

STRENGTHENING THE TURKISH ECONOMY

Turkey's Transition Program

I. THE FUNDAMENTAL PROBLEMS OF THE ECONOMY IN THE 1990s

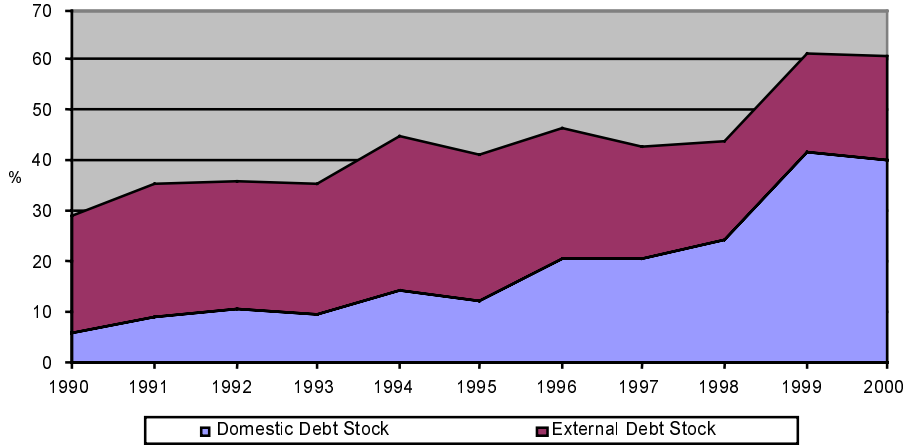
1. *During the 1990s, economic crises began to affect the Turkish economy with increasing frequency. While external factors played a role, the main reasons for these crises were: (i) the development of an unsustainable domestic debt dynamic and (ii) the unhealthy structure of the financial sector, with particular problems caused by the state banks and by the failure to address structural problems.*

A. Unsustainable Domestic Debt Dynamic

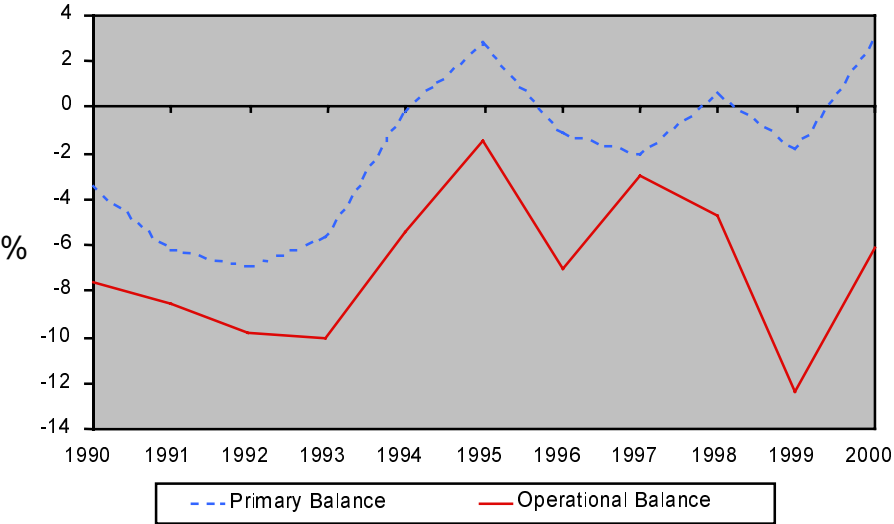
2. *Between 1990 and 1999, the ratio of net public sector debt to GNP rose from 29% to 61%. The increase in the domestic debt stock is even more striking. In 1990, the ratio of net domestic debt to GNP had been 6%. By 1999, it had increased to 42%. (including the "duty losses" incurred by the state banks as a result of the assigned duties of supporting groups such as farmers and artisans).*

3. *In the first half of the 1990s, the increase in debt stock resulted from the high primary deficits of the public sector. During the second half of the decade, the impact of high real interest rates became apparent. In the period 1990-1994, while the annual average ratio of the primary deficit to GNP was 4.5%, the operational public deficit including the real interest payments, discounted for inflation amounted to 8.3% of GNP. Between 1995 and 2000, the primary balance moved into a surplus averaging 0.1% of GNP. However, operational deficit averaged 5.8% of GNP.*

Ratio of Net Public Debt to GNP, 1990-2000

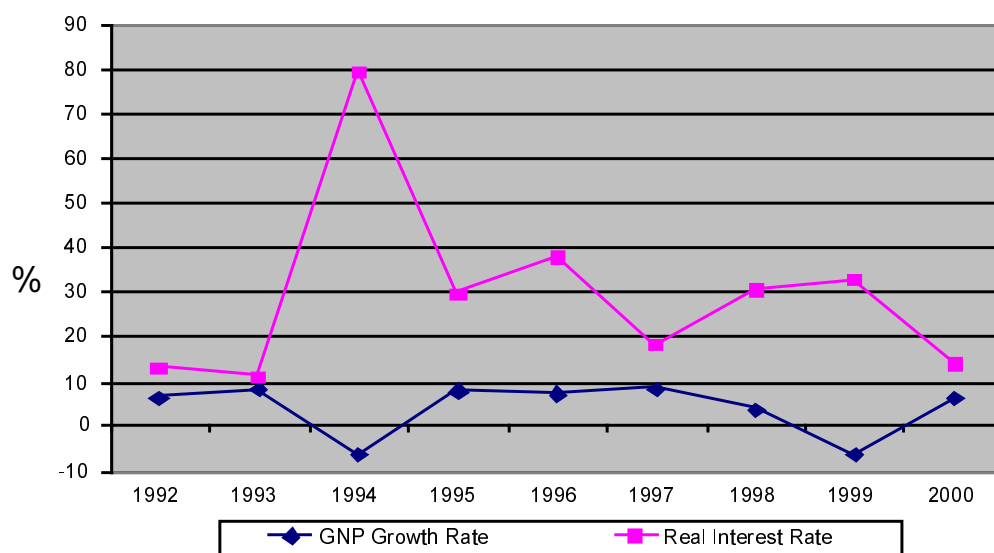


High Real Interest Rate – Operational Balance – Primary Surplus



4. With these high public deficits and with the public sector making net repayments of external debt after 1994, the pressure grew on Turkey's financial markets. A combination of this pressure and the lack of depth of these financial markets opened the way to sustained high real interest rates. A further factor contributing to high real interest rates was the high and volatile inflation rate which increased the risk premium. Between 1992 and 1999, while the annual real growth rate averaged less than 4%, the real interest rate paid on domestic debt averaged 32%. Such levels of real interest rates increased the borrowing requirements of the public sector. All this created a vicious circle of debt and interest payments, pushing Turkey into an ever more difficult financial position. As evidenced by the increase in the debt stock, this situation clearly became unsustainable.

