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Pathways Through Financial Crisis: Turkey

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Turkey's deep financial crisis in 2000–2001 implicated the International Monetary Fund program, adopted in 1999, while the IMF was associated with the successful 2001 recovery program. This article, through studying three critical interventions, finds that the IMF's impact on the policy choices available to Turkey's policymakers varied according to the history of the IMF's engagement with Turkey, the interests of major shareholders in the IMF, and the credibility of Turkey's leaders in the eyes of the IMF. The IMF's engagement substantially affected domestic politics in Turkey by strengthening the voice of economic technocrats within the government. The IMF thus became a contested actor in domestic politics. The crisis had very significant negative economic and social effects, which contributed to a deep political change in 2002. KEYWORDS: Turkish economy, financial crisis, International Monetary Fund.

Turkey's long-standing relationship with the International Monetary Fund (IMF) intensified at the end of the 1990s. The Turkish general election of 18 April 1999 ushered into power a new coalition government that, eight months later, sought US$4 billion assistance from the IMF and committed itself to an IMF-approved program of economic reform. Within a year, an economic crisis peaked—in November 2000 and February 2001—and the Turkish economy experienced a real terms contraction of 3.5 percent, with official unemployment doubling to 11.8 percent.[1] From January 2001 to April 2002, borrowing from the IMF increased by $23 billion. In the general election of 3 November 2002, none of the parties (government or opposition) elected in 1999 were returned.

Turkey raises two questions about the IMF's interaction with the governments of emerging markets facing financial crises. First, how does IMF participation affect the policy choices available to domestic policymakers? Second, what impact does the IMF's intervention have on domestic politics in the crisis country: which actors are empowered or enfeebled, and what are the lasting consequences for domestic politics?

In this study, I focus on Turkey's engagement with the IMF from November 1999 to October 2001, a period that includes three interventions by the IMF. I analyze key decisions associated with these interventions from

the perspectives of the Turkish authorities and the IMF, setting out which alternatives were considered and rejected, and why. Through this analysis, I draw more general conclusions about the relationship between the IMF and Turkey. The study is based on primary materials, in the form of published communications between the IMF and Turkey, and on interviews with key decisionmakers and policymakers in Turkey, the IMF, and the G7.[2]

Turkey's Engagement with the IMF

Turkey's wave of economic liberalization began under the stewardship of economy (then prime) minister Turgut Özal during 1980–1989. This period displayed twin tendencies: liberalizing reforms (including within IMF programs; see Table 1), combined with increasingly clientelistic distribution of the spoils. The decision to liberalize the capital account in 1989 was particularly significant for Turkey's fiscal position. A new source of capital allowed governments to put off unpleasant choices and delay reform.[3] A further consequence was the rapid expansion of the banking sector.

In the second half of 1997, a number of officials in the Turkish economy ministries became alarmed at the direction of Turkey's underlying economic aggregates. Inflation looked set to reach 100 percent by December. At the officials' request, the IMF initiated a Staff-Monitored Program, which was announced in June 1998. The Turkish authorities were keen to move to a full program, but there was no appetite from the IMF's side, given the repeated failure to meet fiscal and structural targets set in the Staff-Monitored Program.

In 1998, the poor underlying structure of the economy was further impacted by two negative shocks. First, the Russian economic crisis and default in August 1998 hit Turkey hard. There was a contagion effect in the

Table 1 History of Lending Arrangements, 1 May 1984–3 February 2005 (in thousands of SDRs[a])

Facility	Date of Arrangement	Date of Expiration or Cancellation	Amount Agreed	Amount Drawn	Amount Outstanding as of 31 May 2006
Standby arrangement	4 Feb. 2002	3 Feb. 2005	12,821,200	11,914,000	6,207,975
Standby arrangement	22 Dec. 1999	4 Feb. 2002	15,038,400	11,738,960	0
Standby arrangement	8 July 1994	7 Mar. 1996	610,500	460,500	0
Standby arrangement	4 Apr. 1984	3 Apr. 1985	225,000	168,750	0
Total			35,357,140	25,947,720	7,873,485

Source: International Monetary Fund, available at www.imf.org/external/np/tre/tad/extarr2.cfm?memberKey1=980&date1key=2006%2D05%2D31.

