YAVUZ CANEVİ

I Witness Turkey

1984-2014

YAVUZ CANEVİ

I WITNESS TURKEY

1984-2014

I Witness Turkey (1984-2014)
Yavuz Canevi

Kapak / *Cover*: Bilal Lekesiz

Özgencil Yayıncılık Tanıtım Organizasyon A.Ş.
Teşvikiye Cad. Alhambra Apt. 28 / 2
Teşvikiye, 34365 İstanbul
T: 0212 241 70 84

Baskı / *Printing:*
Cem Turan Ofset
Litros Yolu II. Matbacılar Sitesi
C Blok 2 BC3 Topkapı, İstanbul
T: 0212 567 04 79

Mayıs / *May* 2014

To Pınar

This book is a compilation of articles written by me on a regular basis in the annual English publication of "Finans Dünyası" called "Economic Dialogue-TURKEY" between the years 1984 and 2014. Economic Dialogue-TURKEY has been and still is the only publication in English from TURKEY that has been accredited for distribution during the IMF-World Bank Annual Meetings and occasionally DAVOS World Economic Forum meetings. My intention has been to bring up to date on an annual basis the international financial community on economic, financial and political developments in Turkey.

From this standpoint, this book provides a short but condense, as objective as possible, unbiased history of Turkish economy. Its ups and downs, difficulties, challenges, successes and failures as it has been explained to the outside world for the last three decades. However please make no mistake, in every annual assessment; although I tried to be unbiased, I have been part of the picture as a technocrat and/or bureaucrat in the public sector until 1989 and as a banker and NGO member in the private sector after that. In these articles there has also been a clear and/or implicit message to the domestic policy makers about the vulnerabilities and the measures to overcome them as well as encouragement to do more. As we Turks say, "I am telling to my daughter what to do, so that my daughter in law would get the message". In so far as Turkey also has been part of globalization this old saying has evolved into "I am telling to my daughter in law, so that my own daughter at home will get the message"! i.e. another way of referring to at least global "best practices".

In retrospect what I can say today is the following:

As it has been suggested by the Brookings Institute human life and corporate governance indicators are significantly improved through establishment, endurance and advancement of democratic regimes. Brazil, South Africa, Turkey, India and Indonesia are the proof of these findings. On the other hand, according to Morgan Stanley's recent reports the very same countries are being labelled as "Vulnerable Five", due to their high current account deficits. It is certainly true that Turkey recent in years we are facing diminishing returns as far as GNP growth and current account deficits are concerned. We had been achieving 5-6% growth with 3-4% current account deficits whereas now just the reverse is true. We are realizing 3-4% growth with 6-7% current account deficit. We are bound to change our growth strategy.

At this juncture a lesson to be drawn is crystalized:

In general five central issues will be dominating in the remaining of the 21st century:

- The future of the capitalism which will effect our daily lives,
- New smart strategies for economic growth,
- Further democratization
- Intergenerational equity in well-being,
- Climate change and environmental issues and how we deal with it.

Any system that can not achieve an optimal balance among these central issues on time, that is earlier than historical transition trend creates unsustainability. As Alan Knight puts it "unsustainability is not sustainable". History will neither allow nor tolerate this. However this type of transition to sustainabilty will be painful. Those who will manage sustainability earlier than historical correction time with wise, smart and forward looking policies will be among the winners.

To achieve sustainable economic development we need to improve our democracy through a shift from hard power, i.e. "Rule of Man" to soft power, i.e. "Rule of Law" and reduce vulnerability due to our current account deficit. Therefore prioritizing technology and innovation, increasing domestic savings, introducing reforms in education and labor markets, particularly women's participation in the work force and energy efficiency and last but not least promoting a "smart regulatory environment" for business to attract both domestic and Foreign Direct Investment (FDI) are in order.

The key throughout this process is to identify the problem on time. Because it takes time not only to identify but to realize and accept that it is a real serius problem. It also takes time to come up with the right solution and ofcourse it takes time to implement the new solution. The secret to success lies in shortening the "identification and acceptance delay". The rest is up to the committment and quality of the governance and legal infrastructure to promote innovative abilty of the society to invent, discover and implement the right solution.

To conclude my introduction I would like to make one final comment. As you will note reading this book for the last three decades and through its ups and downs, I have never lost faith in this country and its people and have never given up hope. Because hope is as important as life itself and there will be no progress without hope. In all honesty, I still hold that belief. Not only that, but I believe also in the power of belief and sincerely wish for you to join me as we look forward to the 100th Anniversary of our Republic.

Yavuz Canevi

Special Issue, June 1984

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister, Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance, Vural Arıkan
Minister of Foreign Affairs, Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM), Ekrem Pakdemirli
Undersecratary of State Planning Organization (PM), Yusuf Bozkurt Ozal
Undersecratary of Ministry of Finance, Ertugrul Kumcuoglu
Governor, Central Bank of Turkey, Yavuz Canevi

THE ANGLOPHONES*

This term now applies collectively to Mr. Yavuz Canevi, governor of the Turkish Central Bank and his Deputy Zekeriya Yıldırım. The Central Bank used to be run by Francophone team until US educated Governor Dr. Cafer Tayyar Sadıklar in 1976 and his deputies Mr. Yavuz Canevi and Mr. Zekeriya Yıldırım who were also Anglophones. Again the Central Bank, which had traditionally directed banknote printing and relied heavily on its introverted policies like administering rediscount facilities, reserve requirements, setting short and medium term interest rates etc. However, as in all newly emergin countries in Turkey too, the role of Central Bank has radically changed as a result of the famous January 24, 1980 economic program. The most pressing subjects now before the Central Bank are foreign exchange movements and foreign banking development. Another mission, according to official pronouncements, is assisting Turkey's over 40 banks to rid themselves of their conventional concepts in a major overhaul of their activities and enter into closer relationships with the foreign world.

The godfathers of this new drive Mr. Canevi and Mr. Yıldırım are aptly named "Anglophones" because they spend much of their working hours on telephone speaking English rather than their native tongue. Both Mr. Canevi and Mr. Yıldırım studied

economy and finance. Mr. Canevi at the Ankara University's Political Sciences Faculty. Later on, he joined the Finance Ministry as a specialist. Mr. Yıldırım, on the other hand, obtained a BA from the Economy Faculty of the Istanbul University. Like his boss, he also joined the Finance Ministry.

But they never suspended their links to the academic life. In the United States, Canevi completed a doctoral thesis on Turkey's development dynamics. He was very adamant over his points. In the early 1970s, Canevi became the focus of attention in the financial and academic circles with his thesis titled, "Continuous Adjustments in Exchange Rates". In this work, Canevi proposed a review of stiff exchange rate policies put into effect by Mr. Ozal when he was in charge of economic planning. Expectations yielded results and Mr. Canevi, in a reshuffle of top posts in the Central Bank, was appointed deputy governor in charge of foreign relations. Mr. Yıldırım was asked to head the Bank's foreign exchange section.

Just when Mr. Canevi and Mr. Yıldırım accepted their new jobs, 1976-1977, Turkey was going through one of its most difficult straits in its history. Turkey had declared moratorium on its nearly 20 billion dollars in debts. The Central Bank was exclusively dealing now with the task of contracting the creditor countries and banks, and the same time finding fresh sources for foreign exchange spending. This called for a careful and sensitive management of the Bank's coffers. A technical team headed by Mr. Ozal has succeeded in consolidating Turkey's debts. It was only a moment's relief for debts amounting to 20 billion dollars in foreign credits and loans.

This showed, without question, the need for a better management of foreign exchange holdings. In the meantime, in a major decision befitting the courageous new policy, the value of the Turkish Lira was to be fixed on a daily basis against hard currencies. A subsequent arrangement decreed on December 29, 1983, upgraded the policy to a so called "framework system". In short, the new attitude required the Central Bank with leading the way in determining foreign exchange rates for other banks.

Now the Central Bank is confronted with another urgent topic. In the aftermath of the 1980 economic stabilization program, the IMF required a biennial consultation with Turkey for IMF sanctioned credits. This process, which appeared to be routine in the beginning, resulted in an increased role for the IMF. The international financial organization was now holding the country's economic barometer in its hands. As a result, the task of facing up to the IMF now rested with Mr. Yıldırım and Mr. Canevi. A common belief is that they have been so far successful in defending Turkey's rights. At least, with the foremost "bridge credit" secured from OECD countries, other credits obtained from commercial banks are a testimony to their uncumbersome operation of the Central Bank's affairs.

Both Mr. Canevi and Mr. Yıldırım symbolizes the importance of personalities in the integrity and cohesiveness of an institution. They are the examples of "converted brains" who have taken over the duty of reorganizing the Central Bank and carrying out the "outward policy" in relations with foreign banks and the IMF in particular.

(*) An Article appeared in the special issue of Economic Dialogue-Turkey in June 1984

Distrubuted at the IMF-WB Annual Meeting

September 1984, Washington DC, USA

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister, Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance, Vural Arıkan
Minister of Foreign Affairs, Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM), Ekrem Pakdemirli
Undersecratary of State Planning Organization(PM), Yusuf Bozkurt Ozal
Undersecretary of Ministry of Finance, Ertugrul Kumcuoglu
Governor, Central Bank of Turkey, Yavuz Canevi

CENTRAL BANK PRESENTS THE TURKISH CASE*

About 40 senior central bankers from various countries met on May 6-9, 1984 at the International Central Banking conference by the Federal Reserve Bank of New York on the theme "LDC Finance-Managing the Way Back". The governor of the Central Bank Yavuz Canevi, the only representative of a developing country to present a paper at the meeting, explained the recent experience of Turkey, a country with an enviable record in debt management.

Yavuz Canevi speaking on the first day of the conference discussed the experience of achieving and sustaining the internal and external stability by implementation of "proper" economic policies and establishing appropriate institutions in the context of the resent Turkish experience. The Central Bank governor drew the attention to the "critical" situation faced by Turkey at the start of 1980; no growth, accelerating inflation and stagnant export earnings, and explained the measures put into implementation to solve the problem.

In the field of institutional reforms, Canevi told his colleagues, Turkey has abandoned the principle of state intervention while adopting the rules of the market economy, introduced a new foreign exchange regime and liberalised foreign trade. Canevi also emphasized the monetary approach to the balance of payments problems and the reform in public finance and incomes policy.

The Governor of the Central Bank elaborated on debt management and rescheduling as well as on the restructuring of the banking system and capital market institutions, and the policy of real interest rates to boost savings.

Export issues were given a prominent place at Canevi's presentations which stressed the implementation of realistic exchange rates, efforts to penetrate new markets and the introduction of "efficient" incentive policies.

Among leading speakers at the conference held between May 6 and 9, were the IMF's managing director Jacques de Larosiere, the chairman of the Federal Reserve Board P.A. Volcker and IBRD Vice President E.Stern.

(*) An announcement in the Economic Dialogue-Turkey's September 1984 issue

ROLE OF STABILIZATION POLICIES IN THE WORLD: THE TURKISH EXPERIENCE*

INTRODUCTION

The aim of this paper is twofold :

- To attempt to revisit the Turkish experience in stabilization, structural adjustment and liberalization policies during the period of 1980-1992
- To draw some lessons from this experience and make an assessment of the current status as to the sustainability nature of the said program.

In order to appreciate the background against which the reform program was set up I intend to give you a brief economic history of the pre-reform period. Therefore it seems appropriate to take a chronological approach in my presentation.

Consequently I have organized my presentation in three sections: (A) Historical Background; (B) Gathering Of Storm Clouds Toward Makings Of A Crisis; (C) Surviving The Storm With Adjustment Policies And Restructuring For The Future; (D) An Assessment Of The Past And Examination Of The Current Situation In Terms Of Sustainability; (E) Conclusion

HISTORICAL BACKGROUND

Historically, one can identify the following distinct periods in Turkey's political and economic development process:

I. 1923-1950

Founding the Republic and rebuilding the war torned country through "Etatism" with a single party political system.

II. 1950-1960

Meeting "Democracy" with a multiparty system and experiencing the first wave of liberalism in economic management.

III. 1960-1971

Facing the first "Coup d'Etat" and introduction of "Five Year Indicative Development Plans" concept with heavy emphasis on import substitution. The first plan covered the period 1963-67 and there have since been successive five year plans and annual programs. The current plan is for 1990-1994.

IV. 1971-1980

Returning back to democracy albeit an unstable one due to successive coalition government's weak enough not to respond to the internal and external economic and political difficulties and changing circumstances. Particularly important were the civil violence between left and right wings and severe labor strikes.

1980-1983

A successful implementation of a new economic reform program with a military backed government (mainly led with technocrats).

1983-1984

Returning back to democracy again with an uninterrupted, even strengthened reform program but gradually decreasing success in achieving intended targets despite having the same type of technocrats in a higher office until 1989.

I am confident that everyone in the audience will appreciate the need for me to focus on a few issues and policy measures that we, in Turkey, consider to be crucial in the success and failures of our stabilization efforts, rather than to try to enumerate all the policy actions that were taken.

In fact emergence of a strong political leadership with a vision and knowledge of country's history of economic and political development and current status of the world economic and political order and creation of a new breed of economic team closely tied to and strongly supportive of leadership were the pillars of new economic program.

GATHERING OF STORM CLOUDS TOWARD MAKINGS OF A CRISIS

Turkey's development strategy during the 1950s and 1960s aimed in particular at fostering agricultural and industrial production, improving basic infrastructure, and integrating the

rural and urban sectors into a single market economy. Implementation of this strategy resulted in a period of steady and substantial growth. The economic programs supported by stand-by arrangements in every year from 1961 through 1969 aimed at moderating fiscal and monetary expansion so as to provide a framework of domestic and external financial stability in support of the development strategy.

Being a relatively well to do developing country, Turkey has maintained annual growth rates averaging 6-7 percent between 1965-1977. This seemingly good growth performance, however, has been realized by an import substituting economy which critically depending on imports of capital and intermediary products and on a highly protected domestic market to the neglect of an export potential of the country. The inefficiencies and distortions developed in the domestic economy as a result of a growing financial repression emanating from increasingly negative interest rates and discretionary allocation of credits deprived the economy of necessary domestic savings to perpetuate high rates of economic growth. Its viability has become critically depended on the availability of external savings to fill both the domestic savings gap and the foreign exchange gap resulting from high import dependence of the domestic economy.

In this early period there were two serious balance of payments crises which ended up with high devaluations rather than comprehensive reform packages. First one was at August 1958.

Since the August 1958 operation was lacking a macroeconomic approach and current populist government continued deficit financing, this situation has been transformed into a political crisis and finally in May 1960 it ended up with a military "Coup d'Etat". In two years time Turkey was back in democratic process. 1960s were the years of "5 year Development Plans" with a close cooperation of IMF and OECD.

However by the end of decade, in 1970, Turkey again faced the foreign exchange crisis and without addressing the underlying macroeconomic weaknesses another major devaluation was the only answer. Economic and political instability further increased when, in 1971, military issued a written "Ultimatum" to the political leadership. This ultimatum opened the way for "Milli Koalisyon-National Coalitions" period in order to broaden the base for sharing the political power and responsibility. Indeed, this situation further contributed to political instability with its short lived coalition governments. In general, two factors played a prominent role in the development of unstable coalition politics. On the one hand, there was the fragmentation of the two main centrist parties along ideological lines. On the other hand, the polarization of the left and right inside and outside the parliament contributed to increase in civil violence and erosion of government authority. All in all it was an atmosphere unfavorable to economic development.

After a prolonged period in which the external payments were continually under strain, Turkey experienced a short period in

the early 1970s during which there was a rapid improvement in the balance of payments, culminating in a current account surplus for the first time since the end of the Second World War, thanks especially to the workers' remittances which rose from an insignificant level in 1970 to about 1.2 billion dollars in 1973, owing to the buoyant economic conditions in the world economy. This transitional improvement in the balance of payments however, has insulated the Turkish government from the realities of the world economic developments.

Thus the Turkish authorities failed to take any serious measure to adjust the Turkish economy to the newly emerging world economic conditions in the aftermath of the first oil crisis. The massive adverse shift in the terms of trade in 1974, brought about by the very large rise in the prices for oil and industrial imports, as well as the recession in the industrial countries, led to the rapid disappearance of the current account surplus. In 1975 and 1976 economic growth was sustained by large-scale short-term borrowing i.e. convertible Turkish Lira accounts (CTLD or DCM) and, by 1977, substantial external payments arrears began to accumulate, leading to a drying up of external credits. The period of rapid growth came to an abrupt halt.

A number of stabilization attempts by the Turkish governments in 1978 and 1979 proved inadequate in the face of the severity of the problems and rigidities developed in the domestic economy. Although there was a considerable decline in the current account deficit during 1978 and 1979, this was achieved mainly through

a severe curtailment of imports. The resulting lack of key imported inputs had a severely adverse impact on domestic industrial output and employment. The reluctance of international banks to provide external finance on the same scale as in the earlier years contributed to the weakening of the balance of payments. As sources of credits continued to dry up, the balance of payments deficit was financed by a further accumulation of external arrears, and a drawing down of reserves.

Therefore the basic inward looking focus of the development strategy promoted a production structure biased heavily toward the domestic market, discouraging exports and resulting, toward the end of the decade, in increasing rigidities and distortions which intensified pressures on domestic resources. At the same time, the stance of financial policies weakened considerably, and increasing resort was made to exchange and trade restrictions and multiple currency practices to fend off pressures on the balance of payments.

