

REPUBLIC OF TURKEY  
PRIME MINISTRY

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Ankara, July 30, 2002

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington, D.C., 20431  
U.S.A.

Dear Mr. Köhler:

- Turkey has maintained the strong implementation of its economic program.** We met the end-May performance criterion for the consolidated government sector primary surplus, and the end-June performance criteria for base money and net international reserves (Annex A). We have also continued to make good progress in structural areas, including toward meeting prior actions and structural benchmarks (Annex B), although the end-June performance criterion on state bank restructuring has been missed by a small margin, as described below.
- This steadfast implementation has delivered positive results, with both the 3 percent growth target and the 35 percent inflation target for 2002 well within reach, even taking into account the effect of recent political developments.** Although the currency depreciation of recent months may still have further effects on prices, with annualized inflation of only 25 percent for the first half of 2002, our 35 percent end-year target remains readily achievable. The prospects for achieving the GNP growth target of 3 percent are also good: in the first three months of the year GNP grew by a seasonally adjusted 7 percent quarter on quarter, and more recent data on capacity utilization, industrial and agricultural production, exports, and tourism suggest that the economic recovery has continued in the second quarter.
- We remain fully committed to the program, and will make every effort to keep it on track, political uncertainties notwithstanding.** Even with the marked worsening of financial market indicators over the past few months, interest rates and the exchange rate remain broadly within our conservative program assumptions. And, with a floating currency, and our ongoing efforts in banking and other structural areas—facilitated by the strengthened independence of institutions, such as the Central Bank of Turkey (CBT) and the Bank Regulation and Supervision Agency (BRSA)—Turkey's economy is now more robust than before. We have also strengthened the program through introducing new structural commitments in key areas, including fiscal policy and banking reform. Moreover, continued broad support for the economic strategy from public opinion and civil society will also help ensure the program's continued strong implementation.
- While early elections could delay legislative reforms, the government remains committed to timely implementation of those aspects of our policy strategy that are the prerogative of the executive branch.** Parliament has been reconvened and is likely to set an election date of November 3. As a result, our legislative reforms will inevitably

face some delay. Even so, the government and its economic team are committed to completing all technical preparations for such legislation, and to submit such legislation to parliament, according to the timetable outlined in this letter. In addition, the vast majority of the program's policies (for example, monetary and fiscal policy, and a wide range of structural reforms) do not require the approval of parliament. We intend to implement these fully, thereby safeguarding the program's macroeconomic policies and objectives.

5. **On this basis, we request that the third review under the SBA be completed.** We also request a waiver of nonobservance for the end-June performance criterion on the closure of state bank branches, which was missed by a narrow margin (with 788 closures, we fell just 12 short of the 800 end-June target), as we continue to make good progress with the operational restructuring of state banks (as described in paragraph 21 below). Moreover, we request that the ceilings and floors for the quantitative performance criteria under the arrangement on (i) the cumulative primary balance of the consolidated government sector, (ii) contracting or guaranteeing new external public debt, (iii) short-term external public sector debt, (iv) net international reserves, and (v) base money will be set for the respective test dates through December 31, 2002 as set out in Annex A. These levels correspond to the indicative targets in the January 18, 2002 Letter of Intent. Finally, to facilitate close monitoring of fiscal performance in the remainder of the year, we propose establishing indicative targets on the cumulative primary balance of the consolidated government sector for end-September and end-October 2002, and a performance criterion on the cumulative primary balance of the consolidated government sector for end-December 2002, as also shown in Annex A.

### **Fiscal policy and public sector reforms**

6. **We remain on track to achieve the public sector primary surplus target of 6.5 percent of GNP in 2002.** We have met all the performance criteria on the consolidated government sector primary surplus so far this year, including that for end-May. Moreover, preliminary data for June show that, cumulatively, the central government primary surplus remains TL 1.2 quadrillion (0.4 percent of annual GNP) above the program target. Finally, price hikes in state economic enterprises (SEEs) in June–July, particularly for telecommunications services, tobacco, alcohol, and natural gas, have helped to recover the bulk of the SEE revenue losses from earlier delays in raising prices. Looking forward, we expect tax revenue to be somewhat below our earlier projections due to lower-than-expected inflation and nominal income, tax rebates are expected to be well beyond program projections due to robust exports, and recent instability has led to some collection problems in social security institutions. In addition, health spending pressures have emerged, largely as a result of higher medicine prices, and we have had to allocate resources for election expenses. Partly offsetting these pressures, we expect higher grants, and some transfer payments will shift to 2003. To address the remaining gap, we will reduce this year's spending in selected earmarked accounts (which will allow us to transfer about TL 300 trillion to the budget), and we expect to achieve savings of about TL 100 trillion in discretionary budget spending due to a lower-than-expected price level. We will also complete all remaining real price increases necessary to fully offset earlier SEE revenue losses. SEE prices will subsequently be changed broadly in line with the WPI, except in the energy sector, where we will continue to pass through world prices.

7. **We remain committed to keeping the public sector primary surplus at 6.5 percent of GNP in 2003, to help further improve public debt dynamics.** On July 16, the High Planning Council issued a decision setting guidelines for the 2003 budget consistent with our macroeconomic framework envisaging real GNP growth of 5 percent and inflation of 20 percent. This decision envisages that real primary spending in the public sector will remain unchanged in 2003, which would support our intention not to raise the already high overall tax burden (see paragraph 8). On the basis of this decision, the government intends to adopt by September 2002 an action plan leading to further reductions in the average project completion time in the public investment program by more than 3 percent annually in both 2003 and 2004. The action plan will include details on the 2003 public investment program and further steps for the 2004 program for which the details will be ratified by the High Planning Council in 2003. In addition to the framework laid out in the decision, our plans for 2003 include the following:

- Our **public sector wage policy** for 2003 will be guided by three considerations. Civil service salary increases will be in line with programmed inflation. In negotiating public worker wages, we will continue to strive to address the large wage premium over the civil service. Finally, we will aim to reduce backward indexation in all future civil service and public sector wage agreements.
- Our **public sector employment policy** will continue. Consolidated budget employment will not be increased, and in state enterprises, hiring will only be permitted (at a 10 percent replacement rate) for attrition in non-budget funded entities. Our retrenchment program will continue as programmed, and for this attrition there will be no replacement hiring.
- We will enforce financial discipline in **state enterprises and local governments**. Backed by the new Debt Management Law, we are pursuing repayment of local government arrears to Treasury on called guarantees. Moreover, we are preparing a comprehensive plan to address tax arrears (completing such a plan is a structural benchmark for September 15, 2002). This will entail financial and/or operational restructuring of certain state enterprises and municipalities.
- We will continue to implement our **pricing policy in state enterprises**. Price increases will be broadly in line with the WPI, and for the energy sector we will pass through world prices. We will aim for real reductions in prices where cost reductions permit.
- Finally, we will continue to implement the **pension reform** agenda for SSK and BK (the funds for wage earners and the self employed) as set out in 1999. To this end, we intend to pass legislation underpinning the necessary institutional and administrative reforms by end-2002. We will also prepare by end-year, with technical assistance as needed, a study of the solvency of our civil service pension fund, to prepare the ground for future reforms.
- In the event of elections this fall, we would issue a provisional 2003 budget to be in effect until the full budget could be passed. This provisional budget would provide for no real increase in appropriations over the same time period in 2002.

8. **We will continue to press ahead with our comprehensive overhaul of the tax system.** Having significantly simplified indirect taxation, we have now turned our attention to direct tax and revenue administration reforms:

- **Our plans for the direct tax reform are taking shape.** (The legislation for this second phase of tax reform is to be submitted to parliament by end-October 2002 as a structural benchmark, and is to be passed by parliament by end-March 2003.) In this reform, our two principal aims are to broaden the tax base (especially by rescinding exemptions and incentives), and to reduce key distortions (especially on capital income). To the extent our expenditure containment efforts allow, we will reduce the overall tax burden.
- **Our revenue administration reforms should help broaden the tax base in the medium term, creating room for reductions in tax rates.** In September 2002, we will approve a new functional structure, which includes units covering taxpayer registration (including tax office management), taxpayer services, audit, collection, legal affairs and procedures, tax policy, international tax relations, as well as units for support functions (budget, human resources, and information technology). In addition, an internal audit group will be established and will report directly to the General Director. In May, a high-level audit coordination committee was established in the Ministry of Finance, and a Ministerial decision, to be issued by end-September, will specify both how it will operate, and what the key elements of the annual audit plan will be. We have already hired 250 new auditors to help us implement our plan for 2003, which we expect to complete by end-November 2002.

