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THE TURKISH ECONOMY

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MÜSİAD

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Foreword

Despite the re-emerging instability in the Turkish politics, especially in the first half of the year, the Turkish economy was able to repeat in this period a high growth performance achieved in the year 1996, whilst high inflation problem still remaining a major policy concern. Whilst the early election results at the end of 1995 had created serious de-stabilizing effects on the domestic financial markets, with resultant rise in market interest rates and accelarated currency depreciation, the Central Bank and the Treasury-through their concerted action - could maintain financial stability in the economy.

Whilst it is an encouraging observation that the Turkish economy is becoming increasingly independent of developments in the political sphere, this is not however to undermine the importance of political stability for an uninterrupted good economic performance along the country's longterm development process. In point of fact; relative stability in the domestic politics and the resultant increased confidence in the economy was seen to have been quickly translated into a betterment in the economic and financial conditions in the final quarter of 1996 (in terms of lower interest rates, high economic growth, more rapid privatization etc.), a trend which was unfortunately reversed with the re-emergence of political instability stemming from unnecessitated political and social tensions in the first months of 1997.

Political stability is, first and foremost, a prerequisite for a fast and enduring economic and social recovery in our country. Hence, by taking into account the abnormally changing structure of representation in the Parliament (20 %) and unrelenting and increasing political tension throughout the country, early elections should be held by March 1998 at the latest.

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 in a persistent and determined manner in order to reverse the present inflation trend.

Hence there is a need for a politically strong and stable government which will draw up and implement a **"medium-term stabilization programme"** to be supported by a wide public consensus that the cost of such a programme would be distributed equitably amongst all sections and that the government has necessary political will and determination to fight with inflation.

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 an IMF prescription-type monetarist and restrictive package.

MÜSİAD finds it imperative to re-iterate that, despite its well-known and long-existing problems, remarkable achievements attained by Turkey are but a manifestation of the relative strength and tremendeous dynamism of the private sector, relatively successful working of free market forces and long term growth potentials of the country. MÜSİAD holds a strong conviction that Turkey, with its considerable human and material resources and its remarkable small and medium scale entreprenurial capacity possesses an unmatched potential for growth and stability in the near future.

This report, based on the most recent figures, summarizes the main developments and trends recorded by the Turkish economy in 1996 and in the first half of 1997. It is the third 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 continued its high growth trend also during 1996, with a GNP growth of well above the targeted four percent for the same year. Resultant largely from considerable growth in final consumption expenditure and partly from expansion of real investment spending, the economy was able to achieve a 7.4 percent GNP growth performance. Largely as a result of favourable climatic conditions, agricultural output, constituting around 15 percent of the total national output, grew at a higher rate in 1996, by 5.2 percent, which compares favourably with 2 percent in 1995 and minus 0.7 percent in 1994. Industrial output, on the other hand, recorded a growth of around 7 percent in 1996, mainly as a result of buoyant domestic demand for durable and non-durable consumption goods. As a result of high rates of growth in agriculture and industry, services output also grew at a considerably high rate, by around 7.8 percent. In 1996; the relatively high growth in services output stemmed mainly from the high rate of growth in imports as the first round impact of the Customs Union with Europe, and in commerce and transportation. The economy continued to use external resource to finance its high growth, with a resultant external gap of around 2.1 percent of the Gross National Product.

The previous coalition government (of the Welfare Party and the True Path Party) targeted a lower rate of GNP growth for the year 1997. Against a target of 4 percent GNP growth, the Turkish economy seems to continue its high growth trend also during 1997, albeit at a lower rate from the previous year. According to the recently published first provisional estimates of the State Institute of Statistics, the GNP growth rate reached to around 5.7 percent in the first quarter of 1997. Despite a negative growth (minus 2 percent) in the agricultural output in the first quarter, manufacturing output continued its high growth trend. Whilst the capacity utilization rate in the manufacturing industry remained around 80 percent in the first half of 1997, manufacturing output increased by around 10 percent in the first quarter of 1997. Better export performance of the Turkish economy in the current year appears to be an increasingly important factor for high capacity utilizati-

on and output increase in the manufacturing industry. In view of the higher-than-projected GNP growth in the first quarter of 1997, the new coalition government (which took office from July onwards) has made an upward revision in the GNP growth target, revising it from 4 percent to 5.5-6.0 percent for the year. In view of the new government's anticipated expansionary fiscal and monetary policies, the new (revised) GNP growth target is highly likely to be achieved.

The total fixed investment continued its fast expansion also during 1996. Whilst there was some slow-down in private investment activity, a somewhat expected development following a high expansion period recent years in the wake of entry to the Customs Union, public investment expenditure showed a considerable expansion in 1996, increasing by around 18.5 percent in real terms. The 1997 Program envisages a slow-down in investment activity with a projected expansion of around 4.8 percent in total fixed investment expenditure. Whilst public investment spending is projected to continue its fast growth, private investment spending is expected to slow down further. As a matter of fact, the new coalition government, in its expansionary (revised) budget, has made a considerable upward revision in public investment spending for the year 1997.

As a result of high GNP growth and accelerated investment activity in the last few years, there has been some slight improvement in the employment situation. The total of open unemployment and underemployment is estimated to have declined to 12 percent in October 1996, from 16.6 percent in 1994 and 13 percent in 1995.

The actual consolidated budget results for the year 1996 indicate that, the contractionary fiscal and budgetary policies pursued in 1994 and 1995 could not be sustained in this year. The coalition governments were observed to have pursued expansionary fiscal policies resulting in higher-than-initially planned increase in the budget deficit. In 1996; public expenditures were observed to have displayed a considerable increase in real terms, mainly as a result of drastic adjustment in public salaries, increasing interest burden of domestic and external borrowing, increase in defence spending and substantial transfer payments to social security institutions faced with huge deficits. Resulting from higher-than-planned deficit in the consolidated budget, the ratio of Public Sector Borrowing Requirement (PSBR) to GNP has risen from around 5.4 percent in the previous year, to around 8.2 percent in 1996.

Relative improvement in the SEE's financial performance during the recent years continued also during 1996; the share of interest expenditure to their total sales turnover is estimated to have declined from 6.3 percent in 1996 to around 4.2 percent in 1996, whilst the share of personnel expenditure declining from 15 percent to 13.5 percent.

The public domestic debt stock has risen by around 130 percent in nominal terms in the last year; the growth in the debt stock continues also during 1997, with the net debt stock reaching to around 4,198 trillion TLs by the end of June, which means a 33.3 percent nominal rise in the first half of the year. The Treasury continues in its efforts to extend the maturities and reduce the cost of borrowing. In the begining of March 1997, the Treasury introduced a new borrowing instrument, namely "inflation indexed government bonds". This new instrument is expected to reduce the nominal interest rates on government borrowing, by reducing "uncertainty premium" arising from high and variable inflation.

The 1997 Budget Program adopted by the previous coalition government (formed by the Welfare Party and the True Path Party) had the distinctive feature of being the first "balanced budget" in the last fifty years.Whilst to what extent the objective of a balanced budget can be achieved under the current conditions is another question, it was 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.

According to the recently disclosed budget figures, the consolidated budget yielded a deficit of around 700.7 trillion Turkish Liras in the first six months of the year. The balanced budget target initially depended on two strong assumptions (expectations). One of these expectations is to achieve an enormous increase in "non-tax normal revenue" mainly through an ambitious privatization program and sale of public real estate. Secondly, and equally importantly, the existing heavy interest burden on the budget would be reduced through both lower cost of borrowing and reduced domestic borrowing. The budget deficit in the first half of 1997 resulted mainly from failure to achieve the targeted level of non-tax normal revenue, whilst the government was able to keep budget expenditures within limits. In other words, the budget deficit was as a result of not being able to generate sufficient privatization revenue, rather than excessive spending. The new government revised the budget expenditure target from 6,254.9 trillion TL to 7,510.0 trillion TL, whilst making a downward revision in budget revenue from the initial 6,254.9 trillon TL, to 5,110 trillion TL in expectation of achieving a much lower level of privatization and sale of public real-estate. The new government's program expects a budget deficit of as high as 2,400 trillion TL, which, given its 80-85 percent inflation target for the year, means a real increase in the budget deficit. Thus, the revised budget appears to be more inflationary than the initial budget adopted by the previous government.

In 1996, the Central Bank continued to pursue monetary policies which aimed at maintaining stability in the domestic financial markets. Resultant from substantial rise in the official foreign exchange reserves, the share of net foreign assets in the Central Bank's balance sheet has risen to around 55 percent at the end of 1996, from 20 percent in the previous year. Excess liquidity pressures were reduced through open market operations and not very frequent interventions in the foreign exchange market by selling foreign currency against the local currency.

The monetary growth in the economy, as measured by various monetary aggregates, in the first half of 1997 was almost in line with the rate of inflation recorded in the same period. The demand for money remained considerably stable throughout 1996 and in the first half of 1997, with a slight rise in the income velocity of money. The Central Bank did not charge its rediscount rates throughout 1996 and in the first half of 1997. The average deposit interest rate, after a somewhat rising trend in the first quarter of 1996 resultant from instability in the domestic financial markets, followed a relatively stable trend in the year 1996; the same trend was observed also in the first half of 1997.

Total consolidated Turkish Lira bank deposits grew by around 130 percent in 1996, meaning a real growth in deposit funds collected by the commercial banks. Growth in the foreign currency deposits stemmed mainly from foreign currency deposits of foreign origin, whilst the growth in foreign currency deposits of domestic origin remained rather limited.

The total credit stock in the economy continued to expand at a fast rate also in 1996, growing at a rate of around 110 percent. Faster growth of foreign currency denominated lending by the commercial banks was mainly as a result of relatively higher Turkish Lira funding costs against expectation of a not very substantial exchange rate depreciation.

In 1996, the Istanbul Stock Exchange has made its long expected upward movement with the ISE composite index going up by around 39.5 percent in US Dollar terms. The ISE index continued its upward trend also during first half of 1997, albeit in a fluctuating manner, rising by around 15.5 percent in US Dollar terms in the first four months of the year.

High inflation continues to remain a major policy concern for the Turkish economy. The annual rate of inflation (as measured by the wholesale prices) which stood at 84.9 percent at the end of 1996, declined to 72.8 percent in April 1997. The declining trend of inflation could not however be maintained in the following months, with the resultant rise in the annual inflation to 74.6 percent in May and 75.7 percent in June 1997.

In 1996, the Turkish economy has faced with a higher-than-projected deficit both in the trade account and in the current account. Nonetheless; official reserves continued to rise during 1996, as the surplus in the capital account, which turned out to be higher-than-initially projected, more than offset the deficit in the current account.

The 1997 Program (initial) projected a trade deficit of 19,350 million US Dollars and a current account deficit of around 5,600 million US Dollars. The new government has also revised the b.o.p. targets whereby the trade account is expected to yield a deficit of 20 billion US Dollars, and the current account to result in a deficit of between 4 and 4.5 billion US Dollars. The balance of payments figures disclosed by the State Statistics Institute for the first five months of 1997 indicates to a 9.4 percent growth in exports and a 3.6 percent growth in imports. The trade deficit stood at 7,833 million US Dollars, indicating to a 2.7 percent decline in the trade deficit in the current year as compared to the same period of the previous year. The current account (exclusive of "unrecorded trade transactions") yielded US Dollars in the first quarter of 1997, whilst that which includes such transactions yielded some 713 million US Dollar deficit.

In 1996, despite a 9 percent rise in the country's external debt stock, there was some improvement in the "external indebtedness" as measured by various internationally accepted criteria.

Turkey's total international reserves continued to rise also during 1996, from around 23.9 billion US Dollars at the end of 1996 to around 27.8 billion US Dollars by the end of 1996. The Central Bank, relying on its strong reserve position, continued its "surveillance" function over the markets, having a close eye on exchange rate movements of speculative nature and interfering with the foreign exchange market in order to iron out short-run fluctuations arising from excess liquiditiy and speculation. At present; the Central Bank holds sufficient foreign exchange reserves in order to maintain stability in the foreign exchange market. The currency basket (of 50 percent US Dollar and 50 percent D. Mark) was observed to have risen by around 30 percent in the first six months of 1997. Given that the percentage change in the SIS's Consumer Prices Index was 35 percent, the currency depreciation was therefore basically in line with the inflation rate, with no substantial real appreciation of the local currency.

CHAPTER 1

GROSS NATIONAL PRODUCT, INVESTMENT ACTIVITY AND LABOUR MARKET

I. MACROEQUILIBRIUM OF THE ECONOMY

Recovery of the Turkish economy which had begun from the second half of 1995, was observed to have continued throughout the year 1996, with the resultant growth in GNP well above the targeted four percent for the year.

In 1996, total avaliable resources in the economy is estimated to have increased by around 9.5 percent in real terms. Given that the GNP grew at a rate of 7.9 percent (revised to 7.4 percent) in the same year, this has meant utilization of net foreign resources by the Turkish economy, as in the previous year.

TABLE 1: MACROEQUILIBRIUM OF THE ECONOMY

	BILLION TL, in Current Prices		Real Percentage Change		
	1997(1)	1996(2)	1997(1)	1996(2)	1995
TOTAL AVAILABLE RESOURCES	26,494,000	15,591,531	2.8	9.5	11.5
a) GROSS NATIONAL PRODUCT	25,360,000	14,777,000	4.0	7.5	8.0
b) EXTERNAL GAP (3)	1,134,000	814,531	1.1	-2.1	-3.4
TOTAL DOMESTIC DEMAND					
a) TOTAL CONSUMPTION	20,091,970	11,880,061	2.1	9.6	6.1
Public	2,708,853	1,523,419	5.4	8.2	5.4
Private	17,383,117	10,356,642	1.6	9.9	6.2
b) TOTAL FIXED CAPITAL FORMATION	6,402,030	3,711,470	4.8	10.0	9.6
Public	1,323,642	622,682	21.2	18.6	-1.4
Private	5,078,387	3,048,789	1.1	8.1	12.4
c) CHANGES IN INVENTORY (3)	119,460	167,671	-0.6	-0.1	4.4
Public	17,376	-14,778	0.2	0.3	0.9
Private	102,084	182,449	-0.8	-0.4	3.5

(1) 1997 Program (2) Provisional (3) As percentage of GNP SOURCE: State Planning Office (SPO)

Resultant largely from growth in final consumption expenditure and partly from expansion of investment expenditure, aggregate effective demand is estimated to have increased by around 9.5 percent in 1996. Total final consumption expenditure, both private and public, which had grown by around 6 percent in the previous year, displayed a considerably higher growth (9.6 percent) last year. Real increase in public expenditure and notable increase in real factor incomes, namely real wage increases and high positive real interest rates, were influential in the growth of final consumption demand.

It is worth noting that, public spending which had declined in real terms in the previous year, displayed a considerable increase as a result of expansionary fiscal policies. Public final consumption expenditure increased by around 8.2 percent as against 5.4 in the previous year, whilst public investment spending which had declined by around 1.5 percent in 1995, showed a remarkable expansion in 1996 by around 18.5 percent in real terms.

It is observed that whilst the government's consolidated budget yielded a higher -than-planned deficit in 1996, the consolidated budget excluding public interest expenditure yielded some surplus, as in the last few years. This means that, whilst the overall budget was "expansionary", the non-interest budget inclusive of consumption and investment expenditure but exclusive of interest expenditure, was "contractionary" to some extent.

Total private final consumption spending displayed a higher rate of increase in 1996, by around 50 percent in real terms, as compared to the previous year's 6.2 percent. Whilst private consumption expenditure inceased at a higher rate in 1996, private fixed investment expenditure was observed to have displayed a slowdown in the same year, increasing by around 8 percent in real terms as against 12.4 percent increase in the previous year. This slow-down in private investment expenditure was a somewhat expected development, as there had been a substantial increase in fixed investments in the previous years in the wake of entry to the Customs Union with an expected growth in foreign demand for Turkish exports especially in the area of textiles. However, the actual increase in Turkish exports to the European market in 1996 was not in line with earlier expectations, especially for textile products, partly due to sluggish demand for exports resulting from stagnation in the European economies.

Inventories which had increased by around 4.5 percent in the previous year, seems to have shown a slight decline in 1996, resultant from decline in private inventories. Whilst inventories in the public showed some increase, this was more than offset by a decline in private inventories by around 0.4 percent.

Whilst, by figures disclosed by SIS, the trade deficit stood at 19,863 million US Dollars in 1996, meaning a notable rise in the trade deficit from the previous year's 13,212 million US

Dollars, the current account deficit remained at a managable level, thanks to surplus in invisibles account and unrequited transfers (mainly workers remittances from abroad). According to the figures disclosed by the Central Bank, the current account exclusive of unrecorded foreign trade activities showed a deficit of 4,393 million US Dollars in 1996; when unrecorded foreign trade activities are included in the current account, the deficit was at a level of only 1,450 million US Dollars. As in previous years, in 1996, the impact of net foreign demand on the aggregate effective demand was negative due to the deficit in current account.

On the assumptions of 4 percent growth in GNP and no net utilization of foreign resources (in fact, the external gap is projected to decline by around 1 percent of the GNP), the 1997 program projects a 2.8 percent real growth in total resources available to the Turkish economy. The program also envisages a change in the composition of aggregate effective demand, with increased share of fixed investment demand and reduced share of final consumption spending. Accordingly; total consumption spending is expected to increase by around 2.1 percent in real terms and the projected total fixed investment expenditure by around 7.5 percent.

Comparing with the previous year, the private investment expenditure is expected to increase at a lower rate in 1997, by around 1 percent, whilst the public investment expenditure is targeted to increase at a higher rate by around 21.2 percent.

An examination of the savings and investment propenties indicates to a fall in domestic savings ratio and a slight rise in investment propensity during the year 1996. The private savings ratio, which had stood at 24.1 percent in the previous year, is estimated to have shown a slight rise to 24.8 percent. The public sector, on the other hand, continued to be a deficit sector, its savings gap rising from the previous year; the ratio of public saving (dissavings) to public disposable income rose from minus 3.8 percent in 1995 to minus 5.2 percent in 1996. The 1997 program projects some decline in private savings ratio, from the estimated 24.8 percent in 1996 down to 22.7 percent in 1997, whilst the public savings ratio is expected to rise to plus 5.5 percent on the assumption of no public sector deficit for the year. However, the budgetary developments in the first of 1997 indicate that there will be some deficit in the public budget; therefore, the public sector continues to be a deficit sector in the Turkish economy also in the current year, absorbing resources from the private sector.

In 1996, the private investment propensity is estimated to have shown some decline, private investment expenditure as percentage of private disposable income falling to 22 percent from 23.1 percent in the previous year. The private investment ratio is projected to stand at around 22.5 percent in 1997.