Real Interest Rates on Domestic Debt and GNP Growth, 1992-2000



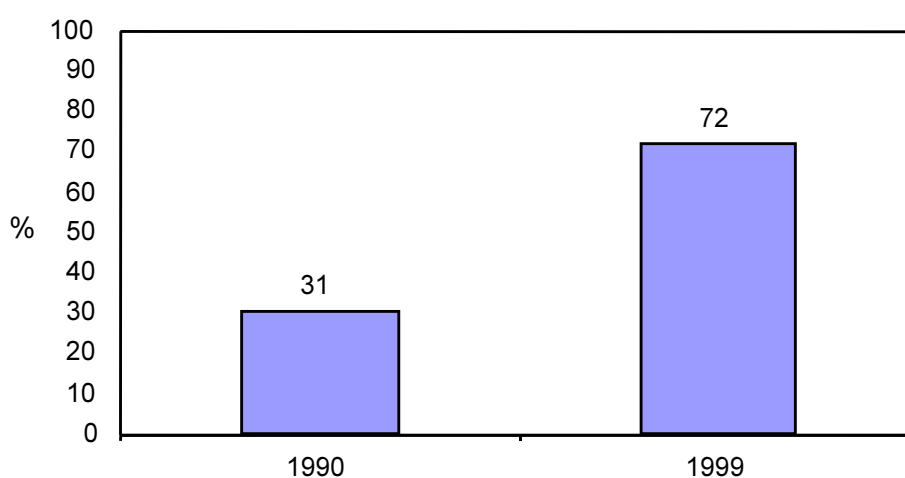
5. As the impact of increasing real interest payments on the debt stock became evident in the second half of the 1990s, it became

clear that, to solve the vicious circle of increasing debt and interest rates, a permanent improvement in the revenue and expenditure balance of the public sector was needed. In this respect, the following expenditure factors were important in the rise of the public deficit over the past decade;

- *The increase in the unmonitored expenditures of extrabudgetary funds, revolving funds, and local administrations, together with expenditures by the state banks, in particular their duty losses. The opaque way in which all these were met undermined fiscal discipline and the integrity of the budget.*
 - *Overemployment in the public sector and wage and salary increases not linked to productivity.*
 - *The excessive increase in the stock of public investment projects, many being costly and unproductive.*
 - *The rapid increase in the deficits of the Social Security Institutions as a result of deteriorating actuarial balance.*
 - *Agricultural support policies not meeting the real needs of society.*
 - *The existence of a large system of state economic enterprises system managed by interventions inconsistent with economic efficiency, and operating at high cost and low productivity.*
6. *Regarding public revenues, the main problems have been the insufficient tax collection stemming from the high tax rates and narrow tax base leading to unequal distribution of the tax burden.*
7. *The practice of financing budget deficits by high cost domestic borrowing has led to a rapid increase in the share of interest expenditures in the budget. In 1990, out of every 100 Turkish*

Liras of tax revenue, 31 Turkish Liras was spent on interest payments. In 1999, this figure reached 72 Turkish Liras. As a result, the government has become unable to allocate sufficient funds to core needs such as education, health and justice.

Ratio of Consolidated Budget Interest Payments to Tax Revenues



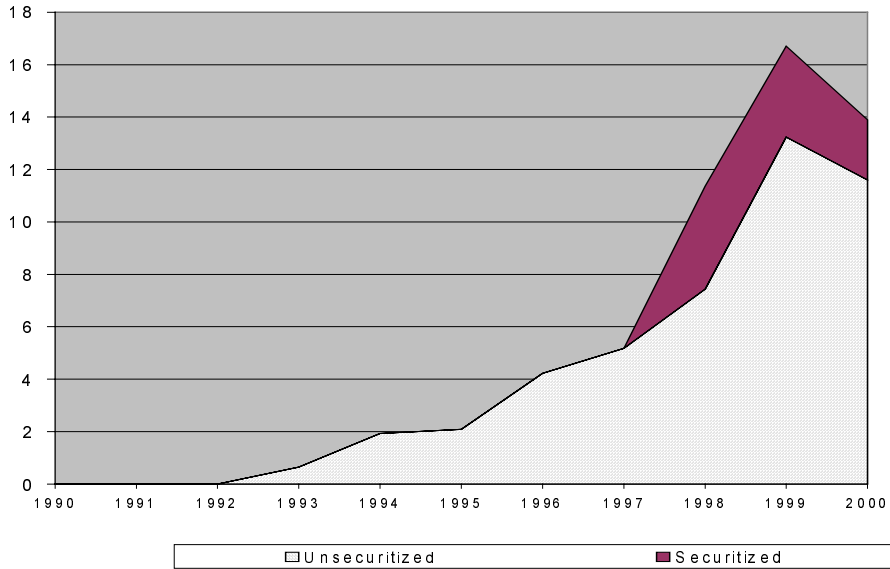
B. The problems in the financial system

8. Duties assigned to the state banks for supporting the agricultural sector and small and medium size enterprises resulted in losses which could not be covered in time by the Treasury. The state banks' financial structure was also weakened by long years of non-economic intervention in their affairs, by bad management of state banks, and by functions assigned to these banks outside their main duties. The state banks started to meet their financing requirements from the market with short maturities and high costs. On the one hand, this caused their losses progressively to increase and on the other it made them a source of instability in the financial sector.

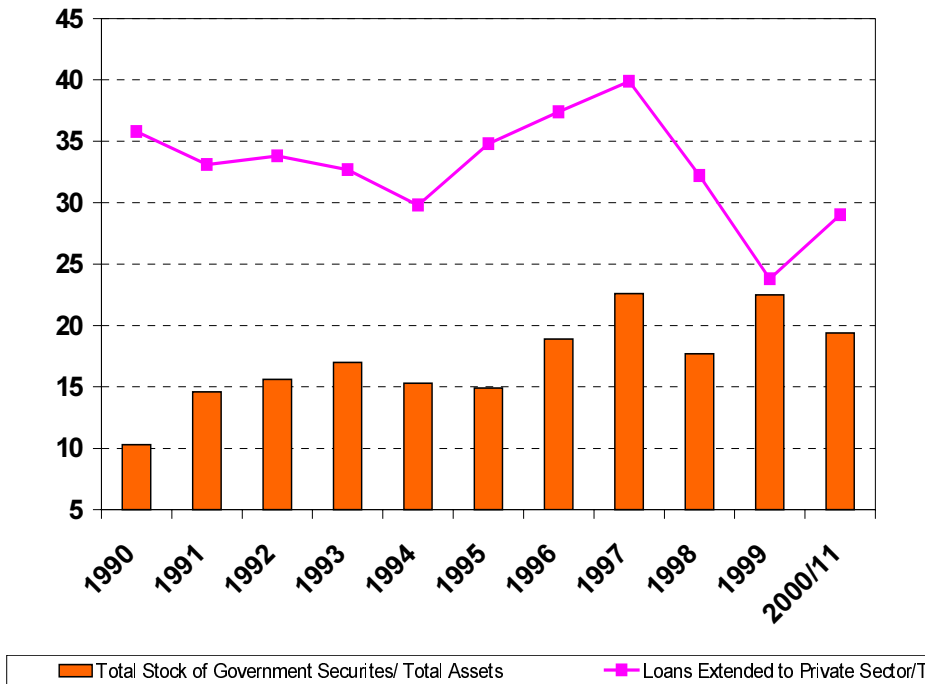
In this situation, interest rates in the markets continued at high levels. As a result, the state banks reached the point where they could scarcely carry out banking operations. While their share in bank deposits in Turkey was 40%, they only accounted for 26% of credits.

