

REPUBLIC OF TURKEY

**PRE-ACCESSION
ECONOMIC PROGRAMME
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CONTENTS

INTRODUCTION.....	1
1. RECENT ECONOMIC DEVELOPMENTS.....	3
1.1. <i>Growth and Employment.....</i>	<i>3</i>
1.2. <i>Balance of Payments.....</i>	<i>4</i>
1.3. <i>Monetary and Exchange Rate Policies.....</i>	<i>6</i>
1.4. <i>Inflation.....</i>	<i>9</i>
1.5. <i>Fiscal Policy.....</i>	<i>10</i>
2. MACROECONOMIC FRAMEWORK.....	13
2.1. <i>Growth and Employment.....</i>	<i>14</i>
2.2. <i>Inflation.....</i>	<i>22</i>
2.3. <i>Monetary and Exchange Rate Policies.....</i>	<i>24</i>
2.4. <i>Balance of Payments.....</i>	<i>26</i>
2.5. <i>Main Risks During the PEP Period.....</i>	<i>28</i>
3. PUBLIC FINANCE.....	30
3.1. <i>Fiscal Policy Objectives.....</i>	<i>30</i>
3.2. <i>Public Debt Management.....</i>	<i>35</i>
3.3. <i>Public Finance Risks.....</i>	<i>41</i>
3.4. <i>Sensitivity Analysis.....</i>	<i>42</i>
4. STRUCTURAL REFORMS.....	44
4.1. <i>Strengthening the Market Economy and Entrepreneurship.....</i>	<i>44</i>
4.1.1. <i>Privatisation.....</i>	<i>44</i>
4.1.2. <i>Competition Law and Policy.....</i>	<i>46</i>
4.1.3. <i>Regulatory Reform.....</i>	<i>47</i>
4.1.4. <i>Improvement of Investment Environment.....</i>	<i>49</i>
4.2. <i>Financial Sector.....</i>	<i>49</i>
4.2.1. <i>Banking Sector.....</i>	<i>49</i>
4.2.2. <i>Capital Market.....</i>	<i>56</i>
4.3. <i>Labour Market.....</i>	<i>58</i>
4.4. <i>Administrative Reforms.....</i>	<i>62</i>
4.5. <i>Agricultural and Rural Development.....</i>	<i>66</i>
4.6. <i>Other Reform Areas.....</i>	<i>72</i>
4.6.1. <i>Education.....</i>	<i>72</i>
4.6.2. <i>Regional Development.....</i>	<i>76</i>
4.6.3. <i>Social Security and Social Assistance.....</i>	<i>77</i>
4.6.4. <i>Health.....</i>	<i>79</i>
4.6.5. <i>Transportation and Telecommunication.....</i>	<i>80</i>
4.6.6. <i>Environment.....</i>	<i>83</i>
4.6.7. <i>Energy.....</i>	<i>86</i>
ANNEX TABLES.....	89

TABLES

Table:1. 1-Growth Rates and Demand Components.....	3
Table:1. 2-Developments in the Labour Market.....	4
Table:1. 3-Foreign Trade by Countries.....	5
Table:1. 4-Balance of Payments.....	6
Table:1. 5-Monetary Targets in 2002.....	7
Table:1. 6-Consolidated Budget Balance by Years.....	11
Table:1. 7-Consolidated Budget Balance in the January-June Period.....	11
Table:1. 8-Revenues and Expenditures of the General Government.....	12
Table:2. 1-Value Added by Sectors.....	18
Table:2. 2-Total Savings-Investment Balance.....	19
Table:2. 3-Growth Rates of Factors of Production.....	20
Table:2. 4-Developments in the Labour Market.....	20
Table:2. 5-Price Targets and Projections.....	23
Table:2. 6-Balance of Payments Forecasts.....	27
Table:2. 7-The Effects of a Slowdown in Foreign Demand.....	28
Table:2. 8-The Effects of Regional Political Tensions and Possible Armed Conflicts.....	29
Table:3. 1-General Government Revenues and Expenditures.....	35
Table:3. 2-Domestic Debt Stock Composition by Instruments.....	37
Table:3. 3-Domestic Debt Stock Composition by Lenders.....	37
Table:3. 4-The Structure of Total External Debt Stock.....	38
Table:3. 5-Total Gross Debt Stock.....	39
Table:3. 6-Public Gross Debt Stock Projections for 2002-2005.....	41
Table:3. 7-The Effects of a Decline in the Growth Rate.....	42
Table:3. 8-The Effects of an Increase in the Exchange Rate.....	43
Table:3. 9-The Effects of a Rise in the Domestic Borrowing Interest Rate.....	43
Table:4. 1-Privatisation Implementation (1985-2002).....	45
Table:4. 2-Privatisation Revenues and Expenditures (1985-2002).....	45
Table:4. 3-Matrix of Policy Commitments: Privatisation.....	46
Table:4. 4-Applications Made to and Resolved by the Competition Authority.....	47
Table:4. 5-Independent Regulatory Institutions.....	48
Table:4. 6-List of the Banks Transferred to the SDIF.....	52
Table:4. 7-Matrix of Policy Commitments: Labour Market.....	60
Table:4. 8-Matrix of Policy Commitments: Statistical Infrastructure.....	66
Table:4. 9-Matrix of Policy Commitments: Agriculture and Rural Development.....	71
Table:4. 10-Matrix of Policy Commitments: Education.....	75
Table:4. 11-Matrix of Policy Commitments: Social Security and Social Assistance.....	78

FIGURES

Figure:1. 1-Average Overnight Interest Rates	8
Figure:1. 2-Developments in Dollar and Euro Markets	8
Figure:1. 3-Monthly Changes in Prices.....	9
Figure:2. 1-GDP Growth Rate	16
Figure:2. 2-Contributions to GDP Growth.....	16

BOXES

Box:2.1-Potential Output and Output Gap Projections	17
Box:2.2-Total Factor Productivity	21
Box:2.3-Determinants of Inflation	23
Box:2.4-New Central Banking Law and Central Bank Independence.....	25
Box:3.1-Major Arrangements Brought About by Public Finance and Debt Management Law	39
Box:4.1-Resources Transferred for the Restructuring of Public Banks	51
Box:4.2-Resources Transferred for the Restructuring of SDIF Banks	53

ABBREVIATIONS

BAĞ-KUR	Esnaflık ve Sanatkarlar ve Diğer Bağımsız Çalışanlar Sosyal Sigortalar Kurumu (Social Security Organisation of the Self-Employed)
AMC	Asset Management Company
BOTAŞ	Boru Hatları ile Petrol Taşıma A.Ş. (Petroleum Pipeline Corporation)
BRSA	Banking Regulation and Supervision Agency
CAP	EC Common Agricultural Policy
CAR	Capital Adequacy Ratio
ÇAYKUR	Çay İşletmeleri Genel Müdürlüğü (Directorate-General for Tea Enterprises)
CBRT	Central Bank of the Republic of Turkey
CITES	Convention on International Trade in Endangered Species of Wild Flora and Fauna
COP	Conference of Parties
CPI	Consumer Price Index
DAP	Doğu Anadolu Projesi (The Eastern Anatolia Project)
DIS	Direct Income Support
DİTAŞ	Doğan Yedek Parça İmalat ve Teknik A.Ş. (Company involved in production of spare parts for motor vehicles)
DOKAP	Doğu Karadeniz Bölgesi Gelişme Planı (Eastern Black Sea Regional Development Plan)
ECOSOC	Economic and Social Council
ECTS	European Credit Transfer System
EIA	Environmental Impact Assessment
EMRA	Energy Market Regulatory Authority
EIONET	Environmental Information and Observation Network
ERASMUS	European Community Action Scheme for the Mobility of University Students
ERDEMİR	Ereğli Demir Çelik İşletmeleri (Ereğli Iron and Steel Works Company)
ESA95	European System of Accounts 1995
EU	The European Union
EÜAŞ	Elektrik Üretim A.Ş. (Electricity Production Cooperation)
EUROSTAT	Statistical Office of the European Commission
FDI	Foreign Direct Investment
FSAL	Financial Sector Adjustment Loan
GDP	Gross Domestic Product
GFS	IMF Government Finance Statistics
GMP	Systems for Good Manufacturing Practices
GNP	Gross National Product
HACCP	Risk Analysis for Key Control Points

ILO	International Labour Organization
ILO/IPEC	ILO International Programme on the Elimination of Child Labour
IMF	International Monetary Fund
İSDEMİR	İskenderun Demir Çelik İşletmeleri (İskenderun Iron and Steel Works Company)
ISE	İstanbul Stock Exchange
İŞKUR	Türkiye İş Kurumu Genel Müdürlüğü (Turkish Employment Agency)
KBİ	Karadeniz Bakır İşletmeleri (Black Sea Copper Works Company)
MARA	Ministry of Agriculture and Rural Affairs
NPAA	National Programme for the Adoption of Acquires
NUTS	Official Nomenclature of Territorial Units for Statistics
OECD	Organisation for Economic Co-operation and Development
ORKÖY	Orman ve Köy İlişkileri Genel Müdürlüğü (Directorate-General for Forestry and Rural Affairs)
PCU	Programme Coordination Unit
PEP	Pre-Accession Economic Programme
PETKİM	Petrokimya Holding A.Ş. (Petrochemical Corporation)
PFPSAL	Programmatic Financial and Public Sector Adjustment Loan
POAŞ	Petrol Ofisi A.Ş. (Petroleum Distribution Corporation)
R&D	Research and Development
SCT	Special Consumption Tax
SDİF	Savings Deposit Insurance Fund
SEEs	State Economic Enterprises
SEK	Süt Endüstrisi Kurumu (Milk Industry Institution)
SEKA	Türkiye Selüloz ve Kağıt Fabrikaları A.Ş. (Turkish Pulp and Paper Production Corporation)
SIS	State Institute of Statistics
SMEs	Small and Medium-Sized Enterprises
SPO	State Planning Organization
SSK	Sosyal Sigortalar Kurumu (Social Insurance Institution)
TAKBİS	Tapu Kadastro Bilgi Sistemi (The Land Registration and Cadastre Information System)
TCDD	Türkiye Cumhuriyeti Devlet Demiryolları (Turkish State Railways)
TDCİ	Türkiye Demir ve Çelik İşletmeleri (Turkish Iron and Steel Works Company)
TEAS	Türkiye Elektrik Üretim-İletim A.Ş. (Turkish Electricity Generation and Transmission Company)
TEDAŞ	Türkiye Elektrik Dağıtım A.Ş. (Turkish Electricity Distribution Company)
TEİAŞ	Türkiye Elektrik İletim A.Ş. (Company involved in the operation and establishment of electricity transmission lines)
TEKEL	Tütün, Tütün Mamulleri, Tuz ve Alkol İşletmeleri Genel Müdürlüğü (General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Enterprises)

TELEKOM	Türk Telekom (Turkish Telecommunication Company)
TETTAŞ	Türkiye Elektrik Ticaret ve Taahhüt A.Ş (Turkish Electricity Trading and Contracting Company)
TFP	Total Factor Productivity
THY	Türk Hava Yolları (Turkish Airlines)
TL	Turkish Lira
TMO	Toprak Mahsulleri Ofisi (Turkish Grain Board)
TRLIBOR	TL Interbank Offer Rate
TRT	Türkiye Radyo ve Televizyon Kurumu (Turkish Radio Television Corporation)
TŞFAŞ	Türkiye Şeker Fabrikaları A.Ş. (Turkish Sugar Factories Joint-Stock Company)
TÜGSAŞ	Türkiye Gübre Sanayii A.Ş. (Turkey Fertiliser Industry Corporation)
TÜPRAŞ	Türkiye Petrol Rafinerileri A.Ş. (Turkish Petroleum Refineries Corporation)
TZDAŞ	Türkiye Zirai Donatım A.Ş. (Company involved in the agricultural input distribution)
UMTS	Mobile and Wireless Telecommunications Systems
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNFCC	United Nations Framework Convention for Climate Change
US	United States
VAT	Value Added Tax
WPI	Wholesale Price Index
WTO	World Trade Organization
YÖK	Yükseköğretim Kurulu (The Higher Education Council)

INTRODUCTION

Turkey submitted its first Pre-Accession Economic Programme (PEP) to the European Commission in October 2001 as a part of the requirements emanating from the Pre-Accession Fiscal Surveillance Procedure, which started in 2001 in relation to the candidate countries. As the Pre-Accession Economic Programme has to be updated on an annual basis, the second Pre-Accession Economic Programme covering the period 2002-2005 has been compiled taking into consideration the assessment of the EU Commission on the first PEP¹. This programme presents the framework of the economic policies to be implemented for the fulfilment of the Copenhagen economic criteria and the structural convergence perspective during the EU accession period.

The programme aims to attain a sustainable growth environment, to converge the inflation rate, fiscal deficits and the public debt stock to Gross Domestic Product (GDP) ratios to the EU averages, to strengthen the market economy with the perspective of EU membership and to accelerate the convergence of the Turkish economy with the EU by improving the competitive capacity of the economy based on productivity. The programme is also based on the aim to narrow the development gap between Turkey and the EU. The envisaged policy framework is consistent with the 8th Five-Year Development Plan (2001-2005).

Eliminating high chronic inflation and macroeconomic instability have also been the main targets of the economic programmes, which have been implemented since 1999 with the support of IMF Stand-by agreements. The policies adopted by the current economic programme covering the 2002-2004 period, will also contribute to the transformation required for Turkey's EU membership.

During the Pre-Accession Economic Programme period a comprehensive economic policy to support these targets will be implemented. While fiscal policy aims at converging to the Maastricht criteria in terms of fiscal deficits and public debt stock to GDP ratios by realising high rates of primary budget surplus, monetary policy aims at switching to inflation targeting under a floating exchange rate regime. In addition, incomes policy will be determined on a participatory basis consistent with monetary and fiscal policy targets.

Within this policy framework, the average annual GDP growth rate is expected to be 4.7 per cent by reaching the potential, and inflation is expected to decrease to around 8 per cent during the PEP period.

Having a significant weight in the programme, structural reforms will have a determining role in reaching the economic targets, while also achieving and maintaining macroeconomic stability. Fulfilment of the Copenhagen criteria is

¹ The 2002 PEP has been prepared under the coordination of Undersecretariat of State Planning Organization with the contributions of Ministry of Foreign Affairs, Ministry of Finance, Ministry of National Education, Ministry of Health, Ministry of Transportation, Ministry of Agriculture and Rural Affairs, Ministry of Labour and Social Security, Ministry of Industry and Trade, Ministry of Energy and Natural Resources, Ministry of Environment, Undersecretariat of Treasury, Undersecretariat of Foreign Trade, Undersecretariat of Customs, Central Bank of Republic of Turkey, Secretariat General for the EU Affairs, State Institute of Statistics, Privatisation Administration, Capital Markets Board of Turkey, Turkish Competition Authority, Banking Regulation and Supervision Agency, Telecommunications Authority, Energy Market Regulatory Authority, and Council of Higher Education.

intended by attaining a sustainable growth environment and establishing a competitive economic structure based on market principles through structural reforms.

Within this context, the main goals are reducing the role of the public sector and improving efficiency in the economy with emphasis on privatisation, developing a transparent and efficient public administration, reforming the banking sector so as to provide the necessary financial resources for the real sector, strengthening the market mechanism with the establishment of regulatory bodies in various areas, and increasing the role of the private sector in the economy.

By increasing the share of education, health, Research and Development (R&D) and other social expenditures through improvements in public finance, considerable progress will be made in raising the quality of life, improving income distribution, and alleviating poverty and regional development gaps.

The Pre-Accession Economic Programme for 2002 consists of four chapters. In the first chapter, an overview of the developments in the Turkish economy in 2001 and 2002 is given. The second chapter presents the main macroeconomic targets for the PEP period and the economic policies to be implemented in order to attain these targets. This chapter also includes a set of macroeconomic forecasts and projections of the baseline scenario and evaluates the risks that may arise in realising the baseline scenario and the impact of these risks on the main macroeconomic variables. The third chapter presents the policy framework for the attainment of a sustainable fiscal stance as well as the targets and projections for the budget and debt management during the programme period. This chapter also deals with the fiscal risks and assesses their impacts on fiscal balances. The last chapter discusses in detail, the structural reforms to be implemented in order to attain a sustainable growth environment, to strengthen the market economy and to enhance competitiveness.

1. RECENT ECONOMIC DEVELOPMENTS

1.1. Growth and Employment

Following the financial crises in November 2000 and February 2001, the crawling peg proved to be unsustainable and was replaced with a floating exchange rate regime. Nevertheless external developments, in addition to the problems in the banking sector, the payment system and the public finance, increased the uncertainty in the Turkish economy and adversely affected the future expectations in 2001. Due to the contraction in domestic demand stemming from excessive real depreciation in Turkish lira (TL) and high real interest rates, the GDP declined by 7.4 per cent in 2001.

The value added in agriculture, industry and services declined by 6.1, 7.5 and 7.6 per cent, respectively in 2001. The factor income from abroad declined drastically in 2001 and the contraction in the Gross National Product (GNP) was 9.4 per cent, 2 percentage points higher than that of the GDP.

Consumption and investment expenditures contracted sharply in 2001 with private and public consumption declining by 9 and 8.6 per cent, respectively.

Gross fixed capital investment declined by 31.7 per cent in 2001. Private fixed capital investment decreased by 35.1 per cent, particularly as a result of a 49.6 per cent decrease in machinery and equipment investments. The decrease in public fixed capital investment was 22 per cent in the same year.

Indicators on the production side revealed signs of economic recovery in the first quarter of 2002. In this period, the GDP increased by 2.3 per cent with respect to the same period of the previous year. As a consequence of a 27.9 per cent decline in the net factor income from abroad in the first quarter of 2002, the GNP increased by only 0.7 per cent.

Table:1. 1-Growth Rates and Demand Components

	(Percentage Change Compared with the Same Period of the Previous Year)						
	Annual		By Quarters				
	2000	2001	2001				2002
			I	II	III	IV	I
Agriculture	3.9	-6.1	8.5	-2.9	-5.6	-13.6	-1.5
Industry	6.0	-7.5	0.8	-10.1	-8.9	-10.7	3.0
Services	8.9	-7.6	-2.4	-10.3	-7.4	-9.5	2.3
GDP	7.4	-7.4	-0.8	-9.6	-7.4	-10.4	2.3
GNP	6.3	-9.4	-3.1	-12.1	-9.0	-12.3	0.7
Total Consumption	6.3	-8.9	-2.4	-10.9	-10.2	-11.2	-1.6
Public	7.1	-8.6	-1.3	-6.6	-15.0	-8.9	2.4
Private	6.2	-9.0	-2.5	-11.5	-9.7	-11.7	-2.0
Gross Fixed Capital Formation	16.9	-31.7	-13.1	-32.1	-37.3	-38.7	-24.8
Public	19.6	-22.0	-5.8	-32.0	-23.4	-18.8	-17.7
Private	16.0	-35.1	-14.4	-32.1	-41.5	-50.2	-26.3
Total Domestic Demand	9.8	-18.4	-9.5	-23.9	-17.6	-21.4	-0.6

The high rate of increase in industrial production in March 2002 continued in April and May, indicating a 7.2 per cent increase in the industrial production in January-May 2002 period compared with the same period of the previous year.

According to the results of the Household Labour Force Survey by the State Institute of Statistics (SIS), the unemployment rate increased from 6.6 per cent in 2000 to 8.5 per cent in 2001. The rate of idle labour force, the sum of unemployment and underemployment rates, increased from 13.6 per cent in 2000 to 14.5 per cent in 2001. In the first quarter of 2002, the unemployment and idle labour force rates increased to 11.8 and 17.7 per cent, respectively.

Contraction in economic activity in 2001 caused a decline in employment in the industry and services sectors, while employment in the agricultural sector increased. The shares of the agriculture, industry and services sectors in total employment realised as 32.6 per cent, 18.9 per cent and 48.5 per cent, respectively, in the same year.

The unemployment rate increased in urban areas where industrial activities are concentrated, particularly due to the lay-offs, and the rate of idle labour force increased to 18 per cent in 2001. This rate was 10.2 per cent in rural areas in the same year.

Table:1. 2-Developments in the Labour Market

	Annual		By Quarters				2002
	2000	2001	2001				I
			I	II	III	IV	
Civilian Labour Force (thousand people)	44,765	45,702	45,354	45,582	45,820	46,058	46,298
Labour Force Participation Rate (per cent)	49.2	48.7	46.4	49.8	51.9	47.9	45.2
Employment (thousand people)	20,579	20,367	19,222	21,127	21,875	19,742	18,467
Employment (percentage change)	-3.9	-1.0	1.1	-0.9	0.7	-2.2	-3.9
Unemployment Rate (per cent)	6.6	8.5	8.6	6.9	8.0	10.6	11.8

The net nominal wages of workers covered by collective bargaining agreements in the public sector increased by 36.6 per cent in 2001, representing an 11.5 per cent decline in real terms. Civil servant salaries increased by 48.6 per cent in nominal terms, representing a 3.3 per cent decrease in real terms. In the same year, the net minimum wage increased by 33 per cent, resulting in a 13.9 per cent decline in real terms. In the public sector, collective bargaining agreements covering 2003 and 2004 will be signed in the second half of 2002 and in the first quarter of 2003.

1.2. Balance of Payments

Current Account Balance

Exports, growing by an annual average rate of 4.6 per cent during the 1996-2000 period, increased by 12.8 per cent in 2001 and reached 31.3 billion dollars. Due to the drop of 2.5 per cent in export prices, exports increased by 15.7 per cent in real terms in 2001. The real depreciation of the Turkish lira, a decline of 30.9 per cent in dollar terms in the unit wage index and a contraction in domestic demand were the

factors contributing to the rapid increase in exports. However, difficulties in financing, high exchange rate volatility and sluggish growth in the export markets kept the increase in exports below expected levels. Exports increased by 3.5 per cent in the January-May 2002 period with respect to the same period of the previous year, reaching 13.2 billion dollars.

Imports (excluding non-monetary gold) increased by 34 per cent in 2000 and decreased by 25.9 per cent in 2001, thus reaching the 40.4 billion dollar level. The contraction in domestic demand and the real depreciation of the Turkish lira were the main reasons for this sharp drop. Imports reached 17.3 billion dollars in the January-May 2002 period, making a slight increase of 1 per cent with respect to the same period of the previous year.

In 2001, exports to the EU countries increased by 11.1 per cent and imports from the EU countries fell by 31.3 per cent, parallel to the sharp decline in total imports. Foreign trade volume with the EU countries decreased by 1.1 per cent in the first five months of 2002 compared to the same period of the previous year.

Table:1. 3-Foreign Trade by Countries

	(Million Dollars)				
	Annual		January-May		
	2000	2001	2001	2002	Percentage Change
MERCHANDISE EXPORTS	27,775	31,340	12,799	13,245	3.5
OECD Countries	19,006	20,623	8,671	8,570	-1.2
EU Countries	14,511	16,118	6,693	6,704	0.2
Non-OECD Countries	7,874	9,783	3,734	4,192	12.3
Turkish Free Zones	895	934	394	483	22.7
MERCHANDISE IMPORTS*	54,503	40,410	17,136	17,314	1.0
OECD Countries	35,682	26,007	10,627	11,411	7.4
EU Countries	26,611	18,280	7,733	7,883	1.9
Non-OECD Countries	18,325	15,089	6,647	6,155	-7.4
Turkish Free Zones	496	303	98	229	132.8

* Excluding non-monetary gold imports

The trade deficit decreased from 22.4 billion dollars in 2000 to 4.5 billion dollars in 2001.

While tourism revenues increased by 5.9 per cent and were realised as 8.1 billion dollars, workers' remittances decreased by 38.9 per cent and were realised as 2.8 billion dollars in 2001. On the other hand, interest expenditures increased by 13.3 per cent and reached 7.1 billion dollars.

As a result, the current account balance ended up with a surplus of 3.4 billion dollars (2.3 per cent of the GDP) in 2001. The current account balance moved from a surplus of 544 million dollars in the January-May 2001 period to a deficit of 884 million dollars in the January-May 2002 period, indicating a decrease of 1.4 billion dollars.

Table:1. 4-Balance of Payments

	(Million Dollars)			
	Annual		January-May	
	2000	2001	2001	2002
Exports (Fob)	31,667	35,258	14,251	15,335
Imports (Fob)	-54,042	-39,748	-16,479	-17,202
TRADE BALANCE	-22,375	-4,490	-2,228	-1,867
Other Goods, Services and Income: Credit	22,320	17,936	7,102	4,853
Other Goods, Services and Income: Debit	-14,989	-13,853	-6,037	-5,219
CURRENT ACCOUNT BALANCE	-9,819	3,396	544	-884
CAPITAL MOVEMENTS (1)	9,610	-14,198	-6,597	882
Direct Investment (Net)	112	2,769	1,612	131
Portfolio Investment	1,022	-4,515	-3,562	-151
Long-term Capital Movements	4,276	-1,131	-1,333	1,008
Short-term Capital Movements	4,200	-11,321	-3,314	-106
TOTAL CHANGE IN RESERVES	2,997	12,924	6,577	1,422

(1) Excluding Reserves

Capital Account Balance

The capital account (excluding reserves) had a deficit of 14.2 billion dollars in 2001 due to the lack of confidence arising from the financial crises. While the net inflow of foreign direct investment was 2.8 billion dollars, outflows of portfolio investment, short-term capital and long-term capital were 4.5, 11.3, and 1.1 billion dollars, respectively. As a result, official reserves decreased by 12.9 billion dollars.

Capital account (excluding reserves) showed a surplus of 882 million dollars in the period of January-May 2002. Net inflows of foreign direct investment and long-term capital were 131 and 1,008 million dollars respectively, while net outflows of portfolio investment and short-term capital were 151 and 106 million dollars, respectively, in the same period.

1.3. Monetary and Exchange Rate Policies

Monetary Policy

The switch in the exchange rate regime and the abolishment of the exchange rate as a nominal anchor necessitated a review of the monetary policy in 2001. In this regard, a more active use of monetary policy was adopted to restrict the inflationary effects of rapid real depreciation in the Turkish lira in an environment of banking sector restructuring and floating exchange rate. In this context, upper limits for net domestic assets and lower limits for the changes in net international reserves were introduced and announced as performance criteria. Due to the abolishment of the exchange rate as the nominal anchor, the monetary base was resorted to as both the intermediate target and the nominal anchor in the formation of inflationary expectations of the economic agents. As the crisis conditions and accelerated structural changes in the financial markets caused a high degree of uncertainty in money demand and monetary base estimations, periodical indicative upper limits on this monetary base, which functioned as the nominal anchor of the programme, was introduced. During 2001, the monetary base increased parallel to the targeted inflation and growth rate, while the short-term interest rates were used actively to eliminate inflationary pressures.

To bring the central banking practice in Turkey in line with EU norms and international standards, the law governing the Central Bank of the Republic of Turkey (CBRT) was amended. According to this amendment, price stability became the primary objective of the Central Bank, which thus gained the autonomy necessary to determine the monetary policy tools while implementing an inflation targeting policy. Furthermore, after the transition period ending in November 2001, direct lending by the Central Bank to the Treasury was terminated completely. By these amendments, the necessary legal framework, allowing the Central Bank to adopt an inflation targeting policy whenever the conditions are met, was established.

Monetary targets in the year 2002 have been determined in compliance with the year-end inflation target of 35 per cent.

Table:1. 5-Monetary Targets in 2002

	Monetary Base (Trillion TL)	Net Domestic Assets (NDA) (Trillion TL) 3/	Net International Reserves (NIR) (Million Dollars) 4/
28 February 2002 1/	8,250	26,100	-6,500
<i>Realisation</i>	7,823	24,318	-4,907
30 April 2002 1/	8,900	27,700	-7,200
<i>Realisation</i>	8,680	25,197	-4,926
30 June 2002 1/	9,250	28,739	-7,800
<i>Realisation</i>	9,009	26,374	-5,755
30 September 2002 2/	10,600	31,139	-8,500
31 December 2002 2/	10,850	33,139	-9,700

1/ Upper limits for performance criteria of Monetary Base and Net International Reserves.

2/ Indicative upper limits for Monetary Base and NDA.

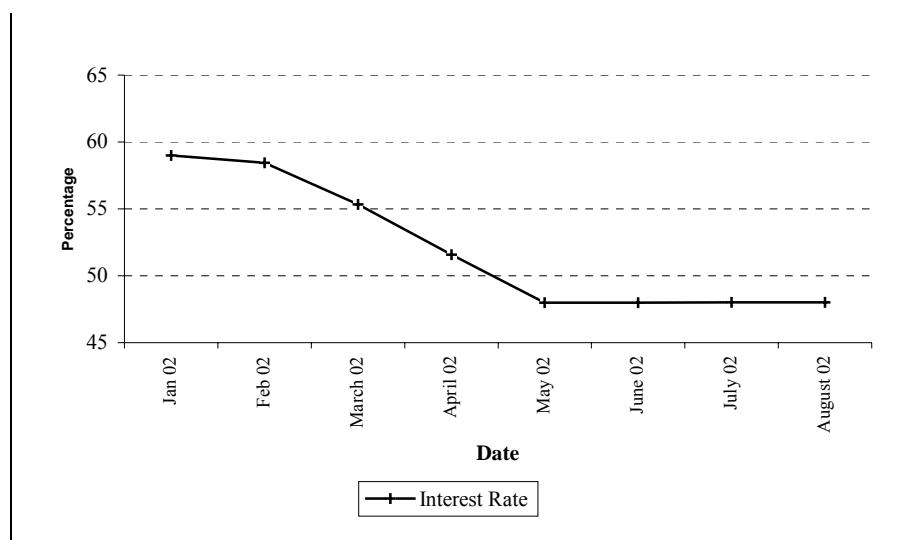
3/ Upper limit of NDA is an indicative target, which may change according to changes in the definition of the aggregate that is subject to the reserve requirement and/or reserve requirement ratio.

