

THE TURKISH ECONOMY 1999



MÜSIAD

INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION

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MÜSİAD

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THE TURKISH ECONOMY 1999

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Foreword

On 17 August 1999, a major part of the Marmara Region, industrially most advanced and densely-populated part of Turkey, was devastated by an earthquake which was undoubtedly one of the century's most horrifying natural disasters. Thousands of lives were lost and many more injured, still leaving tens of thousands of families homeless. Its economic costs to the country are estimated to be in the range of 9 to 13 billion US Dollars, corresponding to around 5 percent of the country's Gross Domestic Product.

Notwithstanding its huge economic costs, the earthquake has once again revealed an important and distinguishing character of the Turkish society, namely solidarity and brotherhood. Shortly after the earthquake was heard, individuals and civilian groups fled into the region in order to assist the victims of the disaster in every ways possible. It is our sincere and firm conviction that, Turkey will soon overcome the difficulties and hardships caused by this earthquake through efforts of non-governmental initiatives and resume its normal course of steady progress, socially and economically. The recent events have once again proven the vital role and importance of civil initiatives in mobilizing the country's resources to the society's common goals. Governments must support, not overshadow, this vitally important potential for the country's and its people's common good and further advancement.

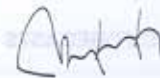
Unfortunately, the Turkish economy enters the third Millenium with important economic and socio-economic problems, notably high inflation, high unemployment, inequitable income and wealth distribution, public sector imbalances, inefficient and insufficient infrastructure, etc.. But, we strongly believe that Turkey and the Turkish people have the required ability, potential, and human and natural resources to overcome these problems, provided that the country's and society's energy and potentials are properly directed.

Apart from an overhaul of the economic and social system, achieving a comprehensive legal reform must also be one of Turkey's utmost priorities at the turn of the millenium. Provisions existing in the Constitution and the laws which restrict freedom of thought, expression and belief must be abolished with immediate effect.

This report, based on the most recent figures, summarizes the main developments and trends achieved by the Turkish economy in 1999. It is the fifth country survey published in English by MÜSİAD with the objective of providing a reliable and objective reference about the Turkish economy, together with MÜSİAD's own assessments and recommendations, for international circles taking interest in Turkey.

Hoping that this report would prove to be a useful reference about the recent trends and near future prospects of the Turkish economy, MÜSİAD looks forward to continuing studies on the critically important economic and social topics on Turkey, and make them available to local and international bodies.

Yours Faithfully,



B. Ali BAYRAMOĞLU

President

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Summary

The Turkish economy, following a fast growth phase for three consecutive years between 1995-1997, entered into a deceleration trend in the second half of 1998, the said deceleration trend turning into negative growth in the first half of 1999. Resulting mainly from sharp decline in private final consumption and private investment spending, Gross Domestic Product declined by 5 percent in the first half of 1999. Given the weak aggregate demand still persisting and low capacity utilization in manufacturing industry, coupled with poor performance (negative growth) in agriculture, GNP growth is expected to remain well below the target level and even to become negative as a result of probable adverse effects of the devastating earthquake which affected a major part of the Marmara Region, the most industrial and densely populated part of the country. Resulting from slowing economic activity, the open unemployment rate has risen from 6.2 percent in October 1998, to 7.3 percent in April 1999; the rise in open unemployment was more visible in urban areas where the unemployment rate has risen to as high as 11.7 percent in April 1999, from 9.9 percent in April 1998.

Mainly as a result of poor tax performance, the total consolidated budget deficit has reached to around 6,300 trillion Turkish Liras, in the first seven months of 1999, meaning a phenomenal 185 percent nominal increase in the budget deficit over the corresponding period of 1998. High and ever-rising share of interest spending has long been the main structural weakness of the annual budgets in Turkey, and the year 1999 is no exception to this. In the first seven months of 1999; for every 1000 TL of tax revenue, 91 TL was spent on budgetary interest payment. Resulting from higher-than-planned budget deficit and renewal of the maturing debt stock, the total public domestic debt stock has risen by around 65 percent (in nominal terms) in the first eight months of 1999, which-given the 32 percent rise in the wholesale prices in the same period-meant a real increase in the debt stock. The average interest rate on public domestic borrowing has risen to as high as 116 percent in August 1999, and given the high borrowing requirement of the public sector in the current year, the public borrowing interest rate is highly likely to remain high, both in nominal and real terms, in the remaining months of the year.

The size of the Central Bank's balance sheet grew by around 56 percent in the first eight months of 1999, the increase in the CB's assets stemming entirely from the increase in for-



foreign assets as opposed to a decline in domestic assets. Given the price inflation in the first eight months of the current year, the growth in various monetary aggregates indicate to a nominal monetary expansion over and above the current rate of inflation, i.e. real monetary expansion.

The Istanbul Stock Exchange was seen to have made its long expected upturn in 1999, the ISE Composite Index rising by as high as 93 percent in the first eight months, which, adjusting for consumer price inflation in the same period, meant a 42 percent real increase.

In Turkey, against the very poor performance of the real estate sector in recent years, financial instruments continue to yield considerably high real returns.

Total commercial bank deposits grew by around 52 percent in the first seven months of 1999, representing a similar growth when compared to the previous year, whilst, resulting from decelerating economic activity, loans extended by commercial banks have slowed down considerably. Direct credits extended by the Central Bank has risen by around 83 percent in the first seven months of the year, which means an acceleration in CB's credits as compared to the previous few years.

The annual percentage change in wholesale prices had steadily declined from 92.5 percent in January 1998, to 48.2 percent in March 1999. Similarly, consumer price inflation was observed to have fallen from 101 percent to 63 percent in the same period. The steadily declining trend of prices seems to be reversing in the recent months; the monthly price rises in July and August were seen to be above the season averages, causing the annual inflation to re-accelerate from 50 percent in May to 53.7 percent in August according to wholesale prices, and from 63 percent to 65.4 percent according to consumer prices. The government seems to be at the cross-roads of continuing with tight monetary stance at the risk of even deeper economic slump, or loosening the monetary conditions to some extent in order to boost the real economy at the expense of somewhat higher inflation in the short-run. Continuing with tight monetary policies in the presence of public budget deficits of record levels is highly likely to end up with higher inflation and deeper economic crisis eventually, since the prevailing exorbitantly high real interest rates (30 to 40 percent) lead to stagflation and are definitely unsustainable in the long-run.

In the first eight months of 1999, the public sector's wholesale prices rose at a faster rate (of 58.7 percent) than private sector's wholesale prices (of 25.2 percent); faster rise of public prices can be interpreted as the inability of private sector to fully reflect the rising cost on their final prices, under sluggish demand conditions.

The declining trend in foreign trade volume was seen to have continued also during 1999. In the first six months of the current year, Turkey's total exports (on FOB basis) were down by around 14 percent and imports by around 22 percent, when compared to the same period of 1998. The current account yielded a modest deficit (of 259 million US Dollars) in the



first half of 1999, as compared to 1,296 million US Dollars deficit in the corresponding period of 1998. The capital account yielded a surplus of nearly 3.9 billion US Dollars in the first six months, resulting from 2,162 million USD net portfolio investment and 1,381 million USD net short-term investment.

Turkey's total international reserves continued to rise during 1999, from 29.5 billion US Dollars at the end of 1999 to 30.4 billion US Dollars by May 1999. The Central Bank's (official) foreign exchange reserves have reached to around 23.8 billion US Dollars at the beginning of September 1999, from 19.7 billion US Dollars at the end of 1998. Given the confidence created by the Central Bank through its strong reserves position and tight monetary stance as well as declining trade deficit in the current year, it is highly unlikely for the foreign exchange rate to move erratically (outside the control of the Central Bank) in the foreseeable future.

The total foreign debt service of Turkey is projected to be around 17.7 billion US Dollars in 1999 and 18.8 billion US Dollars in the year 2000, followed by a projected declining trend of yearly foreign debt servicing in the following years.



CHAPTER 1

GROSS NATIONAL PRODUCT, INVESTMENT ACTIVITY AND LABOUR MARKET

I. GNP PERFORMANCE

Following a fast growth phase during the period 1995-1997, the Turkish economy entered into a deceleration trend in the second half of 1998. The economy which recorded a 4 per cent growth rate in the second quarter of 1998, could only grow by 1.9 percent in the third

TABLE 1: GROSS DOMESTIC PRODUCT (1998)

	BILLION TL (Current Prices)	Percentage Change	
		Nominal ⁽¹⁾	Real ⁽²⁾
Agriculture	8,947,884	114.6	7.6
Industry	11,958,800	64.0	1.8
• Manufacturing	10,128,255	62.9	1.2
• Mining	551,772	63.8	5.9
• Electricity/Gas/Water	1,278,773	73.4	5.3
Construction	3,057,577	75.4	-0.3
Commerce	10,352,369	73.0	1.2
Transportation/Communication	7,181,691	78.7	6.0
Financial Institutions	3,191,373	116.4	6.9
House Dwelling	1,670,980	96.5	2.3
Liberal Professions	1,939,228	81.7	3.3
(minus) Implicit Banking			
Services	3,101,211	126.1	6.0
Public Services	4,782,332	85.4	0.6
Private Non-Profit			
Institutions	98,742	86.2	1.7
Import Tax	1,545,375	59.0	-1.0
Gross Domestic Product	51,625,145	79.0	2.8
Net Foreign Factor Incomes	1,387,638	149.0	-
GROSS NATIONAL PRODUCT	53,012,780	80.4	3.8

(1) at 1998 current prices

(2) at 1987 constant prices

Source: State Institute of Statistics



quarter of the same year. The said deceleration trend has turned into negative growth in the first and second quarters of 1999. The Gross Domestic Product (GDP) recorded minus 8.5 percent and minus 2.0 percent growth, respectively in the first and second quarters of the year. Gross National Product declined by 8.4 percent and 3.4 percent respectively in the first and second quarters. **The contraction in the economy observed since mid-1998 stemmed largely from decline in domestic aggregate demand, a trend which was most visible in the first half of the current year.**

The private final consumption making up around 70 percent of total aggregate demand, declined by 6.7 percent and 0.1 percent respectively in the first and second quarters of the current year, as opposed to 7.8 percent growth in the first quarter of the previous year.

The public final consumption, on the other hand, displayed a 5 percent growth in the first quarter followed by a modest growth (1.9 percent) in the second quarter.