Note: a. Special drawing rights is a unit of account in the IMF, whose value is based on a basket of key international currencies. As at 18 August 2006, 1 SDR was worth $1.48672.

spreads of all emerging markets as investors called in their capital, but Turkey's real economy was also affected: exports to Russia fell 35 percent in 1998, yet still constituted 5 percent of total exports from Turkey.[4] Second, the Marmara earthquakes of 1999 afflicted highly populated, industrialized regions. As growth rates plunged into negative figures, it became clear that Turkey was facing an economic crisis. IMF management and staff began to consider seriously a full program. An increased commitment from the newly elected Turkish government to economic reform, signaled by the adoption of pension reform measures in August 1999, convinced them to proceed.

The December 1999 program set out to tackle inflation and interest rates through a new monetary policy, based on an exchange rate stabilization anchor that incorporated a preannounced and staggered move through widening bands to a free float. A central part of this approach was a firm money supply rule: the Turkish central bank would provide liquidity only in line with increases in its foreign exchange reserves. It was intended that this signaling would improve the credibility of the peg, while still allowing the economy to capture the inflation-reducing benefits of a fixed exchange rate. The monetary policy was supported by an array of fiscal, incomes, and structural policies intended to reduce Turkey's government debt.[5]

The Choice of an Exchange Rate–Based Stabilization Anchor in 1999

Turkey's engagement with the IMF resulted in an innovative currency peg. In 1998–1999, the Turkish authorities were trying to reduce Turkey's net public debt and control the rate of inflation. A radical option would have been to restructure Turkey's debt, rolling obligations onto a longer-term repayment schedule and even contemplating a haircut on some bonds. However, this would have enraged investors and was opposed by the IMF—defenders of the sanctity of contract in financial markets. The Turkish government, conscious of the apparent damage done to Russia's economic standing by its default in 1998, rejected the radical approach.

A second "austerity" option would have been to deflate the economy by adopting a very tight fiscal policy. This would have reduced current government expenditure, allowed for the retirement of debt, and brought down inflation and hence interest rates. However, the results would have been both economically and politically painful for the government, which consequently rejected such an approach at an early stage.

In the end, Turkey opted for an innovative inflation-targeting program based on exchange-rate stabilization (ERBS). The ERBS, which aimed to rebalance the economy gradually, required consistent and careful economic policy management by the authorities. The risk was that any faltering by the

government or any external shocks would destabilize the program and lead to greater economic and financial costs in the medium term. The innovative aspect of the program proposed by the IMF lay in the exchange rate peg and the widening bands and preannounced exit, which were set out partially as an attempt to meet concerns about credibility and speculative attack.[6] This principally reflected the concerns of the US Treasury,[7] but Turkish State Planning Organization (SPO) undersecretary Faik Öztrak also states that he was opposed [8] to a pure exchange rate peg. The resulting policy reflected a willingness on the part of the IMF staff to work with the policy preference of the Turkish authorities (albeit from the menu suggested by conventional economic theory).

The innovation in the arrangement agreed upon with Turkey highlights three factors that affect the policy space afforded when the IMF engages with a country. In the first place, in 1998–1999, there was (relatively speaking) time for innovation. Outside an immediate crisis situation, the IMF had more time to gauge the support of board members for a program, and the details of the program could be negotiated in slower time.

Second, the adaptation of the currency peg also reflected the interests and influence of the United States in Turkey's case. This point should not be overstated: the IMF officials were themselves interested in seeking ways of improving the design of currency pegs for inflation control. Nevertheless, the United States had a strong foreign policy interest in Turkey's political stability. Furthermore, following the Asian crisis, the US Treasury and its secretary, Larry Summers, had also devoted significant intellectual capital to the issue of currency crises and had a strong interest in the demonstration effects of new programs based on a currency device.

Third, within Turkish politics, the engagement with the IMF during this period played out in two different ways. Initially, it empowered economic technocrats within the Turkish administration. These technocrats were responsible for developing the detail of policies and subsequently persuading Turkey's politicians of the merits of their approach as opposed to that of other interested parties. The involvement of the IMF staff and management helped their case. The Fund offered new capital with which to bolster central bank reserves and to start to restructure the debt stock. An IMF-endorsed program would be a strong credibility signal to the markets. This was particularly important to Turkey as it approached the Helsinki European Council, at which its leaders hoped a decision would be taken to begin preparations for its European Union (EU) membership. Thus Turkey's economic bureaucrats were able to make a strong case for the IMF approach.