4/ Net International Reserves is defined as Net International Reserves of the CBRT minus (i) liabilities of the Treasury to the International Monetary Fund and (ii) Treasury foreign exchange denominated borrowing with an original maturity of less than one year.

The Central Bank announced that the monetary indicators would be kept under control during 2002 with revisions whenever considered necessary. During the first half of 2002, net international reserves and monetary base were monitored as performance criteria while net domestic assets were followed as the indicative target. At the end of February, April and June the targeted values for the reference aggregates were realised.

Positive developments as regards the stability of financial markets have been observed during the January-May 2002 period. In line with its aim of controlling inflation, the Central Bank used short-term interest rates as a policy tool and reduced them gradually parallel to the developments in the economy. Since May 2002, the CBRT has been closely monitoring the macroeconomic developments in order to limit the effects of the volatility in the markets on the economy.

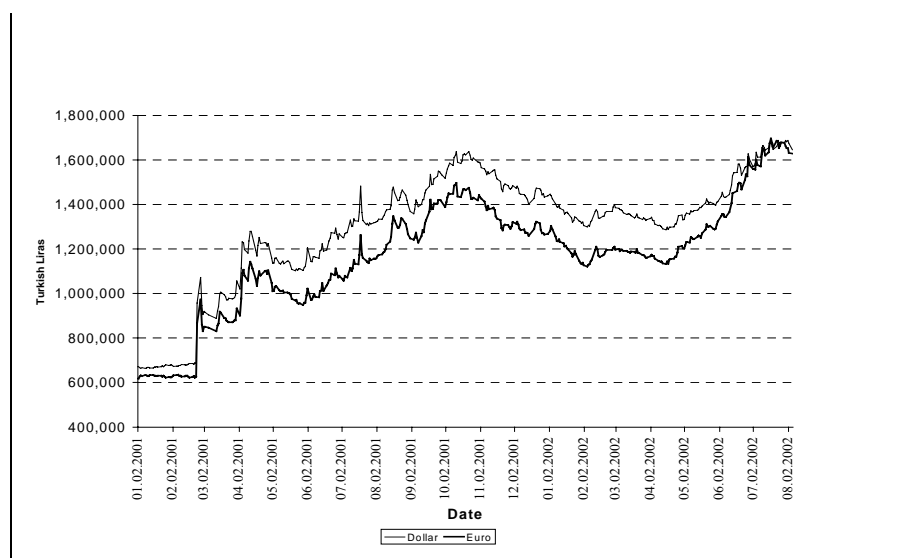
Figure:1. 1-Average Overnight Interest Rates



Exchange Rate Policy

While the exchange rate regime implemented in the year 2000 was a crawling peg regime based upon the foreign exchange basket of 1 dollar + 0.77 euro, this regime was shifted to a floating exchange rate regime following the crisis experienced in February 2001. As a result of this switch to a floating exchange rate regime, the Turkish lira depreciated rapidly in real terms and foreign exchange rate displayed a highly volatile path. Moreover, due to the effects of the September 11 events in the US, the depreciation in the Turkish lira reached its maximum in nominal terms in October 2001. Following the clarification of the macroeconomic policies to be pursued in 2002 and the additional financial support to be extended by the international institutions, the forward expectations related with the economy turned positive and the Turkish lira started to appreciate beginning in November. However, as a result of increasing uncertainty beginning in May 2002, the Turkish lira started showing signs of real depreciation again.

Figure:1. 2-Developments in Dollar and Euro Markets



The Central Bank, within the floating exchange rate regime, continues its policy of exchange rate determination under the rules of demand and supply. However, the Bank has declared that in the face of sudden and transitory fluctuations in the exchange rate, it will intervene in the market in order to dampen those sudden shocks without distorting the long-run equilibrium level of the exchange rate. The CBRT arranged foreign currency selling auctions by pre-announced schedules in 2001 in order to sterilise the liquidity released as the result of the use of the additional foreign resources in budgetary financing during the year. This type of foreign currency selling auctions was terminated in December 2001.

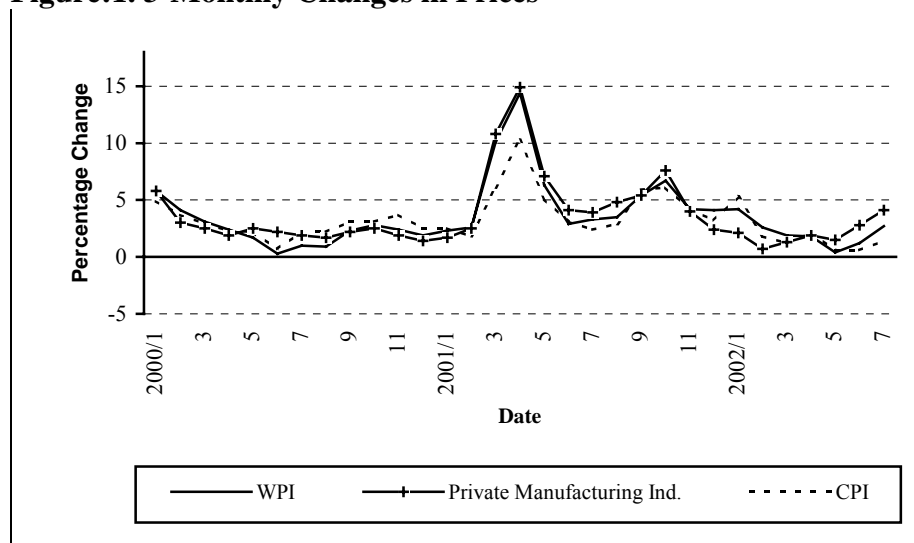
The balance of payments developments being better than expected and the strengthening of reverse currency substitution caused an excess supply in the foreign currency market in the first months of 2002. Due to both the excess supply of foreign currency and the desire to carry a stronger foreign reserve position in the medium term, anticipating that such a move would increase confidence in the economic programme, the CBRT decided to increase the foreign currency reserve level by means of foreign exchange purchasing auctions beginning in April 2002. The excess Turkish lira liquidity released through foreign exchange purchasing auctions was sterilised through 4-week Turkish lira deposit buying auctions.

Following the latest developments prevalent in the markets, foreign exchange buying auctions have been suspended since July 2002. However, 4-week Turkish lira deposit buying auctions are still continued.

1.4. Inflation

The 12-month increases in the Wholesale Price Index (WPI) and the Consumer Price Index (CPI) were 88.6 per cent and 68.5 per cent, respectively, in 2001. The main reasons behind the substantial rise in inflation rates with respect to the previous year could be stated as: the failure to restore confidence in the markets after the switch to the floating exchange rate regime following the February 2001 crisis, the long duration of uncertainty and its impact on exchange and interest rates, and the high rate of price adjustments made by the government.

Figure:1. 3-Monthly Changes in Prices



The prospect of a new Stand-by agreement with the IMF to provide additional financial support eased the markets, causing a revaluation of the Turkish lira and leading to a decline in interest and inflation rates during November and December 2001. The downward trend in inflation rates continued in the first seven months of 2002 and a substantial decline was observed in private manufacturing industry prices, which is perceived as the core inflation by the market, during the same period despite a slight increase in July of 2002. The rates of increase in the WPI, private manufacturing industry prices and the CPI in the first seven months of 2002 were 15.5 per cent, 15.2 per cent and 13.6 per cent, respectively.

The downward trend in inflation can be attributed to insufficient domestic demand in the first half of 2002, the limitation of the monetary expansion by the Central Bank's strict adherence to the monetary programme, the wage and salary increases in the public sector being kept in line with the programme targets, and the strengthening of the Turkish lira in the period from November 2001 to May 2002, which lead to a decline in the cost of imports.

It is expected that the year-end inflation targets will be attained considering that the budgetary performance is in line with the budgetary targets, there are favourable developments in domestic borrowing interest rates and foreign currency in the first half of 2002 and the implicit inflation targeting by the Central Bank. This estimation is also supported by the developments in the first seven months of 2002 and the decline in inflationary expectations, as shown by the Central Bank's expectation survey performed in the same period.

1.5. Fiscal Policy

The budget of 2001 was prepared with the aim of increasing the primary surplus and ensuring debt sustainability. To this end, measures to increase revenues and provide discipline on expenditures were introduced at the end of 2000 and in 2001, in line with the economic programme.

Within this framework, restrictive measures, such as limiting public recruitment and decreasing non-interest expenditures in real terms, were taken. In addition, the measures to increase revenues put into force in 2000 were sustained in 2001. The measures taken were increasing the motor vehicle tax, the motor vehicle purchasing tax and the Value Added Tax (VAT); raising the income tax brackets in line with targeted inflation; reintroducing taxation on the basis of the standard of living for income tax payers; increasing the petroleum consumption tax monthly parallel to the realised inflation rate (WPI); extending the use of tax identification numbers to prevent tax evasion. By the implementation of these measures, a revenue increase of 3.5 per cent of the GDP was achieved in 2001.

As a result of the implementation of these policies, the ratios of budget revenues and expenditures to the GDP were recorded as 28.6 per cent and 44.3 per cent, respectively. Thus, the budget deficit and the primary surplus ratios to the GDP were 15.7 per cent and 6.9 per cent, respectively, in 2001.

Table:1. 6-Consolidated Budget Balance by Years

	(Per cent of the GDP)		
	1999	2000	2001
Expenditures	36.3	37.7	44.3
Non-Interest Expenditures	22.4	21.3	21.7
Current Expenditures	11.8	10.9	11.2
Personnel	8.9	8.0	8.4
Other	2.9	2.9	2.8
Investment	2.0	2.2	2.3
Transfer	22.4	24.6	30.8
Non-Interest Transfer	8.6	8.2	8.2
Interest Payments	13.8	16.4	22.6
Revenues	24.3	26.7	28.6
General Budget	24.0	26.4	28.2
Tax Revenues	19.1	21.3	21.9
Non-Tax Revenues	2.4	2.8	4.1
Special Revenues and Funds	2.5	2.4	2.2
Annexed Budget	0.3	0.2	0.4
Primary Surplus	1.9	5.4	6.9
Budget Deficit	-12.0	-11.0	-15.7

In the January-June period of 2002, expenditures were recorded as 53.7 quadrillion Turkish liras, while revenues were registered as 35.8 quadrillion liras leading to a budget deficit of 17.9 quadrillion liras. This implies a 73 per cent increase in expenditures and a 56.2 per cent increase in revenues, compared to the same period of the previous year. The high rate of increase in domestic interest payments, in particular, contributed to the rise in total expenditures. However, the primary surplus of 10.6 quadrillion liras for the January-June period indicates an improvement over the targeted level.

Table:1. 7-Consolidated Budget Balance in the January-June Period

	(Annual Percentage Change)		
	2000	2001	2002
Expenditures	89.8	31.1	73.0
Non-Interest Expenditures	50.4	43.8	65.0
Current Expenditures	54.1	40.2	64.1
Personnel	50.4	40.2	65.8
Other	75.7	40.5	55.5
Investment	50.5	62.7	59.2
Transfer	106.9	27.2	76.8
Non-Interest Transfer	46.0	45.7	67.0
Interest Payments	141.4	20.8	80.8
Revenues	106.6	47.7	56.2
Tax Revenues	108.0	34.5	53.9
Non-Tax Revenues	160.6	187.5	57.3
Special Revenues and Funds	65.6	13.4	74.5
Primary Surplus	1,003.4	56.1	38.7
Budget Deficit	64.2	-0.4	120.6

The general government balance is obtained by the consolidation of all revenues and expenditures of the consolidated budget, local governments, funds, social security institutions and revolving funds. The revenues and expenditures of the general government are presented in the table below.

Table:1. 8-Revenues and Expenditures of the General Government

	(Per cent of the GDP)		
	1999	2000	2001
Taxes	23.1	25.4	26.6
Direct	10.1	10.0	10.5
Indirect	12.5	15.0	15.7
Wealth	0.4	0.4	0.4
Non-Tax Revenues	4.7	4.8	5.0
Factor Incomes	2.9	3.2	3.7
Social Funds	5.1	5.4	5.9
Total	35.7	38.8	41.2
Privatisation Revenue	0.1	1.5	0.9
Total Revenues	35.8	40.4	42.1
Current Expenditures	17.8	16.9	17.5
Investment Expenditures	4.5	4.7	4.3
Fixed Investment	4.5	4.7	4.2
Change in Stocks	0.0	0.0	0.0
Transfer Expenditures	26.8	29.1	35.5
Current Transfers (Net)	25.6	27.5	34.3
Capital Transfers	1.2	1.6	1.1
Stock Revaluation Fund	0.0	0.0	0.0
Total Expenditures	49.0	50.7	57.2
Borrowing Requirement	13.2	10.3	15.1

2. MACROECONOMIC FRAMEWORK

Main Objectives of Macroeconomic Policy

The basic objectives of macroeconomic policies during the 2002-2005 period are to ensure a sustainable growth environment; to converge the inflation rate, public debt stock and budget deficit to the GDP ratios to the EU averages; to strengthen the market economy towards full membership in the EU; and to accelerate the convergence of the Turkish economy with the EU by enhancing competitiveness. At the same time, these policies also aim at reducing the development gap between Turkey and the EU. Within this framework:

- Fiscal policy will be implemented with a view to reducing public deficits permanently and ensuring the sustainability of the public debt stock.
- Monetary policy will be implemented to combat inflation and provide economic agents with a long-term perspective.
- The floating exchange rate regime will be maintained and exchange rates will be determined by the economic fundamentals.
- The incomes policy will be carried out in a manner consistent with the objective of price stability and also by taking productivity into consideration.
- Structural reforms will be carried out to maintain macroeconomic stability, to strengthen the market mechanism, and to provide an efficient, flexible and productive structure by reducing the vulnerability of the economy to crises.

Fiscal policy

In the 2002-2005 period, the main objectives of the fiscal policy will be to reduce the public deficit permanently and to guarantee the sustainability of the public debt stock by achieving high levels of primary surplus each year. Within this framework, public expenditure, revenue and debt management policies will be pursued in a consistent and efficient manner; tax revenues will be enhanced by broadening the tax base without increasing the tax rates; and efficiency in public expenditures will be attained. Details of fiscal policy and projections for the Pre-Accession Economic Programme period are presented in Chapter 3.

Monetary and Exchange Rate Policies

In the 2002-2005 period, price stability will be the main objective of the Central Bank. To this end, inflation targeting will be adopted and short-term interest rates will be the main policy instrument.

The floating exchange rate regime, which has been implemented since February 2001, will continue. The exchange rates will be determined by demand and supply conditions. However, the Central Bank will only intervene in the foreign currency market to eliminate excessive fluctuations without affecting the long-term equilibrium level.

Incomes Policy

The current economic programme envisages the adoption of a wage and salary determination system based on targeted price increases, productivity and profitability instead of backward indexation.

Public sector wage policy, which is based on forward indexation and has been implemented since 2000, will continue. The government will utilise the Economic and Social Council (ECOSOC) and similar platforms towards reaching a compromise between employers and employee unions so that the private sector will follow this policy.

Structural Reform Policies

The main objectives of the structural reforms are to remove the rigidity of inflation by reducing the inflationary expectations, to increase the competitiveness of the economy, to use resources more efficiently, to strengthen the market mechanism and to enhance the role of the private sector in the economy. Within this framework, the reforms in the public finance, banking sector, agriculture and infrastructure services will be accelerated.

External Factors

There has been a significant slowdown in world economic growth, a sharp reduction in the world trade volume and a reduction in some basic commodity prices since the end of 2000. After the terrorist attacks on September 11, the expectations that the slowdown would deepen were exacerbated, but the initial signs of recovery have been observed starting in the first half of 2002. Despite this, uncertainty about the world economic prospects continues.

The assumptions about the world economic developments that are taken into account in the analysis and forecasts of the PEP are in accordance with the latest forecasts of the European Union Commission, IMF and OECD.

Within this framework, the growth of the EU countries, which account for more than 50 per cent of our export volume, is assumed to be 1.5 per cent in 2002, 2.9 per cent in 2003 and the potential level of 2.5 per cent in 2004 and 2005. On the other hand, the import demand of developing countries is assumed to increase by 6.4 per cent in 2002, 7.7 per cent in 2003, and 8.6 per cent in 2004 and 2005.

Regarding euro-dollar parity, the EU Commission's forecast, which is 0.87 for the 2002-2005 period, is taken.

Oil prices, which are expected to decrease by 5 per cent in 2002, are assumed to decrease by an annual average of 4 per cent in the 2003-2005 period.

2.1. Growth and Employment

In the last decade, aggravating problems in public finance and persistent high inflation have had adverse effects on economic performance, causing growth to fluctuate and remain below potential. One of the main objectives of the macroeconomic policy in the 2002-2005 period is to overcome the structural problems hindering growth and ensure a sustainable growth environment.

The economic programme aims to attain a sustainable structure in public finance and to decrease public debt stock by yielding high levels of primary surpluses. The fiscal policy currently in effect and the slowdown of world economic growth in 2002 will limit economic recovery. The contractionary effect of the tight fiscal policy in the 2003-2005 period will be compensated for by the activities of the private sector as a result of the structural reforms enabling efficient use of resources.

Demand Components of Growth

After the severe contraction in 2001, signs of recovery have been observed beginning in the first half of 2002. Tight monetary and fiscal policy will exert pressure on domestic demand and, thereby, on economic activity. On the other hand, the competitive price advantage, which arose in 2001, is expected to have a positive impact on export performance in 2002. Hence, the increases in exports and stocks will be the main components of growth this year. Recovery in private consumption expenditures is expected with the help of a loosening in the postponement of the consumption expenditures while private investment is forecasted to show an upward trend only towards the end of the year.

Restructuring of corporate debts as a part of the banking sector reforms and the expected increase in the amount of bank credits to the real sector in the second half of the year are foreseen to contribute to growth towards the end of the year. Thus, the GDP is expected to grow by 3.9 per cent and the GNP is expected to grow by 3 per cent in 2002.

Regarding the demand components of growth in 2002, private consumption, public consumption and private fixed investment are expected to increase by 4 per cent, 3.2 per cent, and 4 per cent, respectively, while public fixed investment is expected to decrease by 3.5 per cent. Thus, final domestic demand is estimated to increase by 3.4 per cent. Exports of goods and services are estimated to increase by 6.2 per cent and imports of goods and services are estimated to increase by 15.8 per cent in 2002.

In the medium term, successful implementation of structural reforms will increase competition in the economy and enable more efficient use of resources. As a result of banking sector reforms, the implementation of current fiscal policies and public sector reforms, it is expected that savings will increase, the quality of financial services will improve and the amount of funds directed towards private investments will augment.

During the 2003-2005 period, the GNP is estimated to grow by 5.2 per cent and the GDP is estimated to grow by 5 per cent on average annually. On the demand side, investments and exports are expected to be the main sources of growth. In this period, total fixed investment, private investment and public investment are expected to increase by 14.2 per cent, 15.6 per cent and 10.7 per cent, respectively, on average annually. The average annual increases in exports of goods and services and imports of goods and services are projected to be 6.6 per cent and 8.4 per cent, respectively. On the other hand, private consumption and public consumption are foreseen to increase by 3.8 per cent and 5.6 per cent on average annually.

Figure:2. 1-GDP Growth Rate

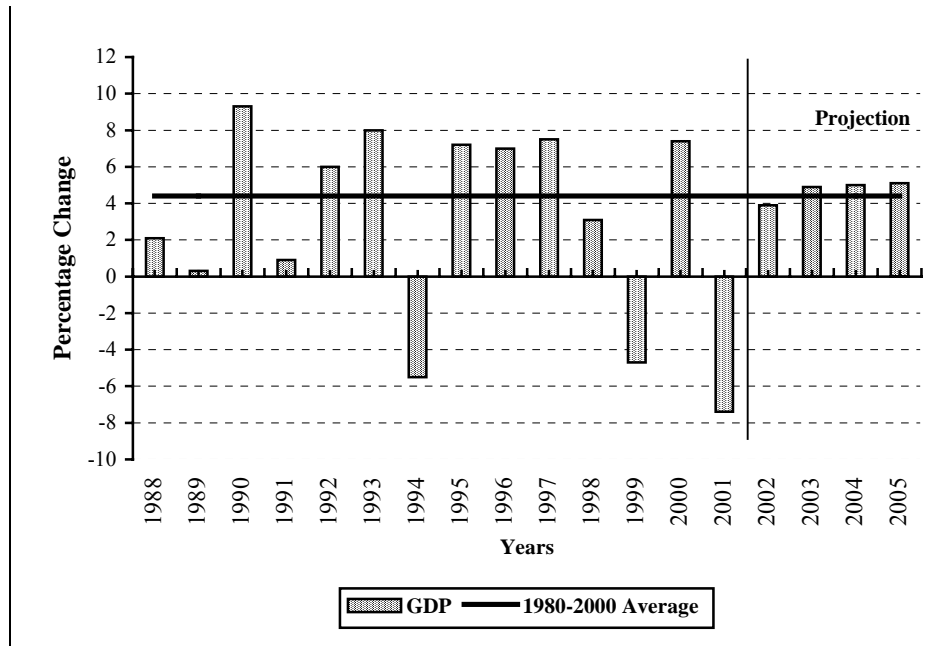
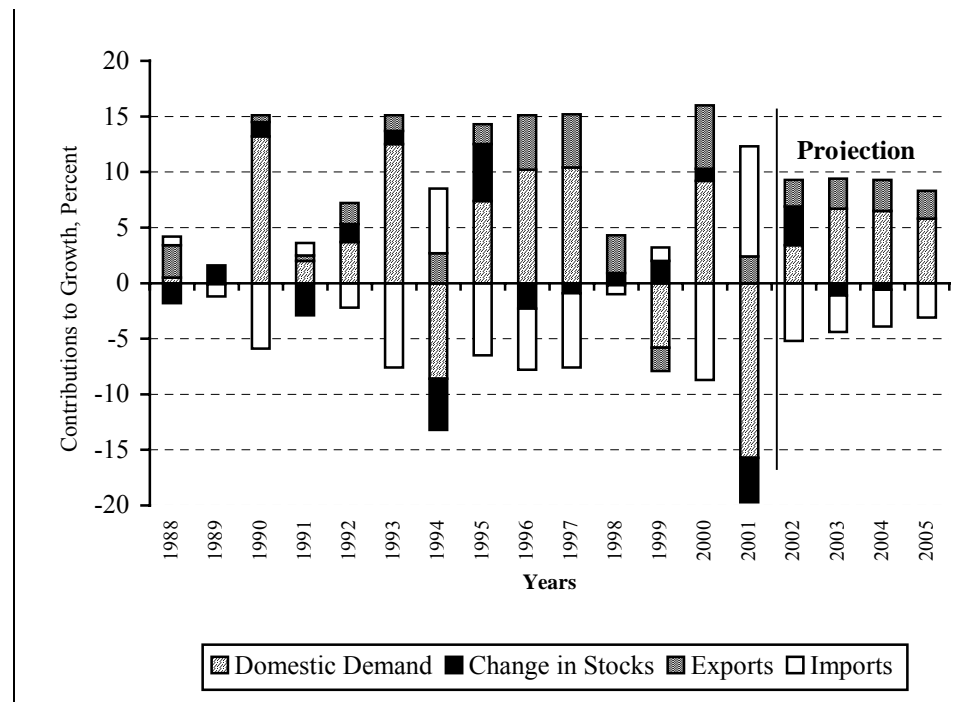


Figure:2. 2-Contributions to GDP Growth



Potential Output

GDP growth, which has fluctuated and remained below the potential level on average over the last decade, will be approaching the potential level beginning in 2003, as structural reforms proceed. The output gap, defined as the difference between actual and potential output, moved to negative levels and widened sharply following the November 2000 and February 2001 crises. Although the output gap is expected to start narrowing beginning in the first quarter of 2002, a rapid recovery is not expected this year. Output is expected to reach its potential in the second half of 2004 and to maintain this level afterwards. Since domestic demand is expected to increase moderately due to tight fiscal and monetary policies during the Pre-Accession Economic Programme period, growth is not expected to have an inflationary effect.

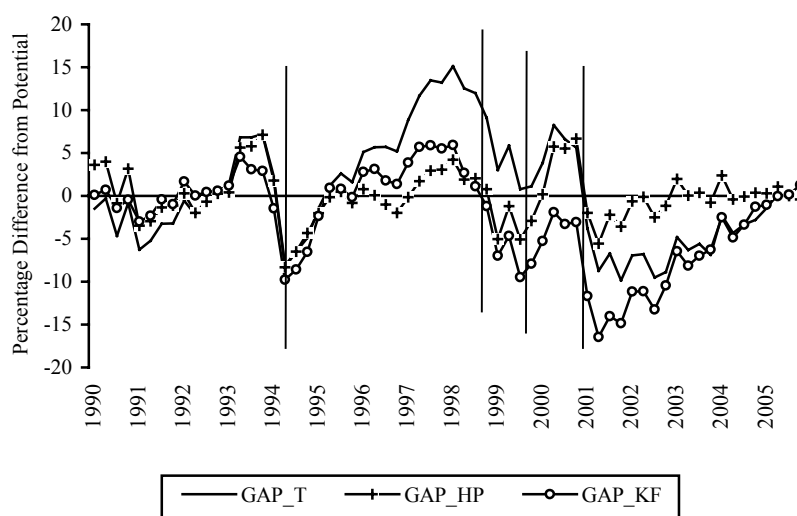
Box: 2.1 –Potential Output and Output Gap Projections

Output gap, defined as the difference between actual and potential output, is an important indicator of the state of the business cycle. Since potential output and output gap are not directly observable, the absolute size of these variables may change considerably depending on the method of estimation. This study uses 3 different methods to estimate potential output and output gap:

1. Linear Method
2. Hodrick-Prescott Method
3. Unobservable Components Method (Kalman Filter)

Output gap estimates for the 1990-2005 period are shown in the figure.

Figure: Output Gap



GAP_HP: Output gap (Hodrick-Prescott)
 GAP_KF: Output gap (Kalman Filter)

GAP_T: Output gap (Linear Method)

Although the broad profiles of the output gap measures are similar across the range of estimation, at particular points in time, the absolute sizes of output gaps differ considerably and sometimes give contradictory indications about whether there is excess supply in the economy. Nevertheless, the output gap series show the expected signs and movements at critical test points: such as the 1994 crisis, the 1998 Russian crisis, the 17 August 1999 earthquake, and the November 2000 and February 2001 crises. Since the output gap series are consistent with observations, paying attention to these measures as economic indicators will be beneficial.

GDP Growth by Sectors

Factors like globalisation, Turkey's integration with the European markets, technological progress and the transition to a knowledge-based economy were taken into account in the estimation of the sectoral composition of the GDP.

In the sectoral composition of the GDP, the share of agriculture is expected to continue decreasing during the 2002–2005 period. Within this framework, the average annual growth rate of the agricultural value added is predicted to be 1.8 per cent in the programme period and the share of the agricultural sector, which was 13.7 per cent in 2001, is estimated to decrease to 12.2 per cent at the end of the period. The average annual growth rates of the industry and services sectors are expected to be higher than the GDP growth rate in the 2002–2005 period, which is expected to be 4.7 per cent. Thus, the shares of the industry and services sectors, which were 28.3 per cent and 58 per cent respectively in 2001, are estimated to increase to 29.1 per cent and 58.8 per cent, respectively, in 2005.

Table:2. 1-Value Added by Sectors

	(1987 Prices)						
	Realisation			Forecast			
	1999	2000	2001	2002	2003	2004	2005
	Growth Rates (per cent)						
Agriculture	-4.6	3.8	-6.1	3.2	1.9	1.0	1.0
Industry	-5.0	5.6	-7.5	5.2	5.3	5.5	5.7
Services	-5.1	9.4	-7.7	3.4	5.4	5.7	5.8
GDP	-5.0	7.5	-7.4	3.9	4.9	5.0	5.1
	Shares in the GDP (per cent)						
Agriculture	14.0	13.5	13.7	13.6	13.2	12.7	12.2
Industry	28.8	28.3	28.3	28.7	28.8	28.9	29.1
Services	57.2	58.2	58.0	57.7	58.0	58.4	58.8
GDP	100	100	100	100	100	100	100

Savings-Investment Balance

Due to the decrease in domestic borrowing and the improvement in public debt management, the resulting drop in interest rates and the increase in financial resources available for private investment is expected to lead to a rise in investment during the 2002-2005 period. Improvement in the market sentiment parallel to the progress in EU-Turkey relations and the market enlargement in line with the integration with the EU will result in a rise in both domestic and foreign investments.