9. **Public worker employment in SEEs and in other parts of the public sector is being rationalized, and we are working toward introducing a retirement program for the civil service as well.** Between end-January and end-June 2002, 11,342 public workers retired from state enterprises. There were no transfers of workers to the civil service during this period. In July so far, 2,580 additional public workers have retired from state enterprises. With this, we are on track to achieve the end-October 2002 structural performance criterion on reducing by two thirds the 45,800 state enterprise workers identified as redundant as of end-January. Outside the SEE sector, in the first half of 2002 4,280 public workers retired from consolidated budget agencies. We are also preparing legislation extending the retirement program to the civil service.

10. **We will shortly introduce ambitious public financial management legislation to help overhaul the budget process.** The new budget systems law (the Public Financial Management and Internal Control Law) will set out a comprehensive framework for budget preparation, execution, accounting, reporting, and internal and external audit. Over many years, Turkey's fiscal system has become increasingly fragmented, undermining transparency and aggregate fiscal control. To address this, the law will consolidate revolving funds, extrabudgetary funds, and annexed and special budgets into one central government budget, under a common classification. It limits the scope for ad hoc policy initiatives which have fiscal consequences. The bill authorizes the Ministry of Finance to set standards for accounting, financial control, and reporting throughout the general government. The law also expands the coverage of Turkish Court of Accounts (TCA) audits to all of general government and provides for external audit of TCA's own expenditures. Finally, over time, it will allow the locus of financial control to shift to line

ministries, removing the incentive for fragmentation and improving performance orientation in government agencies. More specifically, the TCA will lose its ex-ante control function, and internal audit units and ex-ante control functions will shift to line ministries. As indicated in our anti-corruption plan, we will prepare and submit to parliament an Inspection Law to achieve restructuring in all inspection units and begin implementing the inspection standards and establish the hiring and working principles for inspectors. The Public Financial Management and Internal Control Law, originally expected to be submitted to parliament by end-June (as a structural benchmark), and also covering reforms to extrabudgetary funds (whose passage by parliament was a structural benchmark for July), will be submitted to parliament as a **prior action for this review**, and its passage by parliament will be a new **structural benchmark** for end-March 2003.

11. **We are also preparing legislation to improve the governance of state enterprises.** This legislation will clarify state enterprise goals (including financial targets) and set new accountability standards. At the same time, the proposed law will enhance management autonomy and internal governance, preparing the ground for future privatizations. Specifically, it will address accounting, reporting and audit arrangements, and the role, responsibilities, and independence of state enterprise boards. We will submit this legislation to parliament by end-2002, as a new **structural benchmark**.

### **Debt management**

12. **Our efforts to strengthen debt management are continuing.** We continue to improve our risk management capability and the coordination of our borrowing strategy. We will reintroduce a strengthened primary dealer system ahead of schedule by mid-August. The new system will aim to deepen the secondary market for government debt. It will also ensure that a significant share of treasury bills at auction will be placed through primary dealers. In line with the new Law on Debt Management, a communiqué will be published in the Official Gazette by end-September 2002 defining the responsibilities of the middle office and of a new debt management committee that will oversee the development of risk and debt management policy (a new **structural benchmark**). Based on our recently completed study of Treasury operations, which incorporates technical and financial assistance by the World Bank, by end-September 2002 we will formulate an action plan to establish an integrated risk management system to monitor financial risk across the government's debt portfolio. If necessary, the Treasury will hire external consultants for the design of this system in the first half of 2003. In the meantime, we will develop simple benchmarks to monitor financial risk and to guide our borrowing decisions. By end-2003, the middle office will be fully operational.

### **Monetary and exchange rate policies**

13. **Monetary policy will continue to focus on attaining our inflation target of 35 percent for 2002.** In the first half of the year, we have met all of our quantitative monetary program targets. By sticking to the monetary program, we have achieved significant reductions both in inflation and in inflation expectations. As a result, despite recent uncertainties, we are now fully on track to meet our end-year inflation target. For the second half of the year, we reaffirm our commitment to the monetary targets set out in the 2002 program, and are continuing technical preparations for the introduction of formal inflation targeting before the end of the year.

14. **We remain committed to the floating exchange rate regime.** However, as before, the CBT could intervene in the foreign exchange market in a strictly limited manner to dampen excessive volatility. Since recent developments have resulted in renewed currency substitution while the balance of payments position has remained comfortable, the CBT has temporarily suspended its daily foreign exchange purchase auctions. However, depending on developments in the balance of payments and currency substitution, the CBT stands ready to reintroduce these purchase auctions, given our longer-term objective of strengthening our international reserve position.

15. **The efforts to strengthen foreign exchange and money markets continue:**

- **Our earlier efforts are bearing fruit.** Banks are now making increased use of the May 24 relaxation of the system of averaging reserve requirements to better manage daily liquidity demands. Interbank segmentation has declined markedly, with the extension of withholding tax on interest payments to Takasbank. With parliament having passed the needed legislation, stamp duties on forward contracts were removed effective June 22. Moreover, the decree to implement the removal of tax on foreign exchange transactions was issued on July 30, meeting a **prior action for completing this review**. The CBT will continue its one-month deposit auctions, which have been well received by markets, and have helped define the yield curve. Deposit outflows associated with the results of the audit exercise have subsided and the CBT has not had to supply funds under its contingency credit window established on June 19.
- **We are also making further efforts.** The CBT's phased withdrawal as a blind broker for banks in the money and foreign exchange markets remains on schedule. The CBT and the BRSA have established high frequency coordinating arrangements (including daily information exchange) to ensure that only sound intermediaries participate in the money and foreign exchange markets. In this regard, state-owned banks, which have until now been excluded from the overnight markets, will be allowed to re-enter the market, but with exposure restricted to no more than 2 percent of deposits. On August 1, 2002, the Turkish Banks' Association will launch the Turkish Lira Interbank Offer Rate (TRLIBOR) which will provide an interbank reference rate for transactions of a specified size (TL 1 trillion). 13 banks, each with assets exceeding US\$1 billion, will participate, with state banks as price takers.

### **Financial sector reform**

16. **With the independent evaluation of banks' financial condition now completed, the BRSA is continuing to implement its strategy for strengthening the private banking system:**

- **We expect the recapitalization of the banks to be completed by end-August 2002.** A three-stage audit of 26 banks' financial condition was completed in June. All the banks were notified about the outcome of the process, which indicated that (excluding the intervened Pamukbank) the capital needed from banks with deficiencies amounted to TL 1,326 trillion. Of that amount the banks have already raised TL 1,102 trillion during the period of the evaluation process. To fill the remaining capital need, we expect requests from the Tier II public capital support

scheme. Those banks that receive support will have representation by the BRSA or the Saving Deposit Insurance Fund (SDIF) on their boards.

- **We are taking steps to resolve the recently intervened Pamukbank.** The audit confirmed that Pamukbank was insolvent, and the acquisition proposal by Yapi Kredi Bank was not found feasible. As a result, in June the SDIF took over Pamukbank, restored its paid-in capital, changed its board and some senior executives, transferred its nonperforming related party loans to the SDIF's Collection Department, and put it up for sale. Potential bidders will have until September 27 to conduct due diligence, and must submit their bids by October 4, 2002.
- **We are taking steps to ensure that the intervention of Pamukbank does not interfere with the operations of Yapi Kredi Bank, which has a capital adequacy ratio above 8 percent and remains sound.** Pamukbank's previous owners also hold 45 percent of the shares of Yapi Kredi Bank and Pamukbank itself directly holds another 10 percent. With the intervention of Pamukbank, the previous majority owners were no longer allowed to exercise voting rights in Yapi Kredi Bank, which, as a result, have been transferred to the SDIF. However, dividends rights still remain with the owners. The BRSA and SDIF will in consultation with appointed independent advisors develop a strategy for resolving Pamukbank and the ownership in Yapi Kredi Bank by September 16, 2002 (a new **structural benchmark**)
- **Finally, the BRSA has continued its efforts to publicize and explain the results of the audit and recapitalization exercise.** It has published explanatory materials, including detailed reports on the exercise as a whole, and on the SDIF's intervention in Pamukbank. It has also held seminars to explain the process to market participants, investors, and media.

