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Neoliberal reforms, private
entrepreneurship and the informal
economy in Turkey

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The informal road to markets

Neoliberal reforms, private entrepreneurship and the informal economy in Turkey

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Abstract

Purpose – The informal economy has expanded across developing countries during the last decades. Focussing on the Turkish case, the purpose of this paper is to examine the role of neoliberal reforms in this development. The author argues that neoliberal reforms produced a double-edged transformation in the regulatory environment of Turkey. On the one hand, the legal rules that constrain the operation of market forces decreased giving way to more entrepreneurial activity; while on the other hand, the state's effectiveness in "policing" the market declined. As the regulatory barriers to private entrepreneurship decreased, the regulatory barriers to informality also decreased. Private sector growth and informalization emerged as the concomitant outcomes of neoliberal reforms.

Design/methodology/approach – This paper examines how the state's changing regulatory relationship to the private sector under neoliberal reforms fostered informal economic activities through a close study of the Turkish case.

Findings – At the end of the 1980s, the Peruvian economist Hernando De Soto popularized the view that informalization resulted from government regulations imposing rigid constraints and costs on economic actors, and so would be restrained by decreasing or eliminating them. The economic developments of the past few decades challenge this view, however. The size of the informal economy has expanded in developing nations at a period when government regulations have been declining. How can we explain the increasing volume of informal economic activity in developing nations over the past few decades? And more, how can we explain that this has happened during a period when the private sector has grown, and regulatory rigidities have declined? This paper argues that the state's changing regulatory relationship to the private sector under neoliberal reforms was an important factor in the expansion of informal economic activities.

Originality/value – The implications of neoliberal reforms for economic processes have been widely studied in the social scientific literature. Only a handful of studies have explored their implications for the informal economy, however. These studies singled out factors such as the decline in public employment, weakening of labor unions, or capital's enhanced ability to exploit labor in contributing to informalization of developing country economies in the neoliberal era. By discussing how the changing regulatory contours of the state-economy relationship played a role in the growth of informally operating private enterprises, this paper adds to the existing knowledge of this relationship.

Keywords Entrepreneurship, Turkey, Neoliberalism, Informal economy, Local economies, Institutions and institutional analysis

Paper type Research paper

Introduction

At the end of the 1980s, the Peruvian economist Hernando De Soto popularized the view that informalization resulted from government regulations imposing rigid constraints and costs on economic actors, and so would be restrained by decreasing or

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eliminating them (De Soto, 1989). The economic developments of the past few decades challenge this view, however. As Heintz and Pollin (2003, p. 6) note, the size of the informal economy has expanded in developing nations at a period when regulatory rigidities have declined, and private sector has grown[1]. According to internationally comparable estimates, more than one-third of the developing world's GDP and half of its labor force now remain outside the purview of the state. Using data from a cross-national study conducted by the World Bank, Palmade and Anayiotos (2005) estimate that between 1990 and 2003 the average aggregate value of economic activities as a percent of GDP has increased by one-third in developing countries. Informalization, according to a recent report from the OECD Development Center (Jütting *et al.*, 2008) has not only increased in developing nations but also in advanced nations, as seen in Table I. A brief look at employment statistics provides a similar picture. Employment in the informal sector seems to have increased substantially during the 1980s and 1990s (see Table II).

How can we explain that the informal economic activity expanded in many developing nations during a period when the private sector has grown, and regulatory rigidities have declined? Here, we use the case of Turkey to advance the argument that the state's changing regulatory relationship to the private sector under neoliberal reforms was an important factor in the expansion of informal economic activities.

The implications of neoliberal reforms for economic processes have been widely studied in the social scientific literature (Block, 1990; Hall, 1986, 2001; Campbell and Pedersen, 2001; Blyth, 2002; Fourcade-Gourinchas and Babb, 2002; Swank, 2003; Prasad, 2006; Fairbrother, 2007; Mudge, 2008; Kus, 2006, 2010). Only a handful of studies have explored their implications for the informal economy, however (Standing, 1989; Itzigsohn, 2000; Heintz and Pollin, 2003; Portes and Centeno, 2006; Olmedo and Murray, 2002; Pérez Sainz, 2005). These studies singled out factors such as the decline in public employment, weakening of labor unions, or capital's enhanced ability to exploit labor in contributing to informalization of developing country

