MÜSİAD RESEARCH REPORTS - 33

THE TURKISH ECONOMY 1998

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INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION

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(INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION)

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Foreword

Today Türkiye stands to be one of those countries in the world with highest economic growth potential. Owing largely to the incredible dynamism and almost unmatched entrepreneurial capacity of the country's private sector, the Turkish economy maintains its fast growth trend in spite of existance of some serious economic imbalances partly stemming from the ailing public sector.

Certainly, mobilization of the country's great economic potential on a larger scale requires taking certain important initiatives, including;

achieving a greater social harmony; making better and more effective use of the country's important geo-cultural advantages; improving the highly inequitable income and wealth distribution in the country; curbing any and all kind of practices leading to unfair competition and emergence of cartels; restoring long-awaited stability in the political life, and in order to achieve this, holding general elections at the earliest possible time.

Touching very briefly upon some visible trends in the global economy, we may note the following.

Monopolistic trends seem to increase in the world and in Türkiye. Unfair competition become commonplace ever more.

The Asian economies, despite severity of the recent economic and financial crisis faced by these economies, can be expected to resume their high growth performance in a not-distant future.

Comparative advantages (in international trade) based on cheap labour no longer hold; instead, techno-economic factors and international co-operation seem to have gained considerable importance in today's world.

The recent developments in the world economy point to the the need for greater cooperation amongst countries as opposed to building economic blocks in different regions of the world geography. Whilst speculations, an imnate feature of financial markets, and in fact a certain degree of speculation being beneficial for smooth working of free forces and attainment of efficiency in the markets, the recent experience has shown that excessive speculation in the form of manipulations, predatory financial attacks, etc. can produce undesirable results for all economies in today's "global village". Therefore; the existing "rules of the game" in the financial world call for considerable revision whereby new rules and regulations would be established towards a more stable financial environment on a global scale.

This report, based on the most recent figures, summarizes the main developments and trends recorded by the Turkish economy in 1997 and in the first half of 1998. It is the fourth country survey published by MÜSİAD in the English language, with the objective of providing a reliable and objective reference about the Turkish economy together with MÜSİAD's own assessments ad 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 also looks forward to continuing to conduct studies on the critical economic and social topics on Turkey, and make them available to local and international circles.

Yours Faithfully,

Erol YARAR
President

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Summary

The Turkish economy has repeated its high growth performance also during 1997, with a GNP growth of as high as 8 percent against the targeted 4 percent growth for the year. Despite the negative growth in agricultural output, the economy could achieve such a high growth following 8 percent growth in 1996 and 7.9 percent growth in 1995. As in previous years, substantial real growth in the private final consumption continued to be the major determinant of high output growth whilst there was a relative deceleration in fixed investment spending. The most recent figures indicate that high comsumption growth had continued well into the first half of the current year, resulting in a GNP growth of 6.3 percent in the same period, despite declining agricultural output. The government was seen to revise its GNP growth target upwards, from 3 percent to 4.5 percent, the latter seeming to be an easily achievable target despite some signs of economic slow-down in the second half of the year. [MÜSİAD, in its report published in January of this year, had forecasted a 4.5 percent GNP growth for the year]. Average percentage increase in the manufacturing industry output was 8.1 percent in the first five months of 1998, against a 4.4 percent decline in agricultural output in the first quarter.

The SPO (State Planning Organization) figures indicate to a further deceleration in both public and public-fixed investments in the year 1997. Whilst private investment spending in manufacturing industry showed almost no growth in real terms, investment in housing sector which takes up the largest share in total private investment spending, is estimated to have contracted by around 2.5 percent. The 1998 Economic Program projects a further slow-down in the private sector's investment activity, with a modest 3.9 percent growth in private fixed investment for the year. The Program projects a slow-down also in public sector investments as part of the tight fiscal stance.

The labour market statistics indicate to a rise in open unemployment rate in the past one year to April 1998, from 5.9 percent to 6.4 percent. Whilst the rate of open unemployment in the rural areas remained stagnant at around 3.2 percent, in the urban areas it has risen from 9.2 percent to 9.9 percent in the past one year.

The 55th government which took office at the beginning of July 1997, has made certain revisions in the initial "balanced budget", whereby reducing the initial budget revenue target by 18 percent and raising the initial expenditure target by 20 percent. Accordingly; the consolidated budget deficit which had stood at TL 718 trillion for the first six months

of the year was targeted to reach to around TL 2,400 trillion for the whole year. The total consolidated budget revenue rose by around 116 percent against an increase of 104 percent in the total expenditure, thereby yielding a budget deficit of nearly 2,200 trillion for the year. Whilst the tax revenue was higher-than-initially planned, non-tax revenue remained considerably below target mainly as a result of failure to achieve privatization targets.

The 1998 Budget foresees an 84 percent rise in total expenditure, again resulting mainly from the substantial increase in interest payment on public domestic debt stock. The 1998 Budget envisages a 100 percent rise in total budget revenue and a 96 percent rise in tax revenue; the Budget targets a substantial rise in "special revenue and funds" the achievement of which critically depends on realization of a privatization no less than 4.5 billion US Dollars for the year. The first seven month budget results indicate to a budget deficit of nearly 2,200 trillion TLs, meaning a substantial real increase in the budget deficit over the same period of 1997. In spite of higher than projected increases in tax income and other revenue items, the budget deficit rose substantially in real terms, resultant from the substantial real increase in interest spending on domestic borrowing. The 1998 Budget projects a consolidated budget deficit close to TL 4,000 trillion for the current year; the government has not made any revision on the initial budget targets until the time this report went into print.

The total public domestic debt stock has risen by around 100 percent in 1997, and by 43.2 percent in the first seven months of 1998, reaching to a total of close to TL 8,996 trillion by the end of July 1998.

A new law (Law No 4369) involving a number of important changes in the existing Turkish tax system, finally went into effect at the end of July 1998. [A critical assessment of this law is provided in Chapter 2 of this report.]

The monetary program implemented by the Central Bank in the first half of 1998 aimed at achieving monetary control in the economy through the control of reserve money. The Central Bank, with the objective of attaining its monetary and exchange rate targets, was seen to essentially rely on a number of market-oriented policy tools, including open market and interbank money market operations and actively trading in the local foreign currency markets. The reserve money (target variable) grew at a rate of 17.3 percent and 13.1 percent respectively in the first and second quarters of 1998. The growth in reserve money was confined to 33 percent in the first half of the year, thereby remaining within the limits set in the monetary program. In view of the possible difficulties in correctly predicting the demand for money during transition from a high inflation-state to a lower inflation-state, the Central Bank thought it appropriate to adopt a different monetary target towards more effective control of monetary expansion in the economy. Accordingly; monetary targeting for the second half of the year was based on the control of "net domestic assets" in place of "reserve money". The Central Bank anticipates a slower growth in international reserves during the second half of the year which is expected to facilitate a tighter monetary stance. The Central Bank can therefore be expected to pursue less interventionist policies in managing daily liquidity level in the economy, a policy stance which is however highly likely to reverse in the face of current turmoil in the international financial markets.

Both the consumer and wholesale prices indicated to a notable acceleration in current inflation during 1997. The annual percentage change in the wholesale prices was observed to have jumped from 85 percent at the end of 1996 to 91 percent by the end of 1997; similarly, the annual rate of change in the consumer prices has reached to 99 percent at the end of 1997, from 79.8 percent at the end of the previous year. An analysis of price movements on monthly basis show that both the wholesale and consumer prices rose at a higher rate in the latter half of the year, largely as a result of large scale upward adjustment in the prices of publicly produced goods and services by the new government.

The present government intends to implement a three-year stabilization program (1998 through 2000), whereby the annual rate of inflation is planned to be brought down to 50 percent by December-1998, to 20 percent by December-1999, and finally to 3 percent by the end of year 2000. With the objective of reaching its stated inflation targets, the government foresees a considerable slow down in output growth in the year 1998, resulting from contractionary demand management policies. However; given the inflation and budget expenditure targets for the current year, it is possible to discern that the contraction in the aggregate effective demand is made dependant more on private consumption than on public spending since the 1998 Budget does not target any real decline in budget deficit. So far, the government seems to have relied on high positive real interest policy and restrictive monetary policy in restricting demand. However; in view of the forthcoming general and local elections (scheduled to be held on 18 April 1999), it is possible to expect some relaxation in the tight monetary stance, whilst high interest rate policy is likely to continue in the presence of huge borrowing requirements of the ailing public sector.

The wholesale prices rose by 29.6 percent in the first seven months of 1998, whilst the total change in consumer prices was slightly higher, 33.9 percent. The annual rate of change in wholesale prices has steadily dropped from 91.0 percent at the end of 1997, to

72.1 percent by the end of July 1998, whilst a similar declining trend was observed also in consumer prices, with the annual rate of change in consumer prices decelerating from 101.6 percent in January 1998 to 85.3 percent in July. Whilst we may expect some further decline in the annual rate of inflation in the coming months, the year-end inflation rate is highly likely to remain above the government's 50 percent target (for wholesale prices).

In 1997, the imports grew at about the same rate as projected by the Economic Program, by 11.6 percent, whilst the growth in exports (exclusive of "shuttle trade") remained well below the targeted 21 percent. When "shuttle trade" is reflected in total export figures, the trade account deficit stood at 15,398 million US Dollars, marking a 45 percent rise in the trade deficit in 1997 over the previous year. The total merchandise exports ("shuttle trade" included) has not recorded any growth in the first half of 1998, whilst the growth in merchandise imports was 5.4 percent, resulting in a trade deficit of 7,520 million US Dollars. The trade deficit was seen to have widened by around 12 percent in the first half of 1998. In 1997, the current account yielded a deficit of 8.528 million US Dollars ("shuttle trade" excluded). The current account deficit stood at 1,513 million US Dollars for the first half of 1998. Contrary to the last year's trend, there has been a re-acceleration in the inflow of short-term capital since the begining of 1998, and the government anticipates a surplus of as high as 12,400 million US Dollars in the capital account for the current year. The official international reserves were observed to have risen at a very fast rate since the beginning of 1998, exceeding 26,000 million US Dollars in mid-August.

The total external debt stock of Türkiye, expressed in US Dollar terms, has risen by nearly 9 percent in the last year, whilst various measures of foreign indebtedness indicate to no considerable worsening in the foreign debt position of the country during 1997 as compared to the previous year.

The foreign debt servicing of the country is projected to be around 14,000 million US Dollars for the year 1998, consisting of 11,000 million US Dollars of principal repayment and 3,000 million US Dollars of interest payment. The external debt stock has risen by 2,240 million US Dollars (2.4 percent) in the first quarter of 1998, reaching to a level of nearly 94,500 million US Dollars.

The country's total international reserves continued to rise in 1997 and during the first half of 1998, reaching to a record level of 32,400 million US Dollars by April 1998. Fast increase in official foreign reserves enables the Central Bank to perform its "surveillance" function over the local foreign exchange markets quite effectively. At present, the foreign exchange rate appears to move under almost complete control of the Central Bank.

CHAPTER 1

GROSS NATIONAL PRODUCT, INVESTMENT ACTIVITY AND LABOUR MARKET

I. GNP PERFORMANCE

Despite negative growth in agricultural output, the Turkish economy was observed to have repeated its high growth performance also in the year 1997. Against the targeted 4 percent GNP growth rate for the year, the economy was able to achieve a real GNP growth rate of as high as 8 percent, following 8.0 percent growth in 1995 and 7.9 percent growth in 1996.

Substantial real growth in the private final consumption continued to be the major determinant of high output growth. Private final consumption grew by 8.0 percent in 1997, whilst public final consumption grew at a lower rate, by 4.1 percent, in the same year as compared to the previous year (around 7.7 percent growth).

Whilst there was a relative slow down in real fixed capital investment spending as compared to the previous year, total fixed investment expanded by around 14.5 percent in real terms. Further widening in the foreign trade deficit has had a negative impact on the GNP growth.

High rate of growth in final consumption was observed to have continued well into the first quarter of 1998. Whilst the private final consumption grew by 7.1 percent, public final consumption was observed to have expanded at a higher rate, by 8.4 percent, over the previous year. Real fixed investment spending continued to slowdown also during the first quarter of 1998, growing by around 8.0 percent.

Against the initially targeted 3 percent GNP growth for the year, GNP was observed to have grown by as high as 8.1 percent in the first quarter of 1998 despite 4.4 percent decline in agricultural output. Industrial output continued to grow at a high rate, by 7.9 percent in the first quarter, despite relative deceleration from the previous year.

TABLE 1: GROSS NATIONAL PRODUCT

	1997 (Billion TL, current prices	Percentage Change over previous year NOMINAL	REAL
AGRICULTURE	4,396,081	76.6	-2.0
INDUSTRY	7,293,186	96.2	10.4
CONSTRUCTION	1,737,398	102.6	4.6
COMMERCE	6,061,485	100.6	11.2
TRANSPORTATION/ COMMUNICATION	4,046,589	108.4	7.2
FINANCIAL INSTITUTIONS	1,533,314	109.4	3.2
OWNERSHIP OF DWELLING	850,220	92.0	2.3
BUSINESS/PERSONAL SERVICES	1,083,512	95.6	6.8
(-) IMPLICIT BANK SERVICE CHARGES	1,468,695	107.1	
GOVERNMENT SERVICES	2,579,910	108.3	0.1
PRIVATE NON-PROFIT INSTITUTIONS	53,021	96.9	1.0
IMPORT DUTIES	971,532	111.9	14.8
GROSS DOMESTIC PRODUCT (in purchasers' prices)	29,137,554	97.2	7.2
NET FACTOR INCOMES FROM ABROAD	557,335	170.6	
GROSS NATIONAL PRODUCT	29,694,889	98.3	8.0

Resulting from the higher -than- expected economic growth in the first quarter of 1998, the government has revised its GNP growth target to 4.5 percent from the initial 3.0 percent. Given the existing growth dynamics of the Turkish economy, a 4.5 percent GNP growth appears to be an easily achievable target despite some signs of economic slowdown in the third quarter of the year.

Capacity utilization rate in the manufacturing industry appears to follow a fluctuating trend since the begining of the current year. The rate of capacity utilization was observed to have declined to 74.9 percent by June 1998, the lowest capacity utilization rate in the recent few years (excepting one in April 1998).

