cambridge University Press, 2008), 33-61.

⁹⁹⁷ Charles F. Parker and Sander Dekker, "September 11 and Postcrisis Investigation: Exploring the Role and Impact of the 9/11 Commission," in Arjen Boin Allan McConnell and Paul 't Hart, eds., *Governing After Crisis: The Politics of Investigation, Accountability and Learning* (Cambridge: Cambridge University Press, 2008), 255-282.

states. This does not, however, automatically bring about major transformations. In order to address this puzzle, I offered a crisis narratives approach, which integrates external and domestic-level mechanisms. Accordingly, I precipitate that external anchors could assume reform-instigating role only if their policy paradigms are coupled with the narratives of state agents and if domestic institutional structures play facilitating roles. The empirical chapters on Greece and Turkey bring new evidence to substantiate this argument.

The recent crisis in Greece catapulted the IMF-EU anchor into an unmatched status that, in the words of Lavdas, even the sovereignty of the Greek state was put into question.⁹⁹⁸ As Beck suggests the political might of Germany in particular magnified in imposing its crisis narrative over Greece since the entire “Europe has become German.”⁹⁹⁹ This privileged position, however, did not translate into a sustainable reform-activism in Greece. On the contrary, the domestic audience bitterly disputed the IMF-EU conditionality, which led to muddling through and deleterious blame games. The reform package, right from the very beginning, lacked popular legitimacy in the eyes of domestic constituency since social justice dimension perceived lacking. In the Turkish case, however, a dominant crisis narrative emerged from the early phases of the crisis and the IMF-EU anchor turned into a strong pressurizing-machinery toward fisco-financial transformation. The EU created bias for hope and informed the legitimacy of

⁹⁹⁸ Kostas A. Lavdas, Spyridon N. Litsas, and Dimitrios V. Skiadas, *Stateness and Sovereign Debt: Greece in the European Conundrum* (New York: Lexington Books, 2013).

⁹⁹⁹ Ulrich Beck, *German Europe* (Cambridge: Polity Press, 2013). For the structure of economic exchange mechanisms between Germany and southern Europe that underpin unbearable power asymmetries, see Annamaria Simonazzi, Andrea Ginzburg, and Gianluigi Nocella, “Economic Relations between Germany and the Southern Europe,” *Cambridge Journal of Economics* 37, no. 3 (2013): 653-675.

the reform packages that the pro-reform agents skilfully capitalized on. The contrasting performance of the IMF-EU anchor with regard to the Greek and Turkish cases demonstrates that external anchors' transformative capacity is conditioned by domestic-level variables. Thus the same anchors might have totally divergent impacts in different settings.

The EU's changing role in this context is also quite illuminating. In the Greek case, the EU-anchor played an adverse role in terms of reform-activism. The domestic constituency perceived the demands of the EU as 'unilateral imposition' and breach of the sovereignty of the Greek state. Despite the fact that the EU imposed Germany-led strict conditionality, these measures backfired at the domestic level. Rather than empowering the pro-reform coalitions, the EU's extravagant demands delegitimized the reform packages. It is ironic that the anti-systemic policy entrepreneurs, such as SYRIZA leader Tsipras, strongly legitimized their positions in the eyes of domestic beholders. On the other hand, the anchor positively informed the reform dynamics in the post-2001 crisis. Turkish policy entrepreneur, Kemal Derviş, meticulously linked the reform packages to Turkey's candidacy process at the time. The delegitimized political parties, particularly the members of the coalition government, also supported Turkey's EU bid in order to repair their deteriorated legitimacy. Stated differently, the EU turned into a source of legitimacy for Turkish political elite in order to re-legitimize their positions in the eyes of domestic interest groups and electorates. Therefore, paradigmatic fisco-financial reforms were not only perceived as the most secure way to ensure quick economic recovery but also conceived as the only way to clear Turkey's EU

membership path. The divergence of the EU's impact on domestic politics suggests that external anchors play context-specific roles at crisis junctures. I propose that enduring economic reforms are the products of dialectical processes, which requires interactive narrative matching between external anchors and domestic policy coalitions mediated by capable change agents, presumably by policy entrepreneurs.

Third, as a follow up to the previous point, this study adds on the stream of research enquiring policy entrepreneurship. Kingdon offers 'multiple-streams approach' to place reformist change agents within the context of three kinds of processes: problems, policies (i.e., solutions), and politics.¹⁰⁰⁰ Accordingly, policy entrepreneurs are defined as actors who are capable of attaching "problems to their solutions and find politicians receptive to their ideas"¹⁰⁰¹ The coupling of the three independent streams becomes more likely at critical moments in time, which Kingdon calls "policy windows."¹⁰⁰² The basic parameters of multiple stream research, however, are set in a way that the policy entrepreneurship concept is utilized mainly within the context of 'governmental agenda-setting.'

As Zahariadis points out "Kingdon used the framework to explain agenda-setting in the United States... and because most analysts do research at the sub-national level, the lens' [the framework] utility remained limited."¹⁰⁰³ Bakır went beyond the narrow

¹⁰⁰⁰ Kingdon, *Agendas, Alternatives, and Public Policies*, 16.

¹⁰⁰¹ Zahariadis, "The Multiple Streams Framework: Structure, Limitations, Prospects," 74.

¹⁰⁰² Kingdon, *Agendas, Alternatives, and Public Policies*, 165.

¹⁰⁰³ Zahariadis, "The Multiple Streams Framework: Structure, Limitations, Prospects," 80.

governmental agenda-setting by adapting policy entrepreneurship framework in a broader context.¹⁰⁰⁴ In his work on central banking reform in Turkey, Bakır studied the role of Kemal Derviş as a policy entrepreneur mediating transnational and domestic policy communities.¹⁰⁰⁵ In this direction, I studied both successful and unsuccessful cases in crisis and non-crisis junctures in order to explore more on the scope conditions that inform the performance of policy entrepreneurs in reactive states.

In a non-crisis juncture, Simitis emerged as a dedicated reformist agent in Greece. When Simitis assumed premiership a critical juncture opened in Greek politics thanks to the final stage of the EMU membership. Simitis, in a momentous turning point of the European integration project, launched a series of policies (i.e., solutions) that aimed to redress the fisco-financial calamities of Greek economy and ensure Greece's competitiveness in the euro area. However, he spectacularly failed in his reform attempts. It seems that despite EU emerged as reformist-anchor at a critical juncture, the flawed conditionality criteria targeting one-off Potemkin reforms and the constraining role played by domestic institutional structures paved the way for a notable policy failures. Thus Simitis case confirms the previous research that policy windows are more likely to open when an acute crisis hits political agenda. In addition, it also demonstrates that the role of external anchors and domestic institutional structures should also be taken into consideration in order to fully reveal the conditions under which policy entrepreneurs succeed in their attempts. A comparative analysis of the Derviş and

¹⁰⁰⁴ Bakır, "Policy Entrepreneurship and Institutional Change," *Governance: An International Journal of Policy, Administration and Institutions*, 593.

¹⁰⁰⁵ Ibid.

Papademos cases is quite illuminating in this regard. Both Derviş and Papademos were competent technocratic figures capable of identifying economic problems and crafting attainable policies (i.e., solutions). They also had strong linkages with international and domestic epistemic communities. Moreover, both of them were appointed to their posts as non-partisan figures, unequivocally supported by external anchors. Their policy legacy, however, diverged sharply.

A comparative analysis of Derviş and Papademos enable us make two inferences. First one is related to the timing. As I stated above the current literature suggests that crisis-induced opportunity window is a necessary factor that condition the success of reformist agents. I also found out that at a crisis juncture as well, the timing matters significantly. Papademos was appointed in the later phases of Greek economic crisis in a very hostile environment toward the troika program. In this political context, Papademos was considered as one of the crystal clear reflections of the deepening ‘democratic deficits’ in the European politics. The appointment of technocratic Mario Monti government in Italy also reinforced this perception not only in Greece but also across Europe.¹⁰⁰⁶ Therefore, the political parties and trade unions bitterly contested his position on the ground that the appointment of Papademos was an outright attack at the sovereignty of the Greek state.