	1989/1990	1999/2000	2002/2003
OECD (21 nations)	13.2	16.8	16.3
Central Europe & Former Soviet (25 nations)	–	38.1	40.1
Africa (23 nations)	–	41.3	43.2
South America (21 nations)	–	41.1	43.4
Asia (28 nations)	–	28.5	30.4

Sources: Jütting *et al.* (2008); Original data source: Schneider (2002, 2006)

Table I.
The informal economy
as % of GDP

	1980-1989	1990-1999
North Africa	38.8	43.3
Sub-Saharan Africa	68.1	74.8
Latin America	52.3	56.9
Asia	53	63

Sources: Jütting *et al.* (2008); original data source: Charmes (2000)

Table II.
Informal sector
employment as % of
non-agricultural
employment

economies in the neoliberal era. By discussing how the changing regulatory contours of the state-economy relationship played a role in the growth of informally operating private enterprises, this paper adds to our existing knowledge of this relationship.

In Turkey, neoliberal regulatory reforms instituted by the government had both primary (intended) and secondary (less intended) effects which ultimately created an ideal growth medium for informalization. In its movement toward a market economy, the Turkish government introduced a range of actions intended to simplify the regulatory environment for private sector activity, from removing obstacles to market entry and freeing up labor markets, to allowing greater leeway in international trade, to lowering taxes and providing incentives for small- and medium-sized enterprises (SMEs). Within this loosened regulatory structure, however, the country found itself falling short in creating and in enforcing a structure and mechanism for policing economic activity. The result was a vibrant private sector, and one with a pronounced degree of freedom from close supervision, where informality flourished. In short, the informalization which has characterized the country's transition to a market economy did not occur in a situation of economic decline and scarcity of employment opportunities, nor in response to stringent regulatory control. By contrast, informalization and growth both flourished in a deregulated environment, as twin outcomes of a neoliberal regulatory transformation. Indeed, as discussed later, informal practices increased and remained most prevalent in high-growth, high-export sectors, such as textiles, food, and retail and wholesale businesses.

In what follows, we first briefly[2] review what the literature has to say about causes of informalization. Then, we briefly discuss the link between neoliberal reforms and the growth of the informal economy. In the third section, we turn to the Turkish case. We examine how the regulatory changes that took place in the context of Turkey's neoliberal transformation have influenced the growth of informal economic practices. We conclude our paper by discussing the theoretical contributions, and policy implications of the study.

Informalization in the world economy: a theoretical overview

Although its original application in the 1970s was to the subsistence activities of the urban poor excluded from formal employment in labor surplus economies, the term "informal" has since been used to describe economic activities as diverse as street vending, tax evasion, unregistered employment, counterfeit production, and shuttle trade. The thread that unites all these diverse activities is that they all take place outside the official gaze of the state. Informalization can thus be defined as a process characterized by an increase in the size of profit and income-generating activities taking place outside the purview of the state (Castells and Portes, 1989; Hart, 2005).

Extensive literature exists on the causes of informalization, but within this literature, three strands of thought in particular stand out. The first view arose from the first wave of research, which was conducted largely in Africa, and characterizes informal activities as a product of underdevelopment. Based on this perspective, the increased development of a country's economy, through expanded capitalist activities and industrialization, will lead to greater formalization of economic activity, as well.

The second line of thought rejects the connection of informalization to economic underdevelopment. Instead, it claims that the structures that accompany advanced capitalistic economies are compatible with informalization and even help foster it

(Portes and Sassen-Koob, 1987; Sassen, 1994, 2002; Itzigsohn, 2000). Proponents of this line of thought assert that by providing firms with opportunities for more flexible production, profit generation, and cost reduction, informalization can be “an integral feature of advanced capitalism rather than a marginal appendix to it” (Castells and Portes, 1989, p. 12).

The third and final strand of thought on informal economic activity portrays informality as a rational response by economic actors to the state’s regulatory attempts. This view states that economic actors resort to informality in situations where high costs to formal market entry are imposed by the state, often through burdensome registration requirements, licensing fees, high taxes, or strict labor and environmental regulations. Hernando De Soto’s study of Peru’s informal economy, as presented in his book *The Other Path* (1989), provides a clear, widely-used application of this perspective. His study follows small- and medium-sized Peruvian entrepreneurs as they migrated from rural to urban areas in the second half of the twentieth century; the country’s institutional arrangements, he says, led entrepreneurs to rapidly become extralegal, as the costs of entering and remaining in the formal realm were too high (De Soto, 1989, p. xvii).