The share of public investment in the GDP is expected to increase from 5.2 per cent in 2001 to 5.6 per cent in 2005 due to the planned increase in education, health and R&D investments. The moderate increase in public sector investment is based on a perspective to improve the infrastructure, upgrade the quality of labour in Turkey (which has a very young population) and increase the total factor productivity. The share of private investment in the GDP, which decreased to 11.7 per cent in 2001, is forecasted to increase gradually with improvement in the investment environment, reaching 16.8 per cent by 2005. Within this framework, the share of total investment in the GDP is expected to increase from 15.7 per cent in 2001 to 22.5 per cent in 2005.

Public disposable income and public sector savings are expected to increase in the 2002-2005 period, mainly due to the drop in interest expenditures, which have had a large share in public expenditures since 1994. Thus, the public sector savings-investment gap is expected to narrow.

As a result of the increasing share of public disposable income in the GDP, the share of private disposable income, and thus the share of private savings, in the GDP are expected to decrease.

Consequently, a significant rise in domestic savings is expected during the 2002-2005 period with the help of efficiency gains brought about by the drop in inflation and this is expected to contribute to the financing of total investment. The savings-investment gap is expected to be kept under control due to tight monetary and fiscal policies and it is estimated that this gap will be financed without any difficulty with capital inflows that will rise parallel to rising confidence in the economy.

Table:2. 2-Total Savings-Investment Balance

	(Per cent of the GDP)						
	Realisation			Forecast			
	1999	2000	2001	2002	2003	2004	2005
Total Investment	21.8	23.9	15.7	19.3	20.4	21.5	22.5
-Public	5.4	5.8	5.2	5.1	5.3	5.4	5.6
-Private	15.1	15.9	11.7	12.7	14.5	16.1	16.8
-Change in Stocks	1.4	2.1	-1.3	1.6	0.6	0.1	0.0
Total Savings	21.8	23.9	15.7	19.3	20.4	21.5	22.5
Domestic Savings	18.4	16.6	17.9	17.6	18.8	19.7	20.1
Foreign Savings (1)	3.4	7.3	-2.2	1.8	1.7	1.9	2.4

(1) The savings-investment balance is based on the SIS figures of the GDP-by expenditures. Public investments in the table include the investment of the State Economic Enterprises (SEEs) in addition to those of the general government.

Sources of Growth

In the 2002-2005 period, total factor productivity (TFP) is expected to have a significant contribution to the economic growth in addition to the traditional factors of production, capital stock and labour. Capital stock is estimated to increase by 2.9 per

cent on average annually, and its contribution to growth is expected to be 42.8 per cent in the PEP period.

Table:2. 3-Growth Rates of Factors of Production

Period	(Per cent)			
	GDP	Capital Stock	Employment	TFP
1980-2000	3.9	5.7	1.7	0.6
2001	-7.4	1.3	-1.0	-5.6
2002	3.9	2.2*	0.0	0.9
2003	4.9	2.9	3.9	1.5
2004	5.0	3.4	3.2	1.7
2005	5.1	3.2	3.6	1.8

* Growth rate of the capital stock reaches 6.4 per cent when the adjustment for the capacity utilisation rate is considered.

In the 2002-2005 period, new employment will be created with the increase in investment; however, the decrease in the unemployment rate is expected to be limited due to increasing participation rate and high population growth. The participation rate, which dropped to 45.2 per cent in the first quarter of 2002 from 48.7 per cent in 2001, is expected to increase to 49.5 per cent in 2005. Employment is estimated to increase at an average annual rate of 2.5 per cent and the unemployment rate is expected to decrease from 8.5 per cent in 2001 to 7.7 per cent in 2005. The contribution of this rise in employment to economic growth is expected to be 26.4 per cent in the 2002-2005 period.

Table:2. 4-Developments in the Labour Market

	Realisation	Forecast			
	2001	2002	2003	2004	2005
Working Age Population (thousand people)	45,702	46,659	47,619	48,575	49,530
Participation Rate (per cent)	48.7	48.0	48.6	49.0	49.5
Employment Level (thousand people)	20,367	20,380	21,176	21,850	22,633
Employment (percentage change)	-1.0	0.0	3.9	3.2	3.6
Unemployment Rate (per cent)	8.5	9.0	8.5	8.2	7.7

In the 2002-2005 period, TFP is estimated to increase 1.5 per cent annually on average and its contribution to economic growth is expected to be about 30 per cent.

In this context, the projected 5 per cent average annual growth rate for the Turkish economy in the PEP period is considered to be attainable.

Box: 2.2 - Total Factor Productivity

Total Factor Productivity can be defined as the residual part of output growth, which cannot be explained by the traditional factors of production, labour and capital. TFP is an important factor of the sustainable economic growth. The main explanatory variables of TFP are education expenditures, R&D expenditures, foreign direct investment, openness, institutional structure and infrastructure investments.

The contribution of TFP to economic growth of the Turkish economy was about 13 per cent in the 1980-2000 period. This is rather low compared to many countries. However, the main reason for this difference is the serious decrease in TFP during the economic crises years. Excluding these periods, the contribution of TFP reaches 26 per cent, while the contributions of labour and capital become 17.4 per cent and 56.3 per cent, respectively, in the 1980-2000 period. For the 1990-2000 period, the contributions of TFP, labour and capital become 35.3 per cent, 12.5 per cent and 52.2 per cent, respectively.

During the PEP period, the contributions of TFP, labour and capital to growth are estimated to be 30.8, 26.4 and 42.8 per cent, respectively.

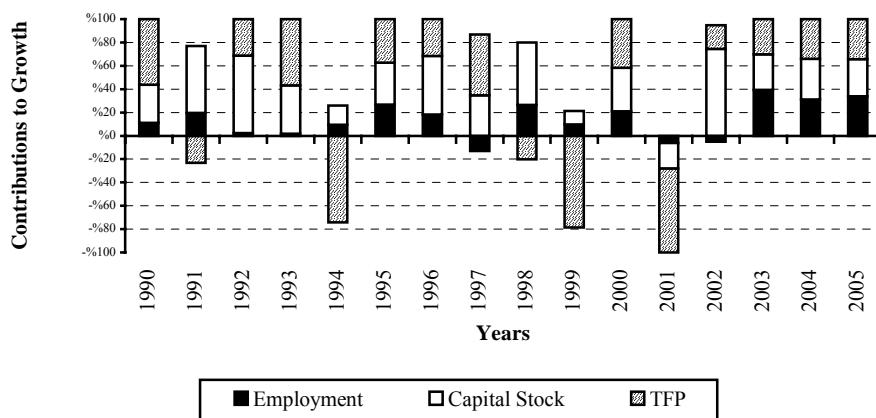
Table: Sources of Growth

Period	Contribution of Capital Accumulation (per cent)	Contribution of Employment Increase (per cent)	Contribution of TFP Increase (per cent)
1980-2000 (1)	56.3	17.4	26.3
1990-2000 (1)	52.2	12.5	35.3
2001	-21.8	-6.2	-72.0
2002(2)	83.2	-5.8	22.7
2003	30.3	39.4	30.3
2004	34.7	31.2	34.1
2005	32.1	33.8	34.2
2002-2005	42.8	26.4	30.8

(1) Excluding crises years

(2) The capacity utilisation rate declined considerably in 2001 due to the economic crisis. Therefore, in the calculation of the contribution of the capital stock to growth, the increase in capital stock figure is revised upwards taking into consideration the fact that the capacity utilisation rose again in 2002.

Figure: Contributions to Economic Growth



2.2. Inflation

One of the main targets for the 2002-2005 period is to reduce the inflation rate permanently and converge it to the EU levels. To this end, in order to lay the ground for switching to an inflation targeting policy, required amendments in the Central Bank Law were enacted in May 2002. Thus, price stability has become the final target of the Central Bank. This structure, being fully consistent with EU criteria, aligns the legislation of the Central Bank with the EU acquis.

The Central Bank will shift to inflation targeting in 2002 following the necessary technical preparations. During the transition period, monetary base and short-term interest rates will continue to be used as policy tools. The Central Bank sets the short-term interest rates considering the future pattern of inflation. In this context short term interest rates are determined by taking into account expectation surveys, inflation estimates, price setting behaviour of the public and private sectors, exchange rate developments, balance of payment developments, employment, unit labour costs, fiscal and monetary policy indicators.

In order to switch to and succeed in an inflation targeting policy, it is necessary to have stability in exchange rates under a floating exchange rate regime, thus weakening the pass-through of exchange rate to inflation (in fact, the pass-through effect of the exchange rate on inflation weakened in 2001 after the adoption of the floating exchange rate regime). It is also necessary to continue fiscal discipline, to strengthen the banking sector, to complete the structural reforms increasing the efficiency and productivity in the public sector, to provide financial deepening, to avoid backward indexation in wage determination and price setting and to overcome the problems that are likely to arise in the relative price structure by achieving flexibility in commodity and factor markets. Implementing tight fiscal policy and structural reforms will reduce the cost of decreasing inflation on the one hand and will support the effectiveness of the monetary policy by converging inflationary expectations to the target levels on the other. Coordination between the monetary and fiscal policies is crucial for the success of the system.

In the context of combating inflation, the forward indexation in the public sector wage setting policy, which began in 2000, will continue in the following period. The government will follow an intermediary role to enable the private sector to adopt a similar pattern. Widespread use of forward indexation in income policy will also support the effectiveness of the policies implemented by the Central Bank.

Furthermore, structural reforms are crucial to bringing inflation down permanently, reducing inflationary expectations and thus eliminating the rigidity in the dynamics of inflation. Within this framework, a reduction in the share of the public sector in the economy and an enhancement of the market mechanism are targeted by ensuring a fiscal discipline through public sector reforms, closure of extra-budgetary funds and legislative reforms like amendments to the Public Procurement Law. In addition, amendments to the laws concerning energy and telecommunications and the establishment of regulatory bodies and the new laws regarding sugar and tobacco can be cited as important steps toward abandoning the existing oligopolistic structure in these sectors.

Rate of growth targets and projections for the year-end CPI and WPI, and the average annual GDP deflator for the 2002-2005 period under this policy framework are presented in the table below.

Table:2. 5-Price Targets and Projections

	(12-Month Percentage Change)			
	2002	2003	2004	2005
CPI (1)	35.0	20.0	12.0	8.0
WPI (2)	31.0	16.2	12.0	8.0
GDP Deflator (3)	51.1	26.9	13.6	9.4

(1) The year-end target for the 2002-2004 period, projection for 2005.

(2) The year-end projection

(3) Projection for annual average change

Box: 2.3 – Determinants of Inflation

For the last thirty years, the inflation rate has displayed an upward trend and high volatility. After the 1970's, the inflation rate has jumped to a new plateau every ten years. This increase in the average inflation rate from 34 per cent in the 1970's to 43 per cent in the 1980's and then to 74 per cent in the 1990's indicates that inflation has indeed become chronic.

Backward indexation in price setting and wage determination and the increase in inflationary expectations stemming from the economic policies pursued by the governments have been the main reasons for inflationary inertia.

Although the sources of inflation in Turkey have changed through time, inflation itself has become permanent. In addition to the demand pressures caused by public deficits and the methods of financing these deficits, and the cost pressures caused by wage, interest rate and exchange rate developments, high population growth rates, urbanization and market structure have also influenced chronic inflation.

Public deficits and the financing of these deficits through domestic borrowing were the main source of inflation until the second half of the 1990's. First of all, the expansion of domestic demand due to the rise in public expenditures created inflationary pressures by increasing the prices of non-tradable goods. Secondly, the use of domestic Treasury bills as a means of payment had an effect on price levels similar to that of increasing money supply. Thirdly, fiscal dominance on shallow financial markets both shortened maturity and put upward pressure on deposits and lending rates, thus causing cost-push inflation. During this period, prices in goods and factor markets were determined by backward indexation and inflation gained inertia.

In the second half of the 1990's, expectations and the persistence of inflation became important. During periods of chronic inflation, inertia in prices continues in the short run, although the macroeconomic factors that create inflation change. Expansionary fiscal policy, inconsistency between monetary and pricing policies, uncertainty in financial markets caused by political instability, unstable growth performance, oligopolistic market structure, inflexibility in labour markets and information lags are the main causes of inertia in the price level.

In this period, another important source of inflation was exchange rate volatility, leading to considerable depreciation of the Turkish lira. This highly fragile structure in the exchange rate was directly reflected in the prices.

The third important source of Turkish inflation in recent years has been public sector price adjustments. The weight of goods whose prices are determined by the public sector is 23.17 per cent in the WPI and 20.72 in the CPI. For this reason, price adjustments by the public sector to finance budget deficits directly affect price levels. Until the 2000's, the monopoly position of the public sector in some goods (tobacco, sugar, tea, etc.) and support price policies had contributed considerably to the inflationary process. The monopolistic position of the public sector in electricity price determination still continues and electricity prices reflect the fluctuations in exchange rates and oil prices. The tax rate for oil products has been very high. Water and gas prices have been set by the municipalities and used as an additional revenue source. Adjustments in energy and other SEEs product prices have exerted inflationary pressure by increasing input prices. These price adjustments have also affected the pricing behaviour of the private sector.

2.3. Monetary and Exchange Rate Policies

The monetary policy that was implemented as of May 2001 was designed in two stages by considering the effects of extraordinary shocks that were experienced. In order to decrease the uncertainty arising from the crises in 2001, target values were determined for net domestic assets, monetary base and net international reserves. Following this period, the transition to an inflation targeting framework was planned. At this stage, short-term interest rates will be the main policy instrument of the CBRT. The short-term interest rate setting process will be based on an evaluation of the factors affecting the future pattern of inflation.

The operational framework of the monetary and exchange rate policies set by the CBRT at the beginning of 2002 rests upon the following points:

- Performing liquidity management through active open market operations to hold fluctuations of short-term interest rates in a narrow band,
- Gradually ending the intermediary role of the CBRT in both interbank and foreign exchange markets by December of 2002,
- Keeping the option of funding banks without limits through the late liquidity window due to the CBRT's lender of last resort function while abandoning the intermediary role in the market,
- Starting future transactions on interest rates in the İstanbul Stock Exchange (İSE) in addition to the forward transactions on foreign currency, and
- Efficiently operating a TL Interbank Offer Rate (TRLIBOR) mechanism.

Through these announced arrangements, the CBRT aims to form a new structure where the market's own dynamics are brought forth and this structure is supported by the Bank itself through an unlimited funding option due to the lender of last resort function. Thus, the CBRT has converged with the central banks of the developed countries in regards to both monetary policy implementation and the principles of transparency and accountability.

The monetary policy that will be implemented by the CBRT in the medium term will be inflation targeting, aiming at attaining and maintaining price stability under the floating exchange rate regime. The Central Bank announced that, stepping back to the point of lender of last resort as in developed country central banks, it would continue implementing the necessary legal arrangements to allow prices and transactions to be determined by the market mechanism. Although the CBRT provided a perspective that monetary policy will be implemented by referring to a forward inflationary path, strong pass-through from exchange rate to prices and subsistence of backward indexation necessitate the Bank's effective use of policy tools while closely monitoring economic developments.

The floating exchange rate regime forms the framework for the implementation of monetary policy and for the permanent reduction of inflation to low levels. In this regard, the exchange rate policy will be implemented in such a way that the market dynamics will determine the level of the exchange rate. In this context, interventions to be performed by the CBRT will aim at eliminating sudden and transitory fluctuations in the foreign currency market and will avoid distorting the long-run equilibrium level of the real exchange rate. The existence of an efficient forward currency market is crucial to providing a medium term perspective to the economic agents in this exchange rate regime.

Box:2.4- New Central Banking Law and Central Bank Independence

Economic conditions have changed dramatically since Central Banking Law No. 1211 was approved in 1970. Various amendments have been introduced to the law following developments in central banking and changes in international banking norms.

In line with the changes in EU norms and international central banking practices, a new Central Banking Law was enacted in May 2001. With this new Law, No. 4651, fourteen articles of Law No. 1211 were amended, seven articles were repealed and a new article was added. The main aim of these amendments was to strengthen the Central Bank's operational independence.

The major changes in the Central Banking Law can be summarised as follows:

Instrument Independence: As a measure of independence, it was decreed that the main objectives of the Bank is to achieve and maintain price stability. Furthermore, the Bank was delegated to be the only body responsible for implementing/determining monetary policy. With this new law, while the Bank attained instrument independence, the task of determining the goal – i.e. the inflation target – was to be carried out jointly with the government.

Accountability and Disclosure to the Public: The new Central Bank law states that the main objective of the Bank is to achieve and maintain price stability. The Bank will determine at its own discretion the monetary policy that will be implemented and the monetary policy instruments that will be used in order to achieve and maintain price stability. As a natural consequence of this discretion, the Bank is required to establish the highest possible level of accountability and transparency.

To this effect, the Governor of the Central Bank will submit a report to the Council of Ministers, in April and October of each year, concerning the operations of the Bank and the monetary policy being followed and to be followed. In addition, the Bank will furnish information twice a year regarding its operations and monetary policy implementations to the Planning and Budget Commission of the Grand National Assembly of Turkey.

Furthermore, the Bank will prepare periodical reports concerning monetary policy targets and implementations and disclose this information to the public to enhance transparency and public monitoring. In the event that the targets are not met, the Central Bank should submit this information to the Government in writing and inform the public, disclosing the reasons why the set targets were not achieved in the allotted time or why there is a possibility of failure to meet the target and the measures to be taken to overcome it.

The Bank will have its balance sheet and income statements audited by independent external auditing institutions.

The Monetary Policy Committee: Similar to international developments, a Monetary Policy Committee was established to ensure effectiveness in maintaining price stability. The Monetary Policy Committee should, under the chairmanship of the Governor, be composed of vice governors, a member to be elected by and from among the Board members and a member to be appointed by a joint decree on the recommendation of the Governor. This joint appointment ensures a link with government policies. The Undersecretary of the Treasury or the Deputy Undersecretary to be designated by him/her may participate at the meetings without the right to vote.

No Extension of Credit to the Public Sector: In order to sustain independence, the law established that the Bank should not grant advances or extend credit to the Treasury or public establishments and institutions. It was also legislated that the Bank should not purchase debt instruments issued by the Treasury or by public establishments and institutions in the primary market.

Lender of Last Resort: The Bank may, as a lender of last resort, provide daily or end-of-day credit facilities to the system against collateral so as to eliminate technical payment problems, which may obstruct the efficient functioning of the financial markets, and temporary liquidity shortages, which may cause interruption in the payment system.

Supervision of Financial and Payment Systems: One of the duties of the Central Bank is to ensure and maintain financial stability. Within this context, the Central Bank improves the financial infrastructure and analyses the systemic risks. Furthermore, the Bank is empowered to monitor the financial system and to take any measures necessary to protect it from financial crisis. The Bank should, in order to monitor financial markets, be authorised to request necessary information and to gather statistical data from banks, and other financial institutions.

Box:2.4- New Central Banking Law and Central Bank Independence (Continued)

The Bank was assigned to establish and sustain a secure and effective payment system, which adopts technological developments in the area. Furthermore, the Central Bank was assigned and empowered to supervise and intervene in its own or other institutions' payment systems in order to ensure their smooth and effective functioning.

Terms of Office: The appointment of the vice governors has been increased from 3 years to 5 years, parallel to the term of office of the Governor of the Central Bank. Furthermore, similar to the Governor, vice governors cannot be removed from their posts before the termination of their term of office. In a similar vein, the term of office of the Monetary Policy Council's jointly appointed member is five years.

Request for Information and Centralisation of Risks: The Bank may, in collecting statistics, cooperate with public establishments and institutions: the Undersecretariat of the Treasury, the State Institute of Statistics, the authorities of foreign countries entitled to collect statistical information, and international institutions. In order to increase the analytical and statistical capacity in the monetary policy implementations to attain price stability, the Bank is authorised to request and collect directly all statistical information relating to the financial system and other statistical information that is deemed necessary for the surveillance of developments in the economy from banks, other financial institutions and individuals.

2.4. Balance of Payments

With the abolishment of controls over capital flows in 1989, the financial liberalisation process was completed. Furthermore, by joining the customs union in 1996, Turkey has achieved considerable progress in the integration process with the European Union.

The composition of foreign trade by countries indicates that EU countries are Turkey's major trade partners. In 2001, EU countries accounted for 52 per cent of Turkey's exports and 44 per cent of Turkey's imports. When past data is examined, a similar pattern is easily recognised. Therefore, the growth rate of the EU is an important variable for the estimations regarding Turkey's exports.

Exports are expected to display an increasing trend during the 2002-2005 period taking into consideration the expected growth prospect in EU countries, other OECD countries and world trade volume. Consequently, Turkey's export volume, forecasted to be 33.3 billion dollars in 2002, is expected to reach 43.5 billion dollars in 2005.

Import volume, which fell remarkably along with the contraction of the domestic demand in 2001 due to its high income elasticity, is expected to reach 44.8 billion dollars by recovering partially in 2002. With the help of recovery in domestic demand, import volume is expected to show an upward trend and reach 59.3 billion dollars in 2005.

Because of her infrastructure and geographical location, Turkey has a huge potential for tourism. However, it is anticipated that tourism revenue, which is currently under its potential level, will be on the rise during the 2002-2005 period as a result of extensive advertising campaigns to ensure full capacity. In this way, the tourism revenue is forecasted to increase to 9.4 billions dollars in 2005 from 7.6 billions dollars in 2002. Considering the average annual growth rate of tourism revenues of 9.6 per cent in the 1990-2001 period, the annual growth rates of 3.9 per cent for the 2002-2005 period and 7.7 per cent for the 2003-2005 period for tourism revenue seem to be attainable.

Workers' remittances, which recorded a sharp decline in 2001, are expected to pick up after the establishment of economic stability and the prospective real appreciation of the Turkish lira and thus to increase from 2.6 billion dollars in 2002 to 4.1 billion dollars in 2005.

Accordingly, the current account deficit, which is estimated to be 1.5 billion dollars in 2002, is expected to oscillate around 1.8 billion dollars in the 2003-2005 period. In other words, the share of the current account deficit in the GDP is estimated to be around 1 per cent in the PEP period.

Turkey experienced a significant capital outflow due to increased uncertainty following the 2000 and 2001 crises. In the 2002-2005 period, Turkey's credibility is expected to increase, leading to net capital inflows following the re-establishment of economic stability and achievements in structural reforms.

Despite the liberalisation of the capital account in 1989, Turkey's share in the world foreign direct investment (FDI) flows has remained very low compared to the other emerging markets. In the 1990-2001 period, cumulative FDI to Turkey only reached 13.3 billion dollars, representing a share of less than 1 per cent of the world total.

In order to stimulate capital inflows more in the form of FDI, important steps are being taken towards improving the investment climate. Nevertheless, in view of the sluggish past performance, the FDI projections are kept moderate for 2002-2005 period, reaching 1.9 billion dollars at the end of the period.

Table:2. 6-Balance of Payments Forecasts

	(Billion Dollars)						
	Realisation			Forecast			
	1999	2000	2001	2002	2003	2004	2005
Merchandise Exports (Fob)	29.3	31.7	35.3	37.4	41.1	44.9	48.9
Exports	26.6	27.8	31.3	33.3	36.5	39.9	43.5
Other	2.7	3.9	3.9	4.2	4.6	5.0	5.4
Merchandise Imports (Fob)	39.8	54.0	39.7	44.2	49.0	54.0	58.9
Imports (Cif)	40.7	54.5	40.4	44.8	49.6	54.6	59.3
Other	-0.9	-0.5	-0.7	-0.6	-0.6	-0.6	-0.4
Trade Balance	-10.4	-22.4	-4.5	-6.7	-8.0	-9.1	-10.1
Other Goods, Services and Income (credit)	18.7	22.3	17.9	16.1	19.2	21.5	23.1
Travel	5.2	7.6	8.1	7.6	8.3	8.8	9.4
Other	13.5	14.7	9.8	8.5	10.9	12.7	13.6
Other Goods, Services and Income (debit)	14.8	15.0	13.9	14.4	17.4	19.1	20.1
Interest	5.5	6.3	7.1	7.0	9.1	10.1	10.2
Other	9.4	8.7	6.7	7.3	8.3	9.0	9.9
Other Goods, Services and Income Balance	3.9	7.3	4.1	1.7	1.7	2.4	3.0
Total Goods, Services and Income Balance	-6.5	-15.0	-0.4	-5.0	-6.2	-6.7	-7.1
Workers' Remittances (private)	4.5	4.6	2.8	2.6	3.4	3.8	4.1
Other Transfers	0.6	0.7	1.0	0.9	1.0	1.0	1.1
Current Account Balance	-1.4	-9.8	3.4	-1.5	-1.9	-1.8	-1.8
Capital Account Balance (Excluding Reserves)	4.9	9.6	-14.2	-2.2	2.8	5.8	7.4
Direct Investment (net)	0.1	0.1	2.8	0.7	1.3	1.6	1.9
Portfolio Investment (net)	3.4	1.0	-4.5	-0.9	0.1	3.7	3.7
Other Long-Term Capital	0.3	4.3	-1.1	-1.8	-0.8	-1.6	-0.4
Short-Term Capital	1.0	4.2	-11.3	-0.1	2.1	2.1	2.1
Net Errors and Omissions	1.6	-2.8	-2.1	-1.3	0.0	0.0	0.0
Overall Balance	5.2	-3.0	-12.9	-4.9	0.9	4.0	5.6
Total Change in Reserves	-5.2	3.0	12.9	4.9	-0.9	-4.0	-5.6
IMF	0.4	3.4	10.2	7.9	0.6	-0.8	-8.0
Official Reserves	-5.6	-0.4	2.7	-3.0	-1.5	-3.2	2.4

In general both the current account and the capital account projections are conservative. Hence, Turkey is not expected to face any problems arising from the balance of payments in the programme period.

2.5. Main Risks During the PEP Period

The macroeconomic framework presented above for the 2002-2005 period is the baseline scenario. The risks that may arise are likely to change the assumptions and hence the results of the baseline scenario. In this context, possible shocks related to external demand and regional political tensions are analysed and the macroeconomic variables, which are likely to be affected directly by those shocks, are given below. The analysis in this section has been conducted by applying shocks to the macroeconomic model, which was used in the estimation of the baseline scenario. Additionally, possible risks that may arise in attaining the inflation target are presented at the end of the section.

Slowdown in Foreign Demand

In this scenario, the possible effects of a drop in Turkey's export demand are analysed. Under the assumption that the growth of foreign demand in the 2003-2005 period is 1 percentage point below the baseline scenario, the volume of merchandise exports is expected to be 0.9, 1.4 and 2.1 billion dollars below the baseline scenario, respectively, in the 2003-2005 period. Accordingly, the growth rate of the GDP is forecasted to decline by 0.9, 0.5 and 0.5 percentage points. The value of imports and the current account balance in this scenario are presented in the table below.

Controlling the domestic demand is the key factor in this scenario. Failure to constrain consumption might lead to higher imports, causing a significant deterioration in the current account balance.

Table:2. 7-The Effects of a Slowdown in Foreign Demand

	The Baseline Scenario			Difference from the Baseline Scenario		
	2003	2004	2005	2003	2004	2005
GDP Growth (per cent)	4.9	5.0	5.1	-0.9	-0.5	-0.5
Foreign Demand Elasticity of the GDP				0.53	0.25	0.25
Exports (billion dollars)	36.5	39.9	43.5	-0.9	-1.4	-2.1
Imports (billion dollars)	49.6	54.6	59.3	-0.6	-1.4	-1.2
Current Account Balance / GDP (per cent)	-0.9	-0.8	-0.8	-0.2	-0.1	0.0
Growth of Developing Countries' Import Demand (per cent)	7.7	8.6	8.6	-1.0	-1.0	-1.0
Growth of the EU Countries (per cent)	2.9	2.5	2.5	-1.0	-1.0	-1.0

Regional Political Tensions and Possible Armed Conflicts

Turkey will be adversely affected by political tensions and possible armed conflicts in her region. The most considerable effect is likely to be felt in the tourism sector. Depending on its time and duration, in the event of a possible armed conflict, tourism revenue is expected to decline by approximately 15 per cent. Moreover, total exports are forecasted to decline by 500 million dollars as a result of the drop in the

border-trade. In addition, a possible increase in oil prices caused by such an operation will affect the trade balance and the economy adversely. Furthermore, problems might be encountered in capital inflows. Consequently, in the event of a possible armed conflict in 2003, the growth rate will be about 1.8 percentage points below the baseline scenario.

