ON THE LETTER OF INTENT AND THE TURKISH ECONOMY AT THE BEGINNING OF 2002

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Introduction

Following the November 2000 and February 2001 crises, the Turkish economy experienced a severe deflation, which is gradually deepening and is gaining structural characteristics. The November and February crises did not only give deep shocks to the financial markets, but also devastated the balance sheets of both banks and private companies. These crises brought about a deep recession in production and employment, as well.

During 2001, the ongoing crisis management under the guidance of the State Minister in charge of the Economy, Mr. Kemal Derviş, was not able to produce realistic solutions to the deepening structural problems of the economy, and was not even close to give a satisfactory response. In May 2001, The *Transition Program for Strong Economy* (TPSE) was presented by Mr. Derviş himself, and was prepared with the claim of being an entirely new program for Turkey to overcome the depression. Those who prepared the program advocated that the depression would only be overcome by putting an end to the unsustainable domestic and foreign borrowing dynamics and by restructuring the state/economy relationships according to the market forces. However, since the announcement of the TSEP, economic problems deepened, national income dropped by 8.5 percent, and the open unemployment rate has increased to above 10 percent. Official statistics issued by the State Institute of Statistics reveal that by the last quarter of 2001, the open unemployment rate has reached to 15 percent in non-agricultural sectors, 27 percent among "educated" youth in all regions, and to 30 percent among the "educated" youth in urban regions.

Simultaneous with these developments, social expenditures of the public sector were shed into shrinkage, and public sector's fiscal policies were restricted to attaining the arbitrarily set targets of "non-interest, primary surpluses". The Central Bank of Turkey (CBT) has become incapable of making effective interventions in the foreign exchange market due to both gross reserve losses and negative figures of net exchange positions, and due to the fact that all possible interventions of the CBT in the foreign exchange market were strictly prevented by the IMF. On the other hand, since November 2001 the CBT was restrained from providing direct or indirect resources to the public sector with vaguely defined policies of "targeted disinflation" and central bank "instrument independence from politics". Under these conditions, significant policy tools through which the monetary authority could intervene in the real economy were severely restricted.

When evaluated from these points, it is observed that the main target of the 2001 crisis management is to leave the future of our country totally to uncontrolled and rambling processes of market forces via a series of structural operations which pave the way for deregulations of the economic and social structure. Beyond this, under the deceit of "incentives to foreign capital", privatizations, supreme boards and governance, strategic sectors and natural resources of Turkey are offered to the multi-national corporations. To this end, between February 2001 and February 2002, except for few technical laws, approximately 65 structural reforms have been issued. Around half of these laws was directly included in the "structural adaptation" program. It is clear that, affinity of the USA and others with Turkey has a good reason.

A new Letter of Intent, presented to the IMF in January 18, 2002 and issued in January 4, further pursues those objectives highlighted above. The new Letter of Intent continues to aim that Turkey's integration to world market will be in the form of a peripheral economy, with low quality labour-intensive technologies.

We, as the Independent Social Scientists - Economics Group, find a pressing need to report the essence of these aims as set forth in the Letter of Intent of January 2002 and the TPSE of May 2001. We also find a need to make critical evaluations on the economic policies as planned to be pursued in 2002. We find that the macroeconomic targets of the last Letter of Intent target slower growth, higher inflation, higher real rates of interest, and higher external borrowing in comparison to the targets of the 2001 crisis management program as spelled out in the official May 2001 TPSE document. Furthermore, the last Letter of Intent pursues the intention of leaving Turkey to open exploitation of international capital under the mask of “structural reforms”.

Turkish Economy Is Condemned To Deflationary Financial And Monetary Policies

Turkish economy has been put under pressures of high real rates of interest and an overvalued foreign exchange rate with the completion of financial liberalization policies in 1989. With the advent of an unregulated and open financial system, the Turkish economy was deprived-off its traditional tools of austerity to maintain its basic macroeconomic balances, and got trapped into short term artificial boom-bust-and-stabilisation cycles by becoming dependent on the speculative hot money flows. In this process, the public sector borrowing requirements have become unsustainable and the public sector became incapable of generating public savings and investments; private sector accumulation preferences receded from real productive sectors towards speculative accumulation areas; and rent-seeking activities gained supremacy over allocation of resources.

