

**SOCIAL POLICY AS A MISSING COMPONENT IN POST-CRISIS
PROGRAMS OF BRETTON WOODS INSTITUTIONS:
A COMPARATIVE ANALYSIS OF THE EXPERIENCES OF ARGENTINA,
INDONESIA AND TURKEY**

**A THESIS SUBMITTED TO
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**IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR
THE DEGREE OF MASTER OF SCIENCE
IN
THE DEPARTMENT OF ECONOMICS**

AUGUST 2004

I hereby declare that all information in this document has been obtained and presented in accordance with academic rules and ethical conduct. I also declare that, as required by these rules and conduct, I have fully cited and referenced all material and results that are not original to this work.

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Signature :

To my family...

ACKNOWLEDGMENTS

First of all, I would like to express my deepest gratitude to my supervisor, Prof. Dr. Fikret Şenses. Without his instructive guidance, insightful comments and endless support, this study would not have been what it is now. I would also like to thank him for his model academic attitude, which will guide me through the rest of my carrier in teaching.

I am indebted to the members of the examining committee, Assist. Prof. Serap Türüt Aşık and Assist. Prof. Dr. Galip Yalman. Their comments and suggestions provided me with the chance to make my thesis more complete.

I owe many thanks to Burcu not only for her editing skills, but also being always there with me. Her marvellous smile, warm personality and moral support made everything much easier.

Last but not the least, I am deeply grateful to my family who supported and encouraged me through all my life. They introduced me to the world of books, which I have been –and will be, for the rest of my life– walking on with joy.

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ABSTRACT

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This study investigates the socioeconomic effects of the economic crises and the post-crisis programs based on the experiences of Argentina, Indonesia and Turkey. For this purpose, main socioeconomic indicators of these countries are analyzed for the 1990-2002 period by utilizing the before-after methodology. The comparative analysis of the results shows that significant deteriorations in the socioeconomic indicators of these countries had occurred in the crisis periods. In addition, the social policy components of post-crisis programs of these countries are analyzed. In this regard, it is found that the governments and the BWIs are more likely to incorporate active social policy measures, which would mitigate the negative socioeconomic effects of the crises on the households, into the post-crisis programs under the presence of significant public pressure emanating from social protests.

Keywords: Argentina, Economic Crises, Indonesia, Social Policy, Stabilization and Structural Adjustment Programs, Turkey

ÖZ

BRETTON WOODS KURULUŞLARININ KRİZ SONRASI PROGRAMLARINDA EKSİK BİR BİLEŞEN OLARAK SOSYAL POLİTİKA: ARJANTİN, ENDONEZYA VE TÜRKİYE DENEYİMLERİNİN KARŞILAŞTIRMALI BİR DEĞERLENDİRMESİ

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Bu çalışma, Arjantin, Endonezya ve Türkiye deneyimleri ışığında ekonomik krizlerin ve kriz sonrası programların sosyoekonomik etkilerini araştırmaktadır. Bu amaçla, bu ülkelerin temel sosyoekonomik göstergeleri öncesi-sonrası yöntemi kullanılarak 1990-2002 dönemi için incelenmiştir. Sonuçların karşılaştırmalı değerlendirmesi bu ülkelerin sosyoekonomik göstergelerinde kriz dönemlerinde önemli bozulmalar olduğunu göstermiştir. Ek olarak, kriz sonrası programların sosyal politika bileşenleri incelenmiştir. Bu bağlamda, hükümetlerin ve Bretton Woods Kuruluşlarının, toplumsal protestolardan kaynaklanan ciddi bir baskı altındayken, krizlerin olumsuz sosyoekonomik etkilerini azaltan aktif sosyal politika araçlarını kriz sonrası programlara dahil etmeye daha çok eğilimli oldukları gözlenmiştir.

Anahtar kelimeler: Arjantin, Endonezya, İstikrar ve Yapısal Uyum Programları, Sosyal Politika, Türkiye

To my family...

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CHAPTER 1

INTRODUCTION

Since the early 1980s, many developing countries have implemented stabilization and structural adjustment programs (SSAPs) that have been designed and supervised by key Bretton Woods Institutions (BWIs), namely the IMF and the World Bank. In the short run, these programs were aimed to correct the macroeconomic imbalances of the countries via fiscal and monetary measures. In the long run, main objective of the SSAPs was to transform the developing countries' economies to market-based, outward-oriented ones, in line with the neoliberal ideology. As the outcomes of the programs matured, it became clear that the SSAPs had some negative effects on the structure of the societies such as the fall in social expenditures, increasing unemployment and/or falling real wages, worsening of inequalities and deepening of poverty.

The developing countries that have been more or less transformed during the 1980s experienced many financial crises during the 1990s, emanating mainly from the highly volatile short-term capital flows. In the wake of the crises, many countries embarked upon new stabilization and structural adjustment programs¹, which seemed to be exacerbating the negative socioeconomic effects of the crises. However, some countries responded to the crises with programs that included measures to protect the poor and the vulnerable segments of the society from the

¹ In general, post-crisis programs of developing countries are named as 'stabilization programs' by the governments and the BWIs. But it is a fact that these programs do not solely rely on short-term stabilization measures, and include structural reform components, which normally belong to structural adjustment programs. In this study, we use the term 'stabilization and structural adjustment program' for the post-crisis programs of developing countries to underline the mixed structure of these programs. See Dabour (1999) for a detailed assessment of these concepts.

devastating effects of the crisis and the program itself. These measures included, but were not limited to, public workfare programs for the unemployed, cash and in-kind assistance to the poor, and health and education programs targeted to the low-income groups.

One of the developing countries that went through nearly all of these stages is Turkey. The country was the star of the act during the 1980s, as it appeared to be successfully implementing structural adjustment and stabilization packages supported by the BWIs and becoming an export-oriented market economy. After the capital account liberalization of 1989, it was an integral part of the neoliberal world economy in full extent. The country experienced a major economic crisis in 1994, which was followed by the implementation of an SSAP for two years. In 1999, Turkey launched a new and ambitious stabilization and structural adjustment program. This program did not last long and ended with the twin crises of November 2000 and February 2001. Socioeconomic consequences of these crises were worrisome, but the new SSAP, which was announced in May 2001, spared a negligible amount of resources to the mitigation of these consequences. In this regard, it was not much different from the post-1994 SSAP, which did not pay attention to the social issues at all. However, the 2001 program had a distinctive feature. It was designed –in close collaboration with the World Bank and the IMF, of course– by the newly appointed Minister of Economic Affairs, Kemal Derviş. Derviş was the Vice President of the World Bank in charge of the poverty reduction unit before the crisis.

Argentina and Indonesia are two other countries that have been through similar experiences during the 1990-2002 period. Argentina implemented a stabilization and structural adjustment program called the ‘Convertibility Plan’ from 1990 to 2002. Although the Plan was considered to be performing well during the 1990s, it came to an end with the emergence of a deep economic crisis during the last months of 2001. The country captured the world headlines with social protest and civil violence scenes after the eruption of the crisis, but the government’s social policy response to the negative effects of the crisis was quite limited. On the other

hand, Indonesia was one of the success stories of East Asia with its thirty years of uninterrupted growth record, when the East Asian financial crisis hit the country harshly. The Indonesian government launched an IMF-supported stabilization program within a short period of time. However, the financial turmoil did not subside for a long period, and the socioeconomic impact of the crisis gave rise to a social crisis in the form of protests, riots and deep civil violence in due course. In the end, President Soeharto, who had been in power for more than 30 years, had to resign. The new government was quick to incorporate active social policy measures to the stabilization program.

Although pure economic effects of the crises and the SSAPs have been assessed in the literature in detail, not much have been said about the social side of the issue, especially for the Turkish case. In this regard, the main objective of this study is to analyze the socioeconomic effects of the economic crises and the SSAPs based on the experiences of Turkey, Indonesia and Argentina during the 1990-2002 period. For this aim, main socioeconomic indicators² of these countries pertaining to labor market, income distribution, poverty, and the public spending on social sectors are quantitatively assessed with a “before and after” methodology. In addition, social policy components of these countries’ SSAPs are investigated to have a better understanding of the underlying processes and the agents that have been effective on the creation or the neglect of these components. The following questions are of primary importance in this context. Why was the social policy component neglected in the post-crisis programs? What are the approaches/responses of the government, Bretton Woods Institutions, and the citizens of the countries to the socioeconomic effects of economic crises? What are the differences and the similarities of social policy components of individual countries’ post-crisis programs? Where do these differences and similarities stem from? While the first question is beyond the scope of this thesis, remaining questions constitute the main axis of the study. A

² Boundaries of the analysis of socioeconomic effects of the crises and post-crisis programs are hard to define; it may include diverse topics such as the assessment of environmental effects. However, such issues are behind the scope of this study, and we concentrated on the main aspects of the subject, which are stated above. These aspects also constitute the central themes of the studies in the literature.

comparative assessment of the results of the individual country analyses enables us to reach a broader picture pertaining to the answers of these questions.

One should note the difficulties we have faced during the conduct of this study for a complete assessment of its results. The first one relates to the difficulty in evaluating socioeconomic effects of the crises and the SSAPs quantitatively. Deterioration in the living standards of the people goes well beyond the ones that are captured by the quantitative indicators used in this study. Many people experienced multi-faceted degradation in their lives, which cannot be explained by any numbers. A more complete assessment in this regard can be attained through personal interviews with the effected households, which is beyond the scope of this study. The second difficulty arises from the data deficiencies, which are most prevalent in the case of Turkey. While household income surveys, which constitute the main data source for socioeconomic analysis, have been conducted annually or once in every two years in Indonesia and Argentina, there have been only two surveys in Turkey for the past 15 years, in 1994 and 2002. Labor market data is also of low quality in Turkey. For the other two countries, the difficulty was related primarily to reaching the available data resources. Last problem is a common weakness of all comparative country studies: the results of the individual country analyses are most meaningful in their own settings. Comparison among them may not always give robust results, due to the differences in underlying concepts or simply because they are different countries with different cultures, life styles, constraints and opportunities. Nevertheless, the similar problems they face and the similar methods they use to solve these problems allow us to reach some broad conclusions based on their experiences.

The plan of this study is as follows. Chapter 2 presents the state of knowledge on the issue by providing a select review of the literature on the socioeconomic effects of the SSAPs. In the following three chapters, three countries are analyzed: Argentina, Indonesia and Turkey, respectively. Each of these chapters is comprised of two main sections. In the first section, economic background of the crises and the SSAPs are briefly assessed. In the second section, socioeconomic

effects of the crises and the SSAPs are investigated. Finally, Chapter 6 presents a comparative analysis of the findings of the individual country assessments and the main conclusions of the study.

CHAPTER 2

SOCIOECONOMIC EFFECTS OF ECONOMIC CRISES AND POST-CRISIS PROGRAMS – A SELECTIVE REVIEW OF THE LITERATURE

Since the second half of the 1980s, stabilization and structural adjustment programs (SSAPs) that are designed and supervised by the Bretton Woods Institutions (BWIs) have been under constant criticism for having negative socioeconomic effects on the people of the countries implementing these programs (Dabour, 1999: 40). Critics have blamed the programs for increasing income inequalities, worsening poverty, and therefore, deteriorating the living conditions of millions of poor and vulnerable people in developing countries (Killick, 1995: 50-51). But the growing literature on the issue have shown that it is not easy to generalize the situation; while most of the evidence supports the critics, there are also some instances that SSAPs result in positive or mixed socioeconomic consequences. So now, it is widely recognized that although the programs certainly have important distributional effects, these are complex and varies according to the specificities of the countries and the individual programs.

In order to understand the impact channels of the SSAPs, and how the country conditions and program features affect the social consequences of the programs, this section makes a brief and select review of the literature on the issue.

2.1 Possible Effects of Programs

It is necessary to analyze the theoretical linkages between the standard measures of programs and income distribution and poverty before reviewing the

empirical studies on the issue. This section benefits from two sources of information for this aim. The first one is those studies¹ under consideration that allocate a section for the theoretical background of their empirical analyses. The second source is Şenses (2001: 183-203). The measures to be discussed are typical components of structural adjustment and stabilization programs, however, specific country programs may exclude some of the discussed ones and incorporate others. It should also be noted that the argued effects of measures are theoretical and for a ‘typical’ economy; the exact effects for a country depend on the socioeconomic structure of that individual country.

- *Devaluation:* This measure aims to reallocate the available resources towards the tradable sectors by decreasing the price ratio of nontradable to tradable goods and increasing the returns to the tradable goods. For the part of the developing countries that are primary commodity exporters, devaluation implies an increase in agricultural commodity prices. Therefore, the rural side will benefit from the measure and the urban will lose, and this is the main case of supporters of programs, who argue that devaluation would improve income distribution. But the expected outcome of this measure is not straightforward. Although the increase in food prices is likely to have a devastating effect on urban poor, who devotes most of their budget to food, the associated benefit to the rural poor should not be taken for granted. The poor farmers may only benefit if they are the main producers of exportable goods; if they are mostly subsistence farmers and the export farming is done by large landholders, the income distribution may deteriorate. So the pattern of asset ownership in the rural sector will define the final outcome.
- *Import Liberalization:* This measure would affect the urban working poor if it leads to the closure of import-substituting industries. Contraction in these sectors would increase the unemployment rate and contribute to the repression of wages.

¹ These studies are: Baer and Maloney (1997), Bourguignon, De Melo and Morrison (1991), Ganuza and Taylor (1998), Garuda (2000), Killick (1995a) and Stewart (1991).

- Food Subsidy Reductions: Costs of this measure are borne by the beneficiaries of the government subsidy programs, who are often the urban poor and the public sector workers. It is also argued that the subsidies depress agricultural prices, so that the associated reductions may benefit the rural poor. But it is again questionable if this potential benefit may offset the direct cost of the measure.
- Public Sector Retrenchments: Obviously, directly affected group is the workers that are laid off. Unemployment rate would increase, but the exact magnitude of the change depends on the size of the retrenchment.
- Cuts in Social Services: Negative impact is most significant for this measure. All the poor and vulnerable groups, either rural or urban, heavily depend on the basic social services provided by the state. When the public expenditure on health and education services is cut, the availability and the quality of the associated services deteriorate. Middle and high income groups are able to protect themselves by switching to private services, but the low income groups face the threat of losing their health, and children of the poor families are less likely to improve their living conditions by getting education. Both of these effects contribute to the further marginalization of the poor.
- Increased Indirect Taxes: In order to reduce budget deficit, the program requires the governments to increase their revenues while reducing expenditures. Easiest way to increase revenues seems to be increasing the indirect taxes. But these taxes are recognized as the most regressive method of taxation; they are likely to hurt the poor, especially if the taxes on food are also increased.
- Privatization: The complex nature of this measure may give rise to complex consequences. The theory of privatization suggests that the sale of inefficient public enterprises would benefit the consumers. But shift of a public asset to private hands at a low price is most likely to benefit the buyers who are already wealthy. If the privatized enterprise possesses a monopoly position in the market,

as it is generally the case in developing countries, the benefit of the buyer will be higher and the consumers will not gain much from this process.

- *Wage Freeze*: Repression of real wages as a fiscal austerity measure is one of the measures with direct negative effect. Fall in the labor share of income is directly reflected in the deterioration of income distribution.
- *Credit Squeeze*: Aggregate credit restraint usually tends to favor large and well-established firms that have access to alternative funds at the expense of small producers that are likely to be engaged in agricultural activities. Therefore, its possible effect is worsening of income distribution.

2.2 Actual Effects of Programs

After evaluating the theoretical effects, the rest of this section is devoted to a select review of the literature on the actual social effects of structural adjustment and stabilization programs. Since the beginning of the neoliberal reforms era there have been studies, which empirically assess the socioeconomic impact of programs for different countries. Although this survey does not include all countries² with program implementation, it covers a diverse sample of countries from different regions and with different characteristics. The chosen studies are among those dealing with the social consequences of IMF and World Bank programs. They are diverse both in terms of their methodology and the authors' stance. They include both 'before and after' analyses and counterfactual simulations, and there are well-known structuralists, as well as staff members of BWIs, among the authors. Not all of them are country case studies, which evaluate only a country in depth; some others analyze a group of countries.

² It should be noted that studies on Argentina, Indonesia and Turkey are left out from this survey, as the experiences of these countries constitute the main body of the study.

Before moving to the review of the studies, it is worthwhile to take an overall look at the results of these papers. Table 2.1 presents a summary of the findings of the reviewed studies. Since the methodologies are quite different, only the directions of the changes –worsening, improvement, no change, mixed– in the indicators are given, rather than the actual figures. Overall picture is a negative one, but there are some improvements and mixed effects in some countries. Moreover, different studies on some individual countries for different time periods have given different results. Therefore, the findings of the reviewed studies show that the socioeconomic effects of the SSAPs are more likely to be negative, but the exact results depend on the peculiarities of the individual countries and the programs.

Table 2.1 Summary of the Findings of the Reviewed Studies

Country	Study, Period	<i>Income Inequality</i>	<i>Poverty</i>	<i>Real Wages</i>	<i>Unemployment</i>	<i>Social Spending</i>
Chile	Bourguignon, et al. 1979-88	-	-	-	-	
	Ganuza&Taylor, 1974-85	+	-	+	-	+
Côte d'Ivoire	Grootaert, 1985-90		-			(-+)
	Bourguignon, et al. 1980-86			-	-	-
Ecuador	Bourguignon, et al. 1975-87	-	-	-	-	
	Ganuza&Taylor, 1983-96	-	(-+)	(-+)	-	(-+)
Jamaica	Handa&King, 1989-93	(-+)	(-+)			-
	Ganuza&Taylor, 1989-95	-		+	=	
Mexico	Lustig, 1982-85	-	-	-		-
	Ganuza&Taylor, 1984-89	-	-	-	-	=
Morocco	Bourguignon, et al. 1980-87	-		-	-	-
Latin American Countries	Ganuza&Taylor, 1974-96	11/16 -	8/17 -	6/16 -	10/17 -	5/13 -
Latin American and African Countries	Stewart, 1980-89		-	-		-

Signs: -, worsening; +, improvement; =, no change; (-+), mixed effect.

Note: The studies that have not given explicit results are not presented in the table.

Structural adjustment and stabilization programs have yielded socioeconomic consequences that are similar in some respects and different in others in different countries. Considering this observation, single-country studies are given priority in this review. In this way, it would be possible to see which kind of similarities and differences in country characteristics bear positive or negative socioeconomic results. Multi-country studies that contribute to the discussion of single-country studies are discussed within the analyses of countries, whenever it is possible. Afterwards, an assessment of multi-country and regional studies follows, which lets us see how the socioeconomic effects of programs emerge in different groups of countries. Finally, cross-country studies, which evaluate the overall effects of programs, are reviewed. This sequencing enables us to observe how the effects in individual countries evolve to general trends.

2.2.1 Single-Country Studies

a) Mexico:

Rising interest rates abroad and falling international oil prices, in addition to the overvalued exchange rate and a large fiscal deficit, induced the Mexican economic crisis in early 1982. Lustig (1990) analyzes the 1982-1985 period, in which an IMF supported stabilization program was implemented as a response to the crisis. The program adopted the reduction of the fiscal deficit and the devaluation of the peso as the main instruments. During the period, average annual GDP growth rate was zero; real wages fell by 30 percent; the wage share contracted by 10 percent; and social expenditures fell on average by 19 percent (Lustig, 1990: 1336). Against this unfavorable background, agricultural production managed to grow slightly; its average growth rate was around two percent. Lustig (1990: 1328) argues that this “acyclical” behavior was due to the favorable weather conditions and the rise in the internal and external agricultural prices. Although prices and employment in agriculture increased, real wages declined substantially. So the below-subsistence level farmers, who are mostly poor and depend on wage income, were the ones that lost in agriculture sector. But the study does not provide the composition of the rural poor population; therefore it is not possible to deduce by how much the living

conditions of the rural poor deteriorated during this period. For the urban part, income concentration shifted from wage income to nonwage income; while real wages declined substantially, nonwage earnings indicated a positive trend during the period. Lustig (1990: 1336-1337) has argued that while it is not possible to disaggregate nonwage income to profits and earnings from informal unemployment, the sharp rise of nonwage income in the manufacturing sector is an indicator of the fact that profits had risen more than informal income, since this sector is dominated by large-scale firms and includes less informal employment. On the health and education side, the negative consequences of the fall in social expenditures have been ambiguous, due to the shortness of the time period under consideration. But some subtle signs of worsening in social indicators such as enrolment rates have been observed. Lastly, Lustig (1990: 1335) has asserted that removal of general food subsidies had been regressive and detrimental for poor households.

Within the scope of a short multi-country study, Ganuza and Taylor (1998) support the claims of the previous study and extend the time limits of the negative picture to the year of 1989. Their results indicate that poverty incidence and income distribution deteriorated between 1982 and 1989. After 1989, there was a period of moderate recovery until the Tequila crisis of 1995.

Another study on Mexico, by Adelman and Taylor (1990), adopts a counterfactual simulation technique to assess the outcome of alternative policy responses to the crisis other than the implemented stabilization program. Findings of the study suggest that the country could do much better without the stabilization program both in growth and distributional terms. But some deficiencies of the study – also indicated by McMahon (1991) – render the results of the study questionable; there are no price effects in the model and the stabilization program is presented as a simple policy of wage repression. These flaws seem to be a reflection of the intrinsic problems of counterfactual studies; to make the models manageable, the authors do not have a choice other than making such simplifying assumptions, and these assumptions undermine the reliability of simulation models as a mirror image of the real world.

b) Jamaica:

Jamaica has had a close relationship with the IMF and the World Bank since 1977. But Handa and King (1997: 916) acknowledge that structural adjustment policies adopted had a limited scope until 1989, comprising mainly public sector retrenchment and some trade and price liberalization. The authors investigate the trends in inequality and poverty for the 1989-1993 period, during which drastic liberalization policies were pursued. Main constituents of the reforms were labor market reform, trade liberalization, privatization, and financial sector reform. Of these, labor market reform consisted of a reduction-and-simplification of income tax, eliminating the dispersion in tax rates and reducing it to a flat rate of 25 percent from a more complex system of taxation with four brackets ranging from 60 to 30 percent with many exemptions (Handa and King, 1997: 917). Trade liberalization policies were adopted gradually. In the first stage (1983-1985), some quantitative restrictions were dismantled. The second stage (1987-1991) consisted of reduction of tariffs and elimination of the state monopoly on imported good. The final stage, which started in 1991, included removal and reduction of stamp duties and tariff rates. As a result of these measures, the share of consumer goods in import basket doubled between 1980 and 1990 (Handa and King, 1997: 918, Table 2). The share of non-traditional exports in total exports also increased from 20 percent to 35 percent during this period (Handa and King, 1997: 919 Figure 2). Privatization gained its pace during 1989-1994; 47 public enterprises were privatized during this period. Although this number constituted of only 15 percent of total number of state enterprises, Handa and King (1997:920) argue that almost all of the large government holdings were privatized. Lastly, Jamaican financial system was under full government control until 1990; neither the citizens nor the commercial banks were allowed to hold and sell foreign currency, and the amount and the direction of credits, as well as the interest rates, were controlled by the state. Liberalization process began in September 1990 when commercial banks were authorized to buy and sell foreign exchange. From this date to 1994, all government controls on the financial system were removed, 1991-1992 being the most intense period in this respect (Handa and King, 1997: 920-921).

The effects of structural adjustment policies on income distribution and poverty have also been analyzed by Handa and King (1997). Main conclusion of the study is that income distribution and poverty incidence worsened in 1991 and 1992, but recovered more than fully in 1993. The authors relate the ‘worsening’ period with the accelerated policy reforms of 1991 and 1992 in the financial and trade sectors, and give three reasons for the rebound of the distributional indicators: fast growth of agricultural production – 11 percent growth in 1993 alone (Handa and King, 1997: 924) – that employs 30 percent of the employed labor force; fast growth of the apparel exports that accounts for 30 percent of manufacturing employment; and lastly, the increased flow of workers’ remittances that represented 8-9 percent of GDP in 1992 and 1993. In 1993, 56 percent of the bottom quintile of the income distribution received these kinds of remittances, and this figure had been 37 percent the previous year (Handa and King, 1997: 925, Table 9). Finally, the study assesses the effects of reduced government expenditure on services such as education, health and housing, and indicates that although the gross indicators of education and health, i.e. enrollment rates, infant mortality rates, etc., did not worsen, the quality of services had deteriorated (Handa and King, 1997: 928). This outcome is likely to have adverse consequences for human capital of the country in the future.

Ganuza and Taylor (1998) briefly analyze the Jamaican experience until 1995, and support the findings of the Handa and King study. Contribution of this study is that it argues that the decline in the poverty rate did not continue after 1993, and with the headcount ratio rising to 50.2 percent in 1995 from 37.5 percent in 1990 (Ganuza and Taylor, 1998: 16, Table 1).

c) Côte d’Ivoire:

Economic crisis hit Côte d’Ivoire in 1980, when the world prices of country’s two main export goods –coffee and cocoa– collapsed. Ivorian government responded by launching a structural adjustment program in 1981, with the support of the World Bank and the IMF. This program appeared successful until 1986, when the exchange rate appreciated suddenly and sharply by 33 percent due to an

exogenous shock³. In 1987, international terms of trade worsened, pushing Côte d'Ivoire to a period of destabilization and recession.

Grootaert (1994) evaluates the 1985-1990 period from poverty and basic needs fulfillment aspects. For poverty, this study's main finding is that the incidence of poverty did not change during 1985-1986 –a period of brief economic upturn, but increased sharply during the recessionary 1987-1988 period. The study has not tried to find causality here, which would not in any case be much meaningful with such short run data, but has emphasized the effect of the recession on pushing households into poverty (Grootaert, 1994: 1526). For the basic needs part, a more important result has emerged; "... [U]nder conditions of structural adjustment as well as destabilization, the poorest population groups can suffer deep setbacks in fulfillment of their basic needs, even when the government maintains the level of social expenditures." (Grootaert, 1994: 1532). Government of Côte d'Ivoire succeeded to keep the level of social expenditures roughly stable⁴ during structural adjustment, but analysis of Grootaert (1994: 1526-1531) has shown that basic needs indicators of education, health and housing declined systematically for the poorest households, and this trend had been against the stable outlook of countrywide –average– figures. This fact points out how the steady average indicators may conceal the deteriorations in the living standards of the poor households. The study infers that the focus of social policies should therefore be on the allocation and distribution of public services, rather than its aggregate level (Grootaert, 1994: 1532). It should also be noted that this study supports the claim that during times of crisis and/or structural adjustment, protection of the poor and vulnerable groups requires not only an increase in the level of social expenditures but also other measures to mitigate the adverse effects.

³ As a member of the CFA Franc Zone, Côte d'Ivoire did not have control over its exchange rate. The associated shock occurred when the US dollar depreciated against the French franc (Grootaert, 1994: 1522).

⁴ Social expenditure per capita declined slightly, but less than other expenditures while the share of social spending in budget did not change (Grootaert, 1994: 1523, Table 2).

d) Nigeria:

The Nigerian economy faced a crisis at the beginning of 1980s, when the world oil prices plummeted. The response to the crisis came a little late, in 1985. The new government decided to follow a structural adjustment program without using IMF loan facilities. But only 15 months later, this program was abandoned and IMF conditionalities were accepted. Ihonvbere (1993) analyzes these programs and their socioeconomic consequences. The first program consisted of a wage freeze in the public sector and pay cut for all workers, a 30 percent levy on all imports, the removal of the petroleum subsidy, and a heavy reduction of subventions to public parastatals and government ministries. The IMF program, which had been adopted after the failure of the first program, included the standard measures: devaluation of the currency, privatization of the parastatals, retrenchment of workers, financial liberalization, and imposition of user fees on social services –especially in health and education– (Ihonvbere, 1993: 143-144). The study is highly critical of the programs. It argues that although the second program registered some modest achievements in resource allocation, these gains were eroded by the inconsistency, insincerity and corruption of the government. Moreover, the direct implementation of the standard measures, which did not pay attention to the specificities and inequalities in the country, contributed to contradictions and conflicts. Lastly, unequal distribution of the pains and the gains of the programs, neglect of the living conditions of the poor majority, and the suppression of the opposition forces had consumed not only the gains, but also the political stability of the government (Ihonvbere, 1993: 145).

Ihonvbere (1993) has pictured the circumstances of the Nigerian society during the adjustment period of 1986-1990 as disastrous. Domestic production was very low, unemployment was extremely high, educated people tended to leave the country. Education and health services deteriorated, and all sorts of crime got out of control (Ihonvbere, 1993: 146-147). Furthermore, there have been serious protests and political actions against the government⁵. Ihonvbere (1993) has put the blame

⁵ Two attempted *coups d'état*, six major religious riots, three serious nationwide protests and several riots and demonstrations by workers, farmers, the unemployed, students, traders, and other disadvantaged groups had occurred. (Ihonvbere, 1993: 148)

for the degradation of the economic and social conditions in the country, which were recognized as “worse than the times of Civil War” by many Nigerians, on the structural adjustment programs, (Ihonvbere, 1993: 147). The study claims that although the Nigerian economy is in need of an urgent structural adjustment, such a program should pay attention to three points. Firstly, it should recognize the specificities of the country; ‘one-size-fits-all’ model of the World Bank and IMF is doomed to fail, and is likely to deepen the problems of the country. The second point relates to the issue of effectiveness of governments. A corrupt and unstable regime, like the one in Nigeria, does not have the capacity to implement serious adjustment policies. The last point is that measures to protect the poor segments of the population should be a part of the conditionalities, so that the brunt of the program is not borne by the poor and the vulnerable.

2.2.2 Multi-Country and Regional Studies

In first of the multi-country studies under review, Bourguignon, De Melo and Robinson (1991) summarize the results of case studies that have been conducted as part of an OECD project. The aim of the project was to understand the effects of structural adjustment programs on income distribution and poverty, and the country studies –complemented by counterfactual simulations– were used for this purpose. Six countries –Côte d’Ivoire, Ecuador, Morocco, Chile, Malaysia and Indonesia– were analyzed, and the study groups these countries according to their export characteristics. Malaysia and Chile form the manufacturing exporters group, Côte d’Ivoire and Morocco form the primary commodity exporters group and Ecuador and Indonesia are the two oil exporters.

The study recognizes Chile and Malaysia as the most outward oriented and the least rigid economies in the sample (Bourguignon, De Melo and Robinson, 1991: 1497). Chile adjusted through its labor market during the 1979-1988 period. As a result of this market’s deregulated structure, unemployment reached 31 percent and the real wages declined sharply. As a result, income distribution and poverty worsened. In contrast, Malaysian adjustment between 1978 and 1987 was not

accompanied by significant distributional shifts. But the country's unique characteristics laid the foundations for this situation. First of all, income equality has been a major component of country's economic policy –“growth with redistribution” strategy– since 1971. Secondly, Malaysia had a relatively better debt position at the time of the crisis in 1982, so it did not require IMF funding and continued to use external borrowing during the structural adjustment period. As a result of these two features, Malaysian adjustment relied on expenditure switching more than expenditure reducing. Under this strategy, social expenditures of government actually increased in real terms during structural adjustment (Bourguignon, De Melo and Robinson, 1991: 1497-1498). Finally, simulations on Malaysia have revealed that a policy package composed of more austere fiscal measures would have been less effective for the country (Bourguignon, De Melo and Robinson (1991: 1502).

The most significant result of the structural adjustment for the two primary commodity exporter countries –Côte d'Ivoire and Morocco– has been the narrowing of urban-rural income gap (Bourguignon, De Melo and Robinson, 1991: 1499). In Morocco, devaluation, combined with good weather and trade liberalization, stimulated agricultural production and exports, leading to a rise in rural incomes. But the urban population has been affected adversely. Not only the unemployment rates increased, but also real wages fell sharply during the 1983-1985 period. Simulation results have pointed out that although cutting public sector wages has been a good method of reducing expenditure –as it has also reduced the income inequality, a public works program, which would have created employment for unskilled labor at low wages, would have yielded more efficient outcomes. Moreover, simulation results have also indicated that devaluation would have lowered growth in the long run for Morocco (Bourguignon, De Melo and Robinson, 1991: 1502).

A similar but less positive situation has been observed in Côte d'Ivoire during the adjustment period between 1981 and 1986. While urban workers lost their jobs and the real wages fell down, there was a slight increase in agricultural prices relative to nonagricultural prices. As a result, the urban-rural income gap

narrowed during structural adjustment. It should be noted that devaluation was not been used in Côte d'Ivoire, since the country is a member of the CFA zone. But interestingly, counterfactual simulations have shown that the country would have benefited from devaluation both in the short run and the long run (Bourguignon, De Melo and Robinson (1991: 1502).

For the oil exporter group, the experiences of the two countries exhibit a great deal of diversity instead of similarity. Indonesia had a relatively light debt burden, and stabilized its economy without recourse to IMF conditionalities when the crisis emerged in 1982. During the course of the post-crisis program, the country implemented some structural reforms such as financial liberalization, and managed to reduce the poverty incidence at the same time. Bourguignon, De Melo and Robinson (1991: 1500) argue that this success has been associated with the continued implementation of the poverty alleviation policies that are not included in orthodox stabilization and structural adjustment programs. Indonesian government maintained policies such as investment in rural infrastructure, the fertilizer subsidy, etc. during the crisis and the structural adjustment periods. Findings of the simulation studies support the Indonesian package. Alternative policies would not have yielded better outcomes (Bourguignon, De Melo and Robinson, 1991: 1502).

In contrast, Ecuador implemented structural reforms under the supervision of IMF. The policy package consisted of typical neoliberal measures: a large devaluation, removal of price controls and trade liberalization. These policies had negative distributional effects. Employment fell especially in urban areas, and the share of labor in value added fell by over eight percent per year. Poverty increased substantially and income distribution worsened (Bourguignon, De Melo and Robinson, 1991: 1500). Furthermore, simulations have shown that other policies would have performed better than devaluation, which had caused inflation in the short run and would lower growth in the long run (Bourguignon, De Melo and Robinson, 1991: 1501-1502).

Dabour (1993) evaluates the impact of structural adjustment and stabilization policies on human development and poverty alleviation for the set of ‘intensely-adjusting’⁶ members of the Organization of Islamic Countries (OIC). The study has utilized Human Development Index (HDI) of UNDP and ‘adjusted HDI’, which is real GDP per capita rank minus HDI rank and taken as an indicator of real human development (i.e. without growth effect). Tabulations of HDI has revealed that intensely-adjusting OIC member countries had a fall in terms of value and rank in the second half of 1980s (Dabour, 1993:63, Appendix 2). Dabour (1993) suggests that this has occurred because of structural adjustment and stabilization policies implemented in these countries. The study also recognizes that HDI in all of these countries have improved in the period after 1991, but underlines the fact that adjusted HDI in almost all of these countries⁷ worsened during the same period. This meant that the improvement in HDIs was due to GDP growth in this period rather than the progress in human development. Dabour (1993: 55) asserts that this supports the argument that policy reforms may be necessary for growth, but they are not sufficient for human development and poverty alleviation. The study also presents data on public expenditure on health and education, and socioeconomic indicators such as adult literacy rate, population with access to health and access to safe water (Dabour, 1993: 64-65, Appendix 3). In the light of these figures, Dabour (1993: 55) concludes that structural adjustment and stabilization programs have been associated with drastic cuts in public expenditure on basic social services, affecting mostly the poor and vulnerable sections of the population.

Ganuza and Taylor (1998) provide a summary of the findings of country studies that are collected in a volume edited by the authors. It presents a brief sketch of the income inequality and poverty trends in Latin America and the Caribbean during the last two decades. Country studies document the macroeconomic policies, growth rates, and various distributional and poverty-related statistics of countries

⁶ Study has used the term ‘intensely-adjusting’ for the countries that have received at least four adjustment loans or facilities of any type from the IMF and/or the World Bank during the 1980-1991 period (Dabour, 1993: 54).

⁷ Actually, 11 of 21 countries experienced such a deterioration (Dabour, 1993: 64, Appendix 3).

over different macro ‘episodes’. The time frames of these episodes are determined by dominant economic policy characteristics and/or substantial economic changes like crises. There are 49 episodes for 15 countries, and most of these episodes are ‘crisis’ and/or ‘structural adjustment and stabilization’ periods, as these have been the prevalent features of the Latin American countries since 1970s. But it should be noted that Ganuza and Taylor (1998) do not aim to analyze the effects of structural adjustment and stabilization programs. Their purpose is instead, to provide “thick descriptions” of how poverty and macroeconomic movements interact (Ganuza and Taylor, 1998: 4). Nevertheless, the summary table of the study provides extensive information on the changes in income distribution and poverty in Latin America during structural adjustment and stabilization periods (Ganuza and Taylor, 1998:16, Table 1). There are 18 episodes of structural adjustment and stabilization with different duration (Some of these episodes are as long as 12 years –1974-1985, Chile–, and some of them cover only three years –1985-1987, Bolivia.). Country studies provide the change of Gini coefficients during the associated period for 15 of the SSAP episodes; only one of them has a negative sign –meaning an improvement in income distribution, ten of them have deteriorated and four of them have stayed the same. But this should not give rise to easy conclusions, because for the rest of the sample, i.e. non-SSAP episodes, majority of the Gini coefficients have also worsened with only eight of 21 non-SSAP episodes exhibiting improvement. Furthermore, results on poverty incidence and extreme poverty are even less conclusive with nine of the 17 SSAP episodes with poverty incidence data and only seven of the 15 SSAP episodes with extreme poverty data displaying worsening of poverty (Ganuza and Taylor, 1998: 16-17, Table 1 and Table 2). Therefore, specific impacts of SSAPs in Latin America and the Caribbean have been mixed, as also emphasized by Ganuza and Taylor (1998: 15).

