# An Assessment of the IMF Stabilization Programs for Developing Countries

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### *Introduction*

This paper examines how successful IMF-supported adjustment programs are. It mainly studies the effects on Turkey, Argentina and South Korea. This paper is divided into three parts. The first part evaluates the purposes of the IMF-supported adjustment programs in general. According to the IMF, the goals of these programs are to restore "sustainable economic growth." The second part studies the IMF Standby Agreements made with Argentina and their impact on the public sector, trade, the finance sector, and the labor market. The third part explores the effects of the IMF's programs on South Korea's macroeconomic balances. Finally, the paper offers a number of recommendations and assesses the overall effect of the IMF programs on Turkey in particular and on developing countries in general.

## What are the Main Goals of the IMF-supported Adjustment Programs?

When the IMF was founded in 1944, it was assumed on fundamental insights of Keynesianism. After the Second World War, the IMF's main goal was to help prevent another worldwide depression like that of the 1930s. That depression was caused by a liquidity failure. The IMF was intended to counter this by lending money to some countries and pressuring others to pursue more expansionary policies. However, the IMF's policy against the debtor countries changed after the collapse of Bretton Wood's system. The 1980s were marked by severe strains in the international economy. External financing slowed to a trickle for many countries while primary commodity prices dropped sharply. Thus, most of the developing countries had balance of payments problems and that as a result the IMF lending rose to unprecedented levels during the late 1980s.

Moreover, conditions in the countries borrowing from the IMF were unusually weak: fiscal and external imbalances were large; output was often falling, inflation was high. Concerned above all the avoid inflation, budget deficits and trade deficits, governments kept interest rates high, spending low, and exports out. These circumstances posed considerable challenges on the fundamentals of the IMF adjustment programs and the IMF's programs dependent on supply-side policies instead of Keynesianism. The purposes of these programs are to secure immediate improvements in external finances as part of the process of establishing conditions for greater efficiency, saving, investment and growth, over the long term. Nevertheless, these policies drastically reduced economic activity.

The new crew of IMF are what Stiglitz calls "market fundamentalists" economists with one prescription for all problems: privatize, stabilize and liberalize (1). Thus supply-side policies aimed at bolstering growth -such as reducing the role of the government and opening the economy to external competition- became an important part of conditionality (2). Condionality had to be pushed beyond the traditional reliance on demand restraint. In order to receive structural adjustment loans, debtor countries had to agree to undergo structural adjustment programs, which were apparently designed to make their economies more efficient and better capable of sustained growth. The conditions usually attached to structural adjustment loans included (3):

- • Removing restrictions on foreign investments in local industry, banks and other financial services. Thus, local industry or banks could not be protected against giant foreign intervention.
- • Cutting tariffs, quotas and other restrictions on imports.
- • Devaluing the local currency against hard currencies such as the US dollar in order to make exports still more competitive.
- • Privatizing state enterprises, thereby providing further access for foreign capital.
- • Reducing wages or wage increases to make exports more competitive. Radically reducing government spending, including spending on health, education and welfare combined with wage reduction would control inflation and ensure that all available money would be channeled into increasing production for export.

- • Undertaking a deregulation program to free export oriented corporations from government controls that protect labor, the environment and natural resources, thereby cutting costs and further increasing export competitiveness.
- • Reorienting the economy toward exports in order to earn the foreign exchange required for servicing the debt and to become correspondingly more dependent on the global economy. The effect was to reduce self-sufficiency and diverse local production in favor of single product manufacture or single crop agriculture.

The IMF demands high interest rates, high exchange rates and budgetary strictness, i.e. reducing spending on food subsidies, education, public health on other social services. Growth and employment may well suffer, but this is necessary in order to maintain the confidence of international lenders. For developing countries, these policies brought an unacceptably deep depression of domestic demand. Also, conditionality began to focus more on the sustainability of policies over the medium term. Because of the lack of institutional infrastructure-property law, regulatory regimes a banking system, a healthy and literature population and social safety net, market economy cannot flourish. Without competition policies in place, privatization may simply substitute private monopolies for public ones; and without new jobs for displaced workers to move into, privatization may cause increased unemployment and political instability. Since structural adjustment programs covered so many dimensions of economic policy, agreeing to structural adjustment programs, debtor countries meant turning over these countries economic control to the IMF. According to Stiglitz, the IMF usually ignores these qualifications and insists that privatization process as widely and rapidly as possible (4). Stiglitz believes that premature capital market, liberalization is the most damaging of the IMF's many misguided policies. (5)

