

# Turkey and the Long Decade with The IMF: 1998-2008

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## ***Background to the “Long Decade”***

In May this year Turkey has ended its last *stand-by* with the International Monetary Fund (IMF) that covered 2005 through 2008. To some this meant the long awaited declaration of autonomy for Turkey and the loss of the final “consumer” for the IMF. For some others who adhere to the neoliberal orthodoxy, this meant the graduation of Turkey and the successful completion of the IMF programme. The reality is that neither of these assessments is correct, as Turkey is currently trapped in a high debt, speculative growth environment with jobless patterns; and its government institutions are put under siege by the eradication of numerous independent bodies of *governance* which are under the direct supervision of both the Bretton Woods Institutions such as the IMF and the World Bank, as well as the International Finance Institutions (IFIs). Thus, there is neither autonomy, nor successful graduation.

Turkey and the IMF signed a *Staff Monitoring Program* in 1998 to enable closer supervision and control of the Turkish economy by the IMF staff. Turkey experienced a severe economic crisis in November 2000 and again in February 2001 when it was following the *exchange-rate based disinflation program* led and engineered by the IMF.<sup>1</sup> During the year 2001, GNP fell by 5.7% in real terms, consumer price inflation soared to 54.9%, and the currency lost 51% of its value against the major foreign monies. The burden of adjustment fell disproportionately on the laboring classes as the rate of unemployment rose steadily to 10% and the real wages were reduced abruptly by 20% upon impact in 2001 and have not recovered to this day.

The IMF had been involved with the macro management of the Turkish economy both prior to and after the crisis, and provided financial assistance of \$20.4 billion, net, between 1999 and 2003. Following the crisis, Turkey implemented an orthodox strategy of raising interest rates and maintaining an “overvalued” exchange rate. The government followed a contractionary fiscal stance, and promised to initiate further steps towards “market friendly” reforms.

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<sup>1</sup> The underlying elements of the disinflation program and the succeeding crisis are discussed in detail in Akyuz and Boratav (2004); Ertugrul and Yeldan (2003), Yeldan, (2002), Independent Social Scientists Alliance, 2006.

The post-crisis economic and political adjustments were mainly overseen by the then newly founded *Justice and Development Party* (AKP) which came to power enjoying absolute majority in the parliament in the November 2002 elections. Though maintaining the pro-Islamic political agenda, the AKP nevertheless distanced itself from the previous “national view” orthodoxy of the traditional Turkish Islamic movement. The AKP refurbished itself with a more friendly view towards the West, ready to do business with the global finance capital and willing to auction-off the strategic public assets to the trans-nationals. On the political arena, the AKP had given unequivocal support to the US interests in the Middle East including the then approaching war in Iraq.<sup>2</sup>

### ***Rapid growth, yet with serious fragilities***

The post-crisis adjustments of the Turkish economy came at a very unique conjuncture of the global economy. First of all, growth, while rapid, showed quite peculiar characteristics. It was mainly driven by a massive inflow of foreign finance capital which in turn was lured by significantly high rates of interest offered domestically; hence, it was *speculative-led* in nature (*à la* Grabel, 1995). The main mechanism has been that the high rates of interest prevailing in the Turkish asset markets attracted short term finance capital, and in return, the relative abundance of foreign exchange led to overvaluation of the *Lira*. Cheapened foreign exchange costs led to an import boom both in consumption and investment goods. The overvaluation of the *Lira*, together with the greedy expectations of the arbitrageurs in an era of rampant financial glut in the global finance markets, led to a severe rise in its foreign deficit, and hence, in external indebtedness. The deficit on the current account rose to above US\$40 billion by mid-2008, or to 7.5% in ratio to the GNP, and led to an increase of the perceived external fragility of the country. To understand the significance of this figure, it has to be noted that Turkey traditionally has never been a current account deficit-prone economy. Over the last two decades the average of the current account balance hovered around plus and minus 1.5-2.0%, with deficits exceeding 3% signaling for significant currency adjustments as had been realized in 1994 and 2001.

A further characteristic of the post-2001 era was Turkey’s *jobless-growth* pattern. Rapid rates of growth were accompanied by high rates of unemployment and low participation rates. The rate of total unemployment rose to above 10% after the 2001 crisis, and despite rapid growth, has not come down to its pre-crisis levels. With the available bonanza of relatively cheap imports, Turkey had been consuming the products of “foreign economies” causing a lower value added production at home. Thus, the joblessness problem and the fragility embedded in the increase of the current account deficit were, in fact, manifestations of the same conundrum.

See the Table below for a succinct summary of Turkish macroeconomic performance along with the IMF’s targets over the last stand by.

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<sup>2</sup> In fact, many analysts draw parallels with the declaration, in the summer of 2002, of the three-party coalition government granting no support for the US plans to invade Iraq and the decision to hold early elections later in the same year.