These existing perspectives, while they provide helpful insights into what is clearly a multi-dimensional, multi-causal phenomenon, offer limited help in explaining why the size of the informal economy increased in many of the world’s developing nations during the 1980s and 1990s. Take, for instance, the argument that informality is about levels of development. It is true that on average, the size of the informal economy as percent of GDP is bigger in less developed countries than in advanced countries. It should come as no surprise then that scholars have focussed on development status as the chief explanation for the size of the informal economy. However, the fact that the size of the informal economy varies significantly across developing countries poses a challenge to this convenient explanation. What is more, in many developed and developing countries alike, the size of the informal economy has continued to expand during times of positive growth.

The argument that informalization is integral to advanced capitalism, as a profit making and cost reducing strategy, remains plausible. However, capitalist economies differ significantly from each other in terms of the institutional structures within which they operate, and it is in part due to the variation in these institutional circumstances that they do not all bear the same degree of informality, or the same types of informal activities. It is important, hence, to identify what these institutional circumstances are, and how they foster informalization. This brings fore the question of the state’s involvement in the process of informalization.

The question of the state’s involvement in the process of informalization has been addressed by De Soto (1989). However, his specific argument that informalization results from the state’s rigid regulatory arrangements that inhibit entrepreneurial activity can easily be challenged, both on empirical and theoretical grounds. To begin with, informalization of developing economies over the past few decades has taken place in a fundamentally deregulated context (Itzigsohn, 2000; Heintz and Pollin, 2003). This is hard to explain for De Soto and his proponents who argued that economic actors resorting to informality due to the high costs associated with operating in rigid regulatory environments would line up to be a part of the formal system once nations got rid of their heavy regulations. From our perspective, however, this is not surprising at all. As various social scientists have noted, the state-informal economy relationship is more complicated than De Soto makes it out to be.

First of all, as Fernandez-Kelly and Garcia (1989), has shown, rather than simply being an outcome of a heavily regulating state, informalization often takes place under the auspices of the state. Through the actions of local and federal agencies, the state may tolerate or even stimulate informal economies so as to reach certain economic and social outcomes.

Second, the capacity of the state in enforcing the regulations matters as much as the actual degree of regulation in the economy, if not more (Portes and Centeno, 2006; Kus, 2010). Examining quantitative data at the macro level across a broad set of countries, Kus (2010) showed, for instance, that while the average size of the informal economy is indeed larger in nations with higher degrees of state regulation in the economy, decreasing the degree of regulations is by no means a recipe for formalization. In contexts where the state lacks the capacity or the political will to enforce these rules effectively, Kus argued, decreasing the scope of regulations is likely to lead to more informality, rather than less. In a similar vein, the social and cultural characteristics of the society in which economic actors remain subject to these rules and regulations also matters. Referring to the Latin American experience, Portes and Centeno (2006) argued that the attempt to foster a regime of minimal but dependable regulations, which would unchain the growth of the private sector and promote formalization, has backfired because the underlying societal structures in Latin America are quite different from those ruled by developed liberal states. In those societies where poverty and inequality abound, they argue neoliberal reforms, by means of weakening unions and government regulators, ended up creating more opportunity for private firms to benefit from informal channels. The end result has been “the decline of protected work, a significant rise in microenterprises and informal employment, and a sustained increase in economic inequality” (p. 38). This argument remains in line with the findings of earlier research by Itzigsohn (2000), and Olmedo and Murray (2002).

Economic informalization: the role of neoliberal reforms

As noted before, although there is a vast literature on neoliberal reforms, the empirical link between their ascendancy and the expansion of the informal economy in developing nations has been systematically analyzed in only a few studies (Itzigsohn, 2000; Olmedo and Murray, 2002; Pérez Sainz, 2005; Jonakin, 2006; Portes and Centeno, 2006). Focussing on informalization in the labor market in particular, Pérez Sainz (2005) emphasized three major channels through which neoliberal reforms contributed to informalization – namely, the decline of public sector employment, deregulatory changes in social security laws, and debilitation of unions. Itzigsohn (2000) showed how the deregulation of the labor market blurred the distinction between formal and informal work. Similarly, Olmedo and Murray (2002), focussing on Argentina, showed that the 1991 National Employment Law, one of the major legislative elements of Argentina’s neoliberal turn, essentially institutionalized and legitimized what had hitherto been seen as defining features of informal labor markets – such as precariousness, lack of social protection, and limited rights to wage bargaining. More recently, Jonakin (2006) argued that the growth of informal activities in the 1980s and 1990s constituted a structural pre-requisite of neoliberal export promotion strategies.

