Statement by Philippe Peeters/Emin Dedeoglu
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**Turkey: Country Assistance Strategy**

On behalf of our Turkish authorities, we would like to thank Bank staff for the comprehensive CAS document which thoroughly and candidly presents the Bank Group strategy, as well as Turkey’s reform needs and the current situation in the country.

After decades of high inflation and underlying structural weaknesses in economic policies, the government launched a comprehensive economic reform program backed by an IMF Stand-by Agreement in late 1999. The CAS document sufficiently elaborates the components of this effort. Hence, we would like to highlight salient features of the program and provide an overview of the Bank agenda in connection with the overall situation of the economy.

Economic reforms in Turkey are being carried out broadly along in two parallel tracks: macroeconomic and sector reforms.

**Macroeconomic Policies**

The first and foremost track of the reforms aimed to reach sound macroeconomic balance mainly through reinstating fiscal discipline and tight monetary policy. These policies are geared to curb inflation in three years time to single digits. First year record has been successful in many aspects:

- Fiscal policy has been implemented rigorously to achieve the 3% target of primary surplus of consolidated public sector. November data indicated that this target will be met with a comfortable margin.
- Growth resumed strongly: after a 6.6% contraction in 1999, the economy is expected to grow close to 6% in 2000.

However, inflation proved to be much more stubborn than envisioned and it is expected to be 35% annually, against a target of 25% in 2000. Although this could be deemed as a success compared to the 69% inflation a year ago, given the crawling peg exchange rate regime, it brought an appreciation in Turkish Lira. This coupled with high oil prices, weaker Euro and stronger domestic demand translated into a current account deficit, which is expected to be around 5% of GNP for 2000.

The 2001 program implementation will be directed to address these weaknesses that became even
more critical after the recent disruption in the financial markets.

Fiscal policy will be strengthened by an additional 2% of GNP as a reflection of the need to ease the pressures on the capital account. Income policies will be proactively used to shift aggregate demand down to a level consistent with the 12% year-end inflation target. In light of these measures and higher than expected interest rates, the growth is expected to slow down.

**Economic Sector Reforms**

The structural reforms undertaken to complement the macroeconomic stabilization policies may be characterized as "first generation" reforms. In several sectors (telecommunication, energy, agriculture and financial sectors), ambitious deregulation and liberalization policies are being implemented. In these sectors, the role of the state has been reformulated as a market regulator instead of being a producer. This is being accomplished by making use of independent regulatory bodies and simultaneously putting in place an equally ambitious privatization program. This part of the overall reform process has benefited from the Bank’s expertise in formulating the policies as well as from the Economic Reform Loan that we have approved earlier this year.

**Banking Sector:**

It was already anticipated that the banking sector would likely be negatively affected (in the short term) from the stabilization package, as was demonstrated elsewhere in the world. Moreover, chronic inflation, universal coverage of deposit insurance for prolonged periods, high public sector financing requirement and ensuing high real interest rates on government paper, structural and institutional deficiencies in the regulatory environment have all contributed to a fragmented and fragile banking system. Notwithstanding the fact that the system was relatively well capitalized, with relatively low level of non-performing loans submitted to the banks, large foreign exchange and interest rate risks exacerbated by the extensive maturity mismatch between their assets and liabilities.

The reform program was designed to address these underlying weaknesses in the system. The main pillars of the program are: 1) introduction of contemporary prudential measures and strictly enforced regulatory framework through establishment of an independent regulatory body, 2) setting out a framework to deal with the problem banks in a most efficient way, and 3) deepening the system by divesting and restructuring the state owned banks.

The recent turmoil has revealed that the sector had been much more vulnerable to external shocks than anticipated and underscored the need to speed up the introduction of measures to reduce vulnerability. This prompted the government to act more decisively to pursue reform process and also heightened the importance and urgency of having a sound and transparent bank resolution mechanism.

**Energy Sector:**

The long term objective of the energy sector reforms is to shift the public resources to social
sectors by creating a competitive market in energy production and distribution as well as a conducive regulatory environment that would encourage private sector to step in.

The draft electricity law that has been recently submitted to the parliament establishes an independent regulatory body and sets out the framework for privatization of generation plants and distribution companies. The government has also been assuming large fiscal risks in the form of contingent liabilities by extending a wide range of guarantees to BO and BOT projects.

**Agriculture Sector:**

Although the relative share of agriculture sector in GDP has been declining steadily since 1980s, more than 40% of workforce is still employed in agriculture. At the heart of the reform program lie measures to replace ineffective and costly support and subsidy schemes with targeted income support, directed explicitly to the poorer segments of farmers. The credit subsidies have already been phased out, input and price subsidies were reduced extensively during the first year of the program. By the end of next year, the modalities to fully implement the direct income support will be completed.

The reform process will be complemented by privatization of major SOEs in sugar production and tobacco sector in 2001.

Further analysis of other factors underlying the low productivity increase in the sector would shed light on the future design of sectoral priorities given the relative importance of agricultural sector in employment.

**Privatization:**

The privatization agenda serves the dual purpose of improving economic efficiency and reducing the financing requirement of the public sector. Total privatization proceeds in 2000 amounted to US$ 5.6 billion of which US$ 3.5 billion was collected in cash and the remaining US$ 2 billion is due in 2001. Although this amount falls short of the target, it marks an unprecedented effort since the inception of the privatization program back in 1986. The authorities are determined to pursue this ambitious privatization agenda with major outright block sales of Telecom and Turkish Airlines shares which are to be finalized by the first quarter of 2001.

The proposed Privatization Social Support Project addresses the social dimension of the privatization program by providing additional resources and setting in place a framework whereby social protection policies could be adequately extended to cover the workers who are affected by the privatization or the restructuring. This is clearly an indispensable component of the overall stabilization program. It would help to sustain the social cohesion and the support that is required to implement hard measures in later stages of the reform process.

**Public Sector Reform:**

The Public Sector Management Reform is an integral part and the most important chapter of the
overall reform agenda in Turkey. In the last instance, weak institutional capacity, lack of strategic policy framework, and an ineffective public governance are at the root of macro and micro imbalances that prevailed during several decades.

Long lasting economic stability hinges on the ability of the public institutions to respond quickly and promptly to the evolving market conditions, to formulate strategic priorities and to implement consistent policies in a way to maximize allocative and operational efficiency.

As with all public management reforms, it is comparatively more challenging for the state as an administrative and bureaucratic establishment to reform itself. It requires a clear vision shared by the society, an appropriate diagnosis, tools for change and adequate motivation to keep the process on track.

Previous attempts of the reform unveiled the major weakness and hurdles in this area. Both the authorities and the Bank have integrated the lessons learnt into their strategy by adopting a more programmatic approach. The ongoing technical work on public accounting, the budget classification and the coding structure would lay the foundations for further more sophisticated reform measures.

The Bank’s role in this process is vital in carrying out the diagnostic work by drawing on its vast international experience. Cognizant of this daunting task, the Bank has completed the CFAA (Country Financial Accountability Assessment), CPAR (Country Procurement Assessment Report), and is working on a PER (Public Expenditure Review), all of which would feed into the design of the coming PSAL.

Upon the request of the Turkish authorities, the Bank is also working on an anti-corruption strategy that would be launched early next year.

**Social Sector Reforms**

The financial imbalances in the social security sector in Turkey exacerbated the fiscal balances throughout the 1990s. The first phase of the reforms in the sector have been introduced in August 1999. However, there is more to be done;

- Coverage and efficiency to be improved
- Private pensions to be established
- Health and pension schemes to be separated.

The government intends to separate the health insurance and the pension scheme. The health care sector has been receiving only 3.5% of the GNP, and the state-run health care system covers a little more than 50% of the population, while the private health insurance scheme is not developed. Therefore, Turkey’s need for support for restructuring the health sector is reflected in the CAS.

The government adopted a new law to increase the duration of the compulsory education from five to eight years which increased the enrollment, particularly among girls. The Bank’s support
has been important for this extension and the new education project will also help the Ministry of Education to further improve the system.

The Bank’s quick response to the earthquake has been highly appreciated by Turkey. As the risk of another earthquake remains, Turkey needs a comprehensive disaster management strategy. A catastrophic insurance scheme has become recently mandatory. The Bank’s experience with disaster management will help to minimize the risks.

Private Sector

The volatile economic environment and macro imbalances have prevented the private sector from developing to its full potential. As one of the major stakeholders, the private sector representatives have been strongly supportive of the stabilization program. The most critical factor for future prospects, both for the private sector and also for sustainability is the lack of FDI in Turkey. IFC and FIAS, together with their private and public counterparts, have been working on a roadmap which will hopefully translate into comprehensive policy measures to attract FDI. Extension of MIGA’s activities in non-financial sectors will be an important vehicle in this respect.

IFC and MIGA activities are crucial for mobilizing the private capital and enhancing the private sector in Turkey. IFC will remain engaged in the development of capital markets and in the support of SMEs.

Recent Turmoil and Policy Actions

Turkey’s determination to continue implementing its reform agenda has been tested during the November turmoil. Albeit with a slight delay, the government reiterated its commitment by strengthening and deepening the measures required for reinstating confidence and putting the program on track.

In fact, the recent problems have not been totally unforeseen. They nevertheless bitterly reminded the authorities that there is no room for complacency yet, and that they need to closely monitor the developments in the markets and to be proactive, when required. It is also fair to underline that the uncertainties on the financial markets have not been matched within the country. As important as these markets are, we should not lose sight of the fact that neither the authorities nor the people abandoned their commitment. And we all in the Bank know how much ownership counts in the success of a reform program.

The crisis revealed extra risks and costs of the implementation of the program. It also showed that the country, while favorably placed in comparison with other countries, still does not fully possess the institutions and expertise to deal with these problems. Not the commitment, but this lack of expertise prevented a swift and more accurate response to the looming crisis.

While this crisis will affect the future of the program, it is still timely to avoid long lasting and deeper effects. A swift confirmation of the strong support from the Bank is critical in this respect. The endorsement of the proposed CAS will provide this signal. With the approval of the two
loans, it will provide Turkey with the opportunity to continue its reform program and with the financial resources it needs to meet its external financing plan.

The endorsement of the CAS, together with the approval of the Supplementary Reserve Facility by the IMF, will also give a clear signal to private investors, as well as to countries and other international institutions, that they can continue with confidence their financial relations with Turkey.