Specially during the 1970s due to mainly political instability, with an unmanageable public sector deficit, unproductive SEE's, runaway inflation, protected markets and domestic currency, a serious BOP crisis due to ill-conceived policies together with the inherent difficulties of the political system as explained above throughout this period and finally the delay of an appropriate policy response to the first oil shock on the part of Turkish government and ensuing adverse world economic developments

left very little room for maneuver in the face of the second oil shock in 1979-1980.

An attempt to redress the deteriorating economic situation was made starting in late 1977. In fact Turkey was forced to make this attempt due to the debt rescheduling talks with creditors. Because of both private and official creditors were putting an IMF standby arrangement as a precondition of a rescheduling. However one should also admit the importance of the international political developments which had positively affected the western countries' attitude towards Turkey. These were the years during which Shah Regime of Iran fell, early signs of second oil shock emerged, Afghanistan was running into an unstable era and therefore Turkey was seen as the only potential island of stability in the area.

This situation, in fact, triggered rescheduling negotiations in coordination with OECD and IMF's technical, economic and political supports. Therefore a stabilization programme mainly designed to improve the balance of payments was developed which formed the basis of a two year stand-by arrangement that went into effect in April 1978 and July 1979. Nevertheless the programme proved to be inadequate in relation to the severity of the economic crisis.

Although some improvement took place in the current account, it was achieved by a drastic curtailment of imports and only a minor increase in exports. Moreover, the public sector finances

continued to deteriorate mostly due to a sharp rise in the operation losses of the State Economic Enterprises. Consequently, the Government could not stay within the IMF set ceilings and limits, so, the program were ineffective in eliminating macroeconomic disequilibria.

This was not surprising when one brings some light to the then prevailing political structure and the compositions of the coalition governments:

Mr. Demirel was prime minister during the 1975-1977 for two consecutive coalitions with NSP (National Salvation Party) and NAP (Nationalist Action Party). During these coalitions NSP was strongly promoting the idea of government involvement in heavy industry e.g. one of their slogan was "factories which manufacture factories". This mentality coupled with right and left wing street clash and terror did not leave too much room for Demirel to tackle with real economic issues. Then Mr. Demirel had to leave and Ecevit took turn, as a minority government, in 1977, and tried to deal with the worst period of economic crisis of the 1970s until 1979. During this period, not only the terror climbed up but queues in front of the stores and markets got longer and longer.

By the end of 1979 Turkey was in the midst of a severe foreign exchange crisis. The country was unable to import the essential items such as crude oil, sugar and even coffee. The inflation had accelerated and the unemployment was widespread and ever

increasing. Moreover, there was political turmoil, partly due to economic difficulties, and partly due to foreign subversion.

During the years in which the crisis was in the making (1974-79), the growth of GNP had declined to an average of 4.4 percent. Public sector deficit expanded rapidly from under 2 percent of GNP in 1974 to over 6 percent in 1979, and averaged 4.5 percent during 1974-79.

Thus, Turkey faced the second round of oil price increases with an extremely weak economy, a grossly overvalued exchange rate, virtually no foreign exchange reserves, highly negative real interest rates, a very high rate of inflation, widespread unemployment, stagnant output, political turmoil, and an external debt in excess of $ 13,5 billion, more than a quarter of which was short term. This was the end of another short lived minority government led by Bulent Ecevit, a social democrat and beginning of Demirel's third JP (Justice Party) coalition government with NSP and NAP again.

SURVIVING THE STORM WITH ADJUSTMENT POLICIES AND RESTRUCTURING FOR THE FUTURE

Faced with the most severe economic crisis in the history of the Turkish Republic, the Government became aware of the need to undertake fundamental reforms that would alter the structure of the Turkish economy. On January 24, 1980 the Government, another minority one, this time led by Suleyman Demirel, right

wing, initiated a major change in the orientation of economic policy and introduced a major and comprehensive economic stabilization package. Behind the package there was Turgut Ozal, a powerful technocrat as the Undersecretary of the Prime Ministry. Simultaneously the Government entered into negotiations with the IMF on the one hand, and other official and unofficial creditors on the other. Negotiations with the Fund resulted in a three year stand-by arrangement in the amount of SDR 1,250 million in June 1980.

However, due to the political weakness of the Government in power not even able to elect the President of the Republic in months long sessions in Parliament, political and economic turmoil continued until September 1980 military intervention. Military was fast enough to form a civilian government and put Turgut Ozal in charge of continuing the implementation and further strengthening the already introduced reform program.

Later in 1980, the stand-by arrangement with the Fund, and particularly, the strength of the underlying economic programme helped to convince the OECD governments to reschedule principal and interest payments falling due between 1980 and 1983 for ten years. Eventually, in 1981, the banks agreed to extend the maturities of the rescheduled bank debts to 10 years, which was done for 7 years.

Turgut Ozal served as Deputy Prime Minister from September 1980 until a bank-brokerage house crisis in 1982 which forced him to resign. Ozal's Minister of Finance, K. Erdem was blamed by the military leaders for causing the crisis. But, in fact, financial

deregulation and interest rate liberalization were the main pillars of Ozal's program. Therefore he took the issue personally and resigned from the office. Prime Minister, a retired navy admiral, Bulent Ulusu, was asked by the military leaders not to appoint a new Deputy Prime Minister but replace only the resigned Minister of Finance with Kenan Evren's chief economic and financial advisor, A.B. Kafaoglu who was an ex beaurocrat of the Ministry.

In fact, Ulusu government was consisted of mainly former technocrats and non-partisan prominent figures and considered as a transitory government leading to democratic elections because a rewritten constitution was submitted to and approved by the public with a vast majority in a referendum in 1982. With the same referendum, Kenan Evren, the military leader who initiated the September 1980 intervention, was elected as President of the Republic for 7 years and first general election based on new Constitution was set to be held in the spring of 1983. The most important element of the election issue was that old politicians and parties were banned to run for any political post. On the other side there were two new parties among others to be mentioned. One of them, Nationalist Democratic Party (MDP) was established by a retired army general Turgut Sunalp and almost publicly supported by the new president, Kenan Evren.

The other one, Motherland Party (ANAP) was established by ex technocrat and technopol, Mr. Ozal. When Mr. Ozal decided to form his own party in this vacuum, he claimed to pool four

wings under one roof. Namely, center right, center left, nationalist and religious oriented conservatists, i.e. national salvation. The Ozal's set up was very much appealing to the public who have been "an instability street clash fatigue" for years which was caused by endless and useless fights among these wings. These concerns coupled with the strong pleas of Ozal team which consisted of new, young and promising figures, for a free market economy and a set of administrative, financial and economic reforms for which the society was hungry. Moreover people were able to observe the performance of Mr. Ozal himself during 1980-1982 and convinced that he could put country's house in order.

Consequently, based on this background and despite an open support given by Kenan Evren to the Turgut Sunalp's party, Mr. Ozal's Motherland party came out of the elections with a comfortable majority and Mr. Ozal resumed office in 1983 as elected Prime Minister. He immediately picked up the January 1980 reform program to push through with some ambitious and major additional policy measures.

The January 1980 program was qualitatively different from the previous ones as it aimed at far reaching structural changes in the Turkish economy towards establishing the basis of an outward oriented growth model.

In fact, the government was determined to attack the sources of the economic crisis after 1980, while previous attempts of reforms were only intending to deal with the symptoms. This

feature constituted one of the main determinants of Turkey's ability to negotiate and implement a successful debt-relief with private, multinational and official creditors.

The policy reforms introduced in the beginning of last decade aimed not only at redressing the economic situation but also at changing the development strategy Turkey followed for several decades.

That is why we always referred to the new economic programme as "Policies with dual goal".

• *Stability was the first and immediate goal*:

One of the fundamental pillars of the free market economy is the ability to establish and maintain relative price equilibrium.

In achieving this goal it was necessary to remove the various imbalances in different markets in terms of relative prices.

By relative prices I refer to the following three markets :

Commodity markets:

Imbalance on these markets originates largely from the pricing policies of state economic enterprises (SEE's). It is aggravated further by certain discrepancies and inconsistencies in import regulations.

Labour markets:

Imbalances on these markets derive from taxation policy, income distribution and wage policies.

Financial markets and capital markets:

If we remember that the public sector has direct or indirect control over 80 percent of Turkey's financial sector, it is no surprise that every instance of inefficiency in the public sector rebounds on these markets, disrupting relative prices. Despite the abolition of price controls, including those on interest rates so long as the public sector and above all SEEs which are indirectly subject to price interventions, continue to dominate the economy, the system can never operate efficiently. Moreover, uncertainties in government policies and even on occasions retroactive decisions, put an even greater strain on these balances.

• *Structural transformation was the second medium term strategy related goal:*

As a developing country who was in need of regaining the international credibility the programme sought for a Balance of Payment viability over the medium term.

On the other hand, ultimate target of the restructuring was to enter into a path of self-sustaining growth.

These two basic and interrelated objectives were designed to correct distortions, inefficiencies, and supply rigidities in the domestic economy developed during the long years of financial repression by restoring market signals as a principal guide to economic policy decisions and also quick adjustments to external developments.

Correspondingly two sets of reforms can be identified to achieve these goals:

• *Institutional (Behavioral) Reforms:*

They are aimed at achieving a better, unified, efficient, coherent, responsive and productive, timely decision making and execution process in all fronts including Central Government, SEE's and private sector.

Starting point for this category of reform was the fact that one of the scarcest resources in Turkey at that time was the lack of an efficient decision making process. As a first step traditional organizational structure of the Ministry of Finance was broken down and Treasury Department was taken of the Ministry of Finance in 1983 when Ozal came to power as the winner of the democratic elections.

A new Undersecretariat under the Prime Minister's office was created as "Undersecretariat of Treasury and Foreign Trade". Consequently, Prime Minister, was consolidating under him the economic and financial management: Undersecretary of Treasury and Foreign Trade, Governor of the Central Bank, Undersecretary of State Planning Organization and newly established Extra-Budgetary Fund Administrations.

Newly established Money and Credit Committee was the technical forum to discuss the policy issues and headed by Minister of Finance and sometimes by Deputy Prime Minister or Prime Minister and attended by at least three Undersecretaries

mentioned above. Economic Coordination Council was the political forum headed by Prime Minister and attended by some key ministers and technocrats mentioned above. These institutions were considered short cuts for long political decision making process.

• *Policy Oriented Reforms:*

Liberalization of Foreign Trade:

Elimination of quantitative controls of imports such as quota and license system, introducing "negative import list" in lieu of "positive list", replacing non-tariff barriers, gradual reduction of protection levels were among the main policy instruments.

Liberalization of the Exchange Control Regime:

A gradual doing away with the conservative and rigid exchange control system called "Regulations for the protection of the value of Turkish Lira" dated back to the early years of the Republic. While a Turkish citizen who use to be penalized by having a single U.S. dollar in his pocket as late as 1980 today is able to open in any foreign currency a savings account at a bank of his choice in the country and make a transfer from that account to anywhere of his choice around the world without any restriction at all.

This is true for most cross border transfers. In addition, investors in Istanbul Stock Exchange may freely move money in and out of the country. Investors in real estate are guaranteed repatriation of principal, profits and rent.

Exchange Rates:

Real exchange rate policy was one of the key policy decisions of the reform program. A gradual process has been applied and from mini devaluations to daily adjustments and finally market determined exchange rates achieved today. Recognizing this progress in April 1990, the IMF accorded Turkey Article 8 status.

Export Orientation:

A new set of tools and institutions introduced for export promotion. Exporters allowed to import their inputs at world prices in order to be able to compete worldwide. Eximbank was established and export insurance scheme introduced first time to cover the country risks.

Financial Sector Deregulation and Reforms:

Freeing interest rates was the main policy decision to boost the savings. In a depressed market with negative interest rates this policy increased the monetization of the economy. However without regulatory and supervisory efficiency this situation first created and oligopolistic reaction from the banking system and then led to a financial crisis when a major brokerage house went under. After this crisis financial sector reforms were institutionalized by a new Banking Law, Central Bank Law, Capital Market Law and Istanbul Stock Exchange Law. First time a Deposit Insurance System was introduced to stabilize the financial markets. Elimination of the market entry restrictions attracted many foreign banks into Turkey, this in turn improved the competitive environment in the sector.

Fiscal Reforms:

Introduction of a major tax, V.A.T. by eliminating nine different taxes was the key reform in this area. Elimination of price controls both State Economic Enterprises (SEEs) and Private Sector, elimination of the subsidies in the Public Sector were important achievements.

Foreign Direct Investment:

Although Turkey had one of the most liberal Foreign Direct Investment Law since 1954 the implementation was conservative. While this negative attitude was overhauled during the new economic program some new elements introduced in order to attract foreign direct investments. The figures are self explanatory today. The total foreign direct investment received between 1954-1980 was 230 million U.S. dollar. Today annual entry is around 1.0 billion U.S. dollar.

Privatization:

When it comes to the weight of the public sector in the economy the privatization programme which is still being implemented at present was introduced as one of the major policies which was put forward in 1984 as an indispensable part of the new economic policy and within the framework of

a wide-ranging programme of structural transformation in the economy. Making the economy more responsive to market forces was the main goal of the government. The role of the government in economy was decided to be confined to the areas where private sector could not and would not enter due to the

considerations of profitability, scope and nature in public services, such as defense, health, education and infrastructure. This policy was viewed not merely as a new method of solution for the problems of publicly owned incorporations; it also made provisions for increasing competition and productivity throughout the whole economy and for increasing the ownership base.

The general objectives of privatization were listed, then, as follows:

- *Strengthening the free market economy*
- *Increasing productivity in the economy*
- *Developing the capital market*
- *Improving the distribution of income*
- *Diversifying the base of capital ownership*

After 8 years of experience, we can say that our lesson from the privatization experience is a mixed one if not favoring pessimism.

First of all privatization process was slow to get underway. The preparation required was frequently underestimated.

Second, institutional arrangement was not proper and efficient in the early stages. What was needed was an independent one stop agency with a strong political backing. Due to already high unemployment rate around to 15 %, people are not convinced yet the merit of the issue, therefore politicians too are still skeptical about the implications on the electoral votes.

Third, legal base has to be fortified in order to give confidence for international investors.

Least but not last, the issue of privatization has been too much politicized both by the administration and particularly by opposition while the shadows of "the capitulations" during the Ottoman Empire still fresh in the public opinion the privatization issue is one of the key issues deserve consensus which has not been addressed so far properly. A depolitization effort is needed in this regard, because the vulnerability of the government is reducing the efficiency of the administration and creating problems for the successful implementation of the program.

Priorities for Key Infrastructural Investments:

In addition to the above reforms, intensive efforts in solving the inability of the existing infrastructure to serve the new economic program should be mentioned here. Therefore energy, transportation and telecommunication investments were given top priority in order to be able to achieve a sustainable growth which in turn helped heating up the economy in short run.

It should be emphasized that although the whole idea is based on more liberalization, deregulation, decentralization and giving market forces more freedom to operate in the implementation process, the policy interdependence and medium term macroeconomic strategy considerations have been proved to be extremely important.

The interdependence of decisions affecting the private and public sectors are the first to be mentioned. The measures influencing the generation of savings and investment and incentives to particular activities and sectors are also interdependent. For one thing, increasing the availability of investible funds is required to develop efficient exports performance and import substitution. For another thing, rationalizing the system of incentives is necessary to ensure the appropriate choice of investments. Similarly, budget implications and the impact on the PSBR of the above policies are to be considered.

Correspondingly, the simultaneous implementation of the designed medium term policy measures is needed for each of them to have maximum effect.

At the same time, one should remember that in Turkish case, the growth of output and employment in the process of stabilization and structural transformation required first a consolidation of the external accounts and then a continuing flow of external resources to Turkey. These were in the form of private international loans as debt rescheduling and fresh loans, multinational organizations contribution as IMF stand-by and IBRD program and SAL loans, government to government arrangements as OECD debt rescheduling and Turkish Consortium fresh program loans, and private foreign capital. In this connection, it should be recognized that the shift from inward to outward orientation is a long process, necessitating considerable investments that could not be financed from

domestic savings alone. Therefore, putting ones house in order through a comprehensive and coherent set of policies is the key and a precondition in mobilizing the required external resources.

AN ASSESSMENT OF THE PAST AND EXAMINATION OF THE CURRENT SITUATION IN TERMS OF SUSTAINABILITY

Up to now, I tried to present a brief historical overview of the Turkish experience with the crisis and economic stabilization and restructuring. It is undoubtedly true that there is nothing novel about these policies which I just described.

These policies are well known, they drive from sound economic theories and they have been practiced elsewhere with mixed results. Why, then, were these policies so much more successful in the case of Turkey, especially for the period between 1980-87.?

I believe that some additional ingredients existed to play the catalytic role of harmonizing these policies and render them to be successful:

- *The commitment and the determination of the political authority to carry through the stabilization programme. It was fortunate for Turkey to have governments with the political will that is necessary to implement and carry out the painful stabilization measures and to*

reorient the economic structure on the basis of free market principles. I should also add that the end of political turmoil and chaotic political structure and the introduction of social peace in September 1980 as a result of intervention by the Turkish Armed Forces together with the commitment on the part of military authorities to maintain the stabilization programme with an increased vigor, greatly facilitated the filtering in economic adjustment process with an "heterodox approach" during 1980-83.

