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Political Economy of Policy Reform in Turkey in the 1980s

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and
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Among the lessons from Turkey's experience with economic policy reform: The political management of reform requires building and institutionalizing coalitions of beneficiaries from reform.

This paper — a product of the Transition and Macro-Adjustment Division, Country Economics Department — is part of a larger effort in the department to understand what is necessary for sustaining structural adjustment. Earlier drafts of this paper were read by participants in the May 1992 conference on Voting for Reform: The Political Economy of Structural Adjustment in New Democracies. Copies of this paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Sharon Gustafson, room IS-193, extension 37856 (December 1992, 60 pages).

Turkey's adjustment experience was a tremendous success in terms of structurally reorienting the economy. The share of output for export rose from 5 percent in 1979 to 23 percent in 1989, and real output roughly doubled. The financial markets opened and have developed depth and sophistication. The program failed to reduce fiscal deficits, inflation, income inequality, and the size of the inefficient public enterprise sector, but the transformation of trade and finance fundamentally altered the context of the problems, changing their effects on the private sector and changing the government's options for dealing with them.

The first phase of economic adjustment was sustained, although not initiated, in an authoritarian context, but the Turks restored democracy when the agenda for reform was incomplete. The Motherland Party (ANAP) won office on the platform of economic success and eventually lost partly because of the failure of economic policy. ANAP's electoral defeat in 1991 did not mean, however, the demise of the pro-structural adjustment or the pro-liberalization coalitions. The long period of ANAP rule helped consolidate reforms to such a degree that all of the principal parties agreed on a broadly similar economic program. The ideological differences between the left and the right — a state-directed versus a

market-oriented economy — substantially diminished.

The reforms of the early 1980s greatly reduced the importance of rent-seeking, particularly through foreign trade, but patronage politics became widespread again in the second half of the decade. The initial strength ANAP derived from privileged access to state resources progressively became a disadvantage, creating resentment and reaction among the populace. One source of discontent was the over-invoicing of exports (that is, "fictitious exports"), designed to take advantage of favorable export subsidies, and the government's failure to discipline or penalize the companies involved. This jeopardized attempts to build a pro-export coalition, and some key features of import substitution continued.

Öniş and Webb attribute the failure of Turkey's macroeconomic policies in the late 1980s to the government's failure to cultivate popular support for macroeconomic stability; to the top bureaucrats' lack of autonomy to counteract political pressures to expand the fiscal deficit; and to the continuation of top-down individualistic linkages between policymakers and key economic interests.

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Comments Welcome

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I. POLITICAL ECONOMY OF POLICY REFORM IN TURKEY IN THE 1980S

Turkey in the 1980s undertook both major structural reforms of its economy and the restoration of democracy. In many respects it succeeded on both fronts, but it did not complete the agenda for democratization and it had some conspicuous failures of economic policy, which were closely linked to the way that the program became subservient to short-term political concerns. The Turkish experience illustrates how a small group of technocrats outside the traditional bureaucracy, organized under a strong leader, can play a key role in the initiation and implementation of structural adjustment policies. Turkey's transition to democracy was controlled from above, as the military and the successor government gradually broadened the scope for popular participation in politics. This helped to contain distributional pressures and to maintain the principal reform measures in the initial years of political liberalization.

Political liberalization from above kept power concentrated with the executive, however, and became a disadvantage during the later stages of the adjustment process, when Turkey faced the challenge of simultaneously sustaining the reform momentum and to extending the scope of democracy. Thus, paradoxically, a concentrated and insulated policy-making process, which helped to initiate and implement reform during the early stages, became progressively more of a liability for sustaining the program. The top-down political liberalization perpetuated the paternalistic tradition of Turkish government and the absence of strong consultative links on policy matters between the government and peak associations of interest groups. This undermined the consolidation of both reform and democracy. Because peak associations were weak, the party system bore undue pressure in mobilizing political support for the economic program.

The political developments affected the prospects for economic reform in diverse ways, which are well illustrated by the evolution of trade and macroeconomic policies. Trade reforms and export promotion successfully served three purposes in the adjustment strategy of the government in the 1980s: to alleviate balance of payments constraints, to restore the confidence of the international financial institutions and external creditors, and to stimulate efficient economic growth. The reforms succeeded in making the Turkish economy more efficient and much more outward oriented, and in establishing a higher standard of expectations for the quality of economic policy making. The economic success of the reforms engendered political support for them; table 1 shows the steady growth of output and the spectacular growth of exports during the 1980s. The government and ruling party usually reaped only a part of these political benefits, however, and efforts to use trade policy to get explicit voter support led to partial reversals of the program.

In contrast to trade, macroeconomic policy witnessed frequent, serious reversals. The resulting high inflation, high real interest rates, unstable real exchange rate, and uncertainty about future fiscal policy made economic recovery slower and less stable than it could have been. The ruling party of 1983-91 paid the political price for these failures, although it also

Table 1. Turkey: 1975 - 1990

TURKEY	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Growth of GDP	8.9	8.4	7.5	-2.9	2.1	-0.8	4.4	5.0	3.7	5.7	5.1	8.3	7.4	3.6	1.0	NA
CPI Inflation	NA	17	27	45	59	110	37	31	31	48	45	35	39	75	70	64
Curr. Acco. Deficit to GDP ratio	-4.6	-4.9	-6.6	-2.4	-2.0	-6.0	-3.4	-1.8	-3.8	-2.8	-1.9	-2.5	-1.2	2.3	1.2	-2.4
Exports to GDP ratio	6.5	7.0	4.9	5.7	4.9	6.6	10.4	14.9	15.7	19.6	20.9	17.6	20.8	24.6	22.5	NA
Growth of Exports	2	21	-18	14	-9	4	85	40	14	20	12	-1	27	20	5	10
For. Debt Service to Exports ratio	11	11	16	16	21	28	29	29	29	23	32	32	33	35	34	NA
Foreign Debt to Exports ratio	136	127	192	219	318	403	255	205	200	170	177	239	223	193	193	NA
Reserves to Imports ratio	21	20	12	19	12	15	12	13	15	12	10	13	13	16	27	NA
Real Exchange Rate Index	195	194	206	204	231	243	178	143	144	119	100	114	128	137	111	145
Central Government Expenditure to GDP ratio	22	23	27	26	28	26	24	NA	24	25	25	21	22	21	23	24
Central Government Revenue to GDP ratio	21	22	22	23	23	22	23	NA	20	15	18	18	18	17	18	19
Public Sec. Borrowing Requirement to GDP ratio	NA	NA	NA	NA	NA	NA	-1.1	5.3	1.7	9.7	6.4	4.8	8.0	6.1	7.2	9.5
Growth of Money (M2)	NA	23.4	33.8	36.5	61.7	74.4	88.2	51.1	29.7	58.7	55.3	43.8	45.6	55.0	72.0	51.4
Central Government Wage Bill to GDP ratio	7.6	7.9	7.6	8.5	9.0	8.2	6.5	NA	5.9	4.9	4.6	4.6	5.1	4.9	7.3	8.9
Real Wages in Manuf. (cpi (TL) deflated, index)	107	112	133	138	147	119	125	119	118	104	100	96	102	97	94	NA
Real Wages in Manuf. (wpi (TL) deflated, index)	101	109	126	124	115	107	121	118	118	103	100	100	111	111	110	NA
Dollar Wages in Manuf.	2780	3063	4124	4615	5891	4231	4154	3535	3323	2667	2618	2613	3036	3065	3356	NA
Unemployment rate	NA	NA	NA	7.8	9.7	11.6	11.6	11.7	12.1	11.8	11.7	10.5	9.5	8.0	8.2	7.7

Data Description: -----	Data Sources: -----
Growth of GDP	IMF-IFS
CPI Inflation	" : Period averages
Curr.Acco.Deficit to GDP ratio	" : Current Account Deficit as percentage of GDP
Exports (GNFS) to GDP ratio	" : Exports of goods and services as percentage of GDP
Growth of Exports (real)	" : Rate of growth of real exports
For.Debt Service to Exports ratio	W.DebtT. : Foreign Debt Service (interest + amortization) as percentage of exports
Foreign Debt to Exports ratio	" : Public and publicly guaranteed
Reserves to Imports ratio	IMF-IFS : Total reserves minus gold as percentage of annual imports
Real Exchange Rate Index	" : Real, dollar weighted exchange rate index (annual averages)
Central Government Expenditure to GDP ratio	IMF-GFS
Central Government Revenue to GDP ratio	"
Public Sec. Borrowing Requirement to GDP ratio	The World Bank Country Study, 1990 and C.E.M., Oct.1991 : Public Sector Borrowing Requirement to GDP ratio
Growth of Money (M2)	IMF-IFS
Central Government Wage Bill to GDP ratio	IMF-GFS
Real Wage Index in Manuf. (cpi (TL) deflated, index)	UNIDO : Real wage bill per worker in manufacturing sector (TL CPI deflated, index 1985=100)
Real Wage in Manuf. (wpi (TL) deflated, index)	" : Real wage bill per worker in manufacturing sector (TL WPI deflated, index 1985=100)
Dollar Wages in Manuf.	" : Wage bill per worker in manufacturing sector (in U.S. dollars).
Unemployment rate	S.P.O. and S.I.S.

reaped some short-term political benefits from the spending and credit policies that underlay the macroeconomic problems.

The paper starts with an historical overview of the political and economic transformation in Turkey. The next section describes the institutions involved formally and informally in making economic policy, which include the constitution, bureaucracy, parties, and interest groups. The third main section looks at how these institutions and the dynamics of the democratization process affected the evolution of trade and macroeconomic policy. The final section draws the lessons from the Turkish experience for the political management of policy reform.

A. HISTORICAL PERIODS

The political developments in Turkey in the 1980s can be usefully broken into four periods -- the political crisis up to the time of the military intervention, the military interregnum, the initiation of democracy, and the consolidation of democracy.

Political crisis

The first period stretches back into the 1970s, when the economic and political systems were experiencing increasing difficulties. The import-substitution strategy of the 1960s and the 1970s had generated an economy highly dependent on imports and foreign borrowing, but with limited capacity to export. The government borrowed imprudently to mitigate the growth-retarding impact of the first oil shock, but was too far in debt to borrow its way out of the second shock in 1979. Foreign lenders had cut off credit to Turkey after 1977, and by 1979 other foreign exchange inflows were declining, as workers abroad reduced their remittances and exports declined because of exchange rate overvaluation and shortages of imported imports. The oil shock of 1979 then led to a severe foreign exchange shortage that forced curtailment of imports and shortages of essentials.

Political instability increased along with economic instability during the late 1970s. Political violence, already serious, worsened in the course of 1979. A series of coalition governments had failed to stabilize the economy, much less to adopt the reforms required to avert a crisis. Turkey had an IMF program in 1978, which was canceled because lack of fundamental reforms made the program go off track. Another IMF program, negotiated in summer 1979 by the left center government of social democrat Bulent Ecevit, was well on its way to a similar fate by the end of the year (Okyar 1983). At the beginning of 1980, Turkey was unable to import the essentials for winter survival -- oil, coal, and coffee. Many homes and government buildings went without heat in that exceptionally cold winter.

In November 1979, a right-center coalition headed by Suleyman Demirel had taken over and brought in a new economic team, led by Turgut Özal. To end the crisis, the government introduced a major package of adjustment measures in January 1980. Initially it mainly addressed the debt crisis and balance of payments problem, but it started the

wholesale reorientation of policy toward a market-based economy. Strikes and political violence continued through the summer, aggravated in part by the economic dislocation originating from the adjustment.

Military interregnum

The military took over in September 1980. They dissolved parliament, outlawed political parties and radical unions, arrested political leaders -- executed some -- and suspended many political and human rights. The military kept Özal as head of the economic team. Structural adjustment continued under military leadership, although they did not traditionally favor open trade and market-oriented economic policies. The military was divided over Özal's plans to reduce the role of the state in running the economy, but they could not argue with his success in stimulating exports and in securing foreign financing.

In June 1982, the Banker's Crisis, in which Turkey's largest money broker and securities house collapsed, led to Özal's resignation and replacement by Turgut Sunalp, a military man with a more traditional etatist orientation. In the remaining year of military government, policy deteriorated in terms of budget deficits and exchange rate overvaluation. The episode illustrates that the military was not the primary force behind the policy reform movement and that it followed policies that would sustain its popularity in the short run.

The military had anticipated that it would have 5 or 6 years to restore political and macroeconomic stability, but they had less. In the tradition of previous military interventions, all sides accepted that the military rule would be temporary. Once the political violence was stopped, public opinion from all but the extreme right called for a return to democracy. The Europeans and Americans also wanted a return to democracy, and U.S. Secretary of State Al Haig pressed the issue in his visit to Turkey in 198x.

Initiating democracy

In November 1982, a new constitution was adopted by referendum and a year later the military permitted elections. There were strict limits on party participation, and only three parties were allowed to contest the election. The newly formed Motherland Party (ANAP), led by Özal, won the election, defeating the parties endorsed by the military, and took power. The rest of the 1980s witnessed a series of elections that broadened the scope of democratic control and participation. The public position of the party and the government was always that economic reform and political liberalization were on the agenda, and reforms on one front or another continued through the 1980s. On the other hand, there were also important delays and reversals of reform, especially on the fiscal reform, bank restructuring, and SEE privatization.

Turkey constitutes a unique case of structural adjustment in terms of the continuity of leadership. Turgut Özal reemerged in a new guise following the general elections of November 1983, this time as the Prime Minister of a democratically elected government.

What came to be the ruling ANAP party (Motherland Party) was centered around the core team that had designed and initiated the structural adjustment program. A key part of ANAP's political appeal was the success of the economic program. Although the party made appeals in other dimensions as well -- some distance from the military, more distance from the left, some association with Islamic fundamentalism, and some appeals to Turkish nationalism -- it repeatedly campaigned as if in a referendum on the economic program.

The new government used the political honeymoon following the resumption of elected government to put through a second wave of economic reforms, especially of the import regime and the capital account in December 1983 and January 1984. Soon after came a series of measures to liberalize the foreign investment regime. ANAP's popularity was bolstered by its reputation for reform and the high rates of economic growth in the mid-1980s, which contrasted with the dismal performance of the economy at the peak of the crisis. The obvious pre-1980 heritage of the two main opposition parties was an advantage for the ANAP governments, especially during the early years of its existence. ANAP could portray itself as the party of the new era, while projecting the opposition parties as institutions of an old order that had ended in abject failure.

In 1985, when it was time to name a new chief of staff of the military, the old chief nominated his successor as was the custom. Özal rejected the nominee, however, and chose someone else. This was significant in two ways. First, it demonstrated an unprecedented degree of civilian control over the military and signalled that the military could not threaten another takeover. Second, whereas the original nominee, like his predecessor, was from the branch of the military that favored statist economic policy, Özal chose a general who was ready to accept the need to move to an open, market-oriented economy.

Completing democratization

Although the resumption of democracy started with the general elections of November 1983, freely competitive politics in Turkey resumed only in 1987. Leading politicians of the pre-1980 period, notably, Demirel and Ecevit, were permitted to contest the elections of November 1987, after a ten-year ban by the military on their participation in politics was lifted by the referendum of September 1987. After that point, Özal increasingly diverted his attention from economic policy toward purely political issues.

The general election in 1987 proved to be a turning point in the fortunes of both the ANAP government and the structural adjustment process. In spite of a decisive victory in the general elections of 1987, the further opening up of the political system presented ANAP with a novel set of challenges, which were largely absent in the preceding era -- the public reappearance of the key political figures of the pre-1980 order and the reemergence of distributional pressures, particularly involving wages and agricultural subsidies. The problem of macroeconomic instability continued and became more severe.

The popularity of ANAP declined dramatically in the eighteen months after its victory in the general election of November 1987. The municipal elections of March 1989 proved to be a turning point, with ANAP emerging as the third party, with a mere 22 percent of the vote. The party never fully recovered. In 1989 Özal had himself elected to the presidency (by the ANAP dominated parliament), and in accordance with the constitution, he had to resign from the party. He still tried to run the party and the government unofficially, through his successor Yildirim Akbulut, but his move upward left a leadership vacuum in the ANAP government and allowed infighting between key policy makers. Özal's election to the presidency undermined the legitimacy of the government; opposition leaders, whose parties had strong support in the most recent elections and polls, claimed that Özal did not have a mandate to assume the presidency since ANAP had received only 21 percent of the vote in the municipal elections. The problems with internal coordination and domestic legitimacy both weakened the implementation of the structural adjustment program. Fiscal instability and chronically high inflation contributed to the loss of popularity of ANAP in the late 1980s. Despite some improvement in its electoral performance compared to 1989, it lost the general election of October 1991, which brought a return of coalition politics to Turkey and the beginning of a new era, following eight years of uninterrupted ANAP rule and eleven years during which Özal dominated economic policy.

