



## THE TURKISH ECONOMIC CRISIS: THE VIEWS OF THE TURKISH BUSINESS ELITE

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**E. YUCAOGLU:** It is always a pleasure for us to come to CSIS. I should really first ask how many of you have heard Minister Dervis in the last two days, or say, who hasn't heard him speak? When we talk about the Turkish economy and all the parameters, I'll try to summarize because you've all heard how the problem emerged and what the country is doing now, and in specific, what Minister Dervis is trying to do now, in the preparation of a new economic program. So, I will approach it from the micromanager's point of view, rather than a macromanager's point of view. In our business community, and just to add, TUSIAD really represents about a third or 40 percent of Turkish private sector. And the private sector, in its totality is about two-thirds of the Turkish economy - one third being the state - and TUSIAD is an organization of CEO's and company owners with about 500 members. In terms of employment, exports, imports, we're all representing about a third of the private sector output; in terms of taxes paid - corporate and otherwise - we're probably over 40, close to 45 percent of the taxes paid to the state. That's obviously one of the reasons, if not one of the most important reasons, why we have a big voice in the Turkish civil society life. And TUSIAD is more of a 'policy house' than a 'business development organization.' Our members are big, and they have their own systems in place for business development, so we don't assist our members to do business with the rest of the world community. In terms of policy, we have three platforms. One is economic policy - obviously very dear to our heart, - a second policy area for us is social priorities of Turkey, like education, healthcare, social security; you name it, and then a third platform, which is a bit more unique for an organization like us, and which is coming to effect in the last five years or so, is to follow up the political reform agenda in Turkey. So when we talk about the economy in Turkey, we really always in some sense, in the medium term at least, tie it to the political reform agenda of our country and I will do that for the last part of my presentation.

Now, I must tell you that, going back to April 1999, after the elections, when this new coalition government came in, as business people, our initial reaction was, "well at last we have a coalition, in spite of the unique way a nationalist party, a center left party and a center right party came together, at least they have majority in the Parliament. If they want, if they build the right agenda, they can both move in the economic reform agenda and the political reform agenda." So our organization basically teamed up and prepared for them. What we thought were priorities of the country, both in the economic and political arena. And we gave them a lot of support, because they showed a real intent of solving some of the structural problems of Turkey that had been with us for the last 20-25 years; namely inflation and a total overhaul of the state machinery. Most of this was, of course, enthusiasm and then they actually started doing a few things, using their majority in the parliament. And towards the end of that year, which, as you know was an unfortunate year with the earthquakes and so forth in Turkey, and we had already entered a recession at the beginning of 1999 after the Russian collapse and the aftereffects of the Asian crises.

So we started the year with a recession, we had elections, as a few things started happening, we had the earthquakes, we said: "OK, well, 1999 was just a bad year." And this government took on a stand-by agreement with the IMF, a major disinflation program, and the most comprehensive program that we ever saw in the country; with its parameters relating to currency management, currency pegging, with its structural reform agenda, privatization, the way the central bank was responding to liquidity issues; everything was a little new, and it was the most comprehensive program. So we supported this program, because we thought, "OK, they have the majority, we can move on with the structural reform agenda." With that impetus, I can tell you, we started 2000 on a very bright note. In fact, the government, on three fronts; public finance, macroeconomic management and on structural reform - the three major areas of the program - they started moving. There was support from IMF, support from all of the international institutions around the world, so all of a sudden, the interest rates in the country which were moving around 100 percent the year before, started falling, and by mid-year we were in the 30-35 percent range on government paper. The basic interest rate, inflation, which had been around 70 percent the

previous year, started falling steadily. I mean, we just couldn't ask for more. This was, we thought, something that could have happened ten years ago, but at last, was happening now and we were very happy about it.

Yes, we businessmen grumbled about a few things, because this was happening in an environment where the currency was pegged to a basket of one dollar plus 0.77 euro, or something like that. And at the beginning of the year, this didn't bother us. But slowly as we went into the year, the divergence of the euro and the dollar started bothering us. Because, about 55 percent of the foreign trade of Turkey is euro denominated. So when the government had pegged the currency, they had announced the exchange rates to us for the whole year, and the target was to bring inflation down to 25 percent and they said the currency will depreciate only 20 percent. So, everybody knew that the basket will appreciate 20 percent. Now, that means, to a business community, that imports will come into the country, and the price appreciation of imports would be maximum 20 percent for the whole year.