Average percentage increase in the manufacturing output was 8.1 percent in the first five

TABLE 2: GROSS DOMESTIC PRODUCT (EXPENDITURE APPROACH)

Real Percentage Change

	1998 FIRST QUARTER	1997 FIRST QUARTER	1997 SECOND QUARTER	1997 THIRD QUARTER	1997 FOURTH QUARTER	1997 TOTAL
I. PRIVATE FINAL CONSUMPTION	7.1	8.5	9.2	8.5	6.0	8.0
II. PUBLIC FINAL CONSUMPTION	8.4	-3.9	0.6	5.9	9.9	4.1
III. GROSS FIXED CAPITAL FORMATION	8.0	8.2	14.7	12.6	21.5	14.6
IV. EXPORTS OF GOODS/SERVICES	14.1	10.3	27.8	23.9	14.1	19.1
V. IMPORTS OF GOODS/SERVICES	10.2	14.5	22.2	23.7	28.7	22.4
GROSS DOMESTIC PRODUCT	7.2					7.4

TABLE 3: GROSS NATIONAL PRODUCT

Real Percentage Growth

	1998 FIRST QUARTER	1997	1996
AGRICULTURE	-4.4	-2.0	5.2
INDUSTRY	7.9	10.4	7.1
CONSTRUCTION	4.2	4.6	4.8
COMMERCE	7.9	11.2	8.7
TRANSPORTATION/ COMMUNICTAON	13.0	7.2	8.4
FINANCIAL INSTITUTIONS	6.1	3.2	2.4
OWNERSHIP OF DWELLING	2.4	2.3	2.4
BUSINESS AND PERSONAL SERVICES	7.3	6.8	6.8
(-) IMPLICIT BANK SERVICE CHARGES	5.5		1.1
GOVERNMENT SERVICES	0.7	0.1	-0.3
PRIVATE NON-PROFIT INSTITUTIONS	1.2	1.0	0.9
IMPORT DUTIES	10.1	14.8	22.9
GROSS DOMESTIC PRODUCT (In Purchasers' Prices)	7.2	7.2	7.2
NET FACTOR INCOMES FROM ABROAD	52.8		
GROSS NATIONAL PRODUCT	8.1	8.0	7.9

SOURCE: STATE INSTITUTE OF STATISTICS (SIS)

TABLE 4: INDUSTRIAL PRODUCTION (1)

Percentage Change

	Percentage Change with respect to the same month of previous year (2)		FIRST FIVE MONTHS (Average % Change)	
	1998	1997	1998	1997
MANUFACTURING INDUSTRY	8.6	11.3	8.1	6.5
MINING	14.8	0.9	16.4	-0.6
ELECTRICITY/GAS /WATER	7.0	12.2	7.7	9.2
TOTAL INDUSTRIAL PRODUCTION	8.6	11.0	8.4	6.5

(1) Percentage Change in SIS's Industrial Production Index
(2) As of end of May

months of 1998, which compares favourably to the 6.5 percent in the same period of the previous year. The average growth in total industrial production was 8.4 percent against the 6.5 percent in the corresponding period of the previous year.

The growth in agricultural output in the first quarter of 1998 was minus 4.4 percent against the minus 1.5 percent growth in the first quarter of 1997 and minus 2.0 percent growth for the whole of last year.

TABLE 5: CAPACITY UTILIZATION RATE IN MANUFACTURING INDUSTRY

Percentage

	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
1996	79.7	78.1	75.2	76.9	83.2	81.5	80.1	79.0	79.4	81.0	76.8	78.8
1997	78.4	77.3	80.8	77.6	82.6	81.0	80.9	82.4	87.2	79.8	84.1	79.0
1998	75.4	77.7	80.4	74.4	81.7	74.9	80.9					

SOURCE: SIS Survey

II. INVESTMENT ACTIVITY

Figures disclosed by the State Planning Office indicate to a slowdown in investment activity in 1997. The growth in public sector fixed investments is estimated to have declined to 17.7 percent, from 27.8 percent in the previous year, with negative growth rates in manufacturing, tourism and health sector investments. The 1998 Program expects further deceleration in public sector investment activity; accordingly, public sector fixed investment is projected to grow at a rate of 4.3 percent in real terms. In fact, the share of investment expenditure in total consolidated budget expenditure is observed to have dropped from 7.5 percent in 1997, to as low as 3.4 percent in the first six months of 1998.

TABLE 6 : GROSS FIXED INVESTMENTS IN PUBLIC SECTOR

	Real Percentage Change			Percentage Share in TOTAL		
	1998(1)	1997(2)	1996	1998(1)	1997(2)	1996
SECTOR						
AGRICULTURE	-24.3	17.7	10.5	8.0	11.0	10.5
MINING	-4.4	44.3	-8.8	1.8	1.9	1.5
MANUFACTURING	28.6	-20.5	-7.5	3.6	2.9	4.1
ENERGY	19.9	15.4	34.9	15.2	13.1	13.0
TRANSPORTATION/ COMMUNICATION	-11.5	10.9	37.5	27.9	32.9	34.2
TOURISM	-15.3	-22.5	-18.8	0.7	0.9	1.4
HOUSING	-19.4	23.8	22.0	1.3	1.7	1.6
EDUCATION	64.8	43.9	58.4	17.7	11.2	9.4
HEALTH	0.1	-2.9	22.1	3.5	3.6	4.4
OTHER SERVICES	1.3	31.4	28.0	20.3	20.8	19.8
TOTAL (BILLION TL)	4.3	17.7	27.8	2,850,000	1,671,929	762,067

SOURCE: STATE PLANNING OFFICE (SPO)
(1) Program
(2) Actualization Estimate

A similar slowdown is observed also in the private sector investment. The growth in private fixed investment is estimated to have declined from 8.5 percent in 1996, to 5.3 percent in 1997. Whilst private investment in manufacturing industry showed almost no growth, investment in housing which takes up the largest share in total private investments, is estimated to have contracted by around 2.5 percent. The 1998 Program projects further decleration also in private sector investments; accordingly, private fixed investment is projected to grow at a modest 3.9 percent in 1998.

TABLE 7 : GROSS FIXED INVESTMENT IN PRIVATE SECTOR

	Real Percentage Change			Percentage Share in TOTAL		
	1998(1)	1997(2)	1996	1998(1)	1997(2)	1996
AGRICULTURE	1.5	4.1	27.8	4.4	4.5	4.7
MINING	5.0	3.4	3.2	1.1	1.1	1.1
MANUFACTURING	2.5	0.9	12.1	24.2	24.5	26.3
ENERGY	75.0	135.7	293.1	6.8	4.0	1.8
TRANSPORTATION/ COMMUNICATION	4.0	11.7	20.4	17.6	17.6	17.5
TOURISM	5.5	8.0	3.8	2.4	2.4	2.3
HOUSING	-2.5	-2.4	-4.0	35.8	38.1	39.3
EDUCATION	4.0	18.4	80.2	1.2	1.2	1.1
HEALTH	5.0	39.1	64.7	2.5	2.5	1.8
OTHER SERVICES	3.0	8.1	8.0	3.9	4.0	4.0
	3.9	5.3	8.5			
TOTAL (BILLION TL)				9,694,305	5,687,840	2,891,166

SOURCE: SPO
(1) Program
(2) Actualization Estimate

The total value of investment incentive certificates issued by the Treasury in the first six months of 1998 increased by 50 percent in nominal terms, meaning a substantial decline in real terms given the rate change in the price level in the past one year to June 1998. The biggest slowdown is observed in the field of manufacturing investments; the total value of investment incentive certificates granted to this sector increased by only 25 percent in nominal terms. The total value of investment certificates granted to services sector has shown a remarkable increase (117 percent) in the first half of 1998.

III. THE LABOUR MARKET

The labour market statistics based on the SIS's most recent Household Labour Force Survey estimate that, the total labour force has grown by around 0.6 percent in the past one year to April 1998, reaching to a level of 22,681,000 persons. The rate of open unemployment, on the other hand, has risen from 5.9 percent in April 1997, to 6.4 per-

TABLE 8: THE LABOUR MARKET

Thousand Persons

	APRIL 1998	APRIL 1997	APRIL 1996
LABOUR FORCE	22,681	22,535	22,809
EMPLOYMENT	21,230	21,201	21,376
UNEMPLOYMENT	1,451	1,334	1,431
OPEN UNEMPLOYMENT RATE (%)	6.4	5.9	6.3
Rural	3.2	3.2	3.8
Urban	9.9	9.2	9.3
UNDEREMPLOYMENT	1,365	1.151	1.440
UNDEREMPLOYMENT RATE (%)	6.0	5.1	6.3
TOTAL UNEMPLOYMENT RATE (%) (1)	12.4	11.0	12.6
LABOUR PARTICIPATION RATE (%)	47.5	48.4	50.0
Rural	57.9	60.0	61.6
Urban	39.8	39.3	40.6

(1) Open unemployment plus underemployment
SOURCE: SIS (Based on Household Labour Force Survey)

cent in April this year. Whilst the rate of open unemployment in the rural areas was stagnant at 3.2 percent, open urban umemployment rate has risen from 9.2 percent to 9.9 percent in the past one year to April 1998.

The concept "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 1998, from 5.1 percent to 6.0 percent. As of April 1998, the total of open unemployment and underemployment stood at around 12.5 percent.

An interest finding of the labour market surveys is that, in Türkiye, nearly one out of every three persons who are unemployed is a graduate of either a high school or a higher education institution.

According to the "productivity index" calculated by the State Planning Office, productivity in the Turkish private sector has risen by around 10 percent, from the last quarter of 1996 to the last quarter of 1997. Unit wage index (nominal unit wage index corrected by the TL/USD exchange rate index), has, however, fallen to 67.4 in the last quarter of 1997, from 76.4 in the last quarter of 1996. This indicates to a fall in manufacturing wages expressed in US Dollar terms against a considerable productivity improvement. (See TABLE 9)

TABLE 9 : WAGES AND PRODUCTIVITY IN PRIVATE MANUFACTURING INDUSTRY (1992 = 100)

	I EMPLOYMENT INDEX	II PRODUCTION INDEX	III=II/I PRODUCTIVITY	IV NOMINAL WAGE INDEX	V=IV/III NOMINAL UNIT WAGE INDEX (TL)	VI EXCHANGE RATE INDEX (USD/TL)	VII=V/VI UNIT WAGE INDEX
1996							
Q1	112.1	122.2	109.0	689.9	632.9	934.0	67.8
Q2	114.1	128.2	112.4	797.2	709.5	1,109.8	63.9
Q3	116.1	129.0	1,11.1	1016.8	915.1	1,242.8	73.6
Q4	120.6	130.5	1,08.2	1189.5	1,099.3	1,437.9	76.4
1997							
Q1	121.7	137.9	113.3	1,337.7	1,180.6	1,721.6	68.6
Q2	123.4	146.0	118.3	1,530.9	1,293.9	1,997.5	64.8
Q3	127.4	149.9	117.7	1,891.2	1,607.3	2,357.5	68.2
Q4	127.2	151.7	119.3	2,199.4	1,844.2	2,734.7	67.4

SOURCE: STATE PLANNING OFFICE
I, II, IV: Seasonally adjusted

CHAPTER 2

PUBLIC FINANCE AND DOMESTIC DEBT

I. CONSOLIDATED BUDGET PERFORMANCE

The 1997 initial Budget has had the distinctive feature of being the first "balanced budget" in the last half a century in Türkiye. Whilst to what extent the objective of a balance budget could be achieved under the then prevailing conditions was another question, it was certainly a positive move on the part of the government to show the necessary political will and commitment to set a balanced budget target in order to reform the ailing public sector. The balanced budget objective critically depended on the assumptions of an enormous increase in "non-tax normal revenue" mainly through an ambitious privatization program and the sale of publicly owned real estates, and of the reduction of the existing heavy interest burden on the budget through both lower cost of borrowing and reduced domestic borrowing.

The budget under the 54th government yielded a deficit of around TL 700 trillion in the first half of the year which meant a real decline in the budget deficit when compared to the corresponding period of 1996. Whilst there was a better-than-expected performance in tax collection in the first half of 1997, the increase in non-tax revenue was considerably below the target level, a critical factor jeopordizing the achievement of "balanced budget" target. The lower-than-expected performance in non-tax revenue stemmed mainly from not being able to achieve a privatization program at the desired rate in the first half of 1997, which was interrupted by the political crisis developed during this period.

TABLE 10: CONSOLIDATED BUDGET PERFORMANCE

	BILLION TL		Percentage Change	
	1997	1996	Nominal	Real (1)
REVENUE	5,854,331	2,702,034	116.7	19.2
(a) Tax Revenue	4,750,451	2,244,094	111,7	16.4
(b) Non-tax Revenue	1,009,783	430,074	134.8	29.1
(c) Annex Budget Revenue	92,405	26,034	254.9	95.2
(d) Donations	1,692	1,832	-7.6	-49.2
EXPENDITURE	8,035,178	3,940,162	103.9	12.2
(a) Personnel	2,072,753	974,148	112.8	17.0
(b) Other Current Expenditure	712,299	306,571	132,3	27.8
(c) Investment	638,660	238,085	168.2	47.6
(d) Interest Payment on Domestic Debt	1.977,967	1.329,087	48.8	-18.1
(e) Interest Payments on External Debt	299,950	168,314	78.2	-2.0
(f) Transfer to SEEs	123,640	50,200	146.3	35.5
(g) Other Transfer	2,209,909	871,752	153.5	39.4
BUDGET BALANCE	-2,180,847	-1,238,128	76.1	-3.1
CASH BALANCE	-2,160,625	-1,267,734	70.4	-6.3

(1) Nominal change corrected by the average annual percentage change in the SIS' Wholesale Prices Index (81.8 percent for the year 1997)

The 55th government which took office at the begining of July 1997, has made certain revisions in the initial budget, reducing the initial budget revenue target by 18 percent and raising the initial expenditure target by 20 percent. Accordingly, the budget deficit which had stood at TL 718 trillion in the first six months of the year was targeted to reach to around TL 2,400 trillion by the end of the year.

Given the above revised budget targets, total consolidated budget revenue rose by around 116 percent for the year 1997, meaning a 19 percent real increase over the previous year. Whilst the tax revenue was higher-than-initially planned, non-tax revenue remained considerably below the initial budget target largely as a result of lower than expected privatization revenue. Total consolidated budget expenditure rose by 104 percent in nominal and 12 percent in real terms. As a result, the consolidated budget yielded a deficit of TL 2,180,847 billion for the year.

The 1998 Budget projects an 84 percent rise in total budget expenditure, again resulting largely from the substantial rise in interest payment on public domestic debt stock. Whilst

TABLE 11: CONSOLIDATED BUDGET (ACTUAL)

BILLION TL

	(JAN-JUNE) 1998	Percentage Change
BUDGET REVENUE	6,152	133.6
* Tax Revenue	4,855	121.5
* Non-tax Normal Revenue	623	256.4
* Special Revenue and Funds	582	162.2
* Annex Budget	92	103.6
BUDGET EXPENDITURE	8,350	137.7
* Personnel	1,985	84.1
* Other Current Expenditure	436	132.1
* Investment	355	83.5
* Transfer	5,574	171.4
- Interest Payment on Domestic Debt	3,593	269.1
- Interest Payment on Extarnal Debt	264	79.7
BUDGET DEFICIT	-2,198	

(1) With respect to the corresponding period of 1997.

personnel and investment spendings are planned to rise at a nominal rate close to the average inflation rate targeted for the year (64 percent), interest expenditure would rise by as high as 175 percent, two-and-a-half times the targeted average inflation rate. As a result, the share of interest expenditure in total consolidated budget expenditure is expected to remain around 28 percent. Given that the government is highly likely to reach its expenditure target in the current year, the level of budget deficit will critically depend on the extent to which the budget revenue targets are reached. The 1998 Budget envisages a 100 percent rise in total budget revenue and a 96 percent rise in tax revenue. The Budget targets a substantial rise in "special revenue and funds" the achievement of which substantially depends on achieving a privatization of no less than 4.5 billion US Dollars for the year.