TABLE 2: GROSS DOMESTIC PRODUCT (EXPENDITURE APPROACH)

(1987 Constant prices, Percentage Change)

	SECOND QUARTER 1999	FIRST QUARTER	
		1999	1998
Private Final Consumption	-0.1	-6.7	7.8
Public Final Consumption	1.9	5.0	8.7
Gross Fixed Capital Formation	-14.3	-18.1	9.6
(a) Public Investment	22.0	1.4	32.4
(b) Private Investment	-22.0	-20.7	7.1
Export of Goods and Services	-10.0	-8.1	22.4
Import of Goods and Services	-5.2	-18.6	15.2
GROSS DOMESTIC PRODUCT	-2.0	-8.5	8.7

Source: State Institute of Statistics

Investment demand was observed to have shown a drastic decline in the first half of 1999. Total gross fixed investment expenditure declined by 18.1 percent and 14.3 percent in real terms, respectively in the first and second quarters, resulting from sharp decline in private investment activity. Private investment demand fell by around 20 percent in the first half of the year, whilst public investment demand was up by 22 percent in the second quarter of the year.

Exports declined by 8.1 percent and 10.0 percent in real terms, respectively in the first and second quarters of the year, whilst imports displaying a similar declining trend, falling by 18.6 percent and 5.2 percent respectively in the first and second quarters.



TABLE 3: GNP GROWTH (1999)

	At 1987 Constant Prices, Percentage Change)		
	FIRST QUARTER	SECOND QUARTER	FIRST SIX MONTHS (TOTAL)
AGRICULTURE	0.2	-7.8	-5.5
INDUSTRY	-9.3	1.2	-3.9
CONSTRUCTION	-2.3	-5.9	-4.3
COMMERCE	-15.4	-4.3	-9.4
TRANSPORTATION/COMMUNATION	-3.5	-0.6	-2.0
FINANCIAL INSTITUTIONS	7.8	7.5	7.6
HOUSE DWELLING	2.2	2.0	2.1
LIBERAL PROFESSIONS AND SERVICES	-7.4	-1.0	-4.0
PUBLIC SERVICES	0.4	0.3	0.3
NON-PROFIT INSTITUTIONS	1.9	0.8	1.3
IMPORT TAX	-23.5	-5.8	-14.9
GROSS DOMESTIC PRODUCT	-8.5	-2.0	-5.0
GROSS NATIONAL PRODUCT	-8.4	-3.4	-5.8

SOURCE: STATE INSTITUTE OF STATISTICS

Resulting largely from the sharp decline in domestic aggregate demand, namely private final consumption and private investment expenditure, Gross Domestic Product declined sharply by 8.5 percent in the first quarter of the year, as opposed to 8.7 percent growth in the corresponding period of the previous year. The decline in GDP was dampened, to some extent in the second quarter, whilst still resulting in a 2 percent negative growth. Drastic contraction in domestic aggregate effective demand, mainly as a result of the sharp fall in private final consumption and investment expenditure, could not be offset by a rise in net external demand, i.e. a considerable rise in exports.

Drastic contraction in domestic aggregate demand could be explained by a number of factors: the first round effects of the new tax law of July 1998 and the resultant negative business expectations, further rise in real (positive) interest rates, the tight monetary stance in the presence high public sector borrowing requirements causing persistence of exorbitantly high market interest rates can be singled out as major factors behind the drastic fall in domestic demand.

The visible fall in exports was resultant mainly from the crisis in the Russian economy, one of Turkey's major export markets in recent years. The sharp fall in import demand was a result of the sharp decline in domestic production and investment activity.



TABLE 4: CAPACITY UTILIZATION IN THE MANUFACTURING INDUSTRY

	Percentage										
	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV DEC
1998	75.8	78.1	80.5	77.4	82.1	78.7	81.1	79.4	81.8	80.8	79.2 74.4
1999	71.5	71.2	73.7	78.0	78.3	76.6	73.7	70.7			

SOURCE: STATE INSTITUTE OF STATISTICS

Industrial output declined by 3.9 percent in the first six months of 1999, whilst agricultural output was down by 5.5 percent. As of July 1999, capacity utilization in the manufacturing industry still remained below the last year's level. On average, the manufacturing output declined by around 5 percent in the first six months of 1999 as compared to 3.3 percent growth in the same period of last year.

TABLE 5: INDUSTRIAL OUTPUT (1)

	Last one year to July		First Seven months- Average	
	1999	1998	1999	1998
• Mining	-7.5	4.3	-7.6	16.7
• Manufacturing Industry	-3.1	-1.0	-5.2	3.3
• Electricity/Gas/Water	5.2	9.9	3.4	8.5
TOTAL INDUSTRIAL PRODUCTION	-2.8	0.2	-4.6	4.3

(1) Percentage Change in the SIS' Industrial Production Index (1997 = 100)

Source: State Institute of Statistics

Given the still persisting weak aggregate demand and low capacity utilization in the manufacturing industry coupled with poor performance (negative growth) in agriculture, **GNP growth is expected to remain well below the targeted level and even become negative as a result of possible negative effects of the devastating earthquake which affected a major part of the Marmara Region, the most industrial and highly populated part of the country.**



II. THE LABOUR MARKET CHAPTER 2

As a result of the declining economic activity in the last one year, the open unemployment rate has risen from 6.2 percent in October 1998, to 7.3 percent in April 1999. Rise in open unemployment was more visible in urban areas where the unemployment rate has risen to as high as 11.7 percent in April 1999, from 9.9 percent in April 1998.

TABLE 6: THE LABOUR MARKET

	APRIL 1999	OCTOBER 1998	APRIL 1998
EMPLOYMENT (thousand people)	22,049	21,958	21,230
OPEN UNEMPLOYMENT RATE (%)	7.3	6.2	6.4
UNDEREMPLOYMENT RATE	6.9	5.7	6.0
LABOUR PARTICIPATION RATE (%)	48.7	48.5	47.5

SOURCE: STATE INSTITUTE OF STATISTICS

The concept of "underemployment" covers economically active people who are currently employed in jobs with less than 40 hours of work a week, but are suitable for longer hours of work in their current employment or in a different job. The underemployment rate so defined has also risen in the past one year to April 1999, from 6.0 percent to 6.9 percent. As of April 1999, the total of open unemployment and underemployment stood at around 14.2 percent, which was 12.5 percent in April 1998.

TABLE 7: URBAN AND RURAL UNEMPLOYMENT

	APRIL 1999	APRIL 1998
OPEN UNEMPLOYMENT RATE (%)	7.3	6.4
Urban	11.7	9.9
Rural	3.4	3.2
UNDEREMPLOYMENT RATE (%)	6.9	6.0
Urban	7.6	7.0
Rural	6.3	5.1

Source: State Institute of Statistics



CHAPTER 2

PUBLIC FINANCE AND DOMESTIC DEBT

I. BUDGET PERFORMANCE

Resulting mainly from a poor tax performance, the total consolidated budget revenue rose by a nominal 48.2 percent in the first seven months of 1999 as compared to the same period of the previous year.

Tax revenue which had increased by as high as 121 percent in the first six months of 1998, could increase by only 50.6 percent in the corresponding period of 1999, indicating the extent of poor tax performance in the aftermath of the new tax laws adopted in the latter half of 1998.

Total consolidated budget revenue consisting of tax revenue, non-tax revenue, donations and annex budget rose by around 48 percent in the first half of 1999, reaching to TL 9,117,227 billion. Due to serious stagnation (and even negative growth) in the economy, tax performance is expected to remain quite poor for the year 1999.

Total consolidated budget expenditure, on the other hand, rose at a faster rate in the first six months of the current year, resulting from a fast increase in personnel expenditure and interest payments on public debt stock. Budget expenditure rose by around 84 percent in the first seven months of the year, reaching to nearly 15,392,552 trillion TL. Personnel expenditure rose by 87 percent, investment expenditure by 58 percent and interest payments on domestic and external debt stock by around 75 percent. There was a notable increase in the amount of transfer payments to State Economic Enterprises.

The primary budget (the budget excluding interest payments) yielded a surplus of 490,124 billion TL in the first seven months of 1999, which compares unfavourably to the primary budget surplus of 1,658,902 billion TL in the same period of the past year.



TABLE 8: CONSOLIDATED BUDGET (BILLION TL)

	JANUARY-JULY		Percentage Change
	1999	1998	
REVENUE	9,117,227	6,152,044	48.2
Tax Revenue	7,080,065	4,855,430	45.8
Non-Tax Revenue	740,561	623,433	18.8
Special Revenue and Fund	1,112,027	581,648	91.2
Annex Budget	184,574	91,533	101.6
EXPENDITURE	15,392,552	8,350,518	84.3
Personnel Expenditure	3,717,639	1,984,737	87.3
Other Current Expenditure	668,934	436,648	53.2
Investment Expenditure	561,031	354,611	58.2
Interest Payment	6,765,449	3,857,776	75.4
on Domestic Debts	6,311,739	3,593,657	75.6
on External Debts	453,660	263,719	72.0
Other Transfer Exp.	3,679,499	1,717,146	114.3
PRIMARY BUDGET BALANCE	490,124	1,658,902	-70.5
BUDGET BALANCE	-6,275,325	-2,198,474	185.4

SOURCE: TREASURY UNDERSECRETARIAT

Due mainly to the slower growth of budget revenue, the consolidated budget deficit has reached to 6,275,325 billion TL in the first seven months of 1999, meaning a 185 percent nominal increase in budget deficit over the same period of 1998.

Given the major budget trends in the first seven months of the year plus the possible adverse (expenditure increasing) effects on the public budget of the devastating earthquake, which took place in August, affecting a major part of the Marmara Region of Turkey, **the budget deficit is highly likely to exceed 10,000,000 billion TL for the whole of 1999.**



II. FINANCING OF BUDGET DEFICIT

The consolidated budget has yielded a cash deficit of around 5,111,000 billion TL in the first six months of 1999.

As in the previous year, the government did not resort to any Central Bank short-term financing in bridging the cash deficit. Instead, there was a heavier reliance on government bond issuance. Whilst there was a decrease in net foreign borrowing and net domestic borrowing through Treasury bills, **a notable rise was observed in net domestic borrowing through government bonds**. As a result, the average maturity of public domestic borrowing has risen from 382 days in January 1999 to 721 days in August.

In the first six months of 1999, the Treasury achieved a net domestic borrowing of TL 5,067,855 billion whilst reducing net foreign borrowing by around TL 187,855 billion. Net domestic borrowing through government borrowing amounted to TL 8,779,940 billion whereas net domestic borrowing through T-bills was reduced by TL 1,335,927 billion. The Treasury did not resort to Central Bank's short-term advances in financing the cash deficit in the first half of 1999.

