Statement by Yuzo Harada  
Date of Meeting: July 12, 2001

**TURKEY: Country Assistance Strategy Progress Report, Programmatic Financial and Public Sector Adjustment Loan, and Agricultural Reform Implementation Project**

**Introduction**

We appreciate very much the efforts of the Turkish authorities, who developed the new economic program entitled "Turkey's Program for Transition to a Strong Economy" in mid-April, and Bank Management and Staff, who developed this CAS Progress Report in coordination with the IMF, in the face of the crisis after the CAS discussions at the Board in December 2000.

**World Bank's Contribution to the Financing Package**

Appropriate and strong assistance of the IFIs - the IMF and the World Bank - is important for dealing with this crisis. Therefore, we support an IBRD contribution of US$2 billion out of a US$10 billion package of exceptional financing from the IMF and the World Bank (IBRD) in 2001. With regard to IBRD's US$ 2 billion 2001 contribution, it is also appropriate that US$ 0.8 billion will be provided by front-loaded disbursements from the existing US$ 5 billion envelope and US$ 1.2 billion will be provided through new financing under Special Structural Adjustment Loan (SSAL) terms. These changes provide for strong Bank involvement and realization of SSAL objectives.

On the other hand, the Government's program anticipates a V-shaped recovery and that Turkey's access to international capital markets is expected to improve in 2002-03 as confidence returns. However, in light of the two financial crises that have eroded market confidence, the market might have the impression that this projection is somewhat optimistic. We would like to hear Management's view in this regard.

**Priorities of the World Bank**

While the collaboration and package between the IMF and the Bank is integral, it is important to maintain a division of labor such that the IMF would deal with monetary and macroeconomic issues while the World Bank Group would deal with social and structural issues, including the protection of vulnerable groups. Therefore, it is quite appropriate that the Bank Group's revised CAS program increases the focus on banking and public sector reforms and enhances assistance to Turkey in order to strengthen its social protection. Given this direction, the proposed drastic
reformulation of the IBRD lending program, including the cancellation of the Second Tranche of the FSAL I which was approved last December, as well as the postponement and alteration of some operations, has been adequately prioritized in order to correspond to the Government's reform program. Therefore, we endorse this revision.

Having said that, we would like to comment on these prioritized issues.

(1) Banking and Public Sector Reform

A Programmatic Approach, which is proposed by Management in order to deal with the reform agenda, supports a phased implementation of a comprehensive reform program. Therefore, it is an appropriate instrument because it is effective and efficient at dealing with a complex structural reform agenda. Moreover, the proposed array of programmatic loans is important in order to maintain Government incentive for reform because future reforms may slow down as the economy recovers.

We welcome that measures to strengthen the fiduciary framework, including a completed Public Expenditure and Institutional Review (PEIR) and Country Procurement Assessment Report (CPAR) and on-going Country Financial Accountability Assessment (CFAA), have been carried out in designing this instrument.

The timeline proposed for the indicative lending program for the remainder of CY01 addresses the financial and public sectors together concomitantly, reflecting the inter-linkage of the reforms in the two sectors, and later separately, reflecting the institutional detail of each sector. This timeline will appropriately provide for feasible continuation of the reforms.

It is appropriate that the proposed First Programmatic Financial and Public Sector Adjustment Loan (PFPSAL I), the first loan addressing both financial and public sector issues, has a higher proportion of financial sector actions that are needed quickly in order to reduce vulnerabilities in the banking sector. As far as the PFPSAL I is concerned, the proposed assistance to the financial sector, including an overhaul of the regulatory framework for banking activity and state bank restructuring and privatization as well as the assistance to the public sector, including public expenditure management and public liability management, is urgent.

