Embassy of the Republic of Turkey

Turkey's Financial Crisis: How Will It Shake Out?

Prospects for the Turkish economy, which has been in crisis since November 1999, are hostage to a host of contingencies. Turkey joins Brazil and Argentina in a state of economic crisis at a time of global uncertainty. If these crises signal the beginning of an extended downturn in the world economy, the outlook for Turkey's economy is bleak. On the other hand, if the world economy turns around and Turkey's economy recovers, the crisis may provide policy makers with the political capital to make key structural reforms that would benefit the economy in the long run.

The situation in Turkey raises some important issues and concerns regarding short- and long-term implications for U.S. agricultural exporters. Because Turkey is a sizable market for certain U.S. agricultural goods, the ongoing financial crisis may affect U.S exports. In the short run, U.S. exports should decline as the crisis shrinks demand, while the *lira's* drastic fall makes imports relatively more expensive. Longrun impacts of Turkey's problems may be mixed, depending not only on whether its economy recovers, but also on whether needed structural reforms in agriculture are implemented.

The U.S. is a major player here. In 2000, the U.S. exported $585 million in agricultural products to Turkey. Major U.S. agricultural exports include cotton, corn, soybean products, and rice, which together amount to between 2 and 11 percent of total U.S. exports for those commodities, generating up to $200 million in revenue. U.S. products accounted for the second-largest share of total agricultural imports into the country, behind the European Union (EU).

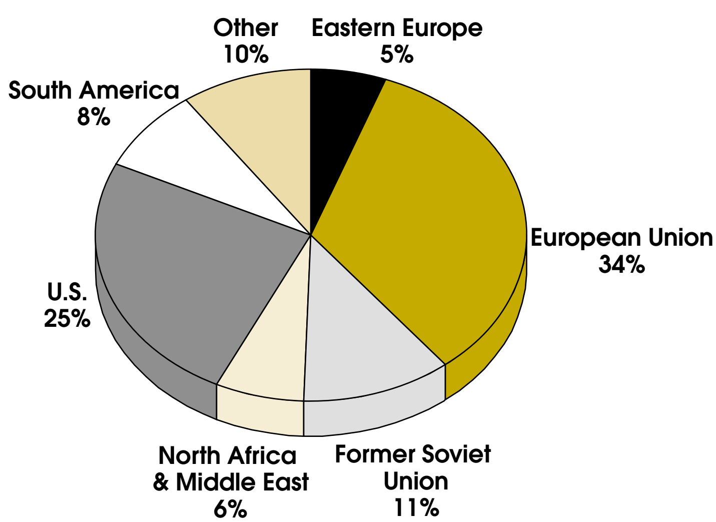
Cereals were Turkey's largest agricultural import in 2001 (approximately $418 million), 30 percent of which came from the U.S. ($113 million).

Turkey occupies a strategic location in the Middle East; keeping its economy afloat is a high priority for the U.S. and the EU. Because the strategic stakes are high, some doubt whether the International Monetary Fund (IMF) can persuade Turkey to implement a carrot-and-stick rescue plan that ties IMF assistance to a program of reform. There are fears the IMF will ultimately rescue Turkey, whether or not Turkey follows through with reform. However, if the IMF reforms are successfully adopted, Turkey's agricultural sector will see measurable structural changes.

Crisis Rattles The Financial Sector

Since November, the Turkish economy has been hit twice by economic crises, each triggered by financial rumors and political concerns. The first crisis, sparked in November 2000 when the government

Among Turkey's Agricultural Suppliers, U.S. Ranked a Sizable Second in 1999



Percentages may not add to 100 due to rounding.

Economic Research Service, USDA

announced plans to investigate 10 banks, significantly reduced investor confidence, driving up interest rates to an annualized 2,000 percent in December. Investors switched out of *lira*-based assets, causing a severe shortage of short-term credit, exacerbating the situation.

Just as recovery seemed imminent, a crisis yet more damaging swept through the nation's troubled financial markets. In February, a public rift between Prime Minister Ecevit and President Sezer unnerved sensitive financial markets, triggering a second short-term credit crunch and the loss of billions of dollars in foreign exchange reserves (generally used by the central bank to defend the *lira*). Turkey was forced to abandon its crawling peg currency regime (where the *lira*'s value was allowed to fluctuate between a predetermined band that grew with inflation) and float the *lira*. Since then, the Turkish *lira* has been floating freely, and has lost over 80 percent of its value.