TABLE 9: FINANCING OF CONSOLIDATED BUDGET DEFICIT

(BILLION TL)

	JANUARY-JUNE	
	1999	1998
CASH BALANCE	-5,111,160	-2,021,187
FINANCING OF CASH DEFICIT		
a) Net Foreign Borrowing	-187,855	-94,271
b) Net Domestic Borrowing	5,067,855	1,917,251
• Government Bonds	8,779,940	417,764
• Treasury Bills	-1,335,927	1,499,488
• Central Bank		
Short-term Advances	0,0	0,0
c) Other	231,160	198,206

SOURCE: TREASURY UNDERSECRETARIAT



III. SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET

High and ever-rising share of interest spending has long been the main structural weakness of the annual budgets in Turkey, and the year 1999 appears to be no exception to this rule. The ratio of interest expenditure to total tax revenue has risen from 83.8 percent in the first six months of 1998, to 91.1 percent in the same period of the current year. In other words, **for every 100 TL of tax revenue, 91 TL was spent on budget interest payment.** Similarly, **the ratio of interest expenditure to total budget revenue has risen to around 72 percent** in the first six months of 1999, from 65 percent in the same period of the previous year.

Mainly as a result of the widening deficits of social security institutions, the share in total expenditure of the other transfer expenditures has also risen to around 23 percent in the first half of 1999.

The steadily declining share of investment spending was observed to have continued also during 1999, the share of total investment expenditure in total expenditure going down to as low as 3.2 percent in the first six months.

In short; major trends related to expenditure side of the public budget indicates to continuing structural weaknesses in the public finance. **Short-term and excessively high cost public domestic borrowing continues to put an ever-increasing heavy burden on the budget.** A rising portion of annual tax revenue is allocated to interest payments every year, with a very small (negligible) portion of the budget being allocated to investment spending related to infrastructural development.

TABLE 10 : SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET

	Percentage	
	FIRST SIX MONTHS	
	1999	1998
Tax Revenue/Total Revenue	78.8	78.4
Non-Tax Revenue/Total Revenue	18.8	19.9
Direct Tax Revenue/Total Tax Revenue	46.8	47.0
Indirect Tax Revenue/Total Tax Revenue	53.2	53.0
Personnel Expenditure/Total Expenditure	24.7	24.4
Investment Expenditure/Total Expenditure	3.2	3.4
Interest Expenditure/Total Expenditure	43.2	47.7
Interest Expenditure/Total Tax Revenue	91.1	83.8
Interest Expenditure/Total Revenue	71.8	65.7
Other Transfer Expenditure/Total Expenditure	22.9	18.6
Other Transfer Expenditure/Total Revenue	38.0	25.6
Budget Deficit/Total Budget Revenue	66.0	37.0

Source: Treasury Undersecretariat

IV. PUBLIC DOMESTIC BORROWING

Resulting from huge budget deficit and renewal of maturing debt stock, **the total public domestic debt stock has risen** from TL 11,612,885 billion at the end of 1998, to TL 19,208,827 billion **by August 1999, meaning a 65 percent increase in the nominal debt stock.** Given the fact that the percentage change in the wholesale price index was 32.3 percent in the first eight months of 1999, it has meant a real increase in the debt stock.

Due to the government's heavier reliance on public domestic borrowing through government bonds, the share in total debt stock of the government bonds has risen from 50 percent at the end of 1998, to 77 percent by the end of August 1999, whilst the share of short-term Treasury bills has declined from 50 percent to 23 percent.

TABLE 11: PUBLIC DOMESTIC DEBT STOCK

(BILLION TL)

	GOVERNMENT BONDS	TREASURY BILLS	TOTAL DEBT STOCK
End-1998	5,771,980	5,840,906	11,612,885
1999			
JANUARY	7,106,180	5,421,065	12,527,244
FEBRUARY	8,128,567	5,018,354	13,146,921
MARCH	9,690,981	4,553,466	14,244,446
APRIL	10,934,477	4,428,145	15,362,622
MAY	11,841,007	4,164,005	16,005,011
JUNE	12,599,220	4,380,495	16,979,715
JULY	13,842,715	4,710,872	18,553,587
AUGUST	14,840,476	4,368,351	19,208,827

Source: Treasury Undersecretariat



The average interest rate paid on domestic public debt has fallen from 145 percent in December 1998, to 100 percent in May 1999. This trend was observed to have reversed in the following months, the average interest rate on domestic public debt rising to 116.5 percent in August. **Given the high borrowing requirement of the public sector, the average interest rate payable on public borrowing can be expected to remain high, both in nominal and real terms, in the remaining months of the year.**

TABLE 12: PUBLIC DOMESTIC BORROWING

	AVERAGE INTEREST RATE (%)	AVERAGE TERM (Days)
1997 (Annual)	108.4	349
1998 (Annual)	115.5	233
JANUARY	120.0	224
FEBRUARY	126.2	169
MARCH	115.0	167
APRIL	105.2	258
MAY	92.6	313
JUNE	91.4	278
JULY	76.7	284
AUGUST	92.6	210
SEPTEMBER	135.8	180
OCTOBER	141.0	252
NOVEMBER	145.2	221
DECEMBER	145.1	266
1999		
JANUARY	131.9	382
FEBRUARY	124.9	338
MARCH	104.0	370
APRIL	100.9	340
MAY	100.1	373
JUNE	111.7	348
JULY	101.2	427
AUGUST	116.5	721
SEPTEMBER	113.2	688

Source: Treasury Undersecretariat

CHAPTER 3

MONETARY TRENDS

I. THE MONEY SUPPLY

The size of the Central Bank's balance sheet grew by around 56 percent in the first eight months of 1999, the increase in the Central Bank's assets stemming entirely from an increase in foreign assets. The Central Bank's foreign assets grew by around 64 percent in the first eight months, owing to the increase in foreign exchange reserves, whereas the decline in domestic assets continued also during 1999.

Reserve money, the target variable in the CB's previous monetary programmes, grew by around 45 percent in the first eight months of 1999. Banknote issue, on the other hand, expanded by around 52.0 percent.

TABLE 13: MONETARY AGGREGATES

	BILLION TL		JANUARY-AUGUST (1)	
	20 AUGUST	25 DECEMBER		
	1999	1998	1999	1998
BANKNOTES ISSUED	1,885,296	1,232,331	53.0	69.3
RESERVE MONEY	3,079,737	2,040,981	50.9	64.3
CENTRAL BANK'S CREDITS	26,239	8,658	203.1	-97.5
Public	18,647	983		
Private	7,592	7,675		
M1 MONEY SUPPLY	3,702,943	2,284,174	62.1	58.0
M2 MONEY SUPPLY	17,502,355	10,856,763	61.2	63.1
M1/RESERVE MONEY (%)	120.2	111.9		
M2/RESERVE MONEY (%)	568.3	531.9		
M1/GNP (%)	-	4.3	(4.6 % in 1997)	
M2/GNP (%)	-	20.5	(17.7 % in 1997)	

(1) as of August 20

Source: Central Bank of Turkey



The growth in M1 money supply (narrowly defined money supply) was around 50 percent in the first eight months of 1999 as opposed to 55 percent in the same period of the previous year.

M2 money supply (broad definition) grew by around 61 percent (63 percent growth in the same period of 1998).

There was a rise in the money multiplier (M2/Reserve Money), from 5.32 at the end of 1998, to 5.58 by the beginning of September 1999.

TABLE 14: CENTRAL BANK'S ANALYTICAL BALANCE SHEET

	BILLION TL		Percentage Change
	27 August 1999	31 December 1998	
ASSETS	10,745,275	6,881,008	56.0
Foreign Assets	11,795,394	7,168,740	64.5
Domestic Assets	-1,050,119	-287,732	
LIABILITIES	10,745,275	6,881,008	56.0
Total Foreign Currency Liabilities	8,352,970	6,352,976	31.5
Central Bank Money	2,392,305	528,032	353.0
(a) Reserve Money	3,098,409	2,145,691	44.5
(a.1) Banknotes Issued	1,830,140	1,328,542	37.7
(a.2) Bank Deposits	1,239,149	782,586	58.3
(a.3) Fund Accounts	19,777	16,546	19.5
(a.4) Non-Bank Deposits	9,343	18,107	
(b) Other Central Bank Money	-706,104	-1,617,659	
(b.1) Liabilities Due to Open Market Operations	-1,078,402	-1,830,591	
(b.2) Public Deposits	372,298	212,932	
Exchange Rate (TL/USD)*	443,953	313,475	41.6

* Average of CB Buying and Selling Rates
Source: Central Bank of Turkey

Income velocity of money (M2/GNP) was higher (20.5) in 1998, as compared to the previous year (17.7).

Given the price inflation in the first eight months of 1999, the growth in various major monetary magnitudes indicate to a nominal monetary expansion over and above the current rate of inflation, i.e. real monetary expansion.

TABLE 15: THE MONEY SUPPLY

	BILLION TL		FIRST 8 MONTHS ⁽³⁾	
	3 SEPT 199	25 DEC 1998	Percentage Change	
			1999	1998
BANKNOTES ISSUED	1,873,245	1,232,331	52.0	67.4
CURRENCY IN CIRCULATION	1,682,449	1,106,023	52.1	72.9
SIGHT COMMERCIAL DEPOSITS	729,844	669,850	9.0	23.5
SIGHT SAVINGS DEPOSITS	1,017,504	507,856	100.4	59.1
DEPOSITS WITH THE CB	157	445		
M1 MONEY SUPPLY	3,429,954	2,284,174	50.2	55.7
TIME COMMERCIAL DEPOSITS	1,282,696	1,084,864	18.2	117.4
TIME SAVINGS DEPOSITS	12,775,906	7,487,717	70.6	61.3
CERTIFICATES OF DEPOSIT	8	8		
M2 MONEY SUPPLY	17,488,564	10,856,763	61.1	62.8
FOREIGN CURRENCY				
DEPOSITS OF DOMESTIC ORIGIN	12,993,203	8,568,813	51.6	32.0
M2Y MONEY SUPPLY ⁽¹⁾	30,481,767	19,425,576	56.9	47.0
M3 MONEY SUPPLY ⁽²⁾	18,508,648	11,944,133	55.0	48.5

(1) M2Y = New Broad Definition inclusive of foreign currency deposits of domestic origin

(2) M3 = M2 + Public Deposits + Other Deposits with CB

(3) As of September 3

Source: Central Bank of Turkey



II. BANK DEPOSITS

Table 16 depicts the relative returns yielded by some selected savings instruments in the last one year to August 1999 and in the first eight months.