- 9. The increase in the funding requirement of the public sector resulting in part from high real interest rates meant that private banks too began to channel less funds to the real sector, and instead increasingly financed the public deficits. In 1990, government domestic securities were equivalent to 10% of total assets of deposit banks. In 1999, this figure had risen to 23%. During the same period, the share of loans to the private sector in the total assets of the banks declined from 36% to 24%. Thus, the banks could not sufficiently support producers and the real economy.*
- 10. This environment of high inflation and uncertainty meant that savings were directed towards short-term instruments, increasing the maturity mismatch of the banks' assets and liabilities.*

Duty Loss Stock of State Banks, 1990-2000 % of GNP

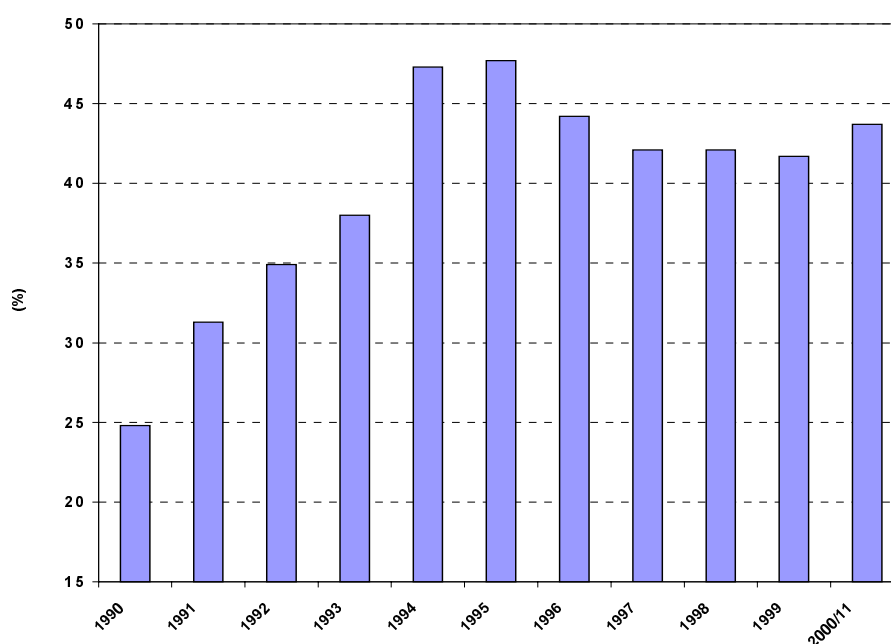


Securities Portfolio and Loans to Private Sector % of Total Assets



11. *The loss of confidence in the Turkish Lira as a consequence of the increasing debt stock as well as high and volatile inflation accelerated substitution of the Turkish Lira. The ratio of foreign exchange deposits to total deposits (including repos) rose from 25% in 1990 to 42% in 1999.*

Foreign Exchange Accounts / (Total Deposits+Repos)



12. *Besides the shift in nearly half of bank deposits towards foreign exchange accounts, the increase in the banks' foreign borrowing also augmented the foreign exchange liabilities of banks significantly. On the other hand, the banks directed their funds into high-yield Turkish Lira denominated instruments, in particular government securities. In this situation, the banks' open foreign exchange positions increased, making the banks extremely vulnerable to currency risk.*
13. *In order to achieve a sound financial sector, there is a need to ensure capital increases by the banks, to address the deficiencies in the harmonisation of legal regulations with international standards, and to accelerate efforts towards transparency in the system.*

II. THE 2000 DISINFLATION PROGRAM AND DEVELOPMENTS

14. *At this juncture, a comprehensive economic program was adopted at the beginning of 2000, to reduce inflation and provide a favorable environment to revive growth. As well as involving a tight fiscal policy and comprehensive structural reforms, exchange rate targets were announced in line with the targeted inflation, and monetary policy was set in a framework that strictly linked liquidity creation to the inflow of external capital. The program aimed to quickly reduce inflationary expectations.*

15. *In the implementation of the program, important steps were taken in structural reforms and in reducing the public deficit. Among the structural reforms, the social security system, for years running at a deficit, was reorganized and important steps were taken to balance its assets and liabilities. In agriculture, the first steps were taken for transition to direct income support and pilot implementations produced positive results. Furthermore, agricultural loan interest rates were determined in line with funding costs. In the financial sector, the establishment of the Banking Regulatory and Supervisory Authority (BRSA) provided the much needed institutional instrument to combine the functions of banking regulation, monitoring and supervision under a single authority. In privatization, 2000 saw the block sale of 51% of the shares of POAS (Petrol Ofisi) and the sale of 31.5% of the shares of TUPRAS by public offering. Besides this, the revenue raised from the sale of GSM licenses exceeded expectations.*

16. *With the implementation of the program, interest rates sharply decreased below expected levels, inflation significantly slowed, and production and domestic demand started to increase.*

17. However,

- *the real appreciation of the Turkish Lira above initial expectations as a result of higher than envisaged inflation rates,*
- *a rapid recovery in domestic demand,*
- *the increase in prices of energy products such as crude oil and natural gas, and*
- *the developments in the Euro/\$ parity,*

all factored in and the current account generated a deficit which seriously exceeded the programmed level. This development led to growing concerns in both domestic and international markets about the sustainability of the exchange rate regime and doubts about the financing of the current account deficit.