Building on this literature, and in particular picking up threads proposed by Fernandez-Kelly and Garcia (1989), Itzigsohn (2000), Portes and Centeno, 2006, and Kus (2010), this study uses the case of Turkey to investigate how the changing contours of

regulation under neoliberal reforms enable informalization of the economy. We show that the same neoliberal measures that served to stimulate growth in the private sector, also removed capacity to police the activities of that sector, thus creating the conditions for a thriving informal economy. With the lifting of regulatory constraints a much broader array of economic activity was possible, and with the state's decreased capacity for law enforcement in regard to this activity, informal as well as formal patterns proliferated within the private sector.

Neoliberal reforms, regulatory change and informalization in Turkey

In the years of economic deterioration following the oil crisis of 1974, Turkey was forced to rethink its state-led, centrally administered development strategy of domestic industrialization. In company with many other nations, Turkey turned decisively away from import-substitution to a more dynamic export-driven economic model in a bid to counter sharp inflation, high unemployment and foreign exchange shortages, instituting neoliberal reforms aimed at radically transforming the country's economy both quantitatively and qualitatively. The government of Turgut Ozal[3] led Turkey in a reform program designed to change the relationship between the state and enterprise through a regulatory about-face. Through the years that followed, various waves of policy implementation methodically removed barriers to market entry, international trade, labor flexibility, and access to financing. Deregulation was complemented by lowering taxes, in a shift toward an export-oriented and enterprise-led private sector. Turkey had, however, never had a strong ability to enact the supervision of its regulatory mechanisms and this, as we will see, coupled with a loosened economic environment, had the effect of compromising effective state "policing" of the economic sphere (Buğra, 1994).

Deregulation in the economic sphere

The deregulatory changes implemented during the liberalization of the Turkish economy revealed themselves most visibly in the area of trade. Protection rates for different sectors of the economy were reduced significantly (Togan and Balasubramanyam, 1996). The share of restricted imports within total imports dropped from 25 percent in 1975 to <2 percent in 1984 (Togan and Balasubramanyam, 1996). The government also enacted a consistent export promotion policy; exports were encouraged through tariff exemptions on imported inputs, foreign exchange allocations, tax rebates, and exemptions from various taxes[4].

Tax policies were altered to promote the growth of the private sector, as well. The state substantially reduced taxes on wealth (including property tax, capital transfer taxes, endowment tax, and capital gains taxes) and put many breaks and exemptions into the tax code. The effective rate of corporate tax was also reduced. Between 1988 and 1993, the share of corporate tax revenues within the total tax revenues dropped from 12 to 5.9 percent, even though the number of corporate taxpayer more than doubled in the same period[5]. Taxes on wealth (including property tax, capital transfer taxes, endowment tax, and capital gains taxes) were substantially reduced[6].

In addition to these tax breaks, significant changes took place in the Turkish state's labor laws. Perhaps most notably, new labor legislation restricted workers' right to unionize[7]. In 1975, there were 781 registered unions in Turkey; by the end of the 1980s, this number had decreased to 81 (Önder, 2000). Many legal obstacles to firing workers were removed, and limitations were imposed on severance payment amounts, annual vacations, and the financial liability of employers (Önder, 2000; Gulmez, 2005).

In short, by the late 1980s, many of the regulations that had constrained the growth of the informal economy and held Turkey to an inward-looking, import-based economic model had been eliminated. The 1990s, propelled by governments[8] that supported the ideological premises of the 1980s reform process, saw even further reduction in state regulatory intervention in the Turkish economy.

Policing in the economic sphere

The same period also saw significant decrease in the effectiveness of the state in “policing” the economic sphere. As Buğra (1994, p. 232) notes, “as the Turkish state, represented by a very narrow group of people, acted as the main agency for the neoliberal restructuring, it had simultaneously dismantled some of the basis of its own power that would permit its much-needed intervention as a regulator.” A variety of ideological and institutional factors underpinned this development. On the ideological front, political leaders came to view the state as a repressor of economic freedom and entrepreneurial spirit. As a result, they regarded evasion of the law by economic entrepreneurs as “justified” and were reluctant to punish offenders, fearing that doing so would prevent entrepreneurs from growing their businesses. Despite criticism from the judiciary and the parliament, a new principle of “economic punishment for economic crimes” became a substitute for penitentiary punishment, even for the most serious economic crimes.

