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Report No.: 21804

PERFORMANCE AUDIT REPORT

TURKEY

INDUSTRIAL EXPORT DEVELOPMENT PROJECT
(Loan 2901)

SECOND SMALL AND MEDIUM SCALE INDUSTRY
(Loan 3067)

PRIVATE INVESTMENT CREDIT
(Loan 3346)

TECHNOLOGY DEVELOPMENT PROJECT
(Loan 3296)

February 8, 2001

Operations Evaluation Department

Currency Equivalents

Currency Unit	=	Turkish Lira
1988 US$1	=	1,422
1989 US$1	=	2,027
1990 US$1	=	2,930
1991 US$1	=	5,080
1992 US$1	=	8,564
1993 US$1	=	14,472
1994 US$1	=	38,726
1995 US$1	=	59,650
1996 US$1	=	94,756
1997 US$1	=	205,491
1998 US$1	=	314,024
2000 US$1		579,391

Fiscal Year

January 1 – December 31

Abbreviations and Acronyms

DM	Deutsche Mark
ECA	Europe and Central Africa
FERIS	Foreign Exchange Risk Insurance Scheme
FSAL	Financial Sector Adjustment Loans
GNP	Gross National Product
GOT	Government of Turkey
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IEDP	Industrial Export Development Project
IFC	International Finance Corporation
JEXIM	Japan Ex-Im Bank
MIS	Management Information System
NAC	National Accreditation Council
OECD	Organization for Economic Cooperation and Development
OED	Operations Evaluation Department
PFI	Participating Financial Institution
PIC	Private Investment Credit
PICP	Private Investment Credit Project
PSBR	Public Sector Borrowing Requirement
PTB	Physikalisch – Technische Bundesanstalt (Metrology Institute of Germany)
SAR	Staff Appraisal Report
SME	Small and Medium Enterprises
SMI2	Second Small/Medium Industry
SOE	State-Owned Enterprise
SPO	State Planning Office
SYKB	Sinai Yatirim ye Kredi Bankasi
TDP	Technology Development Project
TSE	Turkish Standards Institute
TSKB	Turkiye Sinai Kalkinma Bankasi
UME	Ulusal Metroloji Enstitusu (National Metrology Institute)

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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

February 8, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Turkey—Industrial Export Development (Loan 2901, US$287m); Second Small and Medium Scale Industry (Loan 3067, US$202m); Private Investment Credit (Loan 3346, US$198m); and Technology Development Project (Loan 3296, US$97m)

Attached is the Performance Audit Report (PAR) for the above loans to Turkey, made from 1988 to 1998.

The main objectives of the first three projects (the lines of credit) were to increase the availability of medium- and long-term credit, expand production and exports by small and medium enterprises and bolster participating banks. Most of these objectives were not achieved because the lines of credit were implemented during a period of macroeconomic turbulence, with a large and growing fiscal deficit, very high real interest rates and weak financial sector regulation. Two Financial Sector Adjustment Loans (FSALs) implemented at about the same time (1986-92) were not successful in improving these conditions. Disbursements from the credit lines were sporadic, in part due to the formula used to determine interest rates, which often resulted in negative real rates. In most cases, the availability of funds seems to have added little to total credit, but only to have substituted for shorter-term funds available from other sources. However, the credit lines produced some institutional development impact, as banks developed better investment appraisal techniques and a better appreciation for the benefits that long-term funds could bring to their customers.

The Technology Development Project aimed at bolstering the industrial sector by strengthening industrial measurement and standards, testing, and quality systems, supporting R&D, and fostering growth of venture capital. The project was successful at developing national capacity in metrology, standards, testing, and quality, which benefits Turkish exporters and facilitates exports to the European Union (which invited Turkey to become a candidate for membership in 1999). Testing and calibration services are now of high quality and provide real economies to Turkish industry. However, the Turkish Standards Institute failed to set up an independent body to accredit private laboratories as it had agreed with the Bank—a significant shortcoming.

The PAR rates the outcomes of the three credit lines as *unsatisfactory*, sustainability as *unlikely*, and institutional development as *substantial.* These ratings are different than those in the Evaluation Summaries or the ICRs and PCR, which rated outcome as satisfactory and sustainability as likely. The PAR finds that the main *cause* of the shortfall in credit availability, as acknowledged in many Bank studies and in the ICRs and PCR, was the large fiscal deficit, which caused very high interest rates and crowded out industrial borrowers. Also, high inflation diminished long-term funds that banks could have used for term lending. Consequently, the design of the three projects was inconsistent with well-established principles of sound financial sector operations (formalized in the "Levy Report" on financial sector operations), which recommended that (1) financial sector operations be undertaken only when the macroeconomic environment is conducive to their realization, and (2) interest rates be market-determined. The ICRs and PCR, however, rated development outcome as satisfactory mainly because the enterprise credits envisioned were indeed disbursed. The PAR, with access to more information, concluded that under the above conditions most of the lending *substituted* for lending that would have occurred anyway, and that most borrowers chose the Bank credit line because of more favorable pricing or tenor.

In addition, the PAR found the Bank interaction with the Turkish Government was inconsistent. At the same time that the Bank was attempting through the FSALs to reform the banking sector and was urging the GOT to reduce its fiscal deficit, the three credit lines established procedures that exacerbated the deficit and permitted subsidized credit and negative real interest rates.

The PAR rates sustainability of the lines of credit as unlikely as long as substantial deficits and unstable macroeconomic conditions continued. In contrast, the ICRs rated sustainability as likely because it was believed that "enterprise loans that are repaid can be re-lent." For the PIC, the PAR agrees with the EM rating of institutional development as substantial mainly due to the positive impact the credit lines had on improving investment appraisal techniques in participating banks. For the other 3 loans, the PAR rates institutional development as substantial, in comparison to the ES/PCR ratings of modest, again due to access to additional information.

For the Technology Development Project, outcome is rated as *marginally satisfactory*, sustainability as *likely,* and institutional development as *modest.* The outcome rating is lower than the region's because of the failure to set up an independent accreditation body, and the greater weight that OED allots to this.

Three main lessons derive from the implementation of the lines of credit. First, financial sector operations should be undertaken only when the macroeconomic environment is conducive to their success. Second, the Bank should strive to follow a consistent policy line throughout its lending program. And, third, credit lines are a poor substitute for effective reform.

Contents

This Performance Audit Report was prepared by a team consisting of Elliott Hurwitz (Task Manager) and Bill Battaile. The Report benefited substantially from the comments and suggestions of Luis Ramirez. Betty Casely-Hayford and Silvana Valle provided administrative support.

Tables in text:

Annexes:

Attachment

Preface

This is the Performance Audit Report (PAR) for the Turkey: Industrial Export Development Project (Loan 2901-TU), Second Small and Medium-Scale Industry Project (Loan 3067-TU), Private Investment Credit Project (Loan 3346-TU) and Technology Development Project (Loan TR-3296S, 3296A).

The Industrial Export Development Project (IEDP) was approved on December 19, 1988, and totaled US$300 million. The project was closed on schedule on June 30, 1993, with disbursements of US$287.49 million, representing 95.5 percent of the total envisioned.

The Second Small and Medium-Scale Industry Project (SMI2) was approved on June 28, 1989 and made effective on October 26, 1989, in the amount of US$204.5 million. The loan was closed on December 31, 1996, compared with the original closing date of June 30, 1995. Total disbursement amounted to $202.3 million, with the balance of US$2.2 million cancelled

The Private Investment Credit Project (PIC) was approved on June 13, 1991and became effective on November 22, 1991, in the amount of US$200.0 million. The loan was closed on June 30, 1997, compared with the original closing date of December 31, 1996. Final disbursement under the loan took place on July 30, 1997, and an undisbursed portion of US$1.8 million was cancelled.

The Technology Development Project (TDP) was approved on February 28, 1991 and became effective on September 6, 1991, in the amount of US$100 million. The loan was closed on December 31, 1998, instead of the original closing date of April 30, 1997. The last disbursement took place on April 30, 1999, and US$2.92 million was cancelled.

This PAR is based on Staff Appraisal Reports, President's Reports, loan, project agreements, project files, Economic and sector reports from 1986 through 1998, documents from the International Monetary Fund, discussions with current and former Bank staff involved directly in the loans or other aspects of the financial sector in Turkey, Project and Implementation Completion reports, data transmitted by participating financial institutions (PFIs), and a mission that visited Turkey in March, 2000.

Although the PAR does not concur with the PCR/ICR findings on the operations, the PCR/ICRs provide adequate accounts of implementation and lessons learned. Differences in judgment are mainly due to additional information that was available to the mission. In addition, the PAR assesses the consistency in the Bank's approach across four projects, something that individual PCR/ICRs would find difficult to do.

The draft PAR was sent to officials in government, participating banks, and the private sector. Comments received are attached as Attachment 1.

Ratings and Responsibilities

Performance Ratings

	Ind. Export Development Project	*Second Small/Medium Ind.*	*Private Inv. Credit*	*Technology Development Project*
Outcome	Unsatisfactory*	Unsatisfactory*	Unsatisfactory*	Marginally Satisfactory*
Sustainability	Unlikely	Unlikely*	Unlikely*	Likely
Institutional Development Impact	Substantial	Substantial	Substantial*	Partial
Bank Performance	Unsatisfactory*	Unsatisfactory*	Unsatisfactory*	Satisfactory
Borrower Performance	Unsatisfactory*	Unsatisfactory*	Unsatisfactory*	Satisfactory

* Differs from EM/EVM rating

Key Project Responsibilities

Project	*Staff*	*Appraisal*	*Completion*
IEDP	*Task Manager*	Dalla	Gurhan Ozdara
	Division Chief	E. Segura/M.Nishimizu	Franco Batzella
	Country Director	n.a.	Kenneth Lay
SMI2	*Task Manager*	Joseph Pernia	Tunc Uyanik
	Division Chief	Mieko Nishimizu	Franco Batzella
	Country Director	n.a.	Kenneth Lay
PIC	*Task Manager*	Joseph Pernia	Tunc Uyanik
	Division Chief	Mieko Nishimizu	Franco Batzella
	Country Director	Michael Wiehan	Ajay Chibber
TDP	*Task Manager*	Jeremy Oppenheim	Vinod Goel
	Division Chief	Mieko Nishimizu	Lajos Bokros
	Country Director	Michael Wiehan	Ajay Chibber

1. Introduction

Background

1.1 From 1980-1985, Turkey carried out a major stabilization and reform effort, supported by five Bank SALs and stand-by arrangements with the Fund. From 1981—85, inflation and the current account deficits were cut by two thirds; the fiscal deficit[1] was reduced from 8.8 percent of GNP to 3.6 percent; and real GNP growth averaged 4½ percent. Structural reforms were implemented, such as import and exchange rate liberalization, tax reform, and relaxation of price controls. But during 1986 and 1987, financial policies were significantly relaxed,[2] the fiscal deficit rose to 6.1 percent of GNP, and real GNP growth rose to around 8 percent. By late 1987, inflation increased from an average of 38.5% during 1981-87 to 71.4% during 1988-94 (see Table 1.1 below). Inflation was also erratic, which made term lending difficult. High inflation also became endemic, resulting in higher inflationary expectations and widespread indexation.[3]