Agriculture and labor were the principal losers of the structural adjustment process, and these two groups determined the outcome of the 1991 election. They were the principal bases of support for the two parties that became the ruling coalition partners in November 1991 -- the True Path Party (DYP) and the Social Democratic Populist Party (SHP).

B. INSTITUTIONAL STRUCTURE AND CHANGE

Before turning to a detailed chronology of the trade and macroeconomic policies in the periods outlined above, we must examine the formal and informal institutions of decision making, which have received relatively little attention in previous studies of Turkish political economy.¹

Although the structural adjustment process in Turkey in the 1980s was closely associated with the personality of Özal, the political and bureaucratic institutions and changes to them were also important. He often took the initiative in restructuring institutions, and the nature of these changes affected the course of the structural adjustment. The institutional side of the story is especially important for the World Bank, because the experience with institutional innovation is most likely to be relevant for other countries seeking to replicate Turkey's successes while avoiding the pitfalls.

1. Celasun and Rodrik 1989; Keyder 1987; Krueger and Turan 1992; Öniş and Riedel 1992; Waterbury 1992; Aricanli and Rodrik, *cd.*, 1990.

Formal and informal constitution

The transition to democracy involves changes in the formal constitution of political decision making, but the meaning of the legal document depends on the political culture that is inherited from the past and on the interpretation of the constitution as it is put into practice. The following section lays out a few features of political culture and constitution that are most relevant for economic policy.

Political culture

A strong patrimonial state tradition, which dates back to the pre-Republican Ottoman period, remains a key element of Turkey's political culture (Heper, 1985; Mardin, 1973). Central to this tradition is the idea that the state is a provider, an institution to guarantee the livelihood of broad strata of the population in a hierarchically organized society. The popular notion of the father state ("papa-state") symbolizes the idea of the state as the provider in the Turkish society. For lower-income groups, a major form of provision involves employment opportunities within the large public sector. For business groups, entrepreneurs or producers, state provision takes the form of a wide variety of subsidies. At the Third Izmir Congress on the Turkish Economy in 1992, the founder and head of Turkey's largest industrial group, Vehbi Koç, credited the success of his firm and others like it, not to the energy and skill of the entrepreneurs, but rather to the support of the state.

A counterpart to the strong patrimonial state tradition in Turkey is the weakness of the civil society, as manifest by the weakness of autonomous interest associations. The strong state-weak civil society dichotomy (or strong center versus weak periphery) has the result that the Turkish state elites (politicians and bureaucrats) will not enter into institutionalized contact or dialogue with interest organizations, concerning policy formation and implementation. The weakness of institutionalized links with formal interest associations encourages the development of extensive patron-client networks and leads, under the constraints of parliamentary democracy, to attempts to build up popular support through the dispersion of patronage resources on a large scale.

This tradition had two effects on the structural adjustment process: A highly centralized and insulated state apparatus helped to initiate stabilization and structural adjustment and to maintain the momentum of the process during its early stages. However, the absence of strong formal links with interest associations or organized groups in civil society proved to be a disadvantage during the later stages of structural adjustment, when the problem became one of consolidating, institutionalizing, and maintaining the momentum of the reform process, and particularly when consolidation of democracy itself was emerging as an overriding objective. Although the paternalistic political culture has continued in Turkey, civil society has strengthened somewhat since 1983, and developments such as reduced tolerance for corruption signal the rise of an alternate, more modern political culture.

Electoral and constitutional changes

The Turkish constitution of 1982 set up a government with a president, prime minister, cabinet, and parliament. Compared to the typical European parliamentary system, the Turkish president and prime minister had slightly more power on paper relative to the other parts of government, and considerably more in practice. The process of democratization was controlled from above and was phased in two senses. At first General Erven, who had led the military takeover, remained president, and then in 1989 the parliament elected Özal, the head of the ruling party, to be president. Also, the participation of parties and of former politicians was severely circumscribed in 1983, and only since 1987 has a broad spectrum of parties been able to participate fully in elections and parliament. Parties based on economic groups, regions, and ethnicity (eg. Kurdish) were expressly forbidden.

The electoral system, first used in 1983 and modified just before the elections of 1987, was consciously designed to eliminate minor parties, especially regional ones, and consequently to avoid the instability associated with coalition governments in the late 1970s. The problem of an excessive number of parties was tackled directly by the military in the context of the 1983 elections in the sense that only three parties (ANAP, MDP, and MP) were allowed to contest the elections. In the 1987 and 1991 general elections, however, the multiple-member constituency electoral system was the key indirect instrument that effectively excluded minor parties from representation. A party had to pass both a national threshold of 10 percent and local threshold that depended on the nature of the electoral district. A party which failed to satisfy the national requirement was automatically barred from returning deputies anywhere, regardless of its performance in a particular electoral district. Minor parties were particularly disadvantaged in small electoral districts.²

In 1987, the four minor parties in total received 19 percent of the vote, yet they could not elect any deputies. The presence of the minor parties had one significant impact, however, in terms of changing the balance from the two major opposition parties to the governing party. The electoral system enabled ANAP to secure a narrow electoral coalition whereby the party managed to claim two thirds of the seats in parliament with only 36 percent of total vote.

2. Local thresholds are determined by dividing the total number of votes in the constituency by the total number of seats allocated to the constituency. The local threshold therefore varies, from a minimum of 20 percent in the largest 48 constituencies with six seats each (also in districts with five seats) to a maximum of 50 percent in the constituencies with only two seats each. Furthermore, in 46 constituencies only one member is elected on the basis of simple majority, which also hinders small parties.

Rule by Decree and Role of Parliament

The military interlude and the constitution of 1982, which set the terms for returning to democracy, concentrated power at the center. The new constitutional order strengthened the executive power at the expense of the legislature, and centralized power within the executive with a corresponding decline of the cabinet as decision-making entity. The strong-executive/weak-parliament dichotomy continued after the re-establishment of democracy in 1983. A central feature of the ANAP governments was a highly concentrated decision-making structure, with the responsibility for key economic decisions being confined to the Prime Minister, an inner or core cabinet and a small group of top-level bureaucrats. The dominance of the executive over the Parliament and even over the non-core cabinet was reflected by the emergence of government decrees as the major instrument for introducing policy changes during the period. The dominance of government decrees was justified on the grounds that they offered flexibility and could introduce decisions rapidly without unnecessary delays or inertia. Yet, the reliance on government decrees rather than legislation often led to more arbitrary decision making. Government decrees frequently changed policy and caused uncertainty on the part of economic agents, leading to shorter investment horizons and reducing the credibility of the adjustment measures.

Political parties

The military outlawed all political parties when it took over in 1980. When democracy returned in 1983, all the parties had to have new names, and they were not allowed to have any explicit links to economic interest groups or regions. To some extent old wine ended up in bottles very similar to the old ones, except for the labels. But there were a few major realignments, and the economic platforms were all substantially different, because the structural adjustment experience had fundamentally changed the issues of debate on economic policy.

Motherland Party

The support base of the Motherland Party (ANAP) is predominantly urban, from groups other than unionized workers, as an examination of the distribution of votes by provinces during the general elections of 1991 reveals. ANAP's best performance was registered in Istanbul, where the party won 33 out of fifty seats (with DYP and SHP gaining a mere five seats each). In Izmir and Ankara, ANAP also did well, but by smaller margins. Among the major urban centers, Adana was the only one where ANAP lost -- not surprising given its agricultural hinterland. The pro-urban character of ANAP is also confirmed by its good record in the comparatively prosperous provinces of the Aegean region in the West.

ANAP started as a coalition, with a liberal wing and a conservative wing. Religion was important for securing the loyalty of the conservative faction and in holding the basic coalition together. Özal himself was closely associated with the Islamic fundamentalist party (The National Salvation Party) for which he had run for Parliament and lost in 1977, and his

Table 2: Results of the Major National and Municipal Elections
1983-1991

<u>General Elections of November 1983</u>		<u>General Elections of November 1987</u>		<u>Municipal Elections of March 1989</u>	<u>General Elections of October 1991</u>	
Share of vote (%)	Share of Seats in parliament (%)	Share of vote (%)	Share of Seats in parliament (%)	Share of vote (%)	Share of vote (%)	Share of seats in parliament (%)
ANAP	45	53	36	66	22	2426
HP	31	29	--	--	--	----
SHP	--	--	25	22	29	2120
DYP	--	--	19	12	25	2740
DSP	--	--	9	--	9	112
MÇP	--	--	3	--	4	----
MDP	23	18	--	--	--	----
RP	--	--	7	--	10	1714
DP	--	--	0.8	--	0.9	----
SP	--	--	--	--	--	0.4--
Independents	1	--	0.5	--	0.6	0.1--

Notes: Results of the 1984 municipal elections are not included because they are broadly parallel to the outcome of the preceding national elections. ANAP (Motherland Party); HP (Populist Party); SHP (Social Democratic Populist Party); DYP (True Path Party); DSP (Democratic Left Party); MÇP (Nationalist Work Party); MDP (National Democracy Party); RP (Prosperity Party); DP (Reformist Democracy Party); SP (Socialist Party).

older brother is a well-known religious leader. Thus, ANAP had a widespread appeal in the 1980s because it managed to represent a mixture of neo-liberal and Islamic ideologies, and did not have to choose between them.

In the elections of 1991, ANAP lost some of its support to the Welfare Party (RP), with a strong Islamic orientation. RP consolidated its position particularly in the districts of the Inner Anatolia region. ANAP increasingly shed its religious or conservative components under a new leadership in the beginning of the 1990s. Consequently, the party emerged in the election of 1991 with a more homogenous outlook as an urban-centered and secular party, committed to the neo-liberal model -- hence, a party conceived as an attractive choice for the relatively prosperous strata, the managerial and business elites. Yet, the result was a transition from a broad-based national party, with some urban bias, to a party with a much diminished electoral base.

The change of ANAP's electoral base followed after major losses in the municipal elections of March 1989. Compared to the 1987 election, the losses were particularly pronounced in the urban centers (Cakmak, 1990). ANAP confronted SHP in the urban centers during the 1980s, whereas the competition with DYP has been in rural areas.

How do we explain ANAP's electoral success in the 1980s, particularly considering that the structural adjustment program generated intense distributional problems? At least well into 1990, the electoral fortunes of ANAP were closely tied to the popularity and the performance of its leader. Özal played a major role in the success of ANAP between 1983 and 1987. He portrayed himself as a leader with influence abroad, boosting the foreign image of Turkey, and as the architect of the new program for economic recovery. Equally striking was his ability to portray the crisis of the late 1970s, the most acute crisis in recent Turkish history, as the failure of the opposition. He was able to project ANAP as a new party of the 1980s, with a novel economic program, whereas other parties represented a continuation of the pre-1980 politics whose policies had already been tried and had ended in object failure. Özal bolstered his position as the leader of the party by keeping tight party discipline, choosing candidates and dispensing with those who deviated from the party line.

It might appear paradoxical to view ANAP as a party of the new era, given that it was one of the three parties allowed by the military to contest the general elections of November 1983 as part of the top-down process of gradual political liberalization. ANAP was not, however, the party that the top military leadership wished to see in government after the 1983 elections. The military implicitly backed the National Democracy Party (MCP) headed by an ex-general, Sunalp. Part of ANAP's unexpected success in 1983 derived from being the party that dissociated itself most from the military. It also helped that Özal had been out of office since the Banker's Crisis of June 1982.

The economic reforms evoked general electoral appreciation for ANAP, while at the same time unreformed aspects of economic policy were increasingly involved in the distribution of favors to ANAP supporters. Some of the patron-client networks were

traditional, dating from Justice Party governments in the pre-1980 period. Although left and left-center governments also used such networks, the right of center governments tended to rely on them more, going back to the 1950s. (The left-center governments were in power less of the time and relied more on direct redistributive measures.) The electorate expected disproportionate benefits to be derived from close association with the top leadership and its close proximity to patronage resources. For example, ANAP did well around Malatya, Özal's home town, and in the provinces in the East Coast of the Black Sea Region, from where Mesut Yılmaz came, the party leader in 1990-91. Employment opportunities in the public enterprise sector and bureaucracy were the traditional avenues for patronage, and Turkey's public sector remained largely intact throughout the 1980s.

Also important were the distribution of credits by public banks and frequent rescue operations for troubled private firms. The public sector continued to dominate the financial system throughout the 1980s and, in fact, public banks' share of total bank credits has expanded during the period. Lucrative public sector contracts and preferential access to SEE output, being sold at prices that had lagged behind inflation, constituted other avenues whereby firms favored by the government could benefit in return for political support.

Two new means of disposing patronage emerged during the 1980s -- the extra budgetary funds and the local budgets. EBFs clearly provided an important avenue for ANAP governments to direct public expenditures to specific groups or regions with the explicit objective of constructing electoral support. Yet another major avenue concerned the increasingly important role played by the local authorities, which employed an extension of their power under the ANAP rule, in dispensing the patronage resources. A key instrument for this purpose was issuance of construction licenses, the responsibility for which was transferred to the local authorities under ANAP rule.

ANAP's success also derived from the relative weakness of the opposition. The opposition parties in Turkey suffered from having much less access to state resources than the governing party. Through control of the large public sector, the governing party could use patronage to augment its electoral base. The weakness of the opposition parties during most of the 1980s, however, was not due primarily to a weak financial base but rather to their inability to formulate a coherent and convincing alternative to the government's economic program.

Finally, part of ANAP's success ought to be traced to the electoral laws described above. This was particularly true in the 1987 elections, where the party increased its share of seats in the parliament while experiencing a declining share of the national vote.

Opposition Parties

After the transition back to democracy started in 1983, there were two major opposition parties: The Social Democratic Populist Party (SHP) and the True Path Party (DYP). They are direct descendants of the two principal political parties of the pre-1980

era. SHP may be regarded as the reincarnation of the Republican People's Party (CHP) which dates back to the very beginning of the Republic in 1923. CHP had been the dominant institution in the single party era until the inception of multi-party democracy in 1950. Subsequently, CHP converted into center-left social democratic party in the late 1960. Shortly after the Nov. 1983 election, the Populist Party (HP) merged with the Social Democratic Party (SODEP), excluded from the election, to become the Social Democratic Populist Party (SHP), which contested the municipal elections in March 1984 and became the principal center-left party in the 1980s. Compared with the Populist Party, the SHP was a more typical social democratic party in its pro-labor objectives and electoral base.

After 1983, with no more limit on the number of parties in the elections, several new parties emerged. Ecevit (initially acting through his wife) started another socialist party, the Social Democratic Party (DSP), as a vehicle for his return to political life, because he did not regard SHP as a true social democratic party. The Welfare Party (RP) also formed as a reincarnation of the National Salvation Party (MSP), representing Islamic fundamentalism.

During the post-1983 period, SHP drew its support primarily from urban wage earners and lower- and middle-level public sector employees. Although SHP was the main political outlet for wage earners and lower-income groups, the links with the union movement remained weak in the post-1983 era. This was mostly due to constitutional restrictions on the interaction between political parties and interest associations. But, it was also partly due to the failure of the party itself to make even, particularly toward the end of the decade. The party remained the principal opposition party until the elections of November 1991. For most of the decade, redistribution in favor of lower-income groups constituted the focal point of the party's economic program. Important elements of the party's "etatist" heritage remained intact throughout the 1980s.

In the municipal elections of March 1989, the social democrats strongly increased their vote share nationwide and won most of the key municipalities. Ironically, ANAP's partial recovery during the general elections of 1991 has been a predominantly urban phenomenon and has occurred at the expense of the social democrats. This may be explained by factors which are independent of the process of structural adjustment. The social democrats remained deeply divided -- into two parties (SHP and DSP) and into factions within SHP. In addition to internal conflicts, the weakness of the left was accentuated by its almost exclusive focus on redistribution, with no serious discussion of how a major redistribution program would be compatible with an acceptable rate of economic growth or accumulation. Consequently, the social democrats could not come up with an economic program which would allow them to win an outright majority. The international climate, with market-oriented reforms representing an almost universal phenomenon, also operated to the left's disadvantage.