This principle was most notably applied during the “fictitious exports” episode of the early 1980s, in which rent-seeking enterprises tried to take advantage of generous export subsidies and tax returns through over-invoicing and other mechanisms. It soon became clear that a large number of firms had violated the law, claiming large amounts of export subsidies and tax returns for exports that, in reality, were much smaller than the firms declared. Still, when the Turkish Prime Minister heard of the issue, he argued that, in this situation, the state was to blame, and the entrepreneurs were only acting with the objective of making the economy work better (Çetin, 1988). The government went even further, issuing an official decree concerning exports dated December 29, 1983 (887/7340), which stated that “No official can prevent exporters’ trade activities from happening in order to perform his duty. Exporters’ transportation of goods cannot be stopped.”[9] The same day, the Official Gazette issued another decree in regards to Law No. 1567, on Protecting the Value of the Turkish Currency: “It is free to bring in Turkey foreign currency of all types by all means. It cannot be registered; its origins cannot be investigated.”[10] With these decrees in place, fictitious export activities continued until they reached levels that could no longer be ignored. Offenders were finally indicted under existing laws; however, with the amendments that had been made to the existing laws, they were soon bailed out. The “fictitious exports” incident reveals the Government’s reluctance in creating a regulatory climate in which economic laws were upheld and enforced.

This ideologically driven lack of political will, however, was not the only reason for the states ineffectiveness in policing the economic sphere. Structural changes to state institutions also contributed to the state’s decreased capacity for effective control. One tactic which had made possible a decisive response to the crisis of the 1970s and 1980s was the centralizing of policy making within a small hub around the Prime Minister, thus cutting past the potential inertia maintained in such bureaucracies as the State Planning Organization which had overseen development in the preceding period of inward focus. In bypassing these institutions, however, the state mechanism effectively isolated itself from society also, and although the decision-making

core gained the coherence and autonomy cited by Evans (1995), it had lost accountability and “embeddedness.” State policy was thereby insulated against the society it sought to serve.

There were other structural changes which were to have even greater and very specific impact on the relationship between society and state. Under the new Constitution of 1982, the powers of the legislative and judicial branches of government were subsumed to a significant extent by those of the executive branch. Successive Prime Ministers and Councils of Ministers all throughout the 1980s and 1990s found it convenient to make frequent use of the provision to make regulatory changes through extra-parliamentary means. There was a dramatic increase in the proportion of legal changes implemented through decree, from 34 in the 1970s to 186 during the 1980s (Ünay, 2006, p. 123). As with the centralizing of policy making critiqued above, there were positive as well as negative aspects to this changed legal structure. Properly used, the new format allowed for swift and effective implementation of reforms. Less scrupulously employed, however, it became an avenue along which to push a political agenda without exposing it to the tempering effect of a broader clientele. Laws, in this way, came and went during the 1980s and 1990s, in the hands of a succession of governments that formed and instituted policy objectives without regard for existing law, which could after all be changed at will (Buğra, 1994).

This state of affairs did not, of course, proceed without remark. The legal landscape was becoming cluttered with contradictory information, and the President of the Turkey Bar Association criticized the government in a 1985 speech for creating what he termed ambiguity. He declared that the government’s decrees were creating an unpredictable and confusing condition in the country’s legal system. The independence of the judiciary was being impaired, he claimed, by these frequently issued decrees, and the state’s legal capacity was suffering (from *Cumhuriyet* dated May 11, 1985; author’s translation). Ünay (2006, p. 13) makes the point that in the chaos of a collapsed judiciary-parliamentary balance characterized by unaccountable changing and flouting of established rules and practices, the socioeconomic landscape of Turkey was propelled through rapid changes. As is shown in the following section, the country experienced strong economic growth during and following this transitional period.

Growth and informality as two faces of Turkey’s neoliberal transformation

The scope of the re-landscaping addressed – and indeed accomplished – by Turkey’s neoliberal reforms of the late 1970s and 1980s can perhaps best be comprehended through before and after snapshots of Turkish industry and employment. The state, in the pre-crisis model, was the country’s main employer and kept a tight rein on a geographically centralized import-substituting industrial base favoring a small number of large private conglomerates. Such SMEs as existed faced barriers to market entry, trade restrictions, and limited access to finance. Barkey (1990, p. 63) reckoned the state’s contribution to value-added manufacturing at 30 percent of the national total at the end of the 1970s, the final decade of the state-led model. At that time 40 percent of the country’s labor force was on the state payroll. The five hundred industrial firms that generated over half of manufacturing sales nationwide tended to be concentrated in and around Istanbul.