The post-1989 path of artificial boom-bust-and-stabilisation cycles was clearly unsustainable, and finally in late 1999 the Turkish government implemented a disinflation program using the exchange rate as the nominal anchor. The program was designed and implemented under the close supervision of the IMF. However, the 2000 disinflation program did not aim at transforming the dependency of the domestic financial markets on the short term speculative foreign capital flows. Rather it continued to maintain the sources of growth to be directly dependent on the hot money flows. Furthermore, it aimed at generating budget income from privatisations by selling of public assets with the explicit objective of offering the national resources to the hegemony of global capital. Such endeavours, together with increased political corruption and legal defects, involved direct transfer of rents to the national and international capital, and were presented to the public under the discourse of "structural reforms".

Meanwhile, the national economy was condemned to deflationary fiscal and monetary policies, and budgets were left to the dogma of attaining "primary surpluses" targeted at ad hoc levels. As a matter of fact, the 2000 disinflation program and the 2001 crisis management accepted the primary surplus target as a prerequisite, and framed public expenditures under the tight control of this objective.

Observations on the 2000 and 2001 consolidated budget figures clearly show that in both periods the *targeted values of fiscal revenues and expenditures were met*. Consolidated budget data tabulated in Table I reveal budget revenue realisations are actually higher than the targeted values by 3.6 percent in 2000, and by 5.1 percent in 2001. On the other hand, expenditures remained 0.2 percent lower than the 2000 targets, and as for 2001 targets it is exceeded only by 1.7 percent so far. Consequently, in the concerned years, public management expenditure and revenue targets were achieved and the primary (budget) surplus as a ratio to national income (including privatisations and other non-fiscal revenues) were increased to 6.1 percent in 2000, and to 6.7 percent in 2001. This "success" in the public sector balances was attained by restricting expenditures on public services through extraordinarily shrinking public investments, and by way of extraordinary taxation possibilities peculiar to 2000 (utilizing the increased social awareness and solidarity after the 1999 earthquake).

TABLE I

Despite the surplus in the primary balance of the consolidated budget, net new domestic borrowing have been gradually increasing. The net new domestic borrowing was kept at the level of 7.5 percent to the Gross National Product (GNP) in 2000, yet this ratio increased very rapidly reaching 12.7 percent in 2001. Consequently, achievement in the primary surplus targets, chief among the macroeconomic indicative targets, was not enough to slow down the borrowing requirements and to maintain the desired balance in the public sector accounts.

Although the targeted values of the 2000 and 2001 public expenditure program were achieved, burden of the interest repayments (expenditures) on the domestic financial markets continued to increase. Interest expenditures as a ratio of tax revenue increased to 77.1 percent in 2000, and reached 103.3 percent in 2001. Under the crisis management targets, interest expenditures were fixed as 88.1 percent of the tax revenue in 2000, and 109 percent in 2001. In 2002, it was anticipated that target of interest expenditures would reach to 73.9 percent of the tax revenue targets. It is clear that while the public sector consolidated budget in the last Letter of Intent persisted the policy of "facilitating a smooth rollover of the government's domestic debt" with a targeted primary surplus, it does not suggest any realistic measures to decrease the burden of interest spending program on public disposable income.

Moreover, macroeconomic balances in the Letter of Intent assume an average nominal interest rate of 69 percent on Treasury Bills in 2002. This projects a real interest rate of 30 percent during 2002. However, the 69 percent interest rate prevailed only in the beginning of 2002. In other words, a possible decrease in the nominal interest rate parallel to inflation rate during the year is clearly not desired. As a result of this preference, the average real rate of interest on Treasury bills was kept as high as 33.2 percent. That is to say until new habituates are adopted, it is promised to provide the financial system with public debt instruments offering high real returns. The real rate of interest was –9.4 percent in 2000, and 32.4 percent in 2001. In the continuation of this program these values are expected to be 27.5 percent in 2003, and 20.5 percent in 2004. Despite this modest deceleration, it is understood that the Turkish Treasury will continue to borrow at higher cost than the world average. Under the light of these data, it is clearly seen that the main objective of the Letter of Intent of 2002 as well as of the TSEP of May 2001 is to help the financial capital first of foremost to overcome the crisis.

