

## **February 2001 Crisis in Turkey: Causes and Consequences**

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### **I. INTRODUCTION**

Turkey has suffered from different economic crises since 1990. However, the February 2001 crisis has been unprecedented in intensity and repercussions. Although many factors, both internal and external, may have contributed to their occurrences, the former owing to their inducing corruption and waste in the economy, seem to have fomented them more than the latter.

Although Turkey has been getting transformed into a market economy since 1980, government intervention is still pervasive in its economy. Government still controls Central Bank, owns commercial banks, and operates public enterprises. It has liberalised market, currency, foreign trade and foreign direct investment (FDI), but still operates sectors like energy, sugar and tobacco. Such a level of state intervention had adverse implications for corruption, waste, effective reforms, etc. in the country. Further, since the transformation of the economy could not be accompanied by concomitant structural, legal and institutional reforms in 1990s, resources have constantly been misused over the years. Further still, groups owning bank, media and holding companies jointly have notoriously precipitated domestic financial crisis by stashing away the home deposits in their offshore branches. Finally, supporting agriculture and industry with politically-motivated credit for voting purposes has constantly been aggravating the drain of resources and thereby financial crises of the country. This paper attempts a critical examination of how such factors may have contributed to the occurrence and accentuation of economic crises suffered by Turkey over the last decade.

### **II. LIBERALISATION MEASURES**

Turkey pursued an inward-oriented economic policy from early 1920s through 1970s. But for some efforts at liberalisation during “Democrat Party” government between 1950–53, real progress in this direction began in January 1980 and accelerated in 1983 when Ozal-led Anavatan (Motherland) Party came into

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power.<sup>1</sup> Following ‘January 24 Decisions’ as guidelines for transforming the economy, the government expedited reforms aimed at removal of price controls and subsidies, expansion of private sector, encouragement of private savings and investments, freeing foreign trade by reducing tariffs and other barriers, relaxing controls over money transfers, improving the tax system, and finally encouraging FDI. These reforms attempted to achieve three objectives: minimisation of state intervention in the economy, formation of a free market economy, and, finally, integration of domestic economy into world economy. As a result, trade and FDI increased significantly as depicted in Table 1. However, there is need to carefully examine the measures undertaken to encourage FDI and to liberalise the financial sector of the country and to properly understand the consequences of its crises.

To encourage FDI, the government issued “The Foreign Capital Framework Decree” in 1980. It simplified the administrative procedures of FDI and capital flows and established a separate institution called “The Foreign Investment Directorate”. Although the government issued two other decrees in 1983 and 1984 to relax the constraints on FDI, it enacted more fundamental FDI-related measures in 1985 and 1986, which led to the formation of free trade zones, removal of restrictions on foreign equity participation and discontinuation of minimum export requirements. Consequently, number of foreign equity ventures increased to 2900 and foreign capital inflows to US\$7,572 million during 1980 to 1995 [Tatoglu and Glaister (1996)].

However, despite the decrees, administrative obstacles are still pervasive in the country. They cost in various ways. For example, World Business Survey reported that investors in Turkey spend 20 percent of their time in meeting official formalities compared to 8 percent in East and Central Europe. Similarly, Price Waterhouse Coopers argues a number of regulations are not easily understandable and widely applicable. Such a state of affairs creates uncertainty and thus costs the country \$1,822 million annually.<sup>2</sup>

Table 1

*Imports, Exports, and Net FDI into Turkey, 1970–1990*

	(Million Dollars)									
	1970	1973	1976	1978	1980	1981	1983	1985	1988	1990
Exports	588	1,317	1,960	2,288	2,910	4,703	5,905	8,255	11,929	13,026
Imports	948	2,086	4,872	4,369	7,513	8,567	8,895	11,230	13,706	22,581
FDI	58*	–	–	–	18	141	87	158	387	788

Source: State Planning Organisation, Undersecretariate of Treasury.

\* Total capital flow, both inflow and outflow.

<sup>1</sup>Turgut Ozal worked as a Deputy Counselor in the Prime Minister’s office from December 1979 till the military coup in September 1980, during which he prepared “January 24 Economic Package”. After the military intervention, he first became a State Minister, then Deputy Prime Minister until July 1982. On winning election with the help of self-found Motherland Party in May 1983, he became Prime Minister. He was Premier till November 1989 when he became the President of the country. He died in 1993 of a sudden heart attack while he was still the President.

<sup>2</sup><http://www.hazine.gov.tr/> (official site of the Treasury).

Beside relaxation of constraints on FDI, the government also liberalised the financial sector considerably by eliminating the interest ceilings on loans and deposits in 1980, phasing out direct credits in 1988<sup>3</sup> and liberalising capital flows in 1990 [Mehrez and Kaufmann (1999)]. Consequently, Turkish Lira became a fully convertible currency. To liberalise this sector further, government established “Istanbul Stock Exchange” in 1986 and “Istanbul Gold Exchange” in 1994, which accounted for virtual milestone efforts at its liberalisation. Additionally, government allowed residents to open foreign currency accounts in 1984 and banks to have interbank borrowing for overnight facilities in 1986 [Denizer (2000)].