Later in 1999, once the negotiation was complete and the program was adopted, the political incentives changed. The IMF went from being cash cow to scapegoat. Although the Letter of Intent of 9 December was signed, on behalf of the government, by Recep Önal, economy minister of the Democratic

Left Party (DSP), and by Gazi Erçel, governor of the central bank, it was left to Erçel and, to a lesser extent, the treasury undersecretary, Selçuk Demiralp, to defend it. Following adoption of the program, the IMF became the monitor and enforcer of tough policies that domestic coalition partners needed to explain to the public. Instead, domestic politicians blamed the need to implement unpopular policies on the IMF. Such scapegoating was exacerbated by the fact that Turkey's government was a coalition. Ministers had little incentive to stand up for unpopular policies and risked at any time being outflanked by populist competitors within the government.

Within a few months, the program was in trouble. The April 2000 inflation figures showed that wages and prices were stickier than expected due to the backward indexation of pay agreements and the exogenous shock of a steep increase in world oil prices. At the same time, while the government was broadly sticking to its expenditure commitments, total public liabilities continued to rise, due to contingent liabilities and delays in adopting cost-saving structural actions. Furthermore, the interest rate (which fell almost immediately on adoption of the program from 100 percent to 30–40 percent) was low enough to stimulate a credit-funded consumer boom but did not decline rapidly enough to eliminate strong opportunities for arbitrage by portfolio investors. These inward flows generated a real-terms appreciation of the Turkish lira of over 10 percent,[9] damaging domestic competitiveness[10] at the same time as it further fueled domestic consumption. As imports rose by 37 percent in the first eleven months of 2000, the trade deficit more than doubled to $25 billion.[11]

By late summer 2000, the Turkish economy was teetering on the edge, held back only by the continuing inward flows of portfolio capital. As domestic private banks competed hard in a fevered atmosphere, the Banking Regulation and Supervision Agency (BRSA), whose establishment by March had been a condition of the 1999 program, was stymied by party political haggling over the composition of its board. Nevertheless, in October and November, the BRSA acted on rumors of malpractice, and two banks (Etibank and Bank Kapital) were brought under management of the Savings Deposit Insurance Fund (SDIF), the public body created after the 1994 crisis to back up the Turkish government's guarantee of bank deposits.[12] This further contributed to the sense of volatility in Turkey's banking system.

Shortly after these actions, interest rates started to rise, bringing immediate liquidity problems for a banking sector highly leveraged with borrowed short-term foreign capital. Constrained by the strict money supply rule of the 1999 program, the central bank did not initially act. However, as interest rates continued to go up, the central bank did intervene, providing $6 billion during the period 22–29 November. When it reverted to its rule, interest rates skyrocketed: from 160.8 percent overnight on 29 November to 873.1 percent at their peak overnight on 1 December.

To Float or Not to Float? Managing the November 2000 Crisis

In the midst of the November crisis, the Turkish authorities had to choose their immediate policy response. They needed to halt the outflow of central bank reserves and they needed to bring down the interest rate to avoid a massive debt default.

One choice would have been to abandon the exchange rate regime, accept that a peg was not sustainable, and pick up the pieces of economic policy from there. This was the approach advocated by the IMF. Michael Deppler, director of the Fund's European Department, suggested this to the Turkish authorities at the September 2000 annual meetings of the IMF in Prague.[13] Of course, this represented a significant change in the IMF's position from nine months previously; IMF officials would subsequently justify the shift on the basis of a loss of faith in the Turkish authorities' commitment to the accompanying reforms necessary for the peg to be sustainable.[14]

Turkey's political leaders and senior officials were not, however, willing to agree to such a policy. Their political credibility rested on the program they had endorsed. Turkey had been thriving on a borrowed boom throughout 2000, and they realized that moving off the peg would trigger a massive devaluation with severe consequences for Turkish domestic demand and employment. During the implementation of the program, Turkey's short-term foreign debt had increased significantly. Furthermore, the influential Turkish financial sector would have been particularly adversely affected. It was highly exposed to exchange rate risk, having borrowed short in dollars in order to invest in Turkish government bonds, on the assumption of interest rates continuing to fall.

An alternative approach might have been to defend the currency more robustly from the outset, using central bank reserves. However, in the heat of an incipient financial crisis, when the outflows of capital are rapid and unrelenting, the central bank would have had to act early as well as swiftly and credibly. Such an approach would have violated the nonintervention terms of the 1999 program. Indeed, the fact that it took several days from the start of the rapid tightening before the central bank decided to intervene can be largely attributed to the constraints of the program. By the time that intervention was enacted, the policy was already noncredible: market actors were herding toward the exit, with some $5.3 billion withdrawn in the last week of November alone.[15]

Facing increasing speculative attacks on the lira, the Turkish authorities turned to the IMF for further assistance. On 21 December, the executive board agreed to the Turks' request for a further $7.5 billion from the Supplementary Reserve Facility (SRF) in return for a tightening of the program, which included strengthening the primary surplus target for 2001

from 3.75 percent to 5 percent. Central bank reserves rose from $18.3 billion on 5 December to $28.2 billion by 15 February.