TABLE 16: RELATIVE RETURNS ON SOME SELECTED SAVINGS INSTRUMENTS

	Percentage			
	JANUARY-AUGUST (1999)		LAST ONE YEAR TO AUGUST 1999	
	NOMINAL	REAL(5)	NOMINAL	REAL(6)
COMMERCIAL BANK DEPOSITS (1)				
3- month	50.0	10.5	80.4	9.1
6-month	49.6	10.2	75.8	6.3
1-year	48.5	9.4	66.9	0.9
FOREIGN CURRENCY(2)				
US DOLLAR	41.2	4.1	60.5	-3.0
GERMAN MARK	27.8	-5.8	53.5	-7.2
JAPANESE YEN	47.0	8.3	108.7	26.2
GOLD (Bullion)(3)	26.3	-6.9	48.5	-10.2
ISE INDEX(4)	93.1	42.3	90.4	15.1
GOVERNMENT BONDS TREASURY BILLS(5)				
One-Month	45.0	6.9	82.2	10.2
Three-Months	48.9	9.7	87.5	13.4
Six-Months	61.3	18.9	107.7	25.6

(1) Average of deposit interest rates of top ten Turkish commercial banks

(2) Based on Central Bank's foreign exchange buying rates

(3) Based on gold prices on the Istanbul Gold Exchange

(4) Istanbul Stock Exchange (ISE)

(5) Based on ISE's Public Domestic Borrowing Performance Index

(6) Nominal Returns Corrected for the percentage change in the SIS' Consumer Price Index

Source: Central Bank of Turkey

TABLE 17: COMMERCIAL BANK DEPOSITS (BILLION TL)

			JAN-AUGUST(*)	
			Percentage Change	
	1999(*)	1998	1999	1998
Savings Deposits	13,135,927	7,995,581	64,3	61,0
(a) Time Deposits	12,147,536	7,487,717	62,2	61,9
(b) Demand Deposits	998,391	507,856	94,6	51,7
Commercial Deposits	2,050,832	1,754,714	16,9	67,6
(a) Time Deposits	1,341,634	1,084,864	23,7	125,2
(b) Demand Deposits	709,198	669,850	5,9	24,9
Public Deposits	588,649	621,073	-5,21	-16,4
(a) Time Deposits	117,032	67,265	74,0	74,5
(b) Demand Deposits	471,617	553,808	-14,8	-22,8
TOTAL BANK DEPOSITS	15,775,408	10,371,368	52,1	53,9

(*) As of 6 August

Source: Central Bank of Turkey

In 1999, the Istanbul Stock Exchange was observed to have made its long expected upturn, with the ISE Composite index rising by as much as 93 percent in the first eight months of the year. Adjusted for the percentage change in the consumer prices in the same period, this has meant a real return of around 42 percent on the stocks, on average.

Government borrowing instruments, namely government bonds and Treasury bills, continued to yield one of the highest returns in the domestic financial markets. Six-months T-bills yielded a nominal return of 61 percent (around 19 percent in real terms) in the first eight months of the year.

Commercial banks' deposits, with short and long maturities, have also yielded considerably high real returns. Compared to different periods, the real return on commercial banks' deposits were seen to have risen in the first eight months of 1999.

In Turkey, as opposed to the very poor performance of the real estate sector in the last few years, financial instruments seem to yield considerably high real returns.

TABLE 18: FOREIGN CURRENCY DEPOSITS WITH COMMERCIAL BANKS

	MILLION US DOLLARS	
	13 AUGUST 1999	25 DECEMBER 1998
FOREIGN CURRENCY DEPOSITS OF:		
(a) Domestic Origin	33,573	32,063
(b) Foreign Origin	6,220	6,123
TOTAL FOREIGN CURRENCY DEPOSITS	39,792	38,186

Source: Central Bank of Turkey

Total consolidated bank deposits grew by around 52 percent in the first seven months of 1999, representing a similar rate of growth when compared to the previous year.

Time savings deposits grew at a rate of 62 percent in nearly seven months, whilst commercial demand deposits displayed a small increase, by as much as 6 percent.

Total foreign currency deposits increased by around 4.2 percent in the first seven and a half months of 1999, mainly as a result of an increase in the foreign currency deposits of domestic origin.



III. CREDIT STOCK

Resultant from decelerating economic activity (negative growth in the first half of 1999), loans extended by commercial banks have slowed down considerably in the first seven or eight months of 1999, rising as low as 28 percent in just over seven months as compared to the 61 percent in the corresponding period of the previous year.

The cost of foreign currency denominated loanable funds still remain considerably below the cost Turkish Lira funds, given the exorbitantly high TL interest rates and the depreciation of the Turkish Lira against major currencies being expected to remain around the actual rate of inflation in the near term.

Credits extended by the investment and development banks grew by 40 percent in just over seven months of 1999, as against 46 percent increase in the same period of 1998.

Direct credits extended by the Central Bank has risen by around 83 percent in the first seven months of the year.

Total credit stock grew at a slower rate in 1999, as compared to the previous year. In just over seven months, the total nominal credit stock grew by around 28 percent as against 52 percent in the same period of the previous year.

TABLE 19: TOTAL CREDIT STOCK (BILLION TL)

	1999(*)	1998	Percentage Change JAN-AUGUST(*)	
			1999	1998
• Commercial Bank Credits	13,292,344	10,389,202	27.9	61.1
• Investment and Development Bank Credits	839,382	597,941	40.4	46.5
• Central Bank Direct Credits	1,804	983		
TOTAL CREDIT STOCK	14,133,530	10,988,126	28.6	52.7

(*) As of August 6

Source: Central Bank of Turkey

IV. THE CAPITAL MARKET CHAPTER 4

In 1999, the Istanbul Stock Exchange (ISE) made its expected upward move, with the IMKB composite index rising by around 120 percent in just over eight months. The composite index went up to 5800 by 7 September 1999, from 2598 at the end of 1998. The financial index rose by around 132 percent in the same period, whilst the rise in the industrial index was around 110 percent. The daily trade volume has also increased, from TL 18,962 billion at the end of 1998 to TL 70,576 billion by 7 September 1999.

TABLE 20: THE ISTANBUL STOCK EXCHANGE

	7 SEPTEMBER 1999	31 DECEMBER 1998
COMPOSITE INDEX	5,800	2,598
FINANCIAL INDEX	7,608	3,270
INDUSTRIAL INDEX	4,116	1,944
DAILY TRADE VOLUME (BILLION TL)	70,576	18,962

Source: The Istanbul Stock Exchange

In the first five months of 1999, the private stocks increased by around 26 percent, while the increase in public stocks, mainly in the form of government bonds, was 37 percent. As of May 1999, share certificates constituted around 99.5 percent of total private stocks, whereas the share of government bonds and Treasury bills in total public stocks was around 99 percent.

That the public stocks make up around 88 percent of total stocks in Turkey indicates to the dominance of public sector borrowing in the domestic financial markets, which is the single major reason for the persistence of exorbitantly high nominal and real interest rates.

TABLE 21: STOCKS

	1999 (1)	(BILLION TL) 31 DECEMBER 1998
PRIVATE SECTOR STOCKS	2,394,783	1,900,219
- Share Certificates	2,384,065	1,885,946
- Bonds	6,491	6,956
- Commercial Papers	-	-
- Asset-backed Securities	4,220	7,305
- Profit-Loss Sharing Certificates	-	-
- Real-estate Certificates	-	-
- Bank Bonds	7	11
PUBLIC SECTOR STOCKS	16,164,558	11,789,178
- Government Bonds	11,841,007	5,771,980
- Treasury Bills	4,164,005	5,840,906
- Revenue-Sharing Certificates	-	-
- Foreign Currency Indexed Bonds	-	-
- Privatization Bonds	159,546	176,292
TOTAL	18,559,342	13,689,396

(1) As of end-May

Source: The Istanbul Stock Exchange



CHAPTER 4

PRICES AND INFLATION

I. THE GENERAL PRICE LEVEL

The annual rate of inflation which, resulting from substantial upward adjustment of public prices, had reached to three-digit levels by the end of 1997, displayed a decelerating trend during the course of 1998. The annual percentage change in wholesale prices had steadily declined from 92.5 percent in January 1998, to 48.2 percent in March 1999. A similar trend was followed by consumer prices, whereby the annual percentage change in consumer prices, once reaching to as high as 101.6 in January 1998, was down to 63 percent in May 1999.

TABLE 22: ANNUAL RATE OF INFLATION

	Percentage Change (*)			
	WHOLESALE PRICES		CONSUMER PRICES	
	1999	1998	1999	1998
JANUARY	50.0	92.5	65.9	101.6
FEBRUARY	48.3	89.6	63.9	99.3
MARCH	48.2	86.0	63.5	97.2
APRIL	50.0	83.3	63.9	93.6
MAY	50.0	79.9	63.0	91.4
JUNE	50.3	76.7	64.3	90.6
JULY	52.4	72.1	65.0	85.3
AUGUST	53.7	67.4	65.4	81.4
SEPTEMBER		65.9		80.4
OCTOBER		62.0		76.6
NOVEMBER		58.6		72.8
DECEMBER		54.3		69.7

(*) SIS Index (1994 = 100)

Source: State Institute of Statistics



TABLE 23: MONTHLY PRICE MOVEMENTS

	WHOLESALE PRICES		Percentage Change(*)	
	1999	1998	1999	1998
JANUARY	3.6	6.5	4.8	7.2
FEBRUARY	3.4	4.6	3.2	4.4
MARCH	4.0	4.0	4.1	4.3
APRIL	5.3	4.0	4.9	4.7
MAY	3.2	3.3	2.9	3.5
JUNE	1.8	1.6	3.3	2.4
JULY	4.0	2.5	3.8	3.4
AUGUST	3.3	2.4	4.2	4.0
SEPTEMBER		5.3		6.7
OCTOBER		4.1		6.1
NOVEMBER		3.4		4.3
DECEMBER		2.5		3.3
FIRST EIGHT MONTHS	32.3	29.6	35.7	33.9
ANNUAL(1)	53.7	72.1	65.4	85.3
ANNUAL AVERAGE (1)	53.1	84.0	67.1	93.6

(1) As of July 1999

(*) SIS Index (1994 = 100)

Source: State Institute of Statistics

Both wholesale and consumer prices indicated to a visible deceleration in annual inflation throughout 1998. The following main reasons can be singled out for the said deceleration in inflation:

(a) Declining Economic Activity

The economic stagnation which became visible in the second half of 1998, had a depressing impact on prices mainly on the demand side, whilst cost side factors (exorbitantly high real interest rates) continued to fuel price increases. There was a considerable contraction in private final consumption and private investment expenditure, in real terms, a trend which continued well into the current year. There were, however, some signs of revival in private consumption demand in the third quarter of the year, whilst the propensity to invest is still quiet weak.