The above-mentioned measures point to the fact that Ozal was the main force behind the transformation of the economy. He always advocated three principles: entrepreneurship, freedom of thought, and freedom of belief, claiming them as dynamic forces for transformation of the nation into modern society. He was the first person to make his people believe that they are endowed with abilities of international competition. Because he was a staunch believer of trade as a means of Turkey’s transformation, he told even to USA: “Do not lend us, we want more trade”.<sup>4</sup>

Unfortunately, the current trend is opposite of it; the country is plunging into more and more foreign debt, causing balance of payments deficiencies and thereby increased deficit financing. Increased dependence on external financing aside, measures of liberalisation and democratisation of the economy in the 1980s were not accompanied by concomitant reforms in the following decade. For instance, reforms to strengthen public finance and to develop infrastructure meeting the open market requirements were not introduced. Similarly, structural and legal reforms to simultaneously prevent corruption, and to improve governance, transparency and accountability were also not implemented. Consequently, the economy got overtime plagued with large-scale squandering of resources, paving the way for the November 2000 and February 2001 crises that the country suffered.

### III. THE LAST DECADE IN TURKEY, 1990–2000

#### Two Recent Crises

Since the liberalisation endeavors of the 1980s were not followed by necessary legal and institutional reforms, the country became vulnerable to different crises in the 1990s. The occurrence of colossal waste, widespread administrative inefficiency and excessive politisation of the economy succumbed the country to successive crises of variable magnitudes in 1991, 1994, 1998 and 1999 with the last resulting partially from a severe earthquake. The country withstood these crises of

<sup>3</sup>Directed credit programmes absorbed almost 75 percent of loanable funds [Denizer (2000)].

<sup>4</sup>Gonultash Nuh, *The Zaman*, March 21, 2001.

somewhat lesser adverse consequences but took no precautionary measures to avoid them in the future. Obviously, all these crises had weakened the economy in many ways. The vulnerability of the country was indicated by the probability of its financial fragility estimated at 41 percent, which is nearly three times that of the industrialised countries [TOBB (2001)].<sup>5</sup> Similarly, since the overall governance had seriously impaired during this period, government could not control financial risk, which caused frequent banking and currency crises in the country. According to Celasun *et al.* (1999), the financial sector of the country, despite the beneficial effects of liberalisation efforts, operated in an unstable environment and therefore, the reforms undertaken in the 1990s could not improve its efficacy. Nor, the legal and supervisory frameworks to anticipate and deal with weaknesses in the banking system were desirably improved. In fact, conditions continued to deteriorate and led the country to yet another severer crisis of November 2000.

One natural consequence of the unstable environment was high inflation. With the support of IMF, Turkey started in January 2000 a Disinflation Programme under pegged exchange rate regime. Although the programme operated apparently well for a while, some snags began to appear in September 2000 [Uygur (2001)]. For example, interest rates despite decreasing inflation began to fluctuate well before the November crisis. While overnight interest rates fluctuated between 18.9-45.9 percent and between 13.6-38.8 percent in April and July 2000, respectively, it fluctuated between 23.7-79.6 percent in September and peaked at 315.9 and 873.1 percent in November and December, respectively. Following a short stability in January, it hit 4,018 percent in February 2001. Actually, decline in inflation associated with fluctuating interest rates was the weakness of this economic programme. The government could not recognise it in time to avoid the November crisis [Fisunoglu (2001)]. The crisis accentuated when the people at large especially foreigners ran for panic conversion of Lira into foreign currency, leading to depletion of Central Bank's foreign currency reserves by \$5.5 billions over fortnight between November 17 and December 1 of 2000. To make up for the excessive withdrawals, the government approached IMF for compelled borrowing of \$7.5 billions. Although Turkey was able in this way to withstand this crisis, it had eroded its resilience against any other crisis like the February 2001 crisis.

Exchange rates, despite fluctuations in both interest rates and currency reserves, remained unchanged in November crisis. This was due to the specific nature of the pegged exchange rate programme. But, despite the stability of exchange rates, this crisis had impaired badly especially foreigners' trust in the effectiveness and ability of the government to implement this programme [Uygur (2001)]. The decline in foreigners' trust in this programme was reflected from escape of some portfolio investment and then from the relinquishment of 16 running IMF-based

<sup>5</sup>TOBB stands for "The Union of Chambers of Commerce, Industry, Maritime Trade and Commodity Exchanges of Turkey".

economic programmes in the country. It may be argued that the pegged exchange rate regime-based stabilisation programmes had proved ineffective not only in Turkey due to their unsound monetary and interest policies.<sup>6</sup> Inherent drawbacks of the programme aside, it was started with inadequate knowledge of its effects on domestic consumption pattern and trade. This programme caused more than expected increase in domestic consumption, increasing imports. The appreciation of Lira also contributed to increased imports, which were nearly double of exports in 2000 (Table 2). Further, failure in completing privatisation of important enterprises such as Turktelekom also contributed to the adverse effects of this programme.