Neoliberal reforms, and the regulatory transformation that accompanied them, successfully promoted the growth of Turkey’s private sector and export activity. In less than two decades, Turkey transformed from a tightly regulated, import-substituting

economy dominated by large, geographically consolidated enterprises into an export-oriented market economy with numerous small- and medium-sized businesses based all across the country. The economic growth rate, which was negative as of 1980, remained consistently positive during this period, economic openness has increased, and export volume rose substantially.

From 1980 to 1995, the private sector's share in total employment increased from 64 to 85 percent, and its share in total value-added increased from 60 to 77 percent[11]. Much of this new private economic activity was based in Anatolia and consisted of SMEs; the share of small- and medium-sized firms in total employment rose from 37 in 1980 to 46 percent in the mid-1990s. Figure 1 below captures these trends in the Turkish economy – namely, the growth of the private sector, export-orientation, and the rising prominence of SMEs.

Turkey's regulatory transformation also brought about a change in the common perception and frequency of various business practices. Most notably, evasion of legal rules became a much more feasible and acceptable practice across a variety of economic sectors. There is compelling evidence that much of the new entrepreneurship in Anatolia (and all across Turkey) in the 1980s and 1990s remained informal. The majority of these small enterprises were family-based firms in labor-intensive industries, such as textiles, clothing, and food processing. They began with limited capital and employed workers with little or no social security or health benefits, evaded taxes, and often failed to register as legal entities (Pamuk, 2008).

According to data from TURKSTAT[12] presented in this Figure 2, between 1980 and 1995, the share of unregistered labor in total employment increased from 32 to 37 percent. More recent data from TURKSTAT shows that a decade later in 2005, this ratio rose to 44 percent. The two aggregate estimates of the informal economy, which are presented in this figure, also point to the informalization of the Turkish economy under neoliberal reforms. While it is important to note that the actual measurement of the size of the informal economy can vary based on the specific indirect aggregate measurement technique used[13], the growth trend in the Turkish informal economy is consistent across all measurement techniques.

The findings of a recent survey conducted by a TOBB-affiliated research institute among 1,733 of its members support these conclusions. When the survey asked

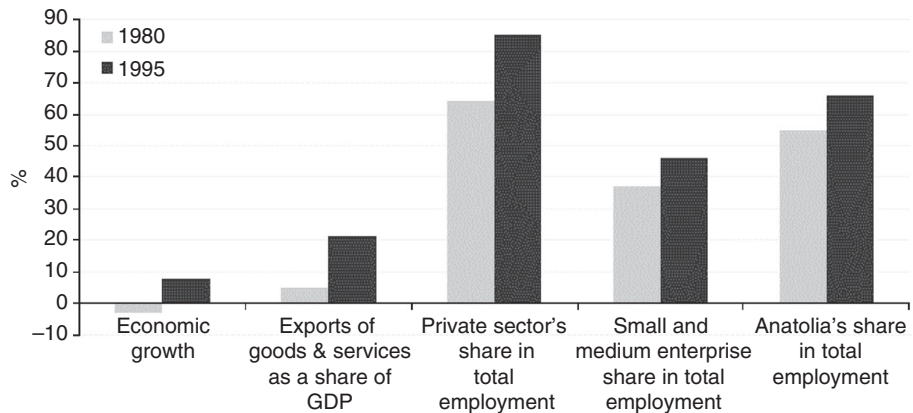


Figure 1.
GDP, economic openness,
private sector expansion,
and employment
1980-1989

Source: Turkish Statistics Institute

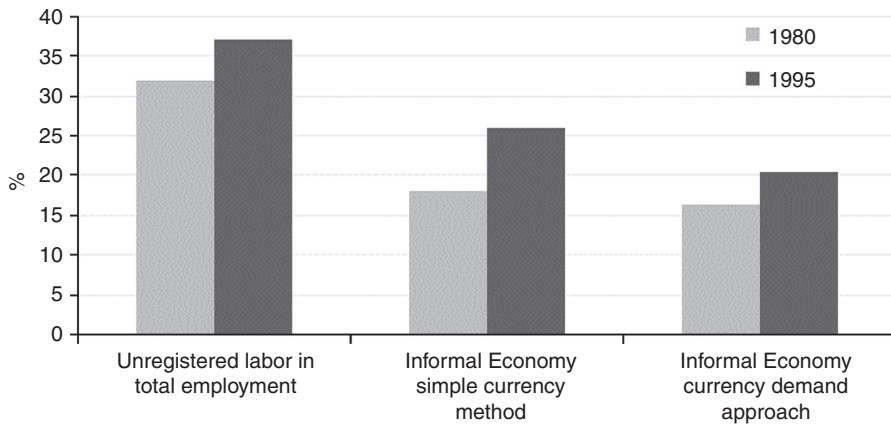


Figure 2.
Informality in the Turkish Economy

Source: Yeldan *et al.* (2000); Ögünç and Yılmaz (2000)