Table 1.1: Macroeconomic and Fiscal Performance, 1981-1998

Year	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
GNP deflator % incr	44	28	26	49	53	36	34	70	76	58	59	64	67	107	87	78	83	64
PSBR (% GNP)	4.0	3.5	4.9	5.4	3.6	3.7	6.1	4.8	5.3	7.4	10.2	10.6	12.0	7.9	5.2	9.0	9.5	8.6
Consol. Budget Int. Payments (% GNP)	0.9	0.8	1.5	2.0	1.9	2.6	3.0	3.9	3.6	3.5	3.8	3.7	5.8	7.7	7.3	10.0	7.9	12.0

Source: SPO

1.2 A key factor in the poor macroeconomic performance was the high fiscal deficit--12 percent of GNP in 1993. This was driven by SOE losses, growth in state payrolls,[4] higher interest payments, and mounting social security deficits.[5] The GOT financed the deficits mainly by domestic borrowing, which provided very high returns to banks and bond-holders, but which "crowded out" potential business borrowers. In 1986 and 1988 the Bank initiated two Financial Sector Adjustment Loans (FSALs). However, although they resulted in some improvement in prudential regulation and strengthening of the capital base, these operations were rated as unsatisfactory by both ECA and OED, and were characterized by incomplete implementation, backsliding, and relatively little real advancement. Missing was progress on loan concentration, capacity to handle bank failures, and on-site bank supervision.[6] This was the prevailing situation when the four audited loans were initiated. Figure 1 shows the size and phasing of each of the four audited projects along with other related loans to Turkey.

1. As measured by the public sector borrowing requirement (PSBR).
2. International Monetary Fund, Recent Economic Developments, 1988.
3. Turkey CAS, August 1997, p. 11.
4. Government personnel costs doubled in real terms from 1988 to 1993.
5. The social security deficit reached 2.7 percent of GNP in 1998.
6. OED Performance Audit Report, FSAL I and II, August 8, 1994. The first loan was for US$300 million, and the second for US$400 million, of which US$100 million was cancelled.

Figure 1.1: Four Audited Projects and related Loans

	$	*1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999*
Small/Medium Industry I	98	
FSAL 1	300	
FSAL 2	300	
➡**Indust Expt Devmt**	287	
Industrial Training 2	113	
Agroindustry Project	150	
➡ **SMI2**	202	
➡**Private Inv Credit**	198	
➡**Technology Dev't**	97	
Privtzn Implementatn	100	
Industrial Technology	155	
Export Finance	252	
➡**Project included in this audit**		

2. Objectives and Design

2.1 The objectives of the four projects are shown below in Table 2. The key objectives of the first 3 projects were similar: the Industrial Export Development Project (IEDP), Second Small/Medium Industry (SMI2), and Private Investment Credit (PICP) Projects were intended—by providing enterprise credits—to expand production and exports (especially by SMEs), and "improve the credit delivery system."[7] Ideally, the 3 projects would have had a catalytic effect by demonstrating to PFIs that investment lending was feasible and profitable, and these institutions could then have accessed other sources of long-term funds to continue and expand this lending. The Private Investment Credit Project was considered to be a "follow-on" of the Industrial Export Development Project.

2.2 The Technology Development Project had a somewhat different focus, aiming to bolster the industrial sector by strengthening industrial measurement and standards, testing, and quality systems, supporting research and development (R&D), and fostering growth of the venture capital sector. This audit focuses first on the three credit line projects, and then on the Technology Development Project.

7. It was the intention of the 3 credit line projects to improve the "credit delivery system" by bolstering PFIs and strengthening the banking system. It was believed that implementing the 3 projects would strengthen the more robust banks by providing stringent criteria aligned with those of the FSALs—that they needed to meet in order to participate—and would provide these banks with a strong incentive to meet the criteria.

Table 2.1: Objectives of Four Audited Projects

	Projects			
Objective/Component	*1 Ind. Export Development*	*2 Second Small/ Medium Ind*	*3 Private Inv. Credit*	*4 Technology Development*
➡Provide enterprise credits	✔	✔	✔	
→Support export expansion	✔	✔	✔	
→Strengthen policy framework for export finance	✔			
➡Improve "credit delivery system"/ bolster PFIs	✔	✔	✔	
→Bolster TSKB and SYKB	✔		✔	
→Provide technical and marketing services to SMEs		✔		
→Enhance data on SMEs		✔		
➡Strengthen industrial measurement/ standards/ testing/quality system				✔
➡Support R&D projects				✔
➡Foster growth of Venture Capital sector				✔
Total IBRD Project cost ($US million)	**287**	**202.3**	**198**	**97**
Technical Assistance	**1.1**	**4.5**	**1**	**n/a**

Assessment of Objectives: (1) Increase Availability of Term Credit

2.3 *Diagnosis of the Problem*: The three credit lines were intended to increase the availability of medium- and long-term project credit (and later working capital) for Turkish manufacturers and exporters, and improve the credit delivery system. While the condition the three credit lines addressed was inadequate medium-term credit, the most significant cause of this shortfall in credit availability, as acknowledged in many Bank studies and documents,[8] was the excessive fiscal deficit, which caused real interest rates to rise to very high levels and crowded out industrial borrowers.[9] Uncertainty about inflation and inadequate financial sector regulation were also factors constraining credit. As shown earlier, at the times when the three credit lines were identified, the fiscal deficit was high and rising: 1984-86, 4.2%; 1987-89, 5.4%; 1990-91, 8.8%. In addition, the high-inflation environment substantially diminished long-term sources of funds which the banks could have used for term lending. So the three credit lines were addressing the wrong problem.

8. E.g., see IEDP Project Brief, December, 1986; Bank presentation to Turkish delegation during the 1987 Annual Meetings; 1987 CEM; 1988 CEM; 1993 CAS; also see Box 1, below for additional assessments.

9. However, the SAR for the PIC identifies the causes of insufficient long-term credit as (1) inadequate growth in Central Bank rediscounts; (2) insufficient foreign credits obtained by development banks; (3) inadequate sources of long-duration funds by deposit banks; (4) a fall in overall bank lending to industry.

2.4 The credit lines also failed to take adequate account of lessons learned during implementation of the FSALs. As noted earlier, while the FSALs did achieve some successes, they were rated unsatisfactory by both ECA and OED. As the PCR on the IEDP (June, 1995) notes: "Although FSAL II was eventually approved [effectiveness was in early 1988], it was not fully implemented, and the dialogue on the expected reforms for industry and trade was also abandoned. At the same time, IEDP's follow-on project [PIC] was prepared and approved, and its implementation continues to suffer from yet-unresolved systemic issues which IEDP, combined with other Bank assistance of its period, aimed to address." The PCR was also critical of the Bank's decision to permit a subsidized scheme for foreign exchange risk coverage (FERIS, explained below) within the project, since adoption of FERIS (1) exacerbated the GOT's fiscal deficit (see below); and (2) contradicted the Bank's message concerning the need to eliminate subsidized credits and maintain positive real interest rates.[10]

Were These the Correct Instruments?

2.5 As noted earlier, since macroeconomic imbalances and financial sector weaknesses were the root causes of the inability of Turkish banks to make term loans, it follows that the three credit line projects were not the correct instruments to deal with this problem. For example, no matter how successful the projects were at strengthening Turkish banks, if the banks had no other prospects for access to longer-term funds, then the lines of credit would make only a temporary impact on their ability to lend long-term. A more appropriate instrument would have been an effective FSAL, with strong conditionality, that tackled head-on the root causes of the problem.[11]

Were These Instruments Well-Designed?

2.6 Given that the diagnosis of the problem was deficient, was the design of the three credit line projects adequate? Regrettably not. The design of the three credit line projects was not consistent with well-established principles of sound financial sector operations. These principles, formalized in the Levy Report[12] (issued in August, 1989), had been discussed extensively within the Bank in the years preceding. The report stated that some clear preconditions for successful financial sector operations should be recognized and taken account of in any reform program:

> (1) "Financial sector reform and macroeconomic stability are intimately interrelated...High inflation breeds uncertainty regarding prices, real interest rates and exchange rates, thus inhibiting savings and investment...Proposed financial sector operations, therefore, should be preceded by a determination that the macroeconomic environment is conducive to realizing their objectives.
>
> (2) "The market determination of interest rates is an essential element of financial market competition and of the efficient mobilization and allocation of financial

10. The GOT had committed to both macroeconomic improvement and elimination of credit subsidies under the FSALs.
11. Of course, there were already two FSALs in place, but they did not achieve the requisite results.
12. Officially, the "Report of the Task Force on Financial Sector Operations."

resources...Administered interest rates and credit lines usually lack the flexibility to adjust...to changing economic conditions, [and] tend to lag behind inflationary and exchange rate expectations..."

2.7 The macroeconomic environment was not conducive to the credit lines, and severely hampered their disbursement and development impact. As explained below, while the Bank intended to use market interest rates, for a number of years this was not done and thus for much of the period the credit lines were being used, an administered rate was utilized.

Initiating Credit Lines in an Unsuitable Environment

2.8 When the first credit line (IEDP) was being identified, the Bank had ample information that the macroeconomic framework was unpromising for a credit line. For example, the IEDP Project Brief, dated December, 1986, stated, "The main problems regarding industrial finance in Turkey are the very high real interest rates...interest rates will come down only if there is a corresponding adjustment of the public sector deficit." And the 1988 Country Economic memorandum stated, "The analysis of this report points to the need for a significant and sustained reduction of the fiscal deficit in order to restore macroeconomic balances." (See also Box 1)

2.9 The 3 credit lines were initiated (effective 4/88, 10/89, 11/91) on *the presumption that macroeconomic and financial system performance would improve*, in part due to policy reforms and plans scheduled to be implemented under the FSALs. Each project acknowledged that macroeconomic progress was crucial to increasing private investment (see Box 1), but proceeded on the presumption that Government spending would be reigned in, and, in the words of one participant, that "the problem was being addressed" by the FSALs. In the context of the prevailing paradigm—and based on the poor record of Turkish realization of macroeconomic goals—*this was unrealistic and unwise.*

Box 2.1

Acknowledgement by Credit Line Projects of the Importance of the Macroeconomic Framework

"Revival of private investment in the manufacturing sector...and its efficient allocation will depend on the ability of the Government to create and maintain a positive and stable economic environment in which policy distortions are minimized so that market forces can operate efficiently." (IEDP SAR) "Thus, policies to restore internal macro balances and to reform the financial sector remain the highest priority both for the Government and for the Bank's policy dialogue...The reduction of real interest rates will require: (i) a reduction in the level of Government borrowings, since they crowd out private borrowings...The reduction of Government borrowings and reserve requirements can only be achieved by reducing the size of the fiscal deficit. Macroeconomic adjustment is, therefore, an item of high priority in the Bank's dialogue with the Government and is a central item in the Government's letter of macroeconomic policies. (SMI2 SAR) "While private manufacturing investment can be expected to rise in the short term, sustained growth in investment will depend on a number of factors that are closely linked to macroeconomic stability. Perhaps most important for the investment climate is the perception that the Government's fiscal and monetary policies will be successful in reducing inflation." (PIC SAR)