TABLE 2: GROSS DOMESTIC PRODUCT (EXPENDITURE APPROACH)	NOMINAL PERCENTAGE GROWTH		REAL PERCENTAGE GROWTH		PERCENTAGE SHARE IN GDP	
	1996(1)	1995	1996(1)	1995	1996(1)	1995
I. PRIVATE FINAL CONSUMPTION	72.9	110.5	8.6	7.6	69.3	70.4
II. PUBLIC FINAL CONSUMPTION	76.1	85.7	7.7	6.7	11.1	10.9
III. GROSS FIXED CAPITAL FORMATION	97.0	88.8	16.2	8.3	28.2	23.3
PUBLIC INVESTMENT	120.0	39.7	30.5	-16.9	16.6	16.2
PRIVATE INVESTMENT	93.0	102.6	13.7	14.9	83.4	83.8
IV. CHANGES IN INVENTORY	-	-	-	-	-0.7	
V. EXPORTS OF GOODS/SERVICES	94.5	85.4	16.6	6.7	22.8	20.0
VI. IMPORTS OF GOODS/SERVICES(-)	119.0	138.4	24.1	30.0	30.6	24.6
GROSS DOMESTIC PRODUCT	71.6	97.8	8.0	7.5	100.0	100.0
Statistical Discrepancy	-	-	-	-		
GROSS DOMESTIC PRODUCT	79.4	95.3	7.7	7.3		

(1) Second quarter

The ratio of public fixed investment expenditure to total public disposable income is estimated to have risen to 6.6 percent in 1996, from 4.1 percent in the previous year, and is expected to fall to around 4.6 percent in the current year. The ratio of total fixed investment expenditure to Gross National Product is estimated to have shown an upward trend from 23.4 percent in 1995, to 24 percent in 1996; this ratio is projected to rise further in 1997, to 24.8 percent.

II. GNP PERFORMANCE

High growth performance of the Turkish economy, which had begun in the third quarter of 1995, continued also during 1996. According to the provisional estimates disclosed by the State Institute of Statistics, similar to the previous year, the Turkish economy grew at a considerably high rate also in 1996. Against the targeted 4 percent GNP growth rate for the year, the economy was able to achieve a GNP growth rate of as high as 7.9 percent (later revised to 7.4 percent) in the year 1996, largely as a result of high rates of growth in industry and services, and also in agriculture.

Largely due to favourable climatic conditions, agricultural output which constitutes around 15 percent of GNP, grew at a higher rate by 5.2 percent in 1996, which compares favourably with 2.0 percent in 1995 and minus 0.7 percent in 1994.

TABLE 3: GROSS NATIONAL PRODUCT (1)

SECTOR	1996 VALUE (BILLION TL)	NOMINAL GROWTH RATE (%)	REAL GROWTH RATE (%)
AGRICULTURE	2,545,288	108.9	5.2
INDUSTRY	3,716,528	82.0	7.1
Mining	183,080	85.8	2.3
Manufacturing	3,123,034	78.3	7.1
Energy	410,414	113.6	9.7
CONSTRUCTION	850,060	99.4	4.8
COMMERCE	3.025,416	90.6	8.7
TRANSPORTATION/COMMUNICATION	1,928,852	96.6	8.4
FINANCIAL INSTITUTIONS	668,544	107.2	2.4
OWNERSHIP OF DWELLING	442,903	77.8	2.4
BUSINESS AND PERSONAL SERVICES	553,611	92.9	6.8
(-) IMPLICIT BANK SERVICE CHARGES	600,837	122.2	1.1
GOVERNMENT SERVICES	1,238,527	99.8	-0.3
PRIVATE NON-PROFIT INSTITUTIONS	26,922	84.7	0.9
IMPORT DUTIES	458,588	61.4	22.9
GROSS DOMESTIC PRODUCT (In Purchaser's Prices)	14,854,405	91.4	7.2
NET FACTOR INCOMES FROM ABROAD	270,687	192.9	
GROSS NATIONAL PRODUCT	15,125,092	92.6	7.9

(1) Current prices
SOURCE: State Institute of Statistics (SIS)

TABLE 4: GROWTH RATES

Percentage Change

	1996 TOTAL	1996 IV	1996 III	1996 II	1996 I	1995	1994
AGRICULTURE	5.2	14.4	2.8	3.9	1.8	2.0	-0.7
INDUSTRY	7.1	7.1	5.5	7.4	8.8	12.1	-5.7
SERVICES	7.8	7.2	6.5	8.5	9.4	6.3	-6.6
GROSS DOMESTIC PRODUCT	7.2	8.0	5.3	7.7	8.8	7.2	-5.5
GROSS NATIONAL PRODUCT	7.9	8.8	5.8	8.2	10.3	8.0	-6.1

The growth in industrial output, whilst decelerating from the previous year, continued to be considerably high also during 1996, mainly as a result of bouyant domestic demand for consumer durables. Industrial output is estimated to have grown by around 7.1 percent in 1996, as against 12.1 percent growth in 1995 and 5.7 minus growth in 1994.

As a result of high rates of growth in industrial and agricultural sectors, services output also grew at a considerably high rate by around 7.8 percent. Services output had grown by 6.3 percent in 1995 and minus 6.6 percent in 1994. Relatively high growth in service sector stemmed mainly from high rate of growth in imports, commerce and transportation. Import duties have shown a 22.9 percent real growth in 1996 due to highes than expected growth in imports as a first round effect of the Customs Union.

TABLE 5: PER CAPITA INCOME (GNP)

YEARS	PER CAPITA GNP (THOUSAND TL)	PER CAPITA GNP IN US DOLLAR	PER CAPITA GNP BASED ON PURCHASING POWER PARITY (1) (IN US DOLLAR)
1990	7,080	2,152	4,699
1991	11,070	2,114	4,805
1992	18,897	2,207	5,143
1993	33,573	2,343	5,561
1994	64,182	2,161	5,270
1995	127,423	2,292	5,411
1996(2)	235,689	2,423	
1997(3)	397,835	2,478	

(1) P.P.P. calculated by the OECD for GNP
(2) Provisional
(3) Target

Examining the relative contribution to the GNP growth of various demand categories, it is observed that the output growth was based largely on final comsumption growth and partly on fixed investment growth. The economy continued to use external resources to finance its high growth, with the external gap reaching to an estimated 2.1 percent of the GNP.

In 1996, Turkey achieved its high growth performance in relatively favourable conditions of the world economy. According to the IMF and OECD estimates, in 1996, the world output is estimated to have grown by 2.8 percent on average, world trade volume expanding by 6.5 percent coupled with a slowdown in inflation.

In 1996, whilst the industrial economies grew at an average of 2 percent, developing economies achieved considerebly high rates of growth (6.3 pecent on average); the growth performance of what is named as "economies in transition" is somewhat slower (2.5 percent on average). On the other hand, the economic stagnation still continues in the European Union which is the major market for Turkish exports. According to the estimates, the European Union which had shown a 2.6 percent growth in 1995, is estimated to have grown by around 1.8 percent. The stagnation in the European economies can be singled out as one of major reasons for Turkey's failure to achieve an export-led growth in the year 1996.

Parallel to the high GNP growth, per capita income is estimated to have risen from 2,292 US Dollars in 1995, to 2,423 US Dollars in 1996. However; according to the Purchasing Power Parity measure of the OECD, which appears to be a better approximation of the real size of the GNP, per capita GNP stood at around 5,400 US Dollars in 1995, from 5,270 US Dollars in 1994.

TABLE 6: CAPACITY UTILIZATION RATE IN MANUFACTURING INDUSTRY

Percentage Change

	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
1995	74.7	73.2	74.6	78.9	79.4	81.5	83.4	82.6	84.3	80.7	79.4	81.4
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	77.2	80.3	77.4								

SOURCE: SIS Survey

Industrial output, accounting for around 30 percent of Gross National Product, grew at a fast pace in the first half of 1996, but slowing down in the second half of the year parallel to the declining capacity utilization in the manufacturing industry.

Capacity utilization rate in the manufacturing industry, after reaching a peak level of 83.2 percent in May, declined to 78.8 percent and stood at around 77.5 percent in April 1997.

Manufacturing output was up by an average of 5.8 percent in the first four months of 1997, which was more or less the same growth when compared with 5.6 percent of the previous year. With minus growth in mining output and slower growth in electricity -gas-water production, total industrial production grew at a slightly lower rate by 5.9 percent in the first four months of 1997, as against 6.4 percent in the same period of the previous

TABLE 7: INDUSTRIAL PRODUCTION(1)

Percentage Change

	Percentage Change with respect to the same month of previous year (2)		FIRST FOUR MONTHS (Average % Change)	
	1997	1996	1997	1996
(a) MANUFACTURING INDUSTRY	7.4	-2.5	5.8	5.6
(b) MINING	4.7	-4.2	-0.8	1.8
(c) ELECTRICITY-GAS-WATER	9.1	8.7	8.8	12.6
TOTAL INDUSTRIAL PRODUCTION	7.6	-1.2	5.9	6.4

(1) SIS's Industrial Production Index
(2) As of end of April
SOURCE: SIS

year. In 1996, certain sectors including food-beverages, textile and metal industries grew at a higher rate than the previous year, whilst other sectors including paper and printing showed a slower growth in output.

III. INVESTMENT ACTIVITY

According to the estimates of the State Planning Office, total fixed investment continued its fast expansion also in 1996. Total fixed investment is estimated to have grown by 10 percent in 1996 as compared to 9.6 percent in 1995. Whilst there was some slowdown in private investment activity, public investment after declining in real terms in the previous year, showed a considerable expansion in 1996, increasing by around 18.6 percent in real terms. In 1996, whilst there was no notable change in the sectoral distribution of fixed investment spending, there was some slight rise in the share of energy, transportation and education sectors. The 1997 program envisages a slow-down in investment activity, with the projected expansion of total fixed investment by around 4.8 percent in real terms. Whilst public investment spending is projected to continue its fast growth due to infrastructure investment, private investment spending is expected to slow down further.

TABLE 8: PRIVATE FIXED CAPITAL INVESTMENTS (1)

	Percentage Change in Real Terms			Percentage Share in TOTAL		
	1997(2)	1996(3)	1995	1997(2)	1996(3)	1995
PRIVATE INVESTMENT						
Agriculture	9.5	26.7	70.3	4.7	4.5	3.9
Mining	4.0	-8.2	4.8	0.9	0.9	1.1
Manufacturing	3.4	12.1	15.7	25.3	25.7	25.4
Energy	106.9	94.8	-6.8	1.7	0.9	0.5
Transportation	10.0	15.7	46.4	16.9	16.2	15.8
Tourism	12.4	3.8	17.2	2.5	2.3	2.4
Housing	1.0	0.5	1.9	41.4	43.1	45.1
Education	17.5	22.9	-6.5	0.8	0.7	0.7
Health	20.0	50.2	-11.4	1.9	1.7	1.2
Other	4.0	9.5	10.0	3.9	3.9	4.0
TOTAL	5.2	8.1	12.4	100.0	100.0	100.0

(1) In 1994 fixed prices
(2) 1997 Programme
(3) Provisional
Source: SPO

TABLE 9: PUBLIC FIXED CAPITAL INVESTMENTS (1)

	Percentage Change in Real Terms			Percentage Share in TOTAL		
	1997(2)	1996(3)	1995	1997(2)	1996(3)	1995
PUBLIC INVESTMENT						
Agriculture	19.0	13.9	19.2	10.5	10.3	11.8
Mining	9.8	-6.2	-21.7	1.5	1.7	1.9
Manufacturing	-38.0	-11.7	81.0	2.4	4.5	5.5
Energy	53.6	7.5	8.8	16.3	12.3	12.9
Transportation	1.7	14.0	-20.7	27.9	32.4	33.3
Tourism	-8.9	16.8	23.2	1.9	2.5	2.5
Housing	7.9	-36.5	-7.7	0.7	0.8	1.4
Education	32.7	52.2	13.2	12.1	10.7	8.4
Health	27.4	36.1	-1.5	5.0	4.6	4.0
Other	25.0	35.3	6.9	21.6	20.2	18.2
TOTAL	17.3	18.6	-1.4	100.0	100.0	100.0

(1) In 1994 fixed prices
(2) Target (1997 Program)
(3) Provisional
SOURCE: SPO

IV. THE LABOUR MARKET

According to the labour market statistics disclosed by the State Institute of Statistics, the labour force is estimated to have grown by around 0.5 percent between October 1996-October 1995, whilst the demand for labour (employment) displayed a 1.5 percent growth in the corresponding period. Accordingly, the number of openly unemployed population declined from 1,740,000 in October 1994 and 1,522, 000 in October 1995, down to 1,332,000 in October 1996, indicating to some improvement in unemployment. Accordingly; the rate of unemployment, which stood at 7.9 percent in October 1994, declined to 5.8 percent in October 1996.

TABLE 10: THE LABOUR MARKET

(Thousand Persons)

	1996		OCTOBER	OCTOBER
	OCTOBER	APRIL	1995	1994
LABOUR FORCE	23,030	22,809	22,900	22,136
EMPLOYMENT	21,698	21,376	21,378	20,397
UNEMPLOYMENT	1,332	1,431	1,522	1,740
OPEN UNEMPLOYMENT RATE(%)	5.8	6.8	6.6	7.9
Urban	9.3	9.3	10.0	11.1
Rural	2.9	3.8	3.9	5.1
UNDEREMPLOYMENT	1,439	1,440	1,450	1,931
UNDEREMPLOYMENT RATE (%)	6.2	6.3	6.3	8.7
TOTAL UNEMPLOYMENT RATE (%)(1)	12.0	12.6	13.0	16.6

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

The total of open unemployment and underemployment, declined to 12 percent in 1996, from 16.6 percent in October 1994 and 13.0 percent in 1995.

This indicates that, high GNP growth and accelerating investment activity in the years 1995 and 1996, have contributed to improvement in the high unemployment rate to some extent.

TABLE 11 depicts productivity and real wage trends in the manufacturing industry. According to the SPO estimates, whilst productivity index (base 1992 = 100) remained almost unchanged from first quarter of 1995 (Index= 107.0) to the last quarter of 1996 (Index= 106.7), unit wage index (1992= 100), adjusted for the depreciation of Turkish Lira against US Dollar, rose from 62.3 in the first quarter of 1995, to 79.5 in the last quarter of 1996. This indicates that, in the last few years, the rise in real wages in the manufacturing industry is faster than the productivity increase.

TABLE 11: PRODUCTIVITY AND WAGES IN PRIVATE MANUFACTURING INDUSTRY

	I EMPLOYMENT INDEX (1992=100)	II PRODUCTION INDEX (1992=100)	III PRODUCTIVITY (1992=100)	IV NOMINAL WAGE INDEX (1992=100)	V NOMINAL UNIT WAGE INDEX (TL) (1992=100)	VI EXCHANGE RATE INDEX (USD/TL) (1992=100)	VII UNIT WAGE INDEX (USD) (1992=100)
1995							
I	103.0	110.2	107.0	397.4	371.4	596.0	62.3
II	106.2	118.2	111.3	462.2	415.3	621.9	66.8
III	110.2	121.0	109.8	545.3	496.6	672.7	73.8
IV	112.3	118.8	105.8	605.3	572.2	770.7	74.2
1996							
I	112.4	122.4	108.9	693.3	636.7	934.0	68.2
II	113.6	129.2	113.7	821.0	721.9	1,109.8	65.0
III	116.1	129.1	111.2	1,039.2	934.6	1,242.8	75.2
IV	120.8	128.9	106.7	1,219.5	1,142.9	1,437.9	79.5

(I) Seasonally adjusted
(II) Quarterly Production Index, seasonally adjusted
(III)= (II)/(I)
(V)= VI/III
VI= CB Buying Rate
VII= V/VI
SOURCE: SPO

CHAPTER 2

PUBLIC FINANCE AND DOMESTIC DEBT

I. CONSOLIDATED BUDGET

The revised consolidated budget for the year 1996 had targeted a 103 percent increase in budget expenditure and a 92.5 percent increase in budget revenue. Accordingly; the planned budget deficit would reach to 800 trillion Turkish Liras, meaning a 150 percent rise over the previous year. The 1996 Budget also aimed at reducing the importance of short-term borrowing (Treasury Bills) and net foreign borrowing in financing budget deficits, whilst increasing reliance on longer term borrowing through government bonds and the short-term borrowing from the Central Bank (Advances to the Treasury).

TABLE 12: CONSOLIDATED BUDGET

	BILLION TL		Percentage
	1996	1995	Change
REVENUE	2,738,148	1,409,250	94.3
a) Tax Revenue	2,248,422	1,084,350	107.4
b) Non-Tax Normal Revenue	159,884	86,044	85.8
c) Special Revenue and Funds	285,651	217,366	31.4
d) Annex Budget Revenue	44,192	21,490	105.6
EXPENDITURE	3,955,888	1,724,194	129.4
a) Personnel	974,071	502,601	93.8
b) Other Current Expenditure	310,812	143,344	116.8
c) Investment Expenditure	255,244	102,989	147.8
d) Transfer Expenditure	2,415,761	975,260	147.7
BUDGET BALANCE	-1,217,740	-314,944	286.6
Deferred Payments	16,325	52,057	
Advance Payments	-45,931	-29,737	
CASH BALANCE (DEFICIT)	-1,247,326	-292,624	

Both the revised budget targets and the actual budget results indicate that the contractionary fiscal and budgetary policies pursued in 1994 and 1995, could not be sustained in the year 1996; the governments were observed to pursue expansionary fiscal policies, resulting in higher- than- planned increase in the consolidated budget deficit.

In 1996; public expenditures were observed to have displayed a considerable increase in real terms, mainly as a result of drastic adjustment in public salaries, increasing interest burden of domestic and external borrowing, increase in defence spending and substantial transfer payment to the social security institutions faced with huge deficits. The consolidated budget expenditure has risen from around 1,700 trillion TL in 1995 to nearly 4,000 trillion TL in 1996, meaning a 130 percent nominal increase in one year. Given that the actual inflation rate was around 80-85 percent in the same year, this has meant a notable increase in public spending in real terms. The ratio of public expenditure to GNP has risen to around 26 percent in 1996, from around 21 percent in the previous year. Similarly, resulting from higher than-planned deficit in the consolidated budget, the ratio of Public Sector Borrowing Requirement (PSBR) to GNP has risen from around 5.4 percent in the previous year, to around 8.2 percent in 1996.

On the revenue side; in 1996, the consolidated budget revenue has risen at around the targeted rate. The consolidated budget revenue has risen from around 1,409 trillion TL in 1995, to around 2,738 trillion TL last year, meaning a 95 percent increase in nominal terms. Whilst the consolidated budget excluding interest payment yielded some surplus in 1996, as in the previous years, the total budget deficit including interest payment stood at around 1,247 trillion TL, meaning a 50 percent deviation from the revised target. This indicates to an important structural problem in the budget. As long as the existing domestic borrowing process-generating an ever-growing interest burden on the budget-continues, government budget will continue to yield even higher deficits in the future, this process eventually resulting in a situation where total budget revenue would fall short of even meeting the annual interest payment in the budget (As a matter of fact, such trends were forecasted some years ago in MUSIAD's distinctive study on public domestic borrowing titled, "The Debt Crisis).