¹⁰⁰⁶ Matthias Matthijs, “Mediterranean Blues: The Crisis in Southern Europe,” *Journal of Democracy* 25, no. 1 (2014): 102.

In the Turkish case, Derviş was appointed in the immediate aftermath of the crisis with wide-ranging policy and political autonomy. Thus the timely emergence of Derviş positively informed the handling of the post-crisis management and economic recovery processes. Further, domestic interest groups demonstrated an accommodative stance and played relatively facilitating roles from the initial phases. This comparison does not, however, imply that the earlier appointment of Papademos would have fundamentally changed the dynamics of the Greek crisis and reform outcomes. Despite the fact that making a counterfactual analysis is very difficult, it nevertheless seems that even the emergence of a policy entrepreneur in the immediate aftermath of the Greek crisis would not have resulted in a virtuous cycle of reform activism, which brings us to the second inference: the context.

Policy entrepreneurship literature places emphasis on the contextual factors. What differentiates this research from the previous ones is that I particularly tried to explore the role of external anchors and the enabling/constraining function of institutional structures. In the Turkish case, the IMF-EU anchor played a reform-steering role thanks to an appropriate combination of carrots and sticks. Stated differently, for certain conjunctural reasons explored in chapter 6, the IMF-EU anchor provided enough policy and political space for domestic state agents to contribute to the design and implementation of the reform package. However, in the Greek case, the Germany-led IMF-EU anchor imposed a very strict ordoliberal paradigm, which suffocated all possibilities to craft an exercisable reform program from the very beginning. The domestic state agents and pro-reform coalitions had no virtual space to contribute to the

policy mix of the memoranda, which not surprisingly amplified ownership problems. It therefore seems that in late-developed reactive states domestic policy entrepreneurs are more likely to couple problems, policies, and politics when external anchors provide enough flexibility to manoeuvre and domestic institutional structures play enabling role in terms of ownership of the crisis and subsequent reform measures.

7.4. Conclusion

In this chapter I laid out the main findings of my research and revisited the hypotheses. Accordingly, this chapter put the parts of the three-stage framework together by scrutinizing four cases in two reactive states. My findings intend to advance the debate on three possible strands. First, I applied the revised version of ‘reactive state’ concept to late-industrialized political economies, which I believe has more explanatory capacity in grasping the dynamics of continuity and change in these sub-set of states. Second, I claimed that the role and function of external anchors need to be contextualized especially in crisis episodes. I claimed that external anchors play a true reform-triggering role when a dominant crisis narrative emerges along the domestic-external nexus. Third, I compared the performance of policy entrepreneurs in three different cases. I particularly suggested that in late-developed reactive states domestic policy entrepreneurs are more likely to instigate paradigmatic change when external anchors provide enough room to manoeuvre and domestic institutional structures play an enabling role.

Chapter 8: Conclusion

In this study I offered a three-stage framework that tried to explain reform dynamics in a subset of states, i.e., late-industrialized reactive states. I particularly strove to understand the complex relationship between crisis and paradigmatic economic changes. Accordingly, I compared Turkey and Greece as most-similar cases. These two countries pose interesting research puzzles. Both states were late-developers with weak capacities to discipline their fiscal and financial regimes. Similarly, they were hit by severe economic shocks that not only led to serious humanitarian costs but also opened up opportunity windows to reform the bankrupt fisco-financial structures. Furthermore, external anchors, particularly the IMF-EU tandem, imposed strict conditionality measures during the post-crisis restructuring process in these political economies. However, their adjustment capacity showed remarkable divergence. It appears that Turkey introduced a consensus-based reformist agenda to adopt a new fisco-financial regime. Greece, on the other hand, plunged into a virtual deadlock that precipitated endless blame games among domestic distributional coalitions and international creditors. For these reasons a comparative analysis of Greece and Turkey enables us to offer some useful answers to the main research question posed in this study: Under what conditions and through which mechanisms do economic crises lead to substantial fisco-financial reforms in these political economies?

Substantial reforms are the outcomes of complex interactions of a set of factors. A fragile joining up of several agency-level and institutional factors makes reform

processes intricate, contingent, and context-dependent. In order to capture this complexity, I tried to offer a conceptual framework that applies to reactive states. I revisited research hypotheses in the light of my research findings and discussed potential contributions to the literature in chapter 7. Thus, in this short concluding chapter, I will compare my framework with some major explanations and offer three propositions emanated from the central concepts that form the backbone of this study. Finally, I will address the limitations and avenues for future research.

8.1. Revisiting major explanations and three propositions

The literature offers various explanations on how successful economic reforms are initiated and consolidated. For the sake of categorization, it is apt to claim that three sets of arguments dominate the debate: timing-based explanations, structure/anchor-based explanations, and actor-based explanations. The first, and plausibly the most cited, triggering factor for paradigmatic reforms in the fiscal and financial realms is the ‘crisis hypothesis.’ It is assumed that adverse external shocks enfeeble the resistance of pro-status quo groups, which in turn, are expected to speed up the introduction of paradigmatic changes. The interest-based ‘war of attrition’ framework, employed by Fernandez and Rodrik,¹⁰⁰⁷ and Alesina, Ardagna, and Trebbi¹⁰⁰⁸ point out that the cost of adjustment precipitously falls when a crisis disempowers the vested interest groups as

¹⁰⁰⁷ Raquel Fernandez and Dani Rodrik, “Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty,” *American Economic Review* 81, no. 5 (1991): 1146-1155.

¹⁰⁰⁸ Alesina, Ardagna, and Trebbi, “Who Adjusts and When? The Political Economy of Reforms,” *IMF Staff Papers*, 1-29.

compared with pro-reform coalitions.¹⁰⁰⁹ The crisis hypothesis, however, needs to be substantiated with context-specific analysis, as it remains too crude to suggest that reforms would follow crisis straightforwardly. In chapter 5, for instance, I demonstrated in chapter 5 that the 1994 economic crisis in Turkey did not invite any substantial reforms due to a number of factors, which were also revisited in chapter 7. The recent economic crisis in Greece that I explored in chapter 4 also paints a complex and mixed picture because the resistance of domestic policy communities was not substantially weakened. In fact, a careless handling of the economic turmoil plunged the Greek economy into a deeper chaos. More insidious than the economic logjam was the anger of broader societal segments accompanied by widespread pessimism.

Field research findings hint that the crisis could not be exploited as an opportunity window to strengthen pro-reform coalitions vis-à-vis the pro-status quo forces, despite the fact that certain changes did take place in the fisco-financial regime of the country. In spite of the achievement that Greece being successfully kept in the euro area, this should be considered as nothing but a ‘Pyrrhic victory,’ since, after five tortuous years of depression, the gross domestic product contracted by over 30 percent with rampant structural unemployment hovering around 28 percent of GDP as of 2014. It turned out to be conventional wisdom in Greece that “Greek society has lost a great deal, and gained little in return.”¹⁰¹⁰ The Turkish economic crisis of 2001, on the other hand, led to the introduction of a better-crafted fisco-financial regime, backed by new supportive

¹⁰⁰⁹ For a comprehensive overview, see Allan Drazen, *Political Economy in Macroeconomics* (Princeton, New Jersey: Princeton University Press, 2000).

¹⁰¹⁰ Nicos Konstandaras, “Greece’s Economic and Political Traps,” *New York Times*, October 26, 2014.

coalitions. It becomes apparent in retrospect that the state's fiscal house was put in order and the out-dated financial system was overhauled. Partially thanks to the introduction of these fiscal and macroprudential reforms in the post-2001 period, the Turkish economy weathered the global financial storm that broke out in 2008.¹⁰¹¹ The intra and inter-case analyses of the Greek and Turkish cases suggest that crises per se fall short of explaining the magnitude, direction, and durability of change, despite the fact that they render the existing institutional arrangements fluid and potentially weaken the incumbent pro-status quo coalitions.¹⁰¹² On the other side of the coin, my case studies imply that crises, nevertheless, emerge as necessary tipping points to put decisive breaks to the path dependent tiresome reform failures in reactive states.¹⁰¹³

A second set of explanations on how successful economic reforms are initiated and consolidated concentrate on structure/anchor-based explanations. The structural adjustment programs underwritten by the international organizations such as the IMF and the EU are pointed out as constraining anchors factors to adopt disciplined fisco-financial regimes (see chapter 2). For obvious reasons, the anchor-based explanations also prove to be time and context sensitive that is mediated by a set of domestic

¹⁰¹¹ Caner Bakır, "Wobbling but Still on its Feet: The Turkish Economy in the Global Financial Crisis," *South European Society and Politics* 14, no. 1 (2009): 71-85. Bakır also highlights a number of vulnerabilities in the Turkish economy such as non-financial private sector foreign debt rollover risk, increasing household indebtedness, an appreciated domestic currency.