All aforementioned factors increased the current deficit of the country. Internal deficit increased to \$9.8 billions in 2000 against its planned level of \$3-4 billions. Although inflation decreased to end-2000, the overall economic conditions of the country kept worsening. Uygur (2001) put the situation as: "Turkey is borrowing and importing with a decreasing level of export and increasing current deficit". The net result of this scenario was a constant increase in current deficit, which let the current deficit-GNP ratio to exceed well beyond its safe limit of 3.5 percent or of about \$7 billions in absolute terms in 2000, making the risk premium of interest rate on foreign debt to rise in September, foreboding eventuality of a crisis. Similarly, the ratio of monthly current deficit to foreign currency reserves increased rapidly from 6 percent to 50 percent in a year (Table 3). Further, the ratio of short-term debt to foreign currency reserves increased from 1.01 to 1.44 while that of short-term debt to export increased from 0.88 to 1.04 from end of 1999 to end of 2000. Briefly, all these indicators were signaling the occurrence of the second crisis, which then occurred in February 2001.

This crisis occurred on February 19, 2001 in the form of a virtual raid on foreign currencies. Central Bank reserves decreased in a week from \$28 billion to 22.5 billion between February 16 and 23. Foreigners and Turkish residents alike rushed to buy foreign currencies. Realising the difficulty of controlling panic buying of foreign currencies in the presence of the existing fixed exchange rate programme, the government freed the exchange rates on the night of February 21, which increased the Lira-US Dollar parity from 688,001 in a day and continued to increase till it stabilised around 1,400,000. Consequently, rapid increase took place in prices after the exchange rate was freed. Further, foreign currency reserves continuously decreased to \$21.52 billion on March 3 and then further to \$17.90 billion on April 20. The response of the government to this crisis revealed that it neither expected it nor it had an alternative plan [Fisunoglu (2001)]. However, the decrease of around \$5 billions in reserves in the initial days of the crisis was widely discussed in the media. There was a growing consensus that the policy of freeing exchange rates was leaked and those in contact with inner circle purchased significant amounts of foreign currency from the Central Bank and made windfall profit.

<sup>6</sup>How the pegged exchange rate programme has failed in different countries is excellently discussed in Cinquetti (2000); Bird (2001) and Mishkin (1999).

Table 2

*Foreign Trade and FDI, 1991 to 2000*

(Million Dollars)

Year	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Export	13,593	14,715	15,345	18,106	21,637	23,224	26,261	26,974	26,587	27,485
Import	21,047	22,871	29,428	23,270	35,709	43,627	48,559	45,921	40,687	54,150
FDI	910	912	797	937	935	937	873	982	823	1307*
FDI Outflow	127	133	175	78	163	325	319	409	685	718*

Source: Central Bank, State Planning Organization, and Undersecretariate of Treasury.

\*January-October

Table 3

*Selected Financial Indicators for 1999 and 2000*

Date, Months	Monthly Current Deficit/Foreign Currency Reserves (%)	Treasury Compound Interest, Average (%)	Consumer Price Increase, 12 Month (%)	Wholesale Price Increases, 12 Month (%)
1999 10		109.3	64.7	55.2
11		96.4	64.6	56.3
12	5.9	– (*)	68.8	62.9
2000 1	10.2	38.3	68.9	66.4
2	15.2	42.1	69.7	67.5
3	21.5	39.9	67.9	66.1
4	22.9	34.5	63.8	61.5
5	26.7	39.4	62.7	59.2
6	27.7	41.9	58.6	56.8
7	28.6	34.5	56.2	52.3
8	33.5	33.2	53.2	48.9
9	33.6	33.6	49.0	43.9
10	39.2	38.0	44.4	41.4
11	46.7	41.0	43.8	39.1
12	49.7		39.0	32.7

Source: Uygur (2001) "Krizden Krize Turkiye: 2000 Kasim ve 2001 Subat Krizleri".

\* No bid in December 1999.

Indeed, this crisis had diverse effects on the nation. For example, 4,146 firms were closed in the first three months of the crisis<sup>7</sup> and there were large-scale demonstrations against government in many cities disturbing production, commerce, trade, communication, and law and order in the country. To control the situation, the Premier of Turkey invited Kemal Dervish, Vice-Director of the World Bank to control and manage the economy.<sup>8</sup> He was appointed a State Minister to look after the whole economy. He quickly embarked upon the preparation of a new programme of actions regarding legal and structural reforms, which did not receive proper focus in the previous programme. However, one question frequently asked is: Had the outcome been different, if a different disinflation policy had been followed in Turkey? The answer is, possibly not, because the crisis had resulted not from one but from several adverse factors discussed ahead.

<sup>7</sup>*The Radikal*, April 29, 2001.

<sup>8</sup>It is alleged that the Premier had invited Kemal Dervish on behest of IMF, World Bank and the USA to administer the committed foreign aid to Turkey. It is, however, believed that it was not the administration of foreign aid alone. The strategic position of Turkey in the world geography was a more important consideration, which prompted the appointment of a person of their confidence. How important Turkey is strategically may be ascertained from what Stanley Fischer of IMF said: "Turkey is not an ordinary country, it is a member of NATO as well as has a big economy" (*The Economist*, May 19, 2001, pp. 54.) Although they admitted the strategic importance of Turkey, they had reservations about its officials' honesty in using foreign aid.

