THE TURKISH ECONOMY 1995

MÜSİAD
INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION

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FOREWORD

The year 1994 was an exceptional and unprecedented episode in the Turkish economic history. Unprecedented in the sense that, both the highest annual inflation rate, as high as 150 percent, and the worst GNP performance, minus 6 percent growth rate, were experienced for the first time and in the same year throughout the entire Republican history since 1923. Interestingly enough, the Turkish society became faced with a very severe economic and financial crisis in 1994, following a year in which the Turkish economy had enjoyed the highest international credibility, seemingly highest-ever standart of living, fast GNP growth and positive developments in the areas of investment and foreign capital.

Based on the latest available figures, this report summarizes the major developments and trends observed in the Turkish economy since the beginning of 1994, and makes some critical assessments. This is also the first report published by MÜSİAD in the English language, with the objective of providing a reliable and objective reference of the Turkish economy for international circles taking interest in Turkey.

The report is written by MÜSİAD's Economic Advisor Dr. Adnan Büyükdeniz who also regularly contributes to MÜSİAD's economic studies.

Hoping that this report would prove to be a useful reference about the recent trends and near future prospects of the Turkish economy, MÜSİAD plans to continue conducting occasional studies on the critical economic and social topics, in addition to its periodic reports on the Turkish economy.

Yours Faithfully,

Erol Yarar
President, MÜSİAD

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SUMMARY

As against 4.5 percent GNP growth targeted in the 1994 Economic Programme, in 1994 the Turkish economy experienced the worst GNP performance througho-ut the entire Republican period since 1923. Following considerably high growth rates in 1992 and 1993, respectively 6.4 percent and 7.6 percent, mainly resultant from over-expansion of final consumer demand and unprecedented increase in imports, a minus 6 percent growth was recorded in 1994. Negative business expectations created by the severe financial crisis experienced during first half of the year, contractionary demand management policies implemented as part of the April 5 Austerity Package, exorbitantly high real interest rates, the negative impact of incomes policy and the three-digit inflation on the purchasing power of masses, have had the combined effect of reducing aggregate effective demand and thus leading to a notable fall in national output.

It is worth noting that the Turkish economy recorded a negative growth in a year during which there was an overall expansion in the world economy. According to the IMF figures, negative growth rates were recorded only in those economies which are classified as "transition economies". Negative growth performance of the Turkish economy amidst a positive world economic conjunture was mainly as a result of "seeking economic stability in a shrinking economy". In an economy (like that of Turkey) which has been experiencing an unstable but somehow continuous growth process for many years, "stability within negative growth" seems to be an economically more costly approach than "stability within some moderate growth". Resumption of a sustainable growth process shall probably be more cumbersome and time-taking.

The economic slump in 1994 led to a dramatic fall in capacity utilization rate in the Turkish manufacturing industry. The capacity utilization rate, falling as low as to 60 percent (the lowest level in recent years), began picking up gradually only in the last quarter of 1994. The reduced capacity utilization mainly stemmed from insufficent domestic demand which was not fully compensated by increase in export demand on domestic output.

In 1994, investment expenditures as well as final consumption demand were adversely effected from the financial crisis. Private investment expenditures were down by around 9 percent in real terms, whilst the decline in real public investment expenditure was as much as 35 percent, largely as a result of budgetary cuts in public investment expenditure. As a result of the visible slowdown in investment activity, the ratio of private investment expenditure to GNP fell from 18 percent in 1993 to around 16.5 percent in 1994, whilst that of public investment expenditure dropped to 5.3 percent from 7.15 percent in the previous year.

Statistics disclosed by the State Institute of Statistics indicate that, the notable slowdown in production and investment activities during 1994 had impacted the employment situation quite negatively, with the resultant rise in open unemployment to as high as 10.5 percent. Estimates based on the SIS statistics show that the total of open unemployment and under-employment has risen from 14.5 percent of the total labour force in 1993, to 19.8 percent in 1994 mainly as a result of fall in industrial output and decline in productive investments especially in job-creating manufacturing industry.

Total resources available to the economy, following a rapid expansion in the previous year resultant from high GNP growth and large influx of short-term funds from abroad, declined considerably in 1994 largely as a result of minus GNP growth and partly due to net outflow of funds. Whilst the public sector continued to be a "deficit sector" also in 1994, public resource deficit (the difference between public expenditure and public disposable income) is estimated to have declined considerably (around 40 %) mainly as a result of real decline in public expenditure, and partly due to introduction of some new taxes. Private sector's surplus, on the other hand, is estimated to have risen by around 30 percent in real terms as a result of declining final consumption and investment expenditures.

The 1995 Economic Programme based on the assumption of a 5 percent growth in total effective demand, projects a 4.2 percent growth in Gross Domestic Product (GDP) and a 4.4 percent growth in GNP. The projected growth in GDP would be achieved as a result of 2.5 percent growth in agricultural output, 4.9 percent growth in industrial output and 4.3 percent growth in services output. The first six month output trends indicate to the fact that there has been a quicker -than- expected recovery in the real economy following the relative stability now restored in the financial markets. The manufacturing industry production index (base 1986=100), falling to as low as 121 at the peak of the crisis last year (May 1994), has been on a steadily rising trend since February of the current year and has reached to 144.7 by April. Capacity utilization rate has also been on a rising trend, almost reaching to the pre-crisis level by May 1994 (80 Percent). Given the recovery of industrial production, together with some expected growth in agricultural output, it is reasonable to expect some real output growth this year, upon the negative growth of as high as 6 percent in the previous year. Still, the governments projected percent 4.4 GNP growth for the year appears to be a somewhat ambitious target to achieve, unless the present strict fiscal and monetary stances loosen in the second half of the year for political reasons.

The 1995 Economic Programme projects some increase in saving and investment propensities for the current year. Whilst the Programme sees revival of consumption and investment demand, public sector's resource gap is planned to remain at the previous year's level. The programme also expects some surplus in the current account, indicating that there would be no net foreign resource utilization during 1995. However, the first 5-6 months developments show that the Turkish economy has again begun utilizing net resources from abroad.

Parallel to the resumption of positive output growth and increased investment in manufacturing industry, open unemployment rate is expected to fall to around 9.2 percent, from 10.5 percent in 1994.

In 1994, the most important improvement in the Turkish economy took place in the area of balance of payments. As a result of substantial TL depreciation (around 163 percent against US Dollar and 195 percent against DM) and negative GNP growth, trade deficit was reduced from all-time high 14.1 billion US Dollars level in 1993, to around 4.2 billion US Dollars. The current account showed a similar improvement, yielding a 2.6 billion US Dollar surplus as against the record deficit of 6.4 billion US Dollars in 1993.

The capital account which had yielded a surplus of around 9 billion US Dollars in 1993, showed an opposite development in 1994 largely as a result of substantial short-term capital outflow. Short-term capital funds ("hot money") which were attracted into the country in the previous years by way of high interest rate differentials and were used in financing current account deficits, outflew from Turkey in a relatively short period of time, further aggrevating the financial crisis.

Despite a huge foreign debt servicing and minimal use of foreign funds during 1994, Turkey could achieve a substantial rise in its international reserves, with the Central Bank foreign exchange reserves rising from 3 billion US Dollars in April 1994, to around 12.8 billion US Dollars by May 1995. Similarly, foreign exchange reserves held with commercial banks were no less than 9 billion Dollars by May 1995. The substantial increase in official foreign exchange reserves has been partly as a result of reversed currency substitution (the public exchanging its foreign currency holdings for Turkish Lira) and partly due to inflow of short-term capital funds through commercial banks' borrowing from abroad.

Despite the crisis condition, Turkey was able to achieve considerable foreign debt servicing. Short-term foreign debts declined from 18.5 billion US Dollars in 1993, to 1.3 billion US Dollars; as a result, the share of short-term foreign debts to total foreign debts declined from 27.5 percent, to around 17 percent in 1994.

One of the most notable developments in the Turkish economy during the first half of 1994 was the substantial volatility in the foreign exchange market and the resultant high rate of depreciation of TL against foreign currencies. Expectations of a large-scale adjustment in the overvalued exchange rate, the collapse of the İstanbul Stock Exchange, excess liquidity in the market and speculative movement of funds between the financial markets, have had the combined effect of creating drastic fluctuations and "over-shooting" in the exchange rate in the first 3-4 months of 1994.

Turkish exports increased by around 23 percent in the first quarter of 1995 as compared to the corresponding period of 1994, totalling 4.826 billion US Dollars, Imports, on the other hand, increased by 16 percent reaching to 6. 625 billion US Dollars. The government targets a trade deficit of 6.520 billion US Dollars for 1995.

However; given the first three month trends in the trade account, overvaluation in Turkish Lira roughly since the beginning of 1995 and the gradual recovery of the economy, all suggest that this target will be difficult to achieve and the trade deficit is high likely to reach to around 8.5 billion US Dollars for the whole year.

The 1995 Programme projects a 670 million US Dollar surplus in the capital accounts. However, the capital account showed a larger-than-expected surplus (around 1.770 billion US Dollars) in the first quarter of 1995, largely as a result of substantial inflow of short-term capital funds in response to huge interest rate differential.

In 1995, the government expects a further decline in foreign debts and this is expected to be achieved mainly by reducing medium and long term debts. The initial official projections estimated total external debt stock to decline to 62.7 billon US Dollars, but the substantial depreciation of US Dollar against the German Mark and the Japanese Yen in international markets since the beginning of 1995, has led to an increase in Turkey's foreign debt stock in US Dollar terms, to 71.5 billion US Dollars. The declining trend of short-term foreign indebtnedness in 1994 seems to have reversed during 1995, especially as a result of increase in commercial banks' borrowing from international markets. The Turkish government as well as some leading Turkish commercial banks are now able to borrow from foreign markets at acceptable spreads.

Whilst high inflation has been a matter of major policy concern in Turkey for many years, in 1994 the Turkish economy experienced the highest inflation rate throughout the entire Republican period. For the first time since 1980, the inflation rate climbed to three digit levels, the rate of increase in wholesale prices was as high as 149.6 percent, whilst the consumer prices rose by 125.5 percent for the whole year. The annual percentage change in the wholesale price index, after rising to as high as 156.8 percent in the first month of 1995, displayed a sharp fall in the months of April and May; accordingly, annual inflation rate as measured by the wholesale price index fell from 144.3 percent in March, to 91.2 percent in April and to 78.5 percent in May, whilst relatively lower monthly inflation rates are expected, during the summer months, mainly due to reasonal factors, a further decline in annual inflation rate seems unlikely until the end of the year since this would request very low monthly inflation rates in the remaining months of the years. The annual inflation rate is highly likely to fluctuate within the 80-90 percent band during second half of the year.

Domestic borrowing has continued its rapid growth also in 1994, as a result of refinancing of the existing debt stock and higher-than-planned government budget deficit. The net domestic debt stock has risen from TL 356.5 trillion at the end of 1993, to around TL 785 trillion (provisional) by the end of 1994, meaning an approximately 120 percent increase in just one-year. The rising trend of domestic debt stock continued also into 1995, reaching TL 1,107 trillion by the end of June '95, thus far exceeding the goverment's target of TL 1,047.3 trillion for the year-end.

The April 5 Austerity Package put into effect following the financial crisis during first quarter of 1994, emphasized restrictive demand management policies. As a result of implementation of the revised budget, government budget revenues increased by around 115 percent against 85 percent increase in budget expenditures. The targeted budget deficit (TL 98 trillion) was however exceeded by a considerable margin, reaching to TL 145.9 trillon by the year-end. Failure to realize the initial budget deficit target was mainly due to higher-than-expected increase in interest payments both on domestic and foreign debt stock. As a result of relatively tight fiscal stance the ratio of budget defecit to GNP was reduced from 6.7 percent in 1993, to 3.8 percent in 1994.

Similarly; the ratio of public sector borowing requirement (PSBR) to GNP declined to 8.2 percent in 1994, from 11.7 percent in 1993. These improvements were however partly due to minus 6 percent growth in GNP in the same year.

The 1995 Revised Budget targets a budget deficit of TL 218.8 trillon, resultant from 83 percent increase in budget revenues and 78 percent increase in budget expenditure. According to the revised budget targets, the ratio of budget deficit to GNP would further fall to 3.2 percent, and the PSBR/GNP ratio to 5.6 percent for the year.

In the first four months of 1995, the budget revenues increased by around 115 percent as compared to the corresponding period of 1994 whilst the budget expenditures were up by almost 120 percent, resulting in a budget deficit of TL 128.3 trillion. Interest expenses on domestic and foreign debt increased by 288 percent and

93 percent, respectively in contrast to a real as well as nominal fall in government investment expenditure. The first four month trends in the budget performance suggest that the targeted budget deficit will probably be exceeded by the year-end, mainly due to faster than planned increase in government transfer expenditures.

Resulting mainly from rapid growh of public debt stock, the share of interest payments in total budget expenditures has been on a rising trend. Whilst the government expect the share of interest payments to decline to 29 percent in 1995, the first five-month trends indicate that this share will continue to rise also in the current year. The average interest rate payable on one-year government bonds has risen substantially during the past year, from 86 percent in 1993, to 113 percent in 1994. The government targets an average interest rate of 70 percent for the year, but the first five month trends indicate that the government still continues to borrow at higher-than-targeted interest rates.

As a result of refinancing of the existing debt stock and higher-than-planned government budget deficit, public domestic borowing has continued its rapid growth trend also in 1994. The net domestic debt stock has risen by around 120 percent in 1994, reaching to nearly TL 800 trillion by the year-end. Whilst the government projects net domestic debt stock not to exceed TL 1,047 trillion in 1995, the actual trends in the first half of the year indicate to a potentially higher level of domestic debt stock at the end of the year. The ratio of domestic debt to GNP is officially expected to fall from 20.1 percent in 1994, to 15.1 percent in 1995.

In the months following the April 5 Measures, the Turkish Treasury put more emphasis on domestic borrowing and raised its borrowing rates substantially in order to tap large sums from the market. Financial sources obtained through increased borowing were utilized in reducing Central Bank Advances to the Treasury. The liquidity shortage resulting from tight monetary policy was later eased by Central Bank buying of foreign currency (US Dollars) against the local currency which led to re-building of Central Bank foreign exchange reserves to the pre-crisis level, as well as preventing the exchange rate to go below US Dollar 1 = TL 30,000 level.

The monetary control which had been achieved with relative success during second half of 1994, seem to have loosed to some extent since the begining of the current year. Main monetary magnitudes indicate to a faster monetary expansion in the economy during 1995 and the Turkish Central Bank has been interfering in the money market from time to time and draining the excess liquidity in an effort to eliminate potential instabilities in the money and foreign exchange markets.

Following the April 5 Measures, raising deposit interest rates to unprecedented levels and introducing additional tax advantages for Turkish Lira bank deposits could not at the begining restore confidence in the local currency. This was partly due to the bankrupcy three small-scale commercial banks which created inconfience in the overall banking system and the withdrawal of foreign currency deposits from the commercial banks based on the rumours that the government would soon convert all foreign curency deposits into the local currency. However, the government soon became able to restore confidence in the banking system as the Central Bank stepped in to support a number of banks which were facing liquidity problems and the government imposed full state coverage (deposit insurance) for TL saving deposits.