A number of comprehensive studies, including one conducted by the IMF itself, admits these programs did not achieve their goal of stimulating growth. IMF economist Kohen compared countries that underwent stabilization and adjustment programs, and he found that economic growth was higher in the latter than in the former. (6)

## The Argentinean Crisis (1985-2002) and Structural Adjustment Programs

International lending by the IMF to developing countries provides some gains from intertemporal trade and risk diversification. But there are also periodic international crises. In a financial crisis, the borrowing country experiences difficulties in servicing its debts, and it is often in defaults, than is, fails to make payments as specified in the debt arrangements. The IMF cut back new lending as the borrowers viewed as too risky. For instance, with the $155 billion debt and collapsing of the Argentina peso, the resolution of the Argentinean crisis will be far more complex than earlier episodes (7). It has occurred as a combination of banking currency and debt crisis. Most of the Argentines have not been lost to trust in the banks and the peso.

### *Economic Indicators*

The reasons for the failure of economic situation even with the IMF's stabilization programs are discussed below. Especially after 1980's export market orientation programs deviated from import basic philosophies as Keynes' approach and the efficiency of government on economy in 1944's. After 1980, the IMF proposed tight prescriptions which can be summarized as liberalization, privatization, deregulation and smaller public sector. In Argentina, all these proposals adapted, but the government became bigger instead of getting smaller.

Since March 1990, there was a short-term monetarist approach program. The inflation was decreased to 11% in April 1991 while it was 95% in March 1990. The target was to decrease it by 10% for each month, on this short-term program which was the combination of tight monetary and fiscal policies (8). On the other hand, Argentina's economy did not grow up in 1990. The convertibility plan was on by the April 1991. This plan: (9)

- • erased the subventions
- • erased the exemptions of VAT
- • increased the taxes
- • brought limitation on the public wages and new employment
- • brought A new law which forbids governments to signage without any source.

The federal government ran modesty deficits throughout the mid-1990. Adjusting for the cycle, the Federal government's fiscal position deteriorated steadily during the boom years, although this partly reflected a recognition of unfounded pension liabilities. This situation is shown clearly on the table below.

While the inflation was 389% as an average in 1980-1990 time period, it became 13% in 1990-1997. Between 1990-1997, the adjustment program was successful at reining in inflation and balancing the budget. However, this was achieved at the expense of the poor and working class and the poor in general, who have seen their standard of living fall over the past decade as wealth has become more concentrated. But, the economic slowdown in most Latin American countries since 1999 also affected Argentina. Especially by this year, the debts were increased and low growth rate had been occurred because of the problems of short-term debts, budget deficit, and the hard finding new external sources. On the other hand, unstable domestic policies were also effective. Finally, the interest rates increased and the capital escapes became faster. (10). GDP was 38.84% in 1991, and climbed to 64.1% in 2001.

Table: 1 Argentina Selected Economic Indicators

| Years | Real GDP | Consumer Price | Consolidated Dept /GDP | Overall Bal. Inca of bud. |
|---|---|---|---|---|
| 1991 | 10,5 | 67,44 | 38,8 | -3,5 |
| 1992 | 10,3 | 84 | 32,9 | -0,5 |
| 1993 | 5,7 | 93 | 32,8 | -0,3 |
| 1994 | 5,8 | 97 | 35,1 | -1,9 |
| 1995 | -2,8 | 100 | 39,2 | -3,1 |
| 1996 | 5,5 | 100 | 39,8 | -3,6 |
| 1997 | 8,1 | 101 | 38,1 | -2,4 |
| 1998 | 3,8 | 102 | 41,3 | -2,5 |
| 1999 | -3,4 | 101 | 47,4 | -4,7 |
| 2000 | -0,5 | 100 | 50,8 | -3,6 |
| 2001 | -4,5 | 99 | 64,1 | -6,4 |

*Source*: IMF Country Report, Argentina (1991-2001).