Table:2. 8-The Effects of Regional Political Tensions and Possible Armed Conflicts

	The Baseline Scenario	Difference From the Baseline Scenario
	2003	2003
GDP Growth (per cent)	4.9	-1.8
Exports (billion dollars)	36.5	-0.5
Tourism Revenues (billion dollars)	8.3	-1.0
Capital Flows (billion dollars)	2.8	-3.0
Nominal Exchange Rate Increase (TL/\$, per cent)	20.5	2.7

Risks Associated with Monetary Policy and Inflation

Although the preparatory work and legal arrangements necessary to bring inflation down to 8 per cent in the 2002-2005 period have been completed, the possible risks that may arise in attaining this target can be listed as follows:

- An environment that enables fiscal discipline to be maintained and consistent economic policies to be implemented is necessary for the success of inflation targeting.
- An important part of inflation is determined both directly and indirectly by the public sector. As regards medium-term inflation targets, an increase in productivity in the public sector and price adjustments of institutions in line with targeted inflation are very important.
- Especially due to weather conditions, possible high increases in agricultural prices, which has a significant weight in price indices, constitutes a risk.
- When both the direct and indirect effects of crude oil and other energy prices on domestic inflation are considered, the increase in energy prices in line with the programme projections is an important factor in attaining inflation targets.
- Despite the weakening of the pass-through from exchange rate to inflation during the floating exchange rate regime, the relation between the exchange rate and inflation still has to be watched closely to achieve inflation targets.
- The determination of wages and contracts in line with the targeted inflation rather than by backward indexation is important in order to reach inflation targets.

3. PUBLIC FINANCE

3.1. Fiscal Policy Objectives

Fiscal Policy

The main objectives of the fiscal policy are to contribute to the formation of a sustainable growth environment, to support the efforts towards disinflation and to achieve a substantial level of primary budget surplus each year in order to ensure the sustainability of debt service and debt stock. Public revenues, expenditures and debt management policies will be implemented in a consistent manner, taking into account the main objectives of the fiscal policy.

Public Revenues Policy

In the context of the three-year economic programme backed by IMF Stand-by agreement and covering the 2000-2002 period, various measures to increase public revenues with the aim of achieving a primary budget surplus were taken in 2000. However, due to the economic crises, additional measures had to be taken in 2001 and 2002 to attain a sustainable public finance balance. Thus, during the last decade, the total effective tax burden increased by around 10 per cent, reaching 33.1 per cent of the GDP in 2001. However, during the same period, the broadening of the tax base has not been adequately achieved.

In 2002, a tax strategy that aims at the restructuring of tax administration and tax policy was put into effect. This strategy comprises various arrangements to be carried out during the 2002-2004 period. The main goals of these arrangements are the harmonisation of legislation with that of the EU, the simplification of tax legislation and the restructuring of tax administration.

In this context, an important step was taken in the harmonisation of Turkish tax legislation with that of the EU. This was accomplished through the implementation of VAT and the introduction of a special consumption tax (SCT) in 2002, which are the main components of the EU's indirect tax legislation. The SCT has replaced 16 different taxes and extra-budgetary fund deductions. In this way, the number of tax rates for value added tax was decreased from 5 to 3, implying a simplification in the taxation of many products.

In the context of this new tax strategy, the following additional arrangements will be made:

- Special expenditure reductions will be transformed into tax credit.
- Tax exemption on investment will be simplified.
- Effective tax burdens on financial instruments will be harmonised.
- Taxation of dividends will be redefined.
- The tax declaration system will be simplified and a unitary system for taxation will be ensured.
- Tax burdens on corporate earnings will be reduced. In this process, exemptions and allowances will be reviewed and brought down to a minimum level, and withholding tax on corporate earnings will be redefined.

- The General Directorate of Revenues will be functionally reorganised and new positions will be defined accordingly, thus strengthening the administrative capacity.
- Unregistered economic activities will be taken into the scope of taxation by completing the ongoing process of giving each citizen a tax identification number and by the automation of tax administration.
- The necessary infrastructure will be established so as to achieve an efficient and institutionalised auditing process. Tax Intelligence Centres will be strengthened, and receivers of public funds will be monitored through the tax identification number.
- Services provided to taxpayers will be improved and on-line public services will be widely used for tax payment and the acceptance of tax declarations.

The above mentioned arrangements will help in achieving efficiency and justice in taxation and taking unregistered economic activities into the scope of the taxation process.

Local taxes will be redefined so as to provide the local authorities with revenues proportional to their activities and increase their fiscal autonomy. In this context, the related draft law was submitted to the National Assembly.

Public Expenditures Policy

In order to initiate the reforms and measures that would contribute to the attainment of a sustainable growth path, necessary arrangements have been put into effect as of the beginning of 2000.

In addition to the budgetary limits imposed by related budget laws, Public Finance and Debt Management Law No. 4749 has brought a further limitation to expenditures.

According to Law No. 4736, as of 2002, the application of reduced tariffs on the prices of goods and services produced by the public sector have been eliminated except for those deemed necessary for common business practices.

In the medium term, the following expenditure policies will be implemented:

- Over-employment in the public sector will be reduced through retirement and layoffs.
- With the aim of reducing the personnel expenditures in the consolidated budget, excluding education, health care and public security services, the number of new positions was set at a level not to exceed 50 per cent of the positions vacated the previous year due to retirement, death or resignation.
- Wages and salaries in the public sector will be determined according to the inflation target and an effort will be made to attain public sector financial balance and the elimination of wage disparities.
- Closure of regional branches of public institutions will continue as foreseen by the related law. Organisational enlargement and the creation of new positions within public institutions will be avoided.

- Interest burdens on the budget will be reduced through efficient debt management.
- Health expenditures of social security institutions will be brought under control. With the aim of reducing the transfers from the budget to social security institutions, measures concerning pharmaceuticals, health care services and premiums to be paid will continue to be taken.
- It is of vital importance to restructure public administration with the aim of reducing expenditures and insuring efficient allocation of resources according to strategic priorities. To this end, the duties and distribution of authority of the central and local administrations will be redefined, and the restructuring process to increase the authority and responsibilities of the latter will continue.
- In order to rationalise the public investment programme, efforts to reduce the number of public investment projects to a sustainable level will continue by taking into account sectoral priorities and currently available resources.
- To increase the efficient utilisation of resources in the public sector and to meet the demands of the society through an outcome-effective approach, the necessary capacity to implement strategic planning in governmental institutions will be developed in line with the national policy framework. The work will start with pilot studies in 2003 and will then be extended over to others in 2004, under the supervision of the SPO.
- The abolishment of revolving funds, which distort public finance discipline, will continue.
- The number of civil servants, workers on contract and those who work on a temporary and permanent basis in the SEEs and their subsidiaries will be reduced within the context of economic programme targets. Accordingly, the new positions created cannot exceed 10 per cent of those vacated by workers who left the previous year. The letter of intent submitted to the IMF made a commitment to reduce the number of redundant workers in the public sector by one-third before June 2002, another one-third by October 2002 and the remaining one-third by June 2003. To accomplish this, the necessary steps have been initiated.
- The Direct Income Support For Farmers Scheme, which enables the prices of agricultural products to be determined in markets and aims at ensuring farmers a certain level of income, has been underway and efforts to downsize and/or privatise the agricultural SEEs are continuing.

Public Finance Projections (2002-2005)

The general government fiscal balance is the result of the consolidation of revenues and expenditures of consolidated budget, local administrations, funds, social security institutions and revolving funds. General government accounts have been estimated in conformity with ESA 95 and under the assumptions for growth, inflation, interest rates, balance of payments and nominal wage increases for the 2002-2005 period. Along with these assumptions and the revenue and expenditure policies stated

in Section 3.1, other assumptions taken into account in the calculations of the balances of institutions within the general government fiscal balance are as follows:

Revenue-Related Assumptions

- According to projections, the SCT, which is going to be included in tax receipts beginning with 2003, will not cause an extra burden.
- Within the 2003-2005 period, the introduction of any new tax or any significant increase in the current tax rates is not projected. Some of the tax measures that were introduced in 2000, in order to reach the programme targets and compensate for the losses caused by the 17 August 1999 earthquake, will be continued.
- Within the next period, the policy preference concerning the revenues of the local authorities will be to increase their self-revenues rather than to increase their share in the general budget.
- Through a revision in 2002, the Real Estate Tax has been given a certain weight in the system. According to estimations, the Real Estate Tax will maintain its weight in the following period.
- In the calculations, compensation has been assumed for associated revenue losses in the event of the introduction of inflation accounting.
- It has been programmed that new resources will be obtained through the acceleration of the privatisation process. The essence of the fund revenue policy is to support the public finance balance through the transfer of the extra privatisation revenues into the budget. Within this context, during the mentioned period, privatisation revenues will be an important revenue item for the budget. Revenue obtained through the sale of Türk Telekom shares and of power plant ownership and operation rights will be transferred to the budget.
- The Social Aid and Solidarity Fund, which plays an important role in the improvement of income distribution and in the struggle with poverty, will continue functioning.
- The shares of employees, employers and the State in the unemployment insurance premium, which have been decreased by one percentage point in 2002, will be increased to their previous rates in the coming years.
- In parallel with a decline in the interest rate, the income tax revenues are expected to go down in real terms. Hence, it is foreseen that the share of direct taxes in total tax receipt will drop.

According to the projections based on these assumptions, total tax revenue, which makes up approximately 62 per cent of general government revenues, is estimated to be around 25 per cent of the GDP within the 2002-2005 period. In 2002, general government total revenues are expected to be 39.4 per cent of the GDP when privatisation revenues are excluded. With privatisation revenues, it will reach 39.8 per cent of the GDP, indicating an increase of 0.3 percentage points. As for the year 2005, general government total revenues which are expected to be 38.5 per cent of the GDP,

will rise to 40.1 per cent of the GDP with privatisation revenues, representing an increase of 1.6 percentage points.

Expenditure-Related Assumptions

- Within the 2002-2005 period, general government expenditures are assumed to decrease gradually with the help of contractionary measures. Structural reforms, aimed at increasing the efficiency of expenditures, have been partially put into effect. Within this context, a number of measures aiming to increase the efficiency of the public finance have been introduced in certain fields: such as the Public Procurement Law, the rationalisation of the public investment programme, the introduction of strategic planning through pilot studies, the expansion of the scope of the budget and the introduction of a new budget code structure through pilot studies.
- Transfer expenditures, which make up the bulk of general government expenditures, will have a downward trend from 2003 onwards. Transfer expenditures are estimated to decrease in the 2002-2005 period with the help of the gradually declining interest payments of the budget, on the assumption that the Treasury will be able to borrow on a longer term and at a lower cost.
- With the introduction of SCT, some ministries and funds will not receive a share of the tax revenues from 2003 onwards; the system will be simplified by giving these bodies budgetary allocations.
- It is assumed that, within the context of the Agricultural Reform Application Project, the activities of the Support and Price Stability Fund will continue until the end of 2005.
- In the construction of actuarial balances of Social Security Institutions, with the help of measures to be taken, premium receipts have been estimated to increase, and expenditures –mainly health expenditures– to decrease.
- Within the context of employment rationalisation efforts, the extra burden on the Social Insurance Institution (SSK) to be caused by retired workers has been taken into consideration in the calculation of actuarial balances and additional transfers provided to this Institution from the budget.

According to the projections based on the above assumptions, the ratio of general government expenditures to the GDP is estimated to steadily decline from 52.9 per cent in 2002 to 40.6 per cent in 2005. Along with improvements in economic indicators, public finance restructuring reforms have an important role in this contraction in general government expenditures.

The ratio of general government fixed investments to the GDP is estimated to increase gradually from 3.8 per cent in 2002 to 4.3 per cent within the 2003-2005 period. The inclusion of investments financed through Education, Youth, Sport and Health Service Taxes into the budget, will also play an important role in this increase.

Furthermore, the revenue increases in the local administrations will be used for local infrastructure investments. This, in turn, will bring about an increase in general government fixed investments.

Table:3. 1-General Government Revenues and Expenditures

	(Per cent of the GDP)			
	2002	2003	2004	2005
Taxes	24.3	24.8	24.6	24.9
Direct	8.2	7.5	7.2	7.3
Indirect	15.3	16.6	16.8	16.9
Taxes on Wealth	0.7	0.7	0.7	0.7
Non-Tax Revenues	5.3	4.4	4.2	3.9
Factor Incomes	3.8	3.6	3.4	3.3
Social Funds	6.1	6.3	6.4	6.5
Total	39.4	39.2	38.6	38.5
Privatisation Revenues and Asset Sales	0.3	1.4	1.3	1.6
Total Revenues	39.8	40.6	40.0	40.1
Current Expenditures	16.7	16.3	16.2	16.2
Investments	3.8	4.2	4.3	4.4
Fixed Investment	3.8	4.2	4.2	4.3
Change in Stocks	0.0	0.0	0.0	0.0
Transfers	32.4	26.1	22.5	20.1
Current Transfers (net)	31.2	25.1	21.4	19.1
Capital Transfers	1.1	1.0	1.0	1.0
Stock Revaluation Fund	0.0	0.0	0.0	0.0
Total Expenditures	52.9	46.6	42.9	40.6
Borrowing Requirement	13.2	5.9	3.0	0.5
Borrowing Requirement Excluding Interest Payment	-7.9	-8.5	-7.8	-7.8

General Government Borrowing Requirement

In 2002, the general government borrowing requirement is expected to fall to 13.2 per cent of the GDP from 15.1 per cent in 2001. This improvement in the general government borrowing requirement is expected to continue also in the 2003-2005 period, declining to 0.5 per cent in 2005. The major factor contributing to this achievement will be the substantial declines in consolidated budget interest payments. Other contributing factors are the foreseen increase in privatisation revenues, declines in the deficits of social security institutions and the introduction of unemployment insurance fund.

The general government primary budget surplus, which is expected to be 7.9 per cent of the GDP in 2002, is estimated to be 7.8 per cent of the GDP with a decrease of 0.1 percentage points in 2005.

3.2. Public Debt Management

Public Debt and Debt Management Strategy

Due to the economic crisis and developments in external circumstances, foreign borrowing was limited in 2002, leading to greater dependence on domestic borrowing. Moreover, increasing uncertainty led to shorter maturity terms and a rise in interest rates. This caused an increase in the cost of borrowing, creating additional borrowing requirement.

The borrowing requirement and expenditures of the Treasury increased because of the special issue government bonds provided in order to liquidate the duty losses and meet the capital requirements of state banks and strengthen the capital base of the banks under the management of the Savings Deposit Insurance Fund (SDIF).

Since December of 2000, special issue government bonds of 20 quadrillion Turkish liras have been provided to the SDIF to strengthen the capital structure and balance sheets of banks under its management.

As of December 2001 the value of government bonds issued, for the liquidation of duty losses and strengthening of the capital base of state banks within the context of the process of restructuring the banking sector, has reached 32 quadrillion Turkish liras.

Consequently, government bonds issued to the SDIF and the state banks increased to 45 quadrillion liras in 2001 from 6.7 quadrillion liras in 2000, within the context of the restructuring of banking sector. In addition to the direct purchases of the Central Bank, early redemption and coupon payments by the Treasury improved cash availability. Payments by the Treasury, of which 7.4 quadrillion liras went to state banks and 4.8 quadrillion liras to the banks of the SDIF, amounted to 12.2 quadrillion liras.

The issuance of government securities to the state banks and SDIF banks caused an increase in the Treasury's borrowing requirement. Since the short-term debt of these banks was paid, this operation did not change the total amount of public borrowing; however, it enabled the state banks to replace their overnight borrowing with longer-term treasury loans in order to finance their borrowing requirement. Hence the pressure of the state banks on short-term interest rates was removed.

In June 2001, the Treasury conducted government securities swap auctions to extend the maturity of domestic borrowing. The domestic financing need was shrunk by exchanging the 23 Turkish lira denominated domestic debt securities, issued through treasury auctions and maturing in 2001 and 2002, with foreign exchange indexed and Turkish lira denominated floating rate bonds. As a result of the swap operation, securities that had an average of 6 months left to maturity were exchanged for bonds with an average maturity of 37.5 months, thus extending the average maturity of the domestic debt stock.

The state banks will no longer be allowed to run duty losses. As a result of the legislative arrangement made in 2001, in the future, any support provided via the state banks will be budgeted and will not lead to a loss by the state banks.

The issuance of foreign exchange linked and Turkish lira denominated floating rate bonds made an important part of the domestic debt stock indexed to exchange rate and interest rate.

With these improvements, the domestic debt stock, which was 36.4 quadrillion liras in 2000 (by including the 15.1 quadrillion liras of unsecuritised duty loss stock, the domestic debt stock increases to 51.5 quadrillion liras), increased to 122.2 quadrillion liras at the end of 2001, and 126.8 quadrillion liras at the end of June 2002. While the ratio of domestic debt stock to the GDP was 29.2 per cent in 2000, it increased to 67.3 per cent at the end of 2001. At the end of December 2001, 35.6 per cent of the total domestic debt stock was in the form of foreign exchange denominated

and foreign exchange indexed bonds, 49.9 per cent in the form of floating rate bonds, and 14.5 per cent in the form of fixed rate bonds while 52.2 per cent of domestic debt stock is in the form of non-cash securities, and 47.8 per cent in the form of cash securities.

Table:3. 2-Domestic Debt Stock Composition by Instruments

	2000	2001	2002	2000	2001	2002
	December	December	June	December	December	June
	At Current Prices, Quadrillion TL.			Percentage Distribution		
Cash	29.6	58.4	69.3	81.2	47.8	54.7
Fixed Rate	19.4	17.7	28.4	53.3	14.5	22.4
Floating Rate	9.0	11.4	14.5	24.7	9.4	11.4
FX Denominated	1.2	7.1	10.6	3.2	5.8	8.4
FX Indexed		22.1	15.8	0.0	18.1	12.5
IMF Credit		13.8	7.6	0.0	11.3	6.0
Swap		7.7	7.7	0.0	6.3	6.1
Others		0.5	0.5	0.0	0.4	0.4
Non-Cash	6.8	63.8	57.5	18.8	52.2	45.3
Fixed Rate	1.0	-	-	2.8	0.0	0.0
Floating Rate	4.0	49.5	46.3	11.0	40.5	36.5
FX Denominated	1.8	12.4	10.8	5.0	10.1	8.5
FX Indexed		1.9	0.4	0.0	1.6	0.3
Total Stock	36.4	122.2	126.8	100.0	100.0	100.0

Note: The unsecured duty losses were not included in 2000, but were included in 2001 and 2002.

The distribution of domestic debt stock by lenders changed substantially and domestic debts to public institutions increased to 66 per cent of the total debt stock at the end of 2001. In addition, the domestic debt rollover rate was kept under control by restructuring the non-cash securities provided to the public institutions in order to reduce domestic debt redemptions and by decreasing the borrowing requirement through IMF loans.

Table:3. 3-Domestic Debt Stock Composition by Lenders

	2000	2001	2002	2000	2001	2002
	December	December	June	December	December	June
	At Current Prices, Quadrillion TL.			Percentage Distribution		
Total	36.4	122.2	126.8	100.0	100.0	100.0
Public	12.2	80.6	71.2	33.6	66.0	56.2
CBRT	1.5	18.8	18.4	4.1	15.4	14.5
State Banks	2.9	22.7	23.9	8.0	18.6	18.9
SDIF Banks	3.9	15.1	8.6	10.6	12.3	6.8
For IMF Credit	0.0	13.8	7.6	0.0	11.3	6.0
Other	4.0	10.2	12.7	10.9	8.4	10.0
Market *	24.2	41.6	55.6	66.4	34.0	43.8

*The figure which indicates "market" includes SDIF Banks' deposit transfers to the market (4.4 quadrillion TL).

While the annually compounded interest rate of government securities was 34.5 per cent in April 2000, it increased to 130.3 per cent in April 2001 and decreased to 60.8 per cent in April 2002. Due to increasing uncertainty in May, June and July, interest rates entered a rising tendency and reached 72.1 per cent by the end of July 2002. The average maturity, which was 411 days in 2000, decreased to 148 days in 2001, and increased to 285 days in the period from January to July 2002.

While the stock's average day to maturity was 15.5 months at the end of 2000, it increased to 38.9 months at the end of 2001 and 38.2 months in June 2002.

While the total external debt stock including private debt was 119.7 billion dollars in 2000, it decreased to 115.1 billion dollars at the end of 2001 and increased to 117.5 billion dollars in the first quarter of 2002.

While 76.3 per cent of the external debt stock was medium-to-long term, 23.7 per cent of it was short-term in 2000. The share of medium-to-long term debt in the total external debt stock increased to 85.9 per cent in 2001 and the share of short-term debts decreased to 14.1 per cent. This tendency continued in the first quarter of 2002 and the share of medium-to-long term debt in the total external debt stock increased to 87.7 per cent, whereas the share of short-term debt decreased to 12.3 per cent.

While the share of multilateral organisations in the external debt stock increased approximately 10 percentage points over the previous year, the share of other organisations and banks decreased. A similar tendency has continued in the first quarter of 2002.

Table:3. 4-The Structure of Total External Debt Stock

	Million Dollars			Percentage Distribution		
	2000	2001	2002 Q1	2000	2001	2002 Q1
Maturity Composition	119,664	115,084	117,549	100.0	100.0	100.0
Short-Term	28,301	16,241	14,481	23.7	14.1	12.3
Medium-Long Term	91,363	98,843	103,068	76.3	85.9	87.7
By Lender	119,664	115,084	117,549	100.0	100.0	100.0
Multilateral Organisations	11,445	22,180	24,918	9.6	19.3	21.2
Governmental	8,677	7,685	7,592	7.3	6.7	6.5
Commercial Banks	45,469	34,692	33,590	37.9	30.1	28.6
Other Private Creditors	54,073	50,527	51,449	45.2	43.9	43.7
Currency Composition	119,664	115,084	117,549	100.0	100.0	100.0
USD	65,453	58,749	60,297	54.7	51.1	51.3
DEM	23,162	4,344	3,728	19.4	3.7	3.2
JPY	7,445	5,176	4,769	6.2	4.5	4.1
EUR	14,840	30,435	29,667	12.4	26.5	25.2
Other	8,764	16,380	19,088	7.3	14.2	16.2

As a result, while the ratio of the total public debt to the GDP was 62.7 per cent in 2000, it increased to 122.8 per cent at the end of 2001 and the ratio of the total debt stock to the GDP increased from 93.7 to 158.6 in the same period.

Table:3. 5-Total Gross Debt Stock

	(Per cent of the GDP)	
	2000	2001
Public Domestic Debt	29.2	67.3
Public External Debt	33.5	55.5
Total Public Debt	62.7	122.8
Private External Debt	31.0	35.8
Total Debt	93.7	158.6

Debt Management and Institutional Responsibilities for Borrowing Limits

Formulating and implementing debt strategies in order to meet the public financing need are among the duties and responsibilities of Turkish Treasury. Taking into consideration the basic macroeconomic targets and the financial system, it determines the quantity, maturity, types and the selling techniques of government securities.

The Law on Public Finance and Debt Management, aiming at fiscal discipline and transparency as well as effective debt management, was put into effect in April 2002.

This law envisages the establishment of a new unit in the Treasury whose main duty is to formulate and implement a coherent and a unified debt strategy in line with international standards so that effective risk management and closer coordination of domestic and external debt portfolio management will be attained.

Box: 3.1- Major Arrangements Brought About by Public Finance and Debt Management Law

- Separate legal arrangements are incorporated into a single law.
- Only one office is authorised for the operations that create borrowing and liabilities.
- Borrowing limit, including both domestic and external borrowing, is defined as the difference between the total initial appropriations and the estimated revenues in the budget law. This limit will also include Special Issue Government Bonds. It can be increased up to 5 per cent by the Minister in charge of the Treasury according to the needs of the debt administration. If this amount is insufficient, an extra 5 per cent increase can be added by the Council of Ministers. Special issue government bonds issued for onlending purposes are not included in this limit; however, the onlending limit in the budget law is determined separately.
- Treasury guarantees are redefined and build-operate-transfer guarantees are included in this limit.
- Arrangements providing effectiveness in debt management are put into effect.
- A risk account for the Treasury is opened in Central Bank of the Republic of Turkey for payments made under the Treasury guarantees and payments cannot be foreseen by the risk management system.
- According to this law, the Treasury will prepare and send a Public Debt Management Report to the institutions concerned.
- Law No. 4651 abolishes the practice of Treasury borrowing from the Central Bank for very short-term cash needs.
- To meet short-term cash needs, the Treasury is authorised to carry out operations with maturity less than one-month in money markets via the Central Bank, not exceeding 1 per cent of budget appropriations, without issuing government securities.

Lowering Public Debt Stock

To lower public debt stock in the 2002-2005 period, the following measures and policies will be implemented.

Various measures are adopted to provide domestic debt rollover and attract individual investors towards public bills. First, a substantial primary budget surplus is projected to alleviate the pressure of domestic debt on markets and to remove the vicious circle of debt-interest in the economy. This surplus will play an important role in eliminating the uncertainty concerning debt rollover and in restoring confidence in markets.

In addition, as progress in structural reforms stimulates the growth potential of the economy, confidence in domestic and external markets will be built up, leading to a decline in interest rates and public debt.

Strengthening the financial structure of state banks and ensuring additional external financial resources will lower the borrowing need from domestic markets sharply and public domestic debt rollover will ease.

Interest risks, foreign exchange risk, and consistency with macroeconomic policies are important factors that will be taken into account by the Treasury in lowering the debt stock.

Meeting the financing needs in the medium and long term with the lowest possible cost and at a reasonable risk premium is among the main targets. In this context, measures that aim at lengthening the maturity of debt stock, reducing the cost of borrowing, developing new instruments, widening investors' base and deepening the secondary markets become important. Basic policies to enhance the effectiveness of debt management are the following:

- Issuance of floating rate bonds, restarted in January 2002 for lengthening the maturity of debt stock, will continue. Issuance of floating rate bonds, in addition to its role of lengthening the maturity of debt stock, is an instrument protecting the Treasury and the markets against the interest rate risk since interest rates of coupon payments are determined in Treasury auctions.
- A primary dealer system will start functioning by September 2002. In this system, the primary dealers to be selected by the Treasury on the basis of their primary and secondary market performances will inject liquidity to the securities markets by offering bilateral quotations on reference bills.
- A new government securities market will be established by the Central Bank. In this market, primary dealers will be able to borrow the bills for which they have given a quotation. This market will help to develop secondary market functions by increasing the effectiveness of the primary dealer system.
- Consistent with market conditions, the Treasury will continue to issue foreign exchange-denominated and foreign exchange-indexed bonds and international bonds to diversify the investor base and borrowing instruments. While maintaining public offerings, the Treasury will develop new instruments towards non-bank institutions, such as insurance companies.

Public Debt Stock Projections for 2002-2005

During the PEP period, an important recovery is anticipated in the ratio of the gross public debt stock to GDP in a stable growth environment enhanced by the application of a tight fiscal policy and effective public debt management. This ratio, which reached 122.8 per cent in 2001, is expected to fall to 73 per cent in 2005.

Table:3. 6-Public Gross Debt Stock Projections for 2002-2005

	(Per cent of the GDP)				
	Realisation	Projection			
	2001	2002	2003	2004	2005
Domestic Debt Stock	67.3	49.3	44.2	40.6	39.5
External Debt stock	55.5	50.2	41.4	38.9	33.5
Total Debt Stock	122.8	99.6	85.6	79.6	73.0
Total Debt Stock (excluding IMF credits)	112.1	85.8	74.1	69.1	67.0

The decline in the ratio of the domestic debt stock to GDP will be the main determinant in lowering the ratio of total debt stock to GDP. The ratio of the domestic debt stock to GDP, which was 67.3 in 2001, is estimated to be 39.5 per cent in 2005. Primary budget surplus and the decrease in interest rates stemming from lower inflation and improved market confidence will be the main determinants in the drop in this ratio.

The ratio of the public external debt stock to GDP, which rose sharply due to substantial borrowing from multilateral organisations in 2001 and 2002, is expected to be reduced gradually to 33.5 per cent in 2005 resulting from the servicing of this debt in the PEP period.

3.3. Public Finance Risks

In the 2002-2005 period, tight fiscal policy aiming at a high rate of primary surplus has to be maintained in order to bring the public debt stock to a sustainable level. Risks that may arise in this context are given below:

- Domestic debt stock consists mainly of foreign exchange indexed and floating rate bonds. This is a favourable situation for the public sector when macroeconomic stability prevails. This may lead, however, to a sharp increase in the public debt stock in unstable periods.
- Lack of a comprehensive arrangement of public personnel regime and the possibility of a widening in the gap between workers' wages and civil servants' salaries after the collective bargaining agreements may increase current expenditures.
- Rising health expenses and the fact that most of the arrangements concerning the social security system will have an impact only in the long run may increase budget transfer expenditures.
- The existing and possible financial deficits of the Energy SEEs may increase budget expenditures.

- Treasury guaranteed credit and product purchase and input guarantees extended to build-operate-transfer projects exert a risk on the budget.
- Regional political tensions and possible armed conflicts will have an increasing effect on expenditures, especially defence, and a decreasing effect on revenues.
- If privatisation revenues fail to be realised, both the budget and economic efficiency may be affected negatively.

3.4. Sensitivity Analysis

The Effects of a Possible Decline in the Growth Rate

The effect of a lower growth performance on public finance is analysed in two different scenarios beginning from 2003. The GNP growth rates are assumed to be 1 percentage point lower than the baseline case in both scenarios.