¹⁰¹² The diverging reform performances of Greece, Portugal, and Ireland in the recent euro area crisis might also shed light on the intricate relationship between crisis and post-crisis reform performance in this regard. Despite these three countries went through similar bailout packages, their adjustment capacity seems to diverge considerably.

¹⁰¹³ For a parallel analysis in the Greek case see Kalyvas, Pagoulatos, and Tsoukas, eds., *From Stagnation to Forced Adjustment: Reforms in Greece*. For Turkish case, see Öniş and Şenses, "Global Dynamics, Domestic Coalitions and Reactive State," *METU Studies in Development*.

intervening variables since external anchors are more likely to enjoy a high level of transformative impact over national economies, especially when a state seeks to join an international institution or to apply for external financing in hard times.¹⁰¹⁴ The functions of external anchors can be subsumed into two categories: the supply of resources and the supply of credibility. Accordingly, from an interest-based perspective external anchors provide material support to facilitate post-crisis transformations, as the availability of financial resources is crucially important to initiate substantial reforms since it alleviates the distributional pressures emanating from adjustment measures. The resources in question might be fiscal transfers, generally attached to “conditionality” programs. Furthermore, external anchors are supposed to supply information and technical support as part of conditionality programs. Their role, however, needs to be contextualized as they perform a transformative role only if a set of facilitating factors is at work on the domestic plane.

The divergent role of the IMF-EU tandem in the Greek and Turkish cases, chapters 4 and 6, is an illustrative case in point. While the IMF program and the EU-anchor were not severely challenged in the Turkish case, an opposite trend turned out to be the case in Greece (for a detailed discussion see chapter 7). Thus, what matters most is how their role is interpreted and translated into the domestic scene by state agents, which inextricably brings us to the agent-based explanations. Alesina, Ardagna, and Trebbi, *inter alia*, estimated in their empirical model that enduring reforms are instigated when a strong government, either in the form of single-party governments or presidential

¹⁰¹⁴ For a critical overview of this stream of literature, see chapter 2 and chapter 7.

systems, is in charge of the management.¹⁰¹⁵ I discussed in detail in chapter 2 that emergence of reform-oriented agents and political will turn out to be a crucial factor in explaining the reform performance of countries. Accordingly, the “change agents or norm entrepreneurs,”¹⁰¹⁶ “transnational policy actors,”¹⁰¹⁷ and ‘policy entrepreneurs,’ as referred to in this study, are listed as mediators between external and domestic policy communities toward the creation of pro-reformist coalitions.¹⁰¹⁸ I concentrated on the roles of policy entrepreneurs in chapter 3, 4, and 6, respectively. In the Greece case, in chapter 3, Simitis emerged as a dedicated reformist actor to modernize the Greek economy. Despite the EU factor, his attempts did not ensure the fiscal and financial discipline of the Greek state due to a number of time and context specific dynamics, as I discussed in detail in the previous chapters. I also compared the varying roles of policy entrepreneurs in crisis contexts.

In the fourth chapter, I concentrated on Papademos’ failed reform attempts in Greece. Papademos emerged as a capable policy entrepreneur. He was a well-respected and influential transnational technocrat mastering the theory and practise of economic crises and reform processes. In addition to a stupendous academic background, his 16 years-long experience as the governor of the Central Bank of Greece and the vice-president of the European Central Bank catapulted Papademos into the position to play a meditation

¹⁰¹⁵ Alesina, Ardagna, and Trebbi, “Who Adjusts and When?”, *IMF Staff Paper*.

¹⁰¹⁶ Tanja Börzel and Thomas Risse, “When Europe Hits Home: Europeanization and Domestic Change,” *EIoP Online Papers* 4, no. 15 (2000): 2.

¹⁰¹⁷ Öniş and Şenses, “Global Dynamics, Domestic Coalitions and Reactive State,” *METU Studies in Development*, 258.

¹⁰¹⁸ Bakır, “Policy Entrepreneurship and Institutional Change,” *Governance: An International Journal of Policy, Administration and Institutions*, 571-598.

role between the transnational and domestic policy communities. Troika, in particular the German leadership, also threw full support behind Papademos. Despite the efforts of the Papademos government, new supportive pro-reform coalitions could not be created in favour of the troika program. A comparative analysis of Lucas Papademos and Kemal Derviş is illuminating in better explicating under what conditions policy entrepreneurs are capable of building momentum for change. In the Turkish case, Derviş was appointed as the minister for economy in the immediate aftermath of the crisis with wide-ranging policy and political autonomy. The political support of the coalition government was buttressed by the enabling role of institutional structures. Furthermore, the EU-factor added extra-legitimacy to Derviş since he narrated the post-crisis reform measures as part of Turkey's EU membership bid, commonly perceived as the most prominent way for democratization and economic prosperity of the country at the time. It is in this context that Derviş succeeded in garnering the support of the domestic policy communities. Therefore, it seems that in late-developed reactive states domestic policy entrepreneurs are more likely to conjugate problems, policies, and politics when external anchors provide enough flexibility to manoeuvre and domestic institutional structures play an enabling role in terms of ownership of the crisis and subsequent reform measures.

This very broad review suggests that existing literature shed light on different dimensions of reform processes. This study also aimed at building on these major explanations by trying to link timing-based, anchor-based, and actor-based explanations in order to offer a synthetic framework applicable to a specific sub-set of states. To this

end, I utilized state capacity, critical junctures, and policy entrepreneurship as organizing concepts. Having compared the four cases and revisited my research hypotheses, I claimed that reform outcomes in reactive states are informed by time and context specific interactions of agency-level and institutional dynamics along the domestic-external lines.

Accordingly, certain factors are in order for successful and sustainable economic transformations in reactive states: (i) crises constitute critical junctures in reactive states to introduce a nontrivial change in dominant fisco-financial paradigms, (ii) emergence of political will and policy entrepreneurs capable of linking the problems, policies, and politics to communicate a coherent crisis narrative becomes an imperative in times of crisis-induced uncertainty. However, the crisis narratives of state agents must be matched with external anchors or the narratives of external actors need to be internalized at the domestic-level, and (iii) institutional structures, i.e., political context, state bureaucracy, and dominant policy coalitions, should play enabling roles at least to a certain extent in order to create supportive change-oriented coalitions assembled around a dominant crisis narrative. In conclusion, the discussion so far leads to three propositions that can be tested in future studies to better understand reform dynamics in late-developed reactive states:

Proposition 1: State capacity emerges as a crucial variable that determines the long-term adjustment capacity of domestic economies. The policy changes undermining state capacity, whether they are statist or neo-liberal, tend to inform subsequent reform failures.

Proposition 2: The ‘crisis hypothesis’ postulating the reform-instigating functions of exogenous shocks tends to be valid if a narrative match emerges between state agents and external anchors in the wake of the crisis and if a dominant crisis narrative penetrates into domestic institutional structures.

Proposition 3: Policy entrepreneurs are instrumental in linking external dynamics with domestic policy coalitions toward generating a dominant crisis narrative. However, their potential to link problems, policies, and politics are conditioned by the degree of flexibility provided by external anchors and the degree of enabling role exercised by domestic institutional structures.