Another study on Latin American structural adjustment and stabilization experience, by Baer and Maloney (1997), accepts that income distribution have worsened in the region after 1980. But the study argues that this worsening could not be attributed to the neoliberal policy measures. It puts forward three arguments to support this claim. Firstly, it argues that stabilization policies, which are not part

of the neoliberal policy measures according to Baer and Maloney (1997: 315), like fiscal austerity measures and repression of real wages that were adopted in the first half of 1980s had been the major reasons behind the trend in inequality in Latin America, since only Chile and Mexico had been implementing liberalization policies during that period (Baer and Maloney, 1997: 315). Their second argument is that the liberalization policies in the associated countries were mismanaged. The study argues that Chilean collapse of 1982 was the result of poor government exchange rate policy, and bad financial sector management (Baer and Maloney, 1997: 316). Lastly, Baer and Maloney (1997: 319) assert that income inequality has been a historical phenomenon in Latin America, which could not be corrected even with land reforms, populist welfare states, and rapid industrialization. This study's main conclusion is that investment in human capital by states would improve income distribution under a neoliberal regime (Baer and Maloney, 1997: 324).

Stewart (1991) reviews the effects of SSAPs on the poor and vulnerable groups during the 1980s. It investigates the trends in income, unemployment, poverty, government expenditure on social services and other welfare indicators for this purpose. The study has found mixed evidence in overall performance. While some adjusting countries have demonstrated improvements in the associated indicators, the great majority has experienced deteriorations (Stewart, 1991: 1854). Average real wages and real minimum wages fell in eight of 11 Latin American countries, and in 16 of 18 sub-Saharan Africa countries (Stewart, 1991: 1849-1850). This decline in real wages was exacerbated by the increase in food prices as a result of measures such as price decontrols, devaluation and removal of food subsidies implemented under structural adjustment and stabilization programs. The study also notes that these policies that seem in favor of agricultural sector in general have not increased the well-being of the rural poor. Heavy emphasis of the measures on export crop prices have benefited mostly the producer of these products, who exclude the poor. On the other hand, small farmers and rural wage earners are hit by government policies such as the reduction in fertilizer subsidies (Stewart, 1991: 1850). An increase in urban unemployment rates has been observed in ten out of 16 Latin American countries. Moreover, formal sector employment growth rates have

slowed in most of the Latin American countries and declined in some (Stewart, 1991: 1850-1851). Although the systematic evidence on poverty has been scarce, Stewart (1991: 1854) argues that number of poor people have risen in the countries that have available data. In the majority⁸ of the countries, health and education expenditure per capita has fallen (Stewart, 1991: 1851). Finally, the evidence on other welfare indicators has been even more mixed. While educational indicators have worsened in the majority of the adjusting countries, health indicators have not exhibited much deterioration (Stewart, 1991: 1854).

2.2.3 Cross-Country Studies

The first cross-country statistical assessment of SSAPs was by Pastor (1987). This study has analyzed IMF supported stabilization programs in 18 Latin American countries over the 1965-1981 period. It has compared five main indicators –current account and balance of payment figures, inflation and growth rates, and labor share of income– with both pre-program levels and with indicators in a control group of Latin American countries that had not pursued stabilization programs. In both types of comparisons, the most significant results have emerged for the labor share of income. When the level of the labor share during program implementation period was compared with pre-program level, it has been observed that the latter was significantly better. Moreover, a comparison of the rate of change in this ratio before and after the program initiation has revealed that the rate of decline was much greater during the stabilization period (Pastor, 1987: 254, Table 2). These results were further supported by the comparisons of program and nonprogram countries, which have indicated that the program group had experienced smaller increases or larger declines in labor share (Pastor, 1987: 256, Table 3). Pastor (1987: 258) concludes that when compared to relatively insignificant results of other variables under consideration, the most consistent effect of stabilization programs has been the redistribution of income away from workers. Although this result is consistent

⁸ Actual figures are 60% in Latin America and 63% in Africa (Stewart, 1991: 1851).

with the previously reviewed studies, it should be noted that Pastor (1987) had been considering a different period (1965-1981) and only stabilization programs.

Garuda (2000) provides more recent estimates for the impact of IMF stabilization programs on income distribution and the incomes of the poor. The sample of the study covers 58 programs in 39 countries from 1975-1991. Initially, Garuda (2000) disaggregates the sample into three groups according to the pre-program economic condition of the countries, so that the Group I countries are in a relatively better position, Group III countries are in the worst position and the Group II countries somewhere in between. This grouping also allows for an estimation of the strictness of the conditionalities and their implementation (Garuda, 2000: 1047). For measuring the effect of stabilization programs, the study examines the evolution of three distributional indicators – Gini coefficient, income share of the poorest quintile and the average income of the poorest quintile, which incorporates not only distribution of income, but also its growth – over years for program and nonprogram countries. Gini coefficients show relative improvements in program countries of Group I and Group II compared to their nonprogram counterparts, the latter group's improvements being less significant. But in Group III, the roles have changed, countries with stabilization programs have performed systematically worse than the countries without the programs (Garuda, 2000: 1040, Table 4).

The changes in the income share of the poorest quintile exhibit a similar pattern; in Group I and Group II, program countries perform better than nonprogram countries, but the trends in both groups are less systematic than Gini coefficients. The record of nonprogram countries in Group III, on the other hand, are systematically better than program countries (Garuda, 2000: 1040, Table 5). The picture gets more blurred when the changes in the average income of the poorest quintile are considered. It should be noted that the study recognizes this measure as a good gauge of poverty (Garuda, 2000: 1043). In all groups, program countries do better than nonprogram countries but the differences are not significant for the majority of the observations (Garuda, 2000: 1041, Table 6).

Study concludes that these results indicate a relation between the initial economic conditions and the distributional effects of the IMF programs; if the macroeconomic imbalances of the economy are relatively light, program is likely to improve income distribution. But if the economy has experienced severe problems prior to the program, stabilization program would worsen the income inequality (Garuda, 2000: 1047). However, two problems of the study should be noted before accepting such a firm conclusion. First, Africa is underrepresented in the data set; only 48 of the 249 observations were from the region, which has experienced more IMF programs than any other part of the world (Garuda, 2000: 1035, Table 1). Second, significance level of the study seems insufficient; only six of the 36 observations are statistically significant at 5 percent level, and 13 observations are significant at 10 percent level (Garuda, 2000: 1040-1041, Tables 4-6).

Vreeland (2002) is a seminal study in terms of its statistical methodology. It has managed to remove the effects of other events and initial economic conditions statistically, and has isolated the effects of IMF programs. Proponents of SSAPs have criticized the previous studies that have shown that income distribution had worsened during SSAPs by using a before-after or control group approach, with the argument that the associated worsening might have stemmed from the pre-program economic conditions of the countries, and not from the programs themselves. Therefore, Vreeland (2002) has avoided such a pitfall by disentangling other effects. But the study does not directly measure the distributional effects of IMF programs, because it has confined itself to labor share of income from manufacturing in order to work with a longer data set. It includes 2095 observations for 110 countries over the 1961-1993 period. Nevertheless, it has given results that are consistent with the widely agreed statement that the SSAPs reduce the urban workers income. Regression results of Vreeland (2002: 131, Table 6) have shown that there is a 3.5 percentage point difference between the labor shares of program and nonprogram countries when only IMF program effect is considered. But the study also notes that if other effects were not disentangled this difference would be 8.5 percentage points, meaning that other factors influence the labor share more than the IMF programs (Vreeland, 2002: 130).

CHAPTER 3

ARGENTINA – MARCHING INTO SOCIAL EXPLOSION UNDER THE SUPERVISION OF IMF

In December 2001, Argentina drew the attention of the world with its drastic economic and political crisis, and accompanying scenes of public protests, riots and civil violence. Some blamed the IMF-supported stabilization and structural adjustment program for pushing the country in a vicious debt-crisis-debt cycle (Dinerstein, 2001). On the other hand, some others criticized the IMF for not pressing too hard for its conditionality on the Argentine government, and also argued that the government had the biggest share of fault because of its irresponsible fiscal policies (Mussa, 2002). Leaving aside the debate on who is responsible for it, the crisis marked the economic and social collapse of a country that have implemented stabilization and structural adjustment programs during the last quarter of a century, at different periods and with different intensities.

The last 25 years of Argentina's economic history can be roughly divided into three main episodes¹. During the first period, between 1976 and 1980, Argentina undertook its first stabilization program. Its components were freezing of wages, programmed devaluation, trade and capital account liberalization, and the deregulation of domestic financial markets. The second episode, during 1981-1990, was marked by instability. During this 'lost decade', the country experienced the worldwide Debt Crisis of 1982 first, then, unsuccessfully tried to pursue stabilization programs –with the support of IMF– twice, in 1985 and 1987, and

¹ This paragraph draws on Altimir, Beccaria and Rozada (2002), and Ganuza and Taylor (1998). Both studies provide similar, but slightly different decompositions of Argentina's economic history.

ended up in hyperinflation and recession at the end of the decade. The last episode starts with the adoption of the ‘Convertibility Plan’ in April 1991. The strategy was named after its exchange rate policy –a system of convertibility, which pegged the national currency to the United States dollar– and consisted of tight monetary and fiscal policies, privatization of public enterprises, substantial trade liberalization measures, and the liberalization of financial markets. Although some of these reforms were initiated at the first episode, none of them were implemented to the extent that they were during the 1990s (Altimir, Beccaria and Rozada, 2002: 73, Figure 7). With these reforms, the Argentine economy underwent a drastic structural change toward an export-oriented model of market economy.

This chapter aims to analyze the socioeconomic repercussions of the Argentine transformation and the recent economic crisis, and hence, focuses on the last episode (1991-2003). In order to construct a solid background for the analysis, first, a brief macroeconomic sketch of the period is provided. Then, socioeconomic effects of the Argentine stabilization program and the 2001 crisis are assessed by investigating the associated characteristics of the period.

3.1 ‘Convertibility’ Episode – Some Macroeconomic Indicators

In July 1989, –at the end of Argentina’s lost decade– when the newly-elected Carlos Menem administration took office, the country was in the midst of a deep recession. Real GDP was almost 10 percent below the 1980 level, and the annual inflation rate had mounted to 4926 percent. New administration’s first task was to launch a stabilization and structural adjustment program, which was supported by the IMF with a Stand-By loan (see Table 3.1). The program relied on fiscal austerity measures and price controls for the stabilization side, and trade liberalization and privatization measures for the structural adjustment side (Bambaci, Saront and Tommasi, 2002: 76). However the program was ineffective in reaching its targets, as the financial instability and high inflation rates prevailed through 1989 and 1990 (Calvert, 2002: 3). Consequently, the plan was abandoned in 1991.



Figure 3.1 Argentine GDP at 1995 Constant Prices, 1980-2003

Sources: ECLAC Online Database at <http://www.eclac.cl/badestat/> and Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

Domingo Cavallo, who was appointed as the Minister of Economics in January 1991, launched the Convertibility Plan within three months of his appointment. The plan was based on a fixed exchange rate regime where the peso was pegged to the US dollar and was always ‘convertible’ due to the backing up of the Central Bank. In this system, new pesos were issued only when capital inflow occurred, and these pesos were automatically withdrawn from the market when the capital left the country (O’Connell, 2002: 7). With this 100 percent reserve requirement of the Central Bank, which was allowed to be relaxed to 80 percent in emergency situations (Mussa, 2002: 20), monetary policy was completely restrained. Monetizing the budget deficit by printing money was no longer a viable alternative for the government. In addition to the exchange rate regime, the plan included some of the typical ingredients of structural adjustment programs such as trade liberalization, financial liberalization, social security reform, and privatization. This format of the plan was also supported by the IMF. As emphasized by Mussa (2002: 3), not only did the Fund supply “exceptionally large financial support”, but also kept the country under “close scrutiny” throughout the decade (see Table 3.1).

Table 3.1 List of Argentina's Loan Agreements with IMF and the Associated SDR Amounts (1989-2003)

Facility	Date of Arrangement	Amount Agreed (SDRs)
Standby Arrangement	Nov 10, 1989	736,000
Standby Arrangement	Jul 29, 1991	780,000
Extended Fund Facility	Mar 31, 1992	4,020,250
Standby Arrangement	Apr 12, 1996	720,000
Extended Fund Facility	Feb 04, 1998	2,080,000
Standby Arrangement	Mar 10, 2000	16,936,800
of which Supplemental Reserve Facility	Jan 12, 2001	6,086,660
Standby Arrangement	Jan 24, 2003	2,174,500
Standby Arrangement	Sep 20, 2003	8,981,000
	<i>Total</i>	35,692,550

Source: IMF website at http://www.imf.org/external/np/tre/tad/extarr2.cfm?memberKey1=30&date1key=2004%2D02%2D29&finposition_flag=YES

In macroeconomic terms, the Convertibility Plan performed very well initially. The inflation rate declined sharply from the level of thousands to single digits within 3 years, real GDP grew at substantial rates (9-10 percent) for two years and seemed to maintain a good trend thereafter (See Figure 3.1 and Table 3.2). However, there were two areas of concern; appreciation of the exchange rate in real terms and the increasing public debt-to-GDP ratio (Mussa, 2002: 20-27). Real exchange rate had appreciated substantially between 1989 and 1995, and stayed stable after that period (see Figure 3.2). The appreciated peso constituted a two-fold threat for the Argentine economy. Firstly, it could undermine the export competitiveness of the country, and induce an import upsurge. In reality, Argentine exports behaved better than expected; after a five percent fall in 1991 and a 0.5 percent fall in 1992, exports increased continuously until 1999. But the drastic rise of imports overshadowed this success; Argentine imports doubled for two succeeding years (1991 and 1992) and continued to increase faster than exports until 1994, leading to a foreign trade deficit of 2.2 percent of real GDP in 1994 (see Figure 3.3 and Table 3.2). This contributed to the already distressed position of the economy.

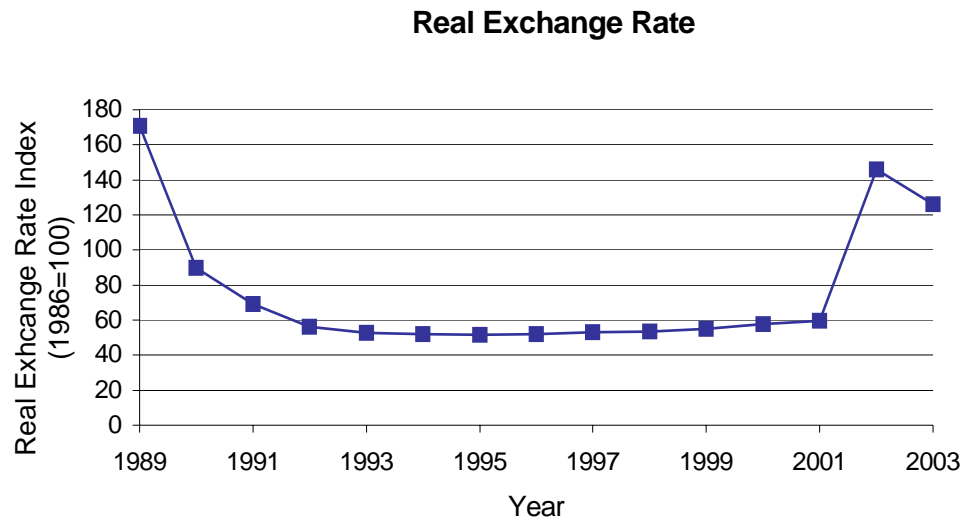


Figure 3.2 Change of Argentine Real Exchange Rate over Time, 1989-2003

Source: ECLAC Online Database at <http://www.eclac.cl/badestat/>.

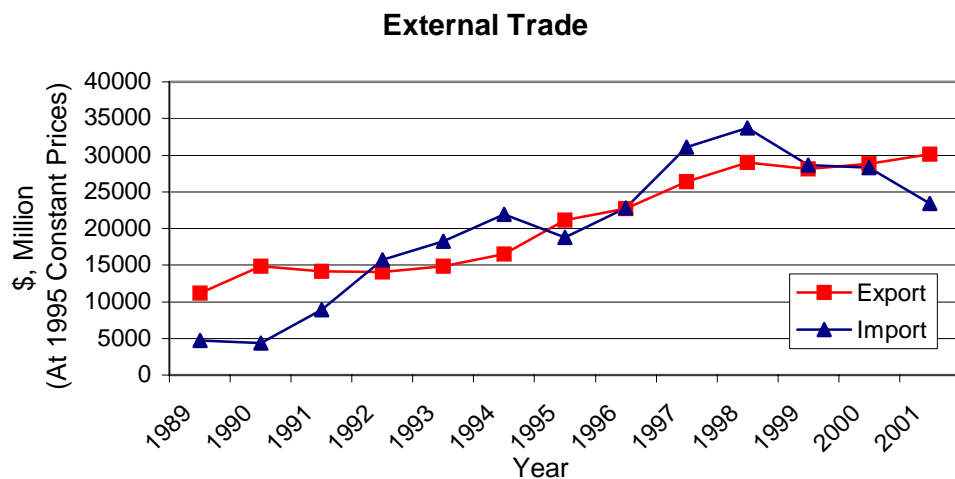


Figure 3.3. Argentine External Trade, 1989-2001

Source: ECLAC Online Database at <http://www.eclac.cl/badestat/>.

The second threat was related to the fact that the appreciated value of Argentine peso could lead to a foreign currency crisis, if the Central Bank were to fail to back up the strong peso for a long period of time, or in a situation where a speculative attack on reserves had occurred. The latter possibility was tested during the Mexican currency crisis, which started in December 1994 and had an immediate

effect on most of the developing countries (Mussa, 2002: 21). In the first few months of 1995, over eight billion dollars exited from Argentina, this amount was equal to 18 percent of the deposits in the Argentine banking system at that time (Pastor and Wise, 1999: 484). The government reacted by using the emergency provisions of the Convertibility Plan, which enabled the Central Bank to hold 20 percent of its reserves in government bonds and inject foreign currency to the system. Moreover, reserve requirements of the banks were halved so that the associated run on banks did not initiate a possible collapse of the banking system (Mussa, 2002: 20). These measures eased the pains of the crisis; the country experienced only a three-percentage fall in real GDP, and it recovered to the pre-crisis level by the end of 1996. By July 1997, industrial production was above the 1994 level (see Figure 3.4). Therefore, the Plan seemed to be stable against exogenous shocks.

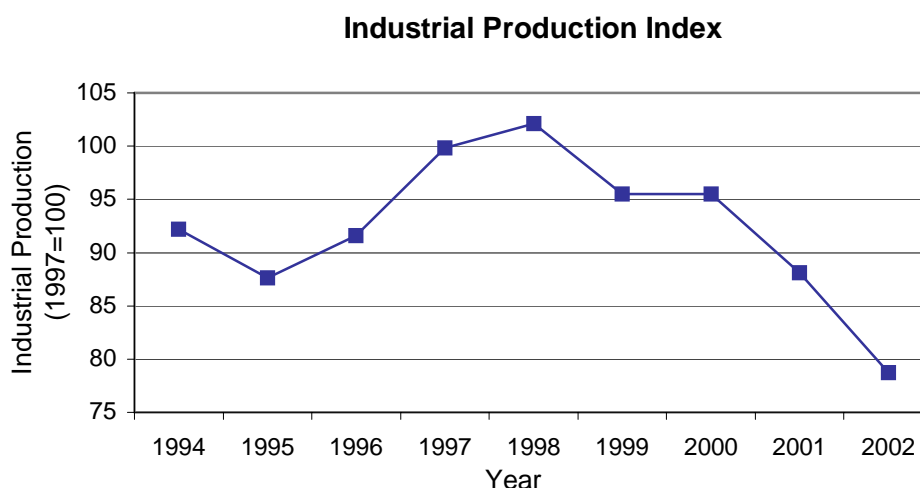


Figure 3.4 Argentine Industrial Production, 1994-2002

Source: Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

Argentine economy continued to grow through 1997 and 1998, but slipped into recession in 1999, partly because of the collapse of Brazil's exchange rate based stabilization program. Brazil was the major trading partner of Argentina, accounting for 30 percent of Argentine exports in 1996 (Pastor and Wise, 2003: 26). The

Table 3.2 Selected Macroeconomic Indicators for Argentina, 1988-2003

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Real GDP Growth	-6.6	-0.5	10.7	9.6	5.9	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.8	-4.4	-10.9	8.7
GDP Per Capita (\$)	5 652	5 545	6 052	6 546	6 839	7 138	6 844	7 126	7 599	7 791	7 435	7 283	6 875	...	...
<i>Inflation</i>															
Annual CPI	4 926.3	1344.2	84.0	17.5	7.4	3.9	1.6	0.1	0.3	0.7	-1.8	-0.7	-1.5	40.9	3.6
Current Account Balance (Million \$) ^a	- 1 305	4 552	- 647	- 5 654	- 8 162	- 11 157	- 5 211	- 6 879	- 12 342	- 14 632	- 12 001	- 8 864	- 4 429	...	...
As Percent of GDP ^a	-1.7	3.2	-0.3	-2.5	-3.5	-4.3	-2.0	-2.5	-4.2	-4.9	-4.2	-3.1	-1.7	...	...
Trade Balance (Million \$) ^a	6 458	10 509	5 184	-1 686	-3 475	-5 427	2 357	-126	-4 666	-4 657	-510	504	6 716	...	...
As Percent of GDP ^a	3.6	5.8	2.6	-0.8	-1.5	-2.2	1.0	-0.1	-1.7	-1.7	-0.2	0.2	2.6	...	...
Total Public Debt (As % of GDP)	...	...	...	...	29.2	31.1	35.9	37.4	38.9	41.4	47.3	45.0	53.7	...	...

Sources: ECLAC Online Database at <http://www.eclac.cl/badestat/>, Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html, and IMF Public Information Notice (1998, 2000) available at <http://www.imf.org/external/country/arg/index.htm?type=9998#10>.

Notes: a/ Minus sign indicates deficit.

... : Data not available.

devaluation of the Brazilian *real* in January 1999 meant a 40 percent real appreciation of the peso against the real (Pastor and Wise, 2003: 53, Figure 7). This appreciation induced a contraction of Argentine exports by around three percent in 1999 (see Figure 3.3). Moreover, the failure of the Brazilian stabilization program reduced the credibility of the Argentine program in the eyes of international financial markets. Capital inflows that had been declining since the 1997 East Asian crisis came to a halt in 1999 (UN, 2004: 5). By the end of this year, pessimistic comments on the Argentina's debt and the current account deficit problems were raised commonly among the analysts of the Argentine economy (Pastor and Wise, 2003: 26 and Mussa, 2002: 26). In 1999, the current account deficit jumped to 4.2 percent of GDP. Moreover, the public debt-to-GDP ratio reached 47 percent (see Table 3.2)

In 2000, the government tried to reverse this situation by fiscal adjustment. It aimed to raise the revenues by higher tax rates, and cut spending by putting a ceiling on transfers from federal government to the provinces (UN, 2004: 6). But these measures were unable to reduce the budget deficit, and the public debt-to-GDP ratio climbed to 47.3 percent in 2000 (see Table 3.2). The shrinking capital inflows and the contraction of the economy in 1999 and 2000 raised the concerns over the sustainability of the excessive debt burden, both domestically and internationally. International interest rate spreads on Argentine debt rose to about 750 basis points in December 2000 –200 points above its level a year earlier (Mussa, 2002: 33). Domestically, a massive run on bank deposits began at the end of 2000. By December 2001, the decline in bank deposits was around \$20 billion, and the government put a \$1000 per month ceiling on deposit withdrawals to stop further losses (Mussa, 2002: 50).

Argentine government took many measures to avoid a full-scale debt crisis in 2001. It pegged the peso to a foreign currency basket composed of 50 percent dollar and 50 percent euro, it restructured its domestic debt via swap operations, it removed the limitations on the Central Bank to inject liquidity to the system, and it cut the public sector salary and pension payments by 13 percent (Mussa, 2002: 39-

41). IMF also supported the Argentine government throughout the year via exceptionally big loans. An immediate disbursement of \$6 billion in January was followed by a \$9 billion disbursement in August² (Mussa, 2002: 44). But, none of these helped the situation. In December, all of the cabinet members as well as the president resigned. The new –temporary– government declared default on its debts, including the social security payments (Calvert, 2002: 8-10). Pegged exchange rate regime was abandoned, leading to a depreciation of the peso by 140 percent (see Figure 3.2) and a compulsory conversion of dollar-denominated contracts and the bank deposits to peso-denominated ones (UN, 2004: 6). Moreover, the economy contracted by ten percent in 2002 and the inflation rate jumped instantly, reaching 40 percent by the end of 2002 (see Table 3.2). This was how the Argentina’s IMF supported stabilization program came to an end, after a decade of implementation.

3.2 Socioeconomic Analysis of the Convertibility Episode and the 2001 Crisis

During the last decade of the 20th Century, Argentina went through a drastic transformation phase under the course of the Convertibility Plan, which not only restructured the economic system of the country, but also affected the fabric of the society negatively. The 2001 economic crisis further accentuated the deterioration in living standards. This section aims to understand the socioeconomic effects of the structural transformation and the recent economic crisis of Argentina by analyzing the evolution of the main socioeconomic indicators during the 1990-2002 period.

3.2.1 Transformation in the Labor Market

During the stabilization and structural adjustment programs (SSAPs), labor markets are mainly affected via three channels: rising unemployment, falling real wages, and shifting employment from formal to informal activities (Şenses, 2001: 190-195). In Argentina, the most effective channel was rising unemployment. As Figure 3.5 shows, unemployment increased steadily from six percent to ten percent

² Second disbursement is not on the official list of arrangements provided by IMF; see Table 3.1.

during the first half of the 1990s –while the economy was growing eight percent per annum. The unemployment jumped to 18 percent in May 1995 in the wake of the Mexican crisis. After that date, the labor market recovered slowly and unemployment retreated to its pre-crisis level in October 1998, only to initiate another upward trend to reach the peak level of 21 percent during the 2002 crisis. Moreover, underemployment³ also rose significantly from eight percent in 1992 to 19 percent in 2002, absorbing some of the labor who lost their jobs during the period.

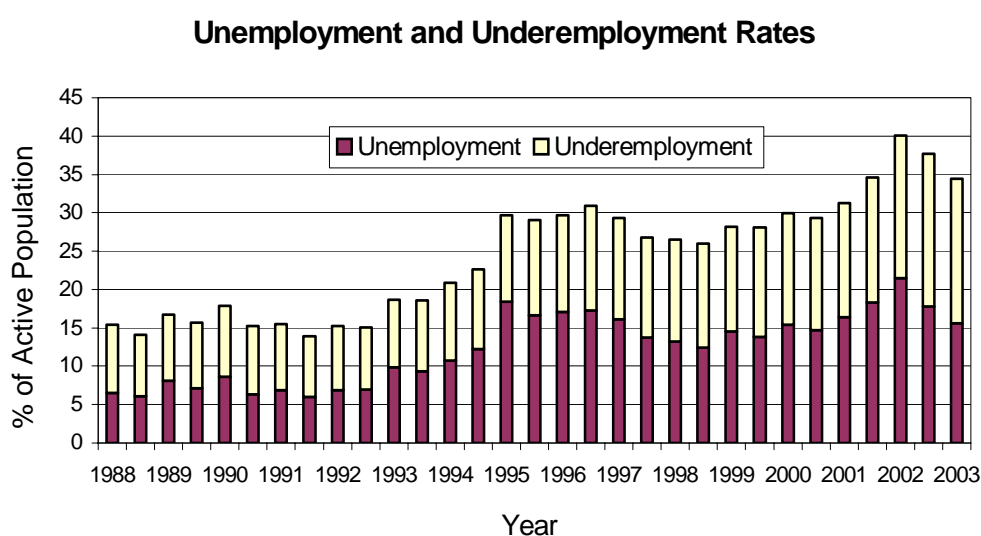


Figure 3.5 Argentine Urban Unemployment and Underemployment Rates, 1988-2003

Source: Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

The steady rise in the unemployment rate during the 1990s –while the economy was expanding significantly– was initially celebrated as the “labor-saving” effect of trade liberalization and the privatization of state enterprises (Pastor and Wise, 2003: 25). However, such high and persistent unemployment rates should be

³ In Argentina, *underemployment* is defined as the status of working less than 35 hours per week either voluntarily or involuntarily. Involuntary part of underemployment –labor who look for full-time employment but cannot find such a job– constitutes the major part of the Argentine underemployment rate (O’Connell, 2002: 16, Chart 9).

considered as a social and political problem for Argentina where unemployment has been historically low (Pastor and Wise, 1999: 483). The roots of this problem are to be found in the change of the country's economic strategy from import substitution to export-led growth as an essential part of the stabilization program. Although Argentina was successful in increasing its exports, albeit at a much slower rate than its imports (see Figure 3.3), the rise in exports has been dominated by low value-added sectors such as natural resource based products⁴ (Pastor and Wise, 1999: 486). Moreover, the largest firms controlling majority of exports have expanded their production through capital-intensive methods. Hence, these factors have worked against "a trade-led reactivation of employment" during the Convertibility Episode (Pastor and Wise, 1999: 486).

Altimir, Beccaria and Rozada (2002: 59) also underline the fact that the rise in the unemployment rate has been concentrated in the manufacturing sector. Moreover, cheapening of capital goods relative to labor under the regime of fixed exchange rate constituted another factor accounting for the low level of labor demand (Altimir, Beccaria and Rozada, 2002: 76). Finally, labor-shedding effect of privatization should also be noted; Altimir, Beccaria and Rozada (2002: 77) argue that around 150,000⁵ jobs –comprising ten percent of the number of unemployed– were lost during the privatization of public enterprises between 1991 and 1995.

A sharp fall in real wages is a frequently observed result of the SSAPs (Şenses, 2001: 191). It is argued that such a fall is necessary for export competitiveness of the country, and a devaluation of the currency, in combination with a 'labor market reform'⁶ are utilized for this purpose. However, Figure 3.6 shows that the Argentine real wage rates have remained nearly constant throughout

⁴ Exports of natural resource based products have jumped from about 25% of all exports in 1989 to 34% in 1994 (Pastor and Wise, 1999: 486).

⁵ World Bank (2000: 79) states that this number is 300,000.

⁶ The associated reform aims to construct a 'flexible' labor market mainly by allowing firms to hire temporary workers, decentralizing the collective bargaining process, and lowering the minimum wage, costs of dismissal and the level of fringe benefits (Thomas, 1996: 91).

the decade with some minor fluctuations. Economically, low inflation rates and the appreciated peso, in addition to the high output and productivity rates are the forces behind the wage rate stability. In this regard, it should be noted that sharp rises in the productivity rates, while GDP was growing strongly especially during the 1993-1998 period, should have declined the share of income going to labor despite the stability of real wages. For the stability of wages, a political force, historical bonds of the Menem's Peronist Party with the labor unions, is likely to be an important factor. Pastor and Wise (1999: 489) argue that the labor unions have resisted a comprehensive restructuring of labor legislation. Although there have been some partial deregulatory changes, the key role of the labor as the main supporter of the Menem Administration has enabled them to block labor market reform. Hence, the strong political relations of labor unions with the political party in power partially account for the stability of real wages in 1990s.

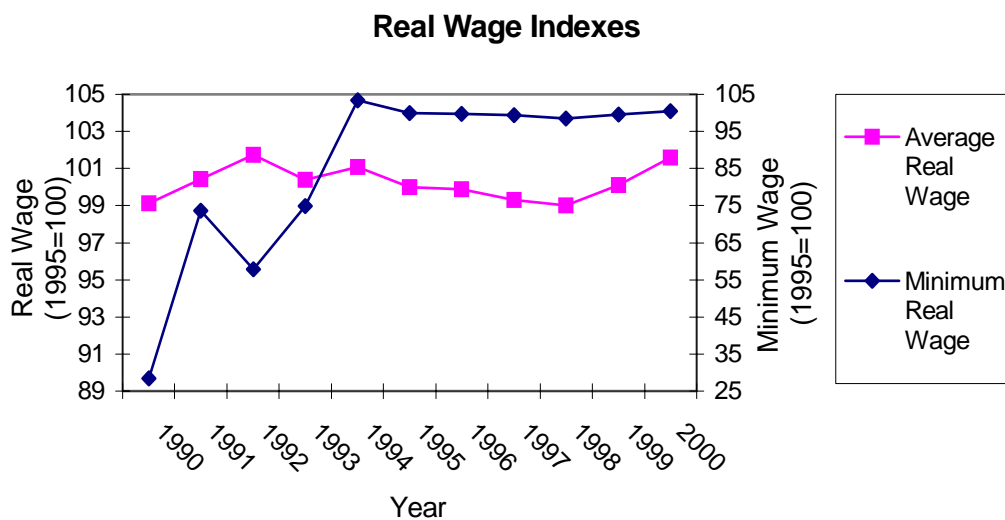


Figure 3.6 Argentine Real Wage Indexes for 1990-2000

Source: ECLAC, Economic Survey of LAC, 2000-2001, Statistical Appendix available at <http://www.eclac.cl/DE/proyectos/eee/eei2001/index.htm>, Table 17 and Table 18.

Note: Data is for industrial workers.

As for the structure of employment, both the World Bank (2000: 20) and Thomas (1996: 88) state that the share of informal sector has expanded at the expense of the formal sector, as the share of the formal sector has declined during

the Convertibility Episode, from 65 percent in 1988 to 55 percent in 1997 (World Bank, 2000: 20, Figure 4). Figure 3.7 shows that there has also been a growing gap between the real wages in the informal sector and the formal sector. Considering that the workers in the informal sector are in general without health insurance, pension, long term jobs and income stability, the rising share of the informal sector no doubt constituted a threat for the welfare of working population, aggravating their distress arising from a high rate of unemployment.

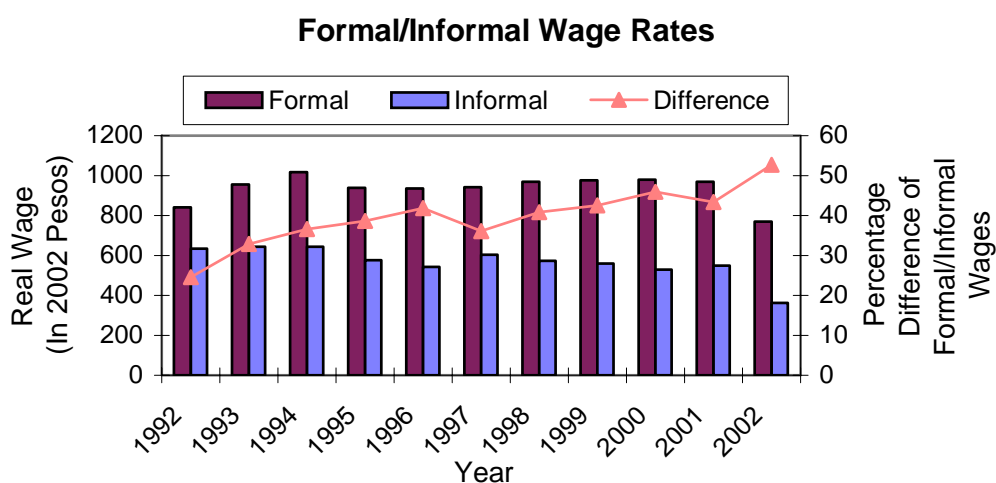


Figure 3.7 Average Formal and Informal Wage Rates and Their Differences, Greater Buenos Aires, 1992-2002

Source: World Bank (2003: 12, Table 1.7).

After the eruption of the 2001 crisis, average level of real wages fell significantly by 24.1 percent in 2002 (see Figure 3.7). Hence, the negative effects of the rising unemployment on the Argentine labor were coupled with the falling real wages during the 2001 crisis. The impact of falling wages was most pronounced for the informal workers, who are amongst the poorest segments of the population. While the decline in the formal wages was 20.7 percent, informal wages decreased by 33.9 percent.

3.2.2 Income Distribution and Poverty⁷

The record of the Convertibility Plan on income distribution is even more disappointing. Income distribution has deteriorated steadily during the 1990s. While the tiny income share of the poor households were getting even smaller, the top deciles of the population have increased their income shares by five to ten percentage points over the period (see Figure 3.8). Consequently, the Gini coefficient has risen from an already high level of 0.45 in 1990 to 0.55 in 2002. Other indicators of income distribution have also worsened during this period (see Table 3.3). Initial impact of the 2001 crisis was a sharp deterioration in income distribution. While the Gini coefficient increased from 0.51 to 0.53, in terms of their income shares Top 10 to Bottom 10 ratio jumped from 58.1 in 2001 to 85.5 in May 2002. The slight improvement between May and October of 2002 can be attributed partly to the social workfare programs designed for the poor (World Bank, 2003: 6), which are discussed below in Section 3.2.3.

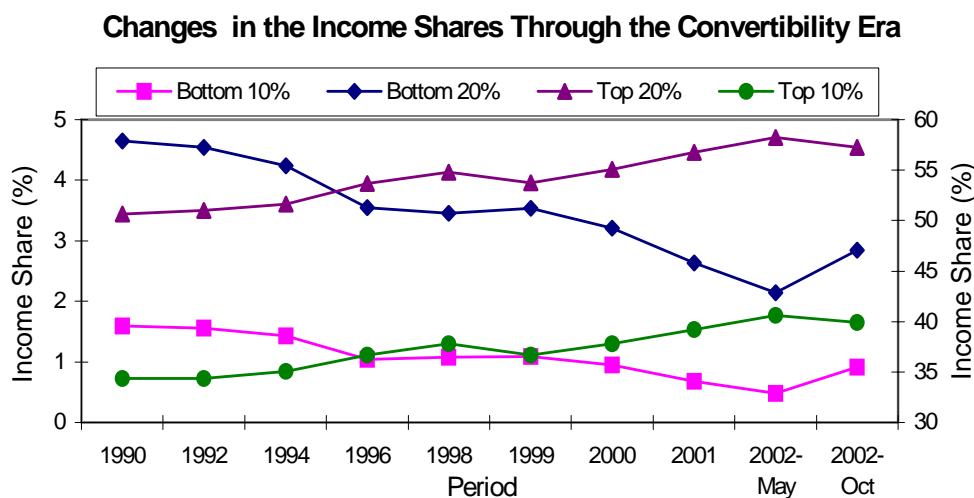


Figure 3.8 Change in the Income Shares of the Top and Bottom Groups, Argentina, 1990-2002

Source: World Bank (2003: 57, Table A.4).