In the first scenario, public revenues and investment and consumption expenditures are assumed to fall with the decline in the growth rate. In this scenario, the whole increase in the borrowing requirement is assumed to be met through domestic financial markets. Thus, the ratio of the domestic interest expenditures to the GDP is forecasted to increase by 0.1 percentage point in 2003, 0.2 percentage points in 2004, and 0.4 percentage points in 2005, compared to the baseline scenario. The general government borrowing requirement and domestic debt to GDP ratios for the same period are estimated respectively as 0.2, 0.2 and 0.5 percentage points and 0.5, 1.2 and 0.8 percentage points higher than the baseline scenario.

In the second scenario, public expenditures are assumed to preserve their nominal levels in the baseline scenario despite the drop in the public revenues resulting from the low growth rates. It is again assumed that entire increase in the borrowing requirement will be met through domestic financial markets. In this framework, the ratio of the domestic interest expenditures to GDP is forecasted to increase by 0.1 percentage point in 2003, 0.2 percentage points in 2004, and 0.5 percentage points in 2005. The general government borrowing requirement and domestic debt to GDP ratios for the same period are expected to increase by 0.3, 0.5 and 0.9 percentage points and 0.6, 1.5 and 1.6 percentage points, respectively.

Table:3. 7-The Effects of a Decline in the Growth Rate

	(Percentages)								
	Baseline Scenario			Scenario 1 Difference from Baseline			Scenario 2 Difference from Baseline		
	2003	2004	2005	2003	2004	2005	2003	2004	2005
GDP Growth Rate	4.9	5.0	5.1	-0.9	-1.1	-1.0	-0.9	-1.1	-1.1
Domestic Interest Expenditures / GDP	14.5	10.6	8.0	0.1	0.2	0.4	0.1	0.2	0.5
General Government Borrowing Requirement / GDP	6.0	2.8	-0.3	0.2	0.2	0.5	0.3	0.5	0.9
Domestic Debt Stock / GDP	44.2	40.6	39.4	0.5	1.2	0.8	0.6	1.5	1.6

The Effects of an Increase in the Exchange Rate

Depreciation of the Turkish lira has important costs not only because of the foreign exchange indexed domestic debt, but also because of the foreign debt. A 10 per cent higher depreciation of the nominal exchange rate beginning from 2003 will cause the ratio of the domestic interest expenditures to GDP to increase by 0.2, 1.2 and 1.7 percentage points in 2003, 2004, and 2005, respectively. The general government borrowing requirement and domestic debt to GDP ratios for the same period are expected to increase by 0.2, 1.2 and 1.7 percentage points and 1, 1.8 and 2.2 percentage points, respectively.

Table:3. 8-The Effects of an Increase in the Exchange Rate

	Baseline Scenario			Difference from Baseline		
	2003	2004	2005	2003	2004	2005
Domestic Interest Expenditures/GDP (per cent)	14.5	10.6	8.0	0.2	1.2	1.7
General Government Borrowing Requirement/GDP (per cent)	6.0	2.8	-0.3	0.2	1.2	1.7
General Government Total Debt Stock/GDP (per cent)	85.6	79.6	72.9	1.0	1.8	2.2
Average Exchange Rate (thousand TL/\$) (1)	1,871	2,064	2,276	10.0	10.0	10.0

(1) The difference from the baseline scenario is calculated as the percentage increase.

The Effects of a Rise in the Domestic Borrowing Interest Rate

The high level of the domestic debt to GDP ratio is one of the main problems of the Turkish economy. An increase in the Treasury bill rate is expected to have important effects on public finance. Under the assumption of a 10 percentage point increase in the domestic borrowing interest rate in 2003, 2004 and 2005 with respect to the baseline scenario, the domestic interest expenditures to GDP ratio is estimated to increase by 0.6, 1.8 and 2.2 percentage points, respectively. Moreover, the general government borrowing requirement and domestic debt to GDP ratios for the same period are expected to increase by 0.7, 1.8 and 2.1 percentage points and 0.7, 2.0 and 3.8 percentage points, respectively.

Table:3. 9-The Effects of a Rise in the Domestic Borrowing Interest Rate

	Baseline Scenario			(Percentages) Difference from Baseline		
	2003	2004	2005	2003	2004	2005
Domestic Interest Expenditures/GDP	14.5	10.6	8.0	0.6	1.8	2.2
General Government Borrowing Requirement/GDP	6.0	2.8	-0.3	0.7	1.8	2.1
Domestic Debt Stock/GDP	44.2	40.6	39.4	0.7	2.0	3.8
Domestic Borrowing Interest Rate (simple)	41.9	26.3	18.5	10.0	10.0	10.0

4. STRUCTURAL REFORMS

In recent years, structural issues have been among the main sources of macroeconomic instability in Turkey. The persistent high inflation and public deficits caused the rate of economic growth not only to remain below its potential but also to fluctuate. It has therefore become a necessity to change this unsustainable structure and to restore macroeconomic balances.

Moreover, the announcement of its candidacy at the Helsinki Summit in 1999 has urged Turkey to fulfil its obligations for the Copenhagen criteria, which the EU has demanded from the candidate countries.

Accordingly, a series of structural reforms were launched in 2000 to ensure a sustainable growth path and to bring about a market-based, competitive production system with a view to meeting the Copenhagen economic criteria.

These reforms comprised, *inter alia*, the downsizing the public sector through privatisation; forming a robust banking system to channel resources to the real sector; developing an efficient and transparent public administration; and adopting a more rational support policy in the agricultural sector.

4.1. Strengthening the Market Economy and Entrepreneurship

4.1.1. Privatisation

The main objectives of privatisation, one of the essential elements of the economic programme, are to integrate fully into world markets, to ensure free market conditions, and to increase the efficiency and competitiveness of the economy within the framework of the Customs Union and with a view to EU membership. It is also aimed to confine the role of the State in the economy to supervision and regulation by minimizing its activities in producing goods and services, and to establish international standards in the Turkish economy. At present, there are 39 SEEs of which 18 are covered by the privatisation programme. The share of the SEEs in total employment was 2.1 per cent in 2001. Over the last five-year period, the share of the SEEs in the GDP has been around 6 per cent.

It is envisaged that the SEEs will be privatised without delay. Thus, as the promotion of wider share ownership and technological renovation are ensured, a decrease in the financial burden of the SEEs on the budget and on financial markets can be achieved.

As of 2001, the State has withdrawn completely from certain sectors such as animal feed, milk processing, cement and airport ground handling services. Moreover, in sectors such as textiles, tourism, meat and fish products, petroleum distribution and maritime transportation, the decisive role of the State has been transferred to the private sector. In addition, the privatisation process of public banks has been launched and significant steps have been taken with a view to reducing state influence in the financial sector.

Table:4. 1-Privatisation Implementation (1985-2002)

Privatisation Portfolio*	Privatised	Recent Situation	
		Privatisation Portfolio	Privatisation Programme
Public share in 219 companies 22 incomplete plants 5 real estate holdings 4 power generation plants	164 companies have been privatised through either share or asset sales.	1 company	32 companies

Currently, public share is less than 50 per cent in 24 companies.

* Subsequently, public shares in 22 companies, 4 power generation plants, and 4 real estate holdings have been excluded from the scope of privatisation.

Table:4. 2-Privatisation Revenues and Expenditures (1985-2002)

Revenues			(Billion Dollars)
Privatisation Revenues	Dividends and Others	Total	Expenditures
7.7	2.2	9.9	9.7

Privatisation targets could not be fully attained in 2001, mainly due to unfavourable conditions in domestic and foreign markets stemming from the September 11 terrorist events. In this year, the management rights of Marmaris Port were transferred to the private sector; certain real estate holdings of SEKA (Dalaman Enterprise), TZDAŞ, KBİ and TDÇİ were sold; Yarımca Complex of PETKİM was transferred to TÜPRAŞ. As a result, privatisation revenue of 120 million dollars was obtained. The transfer of İSDEMİR to ERDEMİR was completed in February of 2002.

Extensive privatisation is envisaged for 2002, with a revenue target of 1.5 billion dollars. In March 2002, 16.5 per cent of the public shares of POAŞ were sold for 168 million dollars. Preparatory work for reducing the public shares in TÜPRAŞ below 50 per cent is in progress. In the third quarter of 2002, the sale of at least 51 per cent of PETKİM shares is planned. Preparatory work for the privatisation of TŞFAŞ and TEKEL is continuing. In addition, asset sales of SEKA and SÜMER Holding, and block sales of Ataköy Hotel, Ataköy Tourism, TÜGSAŞ, DİTAŞ, Eti Krom, Eti Gümüş, Eti Elektrometalurji are among the privatisation targets of 2002.

The Board of Directors of Türk Telekom approved the holding strategy which envisaged the restructuring of the company by dividing it into two different units having separate legal personalities. In view of the restructuring of the corporation and developments in the telecommunications markets, the market price of Türk Telekom determined in 1998 has to be revalued. In this respect, a Council of Ministers' Decree regarding the revaluation of the company was issued in May 2002. Moreover, it is envisaged that the privatisation strategy for Türk Telekom is to be determined in accordance with its restructuring and market dynamics by a Council of Ministers' Decree in November 2002. The privatisation of Türk Telekom is to be completed as soon as possible.

Block sales of Ataköy Hotel and Div-Han are planned for 2003.

It is envisaged that power generation and distribution companies are to be included in the privatisation programme by March 2003. Subsequently, it is planned that the privatisation of these companies will be finalised within 18 months.

Table:4. 3-Matrix of Policy Commitments: Privatisation

(Million Dollars)				
	2002	2003	2004	2005
Privatisation Programme				
	- DİTAŞ - PETROLEUM & PETROCHEMICAL GROUP - SEKA - ETİ - ELEKTROMETALURJİ - ETİ KROM - TÜGSAŞ - ATAKÖY TOURISM - ATAKÖY HOTEL - SÜMER HOLDİNG	- ETİ BAKIR - KBI - TÜGSAŞ - BOTAŞ ESKİŞEHİR NATURAL GAS DISTRIBUTION - BOTAŞ BURSA NATURAL GAS DISTRIBUTION - THY - PETROLEUM & PETROCHEMICAL GROUP - TŞFAŞ - TEKEL - SÜMER HOLDİNG - TÜRK TELEKOM	- THY - PETROLEUM & PETROCHEMICAL GROUP - ELECTRICITY GENERATION COMPANY - ELECTRICITY DISTRIBUTION COMPANY - TŞFAŞ - TEKEL - TÜRK TELEKOM	- THY - PETROLEUM & PETROCHEMICAL GROUP - ELECTRICITY GENERATION COMPANY - ELECTRICITY DISTRIBUTION COMPANY - TEKEL - HALKBANK - TÜRK TELEKOM
A. Implementation Profile	X	X	X	X
B. Net Direct Budgetary Effect	600	3,500	3,600	4,300
B.1. Direct Impact on Budgetary Revenue	600	3,500	3,600	4,300
B.2. Direct Impact on Budgetary Expenditure				

4.1.2. Competition Law and Policy

The ultimate objective of the Turkish competition policy is to create an efficient competitive environment in goods and services markets.

Law No. 4054 on the Protection of Competition was adopted in 1994, in line with Article No. 167 of the Turkish Constitution, which assigns missions and responsibilities to the State to take and develop appropriate measures for the smooth and orderly functioning of money, credit, capital, and goods and services markets, and to prevent monopolistic or oligopolistic competition in those markets. The Law is in harmony with the EC-Turkey Association Council Decision No. 1/95.

Law No. 4054 regulates all behaviours which have as their object or effect the prevention, distortion, or restriction of competition within Turkey. The Law addresses mainly three categories of issues regarding competition policy. The first is agreements, decisions, and concerted practises which hinder, distort or restrict competition among enterprises. The second is the abuse of a dominant position by enterprises. The third is mergers and acquisitions which distort the competitive structure of the market.

The Competition Authority has adopted a considerable amount of secondary legislation to implement Law No. 4054. Preparatory work regarding the adoption of communiqués on de-minimis and R&D is continuing. As foreseen among the medium-term priorities of the National Programme for the Adoption of Acquis (NPAA), the Authority issued the Communiqué on Block Exemptions concerning Vertical Agreements in July 2002.

As referred to in the NPAA, in the fields which are not within the scope of Law No. 4054, the necessary secondary legislation will be adopted by the relevant public institutions.

Draft Law on Monitoring and Surveillance of State Aid has been prepared. The draft Law aims to establish an independent body responsible for monitoring and supervising state aid, excluding aid related to the agriculture and fisheries sectors, and taking the necessary measures to prevent the distortion of competition.

In addition, a working group composed of representatives of related public institutions has been established so that the competition policies applicable to public enterprises and others, to which special or exclusive rights have been granted, can be approximated to those of the EU.

Over the 1997-2001 period, 1,591 applications concerning competition infringements, mergers and acquisitions, and negative clearance and exemptions were made to the Authority and 1,305 of these were resolved.

Table:4. 4-Applications Made to and Resolved by the Competition Authority

		(5.10.1997- 31.12.2001)					
		1997	1998	1999	2000	2001	Total
Competition Infringements	Applications Made	22	177	220	255	213	887
	Applications Resolved	9	44	306	262	211	832
Mergers/ Acquisitions	Applications Made	8	59	80	103	82	332
	Applications Resolved	5	52	76	101	88	322
Negative Clearance/ Exemptions	Applications Made	–	245	44	41	42	372
	Applications Resolved	–	12	64	23	52	151
Total	Applications Made	30	481	344	399	337	1,591
	Applications Resolved	14	108	446	386	351	1,305

4.1.3. Regulatory Reform

In recent years, legal and institutional arrangements have been made with a view to ensuring that the State only lays down rules regulating the market and monitors their observance instead of having an active role in the economy.

Due to the strategic, social or natural monopoly character of certain sectors, regulation in such markets is a major economic and social necessity. In this respect, infrastructure sectors, where the state entrepreneurship could not provide the desired level of efficiency and contribution to the social welfare, have been opened to competition. In sectors which have not been entirely opened to competition, existing policies have been changed in order to increase their contribution to the social welfare.

Table:4. 5-Independent Regulatory Institutions

Institution	Law No./ Year	Sectors	Task
Capital Markets Board	2499 / 1981	Capital markets	Regulating and supervising the capital markets and protecting the rights and interests of investors.
High Audiovisual Board	3984 / 1994	Radio and television broadcasting	Regulating radio and television broadcasting.
Competition Authority	4054 / 1994	Goods and services markets (all sectors)	Preventing agreements, decisions and concerted practices, and abuse of dominant position by undertakings which hinder, distort or restrict competition in goods and services markets; facilitating the regulation and supervision to protect competition; controlling mergers and acquisitions.
Banking Regulation and Supervision Agency	4389 / 1999	Banking	Protecting the rights and interests of depositors; laying down the principles regarding the establishment, management, operation, acquisition, merger, liquidation, and supervision of banks in order to ensure efficient operation of the credit system with due regard to the requisites of economic development, and confidence and stability in financial markets.
Telecommunications Authority	4502 / 2000	Telecommunications	Constituting a dynamic and strong market based on fair competition; contributing to the sectoral policy-making process; taking measures to protect consumer rights; ensuring efficient and productive use of scarce resources in the sector such as frequency and number.
Energy Market Regulatory Authority	4628 / 2001 4646 / 2001	Electric energy Natural gas	Constituting a financially strong, stable and transparent energy market operating under private law in a competitive environment to provide adequate, refined, continuous and environment-friendly electricity and natural gas; ensuring independent regulation and supervision in the market.
Sugar Authority	4634 / 2001	Sugar, starch based sweeteners	Regulating the sugar regime through establishment of procedures and principles regarding sugar production, and the conditions and methods of price setting and marketing.
Tobacco, Tobacco Products and Alcoholic Beverages Market Regulation Authority	4733 / 2002	Tobacco, tobacco products, and alcoholic beverages	Regulating the procedures and principles regarding production, domestic and external purchase and sale of tobacco and tobacco products.
Public Procurement Authority	4734 / 2002	All public institutions	Determining the procedures and principles to be applied in public procurements; examining the complaints concerning all public procurements.

Regulatory bodies have been set up in sectors such as capital market, radio and television broadcasting, banking, energy, and telecommunications, in order to regulate and supervise the market, protect the consumers against monopolistic behaviours, prohibit restriction and distortion of competition, and prevent discriminatory practices of the companies regarding the provision of services. Regulatory bodies for the natural gas, electricity and telecommunications sectors, which were previously public monopolies, were set up specifically to regulate the markets formed through vertical (functional) separation of these sectors mainly due to the implementation of privatisation policy.

It is foreseen that these regulatory bodies will serve productivity, variety of products, quality of services, innovation and competitiveness. A decline in prices, the

acceleration of technological development, the limitation of excessive profits, the regulation of price formation and market entry, and the control of prohibited behaviour in the sectors are also envisaged.

4.1.4. Improvement of Investment Environment

Despite the fact that it has significant potential, Turkey could not avail itself of FDI. In recent years, the FDI to GDP ratio has been below 0.5 per cent. This is partly due to cumbersome bureaucracy, political and economic uncertainties, and slowly progressing structural reforms.

Alongside the policies being implemented to restore macroeconomic stability, the Reform Programme for the Improvement of the Investment Environment, which foresees improvement in the investment environment in Turkey for both domestic and foreign investments, was adopted by the Council of Ministers and put into effect in 2001. The programme envisages the acceleration of investment procedures through the elimination of administrative obstacles and the reduction of bureaucracy.

Technical committees set up within the framework of the reform programme carry on their work in the fields of employment, sectoral authorisations, the establishment of companies, investment location, taxes and subsidies, customs and standards, intellectual property rights, legislation on FDI and investment promotion.

The number of documents required for benefiting from investment incentives has been reduced. A draft law regarding foreign direct investment which envisages, *inter alia*, to ease the employment of foreign workers by foreign companies has been submitted to the Parliament.

To make Turkey an attractive zone for foreign investment, a meeting of Investor Council is planned to be held in Turkey in the next period with the participation of top-level managers of the leading multinational firms.

4.2. Financial Sector

4.2.1. Banking Sector

As a result of the steps taken towards financial liberalisation, drastic changes in the structure of the Turkish banking sector were experienced during the 1980s and the 1990s. In this period, the number of banks and the total assets of the sector increased rapidly. However, the insufficiency of the own funds, the small scale and segmented structure of the system, low asset quality, the lack of internal auditing and risk management, and the low level of governance due to inadequate efficiency and transparency were negative characteristics of the Turkish banking sector. Due to those negative elements, the Turkish banking sector has remained fragile and sensitive to both internal and external shocks for the last 20 years. As a matter of fact, the banking sector incurred high costs due to the realisation of both interest rate and foreign exchange risks following the crises in November 2000 and February 2001. The total assets of the banking sector were 133.5 billion dollars and 155.2 billion dollars in 1999 and 2000, respectively; and reduced to 110.8 billion dollars by the third quarter of 2001. The total assets of the commercial banks in the same years were 127.2 billion dollars, 148.3 billion dollars, and 106.4 billion dollars, respectively. Related to the negative impact of the crises, the number of commercial banks, totalling 62 at the end

of 1999 and 61 by the end of 2000, decreased to 46 by the end of 2001 and to 43 by 28 June 2002. During the same periods, the share of public banks in the total assets of the banking sector reduced considerably. In 1999 and 2000, the weight of public bank assets in the total banking sector was approximately 34 per cent, but this ratio was 27.2 per cent as of the third quarter of 2001.

In order to eliminate the instability, which deepened in the aftermath of the November and February crises, and to strengthen the banking sector, the Banking Sector Restructuring Programme was introduced by the Banking Regulation and Supervision Agency (BRSA) in May 2001. The programme consisted of four core components:

- restructuring the state banks both financially and operationally with the ultimate aim of privatisation,
- resolution or sale after the restructuring of the SDIF banks,
- strengthening the financial structure of the private banks which had experienced distress in the latest crises, and
- completing the legal and institutional framework aimed at enhancing the efficiency of supervision and auditing and competition in the sector.

The State Banks

The increased funding requirement of the state banks forced those banks to demand large-scale overnight borrowing. This situation made them vulnerable to liquidity and interest rate shocks as well as causing distortions in the markets. In addition, operational efficiency had to be ensured in those banks and the guidelines of the public duties imposed on them had to be defined. To address these problems, some steps were taken in 2001:

- In preparation for their eventual privatisation, the state banks were put under the management of the Joint Board of Directors composed of professional managers, and were decreed to be privatised in a three-year period.
- Any government support provided through state banks in the future would have to have appropriations in the budget. To this end, approximately 100 Council of Ministers' Decrees, which allowed subsidised lending through state banks, were repealed.
- To meet their liquidity requirements, the short-term liabilities of the state banks were decreased, overnight borrowing from institutions other than the Central Bank was reduced to zero and they were recapitalised with provisions of government securities.
- A liquidation process was started for Emlakbank and its assets and liabilities were acquired by Ziraat Bank.
- Internal control, financial control, and risk management units were set up within both Ziraat Bank and Halk Bank.
- A detailed strategic and organisational implementation plan for the operational restructuring of Ziraat Bank and Halk Bank was launched. As a result of this plan, the number of branches of these two banks, which was 2,494 in December 2000, was reduced to 1,792 in May 2002 and the number of personnel decreased from 61,601 to 38,303 in the same period.

Box: 4.1-Resources Transferred for the Restructuring of Public Banks

By the end of 2000, the claims of the public banks from the Treasury for their duty losses starting in 1992 were 17.3 quadrillion TL. Of this amount, 2.1 quadrillion TL was securitised while remaining 15.2 quadrillion TL was unsecuritised. All the unsecuritised unpaid duty losses and accrued interest payments were securitised through issuance of special government bonds amounting to 23 quadrillion TL in 2001.

In addition to this operation, additional facility to support the capital base was provided to the public banks in 2001. In this context, 217.6 trillion TL to Ziraat Bank in March, 67.2 trillion TL to Halk Bank, and 40.8 trillion TL to Emlakbank in April were paid in-cash as capital support. Also in May, government securities worth of 624 trillion TL to Emlakbank and 900 trillion TL to Halk Bank were provided as contribution to their capital bases. The additional cost of 1.7 quadrillion TL incurred by Ziraat Bank due to the take over of Emlakbank was compensated through extension of an equivalent amount of non-cash government securities.

The total amount of resources transferred to the public banks through duty loss securitisation and capital support has reached 28.6 quadrillion TL¹.

Table: Composition of Transferred Funds to Public Banks

	(Trillion TL)		
	Outstanding Stock December 2000 (1)	Net Increase in 2001 (2)	Total (1+2)
As a result of Duty Losses	17,279	7,759	25,038
- Securitised	2,083	22,955	25,038
- Ziraat Bank	1,220	12,113	13,333
- Halk Bank	863	10,797	11,660
- Emlakbank	0	45	45
- Unsecuritised	15,196	-15,196	0
- Capital Support (With non-cash Government Bonds)	-	3,224	3,224
- Ziraat Bank	-	1,700	1,700
- Halk Bank	-	900	900
- Emlakbank	-	624	624
- Capital Support (With cash injection)	-	326	326
- Ziraat Bank	-	218	218
- Halk Bank	-	67	67
- Emlakbank	-	41	41
Total	17,279	11,309	28,588

Source: Treasury, BRSA

¹Although unsecuritised duty losses amounting to 15.2 quadrillion TL as of end of 2000 was not included in the debt stock data disseminated by the Treasury, it was included in the debt stock calculations in the publications of the International Monetary Fund. Hence, the additional burden incurred due of public banks' restructuring in 2001 was realized to be 11.3 quadrillion TL.

Banks Under the Savings Deposits Insurance Fund (SDIF)

The restructuring strategy of the SDIF banks comprises four elements: the resolution of the SDIF banks through merger, transfer, sale or liquidation; financial restructuring; operational restructuring; and management of the distressed assets of the SDIF banks.

Major steps towards financial restructuring of the SDIF banks were taken. In this respect, non-cash government securities were extended to the SDIF in order to recapitalise the banks operating under it, all the short term liabilities of those banks were paid up, and their open position amounting to around 4 billion dollars in May 2001 was reduced to around 400 million dollars by the end of 2001. The level of on-

balance sheet open position increased since another bank was taken over into the portfolio. However, the level of the net open position was realised as 209 million dollars owing to the positive forward asset position of 746 million dollars. Moreover, the interest rates on deposits offered by the SDIF banks had been converged to the sector's average.

Operational restructuring was also approached vigorously; the number of SDIF banks' branches, which amounted to 1,815 on the transfer dates was reduced to 873 by June 2002. In addition, the number of personnel was 18,134 by the end of June 2002, having been reduced by 19,755 employees with respect to the transfer dates of those banks.

Table:4. 6-List of the Banks Transferred to the SDIF

Banks Taken Over	Merged Banks	Sold Banks	License Withdrawals	Banks That Remain Under SDIF (as of the end of June 2002)
Türk Ticaret Bankası	<u>Etibank</u>	Bank Ekspres	Etibank	Türk Ticaret Bankası
Bank Ekspres	Interbank	Sümerbank	İktisat Bankası	Toprak Bank
Interbank	Esbank	Demirbank	Kentbank	Milli Aydın Bankası
Egebank		Sitebank		Bayındırbank
Yurtbank	<u>Sümerbank</u>			Pamukbank
Sümerbank	Egebank			
Esbank	Yurtbank			
Yaşarbank	Yaşarbank			
Etibank	Bank Kapital			
Bank Kapital	Ulusal Bank			
Demirbank				
Ulusal Bank	<u>Bayındırbank</u>			
İktisat Bankası	EGS Bank			
Sitebank				
Milli Aydın Bankası				
Bayındırbank				
Kentbank				
EGS Bank				
Toprak Bank				
Pamukbank				

Note: Twenty banks have been transferred to the SDIF during last five years. Four of them have been sold to domestic and foreign investors and eight of them have been merged into three bridge banks. As of July 2002, there are five banks under the control of SDIF, consisting of 1 bridge bank, 3 banks in the process of being sold and 1 bank in legal proceedings.

A new Law No. 4672 amending the Banking Law No. 4389 was adopted in 2001. By this Law, the regulations related to the banking sector became fully consistent with the EU standards. This new Law also improved the collection initiatives of the BRSA to deal with distressed assets of the SDIF-owned banks. Consequently, the total amount of collected and collectables reached 270.3 trillion liras, including sales permits by the end of June 2002.

The main targets as regards the SDIF banks in 2002 might be summarised as: finalisation of the ongoing sales process; the conversion of one of the banks to a bridge bank to fulfil the asset management operations; SDIF's preparation of monthly balance sheets beginning in March 2002 and being audited annually; acceleration of the collection process.

Box: 4.2-Resources Transferred for the Restructuring of SDIF Banks

In the context of the lending agreements that were signed between the Treasury and the BRSA, special government bonds have been issued periodically to improve the SDIF banks' capital base and balance sheets since December 2000. These special government bonds have been transferred to the SDIF banks as contingency reserves.

As the foreign currency denominated and foreign exchange indexed securities are valued by the foreign exchange rate on 31 December 2001, the total debt of the SDIF to the Treasury in regards with the mentioned lending agreements amounts to 21.6 quadrillion TL.

Table: Resources Transferred to SDIF by the Treasury

	Trillion TL	US Dollar and US Dollar Indexed (Million Dollar)	Euro and Euro Indexed (Million Euro)	Total (Trillion TL)
(By the end of 2001)				
Special Government Securities Issued by the Treasury	8,492	8,297	897	21,581

Source: Treasury

According to the lending agreement between the SDIF and the Treasury, the SDIF repaid a total of 1 quadrillion TL of which 378 trillion TL on 3 April 2002, 357 trillion TL on 8 May 2002, and 265 trillion TL on 15 May 2002.

A total amount of resources 2.6 quadrillion TL was transferred to the SDIF banks from the SDIF's own resources. Of that amount, 1 quadrillion TL was paid in cash as capital and 1.6 quadrillion TL was extended as deposits.

Table: Transfers from SDIF's Own Resources

	Trillion TL	Million USD	Total (Trillion TL)
(As of April 18, 2002)			
1. Cash as Capital	1,012	-	1,012
2. Deposits (1)	1,368	193	1,619
TOTAL	2,380	193	2,631

Source: BRSA

(1) 750 trillion TL cash in advance used from the Central Bank against the collateral of special government bonds was deposited with the SDIF banks. Adding this amount, which is placed under the classification of Treasury bond extension, the deposit support totals 2,369 trillion TL.

Private Banks

At the first stage of the programme concerning private banks, steps were taken to strengthen capital base, resolve the non-performing loans, reduce open positions, and encourage mergers and acquisitions. In this regard, the on-balance sheet open position, which amounted to 8.4 billion dollars by the end of 2000, was reduced to 1.5 billion dollars by the end of 2001 and dropped to 274 million dollars on 21 June 2002.

The main aim related to the banking sector for 2002 is to extend capital support under certain conditions to the banks, while resolving the non-performing loans problem through mechanisms of voluntary debt restructuring (the Istanbul Approach) and asset management. To this end, provisions related to the restructuring of the financial institutions' claims, the establishment of the asset management company, the auditing procedure for the determination of the capital needs of the commercial banks, tax exemptions and incentives, the completion of the operational restructuring of the public banks, and arrangements for the accountability of the BRSA were put into effect by the Law for Restructuring the Debt to the Financial Sector and Amendments to Certain Laws No. 4743, issued in January 2002. According to this Law, the claims

of the banks, special financial institutions, and the other financial institutions may be restructured or rescheduled in accordance with the financial restructuring agreement. Also, the SDIF banks have been authorised to participate in the restructuring procedure with the condition of not providing additional financial contribution.