Table: 2 Consolidated Debt, Tax, and Social Security (in percent of GDP)

| Years | Consolidated debt | Tax | Social Security |
|---|---|---|---|
| 1991 | 38,8 | 13,6 | 4,6 |
| 1992 | 32,9 | 16,2 | 5,1 |
| 1993 | 32,8 | 16,1 | 5,9 |
| 1994 | 35,1 | 16,2 | 5,7 |
| 1995 | 39,2 | 15,6 | 5,3 |
| 1996 | 39,8 | 15,8 | 4,4 |
| 1997 | 38,1 | 16,8 | 4,2 |
| 1998 | 41,3 | 17,4 | 4 |
| 1999 | 47,4 | 17,5 | 3,8 |
| 2000 | 50,8 | 18,1 | 3,7 |
| 2001 | 64,1 | 17,5 | 3,6 |

*Source*: IMF Country Report, Argentina (1991-2001)

***Social Indicators***

Argentina is seeking as much as $20 billion in emergency loans from the IMF to rebuild banks and provide social services to about 14 million Argentines living under the poverty line. One facet of the problems in the public finances was the mounting differential between the wages and salaries paid by the federal government and those in the private sector. In 1994, the average Federal employee was paid 25% more than the average private sector employee; by the employee; by 1998 the differential had risen to 45%. (11) While the number of public employee were 1801 thousands in 1990 increased to 1815 thousand in 2001 and the number of federal government quantities were 694 thousands in 1990 decreased to 462 thousands. In the time period by the new finished labor contracts, the unemployment rate increased and that caused to social chaos. Besides the total rate of wages in GDP did not change, in federal sides while it was 2,97 in 1991, became 2,91 in 2001 and thus caused to the continual decline in workers' purchasing power between 1991 and 2001 (8).

Table: 3 Social Indicators: Wages and Federal Pensions (in percent of GDP)

| Years | Total Wages | Federal Pensions | Provinces |
|---|---|---|---|
| 1991 | 7,63 | 2,97 | 4,66 |
| 1992 | 7,98 | 2,7 | 5,28 |
| 1993 | 8,82 | 2,83 | 5,99 |
| 1994 | 8,89 | 3,03 | 5,86 |
| 1995 | 8,87 | 3,01 | 5,86 |
| 1996 | 8,35 | 2,93 | 5,42 |
| 1997 | 8,25 | 2,91 | 5,34 |
| 1998 | 8,33 | 2,7 | 5,63 |
| 1999 | 9,39 | 3,02 | 6,37 |
| 2000 | 9,47 | 2,96 | 6,51 |
| 2001 | 9,87 | 2,91 | 6,96 |

*Source*: IMF Country Report, Argentina (1991-2001).

Table: 4 Public Sector Workers, (in thousands)

| Years | General Government | Federal | Provinces |
|---|---|---|---|
| 1990 | 1,801 | 694 | 1,108 |
| 1991 | 1,753 | 646 | 1,106 |
| 1992 | 1,675 | 556 | 1,119 |
| 1993 | 1,608 | 500 | 1,108 |
| 1994 | 1,629 | 515 | 1,114 |
| 1995 | 1,653 | 518 | 1,135 |
| 1996 | 1,72 | 496 | 1,223 |
| 1997 | 1,731 | 482 | 1,249 |
| 1998 | 1,739 | 465 | 1,273 |
| 1999 | 1,78 | 462 | 1,318 |
| 2000 | 1,815 | 462 | 1,353 |
| 2001 | 1,815 | 462 | 1,353 |

*Source*: IMF Country Report, Argentina (1991-2001)

According to the IMF, the purpose of a structural adjustment program is to restore "sustainable economic growth" and make lasting progress in alleviating poverty. If these are truly the goals of adjustment, the economic and social indicators show it has not worked. Adjustment in Argentina was undertaken too quickly and drastically. The program has not been mortified in response to the social, economic and environmental problems that have emerged. The IMF officials continue to insist that the beneficial effect of adjustment on poverty will take time, but, after more than a decade of adjustment in Argentina, there is still no light at the end of the tunnel.

## The South Korean Crisis and Structural Adjustment Programs

The South Korean crisis took most observers by surprise because in the early and mid-1990's, foreign investors looked favorably at South Korea. In South Korea, macroeconomic policies were solid. The government had fiscal budget with surplus or small deficit; steady monetary policies kept inflation low, and trade policies were outward-oriented. However, the financial sectors in the South Korea like the other "developing Asia," did not evolve in parallel with economic performance. The financial sector in The South Korea has major structural weaknesses.