⁷ It is important to note that the income and poverty figures in this section are based on national income surveys that cover only 70% of the urban population. Since the country is about 89% urban, the associated figures cover only 62% of total population. Given that poverty is probably higher in rural areas, the correct national numbers for both income distribution and poverty may be slightly worse than that is indicated here.

Table 3.3 Distributional Indicators, Argentina, 1990-2002

	1990	1992	1994	1996	1998	1999	2000	2001	2002- May	2002- Oct
<i>Gini Coefficient</i>	0.45	0.46	0.47	0.49	0.50	0.49	0.51	0.53	0.55	0.53
<i>Top 10/Bottom 10 Ratio</i>	21.6	22.0	24.6	35.3	35.2	33.8	39.6	58.1	85.5	43.8
<i>Top 20/Bottom 20 Ratio</i>	10.9	11.2	12.2	15.1	15.9	15.2	17.2	21.5	27.2	20.1

Source: World Bank (2003: 57, Table A.4).

If the incomes of the poorest groups could have increased –but less than those of the richer groups–, deterioration of the income distribution could be a less central concern. However, Figure 3.9 shows that real incomes of the 1st and 2nd deciles have been better than the 1990 level only for 1992 and 1994. In view of the fact that Argentina’s economic performance was disastrous in 1990 with its real GDP at its lowest level of the preceding two decades and the rate of inflation at around 1,000 percent (see Figure 3.1 and Table 3.2), the failure of the bottom deciles to earn more than they did in 1990 shows that the poorest groups have not benefited at all from the considerable growth of the economy during the course of the Convertibility Plan. On the other hand, incomes of the top two deciles have been better than their 1990 levels by a minimum of twenty percent during the decade (see Figure 3.9). Moreover, they have lost a smaller part of their income during the crisis compared to the poorer deciles –income loss between 2000 and 2002 was around 26 percent for the 10th decile and 65 percent for the 1st decile.

Real Income Changes Relative to 1990

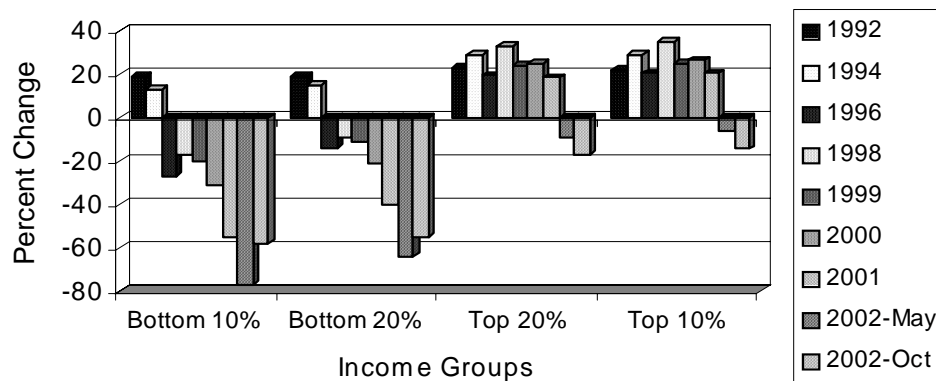


Figure 3.9 Real Income Changes Relative to the Year of 1990, Argentina, 1992-2002

Source: World Bank (2003: 57, Table A.4).

The dramatic deterioration of income distribution during the Convertibility Episode is attributable to two main factors. The first of these factors relates to low labor demand, especially for unskilled workers. By May 1993, the unemployment rate of blue-collar workers was four times that of the university-trained professionals (Pastor and Wise, 1999: 490). This situation is also reflected in the growth of wages during the period. The incomes of professionals grew by a total of 53 percent over the 1990-98 period, while skilled workers' wages, for example, rose by 13 percent and wages of the unskilled workers actually declined by 3 percent (World Bank, 2000: 7). While Galiani and Sangunietti (2000) ascribe the increasing wage disparity to trade liberalization, Pastor and Wise (1999: 490) emphasize the importance of the boom in the financial sector, following liberalization. The second factor is the increasing concentration of assets on the business side. Pastor and Wise (2003: 29) suggest that the top 100 firms controlled 46.5 percent of industrial output in 1997-98, up from 37.2 percent in 1991-93. Even during the 1995 recession, when unemployment and bankruptcy rates of smaller businesses had increased sharply, the top 200 Argentine companies have increased their sales and profits by 11 percent and 30 percent, respectively (Pastor and Wise, 1999: 490).

Poverty rates given in Table 3.4, naturally, mimic the real income trend of the bottom deciles, since these rates are based on income data. During the first years of the Convertibility Episode, poverty incidence in Argentina improved sharply. Poverty rate and extreme poverty rate declined from 40.4 and 11.3 percent in 1990 to 21.1 and 4.9 percent in 1993, respectively. However, this improvement was a result of the taming of hyperinflation that have emerged in 1980s, not due to deliberate poverty alleviation efforts by the government. During the 1980s, poverty rates rose sharply from eight percent in 1980 to 40 percent in 1990, as wage rates were not adjusted quickly enough to keep up with price changes (World Bank, 2000: 3). Therefore, the initial decline in the poverty rates was far from being a great success with the poverty rate retreating only to the 20 percent level, not to the low level of eight percent registered in 1980.

Moreover, after the improvement between 1991-1993, poverty rates and the number of poor people rose continuously for the rest of the period, except for another slight improvement in 1997. In 2001, poverty rate was 37.1 percent, meaning that nearly 14 million people were below the poverty line. Extreme poverty rate was 12.6 percent in this year, after increasing steadily throughout the 1994-2001 period from the low of 4.5 percent in 1994. This rate was even higher than the 11.3 percent registered in 1990. The effect of the 2002 crisis, however, was much more dramatic. In 2002, both the poverty and the extreme poverty rates hit historical highs, even surpassing the very high levels of 1990, the last year of the hyperinflation era. While the poverty rate rose by 18.2 percentage points to 55.3 percent, extreme poverty rate more than doubled, from 12.6 percent in 2001 to 26.2 in 2002. Hence, due to the crisis, majority of the population, nearly 21 million people, suffered the pains of poverty. Number of extremely poor people was also worrisome: nearly 10 million people (see Table 3.4).

Table 3.4 Argentine Poverty Indicators, 1980-2002

	Poverty Rate (Headcount)	Absolute Number of People in Poverty (in Millions)	Extreme Poverty Rate (Indigence)	Absolute Number of People in Extreme Poverty (in Millions)
<i>1980</i>	8.0	2.25	...	...
<i>1985</i>	16.0	4.85	...	...
<i>1990</i>	40.4	13.14	11.3	3.66
<i>1991</i>	27.5	9.07	5.1	1.68
<i>1992</i>	23.0	7.67	4.7	1.55
<i>1993</i>	21.1	7.13	4.9	1.64
<i>1994</i>	21.3	7.29	4.5	1.53
<i>1995</i>	27.4	9.53	7.2	2.50
<i>1996</i>	30.8	10.85	8.7	3.05
<i>1997</i>	29.8	10.61	7.6	2.69
<i>1998</i>	29.5	10.66	7.8	2.82
<i>1999</i>	31.0	11.32	8.6	3.15
<i>2000</i>	33.1	12.26	9.3	3.44
<i>2001</i>	37.1	13.91	12.6	4.72
<i>2002</i>	55.3	20.96	26.2	9.92

Sources: World Bank (2000: 3, Table 1) and (2003: 57, Table A.4), and ECLAC Online Database at <http://www.eclac.cl/badestat/>.

Note: Poverty rates are based on the Argentine Government's official poverty lines, which are as follows. Poverty Rate (Column 2) is equal to \$160 per male adult, per month, in 1998, and Extreme Poverty Rate or Indigence Rate (Column 4) is based on the food consumption portion of the poverty line, and is equal to \$69 per month in 1998 (World Bank, 2000: 4).

3.2.3 Public Social Sector Spending

- *Overview*

SSAPs have been commonly blamed for the dramatic falls in the social expenditure levels of the implementing countries, as diminishing the budget deficits by cutting public expenditures is a common measure of stabilization and structural adjustment programs (Şenses, 2001: 195). However, during the 1990s, Argentina has been one of the countries⁸ with the highest social spending levels in Latin America, both as a percentage of GDP and in per capita terms (ECLAC, 2002: 24,

⁸ Other countries are Brazil, Panama, and Uruguay. See CEPAL (2002: 24, Figure 7 and Table 2) for details.

Figure 7 and Table 2). Moreover, Table 3.5 shows that the Argentine government's social spending level during the 1990s has been higher than it has been in the 1980s, and has remained relatively stable until the 2002 crisis. But there are some qualifications at this point. First of all, public spending on social sectors include social insurance spending in Argentina, in addition to the education, health, housing, water and sewerage, and social assistance and promotion expenditures which are recorded under the name of Other Social Expenditures. Since social insurance spending is mainly financed by its beneficiaries, not by the government, this spending category, comprising around 39 percent⁹ of the public social spending (PSS) by itself, makes the PSS to appear higher than its actual level.

Furthermore, World Bank (2000: 97) states that the elasticity of Argentine public social spending with respect to changes in GDP during the 1980-1997 period was 1.3, indicating that the social spending was procyclical. It was also much higher than overall elasticity of government expenditure (0.95). Therefore, the increasing trend of real PSS should be attributed mostly to the expansion of the Argentine economy, rather than the government's commitment to social issues. Procyclical characteristic further implies a high probability of a sharp fall in the social spending level during the downturn of the economy, when such spending is most needed. This fact was confirmed by checking the crisis level of public social spending. In 2002, real PSS was 32 percent less than its 2001 level, and had plummeted to its 1991 level. Although its rising share in the total public spending in the crisis year –from 61.5 percent in 2001 to 66.9 percent in 2002– can be regarded as an effort of the government to protect the social spending levels, its real level per capita declined by nearly 50 percent. Since per capita spending level is a more suitable measure of average benefit incidence of public spending, the efforts of government were short of protecting the public from the negative effects of the crisis.

⁹ The figure represents the average for the 1991-2000 period, calculated from Ministry of Economy and Production of Argentina data.

Table 3.5 Public Social Spending (PSS), Argentina, 1980-2002

	Real PSS (billions of 2001 Pesos)	PSS Per Capita (2001 Pesos)	PSS/GDP (%)	PSS/Total Public Spending (%)
<i>1980-1985</i>	32.020	1097	15.2	46.5
<i>1985-1990</i>	37.077	1172	17.0	54.6
<i>1991</i>	41.747	1266	17.1	63.2
<i>1992</i>	46.732	1398	18.1	62.9
<i>1993</i>	50.892	1503	20.2	64.0
<i>1994</i>	55.986	1631	20.9	66.0
<i>1995</i>	53.695	1544	21.2	65.1
<i>1996</i>	52.680	1496	20.1	65.7
<i>1997</i>	55.668	1561	19.8	65.1
<i>1998</i>	58.048	1607	19.9	64.4
<i>1999</i>	61.229	1674	21.6	63.2
<i>2000</i>	59.273	1601	21.2	62.8
<i>2001</i>	59.111	1577	22.0	61.5
<i>2002</i>	40.110	1057	17.1	66.9

Source: Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

Actually, significance of the PSS depends on which income groups benefit from it and which of them pay for it. Table 3.6 reveals that the question does not have a straightforward answer in Argentina. While social insurance, which mainly covers formal sector employment, is clearly not beneficial for the poorest quintile, other social expenditures have a more progressive character. In 1996, only ten percent of the social insurance spending was allocated to the poorest –first– quintile, whereas the richest –fifth– quintile got the highest share, 26.5 percent. However, the Other Social Expenditures category, e.g. public spending on education, health, housing, and social assistance, was more pro-poor. While the poorest quintile received 29.8 percent of this type of spending, 13 percent was beneficial for the richest quintile. But the tax incidence is a less positive issue. Although the tax shares of the poorer quintiles –first three quintiles– are lower, they are notably higher than their income shares, which are given in the last row (see Table 3.6). Hence, the poor carry a higher tax burden than the rich with respect to their income levels.

Table 3.6 Benefit Incidence of the Public Social Expenditures and Tax Distribution by Quintiles, Urban Argentina, 1996

	Quintiles:					Total
	I	II	III	IV	V	
<i>Social Insurance Expenditure</i>	9.9	20.6	19.5	23.6	26.5	100
<i>Other Social Expenditures</i>	29.8	18.8	21.7	16.8	13.0	100
<i>Tax Distribution</i>	7.1	10.7	14.9	20.1	47.2	100
<i>Income Shares</i>	4.0	8.4	13.2	21.2	53.2	100

Source: World Bank (2000: 96, Table 3.3).

- **Education**

World Bank (2000: 106) states that the Argentine education system is one of the most developed ones in the region, comparable even to the OECD standards. The country has an adult literacy rate of 97 percent and 9.7 mean education years (World Bank, 2000: 106). As Figure 3.10 shows, the total expenditure on education, albeit its low level at 3-4 percent of GDP, as well as on basic education have risen over the 1990s. Moreover, high school and university education spending constituted only 21 percent of the educational spending on average during the Convertibility Episode, indicating that lower education levels, which are more beneficial for the poor segments by their nature, received the majority of the total spending. However, the fall in the educational spending during the 2002 crisis was worrisome. Total public spending on education as a share of GDP declined from 5.2 percent in 2001 to 4.3 percent in 2002, while the public spending on basic education fell from 3.5 percent in 2001 to 2.9 percent in 2002. Considering that the GDP contracted by 11 percent, this decline of around 17 percent in the GDP shares represents a fall of 28 percent in real terms during the crisis year.

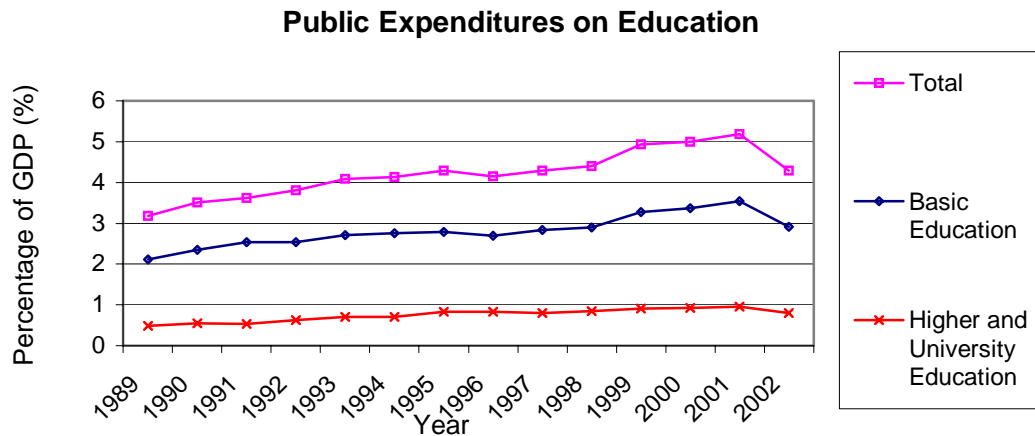


Figure 3.10 Public Education Expenditures as a Percentage of GDP, Argentina, 1989-2002

Source: Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

Moreover, when the educational indicators are disaggregated according to the income levels, the overall picture gets blurred. As can be seen from Table 3.7, the poor do much worse than the rich in all indicators, and the gap gets wider as the considered education level increases. Since less education means less potential income, this educational gap constitutes an important obstacle on the way to poverty eradication. World Bank (2000: 115) argues that the Argentine government has tackled this problem in 1993 by creating a compensatory program (*Plan Social Educativo*) that targeted the schools in the poor regions. But the same study also reveals that the program had not produced any positive results by 1997, as the secondary school enrollment rate of the first quintile has fallen from 72.7 percent in 1992 to 65.5 percent in 1997, and the higher education enrollment rate from 21.6 percent to 9.7 percent (World Bank, 2000: 113, Table 4.7). Although the World Bank study does not provide an explanation for the significant decline in poor children's enrollment rates, it is most likely that the falling real incomes of the poor segments of the population during the associated period (see Figure 3.9) was the main reason behind it. In any case, the program was discontinued during the crisis period.

Table 3.7 Educational Indicators by Income Level, Argentina, 1998

	Quintiles:					Total
	I	II	III	IV	V	
<i>Primary Enrollment Rate</i>	98.5	99.8	99.9	100	100	99.4
<i>Secondary Enrollment Rate</i>	71.1	80.8	90.0	93.3	96	82.8
<i>Out of School (14-18 Age Group)</i>	36.7	27.5	18.8	15.6	7.7	26.0
<i>Delayed Entry to Primary School</i>	32.5	18.6	11.8	8.3	9.3	20.1
<i>Delayed Entry to Secondary School</i>	50.2	45.9	42.8	30.0	24.9	40.9
<i>Repeaters of At Least One Year</i>	24.6	12.8	7.0	4.0	3.6	14.1
<i>Secondary School Completion</i>	23.6	33.9	49.7	64.5	75.8	47.4

Source: World Bank (2000: 108, Table 4.2 and Table 4.3).

Although the school dropout rates were estimated to be relatively low – around 0.5 percent for children under 15, and 2.3 percent for others (World Bank, 2003: 20, Table 2.2), there are signs that the quality of education may have fallen considerably during the crisis. Due to the plunge in overall educational expenditures of the government, there have been payment problems for teacher salaries and associated teacher strikes have occurred, causing many teaching days to be lost (World Bank, 2003: 36). Furthermore, households have reduced their educational expenditures by 70 percent to cope with the crisis (World Bank, 2003: 20, Table 2.3). All of these are likely to have affected the quality of education and may contribute to inequity in the near future.

- **Health**

As in the sphere of education, average health indicators of Argentina are relatively good and have improved over the past decade. In 1995, life expectancy stood at 76 years, 3 years more than that in 1980. The crude death rate and the infant mortality rate were 8 per 1,000 population and 22 per 1000 births in 1995 respectively, both have declined by 16 percent compared to their levels in 1990. Maternal mortality ratio was 14 per 10,000 live births in 1995, down by 14 percent from 1990 (World Bank, 2000: 118). Moreover, public expenditure on health as a

share of GDP has expanded during the 1990s, except for the 1996-1998 period, from 4.2 percent in 1990 to 5.1 percent in 2001 (see Figure 3.11). However, public expenditures on health declined significantly in the crisis year, 2002. While total health spending as a share of GDP declined by 12.6 percent in this year, spending on public health care fell by 12.4 percent. In conjunction with the contraction in the real GDP level, these declines caused the real spending levels of these categories to decrease by more than 22 percent in 2002.

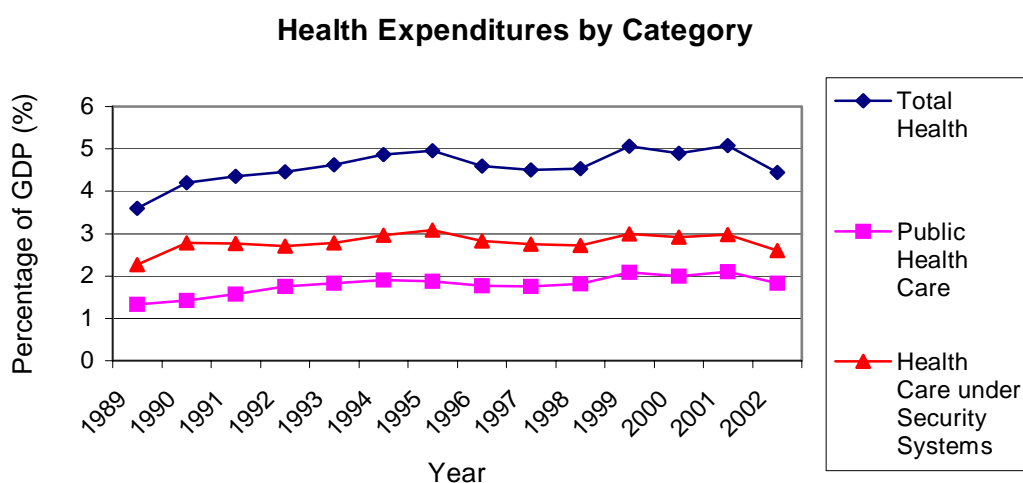


Figure 3.11 Public Expenditures on Health, according to the Type of Health Insurance, Argentina, 1989-2002

Source: Ministry of Economy and Production of Argentina website at http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html

But as in the case of education, general trends hide significant variations between low- and high-income groups, the poor having much worse health status than the rich. For a start, health insurance coverages of people at different income levels are significantly different. As it can be seen from Table 3.8, 67 percent of the population in the lowest income level has no health insurance, meaning that they can use only public hospitals, where the service quality is much lower than private ones. Figure 3.11 shows that public expenditure on the category of non-insurance health care (Public Health Care) comprises only one third of all expenditures and is around half of the expenditures of the security system. Moreover, public system provides

inadequate coverage for pharmaceutical expenditures. In 1996, 43 percent of the poor had to pay for pharmaceuticals out-of-pocket, while eight percent could not afford the medicines they were prescribed (World Bank, 2000: 127). On the other hand, 64 percent of the total population is covered by mandatory insurance or voluntary private insurance, and their health care is provided by the private sector (World Bank, 2000: 126). Partly as a result of the two-fold health system favoring private provision, the poor lack high quality health care and experience relatively higher incidence of communicable diseases and of infant mortality (World Bank, 2000: 119).

Table 3.8 Percentage Health Insurance Coverage by Income Quintiles, Argentina, 1997

	Quintiles:					Total
	I	II	III	IV	V	
<i>Mandatory Insurance</i>	28.3	51.7	59.7	66.8	62.3	51.0
<i>Voluntary Insurance</i>	3.4	6.2	7.8	10.2	16.1	8.1
<i>Both</i>	1.3	2.5	4.6	5.2	11.2	4.3
<i>Without Coverage</i>	67.0	39.6	27.9	17.8	10.4	36.6

Source: World Bank (2000: 127, Table 5.5).

The 2002 crisis further deepened the problems of the Argentine health system. The share of the population without insurance coverage increased from 37 percent in 1997 to 43 percent in 2002. Social security funds failed to collect the majority of the payments. Public hospitals were confronted with a higher demand, while receiving fewer funds from the government because of fiscal restraint. Anecdotal evidence indicates that the situation in public hospitals has been worrisome (World Bank, 2003: 37-39). Hence, the burden of the crisis in this area has again fallen mostly on the poor segments of the population, as the real health spending of the government declined by more than 22 percent.

- ***Targeted Social Spending***

Another classification of the Argentine public social spending divides the PSS into two broad categories: universal and targeted programs. While universal programs are beneficial for the whole public, targeted programs are designed for the poor and the vulnerable groups only, and hence they are considered to be of high importance for the fight against poverty. In 1998, there were 58 targeted programs in Argentina covering a wide range of areas. The programs included food, nutrition, health, employment, training, education, shelter, clothing, cash grants, and emergency programs¹⁰. Despite this thematic richness, the level of public spending on the targeted programs has not increased during the 1990s. World Bank (2000: 95, Table 3.2) states that level of targeted social spending (TSS) as a percentage of GDP in 1995 was lower than its 1980 level. Figure 3.12 shows that during the 1997-2001 period, while total public social spending was expanding (See Table 3.5) TSS has contracted both in real terms and relative to GDP. Since the absolute number of people in extreme poverty was increasing during this period (See Table 3.4), TSS per poor person fell significantly after 1997 (Figure 3.13). Hence, the already low level of assistance provided by these programs has been further weakened during the period.

As a major way of mitigating the negative effects of the crisis, targeted social spending becomes vital for the poor and the vulnerable segments of the society during the crisis periods. Although the Argentine government responded to the 2002 crisis by expanding the on-going workfare programs, real level of TSS did not increase in 2002, despite a one percentage point rise as a share of GDP (see Figure 3.12). More importantly, the real level of TSS per poor person declined drastically in 2002 by 52.3 percent, as the number of the poor rose significantly (see Figure 3.13).

¹⁰ See World Bank (2000: 152-162, Annex 1) for short contents of all of these 58 programs.

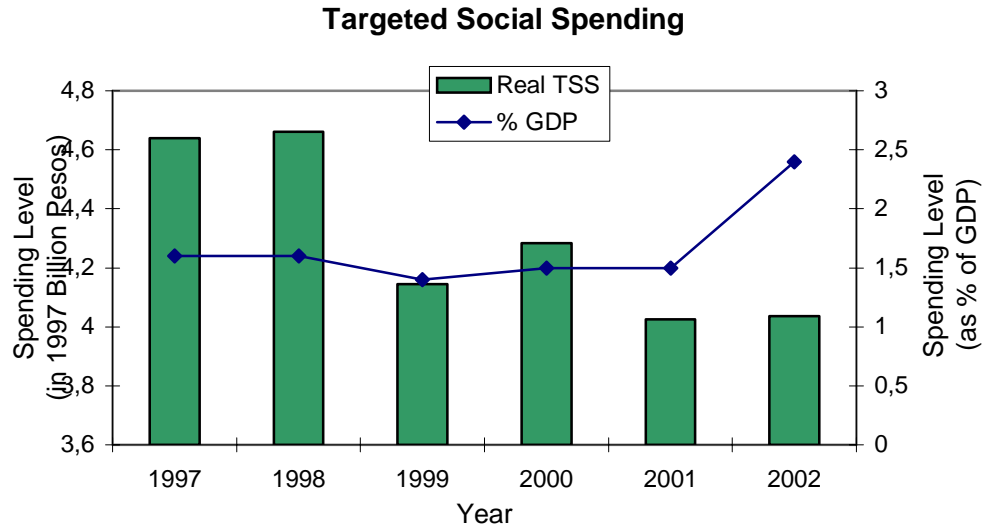


Figure 3.12 Level of Public Expenditure on Targeted Social Programs, in Real Terms and as a Percentage of GDP, Argentina, 1997-2002

Source: SIEMPRO, (2002: 20, Cuadro 3 and Cuadro 4)

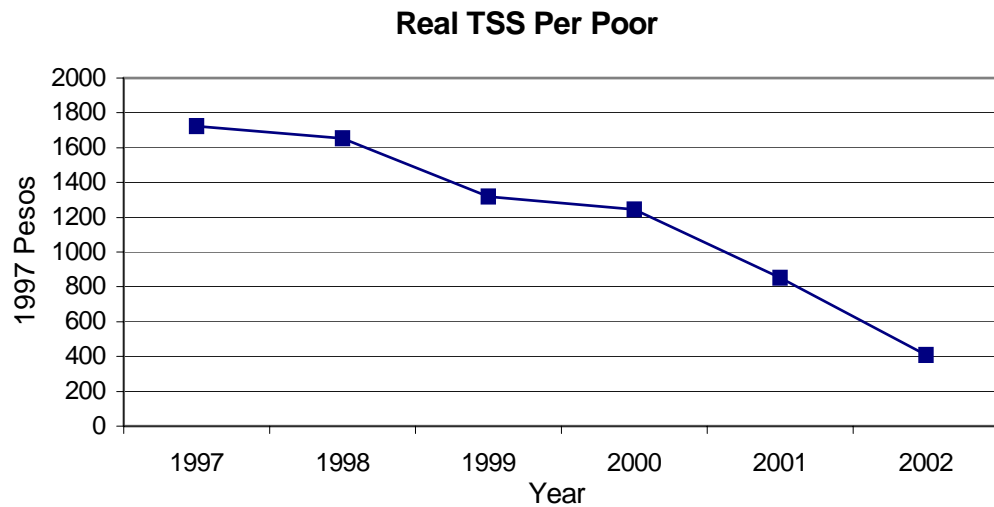


Figure 3.13 Real Targeted Social Spending per Poor, Argentina, 1997-2002

Source: Calculated from SIEMPRO, (2002: 20, Cuadro 3).

While there are only a few studies analyzing the impact and effectiveness of specific programs, general criticisms are not lacking. Pastor and Wise (2003: 35) blame the targeted social programs for being politically driven and poorly

administered. On the other hand, World Bank (2003: 33) criticizes the programs for their fragmented and overlapping structure, arising from lack of coordination among governmental institutions. However, both studies appreciate the social workfare program, which has been initiated as TRABAJAR in 1997 and has evolved to *Jefes y Jefas de Hogar* after the 2002 crisis. These programs provided employment opportunities for unskilled labor, the majority of whom are poor, via infrastructure projects with a wage rate lower than the ongoing market rate. The scale of the TRABAJAR was rather small. Between 1997-2001, government spent 250-300 million pesos for the program annually (SIEMPRO, 2002: Cuadro 3) – comprising 0.5-0.6 percent of total social spending. But *Jefes* emerged as the main safety net response of the government to the 2002 crisis with spending for this program increasing to 2.2 billion pesos (World Bank, 2003: 30). Galasso and Ravallion (2003: 15) estimate that the program had reduced Argentina's unemployment rate by 2.5 percentage points, and the extreme poverty rate by two percentage points during the crisis period. Therefore, *Jefes y Jefas de Hogar* was successful at cushioning the negative effects of the crisis on the poor population, albeit at a small scale.

CHAPTER 4

INDONESIA – FROM SOCIAL MIRACLE TO SOCIAL EXPLOSION

Indonesia was one of the least developed countries in 1965. Its GDP per capita was even lower than the average per capita GDP of the Sub-Saharan African countries (Temple, 2003: 155, Table 6.1). It was an agricultural economy with no modern industrial sector, and it was experiencing an annual inflation of six hundred percent (Hill, 2000: 3, Table 1.1). Majority of its huge population of 105 million was considered poor with a 70 percent poverty rate and had almost no education with adult illiteracy and no-schooling rates of 61 percent and 56 percent, respectively (Hill, 2000: 5, Table 1.2; and UNDP, 2001: 6, Figure 1.2). The country was considered as a “chronic dropout” with “little prospect of rapid economic growth”¹. Then, came the New Order regime in 1966, which managed to reverse the bad fortune of the country and engineer an uninterrupted economic growth period of 30 years. From 1967 to 1997, GDP per capita rose more than fourfold, with an average annual rise of four percent. Share of agriculture in GDP declined to 20 percent from 50 percent, while industry’s share rose to 40 percent from ten percent. Socioeconomic indicators of the country also improved significantly. Poverty rate fell from 70 percent to 11 percent, and the illiteracy rate declined from 61 percent to 15 percent. So in 1997, the country was regarded as one of the East Asian development success stories in all respects (Temple, 2003: 152).

However, Indonesia experienced a sharp reversal in 1997, when the East Asia crisis erupted. Actually, nobody expected the collapse of the Indonesian

¹ These quotations are from Higgins and Myrdal, respectively, as cited in Hill (2000: 1).

economy at the onset of the crisis. It had a better stance than other crisis countries in many pre-crisis indicators such as growth, the fiscal position, the external current account, foreign exchange reserves and inflation (World Bank, 1998: 1.3). But when the fire jumped within the borders of the country, its consequences were more severe than other East Asian countries. Real GDP of the country fell by 13 percent in 1998 – about double that of Thailand and Malaysia– and the national currency, *Rupiah* depreciated by 70 percent between July 1997 and June 1998. Foreign investors rapidly withdrew their funds from the country, and the inflation rate rose to almost 60 percent in 1998 from its low level of 6.2 percent in 1997. Naturally, the effects of the crisis on the poor and the vulnerable were worrisome. Unemployment rate rose from 4.7 percent in 1997 to 6.3 percent in 1999. According to one estimate, poverty rate rose to 37 percent, adding nearly 40 million people to the poor population. Living standards declined significantly. Mass riots and civil violence spread over the whole country.

Indonesia requested assistance from the IMF in December 1997, and the World Bank loan came in July 1998. Post-crisis programs of these institutions that are implemented in Indonesia makes the country a good case to analyze the response of the Bretton Woods Institutions to a full-fledged economic crisis that have resulted in a significant deterioration of socioeconomic conditions. What makes Indonesia more interesting is its good performance in poverty alleviation during the 30-year period prior to the crisis. It is meaningful to assess the post-crisis policies of a government with such a good record in poverty reduction. Hence, this chapter mainly analyzes the post-crisis measures of the Indonesian government against the negative socioeconomic effects of the crisis. This will serve two aims. First one is to dwell on the causes of the pro-poor social policies and second one is to evaluate the social side of the IMF and World Bank structural adjustment and stabilization programs.

After this introduction, chapter proceeds as follows. The following section lays the economic background by looking into the main macroeconomic indicators

for the pre- and post-crisis periods. Then the evolution of the socioeconomic indicators and social policies of the Indonesian government are analyzed.

4.1 Growing into the Crisis – An Overview of Indonesia’s Development and Some Macroeconomic Indicators

4.1.1 Successful Times of New Order, 1967-1993

When General Suharto captured the presidency with a military coup in March 1966, Indonesia was a low-income agricultural economy under the threat of hyperinflation, and had weak growth prospects. But Suharto’s New Order administration, which was a military regime giving near-absolute power to him, was successful in stabilizing the economy and creating sustained growth. As Figure 4.1 shows, starting from the second year of the New Order, 1968, Indonesia’s growth rates were always high –averaging around seven percent– until 1997. Moreover, a least-developed, agricultural country of 1960s evolved into one of the newly industrializing East Asian tigers of 1990s.

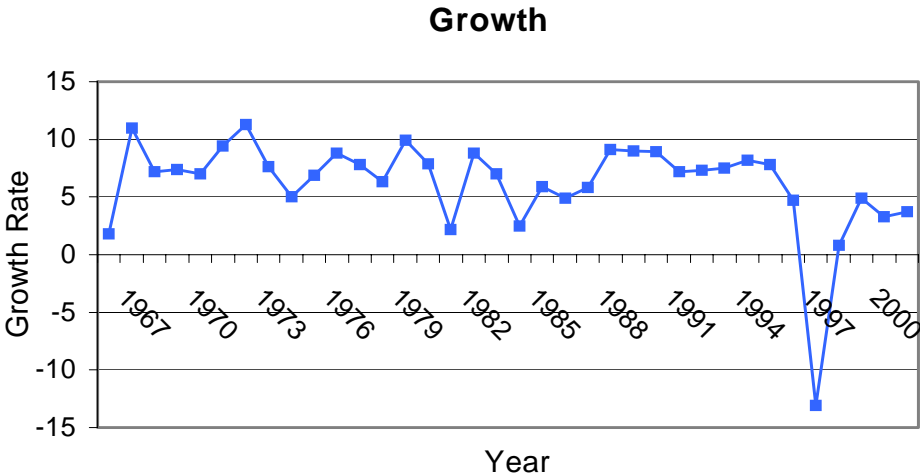


Figure 4.1 Growth Record of Indonesian Economy, 1967-2002

Source: Asian Development Bank (ADB), Key Indicators 2003, Online Edition available at http://www.adb.org/Documents/Books/Key_Indicators/2003/default.asp

Temple (2003: 172) suggests a number of reasons for this success. These reasons include political stability, effective macroeconomic policies of the state, technical progress in agriculture that was possible thanks to the green revolution of the 1970s, and the rapid growth of Indonesia's neighbors and trade partners. Of these, effective macroeconomic policy-making of the state had a central role in the restructuring of the Indonesian economy. Four major instances demonstrate the effectiveness of the macroeconomic management of New Order. These also trace the path of country's economic transformation. First one is the rapid stabilization of the economy at the beginning of the New Order regime. When Suharto took office in mid-1966, annual inflation rate had peaked at almost 1,500 percent. By using tight monetary policy and the balanced budget rule, government successfully took the inflation under control at an annual rate of 15 percent by 1969. Average annual inflation rate for the next 28 years was around ten percent, although there were some short periods of higher rates (Hill, 2000: 31, Figure 3.1).

Second good policy-making instance shows itself in the significant agricultural development of the 1970s. Starting with the stabilization period, New Order saw the rural development as a priority, and channeled a significant portion of its resources for this purpose via large input subsidies, price support for rice, and investment in rural infrastructure (Temple, 2003: 163). As Hill (2000: 129, Table 7.1) demonstrates, the results of the active agricultural policy, combined with the effect of green revolution, have been impressive. Yields of all major crops rose strongly between 1970 and 1990. But the extent of the achievements can be best seen in rice, dominant item of the Indonesian diet. Indonesia moved from a status of being the biggest rice importer of the world in 1970s to self-sufficiency by 1985 (Hill, 2000: 125).

The third good policy instance to cite emerged as a policy response to the 1970s oil boom. When the quadrupling of oil prices in 1973 granted a significant windfall gain for Indonesia, government's policy response was distinctive (Temple, 2003: 166). Unlike most of the other oil exporting developing countries, which wasted the revenues created by the oil boom on extra-risky investments especially in

the resource-based industry, Indonesia spent the real income gain on infrastructure, education, agriculture and capital-intensive industry. In this way, New Order prevented a possible contraction of non-oil sectors and further contributed to the long-term development of the country by expanding the machinery and human capital base of industrial production. Furthermore, the country was successful in adjusting to the finale of the oil boom period. When the oil prices started to decline by the end of 1981, Indonesian government responded with a combination of expenditure reduction and exchange rate alignment measures (Temple, 2003: 167). Although growth slowed down during the period, the country was able to avoid a crisis due to the quick adjustment of macroeconomic policies.

Last of the good policy instances took place with a much broader scope than the other three, under the threat of a potential crisis in mid-1980s (Hill, 2000: 17). This time, via wide-ranging microeconomic reforms, overall economic strategy of the country changed from import substitution to export-led growth, and the role of the private sector in economy was increased. These reforms reflected the revival of the influence of the ideas of the National Development Planning Board advisers, who were called as the “technocrats” or the “Berkeley Mafia” – referring to their Ph.D.s (Temple, 2003: 161). *Technocrats* were committed to the free market doctrine, and their ideas had prominence in the early years of the New Order, as the government had to renegotiate debts with the IMF and the World Bank. In this conjuncture, Indonesia had implemented some trade liberalization measures, during the 1967-1972 period, such as the establishment of open capital account in 1970 (Bevan, Collier and Gunning, 1999: 247-248). But, starting from 1973, the *technocrats’* influence was replaced by the pressure of some generals, politicians and bureaucrats, who favored a state-led, protected national economy. Hence, throughout the 1970s, weight of the state-owned enterprises rose, and the import-substituting industrialization strategy dominated the economic policy. In banking system, state-owned banks gave the subsidized credits to the politically powerful ones. In industry, state-owned companies constituted the biggest part of investment and production. So, prior to the associated reforms, Indonesian economy was driven

by the state enterprises in all sectors and had a high degree of protection (Temple, 2003: 170).

