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POLITICAL RISK IN TURKEY

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Executive Summary

- The military regime has achieved a level of political stability and social peace that would have been unthinkable three years ago. As it begins the process of restoring civilian rule, it has been rewarded with a show of public support in the recent referendum that promises continued stability and effective government for at least the next 3-5 years.
- With the departure of the strongly monetarist Ozal and the impending revival of political party activity, economic policy is likely to shift toward revitalizing the depressed domestic sector. Structural changes that might increase already high unemployment will be postponed. The rate of inflation in 1983 will almost certainly exceed present targets.
- Consequently, the trend toward narrowing current-account deficits may be reversed in 1983, unless exports of goods and (construction) services remain strong. Because of Turkey's increasing dependence on Middle Eastern markets, a substantial drop in OPEC oil prices could cause severe Fx problems in 1984-85.
- Turkey's enhanced strategic importance in American eyes and its progress toward political normalization will lead to increased levels of U.S. and Western Europe aid in the medium term. Relations with Greece, while tense, are likely to remain peaceful.

Implications for Bankers Trust Business: The short and medium-term outlooks are favorable for expanded business, particularly trade financing. Given the vulnerability to external factors, however, close monitoring of trends in Turkish dealings with Middle Eastern OPEC nations is advisable. Since the critical period for OPEC may well be the next six months, it may be prudent to minimize term lending during the first half of 1983.

POLITICAL RISK IN TURKEY

After more than two years of military rule, Turkey made -- on schedule -- a long stride toward return to parliamentary democracy with the national referendum of November 7, 1982. In a smashing success for the regime that surpassed its own most optimistic forecasts, 90% of registered voters turned out to approve the new constitution by a 9-1 margin. Under a temporary constitutional clause, the leader of the ruling junta, General Kenan Evren, automatically became President for a seven-year term.

Major causes for this overwhelming show of support are the vast improvement in the law-and-order situation throughout the country, following the near-anarchy and rampant terrorism of the 1976-1980 period, and Evren's own personal popularity. Even allowing for the fact that political activities are banned under martial law, and no campaigning against the proposed constitution was allowed, the 91% yes vote is quite impressive. All indications are that the referendum was generally free of irregularities, and that there was no interference or pressure by the security forces. While indirect ways of influencing voter choice in the secret balloting may have been used, particularly in the rural areas, it should be noted that the approval ratio generally held steady throughout the country.

Particularly significant is the fact that the main political parties and their leaders -- notably former prime ministers Suleyman Demirel of the Justice Party and Bulent Ecevit of the Republican People's Party, both of whom dominated Turkey's political life over the past two decades -- came out against the constitution, as did the leaders of the smaller extreme-right nationalist and fundamentalist parties. This was not unexpected, as another temporary clause in the constitution bans these leaders from politics for ten years, and prohibits all members of the last parliament from forming new parties or assuming leadership positions in them. The results of the balloting thus amounts to a fairly sweeping repudiation of powerful traditional political figures and groups. This is even more remarkable given the highly politicized character of the Turkish scene prior to the military takeover, and the relatively severe restrictions on civic and political freedoms written into the new construction.

The next step -- scheduled for the second half of 1983 -- is the formation of new political parties and the election of a new parliament. What shape the political scene will take will be largely determined by the terms laid out in the law on political parties yet to be drafted by the Consultative Assembly. The National Security Council is likely to favor a formula that in practice will limit the number of viable parties. To provide Evren with a political base, the regime may throw its support behind a center-right party, possibly under the leadership of current Prime Minister Ulusu or former economic czar Turgut Ozal. Such a party would appeal to, and drain away, the traditional constituency of Suleyman Demirel's Justice Party, which, despite its proscribed status, still retains some structural coherence, particularly in the countryside, and continues to be the most significant opposition force.

Under the new constitution the President has very strong powers designed to prevent the legislative deadlock that frequently occurred under previous

civilian administrations, including the right to rule by decree in emergency situations. For the duration of Evren's tenure, the other members of the junta -- who will retire from active duty -- will become a special presidential council with important, though rather vague, oversight powers. Evidently, the leadership wants to loosen the reins and allow the political game to resume, but only under careful guidance from above and within fairly restrictive rules.

Despite the criticisms and reservations of West European liberals, the message of the Turkish electorate is loud and clear. It has given Evren and his associates a strong mandate to move ahead with the planned restructuring of the country's political system, and to continue down the path of economic liberalization and integration of Turkey into the global market economy laid out in the January 1980 stabilization program. This augurs well for the political stability of the country over the medium term.

The Economic Challenge

With the return to political normalcy under way, the government is widely expected to enact measures designed to ease the heavy burden of economic stabilization, borne disproportionately by the internal economy. The tight monetarist approach favored by Ozal, and the concerted focus on support for export-oriented industries, have yielded dramatic improvement in the balance-of-payments situation. They also have produced a deep recession in all other sectors, with investment almost non-existent and unemployment at a historic high. In the 1970s emigration provided a release valve for surplus labor, but this is no longer the case, what with recession in Western Europe and the heightened sensitivity in the Arab gulf states to the social consequences of hosting large alien worker populations. While industrial peace since 1980 has been secured through martial law and the mass jailing of labor activists, in a democratic context, conciliatory adjustments to pressures from disadvantaged sectors will be required.