Macroeconomic Targets Of The Letter Of Intent Of 2002

Macroeconomic targets in the Letter of Intent of January 18, 2002 espouse basically the anticipated approach in the TPSE. Though with a difference: although the public sector primary targets were totally preserved in the Letter of Intent, henceforth general macroeconomic balances can be achieved with higher inflation, higher real rates of interest rate, and lower rates of growth.

In Table II, macroeconomic indicative targets of TPSE May 2001 are compared with the proposed targets of the Letter of Intent of January 18, 2002.

TABLE II

TPSE expected the recession of the GNP in 2001 as only –3.0 percent; and designed a growth path that is 5.0 percent in 2002, and 6.0 percent in 2003. Interestingly, with a footnote to the Macroeconomic Values Table on page 43 of the TPSE document, it was stated that "if we assume this program will be applied completely, the rate of growth in 2002 and 2003 would reach to 7 percent". Nevertheless, the growth targets were not achieved despite the structural reforms enforced by the open blackmail of "15 Laws in 15 Days" after the public presentation of the TPSE during the summer months, and despite the successful implementation of the stated primary surplus targets for 2001.

Although those who enforce the TPSE try to relate the shrinkage during 2001 to conjuncture of the events of September 11, it is very clearly observed that the contraction of the domestic economy deepened and attained "structural" characteristics already before September 2001. As a matter of fact, in the TPSE the annual change in GNP was projected as –2.9 percent for the second quarter of 2001, yet the realization had been –11.8 percent, and the average of the year has become –8.5 percent. Thus, despite the strategic structural reforms which were fulfilled throughout 2001, and despite the overall shrinking of the public sector as planned, none of the macroeconomic targets were achieved for the rest of the year.

Another pathetic fact in the Letter of Intent is that national income is projected to turn back to $201 billion in 2004, its value back in 1998! If the growth targets for 2002, 2003 and 2004 which were respectively 3 percent, 5 percent, and 5 percent would be met, this is the best that the austerity program outlined in the Letter of Intend can offer. However, income per capita in 2004 will still be lower than that in 1998 because of the population growth in these 6 years. This means that the welfare loss will be deepened. Moreover, these calculations were made with the assumption of just allocation of the growth increase. Yet, because of strong anti-social nature of the program, more unequal income allocation at the end of the term should be expected.

Inflation targets of both the TPSE and the Letter of Intent reveal that the new program is forced to accept higher increases in price inflation. 2002 expectations of the TPSE were planned to be 16.6 percent in WPI, 20 percent in CPI. Yet, the inflation targets for 2002 in the Letter of Intent are respectively 31 percent and 35 percent.

In addition to all these evaluations, it is observed that the foreign economic relations in the Letter of Intent intensify the external dependency of the Turkish economy. The ratio of gross external debt to gross national product in 2002 was targeted to be 71.7 percent in the Letter of Intent. Indeed, this target was set as 59.6 percent in the TPSE. The Letter of Intent could preserve the pace of external borrowing without any change and could target to bring back the 2001 values of external debt-GNP ratio, (63.3 percent) in the last year of the program 2004. Likewise, ratio of public sector net foreign borrowing to the GNP is planned to be 35 percent in 2002, and is expected to decrease to 28 percent in 2004. Yet, the same ratio was 28 percent in 2002 according to TPSE. Thus the Letter of Intent could undertake to realize the public sector net external borrowing target for 2002 only in 2004, after a lag of two years.

Consequently, it is observed that the only tool to maintain the macroeconomic balances of the Letter of Intent is the public sector primary surplus which is planned at a ratio of 6.5 percent to the national income in the post-2002 period. Nevertheless, macroeconomic targets expected in the Letter of Intent show that these policies would be kept up owing to higher inflation, higher interest rates, lower real growth and higher external borrowing than the earlier official TPSE document hailed back in May 2001.