The reform process started with a deregulation in banking system in 1983, removing the entry barriers and most credit subsidies, and continued with a tax reform in 1984 and privatization of customs services in 1985. Most important part of the reforms took place in 1986. In May, import liberalization measures for exporters were introduced and the areas in which foreign companies were allowed to invest were extended. In October, non-tariff barriers were dismantled or converted to tariffs. Trade liberalization measures continued with other packages in 1987, 1988, 1990, and 1991 (Hill, 2000: 116). Hill (2000: 117) argues that the reforms have transformed the Indonesian industry from "... a protected, inward-looking sector to one which is increasingly outward-looking and internationally competitive". The structural change is reflected in the rising share of manufactures in exports, from two percent in 1980 to 48 percent in 1992 (Hill, 2000: 166, Table 8.3). Furthermore, the share of labor-intensive goods in manufactured exports –51 percent– surpassed the historically strong share of resource-intensive goods –37 percent– in 1990. Hill (2000: 158) suggests that this indicated Indonesia's adoption of labor-intensive export-oriented development path of its East Asian neighbors.

4.1.2 Heading Towards the Crisis, 1993-2000

Against this background, Indonesian economy entered the 1990s with good prospects. The backward agricultural economy of 1960s had become a newly industrialized country with growing exports. The country was not without its problems, however. Most importantly, widespread corruption was a well-known fact in Indonesia. Especially after the market-oriented reforms of mid-1980s, the politically well-connected conglomerates and the firms of the Suharto family members filled the vacuum in the economic scene left by the state (Robison and Rosser, 1998). The other problem was the fragile banking system and was related to the first one. Nonperforming loans of the banks, especially the state-owned ones,

had a high share of 11-20 percent of their portfolio, due to their close connections with the groups mentioned above (World Bank, 1999: 2).

Nevertheless, these problems did not seem to have been transmitted to the performance of the Indonesian economy, as the macroeconomic indicators for the pre-crisis 1993-1996 period were quite strong (see Table 4.1.). During this period, real GDP increased by a strong and stable annual average of 7.7 percent, bringing an average per capita GDP growth of 6.1 percent. Moreover, this growth seems to have been led by the growth in manufacturing, which grew by more than ten percent annually during the period. Supporting the growth, gross domestic investment stood strong at around 30 percent of GDP, and national saving was 2-3 percent lower than that. Inflation rate remained stable at relatively low levels of only 8-9 percent. Government's fiscal balance was either positive, or negative with small figures, in accordance with the country's constitutional balanced budget law. On the external front, exports were also in line with the general growth trend, recording a yearly expansion of ten percent. Since imports increased faster than that, the trade surplus declined throughout the period, but remained at a sizeable value. Current account deficit in proportion to GDP increased from 1.3 percent to 3.4 percent during the period. Average foreign direct investment remained at around 3.2 billion dollars, albeit with some degree of variation, and the short-term capital flows nearly tripled over the period, reflecting the increasing interest of the speculative international capital in the country. Total external debt represented a significant 60 percent of GDP, but was not considered to be out of place given the robust growth performance of the country (World Bank, 1998: 1.8). But the share of short-term debt within the total debt rose over the period and its average amount was in excess of the central bank reserves by an average of \$9 billion, creating concern over the short-term debt position of the country.

Hence, the Indonesian economy demonstrated good economic fundamentals during the pre-crisis period, except for some over-confidence as exemplified by the short-term debt position. And, when the Thai currency plunged in May 1997, general expectation, arising from the good indicators, was that the crisis would not

Table 4.1 Selected Macroeconomic Indicators of Indonesia, 1993-2000

	1993	1994	1995	1996	1997	1998	1999	2000
Real GDP (Bn \$, at 1993 Market Prices)	158.0	164.1	170.7	176.7	148.9	37.6	48.3	47.3
(Annual Change, %, Based on Rupiah GDP)	7.3	7.5	8.2	7.8	4.7	-13.1	0.8	4.9
Real Per Capita GDP (\$, at 1993 Prices)	838	856	876	897	747	186	237	229
(Annual Change, %, Based on Rupiah GDP)	5.5	5.8	6.5	6.6	3.5	-14.1	-0.4	3.7
Manufacturing Production Index (1993=100)	100	118	131	139	157	104	105	109
(Annual Change, %)	11.2	17.6	11.0	6.6	13.2	-34.2	1.8	3.6
Gross Domestic Investment/GDP (%)	29.5	31.1	31.9	30.7	31.8	16.8	11.4	16.1
Gross National Saving/GDP (%)	28.7	29.5	27.7	27.4	28.6	20.9	11.8	18.3
Inflation Rate (CPI, Annual Change, %)	9.7	8.5	9.5	7.9	6.2	58.5	20.5	3.7
Nominal Exchange Rate (Rp/\$, Period Average)	2087	2161	2249	2342	2909	10014	7855	8422
Government Budget Balance (% of GDP)	-0.5	1.0	2.2	1.0	0.5	-1.7	-2.5	-1.2
Exports, fob (Mn \$)	36823	40053	45418	49815	53444	48848	48665	62124
(Annual Change, %)	8.4	8.8	13.4	9.7	7.3	-8.6	-0.4	27.7
Imports, cif (Mn \$)	28328	31984	40629	42929	41680	27337	24003	33515
(Annual Change, %)	3.7	12.9	27.0	5.7	-2.9	-34.4	-12.2	39.6
Trade Balance (Mn \$)	8495	8070	4789	6886	11764	21511	24662	28609
Current Account Balance (Mn \$)	-2107	-2790	-6431	-7660	-5095	4098	5783	7992
(% of GDP)	-1.3	-1.6	-3.2	-3.4	-2.4	4.3	4.1	5.3
Foreign Direct Investment (Mn \$)	2003	1500	3742	5594	4525	-401	-2817	-4700
Portfolio Investment (Mn \$)	1805	3877	4100	5005	-2509	-1878	-1792	-1911
Total External Debt (Bn \$)	89.2	107.8	124.4	128.9	136.2	151.2	151.0	144.1
(% of GNI)	58.7	62.6	63.4	58.3	65.0	167.9	116.7	102.0
Short Term Debt (Bn \$)	18.0	19.5	26.0	32.2	32.9	20.1	20.0	22.6
(% of GNI)	11.8	11.3	13.2	14.6	15.7	22.3	15.5	16.0
Total Reserves, Including Gold (Bn \$)	12.5	13.3	14.9	19.4	17.5	23.6	27.3	29.4

Source: Asian Development Bank (ADB), Key Indicators 2003, Online Edition available at http://www.adb.org/Documents/Books/Key_Indicators/2003/default.asp

harm the Indonesian economy and would be easily overcome with a solid response of the government (Feridhanusetyawan and Pangestu, 2004: 2). These expectations turned out to be wrong, unfortunately. As foreign investors pulled their funds from the country and the domestic firms bought significant amounts of foreign exchange to hedge their short-term external debts, the rupiah came under sustained attack. The central bank widened the exchange rate band from 8 to 12 percent in July to defend the currency. The rupiah dropped by about seven percent, but the speculative attack on the currency did not subside. In August, it was not possible to defend the rupiah any longer. The central bank announced that the exchange rate was allowed to float and tightened the monetary policy as a pre-emptive action (World Bank, 1999: 1.4). Rather than preventing the collapse, these measures seemed to make matters worse. As the value of the rupiah vis-à-vis the dollar fell by about 26 percent in August, 40 percent in September and 28 percent in October, the government asked for IMF assistance.

The IMF package was announced in November, and the implementation of the package began with the closing of 16 banks, to show the government's determination to deal with financially troubled banks. But the closures were done without proper deposit insurance schemes in place. Hence, they further reduced the credibility of the domestic commercial banks, and large deposit withdrawals occurred. While the central bank had to issue money to support the rest of the banking system, it was clear that the crisis was expanding (World Bank, 1999: 1.6). In December, rumors about the health of the 77-year old President Suharto and the problems in the implementation of the IMF package deepened the crisis further; nominal value of rupiah fell by 104 percent (Feridhanusetyawan and Pangestu, 2004: 5). Not all of these events, which occurred in the second half of the year, were reflected in the macroeconomic indicators of 1997 as given in Table 4.1. Only a slow-down in the growth rate from 7.8 percent to 4.7 percent, a contraction of imports by three percent and a short-term capital outflow of 2.5 billion dollars gave some clue about what had happened. Since the turmoil in the financial sector was not yet transmitted to the real sector, manufacturing output, export and gross investment indicators of 1997 were quite strong.

The first days of 1998 gave the first signs of the economic and social collapse. On January 6, the government announced a mildly expansionary budget, which was in contradiction with the IMF package. Robison and Rosser (1998: 1601) argue that the government's intention was to prevent the further contraction of the economy and the possibility of social unrest, both of which were likely to occur under tight fiscal policies. But the financial markets perceived the budget as a failure in economic reform commitments. Within two days, the value of the rupiah collapsed by 44 percent against the US dollar, and the Jakarta Stock Exchange hit historical lows. Moreover, the panic spread over the whole population, people rushed to the supermarkets to stock up essential commodities and to the banks to withdraw their deposits. Also, there occurred widespread capital flight in the mean time¹. A second IMF package with a greater range of commitments was announced on January 15, but it was ineffective in the implementation stage and failed to restore the confidence in the economy (Robison and Rosser, 1998: 1602).

For the next three months, the country did not show any good signs except a new IMF package in April, which covered all major issues. However, inflation, and especially, food prices began to rise. President Suharto renewed the term of his presidency in March, taking his daughter and closest business associate into the new cabinet (Hill, 2000: 280). All of these provoked public anger against the regime in the form of student demonstrations all over the country. The protests calling for reforms of the political system mounted in May, and evolved into widespread riots, arson and looting directed largely at Suharto's family and friends and at the ethnic Chinese minority. More than a thousand people died during the protests (World Bank, 1999: 1.7). President Suharto had to resign on May 21, leaving his place to Vice President Habibie, who immediately announced his commitment to political and economic reforms. Although this event provided serious prospects for reforms, the direct economic results were worrisome. Rupiah depreciated by 50 percent against the US dollar (World Bank, 1999: 1.7). The Chinese community and their

¹ Total private capital outflow was 13 billion dollars in 1998, according to the balance of payments data provided by Feridhanusetyawan and Pangestu (2004: 27, Table 4.1).

capital left the country, destroying the distributional system of domestic trade that they have been controlling for generations. This led to food shortages in various parts of the country, leading to further price increases. Finally, a new run on banks occurred, as people withdrew their deposits from the banks of the Suharto family (Feridhanusetyawan and Pangestu, 2004: 8).

The new government instantly embarked upon the reform process according to IMF guidelines. The main tenets of the program were: stabilization of the exchange rate through a tightening of monetary policy, reforming of the banking sector, debt restructuring for the private sector, strengthening the implementation of the structural reforms, fostering the financial sector as a means of reviving the real economy, and implementing measures to protect the poor. Harvie (2002: 189) emphasizes that the last component came to daylight after the riots in May. As a part of this stabilization and structural adjustment program, the government prepared a comprehensive privatization masterplan in September, which envisaged the divestiture of nearly all state enterprises over the next decade.

Macroeconomic indicators of 1998 give the full picture of the devastating effects of the crisis this time (see Table 4.1). GDP plunged deeply by a 13.1 percent drop and GDP per capita declined by 14.1 percent. Manufacturing seems to have been hit most severely; it contracted by 34.2 percent. As a result of the enormous depreciation of the exchange rate and the excessive money printing of the central bank to back up the commercial banks, inflation soared to 58.5 percent in 1998. Exports declined significantly by 8.6 percent. While some of this was due to exceptionally low world oil prices, non-oil exports also declined considerably, leading to a worse export performance than other crisis-ridden East Asian countries (Hill, 2000: 267). Since imports fell by a drastic 34.4 percent, there was a sizeable trade surplus of \$21 billion. Total debt mounted to 168 percent of the collapsed national income, but this time short-term debt contracted by \$12 billion.

In 1999, the Indonesian economy bottomed out and embarked on a fragile recovery with a positive growth rate of 0.8 percent (See Table 4.1). However, this

growth was a mere result of the natural rebound effects of the economy after such a drastic contraction (Feridhanusetyawan and Pangestu, 2004: 9). While the investment and savings rates shrank to around 11 percent of GDP, manufacturing recorded a small growth of 1.8 percent relative to 1998 –but it was still 50 percent short of its 1997 level– and the value of exports were even smaller than that of the previous year. Government budget gave a deficit of 2.5 percent of GDP, the worst figure for the past ten years. As a result of falling goods prices, appreciation of the rupiah and the tight monetary policies (Harvie, 2002: 190), inflation seemed to be getting under control at 20.5 percent rate. On the external side, capital continued to leave the country with a total private capital outflow of ten billion dollars in 1999 (Feridhanusetyawan and Pangestu, 2004: 27, Table 4.1), but external debt remained stable nominally. Structural reforms continued with anti-corruption laws, fiscal decentralization, regulations in the financial sector, and the first free elections in almost four decades (Harvie, 2002: 207-212).

Indonesian economy gave some more signs of recovery, but was still in an insecure position during 2000. GDP grew by 4.8 percent; mainly as a result of 17 percent expansion in domestic investment and 28 percent rise in total exports (See Table 4.1). Annual inflation rate was remarkably low, 3.7 percent, but Harvie (2002: 191) suggests that year on year rates during the year were considerably higher, at around 10 percent. Unlike the past three years, imports expanded this year, but even a growth rate of nearly 40 percent was unable to make it reach pre-crisis levels. Capital outflow did not stop this year either. Private capital outflow was recorded as 7 billion dollars on balance of payments data, but the external debt position of the country improved, albeit slowly.

4.2 Socioeconomic Effects of the Crisis and the Policy Response of the Indonesian Government

4.2.1. Labor Market

In the aftermath of the crisis, International Labor Organization's early estimates on the effects of the crisis on the labor market were worrisome. ILO predicted an unemployment rate of around 15 percent in 1998; three times that of 1997 (Ahmed, 1999: 7, Figure 2). However, as Table 4.2 demonstrates, the rise in the unemployment rate was limited to 0.7 percentage point. Both Manning (2000: 106) and IMF (2002: 79) argue that it was the flexibility of the labor market that bore this swift response to the crisis. Two major factors were behind this flexibility. Firstly, the Indonesian labor market still kept the properties of a classic labor-surplus economy, although the country had evolved from an agricultural economy to an industrializing one in the past three decades. For example, in 1997, the share of the manufacturing sector in total employment was only 13 percent, one-third of that of the agricultural sector (40 percent), despite the fact that former had a much bigger share in total output. Moreover, wage employment accounted for only 30 percent of all jobs (Manning, 2000: 115-116). Secondly, the country lacked the regular labor market institutions in the form of trade unions and the labor laws. In the pre-crisis period, New Order regime had tightly controlled the organized labor. There was only one trade union, which was directed by the government, and the military intervened in labor disputes to settle them to the benefit of the business side (IMF, 2002: 88). Furthermore, labor legislation, which was very limited in scope, was not given priority by the government.

Table 4.2 Indonesian Labor Market Indicators, 1997-2000

	1997	1998	1999	2000
<i>Unemployment Rate (%)</i>	4.7	5.4	6.3	6.1
<i>Employment Index</i>	100.0	102.6	104.4	106.7
<i>Agriculture</i>	100.0	113.1	110.9	118.9
<i>Industry</i>	100.0	87.6	97.3	97.0
<i>of which: Manufacturing</i>	100.0	90.1	104.7	106.1
<i>Services</i>	100.0	99.2	101.1	98.9
<i>Wage Employment Index</i>	100.0	94.5	96.4	96.7
<i>Non-wage Employment Index</i>	100.0	106.8	107.8	109.5
<i>Average Real Wages Index</i>				
<i>Manufacturing</i>	99.5	68.0	75.2	92.3
<i>Agriculture</i>	96.5	65.0	78.9	80.2
<i>Minimum Wage Index</i>	94.9	61.9	70.7	84.4

Source: IMF (2002: 81, Table 2).

So, this flexible labor market of Indonesia responded to the drastic contraction of the output via two mechanisms. First mechanism was the substantial fall in real wages. Since the nominal wages were not able to keep up with high inflation, real wages fell by around 35 percent in 1998. The second mechanism was the changes in the employment of workers by sector and employment status. Reallocation among the sectors was from non-agricultural sectors to agriculture; while agricultural employment rose by around 5 million (13 percent), manufacturing and construction employment levels decreased by 1.1 million and 0.7 million respectively from 1997 to 1998 (IMF, 2002: 83, Table 5). There was also an expansion in the urban trade sector employment by three percent, indicating the employment shift toward small self-employment activities such as stalls and hawking (Manning, 2000: 128). By the employment status, the direction of change was naturally from wage employment to non-wage employment; as the former shrank by 5.5 percent, the latter expanded by 6.8 percent (see Table 4.2). Hence, the overall change was from formal and good-paying jobs in the modern sectors to informal and insecure jobs in agriculture and trade.

The fragile economic recovery of 1999-2000 was partially reflected in employment. There was a weak expansion in non-agricultural employment during this period, but most of this expansion was in non-wage employment, which can be taken as an indicator of informal sector employment (see Table 4.2). Moreover, the economic recovery was unable to create enough jobs for the growing population. Unemployment rate rose from 5.4 percent in 1998 to 6.3 percent in 1999, then slightly declined in 2000 by 0.2 percentage point. On the other hand, there occurred some increase in real wages in 1999 and 2000 compared to 1998. Although these increases were not enough to make the real wage rates reach their pre-crisis levels, they reflected the government's responsiveness to labor demands, as wage rates were mainly driven by the increases in minimum wages set by the government (IMF, 2002: 89). Furthermore, labor gained a number of new rights during the period, as the new government accepted a range of ILO conventions and gave the labor the right to assemble their own unions.

4.2.2 Income Distribution and Poverty

Prior to the crisis, poverty and income distribution records of Indonesia were internationally praised (Hill, 2000: 196). The country was able to keep its relatively low inequality level during its high growth period, 1970-1996. At the beginning of the period, Gini coefficient was 0.34, it fell slowly until the end of the 1980s, and then in 1990s it rose to 0.36. The ratio of the top and bottom quintiles shows a similar trend (see Table 4.3). More importantly, the headcount poverty rate and the absolute number of poor were substantially reduced during the period. While the former came down from 40 percent in 1976 to 11 percent in 1996, the latter declined from 54 million to 22 million during the same period (see Table 4.3).

Although this is a remarkable success, one should note some qualifications. The first is that there is a dense population just above the poverty line in Indonesia².

² See Suryahadi, Sumarto and Pritchett (2003) for a discussion of the elasticity of the Indonesian poverty figures to the choice of the poverty line.

For instance, when the \$1/day poverty line is used, the poverty rate is only 7.8 percent in 1996, and the number of poor is 15 million. But when the \$2/day poverty line is utilized, this rate jumps up to 50 percent, and the number of poor people increases nearly to 100 million (Harvie, 2002: 211, Table 9.8). In this vein, when the Central Bureau of Statistics (CBS) increased the share of the non-food items in the poverty basket of the official poverty line, the change in the poverty rate of 1996 was significant. It rose from 11 percent with the old line to 18 percent with the revised poverty line (UNDP, 2001: 7).

The second qualification stems from a controversy around what has caused this fall in poverty rates. While UNDP (2001: 7) argues that the success was due to high and stable growth of the country, but not the result of a deliberate poverty alleviation program, Bevan, Collier and Gunning (1999: 419) suggest the reverse, proposing that it was New Order's policy to preserve equality. Hill (2000: 202) is in the middle of two arguments. He argues that the government paid insufficient attention to poverty and inequality, but there were also some pro-poor policies such as the expansion of the rice output, investment in rural infrastructure and major emphasis on education. The third is that the income inequality figures understate the real situation, since they are based on consumption expenditure data. As Akita (2002: 3) argues such inequality measures give more equitable estimates than the actual situation, since the upper income groups save a higher proportion of their incomes.

The crisis in 1997 caused the poverty figures to retreat to their mid-1980s levels. Poverty headcount ratio and the number of poor people jumped to 18 percent and 36.5 million in 1998, respectively (see Table 4.3). Therefore, the contraction of the economy and the high inflation during the crisis caused 14 million people to fall below the poverty line. On the other hand, overall inequality improved under the contractionary effect of the crisis; it fell from 0.36 in 1996 to 0.32 in 1998. Tjiptoherijanto and Remi (2001: 11-12) suggest two factors to explain this improvement. The first is that the crisis may have affected the modern-formal sectors more than the traditional-informal sectors. Since the former contains more

middle- and high-income classes than the latter, inequality has improved. The second factor is that the poor people could not bear to reduce their expenditures, since they were already spending at subsistence levels, while the richer people smoothed their consumption due to the crisis.

Table 4.3 Trends of Income Inequality and Poverty in Indonesia, 1970-1999

	Gini	Top 20/Bottom 20 Ratio	Poverty Rate	Number of Poor (Mn)
<i>1970</i>	0.34	5.7	...	...
<i>1976</i>	0.34	5.3	40.1	54.2
<i>1978</i>	0.38	6.2	33.3	47.2
<i>1980</i>	0.34	5.5	28.6	42.3
<i>1981</i>	0.33	5.1	26.9	40.6
<i>1984</i>	0.33	5.3	21.6	35.0
<i>1987</i>	0.32	4.5	17.4	30.0
<i>1990</i>	0.32	4.7	15.1	27.2
<i>1993</i>	0.34	4.8	13.5	25.9
<i>1996</i>	0.36	...	11.3	22.5
<i>1998</i>	0.32	...	17.9	36.5
<i>1999</i>	0.33	5.9	18.2	37.5

Sources: Hill (2000: 197-198), Tjiptoherijanto and Remi (2001: 4-5 and 13, Table 1 and Table 4)

There are two issues that should be emphasized to have a better understanding of the impact of the crisis on poverty, as Dhanani and Islam (2002: 1218) note. First, the transient nature of the crisis-induced poverty is masked in the overall poverty rates. As Figure 4.2 demonstrates, there were a significant number of people moving in and out of poverty in a short period of time. According to the revised poverty line of Central Bureau of Statistics, poverty incidence rose sharply from 19 percent to 37 percent between February 1996 and September 1998. Then it started to decline even faster and returned to the 1996 level by August 1999. This trend was induced by the sharp rise in inflation and more importantly by the upsurge in food prices in 1998, and then by the stabilization of prices by 1999 (Dhanani and Islam, 2002: 1219). The rising household budget shares allocated to food expenditures further accentuated the effect of the increasing food prices. During the

crisis, the associated budget shares rose from 50 percent to 56 percent in urban areas, and from 67 percent to 73 percent in rural areas (Dhanani and Islam, 2002: 1220).

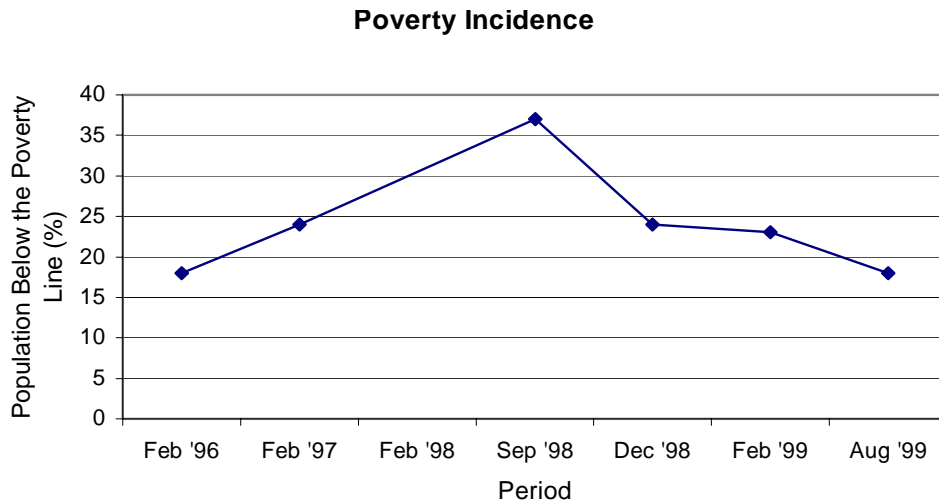


Figure 4.2 Poverty Incidence during the Crisis, 1996-2000

Source: Dhanani and Islam (2002: 1219, Figure 2).

The second issue to be emphasized is the severity of the crisis-induced poverty. Calculations by Dhanani and Islam (2002: 1220, Table 5) show that the number of extremely poor people below 65 percent of the poverty line has increased from 12 million to 19 million between February 1996 and February 1999. This 57 percent rise in the extreme poverty was sharper than the 38 percent rise in the overall poverty of the same period, indicating that the poorest segments of the society were the most heavily affected ones. While the urban and rural areas have equal shares (3.5 million) of this rise, the change in the urban extreme poverty (150 percent) is more drastic than that of rural (35 percent). Another way to illustrate the deepening of the poverty during crisis is to use P2 index –also known as FGT ($\alpha=2$) index– developed by Foster, Greer and Thorbecke (1984). This index measures the depth of poverty by calculating the distance between the incomes of the poor households and the poverty line. Figure 4.3 displays the evolution of this index during the crisis for rural and urban areas. It rose sharply in December 1998; there were increases of 78 percent and 54 percent in urban and rural areas, respectively. As the crisis subsided,

both indexes declined. But as the urban index came back to its pre-crisis level in August 1999, the rural index remained above its pre-crisis level.

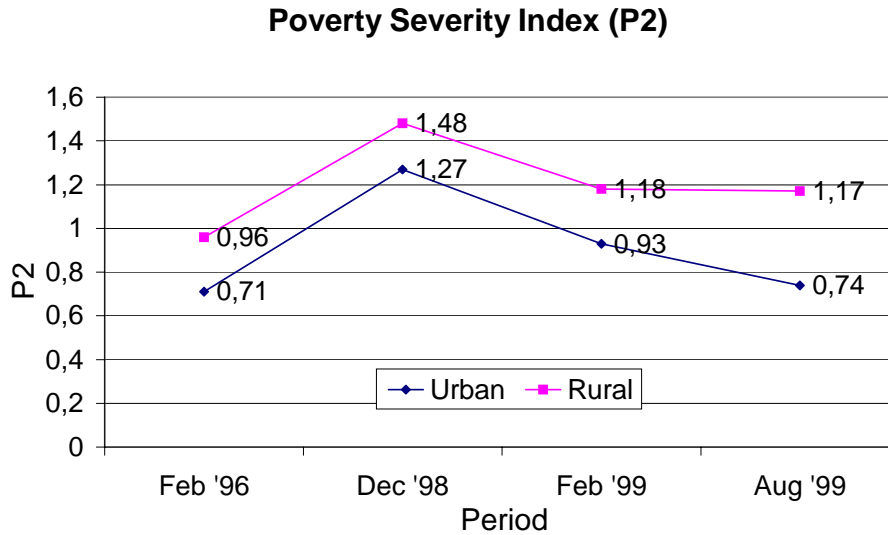


Figure 4.3 Evolution of the Poverty Severity Index, Indonesia, 1996-1999

Source: Dhanani and Islam (2002: 1221, Figure 3).

4.2.3 Education and Health³

Government expenditure on health and education is of high importance for both economic development purposes and the poverty alleviation objectives. For the former, health and education attributes of the society are among the main determinants of the human capital of the country; hence, they would affect the economic success of the country. For the latter, the poor segments of the society generally do not have enough resources to afford their whole health and educational expenses. Hence, they lack adequate health care and education opportunities if they are not assisted by government expenditures. However, government expenditure on

³ The budget of the Indonesian government is presented in a confusing way (See Hill (2000: 45-46) for details) and does not include a separate account for 'Social Spending', and the available studies on the subject limit their analysis to health and education. Therefore, our analysis of social spending and the associated indicators is also confined to these two topics.

these accounts is likely to be reduced after an economic crisis, for two reasons. Firstly, the government would be short on revenues as the general level of economic activities contract substantially during the crisis and in its aftermath. Secondly, IMF-supported stabilization programs, which governments of the countries in crisis have to implement for getting international assistance, require tightening of governmental expenditures to reach a high level of primary budget surplus. But on both occasions, the allocation of the budget to specific accounts depends on government's priorities. Even if the overall level of expenditures is reduced, it is an option to shift some of the resources from other accounts to education and health, in order to maintain the living standards of the population, and to reach the aforementioned aims of development and poverty alleviation. One of the studies in the literature review chapter, Bourguignon, De Melo and Robinson (1991: 1497-1498), has argued that Malaysia had effectively pursued this strategy during its adjustment period, 1978-1987, and had improved its socioeconomic indicators in the process (see Chapter 2).

Indonesian government spent a relatively small, but stable amount of money on health and education between 1995-1999 (see Table 4.4). For education, this amount was around 2.9 percent of GDP. This was significantly lower than the levels attained in comparable countries in the region. Malaysia, Thailand and Philippines spent 6.2 percent, 5.4 percent and 4.2 percent of their GDPs on education respectively during the 1998-2000 period (UNDP, 2001: 7). The share of education expenditure in Indonesia's consolidated government budget was around 15 percent before the crisis, and it has fallen by 1.6 percentage points in 1998. Share of the primary education in total education expenditure seems to be stable at around 52 percent during the pre-crisis years. Unfortunately, there is no data for the crisis period for this indicator.

Government expenditure on health was much lower than on education; it was around 0.5 percent of GDP and its share in government budget was around three percent. Again, this figure is less than that of comparable countries in the region. Lanjouw, *et al.* (2001: 26) report that Malaysia has spent 5.6 percent of government expenditure on health during the 1998-2000 period, and for Philippines, this figure

was 3.8 percent. Share of primary health care fluctuated around 56 percent between 1995 and 1999 in Indonesia.

Table 4.4 Education and Health Expenditures of Indonesian Government, 1995-1999

	1995	1996	1997	1998	1999
Education					
<i>Education Expenditure/GDP (%)</i>	2.9	2.8	2.8	2.9	...
<i>Education Expenditure/Government Expenditure (%)</i>	15.1	15.4	15.7	14.1	...
<i>Share of Primary Education in Total Education Expenditure (%)</i>	52.6	52.0	52.1	...	...
Health					
<i>Health Expenditure/GDP (%)</i>	0.5	0.5	0.6	0.5	0.7
<i>Health Expenditure/Government Expenditure (%)</i>	2.9	3.0	3.1	3.5	3.5
<i>Share of Primary Health Care in Total Health Expenditure (%)</i>	56.6	53.9	57.3	56.9	56.9

Source: Lanjouw, *et al.* (2001: 57-58, Table A1 and A2).

Naturally, households have to cover for the low levels of government spending on education and health. In 1998, total household expenditures on education amounted to 12,400 billion Rupiah, which was slightly below the total government expenditure on education: 14,852 billion Rupiah (Lanjouw, *et al.*, 2001: 25). For health, household expenditure was even more substantial compared to the government spending. While the government spent 3,518 billion Rupiah on health in 1998, household spending was more than twice of that: 7,584 billion Rupiah (Lanjouw, *et al.*, 2001: 27).

Nevertheless, these overall figures do not tell much about the essence of the situation, which consists of the distribution of households' spending and the benefit incidence of the government expenditure on health and education across income groups. Here, the main questions are how much of the health and education

expenditures of the government benefit the poor segments, and how this share compares to the out of pocket spending of these segments. Lanjouw, *et al.* (2001: 28-48) have analyzed the situation in Indonesia in detail, based on the data from the 1998 SUSENAS household survey. Figure 4.4 summarizes their findings. Black portions of the bars, which are labeled 'Government', show per capita implicit transfer amounts of the government spending that benefits each income group; hence, they give the benefit incidence of the government spending on the associated items. It is clear that only the primary education spending of the government had a pro-poor character in 1998. On that account, while the poorest –first– quintile gets around 25 percent of the government spending, the share of the richest –fifth– quintile is around 13 percent. Lanjouw, *et al.* (2001: 31) suggest that this pro-poor bias results from the universal primary school enrolment, combined with the fact that the poor households have more young children. The rest of the government expenditures in 1998 is not distributed progressively, however. Junior secondary education and primary health care expenditures have a fairly even distribution, but senior secondary education and hospital spending of the government are highly pro-rich. In senior secondary education, total implicit transfer to the richest quintile is more than triple that to the poorest quintile. This disparity is even more striking in hospital expenditures. While the fifth quintile, representing the section of the population with the highest income, received 40 percent of the government spending on this account in 1998, first quintile's share was only ten percent.

The comparison of the government and household spending constitutes the second aspect of the issue. There are two types of households spending: expenditures on public facilities and expenditures on private facilities⁴. In primary education, the government financed 82 percent of the total expenditures of the poorest quintile in 1998. For the richest quintile this share is not much lower either

⁴ In Indonesia, private sector has a significant weight in both health and education. In primary education, 17 percent of total enrolment in 1998 was in private schools. In junior and senior secondary education, the share of the private school enrolment was as much as 40 percent and 50 percent, respectively. In health, private sector is as important as the public sector. 52 percent of outpatient visits and 40 percent of inpatient visits went to private facilities in 1998 (Lanjouw, *et al.*, 2001: 25).

with 57 percent. In junior secondary education, the government still financed the majority of the poorest quintile's expenses (56 percent), but the richest quintile received a smaller portion of its expenditures (37 percent) from the government. For this quintile, private education spending had a significant share of 25 percent. Even the poorest did not depend on government transfers in senior education spending; they paid 56 percent of their expenditures out of their pocket in 1998. All households spent more on the private education than they did on the public education in this level. Moreover, while the richest quintile's total spending was higher than even its total primary education spending, the poorest quintile's spending was around one sixth of its primary education spending. This stems from the wide difference in the senior secondary enrolment rates of these income groups.

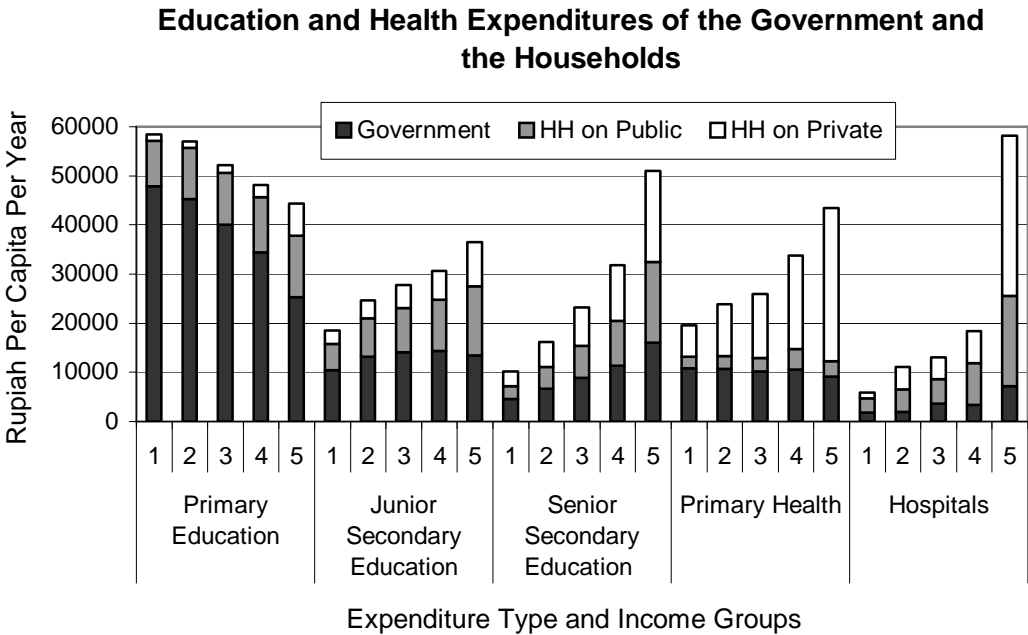


Figure 4.4 Government and Household Expenditures on Education and Health by Consumption Quintile, Indonesia, 1998

Source: Lanjouw, et al. (2001: 59-60, Tables A3-A7).

Large share of the private sector in health is clearly observed from Figure 4.4. In primary health care, government and household spending on public facilities were evenly distributed across income groups, but richer households tended to spend more on private health care in 1998. For hospital care there was open inequality in all types of spending. Very low spending levels of the poorest quintile show that these households could not afford hospital treatment, and the government did not support them either. On the other hand, the rich spent a high amount of money on hospital care, and they received the highest government support in this type of expenditure –around five times that of the poorest quintile.

Although the government expenditure on health and education was not so generous and its benefit incidence was not pro-poor, Indonesia improved its social indicators remarkably during the New Order (see Figure 4.5). Life expectancy rose from 41 years in 1960 to 64 years in 1996, and the infant mortality rate declined significantly from 159 to 61 per thousand live births during the same period. The adult illiteracy rate fell from 61 percent in 1960 to 14 percent in 1996. However, UNDP (2001: 30) is careful to note that this success was mostly a by-product of the rising level of income, rather than intentional government policies. The government's achievement is confined to the sphere of primary education. On that front, New Order regime has made a deliberate effort especially during the 1980s. Despite the low level of overall education spending, vast majority of this expenditure (80 percent at its peak in the early 1980s) was channeled to primary education (UNDP, 2001: 30). As a result, the country achieved a steep rise in the average literacy rate during the past two decades. Another drawback of Indonesia's success in social indicators is that most of the indicators –except the primary enrolment rate– still lag behind other Southeast Asian countries (UNDP, 2001: 11).