The following are the Budget results obtained for the first seven months of 1998:

Total consolidated budget revenue rose by a nominal 134 percent in the first seven months of 1998 as compared to the corresponding period of the previous year, whilst the total expenditure was observed to have risen at a faster rate, by 138 percent.

Tax revenue which makes up around 80 percent of total budget revenue, rose by a nominal 122 percent in the first seven months over the same period in 1996, which-given the annual rate of change in the general price level in the corresponding period-meant a real increase in tax revenue. Largely as a result of the accelerated pace of privatization, "special revenue and funds" rose by around 162 percent, reaching to almost 10 percent of total budget revenue in the first seven months of the year. Non-tax normal revenue rose by around 256 percent over the same period of the previous year.

Largely as a result of substantial rise in interest payment on public domestic debt stock, total budget expenditure rose by around 138 percent in nominal terms, meaning a notable increase in budget expenses in real terms during the first seven months of 1998. Whilst the personnel expenses rose at a rate (84 percent) close to the annual rate of consumer inflation prevailing in the same period, budget spending on investment increased by a nominal 83.5 percent over the same period of last year. Interest payment on domestic debt rose by around 270 percent in the first seven months of the current year as compared to the same period of 1996, constituting as high as 43 percent of total budget expenditure. in the first half of 1998, 77 TLs of every 100 TLs of tax income and 61 TLs of every 100 TLs of budget revenue were spent on interest payment on the existing public domestic debt stock. Apart from substantial interest spending, losses caused by the ailing social security institutions continue to put a heavy burden on the budget. Budgetary transfer to the three social security institutions has amounted to no less than TL 810 trillion in the first six months of the year, constituting nearly 10 percent of total budget expenditures. Total transfer spending, including interest payment on domestic and external debts and the transfer to social security institutions, rose by a nominal 175 percent in the first half of 1998 over the same period of 1997, eating up as high as 93 percent of total budget revenue.

As a result, the consolidated budget was observed to have yielded a deficit of TL 2,198,000 billion in the first half of 1998. In other words, despite higher-than-projected increases in tax income and other revenue items, there was a substantial rise in the budget deficit in real terms, mainly as a result of substantial real increase in interest spending especially on domestic borrowing. The 1998 Budget projects a consolidated budget deficit of close to TL 4.000 trillion for the whole year. The government has not made any revision on the initial budget targets until the time this report went into print.

TABLE 12: SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET

Percentage

	1998 FIRST SEVEN MONTHS	1998 BUDGET TARGET	1997	1996 FIRST SEVEN MONTHS	1995 FIRST SEVEN MONTHS
TAX REVENUE/TOTAL REVENUE	78.9	82.5	81.0	83.1	77.3
NON-TAX REVENUE/TOTAL REVENUE	10.1	6.5	7.0	16.4	20.6
PERSONNEL EXPENDITURE/TOTAL EXPENDITURE	23.7	23.5	25.8	24.7	29.4
INVESTMENT EXPENDITURE/TOTAL EXPENDITURE	4.2	6.7	7.9	5.7	5.4
INTEREST PAYMENT/TOTAL EXPENDITURE	46.2	40.0	28.3	38.2	33.7
INTEREST PAYMENT/TOTAL TAX REVENUE	79.5	66.0	48.0	68.5	53.0
INTEREST PAYMENT/TOTAL REVENUE	62.7	54.5	38.9	56.9	41.0
BUDGET DEFICIT/TOTAL REVENUE	35.7	37.0	37.2	49.0	22.5
TOTAL REVENUE/TOTAL EXPENDITURE	73.7	73.0	72.8	67.0	81.6

II. SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET

(1) Tax Revenue/Total Revenue

Against the projected 70 percent in the initial 1997 Budget, the ratio of tax revenue to total revenue has actually stood at 81 percent, meaning a better-than-initially-projected tax performance for the year. The budget results for the first seven months of the current year indicates that the ratio of tax revenue to total revenue (78.4 percent) was below to the budget projection (78.9 percent). This ratio can be expected to improve in the coming years as a result of the introduction of the new Tax Law which aims at broadening the tax base.

(2) Non-tax Revenue/Total Revenue

Against the targeted 7.4 percent in the 1998 Budget, non-tax revenues appear to have performed better-than-expected in the first half of the year largely as a result of accelerated privatization. Non-tax revenue has made up no less than 10 percent of total revenue in the first seven months of the current year.

(3) Personnel Expenditure/Total Expenditure

Budget spending on personnel constitutes around one-fourth of total budget spending. The ratio of expenditure to total expenditure which stood at close to 24 percent for the first seven months of 1998, is likely to rise further parallel to the higher-than-initially budgeted increase in wages and salaries in the public sector in the second half of the year.

(4) Investment Expenditure/Total Expenditure

The steadily declining trend in the share of investment spending seems to have continued into the current year. Against the projected 7.5 percent share of investment spending in total budget spending for the year 1998, this type of spending constituted a share in total budget expenditure as low as 4.2 percent, for the first seven months of the year.

(5) Interest Payment on Public Debt

The high and ever-rising share of interest spending has long been a major structural weakness in the annual budgets, and the year 1998 seems no exception to this. Against the projected 28.5 percent share of interest payment in total budget expenditure in the 1998 Budget, this share stood at as high as 46.2 percent in the first seven months of the year. Similarly, the ratio of interest payment to total tax revenue was as high as 79.5 percent in the first seven months of 1998 (budget projection for the year: 50 percent). Interest spending has taken up as much as 63 percent of entire budget revenues against the initial budget projection of 42 percent.

(6) Budget Deficit/Total Revenue

The 1998 Budget projects a budget deficit of 48 percent of total budget revenue; the ratio of budget deficit to budget revenue remained at around 36 percent in the first seven months of the year.

III. PUBLIC DOMESTIC BORROWING

The total public domestic debt stock which had stood at TL 3,148,984 billion at the end of 1996 increased at a rate of nearly 100 percent, reaching to TL 6,283,425 billion by the end of 1997. A noticable change was also observed in the composition of total public domestic debt stock. As a result of the previous government's (the 54th government) effort to extend the average maturity of the public debt stock, the share of government bonds rose from 49 percent in January to 73 percent in June, wehereas the share of short-term Treasury-bills declined from 39 percent to 17 percent in the same period; the share also of Central Bank advances to the Treasury declined from 12 percent to 10 percent by mid-year.

Partly as a result of the 55th government's decision to stop inflation-indexed borrowing,

TABLE 13: PUBLIC DOMESTIC DEBT STOCK (IN BILLION TL)

	GOVERNMENT BONDS	TREASURY BILLS	CENTRAL BANK ADVANCES	TRANSLATION (EXCHANGE RATE) DIFFERENCES	TOTAL DEBT STOCK
End-1996	1,250,154	1,527,838	370,953	40	3,148,984
March 1997	2,204,117	1,160,200	471,047	-	3,835,364
June 1997	3,063,323	715,361	420.726	-	4,199,408
Sept 1997	3,223,827	1,620,798	337,625	-	5,182,248
Dec 1997	3,570,811	2,374,990	337,623	-	6,283,425
1998					
January	3,534,115	2,765,951	337,623	-	6,637,689
February	3,430,974	3,243,222	337,623	-	7,011,818
March	3,265,770	4,113,697	-	-	7,379,467
April	3,195,512	4,675,350	-	-	7,870,862
May	3,645,133	4,334,147	-	-	7,979,280
June	4,143,109	4,246,482	-	-	8,389,591

SOURCE: The Treasury Undersecretariat

the average term of borrowing was observed to have shortened in the second half o the year with the accompanying rise in the average cost of borrowing. As of end of 1997, the share of government bonds declined to 57 percent whilst that of T-bills rose to 37 percent. As a result of an agreement between the Central Bank and the Treasury, the short-term advances were gradually reduced, and stood at TL 337,623 billion by the end of 1997. As of March 1998, The Central Bank's short term Advances to the Treasury were reduced to zero. Towards the end of 1997, the government was observed to have resumed inflation-indexed borrowing which had been initiated by the previous government.

The total public domestic debt stock has risen by around 33 percent in the first six months of 1998, reaching to TL 8,389,591 billion by the end of June. Given the rate of change in the general price level, the public domestic debt stock did not rise in real terms in the first half of 1998. The shares of government bonds and Treasury bills each stood at 50 percent at the end of June, whilst the Central Bank advances to the Treasury was completely eliminated. Parallel to the gradual decline in the annual rate of inflation, the interest rate payable on public borrowing showed a gradual decline in the first half of the year.

The average term of borrowing stood at around 14 months in government bonds and 6.5 months in T-bills, in the first six months of 1998. The weighted average term of the existing debt stock, on the other hand, was nearly 17 months.

TABLE 14: TERM STRUCTURE OF PUBLIC DOMESTIC BORROWING

	NET BORROWING IN THE FIRST SIX MONTHS OF 1998 (BILLION TL)	PUBLIC DEBT STOCK (BILLION TL)	AVERAGE TERM OF DEBT STOCK (MONTHS)	AVERAGE TERM OF BORROWING IN 1998 (MONTHS)
GOVERNMENT BONDS	652,329	4,143,109	20.2	14.2
TREASURY BILLS	1,871,491	4,246,482	13.8	6.5
CENTRAL BANK ADVANCES	0.0	0.0	-	-
EXCHANGE RATE (TRANSLATION) DIFFERENCES	-337,623	0.0	-	-
TOTAL	2,186,197	8,389,591	16.9	10.3

SOURCE: TREASURY UNDERSECRETARIAT

IV. THE NEW TAX LAW: A Critical Assessment

LAW No. 4369 involving a number of important changes in the existing Turkish tax system, finally went into effect by the end of July (after being published in the Official Gazette dated 29th July 1998). The government tends to publicize the new arrangements in the tax system as being an "important" tax reform.

Can the Law No 4369 be regarded as a genuine tax reform? What is intended by the changes brought by the new Law? What would be the likely impacts of this new tax system on the economy as a whole and on the citizens?

In what follows, we intend to make a brief critical assessment of the positive and negative aspects of the new tax arrangements:

a) Positive Aspects

Reduced Tax Rates:

The new Law reduces income and real-estate tax rates.

Income Tax Rates:

The income tax rate falls from 25 percent to 20 percent for the lowest income bracket, and from 55 percent to 45 percent for the highest income bracket, for the first year. Effective from the second year, the tax rate applicable to the lowest income bracket will be 15 percent, and 40 percent for the highest income bracket.

The rate cut for the year 1998 will only be applied to wage-earners, whereas non-wage tax payers will be excluded from the tax cut for the year 1998.

The government's claim that it has reduced the corporate tax rate does not seem to reflect the reality. As a matter of fact, corporate tax rate cut will only be applicable to those incorporations which do not distribute dividend to their shareholders. No corporation can possibly continue its activity without distributing dividend forever. For those corporations which distribute dividend, the prevailing corporate tax rate will continue to be applied. Given the fact that all corporations are bound to distribute dividend at some point, the claim that the new Law cuts the corporate tax rate does not in fact reflect the reality completely.

The Law reduces the tax rate on buildings from 5 per mille to 2 per mille, and from 4 per mille to 1 per mille for buildings used for housing. Also, the Law reduces the tax rate on building land from 6 per mille to 3 per mille, and from 3 per mille to 1 per mille for land. Here the Council of Ministers would be authorized to raise the above rate by as much as 3 times.

Inheritance tax rate (currently between 4 to 25 percent) is reduced to 1 to 10 percent. Tax collected from both the buyer and the seller in real-estate purchases, which previously totalled up to 9.6 percent, is now reduced to 2 percent.

In summary, various tax rate cuts can be regarded as the positive aspects of the new Law.

(b) Negative Aspects

(1) The new tax system is likely to increase the size of the unrecorded economy even further.

The Law introduces a new definition for "income", whereby any and all earnings/incomes of a person within a calendar year from which his/her spending or savings are sourced, are regarded as his/her "income". This implies that total spending made by a person or increases in his wealth within a calendar year can easily become subject to questioning from the Ministry of Finance. This is highly likely to reduce the size of documented (recorded) transactions as persons will try their best to avoid from becoming subject to such a questioning and follow-up from the Ministry. Depending on the extent to which this Law is effectively enforced, the following can be expected:

- It may effect spending and aggregate demand in the economy adversely, thus further exacerbating economic stagnation;

- Fall in investment demand;

- Accelerated capital flight from the country;

- Fall in bank deposits, affecting the banking sector adversely;

- Increased size of unrecorded economy.

(2) Wrong Diagnosis about Tax Evasion

The Law appears to focus on a tiny portion of the macroeconomy (ie. low income groups) for solving tax evasion problem. An attempt to control hundreds of thousands of tax payers generating only 10 percent of the GNP means nothing but controlling 10 percent of tax evasion at the best. On the other hand; if around 50,000 tax payers generating 70 percent of the GNP could be brought under control, it becomes possible to cover 70 percent of tax evasion.

In all economically developed countries tax control focuses on holdings and big tax payers. For instance, taxpayers to be controlled are classified into 3 groups; big, medium and small taxpayers. Big tax payers are examined by The Ministry of Finance once a year, whilst tax examination of medium tax payers is done once every eight year.

In short; focusing on small taxpayers is a very inefficient way of dealing with tax evasion problem, with resultant negative impact on taxpayers in small and medium income groups. It is highly likely to broaden the dimensions of unrecorded economy even further as more and more transactions will become unrecorded.

CHAPTER 3
MONETARY TRENDS

I. MONETARY POLICY

The monetary programme announced by the Central Bank **for the first half of 1998** aimed at achieving monetary control in the economy through the control of reserve money, the intermediate target of the monetary policy. At the same time, the programme envisaged an exchange rate policy that would reconcile the two opposing objecives, namely, sustaining a current account deficit at managable levels on one hand, and, keeping the exchange rate depreciation below the current rate of inflation on the other.

With the objective of attaining its stated monetary and exchange rate targets, the Central Bank essentially relied on a number of market-oriented policy tools, including open market and inter bank market operations in the money market and actively trading in the local foreign currency markets.

The net domestic assets which had displayed a notable decline during the course of 1997, stood at TL 142 trillion at the end of the year. The excess liquidity resulting from the increased inflow of foreign currency reserves in the first half of 1998 was absorbed through open market operations. The level of net domestic assets was affected also by the fact that the Treasury did not resort to any Central Bank funding (short term advances) nor any Central Bank funding was availed to the public sector as a whole. As a result; the net domestic assets in the Central Bank balance sheet continued to decline in the first half of 1998, standing at a level of minus TL 1,778 trillion as of 30 June 1998.

The reserve money (target variable) grew at a rate of 17.3 percent and 13.1 percent in the first and second quarters of 1998, respectively. The growth in reserve money in the first half of the year was limited to 32.8 percent, thereby remaining within the limits set in the monetary programme.