18. *The delays in planned actions for certain important public enterprises, problems in enacting proposed regulations for the state banks, political uncertainties and the cautious approach of international capital towards emerging markets as a result of developments in Argentina – a country with a currency board similar to the pegged exchange rate regime in Turkey – led to a decrease in capital inflow to Turkey in the second half of 2000.*

19. *With monetary policy based on a foreign exchange anchor and liquidity creation tied to foreign exchange inflow, the decline in foreign capital inflow led to a slowdown in the growth of liquidity. As a reflection of this tightening liquidity situation, short-term interest rates, which had declined to around 30% in July and August, began to increase from September onwards. In a period in which the banking sector was showing increasing sensitivity to developments in liquidity, interest and exchange rate risks; the tendency of interest rates to rise augmented the*

concerns of foreign investors over the sustainability of the program.

- 20. The jump in short-term interest rates in the second half of November was accompanied by a sharp decline in bond and stock prices. A medium-size bank with large holdings of government securities in its portfolio had to be taken over by the Savings Deposit Insurance Fund (SDIF). With foreign investors taking their funds abroad, the Central Bank of Turkey sold some US\$6 billion of foreign exchange, and international reserves decreased.*
- 21. In order to prevent the deepening of the crisis, a series of measures were taken in November and December. The decision to accelerate structural reforms was announced and an agreement was reached with the International Monetary Fund to support the Stand-by arrangement with a Supplemental Reserve Facility amounting to US\$7.5 billion.*
- 22. As a result of the measures taken after the November crisis and the agreement reached with the IMF, the fluctuations in the financial markets were partially subsided. The foreign exchange reserves of the Central Bank increased, and interest rates declined significantly in comparison to the crisis period. Nonetheless, with interest rates remaining high compared to the pre-crisis period, there was a further deterioration in the financial structure of both the state banks, which needed to make substantial overnight borrowing, and the banks under the control of the SDIF, which had large holdings of government securities in their portfolios.*
- 23. In February, negative developments just prior to the Treasury auction led to a total loss of confidence in the Government's program and a serious run on the Turkish Lira. On February 19th, demand for foreign exchange reached US\$7.6 billion. In*

response to this demand for foreign exchange, the Central Bank attempted to control liquidity. The squeeze on liquidity led to a freeze in the payments system, as the banks, in particular those belonging to the state, failed to meet their excessive overnight needs. Under these circumstances, the crawling peg exchange rate regime was abandoned and the currency was floated.

24. After the floating of the Turkish Lira, in order to ensure the functioning of the payment system, the Central Bank started to meet the TL requirements of the markets. Consequently, short-term interest rates decreased to around 80 %.

25. However, the crises in November 2000 and February 2001 aggravated the existing difficulties of the banking sector and led to the emergence of new problems. The sector suffered large losses due to the rise in interest rates after the November crisis. It then suffered further losses in February as a result of both interest rates and the change in value of the currency. The resources needed for the restructuring of the banking system, in particular the state banks, have become a significant burden on public finances.

26. The two crises, with the increases in interest rates and inflation, and the fluctuations in exchange rates, led to an uncertain economic environment. This situation had a serious adverse impact on the real economy. While the problems in the financial sector eliminated new credit possibilities for the real sector, it also created major problems for real sector's debt servicing.

III. TRANSITION PROGRAM FOR STRENGTHENING THE ECONOMY

A – Main targets and measures in the program –Restructuring the economy and achieving lasting stability

27. *The main aims of the new program are to eliminate speedily the crisis of confidence and instability that emerged as a result of floating the exchange rate, and simultaneously to create a framework for restructuring the public administration and economy in a way which will prevent the re-emergence of this situation. There can be no question of returning to the previous system.*

28. *Towards this end;*

i) Our program is built on a strong political commitment and support for achieving the planned targets and restructuring of the economy.

ii) Our targets include;

- *ensuring transparency and accountability in resource allocation in the public sector,*
- *preventing irrational interventions in the running of the economy, and*
- *strengthening good governance and the fight against corruption.*

iii) In summary, we aim at restoring confidence in the markets and ensuring that the sacrifices made so far are not in vain.

29. *In the light of these principles, the new program sets the following sub-targets:*

- i) *To continue fighting inflation under the floating exchange rate system in an uninterrupted and determined way.*
 - ii) *To carry out a speedy and extensive restructuring of the banking sector, with priority given to the public sector banks and the SDIF banks, with a view to create a stable and sound link between the real sector and banking sector.*
 - iii) *To strengthen the balance of public finances in a way that will prevent deterioration in the future.*
 - iv) *To implement an incomes policy, which:*
 - *is based on social consensus,*
 - *ensures an equitable division of burden between all segments of society, and*
 - *is in line with the inflation targets.*
 - v) *To establish the legal framework for the structural measures that will ensure the effective, flexible and transparent implementation of these policies.*
30. *We aim to create an environment for sustainable growth, to increase the efficiency of resource utilization, and to develop our competitive strength through ensuring an open economy functioning under free market conditions. Our ultimate goal is to achieve an increase in growth, investment and employment that will instill confidence in our people for their future and lead to a permanent increase in their standard of living.*

B. Structural Renewal and Legislative Changes

31. Underlying the program there are 15 legislative measures falling into 4 categories:

- i) Financial Sector Restructuring*
- ii) Increasing Transparency in the State and Strengthening of Public Finances*
- iii) Enhancing of Competition and Efficiency in the Economy.*
- iv) Strengthening of Social Solidarity*

1) Financial Sector Restructuring

32. Putting the banks' financial standing on a sound basis is essential for the stability of the markets and for the real sector. The legal process has been initiated with due priority to amendments to the Banking Law.

33. Guarantees covering deposits and other liabilities of banks will remain in place.

Legal Amendments

1. AMENDMENTS TO THE BUDGET LAW	Passed by the National Assembly
2. DECREE AND LAW TO ELIMINATE DUTY LOSSES	Decree has been submitted to the Prime Ministry. Preparation of the law is underway.
3. PUBLIC BORROWING LAW	To be submitted to Prime Ministry next week
4. EXPROPRIATION LAW	Submitted to the National Assembly
5. LAW REGARDING CLOSURE OF 15 BUDGETARY AND 2 EXTRA-BUDGETARY FUNDS	Under preparation by the Treasury and will be submitted to the Prime Ministry shortly
6. PUBLIC TENDER LAW	Legal preparations underway
7. CENTRAL BANK LAW	Submitted to the Prime Ministry
8. AMENDMENTS TO BANKING LAW	Draft to be submitted to the Prime Ministry. Decree regarding state banks has been published and a joint management board has been appointed
9. JOB SECURITY LAW	Under the short term priority list of the National Program for EU accession, consultations with social partners are underway
10. ECONOMIC AND SOCIAL COUNCIL LAW	Passed by the National Assembly
11. AMENDMENT TO THE CIVIL AVIATION LAW	Submitted to the National Assembly
12. TELECOM LAW	Law proposal submitted to the Prime Ministry
13. SUGAR LAW	Submitted to the President for ratification
14. TOBACCO LAW	Under preparation, to be submitted to the Prime Ministry shortly
15. NATURAL GAS LAW	Approved by the Planning and Budget Commission of the National Assembly