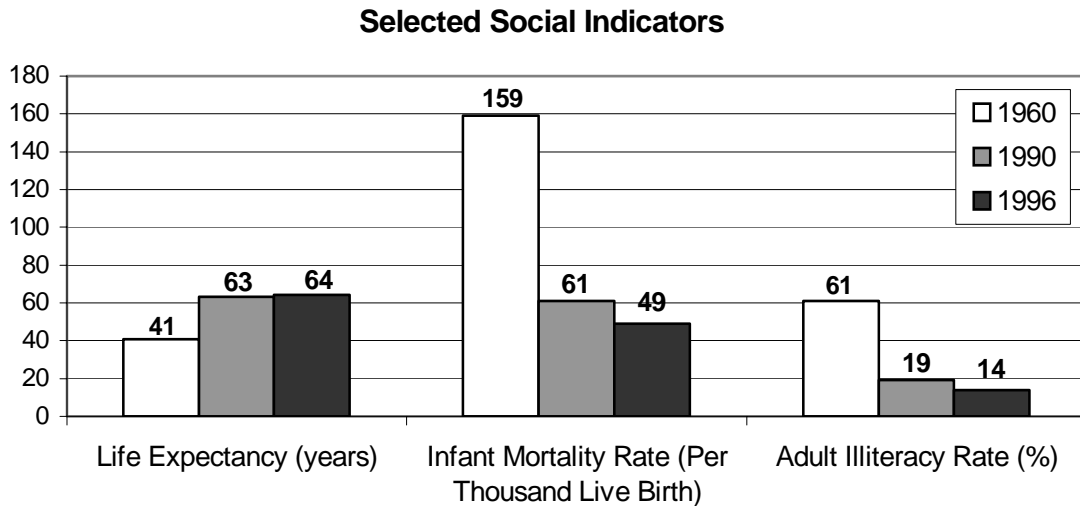


Figure 4.5 Indonesia’s Achievement in Social Indicators, 1960-1996

Source: UNDP (2001: 6, Figure 1.2)

As in the case of unemployment, the actual impact of the economic crisis on public health and education was not as severe as the initial estimates. Booth (1999: 23) notes that some commentators had been forecasting sharp deterioration of health and education indicators during the early periods of the crisis. Fortunately, the crisis had a mild effect on these aspects of human welfare. In education, there were slight declines in national enrolment rates of primary and junior secondary schools from 92.3 percent and 57.8 percent in 1997 to 92.1 percent and 57.1 percent in 1998 (see Table 4.5). Those losses were recovered in 1999. At the senior secondary level, enrolment rate continued to rise even during the crisis. However, Lanjouw, *et al.* (2001: 13) note that the average age of children by school type has increased after the crisis, indicating an increase in the incidence of delayed enrolment. UNDP (2001: 29) suggests that the main factor behind this positive picture was the determination of the parents to keep their children at school: “There is evidence that many parents made considerable sacrifices to protect their children's education. Not only did they sell some of their assets, but in some cases they also went short of food.” (UNDP, 2001: 29). The study argues that the government’s social safety net program in education has also been helpful for those parents.

Table 4.5 Net Enrolment Rates in Primary, Junior Secondary and Senior Secondary Levels, Indonesia, 1995-1999

	1995	1997	1998	1999
<i>Primary</i>	91.5	92.3	92.1	92.6
<i>Junior Secondary</i>	51.0	57.8	57.1	59.2
<i>Senior Secondary</i>	32.6	36.6	37.5	38.5

Source: Lanjouw, *et al.* (2001: 14, Table 4)

On the other hand, Frankenberg, *et al.* (1999) argue that the effect of the crisis has not been the same for different income groups⁵. While the dropout rate of the poorest quartile children in primary school has increased from 1.3 percent in 1997 to 6.2 percent in 1998, same figures were only 0.6 and 1.6 respectively for the richest quartile. Dropouts among older children of the first quartile were more worrisome. This indicator jumped from 14.2 percent in 1997 to 25.5 percent in 1998 for the poorest income group. The rich again fared much better with respect to this indicator; their dropout rate rose from 7.3 percent to 9.5 percent Frankenberg, *et al.* (1999: 21-22, Table 1 and Table 2). Non-enrolment⁶ rates also show a similar disparity among income groups.

For the effects of the crisis on public health, Frankenberg, *et al.* (1999: 10-17) investigate three aspects of the issue: use of health care by children; availability and quality of the health care sources; and the health status of the children. The overall use of health services by children under 15 has declined significantly, from 25.8 percent in 1997 to 19.9 percent in 1998. The most serious fall was in the visits to the community health posts, which provide preventive health care for children by distributing Vitamin A and offering immunization, from 14.7 percent to 8.3 percent.

⁵ This finding is same as the Grootaert's (1994: 1526-1531) for Côte d'Ivoire's adjustment experience during 1985-1990 period. See Chapter 2 for details.

⁶ Non-enrolment is defined as the percentage of children who are not enrolled at the time of the survey. Dropout refers to the percentage of children who have been enrolled in the previous year, but not in the year of the survey. (Frankenberg, *et al.*, 1999: 7). The study is based on the Indonesia Family Life Survey (IFLS), which has a sample size of around 2,000 households with diverse ethnic, socioeconomic and regional characteristics.

In general, the availability of the health care services in 1998 was not seriously affected by the crisis. Only difference is in the Vitamin A offerings of the facilities. There has been a major drop by around 16 percentage points in this category both in public and private facilities (Frankenberg, *et al.*, 1999: 14). Other than that, general availability of health services does not seem to have changed much. However, information on stock outages of drugs in these facilities blurs the picture. In 1998, 27.6 percent of all public facilities experienced shortage of antibiotics. In 1997, this proportion was only 3.5 percent. Moreover, the median prices of the drugs have increased by 50 percent in public facilities and 80 percent in private facilities (Frankenberg, *et al.*, 1999: 14).

These declines in the use and the quality indicators of health services were not transmitted to the overall health status of children. On the contrary, Frankenberg, *et al.*, (1999: 16-17) report that the current health status of children has been better in 1998 than in 1997 in many ways. In self-reported measures, most of the individual illness symptoms and the average number of these symptoms have declined remarkably between 1997 and 1998. In addition, physically-assessed measures of health status, evaluated by the medical personnel of the IFLS survey team, showed improvement. While the average height for age and weight for height measures remained constant, the proportion of the children with remarkable deficiency in both accounts decreased significantly from 1997 to 1998. Finally, the average hemoglobin level of survey respondents and the level of related deficiency have also improved.

4.2.4 Social Safety Net Programs

One final aspect of the Indonesian economic crisis that requires further attention is the government's social policy response to the crisis: "social safety net" (SSN) programs. These programs aimed to mitigate the negative socioeconomic effects of the crisis, such as hunger, malnutrition, dropping out of school, increasing unemployment and rising poverty. Studies assessing the achievements of the SSN programs indicate that the overall record of the programs was not bad. At least, had

these programs been absent, social consequences of the crisis would have been more catastrophic. In addition, SSN measures were not implemented in Indonesia before the crisis in any form. This innovative nature of the programs as a social policy response makes the issue more interesting. Hence, this section first analyzes the motives behind the SSN programs, and then evaluates the effectiveness of the programs in general.

Actually, the reaction of the government to the potentially devastating social effects of the crisis was not as quick as it should have been. The evidence shows that the public protests in the aftermath of the crisis have been effective in the adoption of SSN programs. The first wave of the SSN programs was put into implementation by mid-1998, exactly one year after than the eruption of the crisis (Dhanani and Islam, 2002: 1223). By that time, country's social situation had already worsened significantly. Inflation had taken off, depressing the real income levels of the population. Rice prices were 50 percent higher than the December 1997 levels, creating an extra burden on the poorest households, who were allocating an important portion of their income to this basic staple of the country (Tabor and Sawit, 2001: 268-269). Political protests and food riots were in every corner of the country, inducing the resignation of President Suharto, who had been in power for the past three decades, in the end. In spite of all these dramatic social events, the Suharto government did not take any major actions in terms of social policy against the crisis⁷. Dhanani and Islam (2002: 1227) argue that this was because the government had underestimated the impact of the crisis on the poor and vulnerable population. But, when the new government took office in May 1998, after the resignation of Suharto, it introduced the measures to protect the poor into the anti-crisis program (Harvie, 2002: 189).

⁷ Actually, Social Safety Net term had appeared in the first and second IMF Letter of Intents of the Suharto Government, dated October 31, 1997 and January 15, 1998, respectively. But the associated paragraphs contained merely vague promises of increased social spending and government plans to introduce some community-based work programs. Moreover, in the first half of 1998, there were no signs of such SSN program implementation (See those documents at <http://www.imf.org/external/np/loi/103197.htm> and <http://www.imf.org/external/np/loi/011598.htm>).

Pritchett, Sumarto and Suryahadi (2002: 5) suggest that one of the main motives of this change in the government policy was rather pragmatic: “Both the new government and the international financial institutions and bilateral agencies needed to be seen to be responding pro-actively to the impacts of the crisis in order to sharply differentiate themselves from the past”. Considering the fact that the new government had taken office after the mass riots, political protests and extensive civil violence that emerged as a response to the hardships caused by the crisis, this motive makes the most sense. Pritchett, Sumarto and Suryahadi (2002: 19-20) have put the situation clearly: “The JPS (SSN) programs were being designed literally in the shadow of burned out buildings and with ongoing protests and hence there was a desire to design programs that could generate political support”.

Therefore, an important part of the explanation of the government policy change toward SSN programs consists of public reaction against the crisis and the new government’s need for political support. Another point of concern is the evolution of the IMF’s attitude against the SSN programs over the course of the crisis. In this respect, available studies do not reveal much, and the details of the Indonesian government–IMF meetings are not known. Hence, the only accessible source of information is the IMF’s own official statements on the agreements between the Fund and the Indonesian government, which are published on the web site of IMF under the name of ‘News Brief’ (NB). Although the NBs are quite short by nature, and have a formal tone that disguises the possible disagreements between the two sides of the agreements, they give some hints about the issue. The NBs dated between October 1997 and January 1998, the period between the first and second Letter of Intents of the government, do not include any comment on the social policies to be adopted by the Indonesian government. But they commend the macroeconomic policies of the stabilization and structural reform program of the government by naming each of them.

The IMF statement on January 15, after the second Letter of Intent, has a similar outlook, but this time the then-Managing Director of the IMF, Michel Camdessus, has made an interesting remark at the end of the document. He has said

that if the government of Indonesia would like to reallocate some of its budgetary expenditures of lesser importance to the domain of alleviating the plight of the most vulnerable people in the country, who were affected by the adjustment process, the IMF would approve that. This means that Indonesian government may construct safety net programs but this should be done without increasing the overall level of its expenditures. This is a difficult task for a government that had already cut back its expenditures due to the crisis. But IMF seemed to be giving more importance to a balanced budget than the measures to ease the pains of the poor at that time. However, when the new government introduced the safety net measures explicitly into the new Letter of Intent⁸, IMF's attitude changed remarkably. Alassane Ouattara's, the then-Acting Managing Director of the Fund, statement following the new Letter of Intent demonstrates the obvious change:

They [Executive Directors of IMF] welcomed the economic priorities set by the government to prevent a further economic decline, reduce inflation, and to substantially intensify its efforts to protect the poor from the worst effects of the crisis... Directors also agreed that a much higher budget deficit was necessary to accommodate higher subsidies on essential items and other social spending. (See Footnote 9)

So, the IMF has permitted the new government of Indonesia to build up the needed SSN programs, even if that required a budget deficit.

Although one should not reach broad conclusions from this limited information, it seems that this change in the IMF's attitude was due to two reasons. The first one of these is the new government's approach to the issue that was different from the Suharto's government. They gave priority to the protection of the vulnerable and the poor population from the negative effects of the crisis. The second reason is the dramatic social explosion in Indonesia, which was also one of the motives of the new government's altered social policy as already discussed

⁸ Letter of Intent dated June 24, 1998 is available at <http://www.imf.org/external/np/loi/062498.htm>. IMF's 'News Brief's on Indonesia are available at <http://www.imf.org/external/country/idn/index.htm?type=9998#6>.

above. IMF had to agree to divert some of the scarce resources from debt payments to the social issues in order to prevent a social threat against the program.

For the World Bank's involvement in the SSN programs, it is fair to say that the Bank's response came very late. Although the programs were initiated in mid-1998, World Bank's support for these programs, under the Social Safety Net Adjustment Loan, came in mid-1999 (World Bank, 1999a: ii). Considering that the crisis had erupted in July 1997, this is quite a late response for mitigating the negative effects of the crisis. Moreover, the amount of the loan, \$600 million, was rather small compared to the size of the poverty problem of the country. In 1999, 37.5 million Indonesians were under the poverty line (see Table 4.3). Hence, the Bank's support per poor person was only \$16. The amount of the loan, in conjunction with its lateness, produces concern over the World Bank's sincerity on the alleviation of Indonesian poverty.

The SSN programs mainly aimed to protect the traditional poor and the new crisis-created poor via four strategies: i) providing the basic food commodities at affordable prices, ii) supporting the income level of the poor households by employing them in public works programs, iii) maintaining the access to critical social services such as health and education, and iv) sustaining the local economic activity by regional grants and expansion of small-scale credit (Sumarto, Suryahadi and Widyanti, 2002: 5). The specific programs in accordance with these strategies, as well as their budget shares are given in Table 4.6.

Total budget share of the SSN programs was more than five percent in the first two years, a significant amount, which was more than the health expenditure of the government (see Table 4.4 and Table 4.6). While the government funded some programs such as rice subsidy and scholarships solely on its own, other SSN programs were partially funded by the World Bank and other donor agents.

Table 4.6 SSN Programs and Their Shares in the Government Budget, 1998-2000

<i>Safety Net Area</i>	Programs	Budget Allocation in Fiscal Year of:^a		
		98/99	99/00	2000
<i>Food Security</i>	SMO - sale of subsidized rice to targeted households	5450	6235	2232
<i>Employment Creation</i>	<i>Padat Karya</i> - uncoordinated collection of several "labor-intensive" public works programs	2066	1000	441
<i>Education</i>	Targeted scholarships, and block grants to the schools in the poor regions	1138	1251	667
<i>Health</i>	Subsidy program for several kinds of health services, and nutritional support for pregnant women and their children.	1043	1030	867
<i>Other</i>	Other Programs	5123	2357	1255
	Total SSN programs	14820	11873	5462
	Share of SSN programs in the government budget (%)	5.62	5.58	2.98

a: All in Rupiah Billion, unless otherwise indicated. In the year 2000 fiscal year has been changed from April-to-March type to January-to-December type. Hence the transitional fiscal year 2000 was only for a nine-month period from April to December.

Source: Sumarto, Suryahadi and Widyanti (2002: 6, 26, Tables I and VI)

The major component of the SSN programs has been the rice subsidy program, which has been called "Special Market Operation" (SMO). Under SMO, an eligible household⁹ was allowed to purchase up to 10 kilograms of rice per month at the subsidized price of Rp 1000/kg, nearly one-quarter of the urban market rice price in August 1998 (Tabor and Sawit, 2001: 271). Sumarto, Suryahadi and Widyanti (2002: 16) report that 40 percent of the population was covered in this program. More than 50 percent of all poor households in the first quintile reported

⁹ Eligible households are the ones at the lowest category of the official socioeconomic classification of the National Family Planning Coordinating Agency (Sumarto, Suryahadi and Widyanti, 2002: 9).

benefiting from this program, while nearly 37 percent of the households in other quintiles also reported receiving benefits. Tabor and Sawit (2001: 279) estimate that the average monthly per capita transfer benefit of the SMO program has been around 10 percent of the average income of the poor households in 1998. Dhanani and Islam (2002: 1225) argue that this transfer amount may have prevented 7-12 percent of households from falling into poverty.

Other SSN programs seem to have relatively limited success. Sumarto, Suryahadi and Widyanti (2002: 16) estimate that the second highest coverage ratio was of the nutritional support program. Around 16 percent of both poor and nonpoor households have benefited from this program. General medical services program has covered 10 percent of the poorest quintile, and five percent of other quintiles. Scholarship programs have covered around six percent, 12 percent and five percent of the poor children in primary, senior secondary and junior secondary schools, respectively. Coverage ratio of the employment creation program was eight percent for the poor households. Sumarto, Suryahadi and Widyanti (2002: 16) argue that these results indicate that a large number of poor households were not covered by the SSN programs, and that this undercoverage due to bad targeting has remarkably reduced the effectiveness of the programs. On the other hand, Dhanani and Islam (2002: 1226) reach a more positive conclusion. They accept that the SSN programs, except the SMO, had inadequate coverage, but nevertheless, they have performed reasonably well under the circumstances, given the speed of implementation and other obstacles in the field.

Overall budget share of the SSN programs were reduced in the second and third years of implementation (See Table 4.6). Sumarto, Suryahadi and Widyanti (2002: 25) suggest that this was due to two reasons. First, the financing constraints of the government required such a downsizing. Second, the social impacts of the crisis turned out to be less dramatic than the earlier predictions. Another possible reason is that the government's poverty concern diminished over time, as the general economic conditions of the country improved and the public protests faded away. Among the components of the program, three programs were not affected from the

decline in the funds. While the subsidized rice program and the scholarship programs increased their funds in the second year, health program maintained its share. This was possibly a reflection of the effectiveness and importance of these programs (Sumarto, Suryahadi and Widyanti, 2002: 26). Considering that the SSN programs are designed as a temporary remedy for the hardships caused by the economic crisis, the government would gradually remove the programs, as long as the economy gets on its normal growth path. Nearly all of the cited studies emphasize one point about SSN programs: They should be carefully designed and constructed during the non-crisis periods, so that the necessary programs can be put into implementation with the first signs of a crisis. Indonesia has not done that before the 1997 crisis. In addition, the SSN programs were implemented as late as mid-1998. Nonetheless, the SSN programs were beneficial for at least a portion of the poor, even in their current deficient form.

CHAPTER 5

TURKEY – NEGLECTED SOCIOECONOMIC ISSUES DURING THE DECADE OF FINANCIAL CRISES

Since the beginning of 1990s, Turkish economy has been characterized by boom and bust cycles, in which, periods of high growth were followed by sharp contractions or economic crises. This pattern of growth had structural roots back in the 1980s, when the country's economy was transformed from an inward-looking and state-dominated one to an outward-oriented and market-based one, thanks to the economic reform programs of the period, which were supported by the Bretton Woods Institutions (BWIs). A main component of the programs, capital account liberalization of 1989, was particularly effective in pushing the economy to the setting of boom and bust cycles, as Turkey's economic performance became dependent on the volatile capital flows thereafter.

Against this background, Turkey experienced three major economic crises during the 1994-2002 period; first being in 1994, second in November 2000 and the third in February 2001. These crises were initiated by sharp capital outflows, causing the financial markets to collapse in a short period of time. From the financial sector, the crises were quickly transmitted to the real sectors, which spread them to the entire population. Common outcomes of the crises can be summarized as: a deep contraction of the economy, a jump in the inflation rate, a dramatic decline in real wages and a rise in the unemployment rate. These results affected the poor and the vulnerable segments of the population most negatively. These groups were mostly dependent on labor income generated by informal jobs and spent most of their income on food. While many of them lost their jobs during the crises, the rest saw their incomes significantly declining in real terms. Moreover, food prices rose more

than the average inflation rate. Hence, the poor and the vulnerable experienced the impact of the crises in the most direct way: as a deep deterioration of their living standards.

Another common result of these crises was the adoption of stabilization and structural adjustment programs under the supervision of the IMF and the World Bank. In the short-run, these programs aimed to stabilize the economy by obtaining immediate external financing from the BWIs, and restoring confidence in the economy. Some of the typical measures taken as part of these programs such as suppression of real wages and reduction of public spending and public employment exacerbated the negative effects of the crises on the majority of the population. Since these programs were implemented in the aftermath of the crises without a significant delay, it is hard to differentiate the effects of the programs from the effects of the crises themselves.

The main objective of this chapter is to analyze the socioeconomic effects of the 1994 and 2000-2001 crises in Turkey, in conjunction with the impact of the consequently implemented structural adjustment and stabilization programs. For this purpose, labor market indicators such as real wages and unemployment; trends in income inequality and poverty; and the indicators of public social spending are analyzed for the 1994-2002 period. One particular area of concern in this study is how the main agents responded to the negative socioeconomic effects. In this regard, responses of the Turkish government and the BWIs are analyzed by investigating the social policy component of the post-crisis programs, and the public reaction is assessed through the demonstrations that occurred in the crisis periods and the outcomes of the general elections which took place after the crises.

The chapter proceeds as follows. In the next section, economic background of the 1994-2002 period is examined with a particular focus on the crisis periods. Then, the socioeconomic effects of the crises and the stabilization and structural adjustment programs, together with the responses to the crises are discussed in the second section.

5.1 Economic Background, 1994-2002

This section provides the economic background of the economic crises and the stabilization and structural adjustment programs during the 1994-2002 period. This period is divided into four main episodes: the crisis-year of 1994; the recovery period after the crisis, 1995-1997; the turbulent years of 1998 and 1999, when the economy experienced recession; and the last crisis period of 2000-2002.

5.1.1 The Origins and the Consequences of the 1994 Crisis

In early 1994, Turkey experienced a major financial crisis, which resulted in a sharp deterioration of economic conditions. Real Gross National Product (GNP) declined by 6.1 percent, inflation rate was recorded in three digits –106 percent–nominal value of the exchange rate tripled, real consumption and investment declined by 20 percent (see Table 5.1). Factors behind the crisis are argued to have roots in the year of 1989, when the Turkish government liberalized the capital account and initiated an episode of “new populism” on the basis of short-term capital inflows (Yeldan, 2002: 148; Yentürk, 1999: 101).

Between 1980 and 1989, Turkey followed an export-led growth strategy, in which, the suppression of real wages was one of the main components. During this period, real wages declined continuously (Yeldan, 2002: 147, Table 1). However, after the political opening-up referendum¹ of 1987, distributional demands of the masses started to create pressure on the ruling party, and the real wages increased by 11.6 percent per annum between 1989 and 1993 (Yeldan, 2001: 85, Table III-2). This rise in the real wages was mostly a correction of the wage erosion of the previous period. Moreover, it was at par with the rise in the labor productivity of 11.7 percent per annum during the 1989-1993 period. Nevertheless, Öniş and Aysan (2000: 130) argue that the Turkish government had also met the demands of the business class by low taxes and low costs of imported inputs thanks to an over-valued exchange rate.

¹ *Coup d'état* of 1980 banned all of the existing political parties and their leaders from active politics. This ban was removed in the August 1987 referendum.

In addition, Köse and Yeldan (1998: 53) suggest that the prices of the intermediate goods produced by the state economic enterprises (SEEs) had been kept artificially low in order to serve the same aim. Therefore, during this period, the government pursued an expansionary strategy to increase its popularity among all classes.

The burden of the populist strategy reflected itself in higher public sector debt. The share of the Public Sector Borrowing Requirement (PSBR) in GNP jumped from 4.8 percent in 1988 to 12 percent in 1993 (Ekinci, 1998: 22, Table 2). Thanks to the financial liberalization of 1989, the domestic agents who borrowed heavily from abroad and the short-term foreign capital inflows provided the required funds for the rising public debt. In this scheme, big commercial banks reaped significant profits by first borrowing from abroad and then using these credits in buying government securities. While the share of the short-term part of the foreign debt of the country increased from 16 percent in 1988 to 27 percent in 1993, 60 percent of this debt was owned by the commercial banks in the latter year (Ekinci, 1998: 22, Table 2). As the debt requirement of the public increased, interest rates on government securities soared from 55 percent in 1990 to 80 percent in 1993 (Yeldan, 1998: 399, Table 1). Consequently, the interest payments of the debt began to deplete a significant portion of the government resources. The associated payments constituted 24 percent of all government expenditures, and used 33 percent of government revenues in 1993.

In mid-1993, the new Prime Minister, Ms. Çiller, often stated that the government aimed to reduce the interest rates and, consequently, the debt burden of the government. To fulfill this objective, the government took three measures in the second half of the year (Özatay, 2000: 345-346). Firstly, the accumulated debt of the Treasury to the Central Bank was cancelled, and the Treasury's limit for borrowing from the Central Bank was doubled. Secondly, the Treasury cancelled the seven of the nine government security auctions in the last two months of 1993. Lastly, the government introduced a five percent income tax on government securities.

However, these actions –combined with the two major international agencies' (*Moody's*, and *Standard and Poor's*) downgrading of the Turkey's credit rating–

resulted in a confidence loss of both the domestic and the foreign financial agents, and triggered the 1994 currency crisis (Yentürk, 1999: 102-103). While the foreign investors pulled their funds out of the country, domestic agents hastened to cover their open positions by buying big amounts of foreign currency. Central Bank tried to defend the currency by using its foreign exchange reserves; the level of reserves declined from \$7 billion to \$3 billion during the first quarter of 1994. Despite this heavy intervention, the run on the Turkish Lira did not subside until the government announced a stabilization package on April 5, 1994.

The April 5 Program consisted of two main components. The first one of these was the fiscal austerity part, which aimed to reduce the PSBR by half (World Bank, 1996: 6). The principal measures of this part were freezing of most current and investment expenditures, restraining the wage increases, immediate price increases in SEE products, increases in some tax rates and introduction of some one-off tax measures. To restore the confidence in the financial system, bank deposits were given 100 percent state guarantee, and the Treasury's recourse to short-term advances from the Central Bank were limited (Parasız, 1996: 255-263). The second main component of the program was a set of structural reforms, including: privatization and closure of some SEEs, social security system reform, tax structure reform, and agricultural support policy reform. Although the stabilization package was not designed with the assistance of the IMF, it was in line with the general form of the Fund's structural adjustment and stabilization programs, and the IMF demonstrated its support to the program by approving a Stand-By Agreement in July 8, 1994.

The joint impact of the currency crisis, fiscal tightening and high interest rates created a serious downturn in the Turkish economy in 1994 (see Table 5.1). Real GNP declined by 6.1 percent, contraction in manufacturing output was more than that: 8.3 percent. Investment rate decreased by nearly 15 percent. Per capita income fell by 7.8 percent. Induced by the sharp devaluation of 25 percent in real terms, imports decreased by 20.9 percent and exports increased by 18 percent. These changes in foreign trade accounts were not enough to generate a surplus in the trade

balance. Nevertheless, they brought a current account surplus of two percent of GNP. Foreign investors pulled their funds out of the country. Outflow of the foreign capital was as much as 4.8 percent of GNP in 1994. Most of this outflow –3.9 percent of GNP– involved funds with short-term nature (see Table 5.1).

Table 5.1 Selected Macroeconomic Indicators of Turkey, 1994-1997

	1994	1995	1996	1997
<i>Real Growth Rate (% , Based on GNP)</i>	-6.1	8.0	7.1	8.3
<i>Real Per Capita GDP (\$, at 1987 Prices)</i>	1769	1875	1972	2097
<i>(Annual Change, % , Based on TL GDP)</i>	-7.8	6.0	5.2	6.4
<i>Annual Change in Manufacturing Output (%)</i>	-8.3	13.5	7.4	12.1
<i>Annual Change in Investment (%)</i>	-14.8	8.8	12.3	14.2
<i>Inflation Rate (CPI, Annual Average Change, %)</i>	106.3	88.0	80.4	85.8
<i>Real Exchange Rate Index* (1982=100)</i>	66.7	75.9	74.4	74.0
<i>Consolidated Budget Balance (% of GNP)</i>	-3.9	-4.0	-8.3	-7.6
<i>PSBR (% GNP)</i>	7.9	5.0	8.6	7.7
<i>Exports, fob (Mn \$)</i>	18109	21636	23225	26261
<i>(Annual Change, %)</i>	18.0	19.5	7.3	13.1
<i>Imports, cif (Mn \$)</i>	23270	35709	43627	48559
<i>(Annual Change, %)</i>	-20.9	53.5	22.2	11.3
<i>Trade Balance (Mn \$)</i>	-5161	-14073	-20402	-22298
<i>Current Account Balance (Mn \$)</i>	2631	-2339	-2437	-2638
<i>(% of GNP)</i>	2.0	-1.4	-1.3	-1.4
<i>Net Capital Flows by Non-Residents (% of GNP)</i>	-4.8	3.5	5.4	5.8
<i>Net Short-Term Capital Flows by Non-Residents (% of GNP)</i>	-3.9	2.2	3.2	0.9
<i>Total External Debt (Mn \$)</i>	65601	73278	79194	84182
<i>(% of GNP)</i>	50.0	42.6	42.9	43.3
<i>Short Term Debt (Mn \$)</i>	11310	15701	17072	17691
<i>(% of GNP)</i>	6.4	8.4	8.7	8.4

* : An increase in the index indicates an appreciation.

Sources: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>, Yeldan (2002: 147 and 151, Table 1 and Table 3), Boratav and Yeldan (2001: 9, Table 4) and Undersecretariat of Treasury (2003: 29 and 31, Table 1.9B).

Actually, the drastic contraction of the Turkish economy, as reflected in output, income and import figures, was an expected result of the stabilization program. Since reducing inflation was one of the top priorities of the April 5

program, it aimed to compress the domestic demand by cutting government expenditure and freezing nominal wages, and this compression exacerbated the negative effects of the crisis on the associated indicators. However, despite the contractionary measures, inflation could not be tamed; annual change in Consumer Price Index came out as 106 percent in 1994. Moreover, the IMF refused to disburse the remaining part of the Stand-By credit by the end of the 1994, due to the insufficient progress in the structural reform component of the program. Under these circumstances, the government prepared a new stabilization program, which aimed to reduce the annual average inflation to around 70 percent and included an ambitious privatization agenda, in early 1995 (World Bank, 1996: 9). The Fund approved the continuation of the Stand-By Agreement on April 26, 1995.

5.1.2 Recovery Period, 1995-1997

In 1995, Turkish economy experienced a rapid recovery (see Table 5.1). Real GNP grew by eight percent, investment increased by around nine percent, and manufacturing output was 13.5 percent more than its 1994 level. On the income side, the increase in real per capita GDP was not able to offset the sharp fall in 1994, but increased significantly by six percent. Boosted by the recovery in income and output, and the appreciation of the real exchange rate –by nearly 14 percent– imports took a sharp rise by more than 53 percent. Although the export performance was also quite strong with a growth rate of 19.5 percent, the upsurge in imports caused the trade deficit to jump by 172 percent to \$14 billion, and the current account balance recorded a deficit of 1.4 percent of GNP. Average annual inflation retreated slightly to 88 percent, but was still above the 70 percent target of the new stabilization program. Actually, the 1995 program lost its significance by the summer of the same year, as the early elections that were scheduled for December dominated the political agenda of the country (Celasun, 1998: 17). The government relaxed its tight fiscal stance, and the program implementation lost its momentum during the last quarter of 1995. Since the privatization and the reform of the social security system components of the stabilization package were also implemented very slowly, the IMF withdrew its support at the end of the summer of 1995 (World Bank, 1996: 9).

In 1996 and 1997, Turkish economy exhibited a similar performance to that in 1995 (see Table 5.1). While real GNP grew by 7.1 percent in 1996 and 8.3 percent in 1997, manufacturing production expanded by 7.4 percent and 12.1 percent respectively in these years. Investment regained its strength by growing 12.3 percent in 1996 and 14.2 percent in 1997. Export growth slowed down slightly with rates of 7.3 percent and 13.1 percent during these two years. Following the spectacular boom in 1995, imports also cut pace, but remained strong with a 22.2 percent growth in 1996. Growth of imports further slowed down in 1997 with a growth rate of 11.3 percent. Consequently, trade deficit worsened by around 45 percent in 1996 and nine percent in 1997, and moved into the plateau of a significant 20 billion dollars. Thanks to a solid performance of the services sector and the growth of the GNP itself, current account deficit remained stable at around 1.4 percent of GNP in 1996 and 1997. Due to the strong domestic demand and the nonsterilized capital inflows, inflation could not be controlled. It slightly fell to 80 percent in 1996, but jumped to 86 percent in 1997.

For the public sector, consolidated government budget deficit as a share of GNP rose to 8.3 percent in 1996 from four percent in 1995 and was 7.6 percent of GNP in 1997. Although this looks like a direct result of the abandonment of the stabilization program, Yeldan (2002: 153, Table 4) clearly shows that the total share of the current and the investment expenditures in the consolidated budget in 1996 and 1997 had remained well below the 1994 and 1995 levels. On the other hand, it was the interest and transfer payments that had a growing share in the budget during the same period. Hence, debt–expenditure relationship took a new shape after the crisis. Prior to 1994, government borrowed heavily for spending more, after 1994, it cut its expenditures –and re-borrowed– to pay back its debts.

Both Yeldan (2002: 147, Table 1) and Yentürk (1998: 104-106) indicate that the uncontrolled flows of the foreign capital had affected the dynamics of the post-crisis recovery period, i.e. 1995-1997, as they did during the pre-crisis period. Since the government offered higher rates of return on its debt instruments after the crisis,

foreign capital returned to the country in 1995 (3.5 percent of GNP, see Table 5.1). This flow, Yentürk (1998: 104) suggests, caused appreciation of the currency, extremely high interest rates and a rise in the trade deficit. Yeldan (2002: 149) and Boratav and Yeldan (2001: 10-20) argue that short-term capital inflows had distorted the real side of the economy by inducing the entrepreneurs to engage in rentier type accumulation. Moreover, these studies suggest that the economic growth of the country had become dependent on these flows, since the financial liberalization of 1989, as reflected in mini boom-and-bust cycles of 1990s. Figure 5.1 demonstrates how the movements of the economic growth rate and the foreign capital inflows coincide between 1990 and 1998. World Bank (1996: 14) also states that with the open capital account it has been more difficult for the Turkish government to pursue discretionary monetary policies that could control domestic demand, and that the vulnerability of the economy to external shocks and to investors' expectations has increased significantly. All these arguments indicated a fundamental problem of the Turkish economy, namely the over-effectiveness of the volatile capital flows, which was also partially responsible for the disturbances of the economy in the following years.

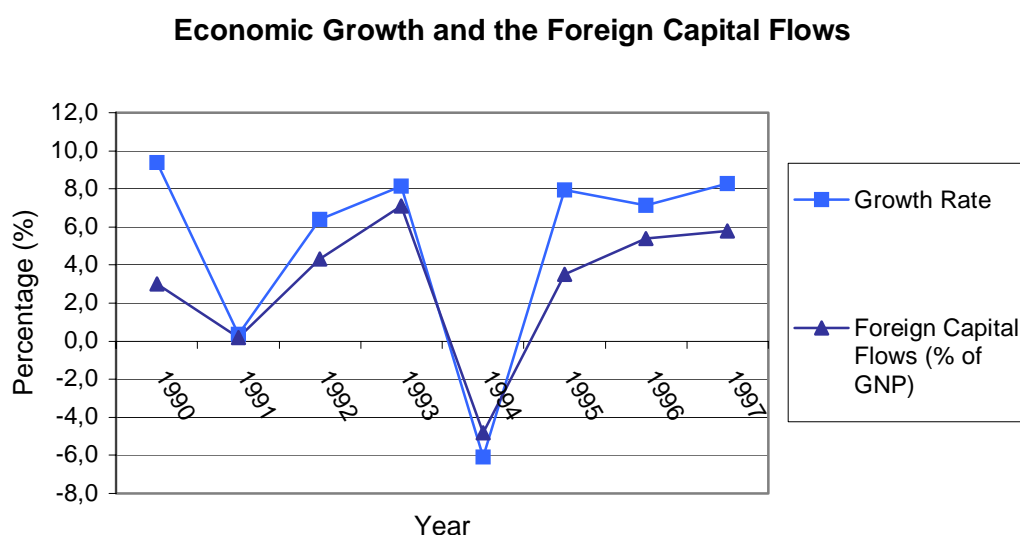


Figure 5.1 Economic Growth-Foreign Capital Flow Relationship in Turkey, 1990-1997

Sources: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm> and Boratav and Yeldan (2001:9, Table 4).

5.1.3 Turbulent Years, 1998-1999

After three successive years of high growth, the Turkish economy experienced a serious downturn in 1998 and 1999. In the first of these years, growth rate fell down to 3.9 percent, and in the second year, economy moved into a severe recession as the GNP declined by 6.1 percent. Contraction of the economic activity was mainly produced by two events. The first one of these events was the disinflation program of the Turkish government that was launched at the beginning of 1998. Second one was the mid-1998 financial crisis in Russia, an important trading partner of Turkey. Two major earthquakes in August and November further exacerbated the situation in the second half of 1999.

In line with the previous stabilization programs, the disinflation program of 1998 was a mix of ambitious structural reforms, which were neoliberal in nature, and tight fiscal and monetary policies. The structural part included privatization of SEEs, reform of the social security system and establishment of an independent regulatory agency for the banking system. The second part aimed to improve the budget balance by reducing expenditures, limiting the public sector wage and agricultural support price increases by indexing them to the targeted inflation, and squeezing the monetary base via a ceiling on the net domestic assets of the Central Bank (Undersecretariat of Treasury, 1998).

In the first half of 1998, the program was successful on both fronts. The privatization receipts amounted to \$1 billion, representing nearly a quarter of all privatization earnings since 1986, and half of the initial target for 1998 (TÜSİAD, 2000: 44). The 12-month inflation rate declined by 15 percentage points from January to July (IMF, 2000). Moreover, the program gained the approval –but not the financial support– of the IMF, as the Fund accepted Turkish government’s request for an 18-month Staff-Monitored Program (SMP)² in June 1998. However, the program lost its momentum in the second half of the year. Since the decision for an

² Under an SMP, IMF staff monitors the implementation of an economic program designed by the national authorities, but the Fund does not give financial support to the country.

early election in April 1999 was taken, the structural reforms were postponed, and the fiscal policies were slightly relaxed. Nevertheless, the program targets for the PSBR and the consolidated budget deficit, which were 10.4 and 7.6 percent of GNP respectively, were achieved (see Table 5.2).

The Russian financial crisis, which emerged in August 1998, affected the Turkish economy deeply. On the side of the real sector, trade with Russia and other post-Soviet Republic countries declined (IMF, 2000). More importantly, a huge capital outflow of \$7 billion in the second half of 1998 was triggered by the Russian crisis (TÜSIAD, 2000: 77). In addition to the consequent sharp rise of the interest rates, this outflow caused eight private banks to go bankrupt, and they were taken over by the Savings Deposits Insurance Fund –in effect, by the Treasury– creating an extra burden on the public sector (Boratav and Yeldan, 2001: 11). In conjunction with the contractionary economic measures of the disinflation program, these effects of the Russian crisis resulted in a slowdown of economic activities in 1998. Growth rate fell down to around four percent, manufacturing output stagnated. While exports increased slightly by 2.4 percent, imports declined by 5.4 percent. Despite the contraction of the economy, inflation rate was only one percentage point below its 1997 value. At 84.6 percent in 1998, it surpassed the 78-percent target of the disinflation program by a seven-percentage point margin (see Table 5.2).