respondents whether or not they were competing with informally operating and unregistered enterprises in their respective sectors, 821 (64 percent) of the 1,282 responding enterprises reported facing competition from informal firms. Further, only 57 percent of the firms located in Istanbul reported experiencing informal competition, suggesting that informality is more prevalent in the newly operating firms of Anatolia.

The survey data also shows that the sectors where informality levels seems to be higher are the ones where the highest rates of economic growth and export activity were observed in the 1980s and 1990s – namely textiles and apparel, food, and retail and wholesale business sectors. In all, 79 percent of enterprises in the textile and apparels sector, 66 percent of enterprises in the food sector, and 68 percent of enterprises in the retail and wholesale business sectors reported facing informal competition, while the average across the entire economy was only 64 percent (Figure 3).

Conclusion

Economic activities that take place outside the state’s “bureaucratic gaze” comprise a substantial economic value, which, in some countries, remains as big as the official GNP.

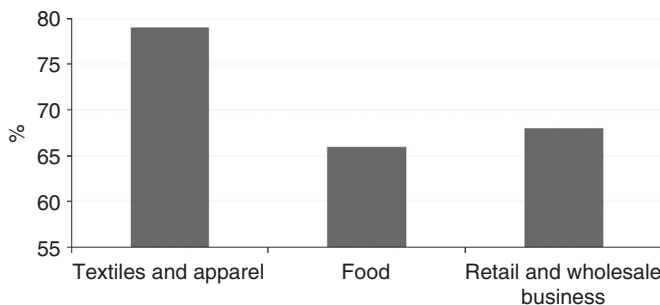


Figure 3.
Informality across sectors of the Turkish economy

Source: TEPAV (Türkiye Ekonomi Politikaları Araştırma Vakfı) Enterprise Survey (2006)

As it has been discussed extensively in this paper, the existing literature offers several explanations for the growth of informal economic activities – namely, that informalization results from lack of capitalist growth; that informalization is an outcome of heavy state regulations, and that informalization is an integral element of advanced capitalism. While the first two of these perspectives cannot explain how it is that the size of the informal economy expanded in many countries over the world at a time of increasing private sector growth and decreasing regulations, the third perspective, by virtue of attributing informality to a systemic variable, fails to specify the mechanisms through which this has happened, and ends up overlooking the explanatory significance of the domestic legal and institutional circumstances.

This paper considered the link between the ascendancy of neoliberal reforms and the expansion of the informal economy from a regulatory perspective taking the case of Turkey as a point of reference.

Rather than explaining the proliferation of informal practices as a natural element of advanced capitalism; it illustrates, by using the Turkish case, how it has become increasingly possible for private economic actors to stay in the shadows in the regulatory climate created by neoliberal reforms. Specifically, we argued: that the growth of the informal economy is inherently linked to the state's regulatory intervention in the economy; that neoliberal reforms brought about a double-edged regulatory transformation, which included, on the one hand, deregulatory policies aimed at promoting the growth of the private sector, and on the other hand, decreasing enforcement efforts in the economic sphere; and that this led to an expansion in private economic activities but also in informal practices in the Turkish economy during the 1980s and 1990s.

To what extent is the framework generated around this case study generalizable to a broader applicability? Looking to the existing literature, we begin to be able to gather together a credible body of evidence across countries, filling in the picture of how countries tend to function in the process of neoliberal transition. Stark (1996) characterized the shift in mindset that provides a new algorithm for the creation of a dynamic private sector. According to Stark, the legal principle whereby “everything is prohibited that is not explicitly allowed” is stood on its head to produce a logic where “everything is allowed that is not explicitly prohibited” (p. 659). Under these conditions, an informal economic pattern can become established. In a broad-based quantitative analysis of the newly deregulated countries outside the OECD area, Kus (2010) showed that informalization of the economy tends to accompany ineffective policing of economic actors, and this is indeed borne out by the Turkish example. The current study looks more closely at this case to identify the mechanisms of this transformation.