(b) Delayed Public Price Adjustments

The large-scale adjustment in the prices of public goods and services made in the second half of 1997 was followed by a period of repressed public prices. As a result; whereas in 1998 the private wholesale prices has risen by around 60 percent, the public wholesale prices lagged well behind private sector prices, rising only by as much as 35 percent for the whole year.

(c) Falling Prices in World Commodity Markets

Falling commodity prices in the world market, notably oil prices, was seen to have a considerable impact on domestic prices.

(d) Contractionary Fiscal and Monetary Policies

Restriction of current and investment expenditures, at a time when interest payments on the public debt stock was continuing to exert an unbearably heavy burden) in the public budget, had a depressing impact on domestic aggregate demand leading to slower rise of prices.

The steadily decelerating trend of prices seems to be reversing in the recent months. In the months of July and August, the monthly price rises were seen to be above the season averages, causing the annual inflation rate to rise from 50.0 percent in May to 53.7 percent in August according to wholesale prices; and from 63 percent in May to 65.4 percent in August according to consumer prices.

Given the trend of monthly change in prices in the previous year, the annual rate of inflation can be expected to rise further when one adds the likely adverse impact of the devastating earthquake in August, which affected a major part of the Marmara Region, the economically most active and densely populated region of Turkey. **Given that the public budget deficit is currently running at record levels, the real market interest rates are excessively high and the economic stagnation is still persistent, a looser monetary policy is required under the present circumstances in order to boost the economy.** The government seems to be at the cross-roads of continuing with tight monetary stance at the risk of even deeper economic slump, or loosening the monetary conditions to some extent in order to boost the real economy at the expense of somewhat higher inflation in the short-run. On the other hand, continuing with tight monetary policies in the presence of public budget deficits at record levels (fiscal indiscipline) is highly likely to end up with high inflation and deeper economic crisis eventually, since the prevailing exorbitantly high real interest rates (30 to 40 percent) are definitely unsustainable in the long-run.

II. PUBLIC AND PRIVATE SECTOR PRICES

As opposed to the faster rise of private sector prices in 1998, the public sectors prices were observed to be rising at a considerably faster rate than private sector prices during the current year, which can be considered as one of the factors responsible for the faster-than-expected rise in prices in recent months. Whilst the wholesale prices rose by 32.2 percent in the first eight months of 1999, the rise in public sector wholesale prices (% 58.7) was much higher than private sector wholesale prices (25.2 percent). Substantially differing rates of change in the public and private sectors in the current year can be attributable to various factors. **Cost (supply side) factors still continue to be predominant in**



TABLE 24: CHANGES IN PUBLIC AND PRIVATE SECTOR PRICES (*)

	FIRST EIGHT MONTHS (1999)			LAST OF YEAR TO AUGUST 1999		
	PUBLIC	PRIVATE	TOTAL	PUBLIC	PRIVATE	TOTAL
Agriculture, Forestry and Fishery	-	11.9	11.9	-	39.6	39.6
Mining	60.7	27.5	50.7	77.6	38.7	65.8
Manufacturing Industry	62.8	33.4	40.5	83.9	50.8	58.8
Electricity/Gas/Water	41.7	-	41.7	61.1	-	61.1
OVERALL	58.7	25.2	32.2	79.2	46.7	53.7

(*) Percentage Change in the SIS's Wholesale Price Index (1994 = 100)

Source: State Institute of Statistics

the formation of inflation. Public enterprises in Turkey supply inputs for private sector's production. Faster rise in public sector wholesale prices can be interpreted as the inability of private sector under sluggish demand conditions, to fully reflect the rising cost on their final prices. With the revival of demand in the economy, the lagged adjustment of private sector prices to rising costs can be expected to take place, thus causing inflation to re-accelerate. Secondly; the government seems to be pursuing a public price policy which would not lead to huge losses in the public economic enterprises and thus not putting an extra burden on the consolidated budget which is already running record levels of deficit in the current year owing to poor tax performance and unbearably huge interest burden.

III. INTERNAL TERMS OF TRADE

In 1998 and during the first four months of 1999, the agricultural prices rose faster than industrial prices, thus causing internal terms of trade (the ratio of agricultural prices to industrial prices) to steadily rise to 155.5 by April 1999 (base 1994=100). The rising trend of internal terms of trade was seen to have been reversed beginning with the month of May. The domestic agricultural prices actually declined in the months of May, June and July, mainly as a result of seasonal factors, whilst the average rise in industrial prices for the three months from May to June, was no less than 5 percent. As a result, the internal terms of trade has deteriorated against agriculture from 155.5 in May 1999, to 123.7 in July. However, given the poor performance of agriculture (agricultural output declined by 5.5 percent in the first half of the year), domestic agricultural prices can be expected to begin rising again in the remaining months of the year.



TABLE 25: INTERNAL TERMS OF TRADE

	Percentage Change		Internal Terms of Trade (1994 = 100) (Agricultural Prices/ Industrial Prices)
	Agricultural Prices	Industrial Prices	
1997	96.5	91.2	130.0
1998	71.9	47.1	145.5
1999			
January	4.6	3.1	151.7
February	3.9	3.0	153.1
March	4.4	3.9	153.9
April	6.0	4.9	155.5
May	-0.4	4.6	148.2
June	-4.4	4.4	135.6
July	-2.6	6.8	123.7
August	0.3	4.1	119.1

Source: State Institute of Statistics



CHAPTER 5

EXTERNAL ECONOMIC RELATIONS

I. THE BALANCE OF PAYMENTS

The world economy which had achieved an average of 3.4 percent growth in 1997, was seen to have experienced a considerable slowdown in 1998, the world output growing by only as much as 1.9 percent, a trend which is forecasted to be continuing also during the current year. The OECD forecasts indicate to an average growth of 1.9 percent in the world output for the year 1999, resulting from projected further slowdown in the developed economies and some negative growth in what is termed as "economies in transition". The developing economies (Turkey is also included in this category) is projected to achieve a higher growth on average (2.5 percent) in the current year, as compared to the previous year (1.7 percent).

TABLE 26: WORLD ECONOMIC GROWTH

	Percentage		
	1999(*)	1998	1997
World	1.9	1.9	3.4
Developed Economies	1.8	2.0	2.8
Developing Economies	2.5	1.7	2.5
Economies in Transition	-0.3	0.5	2.5

*OECD forecast



TABLE 27: BALANCE OF PAYMENTS

(Annual, Million USD)

	1998	1997
CURRENT ACCOUNT		
Exports (FOB)*	31,220	32,647
Imports (FOB)	-45,552	-48,559
Trade Balance	-14,332	-15,358
Other Goods and Services Income:	25,802	21,273
Tourism	7,177	7,002
Interest	2,481	1,900
Other	16,144	12,371
Other goods and Services Payment:	-15,326	-13,419
Tourism	-1,754	-1,716
Interest	-4,823	-4,588
Other	-8,749	-7,115
Private Unrequited Income (net)	5,568	4,552
Workers' Remittances	5,356	4,197
Public Unrequited Income (net)	159	314
CURRENT ACCOUNTS BALANCE	1,871	-2,638
CAPITAL ACCOUNT	773	8,737
Direct Investment (net)	573	554
Portfolio Investment	-6,386	1,634
-Other Long Term Investment	3,985	4,788
-Short-Term Investment (net)	2,601	1,761
STATISTICAL DISCREPANCY		
(Net Errors and Omissions)	-2,197	-2,755
RESERVE MOVEMENTS	-447	-3,344
IMF	-231	-28
Official Reserves	-216	-3,316

(*) Inclusive of the estimated sum of unrecorded luggage trade.

SOURCE: CENTRAL BANK OF TURKEY

(a) Trade Account

Parallel to an expected slowdown in the economic growth, the 1998 Economic Program had projected a slower growth in both imports (4.9 percent) and exports (7.6 percent). As against 3.8 percent GNP growth, however, in 1998 Turkish exports declined by around 4 percent and imports by around 6 percent. As a result; total exports declined from 32,647 million USD in 1997, to 31,220 million USD in 1998, whilst total imports were down to 45,552 million USD, from 48,559 million USD in the previous year. Accordingly; there was a shrinkage in trade deficit from 15,358 million USD in 1997, to 14,332 million USD in 1998. The **apparent improvement in the trade deficit was not however due to an improved export performance, but was**

TABLE 28: BALANCE OF PAYMENTS (MILLION USD)

	JANUARY-JUNE	
	1999	1998
CURRENT ACCOUNT		
Exports (FOB)	13,537	15,765
Imports (FOB)	-17,955	-22,891
Trade Balance	-4,418	-7,126
Other goods and Services Income:		
Tourism	1,791	2,815
Interest	1,161	1,060
Other	6,157	6,822
Other goods and Services Payment:		
Tourism	-867	-1,025
Interest	-2,713	-2,165
Other	-3,962	-4,154
Private Unrequited Income(net)	2,471	2,415
Workers' Remittances	2,379	2,290
Public Unrequited Income (net)	121	62
CURRENT ACCOUNT BALANCE	-259	-1,296
CAPITAL ACCOUNT	2,859	7,648
Direct Investment (net)	265	220
Portfolio Investment	2,162	1,420
Other Long-term Investment	-949	2,607
Short-term Investment (net)	1,381	3,401
STATISTICAL DISCREPANCY		
(Net Errors and Omissions)	1,205	1,818
RESERVE MOVEMENTS	-3,805	-8,170
IMF	-157	-80
Official Reserves	-3,536	-8,090

SOURCE: CENTRAL BANK OF TURKEY

rather as a result of decline in imports (mainly raw materials and investment goods).

The declining trend of foreign trade was seen to have continued also during 1999. In the first six months of the current year, the total exports (FOB) were down by around 14.0 per cent and imports by around 22 percent, when compared to the same period of 1998. **The substantial fall in imports was the result of further contraction in the economy (the real GDP declined by 5 percent and GNP by 5.8 percent in the first half of 1999).**

The external terms of trade (1994 = 100) which had risen to 108 in February-March of 1999, was observed to have deteriorated to 105.3 in April.