Undoubtedly, a major contributor to the sharp decline in SHP's popularity was the poor performance of its municipal governments during the 1989-1991 period, partly because of management problems and partly because of the broader economic context, including the

tendency of the ANAP government to offer less funding to SHP-run cities. Also the DYP offered a populist but less ideological alternative, which gained them votes in a number of traditional strongholds of the SHP.

The True Path Party (DYP) was the clear successor to the Justice Party, the principal center-right party of the pre-1980 era. Demirel led the Justice Party with a charismatic style up to September 1980 and resumed leadership to the DYP after the referendum in 1987. The True Path Party drew its support primarily from the rural areas and small business. Rural support proved to be a considerable asset, given that more than forty percent of the population in Turkey is still in rural areas and employed in agriculture, although the sector's share in value added is considerably lower. The vote of the agricultural regions was decisive for DYP's emergence as the leading party in 1991. Both SHP and DYP differ from ANAP in their explicit concern with income distribution and the position of lower-income groups.

While the major parties had converged on most key aspects of the structural adjustment program by the early 1990s, important differences between ANAP and the other parties remained. There was a consensus on the irreversibility of trade and capital account liberalization as well as on the importance of the key institutions of the neo-liberal model, such as the capital market and the foreign exchange market. There was not, however, a similar consensus concerning reform of the public sector, with both SHP and DYP being less disposed to privatization than ANAP, although the latter certainly did not move quickly on the issue either.

Interest groups

Compared with corporatism in Western Europe, the peak interest associations in Turkey contributed little to policy formation and implementation in the 1980s. The insulation of the executive policy-making elite from societal and interest group pressures proved to be a decisive advantage for initiating and implementing the early phases of structural adjustment program. Yet, as the restoration of democracy brought new distributional claims into the picture in the latter half of the 1980s, the pattern of insulated decision making increasingly became a disadvantage for sustaining macroeconomic discipline and the overall momentum of the program.

Business associations

Institutionalized business associations made only limited contributions to the formulation and implementation of structural adjustment policies in the 1980s, in spite of the privileged position of private business.

The interaction between government and business occurred mainly at a personal level, involving direct contacts between key businessmen, on the one hand, and the Prime Minister plus a small core of Ministers and top-level bureaucrats, on the other (Heper 1991; Bugra,

1991). Contact between business and government became more prevalent in the late 1980s, as senior officials and sometimes Özal himself attended meetings of the Political Science Graduates Association of Istanbul and the Taksim Round Table discussions, open to all businessmen, for something like \$500 per place. Also, by the late 1980s, the young business leaders of TUSIAD were meeting regularly with senior bureaucrats at Treasury and the Central Bank, to discuss a variety of broad policy issues.³ The contacts did not go farther and become part of the official decision process, however, partly because of restrictions imposed on interest group activity by the Constitution of 1982, but also because of Turkey's paternalistic state tradition, with a strong center confronting a weakly organized periphery and civil society (Özbudun, 1991; Mardin, 1973; Heper, 1985). In the early 1990s, business leaders still complained that important policy measures would be announced without prior consultation and certainly without bargaining and reaching an agreement with organized interest group representatives.⁴

The Turkish business associations have weak organizations, reflecting the fragmented nature of the business community itself. The two main organizations, TOBB (The National Union of Chambers of Commerce and Industry) and TüSİAD (The Turkish Industrialists' and Businessmen's Association), reflect the divisions and conflicts within the business community. TOBB, with a total of 687,000 members drawn from all parts of the country, regards itself as the sole legitimate representative of business interests and opinion. It bases the claim on the size and nature of its membership, which is compulsory for all firms. By weight of their numbers, small Anatolian businessmen dominate TOBB. By contrast TüSİAD, comprises only the elite of the business community, namely the large-scale conglomerates located almost exclusively in the Istanbul area.

Neither institution adequately represents the varied interests of the business community. For TOBB the problems are, first, that it is too all encompassing to have a well-defined interest and, second, that the government finances and dominates its leadership. In practice, the government uses TOBB as an instrument to divide and rule business and as a source of statements of business support for government policies. TüSİAD, in contrast, is a voluntary association and thus required by law to act in the general public interest. TüSİAD lacks the unifying purpose of a true interest-group organization and does not lobby for its members interests, both because of the law and the free-rider problem discussed below. Given the one-member/one-vote system in TOBB elections, the TüSİAD members, which economically dominate their industries, are unable to exercise corresponding influence in TOBB. Furthermore, the majority of TOBB membership exercises a close surveillance over TOBB's relations with TüSİAD, which seriously constrains the development of a closer relationship between the two organizations (Arat 1991; Özbudun, 1991; interview with Ücer).

3. Interviews with N. Akturk, E. Kumcu.

4. Interviews with Akdemir, Dinçkök, Ücer.

The conflict between TOBB and TüSİAD illustrates the fragmented nature of business representation in Turkey. Yet, the line of cleavage is not simply along the lines of small versus large business. Important conflicts of interest have arisen within the community of large-scale conglomerates, which TüSİAD represents, particularly between outward-oriented firms and those with a predominantly inward orientation. This conflict has manifested itself particularly in the textile sector -- imports of raw materials (yarn and fiber) versus exports of clothing.

Large family-controlled conglomerate firms play a leading role manufacturing in Turkey, producing both exports and import-competing goods and owning banks. Often their shift from import competing to export involved mainly a transition to higher quality lines of production, which firms were glad to make. Most of the manufacturing production before 1980 went to the heavily protected domestic market. By the late 1970s, however, many firms saw that the import-substituting model had become unsustainable, and they began to support more export-oriented policies.

The perception of business associations by the bureaucracy and politicians also weakened the influence of the associations on the policy process in the 1980s. Both businessmen and bureaucrats are fully aware of the fragmented nature of the business community and its principal interest organizations.⁵ Consequently, the top bureaucrats do not regard the business associations as a united front representing their members' interests and do not enter into institutionalized dialogue with the organizations. This process, in turn, encourages the individualized contact between businessmen, bureaucrats and politicians.

This represents a free-rider problem, because no one wants to bear the cost of starting to improve things, even though most of them would accept the benefits. At any point in time, key members of each group are getting advantages from the system of individualized contacts -- businessmen get favors, bureaucrats get options for mobility into top private-sector jobs, and politicians get political support and freedom from having to deal with a unified and powerful business lobby. For the economy as a whole, the cost is unsystematic and unpredictable policy and the encouragement of rent-seeking. The compensating benefits of a more rational system, however, would materialize only in the long-run, and only if all participants gave up rights of individual access. Realizing this would require strong, encompassing interest associations that could discourage their members from trying to act independently (Olson, 1965, 1982).

At the micro-level, the Special Sectoral Committees (Özel İhtisas Komisyonları) could have become a key form in the 1980s for institutionalizing discussion of government-business relations, but did not. The committees, with representatives of state agencies, the business community and academia, had been important for discussion and providing information input into SPO's five year plans in the pre-1980 era. These micro-level committees continued to exist in the 1980s -- 120 of them for the sixth five-year development plan, which extends into

5. Interviews with business leaders.

the mid-1990s -- but their importance declined as the five-year plans themselves were marginalized during the 1980s. The committee reports are useful in identifying the development trends and prospects in the relevant sectors or sub-sectors, but are weak in terms of actual policy recommendations because their scope remains micro sectoral. The major firms with political clout do not bother with the committees, because they have direct access to the politicians who make the final decisions.

Labor

As of the late 1970s Turkey had two main labor organizations -- the Confederation of Labor Unions in Turkey (Türk-îs), the larger of the two, and the Confederation of Revolutionary Labor Unions (DISK), the more leftist and confrontational. The latter had been achieving large wage gains and organizing mass demonstrations in the big cities, thereby gaining size and influence.

The military regime, as soon as it took over, banned strikes and suspended collective bargaining over wages. It outlawed DISK and jailed its leaders. Türk-îs remained in existence, but with much reduced opportunities for representing the interests of labor.

The military government created new labor institutions to replace those it destroyed or weakened. It set up a council of arbitration to settle wage disputes, which repeatedly gave nominal wages increases below the previous and future inflation rates. The government wanted cheap labor but not unemployment, which would have increased political unrest, so it required employers to agree not to lay off workers. This may have acted to some extent as a disincentive for firms to hire new workers; and unemployment did remain a problem through much of the 1980s. Nonetheless, it was widely believed that the arrangement prevented unemployment from being worse than otherwise. From the point of view of those already employed and in the labor movement, it almost certainly was true. In other words, the government protected some elements of wage labor, namely those that would have been laid off, at the expense of those that would have kept their jobs even with high real wages. Thus, the government displaced and to a limited extent replaced unions as arbiters and representatives of labor interest.

When the military government wrote the new constitution in 1982, laying down the terms for a return to democracy, it perpetuated the reduced status of unions. Labor unions, like other interest groups, were not allowed to have any direct connection with political parties. Unlike businessmen, workers had virtually no personal connections with the political elite.

The ANAP government in the mid 80s did little to relax the inhibitions on union power. The persecution of labor leaders virtually stopped, but it had in any case become unnecessary for curtailing union power, at least in the short run. All strikes were outlawed until 1987, and they are still banned in the financial and public sectors. Binding arbitration was still required until 1987, and real wages stayed low.

None of the three parties permitted in the 1983 election represented labor interests in the formal sense of consulting with labor unions in developing their economic programs, but the Populist Party (HP) made electoral appeals to the economic interests of wage labor. The Social Democratic Populist Party (SHP), which became the principal center-left party in the 1980s, was a more typical social democratic party in its pro-labor objectives and electoral base.

Three characteristics of labor unions in Turkey precluded labor in the 1980s, or before, from becoming an active party to a tripartite corporatist agreement, with the state and private business. First, *Türk-İs* has a weak organization and lacks technical capacity and research infrastructures. Furthermore, labor unions in Turkey have a low status in Turkish society, compared with German unions, for example. They lack the technical base, the vision of longer-term interest, and the self-confidence required for effective participation in economic decision making at the national level. Second, collective bargaining in Turkey has been organized at the level of industrial sectors; consequently sectoral unions are key actors involved in the wage bargaining process. While *Türk-İs* plays a coordinating role, its ability as a peak association to control and discipline individual sectoral labor unions is rather limited. Hence, even if *Türk-İs* were to become a member of a corporatist general council for economic policy making, this membership would not necessarily contribute to greater coordination of the economy, since *Türk-İs* would have little power to make its constituent unions conform to the council's decisions. In the medium or long run, however, the formation of such a Council with labor could contribute towards a learning process, whereby union leaders would become increasingly aware that they could play a novel social role. The requirement of effective participation in the corporatist council could act as an top-down incentive for the reorganization and reconstitution of union activity away from decentralized wage bargaining, toward bargaining in the context of national goals, which would be in the union's long term interest.

Finally, the negative experience of labor in the 1980s was and remains an obstacle to the incorporation of labor into a corporatist framework. The direct exclusion of labor during the early parts of the decade undermined trust in the value of co-operation and institutionalized bargaining with other key actors. Labor declined participation in corporatist institutions, because they conceive such organizations as a means of imposing labor discipline *per se*, without parallel sacrifices incurred by other social groups.

The various phases of industrial labor relations in Turkey in the 1980s all support the hypothesis that either direct exclusion of labor from the policy process or its inclusion through corporatist agreements facilitates structural adjustment, but intermediate arrangements lead to problems. Prior to the military takeover in September 1980, labor unions were strong in their ability to bargain with employers, including the government, but they were excluded from the policy making process after the right-center Justice Party replaced the Social Democrats in November 1979. The Turkish government chose direct exclusion of labor in the early 1980s. The resultant flexibility of real wages downward greatly helped the authorities to engineer real devaluations of the exchange rate, which

stimulated Turkey's export. After 1987 the direct exclusion ended, but no inclusive corporatist arrangement took its place. The resultant intermediate regime contributed to macroeconomic instability.

Agriculture

Most agricultural producers lost during the structural adjustment process of the 1980s. A key component of the structural adjustment program which directly affected the agricultural sector and the rural community (constituting more than forty percent of the labor force) concerned the significant reduction in subsidies provided to the sector through high support prices. The decline in subsidies involved both the magnitude of support prices and the number of commodities covered (Olgun 1991). The share of national income going to agriculture declined from 25.5 percent in 1978-79 to 20.5 percent by 1984-85 and to 18.3 percent in 1989-90 (Ozmucur 1991).

The principal organization representing agricultural interests was the Turkish Union of Chambers of Agriculture (TZOB). The agricultural community loudly criticized what it considered to be the obvious pro-urban bias of the ANAP governments. In spite of this vocal criticism agricultural interests for most of the 1980s could not engineer a decisive shift in the policy stance of the government in their favor. The turning point arrived, however, with the municipal elections of March 1989, in which the True Path Party (DYP), a party with a strong rural base of support, emerged ahead of ANAP as the second major party in the country. Thus it was through the party system and electoral competition rather than direct interest representation by the relevant association that the agricultural sector could exert an influence over national politics (Ergüder 1991).

Paternalism and impotent interest groups

The prospects for European-style corporatist intermediation of interest groups in Turkey remain limited, at least in the immediate future. Corporatist economic management, through a general council, for example, would not be feasible unless the government actively sought out the views of organized groups for both labor and business. Furthermore, the ability to secure a corporatist pattern of policy making would require healing the deep divisions within the business community, along with a much greater, organizational capacity on the part of the peak associations to discipline their membership and to force compliance with decisions taken (Onis and Sunar 1992).

Bureaucracy and Cabinet

Besides the office of the Prime Minister itself, three institutions in the central government were crucial for the structural transformation of Turkish economic policy in the 1980s -- the State Planning Organization (SPO), the Undersecretariat for Treasury and Foreign Trade (UTFT or just Treasury), and the Central Bank. Other ministries and the Parliament played mostly passive roles. Since the election of 1983, and particularly since the

installation of Özal's choice for chief of staff in 1985, the military stayed out of politics and did not play any role in economic policy making.

Restructuring the bureaucracy

Prior to 1980, the principal agencies for economic policy were the Ministry of Finance and Customs, the Ministry of Commerce, and the State Planning Organization. All three were involved with trade policy and the allocation of foreign exchange. The State Planning Organization was the premier economic agency in the 1960s and 70s. It produced the 5-year plans and enforced their implementation. The state-owned enterprises had to meet the plan targets, and there were numerous incentives to pressure private firms to meet them, especially the SPO's control of import and investment licenses. SPO staff believed in the efficacy of state-led development and had, accordingly, staked their careers on this presumption. SPO and the Finance Ministry handled fiscal policy and, through the subordinated central bank, monetary policy as well. All three agencies were staffed and directed predominantly by persons who believed that state-directed development was the most appropriate for Turkey's circumstances.

Coordination problems between the economic ministries date back at least until the 1970s, when Turkey had a series of coalition governments. At that time each party in the coalition got certain ministries, in which it built little patronage empires and carried out portions of its electoral program. To maintain some coherence for the government as a whole, there had to be coordination committees of the relevant ministers in various policy areas, including economics. The military and the Özal governments continued the tradition.

The Özal governments undertook two major reorganizations of the economic bureaucracy, in 1983 and 1991, and several minor ones. The reorganizations had three objectives. One objective was to deal with the coordination problems mentioned above. Second, the political elite and particularly Özal wanted to have the facility to reward political friends and punish enemies. Finally, enacting and sustaining the reforms required taking power from the parts of the bureaucracy opposed Özal's economic program. These objectives were not mutually exclusive, but they did conflict at times.

In the early 1980s the third objective -- taking power from the old, etatist bureaucrats -- was predominant. The key move that Özal took in 1983, as soon as he returned to power, was to create the Undersecretariat for Treasury and Foreign Trade and to put it under a new Minister of State for economic affairs. This minister was also (although not permanently) made deputy prime minister, as Özal had been in 1980-83. Thus, rather than try to reform the old bureaucrats, he created a new agency and transferred key powers to it. The economic team was headed by Özal, until 1989, and consisted of the inner cabinet of four or five politician (and three technocrats) -- the Undersecretariat for Treasury and Foreign Trade, the head of the central bank, and (in a weaker role) the head of SPO. The old agencies were left intact but relegated to less crucial functions, such as revenue collection (Finance) and forecasting (SPO). Sometimes key economic policy makers were appointed to

head the agencies (Yusuf Özal at SPO and Pakdemirli at Finance, both in 1987), but they did not represent the views of their agencies. They held the positions in order to be part of the economic team and, in effect if not by design, to stop any etatist initiatives from traditional elements in their agencies.