Therefore, we felt the competitive strains of trying to redo our businesses, because, although labor is cheaper in Turkey, although major inputs are reasonably priced, two or three factors were really pushing us: cost of financing, which was totally out of any comparison with the world, what the world was subject to, and, of course, we had the additional strain of having lived with inflation for 20 years, high inflation, and therefore the labor unions and people did not want to respond to the targets of the program, they continued living in the past and saying "I've lost six months of purchasing power, so you just reinstate that." So that created a little friction, but then we said: "If there is growth, growth will bring us the economies of scale and productivity, so that we can make up for the higher wage settlements that our labor wants, and also maybe absorb this relatively high financing cost as we grow." And that's exactly what happened. We had six and a half percent growth in the year 2000.

So with growth, we could all slowly redo our numbers, feel the competitive pressure from imports, whose prices were going up only 20 percent, but something started happening. As the euro started falling, by the end of the year the appreciation of the euro was only 7.5 percent with respect to the Turkish Lira. The dollar was higher, so all of a sudden, that equation, that basket really didn't work. We felt this during the mid-year term, and we started calling out to the IMF and everybody saying: "Look, number one, you guys, all you do is sit down in Ankara - IMF, World Bank, Treasury, State Planning and you don't invite us to the table. Why do we have to talk to you through the press all the time? We don't understand macroeconomics - we do but we say we don't - but at least you could listen to us, you could listen to the markets a little bit." But they didn't want to do that. They were saying: "No, it's going fine, fine."

But, in reality of course, when you have your internal costs and inflation still running around 40 percent, lower than 70 percent, 40-45 percent, your financing costs are still much higher than your competitors, and your imports coming into the country with only a 7.5-8 percent price increase; you can imagine what it does to your margins, to your competitive strength, and the only solution is growth. If you have growth in the markets, you can take it. Now this tableau, we kept supporting, we said: "Fine, OK, we'll take it, the competition and all." You must all realize that Turkey is already in the Customs Union for the last five years. Turkey is an open market, so there are no restrictions on imports or import duties. So 7.5 percent is just 7.5 percent price appreciation on imports whereas our costs were going up 40 percent.

In that environment, until about October, we said: "OK, we're going to take this, whatever the pains are, we're going to live through this," because at least on the public finance side, the government started turning out a surplus before interest payments - which was very positive.

On the macro-management, aside from these fine-tuning criteria, things were going fine. On the structural reforms, the government moved fast in the first six months. You know, we had some successful privatization events, of TUPRAS, the state refinery system; a new GSM license was sold; the state petroleum distribution company was sold; these are all \$2-3 billion affairs. So, our view was fine. As the parliament went into recess at the end of June - and they do every year - the previous year they hadn't, they had only taken a month off, but when our parliamentarians go for recess they go for three months.

Starting with the July to October time frame, all these structural reform agendas were put aside. We started seeing a lot of bickering developing between the coalition partners on small items, there was also a little row between the president and the cabinet, because they kept pushing legislation through a power they got from the parliament - with the power of decree which could replace laws, but the president kept saying "No, we can't do this, we can't do that," and the new president, who also came to power in early 2000, is a man of law, we respect him a lot, the public has put him up there, a man who was the head of the Constitutional Court before as president. All of a sudden, there was this lack of a dialogue and legislative efforts slowed and the agenda started changing, in our view, to those things that did not relate to the reform agenda that we thought should have been pursued.

The first week in October, the IMF came and said: "You know, we are not going to give you the third tranche of the standby package because you haven't done these reforms. What we'll do is we'll come back in December and review the third and the fourth tranches together." A week later, the World Bank came and said: "We are not going to give you the \$800 million loan, which was to go into restructuring of your financial markets - a programmed loan - because you haven't passed the laws for privatizing and normalizing your statements." These two pieces of information hit the financial markets in a very strong way.