- *The speed of implementation of the adjustment policies was crucial for their success. Since policy measures were considered a bitter medicine, they should better be taken quickly rather than gradually.*

- *The confidence of the public in economic leadership made the adjustment process acceptable, although it was made quite clear by the authorities that the results might be obtained only after 3 to 5 years. This was the reason for working class accepting a decrease in real wages in the early years of the program.*

- *The existence of economic and human resources to be tapped, a potentially sound infrastructure to start with, and as high as 50-60 percent idle industrial capacity to be utilized, eased the adjustment problems when the crisis emerged. In addition, a wave of reverse brain drain after 1983 contributed to the adjustment process.*

- *Availability and relatively easy access to new export and construction markets, despite the world recession and heavy protectionism, greatly facilitated the adjustment.*

- *To have a relatively small share of total debt owed to international commercial banks, a large portion of the total debt to the governments and official bodies. This structure of external debt eased the management of rescheduling.*

Even keeping these special features in mind I believe that any developing country which is in the process of structural adjustment and in need of external financing has the primary responsibility of displaying the political will and determination, working together with the international financial community, to undertake the necessary steps through which it can assure a successful adjustment to the changing economic environment.

However, it is not my intention to suggest that the problem at hand does not have more than one dimension and I do not think that anybody can neglect the multidimensional character of the issue. The problem has to be considered within the context of the underlying economic and financial policies and developments from which the existing crisis has emerged.

When the aforementioned facts are coupled with volatile interest rates and cross-currency rates, the problem of stabilization, specially external debt adjustments becomes rather unmanageable. Due to this result, developing countries found themselves faced with capital outflows when they needed fresh capital inflows. Therefore, a significant reduction in the international interest rates and foreign exchange rates volatility should be considered as a crucial element in achieving a

workable set of measures to deal with the problem of sustainable stability and adjustment.

Finally it should be said that without the restoration of terms of trade of the developing countries, without a sustained improvement in the access of developing world's exports to the markets of industrialized countries, and without an increasing level of private direct investment, every effort of the developing countries in designing and implementing a coherent stabilization or austerity programme will be bound to be short lived as well as politically and economically unbearable. Of course there will always be special cases subject to special considerations.

As I have just gone over, the last decade undoubtedly has witnessed unprecedented and even more important, unreversable changes on the Turkish economy. Nearly 70 years after the foundation of the Republic we can at last look forward to both a healthy and sustainable free market oriented growth and a gradual integration of the Turkish economy to the European Community and the world economy.

Some Key Observations:

- *The most conspicuous characteristic of the 1980 economic programme was its accurate diagnosis of Turkey's one of the scarcest resources. This resource was neither foreign exchange, nor savings, nor labour but it was an efficient decision making mechanism in macroeconomic issues. The efficiency, speed and flexibility imparted to the previously inert mechanism by such institutions as the Money*

and Credit Board and the Economic Coordination Committee go a long way to accounting for the programme's success up to 1985-86. Clearly it is a foremost priority today to set the economic decision-making mechanism functioning properly again which has been deteriorating since 1987. This deterioration or "Reform Fatigue" accelerated in 1989 when Mr. Ozal moved to the presidency of the Republic and reached its peak with the new coalition after 1991.

- *Similarly, extra-budgetary funds which were introduced as an institutional reform have lost their original target of allocative efficiency in public funds and became the major source of the financial disarray. That is why a movement has started to send these funds back to the budget.*

- *The foreign trade regime has been increasingly liberalised over the past decade. As there is no question of reverting to the quota system or export incentives in the form of tax refunds, the time has come to liberalize the system still further, avoiding unfair competition by the objective and effective implementation of anti-dumping and anti-trust regulations, while simultaneously expanding Eximbank and export insurance service.*

- *In order to capitalize these developments Turkey has to develop her own export markets by using new opportunities such as Black Sea Economic Cooperation Zone and new Republics in the Eastern Europe and former USSR since easily accessible markets like the Middle East markets are no longer exist as was the case in the early 1980's.*

- *It is crucial not to overemphasize the role of the monetary authority and monetary policy in market orientation with export led drive.*

In fact, monetary policy, since 1980, had to do both the domestic stability and the balance of payments side, to the extent that one could pursue two goals with one instrument. This means that more support from the fiscal side is urgently needed. Otherwise Central Bank's credibility will be at risk for an unintended cause. Therefore a new set of consistent macro-economic policies as well as the coordination in their implementation is required in restoring and sustaining credibility, and achieving steady growth under price stability.

- *Foreign Exchange control regulations and policy have been deregulated to the point of no return, and the integration with international markets is on the march. Consequently the response to developments on foreign markets should not be to make artificial amendments and interventions to exchange controls or policy, but rather to adjust domestic economic policies (budget, money, elimination of the differences between inflation rates in Turkey and her trading partners, i.e. realistic exchange rate policy is a tool for balance of payments adjustment not for inflation control).*

- *It is particularly important that the Turkish financial markets, which have been integrating with international financial markets since 1980, continue to do so and to keep up the process of self renewal.*

- *As the market economy has taken root the "buttons" which can be pressed by the public authorities in order to achieve economic development and combat inflation are now fewer in number; this is the inevitable outcome of free market economy. Moreover, their characteristics and functions have also changed. Against these limitations on part of the policy makers, there is an important positive side of having market forces and institutions functioning: Today we can comfortably talk about a considerable improvement of the Turkish economy's ability to respond to external and internal shocks without any public authority's intervention by law or decree. I would like to remind that this lack of responsiveness was the leading cause of the crisis in late 70's. However one should also remember that this phenomena itself makes the whole system more vulnerable to any change. Developments in the area of currency substitution by increasing foreign currency denominated savings to a level of around 50 % of the bank deposits is a good example of this vulnerability.*

- *One should bear in mind that the bitter flavor of stability programme remedies cannot be disguised by any name. Whereas doctors shake the bottle before giving the medicine to their patient, in economics you have to shake the patient first. This is because markets i.e. patients of the economy, are attached to the status quo. They would prefer to assume that the current situation will continue indefinitely, because the players have adapted themselves to the system and are reluctant to change. To break down this resistance the patient must first be shaken out of this comfortable expectations by convincing him that in the not so long term the system will work better with the new adjustment policies.*

- *It is important to note that initiating a reform program depends on certain preconditions, but sustaining that program requires some additional sets of conditions. January 1980 program is the case in point. Although it looked comprehensive, in the implementation stage it ignored or postponed or put aside one of the key segment of the program, namely the public sector finance. That is why the inflation has remained as an unresolved issue. The danger is not addressing this problem directly and in time was that the credibility of the whole program is being questioned today and reform fatigue has started to build up.*

Assuming for a moment that the reforms are completed in all fronts then in order to avoid slippages, the system has to create its own "guardians" who would lobby in favor of sustaining the reforms e.g. beneficiaries of the program such as exporters, construction companies, savers, importers on the one side, professional market representatives such as, chamber of industries, trade unions, academia and media on the other.

What we are observing today in Turkey is just the opposite. Due to the long lasting, almost ten years, inflationary environment a disguised proinflationary lobby has been created which may be stronger than reformist lobby.

Since there is no visible crisis which would make easier to initiate a new reform package, the current government is facing a real challenge to reverse this situation and push through a complementary reform package which will include public finance reform in it.

On the other hand, the current government might not have another alternative than acting on fiscal discipline i.e. reduction in PSBR, for at least the following reason:

As it is explained above while the reforms related with public sector finance and PSBR either put aside or postponed liberalization and deregulation policies related with financial deepening such as new capital market instruments and institutions and particularly policy actions towards the convertibility of Turkish currency announced out clearly .This situation brought with it a public sector crowding out effect in financial markets which can easily lead a short term capital out flow in case of a crisis. In short, the vulnerability of the liberalized and deregulated economy should always be a prime concern to the decision makers.

- *Last but not least, one of the key deficiency in implementing market oriented reform policies was the lack of efficient, speedy and just, legal system, be it administrative, tax or juridical. While financial administrative reforms were given some degree of priority, working of the legal system was taken as a given. In fact, the most important element of a successful free market economy is to create an atmosphere in which there is little or no space at all for an unfair competition. If some market players can easily get away with already reduced rules and regulations without getting penalized neither by the market nor the establishment, then the new market system easily becomes a self defeating system. In this case, most observers are inclined to blame the market system rather than the determinants of that system: tax and audit system, SEE system, subsidy system, court system etc.*

CONCLUSION

Turkey's experience in market economy in order to design and implement a growth oriented adjustment strategy during the 1980's, suggests that a set of comprehensive and coherent reform policies with a political determination and public support can make an economic recovery leading to a sustainable growth possible.

In fact, each country will necessarily have a different but appropriate sets of policies and instruments to choose from in launching a structural transformation programme. However, regardless of the selected policies and instruments, the commitment and the determination of the political authority to carry through the programme and the confidence of the public in economic leadership are essential ingredients in the success of any programme.

Furthermore, it is important to note that it would be inappropriate for any country who is undertaking a major structural transformation through market orientation to adopt a static/fixed strategy. Due to the dynamic nature of a developing country on the one hand and unstable but mostly progressive nature of the international markets on the other, the initial set of policies will be and should be subject to continuous review. In fact one of the most significant end results of the market oriented structural programmes is to increase and improve the economy's ability to respond to internal and external developments through market forces.

Indeed economic growth is an imperative not a choice. Without growth you cannot achieve more. But what is important today is the model of growth which links growth with the life of people. So, the problem is now how to survive, not how to grow sufficiently for the new concept of sustainable development which is based on structural economic humane and environmental constraints.

In this context, the dimension of human development elaborated by the UNDP appears as a realistic way out, as a means of salvation. Only can the creative capacity of well educated human beings seize the opportunities offered by and, overcome the difficulties arising out of the integration with the world economy. Only can they compensate for the lack of increased competition. Only can they raise foreign savings and investments and import and adapt appropriate technologies. Only can they reach the global market.

Turkey is a much luckier developing country than many others in this respect. Paradoxically, the fact that it was one of the first which went virtually bankrupt in the late 1970's led it to a major policy shift in the early 1980's, hence gaining a very valuable time. I wish only stress one point.

Success in a free market economy depends squarely on private initiative. In this process, Turkey discovered that it had some very good entrepreneurs, a new breed of managers, disciplined and productive manpower and a service sector highly adaptive

to new technologies. In other words, the new era found Turkey quite ready for new challenges in terms of human development.

Our decade old structural adjustment and economic transformation program were in fact intended to build on the achievements and mistakes of the past.

Similarly to impart a new element of dynamism and to inject a new momentum to the Turkish economy in which the problems are less severe and fundamentals are much stronger, all we have to do to look back and take stock of the developments and develop a skill for converting our mistakes into our assets. Because that is what they are. This does not mean that we don't have shortcomings. We still do, but one can easily identify them and reach the conclusion that we are also not short of solutions.

No one today challenges the achievements on market orientation in Turkey. Therefore majority of the people agree that Ozal has done a great job in the 80's. But with this acquired momentum of the 80's people are looking for new dimensions, new waves and wondering where to go from here i.e. specially after the cold war is over, the question of identity has re-emerged with force.

At this juncture, on the way to the full membership of the European Community, Turkey's challenge is that she must pursue her uninterrupted transformation and adjustment for market economy and democratization to secure a sustainable but rapid growth in order to provide the living standards that Turks have come to expect.

However the real challenge, it seems, is "keeping the dynamism going". It is to believe that this dynamism looks solid, deep rooted, but it can be lost if it is mismanaged.

Consequently, what is striking today is the awareness of the Turkish people that to avoid an increasing marginalization of the country within the context of the European cause regardless of her temporary political and economic crisis, and evolving world economy, not only the reforms will have to be consolidated as they go along but new attempts in reforming the public sector activities, including privatization, will have to be accelerated to take full advantage of global opportunities. There are enough reasons, today, to believe that these opportunities will not be missed.

(*) This presentation later published in January 1993 by the Institute for International Economics, Washington D.C. under the title of “The Political Economy of Policy Reform: Reflections on the Turkish Experience”

Special Issue April 1985

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister, Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance, Vural Arıkan
Minister of Foreign Affairs, Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM),Ekrem Pakdemirli
Deputy Undersecratary of State Planning Organization (PM), Cengiz Aysun
Undersecretary of Ministry of Finance, Ertugrul Kumcuoglu
Governor, Central Bank of Turkey,Yavuz Canevi

THIRD WORLD DEBT ISSUE*

Let me briefly reassess the origins and the current trends in debt issue with broad lines in order to set up a background for my analysis. In the 1960's the world economy was in a relatively stable state and the developing economies were experiencing a good level rate of growth over 5 percent annually on average, exceeding the growth rates of industrial economies.

- *The stability of the global economy helped the developing countries to carry out investments over their domestic sayings where the difference eventually reflected in their current accounts. The current account deficits which were actually not unbearable due to unfavorable terms of trade, financed mainly by official capital inflows and direct foreign investments. Until 1970, the developing economies did not borrow heavily from international financial markets and bank lending to developing economies were mainly limited to finance trade, and while total outstanding debt was U.S$70 billion, approximately 50 percent were owed to private sources.*

- *In the late 60's we saw the emergence of some monetary problems in the global economy and while the growth rates of industrial economies declined, inflationary pressures had begun.*

- *In 1973 and l974, the oil prices quadrupled and major economies began to enter recession. Both of these developments adversely affected the developing countries, increasing import expenditures and squeezing exports. These developments in turn considerably increased their external financing requirements. Some of the countries which are generally called 'aid graduate' began to borrow from international market due to inadequacy and insufficiency of official credits. And by 1975, the current account deficits of oil importing developing countries rose to 4 percent of their GNP on average from about 1 percent in 1972.*

- *The funds of the OPEC countries which accumulated in international banks eased the finance problem, and developing economies borrowed from these funds in order to finance their vital imports such as fertilizer and essential inputs for economy besides oil. The industrial countries encouraged this lending process or the `recycling' in order to moderate the impact of oil price increase. Besides the recycling operation, the funds of the IMF were enlarged through oil facilities. Generally, the recycling of the funds of the OPEC proved successful and the impact of the shock cushioned, although some countries including Turkey could not had overcome the problems caused by the oil shock and went eventually, to rescheduling. The main reasons behind the failure were the lack of adjustment of the economies by keeping unrealistic exchange rates and not to control domestic*

demand besides heavy borrowing with short-term maturities mainly to cover the local currency needs.

- *But in general, part of the reason why developing countries did not experience much deterioration in their debt ratios was the world inflation which picked up with additional effect of oil prices. This, in turn, eased the interest burden on debts. Also, the monetary policy pursued in major economies kept the interest rates low and even negative in real terms which helped the developing economies to borrow from markets.*

- *The same assessment cannot be made regarding the developments after the second oil shock in 1979. I think the key difference was the change in global economy which turned out to be more difficult for developing economies in 1980's than 1970's. The governments of industrial countries where the adjustments have been completed mostly concerned about the inflation and given the difficulties to cut government spending, they emphasized on monetary aggregates and restrictive monetary policy was pursued in industrial countries. This resulted in record high interest rates both in nominal and real terms. On the other hand, the consequences of their development on indebted countries were not deeply considered due to confidence in the ability of the international banking system to continue playing its role in recycling.*

The rarity of defaults on sovereign loans and the squeeze of the markets in major economies relaxed the banks' attitudes for lending, and the loans to developing countries expanded rapidly

after 1979 at over 20 percent annually and the share of short-term credits in total borrowing rose substantially with the belief that they are less risky than long-term credits. But the rapid buildup of short-term debt increased the vulnerability of borrowers to a sudden cut in credit lines.

- *Therefore the prolonged world recession and deterioration of terms of trade with sustained high real interest rates led to a debt crisis which the world experienced in 1982.*
- *In the course of 1983, the industrial world has begun to experience recovery which the U.S. got much of the credit, and last year recovery has accelerated in the benefit of global economy. These developments had positive effects on developing economies and on their debt burden. While the current account deficits of developing World declined and became 7 percent of their exports, their exports rose more than 8 percent, their GNP rose 4 percent on average against 2 percent increase in 1982-3 and the total disbursed debt reached around US$ 700 billion in 1984 which was US$ 140 billion in 1974 and US$70 billion in 1970.*

The Turkish Experience

- *In my assessment of the debt issue of the developing countries, mentioned that the debt accumulation in 1973-79 period did not lead to a debt crisis by the help of several policies. Then it is interesting to review the experience of Turkey in debt servicing to see that it was the result of deferred adjustment and heavily borrowing in short-term.*

- *Turkey, as a general attitude, has the ambition to achieve high growth rates to reduce the high unemployment rate and to provide higher living standard, and to this end a planning organization has been established in the 1960's for a planned economic growth and in fact until mid 1970's high growth rates were achieved.*

- *In the wake of the first oil shock the Turkish economy remained healthy despite some signs of weakness in certain areas. During 1968-73 GNP has increased at a rate about 7 percent annually. While the terms of trade deteriorated gradually, the current account of the balance of payments improved and recorded surpluses between 1971-73. As a result of the improvements in current account as well as the consistent surpluses recorded in the capital account, the gross international reserves increased rapidly and reached to U.S.$ 2 billion by 1973 and the total external debt was under U.S.$ 3 billion of which 8 percent was short term. Moreover the debt service ratio was as low as 5 percent in 1973. On the domestic side, while the monetary aggregates expanded accomodatively, the economy was living a moderate rate of inflation which was 13 percent on average between 1968-73. The Central Bank generally financed both public and private sectors due to the structural weakness of the financial system and while currency issue increased by 20 percent between 1970-73, the money supply increased by 25 percent showing a financial deepening in the economy.*

- *I think both domestic and external factors contributed to the gradual deterioration in the terms of trade and balance of payments from*

1973 through 1977. While the value of imports increased rapidly due to terms of trade effect and due to quadrupling of oil prices, the onset of the recession in industrial economies coupled with the lack of domestic reorientation policies led to a stagnation of exports. The current account deficit climbed over US$ 3 billion in 1977 from US$ 720 million in 1974. The policy makers of the time decided to finance the balance of payments by borrowing, perceiving that the effects of the oil price increase was temporary. The external debt rose rapidly and stood over US$ 11 billion in 1977 from US$ 2.8 billion in 1974, of which 54 percent owed to private sources.

