The Origins and Aftermath of a Foreign Debt Crisis — Turkey 1977

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The study of international debt problems, as in the case of Poland and Jamaica, illustrates well how many ostensibly "economic" crises are, at heart, political ones. Indeed, a strictly economic approach to such matters can often lead to unintended, deleterious consequences for a country. In this article, Dan Grosz analyzes the development and repercussions of one such instance — the Turkish debt troubles of the 1970s and early 1980s. He demonstrates that a proper understanding of a nation's financial health requires more than a familiarity with numbers. It requires also a proper sensitivity to basic political and social forces.

Debt analysis, like medicine, is more art than science. Like two patients reacting differently to the same sickness, a debt one country can shrug off with relative ease may bring another to heel. Turkey's debt crisis in 1977 involved a multiplicity of issues, including the role of the state in industrial development, development finance, decisionmaking in weak coalition governments, and debt finance management.

Using these as guideposts, this paper will review the time period 1973 to 1982, which corresponds to the immediate roots of the Turkish debt problem, the crisis itself, and the outcome. The six year span up until 1979 falls roughly into Turkey's third cycle of economic development since World War II.[1] Each of these cycles was characterized by rapid growth followed by economic turmoil which led to political instability. The aftermath of the military coup of September 1980 appears to be ushering Turkey into yet another cycle.

An important theme of this paper will be that quantitative data in financial analysis did not provide an adequate representation of Turkey's predicament. For a more balanced representation, it is necessary to dig

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1. Kemal Dervis, et al., *The Foreign Exchange Gap, Growth, and Industrial Strategy in Turkey: 1973-1983* (Washington, D.C.: The World Bank, 1978).

below the surface, and to analyze the constellation of political, social, cultural, and historic factors that propel events.

BACKGROUND

Turkey is the largest country in Europe and, in 1979, had a population of 44.2 million.[2] Since 1950, real GNP growth averaged 6.6 percent per annum, one of the highest rates of continuous growth in the world. Industry accounts for 73 percent of GDP, agriculture for 27 percent. Unlike many other lesser developed nations, Turkey enjoys a favorable, though largely untapped, resource base. Oil, lignite, coal, iron ore, copper ore, manganese, lead, and zinc are some of the minerals that have been found in large quantities.[3] In addition, there is an abundance of timber and the hilly terrain provides for numerous hydroelectric sites.[4]

Population growth is very rapid, estimated at between 2.5[5] to 3.0 percent[6] per year. The bulk of the population is rural, though massive migrations to the cities have been common since the early 1960s. Over 80 percent of the population is Turkish, with Kurds, Arabs, and Greeks forming important minorities.

The Philosophy of Government: Etatism and the SEEs

Since the founding of modern Turkey by Mustafa Kemal in 1923, Turkey has had a strong tradition of state intervention in economic development, or *etatism*. This role can be traced to the Turkish philosopher Ziya Gökalp, Attatürk's mentor. Gölkap wrote:

> Turks also have a second economic ideal, which is to endow the country with a large industry, . . . Without the guidance of the state, we Turks could not even take a step in this direction.[7]

Etatism was formally written into the constitution in 1937, and is regarded as one of the "six arrows" or cardinal principles of the state.[8]

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2. Richard Nyrop, ed., *Turkey: A Country Study* (Washington, D.C.: The American University Press, 1980), p. vii.
3. Department of State, *Background Notes: Turkey* (Washington, D.C.: September 1979).
4. Nyrop, *Turkey*, p. viii.
5. The smaller estimate is given in Department of State, *Background Notes*, and probably represents the rate since 1965.
6. The larger rate is given in OECD *Economic Survey: Turkey*, May 1963, and is probably more accurate for population growth before 1965.
7. *Financial Times of London (FT)*, 13 November 1978, p. IV.
8. A. G. Carey and J. P. Carey, "Turkish Industrialization and the Five Year Plan," *Middle East Journal* (Summer 1971), p. 391.

State economic enterprises (SEEs) grew directly out of this philosophical and legal foundation. SEEs are corporations controlled by the state, in which the state provides more than half the capital. By the mid 1970s, SEEs constituted about 40 percent of Turkey's total industrial capacity, and were engaged in a wide variety of activities, ranging from petrochemicals to agribusiness.[9]

The state exerts considerable political leverage in the investment, personnel and pricing policies of SEEs. This is because the government intended the SEEs to perform two vital and often contradictory tasks: economic development and social change. Investment was often based not on careful cost analysis, but rather on the need for industrial projects in impoverished regions. Because of high unemployment caused by population growth, SEEs tended to have swollen payrolls and high labor costs. For example, one SEE, the Iskedren Iron and Steel Works, had 18,000 workers when only 6,000 were required.[10] In addition, there was a dearth of management personnel with adequate technical and administrative backgrounds.

Even though these weaknesses were generally recognized, proponents of SEEs argued that these state enterprises were needed because the private sector lacked the proper incentives, capital, entrepreneurial spirit, and technical training to fuel a modernizing economy. Further, infrastructure projects, which constituted the bulk of all SEE activities, had relatively low profit margins.