34. *The state and SDIF banks' recourse to markets to meet their sizeable liquidity requirements not only distorts the balances in the markets but also impairs the financial soundness of these banks. To remedy this situation, Treasury securities bearing market interest rates will be given to the banks in exchange for their receivables from the Treasury. In this way, duty losses will be eliminated as quickly as possible. Under a pre-determined program, the state and SDIF banks will reduce their overnight liabilities to the banking sector and non-banking sector by raising liquidity from the Central Bank by repo or by outright sale of these securities. The Central Bank will soak up excess liquidity from the market via reverse repo or interbank operations. In 2001, the Treasury issued papers of TL 10.3 quadrillion to the state and the SDIF banks in order to strengthen their financial standing.*

35. *Other work towards restructuring the banking sector is being handled in three main groups:*

- i) State banks*
- ii) SDIF banks*
- iii) Private banks*

State Banks

36. *In co-ordination with the permanent elimination of liquidity problems in state banks, other necessary measures are also being taken:*

- i) No functions which might generate losses will be assigned to state banks. A decree repealing the current decrees regarding duty losses has already been submitted to the Prime Ministry. Work is continuing to eliminate the duties assigned to banks by law. Where deemed necessary, support provided via public banks will be financed by specific allocations in the budget.*

- ii) *Undercapitalised state banks will have their capital raised to an adequate level. Capital increases will be cashed in immediately.*
 - iii) *In line with the principles of operational effectiveness and efficiency, all state banks will continue to lend within their areas of specialization taking into account their financing costs.*
 - iv) *Work is continuing to merge Emlak Bank and Ziraat Bank.*
 - v) *Work has started to hand over state banks' management to a joint board of directors consisting of professional bankers. This board is authorized to restructure state banks and prepare them for privatization.*
 - vi) *Unproductive branches of state banks will be closed down, and retirement incentives will be given in order to reduce the number of employees.*
37. *This set of amendments regarding state banks is a fundamental change for Turkey. It represents the end of a failed system which had persisted for too long.*

SDIF Banks

38. *The swift resolution of the problems of the banks currently under the SDIF is essential for the stability of the financial system and for reducing their burden on public finances.*
39. *Five of the 13 banks currently under the SDIF have been merged into a single bank under Sumerbank. The number of personnel in these merged banks, which stood at 9,141 at the time they were taken over by the Fund, has been reduced to 4,596 as of 30 March 2001. The number of branches has been*

slashed from 396 to 213. The number of branches will be reduced further to 134 by June 2001.

40. The process for the sale of Demirbank under the SDIF is continuing and evaluation of the bids will be completed by end-April. Banks which have received no bids by 6 April 2001 will be merged with Sumerbank or with another transition bank. The number of personnel and branches of these banks will be rationalised.

41. The amendments to the Banking Law will provide increased ability in collecting the receivables of the SDIF banks and expedite the collection process. Furthermore, the bad assets of these banks will be managed more effectively by the newly established single body, the Asset Management Unit.

Private Banks

42. Measures have already been taken to restore as quickly as possible healthy finances to the private banks hit by the crisis:

i) Since adequate capitalisation is a criterion for financial health, the BRSA is reaching agreements with private banks to increase capital and carry out restructuring plans within a fixed time frame. This work will be accelerated.

ii) Profits of banks have been added to their capital.

iii) Work is continuing on additional measures to facilitate mergers and acquisitions of both banks and corporations.

iv) While allowing a reasonable time frame for adjustment, banks will be required to reduce their investments in non-financial institutions and the share of their equity that these constitute.

- v) *The Banking Law is being amended to clarify the legal standing of special provisions recorded as expense items in the calculation of the corporate tax base.*
- vi) *In accordance with the developments in the banking system, taxes and required reserves will be revised with the aim of encouraging long-term investments and eliminating yield differences between savings instruments.*

(2) Arrangements to increase the transparency of the state and strengthen public finances.

Arrangements Regarding Duty Losses

- 43. *Measures will be taken continually to minimize the loss generating duties of state economic enterprises. The draft decree by the Council of Ministers on the elimination of duty losses, which are borne mainly by state banks, has been submitted to the Prime Ministry, and preparation of the draft law is close to completion. Henceforth, where state banks are assigned duties that might generate losses, necessary financing will be made available in the budget for that specific year and will be transferred in advance to the relevant institutions.*
- 44. *As is well known, the endorsement of the balance sheets of state banks in accordance with the relevant laws does not prevent legal and administrative action. In this framework, the payment of state banks' duty losses will not abolish legal and administrative investigations.*
- 45. *Treasury securities bearing market rates have been given to the state banks in an amount equal to two-thirds of their overnight liabilities as of end-February. Additional securities will be issued by the end of May for the remainder. Through coordinated action by the Central Bank and the Treasury, these*

securities will be converted into cash while avoiding any adverse effect on the market.

Public Borrowing Law

46. This law aims to bring transparency and accountability to the state. Domestic and international borrowing by the Treasury and issuing of Treasury guarantees have been regulated by budget laws and by various other legislation. The new law will bring the management of public debt under a single legal text which will define limits with clarity and transparency. In addition, borrowing and debt management policies will be developed through a flexible legal infrastructure which will allow decisions to be taken and implemented rapidly. The Grand National Assembly will be kept informed of borrowing activities with a debt management report published every quarter.

Expropriation Law

47. The principle of up-front cash payment of amounts due from expropriation is stated in the constitution and in related laws but this principle does not serve the intended purpose. The administrations of state bodies shy away from fiscal discipline in expropriation decisions and value assessment. Under this new law, expropriation operations will not begin until necessary allocations are made. Expropriation operations will primarily be carried out using outright purchase and exchanging. Courts will rule on disputed expropriation values.

Public Tender Law

48. The amendment of the public tender law will establish a more competitive and effective tender system, which will comply with international standards. Through turnkey tenders based on project implementation plans, public tenders will not only be

more effective and competitive, but also prevent the escalation of costs in tendered projects.

Closure of budgetary and the extra-budgetary funds

49. In addition to the 46 budgetary and 6 extra-budgetary funds already closed, 15 budgetary and 2 extra-budgetary funds are to be closed, enabling the ultimate consolidation of the fund system. In this way fiscal discipline and transparency will be enhanced.