- *Although the deterioration of economic environment originated in the external sector, failure or deferment to adopt adjustment policies on time contributed to this deterioration. Particularly important in this respect were continuation of import substitution policies which necessitated overvaluation of exchange rate of the Turkish lira and the continuation of the ambitious public sector investment programs which consequently led to worsening of public sector finance. Actually after the initial shock in the oil prices, the private sector adjusted by curbing investment, but the public sector, in order to secure high growth rates which was seen the way to reverse the developments in external sector, continued to realize high rates of investments.*

The ambitious investment policy of the public sector, besides increasing current and transfer payments, increased the level of public sector deficit. The budget deficits were mainly financed through domestic resources and by the Central Bank and to keep

cost of the finance low the interest rates on deposits were kept artificially low. The decreasing ability of the domestic capital market to yield savings and to finance budgetary deficits has led the government to inflationary financing in order to close the savings gap of the public sector. And the borrowings of the government from the Central Bank increased, putting pressure on the rate of inflation. With the decreasing ability of the low interest rates to yield financial income after the increasing inflation, demonetization process fastened while capital flight increased due to interest differentials caused by the overvalued currency and unstable environment.

- *The delay in policy adoption to meet the emerging external difficulties was also partly a consequence of the political instability where no political party had the majority in the parliament to show the will to accept adjustments policies.*

- *The accumulation of short-term borrowing began in 1975 after the increasing need for external financing which could not be met by official credits. The accumulation of short-term credits began by the reactivation of convertible Turkish lira deposits (CTLDs) and was followed by short-term borrowings of the Central Bank introducing of acceptance credits and finally by the accumulation of suppliers' arrears.*

- *During this period, tempted with the high spreads and fees which the country had to give to finance the oil import bill, the international banks increased short-term lending. At the end 1977, the traditional measure of debt service was around 20 percent.*

However, if the short-term debts were to be included the debt service ratio would have risen to 42 percent, 97 percent and 231 percent for years 1975, 1976, and 1977 respectively. Assuming that the part of short-term debts equivalent to six months of import purchases falls under the scope of trade financing and should not be included in the debt service ratio then the figure still remained as high as 131 percent in 1977 for Turkey. What the banks did not take into account was the consequences of a possible liquidation of short-term debt stock. This rapid rise in short-term debts combined with depletion of foreign exchange reserves left Turkey to reschedule its debts.

- *An attempt to redress the deteriorating economic situation was made late 1977. A number of measures designed to improve the balance of payments were implemented and Turkey entered in negotiations with the IMF and foreign creditors. Nevertheless, the program initiated proved to be inadequate in relation to the severity of the economic crisis. Although some improvements took place in the current account, it was achieved by drastic curtailment of imports and only minor increase in exports. Moreover, the public sector finance continued to deteriorate mostly due to a sharp rise in operating losses of state economic enterprises.*

- *In addition, between 1978-80 Turkey had to deposit its limited foreign exchange reserves as full cover with the correspondents so that letters of credits opened by the Turkish commercial banks would be confirmed. The need for foreign exchange became more urgent after the second oil shock by the end of 1979 and the country failed to import even the essential items, such as crude oil.*

- *On the other hand, the accumulation of short-term debt and the service of debts besides the import bill of essential inputs put pressure on foreign exchange reserves and foreign exchange reserves declined to US 8 950 million in 1979 from U.S. $ 1.6 billion in 1974.*

- *Consequently, a concerted action by five major parties made it possible to launch such a reformist program.*

  - The government, as the principal party with the determination and commitments, initiated a major change in the orientation of the economic policy and introduced a major and comprehensive adjustment and stabilization package in the beginning of 1980.

  - IMF was the second party with which Turkey successfully negotiated a three years stand-by agreement provided U.S.$ 1250 million.

  - Third party was the OECD. Later in 1980, the OECD governments agreed to reschedule the principal and interest payments of the debt for ten years falling due between 1980-1983 after the open commitment of the government to the adjustment program and also with the reactivation of the consortium for Turkey within the OECD, it was possible to arrange some, special assistance program along with the rescheduling.

▪ As the fourth party, IBRD supported the program with consecutive structural adjustment programs (SA Ls) and project financings.

▪ Finally the fifth party was the international banking community. A rescheduling was agreed in 1979 for a seven year term and later in 1981 banks agreed to extend the maturities to ten years. In 1979, around US$ 400 million fresh money portion was also agreed upon as part of the overall rescheduling negotiation. In our experience of stabilization program, the crucial issue was the judging the economy's ability to respond to different sets of policies. Because, in structural adjustment programs economic and institutional policies are designed to eliminate the rigidities built in the system. So that economy can respond to changes and be more flexible. When we examine the adjustment program from this point of view we first see that it was internally consistent. Because overall new economic policy had twin goals:

• Political and economic stabilization,

• Restructuring of the economy, for the purpose of regaining sustainable growth path through strength and stability. In achieving these goals the program had adopted the principles of free market economy in order to secure the optimum allocation of resources.

I would like to remind you that all these were planned and had to be implemented in an environment of world recession between 1979 and 1983.

Let me briefly go over the major policy measures that contributed to obtaining positive results:

I- Financial sector:

• *Real interest rate policy*
• *Banking sector reform*
• *Capital market reform*

II- Foreign exchange policy and foreign trade regime:

• *Flexible foreign exchange policy*
• *Liberalization of imports*
• *Export orientation*
• *Elimination of exchange controls.*

III- Public sector:

• *Change in pricing policy of state economic enterprises and elimination of subsidies.*
• *Privatization efforts*

IV- Budget policy and introduction of V.A.T.

V- Adoption of a tight monetary policy

VI- Private foreign investment policy

• *Reform in implementation of the foreign investment law*
• *Introduction of leasing law*
• *Introduction of free trade zones law*

• On the monetary side, the government adopted a more restrictive monetary policy with the understanding that a

noninflationary environment was necessary to provide optimal resource allocation. In order to encourage domestic financial savings and to arrest inflation, a new interest rate policy was adopted. Before, the interest rates were kept pressed in order to support investors with cheap credits. Of course this was an element of import substitution but it led to an insufficiency in domestic financial resources and misallocated the available funds. With the new interest rate policy, interest rates on deposits were raised considerably to provide positive real interest yield for savers and to channel the savings to the financial system.

Through the implementation of new interest policy, the financial savings increased and by this development domestic consumption was controlled and the financing of the public sector deficit which was responsible for inflationary process besides private domestic consumption was stopped.

- *Owing to the tight monetary policy, the domestic inflation came down and inflation rate subsided to 37 percent in 1981 and further to 25 percent in 1982 after the record level of 107 percent in 1980.*

- *The new economic program adopted a growth strategy based on export promotion against ever implemented import substition. The new strategy necessitated a realistic exchange rate policy and with the realization of this need the Central Bank started to announce the foreign exchange rates daily by using the principle of elimination differentials based on a simple dollar/DM trade weighted basket plus a marginal real devaluation factor to keep the*

competitiveness of the export sector. Since the increase in export earnings tog-ether with the decline in inflation emerged as a way out of Turkey from the crisis, some incentives such as preferential access to subsidized credits, waiver of import duties and tax rebates for export oriented production were introduced to ensure efficiency in this field.

- *The flexible exchange rate policy which we have adopted and ensuing gradual real depreciation of the Turkish lira provided the greatest incentive for the Turkish exporters while at the same time, helped to control import expenditure.*

- *The realistic exchange rate and interest rate policies also combined to bring the over flow of capital to a halt and reverse the flow. Due to the volatile nature of capital flows and the revealed inability to prevent such flows through regulation, it was provided by an environment of confidence and by assuring a rate of return for such funds which was sufficiently high in the view of international rates of interest and risk factor.*

- *In order to ensure market mechanism, the pricing policies of the state economic enterprises were changed and adjusted to market principles. As a result of this new pricing policy the state economic enterprises generated additional revenues to about 12 percent of GNP in 1980. Hence the borrowing requirement of the public sector reduced gradually and public sector deficit declined to 3 percent of GNP in 1981 from 7 percent in 1980.*

- *All these policies implemented with commitment proved successful. In both 1981 and 1982, GNP growth exceeded 4 percent. The rate of inflation fell rapidly, export revenues doubled between 1980-1982 while the current account deficit was reduced from US $ 3 billion to $ 1 billion and domestic financial savings doubled in two years.*

- *In 1983, the performance of the Turkish economy was less satisfactory than the previous two years and I think that was the result of minor policy slippages. After the policy slippages in late 1982 and 1983, the monetary policy has been eased and while reserve money and money supply growth rates increased over recent years, the rate of growth of financial savings declined due to decreases in interest rates. By the end of 1983 inflationary pressures began to build up besides the overvaluation of exchange rates which resulted in stagnation in exports.*

- *But in 1984 a newly elected government immediately started to install the policies that were necessary to put the economy back on the adjustment path. Moreover, the government introduced a wide ranging liberalization of trade and payments system. While the import regime has been fundamentally altered and liberalized, recently the government freed the Turkish commercial banks to set their exchange rates in foreign exchange dealings. More importantly, "rolling five year plan concept" is introduced.*

- *After the new banking law in 1984, commercial banks proved to be successful in strengthening their balance sheet structure. Moreover, thanks to the liberal foreign exchange policies, their foreign reserves increased by almost US $1 billion.*

- *It should be noted, however, that the safety and soundness of the banking system is not less compelling today than it was a year ago or five years ago. This is particularly true in a setting in which still a lot of corporations have not been able to complete their adjustment process or even worse, never tried to adjust. This obviously leads us to the non-performing loans issue which we still have to deal with. In this setting, majority of the firms will be able to survive and increase their profitability but some may not.*

Over time, market forces will make the determination as to winners and losers in this process of structural change. However in banking and finance where the principal ingredient to success is that great intangible-confidence the problems of the weak can undermine the prospect of the strong, especially during a period of transition. Therefore with steadily increasing number of foreign banks, in this liberal and competitive environment, all market participants are being made aware of the fact they have a mutual interest in seeing to it that the next phases of the evolution of our system give adequate weight and attention to structural arrangements. We believe a more efficient and innovative financial system within this scope which is expected of the foreign banks' presence in our country can do much to promote increased economic growth.

- *As the Central Bank of Turkey, with the authority and responsibility given to us by the new banking law, we are determined to guide and supervise all these efforts in order to enhance the stability as well as the dynamism of our financial markets. Because we strongly believe*

that, in the end the effective conduct of monetary policy is inexorably related to the strength and stability of the banking system.

- *Overall, successful results were achieved by the end of 1984 and while GNP has increased almost 6 percent in real terms, exports boosted to over US$ 7.1 billion and the current account deficit declined to US$ 1.4 billion from US$ 1.8 billion in 1983. In 1985, the corresponding figure is expected to be around US$ 0.8 billion. As a result of all these, the risk rewarding ratio is becoming seemingly higher in Turkey than in other developing countries in the region.*

- *As can be observed from the figures, a sustained improvement in the current account of the balance of payments is essential, particularly in view of Turkey's obligation to make substantial repayment of foreign debt in the period ahead. This improvement could not be obtained with an external sector that relied on restrictions and widespread protection against foreign competition. Therefore, credit should be given to the export led policies and wide ranging liberalization of the trade and payments system. Apparently, tight monetary policy together with an appropriate exchange rate policy can keep imports restrained even following a wide ranging liberalization.*

- *I think the Turkish experience with the crisis and economic stabilization and restructuring was very instructive. A special mention should be made here to the fact that overall adjustment period and particularly the fight against the inflation has taken more time than it was originally estimated.*

In retrospect, one can briefly analyze the reasons for this:

I- External factors:

• Development abroad of a sharp increase in the value of the dollar taken together with new flexible foreign exchange policy pushed the domestic prices upward through the price of oil, energy, imported inputs of industry, transportation.

- *High interest rates and strong dollar increased the debt servicing burden unexpectedly.*
- *Terms of trade effect was unfavorable.*
- *Protectionist trade policies by the industrialized countries made it very difficult for the country to implement its export orientation policies efficiently.*

II- Internal factors:

- *Resistance to adjustment policies. In the beginning of the program there had been a considerable resistance to the program with a view that no one can pursue permanently such a strong structural transformation. So it was considered a temporary set of measures. This attitude caused a delay in proper functioning of the system. More importantly, cost of adjustment had to be higher and period of adjustment had to be longer.*

- *In restoring their debt equity ratio under the new positive interest rate policy, corporations needed more time than it was anticipated.*

- *SEE's new pricing policy, though eliminated the budget subsidies to this sector, pushed the price indices upward.*

- *Introduction of the V.A.T. in the beginning of 1985 obviously made shock effect on prices.*

- *Budgetary constraints of the government and related domestic borrowing requirement made it very difficult for the domestic lending rates to come down with the expected speed.*

- *Due to the new liberal and deregulated foreign exchange policies, Turkish residents opened over $1 billion foreign exchange accounts with the Turkish banking system, with this potential of highly liquid assets it was rather difficult to control the monetary base.*

In summary, we can say that it was not the deficiency of the program itself which caused some delays in achieving certain targets, like inflation rate, but the already mentioned sets of internal and external factors were responsible for the current situation. Therefore, the government is convinced today that it cannot and should not afford to relax its commitment to pursue this free market and export orientation with stable and realistic exchange rate and positive interest rate policies.

- *The government is still in the opinion that inflation is not an inevitable accompaniment to economic development. In other words stability and growth are mutually incompatible and they can be achieved once again if policies and behaviour are both directed towards*

that end. So, rehabilitation and restructuring of the economy need not entail an enduring severe crisis.

- *I tried to present a brief historical overview of the Turkish experience with the debt crisis, economic stabilization and restructuring. It is undoubtedly true that there is nothing novel about these policies which I just described. These policies are well known; they derive from sound economic theories and they have been practiced elsewhere with mixed results. Why, then, were these policies more successful in the case of Turkey? I believe that some additional ingredients existed to play the catalytic role of harmonizing these policies and render them to be successful:*

The realization of the fact that one of the scarcest resources in a developing country is a decision making power. Therefore the government showed the ability of improving the efficiency of the decision making process.

- *The commitment and the determination of the political authority to carry through the stabilization program was there. It was fortunate for Turkey to have governments with the political will that is necessary to implement and carry out the painful stabilization measures and to reorient the economic structure on the basis of free market principles. I should also add that the end of political turmoil and chaotic political structure and the introduction of social peace with Turgut Ozal government in 1983 with a commitment to maintain and strengthen the stabilization program with an increased vigor greatly facilitated the economic adjustment process.*

- *The speed of implementation of the adjustment policies was crucial for their success. Since policy measures were considered a bitter medicine, they should better be taken quickly as a shock rather than gradually.*

- *The confidence of the public in economic leadership made the adjustment process acceptable, although it was made quite clear by the authorities that the results might be obtained only after 3 to 5 years.*

- *The existence of economic and human resources to be tapped, a potentially sound infrastructure, and as high as 50-60 percent idle industrial capacity to be utilized, eased the adjustment problems when the crisis emerged.*

- *Availability and relatively easy access to new export and construction markets, despite the world recession and heavy protectionism, greatly facilitated the adjustment.*

- *To have a relatively small share of total debt owed to international commercial banks. A large portion of the total debt was due to the governments and official bodies. This structure of external debt eased the management of rescheduling.*

- *Even keeping these special features in mind, I believe that LDC's which are in need of external financing have the primary responsibility of displaying the political will and resolve, working together with the international financial community, to undertake*

the necessary steps through which they can assure a successful adjustment to the changing economic environment.

However, it is not my intention to suggest that the problem at hand does not have more than one dimension and I do not think that anybody can neglect the multi dimensional character of the issue.

The problem has to be considered within the context of the underlying economic and financial policies and developments from which the existing debt crisis has emerged.