The Political Arena

Modern Turkey has strong democratic roots, but ones which have been tainted by numerous instances of military intervention. In 1963 and 1971, the army took power when it felt that the civilian leadership could no longer maintain adequate control. The coup of 1980 represents just one more example of martial intervention. Even when civilians were in charge, air force jets had a nasty habit of buzzing the National Assembly (Turkey's parliament) to protest policies that they viewed with disfavor.[11]

Turkish politics is fragmented along ethnic, political, and economic lines. There are eleven political parties, none of which is powerful enough to win a majority on its own. Four parties play predominant roles — the Republic People's Party (RPP), the Justice Party (JP), the National Sal-

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9. OECD, *Economic Survey: Turkey*, August 1976, p. 9.
10. *Middle East Economic Digest (MEED)*, 19 November 1979.
11. This happened in 1973, for example, when Fahri Korütürk was elected as president over the objections of the army, which wanted its own candidate. *See Middle East Intelligence Survey (MIS)*, 5 April 1973.

vation Party (NSP), and the National Action Party (NAP). Below is a short profile of each:

1. RPP — Oldest and largest party, founded by Attatürk, who was its first leader. Stands for reform, technological progress, westernization, and secularization. It is elitist, left of center and social democratic. Its present leader is Bülent Ecevit.
2. JP — Second largest party. Represents Turkey's industrialists and wealthy farmers. Committed to rapid growth and increased military strength. Disdains reforms in such areas as taxation, land tenure, and basic institutional changes. Leader is Süleyman Demirel.
3. NSP — Represents a constituency strongly identified with the country's Islamic past. Favors distance from NATO and closer ties with the Arab world. Zealously supports heavy industrialization. Leader is Necmettin Erbakan.
4. NAP — Neo-facist group whose philosophy is a mixture of socialism and nationalism. Places emphasis on Turkishness. Symbol based on Grey Wolf, which according to legend guided the Turks from Asia Minor. Leader is Arparslan Türkes, whose followers howl in greeting him. Depicted in press as "dwarf Asiatic Hitler."[12]

The following is a short chronology of political dynamics since 1973:

October 1973 — RPP plurality. Three month political crisis resulting in coalition with NSP.
September 1974 — Ecevit government collapses. Six months of political turmoil.
March 1975 — Demirel coalition with NSP and NAP.
June 1977—Ecevit and RPP emerge victorious, but are quickly succeeded by Demirel and his coalition.
June 1978 — Ecevit wins with support of independents who are actually defectors from JP.
October 1979 — Demirel resurrects coalition to resume control of government.
September 1980 — Military takes over.[13]

In addition to fragmentation, the most notable feature of the political system is its weakness. Rarely does a coalition have a plurality by more

12. *MIS*, 15 February 1975; *FT*, 13 November 1978, p. IV; see also Morris Singer, "Turkey in Crisis," *Current History*, vol. 80, no. 462 (January 1981), pp. 27-31.
13. Nyrop, *Turkey*, pp. 226-231; Singer, *Ibid.*, p. 28.

than 10 percent of the total votes.[14] This is primarily due to the basic split between the RPP and the JP, who have never aligned to form a government. The bitter personal animosity between Demirel and Ecevit, not any fundamental ideological differences, is responsible for this rift. Indeed, at times, the two parties are closer to each other than to their coalition partners.

Unions also play a major role in the Turkish polity. The labor force is highly organized, although split along ideological lines which roughly correspond to the two largest labor federations Türk-Is and DISK. Türk-Is, the larger of the two, is basically conservative, made up largely of public sector (SEE) employees. DISK, on the other hand, is more radically oriented. As far as the unions are concerned, the government's legitimacy rests largely on the success or failure of its economic policy, which is part of its constitutional imperative.

A situation exists in which, while decisionmaking is highly fragmented and therefore weak, the political environment is highly organized, and therefore volatile.

Development Finance

Following elections in early 1974, a new government coalition was formed, consisting of the JP, NSP and NAP. This government was deeply committed — by way of heavy prompting by industrialists — to rapid economic development. Expectations for growth jumped to 7.9 percent, up from 7 percent, which had been the target rate since formal planning came into being in 1962.[15] Concurrently, the government pledged to increase the minimum wage, provide agricultural price supports, and increase distributive justice.[16] These objectives were formalized in a revised edition of the Third Five Year Plan (TFYP), 1973-1978.

The means to achieve the TFYP were twofold: to relax the tight monetary policy which had been the hallmark of previous governments; and to expand greatly the SEEs. In fact, a full 56 percent of investment under the plan was to be channeled into the public sector. The success of the plan was based on two critical assumptions: that profits of SEEs would improve sharply; and that revenue receipts under the consolidated budget would increase as planned.[17]

In the short run, the Turkish economy was not able to sustain the level of expenditures required by such an ambitious plan. Therefore, the TFYP's

14. Nyrop, p. 216, for a breakdown of election results, 1961–1977.
15. OECD, *Economic Survey: Turkey*, November 1978, p. 6.
16. OECD, *Economic Survey: Turkey*, November 1974, p. 5.
17. *Ibid.*, p. 10.

objectives depended on Turkey's ability to obtain foreign credits, particularly from commerical sources. Previous plans had assiduously avoided incorporating commerical credits as sources of external finance because of bad experiences with such borrowing in the 1950s. In late 1973, however, Turkey's Central Bank held an abundance of foreign currencies (mainly as a result of the growth in workers' remittances from Turks employed abroad) and Turkish authorities minimized the risks.[18]

In 1974, a new law was passed designed to ease the flow of private credit into the country.[19] Credits spawned by this legislation became known as Turkish convertible lira accounts (CLAs). These accounts would eventually include reciprocal business between international and Turkish banks, investment capital supplied by foreign companies to their local affiliates and branches in Turkey, and deposits by Turkish workers abroad.[20]

Convertible lira accounts consisted of foreign currency lent to Turkish banks at a rate of 1.75 percent over the London Inter-Bank Offered Rate (LIBOR). Front-end fees were also paid as inducements, and depending on the desire of the borrower, these could be very high. The interest rate charge did not vary over the duration of the CLAs. Thus, a twelve-month account carried the same spread as a three- or six-month account. The exchange rate at which the foreign exchange was lent was fixed at the time of transaction and guaranteed by the Central Bank. The banks were required to deposit their foreign exchange with the Central Bank, and received the equivalent amount in Turkish lira. The banks were now able to use the lira as they pleased, and the Central Bank had foreign exchange with which to finance foreign trade. Although CLAs were private and did not contribute directly to public finance, to the extent that money is fungible they provided an important addition to the country's supply of foreign exchange.[21]