8.2. Avenues for future research

There are two possible avenues to further this study. First one is related to the *scope* of my research. In this study, I aimed to offer a holistic political economy framework with a particular emphasis on state’s reform capacity to ensure fiscal discipline and financial prudence. To this end, throughout the study I referred to certain structural deficiencies that put Greek and Turkish states’ fiscal sustainability into constant jeopardy, such as labour market rigidities, tax reform, state subsidies, pension system reforms, and lacklustre performance in privatization implementations, or the failures thereof. Apart from this I did not enter into an in-depth comparative analysis of micro-sectoral transformation. One should keep in mind, however, that the resistance capacity of domestic policy coalitions might diverge in different sectors due to their more sticky nature of respective institutional structures in comparison to others as well as due to the low degree of penetration capacity of external anchors. Güven, for instance, demonstrates in the Turkish context that the degree of change in the financial services industry has been much more profound than the agricultural sector because of the ‘more

stick nature' of distributional coalitions and the persistence of dominant ideas in the latter.¹⁰¹⁹ Featherstone and Papadimitriou also reveal in the Greek context that the degree of change, i.e., Europeanization in their terminology, varied significantly across sectors as the external pressure asymmetrically affected different economic sectors in the domestic plane.¹⁰²⁰ These two interdependent dimensions, domestic and non-domestic, necessitate a micro-institutional and sectoral analysis. In this sense, new studies might apply three-stage framework to investigate the micro-institutional dynamics of diverging reform performance in different sectors in crisis and non-crisis contexts.

Second point is related to the *focus* of the research. In their oft-cited book, George and Bennett recommend “process-tracing as a means of examining complexity” and “suggest typological theorizing as a way to model complexity.”¹⁰²¹ Qualitative researchers are also often cautioned against the problems of overgeneralization. King, Keohane, and Verba, for instance, claim that case studies are better suited to making “descriptive” generalizations that are contingent and limited in scope.¹⁰²² Accordingly, this study tried to offer a holistic framework that applies to late-industrialized reactive states. It does not deal with developed political economies, developmental states and/or predatory states. The findings, however, enable us to offer certain ‘bounded generalizations’ in a sub-set of states as it compared Greece and Turkey within the context of a most-similar case design: Two hitherto reactive states with lacklustre performance in the fiscal and

¹⁰¹⁹ Ali Burak Güven, *Peasants, Bankers, and the State: Forging Institutions in Neoliberal Turkey*, Unpublished PhD Dissertation submitted to the Department of Political Science, University of Toronto, 2009.

¹⁰²⁰ Featherstone and Papadimitriou, *The Limits of Europeanization*.

¹⁰²¹ George and Bennett, *Case Studies and Theory Development in the Social Sciences*, 13.

¹⁰²² King, Keohane, and Verba, *Designing Social Inquiry*, 228.

financial realms faced severe exogenous shocks but showed divergent reform performance in the post-crisis period. The comparative analysis of Greece and Turkey, therefore, might provide insights to be tested in other reactive state contexts. Furthermore, this study concentrated on the fisco-financial regulation. The isolated analysis of regulatory state capacity, however, provides only a partial account in terms of state capacity debates. I explained in the introduction chapter that states are polymorphous entities. Accordingly, capacity of the same state might diverge across regulatory, transformative, and distributional dimensions. Among these three dimensions, transformative capacity turns out to be the most important one as it determines the ultimate limits of long-term growth performance of national economies.¹⁰²³ The mysterious point within the context of this study is the often overlooked relationship between regulatory and transformative state capacities in the medium and long-term. The reactive states, even with augmented fisco-financial discipline, still might not be able to shield themselves from the side effects of the exogenous shocks if they fail to supplement it with transformative state capacity.

One possible avenue for future research in this regard is a comparative analysis of different dimensions of state capacity in southern European economies. Accordingly, Spain, Portugal, Greece, and Turkey can be compared and contrasted in terms of their regulatory, transformative, and distributive capacities. It is highly likely that the

¹⁰²³ Chang, *Globalization, Economic Development, and the Role of the State*; Weiss, "Globalization and the Myth," *New Left Review* 1, 3-27; Weiss, *The Myth of the Powerless State*; Linda Weiss, ed., *States in the Global Economy: Bringing Domestic Institutions Back In* (Cambridge: Cambridge University Press, 2003).

southern European economies concerned would diverge in these three different dimensions. Therefore, a stylized comparison might shed fresh light on the sources, dynamics, and mechanisms of transformations from ‘reactive’ to ‘proactive,’ or vice versa, in these polities. Furthermore, this can also extend boundaries of our understanding by enabling researchers to concentrate on the dialectical relationships between different capacities within the same state as well as the sustainability of a state’s capacity in one realm in the absence of substantial improvements in other domains. For instance, Spain substantially improved its transformative capacity over the last three decades. Thanks to proactive state policies, Spanish firms became major players in European and Latin American countries.¹⁰²⁴ However, due to lack of adequate regulatory state capacity, Spain turned out to be one of the worst affected countries from the financialization-led global economic crisis.¹⁰²⁵

In this sense, there are also certain lessons to be taken from Turkish case. Despite substantial improvements achieved in the fiscal and financial indicators (see chapter 6), Turkey suffers from certain structural deficiencies, which indicates that transformative state capacity still remains weak, to say the least. Despite some initiatives put into practise over the last decade, such as budgetary improvements in research and development expenditures, introduction of new investment incentive systems, and the restructuring of the state economic bureaucracy dealing with industrial policy, the

¹⁰²⁴ Mauro F. Guillen, *The Rise of Spanish Multinationals: European Business in the Global Economy* (Cambridge: Cambridge University Press, 2005).

¹⁰²⁵ Kutlay, “Internationalization of Finance Capital in Spain and Turkey,” *New Perspectives on Turkey*, 115-137.

transformation degree of the domestic production structures over the last decade is far from being a success story.¹⁰²⁶ According to the World Bank data, the share of high-value added goods as percentage of total manufactured exports is just 1.8 percent.¹⁰²⁷ The alarmingly low level of domestic savings, which hovers around 13 percent of GDP as of 2013, is also another indicator of Turkey's weak developmental capacity.¹⁰²⁸ Furthermore, there are strong signs indicating ominous policy reversals and institutional retreat concerning the regulatory state paradigm. The mounting evidence suggests that the AKP government's commitment to the regulatory state paradigm waned, especially in the aftermath of the 2011 elections.¹⁰²⁹ The government's intensifying critique of the independent status of the Central Bank over the interest rate policies pursued by the latter, the frequent interventions into the functioning of the BSRA mainly because of the political concerns, and the increasing politicization of other independent regulatory agencies should be interpreted as important signs of this institutional erosion, though they have not yet adversely affected the fiscal and financial indicators as of 2014.

The AKP government's increasingly lukewarm approach toward the regulatory state paradigm is closely related to the changing political context of the country. The AKP succeeded in winning three general elections with increasing vote shares in addition to a

¹⁰²⁶ For a critical overview see, Ziya Öniş and Mustafa Kutlay, "Rising Powers in a Changing Global Order: The Political Economy of Turkey in the Age of BRICs," *Third World Quarterly* 34, no. 8 (2013): 1409-1426.

¹⁰²⁷ I retrieved the data from the World Bank, World Development Indicators Database. The figure belongs to 2012.

¹⁰²⁸ This ratio has been around 19 percent during 2000-2010, which is below the average of emerging and developing countries—that is, 27.5 percent. Sena Eken and Susan Schadler, *Turkey 2000–2010: A Decade of Transition* (Istanbul: DEİK Publications, 2012), 36.

¹⁰²⁹ Işık Özel, "The politics of De-delegation: Regulatory (In)dependence in Turkey," *Regulation and Governance* 6, no. 1 (2012): 119-129.

series of clear-cut victory in three subsequent local elections.¹⁰³⁰ In the words of Keyman, the election outcomes led to the “electoral hegemony” of the AKP government.¹⁰³¹ The dominant party-politics, in turn, informed the political landscape in the way “that social and political polarization remains potentially explosive and reduces the capacity for social consensus and political compromise.”¹⁰³² It is fair to argue in this context that the increasing polarization of the domestic political setting, especially following the 2011 elections, tends to inform state capacity adversely, as it reinvigorated a vicious cycle of politicization in economic bureaucracy and state’s relations with non-state economic actors. Even though the recent developments in the Turkish political economy are beyond the scope of this research, it demonstrates how fragile the equilibrium remains in reactive states. Therefore it poses interesting puzzles for new studies not only in terms of the relationship between regulatory and transformative capacities in reactive states but also regarding the long-term sustainability of reform measures that were instigated in the aftermath of the deep economic crisis.