(3) Reforms to Raise Competition and Effectiveness in the Economy

Sugar Law

50. This law sets out the procedures and principles in production, pricing and marketing of sugar, thereby establishing stability in the market. From the 2002-2003 production season, the government will no longer set and announce the price. The sugar market will instead be regulated by the Sugar Board. By halting sugar production when it exceeds market demand, losses to the state will be avoided. Producers will know in advance the price each season before making decisions to proceed with planting. Turkish people will be able to consume sugar at lower prices. By extending direct income support to all farmers, income losses will be compensated. Obstacles preventing the privatization of sugar factories will be eliminated.

Tobacco Law

51. The procedures and principles regarding the pricing, distribution, sale and control of tobacco and alcoholic beverages will be regulated by the Tobacco Products and Alcoholic Beverages Regulatory Board. From 2002 the state will no longer make direct purchases. The ground will be prepared for the

privatization of Tekel's production and marketing units. The practice of leaving excess tobacco to rot or be burnt will be stopped. Uncertainty for producers will be eliminated by contracting and auction methods. Tobacco producers will receive support from the alternative crop program and direct income support.

Natural Gas Law

52. The purpose of this law is to liberalize the natural gas market and so provide consumers with supplies of high quality, continuous and affordable natural gas in a competitive market that will not harm the environment. Under the new law, BOTAS's monopoly in the import, transportation and distribution of natural gas will be eliminated, and participation of the private sector at all stages will be introduced. The market created in this way will have a financially strong, stable and transparent structure. The natural gas market will be regulated by an independent regulatory board, which will also embody the current Board regulating the electricity market.

Privatization of Turk Telekom

53. The legislative process to accelerate the privatization of Turk Telekom has begun and comprises the following elements:

- i) Company shares – except Golden Shares reserved in the interest of the public and national security –will be privatized through a block sale to a strategic investor as well as through offerings to the public and to company employees.*
- ii) The company's monopoly in fixed line services will be eliminated following privatization.*

- iii) The Telecommunication Board will be authorized to issue licenses.*
- iv) Action will begin to raise the efficiency of the sector's management, and to accelerate the privatization process.*
- v) The percentage of shares to be sold to a foreign strategic investor will not exceed 50%.*

All this will lead to speedy development of the telecommunications infrastructure, on which development of all other sectors in the ongoing technological race depend. By eliminating the obstacles standing in the way of the sector's development, domestic and international investors will be encouraged to participate.

Civil Aviation Law

54. Turkish Airlines and other airline companies will be granted the power to determine freely their pricing of fares on domestic routes. With the freedom to set different fares and flight schedules, the existing fleet capacity will be used more effectively. Furthermore, these measures will increase competition which will in turn lead to more employment in the sector in the medium to long term and contribute to tourism. Turkish citizens, including those living abroad, will be given incentives to invest in the sector.

(4) Measures to Strengthen Social Solidarity

Job Security Law

55. This issue has been defined as a priority area in the National Program for accession to the EU, and consultations with social partners are continuing as the draft law is drawn up.

Economic and Social Council Law

56. This law aims to develop consensus and collaboration among social partners in formulating economic and social policies. The law, which brings together employers and employees of the public and private sectors and other civil society organizations has already been enacted.

(5) Measures Towards the Real Economy

57. Additional measures will be taken to increase exports:

- i) Eximbank's loan volume will be increased in line with the resources provided from the budget and other sources.*
- ii) Payments on VAT rebates on exports will be accelerated.*
- iii) The bureaucracy involved in extending official support will be cut back.*

To these ends, TL 128 trillion has already been transferred to Eximbank by bringing forward budget allocations. TL 103 trillion of this amount was transferred last week.

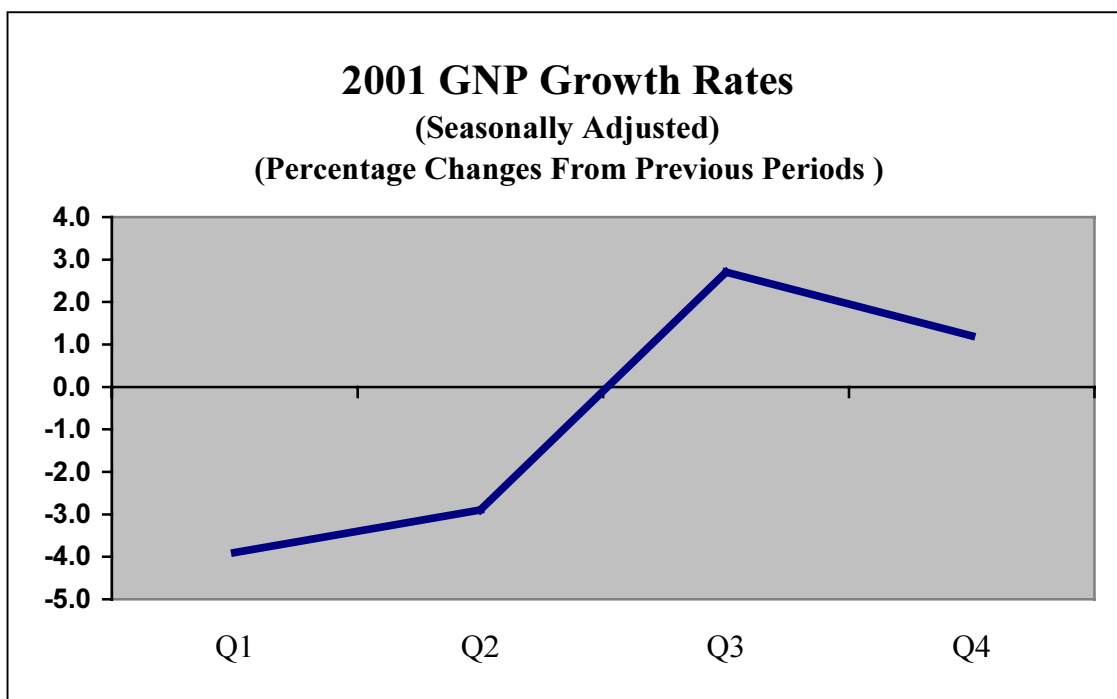
58. A constitutional amendment granting the right for international arbitration was made to boost the flow of foreign direct investment into Turkey. Laws to implement this will be enacted. In addition, an action plan is underway aimed at reducing bureaucratic and administrative barriers to FDI.

59. TL 400 trillion has been earmarked in the budget to ensure that higher financing costs are reflected to a minimum in credits extended by Ziraat and Halkbank to farmers, small merchants, artisans and small and medium-sized enterprises, with a view to alleviate the burden of the crisis on these groups.