Turkish financiers and administrators recognized that short term finance — as implied by CLAs — was not the optimal way to finance industrial development. There was not enough time to syndicate Eurobond loans, however, and there was doubt whether the Eurobond market could provide for Turkey's needs. The fragile parliamentary balance in 1974 precluded passing more comprehensive financial legislation, the result of which might have been better terms for credits.[22] Finally, short term credits had

18. OECD, *Economic Survey: Turkey*, Auqust 1976, p. 31.
19. Pamela Clarke, "Will the Banks and the Fund Make an Example of Turkey?" *Euromoney* (September 1977), pp. 16-23.
20. *FT*, 13 November 1978.
21. *FT*, *Ibid.*
22. Clarke, "Banks and the Fund" p. 16.

been used successfully in 1967 to alleviate the government's temporary cash shortage.[23]

Workers' Remittances

Turkey's high rate of population growth coupled with strong demand for labor by the economies of Western Europe led to a formal agreement between Turkey and the EEC to export Turkish workers to EEC members. By 1974, 750,000 workers had been placed in Europe by the state. The overwhelming majority, 600,000 were located in West Germany.[24]

Although the agreements with the EEC were originally intended to act as a safety valve for Turkish unemployment, by 1965 the savings these workers sent back home began to have an important impact on the Turkish economy. Not all the savings were repatriated, however, and deposits in European banks by Turkish workers reached DM 3,000 million by the mid-1970s. In part, CLAs were set up to encourage the remittance of this pool of money. Given the foreign exchange guarantees, workers would not have to fear the specter of devaluation as a threat to their hard earned savings.

THE CRISIS

Origins — External

The oil crisis in 1973 set off a series of events which brought Turkey to the verge of financial disaster by 1977. The oil crisis itself had important consequences. Between 1973 and 1974, the cost of oil imports nearly quadrupled from $201 million to $694 million,[25] 45 percent of Turkey's total exports for that year.[26] By 1977, oil costs had risen to $1,152 million, equivalent to 66 percent of export earnings. These increases were a severe setback to Turkey's development strategy, which had until then been predicated on cheap energy.

The oil shock sent the economies of the industrialized nations into a tailspin — particularly those European economies which were Turkey's largest export markets.[27] Trade restrictions were imposed (especially in Britain and Italy) on the importation of Turkish goods. Turkish workers in Europe, whose remittances in 1973 almost equaled the total value of

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23. OECD, *Economic Survey: Turkey*, July 1967.
24. EEC, *Association Between the EEC and Turkey* (January-December 1978), pp. 57-60.
25. OECD, *Economic Survey; Turkey*, April 1980, Table G.
26. *Ibid.*, Table H.
27. *International Currency Review (ICR)*, Vol. 8, No. 6, p. 105.

all of Turkey's imports, were laid off in significant numbers. Those workers who managed to keep their jobs drastically reduced remittances, fearing instability both in Turkey and abroad. Remittances dropped from $1,400 million in 1973, to $982 million in 1976.[28]

This international economic uncertainty created a hoarding mentality within Turkey. There was a massive accumulation of consumer products (many of which were imported), as well as industrial products by major industries (also largely imported). Between 1973 and 1974, imports of agriculture and livestock grew by almost 500 percent and imports of industrial products by 70 percent.[29] At the same time, because of growing worldwide inflation, prices paid for these goods increased sharply.

Turkey's woes at this time were exacerbated by the Cyprus question and deterioration of relations with Greece. The combination of the expense of the Turkish military force sent to Cyprus, and the paranoia engendered by a U.S. embargo of arms and credits, led to a massive increase in military spending. Between 1973 and 1977, military expenditure rose by 710 percent.[30]

Origins — Internal

Against this backdrop, the SEEs, slated to be the bulwarks of the TFYP, performed extremely poorly. Instead of becoming increasingly profitable, they became more and more reliant on the government to finance their growing deficits. Productive SEEs experienced a jump in new investment requirements, an increase which they themselves could not finance. These needs grew from 1,605 million Turkish lira (TL) in 1973 to TL 5,851 million in 1974, and TL 11,877 million in 1976.[31] Instead of becoming the engines of industrialization, the SEEs quickly became major headaches.

By 1977, roughly $2,000 million had been placed in CLA deposits.[32] As economic conditions deteriorated, more rather than less reliance was put on CLAs. A robust economy might have been able to weather the high costs, but Turkey's economy was anything but healthy. The money thus borrowed, instead of promoting investment as originally intended, was used to bridge the ever-widening foreign-exchange gap.[33] Turkey used short-term funds for uses which required long-term facilities.

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28. OECD, *Economic Survey: Turkey*, Table I.
29. *Ibid.*
30. Nyrop, p. 314, Table 17.
31. OECD, *Economic Survey: Turkey*, Table K.
32. *FT*, 13 November 1978, p. IV.
33. *Ibid.*, p. IV.

CLA accounts also developed a number of interesting unforeseen characteristics. First, the CLA scheme was not very successful in attracting the savings of Turkish workers abroad; foreign banks, finance companies and money brokers were. These agents were not as interested in Turkish development as they were in interest rate arbitrage and high fees. The constant spread irrespective of maturity provided no incentive for investors to make long-term deposits. The risks of such credits were recognized by lenders but the short maturity justified financial "Russian Roulette." Banks, extremely liquid in short and medium term liabilities because of tremendous OPEC surplus deposits, were eager to match their short term obligations with similar assets, and CLAs provided convenient avenues.[34] Because there was no foreign exchange risk for depositors or borrowers, most CLAs were transacted in hard currencies such as the Swiss Franc and German Mark.