Final Comments

- *It should be noted that the last couple of years' attempt of coordinated approach of the Fund, World Bank, governments of lending countries (OECD, Paris Club) and international banking system to the debt problems has certainly helped to bring about a greater consistency between the banks' lending policies and countries borrowing policies on the one hand, and broad macroeconomic requirements, on the other.*

- *Much remains to be done, however, if the progress made and experience gained so far is to be extended and consolidated, and there is therefore a continued need for an "ex-ante" rather than "ex-post" concerted action by all major actors on the international financial sector. That is to say all these efforts must be put together with a forward looking view for the development financing rather than rescheduling or crisis management purposes after the fact.*

- *As Prof. Wallich puts it in one of his recent papers, "The most interesting problems of financing developing countries, therefore, may lie in the area, not of shoring up and improving bank lending practices, but in the creative innovation of new forms of international capital movements."*

- *However, before being too much innovative we have to agree on making some visible progress with some already identified bottlenecks.*

- *Third World debt issue needs a medium term perspective, so does development financing.*

- *Reactivating development assistance concept is crucial.*

- *"Oil facility", "Compensatory financing" type of a new, well defined facility should be established for drastic fluctuations of foreign exchange and interest rates.*

- *Creating an effective system in which good performance being rewarded. There should be clear incentive for better performance.*

- *Restoration of project lending is essential.*

- *Promoting direct investment and equity investment. (Risk capital).*

- *A more flexible and realistic attitude by the export - import banks in terms of their credit ratings and lines is absolutely necessary.*

- *A workable solution for the protectionist trends and other barriers preventing the growth of world trade. So access to export markets is crucial.*

** Yavuz Canevi, Governor, Central Bank of Turkey*

Distributed at the IMF-WB Annual Meeting / Seul, South Korea

Special Issue October 1985

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister, Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance, Vural Arıkan
Minister of Foreign Affairs, Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM), Ekrem Pakdemirli
Deputy Undersecratary of State Planning Organization (PM),
Cengiz Aysun Undersecretary of Ministry of Finance, Ertugrul Kumcuoglu
Governor, Central Bank of Turkey, Yavuz Canevi

FIRST JUMBO LOAN: $ 500 MILLION FOR TURKEY'S BALANCE OF PAYMENTS*

Underwriting of the U.S. $500 million multiple facility jumbo loan, recently raised by the Turkish Central Bank for the purpose of supporting the balance of payments, was finalized with the participation of 20 foreign banks and one Turkish bank. The credit agreement of the syndication which was launched in the beginning of March 1985 was signed in April at London. According to Governor Canevi and his Deputy Yıldırım, Turkey, which undertook a series of rescheduling operations towards the end of 1970's, has proved once again the effectiveness and the trustworthiness of its borrowing strategy by raising a "Jumbo" loan for the first time.

The confidence achieved is a result of carefully determined policy measures in the borrowing strategy and influenced the structure and the terms of the loan favorably. The most important feature of the loan, which is also described as a "hybrid loan" in line with terminology used in international capital markets, is a

sign of the ability to combine the advantages of the uncommitted short-term advances facility with the committed medium-term facility in a revolving manner upon the discretion of the borrower.

This feature provided to the Central Bank not only the means necessary to implement its flexible financial policy but will also enable Bank to make various short-term borrowings from a medium-term loan during the seven-year duration, hence making use of the lower spreads generally applied to short term borrowings. As it is known, last year, Sweden and New Zealand have also raised loans using the multiple facility technique which is considered new in the financial markets.

Turkey's success in securing a loan with the same technique, along with the high prestige countries of the money markets, is another concrete example of the achievements of the debt management policies of the past years. When the terms of the $500 million loan are compared with the terms of $200 million and the $300 million loans obtained in the past two years for the same purpose, the advantages obtained in the new loan related to spread and the term can easily be observed.

The new loan has a maturity of 7 years whereas the $200 million and the $300 million loans had 5 and 6 years maturity, respectively. In addition to the improvements achieved in the term of the loan the $500 million level is the highest amount Turkey has raised in the international markets up to date.

Another important improvement over credits obtained before is the elimination of prime rate option given to the creditor banks which generally hover over Libor rate. The spread over Libor is also reduced below 1.5 percent for the first time as compared to loans obtained in the past. The underwriting group of the $500 million loan consists of 21 banks. These include seven US, three German, three French, two Bahrain and two Japanese banks. Banks each from Switzerland, Libya, Kuwait and Turkey have also participated in the syndication as lead managers. Out of these 21 lead managers, eight of them participated with $301 million cash and the remaining 13 banks staked in $20 million each. Furthermore, five of these banks, including the New York branch of T.C. Ziraat Bankasi, are participating in the loan as lead managers for the first time. Observers in money markets hint at a widespread unwillingness in the international banking community against loans designed to support the balance of payments and foreign exchange reserves. Banks generally prefer to provide credits for projects on which they can make a concrete evaluation rather than loans supporting balance of payments.

Therefore, the realization of $500 million loan during a period when efforts were also concentrated on raising credits for important development projects such as the Airbus, the nuclear power plant and the 2nd Bosphorus bridge, reconfirms the remarkable achievement of the Central Bank management.

** Yavuz Canevi, Governor, Central Bank of Turkey*

This article appeared in Economic Dialogue-Turkey's October 1985 issue

Distributed at the IMF-WB Annual Meeting / Washington DC, USA

Special Issue September 1986

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister, Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance, Vural Arıkan
Minister of Foreign Affairs, Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM), Yavuz Canevi
Governor, Central Bank of Turkey, Yavuz Canevi (Jan-Oct 1986)
Acting Governor, Central Bank of Turkey, Zekeriya Yıldırım (Nov-Dec 1986)

TURKEY'S EXAMINATION WITH THE OUTWARD ORIENTATION*

New Institutions and Regulations:

When we look back today we observe pleasant developments about Turkey's liberalization and deregulation policies since 1980. First we see a visual progress and improvement about the institutional infrastructure and efficiency in particularly economic decision making process. On the public sector side, the coordination among the Central Bank, Treasury, SPO and Ministry of Finance has been keen to come up with the right policy measures at the right time. New and functional semi-independent institutions such as Capital Market Board, Competition Board, Mass Housing Fund, Public Participation Fund, Privatization Board, Defense Industrialization Fund have been put into operation. All these efforts have been aiming for enhancing the market forces and reducing the government intervention in the private sector.

On the private sector side, with the help of new liberal regulatory environment new institutional reforms have been realized. Particularly, Foreign Trade regime was liberalized and restrictions on import and exports were abolished. The ratio of

foreign trade to nominal national income jumped from 15% to 35%. The most important reform was the implementation of realistic exchange rate policy as opposed to stop and go devaluation policy.

Introduction of EU style VAT tax, establishment of Free Trade zones, establishment of Money Market, Foreign Exchange Market, deregulation of interest rates, drastic cut back in red tape and bureaucracy, redefining the role of private sector in economic life, allowing corporation to raise capital by disposing of corporate estate, introducing new investment incentives to under developed regions of the country, upgrading the FDI regulation and establishing a "one stop agency" were all done during this period.

Furthermore in order to promote export sector General Trading Companies etc., a kind of Japanese sogo-shosha model, were established with special incentives. Similarly multifunctional Foreign Trade Corporate companies (FTCC), Exporter Corporate Companies, were established during the same period.

The unprecedented growth of the big trading companies were signaling a new trend in export and import business. In fact, in 1981, per company sales of the top 10 private industrial enterprises were more than twice as much as that of the top 10 trading companies. Four years later, the situation is reversed. The per company sales of the top 10 FTCCs in 1984 were 50% more than 10 industrial enterprises. Therefore the new export incentive system implemented since 1980 prompts the small and medium scale companies to route their exports through large and

specialist trading companies. Thanks to these outward orientation Turkey's foreign trade composition has shifted from being mainly agricultural products to being mainly industrial goods which is accountable around 75% of the total figure.

Geographical Shift in Turkey's Trade:

Between 1980 and 1986 there has been two clear shifts in Turkish foreign trade.

- *Trade towards Middle East and North Africa, led primarily by contracting companies,*
- *Trade towards the COMECON countries.*

These two shifts played an important role for Turkish export sector to improve their marketing, transporting, packaging and other logistic skills. Today, Turkey has one of the largest road transport fleets in the Middle East and Balkans, carrying not only Turkey's own goods, but also transit goods to the Black Sea Ports and Iskenderun Port. However when we look at Turkey from a medium to long term perspective, it is clear that our natural target for trade is Europe and OECD countries. Therefore we have to formulate comprehensive strategies to explore these markets while using existing markets as a trump card in transit trade and in Turkey's dream to enter into the EEC which will require much more efforts.

"A PRESENTATION MADE FOR THE LONDON CENTRAL BANKERS PLATFORM IN JUNE 1986"

* *Yavuz Canevi, Governor, Central Bank of Turkey*

Distrubuted at Davos in January 1987

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister,Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance,Vural Arıkan
Minister of Foreign Affairs,Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM),Yavuz Canevi
Undersecretary of State Planning Organization (PM),
Ertan Yülek Undersecretary for Ministry of Finance, Biltekin Ozdemir
Acting Governor, Central Bank of Turkey, Zekeriya Yıldırım

GOVERNMENT EXPORT POLICY

Dialogue interviewed Yavuz Canevi Undersecretary for the Treasury and Foreign Trade, before DAVOS meeting.

DIALOGUE: Can you say that Turkish government's commitment to export orientation is still continuing?

CANEVİ: Yes by all means. Our commitment to export oriented policy has never stopped and will have to continue on all fronts. The latest proof of this very fact has been what I may call our "Second Wave" of export promotion measures that we announced last month. I can summarize the recent measures in four categories:

- *Measures leading to increased international competitiveness of our exporters. Reviewing of the export tax rebate system, introducing new "specific" incentives rather than "advalorem" ones and freight supports for long distance new markets can be mentioned in this category.*

- *Measures leading to lower cost of financing for exporters. New export rediscount facilities of the Central Bank based on past performance of exporters position and buying and selling arrangements were among these measures.*

- *Measures leading to increased marketing facilities for exporters. Supporting overseas offices, establishing trade centers, and supporting trade fairs were among these.*

- *Finally the new dynamic and flexible approach for reviewing export performance and taking proper new measures. The above incentives were announced mainly for new markets and better performance for the existing markets. Quality consciousness will be the new mot to for our exporters. Trade and investment coordination will be the new strategy for major investment projects.*

DIALOGUE: Do you think Turkey has been able to adjust her export sector since 1980?

CANEVI: Yes of course. Due to changing world environment and the dynamic structure of our own economy we have been constantly reviewing and restructuring our export policy with a view to increasing export capacity and diversifying our export composition and markets.

Turkey was exporting less than 100 items to less than 20 countries before 1980. Today we are talking about over 3000 items to more than 120 countries. And what is even more important 75 percent of total exports are the products of the manufacturing sector as against 30 percent in 1979.

DIALOGUE: What are the Institutional developments with regard to your new trade policy?

CANEVI: As long as the competitiveness is the top priority both in price and quality we are bound to work harder. It seems that we have slightly misjudged the "free trade advocation" of the industrialist countries. So we have also decided to equip ourselves with the same institutions like Turkish Exim Bank and Credit Guarantee Agency and antidumping regulations.

Distributed at the IMF-WB Annual Meeting / Washington DC, USA

Special Issue September 1987

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister,Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance,Vural Arıkan
Minister of Foreign Affairs,Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade(PM),Yavuz Canevi
Undersecretary of State Planning Organization (PM),Ertan Yulek
Undersecretary of Ministry of Finance, Biltekin Ozdemir
Acting Governor, Central Bank of Turkey, Zekeriya Yıldırım (Jan-Aug 1987)
Governor, Central Bank of Turkey, Dr. Rustu Saracoglu (Aug-Dec 1987)

READJUSTMENT, OUTWARD ORIENTATION AND STABILIZATION IN A RAPIDLY GROWING ECONOMY*

As K. Dervis and P.A. Petri of the World Bank recently pointed out in their articles, economic theories of growth have changed in the causal mechanisms they emphasize. The neoclassical growth theory distinguished broadly between capital accumulation and technical progress as the mechanism leading to higher labor productivity. Early adaptations of this model in development literature focused not only on the role of savings, but also introduced foreign exchange as a critical constraint on capital accumulation.

In fact, increased domestic savings would raise investment only to the extent that it could be translated into increased availability of foreign exchange.

When we look at the new Turkish economic policies we can easily observe two major policy changes which are in line with the above assessment, under the umbrella of an economic philosophy of free market orientation and outward oriented development.

The first one was a positive or real interest rate policy supported by fiscal reforms in the public sector in order to increase domestic savings.

The second one was a flexible and real exchange rate policy together with an overall liberalisation of current account transactions and a positive export promotion program in order to achieve an export led growth.

Both policies have played a major role in obtaining a better and more efficient allocation of resources, exploiting scale economies, encouraging and increasing the absorption capacity of the economy in terms of industrialization in general and know how in every field in particular.

Expansionist Years

It is true that in both 1985 and 1986, it was the public sector that was the leading element in domestic expansion, both of consumption and investment. However it is expected that this trend will gradually be reversed in the period ahead. As in many NIC's in Turkey too, rapid economic growth is the overriding medium and long-term macro economic objective.

We accept that in the short run, there is a cost attached to this objective, such as inflation, high interest rates and high level of currency depreciation. The real challenge is to keep the balance between mobilizing resources for higher growth and achieving

a sustainable external account without a damaging sacrifice in the standard of living.

Transformation in the economy

It is crucially important to note that the Turkish economy has gained much more flexibility and ability to respond to any external and internal developments and policy signals during the last 6-7 years, due mainly to the free-market orientation. The best example of this was the 1985-1986 oil price to drop and the response of the Turkish export sector to it. We all remember that Turkey had to wait 6 years after the oil shock to adjust, whereas it took only 6 months for adjustment in this event, that is to say, switching from the shrinking oil producing markets to the EEC and others. This should answer many questions on what has happened in Turkey during the structural adjustment program.

What is more important in these developments is the following. In general any stabilization-adjustment policy requires substantial sacrifices and therefore becomes an inevitable political liability for the decision makers. However, the pillars of the new economic policy that I have already mentioned have become irreversible and widely accepted elements of the future economic policy measures. In other words in the Turkish case, structural adjustment policy was turned into a substantive political asset.This is an important difference to be underlined. Having understood the importance of this "political asset" we

can add the following assets for Turkey's successful implementations of her new economic program.

- *Turkey finally rightly identified one of her weak spot as the lack of economic decision making and introduced a dramatic improvement in this field.*

- *The management ability of the business sector, productive and hard working people are the main and the most dependable and promising assets of the country. (50% of the population is under age of 20.)*

- *Turkey's key and leading industries are young and depend on the latest technology. This coupled with labor productivity and relatively lower wages means that they are bound to be competitive.*

With the new revitalization program on the way, industry today covers a diverse range of sectors from consumable goods to household durables and major intermediate products. The Government's new defense industry drive will certainly bring a new dimension in our technology and industrialization. While industry used to lean on the public sector, the new economic program is designed to lower the public sector role and put heavy emphasis on the private sector. It should be noted that in 1985 and 1986, approximately 35-40% of industrial exports originated from 8 private holding companies.

- *Tourism is the "best kept secret asset" of Turkey and has just started to make its long due contribution to the Balance of Payments.*

- *Turkey's privileged geographic situation gives her a central role in trade between.*

Europe

- *The Middle East, North Africa and the Islamic world*
- *The Soviet Union.*

What is more important is that new dimensions have emerged in this natural role:

- *With Europe: The application to the EEC*

- *Proves the determination of the administration to further pursue and the willingness of the people to live with existing comprehensive policies without which integration with the community is neither possible nor means anything. This seems to be the great concern for the potential investor.*

- *Again, the application to the EEC is itself a guarantee and an institutional umbrella for further liberalisation and democratization efforts.*

- *With the Middle East and the Islamic world: The new dimension here is the increasing level of Turkey's leadership within the OIC's (Islamic Conference) economic front. (COMSEC; our president is the chairman of this economic cooperation group)*

- *With the USSR: The natural gas pipeline agreement will create a volume of trade up to $1.0 billion during the next couple of years.*

- *Agricultural strength makes Turkey self-sufficient in food supply. There is a potential for further growth and this is going to be realized through productivity increase, a seed improvement program, mechanization, fertilizer use and also the GAP project (Southeastern Anatolia Development Project.) GAP itself is potentially able to feed another 25-30 million population in addition to energy production.*

- *And last but not least, there is a rapid and healthy expansion of the capital market which has already started and will continue with a major privatization program to draw new funds into the financial system and also increase the net flow of savings. From now on the increased share of domestic private savings in financing investment at the expense of both foreign and government saving will be the key for further sustainable noninflationary growth in Turkey.*

Having said all these, one can and should ask:
"What lies in the future for Turkey?"

I hope, we all agree or at least are inclined to believe that the worst is over! This could be true, provided that:

- *The Fx market is more stable and uncertainties are eased,*
- *Interest rates do not skyrocket,*
- *Protectionism with the new GATT round on the way is eased,*

- *The world debt (not the Third World) issue will be dealt with a medium term and proper perspective, so that overall external factors work in the right direction;*

  in this case, Turkey's performance is bound to be better.

* *Yavuz Canevi, Governor, Central Bank of Turkey*

Distributed at the IMF-WB Annual Meeting, Berlin Germany

Special Issue September 1988

Key Decision Makers For Economy and Finance in Turkey:

President, Kenan Evren
Prime Minister,Turgut Ozal
Deputy Prime Minister, Kaya Erdem
Minister of Finance,Vural Arıkan
Minister of Foreign Affairs,Vahit Halefoglu
Undersecretary of Treasury and Foreign Trade (PM), Yavuz Canevi
Undersecretary of Ministry of Finance, Biltekin Ozdemir
Governor, Central Bank of Turkey, Dr. Rustu Saracoglu

INCREASING CONFIDENCE IN THE TURKISH ECONOMY

So many arguments both, good and bad, have been put forward for economic performance of the Turkish economy since the adoption of "January 24 Decisions" in 1980. I believe more and more people are becoming convinced of the positive results of these stabilization and structural adjustment policies with the passing of time. So, what remains to be done is to guarantee the continuity of these policies. To guarantee that Turkey is not going to change the direction of the policies that it has already started to implement.