¹⁰³⁰ In 2002 general elections, AKP won 35 percent of total votes, which increased to 47 percent in 2007, and 50 percent in 2011. Also, in 2004 local elections, the party won 42 percent of votes, which turned out to be 38 percent in 2009, and 45 percent in 2014.

¹⁰³¹ According to Keyman, electoral hegemony “refers to a situation in which the dominance of one party in the electoral process becomes so strong that its power exceeds simply being a strong majority government, it becomes hegemonic over society at large and other parties and their supporters have no convincing ability to win elections.” See, E. Fuat Keyman, “The AK Party: Dominant Party, New Turkey, and Polarization,” *Insight Turkey* 16, no. 2 (2014): 23-24.

¹⁰³² Meltem Müftüleri-Baç and E. Fuat Keyman, “The Era of Dominant-Party Politics,” *Journal of Democracy* 23, no. 1 (2012): 93.

Appendix 1: List of interviews

Greece

Christos A. Ioannou, Greek Deputy Ombudsman and Mediator and Arbitrator with the Organization for Mediation and Arbitration in Greece, June 26, 2014.

Christos Dimas, Member of Parliament, New Democracy, June 25, 2014.

Dimitri Papadimitriou, Professor of Political Science, University of Manchester, June 18, 2014.

Dimitris A. Sotiropoulos, Advisor to Lucas Papademos, June 24, 2014.

Dimitris P. Sotiropoulos, SYRIZA London Representative, June 16, 2014.

Dimitris Daskalopoulos, Former President of SEV (2006-2014), June 25, 2014.

Dimitris Katsikas, Head of Crisis Observatory, ELIAMEP, June 24, 2014.

Dimitris Papadimitriou, Professor of Political Science, University of Manchester, June 18, 2014.

Dimitris Tsarouhas, Professor of European and Greek Politics, Bilkent University, June 10, 2014.

Ellie Varchalama, Legal Advisor to GSEE/ADEDY, June 26, 2014.

George Pagoulatos, Senior Advisor to Lucas Papademos, June 24, 2014.

Kevin Featherstone, Director of Hellenic Observatory, LSE, June 11, 2014.

Kostas Triantafyllos, Member of Parliament, PASOK, June 19, 2014.

Lefteris Kretsos, Representative of SYRIZA, June 7, 2014.

Manos Giakoumis, Chief Economic Analyst at Macropolis, Athens, June 23, 2014.

Michael Mitsopoulos, Senior Advisor to the President of SEV, June 23, 2014.

Othon Anastasakis, Director of European Studies Centre, Oxford University, June 13, 2014.

Savas Robolis, Scientific Director of Labour Institute (INE)/GSEE-ADEDY, June 24, 2014.

Sotirios Zartaloudis, Lecturer, Loughborough University, June 16, 2014.

Theodore Fessas, President of SEV, June 24, 2014.

Vassilis Monastiriotis, Professor of Political Economy, LSE, May 20, 2014.

Zoe Lanara, Secretary General of GSEE, June 26, 2014.

Stella Ladi, Lecturer, Queen Mary University of London, June 17, 2014.

Turkey

Ali Coşkun, Minister of Industry and Trade (2002-2007), September 12, 2014.

Bayram Meral, President of TÜRK-İŞ, September 10, 2014.

Doğan Cansızlar, Chairman of Capital Markets Board of Turkey, September 11, 2014.

Faik Öztırak, Undersecretary of Treasury, September 10, 2014.

Hasan Ersel, Chief Economist and Senior Executive Vice President of Yapı Kredi Bank, September 28, 2014.

Kemal Derviş, Minister of Economic Affairs and Treasury, September 11, 2014.

Masum Türker, Member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002), September 10, 2014.

Ömer Bolat, President of MÜSİAD, September 16, 2014.

Rıdvan Budak, President of DİSK, September 9, 2014.

Süreyya Serdengeçti, Governor of the Central Bank of the Republic of Turkey, September 15, 2014.

Şevket Bülend Yahnici, Deputy Leader of MHP, September 4, 2014

Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD, September 24, 2014.

Yusuf Işık, Chief Advisor to Kemal Derviş, September 26, 2014.

Appendix 2: Interview questions, Greece

Political Elite

1. What are the main institutional and agency-level dynamics that inform reform-inertia in Greece? (**Hint:** Please comment on domestic political context, state bureaucracy, labor and business unions. **Hint 2:** Please feel free to develop a historical perspective)
2. What is your assessment about the root causes of Greek crisis? Was Greece a “test case” (i.e., the victim of the flawed institutional structure of the euro area and international speculators) or a “special case” (i.e., the victim of domestic reform failures and fiscal irresponsibility of the Greek state)?
3. To what extent the EU-IMF anchor has been responsible for the reform failures in Greece? (**Hint:** Please feel free to develop an historical perspective). What do you think about Merkel’s role in the management of Greek crisis?
4. Could the crisis be exploited as a window of opportunity to reform Greece’s enduring fiscal and financial problems? Could Papandreou demonstrate policy entrepreneurship to coordinate and communicate reform programme effectively at the EU and domestic level?
5. How did your party approach the Memorandums? Did you support the reform programme? Why?
6. Do you think that reform programme would improve Greek state’s capacity in the long run? Could new pro-reform coalitions be created over the last five years?
7. What is your assessment about the technocratic government formed by Lucas Papademos? Why consensus and cooperation-based environment could not be created among political parties and major interest groups (i.e., labor unions and business associations)?

Trade Unions, Business Associations

1. What are the main institutional and agency-level dynamics that inform reform-inertia in Greece? (**Hint 1:** domestic political context, state bureaucracy, and reform-resistant interest groups. **Hint 2:** Please feel free to develop a historical perspective)
2. What is your assessment about the root causes of Greek crisis? Was Greece a “test case” (i.e., the victim of the flawed institutional structure of the euro area and international speculators) or a “special case” (i.e., the victim of domestic failures and fiscal irresponsibility of the Greek state)?
3. To what extent the EU has been responsible for the reform failures in Greece? (**Hint:** Please feel free to develop an historical perspective)

4. How did your institution approach the Memorandums? Did you support reform proposals? Do you think that memorandums would improve Greek state's reform capacity in the long run?
5. Could the crisis be exploited as a window of opportunity to reform Greece's enduring fiscal and financial problems? Could Papandreou demonstrate policy entrepreneurship to coordinate reform programme effectively at the EU and domestic level?
6. What do you think about Germany's role in the management of Greek crisis? Did Merkel play a positive or negative role? Was it possible to negotiate a better programme in May 2010?
7. How were your institution's relations with the Greek governments and Troika over the last five years? Were you involved in the design and implementation of the reform programmes?

Third Party Observers

1. What are the main institutional and agency-level dynamics that inform reform failures in Greece? (**Hint 1:** please comment on domestic political context, state bureaucracy, and reform-resistant interest groups. **Hint 2:** Please feel free to develop a historical perspective)
2. What is your assessment about the root causes of Greek crisis? Was Greece a "test case" (i.e., the victim of flawed institutional structure of the euro area and financial speculation) or a "special case" (i.e., the victim of domestic failures and fiscal irresponsibility of Greek state)?
3. To what extent the EU has been responsible for the reform failures in Greece? (**Hint:** Please feel free to develop an historical perspective)
4. Could the crisis be exploited as a window of opportunity to reform Greece's enduring fiscal problems? Could Papandreou demonstrate leadership to coordinate/communicate reform programme effectively with labor unions and business associations?
5. What do you think about Merkel's role in the management of Greek crisis? Was it possible for Papandreou to negotiate a better programme (with less emphasis on austerity and more emphasis on structural reforms)?
6. How do you assess Papademos' performance during his premiership? Could he fulfill the policy entrepreneurship role expected from him?
7. Do you think that reform programme would improve Greek state's reform capacity in the long run? Given the positions of political parties, labor unions, and business associations, could new pro-reform coalitions be created over the last five years?