Even if the financial sector, which can directly address the crisis, is focused, its reform agenda, after the February crisis, is now broader than envisaged when the FSAL I was prepared. It is rational that some operations in the financial sector, which were proposed in the CAS, are proposed to be combined into a programmatic approach in order to appropriately and comprehensively address the agenda. Therefore, we support the PFPSAL I which is an important first step in the phased and comprehensive reform assistance program. We wish its successful implementation.

Having said that, we would still like clarification on the PFPSAL regarding three points. First, the PFPSAL document seems to be designed based on the situation and projection as of
May 2001. For example, the possibility of an increase in non-performing loans can now be better predicted than in May, so we would like to hear if there is something additional that needs to be explained. Second, the November 2000 banking crisis resulted from the fact that the asset portfolio of a medium-sized private bank (Demir) was centered on Government securities and thus, financially vulnerable. We would like clarification on how this issue is addressed in the PFPSAL. Third, we would like to hear Management's view at this stage regarding the possible targets before and after the PFPSAL II.

(2) Social Protection

We highly appreciate that this Progress Report also pays attention to assistance to groups affected by the crisis and those potentially affected by structural reforms, such as a social impact assessment. In this regard, we support the proposed Agricultural Reform Implementation Loan, which is designed to mitigate potential short-term adverse impacts of reform in that it assists farmers who will no longer receive price supports and other distortional subsidies, as well as helping implement the Government's structural reform in the agricultural sector, which accounts for 16% of GDP. Budgetary support provided by the PFPSAL is also expected to help the Government finance costs stemming from the financial crisis while continuing to fund critical social programs.

Furthermore, we also appreciate that IBRD selectively prioritizes and continues parallel support to the social sector as this has a positive long-term impact on aspects of the human and sustainable development agenda, such as education and health.

Other Points to be Noted

We would also like to note two points on the overall new Bank lending program.

Regarding one of the Revised Triggers for the High Case envisaging a sustained fiscal adjustment yielding a primary surplus for the consolidated public sector of at least 5.5 percent of GNP, this requirement is critical for maintaining an austerity budget and implementing the Government's program, which incorporated this target, in order not to erode market confidence in the program. We strongly expect authorities' efforts to adhere to the precondition.

Under the High Case lending program with the SSALs, IBRD debt outstanding and disbursed would increase from US$3.6 billion or 3.0 percent of the total IBRD portfolio, as of December 2000, to US$9.2 billion or around 7.2 percent of the total IBRD portfolio in 2003. Such risks are acknowledged by the CAS Progress Report, and a prudent monitoring of Turkey's creditworthiness is important. Furthermore, as financial crises of such a large scale were not predicted until the first crisis in November 2000, the idea of an Early Warning Mechanism should be incorporated in future reform programs and Bank assistance.

IFC
We appreciate that IFC is adjusting its short-term strategy to respond to the financial crisis, while the underlying medium- and long-term strategy remains the same as presented in the CAS. Thus, IFC has a role to play by taking risks; but at the same, as the CAS Progress Report correctly points out, IFC must maintain its reputation as an internationally credible investor with a AAA rating. Therefore, we support the focus on a few key, visible interventions, with strong demonstration effects and positive impacts on market psychology.

In this regard, it is appropriate that IFC proceed with its assistance with the Bank and place priority on (1) the financial sector; (2) restructuring industrial companies; and (3) privatization and FDI. We would like more concrete clarification on the resolution of issues regarding non-performing loans, work with mid-sized banks, and the advisory role in the privatization of Turk Telekom.

Conclusion

The most important thing in proceeding with the reforms entailing various risks and "pain" is ownership backed by strong political will and timely implementation of policies. This applies to all important development agenda, such as achievement of a primary surplus of 5.5 percent of GNP, moving forward on privatization, and protecting social sector spending and bolstering safety nets.

It is necessary to fully recognize, as the CAS Progress Report indicates, that costly debt restructuring, run-away inflation, and a social crisis would occur without implementation of this reform program. We strongly expect and encourage that the authorities maintain a strong commitment and consensus regarding implementation of the reforms.