In general, any stabilization or adjustment policy requires substantial sacrifices, thus becoming an inevitable political liability for the decision markers. However, the pillars of the new economic policy have become strictly irreversible, widely accepted, fairly digested and further supported elements of the future economic policy measures. In other words, in the Turkish case, structural adjustment policies are turned into a substantive political asset. The free interest rate policy, flexible foreign exchange policy, reduction of government intervention; all these

practices have the full support of the average citizen, and this is the greatest indication for the continuation and durability of these policies as confirmed by the mandate of the existing economic philosophy for another five years. Now, what we should do is to convince the outside world that these policies have worked and they are here to stay. If we can convince the economic world, mainly financial and industrial investors that no reversal from these policies is possible and these policies will even be improved in the future, then Turkey's economic future lies in foreign investment.

I don't think we should place the emphasis on external borrowing, balance of payments borrowing, from now on. What we should really emphasize is direct foreign investment and equity investment in particular. This will prove more productive, safer and faster in terms of economic results.

Today, due to its debt management and overall economic performance, Turkey is in a position to be more selective visa vis the credit offers rather than first come first served position. This is a remarkable achievement if one remembers that we reached this stage from the brink of total collapse only seven years ago. It is also a sign of confidence in Turkey's future on the foreign lenders' side. I accept that it will take longer for foreign investors to reach this level of confidence. This is simply because direct investment presupposes a much deeper commitment and involvement on the part of the investor than lending does on the part of the lender. It is not easy to convince an international

investor about a one or two year performance; he has to believe that this is here forever or at least for the lifetime of his investment which is a minimum of 15-20 years.

So what are we doing to support or encourage foreign private investment? Here are some of the highlights of our foreign investment policy:

- *Foreign capital has the same rights and obligations as local capital and transfer of profits, fees and royalties, and the repatriation of capital in the event of liquidation are guaranteed.*

- *All fields of activity which are open to the Turkish private sector are also open to foreign investment.*

- *On the incentives side no distinction is made between Turkish and foreign investors; i.e. what is being encouraged is the actual investment itself, not the investor engaging in it.*

With the political and economic stability achieved in a relatively short time and by welcoming foreign investment, Turkey should be able to win international confidence in its business climate and we hope to bring advanced technology into the country. Being a newcomer to technology intensive industry means we have the advantage of transferring the latest technology. We can acquire the most up to date industrial developments and immediately start to operate quite profitably both for our country and for the foreign investor.

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 1989

Key Decision Makers For Economy and Finance in Turkey:

President, Turgut Ozal (November 1989)
Prime Minister, Yıldırım Akbulut
Deputy Prime Minister, Ali Bozer,
Minister of Finance, Ekrem Pakdermirli
Minister for Foreign Affairs, Mesut Yılmaz
Undersecretary of Treasury and Foreign Trade(PM), Yavuz Canevi (Jan-May 989)
Undersecretary for Ministry of Finance, Biltekin Ozdemir
Governor, Central Bank of Turkey, Dr. Rustu Sracoglu

DEAR COLLEAGUES AND FRIENDS*

This is my last appearance as a public servant which lasted almost 29 years. I started my carrier as a young Inspector of Finance at the Ministry of Finance in 1960. After 16 years, in 1976 I moved to Central Bank of Turkey and in 1986 took up the Office of Undersecretary of Treasury and Foreign Trade.

I consider myself a lucky person throughout these years for having worked with visionary and honest decision makers, intelligent and brave colleagues and particularly for being a witness to my country's evolution step by step towards a free market oriented democracy. It is certainly true that the context and the speed of this transition and evolution have been visibly more momentous during the last ten years.

I think you will all agree with me that January 24, 1980 Reform Package was a benchmark for our generation for the following reasons: This was the date Turkey has made a fundamental decision to move from a state-run, closed, inward oriented and heavily import substituted economy to a liberal, deregulated and

noninterventionist economy. This was certainly a fundamental shift of economic philosophy since the founding of the Republic. The results and the fruits of this new program are obvious after almost a decade, particularly in terms of growth and export performance. However, due to an ambitious infrastructural program public sector deficit has been growing. This obviously has triggered a chain reaction with high inflation rate, high depreciation of the Turkish Lira naturally leading to high interest rates.

In addition to these negative developments if we also consider Turkey's already high population growth and rapid urbanization rate, to create jobs for the rapidly increasing work force, achieving high growth rate and changing the structure of foreign trade as well as its composition have been a real achievement for the country.

In all honesty, although taking these courageous and radical policy decisions political authorities deserve the credit, bureaucracy's efficient and flexible ability in implementation and also private sector's adjustment capacity and efforts and their response to the stiff challenge they faced with these fundamental and structural changes, have to be recognized and given equal credits.

During my three years of service at the Treasury I can name two more developments that I was proud of witnessing. First, in August 1987, the establishment of a financial Institution that will

contribute to the promotion of Turkey's export sector, namely TURK EXIM BANK (The Export Credit Bank of Turkey, Inc). I take great honor to be the first Chairman of the Board of this great institution. Second, Turkey's application for the full membership to the EU which took place in April 1987 and which was truly an exciting event for all of us.

Let us remember that from then on, a would-be member, Turkey had to deal with a number of issues, ranging from legislative adjustments relating to Custom Unions to other organizational issues including education.

From Turkey's point of view, it is necessary that European parliament see the real situation in Turkey from a sufficiently close range and regard Turkey in the light of Europe's interests without becoming a party to political manoeuvers. Just as it is natural to expect the European Parliament not to misjudge Turkey, it is also natural to expect Turkey to continue to make sincere efforts to adjust her social and political norms to those of Europe by exploiting this new "ANCHOR".

With this application Turkey showed its intention and direction. However, successful continuation with these efforts will significantly depend upon the Turkish people's dedication and commitment and will determine the direction Turkey EC political relations will take over the coming years. Planning for the future will equally depend on how Turkey's accession application will be treated by the Community.

I thank you for all your support and wish you all a successful carrier.

** Mr. Canevi's retirement speech on June 1989*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 1990

Key Decision Makers For Economy and Finance in Turkey:

President, Turgut Ozal
Prime Minister, Yıldırım Akbulut
Deputy Prime Minister, Ali Bozer,
Minister of Finance, Ekrem Pakdermirli
Minister of Finance, Adnan Kahveci
Minister of Foreign Affairs, Mesut Yılmaz
Undersecretary of Treasury (PM), Namık Kemal Kılıç
Undersecretary of State Planning Organization (PM),
Ilhan Kesici Undersecretary of Ministry of Finance,Biltekin Ozdemir
Governor, Central Bank of Turkey, Dr. Rustu Saracoglu

ECONOMIC RECOVERY REVISITED*

Refreshing our memories:

It has already been ten years since Turkey adopted a comprehensive new economic programme to overcome a severe balance of payments crisis. The impacts of the first oil shock and the continuation of an expansionist policy brought the country to unbearable foreign trade deficits and prevented it from servicing its external debts. Due to this Turkey has faced a serious economic and financial crisis by the end of 70's. Alter having successfully negotiated through some gradual procedures, with IMF, World Bank, OECD and International Banking Community, Turkey staged a remarkable recovery from this severe crisis. The recovery program had a dual goal: On the one side it was crucial to re-establish the stability in the economy, on the other side the structural transformation and adjustment process were essential.

Therefore, on the basis of such a comprehensive adjustment programme to stabilize and liberalize the economy, it attained a sustainable pace of growth, and made considerable progress toward internal and external balance. Despite some discontinuities in its implementation the programme has at least

enabled the country to enjoy a high growth rate, average 4.5 percent despite two consecutive low growth years of 1988 and 1989. It resulted in a spectacular increase and diversification in exports which in turn led to serious improvements in the current account deficit of the country; employment in industry rose by almost 3.5 per annum.

However, throughout the decade inflation continued to be the single pressing issue for the economic management. Thanks to the Central Bank's self imposed monetary programme we observe a considerable ease in the prevailing inflationary expectations due to strict implementation of the programme towards prohibitive excessive monetary expansion.

Are our priorities changing?

The official policy as it is observed today is not to give in to devaluation but to fight inflation by stepping up domestic industrial production.

Does this mean that Turkey is experiencing a change of priority in economic growth. That is to say, are we switching from an external demand led growth to domestic demand led one? Not exactly; it appears that this is an intentional short-term dual goal policy that aimed at changing the course of the economy; on the one side it is geared to change the inflationary expectations, on the other to achieve a partial correction in foreign exchange policy which was believed to be slightly overdone in the previous period.

The timing was appropriate. Because for the first time in the recent economic history of Turkey, the structure of the balance of payments does not appear to be anymore an obstacle to growth in Turkey.

Now Turkey's liberal trade practices coupled with lower customs protection of industry, privatization of some public enterprises and reevaluation of the lira in real terms expose Turkish industry to international competition. There are already some early signs that this will probably force modernization, improved concept of competitiveness through cost, quality, efficiency and marketing. In turn this will reduce the inflationist pressure engraved upon entrepreneurial mentalities.

It was confirmed by the State Institute of Statistics last month that the trends in the economy that prevailed in the second half of 1989 has continued in the first half of 1990. That is to say, industrial production has further revitalized and average growth rate in the manufacturing sector was announced for the first six months as 10.4 percent. Considering 1990 as a good harvest year, I expect that these upward trends will lead to an improved growth performance and hopefully to a pickup of manufacturing investment.

• *How Turkey's future will be shaped?*

The attainability of the economy's medium term targets is closely linked to the emergence of an internationally competitive and viable economy. This fact gains further

importance given first Turkey's application to the EC and second, the recent developments in Eastern Europe. It is important to note that developments in Eastern Europe do not necessarily mean, as some people are inclined to think, negative results for Turkey. It is not a zero sum game i.e. if one loses, the other gains, or vice versa. Turkey will gain from progress in Eastern Europe, because of;

- *an extended European market,*
- *free market orientation of the Eastern Europe*
- *new opportunities in taking part in building up the infrastructure of the Eastern Europe.*

There is no doubt in my mind that the future shaping of our political, social and economic policies will inevitably be deeply affected by the series of transformations catalyzed by the inherent dynamics of the single market, its probable ramifications and its likely interactions with Eastern Europe. I therefore think that to achieve a competitive industrial structure is crucial for Turkey, irrespective of the state of her application for full membership.

I am sure you are aware that the Turkish Economy still faces real issues as well as short to medium term constraints. Whether or not the current outstanding issues will be successfully resolved will clearly depend on the ability to remain allegiant to a sound and balanced macroeconomic policy stance in the medium term. Not withstanding the risk of external shocks, the

real risk taken by the current strategy will be gauged by the capacity and desire of our industrial sector to rise to the challenge.

At this juncture allow me to make the following observation; while there are still some countries in the race who are trying to figure out what the problems are rather than dealing with the solutions.

Fortunately Turkey has already gone a long way to dealing with the solutions.

In this respect, at least one progress cannot be denied: Market forces have gained roots and what is more they have taken the lead. That is to say, the economy is functioning more or less independent of what is happening in Ankara.

Because of deregulation, liberalization and market orientation mainly in trade, foreign exchange and financial markets, the Turkish economy is much more vulnerable to internal and external developments.

However, thanks to the same development and structural transformation achieved through them the Turkish economy's

- *capacity for absorbing shocks*
- *ability to adjust to new conditions, as in the case of the recent Gulf crisis has tremendously improved.*

Therefore Turkey's vulnerability because of these liberalization policies to new economic and political developments both at home and abroad can and should be interpreted as a point of strength rather than weakness for the following reasons:

- *It shows the government's confidence in the system,*
- *It shows how the general public and business circles feel comfortable with the system,*
- *It is an indication of or rather insurance for the continuation of the liberal policies for the fact that private enterprise is essential for extending democracy.*

Having said all these I would like to conclude that Turkey's economy and her development belongs to the main stream of Europe in which the overall economic and political landscape is changing. In fact, we are faced with a "moving landscape". So, it is up to every player in this to make some real effort to keep and even further improve its position. Turkey is determined to perform better. Turkey is entitled to perform better. Turkey is capable of performing better and we will do it. This is the challenge up to 2000 for both private sector and public sector policy makers in Turkey.

Yavuz Canevi, Managing Director, EuroturkBank

TAKING STOCK OF THE DECADE OLD BANKING RESTRUCTURING*

While we are entering into 1990's, I think it would be wise to try to find and answer to the following basic issues that concern the financial sector:

• Did the Turkish financial sector go through a change during the past decade? If so, in what direction did the changes occur and what were its reasons?

• *Why is this change important to us?*
• *What are our targets for further developments in the financial sector?*
• *What are our alternatives?*

THE DEVELOPMENT OF THE TURKISH FINANCIAL SECTOR:

I think that it would be appropriate to start with the fact that the Turkish financial sector has undergone a noteworthy restructuring thanks to the harmonious adaptation and equilibrium period that the Turkish economy has been enjoying during the last decade, and analyze in rough lines the underlying reasons:

Internal Reasons:

- *Monetarization of the economy as a result of liberal economic policies and "deregulation"*
- *Dynamism created in the banking sector under the influence of free interest rates and realistic foreign currency policies and the constraints of following up and complying with the market conditions*

Developments in the capital markets

The potential developments that have resulted in the overall financial system of the country and in the banking system as a result of the protective attitude adopted by the Central Bank of Turkey who took over the role of acting as the "Big Brother"; namely by the installation of:

- *the Turkish Lira and Foreign Currency Interbank markets*
- *the Gold market*
- *special transactions such as "Swaps", "Repos" etc.*
- *Several examples could be cited to picture the competitive environment that has developed following the coming in of foreign banks and the ensuing evolution Observed in the banking system. For instance, the M2/GNP ratio which used to be 15 % in 1980, came up to 26 % in 1989. While the bank balance sheets represented 35 % of the G.N.P. in the 1975's, they reached 70 % of the G.N.P. in 1989. Similarly, the share of FX transactions in banks' balance sheets climbed to 1/5th of total transactions.*

External Reasons:

- *Drastic developments in the computer technologies*
- *Worldwide deregulation*
- *Internationalization and Universalization*
- *The necessity felt by supervisory authorities to redefine or update the definitions of capital and risk and the notion of "Cook Ratios", within the context of a new concept created as a result of the fluctuations of the FX and interest markets as well as the debt servicing crisis undergone by Third World countries.*

Can we say that the above picture, which I have presented with its generally positive aspect, is perfect and does not have any faults? What did it cost to the Turkish economy? The above disadvantages have resulted in:

- *Bad ("frozen") loans and loans that try to appear as unfrozen, as well as unproductive assets items in the balance sheets of banks, in other words, participations and real estate properties owned by banks, have shown an increase (up until the past two years)*

- *This situation increased the cost of funds and the cost of loans*
- *The system that transformed this cost into high inflation via industrialists and businessmen has, in turn, has put this high cost on the shoulders of consumers*

Although in an oversimplified format, one can say that the financial sector (one must bear in mind that the financial sector

in Turkey is composed 90% by the banking sector) in the country has played the role of a shock absorber during the period of implementation of structural adaptation policies; thus absorbing the shock of the business world and that later on, by eroding the road on which the vehicle was running (i.e. increasing the inflation rate) and eroding the shock absorbers themselves (i.e. causing higher cost of funds and bigger placement difficulties) the whole deficiency of the system was reflected back, in a magnified manner, to the financial system and the consumer.

"PROLONGED" MEASURES OF PREVENTION:

The changes originating from the above described economic policies and increasing the debt of the financial sector constitute a prerogative for the market economies. The deeper the system, the bigger and more powerful (and therefore, the more efficient) are the mechanisms and instruments available for a better price equilibrium, a greater budgetary discipline, and consequently a more effective and flexible monetary program to fight the inflation.

One can, therefore, conclude that, in a developing economic system, the financial sector like all the other sectors is bound to undergo a dynamic development and propagation to harmonize with internal and external conditions.

Within this context, we can summarize our expectations in three groups:

• *Expectations from Banks:*

- *It can be noted that the "deregulation", "Big Bang", "Euro Bang", "Single Bang" and the dramatic structural changes created by "Single Market" event forecasted for 1992 have caused an every increasingly dense competitive environment not only in European banks but also in countries surrounding the European Community as well. In order to survive and sustain the profitability of operations in such an environment, the following are essentially the preconditions:*

- *From the standpoint of liquidity and capital structure, the Turkish banks have not, as yet, reached the European standards. Generally speaking, European banks traditionally have a better structure from the viewpoint of capital versus assets ratio. Furthermore, within the European Community, the balance sheet "healthiness" of a bank is measured on its capital structure. Under these circumstances, the Turkish banks have to increase their capital or widen their capital base, if they want to approach the European standards.*

- *Among the factors that could be used to determine the competition potential of Turkish banks the most important ones are: the resource accumulation, the cost of sources and the modes of placements (i.e. lending). We have all gone and we are still going through the inconveniences caused by "problem creating loans" on the cost of funds and the influence of this cost factor on the credits extended to top tier customers of the banks or on the overall banking system.*

- *Such experiences have led to a new approach in the credit extension/lending techniques which has, in turn, forced the banking institutions to shift from traditional credit analysis principles and tendencies to risk coverage by means of real estate property mortgage towards renovated analysis and study techniques that define the real value of the assets, take into account the business potential and performance of companies as well as the quality of their management teams and gather all this information on a project basis evaluation of the customers.*

- *It is becoming necessary to revise and reshape the existing service customer structure and remodel it according to renovated standards; and become active in "universal banking" while at the same time offering some "specific special" services to the customer (this approach is also called "the Nishe Policy").*

- *The trend of internationalization, universalization and integration among markets, observed on a worldwide dimension, have not only caused banks to enter a rapid development phase but also forced these to use new financial instruments and techniques. Aside from these new instruments that were created because of fluctuations in foreign currency and interest rates, financial instruments aiming at a new mode of risk participation and securitization have become novel and popular financing techniques.*

The following are some examples:

- *Prime Rate and variable interest rate applications*
- *Multi currency bonds and options*

- *Interest and Foreign Exchange Swaps*
- *Interest Ceiling and Base (caps) transactions*
- *Matched fundings*
- *Investment Funds and Clubs (syndications)*
- *Real-estate based bonds and investment funds*

When you compare these instruments with the limited financial instruments or papers that are being purchased and sold within the existing banking system of Turkey and consider the unimaginative simple instruments that are based on fixed interest rate; it becomes all the more obvious how big an opportunity the above represent for the Turkish Banking System.