2.10 While the Bank emphasized the need for improving the macroeconomic framework before initiating the new projects, it went ahead with starting the 3 projects despite the absence of macroeconomic improvement. Although the 3 credit lines were explicitly "linked" and "complementary" to the FSALs, they did not have any formal conditionality concerning macroeconomic performance and *their implementation probably contributed to GOT complacency* regarding the need to control public spending. For example, the Bank's presentation to the Turks during the 1987 Annual Meetings stated: "...our operations would comprise the following types of projects, provided of course that the macroeconomic framework is sound: Export Development, Industrial Technology, and Small Scale Industry 2." These 3 projects, the subjects of this audit, were implemented *even though the macroeconomic environment markedly deteriorated* and the fiscal deficit increased substantially in the period following this meeting

2.11 The Turks may have perceived that the Bank was not being strict in requiring that macroeconomic reforms be implemented, as reflected in the Borrower Contribution to the SMI2 ICR (June, 1997), in which the GOT stated, "The economic impact of the credit component was very positive...Although it was implemented in difficult economic situations, the project clearly supported investment in niches of high export and development potential through sound financial institutions. This project makes it clear that the Bank should be ready to revise its fanatic concern for macroeconomic variables." [13]

Lending Terms

2.12 Lending terms under the credit lines varied—with interest rates varying from negative in real terms to positive but lower than rates available on short-term loans.[14] Naturally, disbursements went quickly when rates were negative or low, and slowed when rates rose. From 1988 to 1992, sub-loans for the IEDP and the SMI2 projects were made via the FERIS program,[15] explained in detail below. FERIS exacerbated the fiscal deficit. The lending terms—discussed in detail later—comprised a critical design flaw in the IEDP, and to some extent in the SMI2.

Assessment of Objectives: (2) Improve "Credit Delivery Systems"

2.13 The second objective of the 3 credit line projects was to improve the "credit delivery system" and bolster PFIs. It was believed that implementation of the 3 projects would strengthen the financial system by promoting competition among banks.[16] However, as noted earlier, the diagnosis of the problem—lack of term credit—was deficient, and so the credit line

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13. Several participating banks commented that the credit lines did have a significant impact in providing funding to participating enterprises and banks. While this was undoubtedly true, it had been hoped that the 3 projects would have a catalytic effect by demonstrating to PFIs that investment lending was feasible and profitable, which apparently did not happen, in large measure because of the unfavorable macroeconomic environment.
14. Although it was intended in all 3 projects that "pricing of funds be market-based," there was virtually no term lending and thus no comparator to use.
15. The Foreign Exchange Risk Insurance Scheme (FERIS) was established in 1985 by the Central Bank as a means of insulating borrowers from foreign exchange risks. Details are presented in paragraph 3.2.
16. The IEDP was the first credit line in Turkey that utilized commercial banks.

projects did not deal with the root causes of the problem.[17] Given this faulty diagnosis, the project had very limited relevance, nor did the three credit lines deal with other critical problems of the financial sector which are reviewed below.[18] The appropriate instrument to meet this objective would, as in the case of the first objective, have been a FSAL which had sufficient government commitment.[19]

3. Implementation Experience

3.1 Implementation of the three credit lines was difficult due to the administered interest rates under FERIS, which caused real interest rates to fluctuate substantially, with analogous swings in disbursements. Additional difficulties were caused by the initial design—corrected in 1994—which did not permit borrowing for working capital nor pre-payment.

Lending Terms and Disbursements

3.2 FERIS—the Foreign Exchange Risk Insurance Scheme—was established in 1985 by the Central Bank to insulate borrowers from foreign exchange risk. Under the program, sub-loans were made in Turkish Lire and the GOT carried the foreign exchange risk. However, a study of FERIS under FSAL I found that FERIS (with fixed rates as it then had) had a significant negative impact on the budget, and so in the IEDP appraisal, the Bank stipulated that FERIS move from fixed to floating rates. But in negotiations, the GOT was reluctant to move to floating rates immediately, and the Bank agreed that floating FERIS would be considered within six months.[20] As noted earlier, fixed FERIS rates were negative in real terms, which was a primary reason for very rapid initial disbursement under IEDP. Later, with floating FERIS rates, the GOT introduced a subsidy scheme under which borrowers could deduct from the FERIS rate the withholding tax normally applicable on T-bill income, effectively providing a subsidy for borrowers under the credit lines. It is estimated that under the IEDP project alone, FERIS and related subsidies created budgetary costs of US$387 million—more than the total IEDP loan.[21] As noted below, by project end lending was based on market interest rates.

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17. As noted earlier, the root causes were the excessive fiscal deficit along with uncertainty about inflation and inadequate financial sector regulations.
18. Very high real interest rates on government paper, four inefficient state banks holding around 40% of total sector assets; and lack of adequate transparency and prudential regulation.
19. Several participating banks noted that the credit lines, especially considering their long grace periods, were attractive to small and medium-sized enterprises that received funds.
20. During negotiations, the GOT also proposed that IEDP policy conditionalities relating to export finance and GOT subsidy programs be dropped (there was no Cabinet in place at the time). The Bank agreed, reasoning that a future Cabinet would be likely to follow the same policies on export promotion, and that conditionality on incentives would be the subject of the upcoming FSAL II project.
21. These budgetary costs would have continued for the duration of the repayment of the IEDP by the Government.

Table 3.1: Real Lending Rates Under FERIS (Percent)

1988 (average)	*Dec. 1989*	*July 1990*	*Jan. 1991*	*July 1991*	*Jan. 1992*	*July 1992*	*Jan. 1993*
-15.0	-12.7	-2.0	3.0	6.8	0.8	11.0	14.4

Source: Annex 4 to Aide Memoire of May 12-29, 1993 supervision mission (PICP).

- In 1988-90, loans were made for the IEDP and the SMI2 under FERIS. During this period, a fixed FERIS rate was used based on the previous year's wholesale price index, and adjusted twice a year. Loan rates were negative in real terms and disbursements were very rapid (Table 3.2).

- In 1990-92, a variable FERIS rate was instituted, based on the 3-month Treasury bond, and adjusted quarterly. Through mid-1992, rates were positive in real terms (Table 3.1), but were low by comparison to alternative sources, and so disbursements diminished somewhat but continued to be robust.

- However, in 1993 and 1994, lending dropped sharply due to:
  - Deteriorating and turbulent macroeconomic conditions.
  - Higher rates for the credit lines, in real terms, and competition from subsidized government credits.[22] While numerous Bank missions discussed the subsidy programs with the Government, subsidies were eventually cut back but not completely terminated.
  - PICP required participating banks to manage the cross-currency risk associated with the (Bank's currency-pooled) loan,[23] and the PFIs passed the foreign exchange risk on to sub-borrowers.

- Slower disbursements caused the Bank to re-examine the Credit Lines and act to make them more attractive to participating banks and sub-borrowers. In 1994, the credit line projects were restructured, FERIS was discontinued, and market interest rates prevailed.
  - Sub-loans were made in a single currency—US$ or DM.[24]
  - Lending terms were based on market interest rates.
  - Pre-export and working capital loans became eligible (in addition to fixed capital investments, which still predominated).
  - A pre-payment option was added.
  - Although GOT subsidy programs continued, their funding was diminished.
  - Because of the more favorable terms, disbursements resumed at a brisk pace.

22. Business expectations of lower rates from subsidized government credit hindered disbursement under the 3 credit lines. Subsidized credit explicitly contravened GOT commitments under FSAL II.
23. PICP did not utilize FERIS.
24. This was attractive to many borrowers that were exporting and being paid in $ or DM.

Table 3.2: Credit Line Disbursements

Disbursements of the Three Credit Line Projects, FY88-FY99

	Total	*FY88*	*FY89*	*FY90*	*FY91*	*FY92*	*FY93*	*FY94*	*FY95*	*FY96*	*FY97*	*FY98*	*FY99*
	US$ million												
Indust Export Development	287	16	136	113	21	1	0						
Small/Medium Industry 2	202			21	66	35	9	4	3	51	13		
Private Inv Credit	198						21	5	2	137	33		
Total	**687**	**16**	**136**	**134**	**87**	**36**	**30**	**9**	**5**	**188**	**46**	**0**	**0**

Bolstering Participating Financial Institutions

3.3 Objective (2) was to improve the credit delivery system and bolster the performance of participating financial institutions (PFIs). In the course of the 3 projects, the financial performance of participating financial institutions was good, and they learned a considerable amount from their experience in performing investment lending under the projects. However, this institutional development remained largely a "potential" benefit because of the turbulent macroeconomic situation and the severely limited availability of longer-term funds. While, as noted earlier the 3 credit line projects failed to achieve their most important objective—stimulating investment lending—institutional development under the credit lines was *substantial.*

3.4 *Financial Performance*—Financial performance of participating banks under the three projects was good. However the extent to which even stronger banks could contribute to the overall project goal of increasing investment lending was severely constrained by the continued macroeconomic turbulence and the inability of banks to obtain other longer-term sources of funds.

3.5 Table 1 in the Annex lists the 13 commercial banks and two development banks that participated in the three credit line projects.[25] Broadly, participating banks were required to meet the following criteria:

• Debt service cover	1.1 minimum
• Debt/equity ratio	10.1 maximum
• Adequacy of provisioning	Based on GOT 1988 decree
• Loan collection ratio	85% minimum
• Unqualified auditors' opinion	Adherence to IAS rules

25. It should be noted that a number banks which could not meet the criteria for participation either were not accepted, or were dropped from participation after initial acceptance.

3.6 While participating banks generally met most criteria when examined during supervision missions, they often went out of compliance on one or more criteria for a period, then improved their performance and came back into compliance. The most frequent cause of non-compliance was the requirement for an unqualified auditors' opinion. When the IEDP became effective, no Turkish banks met IAS Rule 29, which provided that "inflation accounting" be used when certain macroeconomic criteria were met (which Turkey met by a wide margin), and hence all participants were technically out of compliance. Numerous missions urged participating banks to comply, and then finally, all participating banks eventually adopted Rule 29.

3.7 However, the overall condition of the financial system did not improve over the period of the three credit lines—in fact, it worsened. Real interest rates rose substantially, and the very high real rates the government had to pay to finance new borrowing comprised, for many financial and non-financial companies, their most profitable activity. A 1996 study of the top 500 Turkish corporations by the Istanbul Chamber of Commerce found that corporations were making more profit from government paper than from operational activities. The study showed that income generated from non-industrial activities rose from 20% of total income in 1983 to 53% in 1996.

3.8 Other problems of the financial sector as of mid-1999 included: four inefficient state banks, which held around 40% of total assets; a 100% deposit insurance scheme, which provided incentives for banks to take large risks since depositors would be reimbursed by the state even if the banks failed; and lack of adequate transparency and prudential regulation.