TABLE 29: MONTHLY FOREIGN TRADE (MILLION US DOLLARS)

	EXPORTS		IMPORTS	
	1999	1998	1999	1998
JANUARY	1,864	2,194	2,203	3,106
FEBRUARY	2,160	2,064	2,793	3,875
MARCH	2,364	2,477	3,004	4,364
APRIL	1,870	1,977	3,327	3,634
MAY	2,125	2,418	3,329	4,175
JUNE	1,962	2,262	3,510	4,167
JULY		2,209		4,192
AUGUST		2,237		3,729
SEPTEMBER		2,208		3,660
OCTOBER		2,495		3,638
NOVEMBER		2,253		3,512
DECEMBER		2,239		3,870
FIRST 6 MONTHS	12,382	13,332	18,166	23,320
YEARLY		26,974		45,921

Source: State Institute of Statistics

TABLE 30: EXTERNAL TERMS OF TRADE (1994= 100)

	EXPORT PRICES	IMPORT PRICES	TERMS OF TRADE
1996	107.6	109.7	98.1
1997	102.5	100.2	102.3
1998	98.4	96.1	102.4
MARCH	98.8	99.0	99.8
JUNE	97.4	96.2	101.2
SEPT	98.3	94.5	104.0
DEC	97.6	92.7	105.3
1999			
JAN	99.1	92.0	107.7
FEB	97.4	89.7	108.6
MARCH	94.7	87.7	108.0
APRIL	92.6	87.9	105.3

Source: State Institute of Statistics



(b) Current Accounts

Partly as a result of declining trade deficit and surplus attained in other goods and services income, the current account yielded a surplus of 1,871 million USD in 1998, which compares favourably with the current account deficit of 2,638 million US Dollars in the previous year.

Other goods and services (including tourism, freight, financial incomes etc.) yielded a surplus of 10,476 million USD in 1998, which meant a remarkable 33 percent increase from the previous year. Workers' remittances was also up by around 27 percent in 1998, reaching to around 5,356 million USD.

The current accounts yielded a modest deficit of 259 million in the first six months of 1999, as compared to 1,296 million USD deficit in the corresponding period of 1998. This was mainly as a result of further decline in the trade deficit. Despite declining tourism revenues, a small surplus in other goods and services has been achieved in the first half of the year.

(c) Capital Account

Mainly as a result of substantial decline in portfolio investments from abroad, the capital account has yielded a small surplus in 1998 (around 773 million USD), which when compared to the previous year's 8.7 billion USD surplus, underlines the extent of reduced foreign capital inflow during 1998. Net direct investments maintained almost the same level in 1999 as in the previous year, whilst there was a substantial outflow of portfolio investments (minus 6,386 million USD as opposed to 1,634 million USD net inflow in the previous year). There was however some increase in net short-term investments from abroad, an important source of capital inflows in recent years, from 1.7 billion USD in 1997, to 2.6 billion USD in 1998.

The capital account yielded a surplus of nearly 2.9 billion USD in the first six months of 1999, resulting from 2,162 million USD net portfolio investment and 1,381 million USD net short-term investment.

(d) Official Reserves Account

Resulting from a small deficit in the current account and a nearly 2.9 billion US Dollars of surplus in the capital account in the first six months of 1999, there was a corresponding rise in official reserves by around 3.5 billion US Dollars.



II. INTERNATIONAL RESERVES

Turkey's total international reserves continued to rise during 1999. Total net international reserves which had stood at 29.5 billion US Dollars by the end of 1998, rose to 30.4 billion US Dollars by May 1999.

The Central Bank's (official) foreign exchange reserves have reached to around 23.8 billion US Dollars at the beginning of September 1999, from 19.7 billion US Dollars at the end of 1998. **Given its strong foreign exchange reserves, the Central Bank of Turkey continues to pursue its "surveillance" function over the local foreign exchange markets and closely monitors day-to-day movements in the foreign exchange rate to keep it within the targeted levels.** Given the confidence created by the Central Bank through its strong reserves position and tight monetary stance as well as declining trade deficit in the current year, **it is highly unlikely for the foreign exchange rate to move erratically (outside the initiative of the Central Bank) in the foreseeable future.**

TABLE 31: INTERNATIONAL RESERVES

(MILLION US DOLLARS)

	CENTRAL BANK		FOREIGN EXCHANGE RESERVES WITH COMMERCIAL BANKS	TOTAL NET INTERNATIONAL RESERVES
	GOLD	FOREIGN EXCHANGE		
1996	1,383.2	16,272.5	7,351.9	24,965.9
1997	1,124.4	18,418.8	7,625.1	27,138.1
1998	1,012.1	19,721.0	8,772.9	29,489.6
1999				
JAN	1,124.5	20,266.6	7,878.2	29,250.6
FEB	1,012.1	20,147.4	7,541.7	28,681.2
MARCH	1,012.1	21,438.0	8,432.3	30,869.4
APRIL	1,012.1	21,738.8	7,684.4	30,421.9
MAY	1,012.1	21,774.1	7,653.2	30,427.4
SEPT 3	1,012.1	23,871.0		

Source: Central Bank of Turkey

III. FOREIGN EXCHANGE RATES

The external value of the Turkish Lira against major currencies was observed to have followed a remarkably stable (steadily rising) trend under the close scrutiny of the Central Bank during 1998 and also in the first 8 or 9 months of 1999. The foreign exchange rate has moved (and still moves) under almost full control of the Central Bank and is freely determined by the market.

TABLE 32: INFLATION AND CURRENCY DEPRECIATION

YEARS	TL DEPRECIATION AGAINST US DOLLAR	TL. DEPRECIATION AGAINST D. MARK	CURRENCY DEPRECIATION AGAINST BASKET ⁽¹⁾	Percentage Change	
				INFLATION RATE ⁽²⁾	REAL CURRENCY DEPRECIATION (BASKET)
1990	26.7	42.7	34.7	60.3	-16.0
1991	73.4	71.5	72.4	66.0	3.9
1992	68.6	58.8	63.7	70.1	-3.8
1993	69.0	57.4	63.2	66.1	-1.7
1994	165.7	195.0	180.3	106.3	35.9
1995	58.0	66.0	62.0	93.6	-16.3
1996	80.6	66.3	73.0	79.8	-3.7
1997	90.8	65.7	78.2	99.1	-10.5
1998	52.4	63.7	58.0	69.7	-6.9
1999 ⁽³⁾	41.2	26.5	33.8	35.7	-1.4

(1) Currency basket comprising of 50 percent US Dollar 50 percent D. Mark

(2) December-on-December percentage change in the SIS' Consumer Prices Index (1987-100)

(3) First eight months of 1999

Source: Central Bank of Turkey

In 1998, the Turkish Lira depreciated by 52.4 percent against US Dollars and 63.7 percent against German Mark. As against the currency basket, consisting 50 percent US Dollars and 50 percent D. Mark, the Turkish Lira depreciated by around 58 percent.

Nominal depreciation of the currency basket corrected for the actual rate of inflation, on the other hand, indicated to a real exchange rate appreciation of somewhere around 7 percent in the year 1998.

The Turkish Lira depreciation against USD and D. Mark was 41.2 percent and 26.5 percent, respectively, in the first eight months of 1999, whilst the nominal depreciation of the "currency basket" remained around 34 percent in the same period. Given the 35.7 percent price inflation (as measured by consumer prices) in the first eight months, this has meant a negligible (1.4 percent) real appreciation for the Turkish Lira since the beginning of the year.



IV. EXTERNAL DEBTS

Turkey's total external debt stock, expressed in US Dollars, had risen by around 13.5 percent in 1998, reaching to around 103.3 billion US Dollars by the end of the year. Short-term debts were observed to have risen at a faster rate (20 percent) than medium and long terms debts (11 percent), as a result of which the share (in total external debt stock) of the short term debts had risen to slightly over 26 percent. The external debt stock, expressed in US Dollars, has fallen to around 101 billion US Dollars by the end of March 1999, mainly as a result of change in the parity between USD and D. Mark (in favour of the latter).

TABLE 33: EXTERNAL DEBT STOCK (MILLION USD)

	MARCH 1999	1998	1997	1996
Short-term Debts	27,512	27,236	22,634	20,517
Medium and Long-term Debts	73,487	76,061	68,357	63,405
TOTAL EXTERNAL DEBT STOCK	100,999	103,297	90,991	83,922

Source: Treasury Undersecretariat

Various internationally accepted measures of foreign indebtedness indicate to a change in the foreign indebtedness position of Turkey, from 1997 to 1998. The ratio of external debt stock to GNP has risen from 47.3 percent in 1997 to 50.2 percent in 1998, whilst the ratio of external debt stock to exports has also deteriorated from 278 percent to 329 percent. External debt service to foreign exchange earnings had risen from 20.8 percent in 1997 to 25.1 percent in 1998, whilst the ratio of interest payments to foreign exchange earnings remaining almost the same at 7.6 percent. Nevertheless, despite its steadily growing foreign indebtedness, it is well worth mentioning that Turkey has fulfilled its foreign debt obligations in a timely and regular manner, uninterrupted since 1980.



TABLE 34: EXTERNAL DEBT INDICATORS (MILLION USD)

	1998	1997
EXTERNAL DEBT STOCK	102,651	91,030
Short-term	27,236	22,634
Medium/Long-term	75,415	68,396
GROSS NATIONAL PRODUCT (GNP)	204,592	192,382
FOREIGN EXCHANGE EARNINGS	63,557	58,786
INTERNATIONAL RESERVES	29,505	27,168
Percentage		
	1998	1997
External Debt Stock/GNP	50.2	47.3
Medium and Long-term Debt/GNP	36.9	35.5
Short-term Debt/GNP	13.3	11.8
External Debt Stock/Exports	329.8	278.6
Short-term Debt/International Reserves	92.3	83.3
Interest Payment/GNP	2.4	2.3
External Debt Service/GNP	7.8	6.3
External Debt Service / Foreign Exchange Earnings	25.1	20.8
External Debt Stock/Exports	51.3	37.5
Interest Payment/Exports	15.5	14.1
Interest Payment/F.E. Earnings	7.6	7.8

Source: Treasury Undersecretariat

TABLE 35: EXTERNAL DEBT SERVICE PROJECTION (1999-2004)

	MILLION USD					
	2004	2003	2002	2001	2000	1999
Interest Payment				2,967	4,055	4,458
Principal				11,894	14,794	13,246
TOTAL DEBT SERVICE	7,391	10,864	11,992	14,861	18,849	17,732

SOURCE: TREASURY UNDERSECRETARIAT

The total foreign debt service of Turkey is projected to be around 17.7 billion US Dollars in 1999 and 18.8 billion US Dollars in the year 2000, followed by a projected declining trend of yearly foreign debt servicing in the following years. The total debt service is projected to be around 7.4 billion US Dollars by the year 2004.



V. FOREIGN CAPITAL

There was a sharp fall in the inflow of foreign capital during 1998. The capital account yielded a net capital inflow of only 773 million US Dollars as against 8,737 million US Dollars in 1997. The capital account yielded a surplus of 2.859 million US Dollars in the first six months of 1999, resulting from net inflow of portfolio investment and short-term investment.