That the IMF was forthcoming with these additional funds highlights several key factors shaping the decisionmaking of the Fund. Initially, the management and staff had been opposed to Turkey maintaining the peg. However, had they withheld financial assistance and pressed for a float, a full-blown crisis would likely have been precipitated. Furthermore, their choices were compromised by their prior engagement in the program design. Had they been tough with the Turkish authorities, the latter would surely have blamed them for not supporting a program they (the IMF) had helped design.

Second, the Fund's officials *might* have been tougher had they been able to rely on strong support from their key shareholders—but they did not enjoy this. While senior Treasury officials in the outgoing US administration were highly skeptical about Turkey's prospects,[16] they were ultimately unwilling to use a key strategic ally as the test case for a tougher lending policy at a time when they were about to demit office.

Finally, even those within the Fund who doubted that Turkey could avoid a crisis saw that it was better for the IMF to be still engaged with Turkey when a crisis came than for there to be acrimony and mistrust between the two. After all, the IMF was financially exposed to Turkey at this point. The argument can be dressed up in the legalistic view—deployed in interviews by a number of Fund officials—that the Fund has a duty, under its Articles of Agreement, to support the exchange rate chosen by a sovereign government.

Although the new capital sanctioned by the executive board in December 2000 took Turkey's authorized borrowing to over 900 percent of quota,[17] these funds were, arguably, too little too late. Since the central bank had seen losses of over $3.5 billion in one day, an immediate replenishment of $2.8 billion (even with a promise of up to $6.9 billion to follow) looks inadequate. More would have been needed to see the lira through to the widening of its bands, foreseen from 1 July 2001. Thus, a messy compromise between Turkey and the IMF merely served to delay the inevitable and to deepen its effects (for both parties) when it came.

After the IMF intervention in December 2000, tensions within the government continued to fuel the fragility of market confidence in Turkey. On 19 February, following an ill-tempered meeting of the National Security Council, Prime Minister Ecevit complained to assembled journalists about a crisis at the heart of the government. The immediate reference was to a dispute over the right of the president to investigate public banks. However, in the context of diminishing confidence in the commitment of the Turkish authorities to the program, the stubborn inertia of inflation, and concerns about continuing corruption, investors and creditors took the message to heart.

The lira came under severe speculative attack. Interest rates soared from 43.7 percent on 19 February, with overnight rates of 2,057.7 percent on 20 February and 4,018.6 percent on 21 February.[18] The central bank sought to maintain the peg with dramatic reserve outflows, but this position was unsustainable. On 22 February, the Turkish authorities abandoned the peg. The lira plunged from its pegged value of 685,000 to 958,000 against the US dollar in one day.[19]

On 2 March, the appointment of Kemal Derviş as state minister responsible for the economy was announced. Derviş entered the government as an outsider, a nonpartisan technocrat with significant international experience. He had worked at the World Bank since 1978 and was serving as a vice-president (Poverty Reduction and Economic Management) when he was approached by Prime Minister Ecevit.

Negotiating the May 2001 Program

Derviş and the new Turkish economic team had to think radically. Despite the earlier political and economic opposition, an involuntary debt restructuring was considered by Derviş and his team. Critical to their decision to reject this course of action was analysis of the ownership of outstanding debt. They calculated that over 60 percent was held by domestic banks owned by Turkish capital.[20] In light of this, an involuntary restructuring would have severely damaged the domestic economy and retarded any recovery. The long-term economic effects of damaging Turkey's international credibility were a factor but were secondary to consideration of who would pay for such an imposed restructuring. By implication, despite IMF resistance, they would have considered this path had the debt been more externally held.

With the exchange rate–based approach in tatters and a debt restructuring rejected, Turkey had little option but to pursue a fiscally contractionary, IMF-supported program. Both Turkish and IMF participants in the negotiations recall that Horst Köhler, the relatively recently appointed managing director of the IMF, was insistent on the primary surplus target of 5.5 percent.[21] On this, there was no room for negotiation.[22] Such a fixation on this variable is understandable from the perspective of the IMF, seeking to ensure that Turkey mend its profligate ways and, by so doing, put itself in a sound financial position to start repaying its substantial debts to the IMF. But what is interesting is that, beneath this headline target, Derviş and his team were able to exploit some flexibility in IMF negotiations.