In the first four and a half months of 1995, total TL deposits displayed a faster growth when compared to the corresponding period of 1994. A positive development took place in the composition of total bank deposits whereby the share of TL deposits rose from 45 percent at the end of 1994, to around 50 percent by mid-May 1995, partly as a result of slower depreciation of TL which reduced demand for foreign currency as an investment instrument, and partly as a result of reversed currency substitution process in the recent months.

In 1994, commercial banks were seen less willing in providing credit funds to the corporate sector under the crisis environment, but rather preferred investing in zero-risk, high-yield, tax-exempt government borrowing instruments. The credit stock seems to have been expanding at a higher rate in 1995 as compared to the previous year. Commercial banks' credits (mainly short-term, general purpose commercial credits) expanded by around 35 percent in the first four and a half months af 1995, aṣ compared to 7.2 percent in the previous year. The Central Bank's direct credits on the other hand grew at a slower rate mainly as a result of repayment of Treasury Advances. Market interest rates have been mainly on a declining trend in the recent months mainly as a result of slow-down in the annual inflation rate to around 80 percent (following three-digit levels since April 1994), abundence of Turkish Lira funds and the gradual decline in government borrowing rates.

CHAPTER 1

GROSS NATIONAL PRODUCT, INVESTMENTS AND LABOUR MARKET

I. MACRO-EQUILIBRIUM OF THE ECONOMY

Total resources available to the economy displayed a considerable contraction in 1994, following a rapid expansion in the previous year resulting from high GNP growth and large influx of foreign funds. The contraction in total resources was largely due to the decline in GNP (minus 6 percent growth in GNP), and partly to net outflow of funds.

On the aggregate demand side; private final consumption, having recorded an 8.4 increase in 1993, declined by around 5.4 percent in real terms. Similarly; as a result of the contractionary fiscal policy implemented during second half of 1994, public final consumption also contracted by around 3.5 percent (as against the 5.4 percent increase in 1993). The substantial decline in domestic demand as a result of a sharp decline in purchasing power and the overriding market uncertainties, was the main reason for the considerable slowdown (contraction) in the economy. Tha decline in domestic demand largely stemmed from the sharp decline in demand for consumer durables. Paralel to the sharp decline in final consumption demand, total fixed capital investment expenditures also showed a real decline in the year 1994, recording a minus growth of 15.9 % as against the considerable growth of 24.9 % in the previous year. Whilst the private investment expenditures showed a 9 percent decline in real terms, the decline in public investment expenditures was more notable (around 35 percent decline in public investments as against the 3.4 percent growth in the previous year). Public investment expenditure was one of the major budget items being most adversely affected from the April 5 Austerity Package.

The public and private sectors' inventories declined in 1994, mainly as a result of sharp decline in imports, shrinking production and notable increase in exports. The increase in inventories which had reached to around 1.8 percent of the GNP, declined to 1.4 percent of the GNP in 1994.

Public deficit (the difference between public expenditures and public disposable income) is estimated to have declined by around 40 % in 1994, as a result of a decline in public final consumption expenditures and especially in public investment expenditures. Private sector's surplus, on the other hand, is estimated to have risen by around 30 % in real terms, as a result of declining consumption and investment expenditures.

The ratio of public dissaving to GNP is seen to have declined from -2.8 % in 1993 to-1.7 % in 1994. The private saving ratio (private savings/GNP) on the other hand, declined from 24.7 % to 23 % in 1994 under the recessionary conditions.

TABLE 1) SAVINGS AND INVESTMENT PROPENSITES (%)

	1994[1]	1993	1992
Private Savings/GNP	23.0	24.7	22.6
Public Savings/GNP	-1.7	-2.8	-1.0
Total Domestic Savings/GNP	21.3	21.9	21.6
Private Fixed Investment/GNP	16.7	17.9	15.2
Public Fixed Investment/GNP	5.3	7.2	7.3
Total Fixed Investments/GNP	22.0	25.1	22.5

(1) Estimate

The demand for fixed capital investments was also affected negatively during 1994; as a result, the ratio of total fixed investments to GNP declined from 25 percent in 1993, to 22 % in 1994. Whilst both public and private investments declined in real terms, the decline was more notable in public investments due to contractionary fiscal and monetary policies of the April 5 Austerity Package. The 1995 Economic Programme (the "Transition Programme") envisages a 4.4 percent growth in GNP and 430 million US Dollars surplus in the current account. The programme projects a 3.1 % increase in public consumption, 2.1 % increase in private consumption and 2.3 % increase in total final consumption. A 5 % increase in public fixed investments and 6.2 % increase in private fixed investments are amongst the Programme's targets for the year 1995.

In 1995, whilst the public sector gap (deficit) is expected to remain at the previous year's (1994) level, private sector's surplus is projected to show some decrease due to expected rise in consumption and investment expenditures for the year.

The program also envisages some increase in savings and investment propensities during 1995.

In sum, whilst the 1995 Economic Programme sees revival of consumption and investment demand, the public sector's gap is planned to be maintained at the previous year's level, especially by way of raising public disposable income. The expected surplus in the current account indicates to the expectation that no net foreign resources shall be utilized during 1995.

II. GNP PERFORMANCE

Against 4.5 percent GNP growth envisaged in the 1994 Economic Programme, in 1994 the Turkish economy experienced the worst GNP performance since the foundation of the Republic in 1923. Following considerably high growth rates in 1992 and 1993, respectively 6.4 % and 7.6 %, a minus 6 percent growth was recorded in 1994. Gross National Product which recorded a 4.0 % growth in the first quarter of 1994, declined by 9.7 percent in the second quarter. The declining trend of GNP also continued into third and fourth quarters of the year; as a result GNP displayed a 8.6 % and 6.8 % decline in the third and fourth quarter, respectively. **The contractionary fiscal and monetary policies of the April 5 Package,**

uncertainties as to the near and medium course of the economy, exorbitantly high real interest rates and the negative impact of the three digit inflation on the purchasing power of masses, were amongst the major reasons for negative growth rates recorded in the second, third and fourth quarters of 1994.

TABLE 2) SECTORAL GROWTH RATES[1]
(at 1987 producers' prices)

	1994						
	I	II	III	IV	TOTAL	1993	1992
Agriculture	0.6	-0.4	-4.9	15.1	-0.3	-1.3	4.3
Industry	6.4	-11.9	-8.3	-7.3	-5.7	8.2	5.9
Manufacturing Industry	6.5	-15.4	-10.5	-9.1	-7.6	9.3	5.8
Services	3.2	-10.2	-10.5	-10.5	-7.6	10.8	7.3
GNP	4.0	-9.7	-8.6	-6.8	-6.0	8.1	6.4

(1) Percentage change with respect to previous year.

Whilst the agricultural sector recorded a minus 0.3 percent growth (as against the minus 1.3 percent growth in 1993), manufacturing output experienced a considerable contraction, declining by around 7.6 percent (as against a growth rate of 9.3 percent in 1993). Services output showed a parallel decline, recording a minus 7.6 percent growth in 1994 (as opposed to 10.8 percent positive growth in the previous year.)

The economic slump resulting from the financial crisis led to a dramatic fall in capacity utilization rate in the manufacturing industry. Capacity utilization rate fell as low as to 60 percent, picking up gradually in the latter half of the year. The low capacity utilization was mainly as a result of insufficient domestic demand, which was not fully compensated by increase in export demand.

TABLE 3) GROSS NATIONAL PRODUCT[1]
(At Current Producers' Prices, Billion TL)

SECTORS	1994	1993
AGRICULTURE	610,632	305,525
INDUSTRY	1,019,767	485,672
Mining	54,099	21,814
Manufacturing	853,488	412,408
Energy	112,181	51,450
CONSTRUCTION	263,720	145,834
TRADE	752,953	368,385
TRANSPORTATION and COMMUNICATION	514,375	236,860
FINANCIAL INSTITUTIONS	115,011	84,453
OWNERSHIP OF DWELLING	127,018	68,178
BUSINESS and PERSONAL SERVICES	143,431	71,449
(-) IMPLICIT BANK SERVICE CHARGES	163,471	75,654
GOVERNMENT SERVICES	344,530	203,922
PRIVATE NON-PROFIT INST.	9,070	6,015
IMPORT DUTIES	135,892	81,229
GROSS DOMESTIC PRODUCT	3,883,827	1,981,867
NET FACTOR INCOMES FROM ABROAD	19,474	15,486
GROSS NATIONAL PRODUCT	3,903,301	1,997,353
AVERAGE EXCHANGE RATE (US$/TL)	29,704	10,985

(1) New GNP Series
SOURCE: State Institute of Statistics

The 1995 Economic Programme, based on the assumption of a 5 percent growth in total effective demand, envisages a 4.2 percent growth in GDP and 4.4 percent growth in GNP. According to the Programme, agricultural output is expected to record a 2.5 % growth, whilst industrial and services output are projected to grow by 4.9 percent and 4.3 percent, respectively.

TABLE 4) GNP GROWTH RATE[1]
(At 1987 Producers' Prices)

(Percentage Change)

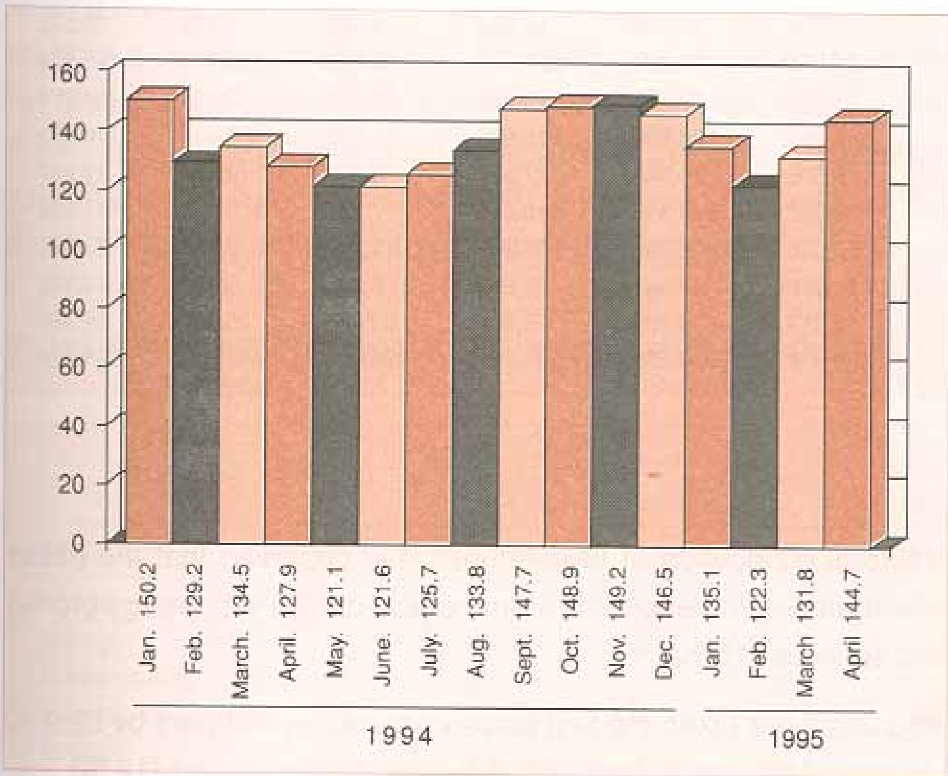
SECTORS	1994	1993	1993
AGRICULTURE	-0.3	-1.3	4.3
INDUSTRY	-5.7	8.2	5.9
Mining	8.0	-6.4	0.3
Manufacturing	-7.6	9.3	5.8
Energy	3.4	8.9	11.8
CONSTRUCTION	-2.0	7.9	6.2
TRADE	-7.5	11.6	6.9
TRANSPORTATION and COMMUNICATION	-2.0	10.8	8.1
FINANCIAL INSTITUTIONS	-1.5	-0.4	2.1
OWNERSHIP OF DWELLING	2.8	2.8	2.5
BUSINESS and PERSONAL SERVICES	-4.2	6.9	5.5
(-) IMPLICIT BANK SERVICE CHARGES	-1.8	-0.6	-2.3
GOVERNMENT SERVICES	0.8	1.8	3.4
PRIVATE NON-PROFIT INST.	-2.5	3.0	2.2
IMPORT DUTIES	-35.2	32.8	11.3
GROSS DOMESTIC PRODUCT	-5.4	8.0	6.0
NET FACTOR INCOMES FROM ABROAD	-61.0	14.6	72.5
GROSS NATIONAL PRODUCT	-6.0	8.1	6.4

(1) The New GNP series
SOURCE: SIS

Some leading indicators suggest that there has been a gradual recovery in the real economy following restoration of stability in the Turkish financial markets since the second half of 1994. The industrial production index (1986=100), after having fallen to as low as 128 in May 1994, has risen to 153.6 in April 1995. Similarly, manufacturing industry production index, going as low as 121 in May 1994, has been on a rising trend reaching to 144.7 by April 1995. Capacity utilization rate in the manufacturing industry is also on an increasing trend, climbing up to 80 percent by May 1995. **Revival of industrial production, together with expected rise in agricultural output, indicate that there will be some real output growth during 1995. Still, the government's GNP growth tar-**

get of 4.4 percent for the year 1995 appears to be a somewhat ambitious target to achieve.

GRAPHIC 1) Manufacturing Industry
Production Index (1986=100)



III. INVESTMENTS

In 1994, private investment expenditures is estimated to have declined by around 9 percent in real terms, whilst the decline in public investment expenditures was much more drastic (around 35 percent). As a result, the ratio of private investment expenditures to GNP fell from 18 percent in 1993, to around 16.5 percent in 1994, whilst the ratio of public investment expenditures to GNP dropped to 5.3 percent, from 7.15 percent in the previous year.

TABLE 5) SECTORAL DISTRIBUTION OF FIXED CAPITAL INVESTMENTS
(Current Prices, Billion TL)

SECTORS	1995[2] PUBLIC	1995[2] PRIVATE	1995[2] TOTAL	1994[1] PUBLIC	1994[1] PRIVATE	1994[1] TOTAL
Agriculture	33,646	28,794	62,440	21,303	18,962	40,265
Mining	724	11,799	19,522	4,762	7,770	12,532
Manufacturing	11,578	209,977	221,555	5,703	140,276	145,979
Energy	56,850	13,500	70,350	31,973	2,791	34,764
Transportation	87,361	128,600	215,962	69,550	76,641	146,191
Tourism	5,608	21,945	27,553	3,309	16,178	19,487
Housing	6,852	506,358	513,210	7,392	339,910	347,303
Education	28,575	9,363	37,938	18,025	5,545	23,571
Health	11,266	14,641	25,907	6,896	9,410	16,306
Other Services	55,519	38,285	93,804	29,463	25,527	54,990
TOTAL	304,978	983,252	1,288,240	198,376	643,012	841,388

(1) Provisional
(2) Projected
SOURCE: SPO

Examining the sectoral distribution of investments, it is observed that the public investments concentrated in transportation/communication (35 %), energy (16 %) and in other public services (15 %) .

Investments in housing have taken the first place in private investment by 52.9 % share, followed by manufacturing industry (21.9 %) and transportation (12 %).