- *Meanwhile, with closer cooperation with the insurance sector, which we believe will gain new momentum in the 1990's, new products will be developed and add new dimensions to the market and consequently enable to have longer tenors on creditable funds.*

- *The Turkish Banking System will have to prove itself by implementing a reformist reorganization and will have to look for better operations methods while providing higher quality and more efficient services for the Turkish economy.*

- *The universalization of the banking system may create excess capacity in some markets. In fact, we are noting worldwide mergers and acquisitions among banks, including big banking institutions, in an effort to better meet the universal competition. It would, therefore, be realistic to forecast concentrations and grouping in the banking sector*

in before the year 2000. It appears unavoidable for the Turkish banking sector to have to:

- *Increase its market share*
- *Increase and diversify its banking products*
- *Enter into strategic partnership and cooperation agreements to reinforce and restructure its capital and balance sheet.*
- *Finally, I would like to underline a point of major importance: Along with the need for qualified bank personnel, the training of the existing staff is a necessity. From the days when customers used to go to banks to get the banking services, we have come to a time when banks have instituted "Marketing Departments". Even more important than that, the customers have now learned to act in a more conscious way and to better compare and select the alternative sources offered to them by various banking institutions. We can conclude from the above that, in consideration of more complex banking transactions both in the local as well as international financial markets, the acquiring of a better awareness by customers and increased demand to banking services, banks are facing the necessity to use qualified personnel.*

Now is the auspicious time for our banks to redetermine the share of personnel training/educational expenses, especially in comparison to the share of public relations and advertisement expenses.

Expectation from the Public Sector:

When we say "public sector" we primarily mean the institutions having a supervisory, control and implementation authority and

responsibility such as the Undersecretary of Treasury and Foreign Trade, the Ministry of Finance and Customs, the State Planning Organization and the Capital Markets Board.

- *The Banking and Insurance Transaction Tax (BIT in abbreviation) and the Source Utilization Support Fund, which constitute important factors on indirectly affecting the cost of loans, should, within a calendar to be announced if not abolished totally be reduced to a level that does not hinder the system's logic and functioning, and more importantly, its macro policies and indicators.*

- *Now is the best time for the country's tax policy to be revised and reimplemented to encourage the development of the capital markets and better suit its opening to the public while, at the same time, support the institutionalization efforts.*

- *The status of Capital Markets Board should be modified as soon as possible, to allow before everything else the implementation of new financial instruments, primarily those based on real estate property and the investment funds.*

- *More important than all these, the public sector, with its state economic enterprises, its banks, its unions and Cooperatives, with its extra budgetary funds and with its "State Budget" which is in reality a reflection of all the rest, should become more "transparent".*

Within this context, I perceive the last venture of the Undersecretary of Treasury and Foreign Trade as a very positive

step. The purpose of the new venture is to "draw a map of the State's transfer of funds" which will enable us to see clearly the open funds transfers made by the State to such sectors as industry, agriculture, housing, small commercial units and exports.

What we hope to see after this first step is a similar "map" for the "invisible" funds transfers made by the State. The importance and meaningfulness of the above mentioned "transparency" depends totally of these "maps". It is understandable that drawing such "maps" is much more difficult than you think of it, if you take into account how "uneven" the country's natural and political structure is.

- *While the banking sector of the country underwent drastic development within the environment of competitiveness and its efforts to integrate the international financial system during the course of the past decade, it is most interesting to note that the "Bank Auditing Council" in charge of supervising and controlling the Turkish banking system, was left by itself and failed to reorganize itself in accordance with the dynamics of the system. This issue, which becomes one of the major concerns within the framework of the World Bank's Financial Sector Loans, should be quickly resolved and this "traditional" Board, trying to work with a staff of 45-50 persons, should be upgraded from the qualitative as well as quantitative standpoints within a short time. May be the real solution for the "Bank Auditing Council" would be to form a semi-independent board based on the model of the Capital Markets Board.*

- *Expectations from the Central Bank of Turkey:*

The special place occupied by the Central Bank of Turkey in the Turkish financial system and its role and weight on this have lead us to review our expectations pertaining to the C.B.T. itself under a separate chapter.

- *It is now time for the Central Bank of Turkey to gradually leave its role of "Market Maker" to the real players of the system.*

We are conscious of the establishment of FX and TL Interbank markets under the umbrella of the Central Bank of Turkey and its role of "Big Brother" and believe that, within the Turkish Banking System, there are appropriate candidates to become a "Primary Dealer" or a "Clearing Bank", ready and willing to share the responsibilities in this respect.

Also, one should also not forget that, considering today's and future interbank volumes, this "umbrella" based on 100 % State guaranteed bonds and T-bills risks to serve certain "unwanted and unsought for" policies and will fall into contradiction with its reason to exist.

- *In order to deepen and widen the dimensions of the system, the Central Bank of Turkey may present itself as a "Big Brother" on other issues, such as:*
- *Creation of an interbank or pool market for Private Sector commercial papers such as CP or bonds*
- *Formation of a time/call FX market*

In a period of abundant reserves, while the Turkish Lira is being revalued against a devaluation policy full of vagueness beyond the control of the CBT, the most economical and professional way of preventing the speculations on the Turkish Lira is to put into operation the FX and TL forward markets.

• We have already commented on the fact that the Turkish banking system is gradually moving from its traditional deposit oriented structure towards a transaction based, capital and money market oriented, more dynamic and creative financial structure thanks to the changes in its liability structure and more specifically due to "securitization". If we want to support this trend and secure a healthy development environment for this, then the following should be made:

Maintaining at today's levels under the existing circumstances the Reserve Requirement and Liquidity ratios that constitute CBT instruments for money policies and which are indirect factors affecting the cost of funds, is an unfair attitude for the whole banking system.

It should be underlined that currently, the 25 % of banks' assets are being controlled and monitored by the decisions of the country's monetary authorities.

It would therefore be reasonable to fix and announce a calendar for reducing by at least 50 % the Reserve Requirement and Liquidity ratios, as soon as possible.

TARGETS AND ALTERNATIVES:

- *Turkey and more specifically the financial sector of Turkey are in need to have a medium term "perspective" (if not a longer term perspective) ahead. A perspective for 3 weeks or 3 months is far from being sufficient.*

- *Without having to sacrifice anything from the credibility, healthiness and equilibrium that constitute the essentials of the financial sector and with a little effort and cost, efficient steps can be taken to attain better profitability and further efficiency.*

It is frequently observed that if a rapid, healthy and contextual approach to the issue is not provided, the river (i.e. money) will change its course under the developing and dynamic market conditions.

What we mean by a contextual approach is an approach that would cover integrally and individually all the factors that influence the supervisory and control mechanisms, the "market makers", the sector's own institutions, the factors that influence the profit versus cost factors, regulation versus deregulation, short term and long term needs prevailing in the economic environment.

Within this context, the course of the river may not necessarily be changed and turned into illegal methods. The "tax paradises" the "Big Bangs" the "1992 Single Market" project are all "legal" courses created for serving this purpose.

However, one should not forget that the interventions of the Government and other monetary authorities that put under constraint the whole system at risk will cause "disintermediation" which is equivalent to say that the customers refrain to use the banking system overall. In other words, the concept of "do your financing your self" is a reality created by the "Off Shore Turkish Lira market".

- *If our bankers nourish some optimistic expectations on the applicability and efficiency of future anti-inflationary policies, despite the existing inflationary environment, they should refrain from excessive loans that may be extended to customers who approach them for high interest credits, with the belief that the inflation will continue anyway.*

Nevertheless, we have been observing this duality for a long time. This is not only a typically Turkish approach. Remember that, in 1985 - 1986, 260 banks in the United States only had to be closed because they were unable to reschedule the debts of the energy and real estate sector companies which entered a crisis.

- *It is absolutely necessary that the regulations pertaining to the operation of the financial sector which are medium or long term "service" institutions be made or amended by Laws. Ministerial decrees should only cover issues concerning the supervisory and control institutions and the applications of the Laws.*

Failing to do this would mean that the above described "Perspective" is being hindered from the very beginning. The most unforgivable approach to adopt in a developing economy is to condemn savings to a short term perspective in a "we don't know what will happen in three months" approach.

- *I feel that more objective and flexible regulations for establishing or closing banks should be adopted, once that the necessary transparency for the financial system is achieved, and more specifically after fully acquainting the small, medium and large size saving customers with the information pertaining to the financial system.*

In other words, it would be wise to facilitate the entry and exit to the system and to leave it to the care of the market conditions. However, this should have a precondition: the financial institutions in the sector, and more specifically the banks, should ensure a correct analysis of their balance sheets from the risk standpoint.

To be more specific;

- *The performance of the credit portfolio, constituting the basis of the assets side in the balance sheet, should be brought to the attention of the public/savings holder in a systematical manner. Important steps have already been taken in this direction. However, no transparency has so far been attained as far as "Correlated Credits" are concerned.*

- *An Early Warning System within the banking sector should be instituted and this should be announced to the public/savings holder on a quarterly or on an annual basis for the time being. The Central Bank of Turkey is on the way of implementing such a system for its internal use. However such information should start being divulged beyond the walls of the CBT or the Undersecretary of Treasury and Foreign Trade.*

Even in a country like Chile, monthly "Risk Rating" reports for banks have been published during the past decade. Such publications are being made by the country's monetary authorities.

Banks are being rated and ranked in terms of a "basket" based on definite and generally internationally acknowledged criteria: there is a range of five different criteria, starting with "A" High Risk; "B" Medium Risk; and "C" Low Risk and so on.

The following factors play a role in determining the rank:

- *Capital Adequacy "C"*
- *Asset Quality "A"*
- *Management Quality "M"*
- *Capability to Create Earnings "E"*
- *Liquidity "L"*

The basket is called "CAMEL" criteria. It has been in use in the United States since 1970's. The best would be that the country's

monetary authorities apply this criteria to our banking system and publish the results accordingly.

If the monetary authorities in question fail to do it, then specialized private institutions will take over this responsibility. I feel that this should be done despite the risk of negative comments concerning the imperfection of the existing system, because market needs this service.

In order to avoid any misinterpretation or misunderstanding, this should be underlined one more time. I am not recommending that the system be left to itself. One should not forget that, in banking, like in driving, there is the risk of damaging third parties. We do not refrain from regulatory mechanisms such as policemen or rules just because everyone drives perfectly.

In a similar manner, we cannot give up the responsibility of supervising, controlling and applying regulatory measures for our banking, just because we have good banks and bankers. However, the point is to have the traffic signs posted at points visible for everyone and in a manner comprehensive for all of us.

During the last decade, Turkey appears to have solved most of its "outward oriented" problems thanks to opting to "outward oriented" economic policies. We can, in fact, note that today:

- *Turkey has no problem for foreign debt servicing*
- *The composition of Turkey's short term loans is positive*
- *Turkey does not have any current account deficit problem; on the contrary, it has a surplus*
- *The Balance of Payments is positive and is sufficient for import financing for a period of at least six months*
- *Despite its FX policies, Turkey's demand for FX is quite low.*

In short, Turkey is not facing and FX bottleneck that economists and politicians alike have been finding as "guilty" for the crisis that occurs every decade.I therefore think that it is high time for us to turn our heads back and start looking for solutions for some basic problems that we have been neglecting.

This article is published in the "Middle East Business and Banking" monthly on the April 1990 issue

** Yavuz Canevi, Managing Director, Euroturk Bank*

Distributed at Davos

Special Issue January 1991

Key Decision Makers For Economy and Finance in Turkey:

President, Turgut Ozal
Prime Minister, Mesut Yılmaz
Deputy Prime Minister, Ekrem Pakdemirli
Minister of Finance, Adnan Kahveci
Minister for Foreign Affairs, Safa Giray
Undersecretary of Treasury(PM), Tevfik Altınok
Undersecretary of Ministry of Finance, Okmen Mecdi Atamyıldız
Governor, Central Bank of Turkey, Dr. Rustu Sracoglu

TURKEY; AN OLD PARTNER WITH REGAINED DYNAMISM FOR A NEW EUROPE*

In order to have a better assessment of the current market situation with a perspective of Turkey's short term and medium term macroeconomic balances I will have to take you back and give you a brief summary of the recent economic developments in this country. In the second half of the seventies the Turkish economy faced a worsening external environment due mainly to oil shocks and to a subsequent deterioration in foreign trade. Although the problem originated in the external sector, the failure to adopt adjustment policies on time contributed to this unfortunate situation, and circumstances were aggravated by domestic expansionary policies financed by inflationary money creation and short term external debt. These developments led the economy into a severe crisis where national income declined in real terms.

The inflation rate reached three digits and country was unable to import even the most essential items such as crude oil, due to a foreign exchange shortage. In order to control the situation and

to pull the economy back from the edge of disaster, a far reaching adjustment program was put into force in the beginning of 1980. The program changed the economic strategy fundamentally from a traditional inward looking one with heavy state intervention to one led by a growth in exports and by trade liberalization with the full play of market forces in order to improve the allocation of scarce resources. The so called "Recovery Program" had a dual goal:

I - Reestablishing political and economic stability
2- Restructuring the economy with a view to regaining a sustainable growth path through a dynamic adjustment process.

Therefore on the basis of such a comprehensive structural adjustment program to stabilize and liberalize the economy, Turkey has attained a sustainable pace of growth and made considerable progress toward internal and external balances.

Despite some discontinuities in its implementation the program has at least enabled the country to enjoy a high growth rate averaging 5%. Furthermore it resulted in a spectacular increase and diversification in exports which in turn led to serious improvements in the current account deficit of the country employment in industry rose by almost 3.5 % per annum.

I would like to remind you that this recovery took place during a period in which a series of adverse developments occurred in the world:

Some other aggregate indicators

	1980%	1990%
Export/GNP	5	15
Import/GNP	14	20
Volume of Foreign Trade/GNP	19	35
Industrial Goods/Total Export	36	78
Reserves/Import	10	60
Foreign Invest. (1954-80)	$228 million	(1980-90)
		$ 4.5 bil. permits
		$ 2.2 bil. inflow

- *World trade was depressed until 1985 -86 due to slower growth in industrialized countries: as a result volume of trade and T/T went down for less developed countries,*
- *Interest rates were relatively high,*
- *Third world debt crisis was at its peak, i.e. availability of external financing was very limited.*
- *Protectionism was a real issue, i.e. access to the developed world's market was constrained.*

In addition to the above, one should not forget the new historical stage and perspective in industrialization:

- *Environmentalism (leading to expensive industrialization) has gained momentum in the developing world.*
- *Unionism and the trend for less and less working hours within a new human dimension of development has become a fact.*

If one takes into consideration the above adverse background. Turkish experience in restructuring the economy will be appreciated more.

As we learned from this structural adjustment programme the crucial issue was to judge the economy's ability to respond to different sets of policies. We further aimed to eliminate the rigidities in the Turkish economic system so that it can respond to changes and be more flexible. The best way to demonstrate this is to make the following observation:

It took 6 years to respond to the first oil shocks in 1973/4 and 1979/80 (external). It took 6 months to respond to the "reverse oil shock, the price fall in 1985-86 (external).

It took 6 weeks to respond to the foreign exchange crisis in the unofficial market 1988 (internal). It took 16 days to respond to the Gulf Crisis (external and internal).

In this context, at least one progress cannot and should not be denied: Market forces have gained roots and what is more they have taken the lead. That is to say, the economy is functioning more or less independently of what is happening in Ankara. Because of these deregulations, liberalizations and financial markets, the Turkish Economy is much more vulnerable to internal and external developments. However, thanks to the same developments and structural transformation achieved through them the Turkish economy's

- *capacity to absorb shock,*
- *ability to adjust to new conditions have tremendously improved.*

Therefore Turkey's vulnerability because of these liberalization policies to new economic and political developments both at home and abroad can and should be interpreted as a point of strength rather than weakness for the following reasons:

- *it shows the government's confidence in the system.*
- *it shows how the general public and business circles feel comfortable with the system as they see these policies as irreversable, and not subject to political changes.*
- *it is an indication of or rather insurance for, the continuation of the liberal policies, and for the fact that private enterprise is essential in deepening democracy.*

Now based on this background what does the Gulf Crisis imply for Turkey? First let us look at the map:

Considering the eight neighbours Turkey has I do not think any country in the world envies our geostrategic regional positioning. This region has always been subject to grave tensions with worldwide implications. So if one tries to rationalize this situation, I think the common denominator would be the following: This turbulent region needs a stable and economically strong country: who else but Turkey can be a better candidate for this? This is a role crucial not only to Turkey, but to the checks and balances of the region and global stability. If this is the case,

as a geopolitically pivotal county Turkey should be supported in her efforts to be economically stronger.