Therefore, macroeconomic calculation in the Letter of Intent uncovers officially that crisis management of the Turkish economy under the TPSE had been unsuccessful. Although the public finance targets were attained and all the structural reforms were realised as projected in the TPSE, 2001 crisis management could not hinder the depression of the Turkish economy from deepening. Unfortunately, the Letter of Intent of the January 18, 2002 refused to derive lessons from 2000/2001 crises, and insisted on its strategic preference to sacrifice Turkey's economic, social and cultural resources to the strategic interests of foreign capital and the multi-nationals.

The Existing Unequal Structure Of Income Distribution Will Be Deepened By The Letter Of Intent

Macroeconomic targets in the Letter of Intent will by their nature lead to worsening of income distribution. Since the unjust burden of the program could not be hidden, it is observed to retain a temporary 43rd paragraph stating that "already in 2002 (only in 2002), we are increasing social spending substantially in real terms"

Additionally in this 43rd paragraph,

i) It is anticipated that "we will address the impact of the public sector retrenchment through labor re-deployment and re-education program (supported under the World Bank's Privatization Social Support Project". However, so far, there has been no serious results from this labor force education program in terms of its contribution to employment.

ii) In the same paragraph it is also stated that "through unemployment insurance for which benefit payments are set to commence in 2002 workers who are not eligible for adequate severance would be protected". As this statement pinpoints rather than an additional right, those who will be fired without seniority compensation is to be targeted mass. Furthermore, as it is known, unemployment benefit is a fund, which works with self-contributions of the insured people. Thus, as such it is an insurance, which pays an allowance at least half of the legal minimum wage (and *at most* the minimum wage), to whose who made contributions to the fund for at least 20 months.

iii) As an additional measure, there is a statement as "to increase resources allocated to direct income support (DIS) to the farmers, we will eliminate all agricultural subsidies in the 2002 budget". The statement depicts that all the supports will be ended, and in place the DIS is introduced. In other words, price supports to agriculture will be limited, and in the meanwhile a symbolic premium support which still remained in the system will be cleaned off. Followingly, despite the IMF and the Treasury, the price support system has been continued for cotton, sunflower and olive oil in 2002, and its costs were paid by the commitment to shift the allowance to sugar beet producers to the DIS by the Ministry of Finance.

iv) Another statement states that "the World Bank supported Social Risk Mitigation Project will totally be implemented". That is to say, the unused part of $500 million credit allocated by the World Bank last year, will be put into process, and in so doing, a symbolic contribution to income distribution would continue against feared social explosions. Therefore, the $50 billion national income loss during 2000-2002 is expected to be compensated with such a donation, reaching only to 1 percent of the original loss.

Concluding Comments

Given these evaluations, it is clear that the Letter of Intent of January 18, 2002 and the TPSE of May 15, 2001 as well pursue the dogmatic "development" model proposed by the neo-liberal hegemony to the less-developed countries. This model depends on the contractionary monetary and finance policies and assumes an open (i.e. dependent on foreign capital) economic structure ensuring the liberalization of the international capital flows. In this model what is really meant by the concept of "stabilization" is to establish an exchange rate system purified from devaluation risk, and to maintain a high real return in the national financial markets to attract the inflow of foreign capital.

Under this structure, the central banks are set to be "autonomous" and all means of intervention are restricted so that it could not undertake any role apart from maintaining price stabilization. Public sector fiscal policies are to be directly focused on the objective of "budget with a primary surplus". As result of these policies, boundaries of the public space are expected to be restricted, and all traditional economic and social infrastructural facilities of the public sector are being left to the strategic interest area of foreign capital at the cost of extraordinary cuts in the public spending and investments.

The neo-liberal thought dictates that in order to take advantage of the benefits of the globalization, national central banks with autonomous monetary, interest and exchange rate policies should not be a hindrance to international capital flows. The real objective of this thought is to make the central banks to be in charge of maintenance of price stability and to sustain the level of high real returns in the national financial markets. In so doing, rents allocated to the rent owners would be secured. Public finance, on the other hand, is limited to take all measures directly to enlarge the interest area of international capital.

Departing from all these observations, it is obvious that debates on the economic policies of 2002 in Turkey will continue with puzzles such as “debt rollover”, “the level of monthly inflation”, and “devaluation of the Turkish Lira”. Under these circumstances, issues like long-run industrialization of the Turkish economy, attaining development targets via acquiring new technologies, or providing a more fair structure in the allocation of income will not be in the economic policy agenda in 2002, as well.