### Unsustainable Debt Stock

The first factor that contributed significantly to the crises was rapid increase in the overall debt of the country. Specifically, the total debt increased in a short period from \$115 billion in 1997 to \$171 billion in 2000.<sup>9</sup> In this period, the internal debt of the country showed a phenomenal increase from 14 percent of GNP in 1990 without any duty losses to 46 percent in 1999 with 17 percent out of it as the state banks' duty losses. Such a rapid increase in debt was due mainly to high primary deficit in the first half and borrowing at high interest rate during the later half of the decade (Appendix 1). Although the primary deficit's share of the overall debt reduced and then completely disappeared during the second half of the decade, share of duty losses rose continuously due to high real interest rates and political use of state banks. As such, high budget deficits had caused especially after 1994 a merciless distress on domestic financial markets by forcing real interest rate to rise constantly. Beside high budget deficit, inflation rate fluctuations had also by increasing risk-premium contributed to the prevalence of high real interest rate in this period. As a result of the combined effects of these factors, the real interest rate averaged 32 percent compared to GNP growth rate of 4 percent during 1994-99. It may be realised that high real interest rate necessitated repeated borrowing creating a 'Debt-Interest Vicious Circle', whose breaking became more and more difficult overtime. In the ultimate analysis, high interest rates overburdened the people, because increasing interest payments had to be paid out of budget by recovering them from people by levying new taxes. Sadly, interest payment, which constituted 31 percent of the country's tax revenue in 1990, increased to account for 77 percent in 2000. Governments continuously borrowed to repay principal and interest. This way, they increased the total debt further that incurred yet higher interest payment, which necessitated new borrowings and so the story went. As such, state budget turned into a budget that served interest payments, deferring its real functions. A continuous increase in taxes in the presence of no increase in income led to widespread avoidance of tax payment. According to the State Tax Administration, correct tax returns reduced from 2.2 percent in 1999 to 1.2 percent in 2000.<sup>10</sup> What this implies is that more corruptive use of national resources by the public sector, the less the trust in government leading ultimately to tax avoidance.

The risk premium of interest on foreign debt has also been affected by the country's political instability. During 1990-2000, Turkey held 2 presidential elections, 4 general or local elections and several mini elections. These elections incurred huge expenditures disturbing badly the economic and budgetary discipline of the country. Further, 10 governments changed in the last 11 years. Frequent government changes resulted in stoppage of old and starting of new development projects and also in interruption of economic stabilisation programmes of the country. This political instability did not result only in relinquishment of four

<sup>9</sup>Egilmez, Mahfi, "Borc Yuku ve Reyting", *The Radikal*, April 24, 2001.

<sup>10</sup>*The Zaman*, May 26, 2001.



successfully implementable economic stabilisation programs but also increased the risk premium of foreign debt interest to almost 4.5 percent.<sup>11</sup> In sum, the political instability in the country caused by politicians had acted to increase debt, both domestic and foreign, of the country. Appendix 1 highlights the facts of the increasing debt of the country over the last decade.

### **Waste, Lack of Good Governance, and Government Intervention in the Economy**

Although high real interest rates have been among the major factors increasing the national debt, uncontrolled public expenditures have also added to the need of additional borrowing. Corruption and rent-seeking activities have overtime rendered the control of public expenditures more and more difficult. While governments have over the years levied new taxes and admonished the people to live frugally, they themselves have wasted the financial resources in untold manners. Government expenditures have swelled rapidly during the last decade from expenses incurred out of extra-budgetary funds and revolving funds, expenditures made by local administrations and expenditures to meet the duty losses of banks, etc.

Table 4 shows how the government expenditures in certain sectors increased in a single year of 2000. Inflation having decreased to 36 percent toward the end of 2000, as shown in Table 3 before, these expenditure expansions reflective wasteful use of financial resources by politicians and public officials. Further, governments are spending on their own without accounting to the Parliament. For example, according to Turkish Court of Accounts, government spent \$16 billion from an unknown source out of the budget without accounting it to the Parliament in 2000. One opinion is that this amount was raised as internal debt and spent by the government on its own without recording it. True, government in power was not the first one who did it. Nevertheless, total expenditure of money raised from unknown sources amounted to \$116 billion between 1981 and 2000.<sup>12</sup> This, indeed, is a good example of the lack of transparency and of accountability that have prevailed in the country for years.

Further, state is continuing unnecessarily to own assets. For example, it currently owns around 235,000 apartment flats and 2,340 resorts, 132,240 telephones and 86,338 cars.<sup>13</sup> Although all these cars are mainly for use of government functionaries, 35,000 are individually allocated to different public officials. The number of cars increases to almost 125,000 when cars allocated to state-owned enterprises (SEEs) are also included. The bulk of the expenditure from the ownership

<sup>11</sup>What this means is that if LIBOR is, for example, 6 percent, interest rate for Turkey becomes 10.5 percent. In contrast, it is only 6 to 6.1 percent for the developed countries like USA, France, Belgium, etc. By comparison, the risk premium is around 2.5 percent for South Korea and Thailand, which faced a similar financial crisis in 1997-98 and 3 percent for Mexico that experienced a much worse crisis in 1995 [TOBB (2001), p. 8].

<sup>12</sup>Ulsever Cuneyt, "Zaten Bu Duzen Coktan Batmis!", *The Hurriyet*, November 5, 2001.

<sup>13</sup>By comparison, the industrialised countries like Japan, France and England have only about 10 to 20 thousand cars set aside for official use [TOBB (2001), p. 13].