The first half of 1999 saw the continuation of the main trends of the second half of 1998. While the capital outflows persisted, fiscal policies were further relaxed due to the April elections. After the elections, the new government took up the Staff-Monitored Program from where it was left a year ago. Demonstrating its determination, the government passed a new Banking Law and a law for social security reform, acted to reduce public expenditures and started discussions with the IMF for a new stand-by agreement within three months (IMF, 1999 and 2000). These discussions were concluded in December with a three-year Stand-By Agreement, which would deeply affect the Turkish economy in the subsequent years.

Table 5.2 Main Economic Indicators, Turkey, 1998-1999

	1998	1999
<i>Real Growth Rate (% , Based on TL GNP)</i>	3.9	-6.1
<i>Manufacturing Production Index (1997=100)</i>	100.1	95.9
<i>Inflation Rate (CPI, Annual Average Change, %)</i>	84.6	64.9
<i>Government Budget Balance (% of GNP)</i>	-7.3	-11.9
<i>PSBR (% of GNP)</i>	9.4	15.5
<i>Exports, fob (Mn \$)</i>	26973	26588
<i>(Annual Change, %)</i>	2.7	-1.4
<i>Imports, cif (Mn \$)</i>	45921	40671
<i>(Annual Change, %)</i>	-5.4	-11.4
<i>Trade Balance (Mn \$)</i>	-18948	-14084
<i>Current Account Balance (Mn \$)</i>	1984	-1344
<i>(% of GNP)</i>	1.0	-0.7
<i>Total External Debt (% of GNP)</i>	46.8	54.9
<i>Outstanding Domestic Debt (% of GNP)</i>	21.7	29.3

Sources: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>, and Undersecretariat of Treasury (2003: 29 and 31, Table 1.9B).

The Marmara Earthquake of August 17th hit the final blow to the economy, which had showed some signs of recovery at the end of the second quarter as the capital flows reversed their direction into the country and the manufacturing output slightly increased by one percent (TÜSİAD, 2000: 23 and 77). The region that has been affected by the earthquake was the heartland of the industry, producing seven percent of the country's GDP. The direct output loss due to the earthquake was estimated to be 0.5 percent of GDP (IMF, 1999a). Hence, the devastating effects of the earthquake consolidated the contraction of the economy under the Russian crisis and the tight economic policies in 1999. GNP declined by 6.1 percent, manufacturing output fell by around four percent (see Table 5.2). This significant contraction created a deflationary effect; inflation rate came down to 65 percent in 1999 from 85 percent in 1998. On the external side, exports and imports decreased by 1.4 percent and 11.4 percent, respectively. Higher contraction in imports gave rise to a \$5 billion decline in the trade deficit. However, a deficit of 0.7 percent of GNP occurred in the

current account, as a result of the declining tourism revenues after the earthquake (TÜSİAD, 2000: 75).

Rising interest rates after the Russian crisis, election expenditures and the reconstruction costs of the earthquakes caused an unprecedented deterioration in public accounts (TÜSİAD, 2000: 31-41). While the consolidated budget deficit rose to 11.9 percent of GNP in 1999 from 7.3 percent in 1998, Public Sector Borrowing Requirement hit a historical high of 15.5 percent of GNP in 1999. Consequently, domestic and external debt figures increased enormously. While the outstanding domestic debt jumped from 21.7 percent in 1998 to 29.3 percent in 1999 with respect to GNP, total external debt soared to 54.9 percent of GNP in 1999, from 46.8 percent of the previous year (see Table 5.2). To restore the economic stability and the credibility of the country, Turkish government prepared a new stabilization program at the end of 1999, which was supported by the IMF with a Stand-By Agreement. The World Bank also supported the program under different loan types with a financial package of \$1.8 billion for the year 2000 (World Bank, 2000a: 7).

5.1.4 December 9 Stabilization Program, 2000-2001 Financial Crises and The Strengthened Program of May 2001

- ***December 9 Stabilization Program***

The new stabilization program had three main components, as it was structured in the Letter of Intent given by the Turkish government to the IMF on December 9, 1999 (Yeldan, 2001: 161-170). Of these components, first two was the usual tight fiscal policy and structural reform measures. Under the fiscal component, the program aimed to attain a five-percent primary budget surplus in 2000 by additional taxation, cuts in primary expenditures, indexation of wages to the targeted inflation, and privatization revenues³. Structural reform measures included the social

³ Yeldan (2001: 164-165) carefully underlines the evolution of the underlying logic of the privatization policies, from a structural reform tool for “efficiency allocation of resources” to a fiscal tool for “raising revenues for public” over the course of different stabilization programs in Turkey. This was a result of the recent studies demonstrating that the efficiency has not been related to the ownership structure of the enterprises.

security system reform, measures for the effective supervision of the banking system, reform of the public budgeting system by cancelling all extra-budgetary funds, and the transformation of the agricultural support system. These measures were generally in line with the elements of previous stabilization programs. However, the last component of the program –exchange rate policy, in conjunction with the monetary policy– was the distinctive side of it.

Under the exchange rate policy, the program utilized a pre-announced crawling peg set in terms of a foreign currency basket composed of 1 US dollar and 0.77 Euro (Yeldan, 2001: 166). Turkish Lira's nominal depreciation against this basket was determined to be 20 percent over 2000, at declining monthly rates that were announced in the Letter of Intent. Such predetermined exchange rate path would act as a nominal anchor for the inflation rate by reducing the inflationary expectations of the public and lowering the prices of the domestic goods under the competition of the cheaper imported goods (Akyüz and Boratav, 2003: 1553). By July 2001, the crawling peg strategy would leave its place to a more flexible regime, a progressively widening band around the central path of the exchange rate. To support the exchange rate policy, the program required the Central Bank to function as a “quasi-currency board”, where it was not allowed to sterilize the capital flows or print money due to the imposed ceiling on its net domestic assets. In this way, the domestic money supply, and hence the market interest rates, would be determined by the capital flows, leading to a fall in interest rates and lessening of the public debt burden, as long as the capital inflows continued (Yeldan, 2001: 168).

However, the distinctive side of the program was also known to be the Achilles Heel of the exchange-rate-based stabilization programs. Such programs were previously implemented in different countries (e.g., Argentina, Chile, Mexico, Israel, Russia and Brazil), and in all of these experiences, they had encountered similar problems (Yeldan, 2001: 187). When the exchange rate is used as an anchor, it directly leads to currency appreciation, which is desirable for the disinflation target. Appreciated currency, in combination with the low interest rates due to nonsterilized capital inflows, leads to a domestic demand boom, which is satisfied by

imports. Hence, as long as currency appreciation and capital inflows continue, country's external deficit gets wider. The obvious rise in the external vulnerability is reflected in the sharp currency depreciation expectations, and consequently, capital rapidly leaves the country at a certain point. This results in a financial turmoil and the sharp reversal of the process, as exchange rate jumps in the opposite direction and interest rates rise (Akyüz and Boratav, 2003: 1549-1550). Actually, this pitfall of the exchange-rate-based stabilization programs were also known by the IMF, as similar IMF-supported programs in Brazil, Mexico, Russia and Thailand had ended with financial crises (Uygur, 2001: 10). But the program designers aimed to avoid this well-known problem by inserting an exit strategy to the Turkish program, that is the preannounced move to the gradually widening exchange rate band by July 2001 (Fischer, 2001: 9). Nonetheless, Akyüz and Boratav (2003: 1553) argue that the strategy was a "gamble on the pace of disinflation"; should the program fail to meet its inflation targets, investors would expect a sharp depreciation at the preannounced exit date and start an earlier attack on the currency. Authors add that this was what actually happened in Turkey.

Until November 2000, program implementation was on track. While the Central Bank had completely achieved its monetary and exchange rate targets, primary budget surplus target for the whole year was attained by September (Yeldan, 2001: 177-180). Despite these achievements on fiscal and monetary fronts, inflation rate was not declining as fast as it was planned. Although the 12-month CPI-based inflation rate came down from 69 percent in December 1999 to 49 percent in September 2000 (Uygur, 2001: 11, Table 3), it was clear that the end-of-the-year target of 25 percent could not be achieved.

Uygur (2001: 11-12) gives three reasons for the not-so-good performance on the inflation front. The first of these reasons was the inability of the program in convincing the public about the inflation target. During 2000, expected inflation rate was never below 40 percent, this should have been reflected in the pricing behaviour of firms. The second reason was the rise in rents that were higher than the target. Although there was a law against rent increases of more than 25 percent, the rent

component of the CPI recorded a 49.1 percent rise over the year. The third reason was wage rises surpassing the inflation target. In the public sector, this was due to the implementation of the previously agreed contracts. In the private sector, some wage settlements continued to use backward wage indexation. Yeldan (2001: 173) adds the boom in the domestic demand as a result of low interest rates to this list. The most important result of the slow disinflation was the consequent real appreciation of the Turkish Lira. As the strictly followed nominal exchange rate path was built on a better disinflation performance assumption, real appreciation of the currency reached 11.4 percent by November 2000 (Yeldan, 2001: 173).

One of the program goals was to reduce the interest rates, but the actual decline was much faster than expected. The average Interbank overnight interest rate was halved from 70 percent in December 1999 to 35 percent in January 2000, and remained around this level until November, although it was quite volatile (Uygur, 2001: 7, Table 1). Annualized average interest rate on 3-month Treasury bills was around 38 percent from January to November, compared to over 100 percent in 1999. Akyüz and Boratav (2003: 1554) suggest that the resulting negative real interest rate on Treasury bills had been taken as an indicator of the success of the program, as it eased the debt burden of the public sector. Low level of interest rates also induced a sharp rise in economic activity. While private investment increased by 16 percent in 2000, overall GNP growth was 6.1 percent.

On the external front, the joint effect of the currency appreciation and low interest rates was a surge in imports, as expected. For the whole year, imports rose by 34 percent, while export growth remained at less than five percent. Consequently, trade deficit reached to more than 26 billion dollars, pushing the current account deficit to five percent of GNP in 2000 (Akyüz and Boratav, 2003: 1555). Until the crisis, this huge current account deficit was financed by the foreign capital inflows. Net capital flows by non-residents reached more than 15 billion dollars by the end of October 2000, covering the current account deficit of 7.6 billion dollars, capital outflow of the residents (5.2 billion dollars, including Net Errors and Omissions) and build-up of international reserves of 2.3 billion dollars by that date. However, such

unusually high trade deficit was also sending crisis signals to the investors, since the deficit would be unsustainable if the capital inflows ceased for any reason (Uygun, 2001: 17).

- 2000-2001 Crises

After ten months of successful implementation, Turkish exchange-rate-based stabilization program was reaching to the end of its dangerous path in November 2000. The trigger of the unavoidable crisis came from the ill-structured banking sector. At the end of October, two troubled commercial banks, Etibank and Bank Capital, were taken over by the Savings and Deposits Insurance Fund (Çolak, 2002: 172, Table 6). Afterwards, when another commercial bank, Demirbank, which had shares in Etibank, ran into difficulties in finding new credit, it had to unload substantial amount of Treasury Bills (Uygun, 2001: 16). This resulted in a hike in interest rates, and eroded the confidence of the foreign investors, who rapidly sold their TL-denominated assets and began to leave the country. The run on the Turkish Lira was intensified by the domestic banks, which rushed to cover their open foreign currency positions. Consequently, overnight rates tripled to around 110 percent, rates on Treasury Bills rose from 35 percent to 50 percent, and the İstanbul Stock Exchange prices plummeted on November 22nd (Akyüz and Boratav, 2003: 1555; Uygun, 2001: 6). Leaving its program commitments aside, Central Bank supplied liquidity to the troubled banks. However, Akyüz and Boratav (2003: 1555-1556) state that this response accelerated the capital outflow without widening the monetary base. Within a few days, Central Bank reversed its policy and returned to the currency board rules under the insistence of IMF. This slowed the outflows but also further increased the interest rates to a monthly average of nearly 200 percent in overnight rates in December (Uygun, 2001: 6, Table 1).

Markets stabilized after the settlement of a new agreement between the IMF and the Turkish government in early December, which included additional financial support from the Fund totalling \$10.5 billion. Under the agreement, the government renewed its structural reform, monetary and exchange rate commitments, and accepted to impose further restraint on public spending (Akyüz and Boratav, 2003:

1556). More strikingly, the government agreed to guarantee all of the debts of the commercial banks, in addition to the deposits. Boratav (2002: 2-3) argues that this measure did not aim to solve the crisis, but to rescue the funds of the foreign investors, at the expense of an extra burden on the already distressed public accounts.

Nonetheless, the stability period did not last long, since the weaknesses of the program continued to manifest themselves. High inflation, significant appreciation of the currency, and the shortening maturities of government debt instruments with rising interest rates raised concerns over the sustainability of the program by the end of January (Akyüz and Boratav, 2003: 1556). A political conflict between the President and the Prime Minister on 19 February 2001 was enough to start a new and stronger speculative attack on the currency. Two days later, the overnight interest rates were around 4000 percent, and within one week, international reserves of the Central Bank decreased by around 20 percent, as a result of the rapid capital outflow (Uygur, 2001: 22-23). Government abandoned the peg and moved to floating with the support of the IMF in order to keep the reserves and the control over monetary policy. Consequently, the exchange rate shot up, as the nominal value of the dollar against the lira jumped by 40 percent in one day.

- *The Strengthened Program*

As a response to the financial crisis, a new economic team comprising a new Minister of Economic Affairs, a new Central Bank Governor and a new Treasury Head was appointed in early March. The new Minister, Kemal Derviş, was a chief economist and a vice president at the World Bank before the crisis, hence he was expected to build up the eroded confidence of the foreign agents. Under the supervision of the IMF, new economic team prepared a new structural adjustment and stabilization program called ‘The Strengthened Program’ (TSP) by mid-April, which was supported by the Fund by an additional stand-by credit of 8 billion dollars (Akyüz and Boratav, 2003: 1556). World Bank also supported the program with a credit of 800 million dollars under the existing loan agreements, and a new Special Structural Adjustment Loan credit of 1.2 billion dollars (World Bank, 2001: 15).

TSP aimed to stabilize the economy via structural reforms, tight fiscal and monetary policy measures, and a consistent incomes policy. The Program's main emphasis was on the first part, as the structural deficiencies were regarded as the underlying cause of the financial crisis. There were 23 structural policy conditionality actions –most of them envisaged as law amendments– in the structural reform part of the TSP, each precisely describing the content and the timing of the amendments (IMF, 2001: 73-74). These reforms focused on three main areas (IMF, 2001: 13-17). The first one was the banking sector, where the state and Savings and Deposits Insurance Fund (SDIF) banks were to be restructured, and the supervision over the sector would be improved. The second one was the public finance, where the fiscal transparency of the public accounts would be established by eliminating most of the budgetary, extra-budgetary and revolving funds, and making the budgetary information public. The third area was related to privatization under the name of 'increasing the role of private domestic and foreign capital in the Turkish economy'. Other than detailed instructions on the divestiture of SEEs and liberalization of state-led markets such as sugar, tobacco and electricity, there was an envisaged law amendment for the full implementation of the constitutional amendment on international arbitration that was aimed to improve FDI flow to the country. By July 2001, nearly all of these structural conditionality actions were completed (IMF, 2001a: 45-46, Annex B, Table 2).

On the fiscal front, TSP aimed to achieve a primary budget surplus of 5.5 percent of GNP in 2001. For this aim, significant cuts in public employment and investment were envisaged, and a consistent incomes policy, that is the suppression of public sector workers' wages by around 20 percent in real terms, would also be implemented. For the monetary policy side, the Program aimed to control the monetary aggregates by putting a ceiling on net domestic assets of the Central Bank and a floor on its net international reserves (IMF, 2001: 18-21).

Ambitious reform agenda of the TSP and the government's committed implementation was not enough to restore the confidence and start a rapid recovery. By July, capital outflows were continuing and the interest rates rose to over 100

percent (IMF, 2002a: 6). Stanley Fischer, then-Managing Director of the IMF, had to step in mid-July, and made an exclusive statement on Turkey, commending the Program and its implementation in order to “correct the markets’ view on the country’s performance” (IMF, 2001b). In addition, Minister Kemal Derviş toured Europe to explain the program.

Just as the signs of stability had emerged by the end of the summer of 2001, with declining interest rates and a relatively stable exchange rate, acts of terrorism on September 11 in the United States hit the economy (IMF, 2002a: 9). Within a few days, interest rates jumped by around 15 percentage points, stock market prices declined by 20 percent and the exchange rate fell by 10 percent. Although these indicators started to improve after the second half of October (IMF, 2002a: 48), recovery hopes were postponed to the following year.

Deep effects of the twin crises that had occurred at the end of the 2000 and at the beginning of 2001, in addition to the strongly implemented, but unfruitful stabilization program, can be easily observed over the stark contrast of the main economic figures of these two years in Table 5.3. The year 2000, except November and December, was one of an economic boom as a result of the appreciated exchange rate and low interest rates. For the whole year, real growth of GNP was strong at 6.3 percent, manufacturing production increased by a similar 6.4 percent and the rise in imports was spectacular with 34 percent. With the relatively weak performance of exports, growing by 4.5 percent, this boom led to an unsustainable current account deficit of five percent of GNP, which was considered to be a major factor behind the 2000 crisis. In contrast, in the next year, 2001, the Turkish economy nearly collapsed. Real GNP fell by a drastic 9.5 percent, contraction in the manufacturing output was by nearly the same rate, and imports declined by 26 percent. Under the effect of the sharp exchange rate depreciation and the contracting domestic demand, export growth remained strong with 13 percent. This was not enough to create a trade surplus, but it enabled a current account surplus of 2.3 percent of GNP.

Due to the increasing interest rates and the public take-over of the insolvent banks after the crises, consolidated government budget gave a deficit of 16.9 percent of GNP in 2001 in spite of a sizeable primary budget surplus of 5.5 percent of GNP. Consequently, the PSBR rose from 11.8 percent of GNP in 2000 to 16.4 percent in 2001, and the outstanding domestic debt as a proportion of GNP jumped from 29 percent to 69 percent during the same period. Total external debt of the country also increased, from 58.9 percent of GNP in 2000 to 78.7 percent in 2001. Despite the deep recession, TSP was not successful in bringing the inflation down, as it remained at around its level in the previous year, 54 percent.

Table 5.3 Main Economic Indicators, Turkey, 2000-2002

	2000	2001	2002
<i>Real Growth Rate (% , Based on TL GNP)</i>	6.3	-9.5	7.8
<i>Manufacturing Production Index (1997=100)</i>	102.1	92.4	102.5
<i>Inflation Rate (CPI, Annual Average Change, %)</i>	54.9	54.4	45.0
<i>Government Budget Balance (% of GNP)</i>	-10.9	-16.9	-15.2
<i>PSBR (% of GNP)</i>	11.8	16.4	12.8
<i>Exports, fob (Mn \$)</i>	27775	31334	36059
<i>(Annual Change, %)</i>	4.5	12.8	15.1
<i>Imports, cif (Mn \$)</i>	54503	40410	50146
<i>(Annual Change, %)</i>	34.0	-25.9	24.1
<i>Trade Balance (Mn \$)</i>	-26728	-9076	-14087
<i>Current Account Balance (Mn \$)</i>	-9819	3390	-1521
<i>(% of GNP)</i>	-4.9	2.3	-0.8
<i>Total External Debt (% of GNP)</i>	58.9	78.7	72.1
<i>Outstanding Domestic Debt (% of GNP)</i>	29.0	69.2	54.8

Sources: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>, and Undersecretariat of Treasury (2003: 29 and 31, Table 1.9B).

In 2002, Turkey experienced a strong economic recovery with growth rate of 7.8 percent (see Table 5.3). In addition to the expected post-crisis rebound effect, there were a number of factors that enabled such a strong economic performance.

Firstly, under the strong and continuous support of the IMF⁴ and the World Bank, Turkey managed to regain the confidence of international financial markets, inducing a rise in capital inflows and a consequent fall in interest rates. After the huge outflow of 2001, international capital reversed its direction, which was strong enough to create a capital account surplus of 1.1 percent of GNP in 2002. Nominal interest rates declined from around 100 percent in 2001 to 64 percent in 2002 (World Bank, 2003d: 3-5). Moreover, inflation seemed to be getting under control as it declined to an annual average of 45 percent. These favorable conditions together with the low level of real wages generated a strong revival in the real economy. While the manufacturing output rose by more than ten percent, exports grew significantly by 15 percent, notwithstanding an appreciation of the Turkish Lira. The last factor contributing to the solid recovery in 2002 was the relaxation of the fiscal policies during the second half of the year, following the announcement of early elections in November. As a result, primary budget surplus fell short of its program target of 6.5 percent of GNP by 2.6 percentage points (World Bank, 2003d: 5). However, public domestic debt to GNP ratio fell from 69.2 percent in 2001 to 54.8 percent in 2002, because of the high growth rate and declining interest rates.

5.2 Socioeconomic Effects of the 1994 and the 2000-2001 Crises and the Consequent Stabilization Attempts

In this section, we analyze how the economic crises and the stabilization and structural adjustment programs affected the society. There are four main components of this analysis: changes in the labor market; effects on the income inequality and the poverty incidence; changes in the level and the quality of the public social spending, specifically spending on education, health and the social assistance programs; and

⁴ On 4 February 2002, the IMF approved a new \$16 billion stand-by credit to support the government's economic program for 2002-2004, replacing the previous stand-by arrangement which was covering the 2000-2002 period. The new program, as outlined in the Letter of Intent dated 28 January 2002, was a revised version of the strengthened program, modified according to the worse-than-expected performance of TSP. With the new arrangement, total amount of IMF credit to Turkey for 2000-2004 period reached a substantial \$35 billion. This Letter of Intent is available at <http://www.imf.org/external/np/loi/2002/tur/01/index.htm>.

the crisis responses of the main economic agents, *i.e.* the government, BWIs, and the public at large.

5.2.1 Labor Market

- *1994 Crisis and The Recovery Period*

Turkey's labor market could hardly be considered as a rigid one prior to the 1994 crisis (Şenses, 1996: 83). In 1993, share of the wage employment in total employment was slightly more than one-third, and the ones with a social security scheme accounted for a mere 42 percent of the total employed people representing formal employment. Yeldan (2001: 96) estimates that the situation was not much different even in the manufacturing sector, which generally contains the highest share of formal employment among all sectors. In this sector, shares of formal and informal labor in total employment were estimated to be close to each other in 1993: 57 percent and 43 percent respectively. Moreover, agricultural sector, with its 15 percent share in GDP, dominated total employment with a 45.5 percent share in the same year (Undersecretariat of Treasury, 2003: 10, Table 1.2D).

Thanks to the flexible structure of the labor market, the negative effects of the sharp contraction of output in 1994 on employment level were limited (see Table 5.4). In 1994, both the overall unemployment rate and the non-agricultural unemployment rate increased by only one half of a percentage point, whereas the rise in underemployment rate was 1.3 percentage points. Limited increases in unemployment and underemployment rates were possible due to the expansion in the general employment level. The number of the employed workers increased from 19.8 million in 1993 to 20.4 million in 1994. However, drops in manufacturing employment indices and the wage earners' share in total employment indicate that the upsurge in employment was limited to the informal sector and/or to the low-value added sectors such as agriculture. In the manufacturing sector, which accounted for more than 22 percent of GNP in 1994, employment fell both in public and private enterprises, by 7.4 percent and 2.2 percent respectively. The share of the wage and salary earners category, which represents the core of formal employment, declined by 1.6 percentage points from 1993 to 1994. All of these show that the 1994 crisis

led to a slight deterioration in formal employment, especially in the manufacturing sector, and in general, the negative impact of the crisis on employment was cushioned by the flexible structure of the labor market.

Table 5.4⁵ Selected Employment Indicators of Turkey, 1993-1997

	1993	1994	1995	1996	1997
Unemployment Rate (%)	7.8	8.2	6.9	6.1	6.5
Non-agricultural Unemp. Rate (%)	13.4	13.7	11.7	10.5	10.6
Underemployment Rate (%)	6.9	8.2	6.7	6.3	5.6
Total Employment (Thousands)	19804	20356	21106	21537	21008
<i>Manufacturing Employment Indices</i> (1992=100)					
Of Private*	100.6	98.4	108.0	115.8	125.0
Of Public	93.8	86.9	74.9	68.5	63.6
<i>Shares in Total Employment:</i>					
Wage and Salary Earners (%)	34.4	32.8	33.0	34.2	35.2
Agriculture (%)	45.5	45.7	47.6	45.8	42.4
Manufacturing (%)	14.5	14.9	14.0	14.6	15.4

*:For establishments with more than 10 workers

Source: Compiled from the Household Labor Force Survey results and Manufacturing Industry Statistics of the State Institute of Statistics available at <http://www.die.gov.tr/TURKISH/SONIST/ISGUCU/isgucu.html>, <http://www.die.gov.tr/TURKISH/SONIST/IMSANUR/imsanur.html>, and <http://lmisnt.pub.die.gov.tr/die/plsql/lmwebtur.lmwebform>. TÜSİAD (2002: 179, Table 5.1) for non-agricultural unemployment rate.

During the recovery period, between 1995 and 1997, employment indicators improved in general. Unemployment and underemployment rates retreated to 6.5 and 5.6 percent respectively in 1997, whereas the non-agricultural unemployment rate came down to 10.6 percent. The share of wage earners in total employment increased to 35.2 percent by 1997. Employment in the private manufacturing sector rose by around 27 percent over the period. However, the employment index (1992=100) of

⁵ During the construction of this table, it has been observed that there has been a number of inconsistencies among the labor market data presented by the State Planning Organization, the Undersecretariat of Treasury, both of which claim to use the data of State Institute of Statistics, and the SIS itself. These inconsistencies add up to the concerns over the quality of the Turkish labor market data as discussed by Şenses (1996: 70-71).

the public manufacturing declined steadily from 87 in 1994 to 64 in 1997. This trend was the direct result of the downsizing of SEEs under the stabilization attempts, via closures, privatization and, most importantly, the sharp cuts in investment (Şenses, 1996: 85-86). Although the stabilization attempts were abandoned after mid-1995, withdrawal of the state from the production sphere continued during the recovery period.

During the crisis, the main adjustment in the labor market occurred via the drastic fall in real wages. As Figure 5.2 demonstrates, all real wage indicators plummeted by more than 20 percent in 1994, except the public sector gross wage, which declined by around five percent. Both Köse and Yeldan (1996: 74-75) and Ekinci (1998: 23) suggest that the downward flexibility of the wages had been a major factor enabling the swift recovery of the Turkish economy after the crisis. The April 5 Stabilization Program of 1994 froze the public sector wages to compress the domestic demand and this freeze was naturally mirrored by the private sector. Hence, the stabilization program affected the wages even more adversely than the crisis itself. The economy recovered with an eight-percent growth rate in 1995. However, real wages continued to fall with different intensities, since the stabilization measures proceeded, albeit with less momentum. Civil servants' real wages and the minimum wage declined by around five percent, private sector gross wages fell by 14 percent, and the least-affected category of the previous year –public sector gross wages–plunged by 21 percent in 1995. In 1996 and 1997, the economy sustained its high growth rates and the stabilization efforts were abandoned. Consequently, real wages improved, but none of the wage categories were able to reach their 1993 levels (see Figure 5.2). Private manufacturing wages were as low as 71 percent of their 1993 levels in 1997. Köse and Yeldan (1996: 77) argue that this suppression of the real wages during the post-crisis period caused the labor to carry the brunt of the crisis, while capital-owners extracted a sizeable surplus via export earnings and financial market operations.

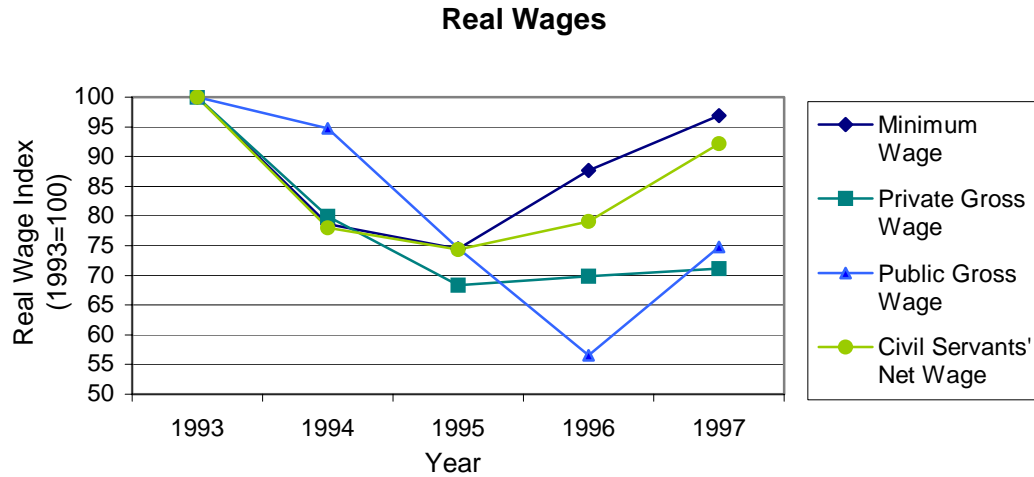


Figure 5.2 Evolution of Real Wages, Turkey, 1993-1997

Source: IMF (1998: 148, Table 36)

- Turbulent Years and the 2000-2001 Crises

When the country's economic performance began to deteriorate in 1998, after three successive years of high growth, labor market indicators showed a mixed record (see Table 5.5). While both of the unemployment and underemployment rates rose by one percentage point, general employment level increased slightly by 2.7 percent with respect to the previous year. There was a slight rise of 1.6 percent in private manufacturing employment, whereas employment in public manufacturing sector fell by 6.3 percent. As the government pursued tight fiscal policies under its stabilization program in most of 1998, public sector wages as a whole declined in real terms. Real minimum, public sector and civil servants' wages decreased by five percent, 1.2 percent and 1.3 percent, respectively. In contrast, real wages in the private sector increased by a significant 17 percent. Despite this rise, private sector wages remained well below their 1993 levels in 1998.

Public sector wages jumped sharply in 1999, as the government tried to gain some support before the April elections (see Table 5.5). Real wages of the public sector workers increased by 42 percent, just enough to make them exceed their 1993 levels. Minimum wages rose by 34 percent. While private sector wages increased significantly by 12 percent, civil servants could only get a rise of four percent.

Despite these generous and politically driven wage increases, economic situation in the country was ringing the emergency bells with a sharp contraction in GNP by six percent. The contraction was reflected in nearly all other labor market indicators of 1999. Unemployment rate exceeded its 1994-crisis level, and rose to 8.3 percent. Underemployment rose by 2.1 percentage points and reached 9.8 percent. Non-agricultural unemployment also reached to a significant 12.1 percent in this year. Although there was a small improvement in the employment share of the manufacturing sector by 0.2 percentage points, private manufacturing employment index fell by nearly 10 percent, from 101.6 in 1998 to 91.7 in 1999. Public manufacturing employment also shrank by around five percent in 1999. Moreover, the share of the wage earners in total employment declined by 0.8 percentage points. Both events indicate shrinkage in formal employment. Hence, against the background of rising real wages, economic recession resulted in a full rise in unemployment in 1999.

Table 5.5 Selected Labor Market Indicators of Turkey, 1998-2002

	1998	1999	2000	2001	2002
Unemployment Rate (%)	7.4	8.3	6.9	9.1	11.5
Non-agricultural Unemp. Rate (%)	10.8	12.1	9.0	12.1	...
Underemployment Rate (%)	6.7	9.8	7.4	6.5	6.1
Total Employment (Thousands)	21778	22048	21581	21524	21354
<i>Manufacturing Employment Indices (1997=100)</i>					
Of Private*	101.6	91.7	90.3	82.5	84.4
Of Public	93.7	89.0	83.6	78.2	70.9
<i>Shares in Total Employment:</i>					
Wage and Salary Earners (%)	36.2	35.4	38.7	39.0	42.0
Agriculture (%)	41.5	40.2	36.0	37.6	34.9
Manufacturing (%)	15.9	16.1	16.9	16.6	17.5
<i>Real Wage Indices (1993=100):</i>					
Minimum Net Wage	92.1	123.9	105.8	91.1	98.4
Private Sector Net Wage	83.2	92.8	93.8	74.8	...
Public Sector (Workers) Net Wage	73.9	105.0	112.3	99.3	90.2
Civil Servants' Net Wage	90.9	95.1	84.1	81.0	85.6

*:For establishments with more than 10 workers

Sources: Compiled from the Household Labor Force Survey results and Manufacturing Industry Statistics of the State Institute of Statistics, which are available at <http://lmisnt.pub.die.gov.tr/die/plsql/lmwebtur.lmwebform>, and <http://www.die.gov.tr/TURKISH/SONIST/IMSANUR/imsanur.html>, respectively, except TÜSİAD (2002: 179, Table 5.1) for non-agricultural unemployment rate and Undersecretariat of Treasury (2003: 34, Table 1.11B) for real wage indices

As explained in Section 5.1.4 above, Turkey experienced a short-lived boom during the first 10 months of 2000 under the exchange-rate-based stabilization program. Although the November 2000 crisis stopped the economic expansion for the rest of the year, real GNP and manufacturing output growth rates were over six percent for the whole year (see Table 5.3). Strong expansion of output had a positive but limited impact on employment indicators⁶. Unemployment rates came down in general (see Table 5.5). Overall unemployment decreased to 6.9 percent in 2000 from 8.3 percent in the previous year. Non-agricultural unemployment also declined sharply, from 12 percent to nine percent, and underemployment rate fell 2.4 percentage points from 9.8 percent in 1999 to 7.4 percent in 2000.

However, manufacturing employment indices did not show good signs. While employment in the private manufacturing sector declined by 1.4 percentage points, public manufacturing employment continued its downwards trend with a 5.4 percentage points fall in 2000. These show that the strong output growth in 2000 was due to the existing capacities of the manufacturing sector. Moreover, increasing share of manufacturing in total employment from 16.1 percent in 1999 to 16.9 percent in 2000 should be attributed mostly to the sharp fall in agricultural employment from 8.8 million to 7.7 million in the same years. Finally, the incomes policy component of the stabilization program led to a deterioration in minimum wages and civil servant wages. Due to the forward indexation principle of the stabilization program, minimum wages and civil servant wages declined by 14 percent and 11 percent in real terms in 2000, respectively. However, forward indexation could not be fully utilized in the private sector, and the real wages in this sector increased by one percent. The public sector had a more pronounced chance to protect their wages,

⁶ It should be noted that the State Institute of Statistics (SIS) has made some modifications to the structure of Household Labor Force Surveys in 2000 to make the survey results more accurate. Starting from this year, surveys have been conducted quarterly, instead of twice a year, survey sample has been enlarged and there have been some changes on the question sheet. Although the SIS argues that survey data before and after the modifications are directly comparable, one should be cautious while comparing the employment indicators for periods before and after 2000. Detailed information about the labor survey modifications is available at <http://www.die.gov.tr/TURKISH/SONIST/ISGUCU/111000ac.htm>. (This note does not apply to the employment indices of the manufacturing sector, since these are the results of a separate survey, which is Manufacturing Industry Statistics.)

since their contracts were mostly bound in the previous year. Consequently, public sector workers' real wages rose by nearly seven percent in 2000.

Then in February 2001, the country was hit by another financial crisis, which the Turkish government responded with a comprehensive structural adjustment and stabilization program (The Strengthened Program of April-May 2001), and entered a deep recession. TSP aimed to reduce the public sector expenditures by cutting employment and suppressing real wages (see Section 5.1.4). These measures, combined with the adverse effects of the crises themselves, produced negative results for the working population, as reflected in employment and wage indicators of 2001 (see Table 5.5). While the overall unemployment rate reached 9.1 percent, non-agricultural unemployment rate jumped to 12.1 percent with a three-percentage point increase. Underemployment rate declined slightly by 0.9 percentage point to 6.5 percent, probably indicating a contraction of the part-time job opportunities after the crises. Private and public manufacturing employment indices fell by 8.6 percent and 7.7 percent, respectively. The rise in the share of agricultural employment, which had been falling since 1996, from 36 percent in 2000 to 37.6 percent in 2001 –indicating a rise of around 320,000 people– shows that some of the newly unemployed labor has been absorbed by this sector.

For real wages, the crises and TSP have induced sharp falls (see Table 5.5). Private sector workers were the hardest hit; their wages fell by around 20 percent in 2001. Minimum net wage declined by 14 percent, whereas the fall in the wages of public sector workers was around 11 percent. The least affected part of the labor was the civil servants, who saw their real salaries decreasing by nearly four percent. After these sharp declines, all of the wage types were at levels less than their levels eight years ago in 1993, private sector wages being in the worst position with an index of less than 75 (1993=100).

Interestingly, the recovery of 2002, with real GNP growth of 7.8 percent and manufacturing output growth of more than 10 percent (see Table 5.3), was not able to generate new employment even with such low wage levels. While there was a fall

in total employment by 170,000 people, unemployment rate reached an unprecedented 11.5 percent in 2002 (see Table 5.5). On the positive side, there was a slight improvement in manufacturing employment. The share of the manufacturing sector in total employment increased by almost one percentage point –implying a rise of 150,000 people– as the share of agriculture fell by 2.7 percentage points to less than 35 percent. Private manufacturing employment index (1997=100) rose from 82.5 in 2001 to 84.4 in 2002. But as retrenchment in state enterprises continued as a part of the stabilization program, the employment index of the public manufacturing sector (1997=100) fell from 78.2 in 2001 to 70.9 in 2002. As a result of continuous lay-offs and privatizations during the past decade, the number of workers in the state-owned manufacturing enterprises in 2002 were less than half of that in 1992. Due to the November elections, the government relaxed its tight incomes policy in 2002, and increased civil servants' wages and the minimum net wage, by 5.7 percent and eight percent, respectively. But the wages of public sector workers declined by 9.2 percent.

