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IMF Executive Board Concludes Ex Post Assessment of Longer-Term Program Engagement and Ex Post Evaluation of Exceptional Access for Turkey

On August 1, the Executive Board of the International Monetary Fund (IMF) concluded the Ex Post Assessment of Longer-Term Program Engagement (EPA) and the Ex Post Evaluation of Exceptional Access (EPE) for Turkey.

Background

By the end of the 1990s, Turkey suffered from chronic inflation, high and volatile fiscal deficits, a large and growing public debt, high real interest rates, low and volatile growth, and a weakly regulated and undercapitalized banking system. By the conclusion of the last Stand-By Arrangement (SBA) in May 2008, the economy had been transformed: inflation had dropped significantly, public debt ratios had declined sharply, the banking system had been restructured, and Turkey had enjoyed a prolonged economic expansion. At the same time, the current account deficit had widened considerably on the back of strong capital inflows and rising commodity prices. Three SBAs—approved in 1999, 2002 and 2005—supported the Turkish authorities' economic programs for most of the period from end-1999 through May 2008.

As required by IMF procedures for cases of exceptional access and longer-term program involvement, the EPA and EPE review the past relationship between Turkey and the IMF. The objective of the EPA is to provide an analysis of the main economic problems faced, and of the progress made by an IMF member under longer-term program engagement with a view to identifying lessons for future engagement with the IMF. The EPE, designed for arrangements with exceptional access, reviews Turkey's 2005 SBA, focusing on whether the macroeconomic strategy and IMF financing were appropriate and in line with IMF policy. Given their partially overlapping objectives, the EPA and EPE for Turkey were combined.

Executive Board Assessment

Focusing on the three SBAs since 1999, Directors noted that, overall, long-term program engagement and exceptional access were instrumental in supporting the authorities' efforts to ensure macroeconomic stability and reduce vulnerabilities. Following the deep crisis and recession in 2001 that marked the end of the first SBA, economic performance improved sharply against the background of an often-challenging economic and socio-political environment, and impressive results were achieved in several areas. In particular, economic growth was strong from 2002, inflation dropped significantly, public debt ratios declined sharply, and the banking system was thoroughly restructured. At the same time, Directors noted that considerable external vulnerabilities remain owing to a large and widening current account deficit.

Directors considered that the Fund's policy recommendations had been broadly appropriate, although a number of Directors felt that structural conditionality—some of which were in areas outside the Fund's core mandate—might have been excessive, particularly in the early period. Directors noted, however, that the path leading to Turkey's remarkable economic transformation had not been a smooth one. A combination of slippages in policy implementation, adverse external developments, and failure to adjust policy to changing conditions undermined the 1999 program. Many Directors were of the view that the exchange-rate-based stabilization program did not leave margin for error, and ultimately was not adequately supported by fiscal policy and banking sector reform. The failure of the 1999 program, and the success of the 2002 and 2005 programs, demonstrated clearly the importance of sound but flexible program design, as well as the crucial role of strong program ownership and political will to enable implementation of complex policies and reforms.

Directors observed that, after the collapse of the exchange rate peg in February 2001, exceptional access to Fund resources and the use of the programs as commitment devices helped to support the authorities' disciplined macroeconomic policies and difficult structural reforms. A more favorable external environment also helped program performance. It was noted that the Fund supported program had focused appropriately on facilitating public debt rollover, a key vulnerability at that time. At the same time, Directors acknowledged that other reforms could have been introduced that would have further entrenched Turkey's impressive macroeconomic gains. Directors noted that improved confidence attracted capital inflows and strengthened the currency. This, along with higher oil prices, contributed to widening the current account deficit.

This review of experience has shown that Turkey still faces challenges to entrench macroeconomic stability, and that disciplined macroeconomic policies will be needed to continue reducing public debt ratios and restart disinflation. Turkey would also benefit from further progress in structural reforms, especially in the fiscal area. Directors also encouraged the continued implementation of the financial sector policies recommended in the 2007 Financial System Stability Assessment.

Directors agreed that the Fund can continue to play an effective role in supporting Turkey's efforts to entrench economic stability and tackle its remaining vulnerabilities. Many Directors considered that the Fund should be prepared to explore all available options for future IMF engagement, and several underlined the importance of close consultations on policy targets with the Fund. Some Directors saw merit in continued IMF program engagement with Turkey in the current difficult global financial environment. All Directors underscored that political commitment to sound policies and reform will remain the key ingredient to ensure future economic success, regardless of the modality of Fund engagement.