In fact, two weeks later in October, those who follow reports on Turkey from the investment banking community must have seen three statements. The Goldman Sachs, the Solomon Smith Barney, everybody, - and most of these analysts who write these reports are young Turks who live in the U.S. - said the foreign fund flow to Turkey has stopped, Turkey is

delaying her structural reform agenda, the risk has increased. Just three statements. Those of you who have the history can go to the records and see how, in October, all components of the interest rate - whether it's the overnight, the bond - they started going up.

We obviously are not, as I said, managers of macroeconomics, but we got a little worried when the interest rates went up; because things, our financing equation, started changing, to the point that the banks started getting worried because they had syndicated loans to pay back at the end of the year. They had a considerable amount of foreign deposits in their banks which had joined the banks' efforts to buy government paper - which everybody thought would keep going down, buy now 35-40 percent, then it goes down, so let's lock in some profit. But that picture changes when interest rates start going up. The funding of all the government paper in the banks all of a sudden became expensive, and the banks started writing losses - to the point that one bank, which had booked 80 percent of its assets into government paper just couldn't take it. You start funding those papers with increasing interest rates of 40, 45, 50 percent and there comes a time when you can't take this anymore.

All of a sudden, early November, interest rates were going up, interbank rates were going through the roof, and signs of a liquidity crisis were starting in some banks. We knew we had a big confidence problem that had changed the course of things in Turkey. Now this was a time when we, as the private sector, said: "Look, we can understand the IMF saying: 'You didn't do your homework, so I won't give you any money,' Fine." But the same IMF, we thought, together with the Turkish officials, should have gotten together backstage and said: "Look, this is our official dialogue, but what happens if there is a bigger crisis? Don't we need to sit down and have a contingency plan?" I think there was complacency on both sides. When in November, things got out of control, the IMF came back and everybody wants to do a new deal. That deal was, as you know, an additional \$7.5 billion of emergency loan package from IMF to Turkey to be used for stabilizing the markets. But by that time, I can tell you that the confidence was so shaken that in spite of all the goodwill, the support we gave to the program in the first year and the fact that we had excellent growth didn't help us.

We started thinking "What if this doesn't work?" And in fact, I think that psychology stayed with us throughout December and January. The markets reacted to this increase in interest rates: the consumer stopped buying. All of a sudden if you see your sales in automotive, appliances, take all the categories - except maybe for food and beverages - a huge growth in the first eleven months, you put down your budgets for 2001, you have this bad 'feeling' in December; and January comes and your monthly sales are down by 60 percent. If you're a holding company, say automotive, you say "My God, 40 percent down! What is this?"

By early January - in fact that was the time we had our general assembly when I stepped down we basically announced it to everybody. Starting with our meeting in December in Ankara when we really had a big row with our ministers; we had five ministers listening to us and we told them the following: "Gentlemen, everything was going fine and now look what happened. In two-three weeks, when the confidence given to the financial markets is gone, this is what happens." By the way, everybody runs to the banks to get that 250 percent repo chance. Our politicians have this tendency of giving very populist statements when problems happen. In that same meeting with all the TUSIAD membership and the ministers, we said: "Look, in the past, you politicians used the terminology, saying 'There's a big lobby for inflation in this country - there are inflation lobbyists'." They are always looking at business, you know. They said: "there is this tendency for business to be the *rentiers*" - the French word meaning you don't want to do any production, but just want to sit on your money and have big interest earnings. At that moment, we had to remind them: "Look, this is what happened in one week. Who created this problem? You the politicians. Therefore, it is you who creates this inflation lobby or who creates the *rentier* class in this country. You cannot go and tell business 'You're rentiers' because the whole population, the people want to preserve their savings, that's why, of course, if interest rates go up to 100 percent, you take it away from 30 percent and go to 100 percent. We did not create this, you created it." The dialogue was pretty much like that, I can tell you. They took the floor, we took the floor and we made our discontent very clear to them. One minister walked out of the meeting; well not really walked out, he had told us that he had to leave early. But the press assumed that he walked out.

Anyway, this was the environment: confidence gone, sales down, interest rates up, and guess what? I would go to a bank, and managers would say: "Do you really want to take the loans?" I'd say: "Yes, well - of course, we had a credit line." We had ongoing operations and our interest rate was around 30-40 percent on the Turkish Lira; on foreign denominated loans 12 percent; 10 percent on the dollar. They said: "No, this is not the right time for you to renew your loan. In fact, we would be very happy if you paid them back now. And, by the way, if you really need money, we'll quote you a 200 percent rate on the Turkish Lira for your loan."