3.9 *Institutional Development Impact*—There was a positive impact on the institutional development of banks that participated in the projects. IEDP supported the restructuring of the two participating development banks, TSKB and SYB, allowing increased diversification and stability. These adjustments were noted to be of particular benefit in weathering the subsequent shocks to the financial system (i.e., 1994 and 1998). The introduction of inflationary accounting practices (IAS Rule 29) under the auditing guidelines of the credit lines was also noted as a direct institutional benefit.

3.10 The majority of participating commercial banks also reported significant institutional benefit from participating in the credit lines, due mostly to exposure to better investment appraisal techniques. These gains have been sustained beyond the period of the credit lines for a number of banks. For example, the credit lines were the first exposure to investment lending for Korfez Bank, requiring the establishment of a project evaluation capacity in accordance with stringent World Bank requirements. This capacity has been maintained, and investment lending is now a key product for the bank. The appraisal techniques developed are also applied in some short term lending products.

3.11 While having previous experience in investment lending, Vakif Bank set up a project evaluation and loan department expressly for the World Bank credits in order to comply with the stringent requirements. This increased capacity led to superior loan utilization by Vakif Bank, relative to other participating banks, and a near tripling in credit allocation under the projects (compared with the initially-envisioned allocation). The project evaluation unit continues to operate today, using the guidelines established in FSAL1 and applied in the credit lines. Through the experience with the credit lines, Vakif Bank has been able to show a track record of successful investment lending which has been a key factor in attracting subsequent external sources for term lending (e.g., Hermes). While this capacity had a one-time use in cases where term lending was not continued, the benefits of past experience with term lending may be useful if the macroeconomic environment allows a market-induced resurgence of term lending in the future.[26]

Technical Assistance

3.12 As noted earlier, each of the three credit line programs contained a technical assistance component—mostly aimed at enhancing know-how relating to exports. However, the impact of these was marginal. For example, in the IEDP, the strengthening of the export promotion role of the Export Promotion Research Center was minimal. And in the SMI2, the transfer of knowledge on exporting practices was weak, and 57% of the funds allocated to this function were transferred to the credit component.

4. Outcome and Assessment

4.1 As shown in Table 4.1 below, the three credit lines supported 420 projects, with a value (including local contribution) of nearly US$3 billion. Sub-loan repayment experience was excellent. However, it is useful to examine the development impact from several perspectives:

- Did the Bank credit lines make a net contribution to the available supply of credit, or just substitute for credit that firms would have obtained anyway?
- Did the projects "improve the credit delivery system"?
- What was the performance of aggregate private credit, as a percentage of GNP, during the period of the credit lines? Although many variables affect credit availability, if the credit lines had substantial development impact—<u>and the activity had a catalytic effect</u>—then we might have seen private credit rising, especially when disbursements of the credit lines were at a peak.

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26. Subsequent Developments—In June, 1999, a new Banking Law was passed which—if rigorously enforced—promised to remedy some sectoral deficiencies. In late 1999, the government indicated a new commitment to reform, and the Bank began discussions on a new FSAL and Economic Reform Loan (totaling US$1.5 billion). In December, when the EU signaled that Turkey would be considered as a candidate for membership, and the Fund signed a Stand-by Agreement with the GOT, the effect was dramatic: equity values rose and nominal interest rates fell substantially. As of February, 2000, there seemed to be a reasonable prospect that Turkey would finally get its macroeconomic situation under control and lay the preconditions for faster growth.

Table 4.1: Credit Lines: Number of Loans and Loan Amount (including local contribution)

	Number of Projects	*Amount Loaned ($US million)*
IEDP	112	1,150
SMI2	250	810
PIC	58	1,020
Total	420	2,980

It Appears that the Credit Lines Mainly Substituted for Other Credits

4.2 We found no evidence that the credit lines caused an increase in total credit availability in Turkey, although the possibility exists that some participating banks were enabled to increase overall lending.[27] Interviews with Turkish businessmen, knowledgeable observers, and participating banks—development banks, state-owned banks, and private commercial banks—indicate that the additional credit brought about by the three credit line projects was marginal, at best. In most cases, investment decisions had been taken, and businesses then sought the best terms available for needed credits. Occasionally, long-term credits from a foreign credit guarantee agency or another source were available. But most often, firms took short-term loans—e.g., for six months—and generally were able to roll over the loans at the end of the term. So in the majority of cases the Bank credit lines were simply a better-priced substitute for credit that firms would have obtained from other sources.[28]

4.3 The effect of the Bank credit lines (on companies receiving the loans) was that firms could plan more easily for an investment project since the term was longer, and often the interest rate was more favorable, as well. Predictability was also enhanced, since there were some occasions (e.g., 1994 economic crisis, 1998 Russian crisis) where banks were not willing to roll over short-term loans as readily, causing difficulties for borrowers.

Improving the "Credit Delivery System"

4.4 As discussed earlier, the three credit line projects did have a significant impact on the *capacity* of participating banks to appraise and provide term lending (although the *access* of banks to long-term funds was severely limited). As part of that impact, Vakif Bank reported that its experience in utilizing long-term funds was a positive one and enhanced its relationships with its customers. Consequently, Vakif became more pro-active in seeking other sources of long-term funds, and succeeded in obtaining funding from Hermes and other export lending agencies. Although other banks reported receiving funds from foreign sources such as export finance agencies, Vakif was the only firm interviewed that attributed the funds to experience with the Bank credit lines.

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27. Although it would have been preferable to examine data on availability of long-term credit, this information was not available.

28. Some participating banks commented that, since the credit lines contributed at most 4 percent of aggregate credits during their duration, it was unrealistic to expect an impact on overall credit availability or exports. However, if the expected catalytic effect had occurred, it would have been more likely that such an impact could have been detected.

Performance of Aggregate Private Credit

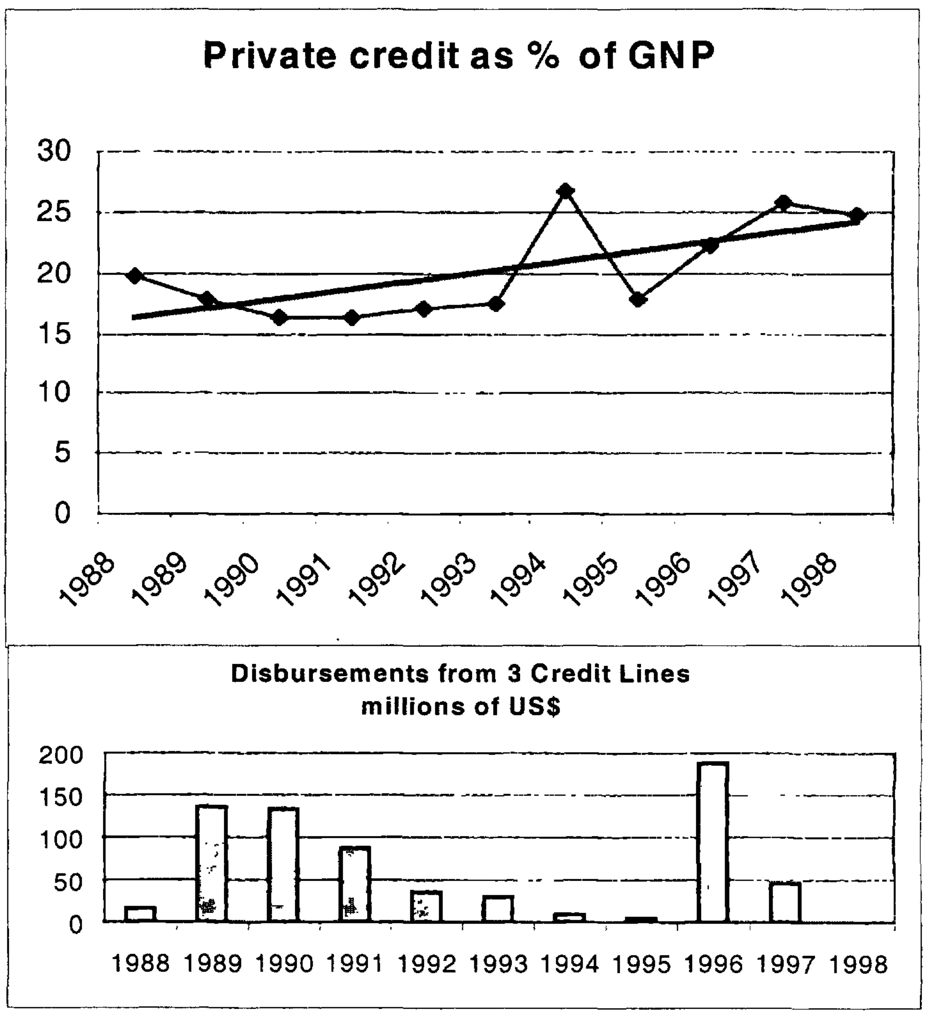
4.5 Since the objective of the credit lines was to increase the availability of credit to businesses, it is useful to examine the performance of aggregate private credit as a percentage of GNP during the period of the credit lines, and to relate this to disbursements under the three projects. This is shown below in Table 6 and Figure 2.

Table 4.2: Private Credit as a % of GNP

	1988	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Pvt Credit % GNP	19.7	17.9	16.2	16.2	17.1	17.4	26.8	17.9	22.2	25.8	24.7

Source: Turkey Country Unit

Figure 4.2: Private Credit as a % of GNP and Credit Line Disbursements



Source: Bank Country Team; Project Documentation

4.6 While we tried to establish a relationship between private credit availability and disbursements from the 3 credit lines, we were unable to do so. As shown in the figure, credit and disbursements generally moved in the opposite direction: when credit trended downward in 1989-91, disbursements were at their peak, and when it rose substantially in 1994, disbursements were very low.

4.7 Another objective of the credit line projects was to increase Turkish exports, particularly manufactured exports. While many factors aside from credit availability influence exports—including relative prices, exchange rates, and relative income growth—it was believed that an increase in credit would stimulate exports. From the data available on export performance, it is not evident that the credit lines had a significant effect on exports. As shown in Table 7, while manufactured exports increased slightly from 11.4 percent of GNP in 1988 to 12.1 percent in 1998, the increase is not large.

Table 4.3: All Exports and Manufactured Exports as a Percent of GNP

	1988	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
All exports as % of GNP	18.7	16	13.1	13.7	14.3	13.6	21.3	19.7	21.2	24.1	26.3
Mfd exports as % of GNP	11.4	9.6	7.7	8	8.3	7.9	13.1	12	12.1	13.1	12.1

Source: Bank Country Team

Summary Assessment of Credit Line Projects

4.8 The credit line projects did not accurately diagnose the problems that were causing the lack of term credit, and consequently the objectives of the projects did not address the problems. To increase term credit and strengthen the banking system, it would have been more effective to utilize a FSAL. In addition, the credit lines were not well designed. Sound principles for the design of financial operations were ignored, and the erratic performance of the projects validated the pertinence of concepts cited in the Levy report. The chaotic macroeconomic environment presented huge obstacles to term lending, and the use by the credit lines (for most of the period) of an administered price for credits caused erratic disbursement and substantial fiscal costs.