In the mid and late 1980s, the objective of having facilities for distributing favors and punishments became more important because the ANAP government, initially elected in the context of a restricted democracy in 1983, faced repeated challenges to its rule as the scope for democracy was progressively expanded through the remainder of the 1980s. As mentioned earlier, however, the electoral payoff of this strategy for ANAP was less than anticipated because the young, internationally oriented businessmen, who were the beneficiaries of the structural adjustment program and thus the most natural constituency for ANAP, were not inclined to make favor-seeking in Ankara the focal point of their entrepreneurial efforts. They were more frustrated than appeased by the prospect of their profits depending on shifting decrees. They preferred a predictable and stable regulatory environment to getting favors today that could be taken away tomorrow.⁶

In the late 1980s coordination problems became more problematic as Özal turned his attention more to politics. This started in 1987 during the debate over allowing politicians from the 1970s to return to active political life, and continued when the referendum approved their participation. Özal's political involvement increased further after the 1989 municipal elections, which ANAP lost, and after he moved up to the presidency later that year. In a reorganization in June 1991, virtually all economic policy making was put under one Minister of State for Economy, who was also named Deputy Prime Minister. Trade, fiscal and monetary policy were put under him, along with the State Planning Organization, the Central Bank, and the major state banks. This move was certainly not inevitable, indeed it was hardly anticipated, but it did aim to address a widely recognized problem in getting the different branches of the economic bureaucracy to cooperate.

Professionalization versus Politicization

During the 1980s, attempts have been made to restructure the bureaucracy and to institute a managerial bureaucracy involving a top-down approach (Heper 1990). The ANAP governments sought these changes as a means of securing the smooth implementation of the structural adjustment program. The most visible manifestation of this trend has been the appointment of a select group of young U.S. educated technocrats, with a strong commitment to the neo-liberal model, to top positions within the economic bureaucracy. This group, popularly known as the Princes, were dependent on and loyal to Özal and became key

6. Interviews with Dinçkök, Kirazci, Üçer.

figures in the implementation of the economic program during the latter half of the 1980s.⁷ This top-down process of restructuring often succeeded in creating nodes of competent technocrats who could carry out a reform program, when the political leaders wanted it. As one would expect, the old-line bureaucrats resented having their traditional policies rejected and their career plans thwarted.

Along side the positive trend in the direction of restructuring the bureaucracy and augmenting its technical capacity, there was sometimes a negative counter-trend of de-professionalization of the bureaucracy at top levels during the 1980s. The erosion occurred through the expansion of the domain of political appointments into the middle levels (general manager level). Promotions within the agencies became less common. The Central Bank has avoided this, and so too has the Treasury to some extent. The growing prevalence of political appointments has severely reduced the autonomy and collective identity of the bureaucracy vis-a-vis the political elites (Heper 1989).

Two institutions illustrate the extremes of professionalization and politicization -- the Central Bank and the extra-budgetary funds, respectively.

Central Bank

The Turkish Central Bank has long been part of the bureaucracy, dating back to 1930, but in the 1980s it underwent changes that enabled it to play an important role in the structural adjustment process. Since the mid 1980s, the central bank has been the principal entry point into the government for economists favoring neo-liberal policies and a base for disseminating their policy ideas. By the end of the 1980s the central bank had the institutional capacity, although not always the mandate, to take independent action that could influence policy outcomes.

Prior to 1983, the central bank was effectively under the Ministry of Finance and had no autonomy from it. With the reorganization in 1983, the central bank was moved out of Finance and put under the Minister of State for Economy, to whom the new Treasury Undersecretariat also reported. Yavuz Canevi was named governor, moving up from being director of the foreign exchange desk. Educated in the Faculty of Political Science at the University of Ankara, like most bureaucrats of the time, Canevi had moved over from the old Finance Ministry in the late 1970s. Along with him came several other bureaucrats -- such as Zekeriya Yildirim -- whose key distinction from the usual type at Finance was that they also had some foreign graduate training and a command of a foreign language. Canevi became Undersecretary of Treasury and Foreign Trade, after Pakdemirli, and Yildirim became acting governor of the Bank after Canevi's departure. Eventually, they moved out to

7. Some of the Princes and their followers started out with a degree from the Faculty of Political Science in Ankara -- the equivalent of the French Ecole Nationale -- but then went on for a graduate degree in the United States or Europe, and perhaps even worked for a time in the private sector, before entering the government. Some of them began their studies at Bogazici or METU, in engineering or economics.

the private sector, but they did start a tradition at the central bank of intellectual leadership for the economics ministry and of an internationalist orientation.

In 1986, the degree of international intellectual influence at the central bank increased further with the arrival of Ruşdu Saracoglu, initially as director of research, his two successors in that position, Bulent Gultekin and Hasan Ersel, and another senior official, Ercan Kumcu. All had graduate training in economics or finance from American or British universities, and they brought with them a number of young economists with a similar background. Rather than emphasizing legal procedures and lines of authority, like their predecessors who only had training as financial auditors from the political science faculty, the new economists emphasized using a statistical basis for policy decisions and evaluating them in terms of functional outcomes. Saracoglu has moved up to be governor, and economists of this new breed have since occupied all the positions of importance in the bank. Gultekin, on leave from the Wharton Business School, moved out from the bank to head up the Public Participation Fund (an agency for the privatization of state-owned enterprises), and then served as a political advisor to ANAP since returning to Wharton. Economists have otherwise not spread out from the central bank to other agencies within the bureaucracy, although the relatively high caliber of their analysis and its resonance with work done at the OECD, IMF, and World Bank has given the central bank a strong voice in discussions of macroeconomic policy (interview with D. Gökçe).

Although the central bank has remained within the economics ministry, it gained some independence there, at the price of more dependence on the prime minister. The central bank law of 1970 stipulated that the governor would be elected by the share holders (Treasury own 70 percent) for a term of three years, and could be dismissed by the shareholders, which effectively required a vote of the whole cabinet. When Saracoglu was appointed governor in 1987, the term was lengthened to 5 years, strengthening his position in the bureaucracy and especially vis a vis Treasury. Saracoglu's power grew because he retained the confidence of Özal and his designated successors in the prime minister's office and thus outlasted his counterparts at Treasury.⁸ Although Saracoglu and the top officials at the central bank retained their positions after the change of government in 1991 -- in contrast to the complete turnover at the top in Treasury, Finance, and elsewhere -- the way that the central bank had to increase its monetary financing for the government in 1992 indicated the limits of its autonomy.

Extra Budgetary Funds: The Sorcerer's Apprentices

From the point of view of sustaining structural adjustment, the proliferation of the Extra Budgetary Funds was the biggest organizational mistake of the 1980s. Prior to 1980, there were 33 funds, all small and some dating back to the 1940s, but 24 were added in 1980-83 and 48 more in 1984-90. The largest funds as of 1991 were the Public Participation

8. Bienen and van de Walle, 1990, show the generality of the pattern where people who remain in office longer gain in power.

Fund, the Mass Housing Fund, the Support Price Stabilization Fund, and the Defense Industries Support Fund. Smaller funds included the Justice Administration Improvement Fund, Mosque Construction Assistance Fund, Cement Fund, Fund for Measurement and Tuning Services, Universities Research Development Fund, and Tobacco Fund (Treasury 1992: 53). They were initially created as agencies to fund priority economic activities, in spite of the temporary borrowing constraints on the central government, and as a way to make imports of consumer goods, like cigarettes and alcoholic beverages, socially and politically acceptable, because taxes on these imports went for popular purposes. In 1984, the new government announced that a surcharge was to be levied on "luxury" goods, with the revenues earmarked for the Mass Housing and Public Participation Fund aimed at providing low-income housing, particularly in the urban areas.

The funds were assigned to different ministries, usually according to their area of concern. Soon each ministry wanted to have one or more funds, for they were convenient ways to avoid the scrutiny of the budget process. A parliamentary law was necessary to set up a fund and to define the goods on which it could set levies, but after that the amount of the levy and the expenditure of the fund could be set by decree. The variable levies are set by the appropriate Deputy Undersecretary for Treasury and Foreign Trade, in consultation with the relevant fund. The check on the creation of new funds usually comes on the revenue side; interest groups and legislators will resist additional taxation, but this has not been able to stop their proliferation, especially where their trade taxes have protectionist effects (Oyan, Aydin and Konukman, 1991). The revenue of the funds grew from 1.3 percent of GNP in 1981 to over 11 percent in 1990 -- over half of all public sector revenue (Oyan and Aydin, 1991: 121, 125).

The levies create economic distortions in several dimensions. The levies distort both production and consumption decisions, except in the now small minority of cases when they are imposed on goods with a negative externalities in consumption, like cigarettes. Mostly they are like tariffs on narrowly defined categories of goods. From a macroeconomic perspective, the funds change aggregate spending and taxation with usually no reference to what the overall stance of fiscal policy should be. The funds occasionally make transfers to the general budget, as in 1987. When a fund runs a deficit, however, it borrows as necessary. Although the loans to the funds carry a government guarantee, they are not coordinated in the government's debt management strategy. Borrowing covered an average of 25 percent of total expenses for funds in 1988-91 (UTFT, 1992: 57). In 1989-91, borrowing by the funds shifted strongly to foreign sources.

The funds have created distortions in political dimensions as well. First, by removing a substantial part of the economic decisions making from the normal bureaucratic routines and from the possibility of democratic oversight, the Turkish political system has avoided developing the consensus-building procedures that are crucial for viable democracy. Second, the expenditures of the funds were often used to reward municipalities that voted for ANAP. The import levies were also an important means to offer selective protection against import competition for industries that the government wants to reward. The levy system reduced the

transparency of the import protection regime. The actual level of protection for any branch of industry was much more difficult to ascertain than from tariffs. The locus of rent-seeking also shifted to an administrative arena, where specialized knowledge both of administrative procedures and of the particular markets provided advantages.

The political control over the funds has become less centralized over time. At first, Özal controlled the funds closely, as he did other aspects of economic policy. As the number of funds grew, however, they proved to be too much for him to monitor, and no one else had the authority to do so. After Özal ascended to the Presidency in 1989, control of most activities of the funds devolved to the separate ministries. Until the end of the ANAP period, the only remaining coherence derived from the fact that all the ministers were from the same party. In 1992, the new government moved to centralize control of the funds under Treasury.

International economic community

International organizations -- the OECD, the European Community, the World Bank and the IMF -- played a big role in Turkey's adjustment program, but were not able to dictate most of its content. Turkey has been a member of the OECD since the beginning, because of its participation in the predecessor organizations created by the Marshall Plan. In the late 1970s, when Turkey's commercial debt crisis became acute, the OECD organized a consortium to orchestrate the rescheduling of Turkey's commercial and bilateral debt. The fall of the Shah of Iran and the Soviet invasion of Afghanistan increased Turkey's strategic importance for NATO, motivating OECD governments to provide financing directly and through international institutions. The OECD reports and other work provided background material for the consortium meetings, which in turn put the muscle of some money behind the recommendations of the OECD.

The European Community functioned more as a source of role models and offered the possibility of membership as an aspiration, for which Turkey knew it would have to improve its policies in many dimensions.

The IMF and the World Bank influenced both the long-term evolution of economic philosophy in Turkey and the short-term determination of policies. The influence on economic philosophy was, if anything, the more direct. Özal worked at the Bank in the 1970s, where he was impressed with the arguments in favor of more open trade regimes.⁹ Saracoglu worked at the IMF prior to coming to the central bank, and this presumably influenced his ideas on the proper conduct of macroeconomic policy and the role of the central bank. The staff of the Bank and Fund developed close working relationships with many staff in the central bank, the state planning organization, and treasury, which led to agreement on the diagnosis and prescriptions for Turkey's economic problems.

9. Interview with Deniz Gokce.

The Bank and Fund were of course key players the development of policy packages in the early 1980s. There was a big need for balance of payments support, and there was a contest of economic philosophies within the Turkish government, and the backing of external official financing and technical advice was crucial in tipping the balance within the Demirel government and under the military. For the government, it was important to be seen publicly in Turkey as acting on their own initiative, rather than at the behest of the international institutions. For this reason, for instance, the January 1980 measures were launched in advance of formal agreements. The first SAL was not signed until April and the new Fund Stand-by not until June. There were informal talks, however, as a routine Fund mission came to Ankara in December 1979, and then Ozal went to Washington (Okyar 1983). "...the World Bank was in a far better position to operate in secret than the Fund. As an instrument, the SALs, and particularly the specific conditions attached to them, were virtually unknown to the public, and this enabled the Turkish government gradually to present the measures agreed with the Bank as its own policy. With hindsight, now that it has actually materialized as a medium-term strategy, the adjustment program also appears more consistent than could have been foreseen in early 1980, when the aim, as in previous years, was to resolve the acute crisis and the debate centered on the Fund's restrictive conditions." (Wolff, 1987, p. 117) Both the Bank and the Fund continued active policy dialogue throughout the 1980s. Turkey had five SALs in 1980-84, and then four Sector Adjustment Loans approved in 1984-88, making it by far the largest recipient of balance of payments support in that period. Turkey had Stand-by Arrangements with the IMF in 1980, 1983, and 1984. The influence of both institutions declined in the late 1980s, especially since the Turkish economy ran BOP surpluses in 1988-89 and restored its access to international capital markets.

C. POLICY OUTCOMES

The picture of the political economy of structural adjustment emerges more clearly as we examine how the institutions described above actually handled the key policy issues from 1980 to 1991. Turkey's trade and exchange rate reform succeeded in bringing about a large and beneficial structural change in the economy, despite some politically motivated slippage at the margins. On the other hand, politically motivated slippage in macro policy left Turkey with severe macro imbalances, despite occasional and temporary success in slowing inflation, reducing the budget deficit, or stabilizing the exchange rate.

Trade policy reform can be divided into three inter-related, yet distinct components: real devaluation and commitment to a more flexible exchange rate policy; export promotion measures; and the liberalization of imports. The mix between these instruments changed during the three main period of the 1980s.

Fiscal deficits and inflation were two of the largest problems with Turkey's adjustment process in the 1980s. Most of the time, the government responded to short-run

political pressures and let macro policy slip.¹⁰ The main exceptions were when the urgency of the situation made stabilization the top priority. On the other hand, the structural adjustment succeeded in shifting the whole context for macroeconomic policy, by creating a more open financial and trade regime. By the end of the 1980s, market forces had been developed to act as constraints on the public sector -- the state had to pay a real interest rate and to endure the inflation that were the consequences of its macroeconomic shortcomings. By 1990, the state enterprises operated with more competition from the domestic and foreign private sector.

First reform wave -- 1980 - 1982

The first wave of reforms started with the January 24 measures in 1980 and continued until Ozal's ouster in summer 1982. From then until the end of the military government in November 1983 there were some minor reversals of reform, although most of the reforms were sustained and provided a foundation from which further reforms could proceed.

Trade issues

In the first phase of trade reform, initiated with the January 24th Measures, the exchange rate and export subsidies were the most critical policy initiatives; the government's objective was to increase the profitability of the tradable goods sector quickly, relying on existing capacity. Some import liberalization also occurred, but as Celasun and Rodrik conclude, the adjustments in trade policy prior to 1984 were modest and "it is perhaps more appropriate to regard the improvement in the macroeconomic context as the enabling cause of trade liberalization, as opposed to the other way around." (Celasun and Rodrik 1989, p. 720).

The first phase of trade reform emphasized export promotion and other measures to eliminate the foreign-exchange constraints that had crippled the Turkish economy by winter 1979-80. Turkish growth since 1960 had been based on inward-oriented expansion. Exports were under 5 percent of GDP. With little foreign exchange coming in, the government controlled its allocation closely and imposed harsh penalties on those caught holding it without authorization. Extensive regulations for licensing trade and allocating foreign exchange fostered the expansion of rent-seeking activities, as described by Krueger in her empirical as well as theoretical work (1974a, 1974b, 1992).

In response to the oil shocks of the early 1970s, Turkey had borrowed heavily from abroad, running its external debt up to almost four times exports, although only about 20 percent of GDP. When the 1979 oil shock hit, credit lines were already dried up, and the government did not have the foreign exchange to meet its debt payments. Import restraints tightened further. The experience of a winter in Ankara without heat or coffee made and

10. As the preceding sections show, the government broadly conceived was not a unitary entity, but the term government will refer in this section to the Prime Minister and the team that was deciding economic policy.

with the spread of political violence made Turks willing to take the economic and political risk of measures to open the economy.