TABLE 6) PUBLIC AND PRIVATE SECTOR INVESTMENTS
(As percentage of GNP)

YEAR	PUBLIC	PRIVATE
1990	12.50	9.80
1991	12.20	10.40
1992	10.20	13.00
1993	7.15	18.00
1994[1]	5.32	16.70
1995[2]	5.40	17.00

(1) Provisional
(2) Programme
SOURCE: SPO

The 1995 Economic Programme projects a 53 % nominal and 6.1 % real growth in total fixed investments. Accordingly; public fixed investments are expected to increase by 5.9 % in real terms, private fixed investments by 6.2 % and total fixed investments by around 6.1 %. Investment in transportation sector is projected to take the first place in public investments (28.7 percent share), followed by energy (18.6 percent) and other public services (18.2 percent). Whilst agriculture is expected to take an 11 percent share in total public investments, shares of education and manufacturing industry are projected to remain at 9.3 % and 3.8 %, respectively. Investment in housing is expected to continue taking the biggest share in private investment (51.5 percent), followed by manufacturing industry (21.3 percent) and transportation (13 percent).

TABLE 7) INVESTMENT INCENTIVE CERTIFICATES BY SECTORS
(JAN-APRIL 1995)

SECTOR	Number of Inv. Incentive Certificates	Amount of Total Investment (Billion TL)
Agriculture	12	3,316.00
Mining	29	2,377.00
Manufacturing Industry	444	132,508.00
Energy	4	841.00
Services	202	38,944.00
TOTAL	691	177,886.00

The 1995 programme expects the private investment/GNP ratio to rise to 17 percent, whilst the ratio of public investment to GNP to remain at around 5.4 percent.

The statistics disclosed by the Treasury Undersecretariat indicate that in the first four months of 1995, there has been a substantial increase in the number and amount of investment incentive certificates granted to investors. Investments under investment incentive scheme have risen by around 178 percent in the first four months of the current year as compared to the corresponding period of 1994. In the first four months of 1995, investments under incentive scheme has reached to around 177.8 trilyon TL in 691 projects. Around 75 percent of these invesments was in the form of completely new investments. These investments are expected to create nearly 42,000 additional jobs. Investment in the current year concentrate in manufacturing industry, especially in textiles and ceramics.

IV. LABOUR MARKET

TABLE 8) THE LABOUR MARKET
(000 Persons)

	1995[3]	1994[2]	1993
SUPPLY OF LABOUR	20,603	20,424	20,232
DEMAND FOR LABOUR (EMPLOYMENT)	18,716	18,235	18,702
UNEMPLOYMENT	1,887	2,139	1,530
OPEN UNEMPLOYMENT RATE	9.2	10.5	7.6
UNDEREMPLOYMENT RATE	8.2	9.3	6.9
TOTAL UNEMPLOYMENT RATE[1]	17.4	19.8	14.5

(1) Total of open unemployment and underemployment
(2) Provisional
(3) Projected
SOURCE: SIS, SPO

The SIS statistics indicate to the fact that the economic crises experienced during 1994 affected the employment situation adversely with the resultant rise in unemployment rate. The supply of labour is estimated to have risen by around 1 percent whilst the demand for labour (employment) falling by around 2.2 percent. As a result, open unemployment rate rose from 7.3 percent in 1993 to around 10.5 percent in 1994. It is estimated that under the crisis conditions underemployment rate has also risen, reaching to around 9.3 percent of the total labour force. Estimates based on the SIS statistics indicate that the total of open unemployment and underemployment has risen from 14.5 percent of the total labour force in 1993, to 19.8 percent in 1994.

TABLE 9) SECTORAL DISTRIBUTION OF EMPLOYMENT
(Percentage Distribution)

	1994	1993	1992
Agriculture	47	44	45
Industry	16	16	17
Services	37	40	38
TOTAL	100.0	100.0	100.0

SOURCE: SIS.

According to the official estimates, in 1995 the supply of labour is expected to rise by around 9.8 percent as compared to the previous year, against the expected rise in demand for labour by around 2.3 percent. As a result, open unemployment is expected to fall to around 9.2 percent (from 10.5 percent in 1994).

CHAPTER 2

PUBLIC FINANCE AND DOMESTIC DEBT

I. DEVELOPMENTS IN CONSOLIDATED BUDGET

The 1994 Economic Programme had initially envisaged a 78 percent increase in public revenues and a 68 percent increase in public expenditures; accordingly, consolidated budget deficit would not exceed TL 192 trillion for the year. Moreover, longer term borrowing (domestic borrowing) at lower interest rates was amongst the Programme's major targets.

The April 5 Stabilization Measures put into effect following the financial crisis during first quarter of 1994, focused on restrictive demand management policies. Reducing public deficits was one of the main elements of the stabilization package; accordingly, targeted budget deficit was reduced from the initial TL 192 billion level, to as low as TL 98 billion, a somewhat overambitious target to achieve. The package included fiscal measures towards both (a) cutting some budget expenditures and (b) raising budget revenues. Investment expenditure was the major item affected most adversely from the budget cut. On the revenue side, a number of measures were introduced in order to strengthen revenues. Amongst these measures were: increase in the share of Fuel Consumption Tax transferred to the budget from 50 percent to 70 percent, substantial increase in prices of some public utilities (electricity, telephone), and some one-off taxes such as 10 percent surcharge on personal tax and a net asset tax on businesses.

TABLE 10) CONSOLIDATED BUDGET
(REALIZATION)

(BILLION TL)

	JANUARY-APRIL			
	1995	1994	1994	1993
EXPENDITURE	470,531	214,536	899,375	485,249
a) Current	151,966	87,689	346,309	204,829
a.1) Personnel	134,742	80,438	272,872	169,511
a.2) Other Current	17,224	7,206	73,437	35,318
b) Investment	10,785	13,323	76,778	53,161
c) Transfers	307,780	113,524	476,288	227,259
c.1) Interest on Domestic Debt	168,600	43,373		
c.2) Interest on Foreign Debt	25,545	13,193		
REVENUE	342,235	159,003	753,440	351,392
a) General Budget	334,785	155,356	744,080	348,035
a.1) Tax Revenue	258,743	118,771	588,091	264,273
a.2) Non-tax Revenue	19,701	12,421	49,344	17,636
a.3) Special Revenues and Funds	56,341	24,164	106,645	66,126
b) Annexed Budget	7,450	3,647	9,360	3,357
BUDGET BALANCE	-128,296	-55,533	-145,935	-133,857

As a result of implementing the new (revised) budget, budget revenues increased by 114.4 percent against an increase of 85.3 percent in budget expenditures. On the expenditure side; current expenditures (some 80 percent of which consist of personnel expenditures) increased by 69.1 percent against an increase of 79.3 percent in the previous year. Given the doubling of inflation in 1994, this meant a real decline in current expenditures. Investment expenditure (making up around 9 percent of total budget expenditures) increased by only 44.4 percent, meaning a substantial decline in investment expenditure in real terms. Transfer expenditures, consisting mainly of interest payments, were up by 109.6 percent.

On the revenue side, the general budget revenues increased at a higher rate in 1994 (by around 114 percent) as compared to the previous year, mainly due to introduction of new taxes and raising some tax rates. Tax revenues were up by 122.5 percent, which compares favourably to 86.6 percent of the previous year. Non-tax revenues and Special Revenues and Funds increased by 179.8 percent and 61.3 percent, respectively.

TABLE 11) CONSOLIDATED BUDGET DEFICIT (BILLION TL)

	1995[2]	1994[1]	1993
Revenue	1,384.3	753.4	351.4
Expenditure	1,603.1	899.3	485.3
BUDGET DEFICIT	-218.8	-145.9	-133.9
BUDGET DEFICIT/GNP (%)	-3.2	-3.8	-6.7
PSBR/GNP (%)	5.6	8.2	11.7
DOMESTIC DEBT/GNP (%)	15.1	20.1	17.9

(1) Provisional
(2) Projected/Revised

However, the targeted budget deficit (TL 98 trillion) could not be achieved but was exceeded by a substantial margin. The budget deficit reached to TL 145.9 trillion by the end of 1994, meaning 3.2 percent of GNP. Failure to meet the initial budget deficit target was mainly due to higher-than-expected increase in interest payments both on domestic and foreign debts.

As a result of restrictive fiscal policy, the ratio of budget deficit to GNP was reduced from 6.7 percent in 1993, to 3.8 percent in 1994. Similarly; the ratio of public sector borrowing requirement (PSBR) to GNP declined from 11.7 percent in 1993, to 8.2 percent in 1994. [These improvements, were however partly due to minus 6 percent growth in GNP for the year 1994.]

The 1995 Revised Budget projects an 83 percent increase in budget revenues and a 78.2 percent increase in budget expenditures. Accordingly, the budget deficit is targeted not to exceed TL 218.8 trillion for the year. According to the revised targets, the ratio of budget deficit to GNP would further fall to 3.2 percent, and the ratio of PSBR to GNP to 5.6 percent.

In the first four months of 1995, the budget revenues increased by 115 percent as compared to corresponding period of the previous year. Budget expenditures, on the other hand, increased by almost 120 percent, yielding a budget deficit of TL 128.296 billion for the first four months.

Whilst current expenditures showed an increase of 73 percent, the most notable increase was observed in transfer expenditures (consisting most of interest pay-

TABLE 12) PUBLIC SECTOR BORROWING REQUIREMENT
(Current Prices, Billion TL)

	1995	1994	1993
TOTAL REVENUE	1,216,193	773,286	377,664
a) Taxes	1,096,226	735,414	355,347
b) Non-Tax Normal Revenue	92,082	45,276	27,546
c) Factor Incomes	104,216	35,303	12,817
d) Social Funds	-72,731	-42,707	-18,046
TOTAL EXPENDITURE	1,520,465	1,073,595	611,635
a) Current	645,043	419,840	245,765
b) Investment	323,267	161,144	139,526
c) Transfer	516,391	410,388	194,497
d) Other	35,765	82,223	31,848
PUBLIC SECTOR BORROWING REQUIREMENT	304,273	300,310	233,927

(1) Provisional
(2) Programme
SOURCE: THE 1995 PROGRAMME

ments on domestic and foreign debts). Interest expenses on domestic debt increased by 288 percent in the first four months of the current year, whilst the increase in interest payments on foreign debt was 93 percent. Investment expenditures fell in real as well as in nominal terms (20 percent decrease in nominal terms).

Tax revenues were up by 117 percent in the first four months, whilst non-tax revenues and special revenues/funds showed an increase of 58.6 percent and 133 percent, respectively.

The first four month trends in the budget performance suggest that the targeted budget deficit (TL 218.8 trillion) will probably be exceeded by the year-end.

II. FINANCING OF BUDGET DEFICIT

In 1994; whilst foreign borrowing and goverment bond issues declined in importance in financing budget deficits, short-term borrowing through bond issues and Central Bank Advances became more important. Thus, the government failed in its objective to lengthen the average tenor of its domestic borrowing to longer terms. **Short-term borrowing both (a) leads to higher borrowing costs and**

(b) causes large-scale liquidity fluctuations in the economy as debt servicing takes place at very frequent intervals. Either of the two options, renewed short-term, high cost borrowing or money printing (monetization) causes speculative expectations in the financial markets and aggravates short-term inflationary expectations.

TABLE 13) FINANCING OF CONSOLIDATED BUDGET DEFICIT
(BILLION TL)

	JANUARY-APRIL	
	1995	1994
Budget Revenue	342,235	159,003
Budget Expenditure	470,531	214,536
BUDGET BALANCE	-128,296	-55,533
CASH BALANCE	-140,750(1)	-64,073[1]
FINANCING OF CASH DEFICIT:	128,296	55,333
a) Domestic Borrowing	95,596	-5,785
b) Foreign Borrowing	-38,849	15,044
c) Central Bank Advances	33,912	55,694
d) Treasury Bills	52,673	12,698
e) Other	-2,582	-13,578

(1) Inclusive of advances and deferred payments

The government's target for 1995 is to increase the importance of longer-term borrowing and reduce Central Bank Advances. In the first 3 or 4 months of the year, the goverment was able to renew the maturing debt stock by offering one-year government bonds at gradually declining interest rates. However from May on, following failure to sell 18-month bonds, the government reverted to short-term borrowing with accompanying rise in interest rates.

In the first four months of 1995, the government realized a net borrowing of TL 128,296 billion as compared to TL 55,333 billion in the corresponding period of 1994. Whilst net foreign borrowing declined by TL 38,849 billion, net government borrowing increased by TL 95,596 billion through government bond issues, TL 52,673 billion through Treasury Bills and TL 33,912 billion through Central Bank Advances. The government has recently revised its debt management targets for the year 1995; accordingly, the government targets a total debt repayment of TL 287,000 billion, 75 percent of which would be in the form of foreign debt repayment and the remaining 25 percent in the form of domestic debt repayment. The government also targets to realize a total gross borrowing of TL 505,800 billion, thus realizing a total net borrowing of TL 218,800 billion, which exceeds the initial target by 10.5 percent.

The revised debt management targets indicate that the government plans to reduce the importance of longer term borrowing (government bonds) to some extent, but increase the importance of shorter term borrowing (Treasury Bills) considerably. Parallel to the re-opening of foreign credit lines for Turkey in the recent months, the government projects to realize a higher level of foreign borrowing during 1995.

III. SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET

Resulting from rapid growth of the public debt stocks, the share of interest payments in total budget expenditures has been on a rising trend. This share has risen from 24.0 percent in 1993, to 33.2 percent in 1994. Whilst the government expects the share of interest payments to decline to 29.2 percent in 1995, the first three-month trends (41.8 percent) indicate that this share continues to rise also in the current year.

MÜSİAD projects that the share of interest payments to total budget revenues will reach to 45 percent in 1995, whilst the share of interest payments to total tax revenues will not be less than 58 percent [For more information, please see MÜSİAD Publication titled "DEVLETIN BORÇ KRIZI: Iflas-1999" (DEBT CRISIS OF THE GOVERNMENT: Bankruptcy-1999).

The share of investment expenditure in total budget expenditures declined from 11 % in 1993, to 8.8 percent in 1994, whilst the share of personel expenditures to total budget expenditures displayed a similar trend, declining from 34.9 percent to 30.1 percent. This shows that interest expenses is rising at the expense of investment and personnel expenses.

TABLE 14) SOME MAJOR TRENDS IN THE CONSOLIDATED BUDGET
(Percentage)

	1995[2]	1994[1]	1993
Interest payment/Total Budget Expenditure	29.2	33.2	24.0
Investment Expenditure/Total Budget Expenditure	9.7	8.8	11.0
Personnel Expenditure/Total Budget Expenditure	31.6	30.1	34.9
Tax Revenue/Total Budget Expenditure	66.1	65.4	54.9
Direct Tax Revenue/Total Tax Revenue	41.1	48.3	48.6
Indirect Tax Revenue/Total Tax Revenue	58.9	51.7	51.4
Average Interest Rate Payable on one-year gov't bond	70	112.8	86.3

(1) Realization estimate
(2) Projected

As a result of additional (one-off) taxes in 1994 together with some budgetary cuts, the ratio of tax revenues to total budget expenditures has risen from 54.9 percent in 1993, to 65.4 percent in 1995. The government expects this ratio to further improve to 66.1 percent in 1995.

The share of direct tax revenues in total tax revenues remained unchanged from 1993 to 1994. **In 1995, the government expects the share of direct tax revenues to decline and that of indirect tax revenues to rise. However, the increased share of indirect tax revenues can be expected to result in further deterioration in income/wealth distribution, as well as having a negative impact on the prevailing high inflation rate.**

The average interest rate payable on one-year government bonds has risen substantially during the past year, from 86.3 percent in 1993 to 112.8 percent. Whilst government initially targeted an average interest rate of 70 percent for the current year, it was able to borrow at higher interest rates (between 100-120 percent) during the first four or five months of 1995.