According to provisional Article 4 of the Banking Law, the process of strengthening the capital structure of commercial banks with public assistance consists of three main steps. The first step is the three-phase auditing process to determine the financial status of all commercial banks according to improved accounting standards so that the amount of public contribution to the recapitalisation process can be correctly determined. After the determination of the capital needs of the commercial banks, in case those losses cannot be met by contingency reserves, the second step is undertaking the needed capital increase by the shareholders through convening the banks' shareholders meeting. Recapitalisation of the banks is the last step, which may occur if the bank's Capital Adequacy Ratio (CAR) is positive but below 8 per cent, to be achieved through the participation in capital injection or provision of subordinated loan from public sources.

As of June 2002, the audit and assessment phase was completed successfully. According to the assessment of the audit results, the banking sector's average CAR, which was corrected by the inflation accounting technique including market risk was 14.8 per cent. As an integral part of this effort, in order to enhance profitability and to guarantee the sustainability of the capital structure, the operational restructuring process of the sector will be monitored in line with the programme. In addition, mergers will be encouraged and intermediation costs will be reduced. Although the CAR of the sector turned out to be 14.8 per cent, the audit results convey that the amount of capital required, excluding the last bank taken over by the SDIF, is 224 trillion Turkish liras.

Within the framework of regulations introduced for restructuring the debt to the financial sector, the Framework Agreement on Financial Restructuring which was prepared by the Banks Association of Turkey and signed by 25 banks, 17 non-bank financial institutions, Emlakbank, and the SDIF, was approved by the BRSA on 4 June 2002. As of the end of June, the Letter of Application and Confirmation, which is to be signed by the debtors, was distributed to the lenders who signed the Framework Agreement.

In addition to the financial restructuring process started in June 2002, the preparation for establishing an Asset Management Company (AMC) is underway. It is expected that preparatory work as regards the AMC will be finalised by the end of 2002.

In December 2000, the Financial Sector Adjustment Loan (FSAL) Agreement, amounting to 777.8 million dollars was signed with the World Bank to constitute and to improve the legal, administrative and auditing infrastructure in accordance with international standards. In this Agreement, the key priorities were defined as:

- making necessary amendments in the banking legislation,
- supporting the formation of the BRSA,
- amending the legislative framework to harmonise the regulations with the Basel criteria, EU acquis, and International Accounting Standards,

- enhancing the prudential capacity of the weaker banks,
- developing resolution strategies for banks without SDIF takeover,
- determining solutions regarding insolvent banks,
- giving support to the financial sector reform strategy as regards the rationalization and privatisation of the public banks ultimately.

The first tranche of 393 million dollars attached to this credit agreement was utilised, while the second tranche of 385 million dollars was transferred into the Programmatic Financial and Public Sector Adjustment Loan I (PFPSAL I).

In July 2001, PFPSAL I amounting to 1.1 billion dollars signed with the World Bank to support the medium-term reform programme for financial and public sectors. This loan agreement was designed as the first loan in supporting the financial and public sector reforms during the 2001-2003 period. In the context of this loan agreement, the targets might be summarised as: enhancing the administrative, legal, and auditing capacity of the financial sector, primarily the banking sector; resolving the SDIF banks' situation; restructuring the public banks financially and administratively; ensuring fiscal discipline and a more transparent and efficient public administration.

The first stage of the restructuring programme, aiming to ensure a more efficient banking sector with an improved intermediary role and thus help the whole financial sector work more efficiently and productively, has been completed to a great extent. To this end:

- The Banking Law has been amended.
- Arrangements to guarantee the efficiency of the BRSA and SDIF, and to help improve their institutional capacity have been completed.
- The first stage of recapitalisation of the banks whose capital base deteriorated due to the crises has been completed.
- Major steps have been taken toward the restructuring and privatisation of the public banks.

Following PFPSAL I, as an extension of that loan, the PFPSAL II Loan Agreement of 1,350 million dollars was signed with the World Bank in April 2002. The total amount of this loan will be utilised in three tranches during 2002.

Strengthening the Supervision and Auditing Base and Increasing Efficiency in the Banking Sector

In line with financial and operational restructuring, legislative and institutional arrangements to strengthen the supervision and audit base and to lead the system towards a more competitive structure have been undertaken. In this respect, some of the steps might be summarised as:

- With an amendment made in the Banking Law in June 2001, the definition of consolidated own funds was introduced.
- The Regulation on Measurement and Assessment of Banks' Capital Adequacy, which defines the principles and procedures for calculating

banks' CAR by also including the risks of interest rate, foreign exchange, and equity, both on consolidated and solo bases, was put into effect in January 2002.

- In the Regulation on Banks' Internal Audit and Risk Monitoring System, which was put into effect in February 2001, the principles for an efficient risk monitoring system were set up.
- As of July 2001, banks are reporting their activities to the BRSA, according to the mentioned regulation, on a quarterly basis.
- The regulation on principles and procedures for the calculation and monitoring of the Foreign Exchange Net Position/Own Funds standard ratio for banks was published in January 2001.
- With an amendment to the Banking Law in June 2001, to prevent credit concentration risk, a risk group was defined regarding direct and indirect lending.
- With other amendments made on the same date, the following changes were made: banks' participation in partnerships other than financial institutions is limited to a ratio of 15 per cent of their own funds, while the total amount of such partnerships is limited to 60 per cent of their own funds, to be effective after a transition period ending in 2009.
- Beginning in 2002, forward transactions, option contracts and other derivatives are included in the definition of exposure.
- The 4-year transition period for loss provisioning was abolished by an amendment to the Banking Law in January 2002.
- The Uniform Accounting Plan and Standards to be applied by banks was amended to enforce the inclusion of repo transactions in the balance sheet as of February 2002.
- By the Regulation on Banks' Accounting Standards, which was put into effect at the beginning of July 2002, convergence of the banks' financial table format to the EC directives was ensured.

4.2.2. Capital Market

The development of the Turkish capital market has been adversely affected by the high public borrowing requirement. This situation, as reflected by the 92 per cent share of public sector securities in the total trading volume of securities at the end of 2001, creates a real obstacle to savings that would normally go to the private sector through the capital market. Institutional investors who invest more than 90 per cent of their portfolio in government securities fall short of fulfilling the function of creating demand for private sector securities.

Beginning in the last months of 1999, expectations turning to positive, raised the trading volume of the ISE. During the same period, the increase in foreign investors' demand helped this trend. However, the trading volume of the stock exchange market decreased during 2001, due to the crises.

In order to protect the investors and to ensure the formation of an efficient market, a series of regulatory steps have been taken, taking the EC directives into consideration. Some of those might be listed as:

- By an amendment to the Capital Market Law, capital market instruments and rights attached to those instruments are to be registered and monitored by the Central Registry Organisation, which started operation in September 2001.
- Although the Regulation on Investors Guarantee Fund, which was issued in June 2001 is not fully compatible with the EC Directive on Investors Guarantee Fund No. 97/9/EC, it can still be termed as an important step toward converging the EU legislation. The Fund operates to fulfil the gradual liquidation process to pay off the liabilities of the brokerage firm which ceased operation, giving priority to customers before other parties. This regulation on the gradual liquidation process was put into effect in June 2001. As regards investors' protection, the principles for the operation of the Special Fund became effective in July 2001. The Special Fund that is complementary to the Investor Guarantee Fund aims to reimburse claims of investors arising from capital market activities of intermediary institutions, regarding the claims arising from the investments on the stock market before December 1999 amendments to the Capital Market Law.
- The Statute of the Association of Turkish Capital Market Intermediary Institutions, whose basic responsibilities comprise defining ethical rules, taking necessary measures to prevent imperfect competition, and contributing to intermediation, became effective in February 2001.
- The Regulation on the Establishment and Operation of Futures and Options Markets was issued in February 2001, and a Council of Ministers' Decree authorised the establishment of Futures and Options Markets Inc. in October 2001. In this context, the market is to start operating within one year following the licensing date.
- Regulations concerning the ISE futures markets entered into force in July 2001. In addition to the transactions on currency forwards, currently in operation, transaction on interest rate futures are planned to start in 2002.
- While the Law on Private Pension Funds was adopted in March 2001, regulations for Pension Fund Companies, Pension Funds, Pension Fund Intermediaries, and Pension Fund System entered into force in February 2002.
- In order to determine the area of expertise in the field of capital markets and to certify the employees working for brokerage firms, a regulation was put into effect in August 2001. The aim is to conduct tests to this end in 2002 and 2003, while efforts will be directed at providing international validity of tests in 2004. Finally, in 2005, it is planned to conduct these tests at the international standards and to licence all the personnel working in the sector.
- In the Capital Market Law, the option of interim dividend payment was introduced. The related Regulation was published in November 2001.

In addition to the aforesaid measures aiming to ensure reliable, transparent and stable operation of the capital markets and to inform the public, the measures being carried out and envisaged to be taken are as follows:

- Implementation of the Communiqués on consolidated financial tables and drawing up of financial tables in an inflationary environment, which were issued in November 2001, will be compulsory as from January 2003.
- Necessary steps will be taken to ensure the compliance of procedures for initial public offerings with the EU standards until the end of 2002.
- It is aimed to monitor closely the transactions at the stock markets and to set up mechanisms to facilitate the surveillance process, through establishing an information system infrastructure within the Capital Market Board. It is expected that analysis, design, and coding phase of the system will be completed in 2002 and coding, test, and establishment phases in 2003.
- Legal arrangements regarding the determination of accumulated voting right principles have not been made yet. These principles, which will facilitate the use of minority rights, will be determined in the near future.
- Alignment with the International Accounting Standards, which will be put into practice, as envisaged by the EU until the end of 2005 has not been achieved yet. Necessary steps will be taken towards ensuring harmonisation of the Capital Market Board's accounting standards with international standards by the end of 2002.
- Communiqué on External Auditing in Capital Markets is to be revised in 2003 by considering the international external auditing standards and related EU measures.
- It is aimed that legal arrangements concerning the markets in which Small and Medium-sized Enterprises (SME) securities are traded, will be made in the near future.

4.3. Labour Market

Increasing employment by means of sustainable economic growth and productive investments is the main objective.

It is important to change employment structure in favour of non-agricultural sectors, to increase the qualified labour force needed by the economy, to raise the quality of the labour force in line with the requirements of the information age, and to increase efficiency of the labour market and labour productivity.

SMEs represent 99.5 per cent of firms, create 35 per cent of the total value added, and provide 65 per cent of the employment in the manufacturing sector. In this respect, the job-creating potential of the SMEs is important for increasing employment. For this reason, it is important to increase the support given to SMEs and individual undertakings in the fields of training, projects, financing, organisation, marketing, and technology.

In 2001, while the labour force increased by 1.1 per cent compared with the previous year and reached 22.3 million, the employment decreased by 1.1 per cent

and the number of employed was 20.4 million. Unemployment rate rose from 6.6 per cent in 2000, to 8.5 per cent in 2001 and the underemployment rate decreased from 7 per cent to 6 per cent, respectively, amounting to a rate of idle labour force of 14.5 per cent in 2001. In the same period, the rate of the idle labour force in urban areas increased from 16.3 per cent to 18 per cent, whereas in rural areas it was 10.2 per cent. Economic recession has influenced employment particularly in non-agricultural sectors and led to an increase in urban unemployment.

The rate of participation in the labour force was 48.7 per cent in 2001. This rate was 71.7 per cent for men and 25.9 per cent for women.

The share of agricultural employment in total employment was 32.6 per cent in 2001. The significant percentage of the labour force employed in the agricultural sector, which has low productivity, contributed adversely to the efficiency in the labour market. The share in total employment of industry was 18.9 per cent and that of services was 48.5 per cent.

Organised industrial zones and small-scale industrial sites are important elements for increasing employment. 65 organised industrial zones with 354,000 employees had been established by 2001. An additional 489,000 people are employed in 81,453 working places at 349 small-scale industrial sites.

The first General Assembly meeting of the Turkish Employment Agency (İŞKUR), which replaced the former Turkish Labour Placement Agency by Decree Law No. 617, took place in Ankara on 23-24 May 2001. The Assembly adopted guidelines for increasing employment, coping with the unemployment problem and devising a national employment policy. Successful results could be achieved in increasing employment by turning those resolutions into an action plan, provided that the public and the social parties involved cooperate.

The unemployment insurance system, which is an important element of the labour market, was introduced in September 1999 by Law No. 4447. Premium collections for the Unemployment Insurance Fund started in June 2000, and as of June 2002, 3.5 quadrillion Turkish liras have accumulated in the fund. Payments to the unemployed from the Fund started in March 2002 and 15.6 trillion Turkish liras was paid to 32,902 unemployed between 31 March and 31 July 2002.

A Privatisation Social Support Project is being coordinated by the Privatisation Administration in order to provide severance payments and notification compensation for the workers in the privatised companies and to offer training to these workers in order to increase their chances of finding new jobs. The total amount allocated for this project is 355.3 million dollars, of which 250 million dollars was provided by the World Bank and 105.3 million dollars by the budget. 25.9 million dollars of this amount is to be allocated for training the 32,000 workers who lost their jobs due to privatisation and economic crisis, and for technical support to those who contemplate setting up their own businesses. The project is expected to be completed by 2004.

Law No. 4702, which envisages improving vocational training, enhancing the quality of employees, increasing product quality and productivity, and providing opportunities to those wishing to set up their own businesses, was adopted in 2001.

Law No. 4747, which oversees active labour market policies, was adopted in April 2002. Programmes for re-training the labour force and providing vocational and employment counselling services continue to be implemented.

Within the framework of EU-Turkey financial cooperation, the Active Labour Force Strategy Project has been prepared in order to enhance the administrative capacity of İŞKUR and to support approximately 350 projects in the context of active employment measures.

The draft Law regarding the setting up of a National Professional Standards Institution has been drawn up with a view to establishing, spreading, developing and sustaining a professional standards, examination and certification system with the cooperation of national social partners.

Following the annulment of the Law on the establishment of İŞKUR by the Constitutional Court, a new draft law was submitted to the Parliament.

Measures aiming to increase employment opportunities particularly for young people, women and the disabled are to be taken. In addition, the implementation of policies aiming to prevent unskilled workers from being unemployed and to improve their skills will continue.

Projects aiming to raise the employment level in less developed regions by using the local potential are to be developed.

The general level of employment will be increased through the adoption of legislation on flexible work organisation that is compatible both with the international standards and national requirements.

Table:4. 7-Matrix of Policy Commitments: Labour Market

(Million Euro)

	2002	2003	2004	2005
Privatisation Social Support Project				
A. Implementation Profile	X	X	X	
B. Net Direct Budgetary Effect		121		
B.1. Direct Impact on Budgetary Revenue				
B.2. Direct Impact on Budgetary Expenditure		121		

Labour Issues

Turkey is close to the EU average as regards labour legislation, the implementation of the legislation and the level of institutionalisation. Nevertheless, there are certain differences regarding norms and standards. In order to eliminate these differences, it is necessary to improve existing social dialogue mechanisms; extend the scope of the Labour Law to the workers not currently covered; draw up legislation for the legal protection of workers, including those in non-standard employment, without distorting the flexibility of the labour market; establish guarantee funds and a system for the representation of workers at their workplace; and speed up efforts to eliminate child labour and gender-based discriminatory practices.

The Law setting up the ECOSOC and an implementation regulation were put into effect in 2001. By this Law, the ECOSOC, which has been working *de facto* as an advisory body since 1995, became a permanent platform of social consensus and

cooperation. This Law envisages that the representatives of the government, employees, employers, artisans, and farmers will be permanent members of the Council. In addition to the permanent members, the Prime Minister may invite other ministers, the representatives of non-governmental organisations, and public servants to participate in the meetings of the Council. All the expenditures of the ECOSOC are financed from the budget. One of the main tasks of the Council is to nominate members for the Turkish delegation of the EU-Turkey Joint Advisory Committee. The Council meets every three months and an extraordinary meeting may be held upon the request of one-third of the members. The permanent working committees established by the Law were listed in the implementation regulation in August 2001.

The Labour Market Information and Advisory Committee was formed by İŞKUR with the participation of the social stakeholders in 2001. The draft regulation on the working principles has been prepared.

The Directorate-General for Occupational Health and Safety at Work of the Ministry of Labour and Social Security set up an Advisory Committee in 2001 as an interim mechanism prior to the establishment of an Assembly for Health and Safety at Work.

The Civil Servants' Trade Union Law No. 4688 and a part of its implementation legislation were put into effect in 2001. The first collective bargaining in accordance with the law will start in August 2002.

A draft law regarding job security is on the agenda of the Parliament. The draft law also envisages that the workers in the agricultural sector will be brought within the scope of Labour Law No. 1475. In addition, in cases of gender-base discriminatory practices, the draft law contains provisions leaving the burden of proof to the employer.

A draft law regarding the Work Permits of Aliens was submitted to the Parliament at the beginning of 2002.

A draft law regarding parental leave and changes in maternity leave is being prepared.

As regards eliminating child labour, four sub-projects under the ILO International Program on the Elimination of Child Labour (ILO/IPEC) Project were launched in 2000. A request has been made to the ILO to extend the duration of these sub-projects. As to legislative arrangements by the Ministry of Labour and Social Security, the following are being prepared:

- a draft law on the minimum working age and working conditions for persons under 18 years-old, and
- a list containing the work suitable for children between the ages of 15 and 18 to be annexed to the Regulation on Difficult and Dangerous Jobs.

A draft law aiming to update the provisions of Law No. 1475 concerning occupational health and safety at work and to approximate Turkish legislation with that of the EC has been prepared by the Experts Committee. Legislative work continues concerning the Regulation on Occupational Health and Safety prepared jointly with the Ministry of Health in accordance with the relevant Framework Regulation of the EC. In addition, the Regulation on Personal Protection Equipment

has been drafted and will be adopted soon. The Regulation on the Minimum Health and Safety Requirement for Improved Treatment on Board Vessels was adopted in June 2002 and the Seafarers Regulation was adopted in July 2002. The draft regulations prepared in line with the EU directives were reviewed in the third meeting of the Regional Development, Employment and Social Policy Sub-committee of the EC-Turkey Association Committee in June 2002.

Within the framework of EU-Turkey financial cooperation, preparatory work for the project on enhancing the administrative capacity in the field of occupational health and safety is about to be completed.

Despite the relatively rigid industrial relations legislation, social partners succeeded in bringing about considerable flexibility in its implementation during the economic crises experienced in 2000-2001. Preparatory work for amending Labour Law No. 1475, Trade Unions Law No. 2821, and Collective Agreements, Strikes and Lockouts Law No. 2822 in accordance with international norms, in particular those of EU and ILO, is being carried out by a tripartite experts committee established by the Ministry of Labour and Social Security. The committee is also responsible for drafting legislation on non-standard forms of work.

4.4. Administrative Reforms

Substantial progress has been made in the fight against corruption and in improving efficiency and transparency in public economic and financial management. Such progress is crucial for the alignment with the EU acquis and for building the administrative capacity required for the implementation of the acquis. To accomplish this, the public procurement system was modified, independent supervisory authorities were established in various sectors (see 4.1.3), and improvements have been made in the functioning and structure of the institutions implementing fiscal and monetary policy. In addition, the Central Bank Law has been amended with a view to harmonisation with the relevant EU acquis (see 2.3). As a result, significant progress has been made in strengthening the market economy and in ensuring sustainable medium and long-term monetary and financial policies as set out by the current economic programme.

Below are the major structural reforms in the area of economic and financial management which are not covered by the other chapters of this programme.

Public Procurement Law

Public Procurement Law No. 4734, aiming to prevent discrimination among bidders while eliminating fraud and increasing efficiency through rules to ensure competitiveness and transparency, was adopted in 2002. All public institutions are subject to the procurement procedures laid down in this law, which is in harmony with the EU, WTO and UN (UNCITRAL) norms. Law No. 4734 will be put into effect fully in January 2003. However, provisions of the law regarding the adoption of secondary legislation and the establishment of the Public Procurement Authority took effect in January 2002. Matters regarding public procurement contracts are governed by Public Procurement Contracts Law No. 4735, which was adopted in January 2002.

The Public Procurement Authority, established in March 2002, is responsible for examining and resolving the appeals concerning procedural infringements, drawing up secondary legislation and monitoring its implementation, providing

information on public procurement legislation, preparing and issuing statistical data, and keeping records of bidders banned from participating in tenders.

Law No. 4761, which was adopted in June 2002, contains provisions regarding threshold levels and time-limits for the notification process in international bids, and revisions in the institutional structure of the Public Procurement Authority with a view to efficient implementation of the Public Procurement Law.

Draft Law on Public Financial Management and Fiscal Control

The fiscal management and control system is being restructured in order to create an environment for the efficient use of public resources. Increasing efficiency of the budgetary system and reaching international standards in fiscal management and auditing have been set as main objectives.

A draft law on Public Financial Management and Fiscal Control, aiming at a more transparent and efficient system and the economic use of public resources, is being prepared in consultation with the EU Commission. The draft law is expected to be adopted by 2003. The implementation of this law will be assessed jointly with the Commission in the context of the developments in 2003 and necessary changes will be made in the administrative structures and relevant legislation in order to prevent the difficulties that are likely to arise. By 2004, the progress achieved will be evaluated jointly with the Commission on the basis of the criteria defined under Chapters 28 and 29 of the *acquis*.

The draft law aims to ensure unity and standardisation in the fiscal management and control system. It introduces a definition of general government which affects the budget preparation process and which is compatible with international standards. Accordingly, the scope of definition of the central government will be expanded so as to cover general, annexed and autonomous budgets as well as the budgets of revolving and extra-budgetary funds. Thus, fragmentation in the management of public resources will be eliminated.

The draft law also aims to redefine the roles and responsibilities of the institutions in implementing the budget and to increase efficiency in internal fiscal control in line with the EU norms. In this regard, *ex ante* fiscal control power will be delegated to the line agencies in order to speed up the procedures without prejudice to the public expenditures process. The financial management and internal fiscal control powers of the line agencies will be increased as the budgetary units in their central offices are strengthened. Priority will be given to performance management and accountability.

External auditing will be strengthened. On behalf of the Turkish Grand National Assembly, the jurisdiction of the Turkish Court of Accounts, which is an independent constitutional institution, will be expanded so as to cover all institutions using public resources. In addition to conformity auditing, the Turkish Court of Accounts will carry out performance auditing; however, its *ex ante* control power will be abolished.

Rationalising the Annual Investment Programme

As foreseen in the 8th Five-Year Development Plan and in the Annual Programme of 2001, a rationalisation process for the annual investment programme was initiated. It aims at providing sufficient funding for the investment projects for their timely completion and preventing cost escalations due to prolonged periods of

realisation, thus ensuring efficient use of existing resources. With this rationalisation process, the average period of completion of projects is expected to be shorter.

In the rationalisation process, 1,002 projects comprising 353 major and 649 sub-projects were removed from the 2001 Annual Investment Programme, which covered 5,047 projects in total. The number of projects in the 2002 Annual Investment Programme is 4,414. Through this process, the average time for the completion of projects was decreased from 12.5 years to 8.5 years, indicating a 32.1 per cent decline. Rationalisation efforts are planned to continue in 2003.

Strategic Planning in Public Sector Institutions

The SPO prepared a draft Guidelines for Strategic Planning at the end of December 2001 with a view to more efficient use of public resources. The draft will be finalised following its implementation in pilot institutions. Consequently, starting with consolidated budget agencies, the Guidelines will be implemented in all public institutions.

In the foregoing reforms, strategic planning has a crucial role in increasing the participation of line agencies in the process of allocation and use of resources as well as in strengthening the link between policy-making, and planning and budgeting.

The strategic plans of institutions will be prepared within the framework of five-year development plans and macro level national strategies. Along with annual programmes, sectoral master plans, regional and provincial development plans, these plans will increase the efficiency of the planning and budgeting as well as the implementation process and contribute to the rational use of resources.

Extending the Scope of Budget and Fiscal Transparency

In 2000 and 2001, with the aim of extending the scope of the budget and increasing fiscal transparency, 69 funds were abolished either by liquidation or by inclusion in the budget. In this regard, all budgetary funds were closed, except the Support Price Stability Fund, through which the World Bank's Agricultural Reform loans are channelled. In addition, extra-budgetary funds were closed, except for the Defence Support Fund, the Social Aid and Solidarity Fund, the Savings Deposit and Insurance Fund, the Privatisation Fund, and the Promotion and Publicity Fund.

In October 2001, along with the Budget, a Public Finance Report containing the government's financial policies and commitments and comprehensive information on public accounts was submitted to the Parliament.

The number of revolving funds was decreased from about 3,000 to 1,473.

The Public Finance and Debt Management Law, aiming to define borrowing rules and limits for the public sector and to incorporate the on-lending and debt-guarantee operations of the Treasury into the budget, was adopted in 2002. The Law will be fully operational in 2003. By this Law, public debt management and the public finance system have been restructured in accordance with international standards (see 3.2).

The draft Law on Public Financial Management and Fiscal Control, which is expected to be adopted in 2002, envisages that all general government institutions will start to apply the new accounting and reporting system (ESA 95-GFS 2001). The new system introduces an accrual base accounting system and foresees the preparation of

fiscal tables in line with ESA 95 and GFS standards. In this regard, three pilot institutions started to apply the accrual base system in 2002.

Regulations on state accounting have been drawn up. The standards defined in these regulations will be applied in institutions subject to the consolidated budget in 2003 and in institutions within the scope of general government in 2004. Thus, it will be possible to provide fiscal information within the same accounting system for the general government.

The new budgetary classification code, which started in 1995 and was adjusted to the GFS budgetary code in 1998, has been adapted to ESA 95 and to the revised GFS. The new code consists of institutional, functional, and economic categories.

The new budgetary classification code enables the determination of responsible authorities for the programmes, introduces a functional classification system specifying the quality of the services produced, includes a detailed institutional codification applicable in all institutions within the scope of the general government definition, and enables international comparisons.

The new budgetary classification code has been applied in 6 pilot institutions since January 2002. There are plans to apply it on a pilot basis in all institutions subject to the consolidated budget in 2003, and in all institutions within the scope of the general government in 2004.

A Council of Ministers' Decree, which contains detailed explanations regarding action plans for enhancing transparency and good governance, was adopted in February 2002. The Decree defines subject-based concrete steps to enhance transparency in the public sector. To this end, a committee composed of ministers is established to ensure coordination and efficiency. It is also foreseen in the Decree that the Council of Ministers will define a reform strategy regarding public services by the end of 2002.

Strengthening the Statistical Infrastructure

A Programme for Updating the Statistical System of Turkey has been put into effect. Activities envisaged in the scope of this programme are:

- improving the technical capacity of the State Institute of Statistics (SIS) staff through training activities and expertise assistance from the EU,
- adopting the methods used in the EU countries for the SIS and developing harmonisation strategies,
- improving the quality of indicators,
- carrying out pilot questionnaire studies compatible with the EU acquis,
- improving the information technology infrastructure in the SIS.

It is envisaged that a 15.3 million euro MEDA-II fund will be transferred to the SIS for the implementation of this programme. The total cost of the programme will be around 19 million euro and Turkey's contribution will be around 3.6 million euro.

Table:4. 8-Matrix of Policy Commitments: Statistical Infrastructure

	(Million Euro)			
	2002	2003	2004	2005
Updating the Turkish Statistical System Programme				
A. Implementation Profile		X	X	X
B. Net Direct Budgetary Effect			3.6	
B.1.Direct Impact on Budgetary Revenue				
B.2.Direct Impact on Budgetary Expenditure			3.6	

4.5. Agricultural and Rural Development

The main objective of rural development in Turkey is to establish an organised, highly competitive and sustainable agricultural sector which takes into account the economic, social, environmental, and international development factors as a whole, with a view to ensuring the efficient use of resources. In accordance with the principle of food safety, balanced and adequate nutrition for the growing population is essential.

The guidelines of the Turkish agricultural policy are defined in accordance with the commitments put forth in the WTO Agreement on Agriculture as well as developments in the EC Common Agricultural Policy (CAP) and in international trade.

The economic programme, which puts into effect the structural reforms, also contains an Agricultural Reform Project. This Project foresees the abolishment of all agricultural price and input subsidies and introduces a Direct Income Support (DIS) system. Following the stabilisation of the economy, new agricultural programmes in line with the CAP are to be adopted and implemented.

With a view to fulfilling the obligations envisaged in the NPAA and ensuring alignment to the CAP, working groups have been established in the following areas: Adjustment to the Common Market Organisations, Phytosanitary Issues, Veterinary Medicine, Control, Fisheries, Land Registration Systems, Animal Identification Systems, and Main Systems to be Established and Rural Development.

Crop Production

Crop production in Turkey amounts to approximately 65 per cent of the total agricultural sector production. Nevertheless, crop production potential could not be reached and the resulting productivity is relatively low. Turkish legislation on plant variety registration and certification, marketing, and market surveillance of seeds will be harmonised with that of the EC. In this respect, developments in the EU acquis will be monitored periodically and the necessary approximation measures will be taken. A draft law on the Protection of the Rights of Breeders of New Plant Varieties has been drawn up by the Ministry of Agriculture and Rural Affairs (MARA) with a view to protecting product varieties.