Trade policy and exchange rate reforms were central to the stabilization and adjustment program introduced on January 24, 1980, shortly after a new government under Demirel took office. The most important reform was the 33 percent devaluation of the Turkish lira and elimination of almost all multiple exchange rate practices. Over the course of the year, a number of small devaluations followed until May 1981, when adjustment began on a daily basis. While exchange rate adjustments seem unremarkable today, one must recall that the Turkish public opinion prior to 1980 viewed devaluation as a national disgrace and as a severe political mistake for a government (Saracoglu 1987). The reforms also liberalized access to foreign exchange, particularly for exporters and banks involved in the export business. These included all the groups or conglomerates, which dominate Turkish manufacturing, trade, and banking. For them, the remaining constraints on holding foreign exchange were not binding, since their import-export businesses and foreign offices gave ample opportunities for legally holding marks and dollars.

The devaluations had more than a passing effect in clearing the foreign exchange market, because other measures contributed to bringing down inflation below the rate of depreciation, thus effecting a real devaluation. The two main policies were reduction of the fiscal deficit, discussed in a later section, and reduction of real wages. Real wages declined sharply with the rapid inflation in early 1980, and labor policy under the military kept them from recovering. Table 1 shows the pattern of real wages and the real exchange rate, calculated in terms of WPI purchasing power. Labor groups were politically active in 1980, up until the time of the coup, but did not focus on or succeed in getting wage increases to match inflation. The military government promptly disbanded all unions and forbade strikes. Any wage disputes were settled by binding arbitration. Wages were typically set with two-year contracts. The first year increase usually provided only a partial catch up and the second year increase was predetermined and based on a forecast of inflation that was usually lower than what actually occurred (Vieira da Cunha, Webb and Isaac, 1990). As a result, real wages declined. To make this harsh wage regime politically sustainable, even in the short term, it was combined with an agreement by all major private and public sector employers not to lay off workers. Thus unemployment was disguised, and the cost of it spread over most of the work force. As the economy recovered the underemployment declined, as well as the unemployment.

The policies of suppressing both real wages and lay-offs carried Turkey through the early 80s. They could not be sustained, of course, in an economy experiencing major structural change and real growth, and in a society where democracy was the norm and military rule was not considered legitimate except in unusual and temporary circumstances. Unwinding the policies became a problem mainly at the end of the decade, as described later.

Export promotion measures included a variety of incentives, several of which constituted direct subsidies. Export credits were the most important in 1980-81, as shown in

table 3. They ran as high as 40 percent for industrial exports. Tax rebates were initially designed to compensate exporters for indirect taxes and as a substitute for a VAT rebate, which is allowed under the GATT. The term rebate is really a misnomer, however. First, the subsidy rate was not related to the total amount of taxes paid by the exporter, and could exceed it. Second, the rebate scheme was introduced prior to the introduction of the VAT, and when the actual VAT rebate was added, the prior rebate scheme remained as a pure subsidy. Over the long term, these subsidies are correctly viewed as undesirable distortions. In the short-run, however, they may have had some rationale as a way to foster infant industries and, perhaps more important, to speed up the expansion of trading and manufacturing firms in the export sector. These firms had a vested interest in supporting the internationalist stance of the Özal government.

Table 3. Export Incentives

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Total	22%	21%	22%	24%	14%	19%	25%	23%	15%	8%
Export Tax Rate	1	4	10	12	11	7	6	5	4	2
Duty Free Imports	6	5	4	6	3	10	14	12	4	--
Pref. Export Credits or FX Allocation	16	13	7	7	--	--	--	--	--	--
Cash Grants and Corp. Tax Rebates	--	--	--	--	--	3	6	7	6	6

Source: Bateman and Arslan, 1989.

The export subsidy rates for the manufacturing sector from 1980 through 1983 averaged 22 percent. (See table 3 and Milanovic 1986.) In the first two years of the program, this subsidy was largely in the form of export credits. The subsidy varied widely - some sectors, such as metal products, received subsidies over 100 percent. Milanovic's calculation show that the higher subsidy rates appeared to go to those sectors in which import-substitution had been of long-standing, including ferrous and non-ferrous metals, electrical and non-electrical machinery and transport equipment. These were mostly sectors where public-sector enterprises were predominant, but the private firms tended to be more involved in the export-oriented subsectors, because they could produce the higher quality products demanded in the export markets.

Not all exports were effectively subsidized. Agriculture, traditionally a stronghold for the Justice Party, lost subsidies. The January 1980 measures established a Price Support and Stability Fund at the Central Bank. The Fund, one of the first new extra-budgetary funds, was financed by a levy equal to the difference between export receipts and domestic support prices for agricultural products. In effect, a tax on agricultural exports would be used to subsidize basic agricultural inputs purchased by farmers, but also to finance export-oriented investments and to provide exporters' risk protection.

There was some liberalization of imports in the early 1980s. Since 1958, when Turkey initiated its annual import programs, all imports were divided between a liberalized and quota list. The liberalized lists contained goods considered essential for objectives of the economic plans; the quota list contained less essential goods and competing imports. In 1980, the quota list was reduced only slightly, but in 1981 it was eliminated. Most of the items from the quota list moved to the liberalized list of goods, and the government retained a positive list system of prohibited goods and a licensing system. Advance deposit requirements were also lowered, though a distinction was still drawn between "importers" and "industrialists," with the former required to pay more substantial deposits. (See appendix table 2.) Perhaps the most dramatic liberalization pertained to exporters. Import taxes on raw materials and intermediary goods imported for incorporation in Turkish exports were reduced to zero, providing the exporter had the foreign exchange to finance the transaction.

Macroeconomic issues

The January 24, 1980 measures contained only a few measures that directly addressed the deficit and inflation problems, because the shortage of foreign exchange was the more immediate problem, and it was not yet realized how comprehensive a solution would be necessary. Some key measures had the immediate effect of increasing inflation -- devaluing currency, abolishing the Price Control Committee, and requiring SEEs to balance their budgets and allowing them to do so by raising prices. As devaluation and elimination of price controls reduced production bottlenecks in the medium-term, supply and output expanded, reducing inflation pressures. The price increases to balance the SEE budgets were necessary for reducing unsustainable deficits and long-term inflation. The increases were equivalent to excise taxes and were indispensable to the stabilization effort. In order to assure that the SEE price increases, as well as the devaluation, were not totally passed along into inflation, money and credit expansion had to be slowed. Monetary policy tightened under the guidance of the newly created Money and Credit Committee, but not enough to prevent an increase of average prices that was unprecedented for Turkey. Interest rates were liberalized in July 1980, so that the effects of tight money would pass through to the rest of the economy, although collusion among banks delayed this effect until the following winter (Saracoglu 1987).

Even though any economist would agree that the January measures improved the trajectory of the Turkish economy, compared to an attempt to persist with the status quo, average prices increased more in the subsequent year than in the year preceding. Real wages and real prices for many goods and services in the non-traded sector did not keep up with overall inflation. Although many of the resulting changes in relative prices were necessary, they caused intense frustration among some groups, which contributed to the continuation of political violence.

With the military takeover, Özal received a mandate to proceed directly with whatever fiscal adjustment he thought necessary. He boasted in the press that he was acting only on economic considerations and that he was ignoring all political considerations (source,

see Ulagay 1987). In light of Özal's subsequent display of political skills, one should not take such statements too literally, but they do suggest that the military government freed him from the short-run political considerations that were later to play such havoc with fiscal policy.

Monthly price increases remained high through 1980, roughly doubling over the year, but then the rate of increase dropped quickly in 1981 to around 35 percent per year, where it remained through 1983. (See figure 1.)

An economist careful with words would describe most of the increase in the average price level in 1980 as a one-time adjustment to recognize previously suppressed inflation, and not true inflation. The distinction was not clear or important to most Turks, especially those who had been getting rents in the form of excess real wages and privileged access to scarce foreign exchange. Some of these groups were active in the protests of summer 1980.

Why did inflation persist at over 30 percent annually after mid 1981 when the government still had substantial instruments of persuasion at its disposal? With two-year, overlapping wage contracts, the goal of lower inflation not only conflicted with the goal of further real devaluation, but a key element in achieving the real devaluation was the persistence of inflation in the face of nominal wage increases in the second contract year that were based on lower inflation projections (Vieira da Cunha, Webb, and Isaac 1991). Also, the military government did not want to press fiscal austerity and tight money to the point where some of their supporters would suffer. This comes out most clearly in the Bankers' crisis in summer 1982, when the military insisted on relaxing the stabilization measures to prevent politically damaging bankruptcies. This serves as a reminder that military, authoritarian governments are not immune to interest group pressures.

The military expected to stay in control longer than three years, either directly or through a hand-picked successor, and therefore thought that the gradual disinflation policy they had been following would have time to complete its course. Leading up to the election in 1983, they did not realize how important the issue remained for people, and the ANAP party campaigned with a platform of making inflation the principal target for policy reform.

Politics

Ideas for the reform package developed in several places. Some economists in the bureaucracy and academia were already advocating devaluation and trade liberalization in late 1970s. The industrial groups in TUSIAD formed the core of interests that would ultimately benefit from open-economy policies, and in 1978 they published an article by Turgut Özal that argued for most of the policies ultimately included in the package. Krueger and Turan (1991) are wise in advising caution about attributing the adoption of the program to pressure from TUSIAD, however. The article by Özal in 1977 is well within the tradition that the president of TUSIAD, then Feyyaz Berker of the Tekfen Group, would sponsor a position piece without being able to mobilize the organization to lobby for it directly with the

government. The World Bank, the IFC, and the IMF were also advocating such policies, both on the basis of analysis by their own economists and as conduit for Turkish business opinion (G. Ercel interview). Özal worked at the World Bank in the early 1970s, and the experience strongly influenced his views on economic policy (speech, Nov. 1991). It seems entirely plausible that Özal himself was the only node at which all these influences converged. Although the program was consonant with many of the ideas current in the business community, there was not an open consultation process between policy makers and the economic interests within Turkey that were effected.

Demirel and Özal briefed the top military leaders, and presumably the Bank and Fund officials, to assure their support, but did not tell all of the ministers of the government what would be in the package. Even the Minister of Finance was not informed, although many of his staff had worked on bits and pieces of the program, without being shown the whole picture. The top technocrats often took pride in the extent to which they had pulled off a surprise move, and for measures like the exchange rate devaluation such secrecy was crucial (Krueger and Turan 1991; interviews with Canevi and G. Ercel).

In this first phase, the reform package benefitted many different groups, compared to their suffering from the inflation and foreign exchange shortage, so that many of the usual dispute over distribution were put aside, making the political choices easier. Export promotion, through exchange rate undervaluation as well as direct subsidy, very quickly increased the aggregate supply of foreign exchange, allowing most parts of the economy to have greater access to foreign exchange. The increase took place directly through higher export earnings and also through greater availability of external finance, in response to the evidence of export growth.¹¹ Since imports were vital inputs to virtually all sectors -- import competing and non-traded, as well as export -- virtually everyone in Turkey benefitted from the relaxation of the severe import constraints that arose in the crisis of the late 1970s. The international community of Turkey's financiers was also pleased. The emphasis on export promotion and restoring financing flows in the first phase stimulated some recovery of employment. That environment made it easier, although perhaps not sufficiently so, to complete the removal of distortions with measures that might require substantial exit from subsidized sectors. Given the continuing weight of import-substituting industries in the economy, and presumably their political clout as well, no effort was made to confront these producers directly through extensive liberalization, despite the additional protection they received from the devaluation itself. Firms with substantial import-competing lines, such as Koc, whose products include cars and home appliances, still lobbied for protection in those particular sectors, but they also favored the framework of a more open economy with a competitive real exchange rate. The main interests that lost were agricultural and labor.¹²

11. Diwan 1990 explains how export promotion measures, which would create distortions and inefficiencies in other contexts, can increase welfare when they are integral to a strategy for debt rescheduling.

12. Ozmucur 1991, Boratav 1990. Many small businesses lost from the stabilization package, because of the high interest costs, but small-business activities were so varied that a comprehensive assessment is not possible. Many small firms profited, for example, from export-oriented expansion.

How important were political events for trade and exchange rate policy? Obviously, the change of government from Ecevit to Demirel in November 1979 was crucial. Ecevit in that period would never have brought a market-oriented, TUSIAD-supported technocrat like Özal to head up the economic team. The biggest question concerns the relation of policy reform to the military coup. The behind-the-scenes pressure of the military in January 1980 for the government to do something about the political and social disorder was also a factor, although it was the civilians who had to sell the military on the need for radical adjustment measures. The political turmoil did not prevent the initiation of adjustment, but it probably would have derailed the program if the military had not intervened. The military did not takeover in order to promote (or to prevent) the economic policies of the Demirel-Özal government, but rather to quell political unrest that most of the population agreed had become intolerable. The political violence predated the January 1980 adjustment measures, and its continuation was only partially in reaction to them.

The January 1980 measures angered the unions, because of their economic effects, like reduced real wages, and because of the exclusion of unions from the process of designing the measures. Strikes and other forms of labor unrest, often violent, became increasingly common during summer 1980. While some of this would have occurred in any case, as a symptom of long-term political factors, the short-run impact of the January measures contributed to making the disruptions severe enough to motivate the military to intervene. Turkey's experience with the initial phase of the adjustment program in 1980 certainly supports the hypothesis that political management of adjustment becomes difficult if not impossible when a strong labor movement is not incorporated into the policy process.

During their tenure in power, the military supported adjustment passively during the years when Özal remained in charge of economic policy, but not after the military put in their own man. By cracking down on unions and imposing tighter social discipline generally, the military helped create the political environment where the stabilization and adjustment began to take effect. After Özal's departure from the government in 1982, along with the core of his economic team, the military government reversed the real depreciation that had been launched with maxi-devaluation in 1980; there was some real appreciation in 1982. The military did not push ahead with deficit reduction or trade liberalization, not to mention privatization. This verifies the impression from the events of 1980 -- the military did not take over in order to impose a strict adjustment program.

The centralized, top-down institutions of policy making under Özal and the military were well suited to policy making in the first phase of adjustment. In the first phase of adjustment, moving fast was important to resolve the crisis and to take advantage of the fresh memory of crisis to push through bold initiatives.

Sustaining and extending reform with democratization: The mid-1980s

A second phase of reform began after the election of November 1983, and most of the positive lessons for politically managing structural adjustment in a new democracy

emerge from Turkey's experience in the mid 1980s. Özal's government was committed to a more market-oriented approach, de-emphasizing subsidies and using active exchange-rate management and import liberalization, including the removal of quantitative restrictions and a reform of tariffs. Some changes, such as the shift to a negative list system, were sudden, but other reforms, including the lowering of tariffs, were introduced gradually and selectively. The scope of liberalization was also partly offset by taxes and surcharges which, while apparently initiated for revenue reasons, had clear protective effects. Nonetheless, both the level and dispersion of nominal and effective rates of protection was reduced.

The military government had already restarted the devaluation policy before the election, and Özal continued it through the first half of 1984. During the second half of 1984 and the first half of 1985, the real exchange rate was once again allowed to appreciate. The reasons for this are unclear, but probably reflect some lag in the adjustment of the rate to domestic inflation, which was higher than anticipated. In order to continue the export drive, the government resumed aggressive devaluation in 1986. See Table 1.

The continued moderation or suppression of wage demands was a critical factor in keeping domestic inflation below the rate of exchange depreciation in the mid-1980s. From 1982 to 1988, industrial wages rose less than domestic inflation and exchange depreciation in every year but 1987, leading to declining real wages. See Table 1. The policy and political reasons for this outcome are obvious. Strikes remained illegal in the private sector until 1987, and for the public sector unions they were still illegal in 1991. Wage labor was definitely a minority of the economically active population, however, and the ANAP had some success in appealing even to labor on more diffuse economic issues, such as general prosperity (lower unemployment), and on religious or nationalist grounds.

The system of import lists was revised in December 1983. Although many restrictions remained, it was a substantial liberalization. Under the old system, everything not on the QR lists was prohibited; the new system had three lists and all other imports were permitted without quantitative limit. Intermediate inputs and investment goods were easier to import, although still with licenses. Some consumer goods were still prohibited, but many were unlisted or readily importable with the payment of a special levy on luxuries. SPO handled the licensing but no longer used its discretion to reward or punish firms according to whether they were meeting plan targets (Baysan and Blitzer 1991). After 1983, the number of categories of goods requiring import licenses declined in every year except 1985, declining from 821 in 1983 to 33 in 1989.