TABLE 15: MONETARY AGGREGATES

	BILLION TL		FIRST SIX MONTHS % CHANGE	
	3 JULY 1998	26 DEC 1997	1998	1997
BANKNOTES ISSUED	1,018,361	719,328	41.6	39.1
RESERVE MONEY	1,618,145	1,142,167	41.7	37.4
CENTRAL BANK CREDITS:	8,488	346,408		
Public	896	338,789		
Private	7,592	7,619		
M1 MONEY SUPPLY	1,831,640	1,378,604	32,9	32,7
M2 MONEY SUPPLY	7,996,969	5,264,529	43.6	42.1
M1/Reserve Money (%)	113.2	120.7	-	-
M2/Reserve Money (%)	494.2	460.9	-	-
M1/GNP (%)	-	4.6 (5.5 in 1996)		
M2/GNP (%)	-	17.7 (18.5 in 1996)		
M3/GNP (%)	-	20.6 (19.9 in 1996)		

The exchange rate, on the other hand, continued its stable trend also during the first half of 1998, which seemed to have contributed to further growth in the Central Bank's foreign currency reserves. The weighted currency basket depreciated by as much as 25 percent in the first five months of 1998, whilst the percentage change in the wholesale prices index (the measure of inflation adopted by the Central Bank) stood at 24.4 percent for the same period. Net official international reserves (inclusive of gold reserve) has reached to around 26.6 billion US Dollars by the end of June 1998, meaning a net increase in official reserves by as much as 8 billion US Dollars since the begining of the year. The real exchange rate, calculated by correcting the percentage change in the nominal exchange rate by the percentage change in the private sector's manufacturing prices, declined by around 3 percent in the first half of 1998, contributing to some limited improvement in the curent account balance in the first quarter of 1998.

The monetary programme announced **for the second half of 1998** aims at pursuing monetary and exchange policies consistent with the 50 percent year-end inflation target. In view of the possible difficulties in correctly predicting the demand for money during the process of moving from a high inflation state to a lower inflation state (which the Turkish economy seems to have been experiencing since the begining of the current year), The

Central Bank thinks that it is more appropriate to adopt a different intermediate target variable (other than the one adopted in the first half of the year, the reserve money). Accordingly, monetary targeting for the second half of the year was based on selecting **"net domestic assets"** in place of **"reserve money"**, towards achieving a monetary control consistent with the year-end inflation target. The programme targets some growth in the net domestic assets for the latter half of 1998; accordingly, the level of net domestic assets is targeted to reach to TL 1,514 trillion by the end of the year.

TABLE 16: CENTRAL BANK ANALYTICAL BALANCE SHEET

(BILLION TL)

	17 July 1998	31 Dec 1997	Percentage Change
ASSETS	7,727,691	4,691,889	64.7
FOREIGN ASSETS	7,600,728	4,392,221	73.0
DOMESTIC ASSETS	126,963	299,668	-57.0
LIABILITIES	7,727,691	4,691,889	64.7
TOTAL FOREIGN CURRENCY LIABILITIES	5,173,374	4,046,109	27.8
CENTRAL BANK MONEY	2,554,317	645,780	295,5
(a) Reserve Money	1,741,278	1,184,212	47.0
(a.1) Banknotes Issued	1,122,802	758,878	48.0
(a.2) Bank Deposits	588,995	370,765	
(a.3) Fund Account	18,213	47,535	
(a.4) Non-bank Deposits	11,268	7,034	
(b) Other Central Bank Money	813,039	-538,432	
(b.1) Liabilities due to O.M.O.	708,369	-720,337	
(b.2) Public Deposits	104,670	181,905	
Exchange Rate (TL/USD)*	267,985	205,245	30.5

** Average of CB Buying and Selling Rate*

The Central Bank anticipates a slower growth in international reserves in the second half of 1998, which is expected to contribute to a better monetary control in the economy. As a result, The Central Bank is expected to pursue less interventionist policies in managing daily liquidity level in the economy. Never-the-less the Central Bank appears determined not to extend any funding to the public sector, thereby keeping net domestic assets under strict control.

II. THE MONEY SUPPLY

TABLE 17: THE MONEY SUPPLY

	BILLION TL		FIRST SIX MONTHS(3) Percentage Change	
	3 JULY 1998	26 DEC 1997	1998	1997
BANKNOTES ISSUED	1,018,361	719,328	41.6	39.1
CURRENCY IN CIRCULATION	921,505	641,707	43.6	42.1
SIGHT COMMERCIAL DEPOSITS	436,195	377,668	15.5	12,7
SIGHT SAVINGS DEPOSITS	473,517	358,973	31.9	51.3
DEPOSITS WITH THE CB	423	256	65.2	-66.5
M1 MONEY SUPPLY	1,831,640	1,378,604	32.9	32,7
TIME COMMERCIAL DEPOSITS	576,724	279,439	106.4	50.6
TIME SAVINGS DEPOSITS	5,588,597	5,466,609	55.0	40.1
CERTIFICATE OF DEPOSITS	8	185	-95.7	-85.2
M2 MONEY SUPPLY	7,996,969	5,264,529	51.9	37.7
FOREIGN CURRENCY DEPOSITS OF DOMESTIC ORIGIN	6,684,084	5,562,768	20.2	39.7
M2Y MONEY SUPPLY (1)	14,681,053	10,827,297	35.6	38.7
M3 MONEY SUPPLY (2)	8,618,936	6,104,543	41.2	40.1

(1) M2Y = New Broad Definition inclusive of foreign curency deposits of domestic origin
(2) M3 = M2 + Public Deposits + Other Deposits with CB
(3) As of July 3

Despite serious instability in the Turkish politics, the financial markets remained remarkably stable during the course of 1997. The Central Bank was observed to continue its surveillance function over the foreign exchange markets whilst not interfering with market interest rates.

The size of the Central Bank's balance sheet grew at a rate close to that of the previous year, by 77 percent, whilst the increase in the CB assets stemmed almost entirely from the increase in net foreign assets resulting from large influx of foreign currency.

Reserve Money, the target variable in the CB's monetary programme, grew by 35 percent in the first half of 1997 and by 85 percent for the whole year. Banknote issue, on the other hand, expanded by around 82 percent, whilst the growth in narrow (M1) and broad

(M2) definitions of the money supply were respectively 66 percent and 97 percent.

The banknote issue increased by around 42 percent in the first six months of 1998 as opposed to 39 percent in the corresponding period of the previous year. The narrowly defined money supply (M1) grew by around 33 percent in the first half of the year whilst the growth in broad money supply (M2) was 43.6 percent.

III. BANK DEPOSITS

TABLE 18: RELATIVE YIELDS OF SELECTED FINANCIAL SAVINGS INSTRUMENTS

Percentage

	1998 JANUARY-JUNE		JUNE 1998-JUNE 1997 LAST ONE YEAR	
	NOMINAL	REAL(1)	NOMINAL	REAL(1)
COMMERCIAL BANK DEPOSITS				
3-month	38.0	6.5	88.6	-1.0
6-month	37.3	5.9	85.2	-2.8
One-year	41.2	9.0	77.4	-6.9
FOREIGN CURRENCY(2)				
US DOLLAR	29.1	-0.4	79.3	-5.9
D. MARK	28.1	-1.2	73.1	-9.2
J. YEN	20.7	-6.9	47.4	-22.5
GOLD (bullion)	32.2	2.0	58.6	-16.8
TREASURY BILLS				
3-month	41.9	9.5	102.6	6.3
6-month	45.1	12.0	105.7	7.9
ISTANBUL STOCK EXCHANGE(3)	18.8	-8.3	120.8	15.8

(1) Nominal yields deflated by the percentage change in the SIS's Consumer Prices Index
(2) Rate of depreciation of TL against foreign currencies
(3) Rate of change in the composite index

A comparison of the relative yields of some major financial savings instruments indicates that, T-bills and one-year bank deposits yielded the highest nominal and real returns in the first half of 1998 [See TABLE: 18]

Total consolidated bank deposits grew at a slower rate in 1997 as compared to the previous year; the growth in bank deposits was 97 percent (as against 133 percent in 1996). Saving deposits increased by around 48 percent in the first half of 1998, resulting from 51.6 percent increase in time saving deposits and 16.4 percent increase in sight savings deposits. Commercial deposits grew by around 55 percent, meaning a faster growth for this category of deposits when compared to the corresponding period of the previous year.

TABLE 19: TURKISH LIRA BANK DEPOSITS

	BILLION TL		FIRST SIX MONTHS Percentage Change	
	3 JULY 1998	26 DEC 1997	1998	1997
SAVINGS DEPOSITS	6,062,122	3,965,459	48.4	40.3
(a) Time Deposits (1)	5,588,605	3,606,486	51.6	39.3
b) Sight Deposits	473,517	358,973	16.5	51.3
COMMERCIAL DEPOSITS	1,012,919	657,107	55.0	20.6
(a) Time Deposits	576,724	279,439	94.1	50.6
(b) Sight Deposits	436,195	377,668	26.1	12.7
PUBLIC DEPOSITS	358,575	526,663		
(a) Time Deposits	58,476	34,406		
(b) Sight Deposits	300,099	492,257		
TOTAL BANK DEPOSITS(2)	7,433,616	5,149,229	43.8	36.2

(1) Inclusive of Certificate of Deposits
(2) Exclusive of interbank deposits

Foreign currency deposits grew by around 11 percent in 1997, resulting fom slower growth of foreign currency deposits of domestic origin and faster growth of foreign currency deposits of foreign origin. Foreign currency deposits grew at a faster rate, by 7.4 percent, in the first half of 1998 as compared to the corresponding period of 1997 (1.4 percent growth).

TABLE 20: FOREIGN CURRENCY DEPOSITS WITH COMMERCIAL BANKS

	MILLION US DOLLARS			FIRST SIX MONTHS Percentage Change	
	3 JULY 1998	26 DEC 1997	27 DEC 1996	1998	1997
FOREIGN CURRENCY DEPOSITS OF					
(a) Domestic Origin	29,244	27,442	25,341	6.9	0.2
(b) Foreign Origin	5,265	4,957	3,918	10.2	9.1
TOTAL F/C DEPOSITS	34,509	32,399	29,259	7.4	1.4

IV. CREDIT STOCK

Total credit stock in the economy grew by 113 percent in 1997, meaning a real expansion in the credit volume. The substantial expansion in the credit stock stemmed from growth in commercial banks' credits against an absolute decline in Central Bank credits.

TABLE 21: CREDIT STOCK

	MILLION US DOLLARS			FIRST SIX MONTHS Percentage Change	
	3 JULY 1998	26 DEC 1997	27 DEC 1996	1998	1997
I. DEPOSIT BANK CREDITS:	9,753,444	6,384,251	2,775,503	44.8	62.2
(a) TL-denominated	5,865,890	3,471,056	1,528,914	53.1	68.1
(b) F/C-denominated	3,887,554	2,913,195	1,246,589	34.9	54.9
II. INVESTMENT AND DEVELOPMENT BANKS' CREDITS	452,144	330,141	173,644	36.3	49.7
III. CENTRAL BANK DIRECT CREDITS	897	338,789	354,308	-99.7	-4.2
TOTAL CREDIT STOCK	10,206,485	7,053,181	3,303,455	37.4	54.4

Turkish Lira denominated credits extended by commercial banks grew by 127 percent in 1997, whilst the growth in commercial banks' foreign currency-denominated credits was 134 percent.

The cost of foreign currency denominated funds to end-users remained below the cost of TL funds also during 1997, which was reflected in buoyant demand for foreign currency denominated funds.

The credits extended by the investment and development banks grew by 90 percent in 1997, meaning no real growth in such credits. As compared to the previous year, this type of credits grew at a slower rate in 1997 despite higher rate of inflation.

Both direct and indirect credits extended by the Central Bank declined in absolute terms in the year 1997. Direct credits extended by the Central Bank declined by 5 percent as against the 82 percent increase in the previous year. The decline in Central Bank's credits stemmed from the decline in short-term advances to the Treasury. The share of CB short-term advances in financing public domestic borrowing continued to decline in 1997. There was no notable change in the volume of Central Bank credits extended to the private sector through the banks.

The total credit stock grew at a slower rate in the first half of 1998 as compared to the previous year, possibly due to sluggish credit demand in expectation of a slow down in the economy in the second half of the year. Total credit stock grew by around 37 percent in the first six months of the current year as against 54 percent in the same period of the previous year.

TABLE 22: CENTRAL BANK DOMESTIC CREDIT EXPANSION

(BILLION TL)

	17 JULY 1998	31 DEC 1997	DIFFERENCE
I. PUBLIC SECTOR CREDITS	898	339,199	-338,301
(a) Treasury	0	337,623	-337,623
(a.1) Advances to Treasury	9	337,623	-337.623
(b) State Economic Enterprises	898	1,576	-678
II. PRIVATE SECTOR CREDITS			
(TO BANKS)	7,675	7674	-1
(a.1) Commercial	7,675	7675	0
(a.2) Industrial	0	1	-1
TOTAL CENTRAL BANK CREDITS	8,573	346,875	-338,302

The Central Bank short-term advances to the Treasury was reduced to zero in the first half of the year, whilst credits extended to the private sector did not show any change.

V. INTEREST RATES

In 1997, the Central Bank continued its "surveillance" function on the foreign exchange rates, whilst not making any intervention to the market interest rates. This can be regarded as an appropriate approach in maintaining stability in the financial markets at a time when market interest rates are almost entirely determined by heavy borrowing requirement of the public sector.

TABLE 23: INTEREST RATES

	Interest Rate on Central Bank Discount and Advance Facility	Interest Rates Turkish Lira Bank Savings Deposits(1)				Interest Rates on Foreign Currency Deposits(2)	
		One-Month	3-months	6-months	One-Year	US Dollar	D.MARK
Dec 1996	50-57	76.06	79.68	84.62	93.77	8.0	6.0
1997							
March	50-57	70.81	76.54	82.58	90.11	7.1	6.2
June	50-57	70.51	77.41	82.88	90.53	7.6	6.6
Sept	67-80	75.90	82.18	90.27	96.22	9.0	8.1
Dec	67-80	78.27	83.20	91.53	96.56	9.3	8.2
1998							
Jan	67-80	78.19	82.59	91.27	96.37	9.3	8.2
Feb	67-80	77.83	82.79	91.34	96.00	9.3	8.3
March	67-80	77.54	82.73	91.21	96.90	9.7	8.3
April	67-80	77.83	81.88	90.09	96.10	9.7	8.3
May	67-80	76.98	81.19	90.11	95.67	9.7	8.3

(1) Weighted Average of Banks
(2) Weighted Average of Banks, payable on one-year deposits.

The Central Bank did not prefer to change its rediscount rates throughout the year 1997, whilst commercial banks' deposit interest rates followed a stable trend. The average overnight interest rate in the interbank money market tended to remain within the 70 to 80 band throughout the year, and continued to reflect the daily liquidity trends in the markets.

Parallel to the declining trend of inflation in the recent months, both the public borrowing interest rates and market interest rates have shown a notable decline, a trend which may reverse in the last quarter of the year.

VI. CAPITAL MARKET

The Istanbul Stock Exchange (IMKB) continued its long expected upward trend also during 1997, with the IMKB composite index going up by around 230 percent in nominal terms and by around 95 percent in real terms (when corrected with the annual percentage change in consumer prices). The financial index was up by around 350 percent, whilst the rise in the industrial index was around 145 percent.

The IMKB index continued its upward trend, albeit in a fluctuating manner, since the begining of the year. The composite index which had stood at 3459 on 30 Dec 1997, rose to 4322 as of 31 July. The financial index moved from 4587 on 30 Dec 1997 to 5278 on 31 July, and the industrial index from 2,650 to 3,721.