I don't know what kind of reaction there would be if ever the United States had the smallest inkling of a reaction from the financial community like that. But we are used to these things, so we said: "OK, we'll stop borrowing. We'll go back to our back pockets, more equity, cut back, reduce size, do this, do that." But we all said: "We'll do this but we hope these guys do the right thing so that we can come back on to the basic program." Ladies and gentlemen, it didn't happen.

And then, on top of that, our prime minister and our president had a little "exchange" in a National Security Council meeting, which the prime minister made public right after the meeting with a statement saying "There's a big political crisis that we have to attend to." Who needs a statement like that when markets are very nervous? This was happening two days before the largest auction of the Turkish Treasury, going out for a renewal of domestic debt. Some \$3 billion of paper was to be renewed. And imagine what happened. As we thought the interest rates were coming back to 60 percent and then there would be a reasonably quiet auction - I think they had planned to make the auction in two packages: a one-year and an eight-month - with these comments to the markets, in that crisis moment, they went back to the markets for one

month for \$3 billion dollars at the interest rate of 125 percent- just to keep liquidity. At this time, the problem is quadruple the one in November. All payment structures in the market were broken; none of your customers would pay you; no terms would be discussed; and the G-20 meeting is happening in Turkey. So Mr. Stanley Fischer of the IMF is in Turkey and he's watching this, they run to Ankara, and say: "Float the currency." Our politicians are totally amazed, they don't know what to do. "OK, float the currency."

There was a little discussion about this in the November crisis. But jointly, they decided they would not do this. Because the previous program had on its drawing board going to, maybe not a full float, but to a semi-float by June of this year anyway. The pegging plan had in itself releasing these restraints on the currency by June, and we all knew that if we could last until that time, the currency would go to the upper hand of the band immediately, with a little devaluation to the take heat out, because of imports rising and the balance of trade getting worse. Anyway, we never got there.

At the same time, the central bank kept saying: "I cannot create liquidity, because I'm still under a program. No liquidity. I create Turkish Liras only when I get dollars in." That was the rule in the program. So, no liquidity - it hit the state banks this time. The big three state banks could not honor their obligations. When they could not honor their obligations, all the private banks that had their money in the state banks could not honor their obligations. Your customers would not pay you; you couldn't pay your debts; everything was being discussed in goodwill; and, there was no exchange rate. People who had sold with the previous exchange rate agreements had to scramble, get back to their trade partners and say: "Let's fix something new on this." All kinds of new negotiations - no transactions, but a lot of negotiations.

This continued for about two weeks, and then Mr. Dervis was invited to come and take the lead for putting together a new program. You heard Mr. Dervis, but I will continue with our observations as micromanagers: The crisis is continuing. The markets are just flat or negative. Growth for this year will be negative in the first six months for sure, and if they could put it back together, and with some positive growth in the last part of the year, they may hit one or two percent positive, I don't know. So, the only thing that the float or the devaluation has brought is some hope to the exporters and to the tourism community for this year. Those who are engaged heavily in that kind of business will enjoy liquidity and some growth.

Given this situation now, we are at a point where we're saying: "OK, this has to be fixed in a very comprehensive manner, and therefore, maybe it should even touch the political side of it." Our companies can go bankrupt, we have to take out people, we're losing money, our books are in red, the only thing that's not changing is the Council of Ministers. We even suggested to them in December that they should revise the cabinet. Who needs 37 ministers in this country?

They said: "Well, you are right," when you talked to them individually. If you take the three leaders together and they won't talk like this. We take them one at a time, they all say: "You're right, but how do we play with the balance of political power in each constituency of each party."

So, I'm just giving you the reactions of the business community. We said: "Something has to happen, you guys have to pay for this. Because every time you make a new program, you come back to us with direct taxes, high interest rates and then you don't deliver anything." So today, I think if it's right to say, instead of just trying to control the interest rates in the realm of the previous program, or to sort of leave it alone but play with it - keep it in a band - now the current macroeconomic managers are like jugglers who want to play with the currency, they want to play with liquidity, with the interest rates just to put everything under a little control.