The full detail of Derviş's recovery plan for the Turkish economy was set out in the Letter of Intent of 3 May, which marked a substantial new step in Turkey's economic reforms. There was to be significant restructuring of the banking system to address the structural weaknesses demonstrated in the

crisis, and fiscal controls would be tightened (including through a new debt law that prohibited government departments and agencies from securing credit independently of the treasury). Monetary policy would move toward inflation targeting, with greater independence for the central bank. Renewed commitments were made to privatize state-owned economic enterprises (SEEs) and to foster greater foreign direct investment (FDI).

The inflation target was a critical element in the May 2001 program. Inflation had played a significant role in the crisis. The IMF initially wanted to see a Consumer Price Index (CPI) target of 20 percent for 2002.[23] With year-end inflation for 2000 at 52 percent, Derviş and his team did not think this target feasible. They ran their own calculations and decided that something in the range of 30–40 percent was more realistic. Lengthy negotiations ensued between the two parties. The Turkish authorities won out and the target was set for 35 percent.

A second area of controversy concerned public sector wages. In late May, the Turkish authorities faced the threat of a general strike, spearheaded by representatives of Turkish Airlines (THY) (one of the SEEs that had been singled out for privatization). Derviş was convinced that the effects of such a strike (particularly on the tourist sector) would be more damaging to the economy than the increase in wages that the unions were seeking.[24] He took this argument to the IMF. Even though it meant revising an agreement previously reached with the Turkish authorities, the IMF team did accept this upward revision of the public sector wage cap.

These examples give two insights into the dynamics of the negotiations. First, the inflation discussions in particular demonstrate the advantage to be had from commanding credibility with the IMF team in negotiating on the economics. Derviş brought some of this credibility and was supported by the quality of the analysis provided by the treasury team beneath him. Second, despite often presenting itself as a purely technocratic (i.e., nonpolitical) actor, the IMF was prepared to make decisions based on the political impacts of policies. Derviş notes with hindsight that the 2002 inflation outturn of 31 percent meant that an inflation target had been met for the first time in twenty years and that this had a huge credibility boost (domestically and internationally) for the program. Similarly, over wage levels, the IMF team was willing to accept that the economic consequences of domestic political reactions to a feature of the program might be detrimental to the overall goals and was therefore prepared to relax a target.

A further key explanation for Turkey's room for maneuver takes us back to the US interest in Turkey. The US Treasury at the time was reluctant to support large IMF programs. Secretary O'Neill had highlighted the moral hazard risks, while his undersecretary for international affairs, John Taylor, had been scathing about accommodating IMF loans during his Senate confirmation hearing.[25] It was Germany that advocated a sizable new program

for Turkey, going so far (partly at the behest of IMF managing director Horst Köhler) as to offer bilateral finance to support Turkey, if the other G7 members would also contribute.[26] Over time, however, the US foreign policy interest in maintaining strong relations with Turkey trumped attempts by the US Treasury to push for a tough limit on excessive lending for moral hazard reasons.[27] This being the case, the IMF team had more freedom to accommodate Derviş's revisions than in other crisis packages.

Finally, it is also important to consider Derviş's role. First, he was uniquely placed to deal with the IMF. Interviews with the IMF team confirm that his position as an outsider, quasi-independent of the government and a newcomer to the negotiations, made him more credible to them. He was not tarnished by the failures of the previous program, nor did he have an obvious political constituency within Turkey to appease. Also, his Washington insider knowledge did matter—not just in terms of knowing the people with whom he was negotiating, but also because, after nearly thirty years in international financial institutions, he commanded the terms of discourse that reassured the IMF team. Moreover, Derviş notes that he was not simply negotiating with the IMF management and staff. Rather, he exploited his contacts with the key officials in G7 capitals and spoke regularly with the G7 deputies. This allowed him to seek to influence them directly and to exploit differences within the Deputies Group and between the deputies and IMF management.[28]

The credibility Derviş commanded with external parties influenced the dynamic between his team and the rest of the government, making it easier for them to exert and maintain leverage. As regards program implementation, Öztrak notes that with a floating—rather than a fixed—exchange rate, the market effect of political backsliding could be seen very clearly, and this helped maintain pressure to deliver the program.[29]

The May program did not have the immediate effect on markets that was hoped for.[30] It was only in October that Turkey's interest rate began a downward movement. This process coincided with the decision by the IMF, following the economic impacts of the September 11, 2001, terrorist attacks in the United States, to approve $3 billion for Turkey.[31] In February 2002, the executive board underlined the IMF's financial commitment to Turkey with a renewed standby arrangement, with $16 billion of new capital.

