The role of IMF in Turkey during crisis and now

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Summing up why and how an economy fails is often daunting, especially given that globalization and the interconnectedness of markets are playing a larger and larger role. Yet, the 2001 economic crisis of Turkey highlights some important issues that often plague countries in the developing world. By looking at this crisis we can see the importance of organizations such as the IMF in trying to avert crises as well as the need for its assistance once a crisis has begun. We can understand how much Turkey has changes as a result of IMF influence.

The lead up to the 2001 crisis was cause by three major factors. Firstly, continued spending without reigning in much needed reforms in banking and privatization meant a very reckless monetary policy. The continued spending saw the lira decrease substantially in value making consequences for the financial sector dire because capital was essentially frozen since there was no liquidity. Investors therefore stayed away which had a large effect on FDI because it came to a virtual halt.

Secondly, Turkey also had an unhealthy trade balance in which not enough exports were being sold to compensate for its imports. Because of this discrepancy, the value of the lira began to decline under an unhealthy trade balance. Thirdly, a large dependence on imported energy sources did not assist the situation because now it was “costing” an incredible amount of money to fuel economic growth. If we had to sum up the 2001 financial crisis’s impact on

Turkey it may be best to do so with some key statistics, at the end of 2001, the GDP shrank by 7.4% in real terms, inflation increased to 68.53%, and the currency lost 51% of its value vis-à-vis other major currencies. With such a huge decline across the financial board, Turkey was clearly in need of some serious reforms because it was unprepared to cope with such a situation.

IMF in the Midst of the Crisis

In 2001, Turkey was certainly no stranger to the IMF; it had been an IMF member since 1947 and had received assistance in the past. The most ironic aspect of the 2001 economic crisis was that since 1999 the IMF had been working with Turkey in order to help it to solve its economic turmoil. IMF proposed reforms and restructuring in the 1999-2001 period were not implemented and thus kicked off the crisis. There was a five part approach to managing the crisis, restructuring the banking system, tightening fiscal controls, creating a monetary policy that targeted inflation, enacting the privatization of SEEs and encouraging FDI.

Distributing Much-needed Funds

In mid-2001 the Turkish government had many high level meetings with the IMF and Kemal Dervis, former head of the UNDP who helped to authorize the release of an additional 12 billion USD in funds to assist Turkey. This came just over 2 years after the IMF had approved a previous loan of 11.6 billion USD. The mismanagement of these initial funds saw a flight of nearly 7 billion USD from the country during the beginning of the crisis in November of 2000. From the IMF, in addition to financial assistance, Turkey also received the benefit of a detailed plan in order to put its economy back on the road to economic health. There was a net assistance of about $23.6 billion USD issued to Turkey to help improve the economy. These funds allowed Turkey to stabilize interest rates as well as the currency in its attempt to reduce the large debt that was preventing the economy from moving forward. After the initial disbursement of funds in 2002, Turkey also received additional funds in 2005 to keep it on the road to progress With both rounds of borrowing came some very strict regulations and reforms that were enacted, especially in the banking sector in which regulations on borrowing and lending were tightly controlled.

IMF Requested Reforms

The IMF requested that Turkey reform two major aspects of its monetary policy, firstly, its inflation rate by a floating foreign exchange regime rather than a pegged one and secondly a tightening of its overall monetary policy by enacting austerity measures on spending. For many years Turkey was essentially on a spending spree without reigning in much needed reform in terms of its monetary policy. This obviously could not go on forever especially since exports were declining and debt obligations came due. Turkey needed to pay back its debt, both previous debt as well as the amount that was to be borrowed, because debt restructuring was not approved. Turkey needed a way to just stop spending. With the help of Horst Kohler, managing director of the IMF, a primary surplus target of 5.5 percent was set. There was no negotiating on this point because fixation on this variable by the IMF meant helping Turkey mend its spendthrift ways and put itself in a sound financial position to start repaying its substantial debts to the IMF.

Secondly, the Turkish government needed to contract its spending and this was only possible with a revision to its overall monetary policy as well as the institution of new goals by an outside agency since Turkey was having difficulty enacting such reforms. A large part of being able to put this program into action was the necessity for a completely independent Central Bank. By ensuring that it was independent there would be a more likely chance at success in creating price stability as well as targeting inflation. Not being subject to political maneuvering was an essential part to the austerity program. In addition to this, the new monetary policy even went a step further by making a new debt law, that prohibited government departments and agencies from securing credit independently of the treasury which had previous been the case and one which had gotten banks into trouble by needing bailouts from the government.

Thirdly, we see that by encouraging the privatization of many industries, such as energy and transportation the government had fewer financial obligations and enterprises to worry about floating in case of failure. Large scale layoffs in public enterprises meant the elimination of redundant workers and less strain on public coffers. The improvement to the four previously mentioned issues meant more financial stability. As investors began to see changes in banking, monetary policy, privatization and more, FDI began to flow back into the country. So by ensuring stability, the IMF in fact helped to bring about a great deal of FDI for Turkey.

Post-Crisis Turkey and the Current Role of the IMF

The cohesive and tailor-made IMF policy that was constructed for Turkey is what truly led it out of the crisis. By sticking to the IMF program despite small hiccups, the country had a guide toward economic reform and proved that it wanted to be on the road to economic health; this attitude seemed to be lacking in years past, specifically in 1999 with the first attempts at reform. After Turkey received its transfers of funds from the IMF there were major changes to its economy and politics based on these policies; over the 2002-2007 period the economy grew at an average of 6% each year, which is among one of the highest maintained growth rates in the world during this period. In addition to the growth, "inflation and interest rates fell significantly, the currency stabilized, and government debt declined to more supportable levels (39.5% of GDP in 2008). It was clear that the fiscal mismanagement of the 1990s was over.

The one issue that still plagues Turkey today is the current account deficit. As the economy began to heat up again due to demand for goods and services, money began to come to Turkey and citizens and businesses wanted to and needed to spend it. But there is no major industry in Turkey, most of the manufacturing involves textiles. Therefore, if a business or individual needed equipment or technology to grow, it had to be purchased from abroad; what this meant was that funds were being spent outside the country and Turkey once again ran the risk of becoming a debtor nation. The 2008 current account figure, -5.6% of GDP or $41.6 billion had many at the IMF concerned because continued implementation of reforms, was essential to sustaining growth and stability. Yet so far the country has been able to maintain this at a reasonable level.

Conclusion:

If we take a look at the country today we can say that Turkey is in a better position now that it has ever been. In fact Turkey was virtually unscathed by the 2008 economic downturn because of its new economic plan. The country's relationship with the IMF is essentially one of creditor and debtor. The finely debt repayment schedule seems to be working for the country seeing that it has already made it first payment in September of this year. Continued obedience to this plan will help us to see over time if the IMF reforms enacted over 10 years ago in fact are helping the country with its overall economic stability.

What we should note is that Greece is in a similar position as Turkey was ten years ago. While the variables are not exactly the same, one factor, insurmountable debt, is certainly weighing on the Greek economy. Yet unlike Turkey, Greece's economy is so entirely connected to those of others in Europe and therefore the impact has much greater consequences. With the IMF Greece needs both financial assistance as well as a debt-targeting individualized plan to help it onto the road to economic recovery.