Appendix 3: Interview questions, Turkey

Political elites

1. What are the main institutional and agency-level dynamics that inform reform-inertia in Turkey? What were the underlying causes that lead to the February 2001 economic crisis?
2. Could Turkey exploit 2001 crisis as a window of opportunity to introduce substantial reforms? What factors do you think account for comprehensive restructuring of Turkey's fisco-financial system in the wake of February 2001 crisis?
3. Did your party support the fiscal and financial reform measures implemented by Kemal Derviş? Could Derviş demonstrate policy entrepreneurship to coordinate and communicate reform programme effectively at the external and domestic level?
4. What do you think about the roles played by external anchors during the post-crisis restructuring process? What is your perspective on the role of the IMF-EU anchor? (Please also comment on the US factor if relevant).
5. What were the main points of disagreement between the IMF and the Turkish side? Did you support the 'crisis narrative' communicated by Derviş and the IMF?
6. What factors, in your opinion, explain the large volume of external financial support Turkey received at the time? (**Hint:** The 'Derviş factor', Turkey's geopolitical significance for the US etc.)
7. To what extent were the reform measures supported by political parties, labour unions, and business associations? Did they play enabling or constraining roles? Could new pro-reform coalitions supporting the reform program be created?

Trade Unions, Business Associations

1. What are the main institutional and agency-level dynamics that inform reform-inertia in Turkey? What were the underlying causes that lead to the February 2001 economic crisis?
2. Could Turkey exploit 2001 crisis as a window of opportunity to introduce substantial reforms? What factors do you think account for comprehensive restructuring of Turkey's fisco-financial system in the wake of February 2001 crisis? What differentiated 2001 crisis from the previous ones?
3. Did your institution support the fiscal and financial reform measures implemented by Kemal Derviş? Could Derviş demonstrate policy entrepreneurship to coordinate and communicate reform programme effectively at the external and domestic level?
4. How were your institution's relations with the state agents and external anchors handling the crisis at the time? Were you involved in the design and implementation of the reform

programme? Did Kemal Derviş and his economic team inform you on the reform measures to be taken?

5. What factors, in your opinion, explain the large volume of external financial support Turkey received at the time? (**Hint:** The ‘Derviş factor’, Turkey’s geopolitical significance for the US etc.)
6. What do you think about the roles played by external anchors during the post-crisis restructuring process? What is your perspective on the role of the IMF-EU anchor? (Please also comment on the US factor if relevant).
7. How do you assess the commitment of the AKP government to the reform measures implemented after 2001 crisis? How did the AKP’s approach during its first term inform the consolidation of a new path in Turkey’s fisco-financial regime?

Third Party Observers

1. What are the main institutional and agency-level dynamics that inform reform-inertia in Turkey? What were the underlying causes that lead to the February 2001 economic crisis?
2. Could Turkey exploit 2001 crisis as a window of opportunity to introduce substantial reforms? What factors do you think account for comprehensive restructuring of Turkey’s fisco-financial system in the wake of February 2001 crisis? What differentiated 2001 crisis from the previous ones?
3. How did think the appointment of Kemal Derviş as minister for economy inform the post-crisis management strategy in the eyes of external anchors and domestic audience? Could Derviş demonstrate policy entrepreneurship to coordinate and communicate reform programme effectively at the external and domestic level?
4. What do you think about the roles played by external anchors during the post-crisis restructuring process? What is your perspective on the role of the IMF-EU anchor? (Please also comment on the US factor if relevant). Do the crisis narratives of the Turkish side and external anchors coincide or diverge one another?
5. What factors, in your opinion, explain the large volume of external financial support Turkey received at the time? (**Hint:** The ‘Derviş factor’, Turkey’s geopolitical significance for the US etc.)
6. To what extent were the reform measures supported by political parties, labour unions, and business associations? Did they play enabling or constraining roles? Could new pro-reform coalitions supporting the reform program be created?
7. How do you assess the commitment of the AKP government to the reform measures implemented after 2001 crisis? How did the AKP’s approach during its first term inform the consolidation of a new path in Turkey’s fisco-financial regime?

Appendix 4: Notes on the analysis of interview data and other sources

Appendix 4 provides more information about the analysis of the interview data and other data sources that jointly informed this study. I stated in the introduction chapter that the analysis of semi-structured interviews could be a difficult task due to the open-ended nature of the responses. Following Halperin and Heath, I analysed the interview data in three main steps: data reduction, assignment, and drawing conclusions.¹⁰³³

Data reduction refers to “the process of selecting, focusing, simplifying, abstracting and transforming the data that appears in written up field notes and transcriptions.”¹⁰³⁴

Accordingly, after reducing the data, I “assigned them to different categories according to the variable to which they relate.”¹⁰³⁵ I assigned three broader categories (with sub-categories in each) in line with the conceptual framework laid out in chapter 2:

1. The respondents are categorized whether they are supportive of the post-crisis reform measures or not. The positive responses were labelled as ‘pro-reformist’ and negative responses were labelled as ‘anti-reformist.’
2. I strove to understand why they supported/rejected the reform packages. To this end, I categorized the interview data according to the criteria of how they interpreted (i) the crisis, (ii) the role of state agents in charge of the post-crisis

¹⁰³³ Sandra Halperin and Oliver Heath, *Political Research: Methods and Practical Skills* (Oxford: Oxford University Press, 2012), 278.

¹⁰³⁴ Matthew B. Miles and A. Michael Huberman, *Qualitative Data Analysis: An Expanded Sourcebook* (Newbury Park: Sage Publications, 1994), 10. Quoted in Halperin and Heath, *Political Research*, 279.

¹⁰³⁵ Halperin and Heath, *Political Research*, 280.

restructuring process, and (iii) the function of external anchors involved in the design and implementation of reform measures.

3. After analysing the interview data and crosschecking their validity, I drew general conclusions whether, why, and how a dominant (or fragmented) crisis narrative emerged in the wake of the crisis.

Greece

1.

In the Greek case, my interview results confirmed that a very strong anti-memorandum coalition emerged. First, the political context plunged into a sub-optimal equilibrium from the initial phases. On the political arena, two major opposition parties, ND and SYRIZA, denounced the reform package immediately. Christos Dimas from ND claimed, “ND believed that first memorandum would not help the country to get out of the crisis. [Therefore] ND opposed the memorandum.” Lefteris Kretsos from SYRIZA also suggested that SYRIZA did a good job, as it became “the main agent of anti-austerity movement in Greece.” The third party observers also confirmed the dominance of anti-reformist reflexes of the main political parties. Manos Giakoumis, Chief Economic Analyst at Macropolis, underlined in our interview that “major political parties negatively informed the implementation of [reform package] for different reasons.” This was also the case even for the ruling party, PASOK. Papandreou, in fact, failed to ensure intra-party discipline in the wake of the crisis. Thus anti-memorandum forces blocked the effective formulation of a coherent crisis narrative and decisive implementation of reform measures. Different interviewees repeatedly confirmed this

point. For instance, Othon Anastasiadis from University of Oxford claimed, “Papandreou could not overcome the intra-party clashes.” Dimitris Papadimitriou from Manchester University similarly argued, “Papandreou did not have time [and team] to articulate PASOK’s own responses. [Therefore] what we have seen in Greece was that the crisis created space for anti-systemic [i.e., anti-reformist] entrepreneurs who capitalized on the discontent.” In the same vein, Dimitris Sotiropoulos, advisor to Papademos government suggested “[PASOK] had no intention of [comprehensive] reforms and had no communication strategy.” Second, labour unions unequivocally opposed the memorandum. My interviews with the representatives of peak labour organizations, namely the GSEE and the ADEDY, confirm this proposition. Zoe Lanara, the Secretary General of GSEE, claimed that they rejected the memorandum since “it paved the way for the IMF to enter into the euro area.” The legal advisor to the GSEE/ADEDY, Ellie Varchalama, pointed out that “the reform program was against human rights [which] would bring total anarchy to the Greek labour market.” Savas Robolis, Scientific Director of Labour Institute (INE)/GSEE-ADEDY also claimed “labour unions from the first moment highlighted the political deadlock resulting from the application of the memorandum.” Third party observers, either in a condemning or praising tone, also acknowledged in a repetitive manner that labour unions were strongly anti-reformist. Greek Deputy Ombudsman and Head of the Organization for Mediation and Arbitration in Greece, Christos Ioannou, who mediated the troika talks with labour unions on behalf of the Greek state suggested, “labour unions were living in a different world.” What he meant was labour unions’ demands were unattainable and unrealistic. Stella Ladi from Queen’s Mary University of London also confirmed that major