Table 1. Developments in the Consolidated Budget

	2000			2001		
	Realization	Target		Realization	Target	
	A	B	A/B	A	B	A/B
Revenues	33,756.4	32,585.5	103.6	51,812.0	49,300.0	105.1
Tax Revenues	26,526.8	24,000.0	110.5	39,768.0	37,710.0	105.5
Direct taxes	10,861.9	9,585.0	113.3	15,647.0	12,741.0	122.8
Indirect Taxes	15,664.9	14,415.0	108.7	18,135.0	18,083.0	100.3
Expenditures	46,602.6	46,713.3	99.8	80,379.0	78,999.0	101.7
Personnel Exp.	9,982.1	9,899.8	100.8	15,203.0	14,630.0	103.9
Investment Exp.	2,472.3	2,351.7	105.1	4,139.0	3,749.0	110.4
Interest Expenditures	20,439.9	21,132.3	96.7	41,064.0	41,268.0	99.5
Transfers to SEEs	885.9	594.6	149.0	1,201.0	1,100.0	109.2
Other Transfers	9,211.1	8,894.5	103.6	8,030.0	7,162.0	112.1
As a Ratio the GDP (%)						
Budget Balance	-10.3			-15.4		
Interest Expenditures	16.4			22.2		
Non-Interest Budget	6.1			6.7		
Net Domestic Borrowing	7.5			12.7		
Domestic Debt Stock	29.0			59.5		

Source: Undersecreteriat of Treasury (www.treasury.gov.tr)

Table 2

TSEP (May 2001) and Letter of Intent (Jan 2002): Macroeconomic Targets

		2001		2002		2003		2004
	2000	**TSEP**	**Letter Int**	**TSEP**	**Letter Int**	**TSEP**	**Letter Int**	**Letter Int**
GNP (Billions $)	***201.3***		150.3		165.6		183.0	***201.3***
GNP growth rate	6.3	-3.0	-8.5	5.0*	3.0	6.0*	5.0	5.0
WPI	32.7	57.6	86.0	16.6	31.0	***12.4***	16.2	***12.0***
CPI	39.0	52.5	68.0	20.0	35.0	15.0	20.0	12.0
Av. Interest rate on Gov. Bonds	38.0		99.7		69.6		46.0	32.4
As a Ratio to the GNP (%)								
Consolidated Budget								
Non-Interest Budget Balance[1]	4.2	5.1	5.0	5.6	5.4	***5.6***	***5.6***	***5.6***
Net Interest Expenditures[2]	15.8	20.1	23.2	19.1	20.5	***16.1***	***16.2***	13.5
Budget Balance	-11.6	-15.0	-18.2	-13.6	-15.2	***-10.5***	***-10.6***	-7.8
Consolidated Public Sector								
Non-Interest Balance	2.3	5.5	5.7	***6.5***	***6.5***	***6.5***	***6.5***	***6.5***
Net Interest Expenditures[3]	21.9	22.6	24.7	16.2	18.4	***13.5***	15.8	***13.3***
PSBR (Inclusive of CB Profits)	19.6	17.1	19.0	9.7	11.9	***6.9***	9.3	***6.8***
Net Debt of the Public Sector								
Net Foreign Debt	18.3	34.2	38.0	***28.3***	35.1	23.5	30.6	***28.5***
Net Domestic Debt	39.1	44.3	54.2	***42.1***	46.2	41.5	***42.7***	40.9
Foreign Sector								
Current Account Balance	-4.9	-0.6	1.3	-0.9	-1.2	-0.6	-1.2	-1.2
Gross Foreign Debt Stock	56.6	66.2	75.4	59.6	71.7	56.8	66.7	63.3
Net Foreign Debt Stock	37.0		51.6		48.1		44.4	40.8

* "If we assume that the Program is administered in full, the growth rates for 2002 and 2003 can reach to 7 percent". (TSEP document p. 43).

1. CB profit transfers, interest revenues, and privatization revenues excluded.
2. Interest expenditures minus interest revenues plus CB profit transfers.
3. Interest expenditures minus interest revenues plus CB profits prior to transfers to the Budget.