IV. DOMESTIC DEBT STOCK

Domestic borrowing has continued its rapid growth also in 1994, as a result of refinancing of the existing debt stock and higher-than-planned government budget deficit. The net domestic debt stock has risen from TL 356.5 trillion at the end of 1993, to around TL 785 trillion (provisional) by the end of 1994, meaning an approximately 120 percent increase in just one-year. **The rising trend of domestic debt stock continued also into 1995, the debt stock reaching to around TL 1 katrillion by May 1995.** The government projects net domestic debt stock not to exceed TL 1,047.3 trillion by the end of 1995, but the actual figures by the end of June '95 show the debt stock to reach TL 1,107 trillion. The government also expects the ratio of domestic debt to GNP to fall from 20.1 percent in 1994 to 15.1 percent in 1995.

TABLE 15) PUBLIC DEBT MANAGEMENT
(BILLION TL)

	1995 Revised Target	1995 Initial Target	1994 Actual
DEBT REPAYMENT	287,000	247,553	206,401
a) Foreign Debt	213,600	186,153	111,204
b) Domestic Debt (Gov't Bonds)	73,400	61,400	95,197
BORROWING	505,800	445,603	363,622
a) Foreign Debt	177,300	141,272	42,690
b) Domestic Debt	328,500	304,331	320,932
b.1) Government Bonds	174,000	234,833	24,858
b.2) Treasury Bills (net)	105,000	25,848	244,217
b.3) Central Bank Advances	49,500	43,600	51,857
NET BORROWING	218,800	198,50	157,221

The average maturity of the domestic debt stock, being 214 days in 1992, deteriorated to as low as 117 days in July 1993. The Treasury became able to extend the maturity of its domestic borrowing to 9 months during the last quarter of 1994. In March 1995, whilst the Treasury was able to borrow for one-year, its attempt to extend the maturity of its borrowing to 18 months has met with failure.

TABLE 16) THE MATURITY COMPOSITION OF DOMESTIC BORROWING
(Percentage Distribution)

	1994	1993	1992
BONDS TOTAL	12.0	54.4	50.8
* 1 year	4.5	44.5	33.5
* 2-5 years	4.9	7.3	14.6
T-BILLS TOTAL	88.0	45.6	49.2
* 3, 6 and 9 Months	73.1	31.3	45.3
* Public Offering (3 and 6 months)	12.9	14.3	4.0
TOTAL	100.0	100.0	100.0

CHAPTER 3

MONETARY TRENDS

I. THE MONEY SUPPLY

The expansionary monetary policies pursued especially during the latter half of 1993 and the increased dependence of government on Central Bank sources in meeting public deficits, had led to excess liquidity in the economy, with the currency in circulation reaching to all time high levels. The excess liquidity is seen to be one of the major reasons causing the severe crisis and instability experienced by the Turkish financial markets at the beginning of 1994. The control of excess liquidity became possible only after the Local Elections. One of the main features of the contractionary monetary policy implemented as part of the "April 5 Stabilization Measures" was to reduce the Central Bank Advances to the Treasury. In the months following the April 5 Measures, the Treasury put more emphasis on domestic borrowing and raised its borrowing rates substantially in order to borrow large sums from the market. Financial sources obtained through increased domestic borrowing were utilized in reducing Central Bank Advances to the Treasury. This policy initially created a severe liquidity shortage in the economy, which was later eased by the Central Bank through buying of foreign exchange against the local currency. In other words, within the first 3 or 4 months following the April 5 Measures, the Turkish Lira moved mainly between the commercial banks-the Central Bank and the Treasury.

Central Bank buying of foreign exchange against TL has had the effect of both increasing CB foreign exchange reserves over US $ 7 billion level and preventing the exchange rate to go below US $ 1= TL 30,000 level.

TABLE 17) SOME MONETARY AGGREGATES

	BILLION TL			YEARLY PERCENTAGE CHANGE	
	MAY 12 1995	DEC 30 1994	DEC 31 1993	MAY 12 1995– MAY 13 1994	1994
Banknotes Issued	208,424	120,212	63,104	128.8	90.5
Currency in Circulation	186,943	104,370	52,517	155.7	98.7
Reserve Money	301,228	185,736	101,720	113.1	82.5
Central Bank Total Credits	209,703	160,431	100,583	32.8	59.5
-Public	197,475	148,108	82,892	44.6	78.6
-Private	12,229	12,322	17,691	-42.7	-30.0
M1 MONEY SUPPLY	323,798	238,981	132,309	142.4	80.0
M2 MONEY SUPPLY	917,000	642,490	291,976	146.4	120.0
M1/Reserve Money (%)	107.5	128.7	130.1		
M2/Reserve Money (%)	304.4	345.9	287.0		
M1/GNP[1] (%)	-	6.1	6.6		
M2/GNP[1] (%)	-	16.5	14.6		
Reserve Money/GNP[1] (%)	-	4.8	5.1		

(1) Based on the new GNP series of SIS.

In 1994, the banknotes issued increased by 90.5 percent, whilst the rate of increase in the reserve money was around 82 percent. The M1 Money Supply (narrow definition) consisting of currency in circulation and sight deposits, increased at a lower rate by 80 percent as compared to the previous year's 88 percent. The broad definition of money supply (M2) consisting of currency in circulation, sight and time deposits, expanded at a higher rate by 120 percent as compared to the previous year's 60 percent due to faster growth of TL time deposits. The money stock (as measured by M1 and M2) declined in real terms, given the rate of increase in wholesale prices by around 150 percent in the same year. **The money creation multiplier both with respect to M1 and M2 (M1/Reserve Money, M2/Reserve Money) fell during 1994, whilst there was no drastic change in**

the income velocity of money, indicating to a relatively stable demand for money especially since the latter half of 1994.

The new definition of M2, including foreign currency deposits of domestic origin, increased at a higher rate in 1994 by around 130 percent, partly as a result of substantial depreciation of the Turkish Lira.

TABLE 18) THE MONEY SUPPLY

	BILLION TL		(JAN-MAY) PERCENTAGE CHANGE	
	MAY 12 1995	DEC 30 1994	1995	1994
Banknotes Issued	208,424	120,212	73.4	44.4
Currency in Circulation	186,943	104,370	79.1	39.2
Sight Deposits	136,603	134,430	1.6	-24.2
Deposits with CB	252	181	39.2	-22.7
M1 MONEY SUPPLY	323,798	238,981	35.5	1.0
Time Deposits	585,997	398,890	46.9	50.0
CDs	7,205	4,619	56.0	14.4
M2 MONEY SUPPLY	917,000	642,490	42.7	27.5
Foreign Currency Deposits of Domestic Origin	745,427	628,711	18.6	69.7
M2 MONEY SUPPLY (NEW DEFINITION)	1,662,427	1,271,201	30.8	46.9

The monetary control which had been achieved with relative success during second half of 1994, seemed to have loosened somehow since the begining of 1995. The rate of monetary expansion has been at a higher pace in the recent months as compared to the corresponding period and latter half of the previous year. The banknotes issued in the first four and a half months increased by around 73.5 percent (as compared to the previous year's 44.5 percent). A parallel acceleration is observed also in the money supply. The rates of growth of M1 and M2 money supplies have been as high as 35 percent and 43 percent, respectively. All these indicate to a faster monetary expansion in the economy since the beginning of the year. Given the excess liquidity in the economy, the Central Bank has been interfering in the money market from time to time and absorbing the excess liquidity in an effort to eliminate potential instabilities in the money and foreign exchange markets.

II. COMMERCIAL BANK DEPOSITS

TABLE 19) TOTAL BANK DEPOSITS
(BILLION TL)

	BILLION TL		JAN-MAY PERCENTAGE CHANGE	
	MAY 12 1995	DEC 30 1994	1995	1994
I. SAVINGS DEPOSITS	629,381	434,300	44.9	40.9
(a) Time[1]	561,510	377,320	48.8	52.4
(b) Sight	67,871	56,980	19.1	-13.5
II. COMMERCIAL DEPOSITS	100,424	103,639	-3.1	-27.2
(a) Time	31,692	26,189	21.0	-3.6
(b) Sight	68,732	77,450	-11.3	-31.4
III. PUBLIC DEPOSITS	23,231	19,560	18.8	-21.8
(a) Time	1,896	1,592	19.1	69.9
(b) Sight	21,335	17,968	18.7	-25.9
TOTAL BANK DEPOSITS[2]	753,036	557,499	35.1	22.7

(1) Inclusive of Certificates of Deposit
(2) Consolidated commercial bank deposits, exclusive of interbank deposits

The financial crisis which broke out at the beginning of 1994, reduced confidence in the local currency and induced flight into foreign currencies ("currency substitution"). Raising deposit interest rates to unprecedented levels and additional tax advantages for TL deposits (the witholding tax on bank deposit interest incomes reduced from 10 % to 5 %) could not at the beginning stop substitution of foreign currencies for TL. The process of currency substitution had in fact begun in the second half of 1993 and accelerated in the first quarter of 1994. In 1993, whilst TL deposits had declined in real terms, the share of foreign currency deposits in total consolidated deposits continued to rise. Announcement of the April 5 Decisions and the accompanying substantial rise in bank deposit interest rates could not at the beginning restore confidence in TL and reverse the process. This was partly due to the bankruptcy of 3 small-scale commercial banks which created in-confidence in the overall banking system and the withdrawal of foreign currency deposits from the commercial banks based on the rumours that the government would soon convert all foreign currency deposits into local currency. However, the government soon became able to restore confidence in the banking system as the Central Bank stepped in to support a number of banks which were facing some liquidity problems and the government imposed full state coverage (deposit insurance) for TL savings deposits.

TABLE 20) DEPOSIT AND LOAN INTEREST RATES
(Percentage)

	1995			1994			1993	
	April 3	Feb 24	Jan 4	Dec	Sept	June	March	Dec
LOAN INTEREST RATES								
Central Bank								
Rediscount Rate	55.0	55.0	55.0	55.0	63.0	79.0	56.0	48.0
Turkish Development Bank:								
Short-term (general)	140.0	140.0	140.0	140.0	150.0	150.0	85.0	85.0
Medium-term (operating capital)	135.0	135.0	135.0	135.0	135.0	135.0	70.0	70.0
Turkish EXIMBANK:								
Pre-shipment	55.0	55.0	55.0	55.0	63.0	79.0	49.0	46.0
DEPOSIT INTEREST RATES (*)								
Sight Deposits Time Deposits	5.0	5.0	5.0	5.0	6.60	14.50	18.70	11.0
One-Month	60.30	69.40	62.10	60.10	54.40	114.50	18.70	11.0
Three-Month	76.00	85.60	78.00	75.90	67.30	121.70	71.40	52.90
Six-Month	83.44	90.40	79.10	77.30	73.20	114.80	87.10	87.10
One-Year	93.10	98.60	93.70	92.20	98.10	125.30	96.90	96.90

(*) Interest rates payable on bank deposits until 3rd quarter of 1994 are the average of 55 banks, but thereafter are the average of leading commercial banks.

Turkish Lira deposits increased at a high rate during second half of the year, the total TL deposits growing by around 120 percent for the whole year. Whilst total TL deposits stood at TL 557,499 billion by the end of 1994, foreign currency deposits displayed a negative growth of 2 percent falling to US $ 18.976 billion.

TABLE 21) FOREIGN CURRENCY DEPOSITS WITH COMMERCIAL BANKS
(MILLION US $)

	MILLION US $		JAN-MAY PERCENTAGE CHANGE	
	MAY 5 1995	DEC 30 1994	1995	1994
Foreign Currency Deposits of:				
(a) Domestic Origin	17,712	16,365	8.2	-26.8
(b) Foreign Origin	2,775	2,611	6.2	-1.4
TOTAL F/C DEPOSITS	20,487	18,976	7.9	-23.9

In the first four and a half months of 1995, total TL deposits displayed a higher growth when compared to the corresponding period of the previous year. Savings deposits increased by 45 percent from January to mid-May, whilst total TL deposits displayed a growth of 35 percent. This would mean some real growth in TL deposits, given that the wholesale prices rose by 27 percent in the same period. Foreign currency deposits which had fallen by around 24 percent in the first four and a half months of 1994, increased by around 8 percent in the corresponding period of 1995, reaching to US $ 20.487 billion. **A positive development took place in the composition of total bank deposits whereby the share of TL deposits rose from 45 percent at the end of 1994, to 50 percent by Mid-May 1995, partly as a result of slower depreciation of TL and partly as a result of reversed currency substitution process.**

TABLE 22) COMPOSITION OF TOTAL BANK DEPOSITS
(Percentage Share)

	May 12 1995	Jan 1995	Sept 1994	April 1994	Jan 1994
TL Deposits	50.2	45.0	48.6	38.7	44.0
Foreign Currencyc Deposits	49.8	55.0	51.4	61.3	56.0
TOTAL	100.0	100.0	100.0	100.0	100.0

TABLE 23) DISTRIBUTION OF COMMERCIAL BANK DEPOSITS BY BANK
(Percentage Share)

	MAY 12 1995	DEC 30 1994	DEC 31 1993
PUBLIC BANKS	59.7	55.7	60.6
PRIVATE BANKS	39.3	43.2	37.8
FOREIGN BANKS	1.0	1.1	1.6
TOTAL	100.0	100.0	100.0

III- CREDITS

In 1994, the total credit stock in the economy, consisting of credits extended by deposit banks, investment and development banks and the Central Bank, expanded by 84.5 percent. This nominal growth, however, meant a real decline in the total credit stock, given 150 percent inflation in the same year. Credits extended by deposit banks grew by 85 %, a lower rate of growth when compared to the previous year. Whilst Central Bank direct credits expanded by around 78.5 %, Advances to the Treasury played a major role in this expansion.

TABLE 24) CREDIT STOCK
(BILLION TL)

	BILLION TL		JAN-MAY PERCENTAGE CHANGE	
	MAY 12 1995	DEC 30 1994	1995	1994
I. DEPOSIT BANKS' CREDITS	704,832	518,908	35.8	7.2
(a) TL denominated	430,728	310,734	38.6	-
(b) F/C denominated	274,104	208,174	31.7	-
II. INVESTMENT and DEVELOPMENT BANKS' CREDITS	54,464	47,480	14.7	45.3
III. CENTRAL BANK DIRECT CREDITS	197,475	148,108	33.3	64.8
TOTAL CREDIT STOCK (in nominal terms)	956,771	714,496	33.9	21.9
Total Percentage Change in Wholesale Price Index (%)			27.1	65.7

Examining the distribution of deposits among different categories of banks, it is seen that the share of public banks is on a rising trend, from 55.7 percent at the end of 1994 to 59.7 percent by Mid-May 1995. Whilst the share of foreign banks remained the same (around one percent), the share of private (Turkish) banks declined from 43.2 percent, to 39.3 percent by Mid-May 1995.

In 1994, commercial banks were seen less willing in providing credit funds to the corporate sector under the crisis environment, but rather preferred zero-risk, high yield, tax-exempt government borrowing instruments (government bonds and T-bills).

The credit stock seems to have been expanding at a higher rate in 1995 as compared to the previous year. Commercial banks credits expanded by 35.8 percent in the first four and a half months of 1995, as compared to 7.2 percent in the previous year. The Central Bank's direct credits on the other hand grew at a slower rate mainly as a result of repayment of Treasury Advances. Direct credits extended by the Central Bank grew by 33.9 percent in the first four and a half months of this year as compared to 22 percent in the corresponding period of 1994.