political parties and labour unions adopted anti-reformist rhetoric and “they were proud of their actions.” Third, peak business associations painted a mixed picture regarding their stance toward the reform program. In the initial phases, SEV’s approach to the memorandum can be labelled as conditional support. Theodore Fessas, President of SEV, stated this point as follows: “SEV initially expressed a cautious hope that the memorandum can pose an opportunity to improve the reform capacity of the Greek state, simply because for the first time a coherent plan that encompassed clear and pertinent targets on fiscal and structural issues was adopted as an official policy along with what appeared initially as a credible mechanism to supervise implementation of this plan.” This cautious support, however, turned into severe criticism in a short time period. Fessas acknowledged this as follows: “Very soon it became evident that the risks identified at the outset were turning into reality and that the implementation was mainly focusing on the parts of the initial agreement that would lead to a deepening of the recession and to unnecessary and huge social costs. SEV began raising the alarm both to the domestic political elite and to the Troika.” Dimitris Daskalopoulos, Former President of SEV (2006-2014) confirmed this point: “As we saw no tendency on the part of the troika to change priorities, SEV became more vocal in our opposition.” In short, the interview data cited in the main text and quotations above demonstrated that ‘anti-reform’ sentiments dominated the political scene, which further consolidated as the time went by. Thus interview findings hint that domestic ownership of the crisis could not be ensured in Greece.

2.

The interview data suggest that (i) the Greek crisis was mainly perceived as a ‘test case for Europe,’ which predominantly emanated from financial neoliberalization and the flawed institutional architecture of the euro area; (ii) Papandreou government failed to counteract the crisis coherently and decisively; (iii) the German-led IMF-EU anchor did play a very adverse role by misinterpreting the Greek crisis and unilaterally imposing the memorandum on Greece. In chapter 4, I discussed in detail how the PASOK and German leadership narrated the crisis with many references to Papandreou’s statements, speeches, and interviews (also see below). Christos Dimas from ND claimed, “Greece was a test case for all Europe [and] the IMF-EU failed to react rapidly and decisively when it was capable of doing so. That would have had many [positive] results. It was not an issue of Greece only, but also a crisis for the whole Community.” Dimas also argued that Papandreou government could not effectively tackle the crisis: “Papandreou was in a problematic situation. He promised several things to the electorate, which the economic situation of the country did not allow him to implement them. He was overzealous when he became prime minister to implement what had said previously, which had further [deteriorated] public balances. So he was a victim of his promises.” SYRIZA was sterner in its criticism toward Papandreou and the troika. Dimitris P. Sotiropoulos, SYRIZA representative, claimed that the “Greek crisis was a systemic test case for Europe, which should be treated at the European-level.” Rather than addressing the crisis at the EU-level, claimed Sotiropoulos, “particular countries [in this case Greece] were blamed in order to set forth austerity policies.” Sotiropoulos also argued, “Papandreou underestimated the problem and the EU’s [Germany’s] intentions... the

plan of the IMF-EU was to consciously implement a neoliberal plan from the very beginning.” Michael Mitsopoulos, Senior Advisor to the President of SEV, claimed that Papandreou failed to develop a coherent crisis narrative: “We did not even know what his agenda was. He was in denial that there was a problem till the spring of 2010. There was a policy failure on the magnitude that simply mind blowing.” The labour unions and business associations also opposed the reform program on the ground that troika’s crisis narrative was simply wrong, they were not regularly consulted, their ideas were not taken into consideration, and the measures were imposed unilaterally. Savas Robolis, Scientific Director of Labour Institute (INE)/GSEE-ADEDY argued, “despite GSEE made specific propositions, they were not taken into account... A completely different program was adopted.” He also claimed, “Germany [and the IMF-EU anchor] prioritized the interests of German and French banks rather applying the principle of reciprocity and solidarity among member states.” Dimitris Daskalopoulos, Former President of SEV (2006-2014) stressed, “the reform program was not instituted by Greece. It was given to Greece from the ‘outside’ and it was implemented top down.” Theodore Fessas, President of SEV, also indicated a very similar point: “On numerous instants SEV expressed clearly positions that were not accepted by the Troika at the time. The need to focus on structural reforms, rather than wage cuts in the private sector, was the most visible case where SEV from the outset clearly stated a position that the troika and Greek government did not take on board for far too long. The same is true with respect to the argument that a disproportionate emphasis on ‘internal devaluation’ and ‘austerity’ would ultimately be self-defeating.” Third party observers also confirmed that German-led troika’s austerity-obsessed crisis narrative was misleading and exhausted all

reform possibilities from the very beginning. Kevin Featherstone Director of Hellenic Observatory at LSE, suggested “the troika’s instinct to have early horizontal cuts was in fact mistaken partly because of the deflationary aspects but also because it diverted the attention from the real recognition of domestic institutional [fiscal and financial] reforms.” Similarly, Dimitris Katsikas, Head of Crisis Observatory at ELIAMEP pointed out “due to Germany’s moralistic rhetoric and troika’s too much emphasis on austerity, the crisis could not be used as an opportunity [to introduce substantial reforms].”

3.

It became apparent that fragmented crisis narratives dominated the political agenda in Greece, as a result of which pro-reform coalitions could not be generated. Without any exception, all respondents negatively answered my question, which asked whether pro-reform coalitions advocating a paradigm change in Greece’s fisco-financial regime could be created. Here I will quote few samples, since reflecting all of them seems impossible. George Pagoulatos, Chief Advisor to Papademos government: “MoU is highly unpopular in Greece. It is difficult to single out a group as gainers of the reforms [which also] created my losers. It is not easy to have particular coalition groups defending the [continuity of fisco-financial reforms].” Dimitris Daskalopoulos, Former President of SEV (2006-2014) also painted a similar picture: “[Reform packages] had no real popular base of support. Within this framework it is difficult to say if a viable pro-reform coalition (political or social) has been created.” Dimitris Papadimitriou from Manchester University pointed out “I don’t think the core logic of the Greek state [which informs fiscal and financial profligacy] will change. It is still operating in the

same way. What we should expect is a bamboo-effect. When the troika goes, the bamboo (anti-reformist coalitions) would go back where it initially was.”

Turkey

1.

In the Turkish case, my interview results confirmed that a pro-reform coalition emerged. First, political performance of the coalition government proved significantly higher than initial expectations in terms of the ownership of the crisis and the subsequent reform measures. The appointment of Kemal Derviş was highlighted as a clear indication of government’s willingness, and arguably predicament as well. Şevket Bülend Yahnici, the deputy leader of the MHP, claimed, “the government searched for a ‘credible figure’ that can [manage reform processes] and represent Turkey at international fora. Derviş was appointed as a minister for economy since he was conceived as an ‘insider’ to the international financial community and institutions.” The MHP, however, did not always supportive to Derviş’s policies. Yahnici suggested “MHP leader, Devlet Bahçeli, on different occasions criticized Derviş ‘as a minister of the DSP, not MHP,’ which I deemed a senseless political manoeuvre.” Masum Türker, member of the Economic Advisors Committee to Bülent Ecevit and Minister of Economic Affairs (August-November 2002) also reiterated government’s willingness to reform Turkey’s fisco-financial regime: “Ecevit government believed that Turkey’s Transition Program was a necessity to overcome economic bottlenecks. The government incorporated these reform measures into the government program. When the economic crisis hit the country, [most of the fiscal and financial reforms] were already in the agenda of the parliament.”