When Mr. Dervis says we have a three-phased plan, he's now talking about the first phase where this juggling is going on, until that time and place where we can put the damage together in terms of calculations and then come back with a new program, because all of this means new inflation targets, new budget, all the financial parameters revised for 2001 - everything. Rightly, they don't want to do it immediately, because they want to see some stabilization in the markets before they can put the numbers together. In the meantime, the only financial facility they have is the remaining part of the \$7.5 billion from the November agreement, which is \$6.2 billion. Today's discussions, as we understand - we don't go to these meetings - is that the Turkish government is saying to the IMF: "Why don't you give us the \$6.2 billion, with a faster schedule - not like \$1 billion every month, that we agreed on before; but give it to us in two months. That's number one.

And number two, allow us to use half of this money - because the IMF gives all this money as reserve to the central bank - for us to put into the state banks as equity." The state banks have accumulated a loss of about \$20 billion over the last ten years. The \$3 billion will just be enough to get them going in terms of working capital. The bigger problem, as you heard today, is to fix the banking system, which is maybe the biggest source of volatility that hits the markets - to the demand of these banks for money, money, money and interest rates shoot up. Now, he has to have a short fix for the next three months. By the way, the government paper, which was sold for a month was just renewed for three months this time, with lower interest rates, but still in the hundreds. There was a lot of subscription, which shows some comfort and some confidence coming back. But I don't know all the government parameters; I believe this short-term fix is for the next three months. Then, we have to see a more comprehensive program, and tied to that, a more comprehensive funding program, if we really want to fix the banks and a few other things during this time.

Now the question is what the Turkish government will do in terms of structural reform, so that they can come back and ask for funding. In the meantime, our forecast is negative growth; everybody is sizing to live; investing to grow; export markets might be OK, tourism might be OK; and we will live.

**B. ALIRIZA:** The question arises as to what the Turkish private sector, which is much more vibrant, visionary and efficient than the government, could have done. I've dug up statements by you throughout your period as chairman, and one has

the feeling that you were talking up the economy - almost deliberately, notwithstanding your reservations, which you told us that you conveyed to the government in December, notwithstanding the problems that you were seeing on part of the government. Now, if you ran your companies like this government ran itself, you would all go bankrupt. We have been hearing TUSIAD articulate its growing role in Turkish society and watching its efforts to play a more prominent role. You called it a "policy house." You got into areas that TUSIAD had not gone into before, but ultimately, the part of the process that you were most involved in was talking about the macroeconomic goals and the efforts of the government to actually achieve the common goals - which is to lower inflation, complete the process of integration into the free market economy, which stretches back 20 years - how successfully we could discuss, but that's not really our goal today. One statement that you made I think really exemplifies the problem that you had as chairman and TUSIAD had - when you said: "Now we can see 10 years ahead of ourselves."

**E. YUCAOGLU:** Yes, I keep getting this question from all.

**B. ALIRIZA:** But it is fair because it's a statement that you do not deny making and the problem, in essence, is exactly that: again, we're in a situation where we cannot see a week, two weeks, three weeks ahead. We are talking about the three-month crisis program that Dervis talked about, and the structural reforms are again being put on the backburner. Now, the public banks were, at the very least, mismanaged and there were allegations of corruption with respect to the private banks. Both of those issues are being raised now by the people who are being asked to lend money to Turkey, including by the IMF. Yesterday, General Scowcroft raised this issue in an interview with CNN Turk, that until the issue of corruption is tackled and transparency is achieved, giving money to Turkey will be difficult. If people are asked to provide money that will go to cover the huge losses, as working capital for public banks, they want to know that a single minister, putting a signature on a piece of paper will not yet again send it to places that it should not go to.

As TUSIAD, you certainly engaged in a mea culpa - we don't see that mea culpa by the government. Every minister in the government that hit the rocks is there - they just added one person. Only the governor of the central bank and the treasury are gone. That's absurd. Do you honestly see a willingness on the part of the political class, the very cast of characters that actually hit the rocks being able to make the necessary changes to permit Kemal Dervis to implement the kind of program that he told us today and yesterday.

