Statement by Richard H. Kaijuka
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Turkey: CAS and Financial Sector Adjustment Loan

Turkey is now at a crossroads as it prepares itself to join the European Union (EU). It is a case where there is a clear mismatch between the basic economic fundamentals and the liberalization policies, particularly the open capital account policy. This has been a recipe for the financial crisis the country is currently confronted with. Notwithstanding its strenuous efforts to rectify the situation and meet the basic requirements for Turkey’s candidacy to join the EU, an unfinished agenda still remain. Structural reforms in key areas, ameliorating social services, improving productivity and competitiveness and bringing different policies and regulations in line with those prevailing in the EU are daunting challenges that need to be addressed with great perseverance. The stagflation that has set in the Turkish economy for some time is a major force holding the economy back. The frequent earthquakes further complicate the authorities’ task in putting the economy on the proper track. Stringent and bold measures are needed to break the vicious circle created by this state of affairs.

We are comforted by the briefing made by Mr. Johannes Linn and his team last Monday on the recent developments in Turkey, particularly on the way the country is handling the crisis. We agree that addressing the problem requires the collaborative effort of both the Turkish authorities and the international community; the former with improved macro-economic management, and deeper reforms and the latter providing financial resources and non-lending services.

We are pleased with the serious steps the new Government is taking in the context of the Eighth Five Year Plan for 2001-2005, which puts the objective of reversing the critical imbalances and correcting the current economic distortions as a top priority. While inflation, currently at 44 percent, has started a downward trend, bringing it down to a manageable level would entail supporting the recently taken fiscal measures with deep reforms in key sectors and areas, especially agriculture, the financial sector, privatization of public enterprises particularly in the infrastructure sector, the pension system and the exchange rate regime. While the measures taken by the Government earlier on in the year have started to bear fruit, some downside effects of the rapid recovery complicated by high oil prices and the weak Euro have emerged resulting in the overheating of the economy. We hope the austere fiscal package taken within the context of the

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FY01 budget will help in arresting the deterioration the economy is currently experiencing.

On the structural reform front, we welcome the newly introduced reforms. Agriculture is a drain on the budget and holds back the overall economic growth. Support prices for major crops and subsidies to agricultural inputs, privatization of state farms and other distortions also need to be eliminated. The shift in the agricultural policy away from a commodity support system to providing direct income to the farmers, is a step in the right direction.

The bringing of the banking regulations to the Basle and EU standards, with appropriate loan loss provisioning, capital adequacy and foreign exchange exposure, and the setting up of an independent Banking Regulation and Supervision Agency (BRSA) is also welcome. The accompanying Financial Sector Adjustment Loan operation fits well in the Government’s strategy and addresses most of these problems. Therefore, we strongly lend our support to this operation.

While Turkey has frequently demonstrated its ability to weather financial shocks, we believe that the problem of the high level of the short maturity external debt should be given special attention as it has been a major source of financial risks. The Government’s plan to gradually reduce deposit insurance from the current high level of 100 percent is a proper course to follow in our opinion. This high level of insurance has been a major incentive for agents in the financial field to engage in risky behavior. Commercial banks should also be encouraged to diversify their assets through less dependence on government securities and increasing their lending to the private sector. Corrective actions are also needed to address the issue of connected banking.

We find the Bank Group strategy for Turkey as reflected in Section V of the CAS appropriate. We commend the IFC for its active role in the country, particularly in developing SMEs, which are critical for resolving Turkey’s unemployment problem. We are also pleased to note MIGA’s plan to diversify its activities in the country.

The Bank’s 2001-03 CAS focus on the social services, particularly education, health, social protection, disaster mitigation and information technology is well in place. The performance benchmarks in paragraph 60 also look realistic. We have no problem with the size and associated triggers of the medium-term macro-economic scenarios, the Sustained Reform Scenario (SRS) and the Transacted Reform Scenario (TRS), the high and base lending scenarios, respectively.

Finally, we welcome the Government’s new holistic long vision strategy that aims at putting an end to the stop-and-go policies pursued in the past and get the economy out of the crisis. Ad hoc liquidity injection and withdrawal measures cannot provide lasting solutions. Speeding up reforms is key for reversing the deteriorating economic situation and calming investors’ sentiments. We would encourage the Bank to, in close collaboration with the Fund, monitor the situation with the Turkish authorities and provide the needed support.

We commend the Staff for their excellent work and wish the Turkish authorities all success in their efforts to address the crisis.