Türker, therefore, suggested, “the political willingness was very strong. Eleven of the most important reforms were already drafted and debated in the parliament even before the appointment of Derviş.” Kemal Derviş also stated this point in our interview: “The coalition leaders were on the same page regarding the urgency and necessity of comprehensive structural reforms.” A high-level bureaucrat and advisor also confirmed “[to decisively implement reform package] the coalition government provided a large space and autonomy to Kemal Derviş in the initial phases. [The coalition government thought like this]: This was a massive crisis, we have to do whatever it takes to overcome it.” Second, labour unions did not categorically reject the reform program. My findings even suggest that they played enabling role in terms of the ownership of the crisis. Rıdvan Budak from DİSK stated, “DİSK adopted a consensus-seeking and solution-based approach [to restore quick economic recovery]. We, of course, put primary emphasis on the wages and rights of the labour class.” TÜRK-İŞ president, Bayram Meral, also pointed out “we [as the peak association of labour class] said that we were ready to shoulder our responsibility. At that time, the business associations also appreciated our approach.” Third, peak business associations also demonstrated a strong ownership of the crisis and subsequent reform measures. Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD, put this point very clearly in our interview: “The content of the reform program was significantly overlapping with the arguments and proposals that TÜSİAD advocated for years. Thus TÜSİAD strongly supported the program. In the initial phases, the only concern, which we did not share with public, was whether it would be possible to implement the reform package properly.” A high-level bureaucrat and a senior advisor confirmed this point: “Step-by-step the business elite

cognized that reform measures were urgent and inescapable, especially in the financial system. The business associations recognized that the reforms would provide stability and unlock Turkey's potential. As a result a broad-based consensus emerged." The same figure also claimed "the labour unions were cautious in the initial phases. However, once they were informed [about the urgency of the situation] in a rather surprising manner they cognized that reform packages were necessary for Turkey's overall interests. For instance DİSK and TÜRK-İŞ were very well aware of what was going on. They did not act in a way to block the reform measures, which turned out to be an extremely positive factor [for the success of reform outcomes]." Faik Öztırak, Undersecretary of Treasury, underlined the same point: "I must admit frankly that both business associations and labour unions owned the reform program and placed their support behind it. This support was crucial." In summary, the excerpts quoted above and the others cited in the main text clearly demonstrates that 'pro-reform' sentiments were much more pronounced than the 'anti-reformist' attitudes.

2.

The interview data suggest that (i) the Turkish crisis was mainly perceived as a 'turmoil made in Turkey,' which predominantly emanated from state's fiscal and financial profligacy; (ii) Derviş played instrumental role to counteract the crisis coherently and decisively; (iii) the IMF-EU duo did play a positive and credible-anchor role by providing an optimal balance of carrots and sticks, especially in comparison to the Greek example. First the crisis was interpreted in a manner that the exiting fisco-financial regime and prevalent mode of state-market relations came to 'the end of the road.' All of

the respondents put a clear emphasis on this aspect of the issue. In fact, it is mainly because of this reason that the ownership of the crisis and reform program turned out to be so strong. Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD pointed out the dominant mood as follows: “The crisis revealed the naked truth that reforms were inescapable. It was not possible for political elite to give ‘lip service’ anymore, rather society pushed for a paradigmatic change.” Hasan Ersel also stressed, “[following the deep economic crisis a paradigm change became possible] because it was seen that there was not other way. The society in general was in a position to accept of all possible solutions as they got tired of the economic instability.”

Second, Derviş factor played a positive role to develop a coherent crisis narrative, steer pro-reform coalitions, and mediate between external anchors and domestic policy communities. In my interviews with top bureaucratic elite, the respondents acknowledged the ‘Derviş factor.’ Since I quoted a sample of these statements in the main text (see chapter 6), in this appendix, I will just refer to three others for illustrative purposes. Doğan Cansızlar, Chairman of Capital Markets Board of Turkey suggested, “Derviş’s appointment was perceived as a positive step by the markets.” Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD: “Kemal Derviş portrayed an entirely different image than the previous political elites. He rejected the ‘populist’ rhetoric. He demonstrated in a convincing and coherent manner that there was nothing to do but to implement the reform measures.” Rıdvan Budak, from DİSK suggested, “Derviş was a credible and trustworthy figure. [His crisis narrative] was reasonable and convincing.”

Third, the IMF-EU anchor played a positive role in the Turkish context. It seems that the IMF-EU anchor did not become an object of intense blame-attribution for Turkish political elite and major interest coalitions, which poses a striking difference in comparison to the Greek case. The important factors highlighted in this context were the large amount of financial support, regular consultations with the labour and business unions instead of an insistence on a top-down implementation of the transition program, the unorthodox elements of the reform package that enabled substantial fisco-financial reforms rather than single-minded austerity, and the linkage established between reform measures and prospective EU membership. For instance, Doğan Cansızlar, Chairman of Capital Markets Board of Turkey suggested, “the reform package incorporated certain elements that went beyond orthodox measures, especially regarding the restructuring of the financial system.” Ümit İzmen, General Secretary Assistant and Head Economist at TÜSİAD: “During the implementation of the program, we regularly came together with the Turkish and [the IMF teams]. I can confirm that there was ideational consensus in terms of the crisis narratives of the parties. TÜSİAD’s proposals were taken into account in the wake of the crisis mainly because of the bottlenecks in the political stream.” Şevket Bülend Yahnici stated “the US supported Turkey’s economic program [and credit requests from the IMF] since the US administration thought that Turkey would continue to remain a loyal partner to the US in the Middle East.” MÜSİAD emerged as the only large-scale organized interest group that criticized Derviş and the IMF-induced program on the ground that they were not informed in any stage. Ömer Bolat, President of MÜSİAD underlined this point as follows: “We thought at the time that IMF-led program was not serving Turkey’s economic interests. The government

[and Derviş] organized joint meetings with civil society actors [economic interest groups]. TÜSİAD, DİSK, TÜRK-İŞ, TOBB were invited these meetings. However, the government did not consult to us [mainly due to political reasons].”

3.

In the Turkish case, it seems that a dominant crisis narrative occupied the political agenda, as a result of which pro-reform coalitions could be generated. The excerpts quoted above as well as other interviews cited in the main text suggest that the crisis was perceived as a domestic problem, which informed a strong ownership of the crisis. The state agents on behalf of the Turkish government also adopted a convincing and credible narrative, which was almost entirely in line with the crisis narrative of the IMF-EU anchor. Finally, the IMF-EU anchor was perceived as a reform-triggering factor, rather than an object of intense blame-attribution. The combination of all these factors informed the emergence and consolidation of pro-reform coalitions that underpinned a new fisco-financial regime, based on a regulatory state paradigm.

A short note on other sources of data

In addition to the semi-structured elite interviews, other data sources also informed this research. I stated in the introduction chapter “that interviews do not provide direct access to the facts and realities on the ground, but enable the researchers to have first-hand information about how interviewees have perceived the events.” Therefore, I reviewed many other printed documents in order to check the reliability and validity of the

information that the respondents provide in our interviews. I reviewed press statements, speeches, interviews, reports, and newspapers articles. The following table tabulates these documents:

	Document types	# of doc.
GREECE		
George Papandreou	Speeches, interviews, op-eds	61
Angela Merkel and Wolfgang Schäuble	Speeches, interviews	64
IMF-EU	Reports, press statements, reviews	28
Business associations (SEV, GSVEE)	Reports, press statements, speeches	22
Labor unions (ADEDY, GSEE)	Reports, press statements, op-eds	6
Athens News Agency	Daily news	126
TURKEY		
Kemal Derviş	Speeches, interviews	8
Business ass. (TÜSİAD, TOBB, MÜSİAD)	Reports, press statements, interviews	32
Labor unions (DİSK, TÜRK-İŞ)	Reports, press statements	9
IMF-EU	Speeches, reports, letters, papers	172
Milliyet Gazetesi	Daily news	226

The review of the documents mentioned above was selective and thematic, conducted in a chronological order. Since it seems neither possible nor necessary to cite all of them in the bibliography, I only cited the ones that I directly refer to in the main text. The other documents, however, also helped me enormously to navigate my way and penetrate into the details of the events unfolded during crisis time.

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