Denouement

Initially, as short term (three- to six-month) CLAs became due, they were automatically rolled over. Still, the high interest rates on these accounts led to very high interest rate payments. On top of that, high front end fees had to be paid every time the accounts were renewed. Between 1973 and 1974, interest payments leapt 350 percent to a point where they devoured 56 percent of all export revenues. This, in combination with the poor trade balance, created a dangerous balance-of-payments deficit, which totaled $4,440 million in 1977.[35] Since the credits available were insufficient — about $1,000 million from all sources per year — reserves of foreign exchange dropped by $5,000 million between 1973 and 1977.[36] By October 1977, only $584 million of foreign exchange were left in reserve, enough to finance no more than six weeks' worth of imports.[37]

As foreign exchange dried up, delays of forty-five to sixty days were encountered for importation of goods due to payment problems. By March 1977, Turkey could no longer pay for most of its imports, and payments ceased.[38] By May, the level of stalled imports had reached $981 million and was growing at a rate of $200 million per month.[39] Italian, German,

34. See William Noellert, "The International Debt of Developing Countries and Global Adjustment," in Franko and Seiber, eds., *Developing Country Debt* (New York: Pergammen Press, 1979), pp. 269-84.
35. World Bank, *World Debt Tables*, Vol. II, p. 181.
36. State Institute of Statistics, *Statistical Yearbook of Turkey* (1979), p. 355, Sec. III.
37. *MEED*, 13 May 1977.
38. *FT*, 20 October 1977.
39. *Foreign Broadcast Information Service (FBIS)*, 6 June 1977.

French, Japanese, and American banks refused to honor Turkish Central Bank cheques.[40] Turkey's diplomats in Japan could not even cash their paychecks.[41]

Seeing the rapid deterioration in balance-of-payments, banks refused to enter into any additional CLAs and only reluctantly rolled existing accounts over because they had few alternatives. Even so, they had to forego interest payments as the Turks no longer had the ability to pay.

Foreign owned enterprises, fearing the imminent possibility of devaluation and the lack of foreign exchange, quickly repatriated any capital they could and sharply reduced inventories. The worst example, from the Turkish perspective, was that of the ATAS Refinery, which was jointly owned by Mobil Oil, British Petroleum, and Shell Oil. As the bill for crude oil imported for use in the refinery accumulated, production was cut back to 50 percent of capacity, the bare minimum required to prevent damaging equipment.

As a result the Turkish economy, which was so heavily dependent on imports, began grinding to a halt. By the second half of 1977, manufacturing was producing at 52.8 percent capacity, textiles 68.9 percent, wood 60 percent, chemicals 65 percent, metal products 51.2 percent, and automotive manufacturing 43 percent.[42] The GNP showed a decline in the rate of growth from 7.3 percent in 1974 to 1.7 percent[43] in 1979, which if taken on a per capita basis is an actual decline due to increases in the population. Unemployment increased to 20 percent and prices rose 200 percent between 1973 and 1977.[44]

POLICY REACTIONS

Political

The relatively sudden crisis, at a time of rising expectations, hit Turkey's decisionmakers like a rabbit punch. The coalition between the JP, the NSP, and the NAP, which was tenuous in the best of times, began to unravel under the stress.[45] The cabinet, representing disproportionately the NSP and the NAP (which in the national context were splinter groups), was irrevocably split.[46] Each party had its own aims and was not about

40. *Ibid.*, 22 June 1977.
41. *Ibid.*, 29 June 1977.
42. *MEED*, 14 July 1978.
43. OECD, *Economic Survey: Turkey*, April 1980, Table B.
44. *Ibid.*, Table F.
45. *MEED*, 14 January 1977.
46. *FT*, 23 November 1977.

to let the national welfare stand in its way.[47] No concrete plans were formulated, and a policy of muddling through was adopted by default.

Strangely enough, Turkey was able to weather the initial shocks sparked by the oil crisis in 1973 without much trouble; but this was primarily due to the growth of CLAs, which was in effect like living on borrowed time. By 1977, the economy had hit bottom and the CLA palliative had vanished. The situation demanded decisive measures.

In February, Air Force General Irfan Ozaydem sent a stern letter warning the government to restore order and to stop the decline of Turkey's prestige both at home and abroad. Letters very similar to this one had heralded military intervention in 1963 and 1971.[48]

Because of growing unemployment, high inflation, military unrest and increasing union discontent elections were hurried. On 21 June 1977, Bülent Ecevit and the RPP, with the help of a few independents, garnered just enough votes to eke out a majority in the National Assembly. On 28 July, a little over a month after Ecevit's narrow victory, a massive walkout by right-wing deputies in the National Assembly resulted in the fall of the government, and the return of Demirel and his tripartite coalition.[49]

This event strengthened the position of the NSP, although its electoral support remained miniscule. Having won only 8.6 percent of the popular vote, the NSP now controlled nine cabinet seats, including the Ministries of the Interior, Agriculture, Labor, and Industry and Technology. The NSP was now the swing party, able to make or break the coalition.[50] Its intransigent insistence on rapid industrial growth became the *sine qua non* of the Demirel coalition.

Thus, during the most critical point in the foreign exchange crisis, in mid-1977 Turkey was effectively rudderless, and drifting on a very dangerous course.

Economic

Necmettin Erbakan and the NSP were determined that Turkey rise to the status of a highly industrialized state. He insisted that by the year 2000, Turkey would be more powerful than West Germany, and have a GNP of $400,000 million.[51] At the same time, Erbakan resisted any and all efforts by the more sober Demirel to disengage from Cyprus and

47. *ICR*, Vol. 11, No. 2, p. 135.
48. *MEED*, 14 February 1977.
49. *ICR*, Vol. 11, No. 2.
50. *The Banker*, August 1977, p. 20.
51. *MEED*, 25 February 1977.

mend relations with the United States. Thus, in 1977, the budget was increased by 75 percent.[52] Military spending rose by $4,100 million, which translated into $40 million a month in imports. In October, as Erbakan was expounding on his plans to begin 210 heavy industrial projects to foreign reporters, a power failure caused by the shortage of imported crude oil forced the conference to be continued with gas lanterns.[53] Even Demirel, whose favorite saying was "borrowing whips brave men into action," was getting a little nervous.[54]

The only response the government could make was in the foreign arena. The EEC was accused (not without some cause) of unjustly limiting Turkish imports in direct contravention to the protocol signed with the Community in 1963; Turkey also accused the EEC of limitinq the migration of Turkish workers. The US was blamed for deliberately blocking aid in an effort to pressure Turkey to change its policy towards Cyprus and to move closer to NATO. Consequently, Turkey downgraded relations with NATO and made overtures to the Soviet Union and the Arab world, especially Libya, for more aid. These efforts did bring some immediate relief, but Soviet and Arab aid was largely symbolic.