Credits extended by investment and development banks have been rather slow in the first half of 1995; such credits grew by only 15 percent in the first four and a half months.

Nominal growth in the total credit stock was around 34 percent in the first four and a half months, which, given 27.1 percent rise in the wholesale price index in the same period, meant some real increase in the total credit stock.

IV. CAPITAL MARKET

In the first half of 1994, various markets within the Istanbul Stock Exchange (ISE) were most adversely affected from the financial crisis . The trading volume in these markets (equity market, stocks and bonds market) fell sharply during this period, from a daily average trading volume of TL 79 Trillion in January 1994, to as low as TL 17 Trillion in March. Whilst the average trading volume in government securities displayed a drastic decline in the first 4-5 months of the year, there were notable increases in the average trading volume of repo and reverse repo transactions.

TABLE 25) THE ISTANBUL STOCK EXCHANGE
Daily Average Trading Volumes
(Million US $)

	EQUITY MARKET	STOCKS AND BONDS MARKET Public	STOCKS AND BONDS MARKET Private	REPO-REVERSE REPO MARKET
1990	23,70	—	—	—
1991	34,42	2,30	—	—
1992	34,50	9,57	0.01	—
1993	88,50	43,57	0.04	22,40
1994	91,71	34,89	0.01	93,69
1995*	200,14	68,95	—	345,51

* as of May 26
SOURCE: Capital Market Board, ISE

Parallel to the normalization of financial markets from the second half of 1994, trading volumes in various markets of ISE began picking up again. Accordingly, daily average trading volume in the equity market increased to equivalent of 91.7 million US Dollars by the end of 1994 and to 200 million US Dollars by the end of May 1995. A similar increase was observed also in the trading volume of public sector stocks and bonds and of repo/reverse-repo transactions.

The ISE (Turkish Lira) composite index, having experienced a sharp fall in the first quarter of 1994, displayed a fluctuating trend during latter half of the year and reached to 27.257 level, meaning a 32 percent increase for the whole year.

The total trading volume of stocks which stood at TL 650,864 million as of end of 1994, increased to TL 819,730 billion by end-May 1995; the number of trading companies reached to 176 as of end-April 1995.

The ISE composite index, being 26,385 on January 4, 1995, has displayed a steadily rising trend during the first four months of the current year, and then followed a fluctuating trend. By July 13, the index stood at 47,659, after having peaked at 54,653 level on April 21, 1995.

TABLE 26) PRICE ÷ EARNINGS RATIO AVERAGES
(Equity Market)

Months	1995	1994	1993
January	11.20	16.96	7.42
February	12.72	12.61	10.26
March	16.70	11.25	10.03
April	18.64	11.73	14.58
May	18.18	11.74	14.83
June		15.90	18.90
July		17.71	11.06
August		21.73	14.06
September		22.34	17.95
October		22.43	17.58
November		25.88	22.27
December		24.83	25.75

SOURCE: Capital Market Board, ISTANBUL STOCK EXCHANGE (ISE)

As of 1993, Turkey ranked thirtieth in the world in terms of market capitalization, and second among the top 25 markets in terms of market performance.

TABLE 27) THE ISTANBUL STOCK EXCHANGE
Total Market Value of Firms Listed in the Stock Exchange
(Million US Dollars)

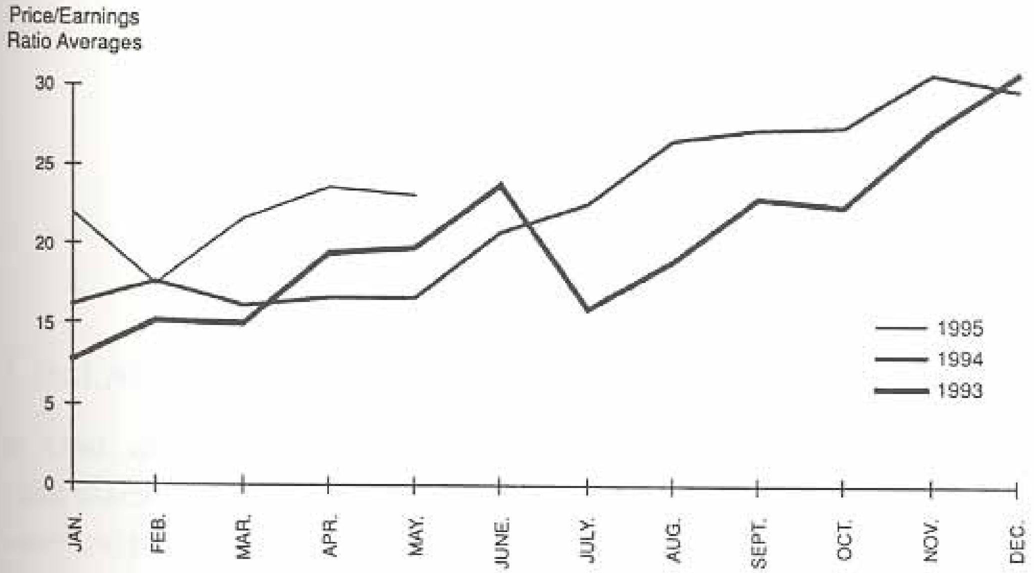
	Total Market Value
Dec 1988	1,128
Dec 1989	6,756
Dec 1990	18,737
Dec 1991	15,564
Dec 1992	9,922
Dec 1993	37,824
Dec1994	21,786
May 1995	29,929

SOURCE: Capital Market Board, ISE

Positive developments in the Turkish money and capital markets in the recent months reflect to a large extent, the quicker-than-expected recovery of

the Turkish economy from the crisis conditions of the previous year, and re-building of confidence towards Turkey both domestically and internationally.

GRAPH 2) PRICE/EARNINGS RATIO AVERAGES IN THE ISTANBUL STOCK EXCHANGE (EQUITY MARKET)



	1993	1994	1995
JAN	7.42	16.96	11.20
FEB	10.26	12.61	12.72
MARCH	10.03	11.25	16.70
APRIL	14.58	11.73	18.64
MAY	14.83	11.74	18.18
JUNE	18.90	15.90	
WULY	11.06	17.71	
AUGST	14.06	21.73	
SEPT	17.95	22.34	
OCT	17.58	22.43	
NOV	22.27	25.88	
DEC	25.75	24.83	

CHAPTER 4

FOREIGN ECONOMIC RELATIONS

I. BALANCE OF PAYMENTS

In 1994, one of the most important developments in the Turkish economy took place in the area of balance of payments which improved considerably over the previous year. Trade deficit was reduced from the all time high 14.1 billion US Dollars in 1993, to around 4.2 billion US Dollars. A similar improvement was observed also in the current account balance which resulted in a surplus of 2.631 billion US Dollars (from a deficit of 6.433 billion US Dollars in 1993).

(a) Trade Account

In 1994, improvement in the current account largely stemmed from substantially narrowing trade account deficit. The substantial decline in the trade deficit was largely due to sharp fall in imports and partly to rise in exports. More than 100 % depreciation of the external value of TL, together with considerable slowdown in the economic activity, was the main reason for the sharp fall in imports from 29.771 billion US Dollars in 1993 to around 22.606 billion US Dollars in 1994. Exports, on the other hand, rose from 15.611 billion US Dollars in 1993, to 18.390 billion US Dollars, marking an 18 percent rise over the previous year. As a result, trade deficit fell from the record 14.160 billion US Dollar level in 1993, to 4.216 billion US Dollars in 1994.

TABLE 28) BALANCE OF PAYMENTS
(MILLION US $)

	JANUARY-MARCH			
	1995	1994	1994	1993
I. CURRENT ACCOUNT BALANCE	440	-1.133	2.631	-6.433
1. Trade Balance	-1.799	-1.799	-4.216	-14.160
Exports (FOB)	4.826	3.914	18.390	15.611
Imports (FOB)	-6.625	-5.713	-22.606	-29.771
2. Balance of Invisibles	868	97	3.755	3.959
2.1. Invisible Earnings	2.908	1.917	11.691	11.788
Tourism	492	441	4.321	3.959
Interest	311	209	890	1.135
Others	2.105	1.267	6.480	6.694
2.2. Invisible Expenditure	-2.040	-1.820	-7.936	-7.829
Tourism	-177	-169	-866	-934
Interest	-914	-854	-3.923	-3.574
Others	-949	-797	-3.147	-3.321
3. Unrequited Transfers	1.371	569	3.092	3.768
Workers Remittances	747	446	2.627	3.035
Import Waivers	33	34	82	116
Official Transfer	591	89	383	733
II. CAPITAL ACCOUNT BALANCE	1.772	835	-4.194	8.963
a) Private Foreign Capital	108	51	559	622
b) Portfolio Investments	-510	1.410	1.158	3.917
c) Long-Term Capital	-371	75	-784	1.370
d) Short-Term Capital	2.545	-701	-5.127	3.054
III. NET ERRORS AND OMMISSIONS	1.445	-2.682	1.769	-2.222
IV. RESERVE MOVEMENTS	-3.657	2.980	-206	-308
a) IMF	-	-	340	-
b) Offical Reserves	-3.657	2.980	-546	-308

Turkish exports increased by around 23 percent in the first quarter of 1995 as compared to the corresponding period of 1994, totalling 4.826 billion US Dollars. Imports, on the other hand, increased by 16 percent reaching to 6.625 billion US Dollars. As a result, a trade deficit of 1.799 billion was recorded in the first quarter of 1995. The government targets a trade deficit of 6.520 billion US Dollars for 1995. However, given the first three-month developments in the trade acount, overvalued Turkish Lira since the beginning

of 1995 and recovery of the economy suggest that this target will be difficult to achieve and if the first three-month trend in the trade account continues into the remaining part of the year, trade deficit is highly likely to reach to around 8.5 billion US Dollars.

(b) Invisibles Account

Invisibles account showed a positive balance of 3.755 billion US Dollars in 1994, as compared to a positive balance of 3.959 billion US Dollars in the previous year. Tourism revenues were up by 9 % totalling 4.321 billion US Dollars whilst interest payments increased by 9.7 % reaching to 3.923 billion US Dollars.

A bigger surplus in the invisibles account was achieved in the first quarter of 1995 (US Dollar 868 million) as compared to the corresponding period of 1994 (US Dollar 97 million).

(c) Unrequited Transfers

Workers remittances which make up around 85 percent of unrequited transfer incomes decreased by around 13.5 percent in 1994, totalling US Dollars 2.627 billion. This was largely due to the inconfidence felt towards the Turkish economy amidst a severe financial crisis. **With the relative stability now restored in the economy, workers remittances started picking up again. In the first quarter of 1995 workers' remittances were up by 67 percent (as compared to the corresponding period of 1994), totalling US Dollar 747 million.**

(d) Current Account

The Turkish economy had experienced an unprecedented current account deficit (US Dollars 6.433 billion) in 1993, which was one of the major reasons for the financial crisis experienced in the first half of 1994. Largely as a result of reduced trade deficit, the current account improved considerably during 1994, yielding a surplus of US Dollars 2.631 billion for the year.

The 1995 Economic Programme projects a current account surplus of US Dollar 430 million. The current account yielded a surplus of US Dollar 440 million in the first quarter of 1995, which compared favourably to the US Dollar 1.333 billion deficit in the current account recorded in the first quarter of 1994. However, the surplus in the current account was largely as a result of the grants received from the Gulf Fund (official unrequited transfer). Parallel to the widening trade deficit in the recent months, the current account is likely to yield some deficit for 1995.

(e) Capital Account

The capital account which had yielded a surplus of US Dollar 8.963 billion in 1993 (largely as a result of short-term capital inflow and portfolio investments), showed an opposite development in 1994, largely as a result of short-term capital outflow, yielding a deficit of US Dollar 4.194 billion. Short-term capital funds (hot money) which were attracted into the country in the previous years by way of high interest rate differentials, outflew from Turkey in a short period of time, further aggrevating the financial crisis. **"Hot money" which was seen to be a potential source of instability in some other countries, played a de-stabilizing role in the Turkish economy during the recent crisis.**

The 1995 Programme projects a surplus of US Dollar 670 in the capital account. The Programme expects a net inflow of US Dollar 800 million under direct investment, US Dollar 1.750 billion under portfolio investment, and a net outflow of US Dollar 1.430 million. **The capital account showed a larger -than- expected surplus of US Dollars 1.772 billion in the first quarter of 1995, largely as a result of substantial inflow of short-term capital funds.** The prevailing exchange rate and interest rate policies create a substantial interest rate differential attracting short-term foreign funds into the economy. Abundance of foreign exchange through inflow of foreign funds has recently led to overvaluation of the Turkish Lira which has already begun affecting the trade account negatively. Contrary to official expectations, there has been a net outflow of long-term capital and portfolio investments in the first quarter of the year.

(f) Official Reserves Account

Despite huge foreign debt servicing and minimal use of foreign funds during 1994, official reserves showed an increase of US Dollar 206 million. The 1995 Programme expects an increase of US Dollar 1.5 billion in official reserves and a US Dollar 1.3 billion increase in foreign exchange reserves with commercial banks. There was a bigger-than-expected increase in the official reserves in the first quarter of

1995; the official reserves increased by US Dollar 3.657 billion in the first quarter of 1995 as against a decrease of US Dollar 2.980 billion in the corresponding period of 1994. **The substantial increase in foreign exchange reserves leaves the Turkish monetary authorities with the difficult options of (a) either to let TL become overvalued or (b) to allow an expansion in the money supply under the prevailing high inflation environment. The Central Bank of Turkey is recently seen to be following an exchange rate policy whereby it has been buying US Dollars against TL in order to eliminate overvaluation of TL.**

II. INTERNATIONAL RESERVES

TABLE 29) INTERNATIONAL RESERVES
(MILLION US $)

	FOREIGN EXCHANGE RESERVES			
	CENTRAL BANK[1]	COMMERCIAL BANKS	GOLD	TOTAL RESERVES[2]
DEC 1993	6.213	10.061	1.488	17.761
JAN 1994	5.524	8.950	1.488	§15.959
MARCH	3.294	8.222	1.488	12.996
JUNE	4.257	8.111	1.476	13.837
SEPT	6.741	8.455	1.439	16.623
DEC 1994	7.112	7.997	1.410	16.514
JAN 1995	9.299	7.478	1.400	18.173
FEB	10.840	7.235	1.400	19.466
MARCH	11.292	7.331	1.400	20.017
APRIL	12.314	8.794	1.383	22.477
MAY 5[3]	12.813	9.010	1.383	23.198

(1) Gross CB reserves
(2) exclusive of overdrafts
(3) provisional
SOURCE: Central Bank of Turkey

The Central Bank foreign exchange reserves which stood at around US Dollar 6.2 billion at the beginning of 1994, showed a rapid decline in the first quarter of the year as a result of its intensive intervention in the foreign exchange market in an effort to stabilize the exchange rate. As a result, the foreign exchange reserves of the Central Bank declined to the US Dollar 3 billion level at the beginning of April. In the following months, the Central Bank continued to interfere in the foreign exchange market, this time buying US Dollars with the purpose of providing liquidity to the economy. As a result of Central Bank buying, the foreign exchange reserves were restored to the pre-crisis level by mid-summer and continued to rise in the latter half of the year, reaching to US Dollar 12.8 billion by May 1995. By May 1995, foreign exchange reserves held by commercial banks were no less than US Dollar 9 billion. Together with gold reserves, total international reserves of Turkey increased from US $ 17.7 billion at the end of 1993, to around US $ 23.3 billion by the begining of 1995, marking an increase of around 31 percent. The substantial increase in foreign exchange reserves has been partly due to inflow of short-term capital funds ("hot money") through commercial banks. **The Turkish commercial banks now run considerable "short positions" in foreign currency in order to profit from high interest rate differentials, a situation which resembles the trends observed in the pre-crisis period. However, given the present level of CB reserves, the central monetary authorities seem to have sufficient reserves of foreign exchange for combatting with unexpected fluctuations in the foreign exchange market.**

III. EXTERNAL DEBTS

TABLE 30) EXTERNAL DEBTS OUTSTANDING[1]
(Million US $)

	1995 PROJECTED	1994	1993
SHORT TERM	11.200	11.310	18.533
-Commercial Bank Credits		2.901	9.526
-Private Lender Credits		8.409	9.007
MEDİUM-LONG TERM	51.500	54.291	48.823
-Multilateral Agercies		9.183	8.674
-Bilateral Lenders		20.678	18.153
-Commercial Banks		2.325	3.083
-Bond Issues		13.788	12.623
-Private Lenders		8.317	6.290
TOTAL EXTERNAL DEBT	62.700	65.601	67.356

(1) By type of lender
SOURCE: Treasury Undersecretariat

Despite the crisis conditions, Turkey was able to achieve considerable foreign debt servicing in 1994. The external debt stock which stood at US Dollars 67.356 billion at the end of 1993, was reduced to US Dollar 65.601 billion by the end of 1994. Short-term foreign debts declined from US Dollars 18.533 billion in 1993, to US Dollars 11.310 billion in 1994; as a result, the share of short-term foreign debts to total foreign debts declined from 27.5 percent, to 17.2 percent, implying a positive development in the term structure of foreign indebtedness. Medium-long term foreign debts, on the other hand, increased from US Dollars 48.823 billion in 1993, to US Dollar 54.291 billion in 1994. The decline in short-term debts stemmed essentially from repayment of commercial banks' foreign borrowing.