4.9 However, considered superficially, the credit lines funded 420 projects with a value of nearly US$3 billion, a "success" claimed by the ICRs for the SMI2 and PICP projects (but not the PCR for the IEDP, which was more realistic). Sub-loan repayment was excellent. However, an examination of data on private credit and manufactured exports, variables that might have been affected by the projects, indicates that the development impact of the projects seemed to be marginal. The most important reason for this was that although the funds were loaned to enterprises, the continuation of large public sector borrowing—and subsequent crowding out of term lending—prevented the 3 projects from having the catalytic effect[29] that was intended. As had been forewarned, the macroeconomic environment was not conducive to financial sector operations. Because the Borrower did not embrace the financial sector reforms that the credit line projects were intended to reinforce, the development impact of the projects was severely constrained.

Table 4.4: Ratings for Credit Line Projects

	Industrial Export Development		
	ECA ICR	*OED ICR Review*	***OED PAR***
Outcome	Marg. Unsatisfactory		**Unsatisfactory**
Sustainability	Unlikely		**Unlikely**
Institutional Development	Modest		**Substantial**

	Second Small/Medium Industry		
	ECA ICR	*OED ICR Review*	***OED PAR***
Outcome	Satisfactory	Satisfactory	**Unsatisfactory**
Sustainability	Likely	Likely	**Unlikely**
Institutional Development	Substantial	Substantial	**Substantial**

	Private Investment Credit		
	ECA ICR	*OED ICR Review*	***OED PAR***
Outcome	Satisfactory	Satisfactory	**Unsatisfactory**
Sustainability	Likely	Likely	**Unlikely**
Institutional Development	Substantial	Modest	**Substantial**

5. Technology Development Project

5.1 The Technology Development Project (TDP) was initiated (1) to bolster the measurement, standards, testing, and quality control ("metrology") infrastructure available to support private industry in Turkey. It was further intended (2) to stimulate private industrial research and development by implementing a program of research support through grants and conditional loans. And finally (3), it aimed at facilitating the growth of the venture capital industry by establishing a legal and regulatory framework, and by actually establishing—with the participation of IFC—a venture fund. These objectives and the funding allocated to each are shown in Table 5.1, below.

29. In a suitable macroeconomic environment, the 3 projects would ideally have demonstrated to PFIs that investment lending was feasible and profitable, and these institutions could then have accessed other sources of long-term funds to continue and expand this lending.

Table 5.1: TDP Objectives and Costs

Objective	*Actual Costs ($US Million)*		
	Local	*Foreign*	*Total*
1. Develop national capacity in metrology, standards, testing, and quality	33.2	56.0	89.2
2. Encourage market-oriented R&D in private sector by financing projects on a matching basis	44.0	40.9	84.9
3. Foster growth of venture capital industry	0	0	0
Total	77.2	97.0	174.2

5.2 OED concurs that these objectives were appropriate—in particular the first objective of strengthening the measurement and testing infrastructure supporting industry. As the Turkish economy opened, with the trade liberalization of the 1980s and Turkish accession to the European Customs Union (1996), the need for metrology services increased. The was because most Turkish firms cannot export manufactured products to OECD countries unless they have complied with international standards, such as ISO 9000. The value of a stronger metrology infrastructure as a "public good" is that Turkish industrial firms can have their machinery calibrated or tested domestically, without a need to send it out of the country, and that domestic specialists (such as those at UME) are available to consult with local firms to help them design and implement technical improvements and adaptations ("technology transfer").

5.3 OED also concurs with the judgment that the TDP was generally successful in meeting objective (1), bolstering the metrology infrastructure. By 1999, the National Metrology Institute (UME) had progressed to the point where it was capable of meeting approximately 50 percent of the requirements of Turkish industry. UME was one of only around 30 metrology laboratories in the world, making Turkey a leader among countries at its level of development and also a regional source of metrology services. UME also provided technical support to private laboratories, which generally furnished metrology services of a less specialized nature. UME progress in these tasks was assessed by the National Physical Laboratory (UK) in May 1997. The report found that UME facilities had developed at an "extraordinarily fast pace." The report found the measuring equipment and facilities of high quality, and recommended that it continue to develop. UME also won recognition from several international and European scientific organizations.[30]

5.4 Another sub-component of the TDP dealt with building up the capabilities of the Turkish Standards Institute (TSE), which provides testing, certification, and calibration services. TSE was enlarged and its capabilities strengthened as a result of project activities: the number of technical staff expanded; a "Quality Campus" was established near Istanbul; and TSE MIS systems were strengthened. There is evidence that TSE testing and calibration services are of high quality and provide real economies to Turkish industry. For example, TSE maintains a very close working relationship with the German calibration organization, PTB.

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30. International Measurement Confederation, Organization for European Cooperation in Analytical Chemistry, and the Organization of European Metrology Institutes.

5.5 However, while TSE intended to transfer technical and other staff from facilities in Ankara to the new Quality Campus, difficulties were encountered in inducing staff to move (in part due to the 2 earthquakes that occurred in 1999, the epicenters of which were near the Quality Campus). Consequently, the effectiveness of the effort to bolster TSE was diminished by these staffing difficulties.

5.6 Additionally, TSE failed to fulfill a key project goal: it did not set up an independent body (the National Accreditation Council) to accredit private laboratories *as it had agreed with the Bank.* Instead, without full agreement by other Turkish groups, it established a captive accreditation body, which did not achieve recognition from international accreditation organizations; as a consequence, some exporters found TSE-issued certificates were not recognized, and their exports were consequently rejected by the EU. The reason that a fully-independent group is necessary is that there is a conflict of interest between TSE's accreditation function and its own provision of testing and certification services. Bank missions had unsuccessfully urged TSE and the government for several years to establish an independent agency. An independent accreditation body, according to the Bank country director's November 1997 letter to Turkish authorities, would "enhance international credibility of Turkish test certificates, *thereby immensely facilitating exports*; reduce testing costs; bring Turkey closer to meeting commitment to EU on quality assurance and accreditation." Despite many years of exhortation by the Bank, TSE did not establish an independent body—a significant shortcoming.[31]

5.7 After the TDP had closed, a new Technology Development Project (TDP2) was approved by the Board in June 1999. The new project shares some of the same goals as the first project, including establishment of an independent accreditation body. While Bank staff urged that establishment of an independent NAC be made a pre-condition for the new project, the GOT opposed this and the Country Director concurred. Reportedly, this was because new legislation was required and the Government could not make that commitment on behalf of Parliament. Instead, a sub-component of US$2 million (of US$155 million) was made conditional on establishment of an independent NAC. In failing to make the establishment of an independent accreditation organization a pre-condition of the TDP2 project, the Bank lost considerable leverage on this issue and signaled to the Turks that, after years of unsuccessful dialogue, the Bank was not being consistent on this important issue.[32]

5.8 The TDP also established a foundation (Technology Development Foundation of Turkey) which provided loans to firms for research and development (R&D). Seventy-nine R&D projects were funded (around US$43 million was distributed on a 50-50 matching basis) which benefited firms and which was intended to contribute to the development of a "technology culture." Seventy percent of the beneficiaries of the loans were SMEs—150 employees or less. The foundation states that the majority of the projects were commercially successful, and that the work resulted in 4 patents awarded with a further 19 patent applications pending. However, from the data available, it could not be determined to what extent the loans stimulated additional R&D, or simply substituted for R&D that would have been performed

31. In the Borrower comments, included as Annex H, TSE states that it disagrees with the conclusions in this section.
32. In the course of TDP2, the required amendment was passed, and an independent NAC was expected to be created by mid-2000.

using existing funding sources. It could also not be determined what was the magnitude of the economic benefit of the loans. Additionally, some products developed under TDP reportedly could not be commercialized due to lack of funding. The new Technology Development Project incorporates additional evaluation measures. TDP also supported four sectoral R&D projects and 18 studies performed on technology strategies and specific technologies, with no clear benefit.[33]

5.9 "Strengthening technology culture" is difficult to assess. The data below illustrate total business spending on R&D from 1990 to 1995 (latest available), as well as the total number of business R&D personnel. Both series exhibit modest annual growth—6.74% and 10.9% respectively—which shows that technology awareness among private firms in Turkey was modestly increasing during this interval; the TDP may have played a role in this.[34]

Table 5.2: Total Business Spending on R&D

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*Average Annual Growth*
Total Business R&D Spending (in Millions of 1990 TL)	259673	423045	456366	429545	358396	384026	6.74

Source: OECD

Table 5.3: Total Business R&D Personnel

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*Average Growth*
Manufacturing	1947	2173	2487	2542	N/A	N/A	
Total Business R&D Personnel	2166	2509	2824	2807		3634	10.9

Source: OECD

5.10 The third component of the TDP was intended to establish a precedent for a venture capital industry in Turkey, first by establishing a legal and regulatory framework, and then by actually establishing a model venture capital fund. While a legal structure, prudential regulations and standards, and fund tax status were established, the model fund was never developed.

5.11 It is OED's judgment that the TDP was overall successful in bolstering Turkey's metrology infrastructure, and that the project may have contributed to a modest increase in the "technology culture." However, the project had serious shortcomings in not succeeding in the establishment of an independent accreditation organization, as well as not establishing a model venture capital fund. Because of these shortfalls, as shown in the table below, OED rates the TDP as "marginally satisfactory."

33. The Technology Development Foundation believes that these studies benefited the sectors for which they were performed.

34. However, the modest scale of the TDP must also be taken into account.

Table 5.4: PAR Ratings

	Technology Development Project		
	ECA ICR	*OED ICR Review*	***OED PAR***
Outcome	Satisfactory	Satisfactory	**Marg. Satisfactory**
Sustainability	Likely	Likely	**Likely**
Institutional Development	Partial	Modest	**Modest**

6. Lessons Learned

6.1 The Lessons Learned included:

- **The Principles of the Levy Report are Valid.** Given the prevailing macroeconomic situation, the three credit line projects had little or no chance of success. Banks could only rarely obtain longer-term funds, and thus were not in a position to lend long-term. Further, the extremely high real interest rates caused by enormous government borrowing provided an opportunity for very high profits, crowding out term lending and other normal business. As had been well-understood earlier and codified in the Levy Report, financial sector operations should only be initiated if a determination is made that "the macroeconomic environment is conducive to realizing their objectives." And in a financial sector operation it is essential that interest rates be market-determined.

- **The Bank Was Not Consistent in its Relations with the Borrower.** Bank interaction with the Turkish authorities was profoundly inconsistent during the period of the four projects. At the same time that the Bank was attempting through the FSALs to reform the banking sector and was urging the GOT to reduce its fiscal deficit, the three credit lines established procedures that (1) exacerbated the fiscal deficit; and (2) permitted subsidized credit and negative real interest rates. While, on the one hand the Bank told the GOT that the main barrier to term credit was the excessive fiscal deficit, on the other hand it initiated 3 credit lines in 3½ years to "provide enterprise credits." It is understandable that the government did not take the Bank's message seriously, and suggested that the Bank "revise its fanatic concern for macroeconomic variables."

  In the Technology Development Project, the Bank informed the GOT from the beginning of the project that an independent accreditation council was critical to enhancing the international credibility of Turkish test certificates, and would significantly facilitate exports. But even though the Turks failed to comply with this request during the TDP, a follow-on TDP II project was initiated without making this action a condition of project approval.

- **Credit Lines (Financial Intermediary Loans) were not a Substitute for an Effective Financial Sector Adjustment Loan.** What Turkey needed during the period of the three credit lines was an effective FSAL that would achieve real financial sector reform and place the country firmly on the path toward fiscal responsibility. While the credit lines were described as "complementary" to the unsuccessful FSALs that were in place, there was in reality no connection, and the utilization of these instruments was inappropriate and ultimately unsuccessful.

Annex Table 1: Participating Banks

Bank	Type	IEDP	SMI2	PICP
SYKB	Development	✔	✔	✔
TSKB	Development	✔	✔	✔
Akbank	Commercial	✔		
Disbank	Commercial	✔		
Ekonomi	Commercial	✔		
Garanti	Commercial	✔		✔
Iktisat	Commercial	✔		
Is Bank	Commercial	✔		
Vakifbank**	Commercial	✔	✔	✔
Yapi Kredi	Commercial	✔		✔
Emlak*	Commercial		✔	
Halk*	Commercial		✔	
Inter	Commercial			✔
Korfez	Commercial			✔
Eximbank	Export Guarantee Agency		✔	

*Government-owned (The Government has said it intends to privatize Vakif, Emlak, and Halk under the proposed Financial Sector Adjustment Loan; a fourth state bank, Ziraat, is to be "commercialized")
**Minority government-owned

BASIC DATA SHEET

INDUSTRIAL EXPORT DEVELOPMENT PROJECT
(LOAN-2901: 0-TU, 1-TU &2-TU)

Key Project Data

	Appraisal Estimate (US$M)	*Actual Estimate* (US$M)
IBRD/IDA	300	287
Total	300	287

Cumulative Estimated and Actual Disbursements (US$m)

End June	*Actual Amount Cumulative*	*Profile Amount Cumulative*	*Original Amount Cumulative*	*Revised Amount Cumulative*	*Actual vs. Original (%)*
1988	15.87		5.00	15.87	300
1989	152.37	30.00	106.00	152.37	144
1990	265.41	102.00	218.40	265.41	122
1991	285.62	210.00	279.60	285.62	102
1992	287.10	270.00		287.10	
1993	287.49	288.00			
1994		300.00			

Project Dates

Steps in Project Cycle	*Planned*	*Revised*	*Actual*
Preparation	N.A.	N.A.	N.A.
Appraisal Mission	05/01/87	04/06/87	04/10/87
Loan Negotiation	07/01/87	07/27/87	11/17/87
Board Approval	12/01/87	12/02/87	12/19/88
Loan Signing	N.A.	N.A.	1/25/88
Loan Effectiveness	N.A.	4/30/88	4/15/88
Closing Date	06/30/93	06/30/93	06/30/93

Staff Inputs (Staff Weeks)

Task	*FY87*	*FY88*	*FY89*	*FY90*	*FY91*	*FY92*	*FY93*	*FY94*	*Total*
Up to Preparation	4.8	4.4							9.2
Appraisal	14.2	19.1							33.3
Negotiation		5.1							5.1
Preparation through Approval	35.9								35.9
Supervision		5.5	27.4	7.2	2.6	2.0	4.2		48.9
Project Completion Report							8.0	4.0*	8.0
Total	54.9	34.1	27.4	7.2	2.6	2.0	12.2	4.0	144.4

Mission Data

Stage of Project Cycle	*Date of Report/Dates Covered*	*Number of Persons*	*Days in Field*	*Project Rating*
Preparation and Pre-appraisal	N.A.	N.A.	N.A.	N.A.
Supervision Mission	01/31/88 11/28-12/09/88	4	11	N.A.
Supervision Mission	05/16/89/ 04/09—20/89	N.A.	11	1

Other Project Data

Related Projects

Loans/Credits	*Purpose*	*Date of Approval*	*Status/Comments*
Ln. 1754-TU, 1755-TU Private Sector Textiles Project.	Assist Financing of subprojects for the development, modernization, productivity improvement and export capacity of the private textiles sector.	09/04/79	Closed 12/31/85. Remaining Balance of US$1.45 million cancelled.
Ln. 1952-TU Labor Intensive Industry Project.	Provide Credit for development of labor intensive small and medium scale enterprise.	03/03/81	Closed 06/03/86 US$0.46 million cancelled.
Ln. 2714-TU Financial Sector Adjustment Loan I	Improve the efficiency of the financial sector by developing a greater variety of financial instruments contributing to resurgence of private investment.	06/10/86	Closed 06/31/91. Fully disbursed
Ln. 2964-TU Financial Sector Adjustment Loan II	Support the development of a more efficient and deeper financial sector that can mobilize and allocate funds more effectively, thus generating higher investments and higher rates of return.	06/21/88	Closed 12/31/92. US$100 million cancelled.
Ln. 3077-TU Agroindustry Project II	Provide funds through participating credit institutions to financially and economically viable private sector agroindustry projects for increasing agroindustry output.	06/15/89	Closing date: 12/31/95
Ln. Industrial Technology Project	Assist in harmonization of Turkish technology infrastructure with EU standards, and assist firms in upgrading technology and competitiveness.	6/17/99	US$ 155m Closing date: 12/31/2003

BASIC DATA SHEET

SECOND SMALL AND MEDIUM-SCALE INDUSTRY PROJECT (LOAN-3067-TU)

Key Project Data

	Appraisal Estimate (US$ Million)			*Actual Estimate (US$ Million)*		
	Local Costs	*Foreign Costs*	*Total*	*Local Costs*	*Foreign Costs*	*Total*
IBRD	-	204.5	204.5	-	202.3	202.3
Total		204.5	204.5		202.3	202.3

Cumulative Estimated and Actual Disbursements (US$m)

FY	*Appraisal Estimate*	*Actual*	*Actual as % of Estimate*
1990	10.0	21.17	212
1991	36.0	87.1	242
1992	82.0	121.66	148
1993	135.0	130.53	97
1994	172.0	134.75	78
1995	194.5	137.51	71
1996	204.5	188.98	92
1997	204.5	202.28	99

Project Timetable

Steps in Project Cycle	*ActualDate*
Identification	01/15/88
Preparation	02/08/88
Appraisal Mission	11/05/88
Board Presentation	06/28/89
Signing	06/28/89
Effectiveness	10/26/89
Project Completion	04/30/97
Closing Date	12/31/96

Staff Inputs (Staff Weeks)

	Planned Inputs		*Actual*	
Stage of Project Cycle	SWS	US$'000	SWS	US$'000
Through Appraisal	140.8	332.7	140.8	332.7
Appraisal Board	8.4	22.4	8.4	22.4
Board Effectiveness			N/A	N/A
Supervision	202.6	403.5	199.3	399.1
Total	351.8	758.6	348.5	754.2

Mission Data

Stage of Project Cycle	*Date*	*No. of Persons*	*Days in Field*	*Specialization(1)*	*Performance Rating*		
Through Appraisal	11/88	5	14	E,F,T			
Appraisal Board	06/89	-	F				
Supervision I	05/89	1	-	OA	NR	NR	-
Supervision II	06/89	2	-	0A,F	1	1	M
Supervision III	06/89	2	-	OA,F	1	1	-
Supervision IV	03/90	5	21	F,F,F,T,RA	1	1	-
Supervision V	03/90	1	-	AC,E,Fi,N	1	1	-
Supervision VI	04/91	1	-	F	1	1	-
Supervision VII	12/91	4	20	F,E,E,C	1	1	-
Supervision VIII	06/92	1	-	F	1	1	M
Supervision IX	05/93	1	14	F	1	3	-
Supervision X	12/93	3	20	E,F,C	2	3	-
Supervision XI	12/93	4	14	F,E,C,AD	U	S	-
Supervision XII	12/94	2	14	C,F	S	S	-
Supervision XIII	09/95	2	14	AC,F	S	S	-
Supervision XIV	02/96	2	22	AC,F	S	S	-
Supervision XV	09/96	2	20	AC,F	S	S	-

1-Key to specialized staff skills:	2-Key to Performance Ratings:	3-Key to Types of problems
AC= Agricultural credit Spec.	1=Minor problems	F=Financial
E=Economist	2=Minor problems	T=Technical
RA=Research Assistant	3=Major problems	M=Managerial
C=Consultant		
AD=Advisor		

BASIC DATA SHEET

PRIVATE INVESTMENT CREDIT PROJECT
LOAN 3346-TU

Key Project Data

	Appraisal Estimate (US$ Million)			Actual Estimate (US$ Million)		
	Local Costs	*Foreign Costs*	*Total*	*Local Costs*	*Foreign Costs*	*Total*
IBRD	-	200.0	200.0	-	198.0	198.0
PFIs	0.5	0.5	1.0	-	-	-
Sub-borrowers	200.0	-	200.0	820.0	-	821.0
Total	200.5	200.5	401.0	820.0	198.0	1,019.0

Cumulative Estimated and Actual Disbursements (US$m)

	FY92	*FY93*	*FY94*	*FY95*	*FY96*	*FY97*
Appraisal Estimate	20.0	80.0	155.0	190.0	200.0	200.0
Actual	-	20.0	26.0	28.0	164.0	198.0
Actual as % of estimate	-	26.0	17.0	15.0	82.0	99.0

Project Timetable

Steps in Project Cycle	*Actual Date*
Identification/Preparation	05/15/89
Appraisal	06/03/90
Negotiation	01/12/91
Board Presentation	06/13/91
Loan Signing	06/28/91
Effectiveness	11/22/91
Project Completion	06/30/97
Loan Closing	06/30/97

Staff Inputs (Staff Weeks)

Stage of project cycle	*Planned Inputs* *SWS*	*US$'000*	*Actual* *SWS*	*US$'000*
Through appraisal	98.9	262.8	98.9	262.8
Appraisal Board	53.9	142.3	53.9	142.3
Board Effectiveness	N/A	N/A	N/A	N/A
Supervision	139.6	335.0	139.6	335.0
Total	292.4	740.1	292.4	740.1

Mission Data

Stage of project cycle	*Date*	*No. of persons*	*Duration (No. of days)*	*Specialized staff skills **	*Performance rating* *Implement. Status*	*Develop. objectives*	*Types of problems*
Through appraisal	06/90	7	-	E,F,AD			
Appraisal Board	06/91	1	-	F			
Supervision I	06/92	1	-	F	2	3	-
Supervision II	08/93	4	-	C,E,F	3	3	-
Supervision III	06/94	4	-	C,E,F,AD	U	S	-
Supervision IV	06/95	4	-	C,E,F,AD	S	U	-
Supervision V	09/95	2	-	AC,F	S	U	-
Supervision VI	03/96	2	-	AC,F	S	U	-
Supervision VII	06/96	2	1	F	S	U	-
Supervision VIII	10/96	2	20	F	S	U	-
Supervision IX	06/97	2	12	F	S	S	-