The Soviets pressed Turkey to leave NATO completely. The JP as well as the NAP were not willing to go quite that far. They reasoned that Turkey's role in NATO was probably the most important card the country had in squeezing more aid out of the West — something not to be abandoned rashly.[55]

As far as the Arabs were concerned (particularly Saudi Arabia) Turkey's relations with Israel precluded any major commitments from them until that relationship had been amended. From Turkey's perspective, the Israeli connection was important. Oil shipments from Haifa continued despite the foreign exchange shortage, and Israeli armaments were needed as long as the US embargo remained in effect. Libya was the most important exception to Arab lack of enthusiasm toward Turkey, and provided important aid. This was due to the deterioration of Libyan relations with Egypt, and the Libyan desire to replace Egyptian expatriate workers in Libya with Turks.

Financial

There was little leeway under existing policies for much change in the financial situation. In March, the CLA scheme was effectively ended when

52. State Institute of Statistics, p. 341.
53. *FT*, 22 October 1977.
54. *Ibid.*, 13 November 1978.
55. Lawrence Neal Benedict, State Department Officer—Turkey Desk, interview conducted by author, March 1981. Mr. Benedict's views are not necessarily those of the US government.

the Central Bank dropped its foreign exchange guarantee, and changed the spread so as to vary over maturity. But this measure proved to be useless because no one used the CLAs anymore. (In fact, Erbakan had the perspicacity to recommend that CLAs should be restored to finance $20,000 million in additional credits.)

As the situation worsened, Turkey finally called the IMF in to help. A three-man team, headed by Charles Woodward, flew to Ankara in October 1977, and conducted a detailed analysis of the economy.[56] The basic conclusion that emerged from the study was that Turkey's problem was caused by a grossly overvalued exchange rate. This over-valuation arose from a variety of factors, including inflation, deceleration of workers remittances, oil price increases, and increased domestic investment. The analysts recommended that Turkey devalue the Turkish lira to "shadow" or black market rates and reduce the rapid growth of the economy.[57]

Given the IMF's charter requirement to provide liquidity only after the institution of sound economic policies, no aid to Turkey was offered until certain policy conditions were met. In 1977, the IMF and the major commercial banks reached a tacit agreement which in effect required the IMF to give the "green light" before commercial credits could be released to an ailing economy. Turkey became the test case for this new arrangement. Therefore, practically no sources of new credit, nor avenues for restructuring old credit, were available without the IMF's imprimatur.[58]

Though the Demirel government could no longer effectively run the country, the internal dynamics of the coalition precluded any bowing down before the IMF's insistence of policy conditionality. But the government's time was almost up. On 4 January 1978, Bülent Ecevit won a majority in the National Assembly, though by a margin of only nine votes. The restructuring of Turkey's debt began in earnest in 1978, albeit with a weak government.

DEBT-RENEGOTIATION

International Monetary Fund

A little over a week after assuming office, Ecevit delivered a major policy speech which would become the touchstone of his relationship with the IMF, and therefore, had great import for debt rescheduling. In his address he said,

56. *MEED*, 21 October 1977.
57. Dervis, *Foreign Exchange Gap*, pp. 55-56.
58. Clarke, "Bonds and the Fund" p. 23.

DEBT DATA -- TURKEY

	1973	1974	1975	1976	1977	1978	1979
Debt/Service %							
(A)	6.8	7.2	8.7	9.6	11.8	13.2	13.9
*(B)	11.1	11.2	13.0	10.9	14.1	14.5	—
Interest/Service %	2.6	2.8	3.5	4.3	5.2	4.9	5.6
Debt as % of Exports	97.8	91.2	99.7	100.0	133.8	170.5	233.2
Debt as % of Reserves	125.9	137.6	234.0	262.8	390.1	412.9	428.3
Terms of Loans							
A. Maturity[1]							
1. Official	12.4	11.0	16.0	10.7	11.0	11.0	9.7
2. Private	10.5	8.4	6.4	6.3	7.1	8.4	9.5
B. Interest[2]							
1. Official	6.4	7.1	8.7	7.5	7.6	7.4	8.4
2. Private	6.8	12.6	8.7	7.8	7.6	8.2	13.7

Unless otherwise indicated all figures are for medium and long term debt only.
*Includes short term debt

Source: World Bank, *World Debt Tables* Vol I and Cline and Weintraub, eds. *Economic Stabilization in Developing Countries* (Washington: Brookings, 1981)

[1]In years
[2]Per cent

> In underdeveloped countries governed by dictatorial systems or in developed countries the IMF prescriptions can be implemented by the use of forceful measures. However, in countries at the stage of development and with democratic systems such as Turkey, the classical IMF prescriptions can be implemented after they are softened to some extent or with certain changes.[59]

The first problem on the agenda for the new government was to figure out how much money Turkey owed and to whom. Available figures were inaccurate, possibly as a result of deliberate manipulations by the previous government. At the end of January 1978, after almost a full month into the new administration, the problem was yet unresolved.[60]

What the Ecevit government found was very interesting. Turkey's total debt was surprisingly low by international standards (see Table 1), amounting to $14,502 million, of which 15 percent was long term, 47.5 percent

59. *FBIS*, 4 January 1978.
60. *FT*, 6 February 1978.

medium term, 18.5 percent short term, and 20 percent in arrears. CLA deposits constituted about 14.5 percent of total debt, 10 percent of arrears, and 41 percent of short term debt.[61] The debt service ratio was 11.8 percent[62] for medium and long term obligations, but 14.1 percent[63] when short term debts were included. The average maturity of total debt was eleven years for official debt and 8.4 years for private debt.[64]

But quantitative data on Turkey's debt obscured the country's actual situation. The relatively modest numbers — which themselves had been twisted to conform to the government's expectations — had eased rather than aggravated financiers' concerns about Turkey. The use of quantitative indicators — such as the debt-service ratio, balance of payment data, foreign exchange reserve levels, and the ratio of imports to GNP — for debt analysis certainly has the advantage of efficiency, but there are other important considerations as well. One is whether, given different political and cultural traditions and different resource bases, quantifiable variables can legitimately be compared internationally.