TABLE 24: STOCKS

(BILLION)

	APRIL 1998	DECEMBER 1997
PRIVATE SECTOR STOCKS	1,054,174	931,926
- Share Certificates	1,036,580	909,295
- Bonds	4,117	4,530
- Commercial Papers	2,200	2,200
- Asset-backed Securities	8,505	13.150
- Bank Bonds	43	22
- Profit-Loss Sharing Cer.	15	15
- Real Estate Cer.	2,714	2,714
PUBLIC SECTOR STOCKS	8,030,597	6,093,227
- Government Bonds	3,195,512	3,570,811
- Treasury Bills	4,675,350	2,374,990
- Revenue-Sharing Cer.	-	-
- Foreign Currency Indexed Bonds	-	-
- Privatization Bonds	159,735	147,426
TOTAL	9,084,770	7,025,153

SOURCE: THE CAPITAL MARKET BOARD

The private sector stocks increased by around 13 percent in nominal terms in the first four months of 1998, whilst the increase in public sector stocks, mainly in the form of T-bills and government bonds, was 31 percent. Share certificates makes up around 98 percent of total private sector stocks.

CHAPTER 4

PRICES AND INFLATION

I. THE GENERAL PRICE LEVEL

Both consumer and wholesale prices indicated to a notable acceleration in inflation during 1997. The annual percentage change in wholesale prices was observed to have jumped from 84.9 percent at the end of 1996 to as high as 91.0 percent by December

TABLE 25: ANNUAL RATE OF INFLATION

Annual Percentage Change

	CONSUMER PRICES	WHOLESALE PRICES
DECEMBER 1995	76.0	65.6
DECEMBER 1996	79.8	84.9
JUNE 1997	78.0	75.7
JULY	85.2	80.7
AUGUST	87.8	83.4
SEPTEMBER	89.9	85.4
OCTOBER	93.2	87.5
NOVEMBER	95.8	88.4
DECEMBER	99.1	91.0
1998		
JANUARY	101.6	92.5
FEBRUARY	99.3	89.6
MARCH	97.2	86.0
APRIL	93.6	83.3
MAY	91.4	79.9
JUNE	94.0	76.7
JULY	85.3	72.1

SOURCE: SIS

1997. Similarly, the annual rate of change in consumer prices has reached to 99.1 percent at the end of 1997, from 79.8 percent at the end of the previous year.

An analysis of the monthly movement of prices show that both consumer and wholesale prices rose at a higher rate in the latter half of the year, largely as a result of large scale upward adjustment in public prices by the new government. Adversely-effected inflationary expectations seem to have played some role in the accelaration of current inflation since the large scale upward adjustment in public prices was not initially introduced as an integral part of a well-designed and convincing stabilization package.

TABLE 26: MONTHLY PRICE MOVEMENTS

Percentage Change

	Wholesale Prices		Consumer Prices	
	1998	1997	1998	1997
JAN	6.5	5.6	7.2	5.9
FEB	4.6	6.2	4.4	5.7
MARCH	4.0	6.0	4.3	5.4
APR	4.0	5.5	4.7	6.6
MAY	3.3	5.2	3.5	4.7
JUNE	1.6	3.4	2.4	2.9
JULY	2.5	5.3	3.4	6.3
AUG		5.3		6.2
SEPT		6.3		7.3
OCT		6.7		8.3
NOV		5.6		6.6
DEC		5.4		5.1
FIRST SEVEN MONTHS	29.6	43.8	33.9	43.9
ANNUAL RATE OF CHANGE(1)	72.1	80.7	85.3	85.2
AVERAGE ANNUAL RATE OF CHANGE(1)	84.0	78.7	93.6	79.1

(1) As of end of July
SOURCE: SIS

The government intends to implement a three-year stabilization program covering the period 1998-2000. Accordingly; the annual rate of inflation is planned to be brought down to 50 percent by December 1998, to 20 percent by the end of 1999 and finally to 3 percent by the end of year 2000. The government projects a considerable slow-down in output growth in 1998 resulting from contractionary demand management policies. However, given the inflation target and the size of public expenditures in the 1998

Budget, it is possible to discern that the contraction in the aggregate effective demand is made dependant more on the private consumption than on public spending since the 1998 Budget does not target any real decline in public spending. So far, the government seems to have relied on high positive real interest policy and restrictive monetary policy in reducing aggregate demand. However, in view of the forthcoming general and local elections in April 1999, it is possible to expect a relaxation in monetary policy whilst high positive real interest rate policy is likely to continue in the face of huge public sector borrowing requirements.

The annual rate of change in wholesale prices has steadily dropped from 91.0 percent at the end of 1997, to 72.1 percent by the end of July 1998, whilst a similar declining trend was also observed in consumer prices, with the annual rate of change in consumer prices decelerating from 101.6 percent in January 1998 to 85.3 percent in July. The wholesale prices rose by 29.6 percent in the first seven months of 1998, whilst the total increase in consumer prices was higher, 33.9 percent. Whilst the wholesale prices have displayed a steadily declining trend since the month of February, the monthly increase in wholesale prices was higher in July (higher-than-expected) than what it was in the preceding month, indicating to a likely reversal in the trend of monthly inflation. A similar pattern of movement was observed also in consumer prices; following a monthly increase of as low as 2.4 percent in June, the consumer prices rose higher-than-expected in the month of July, by 3.4 percent. Whilst we may expect a further decline in the annual rate of inflation in remaining months of the year, the year-end inflation rate is highly likely to remain above the government's target of 50 percent (for wholesale prices). The monthly increase in both wholesale and consumer prices are most likely to become higher than the average of monthly inflation in the last 3 or 4 months.

II. PUBLIC AND PRIVATE SECTOR PRICES

Resultant from large scale price adjustments in the prices of publicly produced goods and services, in 1997 the public prices rose faster than the private prices. As of end of December 1997, the annual rate of increase in the public prices has reached to 97.5 percent against the 89 pecent increase in private prices, meaning that the rate of increase in the public prices was above the rate of overall increase in the wholesale prices. Highest public price increase was recorded in manufacturing industry products (108.5 percent), being well above the private sector's manufacturing prices (85 percent).

The government as part of its anti-inflation program, was seen to follow a public pricing

TABLE 27: PUBLIC AND PRIVATE PRICE CHANGES(1)

Percentage Change

	FIRST SEVEN MONTHS 1998	ANNUAL PERCENTAGE CHANGE AS OF JULY 1998
PUBLIC SECTOR	16.5	55.5
PRIVATE SECTOR	33.7	77.2
OVERALL	29.6	72.1

(1) Percentage Change in the SIS's Wholesale Prices Index (1995=100)

policy in the first half of 1998, whereby most public prices were supressed. As a result, the rate of increase in public wholesale prices in the first seven months of 1998 fell considerably behind that of private sector wholesale prices. Whilst private wholesale prices rose by 33.7 percent in the first seven months, the rate of increase in public prices was only 16.5 percent. As the delayed public price adjustment takes place, it is expected to push the overall price level upwards especially in the last quarter of the year. As of end of July 1998, annual rate of change in public prices stood at 55.5 percent against the 77.2 percent change in private prices and 72.1 percent change in the overall price level.

CHAPTER 5

FOREIGN ECONOMIC RELATIONS

I. THE BALANCE OF PAYMENTS

(a) Trade Account

The 1997 Economic Program had projected a slower growth in imports and a faster growth in exports over the previous year. Accordingly; imports were forecasted to grow at a yearly rate of 12 percent, reaching to 49,450 million US Dollars, whilst a faster growth (21 percent) would be reached in exports. The Program had projected a trade account deficit of 19,350 million US Dollars (excluding "shuttle trade")

In 1997, imports grew at about the same rate as projected by the Program, 11.6 percent, whilst the growth in exports (exclusive of "shuttle trade") remained well below the targeted 21 percent. Exports grew by 13 percent in 1997 reaching to a level of 26,245 million US Dollars. When "shuttle trade" is reflected in export figures, the trade account deficit stands at 15,398 million US Dollars, marking a 45 percent rise in the trade deficit in 1997 over the previous year.

The total merchandise exports ("shuttle trade" included) has not displayed any growth in the first half of 1998 as compared to the same period of the previous year, whilst the growth in merchandise imports was 3.2 percent, resulting in a trade deficit of 7,520 million US Dollars. The trade deficit widened by around 11.4 percent in the first half of 1998.

The government projects a 4.9 percent growth in merchandise imports and a 7.6 percent growth in export for the current year. The total exports (exclusive of "shuttle trade") grew

TABLE 28: BALANCE OF PAYMENTS

MILLION US DOLLARS

	1997(1)	1996(1)
A. CURRENT ACCOUNT		
MERCHANDISE EXPORTS (FOB)	32,631	32,446
MERCHANDISE IMPORTS (CIF)	-48,029	-43,028
TRADE BALANCE	-15,398	-10,582
OTHER GOODS/SERVICES (RECEIPT)	21,273	14,628
TRAVEL	7,002	5,650
INTEREST	1,900	1,577
OTHER	12,371	7,401
OTHER GOODS/SERVICES (PAYMENT)	-13,420	-10,930
TRAVEL	-1,716	-1,265
INTEREST	-4,588	-4,200
OTHER	-7,116	-5,465
PRIVATE UNREQUITED TRANSFER (RECEIPT)	4,552	3,892
WORKERS' REMITTANCES	4,197	3,542
OFFICIAL UNREQUITED TRANSFER (NET)	314	555
CURRENT ACCOUNT BALANCE	-2,679	-2,437
B. CAPITAL MOVEMENTS		
DIRECT INVESTMENT (NET)	554	612
PORTFOLIO INVESTMENT (NET)	1,634	570
OTHER LONG-TERM CAPITAL	4,667	1,636
SHORT-TERM CAPITAL	1,761	5,945
CAPITAL ACCOUNT BALANCE	8,616	8,763
C. STATISTICAL DISCREPANCY	-2,593	-1,781
OVERALL BALANCE	3,344	4,545
D. CHANGE IN RESERVES	-3,344	-4,545
IMF	-28	0,0
OFFICIAL RESERVES	-3,316	-4,545

(1) "SHUTTLE TRADE" REFLECTED

	1997	1996
EXPORTS FOB IN TRADE RETURNS	26,245	23,225
SHUTTLE TRADE	5,849	8,842
TRANSIT TRADE	537	379

TABLE 29: BALANCE OF PAYMENTS

MILLION US DOLLARS		
	JANUARY-JUNE	
	1998(1)	1997(1)
A. CURRENT ACCOUNT		
MERCHANDISE EXPORTS (FOB)	15,156	15,213
MERCHANDISE IMPORTS (CIF)	-22,676	-21,965
TRADE BALANCE	-7,520	-6,752
OTHER GOODS/SERVICES (RECEIPT)	10,683	8,706
TRAVEL	2,733	2,616
INTEREST	1,060	870
OTHER	6,890	5,220
OTHER GOODS/SERVICES (PAYMENT)	-7,157	-6,230
TRAVEL	-1,025	-983
INTEREST	-2,257	-2,027
OTHER	-3,875	-3,280
PRIVATE UNREQUITED TRANSFER (NET)	2,415	1.854
WORKER'S REMITTANCES	2,290	1,645
OFFICIAL UNREQUITED TRANSFER (NET)	66	105
CURRENT ACCOUNT BALANCE	-1,513	-2,317
B. CAPITAL MOVEMENTS		
DIRECT INVESTMENT (NET)	220	256
PORTFOLIO INVESTMENT (NET)	1,420	1,152
OTHER LONG-TERM CAPITAL	2,664	1,614
SHORT-TERM CAPITAL	3,493	1,883
C. STATISTICAL DISCREPANCY	1,885	-1,942
OVERALL BALANCE	8,169	646
D. CHANGE IN RESERVES	-8,169	-646
IMF	-80	0
OFFICIAL RESERVES	-8,089	-646

(1) "SHUTTLE TRADE" REFLECTED

by 2.4 percent in the first six months of 1998 over the same period of last year, whilst the growth in imports was higher, 3,7 percent. The first six month trade deficit ("shuttle trade" excluded) was nearly 9.7 billion US Dollars [MUSIAD in its reported published in January, forecasted a trade deficit of 22 billion US Dollars for the year, being the difference between 52 billion US Dollars of imports and 30 billion US Dollars of exports].

The external terms of trade was observed to have deteriorated in the first six months of 1998 when compared to the first half of 1997. The ratio of export prices to import prices (base year 1994=100) declined from 104.8 in March 1997 to 100.8 in April 1998.

(b) Current Account

The 1997 program projected a deficit of around 5,600 million US Dollars in the current account (excluding "shuttle trade"). The current account (shuttle trade excluded) yielded a deficit of 8,528 million US Dollars, which meant a decline of around 2,751 million US Dollars in the current account deficit over the previous year. "Shuttle trade" figures reflected, the current account deficit stood at 2,679 million US Dollars for the year.

TABLE 30: MONTHLY FOREIGN TRADE

MILLION US DOLLARS

	EXPORTS		IMPORTS	
	1998	1997	1998	1997
JANUARY	2,112	2,039	3,081	3,164
FEBRUARY	1,991	1,851	3,796	3,100
MARCH	2,357	2,176	4,311	3,831
APRIL	1,884	2,026	3,583	3,504
MAY	2,244	2,191	4,179	4,319
JUNE	2,036	2,132	4,145	3,899
JULY		2,150		4,134
AUGUST		2,134		4,159
SEPTEMBER		2,224		4,358
OCTOBER		2,390		4,374
NOVEMBER		2,523		4,353
DECEMBER		2,409		4,941
SIX MONTHS	12,716	12,415	23,086	22,267
YEARLY TOTAL		26,245		48,585

SOURCE: STATE INSTITUTE OF STATISTICS

TABLE 31: COMPOSITION OF FOREIGN TRADE (JANUARY-MAY)

(000 US DOLLARS)

	EXPORTS		IMPORTS	
	1998	1997	1998	1997
INVESTMENT GOODS	634,141	561,035	5,078,518	4,872,526
RAW MATERIALS/ SEMI-FINISHED GOODS	5,549,221	5,466,726	15,294,474	14,968,123
CONSUMPTION GOODS	6,525,723	6,372,717	2,596,731	2,285,605
OTHER	7,471	14,511	121,152	140,425
TOTAL	12,716,556	12,414,989	23,085,875	22,266,679

The current account deficit stood at 1,513 million US Dollars for the first half of 1998, which marks an improvement in the current account over the previous year; the current account had yielded a deficit of 2,317 million US Dollars in the same period of 1997.

TABLE 32: EXTERNAL TERMS OF TRADE

(1994 = 100)

	(I) INDEX OF EXPORT PRICES	(II) INDEX OF IMPORT PRICES	(III= I/II) TERMS OF TRADE
1996	107.6	109.7	98.1
1997			
MARCH	106.7	101.8	104.8
JUNE	103.3	99.2	104.1
SEPT	97.9	98.4	99.5
DEC	101.1	98.8	102.3
1998			
JAN	100.2	98.7	101.5
FEB	99.0	99.6	99.4
MARCH	98.8	99.0	99.8
APRIL	99.0	98.2	100.8

(c) Capital Account

The 1997 Program had projected a capital account surplus of around 8,600 million US Dollars, based on the expectation of a slow-down in short-term capital inflow and of an acceleration in portfolio investments from abroad.