The amount of foreign capital permits remained around 940 million US Dollars in the first six months of 1999, whilst the net inflow of foreign capital amounted to 468 million US Dollars.

TABLE 36: FOREIGN DIRECT INVESTMENT BY NON-RESIDENTS (MILLION US DOLLARS)

YEARS	FOREIGN CAPITAL PERMITTED	NET INFLOW OF FOREIGN CAPITAL (ACTUAL)
1992	1,820	844
1993	2,125	636
1994	1,485	608
1995	2,938	885
1996	3,837	722
1997	1,678	805
1998	1,646	940
1999 (1)	942	468.

(1) First six months.

Source: Treasury Undersecretariat

VI. RELATIONS WITH THE EUROPEAN UNION

Relations between Turkey and the European Union (EU) have had ups-and-downs particularly in the political field in the first 9 months of 1999.

Bilateral economic relations, which were guided by the Association Agreement and its Additional Protocol having resulted at the Customs Union fully in force as from early 1999, have continued unabated, though detrimental to Turkey's interests.

Politically - strained and controversial relations between both sides in the first half of this year had been due to the following factors; from the Turkish viewpoint, firstly Turkey was still feeling bitter and disappointed with the EU's having excluded her from the EU's first and second enlargement process and classified her in a peripheral and uncertain group along with Russia and Ukraine. Secondly, Turkey had vehemently opposed to the EU's opening enlargement talks with the Greek Cypriot Administration despite internationally-recognised and guaranteed Treaties to which Turkey is also a signatory and guarantor. Thirdly, the general Turkish public opinion as well as successive governments had been

disturbed by the EU bodies and its member countries' taking a contrary stance on the capture and then trial of the head of the separatist terror gang, namely, APO.

From the EU's viewpoint, Turkey was still not being considered as a candidate country until it could achieve some serious progress on full democratisation, human rights, socio - political dimension of the South - Eastern Anatolia Problem and the other issues of disarmed with Greece, namely Cyprus and Aegean issues which were suggested to be taken before the International Court of Justice in the Hague. However, the devastating earthquake which hit most part of the Marmara region on 17th August culminated in an unusual rapprochement between the EU and Turkey, also Greece and Turkey in particular. The supportive statements in favour of Turkey's likely candidacy for full membership emerged on headlines provided the above-mentioned requirements be realised very soon. The EU's Council of Ministers invited The Turkish Foreign Minister to an informal gathering on the Earthquake thema of "Relief Operation for Earthquake Victims". On the other hand, the Council also left open the subject of Turkey's likely candidacy in the already difficult negotiations to be taken up in its upcoming meeting at Helsinki in next December. In the meantime, the EU's Council has decided to provide the earthquake-stricken Turkey an urgent financial aid program consisting of a 34 million dollars of grants, a loan allowance of 500 - 600 million dollars from the European Investment Bank at favourable terms for infrastructure projects and the unblocking of 150 million dollars from the EU's coffers.

Here, MÜSİAD believes that the rapprochement between Turkey and the EU seems to be earthquake-related, but not of a long-lasting nature. Both sides, in diplomatic terms, seem to have got exhausted with inciting each other since the Luxembourg Summit in December 1997, but reaching to a climax at the time of the capture and trial of the head of the separatist terror gang in Turkey. This trend has dented images of both sides at world-wide and national level. The devastating earthquake has given both Turkey and the EU a sigh of relief.

However, we believe that both sides, in fact, are determined to maintain their basic positions. It would be an over-optimistic assumption that Turkey could immediately undertake a commitment to fulfill the EU's conditions, i.e. full democratisation, the so-called South-Eastern problem, and solving Aegean and Cyprus problems in the Hague's Court. Again it would be an over-optimistic assumption that the EU could leave aside its entrenched position just for the sake of the earthquake and accord Turkey the status of candidate country in Helsinki in December.

In the economic sphere, bilateral relations in the framework of the Customs Union have been much to the advantage of the EU, notwithstanding irrational and detrimental to Turkey's strategic interests. Hence, this basic fact convinces the leaders of the EU to think, that the Cumtoms Union program with Turkey should be in force in its present form as long as possible, and also Turkey, along with Russia and Ukraine as peripheral countries, be kept waiting only on the last queue in an enlarged Union of above 30 countries by at least 2010.



MÜSİAD strongly contends that Turkey's foreign economic and political policy formulation should not only be restricted with a European Union dimension. But it also equally believes that European Union can not be ignored from Turkey's foreign policy formulation. Having a unique position in the world with its geo - political and eco - strategic importance at the crossroads of civilizations and being at the same distance towards Europe, Asia, Africa - and the Middle - East, Turkey has an enviable opportunity to formulate and pursue a multi-dimensional foreign policy.

TABLE 37: TURKEY'S FOREIGN TRADE WITH THE EUROPEAN UNION (EU)

	1999	1998	1997	1996	1995
First 7 Months)					
EXPORTS TO EU					
Amount (Million USD)	7,846	13,437	12,247	11,548	11,078
Percentage Change (%)	3.8	9.7	6.1	4.2	28.3
Share in Total Exports (%)	53.7	50.0	46.7	49.7	51.2
IMPORTS FROM EU					
Amount (Million USD)	11,533	24,091	24,869	23,138	16,860
Percentage Change (%)	-18.8	-3.1	7.5	37.2	64.0
Share in Total Imports (%)	52.8	52.5	51.2	53.0	47.2
TRADE BALANCE WITH EU					
Amount (Million USD)	-3,687	-10,654	-12,622	-11,590	-5,782

Source: State Institute of Statistics

CHAPTER 6

MÜSİAD'S RECOMMENDATIONS

I. MEASURES RELATED TO ECONOMIC STABILITY

A. The existing public domestic debt problem must be solved without further delay.

The following TABLE 38 gives a good idea about the extent of heavy burden caused by the existing public domestic debt stock.

TABLE 38: INTEREST PAYMENTS ON PUBLIC DOMESTIC DEBT

Year	Interest Paid (Billion TL)	Central Bank Average Exchange Rate (TL vs USD)	Interest Payment on Public Domestic Debt (Million USD)
1989	6,181	2,062.20	2,997.2
1990	12,486	2,619.25	4,767.0
1991	18,608	4,000.95	4,650.9
1992	27,029	6,815.35	3,965.9
1993	69,170	11,506.95	6,011.1
1994	177,784	26,438.00	6,724.5
1995	576,115	48,959.50	11,767.3
1996	1,497,401	83,503.00	17,932.3
1997	2,291,000	156,677.50	14,622.4
1998	5,630,000	260,225.50	21,635.1
1999	10,000,000 ^(*)	400,000.00	25,000.0
TOTAL			120,073.7

(*) Based on an optimistic estimate
Source: Treasury Undersecretariat

MÜSİAD believes that urgent measures (a kind of "shock therapy") are necessary in order to stop the existing public debt problem becoming a no-longer-managable one in the near future. The essence of these measures is to reduce the need for public borrowing and extend the average maturity of the debt stock. For this purpose:



- (1) Inflation-indexed (instead of the existing fixed nominal interest) borrowing must be adopted.
- (2) A part of privatization revenues must be used for the purpose of repaying (thus reducing) the public debt stock.
- (3) A partial and well-calculated monetization must be introduced.
- (4) Centralized fund management system in the public sector must be re-introduced with the purpose of managing public funds in an effective and efficient manner.
- (5) Constitutional and legal constraints must be introduced in order to limit public borrowing which has become an unfair income and wealth redistribution mechanism in Turkey for the past 10 years.

B. Privatization must be realized on transparent and objective criteria and must be completed by the end of year 2000. Cartelization must be avoided.

- 1- Privatization is, beyond doubt, a politically and socially sensitive issue, requiring a wide public support for its ultimate success. Needed public support will only be possible to the extent that the public is convinced about the reasons for and the benefits to be obtained from privatization. Utmost importance should therefore be given to transparency and public accountability issues in privatization procedures. It is imperative that the public is convinced that privatization is not being done simply to transfer the public wealth from the society to a small number of people, but for improving overall productivity in the economy and rehabilitating the ailing public sector.
- 2- The existing (and already worn out) structure related to privatization, must be replaced with a new institutional framework (such as "Treuhand" following the integration of West and East Germany) including representatives also from civilian groups and institutions.
- 3- Privatization process must be speeded up and be completed by the year 2000.
- 4- Public banks must be privatized in the first instance and without any further delay.
- 5- The Competition Law, The Law on Radio and Television Higher Board and other similar regulations must be applied effectively and without any discrimination whatsoever.
- 6- Shareholding structure of companies participation in privatization tenders must be examined closely, and consorsiums which include public banks must not be allowed to participate in such tenders.
- 7- Purchase offers by workers employed in companies under privatization must be considered with due diligence.
- 8- Those companies/enterprises which can not be privatized for specific reasons, must be granted autonomous management.



C- More emphasis must be given to social policies

Within the framework of a social security reform:

- 1- Social security institutions must be able to collect premiums more effectively. They must make better and more profitable use of their participations.
- 2- Social security coverage must be broadened.
- 3- The existing social security institutions, namely SSK, BAĞ-KUR and EMEKLİ SANDIĞI, must be unified under a single institution which would work more effectively and efficiently.
- 4- Private insurance in the areas of health and retirement must be encouraged.

D- A financial reform must be made

- 1- Banks must allocate a larger portion of their loanable funds to venture capital and to medium and long term investment credits. Necessary arrangements must be effected to make banks act accordingly.
- 2- Full (hundred percent) state insurance coverage on banks' savings deposits must be abolished in a gradual manner.
- 3- Banks must be allowed to bankrupt under market conditions and the practice of handing over of banks in financial trouble to "Savings Deposits Insurance Fund" must be abandoned.
- 4- Public banks must be privatized immediately.
- 5- Banking licence must be granted only to those trustworthy entrepreneurs who can carry out banking business. New rules and regulations must be introduced in order to eliminate organic integration of commercial, financial, industrial and mass media capital.
- 6- Public and private banks must be supervised by The Council of Sworn Inspectors (of the Treasury) more closely and effectively. Political pressure on these supervisory bodies must be stopped.

Concerning interest-free banking institutions (what is legally named as "special finance houses):

- 7- The existing restrictions on these institutions in relation to new branch permissions must be eased and must be made compatible to those of commercial banks.
- 8- Rules concerning collection of deposit funds must be revised so as to reflect the interest-free nature of these institutions.
- 9- Special Finance Houses, like commercial banks, must be permitted to act as intermediaries in the Stock Exchange.



E- Growth with price stability must be aimed.