## The IMF Program, Targets and Realizations

	Program Targets			Realizations		
	2005	2006	2007	2005	2006	2007
GDP Growth (%)	5.0	5.0	5.0	8.4	6.9	4.5
CPI Inflation (%)	8.0	6.0	4.0	7.7	9.7	8.4
Current Account / GDP (%)	-3.3	-2.7	-2.1	-4.6	-6.0	-5.7
Non-Financial Public Sector Non-interest Primary Balance / GDP (%)	4.9	4.9	4.9	5.1	4.6	3.5
Notes:						
Unemployment Rate (%)				10.2	9.9	10.1
External Debt (Billions US\$)				168.7	205.5	247.2

Over its period of administration, the *first* AKP government succeeded in attracting a total of \$87 billion of “hot money”, as well as \$30 billion of foreign direct investments most of which were in the form of mergers and acquisitions of domestic firms and land/real estate purchases by foreigners. There had been a significant increase of the external debt stock, from \$130.1 billion at the end of 2002 to \$247.5 billion in March 2008. Much of the increase in external indebtedness, however, was carried out by the *private* sector, especially the non-financial enterprise system. In fact, during the post-2001 crisis adjustments, public sector had mostly substituted *domestic debt* with external debt, and had been a net payer in the external markets.

### *The Essence of the “IMF Program”*

The rapid increase of private sector debt —by the financial and non-financial sectors alike, reveals the true essence of the IMF-engineered adjustment mechanisms following the currency and banking crises of February 2001. The underlying characteristics of the Turkish post-crisis adjustments ultimately relied on maintaining high real rates of interest in anticipation of increased foreign capital inflow into the domestic economy. Coupled with an overall contractionary fiscal policy, the programme found the main source of expansion in speculative inflows of foreign finance. Persistent offerings of high rates of interest against the back-drop of lower inflation and fiscal primary surplus targets were the main attributes of the IMF programme as implemented both by the three-party coalition government under Mr. Bulent Ecevit (until November, 2002) and by the AKP government (post-November, 2002).

The aforementioned elements of this adjustment path were clearly stated, in fact, in the Turkey Country Report prepared by the IMF staff in late 2001. It is very illuminating to note that the *targets of the 2001 IMF Report* encompassing 2002 through 2007 have eventually become *the official targets of all successive governments* over that period. The targeted rate of real GNP growth, for instance, was persistently set at 5% for each coming year, despite the observed rapid expansion of the economy in rates often exceeding 7% in the preceding year! This choice was clearly no coincidence. Likewise, the inflation targets of the “independent” central bank each

year followed the path envisaged in the 2001 IMF Report, beginning with 20% of 2003 to 5% in 2006, and beyond.

As experienced over the *long decade*, the persistence of the high level of real interest rate against falling inflation rates seem to find a resonance in the adjustment path assumed by the IMF staff in the immediate post-2001 crisis. It is clear that the main adjustment mechanism of the post-crisis IMF programme was embedded in maintaining a significantly high rate of real interest. The high interest rates attracted short term finance capital; and the relative abundance of foreign exchange led to overvaluation of the *Lira*. Cheapened foreign exchange costs led to an import boom both in consumption and investment goods. Achievement of the fiscal contraction under severe entrenchment of public non-interest expenditures, in turn, was a welcome event further boosting the hungry expectations of the financial arbiters.

Finally, the very sanctimonious primary surplus target of the public sector at 6.5% as a ratio to the GNP clearly finds its origins in the aforementioned report. What is clear is that over its *long decade* with the IMF, Turkey managed to replace public deficits with the *democracy deficit*.

In sum, contrary to the traditional stabilization packages that aimed at increasing interest rates *to constrain the domestic demand*, the new orthodoxy aimed at maintaining high interest rates for the purpose of *attracting speculative foreign capital* from the international financial markets. The end results in the Turkish context were the shrinkage of the public sector in a *speculative-led growth* environment; and the consequent deterioration of education and health infrastructure which urgently necessitate increased public funds. Furthermore, as the domestic industry intensified its import dependence, it was forced towards adaptation of increasingly capital-intensive and foreign technologies with adverse consequences on domestic employment.

Assessing the process which Turkey has undergone since 2000 along with these arrangements, it becomes clearer that it is not simply a stride to “stabilize” the economy, but goes much beyond it to radically alter the social structure of the country. The executing actors include political circles which shut their ears to reactions coming from different segments of the society, justify their stance by repeating “*it is us who decide on policies to be adopted*” and maintain these policies at any cost whatsoever while keeping themselves content with the slogan “*firm commitment is a virtue*”; top level bureaucrats whom we can classify as a “global elite” sharing same mode of living and discourse worldwide; and finally, some intellectuals attached to these groups. Extremely intolerant to any criticism including very innocent ones, these groups may well behave in a way far from what can be justified as the *sine qua non* of any democracy.

### ***What lies ahead?***

Turkey’s post-crisis adjustment under the AKP administration traces the steps of many developing country governments which are dependent on foreign capital and are conditioned to adopt or maintain contractionary policies in order to secure “investor confidence” and “international creditworthiness”. Such efforts are restricted to a balanced budget, entrenched fiscal expenditures, and a relatively contractionary monetary policy with an *ex ante* commitment to high real interest rates.

Turkey is now entering the second half of 2008 with severe disequilibrium and increased external debt burdens. The generally favorable global conditions that were conducive to the rapid growth performance of the economy under AKP's *first* rule of administration are, generally speaking, not present in the new conjuncture. Turkey has to face the current turbulence and the consequent decline of credit in the global financial markets with a strained labor market and intensified external fragility. There is no doubt that the necessary adjustments that lie ahead for securing economical stability in Turkey under a darkening external environment will be more costly and difficult .

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