The capital account yielded a surplus of 8,616 million US Dollars for the year, which more than offset the deficit in the current account. As expected, the short-term capital inflow declined from 5,945 million US Dollars in 1996, to 1,761 million US Dollars whilst "other" long term capital inflow amounted to 4,667 million US Dollars, which compares substantially favourably to the previous year. This trend seems to have reversed during the current year. There has been a re-acceleration in the inflow of short-term capital since the begining of the year. According to the most recent balance of payments figures, the amount of short-term (net) capital inflow amounted to around 3,500 million US Dollars in the first half of 1998. The government anticipates a surplus of as high as 12,400 million US Dollars in the capital account for the current year.

(d) Official Reserves Account

Largely as a result of a substantial surplus in the capital account, the official reserves rose by around 3.3 billion US Dollars in the year 1997 albeit a slower growth of official reserves when compared to the previous year. The official reserves were observed to have risen at a very fast rate in the first quarter of 1998; the rise in official reserves was as high as 8,089 million US Dollars in the first six months of the current year.

TABLE 33: EXTERNAL DEBT STOCK

(MILLION US DOLLARS)

	MARCH 1998	DECEMBER 1997	DECEMBER 1996
SHORT-TERM DEBTS	23.497	22,634	20,517
- Central Bank	882	889	984
- Commercial Banks	9,173	8,503	8,419
- Other Debtors	13,442	13,242	11,714
MEDIUM-LONG TERM DEBTS	70,959	69,582	64,149
Public	49,779	49,166	51,998
Private	21,180	20,416	13,051
TOTAL DEBT STOCK	94,456	92,216	84,666

SOURCE: TREASURY UNDERSECRETARIAT

II. EXTERNAL DEBTS

The total external debt stock of Türkiye, expressed in US Dollar terms, was seen to have increased by 8.9 percent in 1997, thereby reaching to end-of-year level of 92,216 million US Dollars. Whilst there was not a noticable change in the composition of total external debt stock as between short-term and medium/long-term debts, short-term indebtedness remained at a relatively high level, consisting of nearly one-fourth of the country's total external debts outstanding.

TABLE 34 : EXTERNAL DEBT INDICATORS

Percentage

	1997(1)	1996(1)
DEBT SERVICE/CURRENT ACCOUNT RECEIPTS	21.0	22.0
DEBT SERVICE/EXPORTS	38.0	35.0
INTEREST PAYMENT/EXPORTS	14.0	13.0
CURRENT ACCOUNT BALANCE/GNP	-1.0	-1.0
EXPORTS/GNP	17.0	18.0

(1) "SHUTTLE TRADE" INCLUDED

Various measures of foreign indebtedness indicate that there occured no substantial change in the foreign indebtedness position during 1997 over the previous year. The ratio of debt service to current account receipts slightly declined, from 22 percent in 1996 to 21 percent in 1997, whilst the ratio of debt service to exports showed some deterioration from 35 percent to 38 percent in the same period (according to internationally accepted standards, countries with a debt service/exports ratio higher than 30 percent are considered as "highly indebted countries"). The ratio of interest payment to exports has risen from 13 percent in 1996, to 14 percent in 1997 (international standard for being "highly indebted": 20 percent). The ratio of current account deficit to GNP has remained unchanged at 1 percent, whilst the ratio of exports to GNP displaying a slight decline from 18 percent to 17 percent. However, despite its steadily growing foreign indebtedness, it is important to remind the fact that Türkiye has a fulfilled its foreign debt obligations in a timely and regular manner, uninterruptedly since 1980.

The foreign debt servicing of the country is projected to be around 14 billion US Dollars for the year 1998, consisting of 11 billion US Dollars of principal repayment and 3 billion US Dollars of interest payment. In 1998 Türkiye will have made the highest repayment for its medium and long term foreign debts, until today.

The total external debt stock has risen by 2,240 million US Dollars (2.4 percent) in the first quarter of 1998. The short-term debts were observed to have risen at a higher rate than the medium/long term debts, largely as a result of external borrowing by commercial banks. As of end of March, the short-term debts made up 25 percent of the total external debt stock.

III. INTERNATIONAL RESERVES

The country's total international reserves continued to rise during 1997 and the first half of the current year. Total reserves which had stood at 24.9 billion UŞ Dollars at the end of 1996, rose to 27.1 billion at the end of 1997, and to 32.4 billion by April 1998.

TABLE 35: INTERNATIONAL RESERVES

(MILLION US DOLLARS)

YEARS	GOLD	FOREIGN CURENCY CENTRAL BANK	FOREIGN CURENCY BANKS	GROSS RESERVES	OVERDRAFTS	NET RESERVES
1994	1,410.0	7,112.1	7,997.0	16,519.1	4.8	16,514.3
1995	1,383.1	12,390.6	10,168.7	23,942.4	19.6	23,922.8
1996	1,383.2	16,272.5	7,351.9	25,007.6	41.7	24,965.9
1997	1,124.4	18,418,8	7,625.1	27,168.3	30.2	27,138.1
1998						
JAN	1,383.0	19,860.0	8,859.0	30,102.0	39.5	30,062.5
FEB	1,124.0	19,422.0	8,943.0	29,489.0	36.3	29,452.7
MARCH	1,124.0	21,175.4	8,427.6	30,727.3	36.4	30,690.9
APRIL	1,124.0	23,004.0	8,329.5	32,457.8	34.0	32,423.8
MAY		25,715.0				
JUNE		26,700.0				
JULY		25,711.0				

SOURCE: CENTRAL BANK

There has been a sharp rise in the Central Bank's foreign currency reserves since the end of 1997, from 18.4 billion US Dollars at the end of December 1997 to 26.7 billion US Dollars by June 1998, largely resultant from foreign currency purchases of the Central Bank from commercial banks. Fast increase in the Central Bank foreign reserves, whilst increasing confidence in the foreign exchange markets (since strong reserves make the Central Bank have a full control over the markes) creates serious difficulties for the

Central Bank in controlling monetary expansion in the economy at a time when the tight monetary policy is an important (in fact the most important) element of the anti-inflation program.

As a result of the Central Bank's interventions in the local foreign exchange markets, the amount of foreign reserves with the Central Bank declined from 26.7 billion US Dollars to 25.7 billion US Dollars at the end of July. The Central Bank has recently taken a number of decisions which are expected to slow down the growth of CB reserves. In fact, the monetary program adopted by the Central Bank for the second half of 1998 anticipates a slower growth of official reserves which is expected to assist implementation of tighter monetary policies.

TABLE 36: FOREIGN DIRECT INVESTMENTS BY NON-RESIDENTS

MILLION US DOLLARS

YEARS	PERMITTED	REALIZED		
		INFLOW	OUTFLOW	NET
1992	1,820	811	67	844
1993	2,125	746	110	636
1994	1,485	636	28	608
1995	2,938	934	49	885
1996	3,837	914	192	722
1997	1,678	852	47	805

IV. FOREIGN CAPITAL

In 1997, the capital account yielded a net capital inflow of 8,616 million US Dollars as against 8,763 million US Dollars in the previous year. Of this capital inflow, 4,667 million US Dollars was in the form of long-term capital, whereas the amount of short-term capital inflow (net) dropped sharply from 5,945 million US Dollars in the previous year to 1,761 million US Dollars in 1997. Inflow of short-term capital is seen to have re-accelerated in the first quarter of 1998.

On the other hand, foreign direct inverstment permitted grew by 20 percent totalling 944 million US Dollars in the first six months of 1998 (compared by 785 million US Dollars in the same period of 1997). As a total, the cumulative foreign direct inverstments permitted amounted to 23,149 million US Dollars and the number of foreign firms to 4,257 by end of June 1998.

TABLE 37: FOREIGN CAPITAL PERMITS ISSUED (JANUARY-JUNE 1998)						
(000 US DOLLARS)						
			TYPE OF INVESTMENT			
SECTOR	NO OF PERMITS	AMOUNT	NEW	EXTENSION	CAPITAL INCREASE	PORTFOLIO
AGRICULTURE	9	3,658	346	81	2,450	781
MINING	11	12,717	3,723	1,662	7,221	111
MANUFACTURING INDUSTRY	250	633,700	81,744	309,259	97,967	144,730
SERVICES	334	294,378	111,318	20,909	51,580	110,571
TOTAL	604	944,453	197,131	331,911	159,218	256,193

SOURCE: TREASURY UNDERSECRETARIAT

V. FOREIGN EXCHANGE RATES

The exchange rate was observed to have followed a relatively stable trend also during the year 1997. The Central Bank, backed by strong and steadily growing foreign currency reserves, continued its "surveillance" function over the local foreign exchange markets. The foreign exchange rate has moved under almost full control of the Central Bank. The Turkish Lira depreciated 90.8 percent against US Dollar (80.6 percent in the previous yea) whilst the rate of TL depreciation against D. Mark was limited to 65 percent, owing to rise in the USD/DEM parity in international markets. The currency basket, consisting of 50 percent of US Dollar and 50 percent D. Mark, depreciated by around 78 percent in the year 1997. The nominal depreciation of the currency basket corrected by the actual rate of inflation (which was 99.1 percent) indicates to a real exchange rate appreciation of somewhere around 10 percent for the year.

The local foreign exchange markets continued to remain quite stable also since the begining of 1998. The Central Bank was observed to interfere with the foreign exchange markets occasionally in order to iron out short-term fluctuations. Strong foreign reserves held by the Central Bank play a major role for the stability of the foreign exchange markets. The Turkish Lira depreciated by around 31 percent against US Dollar and 33 percent against D. Mark in the first seven months of the year. The nominal depreciation in the currency basket was 32 percent, implying a negligible real appreciation in the exchange rate in the first seven months. Whilst the exchange rate is expected to continue moving principally under the control of the Central Bank, the monthly depreciation rate can be expected to accelerate to some extent in the remaining months of the year.

TABLE 38: INFLATION AND CURRENCY DEPRECIATION

Percentage Change

YEARS	TL DEPRECIATION AGAINST US DOLLAR	TL DEPRECIATION AGAINST D. MARK	CURRENCY DEPRECIATION (BASKET)(1)	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(3)	30.8	32.7	31.7	33.9(3)	-1.6

(1) Currency basket comprising of 50 percent US Dollar and 50 percent D. Mark
(2) December-on-December percentage change in the SIS' Consumer Prices Index (1987=100)
(2) First seven months of 1998.

TABLE 39: TRADE-WEIGHTED EFFECTIVE REAL EXCHANGE RATE

	Average Exchange Rate		Cross Rate	Average	Price	Germen Price	Trade-Weighted Effective Real
	TL/USD	TL/DEM	DEM/USD	Price(1)	IIndex(2)	Index(2)	Exchange Rate
Dec-1995	56,587.5	39,267.2	1.44	28,163.5	108.4	106.5	70.0
Dec-1996	104,297.5	67,229.5	1.55	51,935.9	111.7	103.8	71.9
Jan-1997	111,651.1	69,845.4	1,60	55,286.8	112.6	103.8	72.0
March	124,559.0	83,464.8	1.70	60,753.5	109.8	103.8	74.3
June	152,826.0	85,457.9	1.79	69,278.3	109.9	104.7	73.9
Sept	169,744.0	94,828.3	1.79	81,890.8	110.3	105.1	75.0
Dec	199,050,8	112,058.2	1.78	96,591.2	109.7	104.9	75.5
Jan 1998	211,141.0	116,326.3	1.82	103,319.9	108.9	104.9	77.4
Feb	222,694.5	122,816.5	1.81	107,644.5	108.4	104.8	76.6
March	234,795.9	128,703.6	1.82	111,858.7	107.8	104.8	76.1
April	244.903.3	134,631.6	1.82	116,044.1	108.0	104.8	75.5
May	251,309.5	141,558.5	1.78	120,141.0	108.0	104.8	75.2

(1) Average Wholesale Price Index (weighted 60 percent State Institute of Statistics' Index, 40 percent Istanbul Chamber of Commerce' Index)
(2) Industrial Production Price Index (1990=10), International Financial Statistics
SOURCE: Central Bank

VI- CUSTOMS UNION AND RELATIONS WITH THE EUROPEAN UNION

The Türkiye-European Union relations which had entered into a turbulent phase at the end of 1997, remained rather distanced and stagnant during the first half of 1998. Following its exclusion at the Luxembourg Summit (12-13 December 1997) from the first and second phases of the EU Enlargement Process, Türkiye has decided not to negotia-te on the issues of Greece, Cyprus, Aeagan Sea and human rights. During the first six months this was perceived as an interruption of political dialogue between the both sides; in point of fact, the meeting (following the last meeting which had been held on 28 April 1997) scheduled to be held in May 1998, could not take place due to Türkiye's unwillingness.

In the meantime, whilst the leaders of 15 EU member countries and of 11 candidate countries in the first and second phases of Enlargement Process participated in the first meeting of the "European Conference" held in London on 12th March 1998, the European Union has started membership negotiations with Poland, Hungary, Chech Republic, Estonia, Slovenia and Greek Cypriot Administration on 31st March 1998.

Following the EU's launch of membership negotitations with the Greek Cypriot Administration without due respect to Türkiye's warnings and to the existence of the Turkish Republic of Northern Cyprus, economic integration process between Türkiye and the Turkish Republic of Northern Cyprus has gained a considerable momentum. Both sides, meeting in Cyprus on 22-23 July 1998, have agreed on fostering and deepening their cooperation in economic and commercial fields towards creation of a common economic area between both countries. Within this framework, they have signed "Economic Cooperation Protocol", "Agreement Concerning State Aid in Investments", "Agreement on Commercial and Economic Cooperation" and "Agreement on Investment Guarantee".

In the meantime, the officials of the EU Commission and EU Council, especially the UK have delivered speeches and made frequent visits in order to remove Türkiye's discontent. The EU Commission, as a result of a decision taken at the Luxembourg Summit, had accepted a document titled **"European Strategy for Türkiye"** which aims at making Türkiye come closer to the EU in all fields. This document, hastily prepared not to "lose" Türkiye completely, was in the nature of a 15-item action plan involving further development of the customs union, cooperation in the free movement of services, communications, monetary union and transportation and activation of the Financial Protocol without any delay.

Efforts exerted by the UK at the Cardiff Summit (15-16 June 1998) have strived to remove Türkiye's disappointment, but failed to succeed as a result of the objections raised by

Greece. The summit has endorsed the document prepared by the EU Commission, and in the Final Communique, the term "candidate country" instead of "eligible for membership" was used to describe Türkiye's status. This document was officially forwarded to the Turkish side at the Türkiye-EU Association Committee held on 30 June 1998.

As a matter of fact, the Prime Minister of Austria (Mr. Victor Klima) which took over the rotating presidency of the EU on 1 st July 1998, has once more confirmed the true intention of the EU when he mentioned Türkiye's name (together with Russia and Ukraine) as a candidate country for the 3rd phase of the Enlargement Process.