Another, and perhaps more significant consideration is the extent to which the important variables are at all quantifiable. The figures above indicate that Turkey's total debts were moderate, which by quantifiable standards was true. But the government confronted major obstacles. The first, as has been noted, was ascertaining just what Turkey owed. A huge wall of short term obligations impeded Turkey's attempts to reach the smoother road beyond. Despite the soothing numbers, Turkey's debt structure was one of the worst imaginable.

The second problem was that the Fourth Five Year Plan (FFYP), put together by the previous government, was scrapped and a new plan was put forth which included a special one year interim period.[65] The interim budget was publicized as reducing the budget deficit by substantially lowering support for the state industry sector. The government delayed revealing details of the full five year plan. Turkey also devalued the lira by an average of 33 percent against a basket of seven major industrial currencies.

In effect, the Turkish strategy for dealing with the IMF was to reject policy conditionality on principle, while voluntarily meeting the IMF's basic stipulations. The Turkish government believed that once it met the broad framework of the IMF conditions, the flow of credits would resume.

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61. *FT, Ibid.*
62. World Bank, *World Debt Tables,* Vol. I, p. xxvii.
63. Irving Friedman, "Private Bank Lending," in Cline and Weintraub, eds., *Economic Stabilization in Developing Countries* (Washington: Brookings Institution, 1981), p. 238.
64. World Bank, *World Debt Tables,* Vol. I, p. xxvii.
65. *FBIS,* 15 January 1978.

Moreover, they believed that the stringent policies would last only a very short time. Things did not work out quite the way the Turks expected.

On 7 March, talks with the IMF were held, and in early May the parties signed an agreement for a $450 million loan (SDR 374 million) over a two year period.[66] The loan consisted of $240 million from Turkey's IMF quota, $120 million from the Jamaica Fund, and $90 million from the Witteveen facility.[67] The loan was to be paid out in four consecutive tranches: $150 million, $49.6 million, $40 million, and $134.4 million.[68] In return, Turkey agreed to allow the IMF to reevaluate Turkey's economic progress at each tranche. The evaluations would be based on Turkey's pledge to reduce the current account deficit from 7 percent to 4 percent of GNP and reduce public sector borrowing from TL 93,000 million to TL 75,000 million, reduce inflation from 40 percent per year to 20 percent, and syndicate a loan of at least $500 million from commercial banks by the date of the third tranche, scheduled for 5 November 1978.[69] The first tranche was released immediately after the agreement.

Commercial Banks

Immediately following the initial agreement with the IMF, the Turkish Central Bank notified the approximately 220 banks, corporations, and individual holders of CLA accounts and bankers' credits (which accounted for about $500 million in short term debt) that it wished to refinance this debt. The Central Bank sent out a special invitation to six banks (later expanded to eight), which held 25 percent of the CLAs, to form a coordinating group to negotiate specific arrangements with it. These eight banks were Barclays Bank, Citibank, Chase Manhattan, Morgan Guarantee Trust, Union Bank of Switzerland, the Swiss Banking Corporation, Deutsche Bank and Dresdner Bank. The total sum to be renegotiated was $2,500 million, of which $2,000 million were in CLAs and $500 million in bankers' credits.[70]

Concurrently, the government also initiated negotiations with OECD countries to reschedule the approximately $1,500 million the government owed them. The talks also entertained questions on Turkey's exports and the migration of Turkish workers within Europe.

The Turkish government believed that once the arrangements had been made with the IMF, OECD, and private lenders, the crisis would end

66. *FBIS*, 28 March 1978.
67. *MEED*, 8 September 1978.
68. *Ibid.*, 31 March 1978.
69. *Ibid.*
70. *FT*, 4 April 1978.

and things would more or less go back to normal. Negotiations proceeded posthaste and agreements, at least in principle, were reached with relative ease.

Turkey's proposal to the banks was composed of two parts: 1) restructuring present debt; and 2) financing a fresh loan of $500 million. Restructuring would take place over a period of seven years, including a 37 month grace period. Interest would be 1.5 percent (the banks insisted and got 1.75 percent) over LIBOR, and repayments were to be made in six equal tranches.[71] The eight members of the coordinating committee would co-manage a fresh credit of $500 million and sell it to a larger syndicate. Originally, the Turks wanted each of the coordinating banks to finance about $32 million, but the actual level agreed upon was $25 million.[72]

In July, the Central Bank and the Ministry of Finance showed interest in hiring the firms of Lehman Brothers Kuhn Loeb of the U.S., S.G. Warburg of the United Kingdom, and Lazard Frères and Compagnie of France.[73] These three investment banks had originally been brought together to work out the details for restructuring Indonesia's debts, a task which they had performed successfully. The government gave official approval in early August, by which time a team of experts was already at work putting together the mechanism implementing the agreement reached in principle between Turkey and the coordinating committee. They accomplished their work in one month, and by 8 September 1978, the proposals for rescheduling the $2,500 million were complete.[74]

That same summer, Citibank put together what was basically a Eurocredit loan worth $100 million, which it touted as a "constructive remittance scheme" but was actually a facility for bad debt refinancing. The money was earmarked for repayment of overdue debts to foreign suppliers. The Deutsche Bank and Dresdner Bank were major participants in the syndicate, which was quickly oversubscribed by 50 percent by many European and American participants.[75]

The generous terms of this agreement kindled unbridled enthusiasm. The spread was 1.5 percent and maturity was over seven years, with a three year grace period. The Ministry of Finance guaranteed the credit, as did each local beneficiary. Each beneficiary, in turn, was subject to thorough screening by Citibank to ascertain its credit worthiness. Finally, the loans, as well as the $2,500 million refinance deal, were subject to

71. *FT*, 24 June 1979.
72. *MEED*, 8 September 1978.
73. *Ibid.*, 21 July 1978.
74. *Ibid.*, 4 August 1978.
75. *FT*, 6 June 1978.