Tariff rates were adjusted in December 1983 and again in January 1984. Some rates went down and others went up, but the overall effect was strongly liberalizing, especially in January. Explicitly to cushion the impact of liberalizing the licensing system, tariff protection was reduced less in sectors that lost the most licensing protection. Most consumer imports were completely liberalized from QRs, but their tariffs were increased, particularly through dollar-denominated levies by EBFs. Tariffs were reduced substantially for most

capital goods, but most of them remained on one list or another, usually the second. For intermediate goods, there was reduced protection from both licensing and tariffs.

The institutions for distributing incentive certificates consciously emulated the Japanese and Korean models of creating general trading companies. Trading companies with exports in 1983 of \$30 million, of which at least 75 percent had to consist of industrial and mining products, were given certificates automatically. The annual export requirement was to be raised each year by 10 percent. The policy contributed further to the concentration of Turkish business and also to creation of a self-conscious interest group favoring open trade, but not necessarily supporting free trade (Öniş, 1992).

Foreign exchange regulations were also liberalized in December 1983 and January 1984. Banks were allowed to deal freely in foreign exchange at a market rate, as long as it was within 6 percent of the (frequently adjusted) official rate. Turkish citizens were allowed to hold foreign exchange and to open domestic bank accounts denominated in foreign exchange; they could not yet freely convert lira to foreign exchange. Except for the allowing of foreign exchange deposits, these regulatory changes only made official and more irrevocable the situation that had been de facto in force since 1980. Nevertheless, the changes were important because before 1980 the power of the government -- specifically the Finance Ministry -- to allocate scarce foreign exchange had been one of the important channels for rent seeking and for enforcement of the central-planning targets. Thus, official liberalization of the foreign exchange regime was an important complement to the relaxation of the licensing system in demonstrating the government's commitment to continue moving toward a more market-directed economy.

Özal had promised in the 1983 campaign to bring inflation under 10 percent within a year, but his government never achieved this objective. In 1984, the new government concentrated on its other electoral pledge, to end the economic hardships associated with stabilization. Özal decided to try supply-side tax cuts, combined with expanded public investment, export subsidies, and accelerated depreciation of the lira, in order to stimulate economic growth. The policies did not have the hoped-for effect of stimulating private investment, which remained well below the levels of the 1970s, but the package did stimulate aggregate demand and thus output growth. Because the expansion resulted from a shift of the demand curve more than a shift of the supply curve, inflation increased again, from 31 percent in 1982-83 to 48 percent in 1984. Stimulating a boom immediately after an election runs counter to the logic of the electoral business cycle. The government did not need to heat up the economy to look good for an election.¹³ They seem to have been genuinely surprised at the inflation in 1984.

The rising inflation alarmed Özal, and the OECD, IMF and the World Bank as well. These supporting external agencies worked closely with Treasury, the Central Bank, and SPO to develop a stabilization program. Again, the ability of the upper bureaucracy to act

13. There were local elections in March 1984 -- early enough so that 1984 was mostly a post-election year.

decisively when it had Özal's support was crucial. Reducing export subsidies and introducing a value-added tax also contributed to the stabilization, as well as to the fundamentals of Turkey's structural adjustment.

For political and institutional reasons, these measures did not realize their full fiscal potential. When export growth flagged, the government raised the export subsidies again in 1985-86. To enforce collection of the VAT, the government setup an elaborate rebate scheme. Besides drastically reducing the effective rate of the VAT, the scheme became a large entitlement program whose removal or serious reduction would arouse political protest. Also, the government did not follow through on complementary fiscal measures, such as permanently reducing subsidies to state enterprises and raising corporate income taxes.

Unlike the typical case of persistent moderate inflation, monetary financing of government deficits played an important role in Turkey up through 1988 (Anand, Rocha and Van Wijnbergen 1988; cf. Dornbusch and Fischer 1991). Expansion of central bank credit to the private sector was not a serious contributor to inflation.

The policy reforms of 1983-84 had been planned in advance of the election by Özal and his top advisors, and, at least in broad outline, trade liberalization had been part of ANAP's electoral platform (Keesings 30: 32926). The ability of the government to modify quickly the trade incentive in January was an important result of the bureaucratic reforms in December, namely creating the UTFT. Several studies by the World Bank in the mid 1980s helped prepare the trade measures, but this was not a case of imposing reforms through conditionality, but more of technical assistance in an endeavor fully supported by the government.

To win political support for his program, Özal exploited the theme of the absence of an alternative economic program. He pointed to the improved performance of the economy and to Turkey's renewed ability to attract external resources on a large scale, which contributed to the rapid recovery of the economy in the early 1980s (Celasun and Rodrik 1987; Celasun 1990). ANAP's popularity in the mid-1980s, also derived from measures which may be termed popular capitalism. Financial liberalization, for example the transition of positive real rates of interest on bank deposits, was instrumental in generating a new group of middle-income rentiers who directly benefitted from the program and added to ANAP's base of support. Similarly, the early features of the privatization program contributed to ANAP's success in the mid-1980s. The sale of revenue-share certificates was popular as a mechanism for extending property ownership to middle- and lower-income groups. The extensive housing program and the development of infrastructure extended basic amenities to many parts of the country.

Although trade reform was surely a less important factor in appealing to the voters in 1983 than the memory of the successful reforms in 1980 and the position of ANAP as the sole alternative to the military-sponsored parties, there was no sense that trade liberalization had been implemented in the face of substantial opposition. This was because much of the

import-competing manufacturing was done by the large conglomerates. They accepted the measures because what they lost from the import liberalization was more than made up for with the improved business opportunities in the financial and export sectors.

Turkey's top-down institutions of decision-making continued to work well in the trade policy area during the second reform phase, because it was important to move quickly in order to take advantage of the honeymoon after the start of restoring democracy. An opportunity was lost, however, to bring a broad spectrum of industrialists and other exporters into the decision process. Individual businessmen continued to petition for specific favors, but there were only ad hoc consultations on the major changes, and not with organized interest groups.¹⁴

Policy oscillations since 1987

While the elections of 1987 largely completed the process of reestablishing electoral democracy in Turkey, major aspects of economic reform remained to be completed, especially liberalizing imports and reducing fiscal deficits and inflation. Some of this agenda was completed by 1991, but much was not, and there were many policy reversals. Often the difficulties in sustaining reform derived from characteristics of the democratic system in Turkey.

Trade policy

Although there were no clear breaks in trade policy in the late 1980s, there was a notable increase in the pattern of "two steps forward, one step backward."¹⁵ In 1986-88 liberalizing trends coexisted with the growth of backdoor barriers in the form of surcharges and taxes, but then in 1989-90 there was a movement toward freer trade. That movement was not complete or uniform, however, for two reasons. First, there was some fragmenting in the responsibility for trade policy and erosion of the centralized bureaucratic process that characterized the decisions of the mid 1980s. Also, a wider range of firms was brought into discussion of the measures beforehand (interview, Nishimizu). By the end of the decade, despite tremendous export performance and an improvement over the system of the 1970s, Turkey retained many features of an import-substituting system, with nominal protection in some sectors offset by subsidies to exporters.

The high volume of trade by the late 1980s suggests that distortions had decreased markedly; also, the actual pattern of trade corresponds in rough outline with what one would surmise is Turkey's comparative advantage. Thus there was probably not a high static

14. Interview with Canevi.

15. This expression in Turkish alludes to a famous and generally successful battle tactic of the Ottoman army. To achieve victory against the opponents of reform, as against the enemies of the olden empire, the tactic requires discipline to assure that the forward steps greatly outnumber the backward.

welfare loss from the trade regime by the late 1980s. The majority of the welfare loss was probably a dynamic one, arising because uncertainty discouraged investment and therefore reduced productivity growth. There remains considerable variation in protection because of EBF levies, although their absolute level is not high, often varying down to zero. This variation seems to have become more discretionary and created many opportunities for rent-seeking. The multiplicity of tariffs, levies, QRs and incentives make it hard to tell at any point in time how the relative prices of inputs and outputs for a sector compare to those in the world market. Quantitative studies of effective protection, such as Olgun and Togan (1989, cited in OECD 1990/91, pp. 86-89) are based on legal tariff rates, and they do not systematically take account of the effects of QRs and export incentives. The lack of transparency and frequent changes were confusing not only to bureaucrats and academics, but also to firms. They were not sure how the trade regulations affected the relative profitability of two activities, but were relatively sure that those regulations would change in a year or two.

The geometry of Turkey's trade reforms, shown in figure 2, sheds light on the political economy. The trade liberalization of the early 1980s had two politically favorable features. First, the degree of distortion was very large initially, so the triangles of efficiency gain were large relative to the rectangles of transfers. As Rodrik shows elegantly, this increases the likelihood of reform. Also, Turkey was a classic case of the trade reform being packaged with a stabilization and external financing package that provided large and quick gains, overshadowing the distributional issues in the early 1980s (Rodrik 1992). In the mid 1980s, the triangles of efficiency gains were smaller and the policy makers had to rely more on rising income through steady growth to distract people from the distributional issues. By the late 1980s, the tremendous expansion of trade made the rectangles of redistribution very long and thus large even for small changes of the tariff rate. Large reductions in tariffs were no longer possible and large increases were out of the question, but even small changes became big favors because of the high volume. Protection became politicized again, in the context of a basically open trade regime.

In 1986-88, import policy vacillated. The number of items subject to restrictive licensing was reduced in May 1986, but in July the advance deposits for imports were increased, although they had been virtually eliminated in 1984-85. The import surcharge earmarked for the Price Stability and Support Fund was increased in December 1986 and then again in October 1987. In January 1988 the number of items requiring import licenses, which had slipped back up to 111, was reduced to 33, and customs tariffs were lowered for 234 items, including basic industrial inputs. This brought all tariffs rates under 50 percent, although this was partially off-set by applying surcharges to more goods and raising the stamp duty on imports. In 1988 total import taxes were 13 percent of the total value of imports, and 37 percent of the value of dutiable imports. Customs duties per se were less than one third of the total (Bateman and Arslan 1989, table 9).

Table 4. Average Tariff Rates (*all averages unweighted*)

	1987	1988	November 1989
All Categories	30	24	11
Agriculture	22	18	11
Mining (& petroleum)	17	18	6
Manufacturing	31	25	11
Consumer goods	45	35	17
Intermed. goods	21	17	6
Capital goods	32	30	10

Source: Bateman and Arslan, 1989, tables 2, 4.

In 1989 and 1990 the direction of change became clearer, with major liberalization of import licensing and tariffs -- the main instruments of protectionism in the past. In August and September 1989, tariffs (and surcharges) were lowered on over 300 items, mostly consumer goods. (During 1989 the import regime was modified at least seven times.) In January 1990 the list of items subject to import licensing was abolished, all import deposit guarantees were eliminated, custom duties were reduced for 7,545 items and eliminated for 333 items, and surcharges were reduced for 1,255 items and eliminated for 2,357 items. Some barriers and distortions remained, as discussed below, but the main instruments of protection had been eliminated or reduced to such a level that it would involve a major policy decision to restore widespread import protection.

The vacillation of trade policy in 1986-88 is consistent with a story of the government having a general objective of trade liberalization, but frequently compromising in order to limit trade deficits and to reward politically favored groups. Major steps were taken in the direction of trade liberalization and establishing full currency convertibility in August 1989. What explains the more consistent liberalizing trend after mid 1989? The government had planned after the election in fall 1987 to liberalize imports further. Liberalization had to come sometime in the next few years anyway, in order to meet Turkey's obligations to GATT and to get back on track with a process of unifying tariffs with the European Community, a process that the Turks had halted during their troubles of the late 1970s. (Bateman and Arslan 1989, p. 5; M. Nishimizu, interview, May 1991). From the view point of a traditional electoral cycle viewpoint, early 1988 would have been a good time, in order to get short-run costs out of the way and to have time to realize the efficiency gains from liberalization. In early 1988, however, the government faced a recession resulting from its anti-inflation stabilization efforts and therefore decided to defer the import liberalization. Also, there were still immediate concerns about external credit and foreign exchange constraints. By late 1988 the situation had changed. The economy was booming, led by export growth that was strong enough to generate a current account surplus. In December

1988 the Turks confirmed in a speech to the EC Ad-hoc Committee that they would fulfill all remaining obligations to tariff reductions on an accelerated schedule, by 1995 (Bateman and Arslan, 1989, p. 5).

Short-run political concerns also added to the pressure for liberalization: high inflation had persisted for over a year, and polls conducted just after the municipal elections in March 1989 singled out inflation as the most important cause for ANAP's unexpected set back. To stem the ebb of his popularity, Özal felt that he had to do more to combat inflation. He had since the 1970s put forth the argument that liberalizing imports could combat inflationary pressure from domestic monopolies (D. Gokce, source). It would lower the price of imports, with a direct impact on price indices and therefore on wage demands, and it would reduce aggregate demand for domestic products, as purchases switched to import goods.¹⁶

There have been two wild cards in the array of protectionist instruments in Turkey -- levies by the EBFs and customs-duty exemptions for incentive programs. The protective effect of the import levies imposed by the EBB increase in the late 1980s. In 1987, the levies contributed approximately 6.1 percentage points to an overall rate of nominal protection of 25.5 percent. More interesting from a political economy perspective, however, is the sectoral incidence of the levies and the way in which they contribute to a highly uneven tariff structure. In general, consumer goods and agricultural products have managed to secure the highest level of protection from the levies, with relative less for capital goods producers and virtually none for intermediate goods. Some traditional consumer goods industries, including beverages and cigarettes, and the transport sector, have been able to secure very high levels of protection, for instance 83 percent on autos. (Bateman and Arslan, 1989).

Exemptions to import duties were widely granted in the 1980s as a way to encourage certain economic activities, particularly investment and export production, (Bateman and Arslan, 1989). In 1988 over two thirds of imports were exempt from all import taxes, not only from customs duties. Just over half of imports were duty free because they were for investment or export production (Bateman and Arslan 1989, p. 1). Exemptions were sometimes granted as purely political favors. In some notable cases, an importer had a large shipment waiting in port, and then a short term exemption would be granted for that particular category. Obviously the importer in question would gain a tremendous advantage over his competitors, at the expense of the public treasury and of the stability of incentives for domestic producers. Other widely-known abuses, like export subsidies granted for fictitious exports by politically favored firms, became an embarrassment to the government and contributed to ANAP's setbacks in the municipal elections of March 1989.

16. To some extent, these effects would be mitigated by the effect of import liberalization on the real exchange rate, causing it to depreciate by increasing the demand for foreign exchange. Depreciation would push import prices back up and increase export demand, but this would take longer than the anti-inflationary effects.

Contemporaneous with the growth of backdoor import protection in the late 1980s was a return to more aggressive export support measures, such as duty-free imports, tax rebates, and subsidized credit. Table 3 shows the changing structure of export incentives.

Macroeconomic slippage

The macroeconomic situation in Turkey in the late 1980s deteriorated seriously, and two of the major causes were political -- electoral cycles and the increased union power of a work force eager to restore real wages, especially in the public sector. In the 1987 electoral campaign, Ozal promised to reduce inflation, but did not state any specific target, as he had in 1983. Those targets had been badly missed, so Ozal softened his promises and started to talk of inflation as a price of high growth (Ulagay 1990).

Turkey's macroeconomic problems and attempted solutions in the late 1980s were closely related to the several elections, but there was not a clear pattern that repeats itself. This illustrates two important points:

- The government always wanted lower inflation, but sometimes it was willing to tolerate higher inflation, especially if it would not come until after an election.
- The macroeconomy was not predictable enough for the government to plan inflation or deflation cycles, in a way to improve consistently its electoral performance.

Before the election, the government increased deficits to finance more public-works projects and subsidies and to cover losses of the state-owned enterprises whose prices were being temporarily repressed, to hold down measured inflation. After the election, public prices would have to be increased to cover costs, and this would give a big boost to the inflation rate, especially since the public sector products were often inputs. The general election in 1987 exemplified this most clearly (Kjellstrom 1990). Central bank credit to the government grew 40 percent in 1986, 60 percent in 1987, and 40 percent in 1988 (Central Bank and World Bank staff estimates).