Table 4

*Increases in Selected Government Expenditures in 2000*

Expenditure	Increase (%)
Communication	99
Transportation	98
Rents	58
Celebrations, Fairs, Promotions, etc.	67
Office Machines Purchases	110
Office Supplies	107
Vehicles Purchases	85
NATO Expenses	151
Nationalisation and Building Purchases	84
Transfer Payments	76

Source: Kadir Dikbash, *The Zaman*, March 20, 2001.

and operation of such assets is also a source of waste. In fact, wasteful use of financial resources seems to be directly correlated with the involvement of the government in the economy. Government intervention, despite the liberalisation efforts mentioned before, has not reduced. It is rather extending further and further, enlarging the public sector thereby increasing waste of resources. TOBB claims that the total public sector cost of waste in the last decade has amounted to over \$195 billion as detailed in Table 5.

Although research findings of TOBB are highly reliable, it has not included all sources of official waste of financial resources. For example, it has not included corruption and waste in local administrations, and has considered only historical figures. Had it included all wastes of resources and presented them in their present value rather than historical value, the figure would have simply been staggering.

### **Unsound Financial Sector**

The most devastating effect of the crisis has been in the domestic banking sector. As is known, banks are financial intermediaries whose liabilities comprise mainly of short-term deposits and whose assets are usually loans to business, consumers and sometimes also to governments. When the liabilities of banks exceed their assets, they become insolvent. On this basis, both state and private banks of Turkey have at one or the other time become insolvent for several reasons. The first reason is that banks have been advancing domestic loans out of loans they obtained from abroad. This practice operated to the serious disadvantage of the banking sector. For example, banks gave unrestricted short-term credit out of foreign loans during 2000. However, when the foreign creditors during the crisis called their loans back, domestic banks and, also private individuals, rushed to purchase foreign

Table 5

*Extent and Sources of Waste in Turkey, 1990–2000*

Type of Waste	Amount of Waste, Billion \$
Excessive interest payments on domestic debt because of high real interest rate caused by bad governance	27.9
Increased interest payment on increased in the principle amount caused by debt-interest vicious circle	95
Excessive interest payment on foreign debt because of political and country risk	6.5
Maintenance cost of delayed but partially completed public investments	6.8
Debt requirements of SEEs	32.2
Minimum estimated corruption in public contracts	2.1
Insolvent banks losses under the Savings Deposit Insurance Fund	12.5
Duty losses of the state banks	20
Treasury and Ziraat Bank losses from lower-interest loans	9.2
Cost of unnecessary excessive staff in embassies	0.7
Probable savings from maintenance and insurance costs of public flats, in case they had been sold (sales revenue is not included)	0.64
Probable savings of maintenance and oil cost if government had used the cars half less	0.96
<b>Total Losses and Waste</b>	<b>195.2</b>

Source: [TOBB (2001), p. 16].

currencies mainly US dollars from the open market to pay them. Consequently, domestic currency reserves reduced and pressure increased on exchange rates.

The situation may have warranted the closure or at least merger of banks in loss. But, the government did not close such public sector commercial banks for political reasons. Powerful politicians have often forced the public sector commercial banks to support agriculture and small cum medium enterprises to maintain their vote bank. In this way, they contributed to budget deficits thereby to rising debt stock. This type of intervention over the years has distorted the financial structure of the public sector banks and, indeed, the entire financial sector of the country. In fact, forced misallocation of financial resources reduced the performance of the government banks to the extent that they could distribute only 26 percent of the loans against 40 percent of the total deposits with them in 2000.<sup>14</sup> In fact, state banks by

<sup>14</sup>[TOBB (2001), p. 5].

collecting high-interest, short-term funds and distributing them among the prospective voters at a considerably lower interest rate have become intermediaries for winning votes for the influential politicians. Also, the state banks together with some newly privatised banks have been accounted for one of the important factors of instability in banking sector. The banking sector instability intensified when some state banks were privatised to corrupt individuals particularly to media owners who stashed away the financial resources of their banks through offshore operations. Massive transfer of domestic capital illegally from local banks into their offshore and domestic companies resulted in their losses much in excess of their capital and thus led to what is called by Demirguc and Detragiache (1997) a systemic crisis in the country. In fact, state banks and private banks, which are incurring losses, are already accounting for over 50 percent of the entire domestic banking sector losses. This may explain why Turkey's economy as a whole was affected and suffered a systemic crisis in February 2001.

Wasteful behaviour of the government functionaries and politicians has also distorted the performance of private banks. The increasing government borrowing from private banks has diverted them from their real functions to financing the budget deficits. Overtime, the increase in the proportion of government securities in total assets of depository banks increased from 10 percent in 1990 to 23 percent in 1999 but their private loans decreased from 36 percent to 24 percent of their total assets. This way, banks could not support private investment sufficiently. Further, high and rising inflation in a situation of increasing debt accelerated "dollarisation", increasing foreign currency deposits from 25 percent to 42 percent of total deposits in the same period.<sup>15</sup> The result was increased incidence of insolvency of banks. As of March 2001, Savings Deposit Insurance Fund had taken over 13 banks in loss of \$12.5 billion.