Starting in Thailand in 1996, crisis spread to a number of other Asian countries, especially to South Korea in the second half of 1997. In South Korea, much of the foreign borrowing was by banks and other financial institutions. The banks took on significant exchange rate risk by borrowing dollars and yen and lending in local currency. And the lending boom led to loans to riskier local borrowers and rising defaults on loans. In South Korea, much of the foreign borrowing was by private non-financial firms, which took on the exchange rate risk directly. Foreign investors lost confidence in local banks borrowers and the local stock markets. In the far east crises in 1997, the exchange rate against US dollar was settled free, by the devaluation on the exchange market, the stock markets fall down, the similar specifications of Korean as other Asian economies (13).

Korea was effected hardly from this crisis for the reasons below:

- too weakness of financial sectors
- too high reactions of international financial markets
- problems on exportations
- weak economic policies
- high rates of short-term debts on reserves
- extensive government involvement investment allocation decisions
- underdeveloped and underregulated stock markets
- crony capitalism
- corruption in bank operations

In response, the IMF organized a new structural adjustment program, with commitments to lend up to $27 billion to South Korea.

Table: 5 Korea: Selected Economic Indicators I (1995-1998)

| Variables | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|
| Real GDP | 8,9 | 7,1 | 6 | 2,5 |
| Consumer Price | 4,7 | 4,9 | 4,2 | 5,2 |
| Budget Deficit | 0,3 | 0,3 | -0,5 | 0,2 |
| Current Account Balance | -8,9 | -23,7 | 13,8 | 2,3 |
| External Dept | 7,4 | 104,7 | 101,5 | 126,8 |

*Source*: http\\www.imf.org/new/relegses

As a result of 1997 crises, Korean Won devaluated almost 80% and Korea signed a standby supported by the IMF. These programs were largely based on structural and financial reforms including competition, government policies, trade regimes. In December 1997, South Korea got 15,5 billion SDR (around $21 billion) external source by this signed standby agreement.

The main targets of the program, was to increase the occultation of growth decreasing the defenses of export-import by using hard monetary and fiscal policies and to control the inflation. The financial markets must be well organized and more transparent. However, the IMF tried to realize Korea situation since August 2001.

Table: 6 Korea: Selected Economic Indicators II (1998-2002)

| Years | Real GDP (Percent change) | Consumer Price | Unemployment rate | Current Account Bal. (in percent of GDP) |
|---|---|---|---|---|
| 1998 | -6,7 | 7,5 | 6,8 | 12,7 |
| 1999 | 10,9 | 0,8 | 6,3 | 6.0 |
| 2000 | 8,8 | 2,3 | 4,1 | 2,4 |
| 2001 | 2,9 | 4,1 | 3,4 | 2,6 |
| 2002 | 4.0 | 2,2 | _ | 1,4 |

*Source*: www.imf.org/external /np/sec/pn/2002

Strides were also made in strengthening the financial system in 2001. Commercial banks have reduced their impaired loans as a share of total bank loans to 3,4% at end December, from 9% at end-2000, and profitability, loan-loss provisioning and capital positions have improved for most banks. Consolidation also continued with the launch of private financial holding company and the creation of the largest commercial bank in Korea through private merger. However, progress has been slow in rehabilitating and privatizing the nationalized financial institutions.

Directors commended the Bank of Korea (BOK) for appropriately cutting interest rates in the second half of 2001, and for successfully balancing the need to cement the credibility of the inflation targeting framework and the need to support the weak economy. Although the easing cycle may have reached its end, Directors noted that, with subdued inflation and a negative output gap, monetary policy still has room for maneuver in the event of renewed weakness in the economy. In this regard, they welcomed the BOK's decision to maintain last year's inflation target range for 2002, pending the switch as soon as feasible to only a medium-term inflation target. Directors also welcomed the greater flexibility in the exchange rate, and encouraged the authorities to continue to limit intervention in the foreign exchange market to instances of exceptionally disorderly trading and to avoid any attempt to hold the won exchange rate constant against any single currency (14).