In the aftermath of the March 1989 elections, the ANAP government made a concerted effort to compete with DYP, in order to enlarge its rural electoral base. A direct manifestation of these efforts involved a striking increase in agricultural subsidies via the traditional instrument -- the support pricing scheme -- which, in turn, contributed to the growing fiscal instability in the late 1980s and the early 1990s.

Exchange rate policy became more complex in the late 1980s. The government still wanted the exchange rate to help stimulate exports and to control inflation, although it could not do both at once, but the government relinquished its direct control of the exchange rate, leaving it more as a intervening market response to other policies, especially monetary and fiscal.

From 1986 to mid 1988, the government wanted strong exports to complete the restoration of its external creditworthiness, and hence resumed its aggressive devaluation policy, linking the adjustment to recent inflation. Money growth stayed high to sustain the undervaluation and to provide monetary financing of deficits. Both fiscal and real exchange rate factors thus contributed to the problem of inflation (Vieira da Cunha, Webb, and Isaac 1990). Saracoglu and others at the Central Bank realized that reducing inflation would be impossible with a devaluation policy aimed at reducing the real exchange rate. The well-publicized lessons of the Southern Cone experience showed that it was risky and ultimately ineffective to try to use the nominal exchange rate as anti-inflationary instrument, especially when the fiscal deficit was not yet under control. A prerequisite for an anti-inflation policy at the central bank, in the presence of high budget deficits, was letting the exchange rate float.

By late 1988 Turkey was running a current account surplus, and in October 1988 the government decided to let the rate float. When a run on the lira ensued, the central bank responded not by backtracking on the floating rate but rather by sharply tightening credit in the recently developed interbank over-night money market. The central bank subsequently loosened credit when the crisis passed, keeping the real exchange rate at about its pre-October level.¹⁷ In contrast to the bad impression created by the failed stabilization attempt in early 1988, the central bank in fall 1988 seized the high ground, demonstrating that tight credit and high interest rates were effective and sometimes necessary means to fight speculation against the national currency and to prevent rapid depreciation that could lead to runaway inflation. The floating exchange rate was obviously managed, through the market, to prevent short-term gyrations, but henceforth the central bank would be able to let economic fundamentals take their course.

After 1988 the exchange rate policy was motivated mainly by macro considerations, and the effects on trade were incidental and largely undesired. Although the real exchange rate continues to have important effects on trade, the nominal exchange rate policy was no longer driven primarily by trade considerations. In 1989-91, the combination of rising fiscal deficits with tight monetary policy led to rising real interest rates, capital inflow and real appreciation, as the nominal depreciation slowed relative to the inflation rate. The fiscal deficits rose for the usually political reasons -- the government thought it could win votes by increased spending and avoid losing votes by holding down taxes. It lacked the institutional linkages that would let it appeal to many groups on any basis other than special favors of spending or tax breaks. Tight monetary policy was used to fight inflation, with the realization that one channel for its short-run anti-inflation effects, especially in 1990, was through increased overvaluation (Krueger and Turan 1992).

17. There was great concern about distress in the banking system at this time, making the central bank reluctant to push up real interest rates permanently. Also, continued tight money would cause the real exchange rate to appreciate, and the central bank presumably did not want the floating rate regime immediately associated with overvaluation. Stopping inflation almost always leads to some overvaluation, whether or not the exchange rate is used as a control instrument (Dornbusch 1980), but the central bank in 1988 was not in a position to lead a full-fledged disinflation program.

The government's influence over the real exchange rate also declined in the late 1980s as the relaxation of legal constraint on the labor movement led to increasing strike activity and more generous wage settlements. Nevertheless, the share of labor costs in value added was still low in 1990-91 relative to the rest of Southern Europe, and relative to the 1970s (OECD 1990/91: 99; Ozmucur 1991). Wages had not yet had a major effect on the real exchange rate, but the direction of pressure was definitely upward.

Labor unions became increasingly active after 1987, following the relaxation of restrictions on strike activity and wage bargaining. The pattern of labor union activity in the late 1980s and the early 1990s, in some ways, resembles the pattern of the late 1970s. Unions conceived their role as a self-interested pluralistic pressure group, pushing for the highest wage increases possible. They did not develop a longer-term vision in which sustainable real wage increases would be limited to increases in productivity. A comparison of the two key wage rounds in 1989 and 1991 reveals the evolution of union attitudes. The wage round of 1989 was mainly defensive -- a long-overdue attempt to recover what workers had lost in real terms during the decade. The wage round of 1991 was offensive, however, aimed to secure the maximum real wage increase (interview Enver Taçoğlu, member of Turk İş governing board, November 1991). This is understandable, given that labor's trust was destroyed by a long period of exclusion and by the refusal of business and other key groups to make reciprocal concessions, such accepting adequate taxation.

Real wages rebounded strongly starting in 1989, and this accompanied a real revaluation in purchasing terms. (See Table 1) The major private sector firms could afford to give substantial wage increases, especially in the export sectors, because they had enjoyed high profits in the 1980s and had been able to make productivity-enhancing investments. In the public sector, however, wage increases proved much more burdensome. Most state-owned firms had not increased productivity in the 1980s as fast as the private sector, so the wage increases often exceeded their profit margins, necessitating of central government subsidies, price increases and reduced sales.

Fiscal and monetary policy

Going into the 1987 election the government stimulated a boom with fiscal expansion, while repressing inflation with restrained devaluation and stagnant public sector prices falling in real terms. Immediately after the election they raised public sector prices, to stem the losses by public enterprises, and resumed devaluations at a pace to keep the real exchange rate competitive. The government realized that the measures would cause average prices to rise, but expected, or at least hoped, that it would be one-time blip in the inflation rate, and not persist. The rise of electricity prices and other inputs to industry pushed inflation up from under 40 to almost 80 percent, and it did not come down quickly. Voters who had elected ANAP for its record of economic management felt betrayed and turned against ANAP in the municipal elections of March 1989.

In 1988 the government tried and failed to have a stabilization led by fiscal retrenchment. The stabilization program of February 1988, designed to restabilize the economy, caused a sharp fall in the growth rate, but without corresponding success in reducing inflation. Inflation rates of 60-70 per cent have become increasingly the norm in the latter half of the decade, from an initial base of 25-30 per cent in 1983. This contrasted sharply with a key promise of the ANAP government in 1983, that inflation would be reduced to 10 percent within a single year (Ulagay, 1987). As the decade progressed, this promise became less and less credible, and the government lost its resolve to reduce inflation. It started making excuses for inflation as a price of rapid development, replacing the earlier declarations that inflation control was the central priority.¹⁸

Technocrats in the central bank, treasury, and SPO understood well the policy changes necessary to reduce inflation -- namely to reduce fiscal deficits in a sustainable way, so that the central bank could slow the growth of domestic credit without starving in the private sector. The policy dialogue with the IMF and the World Bank in 1987-90 explored the deficit-inflation issue with the Turkish government, and at the staff level they reached fundamental agreement. The politicians, at least some of whom also understood the economics, decided against tighter fiscal policy in the end, although several reforms may have helped lay the basis for disinflation later.¹⁹

Following the example of the Bundesbank and other central banks in industrial countries, the Turkish Treasury and central bank agreed that there should be an annual monetary program. The events of 1989-91, and even 1992, illustrate the difficulty and ultimately the impossibility of establishing central bank independence without the government's commitment to low fiscal deficits. The staff of Treasury and the central bank developed a monetary program in 1989, although without public announcement -- effectively a shadow program. It failed because of excess credit demands from the government. The next year, with more foresight, the central bank and Treasury waited until the latter could make a commitment -- sign a protocol -- not to borrow more than a certain amount from the central bank. Then the central bank announced a monetary program, to which it kept. The protocol did not stop treasury from increased borrowing, which was financed that year by borrowing in the domestic capital market, to which foreign capital inflows were coming strongly.

Events in the first half of 1991 illustrate the importance of establishing the precedent and expectation of the monetary program. At the beginning of 1991, the Minister of State for Economy did not have Treasury issue a commitment on the deficit and financing. The Central Bank responded by declining to issue a monetary plan. Treasury furthermore

18. Interview with E. Kumcu.

19. The finance ministry, under Pakdemirli, did develop in 1989 a comprehensive tax reform that would have both raised more revenue and improved efficiency, for instance by establishing a corporate income tax. The proposal was rejected, however, after big business protested.

insisted that the central bank double its rate of financing to the government, in order to hold down the cost of borrowing. The central bank recognized that it could not sustain both an interest rate and an exchange rate targets and, rather than using up its foreign exchange reserves to temporarily hold to the two targets, it let the TL fall rapidly under market pressure. Treasury then retreated. It was by then too late in the year for a formal protocol and monetary program, but Treasury did agree to a fixed nominal limit on its monthly borrowing from the central, which would progressively contract in real terms. The central bank accepted the increase in money base at the beginning of the year but after March kept central bank money growing at a rate slightly below the growth rate for 1990 which was within the range in the monetary program for that year (interview with D. Gokce).

Without exaggerating the degree of intra-bureaucratic conflict, stronger disagreement surfaced as the Central Bank became more autonomous institution during the latter half of the 1980s. The February 1988 stabilization program, following the mini-crisis associated with the pre-election boom of 1987, was prepared essentially by the Central Bank, with no input from SPO (although the report itself which formed the basis of the February measures was publicized as the joint product of the three key agencies: Central Bank, SPO and the Treasury). The first point for disagreement or conflict revolved around the exchange rate policy. The conflict was essentially between SPO, on the one hand, and the Central Bank and the Treasury on the other. SPO opposed the real appreciation of the exchange rate in 1989 and 1990 in terms of its potentially negative impact on the tradable sector and long run competitiveness of the economy. The perspective was supported by econometric evidence which identified the real exchange rate as the key determinant of export performance in the Turkish case (Arslan and Van Wijnbergen, 1990; see also Barlow and Senses 1992 and for an alternate view Celasun and Rodrik 1989). The second area of disagreement involved the timing of capital account liberalization and transition to convertibility. Specifically, the Central Bank opposed the August 1989 measures involving capital account liberalization on the basis that such measures were premature considering the degree of instability which existed at the macro-level. In this instance, the conflict involved the Central Bank and the Treasury. Finally, the Central Bank's monetary program became a subject of disagreement. Following the introduction of its monetary program in 1990, the Central Bank was criticized by the other two key agencies that a monetary program would not be effective unless it was coordinated with other macroeconomic policies, in general, and control over the budget deficit, in particular.

The problems of co-ordination between the key bureaucratic agencies was aggravated further by the political vacuum following Özal's election to the Presidency in November 1989. Işin Çelebi, Minister of the State, took a basically pro-SPO stance (on the exchange rate issue in particular) while Günes Taner, the other Minister responsible for the economy, has been on the Central Bank and the Treasury side particularly in relation to the exchange rate issue. Disagreement over the exchange rate policy reflected SPO's greater emphasis on growth and long run competitiveness plus the Central Bank and the Treasury's corresponding concern with stabilization and inflation. The Central Bank increased its influence at the expense of the State Planning Organization (SPO), the premier institution for the pre-1980

era. This pattern was clearly validated by the attempt in summer 1991 to restructure the economic bureaucracy, a few months prior to the general elections of 1991. A primary objective was to take implementation functions away from the SPO and to give it more of an advisory role.

Political Management

Following the second ANAP victory in the November 1987 elections, Özal's direct involvement with economic management diminished, leading after that to fragmentation and lack of co-ordination in economic decision making. 1987 was also a turning point because of the reemergence of wage pressures, repayment of foreign debt (both the interest and the principal) as a novel form of pressure on the budget and macroeconomic balances, and the increasing loss of control on the fiscal side which, in turn, created conflict between growth and competitiveness, on the one hand, and short run stabilization, on the other.

Whereas Özal and the ANAP party failed to mobilize support from many of those benefitting from trade liberalization because the benefits were too diffuse and the top-down style did not link in such support from the start, the failure to reap political support from the beneficiaries of stabilization is more due to the government's failure to sustain stabilization. When political support wavered, the government did not hark back to the success of the 1980 stabilization and call for a return to sound fiscal policy; rather they usually tried populist measures that were fiscally damaging, such as restraining public-sector price increases, increasing public-sector wages, and spending more on popular local projects. When the political situation became tight, the government often seemed to give up campaigning on the basis of sound macroeconomic policy, returning rather to strategies of interventionism and patronage.

From a political economy point of view, the trade liberalization continued to expand the group of winners from structural adjustment, albeit not quite as large a group as would have existed with more predictable policies. But because the policies often changed unpredictably and without consultation with those most directly affected, the creation of a large group of gainers did not translate into corresponding political support for the ANAP government. ANAP could run as the party of successful structural adjustment in 1983 and 1987, but this reputation had faded by 1991.

D. LESSONS FROM TURKEY

The wide variation in economic and political outcomes in Turkey since the beginning of the 1980s offers the opportunity to draw important lessons on what to do and what not to do in politically managing structural adjustment. We first summarize the balance of achievements and then tell what lessons seem to transcend the Turkish circumstances.

Balance of achievements

In terms of accomplishing a structural reorientation of the economy, the Turkish adjustment experience has been a huge success. The share of output for export rose from five percent in 1979 to 23 percent in 1989, and real output roughly doubled. The financial markets are not only open internationally, in stark contrast to the pre 1980 situation, but they have developed depth and sophistication. Even in the areas where the program must be judged a failure as of the end of 1991 -- reducing fiscal deficits, inflation, income inequality, and the size of inefficient public enterprise sector -- the transformations of trade and finance fundamentally altered the context of the problems, changing their effects on the private sector and changing the options for the government to deal with them.

Although the first phase of economic adjustment was sustained, though not initiated, in an authoritarian context, the Turks restored democracy when the agenda for reform was incomplete. ANAP won office on the platform of economic success and eventually lost in part because of failure of economic policy. The electoral defeat of ANAP in 1991 did not mean, however, the demise of the pro-structural adjustment or the pro-liberalization coalition. The long period of ANAP rule helped consolidate reforms to such a degree that all the principal parties agreed on a broadly similar economic program. The ideological differences between the left and the right -- state-directed versus market-orientation -- substantially diminished. Despite the persistence of significant distributional conflicts, broad agreement on the desirability of market-oriented reforms constituted an important source of optimism for the future of structural adjustment in an era of coalition politics. Without sharp ideological conflicts, coalition politics in the 1990s seemed unlikely to duplicate the highly unstable pattern of the late 1970s.

While the reforms of the early 1980s greatly reduced the importance of rent-seeking, particularly with regard to foreign trade, patronage politics by ANAP became more widespread again in the latter half of the decade. Hence, the initial strength that ANAP derived from privileged access to state resources was progressively converted into a disadvantage. As individuals or firms with direct access to the government proliferated, the specific favors they managed to obtain led to growing resentment and reaction on the part of the wider populace. The experience of over-invoicing exports, or fictitious exports in more popular language, designed to take advantage of favorable export subsidies, and the subsequent failure of the government to adequately discipline or penalize the companies involved also proved to be a major source of discontent. The fictitious exports also jeopardized the popularity of exporters, as a group, and the attempts since 1980 to build a pro-export coalition. Some key features of the import-substitution regime continued.

Although the private sector has become much more vibrant and competitive in world markets, a large public sector remained basically intact at the end of the ANAP era, and rent-seeking was still prevalent. Many people became disaffected by ANAP's arbitrary distribution of rents from the central government. Traditional sources of patronage politics

included state economic enterprises, public banks and public sector contracts. The extra-budgetary funds created new avenues for distribution of rents. Fiscal decentralization during the period, involving the proliferation of extra-budgetary funds and increased spending authority granted to municipalities, also tended to amplify fiscal disequilibrium.

Top-down political liberalization

The hierarchical structure of ANAP, under a strong and dominant leader, helped the party in the early and the mid-1980s, but was increasingly a disadvantage during the latter half of the decade. Özal's style of leadership and his unwillingness to delegate power prevented a smooth transition of leadership within the party. Part of ANAP's defeat in the 1991 elections resulted in part from some of its constituency transferring to the smaller Islamic fundamentalist party, which experienced a striking increase in the share of votes relative to the 1987 elections.

Furthermore, the political vacuum left by Özal's ascendance to the Presidency created divisions within the party and the government itself, which were partly responsible for the problems with macro-economic coordination. The divisions within the party led eventually to the withdrawal of important parts of the conservative-religious faction. In 1991, under the leadership of Mesut Yılmaz, a representative of the liberal wing, ANAP recovered some of its old cohesion and vitality. While this process of recovery was reflected in the election results of 1991, it was not sufficient to prevent defeat.