IMF approval of Turkish economic proposals, which, if not granted, was a cause for default.[76]

OECD

In May, representatives of fourteen members of the OECD agreed in principle to reschedule the Turkish debt of about $1,500 million.[77] The general framework was to extend loans due since 1974 for six to eight years. The details on payment of principal and interest were to be fixed through bilateral agreements with the countries concerned. These bilateral talks began at once and were completed with alacrity. The Turks and the OECD delegation also conducted talks on a number of more general economic issues but no concrete agreements were reached. Again, it was understood that the money was contingent upon IMF approval.[78]

By the summer of 1978, approximately eight months after the Ecevit government had taken office, Turkish officials were confident that the worst financial problems were over, and the credit bottlenecks were largely overcome. But things were not as rosy as they would appear from the initial progress.

Problems and Solutions

In all the previous negotiations, there was one important catch: continued IMF approval. The Turks believed that once the IMF gave the initial go-ahead, as it was in the release of the first tranche of $150 million, the rest would be *pro forma,* and the light would stay green. The IMF had other ideas.

In order to secure IMF confidence, the Turkish government undertook stringent economic policies at least temporarily. This led to increasing worker discontent and acts of political violence. Ecevit realized that the legitimacy of his government could soon be undermined. In June 1978, he signed what was called a "social contract"[79] with Türk-Is, which linked wages to rises in the cost of living and productivity. The government also unveiled the completed plans for the FFYP, which envisaged a high annual growth rate of 8 percent and re-affirmed Turkey's commitment to industrialization. Furthermore, a Price Control and Coordinating Committee was established to limit the price increases of goods sold by SEEs.

In late August, an IMF inspection team flew to Ankara to prepare for

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76. *FT, Ibid.*
77. *MEED,* 26 May 1978.
78. *FBIS,* 23 May 1978.
79. OECD, *Economic Survey: Turkey,* November 1978.

the release of the second tranche of the loan. To their dismay, the team discovered that government policies — especially the social contract signed with Türk-Is — were not doing enough to reduce inflation and increase exports. After five days they left, and the second tranche of $49.6 million was delayed for a month.[80] This delay had important consequences. First, implementation of the private and OECD debt refinancing and credit arrangements could not proceed, and Turkey's credibility (which had improved after the initial agreement) again deteriorated. At this point, the Swiss Banking Corporation withdrew from the eight member bank consortium.

The IMF wanted the delay of the second tranche to convey a clear signal to the Turks that it meant business. It wanted to make it plain that, for the third tranche, approval would not be forthcoming until all the stipulations in the letter of agreement were met, according to the IMF's interpretation of this agreement. For their part, the Turks realized that the tight policies needed to suit the IMF would be harsher than what they had expected or were willing to concede.

The Turkish response was one of disappointment and anger. The Finance Minister called the IMF's insistence on certain conditions "before opening the credit taps" and Turkey's resistance a "cold war."[81] An impasse was reached with the result being that the third tranche, due to be released in mid-1979, was suspended. Ecevit then claimed that "domestic remedies" to solve the problems of the economy would have to be relied on.[82] Unfortunately, there were no domestic solutions and as one banker put it, "Ecevit is deluding himself if he thinks he can continue without coming to an agreement with the IMF."[83]

The stalemate held up a $4,506 million debt rescheduling package that had been ironed out almost a whole year earlier.[84] During this period, very few financial credits flowed into the country. The economy was waning rapidly, as imports remained stalled and factories were forced to halt production.

Finally, the Turks had to give in. On 15 June 1979, Turkey devalued the lira 43 percent. This was a clear signal of submission to the IMF, and the green light was given for release of the third and fourth tranches. The IMF also put together a stand-by facility of $300 million.

The credits which had been frozen thawed. That same week, a forty-six member bank consortium agreed to syndicate $407 million in fresh

80. *MEED*, 8 September 1978.
81. *FBIS*, 29 August 1978.
82. *Ibid.*, 3 March 1979.
83. *Ibid.*
84. *FT*, 5 June 1978.

credit as well as to reschedule $429.3 million of remaining debt. The spread was 1 2/3 percent over LIBOR with the principal repayable over a period of three years.[85]

Only $1,700 million in export credits remained to be repaid. Now, with some leverage on their side, the government was able to settle its debt by offering Turkish lira equivalents, or by giving its debtors the opportunity to buy equity in domestic Turkish corporations. Thus, the immediate crisis, which had lasted continuously for almost two years, was resolved; however, Turkey's long term difficulties were by no means overcome.

In 1979, the Ecevit government collapsed no doubt due to the economic policies it had been forced to adopt. It was replaced by Demirel and his coalition, but incidents of anarchy became so numerous that the army intervened with a coup on 12 September 1980. The army was successful at repressing violence only at the cost of being very heavy-handed and by increasing government spending. By this time, most foreign banks had more or less been rescheduled until 1985–86, so the IMF lost much of its previous leverage.