According to latest macroeconomic indicators in 2001, growth is estimated to have slowed to 2,9% down from 9% in the previous year. Although Korea was hit hard by the global downturn in information technology and slower growth in major trading partners, its economy has suffered less than other export-dependent Asian countries, largely on account of its relatively diversified export structure and steady consumer spending. After peaking in May, headline CPI inflation has fallen steadily reaching 3,2% in December. Although core inflation in 2001 exceeded by small margin the upper bound of the 2-4% (period average) target range set by the Bank of Korea (BOK), it is projected to decline further this year as a result of subdued wage and demand pressures and the large output gap. The external position remains healthy. The current account surplus is estimated at $10,5 billion (2,5 percent of GDP) in 2001, unchanged from the previous year, with the impact of slower export volume growth and sharply lower semiconductor prices offset by lower import volumes and oil prices.

In an effort to support domestic demand, macroeconomic policy has shifted to a more expansionary stance. The BOK cut its overnight call rate target by a total of 100 basis points in the third quarter of 2001 to a historic low of 4%, including a 50 basis points on September 19 in its first ever inter-meeting cut. Fiscal policy however, provided no stimulus, with an estimated consolidated central government surplus of 1,7% of GDP in 2001, up from surplus of 1% of GDP in 2000. (15)

## The Turkish Crisis and Structural Adjustment Programs

Turkey has always been troubled by the problems in macroeconomic balances in her strife for globalization since 1980s. While the discussions concerning the crisis in 1994 arising out of deficits in the balance of payments and the possible effects of the 1997 Asian crisis on Turkey were underway, a complete crisis emerged in Turkey in late 2000 and early 2001. In this framework, we can contemplate over the reasons of the crisis in Turkey under three headings:

- • First, early action of government after 1980s on liberalization of capital movements before perfecting the (economic and legal) infrastructure;
- • Second, the external and domestic borrowing policies misguided as a consequence of the balance of payments deficits or the debt crises, which are, in turn, caused by the current transactions balance disrupted by fiscal expansion and consequently extremely appreciated exchange rates due to populist policies of the past years; or the exchange rate policies aimed at ensuring inflow of liquid money, in sum the structural reasons; and
- • Third, the fact that supply-side policies were seen as the only remedy.

### *1. Urgent Liberalization Concerning Capital Flows and Liquid Money Policies*

For more than 25 years, high inflation has damaged the performance of Turkish economy in different ways. Instability of economic growth trend due to high increases or decreases of inflation, and socioeconomic impacts arising out of disrupted income distribution are the main damages. Inflation has led to loss of confidence in the Turkish Lira; high and unstable interest rates have increased speculation and arbitration; and globalization of international markets and technological innovations have increased the flow of liquid money into and out of

Turkey. Turkey has implemented liberalization policies since 1980. As a consequence of international financial liberalization, the interest rates have come under international monetary movements. Turkey has started to feel the effects of it in 1992-1993. When the treasury bonds brought more than 30% real interest, the private sector preferred the financial investments to the activities which would create employment. When the interest rates of the banks on loans increased significantly, the loan process disrupted and the companies faced with the problems of limited external capital. On the other hand, public fiscal position became unstable due to high interest rates and weak financial position. The public sector debt including the unaccounted losses of the public banks was 44% of the GNP in 1998, increasing to 58% by the end of 1999 (16). This has undermined the confidence of international financial markets in Turkey. In the period up to the Asian crises, the IMF and the World Bank have forced the developing countries to liberalize their capital movements, owing also to the pressures by financial agencies. Yet, complete liberalization of the capital account has worsen the problems especially in the developing countries with a weak democratic practice, i.e. without accountability and openness practices, such as Turkey. Failed to achieve desired targets in tax collection, the governments have obtained all the available loans, trying to save the day through short term capital inflows; and current weak democratic practices have led to abuses, aggravating the situation and initiating crises. For instance, the military expenditures which account for 4,5% of the GNP and for which no accountability is required are very high compared to the European standards (17).

Consequently, high inflation, high interest rates, and unstable growth have increased the poverty of the people and disrupted the social equilibrium.

High interest rates provoked by the public loan demand and by real growth have, together with the slow devaluation rates in the same period, accelerated the inflow of speculative liquid money to Turkey. What were decisive on capital demands were not the long-term productive investments, but the short-term speculations. High interest rates have led to inflation, stagnation, increase in unemployment rates, and disruption of income distribution.