In late July, Türkiye has submitted a document to the EC Commission (titled **"Strategy for Developing Relations between Türkiye and the European Union)**, adding its own proposals. The proposals included in the said document were:

- Association relations must be revitalized;
- Whilst the ultimate goal is Türkiye's full membership to the EU, customs union is by no means a sufficient element in an Association relationship which does not guarantee this ultimate goal;
- The Cardiff Summit has not removed the discriminating attitude towards Türkiye in the enlargement process.
- Consultation Mechanism must be strengthened, and Türkiye must be informed by the EU more directly.
- Turkey should be included into Pan-European Origin-Cumulation System.
- The EU must give its support to Türkiye's participation into the European Transit agreements.
- Türkiye has already achieved an adjustment at the trade and competition policies of the EU to a large extent, and materialized market integration. Therefore, anti-dumping practices effected by the EU against some Turkish exports must be abolished.
- Türkiye, since it is expected to adopt to the EU's foreign trade regime and customs policies, must be allowed to attend at the technical committee works of the EU Commission.
- Türkiye must be provided with administrative support in its adjustment to the EU regulations.
- Türkiye must be allowed to enjoy exceptions in its bilateral trade relations (preferential trade relations) with countries in the Balkans, the Black Sea Regions, Caucasia and the Central Asia with which it has historical and cultural ties.

* * *

Both sides, Türkiye and the European Union, seems willing to resume official dialogue, from September onwards.

On the other hand, two and a half years have already elapsed since Türkiye's entry to the Customs Union on 1st January 1996. It is seen that the Customs Union continues to work unilaterally against Türkiye.

With its entry to the Customs Union, Türkiye has abolished customs duties and the Mass Housing Fund Levy on industrial imports from the EU, reduced tariffs on many agricultural products (including meat and diary products) under the Association Council's Decree dated 29 April 1997, begun to apply the EU's common tariffs (CET) on imports from third countries. As a result, Türkiye has reduced the weighted protection rate from 10.79 percent to as low as 5.6 percent; adopted EU's Common Commercial Policy, put into effect the EU's textile policy; signed EU's Association and free trade area agreements with third countries, and within this framework signed free trade agreements with Hungary, Israel, Romania, Lithuania, Estonia, Latvia, Chech Republic, Slovenia and lastly with Bulgaria on 11 July 1998 (and negotiations with Poland, Morocco, Tunis and Egypt are under way).

Moreover; Türkiye has enacted the Law on Competition, Law on Trade Mark and Patent Rights, Law on the Protection of Consumer, Law on Intellectual Property Rights. The Competition Council has been active since November 1997, and as of July 1998 some 270 applications have been made to the Council, as a result of which the Council has already started investigations for 10 applications. As regards adjustment to the EU regulations, Türkiye is yet to legislate a new Customs Act based on the EU's Customs Code, establish a National Accreditation Centre, legislate regulations pertaining to standards, eradication of technical barriers, and monopolies of commercial nature, and finally legislate a Private Consumption Tax Law.

Despite EU's previous commitment to grant a financial aid worth of 2.5 billion ECU (equivalent of 3.2 billion US Dollars) with the purpose of mitigating the heavy commitments undertaken by Türkiye, the said financial aid has not been released by the EU until today due to Greece's veto and that the release of the aid was made conditional by European Parliament.

The EU still continues to treat Türkiye as a third country, despite the latter's integration to the EU in terms of trade and competition regulations. The EU continues to apply anti-dumping taxes on polyester yarn and unbleached cotton imports from Türkiye.

Moreover, in the first seven months of 1998 the EU has taken a number of decisions which badly harm Türkiye's agricultural exports to EU. The Veterinary Committee (of EU) has banned importation of fresh fish and shelled sea food on basis of the claim that the production units in Türkiye do not meet the required hygenic standards. [In 1997 Türkiye has exported 90 million US Dollars worth of sea food to EU, whereas this figure was 86 million US Dollars in 1996]. On 13 July 1998, the EU has also introduced an extra customs duty (levy) on Türkiye's exports in hazelnuts, watermelon and tomato paste, reasoning that Türkiye had not yet resumed importation of meat and livestock from the EU which it had previously ceased due to "mad cow disease".

The EU has introduced an extra 3.5 percent customs duty on the quotad 9.060 tonnes of hazelnut imports, an extra 9.5 percent customs duty on the quoted 14,000 tonnes of watermelon, and 15,6 percent customs duty on the quotad 15,000 tonnes of tomate paste.

The EU has not taken any steps towards free movement of Turkish citizens witnin the EU which is supposed to have begun from 1 December 1986, nor nothing was done towards relaxing the strict visa requirements imposed on Turkish citizens. Whilst businessmen from the EU can easily travel to Türkiye without any visa hardship, Turkish businessmen are made to wait in long visa queus for weeks (especially in the case of Belgium and Irish visas). This obviously creates a very serious competitive disadvantage for Turkish businessmen.

The EU has recorded a 24.2 billion US Dollar trade surplus towards Türkiye in the first 2 years of the Customs Union, 12.6 billion US Dollars of which was as a result of a substantial increase in Türkiye's imports from the EU since its entry to the customs union in 1996. The

TABLE 40: TURKIYE'S FOREIGN TRADE WITH THE EUROPEAN UNION (EU)

	1998 (FIRST SIX MONTHS)	1997	1996	1995
EXPORTS TO EU				
• Amount (Million USD)	6,200	12,247	11.548	11,078
• Percentage Change (%)	6.9	6.1	4.2	28.3
* Share in Total Exports (%)	48.8	46.7	49.7	51.2
IMPORTS FROM EU				
• Amount (million USD)	11.901	24.869	23,138	16.860
• Percentage Change (%)	6.5	7.5	37.2	64.0
* Share in Total Imports (%)	51.6	51.2	53.0	47.2
TRADE BALANCE WITH EU				
• Amonth (USD)	-5,701	-12,622	-11,590	-5,782

SOURCE: Undersecretariat of Foreign Trade, State Institute of Statistics first six months figures in 1998 indicate that, the share of the EU in Türkiye's foreign trade has risen to 50.6 percent (from 48.9 in 1997), stemming from the increased share of exports from 46.7 percent to 48.8 percent, and of imports from 50.2 percent to 51.6 percent.

The Turkish Treasury is also deprived of a 2.5-3.0 billion US Dollars worth of customs duty and fund revenue, annually.

Contrary to the previous expectations, there has not been any substantial rise in Türkiye's overall exports, especially in textile-clothing exports which was expected to rise by around 15 to 20 billion US Dollars in the past two year. Contrarily, there has been a visible stagnation in Türkiye's exports, mainly in textile and iron and steel, due to the recent crisis in the Southeast Asian countries and Russia.

In summary, whilst Türkiye continues to experience serious difficulties resulting from its full commitments towards full membership to the EU, the European Union continues to carry out its relations with Türkiye within the framework of a "Customs Union" formula whilst leaving out Türkiye from its Enlargenment Process with which it plans to include as much as 26 member countries by the year 2005.

PROPOSALS

Türkiye must follow a more consistent, rational and realistic policy in its relations with the European Union, and must re-arrange these relations on the basis of a "Free Trade Area Agreement" instead of the present Customs Union which has already proven to be working against Türkiye's interests. Such a rearrangement will enable Türkiye to develop its relations with third countries, whilst continuing its relations with the European markets on free trade principles.

Türkiye must also force the EU to release at least 2.5 billion ECU worth of financial aid which is sought in the Customs Union Decree, thereby making the EU to fullfill its long-delayed commitments towards Türkiye, at least partially.

Visa requirement for Turkish citizens which constitutes an unfair competitive disadvantage in free trade must be lifted by the EU at least for Turkish businessmen.

On the other hand; Türkiye must start an intensive diplomatic and commercial attack in re-instituting its relations with countries in the Balkans, Russia, the Central Asia and the Islamic World with which it has eco-strategic and jeo-cultural advantages and benefits. Within this framework, it must halt its steadily deepening military relations with Israel and keep its political relations with this country at a minimum level. It must re-vitalize its institutionalized relations with the Middle-Eastern and North African countries and with Iran, in the intensity which was achieved during the period 1980-1986.

CHAPTER 6

OVERVIEW AND RECOMMENDATIONS

I- OVERVIEW

In late June 1998, the Turkish government and the IMF have agreed on an 18-month staff monitored program whereby the economic program that is currently being implemented by the government would be monitored by the IMF staff during this period. The program involves 3-monthly regular visits by the IMF staff who would assess the results obtained and publicly express opinion on the state of the Turkish economy.

The letter of intent presented to the IMF within the framework of this staff monitored program includes a number of commitments by the Turkish government which are summarized hereunder:

(a) Budget Targets:

- increase the primary budget surplus (expressed as percentage of GNP) above 4 percent for the year 1998;
- restrict budget spending;
- disallow budget interest spending to exceed 9,255 trillion TLs;
- keep the budgetary transfer spending below the previous year's level;
- no extra budget for 1998 (for the first time in many years).

(b) Privatization

- generate at least 3 billion US Dollars privatization revenue for 1998 (3.6 billion US Dollars for the next year) ;
- allocate at least 2 billion US Dollar privatization revenue for reducing public domestic debt stock during 1998 (at least 3 billion US Dollars during next year).

(c) Social Security Institutions

- launch a full-fledged social security reform;
- raise the retirement age to 60 for men and 57 for women for new workers

(d) Exchange Rate Policy

- The exchange rate policy to be determined in compliance to the year-end inflation target (50 percent);
- The Central Bank to continue not extending any credit facility to the public sector, the year-end target for net domestic assets being 1,500 trillion TLs.

TABLE 41: 1998 TARGET INDICATORS IN THE STAFF MONITORING PROGRAM SIGNED WITH THE IMF

	1998 (TARGET)			
	MAY	JUNE	SEPT	DECEMBER
(A) BUDGET INDICATORS				
* Total Revenue (trillion TL)	3,825	4,622	7,780	11,400
* Non-interest Expenditure	2,888	3,582	6,250	9,255
* Primary Budget Surplus (exclusive of privatization revenue)	937	1,040	1,530	2,145
* Privatization Revenue that would be allocated to debt repayment (million USD)	793	1,000	1,500	2,000
(B) MONETARY INDICATORS				
* Central Bank Net Assets (Trillon TL)	-1,498	-1,605		-1,514
C. INFLATION (year-end)				
* Consumer Prices(percent)				55
* Wholesale Prices (percent)				50

(e) Banking Sector

- strengthen supervision over the banking sector;
- closely follow up the arrangements related to ceilings on banks' short position in foreign currency; accordingly, reduce the ratio of short position to capital base to 30 percent by the end of 1998 and to 20 percent by September 1999.
- to enact the Law on the Regulation and Supervision of Financial Markets as soon as possible

TABLE 42: SELECTED ECONOMIC INDICATORS

	1999 TARGET	1998 PROJECTED	1997 ACTUAL
GNP GROWTH (Percent)	4.4	4.5	8.0
CONSUMER PRICES:			
• Annual Average % Change	32.3	78.0	85.7
• Year-end % Change	20.0	55.0	99.1
WHOLESALE PRICES:			
• Annual Average % Change	31.4	69.5	81.8
• Year-end % Change	20.0	50.0	91.0
PSBR/GNP (percent)	8.1	10.4	11.6
CONSOLIDATED BUDGET DEFICIT/GNP (%)	-5.6	-7.6	-7.5
PRIMARY BUDGET SURPLUS/GNP (%)	4.7	4.1	0.1
CONSOLIDATED DEBT STOCK/GNP (%)	34.8	35.4	36.3
EXTERNAL DEBT STOCK/GNP (%)	14.4	14.6	15.1
CENTRAL BANK NET DOMESTIC ASSETS (TRILLION TL)	-2,888	-1,514	142
EXTERNAL TERMS OF TRADE (%)	-0.4	4.3	-0.9
EXPORT REVENUE (% Change)	12.9	7.6	9.7
EXPORT VOLUME (% Change)	12.0	10.3	15.0
IMPORTS (% Change)	9.6	4.9	10.9
IMPORT VOLUME (% Change)	8.3	12.2	18.7
CURRENT ACCOUNT DEFICIT (MILLION USD)	-6,232	5,544	-4,738
CURRENT ACCOUNT DEFICIT/GNP (%)	-2.8	-2.7	-2.5
SURPLUS IN THE CAPITAL ACCOUNT (MILLION USD)	11,866	12,416	9,264
TOTAL EXTERNAL DEBTS (MILLION USD)	105,365	93,376	89,252
SHORT-TERM EXTERNAL DEBTS/ INTERNATIONAL RESERVES (%)	91.3	102.3	119.1
EXTERNAL DEBT REPAYMENT (%)*	21.2	27.0	21.2

** Ratio of interest payment plus annual repayment of medium and long term external debts to current account revenue (excluding official transfer)*

(f) Wages and Agricultural Support Prices

Public sector wages and agricultural support prices to be adjusted according to "expected inflation" rather than "actualized inflation".

Some selected economic indicators included in the government's letter of intent ("Memorandum of Economic Policies") given to the IMF staff witnin the framework of staff monitored program, are provided in TABLE 41 and TABLE 42.

EVALUATION OF THE TOP 500 INDUSTRIAL COMPANIES OF TURKEY

Following the "Fortune 500" tradition, The Istanbul Chamber of Industry has successfully been conducting the "Top 500 of Turkey" survey since 1982. The results for 1997 were disclosed soon after Fortune's latest "Global 500" issue on August 3, 1998. A short appraisal may be useful.

(1) Just as the global 500 controlling about one third of the global industrial output, the Turkish 500 are also controlling some 40 per cent of national industry. So, their development and technological as well as financial performances are crucial for the overall economy. Here are the top performers according to total sales in 1997:

:

State-owned Enterprises

1. Tüpraş	1,122	trillion TL	(US $ 7.0 billion)
2. TEAŞ	408	trillion TL	(US $ 2.6 billion)
3. Tekel	346	trillion TL	(US $ 2.2 billion)
4. Ereğli Iron-Steel Works	164	trillion TL	(US $ 1.0 billion)
5. Turkish Sugar Comp.	146	trillion TL	(US $ 0.9 billion)

Private Companies

1. Arçelik	147	trillion TL	(US $ 0.9 billion)
2. Philsa	128	trillion TL	(US $ 0.8 billion)
3. Ford-Otosan	122	trillion TL	(US $ 0.8 billion)
4. Mercedes-Benz Türk	111	trillion TL	(US $ 0.7 billion)
5. Oyak-Renault	109	trillion TL	(US 0.7 billion)

(2) The Turkish 500 includes 44 state-owned enterprises and 456 private companies. State enterprises are mostly monopolies in their fields. None of them could appear on Fortune's Global 500 list, because the last company (Sun Systems of US) had a sales figures of approximately 9 billion US dollars, whereas Turkey's top state-owned and private companies were standing at around 7 billion and 1 billion US dollars respectively.

(3) Most of the top companies are inward-oriented. The ratio of exports in their overall sales is negligible. On the whole, the top 500 companies export only 16 per cent of their products, whereas their imports continue to constitute a substantial part of their total inputs. None of the above private top performers except Mercedes-Benz are among the top exporting companies.