5.2.2 Income Inequality and Poverty

Turkey does not have a periodic household income and consumption survey system, which would provide data for analysing the trends in income distribution and poverty in the country, as well as the impact of crises on these attributes. Only three surveys were conducted by the State Institute of Statistics during the past 20 years, in 1987, 1994 and 2002. In this section, the results of these surveys are used to grasp the effects of 1994 and 2000-2001 crises. However, since there were long periods between the surveys, comparisons among them do not reflect solely the impact of the crises, but also the consequences of the events that occurred during the interim periods. For the analysis of the effects of the 2000-2001 crises on poverty, another survey, World Bank's Household Consumption and Income Survey (HCIS) that was conducted in 2001, is also used.

- Income Distribution

Between 1989 and 1994, Turkish government pursued a populist strategy, which was based on significant wage increases for labor, and high interest income gains, artificially low input prices and low taxes for the capitalist class (see Section 5.1.1). The strategy came to an end with the financial crisis of early 1994. Populist strategy and the consequent crisis resulted in a sharp deterioration in income distribution from 1987 to 1994, based on the total household nominal income data⁷, as collected by the SIS Household Income and Consumption Expenditure Surveys (HICES) of 1987 and 1994⁸ (see Table 5.6). While the share of the richest quintile rose by nearly ten percent, income shares of the first four quintiles declined in 1994 with respect to 1987. This resulted in the worsening of inequality measures. Gini coefficient increased from 0.44 in 1987 to 0.49 in 1994 and the ratio of income share of the richest quintile to the poorest rose from 9.6 in 1987 to 11.2 in 1994.

The overall deterioration of income distribution stemmed from the urban areas. While the richest urban quintile increased its income share from 50.9 percent in 1987 to 57.2 percent in 1994, all other urban quintiles saw their shares falling by around 11 to 13 percent. Consequently, the urban Gini rose by 18 percent from 0.44 to 0.52 and the income share of the top quintile to bottom quintile ratio increased from 9.4 to 11.9. On the other hand, rural income distribution slightly improved between 1987 and 1994. Rural Gini fell from 0.42 in 1987 to 0.41 in 1994, and the top/bottom ratio declined from 9.2 to 8.5. These improvements were due to the increasing shares of the first two quintiles by 0.4 percentage point for the first and

⁷ World Bank (2000: 25, Table 6) uses real income data by deflating the 1994 survey results to average 1987 prices using regional CPI, and concludes that the distribution of income has been roughly stable over the period with some deterioration at the top and bottom ends. However, the study reports that the nominal Gini for 1994 was 0.448 (World Bank, 2000: 25, Footnote 15), which is much less than the widely cited figure of 0.49, creating concerns over the reliability of the Bank's analysis. Moreover, there are not any other studies utilizing the real income approach for the income distribution of 1994 or 2002, which makes it impossible to verify the World Bank figures for 1994, and make a comparison of income distribution between 1994 and 2002. For these reasons, the associated analysis of the World Bank is not incorporated into this section.

⁸ Sample sizes and methodologies of these surveys were almost same, making them directly comparable. Only difference between two surveys is that the 1994 survey was conducted in two parts: consumption and income distribution questionnaires. In 1987, there was only one questionnaire, covering both issues. See TÜSIAD (2000a: 32-33) for details.

0.1 percentage point for the second. Income shares of other richer quintiles declined by 0.1 to 0.2 percentage point from 1987 to 1994.

Table 5.6 Income Distribution and Inequality Measures, Turkey, Urban and Rural, 1987, 1994 and 2002

Quintiles	Turkey			Urban			Rural		
	1987	1994	2002	1987	1994	2002	1987	1994	2002
<i>1st (Poorest)</i>	5.2	4.9	5.3	5.4	4.8	5.5	5.2	5.6	5.2
<i>2nd</i>	9.6	8.6	9.8	9.3	8.2	9.7	10.0	10.1	10.3
<i>3rd</i>	14.1	12.6	14.0	13.6	11.9	13.9	15.0	14.8	14.7
<i>4th</i>	21.2	19.0	20.8	20.7	17.9	20.5	22.0	21.8	21.7
<i>5th (Richest)</i>	50.0	54.9	50.1	50.9	57.2	50.4	47.8	47.7	48.0
<i>Gini Coefficient</i>	0.44	0.49	0.44	0.44	0.52	0.44	0.42	0.41	0.42
<i>Top20/Bottom20</i>	9.6	11.2	9.5	9.4	11.9	9.2	9.2	8.5	9.2

Sources: SIS 1987 and 1994 Household Income and Consumption Expenditure Survey Results and 2002 Household Budget Survey Results, which are available at: <http://www.die.gov.tr/TURKISH/SONIST/HHGELTUK/hhgeltuk.html>, SPO (2001: 19, Tables 11,12) and Yükseler (2003: 3, Table 1).

The period between 1994 and 2002 was marked with economic instability (see Sections 5.1.1-5.1.4). Volatile growth rates, high interest rates and chronic high-inflation, which the governments of the period continuously tried to bring down with unsuccessful stabilization programs, were the major characteristics of the Turkish economy during this period. 2000-2001 crises further exacerbated the situation; economy contracted drastically in 2001 by nearly ten percent. Although the end year of the period, 2002, was one of recovery, overall result of a period with such characteristics should have been in the direction of higher inequality. However, the results of the 2002 Household Budget Survey (HBS), as presented in Table 5.6⁹, are in open contradiction with these expectations. In 2002, overall income distribution was more equitable than in 1994 according to the HBS results. The Gini coefficient and the income share of the top quintile to bottom quintile ratio declined to 0.44 and

⁹ Although the results of 2002 survey are presented with the previous surveys in Table 5.6, their results may not be directly comparable. In 2002, SIS reduced the size of the survey sample and made some changes in the survey, with the aim of converting the large scaled HICES to an annual income and consumption survey called Household Budget Survey (HBS). See Yükseler (2003: 2) for a discussion of the differences between 1994 HICES and 2002 HBS.

9.5, respectively, from 0.49 and 11.2 in 1994. This improvement was due to the rising shares of the first four quintiles by an average of nine percent, whereas the richest quintile's share declined by the same rate, from 54.9 percent in 1994 to 50.1 percent in 2002.

Between 1994 and 2002, general changes in the income distributions of urban and rural areas have been in the opposite direction of what had occurred during the previous period (see Table 5.6). While rural distribution deteriorated, urban distribution improved between 1994 and 2002. In rural distribution, the second and fifth quintiles increased their shares slightly, whereas shares of other quintiles declined. Most pronounced fall was in the poorest quintile's share; it decreased from 5.6 percent in 1994 to 5.2 percent in 2002, returning to its level in 1987. These changes caused the Gini coefficient and the income share of the top quintile to bottom quintile ratio to worsen. Rural Gini coefficient rose from 0.41 in 1994 to 0.42 in 2002, and the top-bottom ratio increased from 8.5 to 9.2 during the same period. In urban areas, improvement in income distribution originated from the decreasing income share of the richest quintile. 12 percent decline in the share of this quintile was absorbed by all other quintiles, whose shares rose by more than 15 percent individually. This redistribution of income from the richest quintile to other quintiles induced the Gini coefficient to fall significantly from 0.52 in 1994 to 0.44 in 2002. Moreover, the income share of the top quintile to bottom quintile ratio also improved, as it declined from 11.2 to 9.5 between 1994 and 2002.

However, there are serious concerns over the validity of the argument that the income inequality, particularly the one for the urban areas, was reduced between 1994 and 2002. Most importantly, there is the issue of shrinking financial asset income from 1994 to 2002, which raises these concerns. According to the results of 1994 HICES and 2002 HBS, percentage share of the financial asset income in 2002, which was 4.9 percent, was 36 percent lower than its share in 1994, which was 7.7 percent (Yükseler, 2003: 9, Table 6). But such a decline is not plausible, since the main characteristics of the financial markets have not changed after 1994. As mentioned in Sections 5.1.1 through 5.1.4 above, public debt increased continuously

from 1989 to 2002, offering high real interest rates on public debt instruments. This process had led to a significant increase in the share of the financial asset income, from 1.8 percent in 1987 to 7.7 percent in 1994, which mainly accrued to the richest quintiles. Both Yükseler (2003: 8-9) and TÜSİAD (2000a: 90-91) put forward this increase as the main reason behind the deterioration of the income distribution during the associated period. For the 1994-2002 period, Yükseler (2003: 10, Table 7) argues that total financial assets to GNP ratio has increased from 46.4 percent to 112.1 percent, with the largest increase occurring in the ratio of public debt instruments to GNP, which had risen from 14.6 percent in 1994 to 55.2 in 2002. Furthermore, transaction volume of the financial markets has increased drastically and the average interest rate on public debt instruments has been 98.9 percent during this period. Hence, there seems to be no reason for the share of the financial income component to fall between 1994 and 2002. On the contrary, it is more likely that this component had risen over the period, since the domestic interest payments of the public sector as a share of GNP has more than tripled from 6.0 percent in 1994 to 19.4 percent in 2002 (Yükseler, 2003: 10, Table 7). Therefore, households must have underreported a large portion of their financial income in the 2002 HBS, either intentionally or not. This statement is supported by the fact that the total household disposable income in 2002 that emerges from the results of 2002 HBS is only 56.5 percent of the private disposable income in the same year as reported by Undersecretariat of Treasury, based on GNP data (2003: 3, Table 1.1A).

The second source of evidence against the results of the 2002 income survey arises from the poverty analysis in the following part, which shows that poverty, particularly in the urban areas, has risen sharply from 1994 to 2001. Had the incomes of the poorest segments of the population grown as the HBS results suggest, such an increase in poverty incidence should not have taken place. But the available data on poverty indicate a drastic rise in poverty incidence over the 1994-2001 period.

In the light of these facts, the results of the 2002 household income survey indicating an improvement in the Turkish income distribution during the 1994-2002 period is at least controversial. It is more likely that the latest income survey was

biased since the richest households seem to have underreported their financial income. Moreover, the changes in the structure of the survey from 1994 to 2002 would reduce the level of robustness of a comparison between two surveys (see Footnote 9). The next section, which assesses the effects of the 1994 and 2000-2001 crises on poverty, provides a more realistic picture.

- **Poverty**

There is only a handful of studies on Turkish poverty¹⁰. Nearly all of these studies use HICES data, but different methodologies, and more importantly, none of them make intertemporal comparisons *i.e.* between 1987 and 1994 or between 1994 and 2002, except Dağdemir (2002). For the post-2001 crisis period, the only study measuring the level of poverty is a recently published World Bank report (2003a), which is based on Household Consumption and Income Survey (HCIS) conducted by the Bank itself. This study's methodology is the same as that of another report published by the Bank (World Bank, 2000b), making them comparable. Hence, the poverty analysis herein is based on Dağdemir's study for 1987-1994 period, and two World Bank reports for the 1994-2002 period.

Dağdemir (2002: 469) uses two poverty lines. The first one is based on the minimum calorie requirement of an individual, and called the minimum food cost (MFC). Second one adds some other necessary non-food expenditures to MFC, and reaches to basic needs cost (BNC), which is roughly 50 percent higher than MFC. Using these poverty lines Dağdemir (2002: 472, Table 1) calculates the poverty rates of urban and rural areas, and for the whole of Turkey. His findings according to the MFC line suggest that there has been a rise in urban poverty from 6.9 percent in 1987 to 8.7 percent in 1994 (see Table 5.7). However, a fall in the rural poverty from 21.2 to 20.2 has countervailed this rise, and the general poverty level of the country has remained constant at 11.5 percent from 1987 to 1994. According to the BNC line, both the urban and the rural poverty rates have increased from 14.3 percent to 20 percent and from 41.5 percent to 42.5 percent, respectively. These rises have

¹⁰ See Erdoğan (2002) for brief summaries of all of the ten studies on Turkish poverty during 1990s. For earlier periods, there exist only two studies: Derviş and Robinson (1980) and Celasun (1986).

generated an increase in the overall poverty incidence in Turkey, from 27 percent in 1987 to 29.5 in 1994. These results of the Dağdemir's study show that although poverty was mostly a rural phenomenon in Turkey, urban poverty worsened significantly during the 1987-1994 period, most probably as a result of the 1994 financial crisis, which hit the urban sectors worst.

Table 5.7 Poverty in Turkey, Urban and Rural, 1987 and 1994

Poverty Line	Turkey		Urban		Rural	
	1987	1994	1987	1994	1987	1994
<i>Minimum Food Cost</i>	11.5	11.5	6.9	8.7	21.2	20.2
<i>Basic Needs Cost</i>	27.0	29.5	14.3	20.0	41.5	42.5

Source: Dağdemir (2002: 472, Table 1)

To understand the immediate poverty impact of 2000-2001 financial crises, World Bank conducted a Household Consumption and Income Survey (HCIS) in 2001. Due to the time and financial constraints, 2001 HCIS had some differences in its data sample and methodology compared to the 1994 HICES¹¹. Nevertheless, World Bank (2003a) report based on HCIS was the only available study on the level of poverty after the 2000-2001 financial crises, until recently. In April 2004, State Institute of Statistics published a poverty report based on the 2002 HBS (SIS, 2004). However, this report's findings are not comparable to the World Bank (2000b) report –or any other study currently available– since two studies' poverty line methodologies are different in general, although they share the same names¹². On the

¹¹ Most importantly, HCIS had a smaller sample size (less than one-fifth of the sample size of 1994 HICES), and was based on an urban-biased sample. See World Bank (2003a: 1-4) for a detailed explanation of the differences between two surveys.

¹² For the food basket based poverty, compositions of the baskets are quite different, and the SIS's calorie consumption line is slightly lower compared to the Bank's, which are 2100 and 2450 calories, respectively. For the basic needs based poverty, World Bank report's line is twice the food basket based poverty line for urban areas and 1.75 of it for rural areas, whereas SIS uses approximately 2.3 times the food consumption expenditure of the food basket based poor households for the whole country. For the one-half of the median income based (relative) poverty line, the Bank uses income data, while SIS uses expenditure data. For the one-dollar-a-day poverty line, base years of two studies' PPP estimates are different, 1985 for World Bank report and 2002 for SIS report. But more importantly, SIS argues that the poverty rate in 2002 according to this line is only 0.2 percent of total population. This finding, which would be found quite controversial by any scholar of the Turkish

other hand, World Bank (2000b) and (2003a) reports share the same poverty line methodology making them directly comparable to each other. Hence, the comparison of World Bank (2003a) report's findings with those of the World Bank (2000b) report gives a broad idea of what has happened on the poverty front from 1994 to 2001 (see Table 5.8).

Table 5.8 Poverty in Turkey, 1994-2001

Poverty Line	Turkey		Urban	
	1994	2001	1994	2001
<i>\$1/day per capita (at 1985 PPP prices)</i>	2.5	1.8		
<i>Local cost of minimum food basket</i>	7.3	...	6.2	17.2
<i>Local cost of basic needs basket</i>	36.3	56.1		
<i>One-half of national median income</i>	15.7	21.5		

Sources: World Bank (2000b: 36, Table 1; 2003a: 11-23)

Both World Bank reports use four poverty lines: i) an internationally standard poverty line of “One-Dollar-A-Day” per capita; ii) a minimum food basket cost line; iii) a basic needs basket cost line; and iv) a relative poverty line set at one-half of national median income.¹³ Except for the first one, all poverty rates have worsened between 1994 and 2001. Low incidence of extreme poverty based on the “One-Dollar-A-Day” line in 1994, 2.5 percent, has fallen down to 1.8 percent in 2001. World Bank (2003a: 11) notes that with such small numbers the difference is within the standard error of the samples. Nevertheless, if such a decline is present, heavy migration during 1990s from the Southeast Anatolia region, where the extreme poverty is concentrated with a regional rate of nearly five times the national average, to more wealthy regions such as Akdeniz and Marmara may be the reason behind it.

economy considering the heavy financial crisis prior to the survey year, casts serious doubts over the reliability of the SIS report. See World Bank (2000a: 82-83, Technical Annex) and SIS (2004: 9-10) for the details of the reports' methodologies.

¹³ However, reports proclaim only on the overall figures of Turkey for these poverty lines, concealing the urban and rural poverty rates. Only exception is the urban food poverty rate in 2003 report, in which case the study does not give the overall food poverty rate.

The most drastic deterioration was experienced in the urban food poverty rate. It nearly tripled from 6.2 in 1994 to 17.2 in 2001. This seems to be a natural outcome of the 2000-2001 financial crises, as they affected the urban population dramatically, with strictly restricted job opportunities and a sharp upsurge in food prices by 80.2 percent that was much faster than the average price increase of 68.5 percent during the crisis period (Şenses, 2002: 15, Table 4). Similarly, there was a sharp rise in the economic vulnerability rate as measured by the basic needs cost line. It increased by 55 percent, from 36.3 percent in 1994 to 56.1 percent in 2001. Therefore, economically vulnerable population, who are not considered to be poor, but with a high risk of falling into poverty, has constituted the majority of the Turkish population during the 1994-2001 period. More strikingly, the associated figure in the Southeast region was 93 percent (World Bank, 2003a: 23). Lastly, the relative poverty rate based on the poverty line of one-half of the median income rose from 15.7 percent to 21.5 percent.

Hence, the picture of poverty in Turkey in the aftermath of the recent financial crises is a bleak one. Such high levels of poverty and vulnerability in the country create serious concerns over the fabric of the society. Buğra and Keyder (2003: 49) emphasize the stark possibility of social exclusion for the poorest groups, as the traditional support mechanisms within the informal solidarity networks have lost their significance during 1990s, and the formal support mechanisms have been ineffective. Authors argue that this type of exclusion would constitute a serious threat to the social and political stability of the country, a threat that can be avoided by effective social assistance policies of the government. Turkish governments' sensitivity to this issue is investigated in the last section of this chapter.

5.2.3 Public Social Sector Spending

In Turkey, public expenditures on social sectors consist mainly of three categories: education spending, health spending, and social assistance spending¹⁴. Total amount of these expenditures as a share of GNP has been in five to eight percent range during the 1993-2002 period (see Table 5.9), an amount which can be hardly perceived as high for a middle-income developing country like Turkey.

It is commonly argued that the stabilization and structural adjustment programs have a diminishing effect on public social spending (PSS). Turkish experience during the 1993-1996 period seems to be in accordance with this argument. Under the stabilization program of April 5 1994, real PSS fell by a drastic 22 percent, from 31 trillion TL in 1993 to 24 trillion TL in 1994. It further declined by almost four percent in 1995, as the fiscal austerity measures were in place for most of the year. In 1996, with the abolition of the stabilization program, real PSS remained stable at around 23 trillion TL. The overall deterioration in social spending, from 1993 to 1996, was by 25.4 percent. This sharp drop was reflected in a 29.4 percent decline in per capita PSS during the same period, and the PSS to GNP ratio retreated from 7.2 percent in 1993 to five percent in 1996. The share of the social spending in the total public spending also plummeted over the course of the stabilization program, from nearly 30 percent in 1993 to 19 percent in 1996.

¹⁴ Expenditures on housing, water and sewerage and other infrastructure elements could also be included in social spending. However these expenditure types are dispersed under different expenditure headings in the budget or some of them are financed by extra-budgetary funds, making them quite hard to trace. Moreover, transfers to the social security institutions are also considered to be among social expenditures by some studies. But, since these transfers emanate from the operational deficiencies of the social security institutions, and are not the outcomes of government's deliberate social policies, they should not be perceived as social spending. Hence, none of the above items are incorporated into the social spending analysis in this section.

Table 5.9 Public Social Spending, Turkey, 1993-2002

	Real Public Social Spending (PSS) (billions of 1990 TL)	PSS Per Capita (1990 TL)	PSS/GNP (%)	PSS/Total Public Spending (%)
1993	30827	518176	7,2	29,8
1994	24049	396774	6,0	25,9
1995	23135	374728	5,4	24,6
1996	22993	365711	5,0	19,1
1997	27893	435724	5,8	21,3
1998	29892	458764	6,3	21,6
1999	33988	512696	8,1	22,5
2000	34123	506119	7,8	20,9
2001	30907	451008	7,8	16,9
2002	34583	496694	8,1	19,0

Sources: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>; Ministry of Health (2003: 68); SHP (2002: 27, Table 14); World Bank (2000b: 60, Table 2); BYDK (2003: 14); <http://www.emekli.gov.tr/ISTATISTIK/65yas.html>; <http://www.muhasibat.gov.tr/mbulten/T4-2-6.htm>.

Between 1997 and 1999, there were sharp increases in the level of social spending, offsetting the negative effects of the previous period. Over this period, PSS jumped from 23 trillion TL to 34 trillion TL in real terms. Total increase in the PSS per capita was around 40 percent from 1996 to 1999, making it reach its pre-crisis level. Social spending as a share of GNP also rose throughout the period. It steadily increased from the dip of five percent in 1996 to the high of 8.1 percent in 1999. Interestingly, the share of social spending in total public expenditures did not change much, rising from 19.1 percent in 1996 to 22.5 percent in 1999. As Figure 5.3 demonstrates, the rise in 1997 was induced by a sharp increase in education expenditures, which was the result of the extension of the compulsory schooling period from five years to eight years in the respective year (Emil and Yılmaz, 2003: 27). In 1999, all three spending categories recorded rises, partly due to the recovery and aid efforts following the Marmara Earthquake in August.

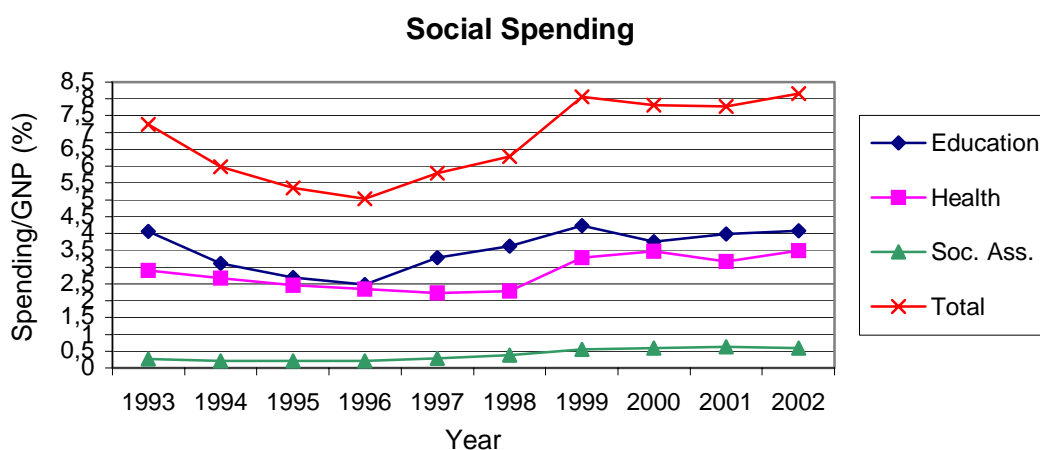


Figure 5.3 Social Spending/GNP Ratio by Category, Turkey, 1993-2002

Sources: Same as Table 5.9.

In 2000, the Turkish government adopted a new exchange-rate-based stabilization program, which was implemented for nearly 14 months and replaced by the so-called “the strengthened program” following the November 2000 and the February 2001 crises (see Section 5.1.4). Under these stabilization and structural adjustment programs, social sector spending demonstrated a mixed performance. Real PSS remained almost stable in 2000, while its per capita level declined by 1.3 percent. PSS to GNP ratio and the share of PSS in total public spending also decreased by 0.3 and 1.6 percentage points. In the crisis year, 2001, social spending declined by all measures. Real PSS fell by nearly ten percent, whereas per capita PSS decreased by 10.9 percent. As a result of heavy contraction in GNP, PSS to GNP ratio stayed stable at 7.8 percent. The share of the social spending in total public spending fell sharply from 20.9 percent in 2000 to 16.9 percent in 2001, demonstrating the priorities of the government in the wake of the financial crisis. However, PSS recovered in 2002. Real social spending and per capita PSS increased by 11.9 percent and 10.1 percent respectively, returning approximately to their levels in 2000. PSS to GNP ratio also rose by 0.3 percentage points, reaching to the high of 8.1 percent, whereas the increase in the social spending share in total spending by 2.1 percentage points, could elevate the figure to only 19 percent. This rise in social

spending in 2002 seemed to be the result of the PFPSAL II agreement¹⁵ with World Bank in that year, which required the social spending levels to be kept in place (Emil and Yılmaz, 2003: 33, Box 2).

Overall review of the post-crisis social spending performance of the Turkish governments has revealed that the governments tend to reduce these types of spending during the post-crisis periods. After the 1994 crisis, PSS declined for three consecutive years. In 2001 crisis, this period was confined to the crisis year itself, as a result of the World Bank agreement (PFPSALII), which is discussed in the last part of this chapter.

To complete the picture, one should analyze the benefit incidence of the PSS. Yet, the available household income data is not sufficient to accomplish this task. Instead, functional distribution of each social spending category is analyzed as a proxy for benefit incidence in the following sections.

- **Education**

Educational spending has constituted the major portion of the total public social spending in Turkey; its share in public expenditures on social sectors was generally around 50 percent during the 1994-2002 period. Nevertheless, its magnitude –around four percent of GNP, at its peak periods (see Figure 5.3 above)– was relatively low by international standards. Emil and Yılmaz (2003: 29) state that the associated figure for developed countries is around five-six percent, whereas in developing countries it is within the range of three to six percent.

Share of education expenditures in total public spending shows the weight that governments give to the issue. Since the beginning of 1990s, Turkish governments have been allocating a steadily declining portion of their total

¹⁵ In July 2001, World Bank agreed to support the strengthened program under two loans: Programmatic Financial and Public Sector Adjustment Loan (PFPSAL) I and PFPSAL II. One of the objectives of these loans was to ensure that the social programs continued to be adequately funded under TSP. See World Bank (2003a: 2-3) for details.

expenditures on education (see Figure 5.4). Share of education in total public spending was 16.7 percent in 1993; thereafter it fell continuously under the effect of the 1994 crisis and the subsequent stabilization efforts until 1996, when it was 9.4 percent of government's total expenditures. In 1997, when the government decided to extend the duration of the compulsory education from five years to eight years, educational spending rose to 12 percent of all public expenditures and remained around this level in 1998 and 1999. Then in 2000, it fell to ten percent, and in 2001, it was at its lowest point during the past ten years with 8.6 percent. In the next year, it only recovered by less than one percentage point. World Bank (2000b: 71) indicates that a share of ten percent for educational spending in budgetary expenditures is low by the standards of developing countries with similar income, such as Thailand, 21.3 percent, and Panama, 18.4 percent. The average figure for the 1994-2002 period was only 11.1 percent in Turkey.

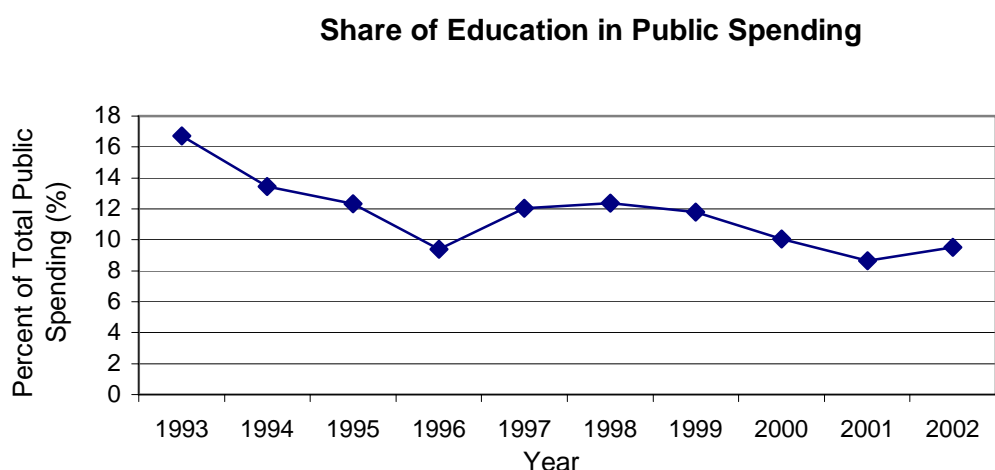


Figure 5.4 Share of Educational Expenditures in Total Public Spending, Turkey, 1993-2002

Source: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>.

Although the budgetary share of education expenditure sheds light on government priorities, investigating the level of educational spending per person would give more information on the benefits of this spending. As Figure 5.5

demonstrates, per capita public spending on education recorded sharp drops during crisis periods of 1994-1995 and 2000-2001. In 1994 and 1995, it declined by 29.2 percent and 8.8 percent respectively. From 1996 to 1997, per capita spending rose sharply by 37 percent under the new compulsory education program. It continued to increase in 1998 and 1999 by seven percent and two percent, respectively. When a stabilization program was put in place in 2000, per capita spending on education fell by almost ten percent. Then in the year of the financial crisis, 2001, its decrease was less than that in 1994: 5.2 percent. In 2002, public educational spending per capita was able to recover to its level in 2001 by a rise of 7.8 percent. Therefore, during the 1994 crisis, public spending on education was severely affected, whereas during 2000-2001 crises, this effect was less pronounced.

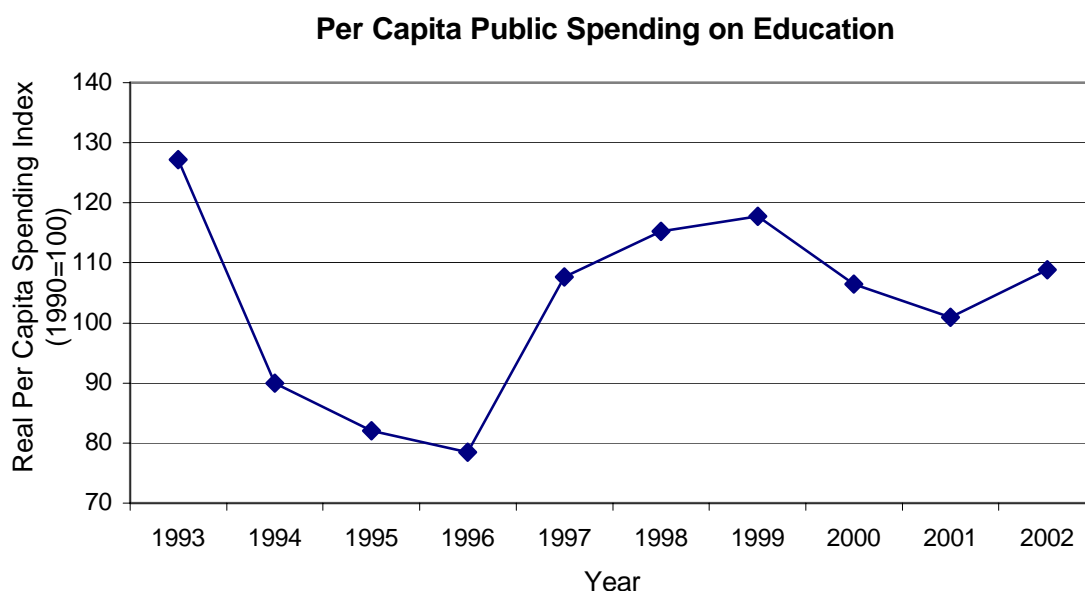


Figure 5.5 Real Public Spending on Education per Capita, Turkey, 1993-2002

Source: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>.

The evolution of public spending on education over time is more or less reflected in the broad educational indicators of Turkey (see Figure 5.6). While the net enrolment rate in primary education declined from 90.1 in 1993 to 89.3 in 1994, adult literacy rate also decreased from 85 percent to 84.4 percent during the same

period. Net enrolment continued to fall during 1995 and 1996 following the similar trend of per capita educational spending. On the other hand, adult literacy rate remained stable at around 85.2 percent from 1995 to 1997. Increased public spending after the extension of compulsory education duration in 1997 showed its immediate impact on educational indicators. Net enrolment rate and adult literacy rate steadily increased from 81.1 percent and 85.3 percent in 1997 to 90.5 and 86.3 in 1999, respectively. In 2000, this rise slowed down as per capita public only 0.25 and 0.1 percentage points respectively in this year. The reduction in public spending caused the indicators to fall in 2001. Net enrolment rate went down to 89.8, and the adult literacy rate decreased to 86.3 percent in this year. For 2002, there is no data on net enrolment rate yet, but the adult literacy rate rose to 87.5 percent, with the increasing public spending on education.

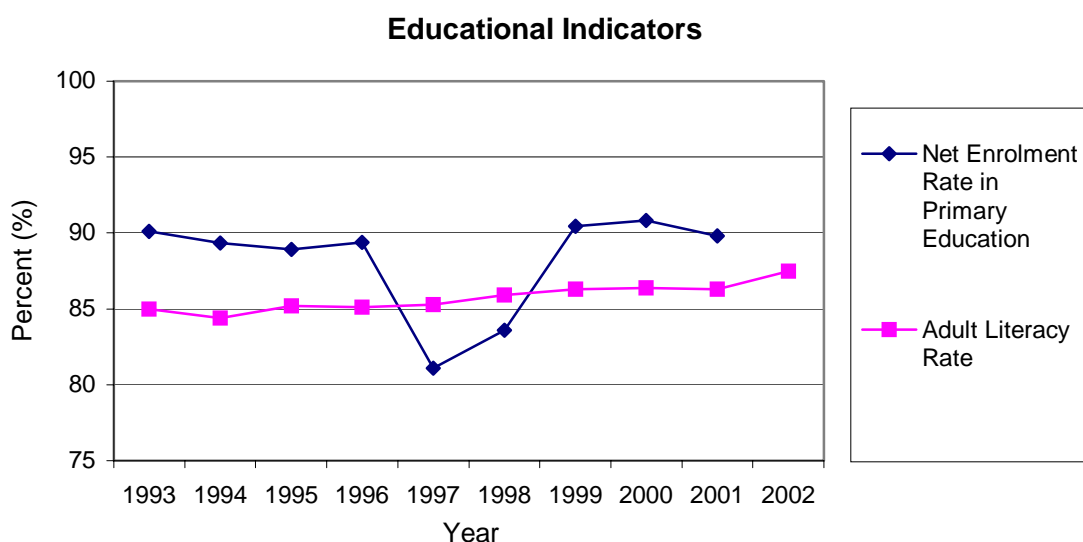


Figure 5.6 Educational Indicators, Turkey, 1993-2002

Source: State Institute of Statistics, *Population and Development Indicators*, online edition, which is available at <http://nkg.die.gov.tr/>.

One particularly important aspect of public educational spending is the distribution of its benefits among households, namely the benefit incidence. If the poorest segments of the population, who face difficulties in financing their educational expenditures, receive higher benefits from public spending on education,

they have better chances for getting out of poverty and improving their living standards. However, there are not any benefit incidence analyses in this regard¹⁶ in Turkey to date, due to insufficient data. One way to get around this problem is to assess the distribution of educational expenditures among primary, secondary and tertiary education. Since the poor are much less involved in higher education¹⁷, the share of primary education in all education expenditures can be used as an indicator of the poor population's benefit incidence. Available data on the distribution of public spending among education levels reveal that the educational spending in Turkey cannot be assessed as pro-poor (see Figure 5.7). Primary education's share among all levels fluctuates around 50 percent during the 1998-2002 period. Considering that the primary education covers an eight-year period, which is compulsory for all children in the relevant age group, this share is relatively low. UNESCO data shows that the average of the associated figure for Thailand, for example, is almost 60 percent for the same period¹⁸. Moreover, a high amount of public educational spending, around 30 percent, is allocated to tertiary education, a level at which poor students constitute only a small minority of all students. Thus, the overall incidence of public educational spending in Turkey seems to be contributing to the inequalities rather than correcting them.

¹⁶ Only study on the benefit incidence of public spending to our knowledge can be found in the World Bank (2000b: 31, Table 9) report. World Bank's analysis does not include public spending on education, however. The study assesses the benefit incidence of four types of state transfers: state pensions; tax return; old age income and scholarships; and in-kind transfers from the state.

¹⁷ Based on 1994 HICES data, Erdoğan (2003: 405, Table 7.3) states that 95.3 percent of the poor population has primary or less education.

¹⁸ See UNESCO Education Online Database at <http://stats.uis.unesco.org>.

Distribution of Educational Expenditures by Level

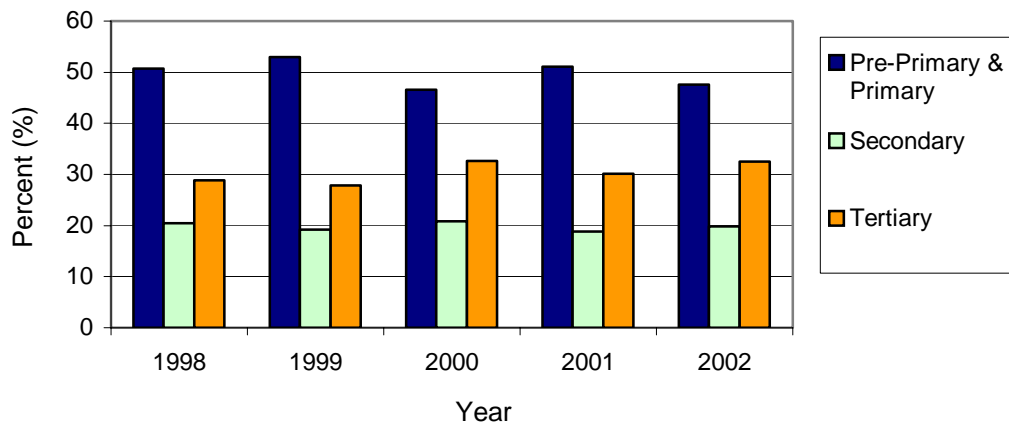


Figure 5.7 Percentage Distribution of Public Educational Spending by Level of Education, Turkey, 1998-2002

Source: Ministry of National Education, *2001 Yılı Başında Milli Eğitim*, and *Milli Eğitim Sayısal Veriler 2002-2003*, online editions, which are available at <http://www.meb.gov.tr/stats/ist2001/icindekiler.htm> and <http://www.meb.gov.tr/stats/apk2003/SayisalVeriler2003.htm>, respectively.