The recent problems in Argentina (*AO* September 2001), as well as political squabbling over reforms suggested by the IMF, have generated further instability in Turkey's financial markets. Nevertheless, recovery is still possible; some crucial reforms have already been implemented, and, with the promise of emergency loans from the IMF, foreign exchange reserves have begun to recover.

The overall effects of the financial crisis on agricultural trade will result from devaluation of the Turkish *lira*, the short-term contraction of the economy, and potential structural and trade policy reforms that the international community may attach to offers of multi- and bilateral bailout packages. Currency devaluation and reduced income levels will combine to shift Turkey's trade balance in favor of exports rather than imports. Domestic prices for imports will rise at the same time the economic contraction reduces purchasing power. Meanwhile, currency depreciation will stimulate domestic agricultural output as Turkey's prices drop relative to those of trade competitors. This stimulus to Turkey's agricultural exports, which include fruits and vegetables, tobacco and wheat, should absorb some or all of the drop in demand due to the fall in incomes.

U.S. Provided Most of Turkey's Imports of Corn, Soybeans, and Meal in 1999

Commodity	U.S. export value	U.S. share of Turkey's imports	Turkey's share of U.S. exports
	$ million	*Percent*	
Cotton	209	12	11
Corn	87	77	2
Soybeans and meal	54	72	1
Rice	35	29	5

Marketing-year 2000 for exports, marketing-year 1999 for imports.
Economic Research Service, USDA

The incentive driving Turkey's reform program is a new $15.7-billion IMF rescue package, designed to help service Turkey's debt and restructure its financial sector. The IMF support requires Turkey to cut spending, accelerate privatization, and totally overhaul the financial services sectors. Whether the reform program, entitled "Turkey's Transition Plan to a Strong Economy," will actually be implemented is questionable, given that the government has failed to implement IMF-sponsored reform programs on two previous occasions. However, in a show of good faith, Turkey recently pushed several banking-sector reforms through the legislature. The IMF rewarded the move by releasing $1.5 billion of the rescue package.

Longer term structural changes that will accompany the IMF/World Bank stabilization program may feature significant reforms of the agriculture sector. If implemented, these reforms may spawn two fundamental changes in Turkish agriculture: the levels and types of agricultural products consumed and produced in Turkey, and import and export tariffs associated with agricultural goods. Both changes could positively affect U.S. producers, particularly producers of tobacco, feed grains, oilseeds and meal, cotton and rice. How quickly Turkey is able to recover from the crisis, as well as to effectively implement the longer term reforms, will largely determine if and how the impact will be felt in U.S. markets.

Optimism in The Long Term?

Despite near-term gloom, structural changes in Turkey's agricultural sector could still have a positive effect on future U.S. agricultural exports to Turkey. These changes, embedded in the IMF/World Bank stabilization program for Turkey, will in part focus on the costly system of agricultural support policies.

Turkey's farm subsidies presently amount to 2.5 percent of the economy, a large share when compared with the U.S., where farm subsidies amount to approximately 0.27 percent of GDP, or with Russia, where farm supports are about 0.28 percent of GDP. Turkey's burdensome subsidization of agriculture has led the IMF and World Bank to push for a reform policy to accompany the economic stabilization program.

Until now, costly government intervention measures in the agricultural sector have included high import and export tariffs, nontariff barriers, export subsidies, high support prices, and a large role for state trading enterprises. High price supports exist principally for several varieties of wheat, rye, and barley. But livestock, meat, dairy, poultry and eggs, and certain grains are all subject to significant support or protection by the Turkish government. Measures of trade protection include high tariffs on imports that compete with domestic production; strict interpretation of sanitary and phytosanitary requirements; various restrictions on, or refusal to grant, import licenses; and preferences for imports from countries with bilateral trade agreements. The U.S. has no bilateral agreements with Turkey for agricultural products.

