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A Sick Man of Europe

A century ago, Turkey was "the sick man of Europe." The Ottoman Empire was falling apart, and other nations were gathering to share the spoils — in particular, Austria (backed by Germany) and Russia (backed by France). The eventual result of their rivalry was World War I.

Today Turkey is again one of Europe's sick men. The economy is beset by inflation. International debts cannot be serviced without additional aid. There is unrest in the principal cities, and even talk of Turkey developing into another Iran.

If we look at crude GNP growth figures, Turkey's are almost as impressive as were Iran's or Cuba's before those countries' revolutions — and well ahead of our own recent growth. However, much of Turkish growth is based on heavy infusions of credit for imported raw materials and capital goods, and it is accompanied by accelerating inflation — approximately 50 percent in 1978. Unemployment is very high, and is kept from rising even faster only by exports of manpower to Western Europe and by overmanning of a wide variety of government enterprises in Turkey's mixed economy.

Lesson in history

A little economic history may explain matters. Turkey enjoyed stable growth in the early 1950's, which might have continued. Small, however, was not Beautiful in those days. Turkish growth was predominantly agricultural at a time when factories and steel mills

were in fashion. So Turkey's gains from growth went largely into government enterprises — factories, steel mills, farm price supports — which failed to break even. A couple of bad harvests combined with recession after the Korean War, and Turkey was in trouble. The Government turned to deficit finance and the printing press to hold down the unemployment rate. It also had to reschedule foreign debts contracted during the boom. Economic and political problems mounted, leading to a brief military dictatorship. Order and stability were restored in the early 1960's, largely by stepped-up exports of labor to Western Europe.

(The need for speed perceived by the Turks in discarding the agricultural-development model is, however, easily understood. Population was rising from 2.5 percent to 3 percent per year. At the same time, the population was moving from the country to the cities. The largest Turkish city of Istanbul, formerly Constantinople, was doubling in size every 7 years, and is now over 4 million! We know what such urbanization requires in employment, housing, public services, and keeping the peace.)

But the decade of the 1960's was a good one for Turkey. Growth was again high and stable, even though much of the production was unprofitable, or required tariff protection to be salable. Remittances from Turkish workers abroad helped finance high growth while keeping Turkey's international payments in balance.

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Then came the oil shock of 1973, followed by the economic slow-down in Western Europe. The oil shock itself raised Turkish energy costs, since the country has few oil resources. The European slow-down reduced opportunities for Turkish workers abroad. These two forces taken together unbalanced Turkey's international accounts. When the Turkish Government turned again to deficits and inflation to keep up domestic employment, the workers abroad reduced their remittances still more, preferring rationally to keep their savings in German marks, Austrian schillings, or Swiss francs rather than Turkish liras.

Funds from abroad

Countries in such difficulties often apply to the International Monetary Fund (IMF) for assistance. The IMF usually makes its aid conditional. The IMF conditions usually include devaluing the domestic currency, balancing the government budget, lowering the growth rate of the money supply, and requiring public enterprises to pay their own way.

Turkey, however, did not want to "put its house in order" by such stringent conditions. The public enterprises, in particular, were being used to keep measured unemployment down by over-manning, and by subsidizing workers to stay on farms. They were also being used to conceal inflation by selling goods and services below cost. With no capital market, also, Turkey cannot finance its government and public-enterprise deficits except by selling bonds to the Central Bank, which pays for them by setting up government deposits (bank money) on its own books. To slow down mone-

tary growth would force the government and its auxiliaries to balance their budgets at high costs in "vote-fare" if not also in welfare.

Enter now Wall Street. The big international banks, not exclusively American, were getting deposits of recycled petro-dollars from the OPEC countries of the Middle East, on which they had contracted to pay interest. Payment of interest on petro-dollar deposits required new loans. When the Turks and other developing countries, fearing IMF "governessing", turned to Wall Street, the latter was willing and able to grant short-term credit without annoying conditions of the IMF type.

(Why, you may ask, did proverbially tight-fisted bankers treat the Turkish Government, or New York City, so much more leniently than they would have treated Joe's Shoeshine Parlor in similar circumstances? Partly, the riskiness of such loans made them more profitable. More important, the banks may have felt that something would turn up if loans of this type went sour. By "going sour" we mean falling due, with no funds for repayment of either principal or interest.)

Nonetheless, in 1978, Turkey eventually went to the IMF, and likewise to the OECD (Organization for Economic Cooperation and Development) to refinance its foreign debt. The IMF, as expected, imposed conditions. The Turks accepted the loans; as to the conditions, they promised compliance in the near future. The IMF claims the Turks did not fulfil their promises adequately, and has refused to provide the latest major instalment of the funds it had previously promised un-

less the Turks offer financial commitments in advance. The Turks refuse to do so, however, and there the dead-lock stands.

View from the Bosphorus

As Premier Ecevit's ruling Turkish Government coalition apparently sees the situation, the IMF conditions require higher unemployment, higher prices for public services, lower standards of living, retardation of measured growth, higher interest rates and lower imports — in short, stagflation. These, it fears, could lead to great unrest. Since the IMF and OECD want no such result, they may feel constrained to grant Turkish aid with less stringent conditions.

Of course the Turks may default on their private debt — not repudiate it, but postpone principal and interest payments indefinitely. But the Turks hesitate to follow this route, possibly because of the political consequences of the previous episode of this sort in

the late 1950's, and also because default is seen as a confession of mismanagement. Furthermore, if any large number of non-oil developing countries default on their oil-shock debts, the combined effect on the profitability of the large international banks would be a serious matter indeed.

All this in a country where most public enterprises were set up on a temporary basis by a "free enterprise" political party, and enjoined to act like private firms! Also in a country whose Central Bank is legally free to withhold financial support from the government deficit by refusing to purchase public securities! The only thing certain is that the paradoxes will continue.

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New Publication Available

Copies are now available of the 720-page **Mineral Resources in the Pacific Area**, a collection of 13 papers on the Pacific Basin's mineral resources and their relationship to global economics and politics. This report constitutes the proceedings of the Ninth Pacific Trade and Development Conference, held in August of 1977 at the Federal Reserve Bank of San Francisco.

Free copies of these **Proceedings** can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415)(544-2184). Note: copies of the Conference Summary and Abstracts of Papers (**Economic Review Supplement**, Fall 1977) are also still available.