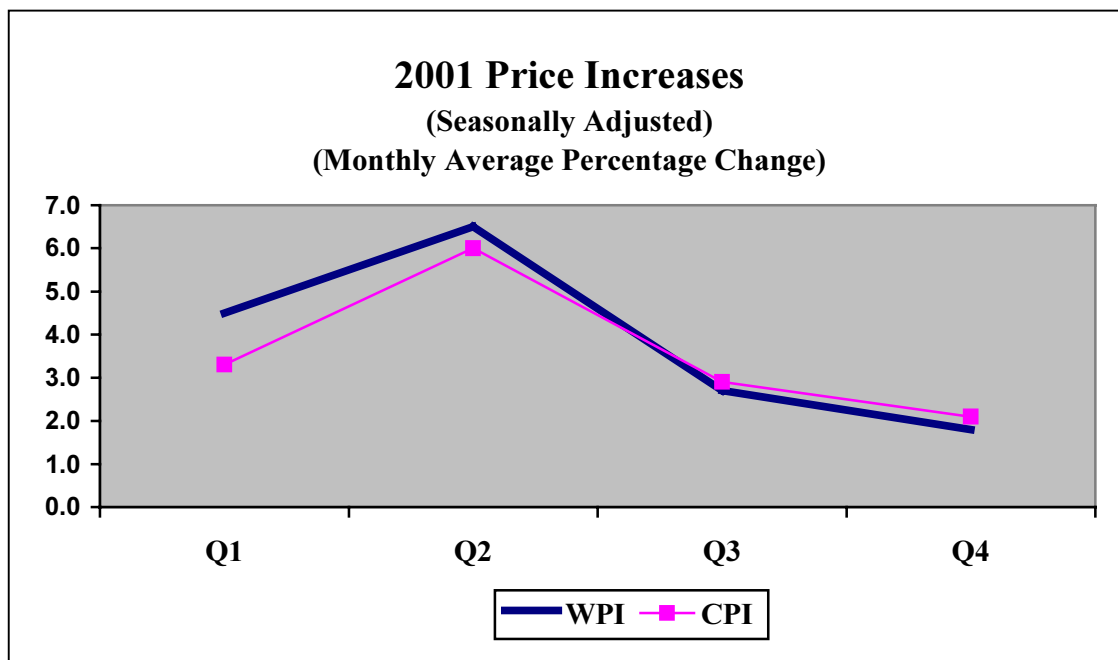
C. Macroeconomic Targets

60. *The recent crises have caused serious damage to the banking sector and laid a major burden on public finances. The increase in interest rates and uncertainty regarding exchange rates have reduced the confidence of economic agents in the future, adversely affected the real sector and pushed the economy into recession. The depreciation of the Turkish Lira has caused an observable jump in inflation.*

61. *It is possible, however, to eliminate the negative impact of all these developments on growth and inflation through gains in competitiveness, the continuing implementation of a strong fiscal policy, an active monetary policy and a consensus-based incomes policy. The current economic contraction will reverse in the second half of the year, with exports and tourism receipts contributing greatly to this recovery. Although GNP is expected to contract by 3% for the year as a whole, the seasonally-adjusted growth rate for the second half of the year will be positive.*



62. The floating of the Turkish Lira has caused an inevitable acceleration in the inflation rate. The end-year increases in the WPI and CPI are expected to reach 57.6% and 52.5% respectively. Strict implementation of the program, however, will cause inflation to resume a declining trend in the second half of the year. Seasonally-adjusted price increases are targeted to fall to around 2% monthly towards the end of the year.



63. Slower economic growth and the contraction in domestic demand are expected to reduce imports, while the improvement in competitiveness is expected to have a positive impact on exports and tourism revenues. Hence, the current account will be close to balance by the end of 2001.

Basic Macroeconomic Targets

	1999	2000	2001	2002
GNP Growth %	-6.1	6.1	-3.0	5.0
WPI (year end) %	62.9	32.7	57.6	16.6
CPI (year end) %	68.8	39.0	52.5	20.0
Primary Balance/GNP(%)				
Total Public	-1.9	2.8	5.5	6.5
Consolidated Budget	1.5	4.6	5.1	5.6
SEEs	-1.5	-1.5	0.1	0.5
Other Public	-1.9	-0.3	0.3	0.4

D. Macroeconomic Policies

Fiscal Policy

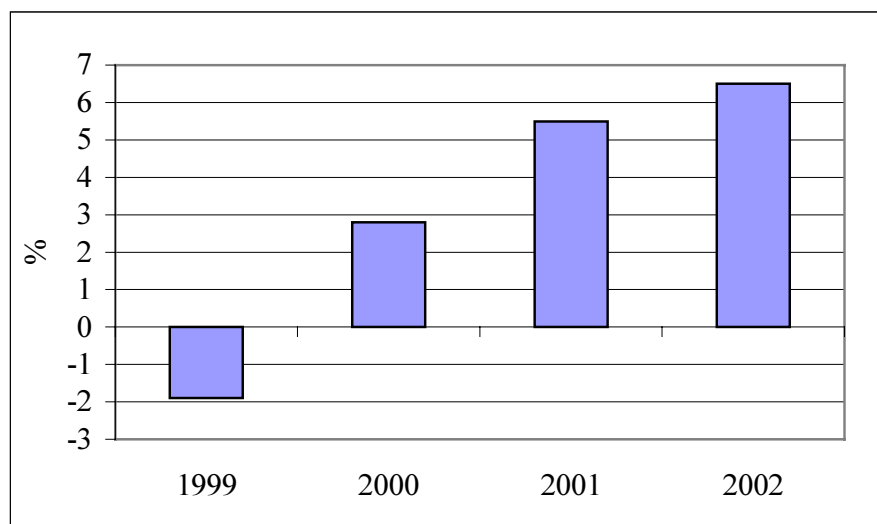
64. *Arrangements related to the restructuring of the banking sector after the crises have put a substantial burden on public finances. At the same time, the depreciation of the Turkish Lira and the increase in interest rates have augmented the burden of debt servicing. In order to keep the increase in the public sector debt stock under control, it is critically important that non-interest public expenditures be subject to discipline and that maximum savings be achieved. This is the framework within which the program's primary surplus and public finance targets have been established.*

65. *The consolidated public sector primary surplus, which was 3% of GNP in 2000, will rise to 5.5% in 2001. To achieve this, the program foresees:*

i) An increase in the primary surplus of the consolidated budget from 4.6% of GNP in 2000 to 5.1% in 2001,

ii) An improvement in the balance of other public sector entities, particularly SEEs, from a deficit of 1.8% of GNP in 2000 to a primary surplus of 0.4% in 2001.