TABLE 31) EXTERNAL DEBT SERVICING
(MILLION US $)

	1995 PROJECTED	1994	1993
Principal (Repayment)[1]	7.790	6.070	4.653
Interest	4.450	3.923	3.574
I. TOTAL DEBT SERVİCE	12.240	9.993	8.227
Export Earnings	20.350	18.390	15.611
Invisible Earnings	12.600	11.691	11.788
Private Unrequited Transfers[2]	2.800	2.709	3.035
II. TOTAL İNCOME	35.750	32.790	30.434
DEBT SERVICE RATIO (I/II) %	34	30	27
TOTAL OUTSTANDİNG EXTERNAL DEBT/GNP (%)	42	50	37
SHORT-TERM EXTERNAL DEBT/GNP (%)	7.50	8.60	10.20
MEDIUM-LONG TERM DEBT/GNP (%)	34.5	41.3	26.8

(1) Inclusive of repayments due on bond issues
(2) Inclusive of workers' remittances, exclusive of official unrequited transfer.

In 1995, the government expects a further decline in foreign debts; this is expected to be achieved mainly by reducing medium and long term debts. According to official projections, total external debt is expected to decline to US Dollars 62.700 billion through a total debt servicing of US Dollar 12.240 billion. However, contrary to official expectations, Turkey's total foreign debt stock has risen to 71.5 billion US Dollars due to the depreciation of the dollar against German Mark and Japanese Yen the proportion of which in the total foreign debt stock has been rising in recent years.

It is projected that the debt service ratio would increase from 30 % in 1994, to 34 % in 1995. Some further improvement is also expected in overall foreign indebtednes; accordingly the ratio of outstanding external debt to GNP is expected to fall from 50 % in 1994 to 42 % in 1995, the ratio of short-term external debt to GNP from 8.60 % to 7.50 % and the ratio of medium-long term external debt to GNP from 41.3 % to 34.5 percent. However, **the declining trend of short-term indebtedness in 1994 seems to have reversed in the first half of 1995, especially as a result of increase in commercial banks' foreign borrowing with the purpose of profiting from the existing huge interest rate differentials. Whilst in 1994 Turkey faced considerable difficulties in obtaining fresh funds from foreign financial markets as a result of overall inconfidence felt towards the Turkish economy, this situation seems to have been changing recently under the improving conditions in the Turkish financial markets and gradual recovery of the real economy. The Turkish government, as well as some leading Turkish commercial banks, are now able to borrow from foreign markets at reasonably acceptable spreads.**

IV. FOREIGN EXCHANGE RATES

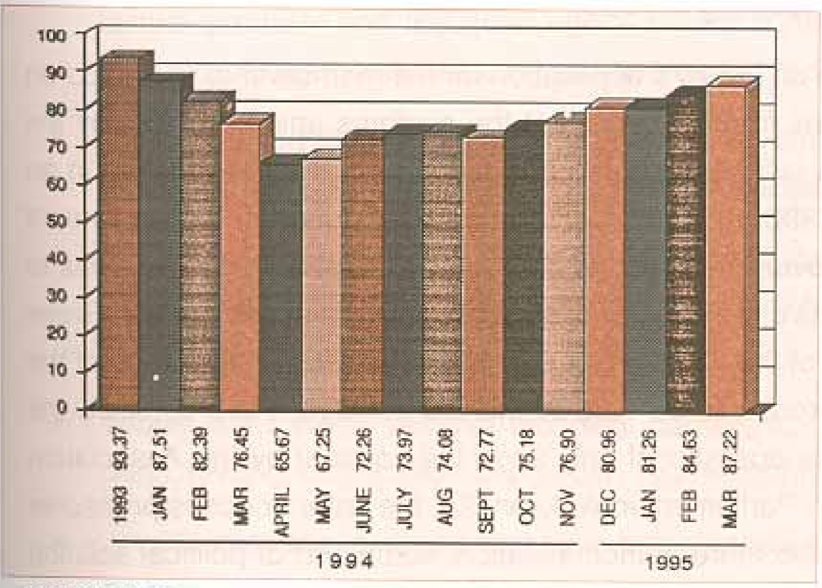
TABLE 32) INFLATION AND TL DEPRECIATION
(Annual Percentage Change)

YEARS	Rate of Inflation	TL Depreciation	
		Against US $	Against DM
1983	37.1	51.5	30.0
1984	49.2	56.1	36.5
1985	44.2	30.3	63.3
1986	30.7	32.7	68.1
1987	55.	144.8	79.7
1988	75.2	63.6	46.2
1989	68.8	27.9	31.7
1990	60.4	26.7	43.7
1991	71.1	88.1	73.1
1992	66.0	55.6	59.5
1993	71.1	70.4	59.2
1994	149.6	163.2[2]	195.1[2]
1995	26.2[1]	4.56	17.49

(1) (January-May) Percentage change in consumer prices
(2) (January-May)

One of the most notable developments observed in the Turkish economy in the first half of 1994 was the substantial volatility in the foreign exchange market and the resultant high rate of depreciation of the Turkish Lira against foreign currencies. The exchange rate policies implemented roughly since 1988 had resulted in "over-valuation" of TL against major foreign currencies. The government's attempt to lower interest rates during second half of 1993 led to excess liquidity in the economy, with currency in circulation reaching to record levels. Expectations of a large-scale adjustment in the exchange rate, the collapse of the Istanbul Stock Exchange, the excess liquidity in the market and speculative movement of funds have had the combined effect of creating drastic fluctuations and "over-shooting" in the exchange rate in the first quarter of 1994. The government, largely for political reasons ahead of Local Elections, strived to repress the exchange rate through exorbitantly high interest rates and intervention in the foreign exchange market. The end result of this policy was the decline in CB reserves by around US Dollar 3 billions, rise in over-night interest rates to as high as 400 percent and increased expectations of a further depreciation of TL.

GRAPH 3) THE REAL EXCHANGE RATE
(1982 JANUARY=100)



SOURCE: SPO
The Real Exchange Rate
1) The weights in the currency basket are 0.75 for US$ and 0.25 for DM
2) In the relative price calculations, producers prices for USA, industrial product prices for Germany and wholesale prices for Turkey are used.

Announcement of the "April 5 Stabilization Measures" resulted in "over-shooting" of the exchange rate. Shortly after, the exchange rate fluctuated within the US $ = TL 30.000 - TL 35.000 band and remained around US $ 1 = TL 30,000 during the summer. The exchange rate, gradually rising, reached to the level of US $ 1 = TL 38.500 by the end of 1994 (this is also being the official target committed to IMF).

Given the prevailing inflation rate differentials between Turkey and its major trading partners, the depreciation of TL against foreign currencies has been rather slow since the beginning of 1995. The TL is said to have become overvalued in the recent months, needing some upward adjustment. Whilst market agents do not expect any big movement in the exchange rate during summer months, the rate of depreciation of TL is expected to accelerate in the fourth quarter of the year.

V. TURKEY'S RELATIONS WITH THE EUROPEAN UNION

Turkey's long-lasting Association with the European Union (EU) has taken a very significant turn in 1995 with the signing of the Decision of 6 March'95 by the Association Council on the implementation of the Customs Union between Turkey and the EU as from the beginning of 1995.

After the implicit rejection of Turkey's application for full membership to the EU on 14 April 1987, negatiations to fully implement the customs union as seen by the Turkish government as a last resort not to drift away from the EU resulted in an agreement on 6 March 1995. Apart from the painstaking rules of this agreement (Decision), the Turkish government had to swallow two important concessions to the EU side; first to connive the start of membership negotiations of the Greek Cypriots under the name of the Republic of Cyprus with the EU in the wake of the inter-governmental conference to be held in the EU in 1996, second, since the customs union will fully be operational only upon the consent by the Association Council and the European Parliament in Autumn '95, the latter imposes pressures on Turkey towards so-called more democratisation, some sort of political solution to the problem in the south Eastern Anatolia, etc.

The Decision of 6 March 1995 which covers 64 provisions basically sets out the following:

- Turkey and the EU will remove all customs duties, charges having equivalent effect, quotas, etc. on industrial imports from each other by 31 December 1995. Since the EU, already long ago, had abolished customs duties, it has to abolish quotas on textiles-clothing imports from Turkey while Turkey that already proceeds on the way to reducing customs duties on industrial imports from the EU will have to remove them as well as Mass Housing Fund charges by then. Iron and steel products will be included in the Customs Union through a Protocol due to be signed soon while industrial part of processed food products will be tariffs-free. The average rate of imports-protection covering both tariffs and Mass Housing Fund charges has been lowered to 14.4 % for the EU and EFTA countries, 18.4 % for third countries by 9 July 1995.

- Turkey will have to adopt the Common External Tariffs of the EU which was, on average, at a rate of 5.7% before the Uruguay Round Agreement, thus lower its national tariffs substantially. Besides, the customs regulations of the EU will have to be adopted by Turkey.

- Turkey will have to enact competition law similar to that of the EU covering cartel-type restrictive agreements, mergers, abuse of dominant position, intellectual property and industrial rights, patent rights, fight with counterfeit goods, etc.. State monopolies will be abolished in two years in Turkey.

- Turkey will forbid state aids in two years (one year for textiles sector) with the exception of social-purpose aids and a five-year extension of regional aids.

- Turkey will have to adopt common commercial policy and regulations of the EU as well as sign preferential agreements, which the latter signed with third countries, in five years.

- Turkey will have to remove technical barriers to trade by adopting the standarts, testing, certification and quality requirements of the EU in five years.

- Joint Committee for Customs Union being established under this Decision will be responsible for overseeing and day-to-day administration of the union. However, the Committee will work on an advisory basis, hence imply not to have much influence on the regulations and decisions.

- In turn for all these burdens, Turkey will be provided about ECU 2.5 billion financial aid in 5 years, most of which will be in the form of project-based credits by the EU, an amount which, in no way, can compensate Turkey's annual tariffs income of about 2.5 billion dollars.

After this brief summary of what the customs union will entail, one should make an assessment whether this grandiose project is to the benefit of Turkey. This assessment can be made from political, economic competitiveness' viewpoints and whether undertakings set out in the Association have been realized.

(i) Assessment on the political goal of the customs union:

The fear which the Turkish government and bureaucracy have had that customs union could have been the last train to jump on the EU as well as the expectation that by way of customs union, the gate to full membership would be opened up were both exaggerated and wrong basis to pursue Turkey's case in the negotiations. It shoult not be forgotten that, Austria, Sweden and Finland that had applied for membership much later than Turkey already joined the EU, while also former communist countries, Poland, Hungary, Czech Republic, Slovakia, Bulgaria, Romania, Baltic Republics have already got the pledge from the EU to be admitted into it by 2000 and 2005. Turkey having already a 36-year relationship with the EU is not mentioned in the enlargement scenarios. Under these circumstances, customs union will put Turkey in a position burdened with enormous undertakings in a club of about 25-26 countries in a few years' time.

Again politically, Turkey has taken the risk of undermining her own cause and arguments concerning Cyprus problem. Because the Decision of 6 March (Article 16) sets out that Turkey will have to sign all preferential agreements at varying levels signed by the EU with third countries, among others the Greek Cypriot administration not recognized by Turkey. Adding to it that the EU will start membership negotiations with Greek Cypriots after the inter-governmental conference to be held in 1996, Turkey will find herself squeezed on Cyprus issue by the EU to be encouraged by its full members, Greece and the Greek Cypriot Administration.

Not to be a member of the EU, does not put a country's future into risk. Norwegian and Swiss people, just in the middle of the EU, did say No to full membership and

European Economic Area Agreement respectively. Countries like Malaysia, Indonesia, South Korea have achieved an impressive economic performance, i.e. about 15 % annual increase in exports and 8-10 % annual economic growth without aligning themselves with the EU in the form of a customs union or full membership. Success depends on implementing sound and prudential economic policies.

We believe that such a major undertaking like customs union should have been discussed in the public, in the National Asembly and put into referandum whose result should be decided by the Nation.

(ii) Unbalanced Committments:

Turkey will be the first country (exception, Andorra) to implement the customs union without being a full member, thus find itself outside the decision-making table of the EU, in a position of executing what is decided by the EU's bodies concerning competition law, state dids, patent rights, common commercial policy, etc. which all concern the customs union. Customs Union will imply that Turkey will no longer conduct an independent policy in her foreign economic relations with third countries, nor can it give more favourable treatment to the latter than it does to the EU. Therefore, Turkey's international agreements like ECO (Economic Cooperation Organization), or COMCEC (Islamic Conference Economic Council) and Black Sea Economic Cooperation Zone will automatically lose their functions at least by the Turkish side.

On the other hand, while Turkey will lose about US $ 2.5 billion a year by removing customs duties and Mass Housing Fund charges on imports, it will get only ECU 2,5 billion (approximately 3,2 billion dollars) in 5 years, most of which will be in the form of project credits, This amount is incomparably low with what Greece, Spain and Portugal have got in their pre-membership period (US $ 5.4 bn) and during their membership. These countries could absorb their huge external trade deficits which arose after the membership with enormous subsidies from the EU.