### **Media-Bank Ownership**

Another factor that increased the instability of Turkey's financial sector is the phenomenon of media-bank ownership. As mentioned before, governments have not only privatised some state banks to holding companies owning TVs and newspapers, they have also allowed some other holding companies to purchase TVs and newspaper, and to establish banks. Table 6 shows the simultaneous bank-media-company ownership network existing in the country. It is very strongly believed that this network has greatly proliferated corruption in the country. In this respect, Gönultash claims:

"Theft is done through a simple model: using their media like a shield, they are hiding and defending themselves, as well as gaining prestige. Further, nobody

<sup>15</sup>[TOBB (2001), p. 6].

can reject the influence of media on government contracts. Their banks are to finance growth; holding company is the body". He also asks: "Is there a holding company that does not have both media and bank?"<sup>16</sup>

Table 6

*Holding Companies Owning Media Companies and Banks, 2000*

Holding Company	Media	Bank
Rumeli Holding	Star Newspaper and TV	Imar Bank
Ihlas Holding	Turkiye Newspaper and TV	Ihlas Finance
Medi Group	Sabah Newspaper and ATV	Etibank
Doghan Holding	Milliyet, Hurriyet, Posta, Radikal Newspapers and Channel D	Dishbank
Doghush Holding	NTV	Garanti Bank
Chukurova Holding	Aksham Newspaper and Channel 6	Yapi Kredi Bank
Bayindir Holding	BRT	Bayindirbank
Zeytinoglu Holding	Es TV	Esbank
Nergis Holding	Olay TV and Newspaper	Interbank

Source: Gonultash, Nuh, *The Zaman*, October 31, 2000 and *The Economist*, April 7, 2001.

It may be realised that in developed countries, a bank owner cannot own media and companies and there are hard restrictions on a simultaneous ownership of media and banks. Such regulations have been openly violated in Turkey. Companies owning more than 10 percent share in a TV or a radio station are not allowed to compete in government tenders. However, they have been openly bidding for them. An important example is Doghan Holding. It, despite the ownership of more than 50 percent of the domestic media, purchased in 2000 together with "Is Bankasi" 51 percent of "Petrol Ofisi", the biggest oil distributor then in Turkey. Similarly, the owner of Medi Group who owns media purchased Etibank during its privatisation.<sup>17</sup> Further, repeated bidding of large media holdings in government tenders has recently been reported by Nuri Kayis, Chairman of the State Broadcasting Watchdog a Parliamentary Commission.<sup>18</sup>

In agreement with Gonultash, Demirguc and Detragiache (1997) had already claimed that in some countries in which the banking sector is liberalised but bank supervision is weak and legal remedies against fraud are easy to circumvent, banking

<sup>16</sup>Gonultash Nuh, "Beyaz Turkler' in En Buyuk Kesfi; Medya, Banka, Holding Ucgeni...", *The Zaman*, October 10, 2000.

<sup>17</sup>The owner of Medi Group has recently been arrested and put in jail for corruption and embezzlement.

<sup>18</sup>*The Economist*, "Dark Morning in Turkey", p. 58, April 7, 2001.

crises may also be caused by widespread “looting”, bank managers may invest in projects that are sure failures but from which they can divert money for personal use. Further, Mishkin (1999) argues that for countries with such situations and having government guarantee for banking sector, pegging exchange rates is a dangerous strategy to control inflation.

### **Corruption and Distrust of Politicians and Government Institutions**

Pervasive corruption is yet another factor that has long been distressing the economy. The way it has been affecting Turkey has already been shown in Table 3. Capital outflows and Turkish direct investment abroad are on the increase but FDI has stagnated. This betrays the lack of trust of even domestic investors in the political and economic stability of Turkey.

The prevalence of corruption has been admitted by as high officials as Kivrikoghlu, Chief Army General,<sup>19</sup> who very pertinently remarked, “If there had not been corruption, there would not have been a crisis”.<sup>20</sup> The extent of corruption in Turkey can also be realised from what the *Zaman* quoted from the *Financial Times* on April 27, 2001 that according to a survey conducted by Ankara’s Chamber of Commerce, firms bidding a contract have to pay 15 percent of it as bribe to the political parties. Further, how rapidly has corruption spread in the country may be realised from the corruption-based ranking of the countries of the world. For example Transparency International placed Turkey in 1999 on top in corruption in Europe whereas International Management Development Center ranked its transparency of governance 44th in a list of 46 countries in 1997.<sup>21</sup> Similarly, Turkey has, according to The World Competitiveness Scoreboard, drifted down from 35th among 49 countries in 1997 to 44th in 2001.<sup>22</sup> Further, factors considered in an opinion survey as hampering foreign investment in the country are corruption, 65 percent, bureaucracy, 42 percent, labour cost, 35 percent, size of local market, 25 percent, customs, 20 percent, economic and political instability, 10 percent, tax regime 5 percent and profitability, 5 percent in that order.<sup>23</sup>

Corruption in Turkey is also said to have international dimensions. For example, President of Turkmenistan, Sapar Murat Turkmenbashi, blamed a Minister to have purchased high-cost Russian natural gas instead of much cheaper Turkmen

<sup>19</sup>Army generals in Turkey do not generally comment about the domestic economic and political circumstances. However, when they do, they do it in strong statements of the type mentioned above.

<sup>20</sup>*The Zaman*, April 04, 2001.

<sup>21</sup>*The Aksiyon*, October 27, 1999.

<sup>22</sup>Rankings from 1997 through 2001 are available at [www.imd.ch/wcy/ranking/pastresults.html](http://www.imd.ch/wcy/ranking/pastresults.html).