The Aftermath of the Crisis

Despite the economic improvements from autumn 2001, tensions persisted within the government. A combination of Ecevit's continuing ill health and splits within the DSP led to an early general election, held on 3 November 2002.

The economy was the central issue of the election. Although inequality of household income and expenditure in Turkey actually decreased over the period 1994–2002,[32] unemployment more than doubled,[33] food poverty among the urban poor increased significantly, and the World Bank found that the lives of the poor were particularly stretched by the consequences of the crisis. Some had to withdraw children from school to reduce out-of-pocket expenses; others had to seek informal earnings. Many reported the collapse under strain of the informal coping mechanisms of reliance on friends and family, and an attitude survey revealed that most households felt worse off in 2001 than in the preceding years.[34]

The government was heavily constrained in responding to the crisis. A loan from the World Bank ($500 million) for a Social Risk Mitigation Project (SRMP) was made in September 2001.[35] However, expenditure on education fell.[36] An increase in the value-added tax had a regressive effect that the government tried to combat by reinforcing social security.[37]

Politically, the economy was a minefield. While there were strong improvements in the aggregate economic performance by mid-2002, the experience of the crisis and its enduring effects on employment and living standards (a comparison made all the more unflattering by the boom of 2000) were still fresh in electors' minds. Opposition parties varied in the focus of their attacks on the economic record of the coalition government, which some blamed for the crisis. Others added that it had not only mismanaged the economy but also capitulated to the IMF. The most straightforward of these criticisms came from the newly formed Youth Party, which ran on a "No to the IMF" platform—and won 7.2 percent of the popular vote.

The final results were a striking demonstration of the public's rejection of the coalition government. The Justice and Development Party (AKP), successor to the moderate wing of the Islamist Virtue Party, which had been outlawed in 2001, won 34.3 percent of the vote and 362 seats, while the Republican People's Party, with Derviş in it, came in second with 19.4 percent and 177 seats. No other party—including the two parties that had formed the 1999–2002 opposition—obtained the requisite 10 percent of the vote to earn seats in the parliament.

The attitude of the AKP toward the IMF and the 2001 program is revealing. Before the campaign started, AKP's leader, Recep Erdoğan, was highly critical of the program, promising that his party would negotiate a new program if elected. This hard-line position was significantly moderated during campaigning and particularly as the AKP's prospects of victory became clear. Immediately after the AKP's success, the new economy minister, Ali Babacan, was dispatched on a tour of key financial centers to reassure market players that the AKP would implement the program.

This gives us a useful insight into the importance of domestic perceptions of the IMF. In criticizing the IMF, the AKP was pandering to a domestic

Turkish hostility to the IMF, based largely on perceptions of its challenge to national sovereignty. However, political leaders in Turkey have to be attentive to the IMF's signaling effect on a second audience: international investors. For this group, the imprimatur of an IMF program is a key indicator of the soundness of investment (whether because of improved credibility of the authorities or a belief that the IMF will bail out investors in the event of difficulties). To the extent that economic well-being is a determinant of voting decisions, and to the extent that this depends on international investors, the government must signal to those investors a commitment to the IMF (even while maintaining a perception of caution toward the IMF for the benefit of domestic observers).

Conclusion

This study set out to explore the impact of the IMF's intervention on the economic policy choices made in Turkey. In the introduction to this special issue, Ngaire Woods identified three stylized impacts of IMF involvement: constraining of policy options, enlargement of policy space, and permissiveness of continued (poor) policies. Turkey's case provides evidence of all three effects. In 1999, the engagement of the IMF initially constrained options to three orthodox macroeconomic alternatives and then to one central proposal once two had been excluded by the domestic authorities. In 2000, the decision to provide Turkey with a further replenishment to support a creaky policy regime was a clear case of permissiveness. In 2001, the willingness to support a substantial financial package for Turkey, allied to the flexibility shown by the IMF team in negotiations, provided enlarged policy space for the economic reformers assembled around Kemal Derviş.

Which factors, then, determined the effect that the IMF's engagement had on Turkey's policy alternatives? First, in dealing with Turkey, the IMF traded in four commodities that affect policy: the provision of capital; the supply of technical expertise and knowledge; the offer of endorsing policy, thereby providing credibility (particularly to international capital markets); and the imposition of conditionalities, which could in turn provide leverage for reformers in domestic politics. Each of these has historical paths. That is, they should not be looked at independently of each separate interaction between the IMF and the Turkish authorities. Hence, in November 2000, the IMF was influenced both by the existing loan outstanding to Turkey and by the embarrassment that Turkey had experienced a crisis despite already being engaged in an IMF program. In May 2001, a further reason for the latitude provided to the Turkish authorities may have been the evident failure of the conditionalities attached to the previous programs.