- **Health**

Health expenditures have been the second major component of the public social spending with an average share of 42.6 percent during the 1994-2002 period. Its shares in total public spending and GNP were 9.1 percent and 2.9 percent on average respectively during the same period. Emil and Yılmaz (2003: 33-34) argue that these figures are not low by developing country standards, but significantly lower than developed countries' associated figures.

From 1993 to 1998, share of health spending in total public spending and GNP declined significantly from 12 percent to 7.9 percent and from 2.9 percent to 2.3 respectively (see Figure 5.8). In the year of the Marmara Earthquake, 1999, health spending's share in expenditures went up to 9.1 percent, while its share in GNP rose to 3.3 percent. In 2000, both measures increased by 0.2 percentage points, reaching 9.3 percent and 3.5 percent, respectively. Then in the year of the financial crisis, expenditure share of health spending fell sharply by 26 percent, hitting its lowest point of the last decade with 6.9 percent. There was also a decline in its GNP

share by 8.7 percent in 2001. In the next year, the share of health in total public spending rose to 8.1 percent, which was still lower than its level prior to the crisis, whereas the share of health spending in GNP recovered to 3.5 percent, the same high level as in 2000.

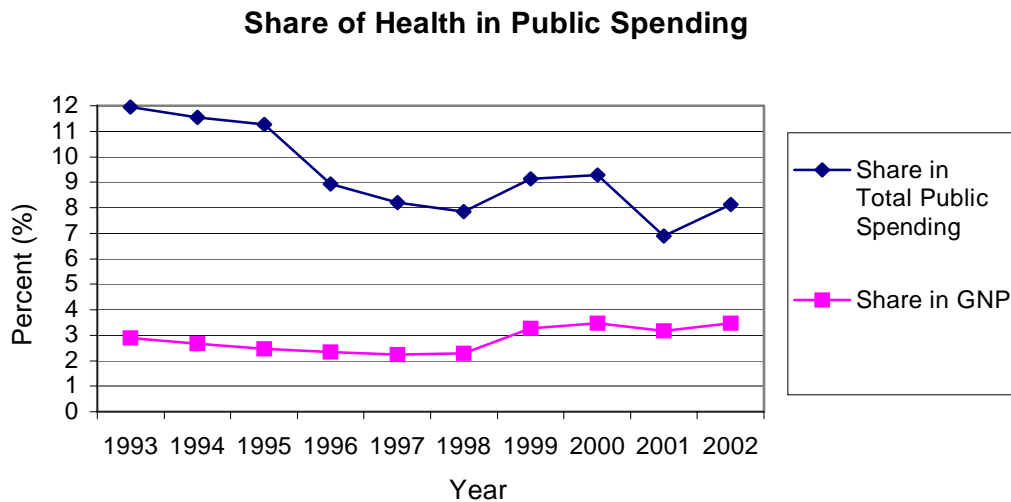


Figure 5.8 Share of Health Expenditures in Total Public Spending and GNP, Turkey, 1993-2002

Source: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>.

As in the case of educational spending, per capita levels of health spending give a better view of how the benefit of this type of spending for the population has changed on average during this period. As Figure 5.9 demonstrates, this measure of health spending was hit severely in the crisis years of 1994 and 2001. In the first of these years, 1994, per capita public spending on health plunged deeply by 15.1 percent. It continued to fall from 1995 to 1998, but with a slower pace of 1.4 percent per year. Then in 1999, per capita health spending jumped sharply by a rise of 24.9 percent, reaching its pre-crisis level in 1993. In the next year, the measure rose by an additional 7.8 percent and attained its highest level of the period under discussion. However, public health spending per capita dropped by 18.3 percent in the second of

the financial crisis years, 2001. Although it recovered significantly in 2002 with a 15.6 percent rise, it was still below its level in 2000 by 5.6 percent.

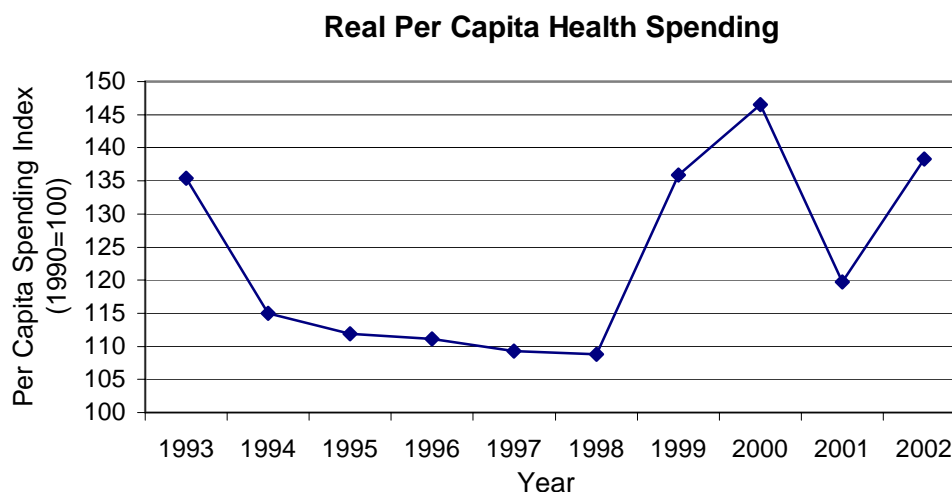


Figure 5.9 Real Public Spending on Health per Capita, Turkey, 1993-2002

Source: State Planning Organization, *Main Economic Indicators, 1950-2003*, online edition, which is available at <http://ekutup.dpt.gov.tr/ekonomi/gosterge/tr/1950-03/esg.htm>.

Hence, real public spending on health per capita has declined significantly in 1994 and 2001, the two economic crisis years. But again, it is the distribution of the benefits of this kind of public spending that has direct effects on the living standards of the population, most notably, those of the poor. As in the case of education, one specific category of health spending, which is preventive health care, is more valuable for the poorest segments of the population, who simply cannot afford the costs of curative health care and depend on preventive public health care institutions for their health problems. Figure 5.10 shows the distribution of public spending on health among spending categories for the 1996-2002 period as calculated by Emil and Yılmaz (2003: 33, Figure 6). It is clear that the curative health care has been consuming the bulk of the health expenditure with a share of more than 80 percent. Moreover, the small share of the preventive health care, which was around ten percent in 1996, declined significantly in 2000 to six percent. Hence the distribution of health spending does not seem to be pro-poor and less so after 2000.

Distribution of Public Spending on Health

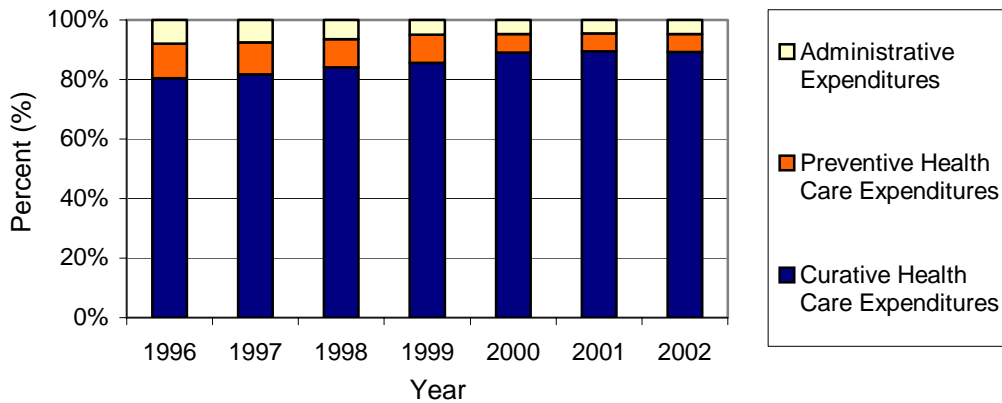


Figure 5.10 Percentage Distribution of Public Health Spending according to Service Categories, Turkey, 1996-2002

Source: Emil and Yılmaz (2003: 33, Figure 6).

- **Social Assistance**

The last component of public social spending in Turkey is social assistance spending. Under this type of spending, the government generally makes direct or in-kind transfers to the poor and vulnerable segments of the population. Hence, social assistance spending is the most direct way to serve poverty alleviation objectives, and protect the poor segments of the society, especially during the crisis periods. Although its magnitude, 0.6 percent of GNP in its peak year in 2001 is very small compared to other two types of social spending in Turkey, the share of social assistance in total social spending, and hence, its relative importance, has almost doubled from 3.8 percent in 1993, to 7.4 percent in 2002.

There are four main social assistance mechanisms/institutions within the governmental structure of Turkey (Seyyar, 2003: 58-63), which are:

- Social Assistance and Solidarity Fund (SASF)**: Provides monetary and in-kind benefit to the needy people at the discretion of the directors of the local branches. Although there are serious criticisms to the SASF for distributing

benefits on the basis of political support¹⁹, its spending has been growing steadily since 1996. Currently, SASF is the largest program of social assistance in Turkey (see Figure 5.11).

ii) Social Services and Child Protection Agency (SSPCA): Its main aim is to provide assistance to the children that require protection, the elderly and the disabled through monetary benefits, orphanages and old people's homes.

iii) Old Age and Disability Assistance Scheme (OADAS): Administered by the Civil Servants' Retirement Fund, OADAS distributes monthly monetary benefits to the elderly with no social protection, and the people with more than 40 percent disability.

iv) Green Card Scheme: Administered by the SASF and the Ministry of Health, this scheme provides health services free of charge to the people with no social insurance and a monthly income of less than one-third of the net minimum wage.

The amount of spending under each of these programs was at very low levels between 1994 and 2002. Average annual expenditures of SASF, SSCPA, OADAS and Green Card Scheme during this period was 0.16 percent, 0.05 percent, 0.09 percent and 0.11 percent of GNP respectively. Although the spending levels have increased since 1996, they are still below the international standards, which range between 0.7 to over one percent of GNP (World Bank, 2002: 23). Hence, in the current situation, social assistance spending is far from being an adequate safety net mechanism due to the insufficiency of its resources.

¹⁹ See Şenses (1999) for a detailed assessment of the organization, resources and the activities of the SASF.

Share of Social Assistance Expenditures in GNP

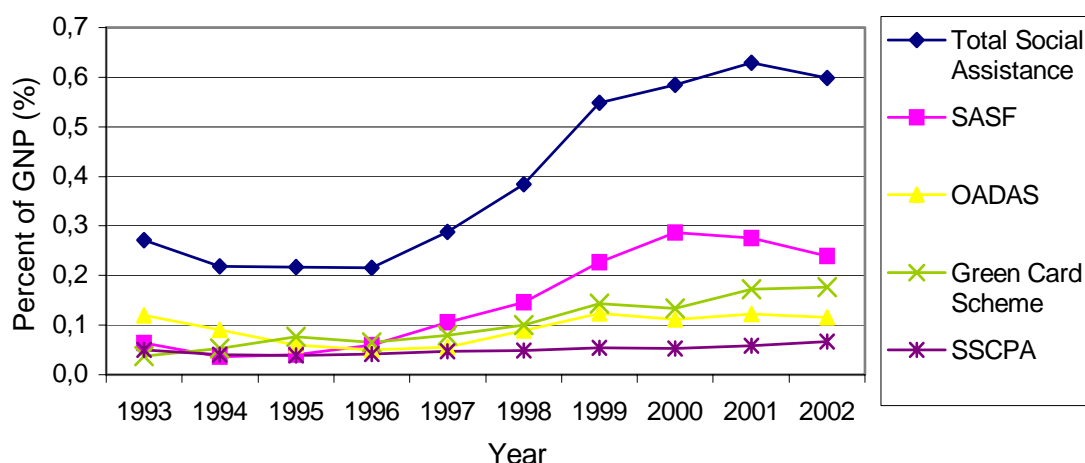


Figure 5.11 Share of Social Assistance Expenditures in GNP, Turkey, 1993-2002

Source: Ministry of Health (2003: 68); SHP (2002: 27, Table 14); World Bank (2000b: 60, Table 2); BYDK (2003: 14); <http://www.emekli.gov.tr/ISTATISTIK/65yas.html>; <http://www.muhasabat.gov.tr/mbulten/T4-2-6.htm>.

More importantly, closer inspection of social assistance payments on a real per capita basis reveals that they have been mostly pro-cyclical, increasing during the boom periods and contracting in crisis years (see Figure 5.12). When the 1994 crisis hit the country, real per capita spending on social assistance declined by more than 25 percent. Then in 1995 and 1996, under the post-crisis stabilization program, while the Turkish economy was recovering slowly, it recorded small rises of 4.6 percent and 3.4 percent. From 1997 to 1999, per capita social assistance spending jumped with an average growth rate of 30.6 percent annually. In 2000, it rose by another 8.6 percent, only to be offset during the 2001 crisis; social assistance spending declined by 9.1 percent in 2001. In the next year, when the economy expanded by nearly eight percent, the contraction in social assistance payments was 2.7 percent. Hence, despite its significant growth during the period, social assistance spending of the Turkish government between 1994 and 2002 failed to fulfill its primary task as a safety net mechanism; protecting the poor and the vulnerable segments of the population during the years of economic downturn.

Real Per Capita Social Assistance Spending

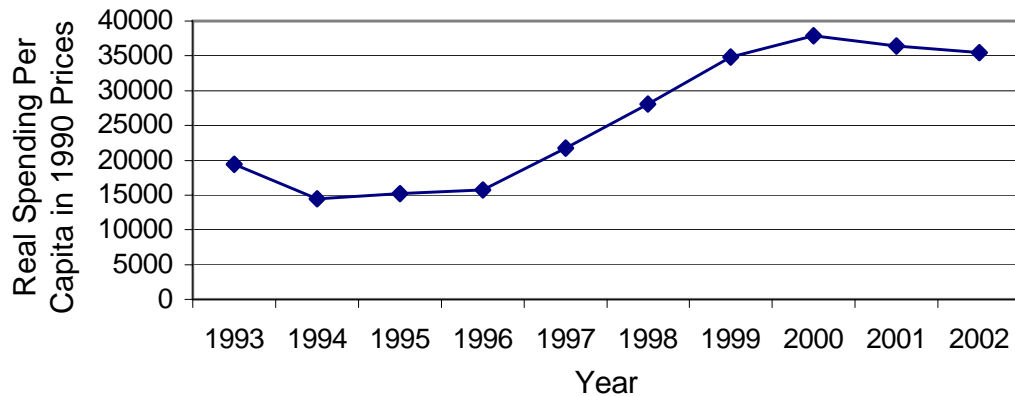


Figure 5.12 Real Per Capita Spending on Social Assistance, Turkey, 1993-2002

Source: Ministry of Health (2003: 68); SHP (2002: 27, Table 14); World Bank (2000b: 60, Table 2); <http://www.emekli.gov.tr/ISTATISTIK/65yas.html>; <http://www.muhasabat.gov.tr/mbulten/T4-2-6.htm>.

On the benefit incidence of the social assistance payments, all studies emphasize the ineffectiveness of the social assistance system in Turkey. Main problems stem from its scattered structure, where four institutions, working for the same aim, lack coordination and consistency among themselves. Firstly, their target populations overlap with each other. It is theoretically possible that an elderly person without social insurance to get benefit from all of the institutions, for example. Secondly, the SASF does not have a clear-cut eligibility criteria and the criteria for the Green Card is loosely implemented. The SASF distributes assistance based on the discretion of the directors of its local branches, who are local government officers, or the village heads –*muhtars*. Anecdotal evidence indicates that this structure produces inclusion and exclusion errors²⁰. For the inclusion error, Şenses (1999: 442-446) states that it is most possible that the assistance payments of SASF have been distributed in a politically biased way, giving priority to the supporters of the party in office, at least in some localities. A similar case emerges for the Green Card; for

²⁰ These errors occur when an ineligible person gets social assistance, and when eligible one cannot, respectively.

example, half of the total population of a city holds Green Card (Dansuk, 2003, 245). For the exclusion error, Buğra and Keyder (2003: 40) argue that many *muhtars* have refused to give SASF benefits to the young and unemployed poor men, although they were eligible for aid. Hence, it seems that the current social assistance system fails to distribute its scarce resources in an efficient way, further diminishing its limited positive effect on the living standards of the poor.

5.2.4 Responses to the 1994 and 2000-2001 Crises

Socioeconomic effects of economic crises generally emerge as declining social spending, increasing inequalities, worsening of poverty incidence, and deterioration in living standards of the population in general. However, governments always have the option to adopt active social policy measures for protecting the most vulnerable segments of the population, as a response to the crises. These measures typically consist of public work programs, making cash or in-kind payments to the poor conditional upon educational or health attainment, and labor training programs. A government's choice over implementing such programs in the wake of a crisis will mostly depend on its approach to the social issues. Governments who implement active social policies at non-crisis times will be more likely to take measures to mitigate the negative effects of the crisis during the crisis periods.

Nevertheless, two other agents' reactions in this vein will also influence the government policies. These agents are the international institutions –namely the Bretton Woods Institutions– and the own citizens of the country. After the crises, nearly all of the countries implement structural adjustment and stabilization programs, which are supervised and financed by the BWIs. Hence, the IMF and the World Bank would easily influence the government's choice on the active social policies, when they stand for or against them. However, Şenses (2002: 22) draws attention to the fact that BWIs have a strange role, when they support active social policy measures after the crises. Since the financial crises are linked to the structural reforms supported by the BWIs, efforts to mitigate the negative effect of the crises make the BWIs look like “attempting to cure a chronic disease to the infliction of which they have contributed in a major way”. For the people of the country, it is not

that easy to affect the government's decision. But the public demonstrations with prospects of political and social instability may induce the government to pursue active social policies. Moreover, the BWIs' increasing attention to the social issues seem to be originating from the linkage between the negative socioeconomic effects and the social reactions, since the latter create serious threats over the sustainability of the post-crisis stabilization programs.

In Turkey, socioeconomic effects of the 1994 and 2000-2001 crises were generally in line with the expectations of worsening living conditions, as analysed in previous sections. However, there has been little – as in the case of 2000-2001 crises– or no –as in the case of 1994 crisis– progress on the active social policy front after these crises. In this section, post-crisis reactions of the government, the BWIs and the Turkish people in the context of social policies are assessed in order to understand why such policies has not erupted as a policy response.

- **1994 Crisis**

Turkish government undertook the April 5 stabilization program after the 1994 crisis. This program did not involve any measures to cushion the negative effects of the crisis (see Section 5.1.1). On the contrary, its fiscal austerity component, which was composed of wage suppression and cuts in public spending, further depressed the income of the vulnerable groups and exacerbated the initial impact of the crisis. Moreover, the government transferred 74 percent of the Social Assistance and Solidarity Fund's income to the general budget in 1994 (Şenses, 1999: 439, Tables 1-2). This action by itself suffices to demonstrate the government's approach to the social policy measures after the 1994 crisis.

Although the IMF did not actively participate in the making of the April 5 program, the Fund supported it with a Stand-By credit. Since there are not any IMF documents available on the program or its implementation, one cannot boldly argue that the Fund did not recommend any active social policy measures. But considering that such social issues were not on the policy agenda of the IMF in the first half of the 1990s, it is more likely that the Fund approved the program, which was totally in

accordance with the typical IMF-supported stabilization programs, without any reservations. The World Bank was on the scene with sectoral reform loans, particularly aiming at the privatization and social security system reform components of the program. The only World Bank document discussing the 1994 crisis and the stabilization efforts does not include any statements on the socioeconomic effects of the crisis and the stabilization program (World Bank, 1996). However, it commends the labor compensation and relocation plans of the government within the context of the privatization plans as a tool for gaining political support for the divestiture of state economic enterprises (World Bank, 1996: 48-49). It can, however, be said that the World Bank did not give importance to the active social policies as a response to the 1994 crisis.

Immediate reaction of the public to the crisis was confined to the demonstrations of the labor unions in 1994 (Şenses, 2002: 23). Despite the initial ineffectiveness of these demonstrations, public anger against the crisis and the stabilization program produced an important result: “a major dislocation in Turkish politics” in the December 1995 elections, as Cizre-Sakallıoğlu and Yeldan (2000: 501) have put it. Authors of this study argue that the winner of the 1995 elections, Welfare Party (WP) with its open Islamist stance, owed its success to the reactive voting of the urban poor. In the absence of notable leftist alternatives, WP gained the support of the low-income segments with its main slogan of ‘Just Order’ and a solid stance against the inequalities within the economic system. This enabled the Party to more than triple its votes from around six percent in the previous elections to 21 percent in 1995 elections. Although the coalition government led by the WP did not change the direction of the economic policies as the WP had promised, Şenses (1999: 438) reports that the Party gave higher importance to the poverty alleviation policies. While the WP was in office in 1996 and 1997, real net income of the SASF increased by 106 percent and 140 percent respectively²¹. This sharp rise was mainly due to the WP’s resistance against the measures for using SASF’s resources for other purposes.

²¹ At the same time, the WP was accused for using the resources of SASF for obtaining political support during this period. See Şenses (1999: 445-446) for details.

Even if the WP-led government did not establish new anti-poverty mechanisms or safety nets, their contribution to the existing mechanisms can be seen as an indirect outcome of the public reaction after the 1994 crisis.

- **2000-2001 Crises**

When the country was hit by the first of the twin crises in November 2000, the government was already implementing an exchange rate based stabilization program with the full support of the IMF and the World Bank. The program did not include any measures on the social policy front. Moreover, the revised version of the program²², which was announced in December 2000, did not contain any statements about the possible negative socioeconomic effects of the November crisis or any measures to deal with them, either. After the eruption of the February 2001 crisis, this revised program was also abandoned and a new stabilization program –The Strengthened Program (TSP)– was announced at the beginning of May. A new economic team led by the newly appointed Minister of Economic Affairs, Kemal Derviş, prepared the strengthened program. Derviş was a Vice President at the World Bank, responsible for the Poverty Reduction and Economic Management Unit, before his new appointment. Under his management, and with the participation of the World Bank, Turkish government seemed more active on the social issues compared to the post-1994 crisis period. Nevertheless, the social side of TSP was very limited considering that Derviş had recently been in charge of World Bank’s program on the struggle against poverty.

At the last paragraph of the Turkish government’s May 3, 2001 dated Letter of Intent to IMF dated May 3 2001, which was presenting TSP to the Fund, it was stated that the government intended to “strengthen our social protection programs, with the support of the World Bank, to help reduce the impact of the economic downturn on the most vulnerable sections of the population”. Interestingly, such a phrase was not included in the previous version of the program²³, which was

²² Letter of Intents of all Turkish stabilization programs are available at the IMF web site: <http://www.imf.org/external/country/TUR/index.htm?pn=0>.

announced to the Turkish public in mid-April as the ‘Program for Moving to a Stronger Economy’. Instead, reducing the public debt burden was declared as a tool for reducing the income inequalities and the poverty in the long-term in that version. The difference may be due to the interim discussions of the government with the World Bank, but of course, it is not possible to identify the exact reason.

The intentions of the government seemed to be materializing when the World Bank approved a \$500 million Social Risk Mitigation Project (SRMP) loan in August 2001. SRMP purely aimed to improve the social safety net mechanism of Turkey both institutionally and financially in order to mitigate the negative effects of the crisis. The Bank agreed to make a disbursement of \$100 million instantly to support the ongoing social assistance programs of the SASF on the conditions that the government shows a satisfactory macroeconomic performance and fulfils the initial conditions of the SRMP (World Bank, 2001a: 23). The rest of the loan was going to be used for the institutional development of the Turkish safety net mechanism and two new safety net programs: Conditional Cash Transfers and Local Initiatives.

Although the magnitude of first part of the loan was far away from being a cure for the negative effects of the crisis²⁴, it was better than nothing as an initial response. In addition, the second component of the SRMP would have been beneficial for the long needed development of the Turkish social assistance system. However, the available evidence²⁵ shows that the project could not be implemented as it was planned. An audit report on SASF states that the SRMP funding was not available to the SASF for 2001, and the amount of credit obtained in 2002 was only

²³ First version is available at Central Bank’s website:
http://www.tcmb.gov.tr/yeni/duyuru/eko_program/program.pdf.

²⁴ \$100 million was approximately equal to less than 0.1 percent of 2001 GNP or one-fourth of the SASF spending in 2001, which was already at a very low level.

²⁵ World Bank has not published any reports on the implementation of the SRMP after the cited Project Appraisal Report of August 2001 until August 2004, even though there were at least three envisaged reviews of the project for the interim period. This prevents a comparison of the BYDK (Turkish acronym for Prime Ministry High Auditing Council) (2003) data with the Bank’s, but at the same time, it may be taken as an evidence for the implementation problems.

3.3 trillion TL, that is less than \$3 million (Prime Ministry High Auditing Council–BYDK, 2003: II). Since the initial disbursement of \$100 million was planned to be transferred directly to the SASF until the end of 2001, this means that the implementation of SRMP was delayed for a long period. The BYDK report does not deal with the reasons of the lack of funding, but it is most likely that the Turkish government failed to fulfill its initial commitments for the loan, so that the Bank suspended the disbursement. Considering that the first of the two conditions, macroeconomic performance, was found satisfactory for other loans of the World Bank (World Bank, 2003b: 2-3), the problem seems to be related to the fulfilment of the initial conditions of the SRMP associated with the SASF. Most important of these conditions was an increased funding for ongoing SASF operations. On this issue, the BYDK (2003: II) reports that the 40 percent of the 2001 income of the SASF was diverted to the general budget of the government. The same figure was 34 percent in 2000. Hence, the government preferred to use more of SASF resources for non-social expenditures in 2001, rather than allocating more funds to this institution.

Therefore, the government's initial actions within the framework of SRMP came out to be rhetorical declarations, as it continued to neglect the social assistance issue in 2001 when the poorest households needed aid much more than ever. At this point, it should be noted that World Bank's attitude was also far away from being effective. Although the Bank took an important step by bringing the social spending concerns forward at the beginning, it was not successful at pursuing the Turkish government to carry out the SRMP commitments. The strengthening of the social assistance system was one of the 'triggers' of the World Bank lending (World Bank, 2001: 25, Box 5), but half- or late- implementation of the SRMP did not cause the Bank to stop or slow down its general lending level, except the funds of the SRMP itself. On the contrary, World Bank (2003c: 11) states that the overall Bank lending has slowed down when the pace of the economic reform process has declined, i.e. when the Turkish government made some unplanned increases in the pension payments at the end of 2002, starkly showing the priorities of the Bank.

Another point of criticism for the World Bank stems from the motives of the SRMP. The Bank has declared that the social pressures emanating from the negative effects of the crisis would constitute a major risk for the economic reform program of the government, but strengthening the safety net through the Bank's SRMP would help the government to gain political support (World Bank, 2001a: 11). So, the name of the loan, Social Risk Mitigation, originates from the risks for the economic program caused by the society, rather than the risks for the society caused by the program. Hence, similar to the Turkish government, World Bank does not seem to be putting the social issues on the top of its agenda.

The IMF's role in the post-crisis social programs was limited to a passive one. IMF statements on the strengthened program and its implementation did rarely include the social issues, and when they did, those parts of the statements would be quite short, generally reiterating World Bank's views. For example, when the journalists asked Michael Deppler, Director of the European I. Department of the IMF, about the possible political implications of a reduction of public employment due to its huge social costs, he responded that there were certain aspects of the program for reducing and equally distributing its negative impact²⁶. This statement is in line with the Bank's view on the linkage between the political support for the program and the social policies.

Public reaction to the 2000-2001 crises was more intense than that of the 1994 crisis. The demonstrations were held in many provinces and some of them involved violence and damage to property (Şenses, 2002: 22-23). Interestingly, organized segments of the self-employed were leading these demonstrations, instead of trade unions²⁷, and one of the most affected groups, the poor, were not involved. Another interesting feature of the demonstrations was that they were not only against the government, but also the IMF and the World Bank. In any case, the demonstrations faded away after the announcement of the strengthened program. But

²⁶ Transcript of the press meeting is available at <http://www.imf.org/external/np/tr/2002/tr020204.htm>.

²⁷ Şenses (2002: 23) notes that the number of strikes of labor unions declined in the crisis period.

while the demonstrations were effective, many comments warning the government for a possible social explosion appeared on the media²⁸. Such a possibility may have played a role in the initial rhetorically active position of the government for pursuing stronger social policies.

As in the case of 1994 crisis, public reaction to the economic situation was sharply reflected in the following general elections, which took place in November 2002. None of the three parties that constituted the coalition during the crisis period could take enough votes to jump over the 10 percent threshold for entering the National Assembly. Moreover, only two parties, which were not present in the composition of the National Assembly during the crises, were granted this right. Justice and Development Party (JDP), which was one of the successors of the Welfare Party, won the majority in the assembly by collecting 34 percent of the votes, and the Republican People's Party (RPP) followed it with 19 percent. During the election campaign, JDP was distinctive with its focus on income inequality and poverty issues. This enabled the Party to collect the reactive votes of the vulnerable segments of the society, which bore the brunt of the crises. Similar to the success of its ancestor, Welfare Party, main factor behind the JDP's success was the public reaction against the crises and the stabilization programs. However, Şenses (2003: 333) states that the JDP government has laid off its poverty alleviation focus after the elections.

²⁸ Two of them were of particular interest. At the National Security Committee meeting on 29 June 2001, the military wing of the committee had presented a report to the government members. This report had warned them about the negative effects of the economic program on the public, and stated that "there may emerge a social explosion in the near future". Second news on this subject gave the results of a public opinion survey, which showed that, 59.7 percent of the respondents believed that "there would be a social explosion in the coming days". See <http://arsiv.hurriyetim.com.tr/hur/turk/01/06/30/turkiye/01tur.htm> and <http://www.radikal.com.tr/haber.php?haberno=16817&tarih=07/10/2001> respectively for these news.

CHAPTER 6

SUMMARY OF FINDINGS AND CONCLUSION

This study has investigated the socioeconomic effects of the economic crises and the stabilization and structural adjustment programs based on the experiences of Argentina, Indonesia and Turkey during the 1990-2002 period. In addition, crisis responses of the governments, the public, and the BWIs have also been discussed.

In the first step, we have documented the changes in the main socioeconomic indicators during the 1990-2002 period for Argentina, Indonesia and Turkey, focusing on the individual crisis periods of these countries. Investigated indicators were: unemployment; real wages; income inequality; poverty rate; levels of the public spending on education, health and social assistance; and health and educational indicators.

Reviewed studies in the second chapter revealed that the socioeconomic effects of the crises and the post-crisis programs were most likely to be negative, but there emerged also some positive or mixed results in a number of countries (see Table 2.1). Results of our study support this picture. Our main findings indicate that there is a tendency toward the deterioration of socioeconomic conditions during the economic crises and the SSAPs (see Table 6.1). However, the findings also show that one should leave some room for the peculiarities of individual countries in such a generalization, as some indicators had moved in the opposite direction of the general tendency. For example, during the 1997 Indonesian crisis, income inequality and health indicators improved. Moreover, the impact on specific indicators varies significantly between countries. Health spending of the government did not change during the 1997 Indonesian crisis, but significantly worsened during the 2001

Argentine crisis, and the fall in public health spending during the 2000-2001 Turkish crises was less pronounced. Finally, the indicators of individual countries behave differently under different crises and different SSAPs. In Argentina, indicators pertaining to real wages, poverty, government's education spending and health spending improved during the Convertibility Episode, whereas they significantly worsened during the 2001 crisis. 1994 crisis in Turkey induced a limited worsening and a significant worsening in unemployment and real wages indicators respectively. But, both indicators worsened mildly during the 2000-2001 crises.

Table 6.1 Summary of Socioeconomic Effects of Crises and Post-Crisis Programs in Argentina, Indonesia and Turkey

	Argentina		Indonesia	Turkey	
	<i>Convertibility Episode</i>	<i>2001 Crisis</i>	<i>1997 Crisis</i>	<i>1994 Crisis</i>	<i>2000-2001 Crises</i>
<i>Indicators:</i>					
<i>Unemployment</i>	W	W	LW	LW	W
<i>Real Wage</i>	LI	SW	SW	SW	W
<i>Income Ineq.</i>	SW	SW	I	SW	I*
<i>Poverty</i>	LI	SW	SW	W	SW
<i>Educ. Spending</i>	I	SW	NC	SW	LW
<i>Health Spending</i>	I	SW	NC	SW	LW
<i>Social Ass. Spe.</i>	NC	W	I	LW	LW
<i>Educational Ind.</i>	...	...	NC	LW	LW
<i>Health Ind.</i>	I	...	SI	...	...
<i>Responses:</i>					
<i>Government</i>	Limited	Limited	Significant, Late	No Response	Limited
<i>BWIs</i>	No Response	Limited, Late	Limited, Late	No Response	Limited
<i>Public</i>	...	Widespread Protests	Widespread Riots, Civil Violence; Social Explosion	Limited Response, Reactive Voting	Public Protests, Reactive Voting

Scale for the changes in indicators (from worst to best):

SW: Significant Worsening, W: Worsening, LW: Limited Worsening, NC: No Change, LI: Limited Improvement, I: Improvement, SI: Significant Improvement.

*: Results of the associated income survey, which showed that there has been improvement, are found to be highly controversial, see Section 5.2.2 for details.

As these findings demonstrate, economic crises are most likely to worsen the living standards of the population. However, governments may cushion the negative socioeconomic effects of crises by adopting active social policy measures, which are known as social safety net programs. In this regard, one of the aims of our study was to answer related questions such as “What are the differences of social policy components of individual countries’ post-crisis programs?” and “Why was the social policy component neglected in some countries, while some others pursue active social policy measures in the post-crisis periods?”, as stated in the first chapter. Since the governments’ decision on the adoption of social safety net programs depends on the associated responses of the BWIs and the public, we investigated how each of these agents behaved during the crisis periods in Argentina, Indonesia and Turkey in the second step of the study to answer these questions (see Table 6.1). Our analysis has revealed that among the countries under our consideration, only Indonesia had implemented these programs rigorously in the post-crisis period. Moreover, the implementation of social safety net programs in Indonesia had emerged after a long period of social protests, riots and deep civil violence, which necessitated the resignation of the 30-year ruler of the country –President Suharto. The BWIs, which were not advocating any kind of active social policy measures during the initial phases of the post-crisis period, agreed to support the Indonesian safety net programs against the background of social protests, when the new government constructed these programs. Hence, the governments’ active social policy response to the crises seems to have stemmed from the strong reaction of the public to the negative socioeconomic effects of the crises. The reaction chain of this process is illustrated in Figure 6.1.

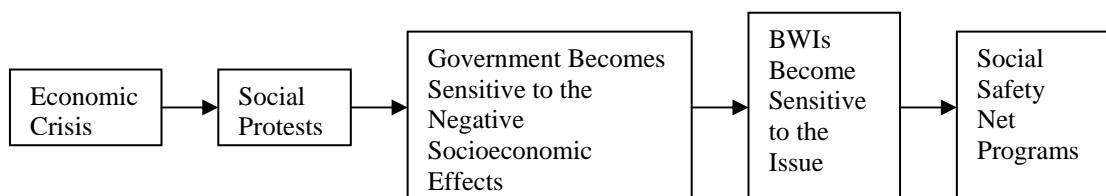


Figure 6.1 Reaction Chain – From Social Protests to Safety Net Programs

In Argentina, the government seemed to expand the existing safety net programs after the 2001 crisis as a response to the public protests, but it allocated a limited amount of funds for this issue so that the per capita public spending on these programs fell during the 2001 crisis. In Turkey, the government did not launch any safety net programs during the 1994 crisis, when the public response to the crisis was confined to some trade union demonstrations. In the wake of the 2000-2001 crises, however, the social protests were more widespread and even the Turkish military was concerned over the possibility of a social explosion. In response, Turkish government stated that the new stabilization and structural adjustment program would include safety net measures with the support of the World Bank. However, there were not any efforts in this respect during the 2001-2002 period. Moreover, the public spending on social assistance programs actually fell in the crisis year of 2001. Hence, in Turkey and Argentina, the chain seems to have been broken at the government's part.

With regards to the second question above, the differences in the actual social policy responses of the three governments seem to stem from three reasons. The first one is the historical approaches of the governments to the social issues such as inequalities and poverty. In Indonesia, government had a traditional role of promoting equitable growth since the late 1960s. The country's inequality level has remained stable at a low level since then, and the poverty rate has declined. On the other hand, neither the Argentine government, nor the Turkish one saw these issues as part of their sphere of responsibility at least over the last two decades. In these countries, income inequality worsened during the last 20 years. This partially explains why both governments' social policy responses to the crises have remained at a rhetorical level. The second reason is that the governments tend to loosen their initial stances at the social policy front, as the effects of the crises wear off and the protests subside over time. For example, the demonstrations in Turkey had vanished by the end of 2001, reducing the pressure on the government. This may have resulted in a loss of momentum of the efforts on the social policy front. The third reason, which is more helpful in the Turkish case, pertains to the political organization level of the poor. In Turkey, the poor lack a significant form of political organization, and

hence, they are not a part of the active politics. This problem presents itself most acutely during the crisis periods. While other segments of the population organize public protest to protect their rights, the poor, probably the most crisis-affected section of the society, are hardly visible as an active participant in the political arena. Consequently, governments, who do not see a political threat in this regard, do not actively pursue the measures that would help the poorest segments.

The most obvious way to solve all kinds of crisis-related problems is naturally not to experience another crisis. This is possible through a set of policies that would correct the structural deficiencies of the economies and define an equitable growth trajectory to move on. This trajectory should be based on rapid growth and industrialization objectives, accompanied by redistributive policies. However, given the difficulty and the long-term nature of achieving this task, governments should adopt more direct kinds of policies that would protect the societies from the negative socioeconomic effects of the crises. Most viable way for this purpose is to construct safety net mechanisms in the non-crisis periods that would expand during the crisis periods. But the momentum of these policies should be kept for a longer time than the crisis itself, since the positive trends in socioeconomic indicators emerge more slowly than their negative counterparts. The last point to note is that the governments should support the political organizations of the poor in order to make them an active part of the political system.

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