17. **We are also taking steps to complete the resolution of the four remaining intervened banks (besides Pamukbank):**

- On July 5, the SDIF received a bid for the purchase of **Toprak Bank**. The SDIF Board will make a final decision on this bid by end-July 2002. If this bid is not acceptable and the bank is not sold by September 16, 2002 the bank's license will be revoked by end-September 2002 and it will either be merged into another bank or liquidation procedures initiated (the revocation of the license is a new **structural benchmark**).
- On June 27, a court ruling was issued allowing the SDIF to proceed with the liquidation of **Türk Ticaret**, and its bank license was revoked. Liquidation will be started once the August 9 shareholders' assembly meeting has formally approved it.
- If by end-August 2002 no qualified investor has offered to purchase **Tarişbank**, its license will be withdrawn. Its nonperforming loans will then be transferred to the SDIF's Collection Department, and remaining liabilities and performing assets absorbed by Bayindirbank, the bridge bank established earlier this year, by end-2002.

- As part of the SDIF's strategy for resolution of assets in intervened banks, it is expected that **Bayindirbank**'s role as a bridge bank will gradually diminish.

18. **The BRSA is developing a strategy for dealing with the bad assets transferred to the SDIF's Collection Department, including the establishment of an asset management company (AMC).** The SDIF, with advice from independent consultants, will develop a detailed sale strategy for disposal of assets held by the Collection Department. This strategy will be announced by end-September 2002 (a new **structural benchmark**). By end-October 2002, the SDIF will also announce the sale of loan portfolios with a total face value of at least US\$250 million (another new **structural benchmark**), with bids to be submitted by end-2002. If private banks or other entities were to express an interest in setting up their own AMC, the SDIF would be willing to participate and provide up to 20 percent of the capital needed as permitted by the law. Otherwise assets in intervened banks would be handled by the Collection Department (bad assets) and Bayindirbank (good assets).

19. **The "Istanbul Approach" for corporate debt restructuring is now operational.** Final institutional elements were put in place in July with the appointment of the Turkish Industrial Development Bank (TSKB) as the Coordinating Agency, the appointment of members of the Arbitration Committee, and the establishment of arbitration procedures. The first corporate debt restructuring agreement under the Istanbul Approach was concluded in late June by a consortium of credit institutions, including the IFC and the EBRD, restructuring debt of a conglomerate group. Negotiations for other corporate workouts are in progress.

20. **The Ministry of Justice is pressing ahead with the reform agenda on bankruptcy and foreclosure laws in consultation with the World Bank.** We have received the World Bank's Report on the Observance on Standards and Codes on Insolvency and Creditor Rights Systems, and endorse the Report's policy recommendations. Based on the recommendations, our aim remains to formulate comprehensive reforms by end-September (a structural benchmark) and enact them by end-January, 2003 (also a structural benchmark). Moreover, we have submitted draft legislation to the Council of Ministers for creation of intermediate courts of appeals in bankruptcy cases and for accelerated creditor enforcement procedures.

21. **Our restructuring of state banks is entering a new phase.** While operational restructuring will continue, the critical phase of major employment reductions and branch closures in Ziraat and Halk is almost complete. Although we have not quite met the target of 800 branch closures (structural performance criterion for end-June 2002), we closed 788 branches between April 2001 and June 2002. In July, we have closed 5 more branches, and expect the 800 target to be reached shortly. Between April 2001 and June 2002 we have reduced staffing by 26,000 employees. With an additional staff reduction of 3,000 in July 2002, the number of employees has been almost halved. Working with the World Bank, we will now prepare the banks for privatization. We hope to appoint an independent advisor on the privatization of Halk by end-September, and to put it up for sale in the first quarter of 2003. We will also seek outside assistance for the privatization of Ziraat, and to sell it later as conditions permit. To maximize the sales value of the two banks, we believe that it is essential that the banks present financial statements for at least one full year after the operational restructuring has been completed, before we complete the sales process. The planned privatization of Vakif Bank was not successful, as no bidder was willing to purchase the bank whole (a condition that had been set for



acceptable bids). We will again work with the World Bank to ensure the success of this sale, by operationally restructuring the bank. We will also look into any legal obstacles to the privatization of Vakif Bank, and submit to parliament any needed legislative amendments by end-October 2002. We expect the bank to be put up for sale again in the second quarter of 2003.

22. **The implementation of International Accounting Standards (IAS) is proceeding as planned.** In June the BRSA issued the final regulation for the implementation of IAS (meeting a performance criterion for end-June 2002), which should be fully reflected in banks' balance sheets by end-2002.

23. **We will continue our efforts to strengthen supervision of financial institutions and to enhance consolidated supervision:**

- **We will transfer the supervision of non-bank financial institutions (excluding insurance companies) from Treasury to the BRSA.** At present, the Treasury is in charge of supervising these companies, even though banks own many of them. To better facilitate consolidated supervision, we will send a draft law to parliament by end-March 2003, which transfers supervisory responsibility to the BRSA effective July 1, 2003.
- **We will also strengthen the supervision of insurance companies, which the Treasury is also responsible for supervising, even though banks own some of these.** The Treasury will launch a study, with independent consultant advice, to be completed by end-2002 that will consider how best to strengthen the regulatory and supervisory framework of insurance companies. In addition, by the end of the year the Treasury will also send to the Council of Ministers a new draft law to regulate insurance companies in line with applicable EU Insurance Directives and IAIS Core Principles.
- **The BRSA is strengthening its banking supervision through introduction of risk-based supervision, including oversight of operational risks.** The BRSA may need to hire outside expertise to be able to carry out such supervision. In light of this, together with its increased supervisory responsibilities of non-bank financial institutions, the BRSA will complete a reorganization study to enhance its supervisory capacity. The study will be completed by end-2002 (a new structural benchmark).

#### **Enhancing the role of the private sector**

24. **We are making progress in the sale of companies that are ready for privatization.** In early July, the Privatization Agency (PA) announced a new strategy for reducing the public share in TÜPRAŞ (petroleum refinery) to below 50 percent: this will be done by end-2002 through a tender for a strategic partner, or the placement of exchangeable bonds, or both, since a public offering is not feasible under current market conditions. On July 16, the High Privatization Council authorized the sale of the remaining state share of 25.8 percent in POAŞ (petroleum distribution company) to the existing strategic investor. We expect the sale to be completed by mid-August 2002. On July 30, we reduced the public share in ERDEMİR (steel company) to below 50 percent through a sale to an investment fund. By October 2002, we will announce a block sale of at least 51 percent of the shares in PETKİM (petrochemical company). We are confident

that these and other sales of state enterprises will bring in enough cash to meet the US\$700 million indicative target on cumulative cash privatization proceeds for 2002.

25. **We are also pressing ahead with the preparation for the sale of other key SEEs.** Preparations for the privatization of **Türk Telekom (TT)** are proceeding according to the road map approved in May. The tender for an advisor on TT's revaluation was announced on July 8, and the advisor will be selected in August. Consultants to prepare the privatization plan for **TEKEL** (the tobacco and alcohol monopoly) were selected in July, and the plan will be submitted to the Council of Ministers in September. The High Privatization Council will approve shortly a road map for the privatization of **ŞEKER** (the sugar company). The road map envisages that 5 inefficient sugar factories will be closed and 7 factories converted into corporations by end-October 2002, and that preparatory work for privatization will be completed by end-2002. In the **electricity sector**, as planned, with the exception of the projects potentially eligible for Treasury guarantee, we will transfer all state-owned thermal generation and electricity distribution assets under the scope of privatization by end-July. Pre-qualification tenders for these distribution assets would be launched by February 2003. We will also transfer two distribution subsidiaries of **BOTAŞ** (natural gas company) to the PA by end-August 2002, with a view to privatizing it in 2003.