Does deregulation lead to formalization? This has certainly not been the case in Turkey. Contrary to earlier assumptions that the widespread neoliberal reforms freeing up previously strict regulatory environments would lead to a formalization of economies through providing incentives for “legitimate” economic activity, examination of what has actually occurred in these economies in response to regulatory change reveals quite the opposite picture. In Turkey, the changed relationships resulting from neoliberal reforms and regulatory change have made space for a strengthened informal economy in the space of private sector growth.

The paper also contributes to the now vast literature on the nature and implications of neoliberal reforms, in two ways in particular. First, analyses of regulatory change under neoliberal reforms have focussed exclusively on deregulatory changes.

The state's declining effectiveness in policing the economic sphere – that is in enforcing the laws and regulations has not been adequately analyzed as part of neoliberal transformations. Therefore, we know little of the structural and ideological causes and implications of this phenomenon. Yet, as our analysis shows, this was a central dimension of Turkey's neoliberal regulatory transformation and remained critical to the proliferation of informalization in the economy. We showed here that both ideological and institutional mechanisms played a role in the state's declining effectiveness as an enforcer of rules and regulations in the economic sphere. While the institutional changes affected the state's actual capacity to enforce its laws in the economic sphere, the ideological factors at play reflected the lack of political willingness on the part of state actors to actually implement laws in the economic sphere, and to punish offenses. This is an issue of paramount importance. The past few decades have seen an outbreak of corporate and other economic scandals and frauds. In many cases, commentators on these processes have argued that these instances have not resulted from a lack of rules, but rather from the state not being able to or willing to implement them. Very few scholars have stressed aspects of the transformation of the state-economy relationship under neoliberal reforms. More work is needed on this question.

Finally, and related to the former point, neoliberal reforms are generally understood to have transformed state-run economies to market-oriented ones with the private sector as the main producer and employer. Yet, it is often ignored that the road to markets has been paved with informal mechanisms in many developing nations. The increasing number of private entrepreneurs, a significant portion of them SMEs, remained partially or fully outside the state's gaze. Thus, it is important to understand neoliberal reforms not only as simply having led to more private entrepreneurship but also to an informal pattern of private sector growth.

Notes

1. See Portes and Sassen-Koob, 1987; Johnson *et al.*, 1997; Charmes, 2000; International Labor Office (ILO), 2002; Feige and Urban, 2003; World Bank, 2004; Schneider, 2005; Palmade and Anayiotos, 2005; Organisation for Economic Co-operation and Development (OECD), 2009 for further discussion and data on the expansion of the informal economy.
2. What we provide here is not an exhaustive review. We focus on the causal accounts of the development of the informal economy, and leave out discussions regarding its nature.
3. Before he became the Prime Minister in 1983, an office he would hold until 1989, Turgut Özal was in charge of the economy as the Head of State Planning Organization and the Undersecretary of the Prime Ministry (1981-1983). Prior to that, was one of the executives of the MESS (The Metal Industry Businessmen's Association) – a leading vocal group of the time pursuing business interests.
4. The share of customs tax within the total tax revenue, which was about 10 percent in the 1960s dropped below 2 percent at the end of the 1980s.
5. In 1980s the share of corporate tax revenues within the total tax revenues was significantly higher than the OECD average; by 1995 it was significantly lower.
6. The ratio of wealth tax revenue to GNP, which was already lower than the OECD average as of 1980, had fallen still lower by 1995 (Yılmaz, 1996).
7. Through Acts 2821 (Trade Unions Act) and 2822 (the Collective Bargaining Strike and Lockout Act).

8. Respectively, Akbulut; Yilmaz; Ciller, and finally Ciller-Erbakan governments.
9. Author's own translation.
10. Official Gazette dated December 29, 1983 number 18266.
11. The figures on Turkish economy provided here are from the Turkish Statistics Institute, unless otherwise noted.
12. The data on labor informality is from the Turkish Statistics Institute as provided in Yeldan *et al.* (2000).
13. The aggregate size of the informal economy as a percentage of GDP can be measured by using a variety of indirect measurement techniques. In Figure 1, the first aggregate figure on the size of the informal economy was calculated using a simple currency method, which measures the informal economy in terms of the increase in monetary notes in circulation. The second aggregate figure was measured using a currency demand method, which tracks the rise in demand for currency.

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