In 1996, the consolidated budget expenditure has risen by around 130 percent, this fast growth in budget expenditure being determined mainly by higher-than-planned cost of domestic borrowing and the upward adjustment of public salaries on a considerable scale. Whilst the revised budget targeted a 75 rise in personnel spending, the actual rise was 94 percent due to real increase in public salaries.

TABLE 13: CONSOLIDATED BUDGET DEFICITS (TARGET VS ACTUAL)

(Current Prices, BILLION TL)

YEARS	TARGET	ACTUAL	DEVIATION FROM TARGET (%)
1989	504	1,157	129,0
1987	903	2,346	152,0
1988	2,452	3,858	57,0
1989	4,447	7,503	68,0
1990	10,540	11,782	11,0
1991	17,135	33,317	94,0
1992	31,987	47,328	48,0
1993	53,215	133,105	150,0
1994	191,839	145,935	-24,0
1995	197,920	316,576	60,0
1996	410,000	1,217,740	
1997	zero	700,700	(first six months)

The 1996 budget had targeted an increased share of investment expenditure in total public budget spending. Against the targeted increase of 127 percent in investment spending, a higher rate of increase, by around 148 percent, was achieved for the year.

The transfer expenditure, consisting mainly of interest payment on public borrowing and net transfer to deficit-facing social security institutions, increased by a remarkable 148 percent in 1996, reaching to around 2,415 trillion Turkish Liras.

On the revenue side, a relatively successful tax performance was observed, tax revenue rising by around 107 percent over the previous year as against 91 percent targeted in the revised budget. The performance of non-tax revenue, on the other hand, remained below target, non-tax revenue rising by around 86 percent as against the targeted 203 percent. Whilst special revenue and fund increased by around 31 percent, the increase in annex budget revenue was slightly over 100 percent.

Examining some major trends in the consolidated budget, the following observations can be made: The share of tax revenue in total budget revenue has improved from 77 percent in 1995, to an estimated 83 percent in 1996. There was a slight decline in the share of indirect tax revenue in total tax revenue (approximately one third of indirect tax revenue is generated from value added tax) from 42.5 percent in the previous year to around 40 percent in 1996, whilst the share of direct tax revenue rising from 57.5 percent to 60 percent.

TABLE 14: SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET

Percentage Change

	1997 (INITIAL BUDGET)	1996 (ACTUALIZATION ESTIMATE)	1995
TAX REVENUE/TOTAL REVENUE	69.8	83.1	77.3
INDIRECT TAX REV./TOTAL TAX REVENUE	41.5	39.9	42.5
DIRECT TAX REV./TOTAL TAX REVENUE	58.5	60.1	57.5
NON-TAX REV./TOTAL REVENUE	29.8	16.4	20.6
PERSONNEL EXPENDITURE/TOTAL EXPENDITURE	26.8	24.7	29.4
INVESTMENT EXPENDITURE/TOTAL EXPENDITURE	8.4	5.7	5.4
INTEREST PAYMENT/TOTAL EXPENDITURE	29.8	38.2	33.7
INTEREST PAYMENT/TOTAL REVENUE	29.8	56.9	41.0
INTEREST PAYMENT/TOTAL TAX REVENUE	42.6	68.5	53.0
TOTAL REVENUE/TOTAL EXPENDITURE	100.0	67.0	81.6
BUDGET DEFICIT/TOTAL REVENUE	-	49.0	22.5
AVERAGE INTEREST RATE ON PUBLIC DOMESTIC BORROWING (Simple Average)		104.2	98.9

The share of interest payment in total budget expenditure continued its rising trend also during 1996, this share rising to around 38 percent from around 34 percent in the previous year. The rise in the share of interest payment was at the expense of personnel expenditure the share of which has declined from around 29.5 percent in the previous year to around 25 percent in 1996. There was not any notable change in the share of investment expenditure which remained of around 5.7 percent.

The rising share of interest expenditure in both total revenue and total tax revenue is quite noticable. The share of interest payment in total revenues has risen from 41 percent in 1995 to around 57 percent in 1996, whilst its share in total tax revenue was up from 53 percent to as high as 68.5 percent in 1996. The ratio of total revenue to total expenditure further deteriorated from 81.5 percent in the previous year to around 67 percent in 1996, whilst the ratio of budget deficit to total revenue rose from 22.5 percent to 49 percent in 1996.

However, the first six months-figures for 1997 show an improvement in the interest burden on the budget. Interest payments in this period accounted for 55.1 % total tax revenues (79 % in the same period of 1996), 45.9 % of total budgetary revenues (65 % in 1996) and 34.1 % of total budgetary expenditures (47.9 % in 1996).

Despite the declining trend of interest rates paid on public borrowing in the latter half of 1996, simple average interest rate on public domestic borrowing rose from 99 percent in the previous year to around 104 percent in 1996.

TABLE 15: FINANCING OF CONSOLIDATED BUDGET CASH DEFICIT (BILLION TL)

	1996	1995
CASH DEFICIT	-1,247,346	292,624
FINANCING:	1,247,346	292,624
Government Bonds (net)	274,040	85,657
Treasury Bills (net)	792,189	197,218
Central Bank Advances (net)	228,953	94,723
Foreign Borrowing (net)	-134,411	-81,238
Other	86,574	-3,737

SOURCE: Ministry of Finance, Treasury Undersecretariat

II. FINANCING OF BUDGET DEFICIT

As in the previous year, the 1996 Program had targeted a greater reliance on longer-term domestic borrowing, and reduced net foreign borrowing and short-term domestic borrowing (T-bills) in meeting financing requirement of the public sector. The government which took office in July 1996, was observed to have exerted a considerable effort in lengthening the average maturity of the existing public debt stock whilst reducing the cost of borrowing.

There were some visible improvements in the last months of 1996 in terms of both extending the maturities over one year and reducing the interest cost on government borrowing. By the end of 1996, the average interest rate on T-bill and bond market was reduced up to 86 percent while the average maturity lengthened up to 270 days from 80 days (even to 13 months in some tenders).

The declining trend of interest rates on government borrowing was however reversed in the early months of 1997, resulting mainly from re-emergence of instability in the Turkish politics. The new government's revision of budget deficit to 2,400 trillion TL for 1997, schocking price increases on petroleum and other basic inputs as well as State Minister Günes Taner's statement on an expected 100 percent inftation rate led the interest rate on bonds to jump to 120 percent from 112 percent (the 54th government had left it to the new government at 101 percent by 11 July 1997) and maturity to lengthened.

Reliance on foreign borrowing was further reduced in 1996, resulting in net repayment of foreign borrowing by around 135 trillion TLs. The government's objective to extend the average maturity of the debt stock could not be met also during 1996. As a result, the share of government bonds in budget financing further declined from 29 percent in 1995 to around 21 percent in 1996. Short-term borrowing, namely T-bills and Central Bank Advances to the Treasury, however, maintained its importance in financing the cash deficit. In short, it was not possible to achieve the desired extension of the average maturities in the public debt stock also during 1996.

III. STATE ECONOMIC ENTERPRISES

TABLE 16: STATE ECONOMIC ENTERPRISES

(Billion TL)

	1997 (2)	1996 (1)	1995
Personnel Expenditure	578,711	360,037	222,903
Fixed Capital Investment	284,380	169,822	78,589
Interest Payment	150,843	113,379	93,285
Sales Turnover	4,602,209	2,673,936	1,474,001
Profit and Loss for the Year	225,234	112,893	17,188
Employment (persons)	470,056	483,623	496,352

(1) Provisional
(2) 1997 Program

The 1996 Program projected a further improvement in the financial performance of the State Economic Enterprises. The Program targeted a 66 percent increase in the SEE's revenue against 70 percent increase in expenditure. The SEEs were expected to increase their investment spending by around 113 percent. Whilst the total deficit of SEEs were projected to increase by around 170 percent over the previous year, this deficit would be financed entirely by domestic borrowing whilst the net foreign indebtedness of the SEEs would decline.

Relative improvement in the SEE's financial performance during the recent years was observed to have continued also in 1996.

SEEs were seen to have increased their sales turnover by around 80 percent over the previous year, total sales volume reaching to around 2,700 trillion Turkish Liras.

The share of interest expenditure in total sales turnover is estimated to have declined from 6.3 percent in 1995 to around 4.2 percent in 1996, whilst the share of personnel expenditure declining from 15 percent to 13.5 percent.

SEEs which had realized an overall profit income of around 17.2 trillion TL in 1995 and 35.3 trillion TL in 1996 are estimated to achieve 97 trillion TL of profit income in the year 1997. SEEs are estimated to have increased their fixed investment spending by around 116 percent in 1996, meaning a considerable real increase in investment spending over the previous year. The ratio of SEEs borrowing requirement (inclusive of budgetary transfer to SEEs) to GNP stood at around 0.2 percent, whilst the ratio of SEEs borrowing requirement (exclusive of budgetary transfer) to GNP was around 0.6 percent.

TABLE 17: BORROWING REQUIREMENT OF STATE ECONOMIC ENTERPRISES

(Billion TL)

	1997 (4)	1996(3)	1995
SALES TURNOVER	4,602,209	2,673,936	1,474,001
BORROWING REQUIREMENT (1)	45,518	34,742	-58,476
BORROWING REQUIREMENT(2)	152,973	91,104	-3,602
INTEREST PAYMENT/SALES TURNOVER (%)	3.3	4.2	6.3
PERSONNEL EXP/SALES TURNOVER (%)	12.6	13.5	15.1
BORROWING REQUIREMENT (1)/GNP (%)	0.2	0.2	-0.7
BORROWING REQUIREMENT (2)/GNP (%)	0.6	0.6	-0.1

(1) Inclusive of Budget transfer
(2) Exclusive of Budget transfer
(3) Provisional
(4) 1997 Program

IV. PUBLIC DOMESTIC BORROWING

The public domestic debt stock has risen from 1,361 trillion TL at the end of 1995, to around 3,150 trillion TL by December 1996, meaning a substantial growth in the public domestic stock by around 130 percent. The growth in the debt stock continues also during 1997, the net debt stock reaching to around 4,198 trillion TL by the end of June which means a 33.3 percent rise in the first half of the year. The fast (and real) growth in the domestic debt stock stemmed mainly from the higher-than-planned increase in the public sector's borrowing requirement.

The new coalition government embarked upon new borrowing (about 850 trillion TL) in the firs two weeks in office. It seems that public borrowing will increase quiet robustly by the end of this year.

TABLE 18: PUBLIC DOMESTIC DEBT STOCK

(In Billion TL)

	Government Bonds	T-bills	Central Bank Advances	Exchange Rate Difference	TOTAL DEBT STOCK
End-1995	511.769	631.298	192.000	25.940	1.361.007
March 1996	604.520	1.015.000	260.784	25.940	1.906.243
June 1996	635.173	1.408.012	140.728	40	2.183.952
September 1996	672.263	1.893.967	168.478	40	2.734.748
December 1996	1.250.154	1.527838	370.953	40	3.148.984
March 1997	2.202.999	1.160.201	471.047	-	3.834.247

Source: The Treasury Undersecretariat

The Treasury continues in its efforts to extend the maturities and reduce the cost of borrowing. As a matter of fact, in the last two auctions at the end of 1996, it was able to extend the maturities over one year, which created positive expectations in the financial markets for the current year.

In the begining of March 1997, the Treasury introduced a new borrowing instrument, named "inflation indexed government bonds", with two year tenor and quarterly interest payment. The principal and interest rate of these bonds is indexed to inflation measured by percentage change in the SIS's consumer prices index.

One of the major reasons for the high-cost and short-term nature of public sector borrowing in Turkey is the existance of high and variable inflation and the uncertainty which it creates in the economy. In an environment of nearly three digit inflation rate, the nominal yields on government borrowing instruments are fixed but the real return (inflation adjusted yield) is

TABLE 19: PUBLIC DOMESTIC BORROWING RATES

Percentage

	Interest Rate*		Interest Rate*
December 1995	181.2	Jan 1997	107.6
March 1996	126.1	Feb 1997	106.4
June 1996	125.9	March 1997	111.6
Sept 1996	124.9	April 1997	122.0
Dec 1996	128.2	May 1997	131.3

* Yearly compounded interest rate

variable and uncertain due to unanticipated changes in the rate of inflation. Uncertainty related to real rates of return on financial instruments makes investors to ask for a very high "uncertainty premium" thereby causing an excessive and inordinate rise in nominal interest rates. Namely, uncertainty caused by high and variable inflation pushes nominal interest rates to excessively high levels resulting in positive real interest rates of as high as 25-30 percent. High and variable inflation also causes investors to confine their investment to short term, making longer term borrowing in the financial markets almost impossible.

The recently introduced inflation indexed government bonds are expected to help reduce the nominal interest rates on government borrowing substantially, by reducing "uncertainty premium" arising from high and variable inflation. Lower uncertainty premium on government borrowing would also mean a considerable decline in real interest rates from the existing exorbitantly high levels. This type of borrowing is also anticipated to encourage governments to fight with inflation, as lower inflation means lower nominal interest rates on government borrowing. In the existing borrowing system which fixes nominal interest rates at the outset, investors ask for the highest possible interest rates against inflation risk, whereas the governments are encouraged to pursue high inflation policies in order to reduce the real value of the public debt stock.

Inflation-indexed government bonds are also expected to enable the Trearsury to borrow with longer maturities, thus extending the existing short maturity of the existing debt stock to longer term. The existing short-term maturity structure is conducive to creating instability and speculative expectations as market agents quite frequently become uncertain as to how the maturing debt stock will be managed by the government.

The recently introduced inflation-indexed government bonds have so far been successful in extending the maturities up to 2 years, whilst the real interest rate (premium paid over and above the current inflation rate) still remain excessively high partly due to political uncertainties in the country.

V. THE 1997 BUDGET TARGETS

The 1997 Budget Program has the distinctive feature of being the first "balanced budget" in the last 50 years in Turkey. Whilst to what extent the objective of a balanced budget can be achieved under the current conditions is another question, it was a positive move on the part of the government (led by the Welfare Party and the True Path Party) to show the necessary political will and commitment to set a balanced budget target in order to reform the ailing public sector.

TABLE 20: 1997 CONSOLIDATED BUDGET TARGETS (INITIAL)

	BILLION TL		Percentage Change
	1997 TARGET	1996	
REVENUE	6,361,685.5	2,738,148	132.3
(a) Tax Revenue	4,368,000.0	2,248,422	94.2
(b) Non-Tax Normal Revenue	1,445,000.0	159,884	803.7
(c) Special Revenue and Funds	424,920.0	285,651	48.7
(d) Annex Budget Revenue	123,764.6	44,192	180.0
EXPENDITURE	6,361,685.5	3,955,888	60.8
(a) Personnel	1,489,434.5	974,071	52.9
(b) Other Current Expenditure	669,261.0	310,812	115.3
(c) Investment Expenditure	521,340.0	255,244	104.2
(d) Transfer Expenditure	3,681,650.0	2,415,761	52.4
BUDGET BALANCE	ZERO	-1,217,740	

The 1997 Budget aims at achieving balance in the consolidated budget through a 61 percent increase in budget expenditure and a 140 percent increase in budget revenue. The objective of balanced budget depends, besides increased tax revenue, on two strong assumptions (expectations). One of these expectations is to achieve an enormous increase in "non-tax normal revenue" mainly through an ambitious privatization program and sale of public real-estate. Secondly, and equally importantly, the existing heavy interest burden on the budget would be reduced through both lower cost of borrowing and reduced domestic borrowing.

The main targets in the 1997 Budget Program (Initial Budget) are summarized hereunder:

(a) Total budget revenue and expenditure are expected to increase by around 140 percent and 61 percent, respectively. As a result, the consolidated budget would balance, following a budget deficit of as high as 1200 trillion TL in the previous year.

(b) Tax revenue is projected to increase by around 98 percent, whilst non-tax normal revenue is expected to increase enormously, by around 765 percent over the previous, mainly through privatization and sale of public real estate.

(c) On the expenditure side, personnel expenditure is targeted to increase by around 53 percent, investment spending by 130 percent, whilst interest expenditure is expected to decline by around 23 percent as compared to the previous year.

(d) As a result of various fiscal measures ("the fiscal packages" announced by the government under Wellfare Party and True Path Party rule), an additional total revenue of around 1,418 trillion TL is expected in the year 1997. Of this total additional revenue, around 258 trillion TL would be generated from additional tax revenue, and the remaining 1,160 trillion TL would come from non-tax normal revenue through privatization and sale of public real-estate.

(e) In meeting the public sector's borrowing requirement, emphasis would be placed on longer term borrowing through long term government bonds whilst the reliance on short term borrowing through T-bills and Central Bank Advances would be gradually reduced.

(f) The share of investment spending in total budget expenditure would be increased from around 5.7 percent in 1996, to 8.2 percent in 1997, whilst the share of interest expenditure declining from 38 percent to 30 percent.

(g) The share of total tax revenue in budget revenue would decline from 83 percent in 1996,to around 70 percent in the current year, whilst there would be a slight rise in the share of indirect tax revenue in total tax revenue.

(h) The average interest rate on public domestic borrowing is expected to decline substantially, whilst the average maturity of the existing debt stock extending to longer-term.

According to recently announced budget figures, the budget seems to have yielded a deficit of around 700.7 trillion TL in the first six months of the year. This can be interpreted as a positive development in the current budget as it means a real decline in the budget deficit when compared to the same period of 1996 (475 trillion TL = 5,801 million dollars in 1996 vs. 700.7 trillion TL = 4,875 million dollars in 1997).

According to the figures disclosed by the Finance Ministry, the total budget expenditure has reached to around 2,816 trillion TL in the first six months of the year, which means a 83 percent rise over the same period of 1996 while budgetary revenues amounted to

TABLE21 : ANTICIPATED EFFECT OF THE GOVERNMENT'S FISCAL MEASURES ON THE 1997 BUDGET REVENUES (INITIAL BUDGET)

(Billion TL)

	CONTRIBUTION TO REVENUE
1. ADDITIONAL TAX REVENUE	258,000
2. NON-TAX NORMAL REVENUE	1,160,000
(1) Sale of Public Real-Estates	240,000
(2) Privatization	585,000
(3) Other	335,000
TOTAL	1,418,000

2,135 trillion TL, indicating to a 98.8 percent increase in the same period. As of mid-1997, the desired decline in public borrowing interest rates has not yet been achieved, a factor which continues to jeopardize the achievement of balanced budget target for the year.

In the first six months of 1997, 83 percent of total budget revenue continued to be obtained from taxation, whilst the share of non-tax normal revenue remained limited to 17 percent. Analyzed in the light of the budget targets, this means a better-than-expected performance in tax revenue collection (a 103% increase as against the planned 94% rise in tax collection in the first five months of 1997). The increase in non-tax normal revenue, on the other hand, is considerably below the targeted level, another factor jeopardizing the achievement of balance 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.