1-Key to specialized staff skills:
AC=Agricultural Credit Spec.
E=Economist
F=Financial Analyst
C=Consultant
AD=Advisor

2-key to Performance Ratings:
1=Minor problems
2=Moderate problems
3=Major problems

3-Key to Types of problems
F=Financial
T=-Technica
M=managerial

Basic Data Sheets

TECHNOLOGY DEVELOPMENT PROJECT (LOAN TR-3296S, 3296A

Key Project Data: Project Financing

(amounts in US$ million)

	Estimated			Actual		
	Local cost	*Foreign cost*	*Total cost*	*Local cost*	*Foreign cost*	*Total cost*
IBRD	5.0	95.0	100.0	0.0	97.0	97.0
IFC	0.0	5.1	5.1	0.0	0.0	0.0
Govt. of Turkey	6.2	0.0	6.2	10.8	0.0	10.8
Private Sector	99.0	32.3	131.3	45.3	0.0	45.3
Development Banks	4.0	0.0	4.0	0.0	0.0	0.0
TSE	7.6	0.0	7.6	17.7	0.0	17.7
Multilateral Donors	2.0	1.5	3.5	0.0	0.0	0.0
Bilateral Donors	0.4	4.0	4.4	3.4	0.0	3.4
Total	124.3	137.9	262.2	77.2	97.0	174.2

Cumulative Estimated and Actual Disbursements

	FY91	*FY92*	*FY93*	*FY94*	*FY95*	*FY96*	*FY97*	*FY98*	*FY99*
Appraisal Estimate	5.1	10.4	22.7	28.4	18.0	15.4	0.0	0.0	0.0
Actual	0.0	0.0	5.2	7.1	6.8	12.7		25.5	13.8
Cumulative	0.0	0.0	5.2	12.3	19.1	31.8	25.9	83.2	97.0
Actual as % of Estimate	0.0%	0.0%	23.1%	25.0%	37.5%	82.55	57.7	-	-

Project Dates

Steps in Project Cycle	*Date Planned*	*Date Actual*
Identification		23-Apr-88
Preparation		12-Mar-90
Appraisal		18-Jun-90
Negotiations		22-Jan-91
Board Presentation		28-Feb-91
Signing		5-Apr-91
Effectiveness	6-Jun-91	6-Sep-91
Project Completion	31-Dec-96	31-Dec-98
Loan Closing	30-Apr-97	31-Dec-98

Staff Inputs (staff weeks)

Stage of Project Cycle		*US$(000)*
Preparation to Appraisal	116.8	306.4
Appraisal	19.9	61.4
Negotiations through Board Approval	7.7	23.9
Supervision[a]	134.1	355.5
Completion	8.0	10.0
TOTAL	286.5	757.2

Mission Data

Stage of project cycle	*Date (mm/ yr.)*	*No. of persons*	*Duration of mission (# of days)*	*Specialized staff skills represented **	*Performance rating*		*Types of problems*
					Impl. Status	*Develop. objectives*	
Supervision	03/93	3	NA	TM, RM, FA	S	S	Establishment of NAC
Supervision	09/93	4	NA	TM, RM, FA SP	S	S	Establishment of NAC
Supervision	06/94	3	NA	TM/FA, RM, SP	S	S	Establishment of NAC
Supervision	12/94	2	NA	TM/FA, RM	S	S	Establishment of NAC
Supervision	07/95	3	NA	TM/FA, RM, SP	S	S	Establishment of NAC
Supervision	09/95	3	NA	TM/FA, RM, SP	S	S	Establishment of NAC
Supervision	07/96	3	NA	TM/FA, RM, SP	S	S	Establishment of NAC
Supervision	02/98	3	NA	TM/FA, OP, SP	S	S	Establishment of NAC
Supervision	06/98	4	NA	TM, OP, SP, SP	S	S	Establishment of NAC
Supervision	10/98	3	NA	TM/FA, RM, SP	S	S	Establishment of NAC
Supervision	03/99	3	NA	TM/FA, RM, SP	S	S	Establishment of NAC

REPUBLIC OF TURKEY
PRIME MINISTRY
THE UNDERSECRETARIAT OF TRESURY
General Directorate of Foreign Economic Relations

Ref : B.02.1.HM.0.DEİ.01.04.G /3032 **Ankara,** October 30, 2000

30.10.00 · 56661

Mr. Ruben LAMDANY
Manager
Country Evaluations and Regional Relations
Operations Evaluation Department
The World Bank
1818 H Street N.W.
Washington, D.C. 20433
U.S.A.

Dear Mr. Lamdany,

I would like to refer to the draft Performance Audit Report (PAR) regarding Industrial Export Development Project (2901-TU), Second Small and Medium Scale Industry Loan (3067-TU), Private Investment Credit (3364-TU), and Technology Development Project (3296-TU) attached to your letter of September 28, 2000. In this context, please find our comments for your consideration attached hereto on the said draft report.

While thanking you for your kind efforts for the preparation of this report, I would like to kindly request you to send us the final version of it whenever it is ready.

Sincerely,

Arif ERDEN
Deputy Director General

Encl.

cc. Ms. Sally ZEIJLON

Comments of the Technology Development Foundation of Turkey (TTGV) for Technology Development Project:3296-TU (TDP):

- The report should mention the name of Technology Development Foundation of Turkey (TTGV) as the "foundation" established to encourage market-oriented research and development (R&D) in private sector by financing projects on a matching basis.

- Under Technology Development Project (TDP), the support provided by TTGV to the industry is for R&D projects. Therefore, the form of support should be stated as R&D in the report, not as research only.

- As TTGV provided loans for R&D projects of the industry for the whole technology areas, the wording "specified areas" should be deleted in item 5.8.

- Considering the scale of Turkish industry, the amount allocated for TTGV which is around US$40 million is quite low to create a remarkable and comparable rise (TTGV could have supported only 79 projects while there are approximately 200,000 industrial companies in Turkey). This issue must be considered while commenting on the impact created in items 5.8 and 5.9.

- As mentioned in item 5.8, the reason for not commercializing the products developed under TDP is lack of funding. Since TTGV provided funds for R&D stage of the products, the companies needed additional resources for commercialization after R&D. This is due to insufficiency of other financial mechanisms in the country to support companies -especially SMEs- after R&D stage.

- 18 studies performed on technology strategies and specific technologies, mentioned in item 5.8, provided benefits to the sectors they belong to as TTGV published and distributed the results of the studies throughout Turkey. In addition, seminars and conferences were organized at the end of the studies. The documents published have been cited in the other studies carried out in those sectors.

Comments of the Industrial Development Bank (*Sınai Yatırım Bankası*-SYB) for Industrial Export Development Project (2901-TU), Second Small and Medium Scale Industry Loan (3067-TU) and Private Investment Credit (3346-TU):

- One of the major criticism of PAR is that the FERIS line had a subsidy element which in turn exacerbated the government deficit. Although it is evident that the fixed FERIS rate meant negative interest rates, we do not share this view on the subsequent structuring of the loans.

The assessment appearing on section 3.2, page 7, "Later, when floating FERIS rates prevailed, the GOT introduced a subsidy scheme under which borrowers could deduct from the FERIS rate the withholding tax that was normally applicable on T-bill income, effectively providing a subsidy for borrowers under the credit lines" is not reflecting the actual situation.

It is true that SYB applied a number of times to the Treasury and to the Money and Credit Board, and further requested the support of the IBRD missions, and urged for the elimination of the effect of the withholding tax in the calculations. Our requests were not treated favorably and the reference FERIS rates continued to be calculated on the basis of yields (carrying the burden of the withholding tax). One can argue that there has not been subsidy element in the floating interest rates. On the contrary, for relatively long periods the sub-borrowers had to pay high real interest rates as the Public Sector's Borrowing Requirements continued to increase which eventually led the market to demand high premiums for risks born.

- In the case of restructured loans, for long periods of time particulary during late 1998 an 1999, the cost of US Dollar single currency funds to SYB varied from 10.88% to 13.97%. On the other hand, the cost to the sub-borrowers ranged around 14% - 17%. Although it was unintentional, the Treasury was making good profit on the IBRD loans. Therefore, it can be said that as in the case of FERIS, the Public Sector's High Borrowing Requirements artificially distorted the borrowing costs of restructured IBRD sources. Currently, the interest rate of the restructured loans are above the market rates since the interest rates are indexed to the interest rates of the foreign currency deposits of the past six months and in periods where interest rates tend to decline, this formulation would result in higher interest rates than the prevailing market rates.

  As a result, the sub-borrowers utilizing IBRD sources were placed in a disadvantageous position in export markets against their competitors which have access to funds at international market rates.

- The real sector and export performance benefited from the loans under review and their contribution to the economy was important. They had positive impact on the institutional development of SYB. Therefore we are in full agreement with the position of the Turkish Government quoted in section 2.11, Page 6.

- As stated in Section 2.1, page 2, the objective of IEDP, SMI2 and PICP was to expand production and exports (especially by SMEs). As stated in the report, exports depend on a very large number of variables and the Exports/GNP ratio might not have shown a significant increase during the period 1988-1998, but the loan had a substantial impact on the exports of the firms financed.

- There is a reference to working capital in Section 3.1, page 7, "Additional difficulties were caused by the initial design – corrected in 1994 – which did not permit working capital". Unfortunately, in the late 1980's when the loans were under preparation, SYB was unable to convince the IBRD counterparts to include working capital financing.

- An important feature of the restructured loans is that the intermediary banks can use the proceeds of the loan for reallocation to new projects as far as collections and payments permit.

- Section 4.1, page 11 and Section 4.7, page 13 evaluates the loans from three perspectives and concludes that the loans have not fulfilled those aims, i.e:

  - The Bank credit lines could not make a net contribution to the available supply of credit;

  - The Bank credit lines did not have a catalytic effect and in return private credit did not rise; and

  - Exports and manufacturing exports had increased but probably less than the Bank had anticipated.

  Total amount of the three loans probably contributed to not more than 4 % of aggregate private credits of Turkish industry during the period 1989-1999. Thus it was unrealistic to expect such a performance.

Comments of the INTERBANK for Private Investment Credit (3346-TU):

- Interbank being a participant in Private Investment Credit Project like the other participating banks benefited the project's long term lending facility. Interbank had been participant to major credit lines such as HERMES, US Exim, OKB etc. but the World Bank programmes- when compared to those- enabled us to improve our abilities in longer term credit evaluation.

- The program itself contributed to our long-term customer relationships, enabled both parties (the customer & the bank) to search for other project finance opportunities and to diversify type of products in customers' use. And like all the long-term syndications that Interbank acted as an agent, the World Bank PICP programme was essential in the means of reputation for our corporation.