Primary Public Balance (% of GNP)



CONSOLIDATED BUDGET	% GNP		
	1999	2000	2001
REVENUES	23,9	25,9	25,5
Tax revenues	18,9	21,0	20,5
- Direct Taxes	8,6	8,6	7,3
- Indirect Taxes	10,3	12,4	13,3
Nontax Revenues	5,0	4,8	5,0
PRIMARY EXPENDITURES	21,8	20,5	19,7
Personnel	8,8	7,9	7,8
Other Current	2,8	2,8	2,6
Investment	1,8	1,8	2,1
Transfers	8,4	7,9	7,4
-Transfers to SEEs	0,7	0,9	0,5
-Interest Differential Payments to State Banks	0,0	0,1	0,2
-Agricultural Support	0,3	0,3	0,6
-Transfers to Funds	1,3	1,6	0,5
-Social Security	3,5	2,6	2,8
-Tax Rebates	1,5	1,3	1,1
-Other	1,1	1,1	1,6
PRIMARY BALANCE	2,1	5,4	5,6
PRIMARY BALANCE	1,5	4,6	5,1
(Excl. Privatization, Interest Receipts, and C.Bank Profits)			

Expenditure measures

66. *The most important tool for achieving public finance targets will be public sector savings. In this regard:*

- i) Care will be taken to ensure that the nominal increase in non-interest expenditures remains below the nominal increase in GNP. Within this framework, the program is targeting a 9% real reduction in expenditures in 2001 relative to 2000.*
- ii) Discipline will be applied to public expenditures to achieve maximum savings. For this, the Public Savings Communiqué will be strictly implemented and the Ministry of Finance will block allocations that it deems appropriate to halt.*
- iii) Increases in other current expenditures, investment expenditures and selected transfer expenditures will be maintained below the rise in the exchange rate and prices, leading to savings equivalent to 1.5% of GNP.*
- iv) In addition to these measures, cuts in other current transfers will lead to savings equivalent to 0.3% of GNP.*
- v) The budget allocates to public sector banks an amount equivalent to 0.2% of GNP for payments related to interest rate differentials. Public sector banks will not be given duties that cause expenses that exceed this amount.*
- vi) Except for health, security, and education services, public institutions will avoid hiring new personnel except under extraordinary circumstances, when new personnel is essential to maintain their effectiveness. There will be no increase in the total number of civil servants.*

- vii) *Individual requests for salary raises, to the extent that they do not apply to all public employees nor target salary equity, will not be considered.*
- viii) *Except under extraordinary circumstances, no new projects will be added to the investment program nor tenders spread over years initiated.*
- ix) *Proposals that increase expenditures, unless they have their own sources of funding, will not be considered. These include plans to expand organisations and create new staff positions.*
- x) *Measures aimed at enhancing the effective operation of state economic enterprises are being implemented. As part of this, SEEs will avoid increases in the number of their personnel; reduce overtime, bonuses and similar payments; maintain current expenditures under control; and rationalise investment expenditures.*
- xi) *Increases in agricultural support prices will not exceed the targeted inflation rate and support purchase volumes will be linked to institutions' financing constraints.*
- xii) *Discipline will be applied to the health expenditures of state social security institutions.*
- xiii) *Vehicle use in the public sector will be curbed and the Vehicle Law will be implemented effectively.*

Revenue Increasing Measures

67. To achieve revenue targets, the program foresees that:

- i) Measures introduced at end-2000 to raise tax revenues continue to be vigorously implemented,*

- ii) Petroleum prices continue to be determined by the automatic pricing mechanism and the Petroleum Consumption Tax (PCT), be adjusted at least according to targeted inflation. The ratio of PCT revenues to GNP will be 2.8%,*
- iii) Prices of import-based products, primarily in energy and petroleum sectors, be adjusted without delay to reflect changes in exchange rates, increasing costs, and economic realities,*
- iv) The use of tax identification numbers be widened to expand the tax base,*
- v) Tax audits be increased to minimise tax evasion and losses,*
- vi) In order to increase tax revenues, penalties and interest rates for late payment continue to be adjusted in line with the inflation rate,*
- vii) In order to increase individual investors' demand for government securities, income earned by individuals on government securities will continue to be exempt from tax.*

External Financing

68. Despite a primary surplus target before interest payments of around US\$10 billion in 2001, the public sector faces a high financing requirement. Funding this requirement solely from domestic markets alone would be inconsistent with current macroeconomic forecasts. Additional financing from abroad is required. In this regard, consultations continue with international institutions and with the industrialised countries on sources of external financing. Following the completion of these consultations, details related to the program's financing and monetary policy will be announced.

Incomes Policy

69. *It is essential that incomes policy accords with targeted inflation. Civil servant salaries will be increased in line with inflation while adjustments to the salaries of public sector workers will take into consideration real increases granted by the 1999-2000 collective wage agreements, as well as public sector balances and salary equity among public employees. The sacrifices made today by all sectors of society will reduce the costs of the crisis on growth and employment and accelerate the return to growth in the second half of the year.*

70. *The main principle of agricultural policy is to strengthen low-income farmers through direct income support. In order to implement this policy nationwide, the Ministry of Agriculture must complete its ongoing project to register farmers. In the short run, state-controlled support prices will take into consideration institutions' financial resources and will not exceed targeted inflation.*

IV. Long-run perspective

71. *Twenty-five years of chronic high inflation and public deficits have prevented Turkey from taking full advantage of its potential and making strong progress forward. From the perspective of full membership in the EU, it is absolutely essential that Turkey finds a lasting solution to the problem of high inflation as quickly as possible, that it restores healthy public balances, and achieves stable growth. The ultimate goal of the Program for Strengthening the Turkish Economy is to realize this structural change.*

72. *Successful implementation of the structural reforms envisaged in the program will increase the economy's efficiency, thus*

facilitating sustainable growth with current resources. Structural reforms will also transform fundamentally the functioning of the state. This way, the state will be prevented from returning to old habits that deteriorate public finances and reduce the efficiency of resource utilisation.

73. A sustained improvement in public finance balances will enable the state to allocate adequate resources to education, health, technology and social expenditures. This will enable Turkey to achieve the improvement in total factor productivity targeted in the Long-term Strategy, increase its share of global revenues, raise living standards, improve income distribution, reduce poverty and eliminate differences in regional development.

74. Through structural reforms, Turkey will permanently reduce inflation to single digits, maintain public deficits at sustainable levels and satisfy other criteria for membership in the EU and the EMU.

75. The past century has taught us that a productive and strong private sector is essential for a strong and reputable state, and in the same way, a well performing state providing social support and regulatory supervision is essential to ensure a sound market economy. A strong economy is created by a fully functional and confident private sector, an effective state and broad-based social consensus. This is our target, our aspiration and, indeed, what Turkey deserves.