Postscript — 1980 to the present

Since the military takeover in September 1980, it has been argued that Turkey has miraculously solved its economic problems. Analysts focus on inflation, which has been reduced from 100 percent in 1980 to 35 percent in 1981,[86] and export earnings, which have climbed by 55 percent over the same period.[87] The balance of trade deficit was reduced to $960 million in 1981, and, except for a number of letters of credit which had been frozen and are still outstanding, all the debts arising out of the 1977 logjam have been rolled over until 2020. In addition, Finance Minister Turgut Ozal has done a masterful job in convincing the media that his policies are working. Given the statistics, is the general optimism over Turkey justified?

While considerable progress has indeed been made, there are nevertheless ominous clouds on the horizon, particularly when one looks beyond short-term concerns. The basic problems that Turkey had in 1977 still exist, both economically and politically. While the military government has done a superb job in repressing them, it has shown itself neither capable, nor willing to solve them.

SEEs remain a key concern. They are still inefficient, overmanned, and

85. *MEED*, 20 July 1979.
86. *Les Echos*, 12 December 1981, p. 4.
87. *The Wall Street Journal*, 4 November 1981, p. 30.

a drain on the economy. The government is committed to 2,000 public projects, few of which have any chance of realization. As there are still three million unemployed[88] (out of a total population of forty-five million), the authorities can do little to reduce disguised unemployment beyond the present policy of limiting additional recruitment to replace those who retire. There is a ban on dismissals and a promise to raise pay by 25 percent in 1982. (Since 1980 there has been an 18 percent decline in real wages.)

The country remains heavily dependent on foreign oil. Development of the oil sector — a critical variable — has been very disappointing, growing only 0.8 percent in the first eight months of 1981, while the bill for imported oil has jumped by over 40 percent over the same period.[89]

While the total trade deficit has indeed shrunk, aggregate statistics are misleading. For example, the trade deficit with Europe has increased. The only thing that has saved the Turks so far has been a rather brisk demand for Turkish products and services by the Arabs. But with the oil glut and the resulting decline in oil revenues for those countries, the Arab market is likely to be soft. So the trade deficit will probably increase substantially.

Politically, despite its ruthless efforts, the military government has not done a very good job in reforming the old system. Political parties have been banned outright, and many politicians arrested and jailed. Arparslan Türkes has been sentenced to death, along with many of his followers. Bülent Ecevit was arrested in December 1981 for making a political speech, though released two months later. During the same month, the state put fifty-two leaders of DISK on trial, and demanded the death sentence for all. In the meantime, the military government has attempted to re-write the constitution and in one stroke create totally new political parties, in the hope that these will somehow perform better than their predecessors. The present Chief of State, General Kenan Evran, has announced that Turkey will return to democracy in late 1983 or early 1984; this is by no means certain.

It seems that the only way the military has been able to cope with the political system is to eradicate it and start from scratch. But while it is possible surgically to rearrange and alter the political superstructure, it remains to be seen whether grassroots politics has changed at all. The government's suppression of dissent and free expression makes this calculation difficult. If and when democracy is restored, it is very possible that the new political parties will buckle under the same pressures that emasculated the old ones.

88. *MEED*, 11 December 1981.
89. *Ibid.*

Suppression of human rights has caused friction between Turkey and Europe. The EEC has already frozen a $647.6 million five-year aid package until the junta restores human rights.[90] This freeze has ominous implications for the Turkish economy, for OECD estimates show that an additional $1.5-3.0 billion in aid is needed by 1985.

So while some progress has been made, important issues remain yet unresolved. The optimism that has surrounded Turkey is premature. Though not as close to the edge as in 1977, Turkey remains at the precipice. Misapplied quantitative analysis led to this unwarranted optimism. A subtler appreciation of qualitative factors — especially the fragility of the Turkish political system — may not have led the Turks and their creditors to more appropriate lending policies, but it might very well have given them a firmer grasp upon the severity of the debt problem before it got out of hand.

Turkey has experienced three cycles of development since World War II. Each cycle has been characterized by rapid economic growth in the beginning, followed by a slowing down in the economy and political turmoil which leads to military intervention. The military cools things down for a while and the cycle begins anew. The third cycle, lasting from 1973 to 1980, is typical, beginning as well as ending with the military. Starting out with high expectations in the Third Five Year Plan, the Turkish authorities watched as the economy began to malfunction. The government, run by a weak, fragmented coalition, could do nothing. Seeing the desperateness of the situation, the military decided to intervene.

Conclusion

The Turkish debt crisis of the 1970s hinged upon two key variables: the political system's basis for legitimacy, and the strength of the decisionmaking process. Rapid industrialization constituted the *sine qua non* of the Demirel coalition's claim to rule, though its policy resulted in severe economic problems. Fragmented and ossified, the decisionmaking structure was an aggregation of recalcitrant units which could not withstand any sort of political pressure. Both these factors clearly exacerbated and prolonged the crisis, if, in fact, they were not its principal causes.

These variables are essentially non-quantifiable. It has been argued in this paper that quantitative variables are insufficient in themselves to analyze a debt structure correctly. Such variables can present an instantaneous picture of the financial situation, but their usefulness in predicting outcomes is very limited. This is particularly true when objective standards derived from the experience of one country are superimposed upon another.

90. *MEED*, January 1982, p. 32.

It is dangerous to apply universal standards of evaluation to countries with vastly different political and cultural traditions.

The example of Turkey, it is hoped, has brought this point home. By international standards, Turkey's overall level of debt was not exceptionally high. The debt-service ratio never exceeded 14.5 percent. The real problem lay in the government's inability to stop relying on short-term credit until it was too late. In looking at numbers, one has to decide which are important and which are not — the decision itself being based upon non-quantifiable considerations.

For the future, the military has promised to set things right by restructuring the economy and reorganizing the political system. But it is very likely that what is happening is that the stage is being prepared for the fourth cycle, and the counter reset to zero. If the pattern continues, in a few years Turkey will find itself embroiled in yet another crisis.