- We regretfully inform you that- as declared by OED- we agree with all the mentioned inabilities of the programme in achieving the goals and the negative impact of the policies adopted by GOT by the time the programme prevailed.

  As:
  Turkey-under the supervision of IMF- is from now on determined to keep the macroeconomic environment conducive to realizing the mentioned objectives.

  World Bank with such an objective point of view trace out inabilities of the designed programmes and ready to take precautions to procee by more appropriate instruments with strong conditionalty.

  We as Interbank would be grateful to accept any invitations to participate in any redesigned programmes of World Bank.

Comments of the Institute of Turkish Standards (TSE) for TDP (3296-TU):

- The Technology Development Project was fulfilled by TSE successfully. In the PAR, Article 5.6 it is mentioned that "TSE" failed to set up an independent body (the National Accreditation Council-NAC) to accredit private laboratories". This statement is not expressing the reality. As it was agreed, NAC was established and started to function according to the international rules. TSE has stressed several times that this organization is completely independent and till the law has been achieved it would be functioning as a temporary solution.

- TSE has extended a great deal of effort to obtain a legal status by the Parliament. Furthermore, it is not correct to say that NAC did not achive recognition from International Accreditation Organization. NAC has signed a Memorandum of Understanding with International Laboratory Accreditation Cooperation (ILAC) at September 13, 1996 together with other 44 national accreditation bodies and has become a full member of ILAC.

- NAC has displayed a good performance both in the national and international arena for the formation of an accreditation infrastructure for Turkish Industry, especially by the calibration and testing laboratories. During this time, eight labs have been accredited by NAC. Several calibration and testing labs have been trained about accreditation procedures and standards. Besides, NAC has created an auditors pool for Turkey. In addition, NAC was a founding member of World Quality Council on September 13, 1996.

- TSE issued certificates have always been recognized and for this reason the exports of Turkey have not been affected negatively. Acceptance of the certificates given by the National Certification Bodies depends on voluntary basis in all over the World. Technical Legislation is being adjusted within the framework of Customs Union between Turkey and the EU. However, the acceptance of the certificates given by TSE is not subject to the regulated area by itself. So called Essential Requirements, especially for safety subjects, and laboratory reports are also very important for a certain product which is subject to export to European Countries. National and/or Regional and/or International Accreditation Bodies could only declare that the certificate or the report given for a specific good is relevant. But the Multilateral and/or Bilateral Agreements cannot force a body to accept or reject the related documents. Therefore, acceptance of TSE issued certication is not directly subject to the formation of the Turkish NAC.

- Turkish Accreditation Council (TÜRKAK) was established by Law that was published at the Offical Gazette on November 4, 1999, with the number 23866. TSE has spend great effort for the establishment of TÜRKAK. NAC has finalized its duties and responsibilities by that time.

- To sum up, Article 5.6 should be deleted or revised according to the above mentioned TSE comments.

<u>Comments of the Vakıfbank for Industrial Export Development Project (2901-TU), Second Small and Medium Scale Industry Loan (3067-TU) and Private Investment Credit (3346-TU):</u>

- Industrial Export Development Project:

  Vakıfbank, as being one of the "Participating Banks", disbursed total USD 12.950.762,81 under the said project.

  The Loan was disbursed to 6 companies (firms) through Vakıfbank. Two of these six companies were performing in tourism sector, two companies in textile sector, one firm in consruction materials, and one firm in other sector.

  All repayments under the said credit line, which was closed on June 30, 1993, were transferred by Vakıfbank on October 1, 1998 without any delay.

- Second Small and Medium Scale Industry Loan:

  The credit was used by 59 firms through Vakıfbank under FERIS (Foreign Exchange Risk Insurance Scheme). Out of 22 loans disbursed under out of FERIS, in foreign currencies, 2 were working capital loans and 20 were investment loans.

A large portion of the credits (36%) was allocated to firms performing in textile sector which is the locomotive sector for Turkey. It was followed by the firms' disbursements in tourism sector with 16%, 12% in food sector and 10% in other sectors including construction materials.

Vakıfbank disbursed USD 81.836.365,66 from the said source for a total of 81 projects. 38 of these 81 sub-projects were small scale, 43 projects were medium scale under the World Bank Standards.

USD 26.832.430,31 of total disbursement amount of USD 81.836.365,66 has been utilised by the small-scale enterprises, and USD 55.003.935,35 by the medium scale enterprises.

According to the Project Appraisal Reports in relation to Loan 3067-TU; the fund created 6684 jobs and USD 277,7 million of value added which is equivalent to 3,4 times more than the amount of the loan disbursement. The 28,7% of the created employment was in food sector, 20,8% in textile, 20,4% in tourism, the rest was created in the other sector category.

Expansion and modernisation investments, financed under loan 3067-TU disbursed by Vakıfbank, created 69% of the value added and 66,7% of the export earnings at full capacity. New investments created 33,3% of the export earnings and 31% of the value added.

With regard to regional distribution, Marmara (31%) and Agean Regions (31%) were first of all and they were followed by Mediterranean Sea Region with 20% and South East Anatolia Region 10%. Central Anatolia Region benefited from this credit 6%, and Black Sea Region and East Anatolia Region 1%.

- Problems Experienced Related With the Loan

FERIS interest rates were quite attractive for the investors in 1989-1990 which were floating around 40%, so this was a reason that Vakıfbank has realised the notable part of the loan disbursement in 1990. However, FERIS interest rates reached to 158,3% in July 1994, because of the constantly rising trend of the interest rates starting from 1991 and general economic crisis rising during the Gulf Crisis. All these had a quite negative impact on investors.

Because of continuos rise in FERIS interest rates, and since FERIS Administration did not accepted early payment, firms demanded early payment of the project loans under FERIS, or at least to capitalise their interest. 15 sub-borrowers wanted to hedge themselves from the high cost of the credit to be faced in the next years, and had paid up their capitalised interests at least.

Under the credit line which was restructured with the 3rd Modification Agreement in 1995, we had presented our views in Closure Report that Vakıfbank prepared on 3067-TU Credit Line in 1996 to present to the Treasury and the World Bank that high interest rates which applied to the credits utilised from the foreign currency pond as foreign currency also caused the investors to have difficulties in Closure Report.

As a matter of fact, in the term April 2000, due to the highness of the foreign currency interest rates compared to the prior term, opposite to the common lower trend in the market, some views have started to appear that investors, not officially, may close credits earlier. In parallel to the opinions of the firms, the method of calculating the interest rates has been changed. -Calculating the weighted average of 5 Agent Banks' that foreign currency accounts interest rates.- 3rd Modification Agreement has been changed in this way and the modification came into effect after signed by Vakıfbank and Treasury on July 13, 2000.

- The Succes of the Project 3067-TU From the Vision of the Banks and Sub-Borrowers

In our opinion, the disbursements from the Credit Line, especially through its long grace period helped creating new small and medium scale firms that wanted to export but were unable to ensure its long term finance requirements from local banks. It also helped improvement of the small and medium scale industry. 3 years grace period helped the small and medium scale investors that started new investments and needed a long period for money to relieve. Credit Line also contributed to the small and medium scale investors to compete in local and foreign markets and to increase product quality by supporting their investments for this purpose.

As mentioned above, the opportunity of procuding the long term credits that is not obtainable from local sources has assisted to the Turkish economy through employment creation, added value and increased export incomes in addition to the above mentioned advantages.

As a result of the restructuring of the credit in 1995, it became possible to ensure the continuous working capital requirements of the firms. Thus ensured the credit to be used on the base of USD and DEM.

In the projects financed, investors were required to use equipment and production technology that were not negatively affecting the environment and human health

In addition agent banks prepared credit evaluation by using World Bank criteria. Thus, it helped the investors in Turkey and the Banks to develop their vision and create much more effective credit evaluation techniques.

Through the World Bank credits both investors and the banks have met their long term credit requirements and obtained new financing opportunities. In order to utilise credit from abroad, investors and the banks made great improvements to integrate the World Bank System.

- Private Investment Credit:

The amount of the credit that was utilised by 22 firms was USD 47.433.955,98. 3 of these firms have used working capital credits and 19 used investment credits.

Vakıfbank under the private sector investment project extended the biggest share of the financing to the textile sector (34%). The share of construction sector was 32% and electronics was 11%.

According to the Project Appraisal Reports in relation to Loan 3346-TU; the fund created 1925 jobs and USD 289,3 million of value added which is equivalent to 6,1 times more than the amount of the Loan disbursement. The 60% of the created employment was in textile sector, 17% in construction materials, and the rest was created in other sector category.

The disbursement has constituted 61,9 % of added value and 77,1 % of export revenue under the loan facility for new investment with the whole capacity. In addition, modification investments have also constutited 38,1% of added value and 22,9% export revenue.

The majority of the Loan 3346-TU has been utilised (40,91%) in the Agean Region, 36,36% of it was utilised in Marmara Region and 9,09% in South East Anatolia Region and then with the equal percentage 4,55%, it is utilised in the Mediterranean Region, Central Anatolia Region and Black Sea Region.

- The Questions About These Credits

Like Loan 3067-TU facility, the Loan 3346-TU had high interest rates as well. The firms were right about their uneasiness. When the adjustment of the interest rate which has been notified by the Bank, it has been realised that it was over the real interest rates, with the result of taking into consideration the abstract interest rates which have not been applied by the Bank in the markets. In order to remove this problem, the clauses of the 3rd Modification Agreement connected with the calculation of the interest rate have been changed.

- The Success of the Loan 3346-TU for the Banks and the Sub-Borrowers

The three year grace period of the credit has been useful for the new investments which have just started. The investors who made modernization investments increased their international competition ability, had their products diversified by the support of long-term financing ensured from the Loan and their exports have been increased by the quality investments. Except for their trading operations another reason for the strength of the investors were to finance the venture capital.

Under the Private Investment Credit facility, the equipment and technology of manufacturing used in the investor projects have mostly included precautions that influence the human health in order to get rid of the churn. The investors' sensitivity has increased and they have taken precautions to prevent the environmental pollution.

Like Loan 3967-TU, these credit facilities have contributed to Turkish economy with respect to added value, employment and revenue of exports.

These credit facilities have helped the intermediary banks such as learning new methods to appraise their projects. In this way their technical experience has increased and extended to the new credit facilities which are provided from abroad.

In conclusion, Vakıfbak has been extremely pleased to support the investors under each of the three credit facilities which have contributed in terms of the education of the bank employees or investors and also pleased to help creating export revenue, added value and employment for the overall economy by having a credit rrelation with the World Bank.

Since 1988, by supporting the investors successfully, whether Vakıfbank or the investors have been satisfied with the allocation of the investment and enterprising credits which have obtained from the World Bank.

It is clear that the credit facilities are highly successful by applying of the credits of project appraising. In addition, these techniques have been applied to all the allocations of the credits for the investors' projects.

Vakıfbank is ready to take part in credit lines obtained from the World Bank with its experienced employees, technical equipment, large branch network, successful sources and the support from the investors and also ready to enter into new cooperations in connection with this subject.