### *2. Effects of the Foreign Exchange Policy Implemented*

The Central Bank has been pursuing a managed floating exchange policy since 1994. In this system based on a foreign currency basket, the Central Bank would try to keep the devaluation closed to inflation to avoid any further disruption on the foreign trade balance, and would interfere with the foreign currency market to devalue the exchange rates so as to ensure an increase in parallel to the inflation. The Central Bank would not inform the financial markets of its target values concerning the foreign exchange rates, and the markets had to predict these targets.

Turkey launched a new program to decrease the inflation under the supervision of the IMF at the beginning of 2000. The primary target of the program was to decrease inflation by using foreign currency and wage baskets. In another words, the increases in currency rates and wages were planned beforehand in accordance with the targeted inflation rate. The suggestion was that the inflation would decrease to 20%, and accordingly foreign currency basket increase was targeted to be 20%, and the wage increase 25%. The interest rates would be determined in compliance with the market conditions. With this program, a devolution strategy which was announced for each day one year before and which was slowed down continually in 3-month periods was pursued. In this system, the Central Bank was under the obligation of buying or selling Dollars in amounts demanded by the market and at TL/Dollar rates determined by it in line with the foreign currency basket announced beforehand and with the internationally applicable Dollar/Euro parities. Starting from July 2001, the currency rates would be determined freely within the specified limits, which would be broadened in 6-month intervals. The purpose of choosing this system was to support the other policies against inflation by using the effects of devaluation on inflation.

In the first half of the year, the effects of the foreign exchange policy change on the inflation appeared, and the inflation started to decrease compared to previous years (18). However, in the second half of 2000, it became clear that things were not as expected. Inflation was going down more slowly than targeted, but the currency baskets were still being implemented as it was. The appreciation of the Turkish Lira stared and the foreign exchange policy was, in effect, transformed into a sort of fixed foreign exchange system. Exports decreased while imports significantly increased; and the foreign trade deficit rose to $21 billion in October.

Dornbush defined the road to crisis as follows: “A stability which depends on foreign exchange rates undergoes into three phases. The first phase is useful; the stability of the exchange rates ensures an overall stability in economy. In the second phase, reel appreciation of money is obvious, becoming clearer in each day, any interference with this situation is not favored. In the third and final phase, it is too late to do something. The real appreciation of money (and other conditions) requires devaluation at a high rate. However, the politics will not allow this. Time passes for a while more by refusing to accept the situation … and then … the bad news comes together, and currency crises begins" (19).

As expected, there was a crisis of rush to foreign currency, and $7 billion went out of Turkey in late November and early December. This problem could be prevented by obtaining an additional loan of $10 billion from the IMF, and by increasing the interest rates significantly. However, the disturbance of markets could not be alleviated since serious warning signals from the public were paid attention to. In the November crisis, the IMF, too, demanded the exchange rates be determined freely within certain limits, i.e. devaluation. Yet, as predicted by Dornbush, politicians and bureaucrats rejected the IMF proposal, knowing that they would suffer from a credibility loss in case of devaluation. Was a limited and controlled devaluation possible even in November? It is really difficult to answer this question (20).

In February 2001, an intensive flow of capital out of country and financial crises stared due to a disagreement among the top ranking staff of the government. This crisis, too, caused a new program be formulated under the supervision of the IMF. This time, however, no exchange rate targets were specified, and it was declared that inflation targets would be determined in the following months. Yet, this new program has not managed to secure the confidence by all of the relevant groups. In the pre-crisis period, the government failed to pay attention to the economists' warning that the Turkish Lira appreciated by 15%; and now the Turkish Lira has depreciated by 55% due to present chaotic situation. Almost one year has passed since the start of the crisis. But, let alone any signs of recovery, it is underway under aggravated conditions, and its effects are increasingly becoming obvious in macroeconomic signals.

***3. Structural Reasons***

The inflation, which has been underway for more than 25 years in Turkey, has brought with a high interest rate policy, too. In particular, the public sector's policy of selling treasury to obtain domestic loans has caused, through crowding-out effects, the flow of resources not to the private sector, but to the government, thereby making the State bigger. The web of friends and acquaintances called "crony capitalism," bribery, corruption, untaxed economy, non-transparent administration have brought the discussions of the restructuring of the public sector into agenda since 1980s. However, neither restructuring and nor privatization attempts have produced desired results. Although desired structural changes have not been realized even with the new laws passed upon the pressures by the IMF. In particular, the new regulations concerning the financial sector were not implemented on time. On other hand, the current structure called the "moral hazard" encourages the financial agencies to obtain loans based on foreign currencies. Moreover, in spite of the Central Bank's rule that the banking systems can keep their own resources at a deficit position rate of 10%, this rate exceeded 200% in September 2001 (21). The banks officially declared that they had closed their deficits, however obtaining loans which accounted for up to two times their capitals by making agreements with the holding companies and affiliated companies.