The World Bank has provided a 600 million-dollar fund for the Agricultural Reform Implementation Project under the economic programme. This project was put into practice in 2001 and is to be implemented by the Undersecretariat of Treasury until 2005. Within the scope of this project are plans to restructure the Agricultural Sales Cooperatives and Unions, facilitate the transition to alternative crops, set up a

registration system for farmers, and provide agricultural funds to farmers through the DIS system instead of price and input subsidies.

In 2001, the DIS system provided 100 million Turkish liras per hectare to farmers who certified that they are engaged in agricultural production and whose cultivated land did not exceed 20 hectares. Payments were made between December 2001 and May 2002 and amounted to approximately 1.2 quadrillion Turkish liras. The amount of the payments and land limits will be revised in the future with the cooperation of the relevant institutions.

It is envisaged in this project that producers growing alternative crops instead of crops with a supply surplus, such as hazelnut and tobacco, are given a net income difference payment with a view to meeting their maintenance costs, harvest costs and input payments for the relevant year. To this end, payments amounting to 16.4 million dollars to ex-tobacco producers and 146.2 million dollars to ex-hazelnut producers have been planned.

Law No. 4572, aiming to reduce the role of the State in the marketing and processing of agricultural products by restructuring the Agricultural Sales Cooperatives and Unions as autonomous organisations, was put into effect in 2000. The high wage and irrational employment policies of the Unions will be abandoned. Moreover, since the price support system has been abolished, these organisations have started to purchase products at market prices according to the schemes prepared by the authorized bodies. The debts of these organisations stemming from the loans borrowed to finance their operational losses and not paid back will be cleared in accordance with instructions of the Restructuring Board. Furthermore, a financial structure that enables the Unions to meet their own resources will be established, ensuring that these Unions operate only in their main activity areas.

As regards the restructuring of the public agricultural enterprises, all enterprises, with the exception of the Turkish Grain Board (TMO), are to be privatised. For this purpose:

- Tobacco Law No. 4733, effective as of 2002, opens up the tobacco market to competition, ensures that tobacco prices are set in a free market, and following a restructuring process, enables the privatisation of the General Directorate of Tobacco, Tobacco Products, Salt and Alcohol Enterprises (TEKEL). In 2001, TEKEL was included in the privatisation programme. A privatisation strategy for TEKEL is to be determined in 2002 and the privatisation process is expected to be carried out in 2003.
- Sugar Law No. 4634, effective as of 2001, envisages that from 2002 on, sugar beet prices will be determined by a consensus between the sugar factory operators and the sugar beet producers and/or their representatives. According to this law, the production in the sugar sector is controlled by a quota system in which starch-based sweeteners will also be included. Implementation regulations based on this law have already been issued. In 2000, the Turkish Sugar Factories Joint-Stock Company (TŞFAŞ) was included in the privatisation programme. A privatisation strategy for TŞFAŞ is to be determined in 2002 and the privatisation process is expected to be carried out in 2003-2004.

- From 2002 on, no support prices will be set for the cereal market. The TMO will be restructured as a market regulating authority in line with the EU system. Strengthening the commodity markets for cereals, limiting TMO's purchases to emergency and supplementary purchases, transferring the existing storage facilities to the private sector and then leasing these facilities to producers or entrepreneurs, maintaining TMO as a central institution with a view to facilitating its emergency and intervention purchases in the medium term, and guaranteeing that the TMO's purchases are made only through the commodity markets are some of the planned changes.
- In the medium term, the draft law regarding Agricultural Product Insurance and the draft law on Producer Associations will be adopted.
- As an example of public and private sector joint entrepreneurship, certain agricultural enterprises affiliated to the Directorate-General for Agricultural Enterprises are to be restructured through the establishment of joint-stock companies with both sectors participating. This joint venture will increase agricultural production and productivity, and ensure technological innovation and efficient service.
- Preparatory work for restructuring and privatising the Directorate-General for Tea Enterprises (ÇAYKUR) is to be initiated.
- Law No 4603, effective as of 2000, has restructured the Ziraat Bank as a joint-stock company. In addition, legislation regarding support purchases of the Bank has been repealed. The practice of the Bank to grant low interest loans without allocating budgetary allowances has also been terminated.

Land and Farmer Register Systems

As put forth in the Accession Partnership Document and NPAA, a working group has been established with the participation of representatives from the relevant institutions with a view to setting up a proper functioning land registration system. This working group is to prepare a report containing an overview of the current situation in Turkey and Turkey's obligations in the process of harmonisation with the EU acquis.

The Land Registration and Cadastre Information System (TAKBİS) project included in the Annual Investment Programme will become an important part of the e-Turkey project after its completion. With the nationwide implementation of this project, all state-owned land will be identified, all land-related policies and decisions of the government will be implemented more effectively, levying and collecting land taxes will be eased, and the necessary infrastructure for the City Information Systems designed by the municipalities will be established. Moreover, revenues from land registration fees and revolving funds will rise substantially. The project, having an estimated cost of 100 million euro, may be accelerated, depending upon the availability of funds.

In 2001, 12.5 million hectares of land and 2.2 million farmers were registered in accordance with the Farmer Registration System carried out under the Agricultural Reform Implementation Project. It is foreseen that the nationwide registration of farmers will be accomplished through this project at a cost of 35.1 million dollars.

Phytosanitary Issues

The Phytosanitary Issues Working Group established under the Agriculture and Fisheries Sub-committee has identified 116 EC directives to be harmonised. Of these, 16 directives on harmful organisms, 17 on pesticide controls, 21 on seeds and seedlings, and 6 on plant variety rights have already been examined and the harmonisation studies regarding these directives have been started. The Project on Combating Plant Diseases and Harmful Organisms is being implemented by the MARA. A plant passport system will be launched following the completion of the land and farmer registration system. The necessary legal and institutional arrangements will be made with a view to carrying out market surveillance of plant protecting products and setting up a monitoring system for pesticides and environmental samples. A Project for the Establishment of the Necessary Infrastructure for Harmonisation of Turkish Legislation with EC Phytosanitary Legislation has been prepared. As part of this project, 4 quarantine laboratories are to be established.

As envisaged in the NPAA, Communiqués regarding potato diseases have been prepared by examining the relevant EC Directives. In addition, new External Quarantine Regulations prepared in line with the related EC Directive are to be issued soon.

Livestock Sector

The main objective of the livestock sector in Turkey is to increase livestock production in order to provide adequate and balanced nutrition for the population. For this purpose, animal-breeding practices will be improved, the quality of concentrated feed and fodder crops production will be increased, the fight against animal diseases and parasites will be intensified, and extension services will be developed. To this end, a variety of livestock projects is being implemented by MARA.

Decree No. 2000/467 on Support for Livestock Sector, aiming to increase fodder crop production, develop cattle breeding and expand artificial insemination practices, will be implemented until 2004. In 2002, 50.1 million euro are allocated for these purposes.

Efforts towards the harmonisation of Turkish legislation regarding the livestock sector with that of the EC are continuing and for this purpose, working groups have been established in the fields of stock breeding, animal health, animal identification, animal product control, market systems, and institutional structures. As regards establishing an animal identification system, around 7 million bovine animals out of a total of more than 10 million have been registered.

Preparatory work for a Veterinary Framework Law and translation of the EC veterinary legislation to be aligned with have been initiated.

Rural Development

The main objectives of rural development policy are to improve the income level and wealth of the rural population, to reduce disparities between rural and urban areas and to prevent excessive immigration to big cities. To this end, the necessary rural infrastructures for education, health, social security, organisation, accommodation, and transport will have to be established and agriculture, agricultural

industries, tourism, and local handicrafts will have to be developed. These activities will be carried out by governmental and non-governmental organisations.

Electrification, communication, and stabilised-road infrastructures in rural areas have been nearly completed; however modernisation is needed.

The ratio of rural areas benefiting from drinking water facilities is 90 per cent, of which only 52 per cent benefit from the drinking water distribution network.

In view of the rising demand in villages for new settlement, zoning and construction plans, and loans for housing construction, efforts for defining new strategies and measures continue. Loans have been provided for 3,399 families building their own houses in 59 villages. During the 1974-2000 period, 250 units (283,410 families and 422 cooperatives) benefited from the funds granted within the framework of various projects carried out by ORKÖY.

The annual financing need for improving the main infrastructure services such as drinking water, sanitation and settlement services in rural areas is about 200 million dollars for the 2002-2005 period. The availability of external funds in addition to budgetary allocations will accelerate the achievement of these targets.

Regarding alignment with the legislation and institutional structure of the EC, work continues on the major systems to be established and the activities of the rural development working group. In this respect, the review and translation of EC legislation and comparison with the Turkish legislation have been completed.

Fisheries

In accordance with a Framework Agreement signed with the aim of harmonising with EC legislation, legislative work for amending Law No. 1380 regarding Aquaculture Products, which forms the legal basis for structural arrangements in the fisheries sector in Turkey, has been initiated.

Regulations on Wholesale and Retail Market Arrangements for Aquaculture Products, in conformity with the EC legislation, have been adopted. Additionally, register books for fishing vessels have been renewed and related records have been transferred to a computer system in order to establish a national database.

The Project for Supporting Turkish Authorities Responsible for the Approximation of Turkish Legislation with that of the EU has been submitted to the European Commission. This project aims at making necessary amendments to the Turkish fisheries legislation with the assistance of EU experts. The project is to be launched in 2002.

Foodstuffs

The ongoing Project on Improvement of Food Control Services contributes to the purchase of laboratory equipment, the training of staff, and the acceleration of the EC harmonisation process. During the last year, six in-service training programmes on food control have been organised and 213 civil servants working at MARA attended these programmes. Within the framework of the Project, new equipment has been purchased in order to improve food control laboratories in Turkey. Additionally, for the implementation of the Project, a grant from the MEDA I Fund is expected to be released in 2002. The main aims are to reinforce equipment and personnel

infrastructure of food control laboratories and to get accreditation for certain laboratories.

A draft Milk Regulation has been drawn up to improve the food safety criteria in the milk sector. This Regulation aims at minimising the risks by monitoring health and quality standards of milk during production and delivery. The Draft Regulation will be put into effect in 2002.

Table:4. 9-Matrix of Policy Commitments: Agriculture and Rural Development

(1000 Euro)

	2002	2003	2004	2005
1. Agricultural Reform Implementation Project				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	29,885	18,391	8,046	4,598
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	29,885	18,391	8,046	4,598
2. Phytosanitary - Project on Combating Plant Diseases and Harmful Organisms				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	9,262	9,285	9,169	8,996
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	9,262	9,285	9,169	8,996
3. Animal Health - Project on Combating Animal Diseases and Parasites				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	8,352	8,373	8,268	8,112
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	8,352	8,373	8,268	8,112
4. Support for Livestock Sector in line with Decree No. 2000/467				
A. Implementation profile	X	X	X	
B. Net direct budgetary impact	58,405	58,707	57,849	
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	58,405	58,707	57,849	
5. Project on Improvement of Food Control Services				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	856	1,014	1,073	1,101
B.1. Direct impact on budgetary revenue	779	625	546	487
B.2. Direct impact on budgetary expenditure	1,635	1,639	1,619	1,588
6. Direct Income Support *				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	1,479,603	1,791,664	1,821,168	1,837,959
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	1,479,603	1,791,664	1,821,168	1,837,959
Total Net Budgetary Impact				
Total net budgetary impact	1,586,363	1,887,434	1,905,573	1,860,766
Total impact on budgetary revenue	779	625	546	487
Total impact on budgetary expenditure	1,587,142	1,888,059	1,906,119	1,861,253

* Based on an average of 17.5 million hectares cultivated area.

Research projects initiated to identify the current situation in the meat, milk and fish processing are almost finalised. These projects also aim at minimising unrecorded production and, hence, monitoring food safety procedures.

Preparatory work for a communiqué on the implementation of controls regarding Risk Analysis for Key Control Points (HACCP) and Systems for Good Manufacturing Practices (GMP) in the food industry is in progress.

The communiqués on a number of foodstuffs were put into effect in order to ensure compliance with the Turkish Food Codex. Legislation regarding analysis methods to specify purity criteria for food additives; packaging materials and articles coming into contact with foodstuffs; and establishment of residue limits for veterinary medicinal products in foodstuffs of animal origin were put into effect. The residue analyses in milk, honey, poultry and fishery products are currently carried out in Turkey and studies are continuing to extend these analyses to a number of other products.

As regards aflatoxin, special requirements have been envisaged for certain products such as hazelnuts, peanuts, and figs. Exportation of these products is subject to a health certificate issued by the Provincial Directorates of the MARA.

4.6. Other Reform Areas

4.6.1. Education

The main objective of the education system is to cultivate individuals of the information age with well-developed thinking, perceiving and problem solving capabilities. They should also be loyal to democratic values, open-minded, responsible, acquainted with their national culture, and able to evaluate different cultures, capable of contributing to contemporary civilisation, predisposed to the generation of science and technology, highly skilled, and productive and creative.

Pre-School Education

As in the EU countries, pre-school education is voluntary in Turkey. Schooling rate of pre-school education in Turkey can be increased to the EU levels by raising social awareness.

In order to inform families about the importance of pre-school education, various television programmes on pre-school education are being prepared by the Turkish Radio Television Corporation (TRT) in line with the related protocol.

It is aimed to increase the schooling rate to 25 per cent by the end of 2005. For this purpose, 5,600 teachers were trained in line with the Project on Training of Teachers for Pre-School Education, making pre-school education available for 114,000 additional children in the 2001-2002 academic year.

Primary Education

The duration of compulsory basic education, which was previously five years, was extended to 8 years by Basic Education Law No. 4306 in 1997. To increase the schooling rate to 100 per cent and to enhance the quality of primary education are objectives of the primary education reform which is known as the Basic Education Programme.

In the 2001-2002 academic year, 10 million students attended the primary education at approximately 34,000 schools and the schooling rate reached 98.1 per

cent. In accordance with the objectives of educational reform, more than 1,000 schools are constructed and 30,000 teachers are trained each year.

Taxes and contributions collected under Law No. 4306, initiating the primary education reform, are used for primary education investments. Between 1997-2001, 3 quadrillion Turkish liras (at 2002 prices) was spent for this purpose. Law No. 4702 extended the implementation period of Law No. 4306 until the end of 2010 in 2001. Although the objectives of the primary education reforms have been attained to a great extent, the need for additional funding still prevails.

In addition, 600 million dollars have been allocated for improving the quality of primary education within the framework of the Basic Education Project, which was initiated in 1998 and financed by the World Bank. The first phase of the Project, amounting to 300 million dollars, is to be completed by June 2003. The second phase of the Project amounting to 300 million dollars, is expected to be initiated in September 2002 and completed by 2005.

A financial agreement was signed in February 2000 as part of the MEDA Programme for the Project on Support for Basic Education. This project, which was included in the 2001 Annual Investment Programme, will be financed by an EU grant of 100 million euro. In hopes of eradicating poverty, this project aims to improve the living standards of the people in slums and disadvantaged rural areas by improving their education level, and to provide basic education for children, young people, and adults who lack it. The project is yet to be initiated.

The destruction caused by the earthquakes that took place in August and November of 1999 demonstrated that the education premises in the Marmara Region, and especially in İstanbul needed to be strengthened. For this purpose, approximately 180 trillion Turkish liras is required for those in İstanbul.

Work on the alignment of Turkish educational legislation with that of the EU continues within the framework of the NPAA.

Secondary Education

In 2001-2002 academic year, 92 per cent of primary school graduates attended secondary education. The preparatory work to extend compulsory basic education to 12 years in the long-term is continuing. Moreover, emphasis is being given to formal and mass vocational technical education within secondary education and there are plans to give more emphasis on programme diversification rather than school diversification.

Opportunities for vertical and horizontal transfers with complementary education are increased in secondary education programmes. Plans are underway to regulate vocational and technical education on a broad base and in a modular manner and to design flexible and comprehensive programmes in order to allow vertical and horizontal transfers within the education system, including higher education.

For this purpose, basic steps were taken with Law No. 4702, adopted in 2001. Under this law, the graduates of vocational and technical secondary schools are given the opportunity of attending vocational colleges, which are related to their branches without taking an entrance exam.

Moreover, revenues collection according to Law No. 4306 for primary education investments has been extended until the end of 2010 to include secondary education.

Full time-full year education practice will continue in order to ensure more effective use of the existing education facilities.

An additional capacity for 1.5 million students is needed to include all those at the age for secondary education.

Higher Education

There are plans to decentralize higher education, to adopt legislation promoting competition within the system, and to provide the universities with the necessary administrative and financial autonomy.

The Higher Education Council (YÖK) will be restructured, so as to endow it with a coordinating role among universities and to prepare long-term plans for the higher education system.

The need for development and diversification in the financial resources of higher education institutions maintains its importance. Thus, by establishing an effective tuition fee-scholarship-credit system, the student fees collected on the basis of solvency criterion will become one of financial resources of higher education system. The financial burden of the universities with sufficient non-budgetary financial resources on the general budget will be reduced by ensuring their financial and administrative autonomy.

In 2001, the number of universities reached 77, with 24 being private universities. In addition, there are 231 higher schools, 413 vocational colleges (two-year vocational schools) and 284 institutes. The academic staff reached 66,750 in the 2000-2001 academic year. The need to increase the quality and quantity of the academic staff still preserves its importance.

The need for new resources arises due to the fact that allocations from the budget to the universities are not proportional to the increase in the number of universities and students.

Thus, to ensure the financial autonomy of the universities and to encourage them to create their own financial resources, a draft law was submitted to the Parliament, introducing a new financial model defined as operation account.

As regards participation in the EU education programmes (ERASMUS), necessary preparations have been made by higher education institutions. Financial assistance from the EU will be available after the related contract is signed between the parties.

Preparatory work towards alignment with the European Credit Transfer System (ECTS) has been initiated by higher education institutions, and ECTS Institution Coordinators have been nominated.

Preparatory work concerning Diploma Supplement is about to be finalised. In the next academic term, Diploma Supplement in conformity with European standards will be given to university graduates.

Law No. 4702 introduces the practice concerning the placement of vocational and technical secondary school graduates in vocational colleges without examination. Additionally, they will be able to make vertical transfers to the university programmes in related fields within the quotas, which will not be less than 10 per cent of the total vocational college graduates. The law also aims at raising qualified intermediate workforce in a short period and increasing the share of vocational education in the higher education system.

The practice of transfers to the vocational colleges without examination will start in the 2002-2003 academic year. To this end, the capacity of the colleges has been increased. Human Resources Development Project for Vocational Colleges is envisaged in the 2002 Annual Investment Programme to meet the need for academic staff in vocational colleges.

The translation of the education acquis envisaged by the NPAA has been completed. Studies by committees of experts towards alignment of educational standards of certain higher education institutions to those of the EU continue.

Table:4. 10-Matrix of Policy Commitments: Education

(Million Euro)

	2002	2003	2004	2005
1. Basic Education Project				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	26.7	31.0	17.6	17.6
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	26.7	31.0	17.6	17.6
2. Supporting Basic Education Project				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	0.1	0.1	0.1	0.1
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	0.1	0.1	0.1	0.1
3. Human Resources Development Project for Vocational Colleges				
A. Implementation profile		X	X	X
B. Net direct budgetary impact		1.1	3.4	5.7
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure		1.1	3.4	5.7

National Agency

In January 2002, a National Agency was established in the SPO for the coordination of EU education and youth programmes in Turkey. Upon allocating the required number of personnel to establish the necessary infrastructure, the Agency began functioning.

The first official contacts between representatives of the National Agency and the Directorate-General of Education and Culture of the EU Commission took place in June 2002 and studies on work programmes, which include preparatory measures, have been initiated. Initial findings demonstrate that 5 million euro has to be allocated

for the preparatory measures to be implemented in 2002 and 2003. It is foreseen that 80 per cent of this amount will be met from EU funds. Pilot projects and activities amounting to 2 million euro, which will be financed by the EU, will be initiated during the implementation of preparatory measures. The budget for the National Agency for 2004 and 2005 is expected to be determined in June 2003, after the full participation of Turkey in EU education and youth programmes.

4.6.2. Regional Development

It is aimed to prepare a Statistical Regional Units Classification corresponding to the NUTS classification in the Member States of the EU, to define an effective regional development strategy, to establish Regional Development Units, and to take into account regional criteria for public investment project selection in order to approximate Turkish regional development policies to those of the EU. Reducing disparities among regions and strengthening social and economic cohesion are also goals.

Statistical Regional Units Classification studies carried out by the SPO and SIS have been completed and approved by EUROSTAT. Preparatory work towards transposing these studies into legislation is continuing intensively.

The preparation of Regional and Provincial Development Plans are continuing.

The Eastern Anatolia Project (DAP) and the Eastern Black Sea Regional Development Plan (DOKAP) have been completed. However, the Southeastern Anatolia Project (update), the Aegean Regional Development Plan and the Western Mediterranean Regional Development Plan studies are still in progress.

Moreover, preparatory work for the Central Black Sea Regional Development Plan and the Yeşilirmak Basin Development Plan has been initiated. In the second half of 2002, preparatory work for the Central Anatolia Regional Development Plan and the Eastern Mediterranean Regional Development Plan will be initiated. All regional plans are expected to be completed by the end of 2005.

Preparatory work for Eastern Anatolia Development Programme I covering the provinces of Van, Hakkari, Bitlis and Muş has been initiated. The programme, for which the EU allocated 45 million euro, aims at building central and local capacity with a view to developing regional policies, ensuring sustainable economic development, reducing regional disparities, and increasing employment and production at the regional level. The project implementation document was prepared in cooperation with the EC Commission.

Preparatory work for other statistical regions and Eastern Anatolia Development Programme II is continuing with financial aid from the EU.

The project for reinforcing the administrative capacity of the SPO with respect to regional development, which is financed by the EU-Turkey Administrative Cooperation Fund, has been initiated.

4.6.3. Social Security and Social Assistance

The main objective is to extend the public insurance programmes, which provide a minimum social insurance protection for contingencies, so as to cover the whole population. In this framework, the aims are:

- to increase the share of working population in total covered by the social insurance schemes,
- to enhance the administrative and financial efficiency of the social insurance institutions, to set the basic principles in order to provide uniformity in norms and standards, and to take measures towards increasing revenues and reducing expenditures,
- to improve the technological infrastructure and personnel quality of the social insurance institutions,
- to separate long-term and short-term insurance programmes from each other,
- to increase control over the health expenditures of the social insurance institutions.

In 2000, while 87 per cent of the population was covered by the social insurance schemes, 83 per cent was covered by the social insurance schemes in respect of health care services. On the other hand, 57.7 per cent of the total civilian employees were covered by the social insurance schemes.

Distortion in the actuarial balance of the social insurance institutions rendered the existing social insurance system unsustainable. In 2001, the transfers to social insurance institutions from the budget reached 5.8 quadrillion Turkish liras raising the share of total transfers to 3.1 percent of the GDP.

Social security reform, which was planned to be achieved in two stages and which aims to ensure a sustainable social security system, to establish the long-term actuarial balances of the social insurance institutions, and to improve their administrative and financial efficiency has been implemented since 1999.

The first phase of the implementation was initiated in September 1999 with the adoption of Law No. 4447. The Law introduced basic arrangements responding to the urgent needs of the system, brought amendments to various laws, to Decree Law No. 190, and to basic parameters of the social security system, and established the unemployment insurance scheme. In addition to the measures introduced to prevent unregistered employment, the ceiling of earnings that provides a basis for the premium to be paid was increased and the relation between the premium and the pension was strengthened with this Law. Moreover, the retirement age was raised progressively. Nevertheless, the Constitutional Court annulled a provision of Law No. 4447 as regards the transition period concerning retirement age. The legal vacuum was filled with Law No. 4759 adopted in May 2002.

Premium deductions for the unemployment insurance envisaged by Law No. 4447 started to be collected in June 2000. Unemployment benefits, health benefits, work placement, counselling and professional training assistance are available to the unemployed, on the condition that they have paid unemployment insurance premium for 600 days starting in June 2000, provided that they apply within 30 days of

becoming involuntarily jobless. As of the end of June 2002, 3.5 quadrillion Turkish liras have accumulated in the Unemployment Insurance Fund. Payments from the Fund started in March 2002 and 26,472 people benefited from the Fund receiving 10.7 trillion Turkish liras between 31 March-30 June 2002.

In the second phase of the social security reform, it is aimed to establish common databases to improve the effectiveness and efficiency of the social security institutions, to harmonize their accounting systems, to prevent waste of resources, to improve computerised automation infrastructure of the institutions in order to ensure efficiency at national level in setting and implementing national health policies, and to restructure the institutions to fulfil their obligations through their own resources in accordance with modern insurance principles. It is also aimed to restructure them with a view to facilitating the implementation of individual pension system, as well as the efficient use of resources in health services.

Decree Laws envisaging significant changes in the social security legislation, in particular regarding the reorganisation of the social security institutions were put into effect in October 2000. Nevertheless, these Decree Laws were annulled by the Constitutional Court. Subsequently, new draft laws were prepared and submitted to the Parliament.

In 2001, supplementary individual pension schemes were established by the Laws No. 4632 and 4697.

Necessary legal and institutional arrangements are being made to reorganize the administrative and financial structures of the social security institutions and to ensure uniformity in norms and standards applicable to these institutions.

The Social Risk Mitigation Loan Project with a budget of 635.5 million dollars was launched in 2001 upon the signing of a 500 million dollars credit agreement with the World Bank. The aim of the project is to alleviate the impact of the currently conducted structural reforms on poor households through improving the social support system, and to reduce the social risk that may arise in the medium-term. This Project, which is implemented by the Social Aid and Solidarity Foundation, envisages to reinforce institutional capacity within the areas of social services and support, to establish databases and systems to support provision of aid in cash, to support projects aiming to create jobs and increasing income at the regional level, and to provide aid both in cash and in kind to the families of children who can not benefit from the education and health services due to poverty. The Project is in progress.

Table:4.11-Matrix of Policy Commitments: Social Security and Social Assistance

	(Million Euro)			
	2002	2003	2004	2005
Social Risk Mitigation Loan Project				
A. Implementation profile	X	X	X	X
B. Net direct budgetary impact	155.7			
B.1. Direct impact on budgetary revenue				
B.2. Direct impact on budgetary expenditure	155.7			

4.6.4. Health

The main objective of the health policy is to have a healthy society by improving the quality of life and increasing the lifespan of individuals who are physically, socially, and mentally fit.

A Health-21 Programme has been developed for Turkey, in accordance with the World Health Organisation's Health for Europe-21 Programme. The programme aims at increasing life expectancy, improving the quality of life, and reducing inequalities among different regions and different socio-economic groups by improving the health status indicators.

In particular, it is aimed to reduce:

- communicable and non-communicable diseases,
- negative effects caused by accidents, violence, and disasters, and
- risk factors,

and to improve:

- health protection for infants and children,
- reproductive health,
- health protection for adolescents, the elderly, and the disabled,
- mental health,
- environmental health, and
- the national health system.

In line with the above-mentioned purposes, preparatory work for a structural reform in the health system has been initiated. The Health Reform Project prepared in cooperation with the World Bank and in conformity with EU norms, aims at improving accessibility to health services, developing financial protection, separating health financing from the provision of health services, ensuring the autonomy of hospitals, restructuring The Ministry of Health with a view to decentralisation, improving primary health care services and the quality of health services, establishing a dispatching system and reinforcing the administrative capacity of the institutions in the health sector.

According to the envisaged timetable, consultations with the World Bank to finance the Health Reform Project will take place in October 2002. Internal and external financing needs for the project will be ascertained after the completion of the preparatory work. The Health Reform Project is expected to be initiated in 2003.

Draft laws regarding the tasks and organisation of the Ministry of Health and establishment of the Refik Saydam National Hygiene Institution were prepared in 2002. In addition, legislative work towards the elimination of difficulties in the fields of medicine and pharmacy is in progress. For alignment with the EU acquis, legislative work envisaged in the NPAA is continuing.

By adopting the following legislation, alignment with the health and consumer protection legislation of the EU will be ensured. Regulation on the Principles of Good

Laboratory Practices and Certification of Test Laboratories, Regulation on the Supervision of Good Laboratory Practices, Regulation on Granting Authorisation for an Marketing of Pesticides and Similar Substances Used in the Field of Public Health, Communiqués on Foodstuffs and Analysis Methods for Foodstuffs, Regulation on Special Requirements for Foodstuffs and Materials related to General Health, Regulation on Cosmetics, Regulation on Medical Devices, Regulation on In Vitro Diagnostic Medical Devices, Regulation on Toys, Regulation on Blood and Blood Products, Regulation on Implantable Active Medical Devices, Regulation on Immunological Medical Products containing Vaccines, Allergens, and Toxins or Serum, and Regulation on Medicine Research. In addition, a National Toxicity, Ecotoxicity and Environment Scientific Committee will be established. Also, laboratory infrastructure will be strengthened and their accreditation will be ensured, institutional structuring shall be maintained by the assignment of approved rating institutions to supervise and control the market.