The consolidated budget had yielded a deficit of around 8 percent of GNP last year. Provided that the existing trends in the current budget do not change drastically in the latter half of the year, the ratio of budget deficit to GNP can be expected to show some improvement, remaining below the last year's level. Nonetheless, the fiscal performance of the new government in the remaining months of 1997 depends almost entirely on the possibility of an early general election in which case a balanced budget target becomes totally irrelevant in the face of extravagant fiscal and budgetary practices.

CHAPTER 3

MONETARY TRENDS

I. MONETARY POLICY

In 1996, The Central Bank continued to pursue monetary policies aimed at maintaining stability in the domestic financial markets. The early general elections which took place at the end of 1995 and the political instability arising from the election results, had created destabilizing effects on the financial markets. However; the Central Bank, properly fulfilling its surveillance function, made rational and timely interferences to the markets thereby counteracting speculative moves in the market in an effective manner.

TABLE 22: CENTRAL BANK ANALYTICAL BALANCE SHEET

	BILLION TL			Percentage Change	
	MARCH 1997	DECEMBER 1996	DECEMBER 1995	JAN-MARCH 1997	1996
ASSETS					
I. NET FOREIGN ASSETS	738,008	632,198	136,150	15.8	364.0
II. NET DOMESTIC ASSETS	700,370	640,317	509,295	9.3	25.7
Total Credits	850,063	825,380	523,762	3.0	57.5
Other (net)	-149,693	-185,083	-14,476		
TOTAL ASSETS	1,438,378	1,272,515	645,445	13.0	97.0
LIABILITIES					
I. RESERVE MONEY	719,404	621,483	343,484	15.7	80.9
(+) Liabilities due Open Market Operations	85,457	51,369	15,926	66.3	220
II. MONETARY BASE	804,861	672,852	359,410	19.6	87.2
(+) Public Deposits	15,539	33,242	13,384		
III. CENTRAL BANK MONEY	820,400	706,094	372,794	16.1	89.4
(+) Foreign Currency Deposits	195,098	212,984	102,802		
IV. TL LIABILITIES	1,015,498	919,078	475,596	10.5	93.2
(+) F/C Deposits of Banks	422,880	353,437	169,849		
TOTAL DOMESTIC LIABILITIES	1,438,378	1,272,515	645,445	13.0	97.1

The official foreign exchange reserves which had declined during the last quarter of 1995 as a result of the Central Bank's frequent intervention in the domestic foreign exchange market, were on a stably rising trend during 1996 and reached to over 18 billion US Dollars by the end of the year. Resultant from rise in the official foreign exchange reserves, the share of net foreign assets in the Central Bank's balance sheet increased to 55 percent at the end of 1996, from 20 percent in the previous year. The excess liquidity in the economy created by the Central Bank's short-term advances to the Treasury in the first quarter of 1996, was later absorbed by open market operations. Similar excess liquidity pressures emerging in the second half of the year were reduced through both open market operations and infrequent interventions in the foreign exchange market by selling foreign currency against the local currency.

An examination of the analitical balance sheet of the Central Bank indicates to a substantial increase in net foreign assets by around 365 percent, resulting from a rise in official foreign exchange reserves. Net domestic assets, on the other hand, showed a modest increase by around 25 percent resultant from the Central Bank's rather restrictive policy on domestic credit expansion. As a result, in 1996, increase in net foreign assets has had a greater impact on the growth of Central Bank's monetary magnitudes.

In 1996; whilst the banknote issue increased by around 76 percent, the reserve money, an important intermediate target of monetary policy, expanded at a rate of 81 percent. The monetary base and the Central Bank money are those monetary aggregates which appear to approximate the actual monetary expansion in the economy quite successfully. The monetary base and the Central Bank money expanded by around 87 percent and 89 percent, respectively. The size of the Central Bank's balance sheet, on the other, grew by 97 percent.

The net foreign assets in the Central Bank's balance sheet grew by around 16 percent in the first quarter of 1997, whilst the growth in net domestic assets continued to be more moderate. The reserve money expanded at a rate of around 16 percent in the same period, whilst the growth in the monetary base and the Central Bank money were 19.6 percent and 16 percent, respectively.

The monetary growth in the economy, as measured by various monetary aggregates, in the first half of 1997 was almost in line with the inflation rate observed in the same period.

The banknote issue increased by around 23 percent in the first four months of 1997 (to May 9) which indicates to some acceleration in the banknote issue when compared to the corresponding period of the previous year. Whilst the growth in the narrow definition

TABLE 23: THE MONEY SUPPLY

(Billion TL)

	9 MAY 1997	27 DEC 199	JANUARY-MAY (3) Percentage Change 1997	JANUARY-MAY (3) Percentage Change 1996	Percentage Change 1996
BANKNOTES ISSUED	485.250	395.018	22.8	16.3	76.4
CURRENCY IN CIRCULATION	439.330	354.901	23.8	24.5	87.2
SIGHT COMMERCIAL DEPOSITS	363.036	314.876	15.3	-6.3	163.3
SIGHT SAVINGS DEPOSITS	217.624	161.477	34.8	6.5	85.8
DEPOSITS WITH THE CB	164	161	1.9		
M1 MONEY SUPPLY	1.020.154	831.415	22.7	11.3	110.0
TIME COMMERCIAL DEPOSITS	100274	83452	20.2	1.4	7.1
TIME SAVINGS DEPOSITS	2.323.350	1.875.597	23.9	37.5	137.5
CERTIFICATE OF DEPOSITS	3.130	11.211	-72.1	27.0	62.2
M2 MONEY SUPPLY	3.446.908	2.801.675	23.0	27.0	120.1
FOREIGN CURRENCY DEPO SITS OF DOMESTIC ORIGIN	3.413.725	2.702.922	26.3	19.2	100.0
M2Y MONEY SUPPLY (1)	6.860.633	5.504.597	24.6	23.0	109.6
M3 MONEY SUPPLY (2)	3.695.828	3.017.282	22.5	30.0	123.0

(1) M2Y= New Broad Definition inclusive of foreign currency deposits of domestic origin
(2) M3= M2 + Public deposits+ Other Deposits with the CB
(3) As of May 9

of money supply (M1) was faster in the first four months of 1997 when compared to the previous year, the broader definitions of the money supply, namely M2 and M3, displayed somewhat lower rates of growth in the first four months of the current year as compared to the corresponding period of 1996, mainly due to slower growth of Turkish lira bank deposits.

The money creation multiplier (the ratio of M2 to reserve money) rose from 3.69 at the end of 1995, to 4.53 by the end of 1996, and stood at around the same level by May 1997.

The demand for money remained considerably stable throughout 1996, with slight rise in the income velocity of money. The ratio of M1 to GNP rose slightly from 5.2 percent at the end of 1995, to 5.5 percent by the end of 1996, whilst the ratio of M2 to GNP rose to 18.5 percent by the end of last year, from 16.6 percent at the end of the previous year.

TABLE 24: SOME MONETARY AGGREGATES

	BILLION TL			JAN-MAY(2) % Change		Percentage Change	
	MAY 9 1997	DEC 27 1996	DEC 29 1995	1997	1996	1996	1995
Banknotes Issued	485.250	395.018	223.934	22.8	16.3	76.4	86.3
Reserve Money	761.045	618.329	343.484	23.1	20.9	80.0	84.9
Central Bank							
Total Credits:	464.932	361.888	206.126	28.5	-23.8	75.5	28.5
-Public	457.296	354.308	193.877	29.1	-25.3	82.7	30.9
-Private	7.636	7.580	12.249	0.7	-0.3	-39.0	-0.5
M1 MONEY SUPPLY	1.020.154	831.415	396.047	22.7	11.3	110.0	66.1
M2 MONEY SUPPLY	3.446.908	2.801.675	1.270.423	23.0	27.0	120.0	97.7
M1/Reserve Money (%)	134	134.5	115.3				
M2/Reserve Money (%)	452.9	453.1	369.9				
M1/GNP(1) (%)		5.5	5.2				
M2/GNP(1) (%)		18.5	16.6				

(1) Based on the new GNP Series
(2) As of May 9

The Central Bank did not change its rediscount rates throughout 1996 and also during first half of 1997. The interest rate applicable on rediscount facility was 50 percent, whilst it was 57 percent on Central Bank advances.

II. COMMERCIAL BANK DEPOSITS

The average deposit interest rate, after a somewhat rising trend in the first quarter of 1996 resultant from instability in the domestic financial markets, followed a relatively stable trend throughout the year. The weighted average of deposit interest rates paid by the commercial banks on 3-month deposits after peaking 85.5 percent in January 1996, declined to 78.3 percent in March 1997, whilst the average interest rate payable on one-year deposit funds remained at around 92-93 percent throughout the same period.

The weighted average interest rate payable on one-year US Dollar deposits, went from 6.5 percent at the end of 1995, to 8.2 percent by March 1997, whilst the average interest payable on DM deposit of similar maturity displayed a declining trend, from 7.1 percent at the end of 1995 down to 5.9 percent by March 1997.

TABLE 25: TOTAL BANK TURKISH LIRA DEPOSITS

	BILLION TL			PERCENTAGE CHANGE		
	16 MAY	27 DEC	29 DEC	JANUARY-MAY(3)		
	1997	1996	1995	1997	1996	1995
I. SAVINGS EPOSITS	2,570,520	2,048,285	883,390	25.5	38.0	131.8
(a) Time (1)	2,351,831	1,886,808	796,516	24.6	40.4	136.8
(b) Sight	218,689	161,477	86,874	35.4	15.7	85.8
II. COMMERCIAL DEPOSITS	452,850	398,328	197,441	13.7	0.3	101.0
(a) Time	93,956	83,452	77,860	12.6	-0.7	7.1
(b) Sight	358,894	314,876	119,581	14.0	0.9	163.3
III. PUBLIC DEPOSITS	1,984,907	1,555,322	682,005	27.6	35.9	298.0
TOTAL BANK DEPOSITS (2)	3,201,180	2,605,574	1,119,755	22.9	34.3	132.6

(1) Inclusive of CDs
(2) Exclusive of interbank deposits
(3) As of May 16

TABLE 26: RELATIVE YIELDS OF SOME FINANCIAL SAVINGS INSTRUMENTS

(Percentage)

	JANUARY-MAY 1997		MAY 1997-MAY 1996 (LAST ONE YEAR)	
	NOMINAL	REAL(1)	NOMINAL	REAL(1)
COMMERCIAL BANK DEPOSITS				
3- month	29.9	-1.3	94.5	9.6
6- month	30.4	-0.9	95.1	9.9
One-year	33.6	1.5	87.4	5.6
FOREIGN CURRENCY (2)				
US DOLLAR	30.0	-1.2	79.1	0.9
D. MARK	18.9	-9.7	61.4	-9.1
J. YEN	29.7	-1.4	66.9	-6.0
GOLD	21.4	-7.8	59.3	-10.3
TREASURY BILLS				
3- month	30.3	-1.0	104.0	14.9
6-month	45.1	10.3	114.7	21.0
ISTANBUL STOCK EXCHANGE (3)	63.4	24.2	160.8	46.9

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

Excepting investment in the Stock Exchange, public borrowing instruments, namely government bonds and Treasury bills, continued to pay the highest real rates of return as compared to other financial instruments. For instance, six month T-bills yielded real (inflation adjusted) return of as high as 21 percent in the last one year to May 1997 whilst the real return on 6-month bank deposits was around 10 percent in the same period. TABLE 26 depicts the relative yields of some financial savings instruments over the last one year and in the first five months of the current year.

Total consolidated Turkish lira bank deposits grew by around 130 percent in 1996, which compares favourably with 100 percent growth in bank deposits in the previous year. Given the inflation rate of around 85 percent in the same year, this has meant a real growth in deposit funds collected by the commercial banking industry. Savings deposits also increased at a faster rate, by around 130 percent, in 1996 as against 103 percent in the previous year. Commercial bank deposits, on the other hand, grew at around 100 percent as against 90 percent in the previous year.

Savings deposits were observed to have grown at a slower rate during the first four and a half months of the current year, by around 25 percent as against 38 percent in the corresponding period of 1996. Commercial deposits, on the other hand, grew at a faster rate by around 14 percent in the same period.

TABLE 27: FOREIGN CURRENCY DEPOSITS WITH COMMERCIAL BANKS

	MILLION US DOLLARS			JAN-MAY(1) % CHANGE	
	16 MAY 1997	27 DEC 1996	29 DEC 1995	1997	1996
FOREIGN CURRENCY DEPOSITS OF:					
(a) Domestic Origin	25,417	25,341	22,195	0.3	-4.5
(b) Foreign Origin	4,581	3,918	3,397	16.9	-1.1
TOTAL F/C DEPOSITS	29,998	29,259	25,592	2.5	-4.1

The total foreign currency deposits grew by 2.1 percent in the first four and a half months of 1996, as against 4 percent decline in the corresponding period of the previous year. Growth in the foreign currency deposits stemmed mainly from f/c deposits of foreign origin, whilst the increase in f/c deposits of domestic origin remained rather limited.

III. CREDIT STOCK

TABLE 28: CREDIT STOCK

	BILLION TL			PERCENTAGE CHANGE JANUARY-MAY(1)		
	MAY 1997(1)	DEC 1996	DEC 1995	1997	1996	1996
I. DEPOSIT BANKS CREDITS	3,959,427	2,775,503	1,297,004	42.7	33.6	114.0
(a) TL-denominated	2,240,422	1,528,914	813,571	46.5	24.7	88.0
(b) F/C denominated	1,719,005	1,246,589	483,433	37.9	48.6	157.8
II. INVESTMENT AND DEVELOPMENT BANKS' CREDITS	237,141	173,644	77,110	36.6	40.9	125.0
III. CENTRAL BANK DIRECT CREDITS	466,703	354,308	193,877	31.7	11.3	82.7
TOTAL CREDIT STOCK	4,663,271	3,303,455	1,567,991	41.2	31.2	110.6

(1) As of May 16

The total credit stock in the economy continued to expand at a fast rate also in the year 1996, growing at a rate of around 110 percent. This expansion in the credit stock was largely due to fast expansion in the commercial banks' credits. Commercial banks' credits extended to the business sector grew by around 114 percent, resultant from 88 percent increase in TL- denominated credits and 158 percent increase in foreign currency donominated credits. Faster growth of foreign currency-denominated credits was mainly as a result of relatively higher Turkish lira funding costs in expectation of a not very substantial exchange rate depreciation.

Resultant from the relatively successful control of Central Bank advances to the public sector, particularly in the form of short-term advances to the Treasury, Central Bank's direct credits had grown at a considerably slower rate (by around 31 percent) in 1995. In 1996, however, the Central Bank was observed to have followed a looser credit policy towards the public sector as a result of which the Central Bank direct Credits grew at a rate of 83 percent.

Credits extended by the investment and development banks grew by around 125 percent in 1996, a higher rate of growth as compared to the previous year's 62.5 percent.

TABLE 29: CENTRAL BANK DOMESTIC CREDIT EXPANSION					
	BILLION TL			Percentage Change FIRST FIVE MONTHS OF	
	30 MAY 1997	31 DEC 1996	31 DEC 1995	1997	1996
I. PUBLIC SECTOR CREDITS	412,712	373,196	193,521	10.6	92.8
(a) Treasury	410,774	370,953	192,318	10.6	92.8
(a.1) Advances to Treasury	410,774	370,953	192,318	10.6	92.8
(a.2) Other	0.0	0.0	0.0		
(b) State Economic Enterprises	1,938	2,243	1,203	-13.6	86.4
I. PRIVATE SECTOR CREDITS (TO BANKS)	7,679	7,681	12,249	-0.1	-37.3
(a.1) Commercial	7,672	7,674	12,174		
(a.2) Industrial	7	14	75		
TOTAL CENTRAL BANK CREDITS	420,391	380,884	205,770	10.3	85.0

In the first four and a half months of 1997, the total credit stock was observed to have grown at a faster rate by 41 percent as compared to 31 percent of the previous year. Both commercial banks' credits and the Central Bank direct credits were effective in this faster growth. Whilst the credits extended by commercial banks grew at around 43 percent, direct credits extended by the Central Bank increased at a higher rate, by around 32 percent this year as compared to the correspanding period of the previous year.

IV. CAPITAL MARKET

In 1996, the İstanbul Stock Exchange has made its long expected upward movement, with the ISE index going up by around 39.5 percent in US Dollar terms. The ISE index, went up to 97,588 by the end of 1996, from 40,024 at the end of 1995, which meant a 144 percent rise in Turkish lira and a 39.5 percent rise in US Dollar terms. The ISE Index continued its upward trend also during the first half of 1997, albeit in a fluctuating mannes, rising by around 45 percent in US Dollar terms in the first six and a half months of 1997.

The private sector stock increased by around 50 percent in nominal terms in the year 1996, mainly as a result of increase in share certificates. Public sector stocks, on the other hand, was observed to have increased by around 130 percent in nominal terms, largely as a result of increase in short-term Treasury bills and partly as a result of govern-

TABLE 30: ISTANBUL STOCK EXCHANGE COMPOSITE INDEX		
	BASED ON TURKISH LIRA (JAN 1986= 100) (*)	BASEN ON US DOLLAR (JAN 1986= 100)
DEC 1995	40.024.6	382.6
1996		
JAN	49,489.5	463.0
FEB	60,546.5	539.4
MAR	67,045.2	554.9
APR	64,722.7	508.9
MAY	61,150.4	458.9
JUNE	70,489.2	506.5
JULY	63,365.6	445.6
AUG	64,533.4	439.1
SEPT	72,452.9	465.1
OCT	82,006.1	502.2
NOV	93,058.5	528.4
DEC	97,588.8	534.0
1997		
JAN	1,605.0	812.0
FEB	1,612.0	773.0
MAR	1,613.0	744.4
APR	1,427.0	617.0
MAY	1,595.0	-

* As of end of month. The index was deflated by a factor of 1/100 by the begining of 1997.

ment bonds due to government's continued reliance on the domestic financial markets in financing the higher-than-planned budget deficits and in renewing the maturing debt stock. The private stock was observed to have increased by around 5 percent in the first months of 1997.

V. INTEREST RATES

The nominal interest rates, after an upward trend in the first quarter of 1996 due to the negative impact of political instability in the financial markets, moved downwards in the following months, following a considerably stable trend thereafter. The Central Bank pursued a monetary policy which aimed at avoiding intervention in the market interest rates whilst keeping a closer eye on the exchange rate, and is expected to continue a similar policy also during the current year.