***4. Ignoring the Problem of Insufficient Demand***

The regression of the demand side enjoyed while emphasizing the supply side of the economy, and insufficient private expenditures for the utilization of the current productive capacity have become problematic in these countries. For several recent decades, the economic theories have shifted from demand side to supply side. This is partially a result of theoretical discussions. Economists always held the belief that the prescriptions favoring the demand side were losing credit and that the insufficient productivity was the only factor on economic performance. Even today, thinking that stagnation is just a secondary issue, most economists are paying more attention to long term growth and technological developments.

## Effects of the IMF Stability Programs on Basic Macroeconomic Indicators

The IMF is an international institution having 183 members which established in 1946 in order to ensure stability of exchange rates and to financially support temporary balance of payment deficits. We will analyze the effects of the stand-by agreements Turkey concluded with the IMF up to day on basic macroeconomic indicators, focus on the period since 1990s. Particularly in 1994 when the crisis was seen, the inflation raised up to 106,3%; the growth of real GDP fell down to -5,5%; and the Dollar/TL parity raised up to 169,9. After a semi-heterodox stability program, similar to Israel's program, was implemented, the inflation decreased to 93,6% and the real GDP rose to 7,2% in 1995. A certain decrease in the current balance of accounts was also seen.

In 1998, the inflation started to increase again. Following the implementation of a stability program, a certain decrease in the inflation was observed, but not as targeted. Yet, on the other hand, the Dollar appreciated significantly, and the balance of current accounts turned to negative. Therefore, as shown in table below, the latest stability program based on exchange rates was a failure, with the high costs to the country.

As in other crises in Asian countries, the main reason for the crisis in Turkey is the pressure by the international organizations such as the IMF and the World Bank for liberalization of capital movements. As a consequence of the increase in the capital accumulation in developed counties, there has been a capital flow through financial agencies other than banks to the countries with liberalized capital accounts such as Turkey. Such inflows of liquid money have aggravated the problems significantly in the countries in which democratic practices and market economy institutions have not settled down fully such as Turkey. The governments which are unsuccessful in tax collection, which implement populist policies, which lack the conception of transparent and clean politics, and political stability preferred to save the day through short term capital inflows, thereby accelerating the crises.

Table 7: Selected Economic Indicators

| Years | Real GDP | Consumer Price | Unemployment Rate | Current Account Balance (In percent of GDP) |
|---|---|---|---|---|
| 1990 | 9,3 | 60,3 | 8,2 | 1,7 |
| 1991 | 0,9 | 66 | 7,8 | -0,2 |
| 1992 | 6 | 70,1 | 8 | 0,6 |
| 1993 | 8 | 66,1 | 7,7 | -3,55 |
| 1994 | -5,5 | 106,3 | 6,2 | 2 |
| 1995 | 7,2 | 93,6 | 6,9 | -1,37 |
| 1996 | 7 | 79,4 | 19,5 | -2,6 |
| 1997 | 7,5 | 85 | 10,2 | -2,5 |
| 1998 | 3,1 | 83,6 | 5,9 | -0,97 |
| 1999 | -4,7 | 68,8 | 3,6 | -0,7 |
| 2000 | 7,4 | 39 | 6,6 | -4,9 |
| 2001 | -6,4 | 68,5 | 10,6 | 1,3 |

*Source*: Republic of Turkey Central Bank (1990-2001) Annual Report

# Conclusion

Assessed with a long-term perspective, it becomes obvious that the IMF policies aggravate the crises though they may at first glance seem to avoid them temporarily. Although the stability programs based on exchange rates in which a certain devaluation rate with a fixed change ratio was predefined as implemented in Turkey especially in 1990s were not successful, the IMF came up with the same proposal for Turkey. This program was approved by Turkey in accordance with the agreement with the IMF. Although such stability programs have advantages in limiting the interest rates and inflation expectations, their negative effects were shown both practically and theoretically. Excessive appreciation of foreign currencies leads to unsustainable huge current deficits, an increase in the ratio of short-term debts to reserves, the weakening of financial sector, liquidity problems, and the disruption of basic macroeconomic indicators. Moreover, the policies based on fixed exchange rates have encouraged banks, financial societies, and companies to lend money in foreign currencies, paving the way to “moral hazard” problem. In such countries as Turkey, where business management is not transparent and the banks are owned by the holdings, the banks tend to source their parent companies, leading to crony capitalism and accelerating the crises. The government, too, contributed to the crisis. Even though signs of a crisis were imminent in early September, the government insisted on maintaining the program fearing to lose its creditability.

