The Heritage Foundation
Executive Memorandum

No. 743 May 3, 2001

THE RIGHT WAY TO STABILIZE TURKEY

JOHN C. HULSMAN, PH.D., AND BRETT D. SCHAEFER

Turkey is a valuable ally that functions as one of America's key geopolitical friends in Europe and the Middle East. Its stability, however, is at risk because the economy remains in turmoil after nearly two months of economic crisis. The lira has devalued approximately 50 percent since the government allowed it to float on February 22; the inflation rate remains above 30 percent; the stock market has lost 70 percent of its value in dollar terms; and the economic slowdown has led to increased unemployment and street protests. Nevertheless, merely granting Turkey another large international bailout would be a mistake, effectively rewarding the government for reticence in making the necessary economic reforms.

The International Monetary Fund (IMF) has granted 17 loan arrangements to Turkey since 1961, yet in each case Turkey has failed to honor in full its commitments to reform. This record argues for requiring tangible progress on reform before giving Turkey access to any new funds—an approach put forth by the Bush Administration in a recently announced initiative to help Turkey. Changing the culture of dependency that the IMF's repeated loans have fostered is a sensible middle-ground approach to helping a country whose stability is in America's interest. Instead of repeating the failed strategy of the past, the Administration is right to demand that Ankara implement the required reforms before the IMF's directors meet to vote on a new loan arrangement.

Turkey's Economic Reform Plan. Turkey's Minister of State in Charge of the Treasury, Kemal Dervis, had pledged that by mid-April, the government would pass 15 laws to recapitalize state-owned and troubled private banks, foster significant structural changes to the economy by making the central bank more independent of political control, allow the lira to float freely, decrease government spending, and arrange further privatization of state-owned banks and some companies. Such a plan, if carried out fully and quickly, would contribute greatly to stabilizing the Turkish economy.

However, the danger that lies ahead for Turkey in reaching its goals is not primarily economic; it is political. As past experience demonstrates, vested interests in Turkey are extremely resistant to reform. Indeed, the parliament is dragging its feet on enacting the Dervis agenda, choosing instead to gamble on another IMF bailout. Despite Dervis's pledge, only five of the 15 laws have cleared parliament, and it is two weeks past the deadline. Senior members of the ruling coalition have criticized the reform plan, including Deputy Prime Minister Devlet Bahceli, the leader of the governing coalition's far-right wing, who stated that the government should avoid "unnecessary haste" in drawing up vital reforms.

Produced by the
Center for International
Trade and Economics (CITE)

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em743.html*

Turkey's record after the past IMF bailouts offers little cause for confidence; few if any of the reform conditions agreed to in the previous 17 arrangements have been met. There is no reason to believe that an 18th arrangement would meet with any greater success.

Another Bailout? Dervis lobbied the IMF for an additional $10 billion to support his economic recovery plan for Turkey. He has earmarked the additional funds for overhauling the failing banking sector, though some estimate that this effort would cost from $16 billion to $25 billion.

U.S. Treasury Secretary Paul O'Neill, critical of previous IMF loans that did nothing to address the structural causes of Turkey's economic problems, has remarked that the IMF should devote more attention to preventing financial fires than to putting them out. Moreover, he told the Economic Club of New York in April, "As we in the finance ministries of the world talk glibly about billions of dollars of support for policies gone wrong, we need to remember that the money we are entrusted with came from plumbers and carpenters who sent 25 percent of their $50,000 income to us for wise use." Such a principled philosophy is a departure from the approach of the previous Administration, which often used lending by international financial institutions as a short-term restorative to prop up crisis-engulfed countries, with marginal results. In Turkey's case, even though it is a strategic ally in a key region of the world and a partner in NATO, O'Neill recognizes that another bailout without reforms in the economy and government would be ineffective and not a wise use of taxpayers' dollars.

A Different Type of Rescue. The Bush Administration, in concert with the other major economic powers, recently pledged to support giving Turkey $10 billion in aid—$8 billion from the IMF and $2 billion from the World Bank. However, three conditions made this a very different type of loan package. First, Secretary O'Neill, who played an active role in arranging the terms of the package, warned Ankara that it will not receive further assistance if this latest overhaul plan fails. Second, despite pleadings from such international figures as IMF Managing Director Horst Köhler, Washington refused to offer Turkey additional bilateral aid to go along with the Fund's program. Third, under pressure from Washington, the IMF agreed to require Turkey to enact its reform program before the IMF directors formally vote on the new loan. Although it remains to be seen whether this new approach is successful, it is far more likely than previous IMF arrangements to convince Turkish policymakers to implement the reform plan quickly.

Conclusion. The Bush Administration is right to encourage Turkey to adopt reforms that will lead to long-term economic growth and stability. By maintaining a strict new stance on a new bailout for its ally, Washington has placed the onus for successful stabilization on Turkey's governing elite. Ankara must recognize that the current economic and political system, plagued by corruption and patronage, undermines its economic prospects and must be reformed. The IMF must recognize that Turkey will not reform its economy under the old-style IMF loan arrangements. The Bush Administration must remain firm in its demand that all reforms be implemented before a single dollar of the new loan is released. Any deviation will undermine reform efforts that are central to making Turkey an economically strong and politically stable ally.

—John C. Hulsman, Ph.D., is Research Fellow for European Affairs in the Kathryn and Shelby Cullom Davis Institute for International Studies, and Brett D. Schaefer is Jay Kingham Fellow in International Regulatory Affairs in the Center for International Trade and Economics, at The Heritage Foundation.