Empowered technocrats

From a comparative perspective, the Turkish experience up to late 1987 shows the effectiveness of the key individual lending a select group of technocrats in securing the necessary degree of consistency and bureaucratic cohesion in the initiation of structural adjustment. Yet, once the leader departs, co-ordination problems arise in the absence of an autonomous and internally coherent bureaucracy.

In retrospect, the failures of macro policy in the latter 1980s can be traced to three forces. First, a broad consultative process had not been institutionalized to cultivate popular support for macro stability. Second, the top bureaucrats lacked autonomy vis-a-vis the politicians, and hence, were unable to counteract the pressures toward the expansion of the fiscal deficit. Third, there were problems of co-ordination and conflict within the bureaucracy itself, which were accentuated further by the appointment in 1989 of two separate Ministers (Güneş Taner and İşin Çelebi) both of whom tried to assume responsibility for the running of the economy.

The highly centralized and insulated policy apparatus which Özal created in the early 1980s proved to be useful in initiating and sustaining reform through its early stages. Yet, insulation and lack of institutionalized links with interest groups increasingly turned out to be

a disadvantage coordinating policy and managing distributional conflicts under conditions of fully competitive politics in the late 1980s.

Dealing with interest groups

Political management of the reform process requires coalition building to deal with interest groups -- developing each part of the reform package so that it contributes to the overall objectives of the program and at the same time satisfies the relevant groups enough for them to go along with the overall program, even if other parts are not to their liking. Turkey had mixed success in this regard.

The support of large-scale business was the domestic counterpart of extensive external assistance, both factors contributing toward the success of structural adjustment efforts. Conglomerates occupy a pivotal position in the Turkish economy. By 1980, the major conglomerates represented by TÜSIAD had recognized that the import-substitution model which involved sales to a heavily protected home market was no longer a feasible option. The conglomerates smoothed the path for trade liberalization. They had been the bastions of import-substitution during the 1960s and the 1970s, but emerged as the principal exporters in the 1980s. The dominant role of export-import companies, the majority of which were the subsidiaries of the major conglomerates, in the export surge of the 1980s clearly testifies the validity of this proposition.

The absence of serious distributional pressures on policy-makers for a considerable period (due to the authoritarian regime during the 1980-1983 phase and limited political liberalization during the 1983-1987 era) also proved to be a key factor which contributed to a process of smooth adjustment from a position of acute crisis. Real wage flexibility, due to the political exclusion of labor up to 1987, contributed to the short-run economic success of structural adjustment, although with obvious costs in terms of the objective of democracy and income equality. The pattern of labor relations after 1987, which fits neither the "exclusion" nor the "corporatist intermediation" categories, clearly has been a source of instability. TÜSIAD recently sponsored a study that recommends the creation of an Economic and Social Council, which would bring together, in a formalized and legally recognized setting, representatives of business (TOBB, TÜSIAD, Turk-Trade, and TISK, the employers' association), labor (Turk-Is and DISK, recently legalized), agriculture (TOZB), and the government. The Council would work to create a consensus on the framework for economic policy and on the specific measures to effect it. It would provide feedback and guidance during the implementation process (Onis and Sunar, 1992).

Packaging and tradeoffs between macro and trade reforms

The Turkish case illustrates both the benefits of packaging trade and macro reforms, in order to make both of them more politically acceptable, and the dangers of letting trade and financial sector reforms attract financing that permits a continuation of non-adjustment in the fiscal dimension.

The crisis of 1979-80 created for most Turks a mental association between unavailability of import goods and the problems of the old economic policy regime. Consequently, through the 1980s, trade reforms were widely recognized as being in the interest of the average man, rather than as concessions to foreign or internationalist interests. Export subsidies in the form of low interest credit and tax rebates played an important role in the Turkish case in terms of encouraging exports and helping to build a pro-export coalition. Thus an unorthodox instrument helped to buy support for the more conventional instruments such as exchange rate devaluation and import liberalization.

Packaging fiscal reforms to help stabilize the economy with trade and exchange rate reforms to alleviate the balance of payments crisis in early 1980s helped to make both kinds of reform more attractive politically. There was also a pattern in the late 1980s, however, of making additional and more radical trade and exchange rate reforms instead of doing the necessary macroeconomic measures, especially reducing the fiscal deficit. This exacerbated economic problems over the longer term, although it did help the government get continued financing over the short term and alleviated some other symptoms of macroeconomic problems.

Speed of reform

A large portion of the reforms were initiated in two windows of political opportunity when the government had a mandate for dramatic action -- in the balance of payments crisis of 1980 and in the post-democratization honeymoon of 1983-4. Making reforms rapidly was important at these junctures. Later in the 1980s, as the democratic process became more routine, reforms succeeded when they were carefully prepared in consultation with the groups affected. Crash programs and gradualism were thus each appropriate for different circumstances.

External financing

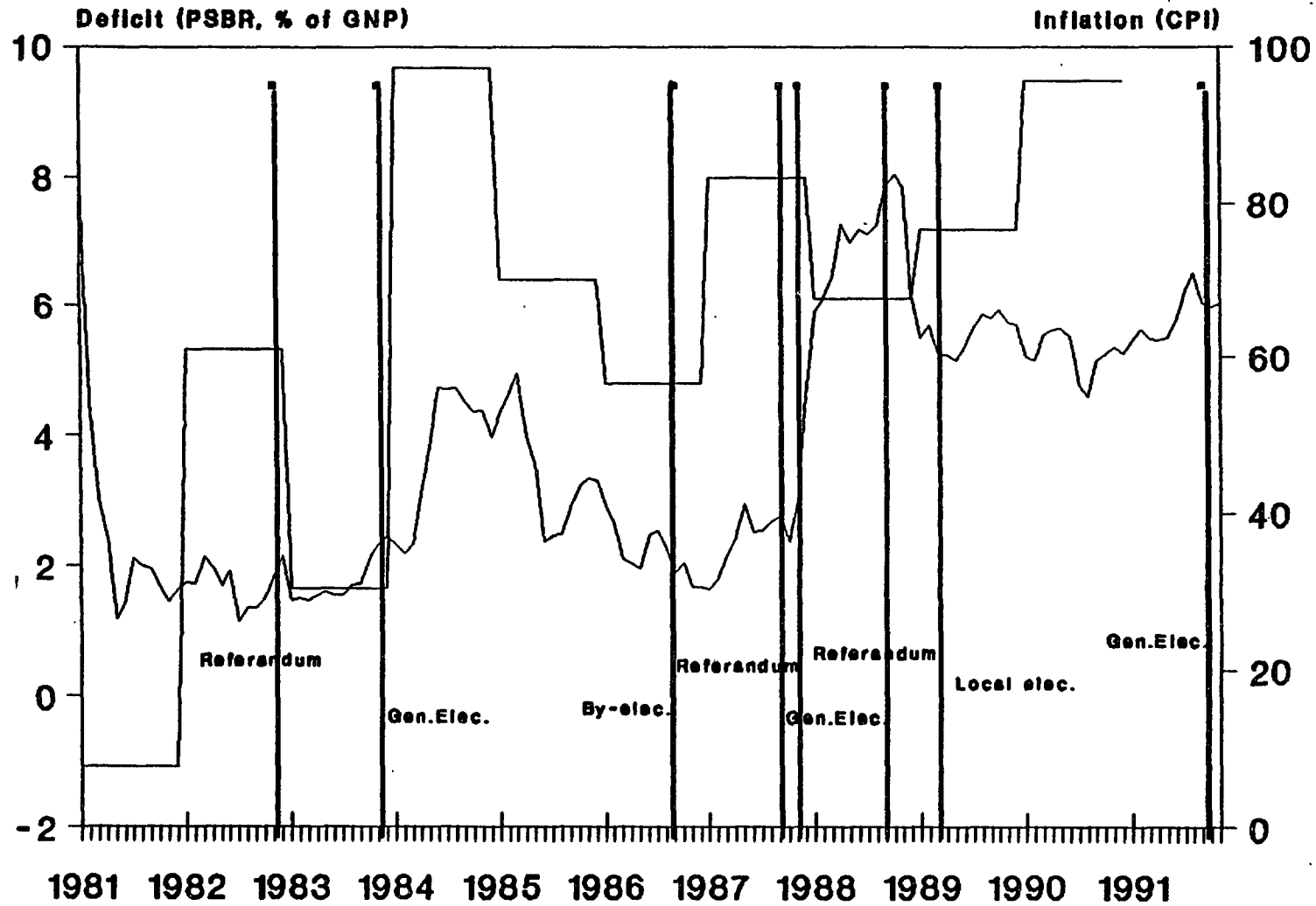
The substantial external assistance that Turkey received in the early 1980s contributed to a large supply response and, hence, to a speedy recovery, which reduced the costs of stabilization and structural adjustment. The scale and speed of the recovery helped the policy makers justify the program to broad segments of the population, to override opposition, and to consolidate a pro-reform coalition. Given the acute import-starvation of the Turkish economy at the peak of the crisis, rapid recovery would not have been feasible in the absence of external assistance on a substantial scale. Slow recovery would have jeopardized the future of the program.

In the later 1980s, however, Turkey's success in getting external financing -- from commercial as well as official sources, and the success of the government in getting domestic financing, unfortunately allowed the government to pursue expansionary fiscal policies for short-term political motives. This caused serious problems with inflation and eventually with other types of macroeconomic instability.

Challenges for the 1990s

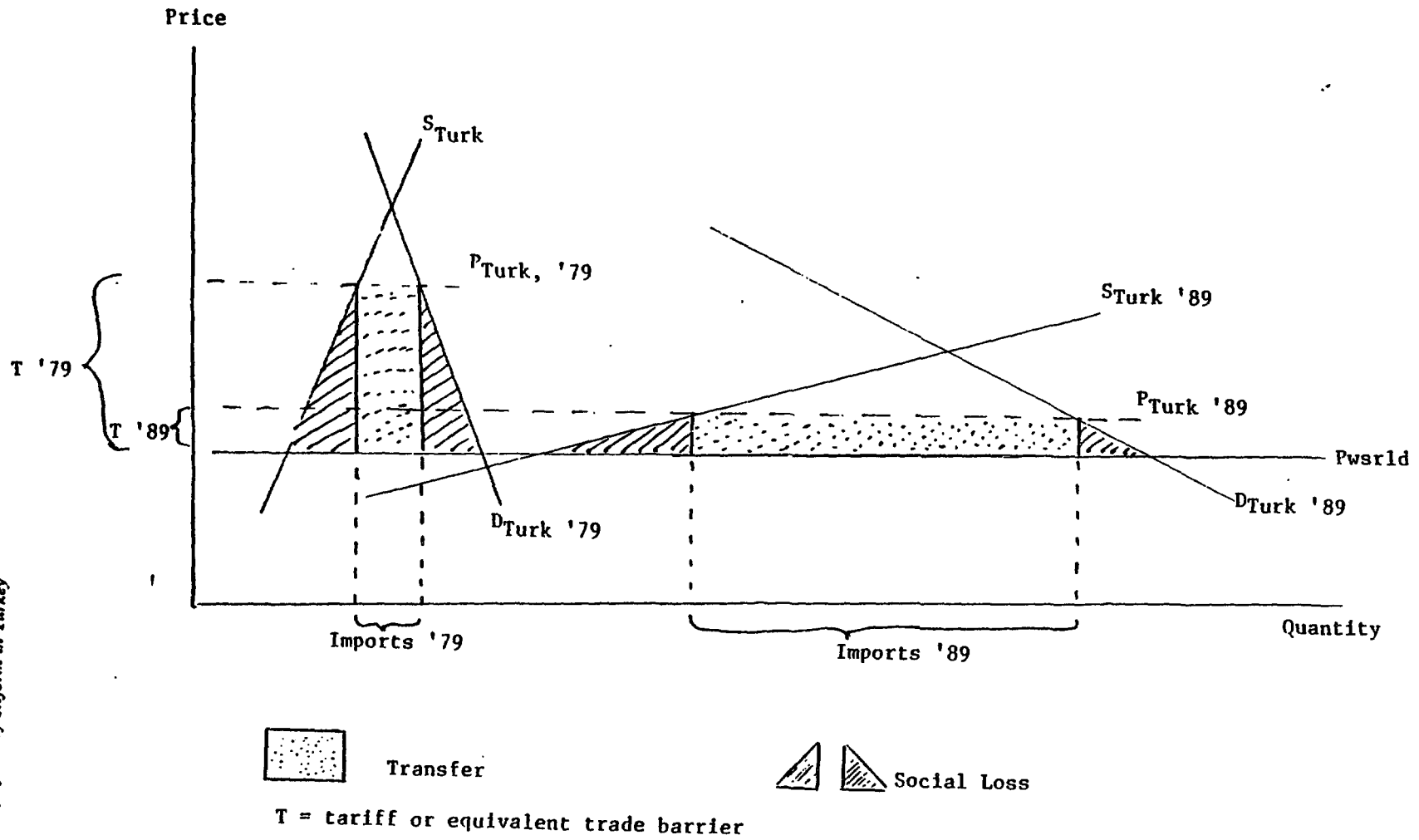
The twin challenges that Turkey faced as it entered the 1990s were to consolidate and broaden democracy and to renew the efforts at economic reform. Consolidating democracy would involve expanding human rights and the avenues for political discussion of economic interests. The experience of the 1980s had modernized the economy and had removed many of the ideological impediments to policy formation, which had paralyzed it in the 1970s. The political culture remained paternalistic, however, so that the democratic incentives to seek popular support were channelled into patronage and the direct provision of benefits, which made good macroeconomic policy almost impossible. To meet also the challenge of economic reform would require political and institutional innovations to resolve distributional conflicts -- over issues like wages, taxation, and agricultural support prices -- and to avoid populist solutions.

Figure 1. Turkey: Deficits, Inflation and Elections, 1981 - 1991



Data Sources: 1. W.B. Country Study, 1990
 2. C.E.M., Oct. 1991

Figure 2. Transfers and Social Costs of Trade Barriers in Turkey



Appendix 1. The Budget Process

The problems in inter-agency coordination for economic policy in Turkey are well illustrated by the routine established after 1983 for making the annual government budget. In the first phase, the Budget Department in the Ministry of Finance gathers current expenditure requests forms from the various parts of the central government and collates them. SPO puts together the investment budget. It is a more political process, with requests coming from various ministries and members of parliament, who are the conduits for any interest group pressure. Only ANAP deputies participated in the process during their tenure in power; opposition parties were totally shut out of the process. SPO receives the requests and collates and reconciles them with the 5-year plan. The draft budgets for the SEEs are done in Treasury, with input from SPO on the investment program. In the second phase, SPO, Treasury, and the Budget Department of the Finance Ministry bring together their parts of the draft budget and reconcile them with the macroeconomic program for the coming year. Treasury prepares this program on the basis of the macroeconomic forecasting done in SPO. The output from the three agencies, the Technical Budget, is passed up to the High Planning Council. Here the Prime Minister and other top politicians make final adjustments and then submit the Budget to Parliament for approval. Further changes in parliament are usually minor -- mainly adjusting salary levels and making a few changes in public investment.

Implementing the budget is the task of Treasury. There is always some divergence between the planned budget and the outcome, and this is inevitable given that the budget is formulated in nominal terms when inflation makes it impossible for the government to forecast accurately the path of prices over the year. If the government wants to convince Parliament of the need for fiscal tightening, it will understate revenues. If the Budget Commission, an inter-agency organization, decides on spending cuts (usually across the board), it passes these on to the Finance Ministry to enact. (Vis a vis the EBFs, Treasury usually tries to understate revenues and claw back revenue from them.) Unanticipated inflation or political pressures may lead the government to decide to have an extra-contractual adjustment of public-sector wages.²⁰

20. Interview with Y. Ege, N. Akturk.

Appendix Table 1. Advance Deposits on Imports (percent)

	Before 1/24/80	After 1/24/80	1/81 to 12/83
Liberalized List I			
Importers	40	30	20
Industrialists	25	15	10
Liberalized List II			
Importers	40	20	20
Industrialists	25	10	10
Quota List			abolished
Importers	10	20	
Industrialists	2.5	10	
Public Sector Imports	--	0	
Additional Deposit Requirements			
Acceptance Credits	--	1	
Imports against documents and suppliers credits	50	20	
<i>Source: OECD Economic Surveys, Turkey, March 1981, p. 48.</i>			

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