26. **We are complementing privatization by other steps to improve the private business environment.** While our preparations for the planned July 18 inaugural meeting of a high-level Investor Advisory Council were well advanced, we decided not to hold the meeting at this time owing to the recent political developments. We remain, however, determined to hold this meeting at an opportune time in future. In the meantime, we are continuing to take steps to improve the business climate for both domestic and international investors. The Coordination Council for the Improvement of the Investment Climate will continue to hold regular meetings to assess private investors' needs and monitor the progress made by the nine technical committees established earlier this year. Specifically, by April 2003, we will submit to parliament (i) a new draft law on company registration to simplify and streamline the company registration process; and (ii) a new draft law on Prohibition and Prosecution of Smugglers.

#### **Follow-up on safeguards assessment**

27. **Building on our earlier efforts, we have further strengthened the transparency and effectiveness of the CBT's control, accounting, reporting, and auditing systems, including in the context of the IMF safeguards assessment, which is required for all new Fund-supported programs.** In particular, on July 5 we issued and posted on the CBT website the external auditor's report reviewing the consistency between the program data reported to the IMF and the audited financial statements. With this action, we met a structural performance criterion for July 15.

Very truly yours,

Kemal Derviş  
Minister of State for Economic Affairs

Süreyya Serdengeçti  
Governor of the Central Bank of Turkey

Turkey: Quantitative Performance Criteria and Indicative Targets for 2002

	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome	Ceiling/Floor	Outcome
	March 31, 2002		May 31, 2002		August 31, 2002		November 30, 2002		December 31, 2002	
<b>I. Performance criteria</b>										
1. Floor on the cumulative primary balance of the consolidated government sector (in trillions of Turkish lira) 1/	2,847	2,924	4,714	5,365	9,600		14,900		16,050	
	February 28, 2002		April 30, 2002		June 30, 2002		September 30, 2002		December 31, 2002	
2. Ceiling on contracting or guaranteeing of new external public debt with original maturities of more than one year (in millions of US\$) 2/	6,500	1,645	10,000	2,402	11,100	3,690	14,300		17,500	
3. Ceiling on the stock of external public debt with original maturities of up to and including one year (in millions of US\$) 3/	1,000	0	1,000	0	1,000	0	1,000		1,000	
4. Floor on level of net international reserves of CBT and Treasury combined (in millions of US\$)	-6,500	-4,907	-7,200	-4,926	-7,800	-5,755	-8,500		-9,700	
5. Ceiling on base money (in trillions of Turkish lira) 4/	8,250	7,823	8,900	8,680	9,250	9,009	10,600		10,850	
<b>II. Indicative targets</b>										
	May 31, 2002		August 31, 2002		September 30, 2002		October 31, 2002		November 30, 2002	
1. Floor on the cumulative primary balance of the consolidated government sector (in trillions of Turkish lira)	...		...		11,300		12,250		...	
2. Floor on the cumulative overall balance of the consolidated government sector (in trillions of Turkish lira)	-17,486	-16,367	-28,250		...		...		-39,750	
	February 28, 2002		April 30, 2002		June 30, 2002		September 30, 2002		December 31, 2002	
3. Floor on the cumulative primary balance of other public entities sector (in trillions of Turkish lira)	...		...		550		...		1,100	
4. Ceiling on the stock of net domestic assets of the CBT and Treasury combined (in trillions of Turkish lira) 4/	26,100	24,318	27,700	25,197	28,739	26,374	31,139		33,139	
5. Privatization proceeds (in millions of US\$)	...		...		...		220		700	

1/ The target for end-March has been adjusted for expenditure arrears outstanding at Bag-Kur (a social security fund).

2/ Applies to nonconcessional external debt with an original maturity of more than one year. Excludes purchases from the IMF, adjustment lending from the World Bank, and other external program financing, long-term liabilities of the Central Bank and sales of treasury bills and bonds denominated in TL or Fx to nonresidents in either the domestic primary market or the secondary market.

3/ Stock of debt of maturity of one year or less, owed or guaranteed by the consolidated government sector. Excludes external program financing, sales of treasury bills denominated in TL or foreign exchange to non residents in either the domestic primary market or the secondary market, normal import-related credits, reserve liabilities of the Central Bank, and forwards contracts, swaps and other futures market contracts.

4/ Target for end-February calculated as four working day average of February 11-12 and March 11-12, 2002, to take account of the transitory impact of the Bayram religious holiday on currency demand. NDA targets for June onward have been lowered by TL 161 trillion compared to the January 18, 2002 Letter of Intent to reflect the drop in required reserves following the SDIF's intervention in Pamuk Bank.

### STRUCTURAL POLICIES, 2002–04

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
<b>Fiscal policy</b>			
1. Implement all further measures to reach the 6.5 percent primary surplus target that are technically feasible to put in place in January:	PA for SBA	13	
(i) Council of Ministers to approve a reduction in the share of central government tax revenues accruing to metropolitan municipalities to 4.1 percent			<i>Done.</i>
(ii) issue a circular to implement attrition rules			<i>Done.</i>
(iii) the Minister of Finance to approve a reallocation of spending to ensure adequate funding for DIS for agriculture			<i>Done.</i>
2. Increase the PCT (on items excluding natural gas) by 1 percent in real terms in early February		14	<i>Not done.</i> Increase was equal to January WPI inflation.
3. By end-March (i) the Ministry of Finance to identify savings from closing regional administrations and other regional line agency offices, and block relevant budget appropriations in the budget, and (ii) SEEs to approve budgets in line with the cost reductions mandated	BM	14	<i>Not fully achieved.</i> (i) In March, a decree regarding closure of regional administrations and other regional line offices was issued. Subsequently, line agencies were asked to block relevant appropriations. However, the measure did not yield the expected amount of savings. (ii) Most SEEs have approved budgets in line with cost reductions mandated and others have been instructed to correct their budgets.
4. Keep investment expenditure in SSK at the level originally planned in the investment program for 2002, implement generic drug purchase program in ES by end-April, and receive profit transfer of TL 180 trillion from Ziraat Bank		5 of April 2002 LOI	<i>Not fully complied with.</i> SSK's investment is not expected to fall, since several of its projects fall outside of the annual investment program and are not subject to the limits therein. The Ministry of Health now aims to finalize the generic drug purchase program by end-2002. The profit transfer from Ziraat was received in April 2002.
5. Refrain from introducing any new tax exemptions or incentives, except those specified in the tax reform plan		14	<i>Not fully complied with.</i> Payroll and personal income tax deferrals were introduced in March 2002 as part of an effort to stimulate employment.

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
6. Refrain from introducing any new discounts or exemptions for SEEs, except those pursued for commercial reasons by enterprises' managements		14	<i>Done, but partially reversed.</i> The president approved Law No:4736 on January 18, 2002 preventing any new discounts or exemptions for SEEs. However, some discounts for electricity were reintroduced in May, for phase out by end-2002.
<b>Public debt management</b>			
7. Continue to lengthen average maturity in Treasury bill auctions and public offerings to the extent demand allows and encourage a diverse range of investors		18	<i>Underway.</i>
8. Resume in January 2002 the program of FRN auctions. Before the first issue publicize a revised standard method of price and yield calculations, in line with international practice		19	<i>Done.</i>
9. Reintroduce a primary dealer program by end-September 2002	BM	19	A draft dealership contract has been prepared and will be discussed with candidate primary dealers in July. The system is expected to be reinstated ahead of schedule by mid-August.
10. Continue to issue, subject to market conditions, domestic FX denominated and FX indexed bonds, as well as international bonds		19	Taking into account redemptions and market conditions, FX denominated and FX indexed securities will be issued.
11. The Treasury to complete a study by end-June 2002 of its operational mechanisms, procedures, and structure to improve its risk and debt management, including through closer coordination between domestic and international borrowing. The recommendations of this study will be implemented during 2002		19	<i>Done.</i> Based on the recommendations of the study, the middle office, which was recently established within the Treasury to coordinate the Treasury's domestic and external borrowing, will formulate an action plan by end-September 2002 to establish an integrated risk management system to monitor financial risk across the government's debt portfolio. In the interim period, the Treasury will develop simple benchmarks to monitor financial risk and to guide their borrowing decisions. The middle office is expected to be fully operational by end-2003.
12. Issue in June government communiqué that spells out details of the operations of the middle office that will formulate overall public debt strategy		6 of April 2002 LOI	A draft communiqué was completed and circulated internally for comments.