The recent arrangements made with the International Monetary Fund is seen to have led to stagflation (low and negative growth with high inflation). Growth within price stability requires increased exports, disciplined public spending, supply-side measures to increase output and perfect competition in goods, services and factor markets.

F- The existing structure of the ECONOMIC AND SOCIAL COUNCIL must be changed for a more effective functioning.

MÜSİAD believes that, changing the existing structure of the Economic and Social Council, to a more civilian, pluralistic and participatory democratic form encompassing representatives from all sections of the society, would yield more fruitful and better results for the functioning of this council. In this council, institutions like semi-governmental bodies such as Union of Chambers of Commerce and Industry, MÜSİAD and other businessmen's and industrialists' associations, Foundation for Economic Development, Assembly of Exporters, Council of Foreign Economic Relations, banks and special finance houses, confederation of government employees, Workers' Trade Unions, Association of pensioners etc., must be represented.

G- Relations with The European Union must be looked at from a more rational and realistic point of view.

MÜSİAD believes that the rapprochement between Turkey and the EU seems to be earthquake-related, but not of a long-lasting nature. Both sides, in diplomatic terms, seem to have got exhausted with inciting each other since the Luxembourg Summit in December 1997, but reaching to a climax at the time of the capture and trial of the head of the separatist terror gang in Turkey. This trend has dented images of both sides at world-wide and national level. The devastating earthquake has given both Turkey and the EU a sigh of relief.

However, we believe that both sides, in fact, are determined to maintain their basic positions. It would be an over-optimistic assumption that Turkey could immediately undertake a commitment to fulfill the EU's conditions, i.e. full democratisation, the so-called South-Eastern problem, and solving Aegean and Cyprus problems in the Hague's Court. Again it would be an over-optimistic assumption that the EU could leave aside its entrenched position just for the sake of the earthquake and accord Turkey the status of candidate country in Helsinki in December.

In the economic sphere, bilateral relations in the framework of the Customs Union have been much to the advantage of the EU, notwithstanding irrational and detrimental to Turkey's strategic interests. Hence, this basic fact convinces the leaders of the EU to think, that the Customs Union program with Turkey should be in force in its present form as long as pos-



sible, and also Turkey, along with Russia and Ukraine as peripheral countries, be kept waiting only on the last queue in an enlarged Union of above 30 countries by at least 2010.

MÜSİAD strongly contends that Turkey's foreign economic and political policy formulation should not only be restricted with a European Union dimension. But it also equally believes that European Union can not be ignored from Turkey's foreign policy formulation. Having a unique position in the world with its geo - political and eco - strategic importance at the crossroads of civilizations and being at the same distance towards Europe, Asia, Africa - and the Middle - East, Turkey has an enviable opportunity to formulate and pursue a multi-dimensional foreign policy.

H. Changes to be made in the Tax Reform Package

- (1) Increases in spending and wealth must be excluded from the definition of "income".

(The government has adopted our above offer for the next three years).

- (2) "Inflation accounting" system must be adopted.

- (3) Given the present conditions in Turkey, the existing VAT rates seem to be quite high, and must be reduced to a maximum of 10 percent in order to boost domestic consumption spending and reduce the size of "unrecorded economy". The definition of "luxurious goods" (subject to 23 percent VAT) must be revised.

- (4) Tax rates, notably Corporate Tax Rate, must be reduced. Proportional Corporate Tax system (alike Income Tax) must be adopted, and corporate and income tax rates must be equalized and applied between a minimum of 10 percent and a maximum of 30 percent. Moreover, dividend distribution must be exempted from withholding tax.

- (5) Non-tax financial burdens (social security premiums and etc.) on wage incomes must be lessened.

- (6) As per provisional Article 23 of the Corporate Tax Law, incorporating profits arising from the sale of real-estates and securities to the company's capital enjoys tax exemption. This exemption must become a permanent practice.

(The government has recently decided to implement the above exemption until the end of 2002.)

- (7) Interest payable on government borrowing instruments (gov't bond, T-bills) must be subjected to withholding tax.

- (8) Income from securities must be subject to withholding tax (instead of declaration)

(The government has recently adopted our above proposal).

- (9) Securities must be evaluated on basis of purchase price and the practice of taxing sale and purchase of share certificates must be postponed until the year 2003.

(The government has postponed the above practice until the end of year 2002).



(10) For Real-estate Tax purposes, the value of the real-estate must not be indexed to revaluation rate, instead, value increases must be left to be determined by municipalities.

(The government has recently adopted a rule whereby the value of the real estate is indexed to 50 percent of revaluation rate).

(11) Donations and aids made to foundations (established according to the relevant-provisions of the Civil Code) must be tax-deductible.

II. MEASURES RELATED TO REVIVAL OF THE DOMESTIC ECONOMY

- 1- The prevailing Value Added Tax rates must be reduced to a maximum of 10 percent, in order to boost domestic consumption spending and reduce the size of "unrecorded economy".
- 2- Resource Utilization Fund (3 percent) currently applied on raw material and semi-finished goods imported on credit (deferred term) basis must be eliminated in order to encourage production.
- 3- Credits related to operating capital needs of the Small-and Medium-Sized Enterprises, suspended by the public banks for quite some time now, must be re-activated. Such enterprises must be granted loans for operating capital (instead of investment) in order to increase production.
- 4- Provisions of the Turkish Commercial Law and Competition Law related to the elimination of unfair competition must be implemented effectively.
- 5- The prevailing Cheque Law must be reviewed in order that cheque accounts regain its old credibility. Stronger provisions must be introduced to the existing Cheque Law.
- 6- The existing volume of currency in circulation is far from meeting the liquidity needs of the Turkish economy. A substantial volume of cheques and promissory notes (the volume can not be estimated easily) circulate in the economy and is used as a substitute for currency. With the purpose of easing the existing exorbitantly high interest rates and mitigating liquidity shortages in the economy, banknote issue must be increased in a controlled manner.
- 7- Measures must be adopted so that commercial banks do not apply excessively high penalty interest rates on overdue loans. Companies facing serious financial difficulty must be able to repay their debt to commercial banks, at interest rates indexed to current inflation rate.



- 8- The minimum tenor on repurchase transactions must be raised to one month (instead of the existing practice of daily or weekly repo), in order to eliminate misuses and relieve the market from liquidity restraints.
- 9- Unjust repression and discrimination on the Turkish investment companies mobilizing savings of Turkish workers abroad and channelling these savings funds into productive investment activities in Turkey, must be ended. On the contrary, these companies must be encouraged to channel more investable funds and foreign exchange into Turkey in a properly supervised manner, especially at a time when the country is in serious need of fresh capital funds.
- 10- With the purpose of increasing tourism revenue, urgent measures must be formulated with active participation of related parties, including travel agencies, operators and owners of touristic hotels and places. Marketing activity abroad (especially in Germany, Middle East Countries, England and Russian) must be speeded up, loans from EXIM-BANK sources must be granted to tour operators and travel agencies and domestic tourism must be given more emphasis.

III. MEASURES RELATED TO ENCOURAGEMENT OF EXPORTS

- (1) Following the first Export Promotion Program during 1980-1987, there needs to be a second and more comprehensive program for the encouragement of Turkish exports.
- (2) A "Foreign Trade Ministry" must be established in order to coordinate bodies and organizations related to foreign trade. This Ministry must be organized both within Turkey and abroad.
- (3) Eximbank resources must be increased on a substantial scale and new arrangements be introduced in order for small and medium size enterprises to make use of these resources on an equitable basis.
- (4) Turkey's export products and export markets must be diversified. At present; the share of exports to the European Union is around 50 percent and to Germany around 24 percent, whilst the share of textile and ready-made clothing is around 39 percent.
- (5) Barter trade must be encouraged with countries facing foreign exchange shortage, notably Russia and Iran, and offset agreements must be signed with these countries.
- (6) Border trade must be encouraged with neighbouring countries like Bulgaria, Ukraine, Romania, Syria and Iraq.
- (7) Turkey's commercial attachés abroad must be reinforced with the purpose of providing studies to Turkish exporters about new export markets and directing them to these markets.



- (8) There exists a need for new incentives to increase exports. Such incentives include reduced air ticket fares for Turkish businessmen flying with the Turkish Airlines, organizing low-cost fairs, reducing and eliminating existing bureaucratic barriers related to marketing of Turkish products abroad.
- (9) Excessive bureaucracy and red taping faced by exporter-producers when purchasing goods from State Economic Enterprises, must be eliminated. Especially small and medium size industrialists must be given the opportunity to purchase (from SEEs) at world prices, upon actual realization of exports, instead of the prevailing system whereby entitlement to purchase at world prices is tied to possession of export certificate.
- (10) Lower freight rates must be applied on exports made to regions outside the European Union countries.
- (11) Lower-cost energy must be supplied to exporter-producers.
- (12) Exports must be encouraged through tax reduction, lower insurance premiums and finance costs.
- (13) Effective anti-dumping measures must be taken on imports from Far-Eastern countries.
- (14) Repayment period on foreign currency loans extended to export activity must be extended from 1 year to 3 years, and must be provided at world market conditions (e.g. libor plus 2-3).
- (15) (Red) diplomatic passport must be granted to exporters realizing a certain volume of exports.
- (16) Producer/exporters must be allowed to make VAT exempt purchases from local markets under commitment of making such purchases for export purposes.

IV. DEMOCRATIC AND SOCIAL REFORMS

- 1- Turkey must achieve a comprehensive legal reform. Provisions existing in the Constitution and the laws which restrict freedom of thought, expression and belief must be abolished. Full judiciary independence must be ensured. The existing slow-working judicial system must be revised so as to work in an efficient manner; in this connection, specialized courts must be established.
- 2- Vocational education must be given more emphasis. Eight-year compulsory education must be changed to eleven-year compulsory education whereby students would be allowed to select the type of education according to their capability and tendency, after the first five years.
- 3- A reform related to local (municipal) administration must be made whereby responsibilities and revenues of local administrations would be increased.



MÜSİAD'S ECONOMIC FORECASTS FOR 1999 (End of Year)

TABLE 39: MÜSİAD'S ECONOMIC FORECASTS FOR 1999 (End of Year)

	MÜSİAD'S FORECAST
GNP (GROWTH RATE)	-1.5, -2.0 %
INFLATION RATE	64-65 %
Consumer Prices	55-57 %
Wholesale Prices	
EXCHANGE RATES	
TL/US Dollar (Year-end)	1\$=500,000 TL.
TL/D. Mark (Year-end)	1 DM=275,000 TL.
EXPORT (Excluding luggage trade)	25,500 million \$
IMPORTS	39,000 million \$
TRADE DEFICIT	13,500 million \$
Consolidated Budget Deficit	11,000 trillion TL.



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