A condition of the IMF's rescue package is to implement a number of structural reforms under the guidance and funding of the World Bank. These policy changes will accompany a specific $600-million agricultural reform loan to support the World Bank's Agricultural Reform Implementation Project (ARIP). The objective of the project is to help the government reduce artificial incentives, government

Trade Restrictions Imposed by Turkey Were Costly to U.S. Exporters in 1999

Commodity	Tariff restriction	Nontariff restriction	Estimated trade impact
Feeder cattle and beef	N/A	Import restrictions ensure that only breeder cattle can be imported, under strictly controlled conditions	$20 million annually for next 5 years
Poultry	65% duty	Sanitary and phytosanitary requirement (SPS): foreign processing facilities must be physically inspected and authorized by Turkish officials at importer's expense	$20 million annually
Corn, barley, sorghum	Seasonal high tariffs: barley 85%, corn/sorghum 50%	Restriction on corn imports by private traders Livestock import ban limits feed demand	$100 million annually (corn) $20 million annually (sorghum/barley)
Soybeans and meal	0% on soybeans, 2% on soybean meal	N/A	N/A
Rice	High tariffs; milled rice 35%, paddy rice 27%	Periodic ban on import licenses to protect local production Zero tolerance of white-tip nematode for paddy rice	$50 million annually N/A
Cotton	0% tariffs	0% tariffs	N/A

Trade impact figures are estimates and include losses and expenses of meeting requirements.
Source: Foreign Agricultural Service, USDA.

Economic Research Service, USDA

subsidies, and the state's role in marketing agricultural products.

The project also calls for direct income support for producers, including funds to help producers make the transition to new sources of agricultural revenue as governmental support is reduced. This means that the government will allocate a one-time payment to farmers who move away from crops that are currently in oversupply because of high support prices. Farmers who instead begin production of more marketable crops will be reimbursed for input costs associated with planting new crops. Some recommended replacement crops include maize, soybean, sunflower, beans and vegetables, and medicinal plants. It is hoped that the ARIP will encourage producers to increase productivity in response to market signals rather than artificial support prices and subsidies—which are expected to be gradually phased out.

Conditions attached to the World Bank loan will introduce a link between support prices and relevant world market prices and will initiate a phaseout of government subsidies for support prices by 2002. In theory, support prices for grains will be linked to appropriate world reference prices and will be set at levels that reduce the premium over these world prices to no more than 35 percent. Import tariffs on grains may be reduced as well, including a potential reduction on import duties for corn from 50 to 25 percent. Turkey may also reduce the premium paid on oilseeds and cotton, as well as reform the pricing mechanisms for sugar beets. There are no indications, at the moment, that nontariff border measures supporting the livestock sector (mainly veterinary restrictions) will be reduced.

If implemented as agreed upon with the IMF and other lenders, these structural changes would liberalize trade to some degree in the longer term, allowing U.S. agricultural products—particularly grain imports—more market access. However, Turkey's political barriers to liberalizing trade and removing key agricultural sector supports appear formidable.

While the IMF and World Bank continue to pressure Turkey to decrease subsidies such as support prices for grain, Turkey's ongoing financial problems this year have delayed the agricultural reform efforts. In fact, a recent decision of Turkey's Council of Ministers will extend many of the low-interest agricultural loans and other subsidies at least through the end of 2001, and possibly beyond. In July, the Minister of Agriculture rejected IMF recommendations that import duties be substantially lowered. Furthermore, while support prices for grains were lowered in May, they were about 15 percent higher than the IMF's recommended targets as of August.

Consumer expectations in Turkey are low. Only 15 percent of Turks feel that the crisis will be over in the next 6 months, signifying that consumer caution is likely to last longer than many observers expect.

Because the government will need to undertake costly and socially unpopular debt restructuring programs, the economic projections for 2002 are not overly optimistic—and the risks of political instability are rising. The most recent economic turmoil is also likely to cause considerable delay in Turkey's accession into EU membership.

However, given Turkey's geopolitical significance as a member of NATO—and its location at the crossroads of Europe and the oil-rich Middle East and southern flank of the former Soviet Union—the strategic interests of both the EU and the U.S. dictate that its economy cannot be allowed to collapse. The new IMF $15.7-billion international rescue package for Turkey and a $16-billion pledge from the U.S. made in December 2000, together represents a significant commitment on the part of the international financial community to support Turkey's economic recovery. AO

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