(iii) Assessment on economic competitiveness:

The macro and micro economic conditions in Turkey put the Turkish industry's competitiveness into risk. Since Turkey enjoys tariff-free regime in her industrial exports to the EU countries, the point reached is not bright, the industry has to work in an economy of 85% inflation, high-interest rates, stagnant economy, lack of aids from the state, high-costly energy and raw material inputs, while the European industry works under incomparably more fovurable conditions. The Turkish government, by signing the Custom Union Decision, has to provide the Turkish government the same favourable conditions.

(iv) Conclusion:

We believe that Turkey should continue her economic relations with the EU on the basis of a preferential trade regime instead of a Customs Union which is feared to put unbearable burdens onto Turkey. Turkey should seek to foster her foreign economic relations in all fronts, COMCEC, ECO, Black Sea Economic Cooperation zone and particularly flourishing Far-Eastern countries. Every market is important for Turkey.

We consider the project called "Silkroad Union" to be based on the already established ECO (Turkey, Iran, Pakistan, Turkish Cypriot Republic, Afghanistan and Islamic countries in the Middle Asia) and later on to be extended to Malaysia and Indonesia, even to Japan, as a viable alternative.

CHAPTER 5

PRICES AND INFLATION

I. THE GENERAL PRICE LEVEL

Whilst high inflation has been a matter of major policy concern in the country for many years, in 1994, the Turkish economy experienced the highest inflation rate throughout the entire Republican period. For the first time since 1980, the inflation rate climbed to three digit levels; the annual rate of increase in wholesale prices was as high as 149.6 percent, whilst the consumer prices rose by 125.5 percent for the whole year.

The inflation rate remained at around 70 percent until March 1994, partly as a result of supressed public sector prices ahead of the Local Elections.

However; the lagged effect on prices of the rapid monetary expansion since mid-1993, substantial jump in the exchange rate (over 100 percent depreciation of TL), exorbitantly high market interest rates and high public price increases have had the combined effect of pushing the annual inflation rate from 70 percent in March, to 125 percent in April (meaning a monthly increase of 32.8 percent). The decelerating trend of prices during the summer months, largely as a result of seasonal factors and reduced domestic effective demand, was reversed in September, with the monthly inflation continuing at relatively high rates.

TABLE 33) CHANGES IN WHOLESALE AND CONSUMER PRICES

	ANNUAL PERCENTAGE CHANGE		
	MAY 1995	DEC 1994	DEC 1993
Consumer Prices	82.4	125.5	71.1
Wholesale Prices	78.4	149.6	60.3

SOURCE: SIS

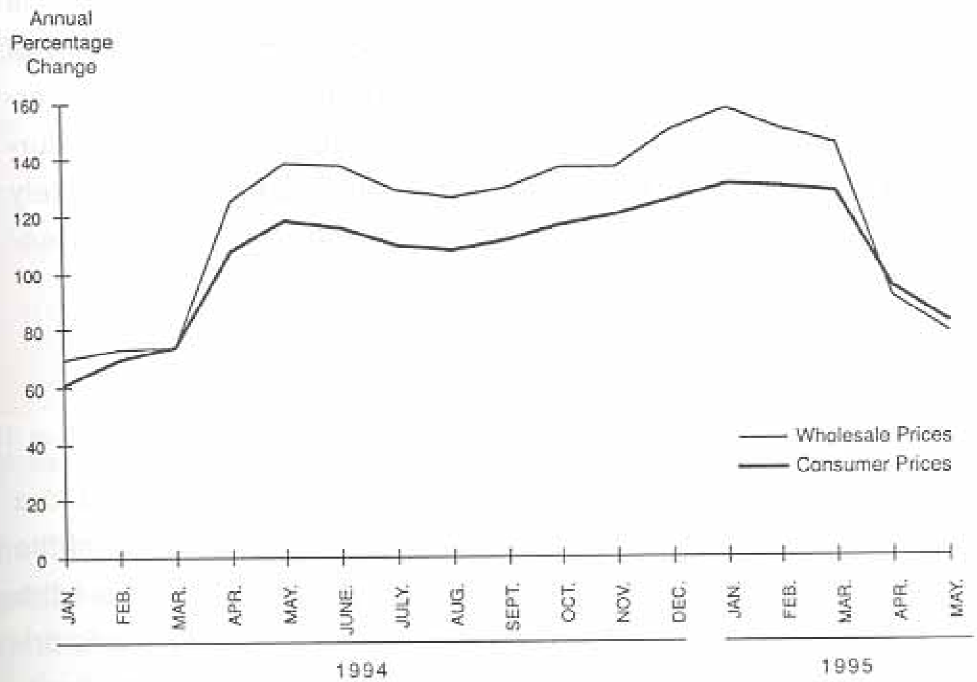
Changes in the wholesale price index (regarded as an indicator of "cost-push inflation") was as high as 120.7 percent (average annual percentage change), whilst the annual (December-on December) rate of change was even higher (149.6 percent). High rate of depreciation of TL, exorbitantly high interest rates, high public price increases were amongst the major reasons for the high rate of change in wholesale prices.

In 1994, consumer prices (regarded as an indicator of "demand pull" inflation) increased at a lower rate (by 125.5 percent) than the wholesale prices, largely as a result of less-than-full adjustment of final prices to cost increases under sluggish demand and contractionary economic policies.

TABLE 34) ANNUAL RATE OF INFLATION

1994	Wholesale Prices	Consumer Prices
Jan	60.6	69.6
Feb	69.7	73.0
March	74.0	73.6
April	125.3	107.4
May	138.6	117.8
June	137.6	115.8
July	128.8	109.3
Aug	126.5	108.0
Sept	129.6	111.1
Oct	136.9	116.3
Nov	137.0	119.7
Dec	149.6	125.5
1995		
Jan	156.8	130.6
Feb	149.8	130.0
March	144.3	127.7
April	91.2	94.3
May	78.4	82.4

GRAPH 4) ANNUAL RATE OF INFLATION



The annual percentage change in the wholesale price index, after rising to as high as 156.8 percent in the first month of 1995, displayed a sharp fall in the months of April and May, mainly for arithmetical reasons (as the high monthly inflation rates of April and May in 1994 was replaced by much lower monthly inflation rates of April and May in 1995). Accordingly; annual rate of inflation as measured by the wholesale price index fell from 144.3 percent in March, to 91.2 percent in April and to 78.4 percent in May.

A similar trend was observed also in consumer prices. **The annual percentage change in consumer prices fell from the all-time high 130.6 percent in January 1995, to 94.3 percent in April and to 82.4 percent in May.** The total change in wholesale prices during the first five months of 1995 was 27.1 percent (which represents a lower inflation when compared to 74.7 percent of the previous year), whilst consumer prices rose by 26.2 percent in the same period (consumer prices had risen by 50.3 percent in the corresponding period of 1994).

Whilst relatively lower monthly inflation rates are expected during the summer months (mainly due to seasonal factors), a further decline in annual inflation rate seems unlikely until the end of the year since this would require very low monthly inflation rates in the remaining months of the year. **The annual inflation rate is high likely to fluctuate within the 80-90 percent band during second half of the year. The government targets an average annual inflation rate of 70 percent and a year-end (December 1995) inflation rate of 40 percent for the current year. Judging from the first five-month trends in prices and the likely developments in the economy during latter half of the year, it seems somewhat difficult to achieve the government's inflation target for 1995.**

II. PUBLIC AND PRIVATE PRICES

The prices of public sector goods and services which had been supressed to a great extent prior to Local Elections, were increased substantially as part of the April 5 Stabilization Package. Public prices were held constant throughout the summer months in an effort to break inflationary expectations. İn 1994, public prices (measured by the Wholesale Price Index) increased by 122.5 percent whereas the rate of increase in private prices was slightly lower (120 percent).

TABLE 35) CHANGES IN PUBLIC AND PRIVATE PRICES
(JANUARY-MAY)

	1995		1994	
	Public	**Private**	**Public**	**Private**
Wholesale Prices	24.0	28.4	76.5	62.2

Public wholesale price increased by 24 percent in the first five months of 1995 as compared to 76.5 percent in the corresponding period of the previous year. Private wholesale prices, on the other hand, increased at a higher rate by 28.4 percent as compared to 62.2 percent of the previous year.

III. SECTORAL PRICE CHANGES

TABLE 36) SECTORAL PRICE INCREASES[1]
(Percentage Change)

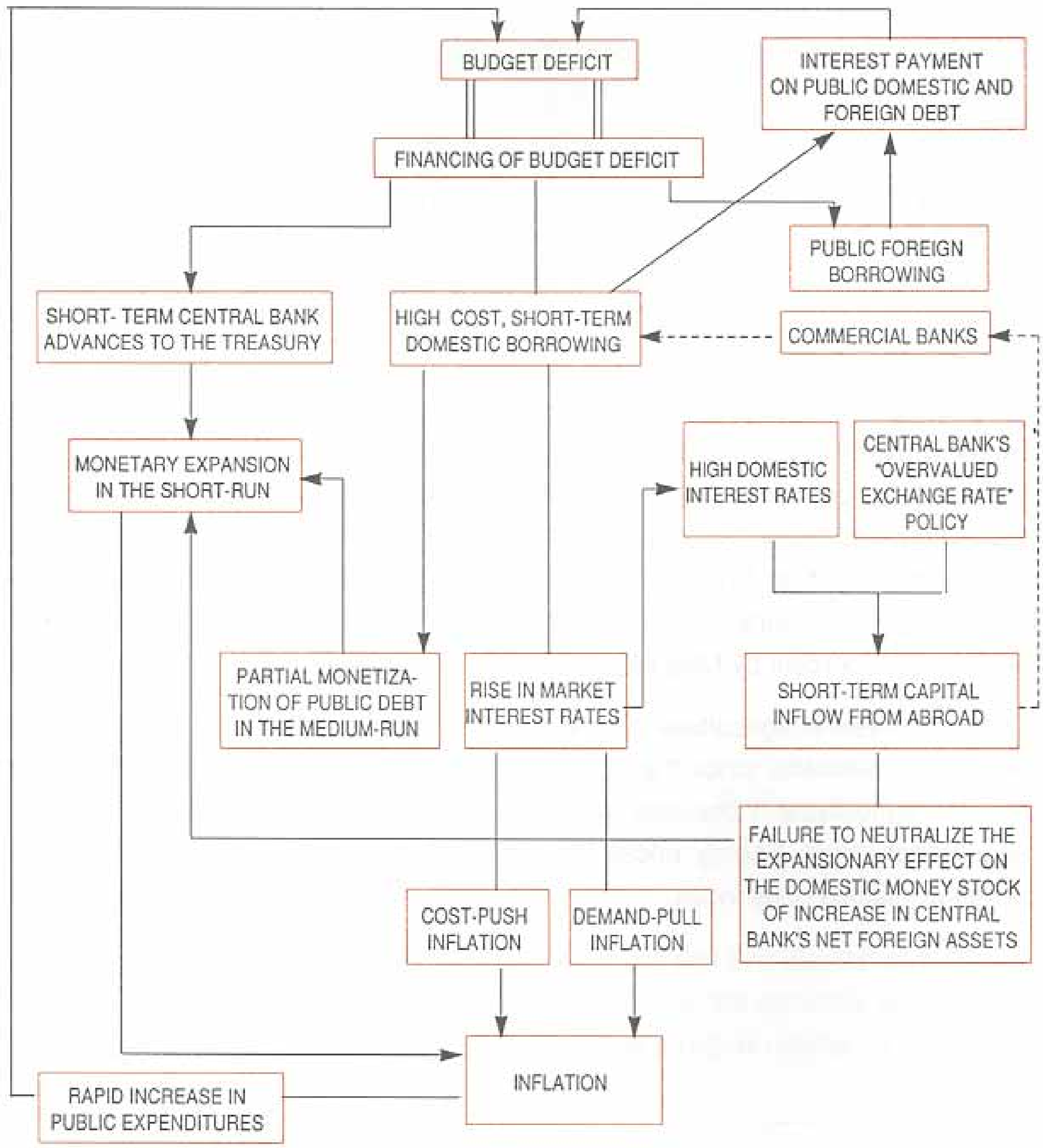
	JANUARY-MAY		ANNUAL	
	1995	1994	1995[2]	1994
AGRICULTURE	45.2	50.2	126.2	96.1
MINING	24.7	91.4	59.1	163.5
MANUFACTURING INDUSTRY	26.7	93.7	69.5	153.6
ENERGY	14.2	65.6	38.5	119.6
TOTAL	30.1	82.0	78.4	138.6

(1) As measured by Wholesale Price Index of SIS
(2) May-on-May annual percentage change.

In 1994, agricultural price increases lagged considerably behind industrial prices with the resultant deterioration of internal terms of trade against agricultural goods. However, this trend seems to have reversed in the current year. The annual rate of change in agricultural prices increased from 96.1 percent at the end of 1994, to 126.2 percent by May 1995. On the contrary, the annual rate of change in manufacturing prices decreased from 153.6 percent at the end of 1994, to 69.5 percent by May 1995.

Faster increase in agricultural prices in the current year can also be seen from the price movements since the beginning of the year. In the first five months of the year, agricultural prices rose by 45.2 percent against 26.7 percent rise in manufacturing prices. Energy prices lagged considerably behind increases in the overall wholesale price index.

DIAGRAM: "BUDGET DEFICIT - INFLATION" VICIOUS CIRCLE IN THE TURKISH ECONOMY



CHAPTER 6

OVERVIEW AND MÜSİAD'S RECOMMENDATIONS

In 1980s, liberal economic and financial policies pursued as part of a structural transformation programme aimed at creating an outward-oriented, free-market economy in Turkey. For this purpose, a number of important reforms have been adopted in the areas of banking, finance, taxation, foreign trade, foreign exchange regime, money and capital markets. These reforms yielded some successful results in the following years, with notable improvement in the areas of foreign trade, balance of payments, stable economic growth and increased technological investments by the private sector. Positive medium term prospects about the Turkish economy also increased the country's credibility in the international financial markets, inducing a substantial influx of foreign funds into Turkey. Despite these positive and encouraging developments, largely due to political factors, necessary steps were not taken in order to decrease the disproportionately large share of the public sector in the economy. The increase in PSBR resultant from huge public sector deficits put a great pressure in the domestic fund markets, resulting in high domestic interest rates. The expected "crowding out" effect of the increased government borrowing was, however, eased to a considerable extent through the accelerated inflow of foreign funds as a result of liberalized regulations on capital movements and in response to high interest rate differentials between the domestic and international markets created by the government's interest rate and exchange rate policies. Easy access to foreign funds thus enabled continued economic growth and investment despite huge government deficits and every-growing trade account gap. This process could not however be sustained forever as domestic and international economic agents have become increasingly more cautious and hesitant about the sustainability of an "equilibrium state" (!) under an ever deteriorating internal and external imbalance.

The long-expected crisis has finally erupted at the beginning of 1994, initiating from the financial markets, and shortly after spreading to the real economy. The worst GNP growth and highest inflation rate were recorded in the same year and for the first time in the Republican history. The crisis experienced by Turkey in 1994 has proven once again how inappropriate it is to maintain a serious disequilibrium situation in the economy, by way of manipulating certain important relative prices, such as interest rate and exchange rate, in order to finance public deficits and public debt stock by short-term foreign funds ("hot money"), and to expand the economy in the short-run beyond its natural limits (or its self-sustaining capacity). A crisis similar in character was also experienced by Mexico at the end of 1994, a country which depended largely on short-term borrowed foreign funds in order to sustain an artificially high consumption and income growth despite fundamental disequilibria in its economy.