A law on Health Professions and their Unions, which is yet to be prepared will lay down profession definitions and education standards for medical doctors, dentists, pharmacists, nurses, and midwives, so as to improve the quality of health services.

The Directorate-General for Health and Directorate-General for Insurance were established within the Social Insurance Institution by Decree Law No. 616.

A Protocol on Cooperation in Medical Treatment was approved by the three social security organisations (Emekli Sandığı, SSK, and Bağ-Kur).

Health Reform Project II is being implemented in 23 provinces in Eastern and Southeastern Anatolia. Activities are carried out in the fields of primary health care education, primary health care interventions, health services and hospital management, computerised management and support systems, national health accounts, the cost of diseases and cost-effectiveness, and international disease classification.

A Report on National Food and Nutrition Strategies and the Draft Action Plan on National Food and Nutrition have been prepared under the coordination of the SPO and project development studies have been initiated by the relevant institutions. They aim at providing balanced and adequate nutrition for individuals, raising healthy generations, and ensuring safe production and trade of food. The Action Plan is expected to be completed by the end of 2002 and to be implemented in 2003.

4.6.5. Transportation and Telecommunication

Reorganisation of the Turkish State Railways (TCDD) is one of the reform areas in the transportation sector. Main objectives of the reorganisation are:

- to increase the share of rail transport in the transportation sector by implementing customer-oriented business strategies, and to establish a sustainable and effective transport infrastructure,
- to ensure sustainability in public transportation service,
- to increase the autonomy of the TCDD,
- to decrease the consolidated operation ratio (operating expenses over operating revenues, excluding subsidies) from 4.3 to under 2,

- to cancel unprofitable local and urban lines where the operational loss is not compensated by the government,
- to develop new markets and increase the quality of services and to extend the product range,
- to use private sector resources at the utmost level,
- to strengthen the information exchange infrastructure of the TCDD.

A draft Railways Law was submitted to the Ministry of Transportation. The draft envisages setting up a framework for the railway sector, and the full commercialisation of its activities.

Being a long-term project, it is estimated that the reorganisation of TCDD requires an annual investment of 140 million dollars for the period of 2002 -2005. In addition, a total of 75 million dollars is needed to eliminate redundant employment in this sector.

Telecommunications

A considerable acceleration in the process of liberalisation and regulation of the market was achieved by the adoption of Law No. 4502 in January 2000 and Law No. 4673 in May 2001.

In line with privatisation efforts, a corporatisation plan for Türk Telekom has been prepared by a consortium to increase its efficiency and profitability, and to prepare it for international competition. Following the finalisation of the Plan, a corporate strategy will be defined for the years 2002-2005.

In accordance with Law No. 4673, a new Bid Committee was set up for the privatisation of Türk Telekom and became operational in December 2001. The privatisation strategy for Türk Telekom will be redefined according to market conditions and the restructuring process. Privatisation of Türk Telekom will be completed as soon as possible with due regard to market conditions.

The Price Cap Communiqué regarding the approval of Türk Telekom's tariffs by the Telecommunications Authority on the basis of a price cap mechanism entered into force in January 2002.

The Telecommunications Authority renewed the duty contract and concession agreements with Türk Telekom and mobile operators, following the conferral of power to grant licenses and general authorisation to Telecommunications Authority by Law No. 4673.

The Authority set firstly the criteria to be considered in determining the authorisation types, with a view to establishing a licensing regime. Accordingly, telecommunications services and infrastructures that require limited number of operators will be authorised by concession agreements or Type 1 telecommunications licenses. Those that do not require limited number of operators will be authorised by general authorisation and Type 2 telecommunications licenses. A Communiqué on Granting Type 2 Telecommunications License and General Authorisation entered into force in February 2002.

The minimum values for the licenses of services and infrastructures, which are proposed by the Telecommunications Authority and which are to be authorised in accordance with the Communiqué on Granting Type 2 Telecommunications License and General Authorisation were approved by the Council of Ministers.

As of 15 March 2002, the Telecommunications Authority started to grant Type 2 telecommunications licenses and general authorisation to the operators willing to provide telecommunications services or to establish and operate infrastructure.

National Roaming Regulation aiming to create a competitive environment in the telecommunications sector was published in March 2002. The Regulation determines basic principles regarding national roaming and the method of intervention in disagreements between the operators.

Preparatory work is continuing for clearing and allocating relevant frequency bands in order to implement the Council and European Parliament Decision of December 1998 regarding the coordinated introduction of third-generation mobile and wireless telecommunications systems (UMTS). In addition, the National Coordination Board and the sub-committees which were established under the coordination of the Telecommunications Authority have started to work towards determining a strategy for transition to UMTS.

Prior to the liberalisation of the market, work concerning interconnection arrangements is continuing. To this end, Interconnection Regulation is expected to enter into force by the end of 2002.

Additionally, preparatory work regarding the revision of Regulation on Telecommunications Services of March 2001 which is compatible with Directive 97/13/EC is continuing with a view to its compliance with Law No. 4673, the EC legislation, and changing needs of the sector.

A draft Licensing Regulation has been prepared and is planned to be adopted in the second half of 2002.

In March 2002, "112" was designated as the National Emergency Access Code and "00" as International Access Code in line with Decisions 91/396/EEC and 92/264/EEC, respectively.

Current National Numbering Plan is being reviewed by taking into account the new operators entering into the market following the full liberalisation in voice transmission and the new services requiring number assignment. During the preparation of the Plan, it is aimed that the number assignments are based on fair, transparent and non-discriminatory criteria, and the numbering is used and monitored so as to ensure effective competition.

The National Numbering Plan will include structuring, divisions and related service categories of the number. The Numbering Regulation, on the other hand, will contain principles and procedures concerning the assignment and use of numbers in the framework of the Numbering Plan. The Regulation will also cover monitoring the use of numbers and penalties to be applied.

It is planned that legislative arrangements are to be made regarding the right of way, facility sharing and collocation in accordance with the Directives 96/19/EC and 97/33/EC.

Preparatory work for a regulation that is compatible with Directive 99/5/EC concerning radio and telecommunications terminal equipment and mutual recognition of their conformity has been completed and is planned to be adopted soon.

Legislation on telecommunications sector foresees cooperation between the Telecommunications Authority and Competition Authority to ensure fair competition in the sector. To this end, preparatory work for a cooperation protocol has been initiated, and is expected to take effect soon.

A National Telecommunications Strategies Research and Development Foundation is planned to be established with a view to determining the sectoral needs. A National Telecommunications Advisory Council which involves all sectoral actors will be set up within the Foundation. Within this framework, working groups will be set up to ensure transparency and collaboration in the system.

Preparatory work for a draft Communiqué on determining the operators having significant market power is continued, in accordance with Directive 97/33/EC. The draft is prepared to ensure the implementation of the Tariff Regulation and the legislation to be drawn up on interconnection, selection and pre-selection of service providers. The draft Communiqué will be revised in line with the changes in EU acquis.

A Centre for Consumer Complaints within the Telecommunications Authority is being established to receive and evaluate efficiently the complaints regarding the violation of consumer rights. As from the second half of 2002, the Centre started to receive complaints from telephone number 199.

In the framework of EU-Turkey Financial Cooperation for 2002, a project is developed to reinforce the administrative capacity of the Telecommunications Authority. Total amount of the project is 2.3 million euro of which Turkey will contribute 40,000 euro.

4.6.6. Environment

The main objective of the environment policy is to ensure economic and social development through the protection of human health, ecological balance and cultural, historical and aesthetic values. Environmental provisions are contained in a range of legislation including, *inter alia*, the Constitution and a framework Law on Environment. Environment Law No. 2872 of 1983 is based on the principles of polluter pays and faultless responsibility. A proposal aiming to amend this Law in order to reinforce coordination among the institutions and to take into account the EU norms regarding access to information has been submitted to the Parliament. In addition, a proposal aiming to reinforce the administrative capacity of the Ministry of Environment and to increase the effectiveness of penalties as regards environmental offences is also on the agenda of the Parliament.

Efficient use of economic instruments is envisaged for the implementation of environmental policies. Additionally, preparation of action plans in different fields in a participatory manner and their monitoring is one of the basic strategies to ensure sustainable use of natural resources.

Priority areas in the field of environment are:

- completion of urban infrastructure (water supply and sewerage system),
- completion of solid waste disposal systems,
- establishment of a database on environment,
- protection of biodiversity,
- protection of air quality, and
- climate change.

Projects in the aforesaid areas have been carried out with domestic and foreign financial resources.

Parallel to the objective of completing environmental investment according to the priorities, efforts towards reviewing the legislation in force and adopting new legislation in accordance with EU norms are continuing. In this regard, the Environmental Impact Assessment (EIA) mechanism has been improved and the relevant Regulation has been updated. In addition, Regulation on Implementation of the Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES) has been put into effect, along with Regulation on Control of Soil Pollution, Protection of Wetlands and Environmental Inspection for the purpose of adjustment to EU norms. Environment Directorates have been established in 81 provinces by the Ministry of Environment, so as to ensure effective coordination and supervision of public institutions.

Legislative work for the implementation of the Water Framework Directive and the Environmental Impact Assessment Directive of the EC is in progress.

Various environmental database projects on different topics are being carried out by different government institutions. In 1999, National Environment Database Project was launched to integrate different databases into a single framework and to present up-to-date, reliable, and scientific data for common use. After completion of the feasibility study, the investment need for extensive and effective use of database will be determined. Furthermore, an agreement concerning the accession of Turkey to the European Environment Agency and to the Environmental Information and Observation Network (EIONET) to ensure integration to the EU environment database has been signed and submitted to Parliament for ratification.

At present, there are 3,227 municipalities in Turkey, of which 16 are metropolitan municipalities. Urban population has reached 66 per cent of the total population. The percentage of the total population, which has access to a sewerage network, is 83 per cent and to wastewater treatment plants is 52 per cent. On the other hand, the ratio of unrecorded water consumption in municipalities is about 32 per cent.

390 million dollars has been allocated for water supply projects including those implemented by Directorate-General for State Hydraulic Works, Bank of Provinces, and municipalities, and 480 million dollars has been allocated for sanitation projects including those implemented by the Bank of Provinces, and municipalities in 2002. Plans have been made to allocate 400, 405, 425 million dollars for water supply projects and 490, 505 and 510 million dollars for sanitation projects in 2003, 2004,

and 2005, respectively. Additional external resources that could be acquired in the following period bear great importance for accelerating investments in this sector.

As regards solid municipal waste management, disposal methods like composting and incineration are not preferred due to their heavy investment and operation costs and special know-how and expertise requirements during operation. Instead, sanitary landfills are the preferred solid waste disposal method.

In Turkey, only 15 per cent of the total solid waste is currently disposed of through sanitary landfills. Due to their high operation costs, the number of composting plants is rather limited. There is one regional plant for dangerous waste disposal with a capacity of 35,000 ton/year in Kocaeli.

As regards solid waste management services, the aim is to improve technical and financial support to the Bank of Provinces.

40 million dollars has been allocated for solid waste management projects envisaged in the 2002 Annual Investment Programme. It is estimated that a total of 120 million dollars will be allocated for the 2003-2005 period. On the condition that this allocation will increase to 390 million dollars, it is estimated that 27 per cent of the total population will be able to benefit from the solid waste disposal system through sanitary landfills.

The alignment of Turkish legislation with the EU environmental acquis has been examined and the needs in different investment areas have been determined within the framework of a project financed from MEDA Fund and coordinated by the Ministry of Environment.

Environmental project development capacity of Turkey will be increased through the activities carried out within the framework of LIFE Programme.

Emission factors in all sectors will be defined and necessary inventories will be prepared in order to monitor and prevent air pollution resulting mainly from industrialisation and urbanisation. The Air Pollution Measuring and Monitoring System Project was initiated to define necessary monitoring and measuring structures and to make a cost analysis for establishing these structures.

The energy-environment relationship is another issue requiring special emphasis in respect to air quality protection. The United Nations Framework Convention for Climate Change (UNFCCC) and Kyoto protocol were introduced to stabilise greenhouse gas concentrations in the atmosphere at a certain level or reduce them to the desired amount by a predetermined date.

Turkey is included in Annex-I of UNFCCC together with the OECD countries and transition countries, and in Annex-II of UNFCCC together with the OECD countries. Annex-I countries are required to lower their anthropogenic greenhouse gas emissions, whereas Annex-II countries are to provide new and additional financial resources and to take steps to promote, facilitate and finance the transfer of environmentally sound technologies and know-how to developing countries.

Turkey has not become a party to the Convention on the grounds that it has not completed its industrialisation yet and it could not fulfil the obligations envisaged for the countries listed in Annex-I and Annex-II. Nevertheless, nature protection

measures and energy saving policies, which serve to stabilise greenhouse gas emissions, are implemented in Turkey.

In the 6th Conference of Parties (COP-6), Turkey proposed being excluded from Annex-II and remaining only in Annex-I, in order to be a party to the Convention. This proposal was accepted in COP-7, held in Marakesh in 2001. Subsequently, the Convention has been submitted to the Parliament for ratification.

For effective implementation of the UN Convention on Biodiversity, to which Turkey is a party, a National Biodiversity Strategy and Action Plan aiming to protect biodiversity and ensure sustainable use of it, will be launched.

The targets included in the strategy are:

- protecting biodiversity and ensuring sustainable use of biological resources,
- improving the level of knowledge on ecosystems and natural resource management,
- increasing awareness towards biodiversity and its sustainable use, adopting necessary legislation, and establishing an incentive system,
- establishing national and international cooperation structures to protect biodiversity, sustainable use of biological resources, and equitable sharing of benefits gained from the use of genetic resources.

4.6.7. Energy

Electricity consumption per capita in Turkey is below the world average. Major steps have been taken to liberate the electricity market with a view to responding to the ever-increasing electricity consumption demand in a reliable and economic manner and with minimum fluctuations in supply, while encouraging the private sector to play a more active role in the sector.

The Law on Electricity Market, which aims to create a transparent electricity market regulated by a totally independent authority with clear and precise rules giving confidence to investors has been put into effect in March 2001. This law aims to create a reliable and stable market by opening the electricity sector to competition, to create an environment in which the private sector can operate freely, and to overcome the difficulties due to insufficient public funds by attracting private sector investments.

A preparatory period is envisaged for the attainment of the market structure targeted by the Law on Electricity Market. During this period, legal and institutional arrangements will be made in a participatory approach and technical infrastructure will be established. Preparatory work for the adoption of secondary legislation will be completed by September 2002.

The Turkish Electricity Generation and Transmission Company (TEAŞ) was separated into three new state-owned companies in line with the Law on Electricity Market. These companies are Türkiye Elektrik İletim A.Ş. (TEİAŞ) authorised to take over and operate publicly-owned transmission lines and establish new ones; Elektrik Üretim A.Ş. (EÜAŞ) authorised to take over the ownership of publicly-owned power plants and establish new ones; and Türkiye Elektrik Ticaret ve Taahhüt A.Ş.

(TETTAŞ) authorised to take over the current electricity purchase and sales contracts from TEAŞ and TEDAŞ (Turkish Electricity Distribution Company) and carry them out thereafter.

Privatisation process of generation plants of EÜAŞ and TEDAŞ by the Privatisation Administration is to continue parallel to the preparatory work for the adoption of relevant legislation. In this regard, a project group has been formed within the Privatisation Administration to carry out the privatisation process in the sector. In addition, certain power plants and distribution facilities determined by the Ministry of Energy and Natural Resources are to be included in the privatisation programme by March 2003. Subsequently, these plants and facilities will be privatised within 18 months.

Legal arrangements were also made for the natural gas sector which has an important share in electricity generation and whose share is expected to increase. Law No. 4646 on Natural Gas Market was put into effect in May 2001. The Law aims to change the monopolistic character of the sector by creating a competitive market through the privatisation of state-owned natural gas companies.

By Law No. 4646, BOTAŞ, a state-owned company, lost its monopoly rights for the import, transmission, trade and storage of natural gas. Consequently, private companies will be able to operate in the market and establish partnerships by obtaining a licence from the Energy Market Regulatory Authority (EMRA). In addition, the market share of any importer or wholesaler, including BOTAŞ, shall not exceed 20 per cent of the estimated natural gas consumption of Turkey in order to ensure competitiveness in the market.

Privatisation efforts continue in the petroleum products sector and no new public investment is envisaged. In order to provide a reliable energy supply, a draft Law on Oil Markets, which aims to encourage the new investments needed in the sector and to establish an institutionalised competitive market has been submitted to the Parliament.

Following the adoption of the draft law, oil markets will be classified according to their field of activities and licensing will be introduced, parallel to the Laws on electricity and natural gas markets. EMRA will be authorised also to regulate the oil market.

A significant restructuring process was initiated in the field of energy through the legal arrangements put into effect in the electricity and natural gas sectors. Turkey will have completed a significant reform process in the energy field with the implementation of the planned activities in the electricity and natural gas sectors.

In March 2002, the World Bank supplied 20 million dollars to finance the above-mentioned restructuring activities, of which 5 million dollars was allocated for unforeseen financial needs. Of the remaining amount, 8.3 million dollars will be used by the EMRA and 6.7 million dollars will be used by TEDAŞ, TETTAŞ and the Ministry of Energy and Natural Resources.

Major activities financed by this loan and which will be completed by mid-2005 are:

- establishment of Programme Coordination Unit (PCU),

- restructuring of distribution networks,
- restructuring of TETTAŞ,
- grouping of distribution and generation companies for privatisation,
- establishment of an information system for EMRA,
- educational activities,
- drawing up and implementing necessary regulations, establishing accounting standards, and issuing a market manual,
- designing a market management system, and
- completing preparatory work prior to privatisation.

In addition, within the framework of EU-Turkey financial cooperation, a 1.1 million euro project aiming to reinforce the capacity of EMRA for the implementation of energy legislation and for the adoption of new legislation in line with developments in the EU has been budgeted in the 2002 Financial Programme.

ANNEX TABLES

Table:1-Growth and Associated Factors

Percentages unless otherwise indicated	ESA Code	2001	2002	2003	2004	2005
1. GDP Growth at Constant Market Prices (14+15+16)	B 1 g	-7.4	3.9	4.9	5.0	5.1
2. GDP Level at Current Market Prices (quadrillion TL)	B 1 g	181.4	284.9	379.3	452.2	519.9
3. Change in GDP Deflator (annual average)		57.2	51.1	26.9	13.6	9.4
4. CPI Change (annual average)		54.4	47.1	28.6	14.4	9.8
5. Employment Growth*		-1.0	0.0	3.9	3.2	3.6
6. Labour Productivity Growth**		-6.4	3.8	1.0	1.7	1.5
7. Investment Ratio (per cent of the GDP)		15.7	19.3	20.4	21.5	22.5
Sources of Growth: Percentage Changes at Constant Prices						
8. Private Consumption Expenditure	P3	-9.0	4.0	3.2	3.7	4.4
9. Government Consumption Expenditure	P3	-8.6	3.2	5.2	6.1	5.5
10. Gross Fixed Capital Formation	P51	-31.7	1.8	19.2	14.2	9.5
11. Changes in Inventories and Net Acquisition of Valuables as a Per cent of the GDP***	P52+P53	-4.0	3.5	-1.1	-0.6	0.0
12. Exports of Goods and Services	P6	7.4	6.2	6.8	6.9	6.0
13. Imports of Goods and Services	P7	-24.8	15.8	8.8	8.5	7.9
Contributions to GDP Growth						
14. Final Domestic Demand		-15.7	3.4	6.7	6.5	5.8
15. Changes in Inventories and Net Acquisition of Valuables		-4.0	3.5	-1.1	-0.6	0.0
16. External Balance of Goods and Services		12.3	-2.8	-0.6	-0.5	-0.6
Growth of Gross Value Added						
17. Agriculture		-6.1	3.2	1.9	1.0	1.0
18. Industry		-7.5	5.2	5.3	5.5	5.7
19. Construction		-5.9	2.4	5.3	5.5	5.6
20. Services		-7.7	3.4	5.4	5.7	5.8

* Occupied population, domestic concept, persons, national account definition.

** Growth of GDP at market prices per person employed at constant prices.

*** Contribution to growth.

Table:2-Labour Markets Developments

	2001	2002	2003	2004	2005
Percentages unless otherwise indicated					
1.Population (thousands - mid-year)	68,610	69,749	70,877	71,994	73,101
2.Population (growth rate)	1.5	1.5	1.4	1.4	1.4
3.Working Age Population (thousands)*	45,702	46,659	47,619	48,575	49,530
4.Participation Rate*	48.7	48.0	48.6	49.0	49.5
5.Employment Level (thousands)*	20,367	20,380	20,176	21,850	22,633
6. Employment (growth rate)	-1.0	0.0	3.9	3.2	3.6
7.Unemployment Rate (ILO definition)	8.5	9.0	8.5	8.2	7.7
8.Average Real Wage (growth rate)	-10.9	0.0	0.0	0.0	0.0

* +15 years-old

Tablo:3-External Sector Developments

Millions of Dollars, unless otherwise indicated	2001	2002	2003	2004	2005
1. Current Account Balance (per cent of the GDP)	2.3	-0.8	-0.9	-0.8	-0.8
2. Exports of Goods (Fob)	35,258	37,437	41,059	44,859	48,865
3. Imports of Goods (Fob)	39,748	44,157	49,040	53,955	58,944
4. Trade Balance	-4,490	-6,720	-7,980	-9,096	-10,079
5. Exports of Services	17,936	16,086	19,163	21,526	23,083
6. Imports of Services	13,853	14,354	17,413	19,093	20,116
7. Services Balance	4,083	1,732	1,750	2,433	2,967
8. Net Interest Payments from Abroad	-4,381	-5,125	-6,348	-6,337	-5,653
9. Other Net Factor Income from Abroad	-1,528	-2,429	-2,999	-2,492	-1,628
10. Current Transfers	1,017	899	1,030	1,049	1,125
11. <i>Of which</i> from EU	-	-	-	-	-
12. Current Account Balance	3,396	-1,459	-1,851	-1,818	-1,865
13. Foreign Direct Investment (net)	2,769	654	1,288	1,574	1,934
14. Foreign Reserves	18,787	21,233	22,740	25,945	23,487
15. Foreign Debt (total)	115,084	118,700	120,870	123,297	119,721
16. <i>Of which</i> : Public	69,914	78,052	79,287	79,752	73,470
16.a. IMF	13,540	21,479	22,076	21,321	13,321
17. <i>Ofw</i> : Foreign Currency Denominated (public)	69,914	78,052	79,287	79,752	73,470
18. <i>Ofw</i> : Repayments Due	8,450	12,227	8,138	8,173	14,369
19. Exchange Rate vis-à-vis EURO (end-year)	1,268,115	1,595,405	1,722,348	1,920,325	2,032,310
20. Exchange Rate vis-à-vis EURO (annual average)	1,093,683	1,350,409	1,627,591	1,795,610	1,980,050
21. Net Foreign Saving (per cent of the GDP)*	2.2	-1.8	-1.7	-1.9	-2.4
22. Domestic Private Saving (per cent of the GDP)*	27.9	27.0	20.3	18.1	16.2
23. Domestic Private Investment (per cent of the GDP)*	11.7	12.7	14.5	16.1	16.8
24. Domestic Public Saving (per cent of the GDP)*	-10.0	-9.5	-1.5	1.5	3.9
25. Domestic Public Investment (per cent of the GDP)*	5.2	5.1	5.3	5.4	5.6

* Savings-investment balance calculations are based on the GDP-by expenditure figures of SIS. The public investment figures in the table also include SEEs investments in addition to general government.

Table:4-General Government Budgetary Developments

Per cent of the GDP	ESA code	2001	2002	2003	2004	2005
Net Lending (B9) by Sub-Sectors						
1.General Government	S13	15.1	13.2	5.9	3.0	0.5
2.Consolidated Budget	S1311	14.1	10.8	4.1	1.2	-1.0
3.Funds	S1312	-0.8	0.0	-0.3	-0.4	-0.6
4.Local Government	S1313	-0.5	0.1	0.3	0.4	0.3
5.Social Security Fund	S1314	3.1	3.1	2.9	2.7	2.6
6.Revolving Funds		0.0	0.0	-0.1	-0.1	-0.1
7.Unemployment Funds		-0.8	-0.9	-1.0	-0.8	-0.7
General Government (S13)						
8.Total Receipts	ESA	42.1	39.8	40.6	40.0	40.1
9.Total Expenditures	ESA	57.2	52.9	46.6	42.9	40.6
10.Interest Payments	B9	23.7	21.1	14.4	10.8	8.3
11.Primary Balance	D41	-8.6	-7.9	-8.5	-7.8	-7.8
Components of Revenues						
12.Taxes	D2+D5	26.6	24.3	24.8	24.6	24.9
13.Social Funds	D61	5.9	6.1	6.3	6.4	6.5
14.Other		9.6	9.4	9.5	9.0	8.8
15.Total Receipts	ESA	42.1	39.8	40.6	40.0	40.1
Components of Expenditures						
16.Total Consumption	P32	17.5	16.7	16.3	16.2	16.2
17.Social Security Transfers	P31	9.1	9.4	9.2	9.0	9.0
18. Interest	D41	23.7	21.1	14.4	10.8	8.3
19.Subsidies*	D3	0.9	1.1	1.0	1.0	1.0
20.Gross Fixed Capital Formation	D51	4.2	3.8	4.2	4.2	4.3
21.Other		1.8	0.8	1.5	1.7	1.8
22.Total Expenditure	ESA	57.2	52.9	46.6	42.9	40.6

* Includes agricultural support, duty losses of SEEs and Support and Price Stability Fund.

Table:5- General Government Debt Developments

	ESA Code	2001	2002	2003	2004	2005
Per cent of the GDP						
1. Gross Debt Level		122.8	99.6	85.6	79.6	73.0
2. <i>Of which</i> : Repayments Due		74.0	36.1	20.6	25.3	27.3
3. Change in Gross Debt		59.6	-24.1	-14.0	-6.0	-6.5
Contributions to Change in Gross Debt						
4. Primary Balance (per cent)	B9	-8.6	-7.9	-8.5	-7.8	-7.8
5. Interest Payments (per cent)	D41	23.7	21.1	14.4	10.8	8.3
6. Nominal GDP Growth (per cent)	B1g	46.0	57.1	33.1	19.2	15.0
7. Other Factors Influencing The Debt Ratio: Exchange Rate Change (Per cent Change, “ Depreciation)		-95.6	-27.3	-20.5	-10.3	-10.3
8. Other Factors Influencing The Debt Ratio: Privatisation Receipts		0.9	0.3	1.4	1.3	1.6

Table: 6-Divergence From Previous Update*

	2001	2002	2003	2004	2005
1.GDP Growth (Percentage Points)					
Previous Update					
Latest Update	-7.4	3.9	4.9	5.0	5.1
Difference					
2.Current Balance (Euro mil.)					
Previous Update					
Latest Update	3,795	-1,677	-2,128	-2,090	-2,144
Difference					
3.Total Foreign Debt Levels (Euro mil.)					
Previous Update					
Latest Update	128,643	136,437	138,931	141,721	137,610
Difference					
4.Actual Budget Balance (Per cent of the GDP)					
Previous Update					
Latest Update	-15.1	-13.2	-5.9	-3.0	-0.5
Difference					
5.Gross General Governments Debt Level (Per cent of the GDP)					
Previous Update					
Latest Update	122.8	99.6	85.6	79.6	73.0
Difference					

*A comparison is not given since the numerical values of most variables in the table above weren't presented in the previous Pre-Accession Economic Programme.

**Tablo:7- Assumptions on the External Economic Environment
Underlying the 2002 PEP Framework**

	2001	2002	2003	2004	2005
Interest Rate (per cent)					
Domestic Interest Rate (Treasury bill rate, simple)	76.7	63.5	41.9	26.3	16.5
Euro Area: Short-term (3-months money market)	4.3	3.4	3.8		
Euro Area: Long-term (10-years govt bonds, lowest one prevailing in Euro area)	4.8	5.1	5.2		
USA: Short-term (3-months money market)	3.8	2.2	3.1		
USA: Long-term (10-years govt bonds)	5.0	5.2	5.5		
Exchange Rate					
TL / €	1,093,683	1,350,409	1,627,591	1,795,610	1,980,050
Change in Annual Average (“-“ depreciation)	-95.6	-27.3	-20.5	-10.3	-10.3
USD / €	0.89	0.87	0.87	0.87	0.87
Percentage Change in Real Exchange Rate (“+“depreciation)	28.9	-11.6	-4.4	-1.7	2.3
GDP (in real terms)					
World, excluding EU	2.4	3.2	4.1		
USA	1.2	2.7	3.1		
OECD	1.3	1.0	3.3	3.3	3.0
EU 15	1.7	1.5	2.9	2.5	2.5
World Trade (in real terms)					
Developing Countries Import (percentage change)	3.5	6.4	7.7	8.6	8.6
International Prices					
World Import Prices (percentage change)	-2.5	0.5	0.9	1.0	1.0
World Export Prices (percentage change)	-2.7	0.4	0.7	1.0	1.0
Oil Prices (USD per barrel)	23.8	22.6	21.5	20.7	20.0