TABLE 31: STOCKS

(BILLION TL)

	JANUARY 1997	DECEMBER 1996	DECEMBER 1995
PRIVATE SECTOR STOCKS	463,903	441,392	295,453
-Share Certificates	447,577	424,725	223,804
-Bonds	3,122	2,719	2,354
-Commercial Papers	2,880	2,880	1,533
-Asset-backed Securities	7,267	8,011	66,785
-Bank Bonds	328	328	961
-Profit-loss Sharing Certificates	15	15	15
-Real Estate Certificates	2,714	2,714	-
PUBLIC SECTOR STOCK	2,780,652	2,779,483	1,202,333
-Government Bonds	987,106	987,106	511,769
-Treasury Bills	1,745,350	1,745,350	631,298
-Revenue-Sharing Certificates	4,457	4,457	12,419
-Foreign Currency Indexed Bonds	14,829	13,660	21,847
-Privatization Bonds	28,910	28,910	25,000
TOTAL	3,244,555	3,220,875	1,497,786

SOURCE: CAPITAL MARKET BOARD

TABLE 32: LENDING AND DEPOSIT INTEREST RATES

(Percentage)

	CENTRAL BANK REDISCOUNT RATES		TL BANK DEPOSIT RATES (1)		FOREIGN CURRENCY DEPOSIT RATES (2)		CORPORATE BOND RATES
	Rediscount	Advance	3-month	One-year	US Dollar	D. Mark	
DEC 1995	50.0	57.0	79.5	91.3	6.5	7.1	95.8
1996							
JAN	50.0	57.0	85.5	93.2	6.5	7.0	90.1
MARCH	50.0	57.0	82.7	92.7	7.2	6.9	93.0
JUNE	50.0	57.0	79.1	91.6	7.7	6.9	100.0(3)
SEPT	50.0	57.0	79.6	93.2	7.5	6.0	-
DEC	50.0	57.0	79.7	93.8	7.5	6.2	-
1997							
JAN	50.0	57.0	77.2	91.3	8.0	5.9	-
FEB	50.0	57.0	77.5	91.8	8.1	5.9	-
MARCH	50.0	57.0	78.3	92.0	8.2	5.9	-

(1) Weighted average of interest rates applied by commercial banks
(2) One year deposits
(3) August
SOURCE: The Central Bank

Throughout 1996 and in the first half of 1997, the Central Bank did not tend to change its rediscount rates as a result of which the interest rate on rediscount facility and on short-term advances remained unchanged at 50 percent and 57 percent, respectively.

The deposit interest rates applied by commercial banks did not display any notable change during 1996 (except in the first quarter of the year) and in the first half of 1997, with the weighted average of deposit interest rates payable on short term (3-months) and one-year deposit funds remaining around 78 percent and 92 percent, respectively. Whilst the average interest rate payable on one-year US Dollar deposits went up from 6.5 percent at the end of 1995, to 8.2 percent by March 1997, the average interest on DM deposit accounts went down to 5.9 percent by March 1997, from 7.1 percent at the end of 1995. The corporate bond rate went up from around 98 percent at the end of 1995, to 100 percent by August 1996.

TABLE 33: GOLD PRICES

	LOCAL MARKET		
	GOLD BULLION (TL per gr)	CUMHURIYET (TL per Coin)	LONDON MARKET (US Dollar per ounce)
DEC 1995	718,600	4,990,000	387.4
1996			
MARCH	876,400	6,140,000	397.1
JUNE	995,750	6,750,000	384.6
SEPTEMBER	1,108,250	7,575,000	383.0
DECEMBER	1,251,000	8,500,000	369.3
1997			
JANUARY	1,285,200	8,720,000	354.4
FEBRUARY	1,360,000	9,212,500	347.9
MARCH	1,425,000	9,762,500	351.4
APRIL	1,468,500	9,950,000	345.3

SOURCE: Central Bank

CHAPTER 4

PRICES AND INFLATION

I. THE GENERAL PRICE LEVEL

TABLE 34: ANNUAL RATE OF INFLATION

(Annual Percentage Change)

	CONSUMER PRICES	WHOLESALE PRICES
DECEMBER 1993	71.1	60.3
DECEMBER 1994	125.5	149.6
DECEMBER 1995	76.0	65.6
DECEMBER 1996	79.8	84.9
1997		
JANUARY	75.7	78.0
FEBRUARY	77.7	78.6
MARCH	77.3	77.0
APRIL	77.2	72.8
MAY	77.5	74.6
JUNE	78.0	75.7

SOURCE: SIS

High inflation continued to remain a major policy concern for the Turkish economy also during 1996.

According to the price indices published by the State Institute of Statistics (SIS), the annual percentage change in wholesale prices accelerated to 84.9 percent at the end of 1996, from 65.6 percent at the end of the previous year. Consumer prices on the other hand rose at a slower rate than wholesale prices, the annual percentage change in consumer prices rising from 76.1 percent at the end of 1995, to 79,8 percent by the end of last year. Both wholesale and consumer prices indicated to a reacceleration in inflation during 1996.

The monthly change in wholesale prices were observed to have followed a fluctuating trend during 1996. The lagged effects of adjusting public prices which had been delayed from the last quarter of 1995 due to general elections, were felt in the first months of 1996. As a result; the wholesale prices rose by 9.8 percent in January, 5.8 percent in February, 7 percent in March and 8.1 percent in April. Similar trends were observed also in monthly changes in consumer prices, with consumer prices rising by 7 percent in January, but at a slower rate than wholesale prices in the following months.

TABLE 35: MONTHLY PRICE MOVEMENTS

(Percentage Change)

	Wholesale Prices		Consumer Prices	
	1997	1996	1997	1996
JAN	5.6	9.8	5.9	8.3
FEB	6.2	5.8	5.7	4.5
MAR	6.0	7.0	5.4	5.6
APR	5.5	8.1	6.6	6.7
MAY	5.2	4.1	4.7	4.5
JUNE	3.4	2.7	2.9	2.5
JULY		2.4		2.1
AUG		3.8		4.8
SEPT		5.1		6.1
OCT		5.5		6.5
NOV		5.1		5.2
DEC		3.9		3.4
FIRST SIX MONTHS	36.6	43.7	35.4	36.7
ANNUAL RATE OF CHANGE (1)	75.7	76.2	78.0	82.9
AVERAGE ANNUAL RATE OF CHANGE (1)	78.3	70.5	78.5	81.0

(1) As of end of May

Whilst the prices were seen to be moving at a slower rate during the summer months due to seasonal factors, monthly price rises were still above the normal season averages. The prices were observed to be re-accelerating in the last quarter of the year, with monthly price changes remaining above 5 percent.

The initial 1997 Program projects a lower rate of inflation for the year. Accordingly; the GNP deflator is projected to rise by 65 percent whilst the annual rate of change in wholesale prices decelerating to 57.7 percent by December 1997, from 84.9 percent in December 1996. The projected deceleration in the inflation rate depends on a number of expectations, including balance in the government budget, a substantial fall in interest rates, restrictive monetary and fiscal policies and the like.

In the first months of 1997; the annual rate of change in wholesale prices was observed to have followed a declining trend mainly due to index reasons (as higher monthly price rises of the previous year were substituted by relatively lower monthy prices rises in the current year). As a result, the annual rate of inflation as measured by the wholesale prices) which stood at 84.9 percent at the end of 1996, declined to as low as 72.8 percent in April. The declining trend of inflation could not however be maintained in the following months, with the resulting rise in the annual inflation to 74.6 percent in May and 75.7 percent in June.

The annual rate of change in consumer prices did not show a notable change in the first half of 1997, and stood at 78.0 percent by end-June.

The total change in wholesale prices was 36.6 percent in the first six months of the year, whilst it was 43.7 percent in the corresponding period of the previous year. The total change in consumer prices was 35.4 percent in the first six months of the year against 36.7 percent in the previous year.

However, the 55th government's estimate of a higher-than expected budget deficit at 2,400 trillion TL and shocking price rises of 32 percent on petroleum and other basic public inputs and goods as well as State Minister Güneş Taner's statement on an estimated 100 percent of inflation rate in year-end of 1997 indicates to a year end 90-95 percent of inflation in the country.

II. PUBLIC AND PRIVATE PRICES

In the last one year to June 1997, the public and private prices changed at different rates. The prices of public goods and services rose by 71.6 percent in the last one year to

TABLE 36: PUBLIC AND PRIVATE PRICE CHANGES(1)

(Percentage Change)

	FIRST FIVE MONTHS		ANNUAL PERCENTAGE CHANGE
	1997	1996	AS OF JUNE 1997
PUBLIC PRICES	25.3	50.0	68.3
PRIVATE PRICES	34.1	37.2	76.4
OVERALL	32.1	39.9	74.6

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

June, whilst the rate of change in private prices was 76.9 percent. In the first six months of 1997, private prices were observed to have risen at a faster rate, by 38 percent, as compared to public prices rising by around 31 percent. The faster rise in private prices in the first half of 1997 indicates to the growing importance of demand factors in the formation of inflation in the current year.

TABLE 37: INTERNAL TERMS OF TRADE

1996	Agricultural Prices/Industrial Prices (1994= 100)	Monthly Price Changes (%) Agriculture	Industry
JAN	119.2	10.0	9.2
MARCH	130.9	9.1	6.3
JUNE	127.3	-0.3	3.7
SEPT	121.8	6.2	4.7
DEC	124.5	4.0	4.0
1997			
JAN	123.8	5.0	5.6
FEB	128.3	9.1	5.3
MARCH	139.3	12.8	3.8
APRIL	147.7	10.2	3.9
MAY	144.4	3.7	6.1
JUNE	138.5	0.3	4.6

SOURCE: SIS

The domestic terms of trade (the ratio of agricultural prices to industrial prices) which had developed in favour of agricultural sector in the previous year, were observed to have maintained a similar trend, albeit in a fluctuating manner, during 1996. The terms of trade continued to develop in favour of agricultural prices during the first half of the current year, the monthly rate of change in agricultural prices remaining below industrial prices only in the last two months, May and June, due to seasonal factors.

CHAPTER 5

FOREIGN ECONOMIC RELATIONS

I. BALANCE OF PAYMENTS

The 1996 Economic Program had projected a 15.1 billion deficit in the trade account and a 3.8 billion deficit in the current account for the year 1996 being the first year for Turkey in the customs union with Europe.

TABLE 38: SOME MAJOR TRENDS IN THE WORLD ECONOMY

	1997(1)	1996(1)	1995
GNP GROWTH RATE	4.3	3.8	3.5
(1) Industrial Countries	2.6	2.0	2.1
(2) Developing Countries	6.4	6.3	5.9
(3) Economies in Transition	3.8	2.5	-1.3
INFLATION RATE (2)			
(1) Industrial Countries	2.5	2.3	2.4
(2) European Union	2.5	2.6	3.0
(3) Developing Countries	9.8	12.6	19.9
(4) Economies in Transition	13.6	38.2	128.2
GROWTH IN WORLD TRADE (%)	7.0	6.4	8.7
UNEMPLOYMENT RATE			
(1) Industrial Countries	7.6	7.8	7.7
(2) European Union	10.8	11.2	11.2
INTEREST RATES (3)	5.6	5.4	6.1

(1) IMF forecasts
(2) According to Consumer Prices
(3) 6-month London Interbank Offered Rate (L.I.B.O.R.)

According to the statistics disclosed by the State Institute of Statistics, in 1996, Turkey has faced with a higher-than-projected deficit both in the trade account and in the current account. However, official reserves continued to rise during 1996 as the surplus in the capital account, which turned out to be higher-than-initially projected, more than offset the deficit in the current account. As a matter of fact; two different figures with regard to the current account balance have been disclosed by the Central Bank. The current account balance which excludes "unrecorded foreign trade activities" yielded a deficit of 4,393 million US Dollars for the year 1996, whereas the current account balance inclusive of such unrecorded activities indicates to a deficit of only 1,450 million US Dollars.

The 1997 Program projects a 19,350 million US Dollar deficit in the trade account, whilst the deficit in the current account is projected to be around 5,600 million US Dollars. The Program also projects the surplus in the capital account to decline from 9,740 million US Dollars in 1996, to 8,600 million US Dollars in 1997, largely as a result of an expected decline in net short-term capital inflow and partly a decline in net long term capital inflow; net portfolio investment is however projected to rise to around 4.5 billion US Dollars in the same year.

TABLE 39: BALANCE OF PAYMENTS (MILLION US DOLLARS)

	1997 (PROGRAM)	1996	1995
CURRENT ACCOUNT BALANCE	-5,600	-4,393	-2,339
a) Trade Balance	-19,350	-18,474	-13,212
Exports (FOB)	30,100	23,461	21,975
Imports (FOB)	-49,450	-41,935	-35,187
b) Invisibles balance	9,500	9,634	6,377
Tourism Revenue	6,850	5,650	4,957
Interest Revenue	1,800	1,577	1,488
Other Revenues(1)	13,000	13,300	9,649
Tourism Expenditure	-1,350	-1,265	-911
Interest Payment	-4,700	-4,200	-4,303
Other Expenditure (2)	-6,100	-5,428	-4,503
c) Unrequited Transfer	4,250	4,447	4,496
Workers' Remittances	3,400	3,542	3,327
CAPITAL MOVEMENTS	8,600	9,740	4,722
Foreign Investment (net)	750	612	772
Portfolio Investment (net)	4,450	570	237
Long Term Capital	300	1,636	-79
Short Term Capital	3,100	6,922	3,713
NET ERRORS AND OMISSIONS	-	-802	2,354
RESERVE MOVEMENT	-3,000	-4.545	-4.658
IMF	-	-	347
Official Reserves	-3,000	-4.545	-5,005

Source: Central Bank
(1) Freight and insurance revenues from export transactions
(2) Freight and insurance payments made, and foreign capital profit transfers and others.

In its last year's country economic survey, The TURKISH ECONOMY 1996", MÜSİAD had provided its own forecasts on certain major economic variables for the year 1996. Accordingly, MÜSİAD Research and Forecasting Unit forecasted total exports to reach to 24,000 million US Dollars (actual: 23,082 million US Dollars) whilst total imports were forecasted to be around 42,000 million US Dollars (actual: 42,945 million US Dollars). The forecast provided by MÜSİAD for Turkish Lira/US Dollar exchange-rate (end-of year) was 110,000 TL to one US Dollar, whilst the actual exchange rate at the end of the year stood at 108,500 TL to one Dollar. This indicates to the high degree of appropriateness in forecasts provided by MÜSİAD on various economic indicators of the Turkish economy.

TABLE 40: FOREIGN EXCHANGE REVENUES-EXPENDITURES

(MILLION US DOLLARS)

	1996		
	INCLUDING UNRECORDED **FOREIGN TRADE**	EXCLUDING UNRECORDED **FOREIGN TRADE**	**1995**
REVENUE	51.397	48.454	42,581
EXPORTS	32,303	23,461	21,975
TOURISM	5,650	5,650	4,957
WORKERS' REMITTANCES	3.542	3.542	3.327
OTHER	9,902	15,801	12,322
EXPENDITURE	52,847	52,847	44,920
IMPORTS	41,935	41,935	35,187
TOURISM	1,265	1,265	911
INTEREST PAYMENT	4,200	4,200	4,303
OTHER	5,447	5,447	4,519
BALANCE	-1,450	-4,393	-2,339

SOURCE: Central Bank

1- Trade Account

The 1996 Program had projected a 15.6 percent rise in total exports and a 15 percent rise in imports. Accordingly; exports and imports would reach to 25,400 million and 40,500 million US Dollars, respectively, thereby yielding a trade deficit of 15,100 million US Dollars. The actual figures related to the trade account in the year 1996 indicate that, as the first round effects of the Customs Union, total imports of Turkey grew at a higher-than expected rate whilst the growth in total exports remained below initial expectations. As a result, against an initial expectation of 15,100 million US Dollar deficit in the trade account, the actual deficit turned out to be no lower than around 19,863 million US Dollars.

TABLE 41: COMPOSITION OF FOREIGN TRADE

(IN MILLION US DOLLARS)

	1996		1995	
	EXPORTS	IMPORTS	EXPORTS	IMPORTS
INVESTMENT GOODS	3,985.9	13,150.3	3,518.8	10,488.1
CONSUMPTION GOODS	13,032.4	6,617.5	12,574.5	4,414.2
RAW MATERIALS	6,063.8	23,177.3	5,543.7	20,806.7
TOTAL	23,082.1	42,945.1	21,975	35,709.0

SOURCE: SIS

According to the revised figures disclosed by the State Institute of Statistics, total exports rose from 21,975 million US Dollars in 1995, to 23,082 million US Dollars in 1996, meaning a lower-than-projected rate of increase of 5.1 percent for the year. Total imports on the other hand displayed a faster-than-projected rate of growth, by around 20.3 percent, with the total import bill rising from 35,709 million US Dollars in 1995, to 42,945.1 million US Dollars in 1996. As a result, the trade deficit grew from 13,734 million US Dollars in 1995 to 19,863 million US Dollars in 1996, meaning a notable rise of as high as 44.6 percent in the trade account deficit for a single year. The lower-than-expected growth of exports in the year 1996 was mainly attributed to stagnation in Turkey's major export markets, mainly the European Market, and to a considerable revival of the domestic demand, notably final consumption expenditure.

The 1997 Program projects a slower growth in imports, by around 12 percent, and a faster growth in exports, by around 21 percent. Accordingly; total imports would reach to 49,450 US Dollars and total exports to 30,100 million US Dollars, thus yielding a trade deficit of around 19,350 million US Dollars.

The balance of trade figures disclosed by the State Statistics Institute for the first five months of 1997 indicates to a 9.4 percent growth in exports and a 3.6 percent growth in imports as compared to the corresponding period of the previous year. Total exports (exclusive of unrecorded foreign trade activities) stood at 9,789 million US Dollars whilst the total imports were at a level of 17,623 million US Dollars, thus yielding a trade deficit of 7,833 million US Dollars for the first five months of the year. This indicates to a moderate decline of 2.7 percent in the trade deficit in the current year as compared to the same period of the previous year.

TABLE 42: BALANCE OF PAYMENTS (FIRST QUARTER OF 1997)

(MILLION US DOLLARS)

	JANUARY-MARCH 1997		JANUARY-MARCH 1996	
	INCLUSIVE OF UNRECORDED FOREIGN TRADE	EXCLUSIVE OF UNRECORDED FOREIGN TRADE	INCLUSIVE OF UNRECORDED FOREIGN TRADE	EXCLUSIVE OF UNRECORDED FOREIGN TRADE
EXPORTS (FOB)	7,747	5,953	7,144	5,590
Correction	1,794	-	1,554	-
IMPORTS (FOB)	-9,822	-9,822	-9,250	-9,250
Gold	-341	-341	-288	-288
TRADE ACCOUNT BALANCE	-2,075	-3,869	-2,106	-3,660
OTHER REVENUE	3,288	4,472	3,162	4,199
TOURISM	828	828	555	555
Correction	-1,184	-	-1,037	-
OTHER EXPENDITURE	-2,813	-2,813	-2,341	-2,341
INTEREST PAYMENT	-898	-898	-922	-922
UNREQUITED TRANSFER (PRIVATE)	830	830	932	932
UNREQUITED TRANSFER (OFFICIAL)	57	57	186	186
CURRENT ACCOUNT BALANCE	-713	-1,323	-167	-684
CAPITAL ACCOUNT BALANCE	2,094	2,302	2,298	2,474
* NET DIRECT INVESTMENT	116	116	212	212
*PORTFOLIO INVESTMENT	891	891	798	798
*OTHER LONG-TERM CAPITAL MOVEMENT	723	723	-327	-327
*SHORT-TERM CAPITAL MOVEMENT	364	572	1615	1,791
Correction	-208	-	-176	-
STATISTICAL DISCREPANCY	-1,422	-1,020	-383	-42
BALANCE	-41	-41	1,748	1,748

SOURCE: Central Bank

However, taking into account the unrecorded foreign trade activities (as determined by the Central Bank), total exports stood at 7,747 million US Dollars in the first three months of 1997 against 7,144 million US Dollars of the previous year, meaning a 8.5 rise in exports in the current year when unrecorded export revenues are also included in the total export revenue. As a result, the trade deficit stood at 2,075 million US Dollars in the first quarter of 1997, which, when compared to the same peiod of the previous year, represents a slightly lower level of trade deficit for the current year.

The current account excluding unrecorded foreign trade yielded a reasonably acceptable level of deficit, albeit double the level of the previous year, standing at around 1,325 million US Dollars. The current account "corrected" for such unrecorded foreign trade activities, on the other hand, showed a lower level of deficit, around 713 million US Dollars, in the first quarter of 1997.

2- Invisibles Account

The 1996 Programme had projected a surplus of around 7,150 million US Dollars in the invisibles account. In 1996, tourism revenue went up by around 14 percent, from 4,957 million US Dollars to around 5,650 million US Dollars. Other invisible revenues, including freight and insurance revenue from export transactions, showed a remarkable growth from 9,649 million US Dollars in 1995, to 13,300 million US Dollars in 1996. Interest payment on external debts, on the other hand, declined slightly from 4,303 million in the previous year to 4,200 million US Dollars in 1996. Workers' remittances remained almost unchanged, standing at around 3,500 million US Dollars.

The 1997 program projects a surplus of around 9,500 million US Dollars in the invisibles balance. The invisibles account (excluding unrecorded transactions) yielded a surplus of 1;259 million US Dollars in the first three months of 1997; including such transactions, the invisibles account stood at around 475 million US Dollars.

3- Current Account

The 1996 Program had projected a current account deficit of around 3.8 billion US Dollars for the year. The actual current account figures for 1996 indicates to a higher-than-projected level of deficit, by around 4,400 million US Dollars when unrecorded transactions are excluded. Inclusion of such transactions in the current account yielded a deficit of only 1,450 million US Dollars. Whether such transactions are included or excluded, the current account deficit in the year 1996 was at reasonably managable levels in view of the considerable surplus in the capital account.

The 1997 program projects a deficit of around 5,600 million US Dollars in the current account. The current account (exclusive of unrecorded transactions) yielded a deficit of around 1,300 million US Dollars in the first quarter of 1997, whilst that which includes such transactions yielded some 713 million US Dollars deficit.

4- Capital Account

Capital Account yielded a substantial surplus of 9,740 million US Dollars in 1996, largely as a result of short term capital inflow, as in the previous year. The net inflow of short-term capital rose from 3,713 million US Dollars in 1995, to 6,922 million US Dollars in the last year, whilst the inflow of long-term capital stood at around 1,636 million US Dollars (from minus 79 million in the previous year). Thus, the substantial surplus in the capital account was able to more than offset the current account deficit.

The 1997 program projected a surplus of around 8,600 million US Dollars in the capital account. The Program expects a larger influx of portfolio investment in 1997, whilst short-term capital inflow would decelerate to a great extent.

The capital account was observed to have yielded a surplus of around 2,300 million US Dollars in the first quarter of 1997. As anticipated by the Program, inflow of portfolio investment contributes more to the surplus in the capital account, than short-term capital inflow which still continues albeit at a slower rate.

5- Official Reserves

The 1996 Program had projected an increase of around 2,500 million US Dollars in official reserves. However, official reserves grew at a higher-than-expected rate in the same year, despite of higher levels of deficit both in the trade account and the current account. The rise in official reserves was around 4,500 million US Dollars, bringing the total official reserves to around 16,500 million US Dollars by the end of 1996.

The 1997 program expects official reserves to rise by around 3,000 million US Dollars.

II. EXTERNAL DEBTS

According to the figures disclosed by the Treasury Undersecretariat, Turkey's total external debt stock has reached to 79,767 million US Dollars at the end of 1996, meaning a 9 percent increase over the previous year. The limited rise in Turkey's external debt stock, expressed in US Dollars, was largely due to appreciation of US Dollars against German Mark and Japanese yen, the currencies in which a considerable portion of the country's external debts are denominated (the parity effect").

There was a noticable rise in the country's short-term external debts, mainly by the private sector, during 1996; total short term external debts rose to 20,536 million US Dollars by the end of 1996, from 15,701 million US Dollars at the end of the previous year. The

TABLE 43: EXTERNAL DEBT STOCK

(MILLION US DOLLARS)

	1996	1995	DIFFERENCE
SHORT-TERM DEBTS	20,536	15,701	4,835
MEDIUM AND LONG TERM			
DEBTS:	59,231	57,577	1,654
-Public Sector	48,815	49,958	-1,143
-Private Sector	10,416	7,619	2,797
PARITY EFFECT (1)	-4,419	1,970	
TOTAL EXTERNAL DEBT STOCK	79,767	73,278	6,489

(1) Effect of changes in cross rates on the external debt stock expressed in US Dollars.

TABLE 44: EXTERNAL DEBT SERVICE

(IN MILLION US DOLLARS)

	EXTERNAL DEBT SERVICE			NET TRANSFER
	Principal	Interest	TOTAL	FROM ABROAD
1992	5,294	3,217	8,511	-1,388
1993	4,653	3,574	8,227	979
1994	6,070	3,923	9,993	-4,702
1995	7,594	4,303	11,897	-5,458
1996	7,618	4,200	11,818	-2,906

SOURCE: The Treasury Undersecretariat

medium and long term external debts (mainly owed by the public sector) on the other hand, showed a more moderate rise, from 57,577 million US Dollars at the end of 1995 to 59,231 million US Dollars by the end of 1996.

As a result; the share of short term debts in total external debt stock rose from 21.5 percent in 1995 to 25.5 percent at the end of 1996, whilst the share of medium and long term debts dropped from 78.5 percent to 74.3 percent. Medium and long term debts owed by the public sector was observed to have declined in 1996 by around 1,140 million US Dollars, whilst that of the private sector rose by around 2,797 million US Dollars.

The external debt service stood at around 11,818 million US Dollars in 1996, meaning a slight improvement over the previous year due to some minor decline in interest payments. The total external debt service was made up of 7,618 million US Dollars principal

TABLE 45: EXTERNAL DEBT INDICATORS

(MILLION US DOLLARS)

	1996	1995	1994
EXTERNAL DEBT STOCK	79,767	73,278	65,601
• Short-term	20,536	15,701	11,310
•Medium and long term	59,231	57,577	54,291
GROSS NATIONAL PRODUCT	183,577	170,076	131,407
EXPORT REVENUE	23,461	21,975	18,390
FOREIGN EXCHANGE REVENUE	48,454	42,581	33,194
EXTERNAL DEBT SERVICE	11,818	11,897	9,993
* Interest Payment	4,200	4,303	3,923
* Principal	7,618	7,594	6,070
EXTERNAL DEBT/GNP (%)	43.5	43.1	49.9
EXTERNAL DEBT/EXPORTS (%)	340.0	333.5	356.7
EXTERNAL DEBT SERVICE/EXPORTS (%)	50.3	54.1	54.3
INTEREST PAYMENT/EXPORTS (%)	17.9	19.6	21.3
EXTERNAL DEBT SERVICE/FOREIGN EXCHANGE REVENUE(%)	24.4	27.9	30.1

repayment and 4,200 million US Dollars of interest payment, which resulted in a net transfer of 2,906 million US Dollars abroad.

In 1996, despite a 9 percent rise in the external debt stock, there was some improvement in external debt indicators ("external indebtedness") of the country. When analyzed in the light of various internationally accepted measures of external indebtedness, we may note the following about the country's external debt performance in 1996:

(1) The Ratio of External Debt to GNP

According to the internationally accepted criteria, a country is classified as "highly indebted", if its external debt stock exceeds 50 percent of the GNP. This ratio was observed to have declined for Turkey, from 50 percent in 1994 to around 43 percent in the years 1995 and 1996. Thus the year 1996 was a period in which Turkey's external indebtedness position did not deteriorate as compared to the previous year.

(2) The Ratio of External Debt Service to Export Revenue

According to the accepted criteria, a country in classified as "highly indebted", if the external debt service exceeds 30 percent of export revenue. This ratio declined for Turkey from 54 percent in 1995 to 50 percent in 1996, thus indicating to some improvement in the foreign indebtedness of the country. However; it is more appropriate to include some other foreign exchange revenues, such as workers' remittances and tourism revenue, besides export revenue in the case of Turkey as these constitute a considerable part of the country's permanent foreign exchange revenue. Doing this, the ratio of external debt service to total foreign exchange revenue which had stood at around 28 percent in 1995, declined to 24 percent in 1996, meaning a considerable improvement over the previous year.

3. The Ratio of Interest Payment to Export Revenue

According to the accepted criteria, a country is classified as "highly indebted", if the yearly interest payment on its external debt exceeds 20 percent of its export revenue. This ratio for Turkey declined from 21.5 percent in 1994, to 19.5 percent in 1995. There was a further improvement in this ratio in 1996, falling to around 18 percent, indicating to a steady improvement in the country's external indebtedness in the recent years.

In short; in recent years, there has been a relative improvement in the external debt service of Turkey, despite a steadily rising trend in the external debts.

III. FOREIGN CAPITAL

TABLE 46: FOREIGN DIRECT INVESTMENTS

(MILLION US DOLLARS)

		INVESTMENT REALIZED		
	INVESTMENT PERMITS	INFLOWS	OUTFLOWS	NET INVESTMENT
1990	1.861	788	88	700
1991	1.967	910	127	783
1992	1.820	912	133	779
1993	2.125	797	175	622
1994	1.485	637	78	559
1995	2.938	935	163	772
1996	3.837	964	–	–
1997(1)	509			

(1) As of end of April (first four months)

The balance of payments table for the year 1996 indicates to a net capital inflow of 9.740 million US Dollars representing a 106 percent increase over the previous year. Of this capital inflow, 6,922 million US Dollars was in the form of short-term capital, whereas the amount of net long term capital inflow stood at around 1,636 million US Dollars as against a slight net decline in the previous year. Direct foreign investment (net) amounted to 612 million US Dollars, somewhat lower than the level achieved in 1995. Portfolio investment amounted to around 570 million US Dollars, more than doubling when compared to the previous year's level.

The capital account yielded a 9,740 million US Dollars, which more than offset the deficit in the current account standing at 4,393 million US Dollars.

In 1996, foreign direct investment permits by the government amounted to 3,837 million dollars, out of which around 3.124 million US Dollars in services, 626 million US Dollars in manufacturing, 64.1 million US Dollars in agriculture and 8.5 million US Dollars in mining sector were earmarked.

Foreign direct investment permits in the first four months of 1997 amounted to a total of around 505 million US Dollars in 337 permits. Manufacturing sector took the largest share (351.7 million US Dollars) in total permits, followed by services (133.9 million US Dollars) and mining (1 million US Dollars).

TABLE 47: FOREIGN DIRECT INVESTMENT PERMITS BY ECONOMIC SECTORS

(MILLION US DOLLARS)

	AGRICULTURE		MINING		MANUFACTURING		SERVICES	
	NO. OF PERMITS	AMOUNT	NO OF PERMITS	AMOUNT	NO. OF PERMITS	AMOUNT	NO. OF PERMITS	AMOUNT
1993	30	31.2	13	11.8	427	1,726.6	650	355.4
1994	27	29.3	12	6.2	438	1,106.2	612	342.9
1995	33	31.7	17	60.6	411	1,996.5	764	849.5
1996	35	64.1	14	8.5	352	625.6	777	3,123.7
1997(1)	6	1.0	4	18.6	105	351.7	222	133.9

(1) As of end of April
SOURCE: State Planning Office and Treasury Undersecretariat

IV. INTERNATIONAL RESERVES

Turkey's total international reserves continued to rise also during 1996, from around 23.9 billion US Dollars at the end of 1995 to around 27.8 billion US Dollars by the end of 1996.

TABLE 48: INTERNATIONAL RESERVES (MILLION US DOLLARS)					
		FOREIGN EXCHANGE			TOTAL
	GOLD	CENTRAL BANK	COMMERCIAL BANKS	TOTAL	INTERNATIONAL RESERVES
1994	1,410.0	7,112.1	7,997.0	15,109.1	16,519.1
1995	1,383.1	12,390.6	10,168.7	22,559,3	23,942.4
1996					
MARCH	1,383.2	13,915.3	8,208.8	22,124.1	23,507.3
JUNE	1,383.2	15,869.5	8,181.2	24,050.7	25,333.9
SEPT	1,382.9	17,263.0	9,390.9	26,653.9	28,036.8
DEC	1,383.2	16,490.9	9,901.8	26,392.7	27,775.9
1997					
JAN	1,383.1	16,658.7	8,965.9	25,624.6	27,007.7
FEB	1,383.2	16,226.1	9,015.6	25,241.7	26,624.9
MAR	1,383.0	15,543.0	8,893.0	24,436.0	25,820.0
APR	1,383.0	15,494.0	n.a	n.a	n.a
MAY	n.a	15,883.0	n.a	n.a	n.a

SOURCE: Central Bank

Whilst the gold reserves remained unchanged at 1,383 million US Dollars, the official foreign exchange reserves held by the Central Bank rose from 12,390 million US Dollars at the end of 1995, to around 16,491 million US Dollars by the end of 1996. Against fast growth of official foreign exchange reserves, the Central Bank continued to pursue a foreign exchange policy which would not allow a notable overvaluation of the local currency against hard currencies. As a result of this policy, the Central Bank continued to face some difficulties in achieving a degree of control over domestic monetary expansion consistent with lower rates of inflation, due to a substantial rise in net foreign assets in the Central Bank's balance sheet. In the existance of the government's reliance partly on the Central Bank Advances (to the Treasury) in financing cash deficits in the consolidated budget, it was not possible to fully sterilize the expansionary effects of the increase in foreign assets on the domestic monetary expansion.

The Central Bank, relying on its strong reserve position, continued its "surveillance" function over the markets, having a close eye on exchange rate movements of speculative nature and interfering with the foreign exchange market in order to iron out short run fluctuations arising from excess liquidity and speculation.

The official foreign exchange reserves held by the Central Bank was observed to follow a declining trend in the first quarter of 1997, mainly as a result of Central Bank's intervention in the domestic foreign exchange market. However, after dipping to around 15.4 billion US Dollars in the month of April, the Central Bank foreign exchange reserves started picking up again, reaching to over 15.8 billion US Dollars by May. At present; the Central Bank holds sufficient foreign exchange reserves in order to maintain stability in the foreign exchange market, whilst not letting the exchange rate become overvalued. At present, there seems to exist no need for a major correction in the exchange rate through a devaluation. As in 1996, currently there exists no substantial pressure on the exchange rate from the balance of payments side.

V. FOREIGN EXCHANGE RATES

In 1996, the exchange rates followed a considerebly stable trend throughout the year, keeping basically in line with the current rate of inflation. The nominal depreciation of TL against the currency basket of US Dollars (50 percent) and DMark (50 percent) was 73.3 percent. Given the yearly inflation rate at 79.8 percent, this has meant a slight appreciation of the local currency in real terms.

The same currency basket was observed to have risen by around 30.0 percent (in nominal terms) in the first six months of the current year. Given that the percentage change in the SIS Consumer Prices Index was 35 percent, the currency depreciation was therefore basically in line with the inflation rate, with no substantial real appreciation of the local currency.

TABLE 49: INFLATION AND CURRENCY DEPRECIATION

(Percentage Change)

YEAR	TL DEPRECIATION AGAINS 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	73.3	79.8	-3.7
1997(3)	37.4	22.6	30.0	35.4	-4.0

(1) Currency basket comprising 50 percent US Dollar and 50 percent D. Mark
(2) December-on December yearly percentage change in the SIS's Consumer Prices Index (1987= 100)
(3) (January-June) first six months

VI. RELATIONS WITH THE EUROPEAN UNION: EVALUATION OF THE CUSTOMS UNION IN PRACTICE

Turkey-European Union (EU) relations, in the period of the year 1996 and the first half of 1997, have been stormy and to the detriment of Turkey in regard to both the Customs Union which was fully implemented as from early 1996 and Turkey's long-lasting ambition of seeking full membership during the forthcoming enlargement wave of the EU towards Eastern and Central Europe as well as tiny Baltic countries.

The 18 month-performance in the Customs Union and EU's decision to exclude Turkey from its new enlargement wave have been dissapointing for Turkey. Concerning the Customs Union, it has worked fully to the advantage of the EU which gained an extra 6 billion dollars over its usual surplus (5 billion dollars) in bilateral trade with Turkey. While Turkey complied with most of its obligations under the Customs Union, the EU did not fulfill its committments. One could hardly mention any pattern of institutional cooperation, or effective working of the Customs Union. Instead of accepting as a partner and a candidate for full membership, the EU has been continuing to treat Turkey as a third country.

1- Evaluation of the Customs Union by mid-year 1997:

*** Turkey has fulfilled most of its committments:**

- Turkey removed all customs duties, quotas and charges having an equivalent effect (such as Mass Housing Fund charges, etc.) on its imports of industrial goods from the EU's member states as from 1st January '97.

- Turkey reduced its customs duties and relevant charges on its industrial imports from the third countries down to the level of Common External Tariffs System of the EU (thus the aggregate protection rate on Turkey's imports from third countries declined from 10.79 percent to 5.6 percent in 1996).

- In parallel to the implementation of the Customs Union, the Free Trade Agreement on the iron and steel products covered in the European Coal and Steel Community between Turkey and the EU was initiated on 21 December '95 and signed on 25 July 1996. The FTA came into force on 1st August 1996.

- In agriculture, the Agricultural Committee, as an organ of Turkey-EU Association, reached an Agreement in late April of 1997 on the partial liberalization of agricultural trade (excluded from the Customs Union) between Turkey and the EU. In fact, this agreement which was later approved by the Association Council on 29th April 1997 in Luxembourg has meant Turkey giving significant customs-duty concessions to the EU on the imports of highly-value added agricultural produce, i.e. mainly meat and diary products through customs duty reductions or removals for certain amounts of imports. Turkey has been exporting most of its agricultural produce to the EU free of tariffs since 1997, however being subject to very restrictive conditions of the Common Agricultural Policy on agricultural imports.

- Turkey, in compliance with the Common Commercial Policy of the EU, signed free trade agreements with Romania Hungary and Israel with which the agreement was put into force by the 55 th (new) coalition government immediately after coming into power.

- The regulation on Border Trade which is a significant source of income for less developed regions of Turkey, particularly the South-Eastern Anatolian Region, was changed in accordance with the Customs Union agreement; restrictions have been brought for the coverage of border trade and the number of cities permitted.

- Regulation to adopt the Competition Law of the EU was enacted and a Competition Board, though too-long delayed, was formed in the meantime. It is very likely that the application rules for this regulation will take effect in a couple of months, thus Competition law will be fully in effect.

- A comprehensive draft law on Customs which is an overdue task for Turkey and should have taken effect in parallel to the Customs Union has made some progress in the Turkish Assembly. It has been adopted by the Commission for Plan and Budget and is now likely to be taken up and adopted by the full session of the Assembly in a few months.

- Turkey lags behind in establishing a National Accreditation Committee to issue a "CE Certificate" for export goods to the EU.

*** The European Union has not Fulfilled its Committments:**

- The EU continues to treat Turkey as a third country instead of a partner in mutual Customs Union and not as a candidate country for a prospective full membership. There seems not to have occurred any pattern of institutional cooperation. The Association Committee could meet only four times in 1996 even though it was supposed to meet every month under the Customs Union Agreement.

- The EU has not extended its committment of ECU 2.2 billion financial aid to Turkey in the period of 1996-2001, which was, though a very insufficient amount, was considered to be as a compensatory remedy for Turkey's probable hardships on trade competition and for its loss of a substantial amount of tax income. (The aid of ECU 2.2 billion in five-year period was in the form of ECUs 375 million of grant from the EU's budget and the rest as project credits; i.e. ECU 300-400 million from Mediterranean Development Fund (MEDA), ECU 750 million of loans from the European Investment Bank). The EU could not extend any of this aid to Turkey owing to both Greece's veto and other member countries' reluctance to override its veto under any circumstances and the European Parliament's decision to make the freeing of MEDA loans being subject to Turkey's compliance of betterment in its human rights performance and the use of these funds in the South-Eastern Anatolia, the conditions not accepted by the successive Turkish governments.

- Being contrary to the Customs Union, and as if it Turkey is a third country, the EU has been continuing to apply its restrictive anti-dumping regulation against some Turkish products, the last example is its investigation on unbleached cotton imports from Turkey in July 1997.

*** The Customs Union Resulted in favour of the European Union**

- The EU did immediately grasp the advantage of exporting to Turkey free of any tariffs and charges having an equivalent effect as from early 1996, therefore increased its surplus in bilateral trade with Turkey from about 6.5 billion dollars in 1995 to 11.5 billion dollars in 1996. As fuelled by the Customs Union, Turkey's imports in total went up from 35,709 million dollars in 1995 to 42,945 million dollars in 1996, which means a sharp increase of 20.3 percent. On the contrary, the long-awaited jump in exports upon the implementation of Customs Union did not materialize, by increasing marely from 21,975 million dollars in 1995 to 23,082 million dollars in 1996, which means a lower-than projected rise of 5.1 percent.

  More strikingly, Turkish textiles and clothing exports, which were claimed to increase sharply and jump over 10 billion dollars in the first year, recorded dissapointing performance with a decline of 8 percent in clothing exports and 23 percent in leather exports but a slight increase of 9 percent in textiles exports (by the figures in the first 9 months of 1996).

However, to the detriment of Turkey in the Customs Union, Turkey's imports from the EU increased by 32.5 percent, higher than the rise in total imports, to 22,590 million dollars in 1996, thus the EU's share in total imports rising from 47.2 percent in 1995 to 52.6 percent in 1996. On the other side, Turkey's exports to the EU recorded a slight increase of 3.6 percent, lower than the rise in total exports, from 11,078 million dollars in 1995 to 11,485 million dollars in 1996, thus the EU's share in total exports declining from 51.2 percent in 1995 down to 49.7 percent in 1996.

On the trade balance, Turkey had a total trade deficit of 19,863 million dollars in 1996 with a significant increase of 44.6 percent over the deficit of 13.734 million dollars in 1995. More strikingly, Turkey's trade deficit with the EU increased to 11,485 million dollars in 1996 which means an unbearable and sharp rise of 77 percent compared by 1995.

This lacklustre increase in exports in general and particularly to the EU can be reasoned with the following factors; abolition of export incentives being a condition of the Customs Union; high cost of inputs, particularly energy and raw materials produced by the public sector, abolition of the incentives for producers to import raw materials from third countries free of tariffs or other charges and lack of sufficient support mechanisms for small and medium-sized enterprises:

- Due to the abolition of customs duties and Mass Housing Fund charges, the Turkish Treasury has faces a loss of about 3 billion dollars a year. The long-dragged draft law on Special Consumption Tax (ÖTV), widely considered to alleviate this loss of tax income, could not be enacted in the Assembly.
- Although the Customs Union was presented in the Turkish public as if people would have benefited from quality goods at lower-cost prices, in reality customs union's benefit of removed duties and other charges went to coffers of importers and wholesalers. Because inflation, on the basis of consumer price indices, stands still at the rate of 78 percent by end-June 1997 compared with 76.1 percent by end-December 1995.
- Also foreign capital inflows which were claimed to overflow into the country after the implementation of the Customs Union stagnated in this period and amounted to 964 million dollars in 1996 as compared with 935 million dollars in 1995.

1- Turkey's Exclusion from the Forthcoming Enlargement Wave of the European Union

Apart from the Customs Union, Turkey-EU relationship in the context of Turkey's long-cherished ambition of seeking full membership in the EU have also been very stormy and dissapointing for Turkey in this period.

The leaders of Christian Democrat Parties in the EU's member countries (Germany, Italy, Belgium, Austria, Spain, Ireland and Luxembourg) unequivocally declared that Turkey has no a future place within the EU because the latter forms a unique European civilization and Turkey doesn't belong to it. This remark which was implicitly mentioned in the past by some unofficial or official circles some times, was declared so openly by some leaders of member countries for the first time.

Turkey's fury and anger over Christian Democrat leaders' remark led the Council of Foreign Ministers of the EU at Apeldoorn, Holland in late March 1997 to rebuke this remark and to state that Turkey be an eligible country for full membership and be treated fairly and equitably on the conditions for membership at the time of deciding about candidate countries for membership in Luxembourg, in December 1997.

However, the European Commission, on its blueprint report on enlargement and restructuring of the EU which is called "Agenda 2000", recommended to the EU's Council that only Poland, Hungary, Chech Republic, Slovenia and Estonia in addition to the previously-agreed accession negotiations for Greek Cypriot Administration should be admitted into full membership in the first wave considered to take place by 2000-2002. The EU Commission left the applications of Bulgaria, Romania, Slovakia, Latvia and Lithuania to the second enlargement wave and did not even mention the name of Turkey among candidate contries. The EU Commission which claims that Turkey should solve its chronic problems in macro economy, Cyprus problem, tension in the South-Eastern Anatolia and make progress in improving deficiencies in democratic and basic human rights norms, suggests, in its Agenda 2000 Report, a so-called "Strengthened Customs Union" with Turkey.

The clear understanding from this picture on Turkey's side is as follows:

- The EU, in order not to lose Turkey, but keep it at arm's length, continues to produce formulas for decades; Association Agreement in 1963, Additional Protocol in 1970, Turkey's right to be an eligible country as a response to its application for membership and subsequently the so-called Matutes Package in late 1989, Customs Union in early 1996, and finally Strengthened Customs Union in mid-1997. This means Turkey is likely to wait for another 20-25 years without any prospect of membership.

- The EU makes this fact so obvious that even though the EC Commission, in its Agenda 2000, rates the Turkish economy's performance, application of market economy and infrastructures as more favourable than most of the Central and Eastern European as well as Baltic candidate countries, it has excluded Turkey from the enlargement wave. Such a stance makes the fact so unequivocal that the EU does not see Turkey as belonging to the European Club whose cultural identity depends on Christian and Judaism.

On the other hand, Turkey reacted sharply to the EU's decision to start membership negotitations with the Greek Cypriot administration under the name of the Republic of Cyprus and henceforth announced with the Turkish Cypriot government that Turkey and the Turkish Republic of Northern Cyprus will soon embark upon a partial but strengthened integration which means for the TRNC keeping its status of independent state politically, but getting integrated with Turkey in foreign policy, defence and economy.

It has been unfortunately understood that as a concession to override Greece's veto in return for the implementation of the Customs Union, it was a bold mistake to let the EU's Council to accept Greece's insistence of starting membership negatiations with the so-called Republic of Cyprus six months after the Intergovernmental Conference (Maastricht II). It seems that the Cyprus issue will bring more headaches for Turkey and a major subject of contention between Turkey and the EU.

-Lastly, in the period of 1996 and the first half of 1997, Turkey, using threat of its veto power as a member of NATO, was accepted to join fully into operations of the Western European Union, the so-called defence arm of the EU, when the latter will be provied facilities and equipments of NATO.

3. MÜSİAD's Proposals

Regarding the detrimental effects of the Customs Union against Turkey's interests and the EU's indifferent approach to Turkey in the framework of the new enlargement wave towards Eastern Europe,Turkey should ask for a renegotiation of the Customs Union on the topics of bilateral trade functioning against Turkey, the EU's not extension of financial aid, anti-dumping practices on some Turkish exports.

Under the present circumstances, Turkey, already having encountered disadvantageous results, has nothing to lose, but to force the EU to act in accordance with the Agreement and committments. As a more realistic policy to correct the deficiencies on Turkey's side in bilateral relationship to a more equal footing and strengthen it in economic sphere, Turkey should negotiate with the EU to keep bilateral relationship on the basis of a Free Trade Area Agreement on the industrial goods.

In order to alleviate detrimental effects of the Customs Union in the short run; the application rules for Competition Board should be immediately decreed by the Turkish government, thus competition law should immediately take effect. Also drafted customs regulations should quickly be enacted into a law in the Parliament.

- In the case of EU's failure to comply with some of its commitments, preventive measures should be taken for Turkey's rights. A preferential treatment should be asked for machinery manufacturing, electrical investment goods, chemical products, furniture-forestry products, pulp and paper, etc..

- Realistic exchange-rate policy could be useful. However, precautions could be imposed on agricultural imports from the EU.

- Turkey should not hesitate to integrate with the Turkish Republic of Northern Cyprus if the EU will go ahead in admitting the Greek Cypriot Administration into full membership, in a clear violation of London Agreement which established the Republic of Cyprus and grants Turkey guaranty power.

CHAPTER 6

OVERVIEW AND PROPOSALS

I- OVERVIEW

At the end of 1996, Turkey, apart from its chronic problems such as high inflation, lack of tax reform and social security reform, long-dragging privatization, record-breaking foreign trade deficit (19.86 billion dollars) and a worsening budget deficit (TL 1,200 trillion) had, on the other hand, some upbeat performance in its economy; i.e. a high growth rate of 7.4 per cent following 8.4 per cent growth rate in 1995; strong growth in industry (7.1 per cent in 1996 and 7 per cent in the first quarter of 1997); a sharp decline in interest rates on domestic borrowing (bonds and T-bills) which is the biggest single expenditure item in the budget (from 140 per cent in mid-1996 down to 86 per cent in early months of 1997 while it was at the rate of 101 per cent on 11 July 1997); also a resultant decline in interest rates on deposits and loans; a much longer period of maturity for bonds (on average 270 days, but in some tenders up to 13 months); start of a transition period from high interest earnings-based economic structure into a production-based economy; and finally a peaceful period in labour relations with workers and public servants satisfied with their wage rises.

Under such an economic outlook at the outset of 1997, there was a general conviction that the economy would have had a much more positive outlook in the year 1997. However, unnecessitated political tension stemming from artificial agendas and political provocations by some interest groups of some business and media circles deeply paralysed the economic management of the government. Despite such a drawback, being free of political conflicts and tension, the Turkish economy could achieve a remarkable growth rate of 5.5 per cent in the first quarter of 1997. The achievement of a robust growth has stemmed from the Turkish private sector's dynamism, productivity as well as its ability not to consider political issues much.

Inflation still stands to be one of the major economic problems. However, on the basis of consumer price indices, inflation rate could show a moderate decline, though insufficient, from 82.9 per cent in 1996 to 78 per cent in the first half of 1997.

On the other hand, political tension led to jittery in financial markets which meant the bottomed-out rates for bonds (down to 86 per cent) have gone up to the band of 100 - 105 per cent by mid-year while their term of maturity lengthened. Also, share prices in Istanbul Stocks Exchange have declined sharply.

In this period, domestic borrowing continued, though slowed down substantially with a rise of only 33.3 per cent in the first half of 1997 as compared to a 130 per cent increase in the whole year of 1996. This notable improvement in domestic borrowing has stemmed from the 54th government's insistent policy on reducing the requirement of new domestic debts through extra revenues-raising iResources Packagesî in this period. As a sign of reduced burden of domestic debts and interest burden on public finance, the ratio of interest expenditures to total budgetary revenues declined to 45 per cent in the first five months of 1997 from 66 per cent over the some period of 1996.

The goal of balanced budget pledged by the outgoing 54th government seems not to have materialized owing to the not-collection of non-tax revenues earmarked in the budget of 1997 in the very instable period of political tensions in the first half of this year. Thus, the budget deficit totalled TL 700 trillion in the first six months of 1997 as compared with TL 475 trillion in the same period of 1996. However this figure shows a notable improvement (20 per cent real decline) in the budgetary performance (on a dollar basis, TL 700 trillion equalled 4,875 million dollars while the deficit of TL 475 trillion in 1996 totalled 5,801 million dollars). This improvement can be reasoned with the slowdown in new domestic borrowing (33.3 per cent in 6 months), the resultant reduction in interest burden on the budget as well as the increase in consolidated budgetary revenues (98.8 per cent in the first six months) far exceeding the increase in consolidated budgetary expenditures (83 per cent). Tax revenues increased by 103 per cent in the five months than it was estimated at 94 per cent.

As for State Economic Enterprises (SEE), the improvement in their productivity and profitability which had started in 1995 and continued in 1996 will be bolstered in 1997 while they are expected to generate TL 97 trillion of profits this year.

Privatization which occupies the agenda of the Turkish economy since 1985, a lacklustre performance was recorded in the period of 1985 - 1996, with the total privatization volume reaching to only 3.4 billion dollars (in this period the total privatization receipts amounted 4.2 billion dollars while total expenditures on privatized SEEs reached to 3.8 billion dollars). Even though a strong privatization performance was achieved with a total of 900 million dollars in the first couple of months of 1997, total receipts from these privatizations by the Privatization Authority lagged much behind during the political tension and instability which left the economy in disarray.

Concerning social security reform, the draft law supported by a consensus of government, trade unions and employers' organizations on increasing the minimum age of retirement to 55 for men and 50 for women could not be discussed in the Parliament. Henceforth, the total deficit of three social security institutions which was TL 275 trillion in 1996 can be estimated to exceed TL 530 trillion TL as pledged by the previous coalition government's budgetary program for 1997.

On the external trade front, it was faced with a record-breaking trade deficit (19.86 billion dollars) in 1996 owing to the sharp increase in imports (20.3 per cent vs. 5.1 per cent in exports) fuelled by the start-up effects of the implementation of Customs Union with the European Union as well as the stronger than expected economic growth rate stimulated by consumption and imports of investment goods and raw materials. Current accounts balance had a deficit of 4.39 billion dollars in 1996.

Customs Union with the EU, in its first one and a half year's implementation, has worked against Turkey's interests under the circumstances that the EU did not fulfill its commitments on financial and technical aid and institutionalized cooperation with Turkey, and that the EU gained an extra 6 billion dollars surplus (out of 11 billion dollars in 1996) in its trade with Turkey under the Customs Union.

Turkey's international reserves continued to increase from 23.9 billion dollars at the end of 1995 to 27.8 billion dollars in year-end of 1996.

Turkey, in 1996, has pursued a multi-polar policy in its foreign economic relations, on the one side, striving to foster its relations with the EU, USA and other western countries, on the other hand bolstering its area of influence and economic relations by embarking upon new openings into Asian, Far-Eastern and African regions.

In this framework, the Developing Countries-8 (in short D-8) integration process has been initiated by Turkey and officially declared by the signing of its Founding Declaration by the heads of state or government of eight founding members in Istanbul on 14 - 15 June 1997.

In summary, at the beginning of the second half of 1997, Turkey has an outlook and agenda in the political sphere darkened by restrictive regulations and practices contrary to democratic traditions and basic human rights and freedoms, most importantly, freedom of belief, reminding of notorious state rule in 1940s. As for the economic sphere, Turkey although still faces such chronic problems as high and institutionalized inflation, budget deficit, public borrowing, lack of tax reform and social security reform, and unfinished privatization, it has also an upbeat outlook, with fast growing economy and manufacturing industry, relative decline in growth of domestic borrowing and its interest burden, reduced trade deficit, relative decrease in budget deficit, etc..

II- THE 55 th GOVERNMENT'S ECONOMIC PROGRAMME AND PERFORMANCE IN ITS FIRST MONTH IN OFFICE

1) Highlights From the Economic Programme of the New Coalition Government

The new government which took office from the beginning of July this year, announced its economic program which contains a number of important and ambitious objectives. The program seems to place top priority on solving the high inflation problem which has existed in the country since mid - 1980s.

Here below are some highlights from the new government's economic program:

(a) Inflation:

The main objective is to restore macroeconomic stability and put the economy back to its long term, stable growth path.

The most important obstacle standing in the way of achieving this objective is the existance of a very high inflation which has the risk of rising even higher. Priority shall be given to fight with inflation problem through a number of reforms. Public deficits which are the main cause of high inflation, shall be reduced permanently, at the same time introducing reforms which aim at restructuring various public institutions.

(b) Public Banks

Structural problems and legal deficiencies in the existing banking system shall be solved, whilst enhancing supervision and surveillance in the system. More efforts will be exerted towards privatization of the existing public banks.

(c) Transparency in the Government Budget

Budgetary and fiscal discipline in the public sector shall be restored, whilst terminating all such practices and exercises which create the image of arbitrariness in the use of public resources. Budget practices will become more transparent and accountable.

(d) Borrowing

The government will put an end to irregular and arbitrary public borrowing, and will continue borrowing within a pre-announced program. The government adopts as its long-term objective, establishment of total quality management in public finance.

Whilst the government considers tax revenue as the healthiest way of financing government spending, it also attaches a great importance to non-tax revenue, such as privazitation, in restoring public revenue-expenditure balance.

(e) No New Taxes

At present, there exists no effective control over taxation.

The government, instead of introducing new types of taxes, shall make new arrangements in the existing tax regulations in order to reduce tax evasion and the size of the unrecorded economy. Tax rates shall be cut in certain areas in order to widen the tax base, whilst protecting taxpayers from the adverse effects of inflation. Tax system shall be reformed so as to encourage higher employment.

(f) The Balance of Payments

A healthy and sustainable structure shall be achieved in the balance of payments. Capital movements shall be directed towards economic development and enhancement of productive capacity.

(g) Emphasis on Export Growth.

Export growth shall receive a special attention. Regulations pertaining to foreign trade shall be designed in such a way to meet the country's international commitments.

(h) State Economic Enterprises

Management and supervision of SEEs shall be re-structured. Necessary measures shall be introduced in order to speed up privatization process.

(ı) Income Distribution

In view of the serious deterioration in income distribution, emphasis shall be placed on mitigation of poverty and reduction of unemployment.

(j) Employment

Special emphasis shall be placed on reducing high unemployment, and in doing so, investment and production shall be increased through private sector.

(k) Relations with European Union (EU)

The process of adjustment to EU shall be speeded up.

(l) Social Security

Top priority shall be given to solving problems of the existing social security institutions. Unemployment Insurance scheme shall be introduced. All citizens shall be entitled to health insurance.

(m) Agriculture and Husbandry

Appropriate policies shall be introduced in order that the rural population receive their due share in the national income. Agriculture shall become a surplus sector.

(n) Small and Medium Scale Enterprises (SMSE)

All appropriate measures shall be taken in order that SMSEs receive a larger share in production and employment. Finance support to SMSE shall be achieved through venture capital and investment trusts.

(o) Infrastructure

Additional resources shall be allocated to infrastructure investments which are near completion. Private sector shall be encouraged to participate in the financing of infrastructure investments.

(p) Transportation

Improvement of air, rail and road transportation shall be given an important emphasis.

(q) Telecommunications

Privatization of the Turkish Telecommunication shall be speeded up. Licences shall be granted in the area of telecommunications.

(r) Tourism

Tourism activities shall be diversified in order to meet changing consumer preferences in other countries.

(s) Maritime

A ministry for maritime affairs shall established.
Maritime transportation in domestic transportation shall be encouraged.

(t) GAP Project

Private investment shall be encouraged in the South Eastern Anatolian Project.

Revised Budget Targets (1997)

(Billion TL)

	INITIAL BUDGET TARGETS	ACTUAL AS OF JUNE 1997	REVISED BUDGET TARGETS (*)
BUDGET EXPENDITURE	6,254,900	2,843,900	7,510,000
Personnel Exp.	1,729,400	865,300	2,053,000
Other Current Exp.	635,800	125,700	685,000
Investment Exp.	495,300	148,300	545,300
Transfer Exp.	3,394,400	1,704,600	4,226,700
-Interest Exp.	1,864,00	969,900	2,268,000
- Social Security	530,000	349,700	742,000
- Other	1,000,400	385,000	1,216,700
BUDGET REVENUE	6,254,900	2,125,200	5,110,000
Tax Revenue	4,368,000	1,759,800	4,368,000
Non-Tax Normal Rev.	1,445,000	154,300	300,000
Special Revenue and Fund	424,900	175,800	425,000
Annex Budget Revenue	17,000	35,300	17,000
BUDGET BALANCE	ZERO	-718,700	-2,400,000

(*) Target Revision by the 55TH COALITION GOVERNMENT.

Revised Macroeconomic Targets

	INITIAL	REVISED (*)
GNP GROWTH RATE	4 %	5.5-6.0 %
GNP DEFLATOR	65 %	75-80 %
WPI (1) (Average Percentage Change)	65 %	75-80 %
WPI (1) (End-of Year)	57.7 %	80-85 %
Average TL/USD Exchange Rate	135,000	147,000-159,000
EXPORTS	USD 29.5 BILLION	25.5-26 BILLION
IMPORTS	USD 50 BILLION	45.5-46 BILLION
TRADE DEFICIT	–USD 20.5 BILLION	USD 20.0 BILLION
CURRENT ACCOUNT DEFICIT	–USD 5.6 BILLION	-USD 4-4.5 BILLION

(1) Wholesale Price Index

* Target Revision by the 55th Coalition Government.

2) Evaluation of the 55th Government's Performance in its First Month in Office

Above all, the developments which took place in the process leading to the 54th government's resignation on 18 June 1997 and the formation of the 55th government did not conform to democratic norms and traditions. The 55th government, though it is hoped to be successful in solving Turkey's major political, social and economic problems, does not seem to have enough political power and a coherent structure within itself.

In a period of major reshuffle in the nation's representation in the Parliament only one and a half years after the general elections through changeover of deputies among political parties (about 20 per cent), the fact that the 55th coalition government could be formed by three political parties with differing views on main economic and social issues and depends on the support of fourth political party and a number of maverick deputies makes an effective governance and decision-making within the coalition very difficult. Restrictive practices and efforts by the government breaching basic right of belief have deepened the political tension and polarization in the country in contrast to the new government's pledge in the beginning to reduce tension and achieve a social peace and harmony in our society.

Also, the unprecedented purge in bureaucracy by the 55th government has caused wariness and hurt the usual working traditions of bureaucracy.

It is, under these circumstances, strongly advised to call for early elections by March 1998 at the latest with a view to reducing political tension, achieving social peace in society by letting nation's will and decision be represented in the new Parliament.

In the economic sphere, the initial statements made and measures taken by the new coalition government have proven to be contradictory with the goals set in the government's program. The first month's performance indicates to the government's lacking a comprehensive and coherent economic stabilization package of bold measures. Markets have been taken by surprise with schocking decisions and statement by the Minister of State responsible for the economy who had claimed in the beginning to pursue only a fine-tuning economic policy.

The new government's initial economic measures seem to aim at removing practice of the outgoing government which had, in fact, brought about positive effects on taking public finance under discipline; i.e. common pooling account of cash inflows and outflows of public enterprises and agencies abolished; newly-born authorities on the valuation and sale of real estate in the government's possession, production mobilization, strategic investments and technological research, etc. dissolved; the indexation system for wage rises to inflation rate for public servants and workers has been announced to be abolished; the Treasury's return to regular domestic borrowing even at times when there is no obligation of repayment has pushed up interest rates on bond market as well as on deposits and loans.

Even though the 55th government announced that it would give top priority to fight with inflation, sudden and sharp price increase of 32 per cent on petroleum prices and its chain effect increases on other public and private sectors' goods have contrarily fuelled inflation even in a dormant period of summer time. Financial markets and goods' markets seem to be in disarray after all and show signs of instable conditions. Upon this, the statement by the Economy Minister that inflation may reach to about 100 per cent this year has poured cold water and led markets to turn perplexed about the government's intentions. After all, inflation is estimated to climb by an 10 - 15 per cent, up to a level of 90 - 95 per cent by the year-end of 1997. Such a result might also be detrimental to the well-being of the vast majority of our people, being in contradiction with the government's pledge on ensuring an even income distribution among people.

On the other hand, there is a general conviction that this fragile coalition government is likely to implement an expansionary economic policy if early elections are called for March 1998. The government's revision of reducing the goal of budgetary revenues by 20 per cent and increasing the goal of budgetary expenditures by 20 per cent, thus setting the estimation of budget deficit at TL 2,400 trillion indicates to this likelihood.

Interest rates have gone up, too, increasing up to 120 per cent from its bottomed-out level of 86 per cent in the beginning of the year, then at 101 per cent during the changeover of the government.

There seems to be a major policy difference between the 54th and 55th governments on tackling the problem of increasing public borrowing requirement. The 54th government tried to solve this problem through searches for new revenues from common pooling of public enterprises' cash inflows and outflows, bringing cash assets of domestic banks held abroad, the system of customs-duty-free importation of cars with the condition of a specified deposit holding in Treasury's coffers, sale of public's real estate inventory and as a last resort, reduced domestic borrowing in bonds and T-bills markets. This policy has lessened public's borrowing requirement and led interest rates to go down sharply and term of maturity to be lengthened. On the contrary, the new 55th government tried to tackle the problem of budget deficit through searches for extra revenues by drastically increasing prices of petroleum products, increased resort to domestic borrowing and widely-mooted tax increases, particularly on VAT rates. This policy has led to increased domestic borrowing, thus interest rates to go up, inflation to go on in a climbing trend and the expectation of devaluation in financial markets. After all, share prices in the Stock Exchange which had made big increases during the formation of the government have fallen sharply. In a nutshell, this unpromising outlook indicates to a departure from production-based and supply-side economic structure and return to interest-based and rent-seeking type economic structure.

In the sphere of foreign policy, the 55th government, in its program, pledged to give priority to strengthening Turkey's ties with the Western World, particularly the European Union and the USA, thus stubbornly seeking full membership in the EU. There was no mention of D-8 integration process in its programme even though it was initiated and headed by Turkey under the outgoing government and had to be kept continuing as a state's policy.

However, the EU Commission's report, which is called Agenda 2000 and was made public only a fortnight ago, has dealt a severe blow to the government's and establishment's hope of joining the club, by excluding Turkey from, even not mentioning its name among 10 candidate countries in the Central and Eastern Europe as well as Baltic Sea region.

In conclusion, we do hope that, by taking into consideration this not-promising outlook in political and economic arena in its first month, the 55th government will embark upon a short-run stabilizing policy in the economy geared to output and export growth, tension-reducing and harmony seeking practices in the divisive social issues until the acutely-needed holding of general elections in March 1998 at the latest.

III- PROPOSALS

1- Need for Political Stability and Reduced Political Tension

Political stability is, first and foremost, a prerequisite for a fast and enduring economic and social recovery in our country. Hence, by taking into account the abnormally changing structure of representation in the Parliament (20 %) and unrelenting and increasing political tension throughout the country, early elections should be held by March 1998 at the latest. If elections could have been held in late Autumn of 1997, the year of 1998 would have been a fresh start having left behind election economics.

In the meantime, the government, as it seems to be pressurized by outside power circles being contrary to democratic traditions, should not insist on imposing laws and regulations on restricting freedoms of thought, expression and belief as basic human rights.

2- Growth And Price 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 in a persistent and determined manner in order to reverse the present inflation trend.

Hence there is a need for a politically strong and stable government which will draw up and implement a **"medium-term stabilization programme"** to be supported by a wide public consensus that the cost of such a programme would be distributed equitably amongst all sections and that the government has necessary political will and determination to fight with inflation.

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.

3- Public Finance and Domestic Borrowing

Government should achieve a balance between its budgetary revenues and expenditures. For this purpose, instead of trying to match expenditures to revenues, a different approach can be adopted, i.e., "revenues matching expenditures." For the government to balance its revenue and expenditures:

(a) Budgetary expenditures, among them, most importantly personnel, interest and investment expenditures should be taken under control.

(b) Excessive burdens of interest and principal debts caused by domestic and external borrowing should be reduced substantially through a **"new restructuring in debt repayments".**

This would entail the following measures to be implemented effectively;

- The existing debt stock must be partially monetized, together with introduction of a 50 percent taxation of interest incomes on T-bills and government bonds which would offset the monetary growth caused by partial monetization. In doing these, the government must act rapidly with determination, not allowing speculative movements in the markets to impact the introduced measures in an adverse manner.
- With the objective of preventing governments from excessive borrowing largely for politically motivated unproductive purposes, constitutional limits must be imposed as to the maximum allowable amount of public borrowing.
- State should reduce investment expenditures by encouraging private sector-and foreign capital-based investments.
- Defence and security expenditures, one of the most important items of which is the expense on the South-Eastern problem should be reduced in parallel with solving that problem.

(c) Increase in budgetary revenues should not be taken as a goal, but as a means in achieving economic equilibria:

- A higher than 12 percent tax on interest income stemming from T-bills, bonds and repo transactions should be imposed.
- Excessive real-estate gains should be taxed whilst annual tax on real-estate should be indexed to inflation rate, but on the basis of a much lower rate.
- Savings of the Turkish nationals working abroad amounting to supposedly 50-60 billion dollars should be encouraged to flow into the country through privatization as well as investment incentives.

4- Restructuring of Foreign Economic Relations

- The government must aim 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 should be employed at the overseas official trade offices of our country. 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.
- 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.

5- Incentive Measures For Investments And Exports

(a) Incentive Policy

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, expot-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.

(b) Investment Incentive Measures:

* Corporations must be exempt from Withholding Tax in their investments made under incentive scheme.
* Tax deductibility must be raised to 200-300 percent in investments undertaken in priority sectors.
* Exemption from tax, stamp duty etc. must also be granted also to investment without export commitment.
* Cash grant applicable in domestic machinery and equipment purchases must be increased from VAT + 10 percentage points, to VAT + 25 percentage points.
* In order to eliminate the existing red-taping in the existing cash grant practice (VAT + 10 percent), VAT must be lifted in investment goods purchase [In the existing practice,

the investor first pays the VAT, and refunds it after 6 months following a lengthy and costly legal procedure).

* 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 sourced from the Seniority Compensation Fund 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.
* State lands must be allocated to investors free of charge, infrastructure (on these lands) must be built by the government. However government must ensure and get necessary guarantees so that investments on these lands must be finalized within a specified period of time.
* 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 offices 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 municipalities from industrial plants in Organized Industrial Zones (enjoying investment incentives) must be abolished.

* Exemption from Import Fund must be applied on a selective basis for imports from non-EU countries.

* Preferential incentives must be introduced in trade relations with member countries of Developing-8 (D-8), the Black Sea Economic Cooperation, the Economic Cooperation Organization (ECO) and with Central Asian Muslim States.

* Some important exemptions and financing support must be ensured in joint-venture investments with Central Asian Muslim Republics through bilateral agreements.

c) Export Incentive Measures:

* Export growth (both in absolute terms and as percentage of total turnover) must be encouraged through tax reduction, reduced finance and insurance premium cost.

* 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 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.

* 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).

* 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 6 years, causing a total foreign income loss of 20 billion US Dollars, 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.

* Permanent Turkish trade centers must be established by the Undersecretariat for Foreign Trade in countries where Turkey has high export potentials.

* Voluntarily-based businessmen's organizations should be encouraged to be specialized on certain groups of countries.

6- Tax Reform

We do hope that the 55th government, in contrast to some strong rumours of drastic tax increases on VAT will comply with its pledge of not imposing new taxes in its programme. On the other hand, the present tax system must be reformed with the objective of encouraging productive activities, "discouraging speculative and rent-seeking activities and reducing the size of the unrecorded economy. The measures to be taken within the framework of this tax reform are listed below:

* The existing VAT (Value Added Tax) rates are too high, thus stimulates unrecorded economy. VAT rates should be reduced to 1 % for basic goods and education, 6 % for other goods while luxury goods should be applied a much higher VAT rate. The new government's consideration of increasing VAT rates with a view to raising tax revenues is fundamentally wrong and may have backlash effect of reduced tax revenue due to VAT avoidance by customers in sales.
* Income and corporate tax rates must be reduced. Also, inflation-based profits must be exempted from taxation in order to encourage new investment and increased employment.
* Government should not give up the previous government's agreement with trade unions to index wage rises to inflation with a view to maintaining real purchasing power of wages.
* A tax-free development method should be developed. Also, in some preferential sectors (i.e. to encourage high technology-based investments).
* Interest income on Treasury Bills, government bonds and repo transactions must be subjected to taxation.
* Inflation Accounting must be introduced, tax policy must encourage employment of equity capital. Under the present system incomes derived from equity (own capital funds) are subjected to full taxation, whilst interest expense on borrowed funds are partially tax deductible.
* Advance payment of tax should be suspended.
* Tax red-taping should be simplified with a major overhaul of hundreds of different tax practices.
* Tax on real-estate must be adjusted every year in parallel to the inflation rate; tax on real estate payable by the seller and the seller must be reduced to 1 percent from the existing 4 percent. Real profits (nominal profit adjusted for inflation) earned on sale of real estate must be subjected to taxation.

7- Privatization

Privatization must be materialized rapidly subject to a certain timetable. However, **the following criteria must be observed in future privatization practices:**

* Revenues generated from privatization must also be utilized for productivity improvement and rationalization of production, whilst being used for reducing the existing public debt stock.

* 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 foreign capital in the privatized state economic enterprises, excepts in those sectors 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 citizens working abroad should be encouraged to be channelled into privatization in the form of "permit for purchasing share" instead of "import permit for car or durable goods" which is the case at present.

8- Labour Relations

(a) Reform in Social Security Institutions:

The existing social security institutions are at the edge of bankrupcy, with the estimated deficit of as high as TL 550-600 trillion for the year 1997. With the purpose of overcoming severe difficulties currently faced by these institutions, the following measures are recommended:

* Retirement age must be raised to 55 for women and 60 for men.

* Insurance premium ceiling must be raised.

* The existing three Social Security Institutions must be 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.

(b) Reform in Minimum Wage.

* Given the unbearably high cost of living in Turkey, it is most appropriate that the minimum wage has been increased just recently by the new coalition government from TL 17 million to TL 35.5 million (a 108 percent rise). However, for the sake of an enduring improvement in minimum wage;

* Income tax rate on the minimum wage must be reduced from 25 percent to 10 percent.

* Stamp duty and "Fund for the Encouragement of Saving" on minimum wage income must be abolished.

* The minimum wage must be revised (adjusted) bi-annualy, in parallel to the change in SIS's consumer price index.

(c) Establishment of "Seniority Compensation Fund"

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

9- Financial Sector

* Necessary regulatory arrangements should be enacted for financial institutions to provide a certain percentage of their funds for venture-capital investments and another certain part for medium-to lon-term investment credits.

* Public banks' allocation of low-cost funds for Small-and Medium-Sized Enterprises should be drastically increased.

9- Customs Union and Relations with the European Union

Regarding the detrimental effects of the Customs Union against Turkey's interests and the EU's indifferent approach to Turkey in the framework of the new enlargement wave towards Eastern Europe,Turkey should ask for a renegotiation of the Customs Union on the topics of bilateral trade functioning against Turkey, the EU's not extension of financial aid, anti-dumping practices on some Turkish exports.

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Under the present circumstances, Turkey, already having encountered disadvantageous results, has nothing to lose, but to force the EU to act in accordance with the Agreement and committments. As a more realistic policy to correct the deficiencies on Turkey's side in bilateral relationship to a more equal footing and strengthen it in economic sphere, Turkey should negotiate with the EU to keep bilateral relationship on the basis of a Free Trade Area Agreement on the industrial goods.

MÜSİAD'S ECONOMIC FORECASTS FOR 1997 (End of Year)

Table 50: MÜSİAD's Economic Forecasts For 1997 (End Of Year) (*)

	MÜSİAD FORECAST
GNP (GROWTH RATE)	5.5-6.0 %
INFLATION RATE	90-95 %
EXCHANGE RATES	
TL/US DOLLAR (year-end)	200,000
TL/D. MARK (year-end)	110,000
EXPORTS (MILLION US DOLLARS)	27,000
IMPORTS (MILLION US DOLLARS)	47,000
TRADE DEFICIT (MILLION US DOLLARS)	-20,000
CURRENT ACOUNT DEFICIT (MILLION US DOLLARS)	-4,500
CONSOLIDATED BUDGET DEFICIT (TRILLION TL)	-1,700
PUBLIC DOMESTIC DEBT STOCK (TRILLION TL)	5,800-6,000

(*) Revised forecasts in the light of the 55TH COALITION GOVERNMENT's program, which took office in July 1997.

(1) Under the assumption that the new government would not deviate from the expenditures amount allocated in the budget and would not be able to make progress on extra revenues from privatization and sales of public real estate.

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