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
13. The Treasury to develop its cash management operations, acting in coordination with the CBT		19	The new Debt Management Law allows for the technical infrastructure for cash management operations in coordination with the CBT.
14. The Treasury to intensify its dialogue with the full range of investors, including bilateral contacts and group discussions with institutional investors and intermediaries, and enhanced retail outreach		19	With the target of broadening the investor base, discussions are ongoing on the conditions of a security which is planned to be issued for insurance companies. A series of meetings are being held with private banks, which provide feedback about market developments and specific concerns banks have.
15. By end-September 2002 publish in the Official Gazette, the communiqué defining the responsibilities of the middle office and of a new debt management committee that will oversee the development of risk and debt management policy	BM	12 of July 2002 LOI	The communiqué is being drafted.
<b>Monetary and incomes policy</b>			
16. Ensure that any new laws or regulations do not undermine the independence enshrined in the CBT law		21	<b>Done.</b> All new laws and regulations are consistent with CBT independence.
17. CBT to continue its technical preparations for the introduction of inflation targeting, including improved modeling and forecasting of inflation		22	Work ongoing at the CBT covers short- and near- term forecasting, and development of the data base.
18. Move to inflation targeting		22	In addition to progress in establishing the necessary technical infrastructure, favorable developments in disinflation and inflation expectations, fiscal policy, and the banking sector are expected to allow the pre-conditions to be met to allow a move to formal inflation targeting by end-2002.
19. Seek a significant reduction of the ex-post indexation element contained in current wage contracts during the next public worker collective bargaining round and civil service salary adjustment, and use the Economic and Social Council as a forum for incomes policy discussions with the private sector		23	An exploratory meeting between labor unions and the authorities to achieve this goal was held in February.
20. a. Consider the possibility of reducing backward indexation of administered prices without compromising SEEs' financial conditions		23	<b>Partially done.</b> Most SEE prices have not been changed from January to mid-May 2002,

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
			weakening the SEEs' financial conditions. Price increases resumed in late May and continued in June and July. All remaining real price increases necessary to fully offset earlier SEE revenue losses will be made shortly. Changes at discrete intervals, in line with the WPI, are expected in the remainder of the year.
b. In the ongoing negotiations on new two-year private sector wage contracts the government to stress to labor unions and employers the need to reduce backward indexation		14 of April 2002 LOI	
21. Encourage a successful conclusion by end-February 2002 of banks' discussions to establish interbank borrowing reference rates in Turkish lira out to at least three-month maturity to enhance money market liquidity and transparency, and to provide accurate reference rates for financial instruments		25	Measures have been taken to deepen the interbank money market. Turkish Bankers' Association will launch Turkish Lira Interbank Offer Rate (TRLIBOR) August 1, 2002.
22. The CBT to gradually end its practice of acting as a blind broker during 2002		25	The phasing out by end-2002 has been announced by the CBT.
23. Working group to facilitate the development of financial markets to identify concrete actions by end-January 2002 in the areas of taxation, accounting, and regulation. The first measures will be put in place by end-February 2002		25	Interagency committee chaired by CBT with membership from Banks Association of Turkey, BRSA, MOF and ISE, established and has held two meetings. Taxation of revaluation profits clarified in February, and prudential rules on market risks effective since January 2002.
24. The Privatization Agency to authorize companies in its portfolio to transact their foreign exchange business at the market rate (not at the CBT official rate). The oil and gas companies (TÜPRAŞ and BOTAS) to work with state banks to improve their foreign exchange practices, to minimize lumpy transactions in the foreign exchange market		25	<b>Done.</b>
25. To encourage development of the foreign currency market, eliminate stamp duties on forward contracts and remove the tax on interbank foreign exchange transactions by end May 2002		9 of April 2002 LOI	<b>Done.</b>
26. Require as of end-May withholding of interest earned through transactions intermediated through Takasbank		9 of April 2002 LOI	<b>Done.</b>
27. To rationalize the system of reserve requirements the CBT, effective from May 2002, to (i) increase the scope and length of the averaging of reserve requirements, and (ii) increase the remuneration of both Turkish lira and foreign currency reserves, linking remuneration to market rates		9 of April 2002 LOI	<b>Done.</b>

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
28. Multi-agency working group to continue to identify measures to ensure the successful development of money and foreign exchange markets		9 of April 2002 LOI	Multi-agency working group chaired by the CBT with the participation of Banks Association of Turkey, BRSA, MOF, ISE, IGE, Treasury, and CMB has held meetings related to the development of the derivatives markets and TL reference rate fixing. Taxation and accounting problems of the futures transactions have been solved by the MOF and BRSA, respectively.
29. Issue the decree to remove tax on foreign exchange transactions	PA	15 of July 2002 LOI	<b>Done.</b> Decree was issued on July 30, 2002.
<b>Banking reform</b>			
30. Pass necessary legal amendments, and issue a Council of Ministers Decree for staff reductions in state banks	PA for SBA	28	<b>Done.</b>
31. By end-June 2002, reduce the number of state bank branches by 800. In this context also reduce staffing correspondingly	PC	28	<b>Missed by a small margin.</b> 788 branches had been closed by end-June 2002. However, the process has continued in July with further closures of 5 additional branches.
32. For Vakif Bank privatization, bids to be invited from potential investors in May		28	No bids were received by the end-June deadline. It is expected that the bank will be put up for sale again in the spring of 2003. In the meantime, an evaluation will be made of the need to make legal amendments to remove any exiting obstacles to this sale.
33. BRSA to issue guidelines for targeted evaluations of private banks in preparation for the public support scheme for private banks	PA for SBA	30	<b>Done.</b>
34. The targeted evaluation of loan portfolios, collaterals, and certain other exposures to be performed by banks' existing external auditors to be completed by end-March		30	<b>Done.</b>
35. Third-party auditing firms to be appointed by the BRSA by end-March 2002 to verify that the guidelines have been followed, and to ensure the integrity of the process	BM	30	<b>Done.</b>
36. a. The BRSA to (i) complete the final interpretation of the evaluations by end-April and (ii) send letters to banks stipulating required actions on the basis of this interpretation by May 15	PA for second review (action # (ii))	30, 31	a. <b>Done.</b> (i) Auditing reports submitted to the BRSA by late May; (ii) Letters to 24 banks sent on June 12. Of the remaining two banks, one was



Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
			intervened on June 19, and a letter was sent to the other bank the same day.
b. Evaluation results to be fully incorporated into banks' end-June 2002 financial statements			b. Evaluation results expected to be incorporated by end-August 2002.
c. Banks to apply for participation in the scheme before end-May 2002			c. Banks expected to apply by end-July.
d. Recapitalization scheme to be completed before end-June 2002			d. Completion expected by end-August 2002.
e. The BRSA to prepare prototype contracts to be signed between the Saving Deposit Insurance Fund (SDIF) and the majority shareholders on the pledging of shares, share buy-backs, and the conversion of Tier-2 capital into Tier-1 capital		10 of April 2002 LOI	e. <i>Done.</i>
37. The legal framework and related regulations for the public support scheme for private banks to become effective in January 2002	PA for SBA	32	<i>Done.</i>
38. The BRSA to undertake legal consultations, as necessary, to ensure implementation of the public capital support scheme as planned		32	<i>Done.</i>
39. Resolve by end-2001 all banks taken over by the SDIF before November 2001, with the exception of two banks whose resolution has been halted by courts	PA for SBA	33	<i>Done.</i>
40. a. Determine final resolution method for Toprak bank taken over in November 2001 by February 2002		33	<i>Done.</i> After no acceptable bids were received by the original sale deadline of April 9, the bank was reoffered for sale in mid-May. One potential bidder made an offer to the BRSA on July 5. The SDIF Board is expected to make a decision on this bid by end-July.
b. The SDIF to revoke Toprak's license by end-September 2002 if the bank is not sold by September 16, 2002.	BM	17 of July 2002 LOI	
41. The SDIF to prepare a monthly balance sheet starting end-March 2002 and become subject to annual external audits; the external audit for 2001 will be completed by end-April 2002	BM (the latter action)	34	<i>Done.</i>
42. Laws and regulations regarding loan classification, loan loss provisioning, and collateral valuation will be amended as necessary following the portfolio reviews by end-June 2002		35	<i>Done.</i>
43. Pass legal amendment in January 2002 to eliminate with immediate effect the existing four-year transition rule for loan loss provisioning	PA for SBA	35	<i>Done.</i>
44. Start trial implementation of new accounting system (for banks) in	PA for	35	<i>Done.</i>

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
line with IAS in January 2002	SBA		
45. Following the trial implementation the BRSA to evaluate the experience and issue by end-June 2002 a revised regulation on the new accounting standards to ensure that banks' end-2002 balance sheets comply with IAS	PC for end-June	35	<i>Done.</i>
46. Improve reporting requirements based on the findings of the independent assessments, and strictly enforce the quality and timeliness of the reporting as of end-June 2002		35	<i>Underway.</i> Quality and timeliness of reporting expected to be improved as of end-August 2002.
47. a. Off-balance sheet repos to be included on balance sheet as of February 1, 2002		35	<i>Done.</i>
b. Capital charges for market risks to be calculated on a solo basis as of January 1, 2002 and on a consolidated basis as of July 1, 2002			
c. Regulation on monitoring of internal control and risk management systems to become effective January 1, 2002			
48. The BRSA and SDIF in consultation with appointed independent advisors to develop a strategy for resolving Pamukbank and the ownership in Yapi Kredi Bank by September 16, 2002	BM	16 of July 2002 LOI	
49. Withdraw Tarişbank's license, if by end-August 2002 no qualified investor has offered to purchase it. Its nonperforming loans will then be transferred to the SDIF's Collection Department, and remaining liabilities and performing assets absorbed by Bayindirbank, the bridge bank established earlier this year, by end-2002.		17 of July 2002 LOI	
50. By end-September 2002 the SDIF to announced a detailed strategy for the disposal of assets held by the Collection Department	BM	18 of July 2002 LOI	
51 By end-October the SDIF to announce the sale of a loan portfolio with a total face value of at least US\$250 million	BM	18 of July 2002 LOI	
52. The BRSA to complete a reorganization study to enhance its supervisory capacity by end-December 2002	BM	23 of July 2002 LOI	
<b>Corporate debt restructuring</b>			
53. Introduce in January 2002 a voluntary market-based framework (the "Istanbul Approach") for dealing case-by-case with multicreditor exposures to large and medium-size borrowers		36	<i>Done.</i>
54. Create in early 2002 a multiagency Coordination Committee with private sector participation under the Treasury, responsible for facilitating and monitoring the corporate debt restructuring process, as well as identifying and proposing the removal of impediments that may exist		36; 13 of April 2002 LOI	<i>Not done.</i> Work to be carried out by the Production and Finance Committee chaired by the Treasury.
55. Establish secretariat to the Production and Finance Committee in		13 of	Although the Committee has not

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
April		April 2002 LOI	been established yet, the BRSA is coordinating the process.
56. Production and Finance Committee to develop further measures consistent with preserving the transparency and integrity of the bank recapitalization exercise, to catalyze banks' and corporates' participation in the "Istanbul Approach"		13 of April 2002 LOI	Although the Committee has not been established yet, the BRSA and Turkish Industrial Development Bank are coordinating the process.
57. Production and Finance Committee to work with the relevant government agencies to establish by June 2002 a database to monitor corporate debt		13 of April 2002 LOI	<i>Not done.</i> The CMB has issued reporting requirements for trading firms who in turn submit information to the ISE. A database on corporate debt has not been developed.
58. A private asset management company will be set up by end-August 2002, with the SDIF owning a minority share		13 of April 2002 LOI	The authorities have been using technical assistance to rethink strategy towards asset sales. Sales strategy for SDIF assets to be developed by end September 2002 requested technical assistance for the drafting of a proposal for potential investors. Implementation contingent on private sector interest.
59. a. The Ministry of Justice to prepare an action plan based on the findings of a World Bank Report on Standards and Codes (ROSC) on Turkey's insolvency regime and form a Commission to prepare necessary amendments to the Bankruptcy Law		37	A commission to prepare necessary amendments to the Bankruptcy Law, in line with the findings of the World Bank ROSC, has been established.
b. The Ministry of Justice to produce a package of comprehensive reforms of the Execution and Bankruptcy Act by September 31, 2002	BM	16 of June LOI	<i>Underway.</i>
c. Enactment of the reforms of the Execution and Bankruptcy Act by end-January 2003	BM	16 of June LOI	
60. Support the upgrading of administrative procedures in the judiciary to improve the capacity of the courts		37	<i>Underway.</i> A draft legislation has been submitted to the Council of Ministers for creation of intermediate courts of appeals in bankruptcy cases and for accelerated creditor enforcement procedures.
61. The CMB to introduce international accounting standards, including inflation accounting provisions, by January 1, 2003.		38	The CMB has issued the regulation. Firms are taking steps to adopt the new accounting framework.
62. Starting end-March 2002, the CMB to require corporate groups to		38	<i>Done.</i> The CMB has issued the

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
provide consolidated financial statements and to set up a dedicated group to monitor their finances			regulation.
63. Starting end-March 2002, the CMB to require corporate groups with financial affiliates to provide consolidated group statements and share those statements with the BRSA		38	<i>Done.</i> The CMB has issued the regulation. The Accounting Standards and Corporate Finance departments of the CMB are monitoring the accounts.
64. Send a draft law to parliament by end-March 2003 which transfers supervisory responsibility of non-bank financial institutions (excluding insurance companies) from Treasury to the BRSA effective July 1, 2003		23 of July 2002 LOI	
65. The Treasury to launch a study, with independent consultant advice, to be completed by end-2002 that will consider how best to strengthen the regulatory and supervisory framework of insurance companies. In addition, by the end of the year the Treasury also to send to the Council of Ministers a new draft law to regulate insurance companies in line with applicable EU Insurance Directives and IAIS Core Principles.		23 of July 2002 LOI	
<b>Public sector reform</b>			
66. Parliament to approve Public Procurement Law in line with UN (UNCITRAL) standards in January 2002	PA for SBA	40	<i>Done.</i>
67. Establish an independent procurement agency by end-March 2002	BM	40	<i>Done.</i>
68. Change laws and regulations to make them consistent with the new public procurement framework		40	See below.
69. Parliament to amend the Public Procurement Law by end-May 2002, to (i) bring the real value of the thresholds toward those in line with international best practice and (ii) extend the minimum time period for procurement applicable for cases below the thresholds	PA for second review	40	<i>Done.</i> Parliament passed the required amendments on June 12.
70. a. Compile a comprehensive list of public investment projects to be phased out in time to make decisions for the 2003 budget		40	The High Planning Council Decision was communicated to spending agencies in mid-July 2002. It instructs line agencies to rationalize their investment programs by 3 percent. Further discussions with line agencies, aimed at greater reductions, will take place during budget preparation and finalized by end-2002
b. The government to adopt by September 2002 an action plan leading to further reductions in the average project completion time in the public investment program by more than 3 percent annually in both 2003 and 2004. The action plan will include details on the 2003 public investment program and further steps for the 2004 program for which the details will be ratified by the High Planning Council in 2003.		7 of July 2002 LOI	

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
71. Approval by Council of Ministers in January 2002 of plan to reform the tax system	PA for SBA	40	<i>Done.</i>
72. a. Enact the first phase of the tax reform plan by end-April 2002	BM	40; 15 of April 2002 LOI	<i>Done.</i> Special Consumption Tax Law (implementing indirect tax changes) was approved by parliament on June 6.
b. Issue a decree by end-August 2002 setting the earmarking of SCT proceeds at zero, starting with the 2003 budget	BM	17 of June LOI	
73. Submit to parliament legislation for the second phase of the tax reform plan by end-October 2002	BM	40	The GDR has been seeking inputs from civil society, and a World Bank technical assistance mission is expected in early-September. Passage by parliament is expected by end-March 2003.
74. Reorganize tax administration in line with the study carried out with the World Bank:		40 and 15 of April 2002 LOI	<i>Underway.</i> The Ministry of Finance put in place an audit coordination unit in mid-May. However the details of its operations remain to be spelled out. The GDR has designed a new functional structure that includes the standard functional units. However, implementation has been delayed by several months; 250 tax auditors have been hired to-date.
a. By end-July, institute an audit coordination unit in the Ministry of Finance, and require that it produce a coordinated audit plan by end-November each year	BM (first such plan by Nov 2002)		
b. By September 15, the Minister of Finance to adopt a strategy to strengthen the collection of outstanding public sector tax arrears	BM		A comprehensive plan to address tax arrears is being prepared
c. In the budget for 2003, include resources to increase the number of auditors by 400 (for October 17) to move toward OECD standards	BM		
d. To help overhaul the revenue administration in the medium term, implement a functional reorganization, beginning at end-June			A new functional structure is expected to be approved in September 2002
75. Council of Ministers to adopt a civil service reform strategy by end-2002		40	
76. As part of the preparatory work for #75, by end-March 2002 establish a ministerial committee to carry out a functional review of government, which will be completed by end-September 2002		40	<i>Done.</i> CoM decision dated February 4, 2002 has been issued. However, the functional review is several months behind schedule.
77. By end-September, have in place an integrated system to monitor total general government and SEE employment levels on a quarterly basis	BM	40	A circular (dated December 14, 2001, No. 94997) has been sent to SEEs; monitoring of SEE employment levels has started on a

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
			quarterly basis as of March.
78. 15,000 individuals (public sector workers) to have been retired or notified of their retirement by mid-January 2002	PA for SBA	41	<b>Done.</b>
79. By end-January 2002, (i) identify all redundant workers and positions in SEEs	PAs for first review (i) and (iii)	41	(i-ii) <b>Done.</b> A total of 45,800 positions have been determined as redundant in SEEs.
(ii) sharpen tentative estimate based on aggregate analysis, by using company-specific information and by end-May produce final estimates		15 of April 2002 LOI	
(iii) eliminate all open, unfilled redundant positions		41	<b>Done.</b>
80. Extend voluntary retirement offers to the recently identified redundant workers in Türk Telekom and in the Privatization Agency portfolio of companies; for those who accept, provide payments, and allow them to retire, no later than end-March 2002		41	<b>Underway.</b> The retirement offer remains open.
81. Through voluntary retirement offers, and layoffs only when necessary, reduce the number of redundant workers by one-third by end-June, and cumulatively by two-thirds by end-October 2002	PC (the Oct action)	41	<b>Underway.</b> Between end-January and end-June, 11,342 redundant positions had been eliminated (including some individuals notified of their impending retirement as part of the prior action for the program—see item #78). In July so far, 2,580 additional public workers have retired from state enterprises.
82. By end-June 2003, phase out the remaining redundancies		41	
83. The Ministry of Finance and the Treasury to formulate by end-September 2002 an action plan to address redundancies in the central government		15 of April 2002 LOI	<b>Underway.</b> The modalities of extending the staff reduction program to the civil service are under consideration.
84. Audit SEE compliance with this program on a quarterly basis		41	<b>Underway.</b> Treasury Controllers audited all SEEs (except Türk Telekom) in April-May. Second-quarter audits have begun.
85. To strengthen the legal framework for fiscal policy pass the Law on Public Debt Management and issue two supporting communiqués	PAs for the first review	42	<b>Done.</b>
86. a. Submit to parliament by end-June 2002 a Law on Financial Management and Internal Control consistent with best international practices	BM	42	<b>Not met.</b> See below.
b. Submit to parliament a Law on Financial Management and	PA for	10 of July	

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
Internal Control	third review	2002 LOI	
c. Parliament to pass Law on Financial Management and Internal Control by end-March 2003	BM	10 of July 2002 LOI	
87. Close, by end-March 2002, 548 additional revolving funds	BM	42	<b>Done.</b>
88. Incorporate in the draft budget for 2003 the revenue and expenditures under Law 3418	BM for Oct 17, 2002)	42	
89. Eliminate the earmarking under Law 3418 and Law 4306		42	
90. Amend by July 2002 the governing legislation for the remaining EBFs to require passage of their budgets by parliament, external audit of their accounts (reported to parliament), and monthly reporting of their accounts, on a consolidated basis, with the central government's accounts	BM	42	A provision in the draft Law on Financial Management and Internal Control addresses this. However, this law will be passed by end-year at the earliest.
91. Eliminate the remaining budgetary fund (the Support Price and Stabilization Fund) in three years, when the World Bank's Agricultural Reform Implementation Project ends		42	
92. In the draft 2003 budget to be submitted to parliament (i) include net lending as an appropriation, and (ii) extend accounting and coding reforms to all consolidated budget agencies, and to general government units on a pilot basis	BMs for Oct 17, 2002)	42	To extend coding reforms to general government units on a pilot basis, the MoF has prepared a budget implementation circular. Studies regarding accounting reform are progressing as planned.
93. Complete, by end-March 2002, a survey of end-2001 commitments in excess of appropriations	BM	42	<b>Done.</b>
94. To monitor and address expenditure commitments on a regular and timely basis, conduct surveys of commitments in excess of appropriations twice a year (as of end-June and end-December), with the aim of having the results available within six weeks after the end of each period		15 of April 2002 LOI	The survey for end-June is being compiled.
95. Address the impact of public sector retrenchment through the labor redeployment and reinsertion program and through unemployment insurance		42	As per the circular (No.1087, 2002/3) issued on January 21, 2002, services for counseling and training have started to be tendered. Unemployment insurance payments started in March 2002.
96. Continue to implement the pension reform agenda for SSK and BK as set out in 1999. To this end, pass legislation underpinning the necessary institutional and administrative reforms by end-2002. Also prepare by end-2002, with technical assistance as needed, a study of the solvency of our civil service pension fund.		7 of July 2002 LOI	

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
97. a. Change the legal framework for SEEs, with effect from 2003, to help strengthen their governance structure, including by increasing the power of their Boards, clarifying their financial relationship with the government, and publishing details about their accounts		5 of June 2002 LOI	A draft law has been prepared and will shortly be circulated within government for comments. It will be submitted to parliament by end-2002. See item #97b.
b. By end-December 2002 submit to parliament legislation to improve governance state enterprises	BM	11 of July 2002 LOI	A draft has been completed and will shortly be circulated within government for comments.
<b>Enhancing the role of the private sector</b>			
98. The Privatization Administration (PA) to proceed with the public offerings of POAŞ by end-March 2002 and the public offering of TÜPRAŞ by end-June 2002 and launch the initial public offering for THY as soon as market conditions allow		45	The sale of the remaining public share in POAŞ to the strategic investor was announced on July 16 and is expected to be completed in mid-August. New privatization strategy has been announced for TÜPRAŞ on July 2002. The privatization of THY depends on market conditions.
99. a. CoM to adopt a privatization plan for Türk Telekom in April 2002	PA for the second review	45	<i>Not met because of change in strategy.</i> The corporatization plan approved on June 4, 2002 requires a more complex privatization strategy than originally envisaged. Deadline changed to end-November.
b. CoM to adopt a privatization plan for Türk Telekom by end-November 2002	BM	21 of June LOI	<i>Underway.</i> Preparations are proceeding according to the road map approved last May. The tender for an advisor on TT's revaluation was announced on July 8, and the selection completed by August.
100. Parliamentary approval of Tobacco Law	PA for SBA	45	<i>Done.</i>
101. Prepare and adopt a privatization plan for TEKEL by end-September	PA for fourth review	45	<i>Underway.</i> A restructuring study is being undertaken to provide a basis for the privatization plan. Salomon Smith Barney was selected on July 23, 2002 to prepare the privatization plan, which will be submitted to the CoM in September.
102. Proceed with the privatization of ŞEKER, with the first step being the adoption of a privatization plan by May 2002		45	<i>Underway.</i> The Privatization High Council will approve shortly a road



Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
			map for the privatization of ŞEKER.
103. a. In the electricity sector, in January 2002, subject to legal clarification, the Council of Ministers to adopt a government decree annulling with immediate effect all the projects for which transfer of operating rights (TOOR) contracts are pending		45	<b>Changed.</b> See item b.
b. Following the Constitutional Court decision regarding the pending transfer of operating rights (TOOR) contracts, determine which, if any, investors are eligible for Treasury guarantees and inform by end-June 2002 those eligible of the amendments needed to bring the contracts in compliance with the license regulations of the Energy Market Regulation Agency and the Electricity Markets Law. With the exception of these eligible projects, transfer all state-owned thermal generation and electricity distribution assets under the scope of privatization by end-July 2002. Moreover, the eligible contracts for which the financial arrangements have not been finalized by end-January 2003 will be cancelled, and the related assets transferred under the scope of privatization by end-February 2003		16 of April 2002 LOI	<b>Underway.</b> With the exception of the projects potentially eligible for Treasury guarantee, all state-owned thermal generation and electricity distribution assets are expected to be transferred under the scope of privatization by end-July. Pre-qualification tenders for these distribution assets would be launched by February 2003.
104. By March 2002, the Ministry of Energy to inform the PA which electricity assets will be privatized, and by April 2002 the prequalification tenders for the distribution companies will be launched		45	<b>Changed.</b> See item #103 above.
105. Complete the transfer of gas distribution companies to the PA by March 2002		45	<b>Underway.</b> A Privatization High Council Decision has been taken to transfer two distribution subsidiaries of BOTAS to the PA by end-August 2002, with a view to privatizing it in 2003.
106. The PA to go forward with the divesting of ETI Krom AŞ, ETI Elektrometalurji AŞ, ETI Gümüs AŞ, which are in the PA portfolio, as soon as licenses are transferred from ETI Holdings		45	A High Privatization Council decision (No: 2002/29) was issued on April 30, 2002 for the transfer of licenses of ETI Krom AŞ., ETI Elektrometalurji A.Ş., ETI Gümüs A.Ş., ETI Bakır A.Ş. to these companies from ETI Holding.
107. By October 2002, announce a block sale of at least 51 percent of the shares in PETKIM		24 of July 2002 LOI	
108. The PA to continue its divestment of ERDEMİR, and of tourism and fertilizer assets in its portfolio. The PA also to continue divesting its portfolio of small and medium-size companies		45	<b>Underway.</b> On July 30, the public share in ERDEMİR was reduced to below 50 percent through a sale to an investment fund.
109. Build on efforts made in 2001 (including legal amendments and simplified procedures) to increase the sale of government land. Initiate a study to evaluate how the remaining obstacles to government land sales could best be removed		45	

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
110. The Council of Ministers to adopt in January 2002 follow-up actions to FIAS study to make Turkey more attractive for domestic and foreign investors	PA for SBA	46	<i>Done.</i>
111. Submit to the parliament by end-May 2002 a new draft Law on Foreign Direct Investment in line with the findings of the FIAS study	BM	46	<i>Done.</i> Law submitted to parliament on June 14.
112. Submit to the parliament by end-March 2002 a draft law on work permits prepared by Ministry of Labor and Social Security, and issue a communiqué by end-April 2002 on the implementation procedures for employing foreign personnel employed by foreign capital companies as soon as the new law is approved by parliament		46	A draft law on work permits has been submitted to parliament and is currently at the General Assembly.
113. Complete by end-February 2002 legislation reducing the number of documents needed to obtain investment incentives		46	<i>Done.</i>
114. Establish and implement by end-February 2002 an employee code of ethical conduct for proceedings at customs		46	<i>Being implemented.</i> A communiqué was issued on September 11, 2001.
115. Submit to the Council of Ministers by end-January 2002 legal amendments to strengthen the Turkish Patent Institute		46	Draft law has been submitted to parliament and passed the Industry Commission. Currently it is at the Budget and Planning Commission.
116. The Council of Ministers to adopt a strategy by end-January 2002 for increasing transparency and combating rent-seeking activities	BM	47	<i>Done.</i> Decree signed on February 13.
117. Define and include as program conditionality concrete follow-up actions for the remainder of the 2002–04 program period based on the plan in #116:		47 and 18 of April 2002 LOI	<i>Done.</i>
a. Establish by end-April 2002 a Steering Group for public sector reform, as well as a subcommittee to provide support to the Steering Group in implementing the plan to enhance transparency and good governance	BM		<i>Done</i>
b. Publish (i) the above-mentioned action plan to enhance transparency and good governance, and (ii) the Report on the Observance of Standards and Codes (ROSC) on the quality of economic data, carried out in consultation with the IMF			<i>Done.</i>
c. Improve the public sector personnel system, including passage of legislation to establish a code of ethical conduct for civil servants and public administrators by end-2002	BM		
d. Increase access to information, through the preparation of an Information Act, defining the rights of citizens to request information and the obligation of public organizations to provide information by end-2002			
118. Establish an Investor Relations Office by February		48	<i>Done.</i>
119. Establish an Investor Council consisting of prominent business representatives from Turkey and abroad		48	Inaugural meeting scheduled for July 18 was postponed.

Action	Type	LOI Para <sup>1/</sup>	Status July 30, 2002
120. Further strengthen the efforts of the Treasury, the CBT, and the BRSA to explain policies under the economic program in their respective areas, including through the arrangement of regular (bimonthly) press conferences by the Treasury		48	<i>Ongoing.</i>
<b>Safeguards Assessment</b>			
121. Follow-up measures in the context of Safeguards Assessment:		19 of April	
a. With effect from 2001 financial statements the CBT to publish audited financial statements consistent with IAS		2002 LOI	<i>Done.</i>
b. Starting with the 2002 financial statements, the CBT to clarify disclosures of the Fund position and the relationship with the Treasury, and limit the amount of profits available for distribution to realized profit, less unrealized losses			<i>Ongoing.</i>
c. CBT to expand the role of its existing audit committee			The Audit Committee will meet twice a year with the external audit firm and, once established, with the internal audit department. It will also review the CBT's overall risk management practices and systems of internal control.
d. Include among the duties of the external auditor to issue a report reviewing the consistency between program data reported to the IMF (specifically covering base money, net international reserves, and net domestic assets) and the audited financial statements			<i>Done.</i>
e. By May 15, 2002 the CBT to ask the existing audit firm to prepare such a report, to be issued by July 15, 2002	PC (issuance of report)		<i>Done.</i>
f. By May 15, 2002, the CBT to issue a Memorandum of Understanding to clarify the Treasury/CBT relationship with the Fund.			<i>Done.</i> Memorandum of Understanding was signed between Treasury and CBT on May 6.
g. The CBT to reorganize by end-2002 the internal audit function. To this end, it will (i) adopt a new charter, which will detail the mission, scope, accountability, independence, responsibility, and authority of the audit function in line with the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors, and (ii) formulate an implementation plan identifying staffing levels, reporting lines, scope of audits, risk assessment methodologies, and developing an internal audit manual and training programs	PC (measure (i) and (ii))		<i>Underway.</i>
i. Internal audit department to conduct an audit of foreign exchange management and program data as of end-2002 by May 15, 2003	BM		

1/ Unless otherwise noted, paragraph numbers refer to January 18, 2002 Letter of Intent.