Despite severity of the recently experienced economic and financial crisis, the Turkish economy is now gradually recovering from the crisis conditions. Quicker-than- expected recovery of the economy can largely be attributed to the relative strength and dynamism of the Turkish private sector, relatively successful working of demand and supply forces in the economy and long-term potentials of the Turkish economy, rather than to the government's well designed medium-to long term economic and financial policies. In assessing the magnitude of the recent crisis, one must also reckon that the real dimensions of this crisis were exaggerated to some extent by the misconception and over-reaction of market agents to the existing fundamental imbalances in the Turkish economy.

One of the important questions at this stage is, whether the recent and relatively rapid recovery of the Turkish economy from the crisis conditions is a permanent or short-lived phenomenon. Stated differently, what are the chances of a new crisis in the future, following a temporary recovery and improvement in the short-run especially resulting from restored financial stability in the economy?

As also repeatedly stated in MÜSİAD's previous reports, Turkey with its considerable human and material resources, and its tremendous entreprenurial capacity, possesses a substantial potential for growth and stability in the future. But sustainable growth and stability can, in addition to other factors, be achlieved mainly through increased production, constant improvement in productivity and competitiveness at international standards in an ever-globalizing world economy.

MÜSİAD's Recommendations

(1) Price Stability

High and variable inflation rate has been a major policy concern in the Turkish economy for the past 15 to 20 years. Time and past experience have repeatedly proven that, it is not possible to reduce the prevailing high inflation to single digit levels through shortsighted, myopic and politically-motivated stabilization measures. Turkey has been "living with high inflation" for many years and this has created an economic structure which is tuned to high inflation and inflationary expectations. Readjustment of the economy to lower levels of inflation therefore inevitably requires implementation of a 4 or 5 year transition programme in a persistent and determined manner in order to reverse the present inflation trend. The government must design a medium-term stabilization programme and secure a wide public consensus by persuading all sections of the society that the cost of such a programme would be distributed equitably amongst all sections. Breaking inflationary expectations which is a very crucial factor in fighting with high inflation (especially in countries like Turkey experiencing high and "institutionalized" inflation for a long time) depends to a great extent on the general public conviction that the government has necessary political will and determination to fight with inflation and has introduced an internally consistent and realistic stabilization program for combatting with inflation. In Turkey, inflation is rather a medium (or even long run) structural problem, and, even if the traditional, short-term demand management policies would achieve some temporary successes in reducing the current infation rate, the process usually ends up with reduced economic growth and even-higher inflation rate. A successful, sustained and enduring fight with inflation in Turkey, can become possible not only through some restrictive demand management policies in the short-run (tight monetary policy, reduced public sector deficits, etc...) but also by adoption of policies and practices aimed at strengthening the supply side of the economy. These policies and practices must aim at eliminating all kinds of imperfections in the goods and factors markets in order to achieve higher production at lower cost. Turkey must prefer a "gradually achieved price stability within some reasonable output growth", rather than by putting a strong break on the real economy for some short-lived gains in inflation front.

2) Promotion of Investment and Export Activities

There has been a notable deterioration in the productive capacity of the Turkish economy, resultant from stagnating productive and technological investments in the recent years. In order to achieve a sustainable, export-led growth in future, more emphasis must be placed on capacity-creating and modernization investments in the internationally competitive economic sectors. In promoting exports, incentives must be granted at the production stage (which aim at reducing input costs), and those monetary incentives which violate the prevailing international trade rules, must be avoided. MÜSİAD proposes the following investment and export incentives in order to encourage a sustainable and export-led growth for the Turkish economy:

(i) Based on certain criteria, additional production and employment creation must be rewarded by way of reduced taxation.

(ii) Increase in exports must be encouraged by tax reduction, cheaper financing and reduced social security insurance premiums payable by the employer.

(iii) For those exporters who do not choose to use EXIMBANK credits, an alternative incentive in the form of "Resource Utilization Support Premium" must be granted.

(iv) Small -and Medium- Sized Enterprises (SMEs) numberwise consist around 98 percent of total economic enterprises in Turkey, also providing 55% of total employment and 38 % of total GNP in the country, More emphasis must be placed on SMEs in granting investment and export incentives and a certain proportion of total incentives must, within this framework, be committed to SMEs.

(vi) An information center must be established with the purpose of providing all kinds of information and data to newly-established foreign trading companies about foreign markets, international trade and financial trends.

(vii) Bureaucratic barriers and red-taping which discourage entreprenuers in their investment and export activities, must be reduced to the extent posible.

(3) Taxation

Governments must realize that the "efficiency" aspect of taxation is as important as -and perhaps even more important than- its "revenue" aspect. Tax system must be re-designed so as to encourage productive activities and discourage speculative, rent-seeking activities. The new tax system must reduce the existing tax burden on industriailsts-producers in order to encourage production and reduce the size of "unrecorded economy" which is estimated to be no less than 40-50 percent of GNP in Turkey. The high tax burden on low income groups must be reduced with the objective of widening consumption base in the economy, which has been shrinking during the recent years as a result of deterioration in income and wealth distribution.

(i) Given the prevailing high inflation environment, the practice of "inflation accounting" must be adopted and the tax system must be amended so as to encourage companies to depend more on equity and less on borrowed funds in their activities.

The prevailing tax system which allows companies to deduct their interest expenses from the taxable income base whilst no such tax advantage is granted to those companies which depend on own funds, feeds inflation and reduces tax revenues substantially, and must therefore be amended immediately.

(ii) The prevailing Value Added Tax rates are very high, encouraging further expansion of the existing large unrecorded economy. VAT rate must be reduced to as low as 3 percent; lower VAT rate will not lead to a fall in tax revenues, but on the contrary, will achieve higher tax revenue through substantial reduction in the size of the unrecorded economy.

(iii) Real estate must be taxed in a realistic manner and rent incomes arising from investment in real estate must be detected carefully and taxed at high rates in order to discourage investment of funds in such unproductive areas.

(iv) Tax Administration must be reformed and simplified in order to increase the efficiency and effectiveness in tax collection.

(4) Public Domestic borrowing

One of the most serious problems faced by the Turkish economy has been the rapid growth in the government's domestic debt stock in the recent years. Domestic debt stock is on a steadily rising trend, resultant from larger-than- planned budget deficits and renewal of the maturing debt stock at high costs and at short intervals such as 3 months, 6 months, 9 months etc.. Unless radical measures are taken today in order to reverse the rapidly rising trend of domestic debt stock, it will be much more difficult to manage it in future. Measures and practices must be adopted towards reducing the high cost of public borrowing and extending the average (short-term) maturity structure of the existing debt stock to longer maturities. 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.

(5) Exchange-Rate Policy

A realistic exchange-rate policy is one of the essential policy instruments in maintaining the external balance, especially under a highly inflationary environment. The exchange-rate must be determined under free market conditions and must broadly reflect the purchasing power differences between Turkey and its major trading partners.

(6) Size of Public Sector and Privatization

Every effort must be exerted in order to reduce the present disproportionately large size of the public sector. The enactment of a privatization law last year has been a positive step, but MÜSİAD draws attention to the following points in future privatization practices:

(i) Revenues generated from privatization must be utilized mainly for productivity improvement and rationalization of production and less for repayment of domestic debt stock and financing of current public budget deficits.

(ii) While privatizing state economic enterprises, these enterprises must not be handed over to a few private 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.

(iii) Privatization must not become a means of money laundering, and transparency in privatization process must be given utmost care in order to avoid any misunderstanding and mistrust in the minds of the general public.

(iv) The share of foreign capital in the privatized state economic enterprises, except 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).

The Customs Union project with the EU is not the correct choice for Turkey since the burdens shouldered by the latter are unbalanced, competition conditions are not favourable to the Turkish industry vis-à-vis its rivals in the EU and Turkey will be constrained by Brussels in pursuing foreign economic relations with third countries. Hence, Turkey should continue her economic relations with the EU on the basis of a preferential trade regime as well as seek to foster her foreign economic relations in all fronts.

WHAT IS MÜSİAD AND WHAT ARE ITS OBJECTIVES?

MÜSİAD, short for Independent Industrialists and Businessmen's Association was established in Istanbul on 5 May 1990 by a handful of young businessmen, with an average age of under 33, dedicated to creating a developed country with advanced high-tech industry within a highly developed commercial environment, but without sacrificing national and moral values, where labour is not exploited and capital accumulation is not degraded and where the distribution of national income is just and fair, a country with peace at home, influence in the region and respect in the world.

The founders set forth their objectives in the charter as follows: "The goal of the organization is to contribute to the orderly and systematic progress of the country with democracy in line, with the constitution and laws of the country and to attain a higher level of civilization for the country with industrial, commercial, social, economic, educational and cultural development through free exchange of ideas and coordinated effort."

Members of the organization, whose number has reached 2000, in a very short time, are committed to social and economic development in the country by promoting quality production in industry, honesty and fairness in trade, high ethical and moral standards in politics. They are dedicated to finding solutions to the problems of Turkey, Islamic countries in the region and mankind in general.

As of 1994, MÜSİAD has established branches in İstanbul, Konya, Ankara, İzmir, Kocaeli, Kayseri, Bursa, Balıkesir, Gaziantep, Kahramanmaraş, Karadeniz Ereğli, Samsun, Çorum, Malatya, Adana, Denizli, Şanlıurfa, Çankırı, Bandırma and Bartın, key cities in the country with industrial and commercial potential. MÜSİAD, with members in small and medium-sized industries, as well as domestic and foreign trade, in short the backbone of commercial and industrial development in the country, is the largest volunteer organization for businessmen in the country with an active interest in the problems of the country.

ACTIVITES OF MÜSİAD

Activities realized by MÜSİAD in conformity with the objectives of the organization are:

a) Studies-Opinions and Reports: Since its establishment, MÜSİAD prepared reports on Medium-Sized Enterprises and Bureaucracy, State Economic Enterprises and Privatization, The Turkish Economy-1994, Debt Crisis of the State-Bankruptcy 1999, the Outlook of the Turkish Textiles Industry and Possibilities of Textile Machinery Manufacturing, Homo Islamicus-Muslim Man in Business Life, Economic Cooperation among Islamic countries (both in Turkish and English) and lastly the Turkish Economy -1995. MÜSİAD also publicized its views on Incentives for Investment and Exports, Tax Reform Bill, Local Administrations Bill, Radio-TV Bill as well as organized panels and publications on Privatization and Incentives for Investment and Exports.

b) Country Reports: Foreign Relations Commission of MÜSİAD carried out studies on trade possibilities between various countries and Turkey. Potential trade with Uzbekistan, Khazakistan, Argentine, Brazil, Egypt, Sudan, the Far Eastern countries (Malaysia, Singapore, Taiwan, Hong Kong, China) as well as with Albania, Macedonia, Morocco, Tunisia, Jordan and Saudi Arabia was explored. A book was prepared for use by MÜSİAD members, containing information on industrial and commercial potential of the country, transport and lodging facilities, laws on foreign trade, and contact points during visits by members.

c) Organization of Meetings on Economics, Politics and Cultural Matters: Speeches and conferences by politicians, government bureaucrats and diplomats of foreign countries are arranged for MÜSİAD members regularly on Friday nights on subjects of interest.

d) Professional Committees: The goal of these committees is to promote co-operation and trade between MÜSİAD members within the same profession, to prepare the environment for mutual investment by members and to help solve common problems. Committees of Construction, Textiles, Food, Machinery and Spare Parts, Electronics, Chemicals, Forestry and others meet once a month at the headquarters in participation of the branch offices.

e) Publications: Apart from studies and reports on specific subjects, MÜSİAD publishes the following periodicals:

1) **MÜSİAD Bulletin:** The Bulletin is published at the beginning of each month. In this publication, information on MÜSİAD activities is provided as well as practical hints on business problems, announcements by MÜSİAD members, information on exhibitions and trade fairs, announcements on domestic and foreign demands for goods. Personnel requirements of MÜSİAD members are also publicized.

2) **ÇERÇEVE Magazine:** ÇERÇEVE is published every 2 months. It contains articles on current problems of interest, MÜSİAD's views, policies, and other topics, as well as essays by educators and businessmen. ÇERÇEVE is circulated to all MÜSİAD members, to the media, prominent persons in business and politics, university professors and teachers, various professional and business organizations and representative offices of Turkey in foreign countries.

3) **MÜSİAD in the PRESS:** Is published every 4 months, this publication informs members of MÜSİAD of news, information, comments and articles about MÜSİAD which have appeared in the press.

f) Training: The Training Commission organizes professional training programs for MÜSİAD members to bring them up to date on current methods in management and business administration. The aim is to provide members with the knowledge and practical experience needed to apply these methods in their own businesses. Seminars on professional management techniques, modern business administration, domestic and foreign trade, and foreign language courses are organized at the 40 person-capacity training center of MÜSİAD's headquarters and at branch offices in various locations. Additional seminars on total quality management, quality control methods, professional salesmanship, effective speaking, meeting management, the role of management techniques in businness success, development of management skills, management assistance, public relations and other subjects were organized by the Training Commission with the participation of MÜSİAD's industrialists and businessmen.

g) Data Bank: The respective commission is preparing data and informative computer discs on individual members and their companies. More important, MÜSİAD has plans to establish data connections through modems with data banks in Turkey and abroad. The aim is to provide this service to members of the organization.

h) Domestic and Foreign Exhibitions and Fairs: MÜSİAD organizes group tours to domestic and foreign trade fairs and professional exhibitions for its members, to provide them with the opportunity to discover, study and follow up developments, and to enhance commercial and technical knowledge with the objective of encouraging members to participate in such events. Under this program, visits to the Turkish Export Products Exhibition (Moscow 1990), TIBCO Fair (Bucharest 1992), Bulgarian Export Products Exhibition (1996), Hannover Fair (1993), 20th International Tehran Fair (1994), International Tunis Fair (1994) have been arranged.

Members are informed by MÜSİAD of all fairs and exhibitions organized in Turkey and are encouraged to participate in such events. Furthermore, to encourage cooperation and foster commercial relations among MÜSİAD members, the first MÜSİAD International Fair was organized for the first time between 29-31 October 1993 in cooperation with İZFAŞ. This general fair enjoyed great success with 134 MÜSİAD member companies and 15 Italian, 37 Litvanian, 3 Ozbek companies participating. A considerable number of businessmen from Turkey as well as from Germany, Austria, Egypt, Sudan and Lebanon visited this fair. The second MÜSİAD Fair which was organized between 27-30 October 1994 in İzmir enjoyed a far greater success with 235 MÜSİAD member companies as well as Jordanian, German and Bangladeshi companies participating.

i) Trade Missions to Foreign Countries: MÜSİAD organizes trade missions abroad for its members to encourage cooperation and establishment of trade relations with companies in other countries. During these missions abroad, MÜSİAD management establishes contacts with government officials, managers and officials of private and state-sector organizations to conduct talks and sign cooperation agreements and facilitates talks between individual businessmen. Trade missions to Russia, Khazakistan, Azerbaijan, Romania, Bulgaria, Germany, Holland, Egypt, Sudan, Malaysia, Hong Kong, China, Taiwan, Singapore, Albania and Macedonia have been organized so far.

j) Domestic and Foreign Communication Center: Due to the strong relations established both inside and outside the country, MÜSİAD has become like a liaison office for many domestic and foreign businessmen. The professional secretariat promptly informs members of any enquiries and offers for goods and services.

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1995

MÜSİAD

INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION