Corruption row sparks financial storm in Turkey

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The decision by the Turkish government and central bank to float the lira is the latest twist in a political and economic crisis that has engulfed the country over the past four days.

In the first day of trading after the lira float, the currency lost 28 percent of its value against the US dollar, falling from 685,000 to the dollar to 962,500 and dropping to 1.02 million to the dollar at one stage during the session.

The devaluation, announced after a 12-hour meeting involving government leaders and central bank officials which finished in the early hours of Thursday morning, followed a day in which the stock market had plunged by 18 percent and overnight bank interest rates had spiraled to 7,500 per cent.

The decision to devalue and abandon the crawling peg, which tied the lira to a bundle of foreign currencies, has knocked aside a key pillar of the government's anti-inflation program developed in collaboration with the International Monetary Fund. It was forced on financial authorities after the Central Bank, earlier in the week, had spent $7.5 billion of its cash reserves—around one third of its total foreign assets—as foreign investors and Turkish banks sold off the lira to acquire dollars.

The crisis had its immediate origins in the heated clash between the prime minister, Bulent Ecevit, and the president, Ahmet Necdet Sezer, which took place at a meeting of the National Security Council on Monday. The meeting was called to discuss Turkey's negotiating strategy for joining the European Union, but, as the *Financial Times* reported, “they never managed to get that far.”

“The argument began when Mr Sezer opened the meeting by accusing the government of obstructing corruption investigations into the banking and energy sectors, rather than pursuing them wholeheartedly. He thrust a copy of the Turkish constitution at Mr Ecevit to prove he was acting within his powers.

“The prime minister reacted with fury, saying he was personally insulted. Husamettin Ozkan, the minister regarded as his right-hand man in the government, threw the constitution back at the president, according to Turkish reports, declaring: ‘We installed you, and we can remove you.' That was when Mr Ecevit stormed out, precipitating an immediate slump in the Istanbul stock exchange, and a record run on the foreign exchange reserves of the central bank.”

The clash has been described as “little children fighting amongst themselves.” But its roots lie deep in the political economy of Turkey. The corruption issue has come to the fore in the wake of government moves to privatise the state telecommunications utility, Turk Telekom, and liberalise the energy sector—part of its strategy to meet financial requirements of EU membership.

The issue of corruption reaches right into the heart of the Ecevit's coalition government, where his partners, especially the Motherland party, have derived considerable benefits from their control of the economy during long years in power. According to the *Financial Times*: “Opposition to the reforms has been growing not just in the ranks of the government and the bureaucracy but also from the business sector. Apart from those who believe in continued state control of the economy, there is a powerful ‘inflation lobby', accustomed to make its living from high interest rates and inefficiently awarded state tenders financed by runaway government spending.”

According to Ozdem Sanberk, the director of the Turkish Foundation for Economic and Social Studies, there are deep reasons for the crisis. “We are talking about overhauling national society in its entirety. But that is shaking the very structures of society and the people who use those structures," he told the *Financial Times*.

Not only does the devaluation represent a debacle for the government, it is a major blow to the "crisis management" credentials of the IMF, which organised a $7.5 billion bailout for Turkey in the midst of a similar financial storm last December.

A statement issued in Washington in the name of managing director Horst Kohler said that the IMF "supports the decision of the Turkish authorities to float the lira" and indicated that it would continue to disburse its loans according to schedule. But it warned that the devaluation involved "a revision of the macroeconomic framework for the economic program supported by the IMF." This is being interpreted to mean that with prices expected to rise sharply in the wake of the devaluation, the IMF will demand specific measures to combat inflation.

The newly installed US treasury secretary Paul O'Neill also indicated his support for the decision. "Turkey is an important ally and good friend of the United States," he said. "The United States continues to back the IMF's ongoing support for Turkey's economic reform program."

It is highly unlikely, however, that this backing will extend to agreement by the US for a further injection of IMF funds. Since taking office, O'Neill has made clear that he favours a less interventionist approach in financial crises than took place under the Clinton administration.

While global markets were reported to be generally stable, the Turkish crisis has again raised fears of a repeat of the turbulence sparked by the devaluation of the Thai baht in July 1997, the trigger for the so-called Asian financial crisis.

Even if the devaluation is able to calm financial markets, it will have far-reaching consequences in Turkey. The near 30 percent cut in the value of the lira will prove a major blow to Turkish banks that have debts in foreign currencies, possibly sending some into bankruptcy. The country's 80 banks are estimated to have $18 billion tied up in foreign currency deals.

According to a report issued by the Deutsche Bank: "The currency adjustment and the losses accrued over the past weeks on the securities portfolio could cause even some large banks to face very serious problems."

The devaluation will also blow a hole in the government's budget and it could face major political problems as a result of inflation.

According to Kamil Yilmaz, an economics professor quoted in the *New York Times*: "Working people and fixed-income people have really suffered under the inflation-fighting program and now they are going to suffer more. They have lost confidence in the government."