<sup>23</sup>*The Milliyet*, May 4, 2001.

natural gas on kickbacks, compromising Turkmenistan's interest in favour of Russia.<sup>24</sup> Similarly, Chandar argues that a Russian Lobby, which has long permeated business and media of Turkey to promote Russian interests, has been an accomplice in hatching this Russian gas purchase agreement.<sup>25</sup>

Adverse events mentioned above do not mean that action is not being taken to contain corruption and influence of corrupt elements over politicians and media. In fact, government has specially been grappling with corruption and organised crime since May 2000. In a year, 18 big operations against corrupt groups and individuals were undertaken in which 637 people allegedly involved in corruption were arrested and 278 out of them including high public officials, bank-newspaper-holding company owners and ex-ministers were prosecuted to jail.<sup>26</sup> Despite the willingness, anti-corruption measures are still not upto the menace. The biggest obstacle in ending corruption is Turkey's weak legal system as well as constitutional immunity. For example, article 100 of the Constitution provides immunity to Premier and Ministers from prosecution. Therefore, no one can investigate or collect inimical evidence against their allegations. How can a minister be adjudged under these circumstances? According to the same article of the Constitution, at least 55 members of Parliament must sign to open an investigation against its member. The inquiry must be conducted by a commission comprising 15 parliamentarians. Any incriminating evidence must be reported in a session of Parliament to decide by voting whether to send the case of a blamed Premier or a Minister to the Constitutional Court. At least, 276 out of 550 parliamentarians must vote against the blamed Premier or Minister for starting legal proceedings. Similarly, article 83 of the Constitution provides immunity to parliamentarians against any investigation of allegations against them. It may thus be realised that it is very difficult, if not impossible, to start legal proceedings against elected members of parliament in Turkey. Further, legal procedures cannot be started against undersecretaries of Ministers without permission of Ministers.

How such immunity encourages parliamentarians, Ministers and officials assigned by Ministers to protect their vested interest and how they interfere in economic programmes and reforms may be realised from what the *Financial Times* said: Although Turkey gets \$19 billion as aid disbursable in 3 years, success of the programme is still unsure due to prevailing systemic faults such as lack of transparency, presence of vested interest groups, etc. Similarly, Mr Dervish cites to the *Financial Times* on the same issue that the new economic programme might be derailed by the vested interests and rent-seeking mechanisms for reasons of its

<sup>24</sup>The current arrangements of selling Central Asian natural resources through Russia, according to USA, constitute a serious threat to the independence of Central Asian and Caucasian countries. (Feraî Tinc, "Butun yollar Mavi'ye Cıkar", *The Hurriyet*, April 29, 2001.)

<sup>25</sup>Cengiz Chandar, "Rus Lobisinin Parmak Izleri..." (Fingerprints of Russian Lobby...), *The Yeni Shafak*, May 8, 2001.

<sup>26</sup>*The Milliyet*, May 4, 2001.

including immediate legal and structural reforms to stop politicians from abusing state assets in order to win votes and distribute favours to their cronies.

When any country immerses so deep in corruption, it can get back on a normal course only with extraordinarily tough measures. This seems to hold, as remarked by the *New York Times* on May 18, 2001, for Turkey, which now confronts the infinitely tougher task of reforming a bankrupt political system, which means dispensing with the state controlled economy created by Mustafa Kemal. Similarly, Swedish Ambassador to Turkey has told in the same newspaper that without external support, the politicians would not have agreed to these far-reaching reforms.

In fact, there seems a wide agreement that real reasons of crises in Turkey are political not economic in nature. For example, Chandar claims that politicians and their parties are responsible for the February crisis of Turkey. The way out of such a crisis, he says, is through democratisation, transparency and political reforms.<sup>27</sup> Chalishkan in agreement with Chandar concludes that this crisis can temporarily be delayed with help of new foreign debt. If 'political crisis' are not solved, new crises are on the way.<sup>28</sup> Conversely, Akyol claims state socialism as the real cause of the crisis. The traditionally strong role of state has further been strengthened in the Constitution and thus its extended intervention is the cause of frequent crises of the country.<sup>29</sup> Gonultash supports Akyol's views on the role of the state socialism in different crises and argues about the necessity of reidentifying the role of the state, which became all the more necessary after the latest crisis. It may, however, be said that political reforms must start with the change of the "Political Parties Law" and the "Elections Law" to end the despotic rule of the party leaders. Traditionally, members of parliament have been voting after their leader irrespective of the issue to be legislated about.<sup>30</sup> There is a critical need to change this tradition to encourage rational legislation in Turkey.

The two latest crises, February 2001 in particular, have triggered wide discussions on the role of state, political integrity and legal system of the country. Increased awareness of the growing number of people about rampant corruption in the country has, inter alia, been instrumental in starting these discussions. People's trust has badly been eroded because even otherwise reliable politicians have been found either involved in corruption or have ignored corrupt politicians and officials.

A recently conducted survey about the public faith in political parties shows that people's trust in political parties has declined to such an extent that no party could get more than 10 percent of the votes. The number of voters who told "I would

<sup>27</sup>Chandar Cengiz, "Türkiye'nin Ecevit Bagajı", *Yeni Şafak* Newspaper, May 4, 2001.

<sup>28</sup>Chalishkan, Kerem. "Yeni Türkiye Partisini Ariyor", April 8, 2001 at <http://www.ntvmsnbc.com/news/75746.asp>,

<sup>29</sup>Akyol, Taha, "Devletçilik Krizi", *Milliyet* Newspaper, April 5, 2001.

<sup>30</sup>Because 'Parliamentarian Candidates List' is prepared by the party leader in Turkey. If they do not behave in accord with the party leader, they cannot be even a candidate in the elections.



not vote for any existing party if there were an election today” constituted 31 percent of sample respondents. The President Nejdret Sezer, who, in fact, is not a politician turned out as the most reliable and successful person. No party leader got even 3 out of 10 points. This survey evaluation implies that all party leaders are unsuccessful.<sup>31</sup>

#### IV. SUMMARY AND CONCLUSIONS

Turkey has been suffering frequent crises since especially 1990s. The latest crisis of February 2001 was perhaps the severest among them. However, it laid bare the causes underlying it. People lost their trust in government, politicians and also officials, and learnt the powerful network of vested interest owners in the country. Through this crisis, they learnt how widespread was corruption, lack of transparency and waste, and how badly they had been governed. Based on the facts and figures presented in the paper, we conclude that the February 2001 crisis was more than a financial crisis. Indeed, it was the outcome of combined effects of adverse economic-political factors, corruption, waste, lack of good governance and transparency, government intervention in the economy, poor legal system, unnecessarily excessive immunity, media-bank-holding company ownership, etc. After the February 2001 crisis, government introduced another new economic programme endorsed by IMF, World Bank and the USA. In fact, the new programme seems more to be a programme of structural and legal reforms than economic measures.

It seems that if the actions proposed in the new programme are carried out successfully, Turkey may riggle out of the crisis and legally restructure itself. But, without reforming politics and politicians, old things may reappear. To preclude the recurrences of such crises, bold measures need to be implemented. The analysis of impacts of new programme can be a subject of further research.

<sup>31</sup>*The Zaman*, April 5, 2001.

Appendix Table 1

*Selected Indicators of Turkey's Economy, 1990–2001*

Year	Domestic Debt/GNP (%)	Foreign Debt/GNP (%)	Public Sector Debt/GNP (%)	Duty Losses/GNP (%)	Primary Deficit / GNP (%)	Interest/Tax Revenue (%)	GNP Growth (%)	Real Interest Rates (%)	Number of Civil Servants and Contracted Employees in Sees	Number of Workers in Sees
1990	14.4	32.2	28.7	0.0	-3.6	30.76	9.4	-	212,157	430,901
1991	15.4	33.2	35.1	0.0	-6.2	30.61	0.3	-	209,216	421,397
1992	17.6	34.7	35.8	0.0	-7.0	28.46	6.4	13.27	203,070	409,138
1993	17.9	37.0	35.1	0.7	-5.6	44.07	8.1	11.21	205,308	393,936
1994	20.6	50.1	45.1	1.9	-0.2	50.75	-6.1	79.17	193,797	361,314
1995	17.3	42.6	41.3	2.1	2.7	53.13	-0.3	29.71	178,159	318,193
1996	21.0	43.2	46.4	4.2	-1.2	66.73	0.6	37.64	157,439	311,230
1997	21.4	44*	42.9	5.2	-2.1	48.00	8.5	18.29	174,665	288,736
1998	21.9	47*	43.7	11.4	0.5	66.90	3.9	30.57		
1999	29.3	54*	61.4	16.7	-1.9	72.40	-6.1	32.71		
2000	28.0*	57*	60.8	13.9	2.9	77.09	6.1	14.04		
2001/3		71*	78.1E				-11.8#			

Source: Domestic Debt/GNP, Undersecretariate of Treasury; Foreign Debt/GNP, Central Bank and Undersecretariate of Treasury; Duty Losses/GNP, Public Sector Debt/GNP, Primary Deficit/GNP, Interest/Tax Revenue, GNP Growth, Real Interest Rates: New Economic programme; number of employees in SEEs, Undersecretariate of Treasury; \* Egilmez Mahfi, the Radikal, April 24, 2001; E: Estimate for 2001; # As of second quarter of 2001.

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## **Comments**

This is a very interesting in-depth analysis of the February 2001 crisis in Turkey in the backdrop of the earlier crises since 1990. The authors after a threadbare analysis of the internal strife in the various entities of the government highlight in detail the failure of the IMF programme without the necessary internal harmony in the economy. The analysis of the factors like corruption, lack of transparency, good governance and legal infrastructure provide a useful starting point for many other developing countries facing all these impediments in their development processes. The most informative part of this paper is the discussion on the phenomenon of media bank-holding company ownership in Turkey. The paper discusses in detail how this phenomenon contributes very significantly to the crisis like the one face by Turkey in 2001.

The paper rightly concludes that the crises, as it is generally believed to be, was not a purely financial crisis. It is indeed the outcome of a combination of economic and political factors. Therefore as they recommend the adoption of a rational economic policy incorporating the role of political factors can only prevent such crisis in future.

The basic problem with this paper is the excessive repetition of the discussion. I would suggest that the authors should consult the presenter of this paper who made a very concise presentation without missing out on matter.

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