Second, all three cases highlight the important role of external actors, especially the United States, as the largest shareholder in the IMF. When these actors had a strong interest in the policy outcome, they constrained the IMF's freedom of action and inclined it toward a particular approach. This was seen most clearly in the December 2000 decision to replenish Turkey's program. Third, on Turkey's side, the cohesion and coordination among Turkish ministries also affected the ability of its negotiators to relate to the Fund. When they were most united, they were able to push back more strongly against unwelcome proposals. When they had attributes that conveyed credibility to the Fund, they again had more leverage.

This study has also considered how the IMF's intervention affected domestic politics. Four key impacts are demonstrated. First, the involvement of the IMF empowered economic technocrats relative to political leaders. This had positive effects insofar as it enabled them to pursue reforming policies, and it gave them external levers with which to tackle vested interests. However, it also had negative effects. In the case of the ERBS program, the political leaders disassociated themselves from the necessary tough decisions and ultimately from the program itself, leading to lack of ownership and delivery of the conditions that would have been necessary for the program to succeed.

Second, the crisis itself had negative social impacts, which in turn had political effects. For these, the IMF must take some responsibility, to the extent that they were attributable to failures in ERBS design and that the replenishment in 2000 represented a poor decision. But the IMF was not solely to blame. The crisis also resulted from historical trends in Turkey's economic policy and the poor implementation of the 1999 program. Furthermore, the IMF was willing to engage (and show flexibility to) Derviş's team in seeking to address the consequences of the crisis, including the social effects.

Third, the IMF became a factor in the domestic elections of November 2002. A number of critics in Turkey highlighted the depoliticization of economic policy.[38] The manner in which economic reforms were presented as necessary technical adjustments, rather than political choices with an impact on the distribution of resources within the economy, struck these critics as deeply antidemocratic. However, the way in which the IMF was invoked as a bogeyman of the financial crisis by the opposition parties during the election suggests that, on the contrary, it was presented as the author of certain policies and outcomes. Certainly, the outcome of these elections suggests that voters were able to exercise their democratic right to oust those who had pursued policies they rejected.

Last, the behavior of domestic politicians toward the IMF demonstrates an opportunistic approach in two respects. As with the interaction between domestic authorities and many multilateral institutions, there was a tendency

for domestic politicians to take the credit for the benefits from a given program (such as the miniboom in 2000), only then to blame the IMF for the costs. Domestic politicians also tended to criticize the IMF's role domestically but to vaunt it internationally, as the AKP's behavior demonstrates.

Notes

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1. The economic contraction (calculated for the period July 2000–December 2001) is based on A. E. Yeldan, *Behind the 2000/01 Turkish Crisis: Stability, Credibility, and Governance, for Whom?* in Z. Oniş and Barry M. Rubin, eds., *The Turkish Economy in Crisis* (London: Frank Cass, 2003), Table 1. Unemployment rose from 5.63 percent in the third quarter of 2000 to 11.76 percent in the first quarter of 2002, as calculated in World Bank, *Turkey: Poverty and Coping After Crises* (Washington, DC: World Bank, 2003), p .8.

2. A number of those interviewed were willing to participate only on condition of anonymity. These interview sources are therefore consequently referred to generically. Interviews were conducted with Turkish officials in March 2004 and with IMF and G7 officials between November 2004 and March 2005.

3. C. E. Alper and Z. Oniş, "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 (2003): 5–26.

4. T. Allen, *Turkey and the EU* (Luxembourg: Eurostat, 2000), p. 3.

5. For full details, see the Letter of Intent of 9 December, Government of Turkey, 1999, available at www.imf.org/external/np/loi/1999/120999.htm.

6. For an overview of ERBS schemes, see G. A. Calvo and C. A. Végh, "Inflation Stabilization and BOP Crises in Developing Countries," in J. Taylor and M. Woodford, eds., *Handbook of Macroeconomics* (Amsterdam: Elsevier, 1999), pp. 1531–1614.

7. Interviews with US officials; see also Secretary Summers's speech to the London School of Economics on 14 December 1999, "The Right Kind of IMF for a Stable Global Financial System," US Treasury Department.