The IMF was too hasty in declaring that a fiscal crisis in Turkey was out of question. For the IMF, the crisis was a consequence of established structural problems in Turkey, and could not be solved without radical reforms. Current reforms have remedied only certain abuses. The banks with the worst management have been closed down, and home of the most corrupted companies of crony capitalism have been punished; however, bribery, corruption, and media-bank-holding-politician relations, which are specific to Turkish economy, have been left untouched. Moreover, as a prerequisite for the loans, the IMF demanded radical structural changes in a couple of months, which cannot be implemented by any country, thereby increasing the panic.

The IMF the presents the success of the case of South Korea as an evidence of the appropriateness of its program. Considering the countries which are effected by the crisis, however, the most important factor for the Korean success was the postponing of the debts in 1998. Moreover, Korea enjoys a trend of recovery in spite of global stagnation following the crisis with the structural reforms specified by the IMF. The point here is the narrowing down of Korean foreign trade due to the stagnation in the world trade.

In the case of Argentina, it is no possible to talk about the success of the IMF stability policies. In particular, starting from 1999, the public debts doubled and low growth rates were scored in Argentina due to short term debt problems, budget deficits and difficulties in finding foreign loans. Consequently, the interest rates increased and capital flow out of the country accelerated. Although a new standby agreement with the IMF was concluded in 2000, no economic growth was achieved due to the weak fiscal position, the inflation increase, the excessive external debts, and the increase in monetary expansion. And the position of Argentina is still critical because of the current social problems amplified by increased unemployment.

For the success of the IMF supported programs, there are certain duties of both the IMF and the countries. In such countries as Korea, Turkey, and Argentina, effective operation of all market economy rules is a prerequisite. With a premature market structure, the supply side recipes cannot be successful. Even though such policies are successful with respect to external balances, they create depressive problems on domestic balances, and cause serious problems on growth, inflation and unemployment. Consequently, these countries go into recession. Therefore, these countries, in the first instance, have to make their domestic markets perfectly competitive. The prerequisites for the success of these policies are the implementation of structural reforms, and the creation of stable political structure, avoiding populist politics.

First, these countries cannot achieve economic freedom unless they give up populist politics and implement an authentic democracy. Imperfect market structure makes any search for a solution within the existing market mechanism nonsense. Second, with respect to duties of the IMF, the IMF should not ignore such structures of the countries in question. With an administration consisting of only market fundamentalist economists, lending money to these countries leads to “moral hazard” effects, depriving the loans of their intended use.

## Notes

(1) Stiglitz was chairman of the Council of Economic Advisers from 1993 to 1997, then chief economist and senior vice president of the World Bank from 1997 to 2000. In 2001, he was awarded the Nobel Prize in economics for his earlier work on market imperfections, especially the effects on inequalities of information. See Stiglitz (2001).
(2) Conditionality are the policies that a country agrees to follow as a condition for borrowing from the IMF, see Schadler (1996)
(3) See Bello (1996)
(4) See Globe (2002)
(5) See Stiglitz (2001)
(6) See Bello(1996)
(7) See Lyons &Plumb (2002)
(8) See. Krueger (2002)
(9) See. Kiguel and Liviatan (1994)
(10) See. IMF World Outlook (2001)
(11) See .Krueger (2002)
(12) See. Krueger (2002)
(13) See. Arıcan (2002)
(14) See.www.imf.org/external /np/sec/pn/2002
(15) See.www.imf.org/external /np/sec/pn/2002
(16) See. www.tcmb.gov.tr/1999
(17) See. papers.sırn.com
(18) See. Özel (2000)
(19) See. Uygur (2001)
(20) See. Uygur (2001)
(21) See. Uygur (2001)

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