(4) Most of today's major industrial enterprises were established through direct state aid during the 1960s. For almost two decades, an intense import-substitution policy benefited these enterprises. 1980s have been the years of export-led growth, during which these enterprises were subsidized substantially in order to produce for the world market. However, despite large sums of direct state aid and financing, many of them failed to transfom into competitive enterprises. With a few exceptions, they are still inward-oriented, producing largely for the local market. This explains, first, their lack of optimum capacity at world standards, and secondly, their almost hostile standing toward the newly emerging "Anatolian Lions". Since the domestic market has had a limited purchasing power, inward-oriented companies could not expand capacity compared to genuine export-oriented enterprises.

(5) Again, most of the major private industrial companies are merely distributors of the European and American manufacturers, such as Fiat, Ford, or General Electric. Being, at most, semi-independent, they are unable to export freely. Moreover, almost half of their inputs are being imported from the licencing company's home market. In 1993, the top five private sector industrial companies had a total export volume of 154 million US dollars, whereas their combined imports reached 782 million US dollars. On the average, each company caused a foreign exchange loss of 126 million US dollars to the national economy. We had labelled these seemingly modern manufacturers as the Blackholes of the Turkish Economy. The situation has only slightly improved since 1993.

(6) Unable to produce for world markets, Turkey's big enterprises have been left with the domestic demand, which has been undermined in face of chronic inflation. They had to contrive some genius device or close doors. They could not overtly demand state

aid in the form of either investment or export subsidies, because uncontrolled incentives during the last three decades did not produce much output. The rescue came in the form of domestic borrowing at higher real interest rates. During the first half of the 1990s, real interest rates paid for government bonds oscilated between 15 and 50 per cent! The major customers of these bonds are large industrial groups using their own banks and financial institutions. As a result, today four fifths of Turkey's overall tax revenues are paid as interest to these industrialists, whereas 52.7 per cent of 'industrial' profits come out of non-productive activities, that is to say, interest earnings.

(7) The state-backed policy of big industrialists has had a severe impact on the development of the small and medium size Anatolian companies which have been trying to produce for world markets during the last decade. Of the financial resources (mainly deposits) obtained through commercial banks, 55 per cent are used for financing the state (at extraordinary interest rates as indicated above). The remaining part are mostly allocated to large companies. It is estimated that only 3 to 5 per cent of national savings are utilized by small and medium size companies.

Despite this, the so-called Anatolian Lions are growing year by year. Apart from conventional family firms, we now have the multi-partner corporations. Local people, suppliers, customers, managers and workers of the company are all becoming partners. We call this as growth through equality. However, under ideological guises, there are pressures to prevent this efficient development. Such efforts will prove counter-productive, since a state devouring its most wealth-generating companies cannot live on the shoulders of uncompetitive domestic monopolies.

II- MÜSİAD'S RECOMMENDATIONS

1) Need For Political Stability, Social Harmony and Institutional Reforms

As has been repeatedly expressed in our previous reports, reinstituting political stability and achieving social harmony is far the most important pre-requisite for the fast and sustainable economic and social development of Türkiye. The present government, being a minority coalition, does not possess the necessary political strength and determination for putting into effect the most needed reforms in the areas of public finance, banking, public domestic borrowing and social security.

Türkiye must also achieve a fully-fledged legal reform. Provisions existing in the Constitution and the laws, which restrict freedom of thought, expression and faith must be abolished, electoral system must be amended so that the people's preferences are better reflected in the Parliament. The existing justice mechanism must be revised so as to work in a more proper and efficient manner.

Long-awited stability in the political life can only be restored by holding general elections at the earliest possible time, so that nation's will be reflected on the Parliament and social harmony be achieved in our society.

2) Restoring Economic Stability

Huge public deficits, an ailing social security system and a galloping inflation are the major elements of economic instability in the country. Restoring economic stability must be based on the following five principles, which are:

- increase in production,
- increase in incomes,
- encouraging high domestic savings and, attracting funds fom abroad (funds of expatriates and foreign nationals),
- curbing any and all kind of practices leading to unfair competion emergence of cartels.
- disciplining public budget,

With the objective of disciplining the public finance, the following measures are recommended:

- the high interest burdens on the budget must be reduced. Constitutional limits must be introduced on the maximum amount of public domestic borrowing.
- a social security reform must be made whereby the retirement age would be raised. Measures must be introduced in order to increase the revenues of social security intitutions.
- The deficits of state economic enterprises must be eliminated.
- privatization must be speeded up, but with certain transparent and objective criteria.
- Economic, social and foreign policy solutions must be formulated to the outstanding southeastern question which puts an extremely heavy burden on the public budget in terms of defence spending. This should of course be done without burdening national unity of the country.

3) Growth within Stability

Turkey has been "living with a high and institutionalized inflation" for more than 20 years. Readjustment of the economy to lower levels of inflation therefore inevitably requires implementation of a 3-5 year-transition programme by a politically strong government in a persistent and determined manner in order to reverse the present inflation tend.

Anti-inflation programme of the government must be in the nature of an **"economic restructuring"**, by aiming gradually achieved price stability based on exports-and investment-led output growth, reduced public sector deficits, restored production-consumption balance and increased competition in the economy rather than a IMF prescription-type monetarist and restrictive package.

4) A New Effort to Boost Exports

- The government must adopt and implement a **"Dual Economic Model"** by aiming at increasing exports whilst reducing imports to the minimum possible. For this purpose, foreign economic relations of the country must be reformed; a Foreign Trade Ministry must be established and this ministry must be organized both within Turkey and abroad.
- Experts on various sectors and varying from one country to another must be employed at the overseas official trade officies. A communication network comprising all country profiles and markets - products information geared to foreign trade and investment should be formed among our country's overseas official trade offices and interlinked.

All business organizations in Turkey, either semi-public chambers or voluntarily-based business associations, should be allowed to be linked with this data network to enable their members to take advantage of global trade information.

- All kinds of data and information must be made available to newly-established companies in foreign trade sector, a fast-functioning Information/Data Center must be established (the existing IGEME is far from fulfilling this function properly).
- Businessmen also from the private sector must be employed at Turkey's representative offices abroad; these offices must provide legal, technical and marketing support needed by Turkish businessmen abroad.
- Turkey should definitely diversify its export markets (EU accounting for 50 %, Germany alone 23.8 %) and export products (textiles clothing 38.8 %). New potential export markets are Russia, Iran, Saudi Arabia, Ukraine, Pakistan, Egypt, Kuwait, Romania, Bulgaria, Jordan, Azerbaijan, Khazakistan, Turkmenistan, Sudan, Nigeria.
- Border-Trade with neighbouring countries should be encouraged whilst also permanent trade centers in the potential markets should be established.
- Passenger and cargo transportation links should be developed with Middle-Eastern, Caucasian, South-East Asian, Central Asian and African countries. Some of EXIM-BANK's credit lines could be opened for exports to these countries. Also financial transactions between Turkish financial institutions and their counterparts in those countries should be eased. If there is no transportation and financial link with an overseas market, then there would be no chance for reciprocal trading.
- It is feared that the economic crisis in Russia which is Turkey's second biggest foreign trading partner after Germany, could advesely affect Turkey's both official trade and the so-called shuttle trade with Russia. Turkey's official trade with Russia amounted to about 4 billion US Dollars in 1997 while shuttle exports (mostly to Russia) totalled 5.5 billion US Dollars (going down from 8.5 billion US dollars in 1996).

In order to tackle the crisis on trade with Russia; the Turkish government should urgently provide support to export promotion activities and to open shops or department stores for Turkish exporters in trade centers of Russia; Sea-and airport services in Istanbul should be made cheaper and more convenient; Decrees No: 61 and 64 on VAT concerning shuttle trade should be put into force.

- Export growth (both in absolute terms and as percentage of total turnover) must be encouraged through tax reduction, reduced finance and insurance premium cost.
- Businessmen who compete in and exceed a certain amount of exports should be

prized with red-diplomatic passport which would enable the holder to move more conveniently and quickly abroad.

- Financing support must be provided to exporters on an interest-free basis in three months and on a profit-sharing scheme in the second three months.
- Exporters not utilizing interest-based EXIMBANK's credits must be given alternative opportunities, such as "Resource Utilization Support Premium."
- Small and Medium-Sized Enterprises comprising 98 percent of all enterprises in Turkey and providing a major portion 61,5 percent of total employment in the country must be provided with investment and export incentives. A certain share of total incentives must be committed to them.
- Customs must be re-organized for smoother working of export import procedures under the new regimes of Local Processing and External Processing.
- The embargo imposed on exports to Iraq for the past 8 years, causing a total foreign income loss of 30 billion US Dollars for Turkey, must be lifted with immediate effect and the right of exporting to Iraq as mandated by the United Nations to Jordan should be granted to Turkey as well.
- Voluntarily-based businessmen's organizations should be encouraged to be specialized on certain groups of countries.

5) Customs Union with the European Union Should be Reassessed

Türkiye must follow a more consistent, rational and realistic policy in its relations with the European Union, and must re-arrange these relations on the basis of a **"Free Trade Area Agreement"** instead of the present Customs Union which has already proven to be working against Türkiye's interests. Such a rearrangement will enable Türkiye to develop its relations with third countries, whilst continuing its relations with the European markets on free trade principles.

Türkiye must also force the EU to release at least 2.5 billion ECU worth of financial aid which is sought in the Customs Union Decree, thereby making the EU to fullfill its long-delayed commitments towards Türkiye, at least partially.

Visa requirement for Turkish citizens which constitutes an unfair competitive disadvantage in free trade must be lifted by the EU at least for Turkish businessmen.

On the other hand; Türkiye must start an intensive diplomatic and commercial attack in re-instituting its relations with countries in the Balkans, Russia, the Central Asia and the

Islamic World with which it has eco-strategic and jeo-cultural advantages and benefits. Within this framework, it must halt its steadily deepening military relations with Israel and keep its political relations with this country at a minimum level. It must re-vitalize its institutionalized relations with the Middle-Eastern and North African countries and with Iran, in the intensity which was achieved during the period 1980-1986.

6) Privatization

The present government aims at generating a privatization revenue of 3 billion US Dollars for the current year and 3.6 billion for next year. However, in case of the privatizations of Electricity Distribution Network Companies (TEDAŞ) and Petroleum Distribution Inc. (POAŞ), there occurred serious mistaken decisions which have contravened some existing laws, rules of transparency and objective eriteria.

Whilst it appears to be an appropriate move on the part of the government to allocate a part of privatization revenue for reducing the existing public debt stock (at least 2 billion US Dollars in 1997 and 3 billion US Dollars next year), revenue generated from privatization must also be utilized for productivity improvement and rationalization of production. Privatization revenue must not be viewed as an additional source for increasing unproductive public spending. The public banks, often subject of suspicious loan defaults, must be privatized without delay.

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 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 accountibility 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.

While privatizing state economic enterprises, they must not be handed over to a few monopolies; rather, anti-cartel laws already enacted by the Assembly must be effectively implemented in order to establish and maintain competitive conditions in the economy.

Purchase offers by workers through their trade unions must be treated seriously and be given equal opportunity (a successful example is KARDEMİR).

The share of foeign capital in the privatized state economic enterprises, excepts in those sector requiring high-technology investments, must be limited to a certain percentage (as in the case of privatization practices in France and Switzerland).

Savings of Turkish cizitens working abroad should be encouraged to be channelled into privatization in the form of "permit for purchasing share".

7) Social Security Institutions

The letter of intent given to the IMF does not seem to include any serious plan for reforming the ailing social security system which is expected to generate a deficit of as high as 1.500 trillion TLs in the current year, except for the intention to raise the retirement age for new workers from 55 to 60 for men and from 50 to 57 for women (a similar recommendation was made in the last year's MÜSİAD report). The following are MÜSİAD's recommendations for reforming the existing social security system:

* Insurance premium ceiling must be raised;
* The existing three Social Security Institutions must bu unified under one structure thereby reducing the highly complicated and inefficient structures of the existing social security system;
* Collection of premiums due to Social Security Institutions must be speeded up; effective collection of revenues from the real estates (of these institutions) must be ensured;
* Private insurance corporations must be encouraged to enter into health and retirement insurance business;
* Social security institutions must increase their rent revenue from their real-estate;

The existing system creates a heavy burden on the employer and leads to disputes in employer-employee relations. MÜSİAD has published a study on **"Seniority Compensation Fund"** which aims at offering a solution to the problem.

8) Incentive Measures For Investments

The government must introduce incentives which would increase investments and industrialization in order to increase total supply of goods and services. Resultant from stagnation in productive and technological investments in recent years, the productive capacity of the Turkish economy has not been growing. With the purpose of achieving a sustainable, export-led growth, priority must be given to investments geared towards additional capacity creation and modernization.

In encouraging exports, monetary incentives which violate international trade rules must be avoided; incentives must aim at reducing the cost of production inputs and must be granted at the production level.

* Corporations must be exempt from Withholding Tax in their investments made under incentive scheme.
* Tax deductibility must be raised to 200 percent in investments undertaken in priority sectors.
* Exemption from tax, stamp duty etc. must also be granted also to investment without export commitment.
* Those investors who do not honour their debt towards the Tax Office, Social Security Institution and to public banks on time, must be deprieved from receiving Incentive Certificate.
* In case the loans received for investment purpose begin to be paid back within 3 to 6 months, interest must not be applied on such loans.
* Investments must be encouraged by an "Investment Fund" and "Venture Capital Fund". Investment Fund can be source from the Seniority Compensation Fund (please see MÜSİAD's Report No: 22) to be established.
* In view of the scarcity of local funds, measures and incentives must be introduced in order to attract savings of Turkish workers abroad, which are estimated to be no less than 10 billion US Dollars on a yearly basis.
* Investors must enjoy some kind of "exchange risk guarantee" through writing off as an expense any excess of finance cost over the inflation rate (as measured by the annual rate of change in the Wholesale Price Index)
* Bureaucratic formalities at customs and in tax officies must be reduced to a minimum for companies holding Investment Incentive Certificate.
* Lease contract period must be reduced to 3 years in the case of financial leasing companies leasing out machinery and equipment.
* Maximum financial incentives such as tax deduction, as well as exemption from taxes on building and construction must be granted to joint ventures bringing high-technology and know-how into the country and creating high employment.
* In case of importing an entirely second-hand plant under a joint venture, maximum possible benefit must be granted.
* Energy support must be given to manufacturing industry.
* Some taxes collected by municipatilies from industrial plants in Organized Industrial Zones (enjoying investment incentives) must be abolished.

MÜSİAD'S ECONOMIC FORECASTS FOR 1998 (End of Year)

TABLE 43: MÜSİAD'S ECONOMIC FORECASTS FOR 1998 (End of Year)

	MÜSİAD'S FORECAST
GNP (GROWTH RATE)	4,5-5 %
INFLATION RATE	
Consumer Prices	70-75 %
Wholesale Prices	65-70 %
EXCHANGE RATES	
TL/US Dollar (Year-end)	340,000 TL - 350,000 TL
TL/D. Mark (Year-end)	190,000 TL - 195,000 TL
EXPORT	27,5 Billion Dollars
IMPORTS	50 Billion Dollars
TRADE DEFICIT	-22,5 Billion Dollars
Current Accounts Deficit	-3,5 Billion Dollars
Consolidated Budget Deficit (Trillion TL)	5,000 Trillion TL

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