8. Interview with Faik Öztrak, 10 March 2004.

9. N. K. Ekinci and K. Erturk, *Turkish Currency Crisis of 2000–1, Revisited,* Working Paper 2004-01, Center for Economic Policy Analysis, New School University, New York, 2004, pp. 1–23, set out the argument that speculative capital and the expectations behavior of portfolio investors were the principal causes of the crisis.

10. See B. J. Eichengreen, "Crisis Prevention and Management: Any New Lessons from Argentina and Turkey?" background paper written for the World Bank, *Global Development Finance 2002,* October 2001, available at: http://www.econ.berkeley.edu/~eichengr/policy/crisis101901.pdf>.

11. A. E. Yeldan, *On the IMF-Directed Disinflation Programme in Turkey: A Programme for Stabilization and Austerity or a Recipe for Impoverishment and Financial Chaos?* September 2001, p. 6, available at http://ssrn.com/abstract=290539.

12. F. Özatay and G. Sak, "Banking Sector Fragility and Turkey's 2000-01 Financial Crisis," *Brookings Trade Forum 2002* (Washington, DC: Brookings Institution Press), p. 149.

13. Interviews with IMF and Turkish officials.

14. Interviews with IMF officials.

15. Yeldan, "On the IMF-Directed Disinflation Programme in Turkey," p. 5.

16. Interviews with US officials.

17. Standard borrowing limits are 300 percent of quota, and a board decision in favor of granting "exceptional access" is required to exceed these.

18. Özatay and Sak, "Banking Sector Fragility," p. 153.

19. Ibid., p. 151.

20. Comment made by Kemal Derviş at the "Pathways Through Financial Crises" roundtable, Oxford University, 29–30 April 2004.

21. Interviews with Turkish and IMF officials.

22. Interview with Kemal Derviş.

23. Speech given by Kemal Derviş to the ABCDE Conference in Paris, 16 May 2001, see http://wbln0018.worldbank.org/eurvp/eurvpwebtv.nsf/($All)/F8799DA148740365C1256D2F0053DEB2?OpenDocument&High for web-stream.

24. Ibid.

25. United States Senate, *Hearing on the Nomination of John B. Taylor to be Undersecretary of Treasury for International Affairs,* 107th Cong., 1st sess., 2001.

26. Interviews with G7 officials.

27. Interviews with US officials.

28. Comment made by Kemal Derviş at the "Pathways Through Financial Crises" roundtable, Oxford University, 29–30 April 2004.

29. Interview with Faik Oztrak, 10 March 2004.

30. Özatay and Sak, "Banking Sector Fragility," p. 157.

31. International Monetary Fund, *News Brief No. 01/121* (Washington, DC: IMF, 2001).

32. It is important to note that the data is limited and characterized by long intervals between household surveys, making it very hard to attribute changes to the crisis. This observation is based on the 2002 State Institute of Statistics (SIS) Household Income and Expenditure Survey (HIES), comparing results from 1994 and 2002; and on a World Bank survey comparing 1994 and 2001, reported in World Bank, *Turkey: Poverty and Coping After Crises* (Washington, DC: World Bank, 2003).

33. World Bank data show a doubling of unemployment from the third quarter of 2000 (5.63 percent) to the first quarter of 2002 (11.76 percent). See ibid., p. 8. The SIS Household Labour Force Survey shows a fall of 6.5 percent in total employment from 1998 to 2002; this was more concentrated among men (–7.1 percent) than among women (–5.0 percent), although the fall in employment among women was 7.5 percent from 1999 to 2002.

34. Ibid.

35. Ibid., p. ii.

36. Although government expenditure was largely unchanged as a percentage of GNP during the period 2000–2002, given the 9.5 percent fall in GNP in 2001, this indicates a sharp real fall in expenditure in that year (IMF, *Third Review Under the Stand-by Arrangement–Staff Report,* 2002). Data from SIS shows that the share of central government expenditure assigned to education fell significantly from 1998 to 2001 (by 42 percent) before picking up again in 2002. The SIS data show that there were dips in the otherwise upward trends of net secondary school enrollments

in 2000 and of net primary school enrollments in 2001. Health expenditure as a share of central government total fell somewhat from 1998 to 1999 before rising consistently to 2002.

37. K. Dervis, *A Better Globalization* (Washington, DC: Brookings Institution, 2005), 119–120.

38. See, for example, U. Cizre and E. Yeldan, *The Turkish Encounter with Neo-Liberalism: Economics and Politics in the 2000/2001 Crises* (Ankara: Bilkent University, 2004).

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