**E. YUCAOGLU:** When I made that comment, and that came out of the context of a speech I made, where I made the reservations, and to the point of saying we should not delay the structural reform in order not to lose confidence in the financial markets of the world. But, that statement was made with the nine month performance that I mentioned to you, truly, when you enjoy 6.5 percent growth as a country, as you see some work done, good direction in public finance environment, half of the structural reforms done and the world responding to this; truly all our companies started looking into the future. That's why I said: "We can now start seeing 10 years ahead." Because in the past 10 years we never had a chance to see moving in a positive direction for nine or ten consecutive months.

**T. OZILHAN:** I want to question the IMF a little bit, too. The last letter of intent was signed by the IMF and there were two major legs: one was the currency peg and the other was the structural reforms and privatization. In the first six months of 2000, the government did a quite a good job, they made some structural reforms, they did some privatization, everything was going well. But later on ... Turkish companies started losing competitive advantage... The IMF must see that there will be deficits and the Turkish economy will not carry this burden. ... They came at the end of 2000, they proposed that Turkey float the currency, but in those days the politicians couldn't get enough courage to do it because still the car was running, was not blocked to the wall; but in February they saw that they cannot go further... Everybody was penalized because they depended on the state, they borrowed in dollars, and with the 40 percent devaluation, many companies, even large ones, and the banks are struggling. Most probably that is the reason why everybody lost confidence and liquidity...The IMF remedy was not correct; they couldn't analyze the condition of the country...

For sure, the major reason of these crises is political. Unfortunately, the politicians in Turkey are very populist and corruption is high... After this crisis, Turkey will start talking about the politicians, election systems and parties law. Most probably, the public will force the politicians to change and the new generation of politicians must come to Turkey to govern with transparency and without corruption.

**E. YUCAOGLU:** When we talk about corruption, part of it is financial corruption, but a lot of it is cronyism, political corruption, in the sense of spending money, keeping your political system alive across the country without regard to your own budgets and what it does to the economy.

**U. ENGINSOY:** It seems that there is a vocal resistance from the Nationalist Action Party. Under these conditions, do you think that Dervis's proposals could take effect, could the parliament endorse the related fifteen legislative changes in the required time? Do you expect this to happen? Do you expect a bigger resistance? Would you expect an eventual resignation of Dervis?

**E. YUCAOGLU:** In an environment like this I don't think we should look for quick fixes... Deadlines like that don't work as perceived. The deadline refers to the fact that the IMF will have a board meeting in late April, by that time, it would be very appropriate for the Turkish government to come with a new letter of intent and with a history of saying: "Out of the 15 things, I did 10. So you see, I have started my list, I could not finish it all, but I finished these, and this is the structure of my new program." This deadline is clearly one that needs a lot of work, but I don't think it's a deadline where you can say: "OK, everything is done, now you can come in the door."

**E. CHOW:** It was said that political change was coming to Turkey; and I was wondering what would be the agent of that change, because you have a very broad based coalition government right now, that marched you into the political cul de sac that you're in. They are unlikely to reform themselves. If the change is going to be a smooth transition, what might act as the agent of change? Is that EU accession, is it the military - what's going to cause this change to happen in a way it's something other than this type of social explosion that might take place if nothing happens.

**E. YUCAOGLU:** In my view, first of all, let me touch on the timing of such change, because I think now, everybody is focused on to the next two three months to stabilize the markets, priorities are very different and we will talk in generic terms about the need for political change, but the real thrust of calling for change will probably happen in the fall. Now, if things don't go right, just to give you scenarios. I think if there was a resignation of this government, the president will chose a new prime minister who's probably non-partisan and that new prime minister will probably end up with 15 or 20 ministers, all technocrats, mostly from outside of the assembly. This is one scenario that can instigate change. Obviously, the key here is that the parliament will have to give a vote of confidence to that new cabinet and then wait for their performance, and they will try to use that back again for their campaign for elections, say, in the next two years. A two year technocratic government; this is one scenario. Another scenario for the kind of agent you're looking for is just the three coalition leaders getting so much pressure from business, from the unions, from everybody, for some change, they will instigate change with some optical measures, like bring down the 37 ministers down and through the process, eliminate the ministers that became a headache for the program execution; this is one sign of change. So there are many ways it can happen. Now, who will push for change? One force is here. But there are other NGO's in Turkey which are gearing up - like we did three four years ago on some other issues - to create a broad coalition for this pressure. "Either you play right, or go away."