ICRR 11463
Report Number : ICRR11463

ICR Review
Operations Evaluation Department

1. Project Data: Date Posted : 03/18/2003

		Appraisal	Actual
PROJ ID : P070561			
Project Name : Programmatic Financial And Public Sector Adjustment Loan I	Project Costs (US$M)	1100	1100
Country : Turkey	Loan /Credit (US$M)	1100	1100
Sector (s): Board: FSP - Central government administration (50%), Banking (46%), Capital markets (2%), General industry and trade sector (2%)	Cofinancing (US$M)		
L/C Number : L4632; L4633			
	Board Approval (FY)		2
Partners involved :	Closing Date	12/31/2001	12/31/2001

Prepared by :	Reviewed by :	Group Manager :	Group :
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2. Project Objectives and Components

a. Objectives

The main objectives were to address immediate financial and public sector reforms . In the financial sector: (i) overhaul of the regulatory framework for banking activity, (ii) institutional development of the new Bank Regulation and Supervision Agency (BRSA), (iii) problem bank/bank failure resolution, and (iv) state bank restructuring and privatization. In the public sector: (i) structural fiscal policies, (ii) public expenditure management, (iii) public sector governance.

b. Components

Financial Sector --1. Improvement of the legislative and regulatory framework for banking activity; 2. Institutional development of the new Bank Regulation and Supervision Agency (BRSA), and the bank failure resolution entity, the Savings and Deposit Insurance Fund (SDIF); 3. Problem bank/bank failure resolution, to undertake restructuring of private sector banks; 4. State bank restructuring and privatization . Public sector --1. Implementation of structural fiscal policies to underpin fiscal adjustment; 2. Design and implementation of reforms to modernize public expenditure management in line with EU and international norms including budget reform, financial accountability and public liability management; 3. Institutional reforms to improve public sector governance .

c. Comments on Project Cost, Financing and Dates

The loan disbursed in one tranche immediately after effectiveness .

3. Achievement of Relevant Objectives:

Banking Regulatory Framework :

Loan loss provisioning, formerly considered on an individual basis, was modified to be considered on a consolidated basis (i.e., to banks and their subsidiaries together)

a Basel-compliant market risk based capital charge was imposed

a new, stronger capital adequacy regulation was introduced

Institutional Development of the BRSA /SDIF: SDIF

BRSA and SDIF Boards adopted time-bound plans for institutional development

Problem Bank /Bank Failure Resolution :

BRSA identified all capital deficient banks, and Treasury and the Central Bank injected sufficient capital into SDIF banks to ensure that the banks had a positive CAR and sufficient liquidity

problem banks were resolved by merger into other banks (10 banks) or sale (4 banks)

non-performing loans of intervened banks were transferred to an SDIF -controlled bank (of which there are 2)

State Bank Restructuring and Privatization :

Remaining state banks were financially restructured, with the injection by Treasury of sufficient marketable securities and cash, to ensure a CAR of 8% and adequate liquidity. Including both State banks and SDIF banks, the fiscal cost of bank recapitalization in 2001 through May 15 was 23.8% of GNP, with a net increase in the public debt stock of 13.3% of GNP.

legislation permitting sale of Vakifbank shares was adopted

a privatization advisor was appointed for Vakifbank

Structural Fiscal Policies :

The primary balance was +5.9% of GNP in 2001, a significant improvement from the two previous years (in 200 it was +2.3%, and in 1999 it was -2.0%), and met program targets; fiscal performance in 2002 broadly met targets. The improvement in the primary balance was an effort to offset the larger interest payments resulting from the bank recapitalization and the related increase in domestic debt

a rule was established that SOEs could replace only 15% of the employees retiring

Public Expenditure Management --

Additional budgetary and extra -budgetary funds were closed, leaving just 1 budgetary fund (out of 62 before reforms were undertaken) and 5 extra-budgetary funds (out of 13)

an improved budget classification system, GFS, was introduced on a pilot basis and will be made mandatory in 2004

the process of preparing the government budget and public investment program was rationalized

Financial Accountability :

An automated accounting system for all government agencies --linking 1500 sites--was implemented

a new public procurement law was enacted that meets UN standards

Public Liability Management :

The legal basis for authorizing imposition of duty losses was eliminated

public debt management was strengthened by the enactment of new legislation confirming Treasury as the single borrowing authority for the government, and establishing an office for public debt and risk management

Public Sector Governance :

An anti-corruption strategy was adopted

4. Significant Outcomes/Impacts:

BRSA completed comprehensive audits of all banks for compliance with capital adequacy, connected lending and non-financial equity exposure, and all non -compliant banks either came into compliance or were intervened .

The number of staff and branch offices of SDIF -controlled banks was reduced significantly

SDIF auctioned US$2.9 billion of SDIF bank liabilities along with matching assets

The remaining state banks were financially restructured to restore their solvency and increase their liquidity

Fifteen budgetary funds and 2 extra-budgetary funds were closed

A new public procurement law was enacted that is a significant advance toward EU standards

5. Significant Shortcomings (including non-compliance with safeguard policies):

The project was overly ambitious in expecting that substantial progress could be made in developing BRSA and SDIF capacity--including harmonization and integration of staff structure, data systems, and procedures--while these agencies were consumed with addressing pressing operational problems

Institutional development of BRSA and SDIF has proceeded much more slowly than envisioned

6. Ratings :

	ICR	OED Review	Reason for Disagreement /Comments
Outcome :	Satisfactory	Satisfactory	
Institutional Dev .:	Modest	Substantial	Sufficient improvements were made in the enabling environment and restructuring of the financial sector to warrant an IDI rating of substantial: implementation of specific acts to strengthen banking regulation, legislation to permit privatization of Vakifbank, bank restructuring including the merger or sale of weak private banks, closure of around 800 State bank branches and a reduction in staffing of around 50% in the remaining state banks, improvement in the governance of state banks, closure of budgetary and extra-budgetary funds, and additional improvements to fiscal and public expenditure management and public liability management.
Sustainability :	Likely	Non-evaluable	Although the Government has followed responsible fiscal policies as shown by the impressive increase in the primary balance, Turkey is facing a very hostile environment, including the risk of war in the middle east. It is difficult to predict the potential consequences of a conflict on Turkey's economy and further demands for fiscal adjustment.
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Satisfactory	

NOTE:

NOTE ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

It is very difficult to build capacity or make major organizational changes to agencies that have major and pressing operational responsibilities

Implementing financial sector and public sector reforms concurrently yields considerable benefit, in that

establishing an improved fiscal situation removes the major source of the country's macroeconomic instability
and thereby lessens pressures on the financial sector

8. Assessment Recommended? Yes No

Why? Given the extensive Bank assistance to the country's financial sector, it would be useful to examine
the impact of this assistance through a cluster audit .

9. Comments on Quality of ICR:

The ICR is satisfactory. It would have been helpful if additional macroeconomic analysis had been presented, as
well as data on the cost of the banking recapitalization program . Additionally, enumeration of PFPSAL II achievements makes assessment of PFPSAL I more difficult .