Ozal's successor, Finance Minister Adnan B. Kafaoglu, appears determined to protect the domestic front from further severe shocks. The bail-out of Asil Celik, a steel-making subsidiary of the Koc group, is an example of an interventionary measure that Ozal had refused to take. Substantial divestiture of the perennially money-losing State Economic Enterprises, which make up more than 40% of total industry and constitute a heavy drain on the Treasury, is unlikely for the medium term in view of the unemployment problem. Money will be pumped into the economy in early 1983 to save a number of select companies from bankruptcy. What this trend indicates is a likely increase in 1983 inflation levels, possibly to 40-45%, and very limited, if any, efforts to restructure the economy.

The challenge for Evren and his planners will be to strike that careful balance between the inevitable concessions demanded by political pressures and the need to revive the internal economy on the one hand, and the continued fiscal and monetary discipline required to maintain the confidence of international credit sources on the other, that will keep the impressive recovery of the past two years on track.

The External Environment

Turkey's ability to meet its foreign obligations in 1984-85 will depend heavily on maintaining the momentum of its highly successful export drive, on the level of remittances from expatriate workers, and on the availability of OECD aid. Overall, prospects are good. However, the vulnerability of this strategy to a substantial break in oil prices must be underlined, given the heavy Turkish dependence on Middle Eastern markets.

Exports: In 1982, the Middle East and North Africa for the first time overtook Europe as the major market for Turkish goods (52.3% of total exports). Iraq replaced the FRG as Turkey's largest trading partner, and Iran moved into third place. The Gulf war, on which Ankara has carefully maintained a neutralist position, has been a key factor in spurring trade. Opportunities afforded by Iran's rocky relations with much of the rest of the world also have been used to good advantage by Turkish companies. On the other hand, there is considerable grumbling over more frequent Iranian and Iraqi insistence on oil-barter deals, usually at official prices, following the example set earlier by Libya. Since Turkey must then turn around and sell the oil on the soft spot market, it is currently recovering only some 80% of the value of its goods. Reduced oil revenues also have led to sharply lower imports by Libya in 1982 (reported at \$400 million vs. \$600 million in 1981), and similar cutbacks could affect trade with other OPEC members, particularly Iraq.

Textile exports to Europe are suffering due to rising protectionism within the EEC, and overall Turkish relations with France, whom Ankara sees as the main culprit, have deteriorated sharply.

Another important and growing source of foreign exchange that would be adversely affected by a continued weak market for OPEC oil is construction work in Middle East countries. As of October 1982, 156 Turkish companies were engaged in contract work totaling \$12 billion, of which \$8 billion worth is in Libya. Repatriated profits in 1981 totaled some \$165 million.

Favorable elements that help counteract the recessionary impact on Turkish exports of goods and services are geographic location and the sociopolitical attractiveness for Middle Easterners of Islamic Turkey as a partner. For Iranian military and civilian imports in particular, and for Iraqi oil too, Turkey is an indispensable channel, as well as the nearest and cheapest source of agricultural products and livestock (which make up the bulk of Turkish exports to the Middle East). Politically, decades of aloofness from Middle Eastern conflicts and cultivation of amicable relations with all today, help insulate Turkey from regional rivalries and suspicions. Religious affinity and shared social values are welcome assets in North Africa and the Arabian Peninsula.

Remittances: These same factors and the rapid expansion of contract work have led to a quick rise in the number of Turkish workers employed in the Middle East, to some 200,000 in 1982. Remittances from the Middle East in 1981 reached \$800 million, out of a total of \$2.49 billion. In the first eight months of 1982, total remittances were down by some 12%, mainly due to the

European recession, with steady growth in the Middle Eastern share helping to cushion the impact. This trend is likely to persist. Although development and infrastructure projects in some OPEC countries may be cut back in 1983-84, sorely needed reconstruction work in Iraq and Iran will more than pick up the slack as the Gulf war winds down.

Foreign aid: The IMF and OECD consortium are encouraged by the steady improvement in the balance-of-payments picture, and are proceeding with scheduled disbursements. Despite opposition among some Social Democrats, the German Bundestag is now likely to approve both economic aid and military credits shortly, on the recommendation of its Foreign Affairs and Development committees. West European reservations are mainly political, and they will subside as Turkey moves steadily closer to parliamentary normalization and the credibility of Evren's commitment to this process increases in the next several months.

U.S. aid has increased with the implementation of the 1980 Defense and Economic Cooperation Agreement, with \$800 million budgeted for 1983-84. As programmed U.S. capabilities for power projection into the Middle East come into being, and strategies for defense of the Gulf mature, Turkey is taking a progressively more important role in American planning. The Department of Defense expects Turkey to be the main forward staging base for air interdiction of Soviet forces in the Caucasus were Moscow to attempt an invasion of the Gulf through northern Iran. An extensive program for modernization of Turkish air bases was signed this past November. In short, the American stake in a stable, viable Turkey is higher today than at any other time since the early 1950's. Were a financial crisis to recur, a strongly sympathetic attitude on the part of Washington should be expected.

Relations with Greece: A half-hearted attempt by both governments in mid-1982 to declare a moratorium on mutual recrimination and to improve ties fizzled within weeks. Passions are running high over boundary issues and exploration rights in the eastern Aegean, in addition to the festering Cyprus dispute. Since the election of Socialist Andreas Papandreu, frictions have been exacerbated by rhetorical excesses on the Greek side, mainly motivated by the Prime Minister's domestic political considerations. Ideologically, the two governments stand at diametrically opposite ends of the spectrum, and the growing rapprochement between Washington and Ankara is strongly resented in Athens. Nonetheless, clearly neither capital wants an armed clash, which would solve nothing and exacerbate already very difficult domestic economic conditions. While military incidents in the Aegean cannot be ruled out, chances of serious warfare are minimal.

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