Turkey today with her reorientation and dedication to the market economy and the democratic regime has a unique position among her regional partners or competitors, so to speak, in yielding better and quick returns on any investment that will be made, be it economic and for political investment.

That is to say, Turkey as an emerging newly industrialized country whose politics and dedication to the democratic regime have been coming of age and gaining respectability even by the standards of more established European democracies has the lowest Risk/Return ratio in the region. Let us now, look at the short term impacts of the crisis:

Loss of revenues

$ 300 million oil pipe-line (250 already taken in)
$ 400 million tourism cancellation for 1990
$300 million transit trucking/lorry fee
$100 million port fees and other services
$300 million debt payment by Iraq

Export Proceeds: $600 million

Construction Sector: Confiscation the assets of Turkish companies and losses of contracts. $ 500 million

Additional oil bill because of high prices $ I billion
Additional Defense Expenses $ 500 million
TOTAL: $ 4.0 billion (an approximation)

Considering the reserve level of the country (Central Bank + commercial banks) as of today, as $11.5 billion without taking into consideration the multinational compensation package, we can easily argue that this short-term burden will be absorbed without creating a serious problem provided that the government keeps taking necessary medium-term measures.

Oil prices and VAT have already adjusted to accommodate new developments and keep the budget deficit under control. 1991 preliminary budget figures has just been announced and contain some indication of new austerity measures. However, what is more important today, as I have already mentioned is Turkey's increased ability to adjust and absorb external and internal shocks.

Although I'm not in a position to speculate about the duration of the crisis here, in a medium-term perspective, Turkey will have better chance to adapt to and compensate for the burden with her much more flexible and market oriented approach. However, as a former conservative public servant and a new merchant banker I should avoid signaling more optimism than it is justified.

I am sure you are all aware that the Turkish Economy still faces real issues, inflation, as well as short to medium term constraints. Whether or not current outstanding issues will be successfully resolved will clearly depend on the ability to adhere to a sound and balanced macroeconomic policy stance in the medium term.

The attainability of economic medium term targets is closely linked to the emergence of an internationally competitive viable economy. This fact gains further importance considering first, Turkey's application to the EC and second the recent developments in Eastern Europe. Turkey, with her firm adherence to pluralistic democracy and the market economy certainly welcomes these developments. It is important to note that developments in Eastern Europe do not necessarily mean, as some people are inclined to think negative results for Turkey. It is not a zero sum game i.e. one loses, the other gains or vice-versa.

Turkey will gain from progress in Eastern Europe, because of:

- *the extended European market,*
- *free market orientation,*
- *taking part in building infrastructure.*

On the other hand, comparing Turkey with the Eastern European countries is certainly enlightening and worthwhile. However it underestimates and disguises the real level of development in Turkey.

One should go further and compare Turkey's economic and financial strength with Spain, Portugal and Greece. There is no doubt in my mind that the future shaping of our political, social and economic policies will inevitably be deeply affected by the series of transformations catalyzed by the inherent dynamics of

the single market, its probable ramifications and its likely interactions with Eastern Europe. This transformation will be smoothed out by Turkey's most recent negotiations with EFTA, the ongoing process of Customs Union with the EC, which is bound to be finalized by 1996, and the new enlarged and diversified cooperation agreement with the community.

I therefore think that to achieve a competitive industrial structure is crucial for Turkey, irrespective of the state of her application for and the realization of full membership.

With this ultimate aim in mind Turkey is looking at the 1990s as a decade of consolidation in order to ensure a safe entry into the 21st century. As has already been mentioned, for the next five years the average growth rate is forecast as 7% with a target rate of inflation of 15% by 1994.

This implies

- *a progressively increasing resource transfer to the manufacturing sector,*
- *Further reduction in the weight of the public sector together with public sector borrowing requirements,*
- *Further rationalization of the banking sector,*
- *Stronger and deeper capital markets, where stock exchange developments are already to helping to cushion the impact of the financial liberalization process on the product markets and help more equity financing in order to lower Debt /Equity ratios for firms.*

In conclusion my message would be the following:

- *Let us remember the fact that Turkey's economy and her development belongs to the mainstream of Europe in which the overall economic and political landscape is changing. In fact, we are faced with a "moving landscape".*

- *Turkey is not only the Southern Gate of the west but is the Western Gate of the East,*

- *Turkey is not only the" armed guard" of the west but with her adherence to pluralistic democracy is a frontier for political global stability,*

- *Turkey is no longer just another country trying to figure out what the problems are rather than dealing with the solutions, as many others still do, but she is a country who has already gone a long way in achieving the solutions.*

- *Turkey is not only a growing market whose large population has close to $2000 per capita income and high GNP growth, but with her market oriented and deregulated liberal economy and dedicated private sector, coupled with productive labour and a new generation of well and properly educated and industrious minded managers, is a well placed partner for the European economic challenge.*

- *Last but not least. Turkey is not a new partner for the old Europe, but she is an old partner with a regained dynamism for a new Europe.*

** Yavuz Canevi, Managing Director, EuroturkBank*

Distributed at the IMF-WB Annual Meeting, Bangkok, Thailand

Special Issue January 1991

Key Decision Makers For Economy and Finance in Turkey:

President, Turgut Ozal
Prime Minister, Mesut Yılmaz
Deputy Prime Minister, Ekrem Pakdemirli
Minister of Finance, Adnan Kahveci
Minister for Foreign Affairs, Safa Giray
Undersecretary of Treasury (PM), Tevfik Altınok
Undersecretary of Ministry of Finance, Okmen Mecdi Atamyıldız
Governor, Central Bank of Turkey, Dr. Rustu Sracoglu

FROM THE THIRD WORLD TO THE FIRST, FROM THE SOUTH TO THE NORTH: AN ERA FOR REALIGNEMENT AND REDEFINITION*

The last decade has witnessed unprecedented and even more important, unreversable changes on the Turkish economy. Nearly 70 years after the foundation of the Republic we can at last look forward to both a healthy and sustainable free market oriented growth and a gradual integration of the Turkish economy to the European Community and the World economy.

While many of the representatives of the developing world have been trying to identify their problems Turkey has already been busy in dealing with the solutions.

The so-called Eastern Block countries along with other members of the third world now seek to imitate Turkey's economic achievements.

The stagnant economies and confused economic managements and complicated market structures of the surrounding countries stand in stark contrast to the dynamism of the Turkish economy, demonstrating for all the advantages of an economy based on market forced and tied to the world trading system.

Living in Turkey today, one can hardly find a trace of the Turkey of 60's and even 70's. At that lime, per capita GNP stood at only less than US$1000 and GNP at around US$50.0 billion. Total trade volume was around US$1.0 billion. Turkish economist at the State Planning Organization were pre-occupied with questions of how to build an economy that could supply the most basic needs of its people.

Today, with her US$2600 per capita income, 5.3 percent the average annual growth rate for the last ten years. US$150.0 billion GNP and US $30.0 billion trade volume corresponding almost 20 percent of GNP and in ten years tenfold increased foreign direct investment inflow. Turkey is considered one of the, if not the leading, representatives of the second generation of the so-called "TIGERS".

No one today challenges the achievements registered in market orientation in Turkey. Therefore the majority of the people agree that Ozal has done a great job in the 80's. But with this acquired momentum of the 80's people are looking for new dimensions, and wondering where to go from here i.e. specially after the cold war is over, the question of identity has reemerged with force.

Therefore, from whatever angle we look at it we can argue that Turkey is heading into a period of fundamental realignment and redefinition. This was necessitated both by internal and external developments.

Internally, some argue that Turkey has suffered from a classic model of rapid development. That is to say, much too fast for a society and infrastructure not ready to handle it. When one considers the achievements, this may not be a fair assessment. In retrospect we can say that development of the infrastructure has been an important element in both overheating the economy, together with its inflation induced social problems, and stimulating growth in order to pave the way for international integration. Besides easing bottlenecks in energy, transportation and telecommunication, it brought extra employment and provided a basis for the establishment or the expansion of related industries. One can, however, only question today the priorities that have been applied, the speed at which these projects were implemented and most importantly the sources of financing which were used for the implementation, which constituted, all together the main causes of overheating.

When it comes to external developments, especially keeping in mind the fact that Turkey played the West's forward position in the most recent Gulf War, European Governments have always hesitated to take a clear stance on Turkey. In fact the energy, devoted to creating associate status for the former Warsaw Pact countries, not to mention the EFTA club member's natural status,

tend to push Turkey to the end of the queue as far as membership is concerned. In addition to being shunned by Brussels for the Common market, the proliferation of strategies for renewal prove to be tragically shortsighted as the Mediterranean remains a critically important and unstable region.

With Turkey's phenomenal success in economic restructuring and adjustment, her efforts in promoting integration to the world financial and commodity markets with the help of policies such as full liberalization of the capital transactions and convertibility of the Turkish currency are evolving into a series of true economic partnerships, providing enormous benefits to the involved parties.

In the wake of an election period which will be over by the 21st of October 1991, what we can expect as for the future of this country should be a conforming base for both domestic and international investors.

First of all, all four major political party leaders have committed themselves to further market orientation, privatization and democratization.

Second, almost all of them are for a consistent, complete and coherent policy implementation, for the next 4-5 years in order to secure a stable, noninflationary, and sustainable growth.

Thirdly, there is a national consensus on the labor relations and social place at large. Therefore recent labor disputes should not

be exaggerated. Unions are beginning to digest the critical balance between the high wage, low employment, capital intensive industrial structure and productivity related wage demands coupled with relatively skilled labor intensive industrial structure.

We are aware of the fact that further prosperity can only be achieved by acquiring improved technology and training workers to master it. Thus, the traditional emphasis on saving, Investing, exporting, education and training is logical, as is the newer emphasis with her natural and human resources on the one hand and the existing industrial and managerial fabric on the other. The challenge for Turkey today, will be to speed up and complete the move from the Third Word to the First or from the South to the North.

It is clear that opportunities for the future is abound. The development of the surrounding region like reconstruction and the reshaping of the Middle East, Eastern Europe and USSR is a unique opportunity for country like Turkey to cooperate with the rest of the world.

To continue her almost unparalleled record of economic recovery leading to a sustainable growth Turkey is determined to take further steps to liberalize her economy, reduce the weight of the public sector in the system with an aim of facilitating her adjustment and harmonization with the New Europe which will start emerging in 1992.

Turkey, I believe, with all her democratic institutions and professional organizations and including the men on the street recognizes today, the need to continue this pace of liberalization, to take the maximum advantage of the competitive and innovative environment which is expected of the current GATT Uruguay Round negotiations to strengthen the international trading system. More importantly to initiate and seek support for new regional cooperation setups to find imaginative answers to the challenges of the future like Black Sea Economic Cooperation Council, Middle East Peace Pipeline.

At this juncture, on the way to the full membership of the European Com-munity, Turkey's challenge is that she must pursue her uninterrupted trans-formation and adjustment for market economy and democratization to secure a sustainable but rapid growth in order to provide the living standards that Turks have come to expect.

However the real challenge, it seems, is "keeping the dynamism going". It is to believe that this dynamism looks solid, deep rooted, but it can be lost if it is mismanaged. Due to this awareness there is a society today where everybody wants to move up, and there is no question of lack of ambition, there is a desire to learn, to be trained, to produce, to serve, therefore to achieve the "deserved status".

** Yavuz Canevi, Governor, Central Bank of Turkey*

This article is published in the "Middle East Business and Banking" monthly magazine on the December 1991 issue

Distributed at the Davos-World Economic Forum in Switzerland

Special Issue January 1992

Key Decision Makers For Economy and Finance in Turkey:

President, Turgut Ozal
Prime Minister, Suleyman Demirel
Deputy Prime Minister, Erdal Inonu
Minister of Finance, Sumer Oral
Minister of Foreign Affairs, Hikmet Cetin
Undersecratary of Treasury (PM), Tevfik Altınok
Undersecretary of Ministry of Finance, Okmen Mecdi Atamyıldız
Governor, Central Bank of Turkey, Dr. Rustu Saracoglu

NEW STRATEGIES FOR AN OLD SCENARIO*

In the wake of a challenging year and an environment in which intensive and comprehensive plans are being drawn up to redefine and reestablish the financial and economic balances it is time for weighing up trends, probabilities and commitments.

For Turkey, entering the new year with a new government, this analysis seems to be very essential. Watching the feverish activity in financial and economic spheres, and preparations for an economic stability programme, I could not help thinking that I had seen this movie before. The scenario is the same: development, inflation and stability. As a developing country these three issues are bound to take center stage, because development is a dynamic process. Apart from the scenario, everything is changing; from director to audience, from cameraman to makeup. Decision makers who fail to capture the dynamic process of technological, social and economic changes at the infrastructural level cannot be expected to make a success of filming this scenario even though it remains the same. The economic programme of the early 1980s was driven by two main objectives:

- **Economic stability, price stability;**

- **Structural change, structural adjustment.**

Please note that considerable headway was achieved where economic stability was concerned, although the anti-inflationary campaign was markedly less successful. The most vital point in the search for new stability policies in my view is selecting the right vehicles, since those employed in the 1970s and 1980s are no longer valid in the context of the 1990s; for the following reasons:

The most conspicuous characteristic of the 1980 economic programme was its accurate diagnosis of Turkey's one of the scarcest resources. This resource was neither foreign exchange, nor savings, nor labour but it was an efficient decision making mechanism in macroeconomic issues.

The efficiency, speed and flexibility imparted to the previously insert mechanism by such institutions as the Money and Credit board and the Economic Coordination Committee go a long way to accounting for the programme's success up to 1985-86. Clearly it is a foremost priority today to set the economic decision-making mechanism functioning properly again.

- *The foreign trade regime has been increasingly liberalized over the past decade. As there is no question of reverting to the quota system or export incentives in the form of tax refunds, the time has come to*

liberalize the system still further, avoiding unfair competition by the objective and effective implementation of anti dumping and anti trust regulations, while simultaneously expanding Eximbank and export insurance service.

- *Foreign Exchange control regulations and policy have been deregulated to the point of no return, and the integration with international markets is on the march. Consequently the response to developments on foreign markets should not be to make artificial amendments and interventions to exchange control or policy, but rather to adjust domestic economic policies (budget, money supply, interest and so on) and not to ignore the elimination of the differences between inflation rates in Turkey and her trading partners.*

- *One of the fundamental pillars of the free market economy is the ability to establish and maintain relative price equilibrium. By relative prices I refer to the following three markets:*

Commodity markets

Imbalance on these markets originates largely from the pricing policies of state economic enterprises (SEE's). It is aggravated further by certain discrepancies and inconsistencies in import regulations.

Labour markets

Imbalances on these markets derive from taxation policy, income distribution and wage policies.

Financial markets and capital markets

If we remember that the public sector has direct or in-direct control over 80 per-cent of Turkey's financial sector, it is no surprise that every instance of inefficiency in the public sector rebounds on these markets, disrupting relative prices. Despite the abolition of price controls, including those on interest rates so long as the public sector and above all SEE's which are indirectly subject to price interventions, continue to dominate the economy, the system can never operate efficiently. Moreover, uncertainties in government policies and even on occasion retroactive decisions, put an even greater strain on these balances.

In this respect macroeconomic policy decisions should also take into account the views of the private sector for which a consultation mechanism should be established. Such a coordinated system is the prerequisite of success.

- *Despite all setbacks, Turkish financial markets now have the capacity to attain a greater depth. What they require now is fresh momentum. While there were less than a dozen financial instruments in the 1970's, today there are three to four dozen (still low compared with around 400 in Western Europe). The goal of still greater market depth requires legislative reforms to give savers and investors access to a more diversified and flexible and liquid (by flexible I mean easy to buy and sell) "Table d'hote" menu as well as an "A la carte" menu responsive to ever changing needs of the customers as available in developed world markets. Among the principal changes required are:*

- *Securitization of a balance sheet assets and liabilities of banks and companies, in other words their transformation into independent money or capital market instruments;*

- *The issuing of real estate, backed securities,*
- *Expansion of the insurance sector,*
- *Formation of venture capital, and*
- *Laying the ground for institutional investors*

Changing world of financial markets

Getting a true picture of the proportions of the changes and developments in the international financial sector should start with the following concrete observations. These will provide clues as to how and why the system is changing, how these changes are affecting us, and finally where this process is leading the financial sector.

- *Looking around us we can see interesting developments and phenomena taking shape in financial markets. For example, the boundary between short-term money markets (including the overnight money market) and medium and long-term capital markets is rapidly fading. Furthermore the legal and functional barriers which once jealousy preserved borders between national financial markets are either being lifted or becoming more penetrable.*

Indeed, national and international money and capital markets are already on the way to becoming a single international market.

The 1992 Single Market of the EC does not conflict with this general trend and might even be a sign that the farsighted EC member countries are already preparing to face the fiercely competitive conditions which will prevail on the global markets of the future.

- *Meanwhile the universal banking concept of continental Europe and the Anglo Saxon concept of specialized banking are becoming steadily more inextricable, leading to mergers of very diverse financial bodies operating in these areas. At the same time insurance companies, institutional investors and even industrial companies are becoming directly involved in financial markets to an ever increasing extent. This not only puts a heavier burden on supervisory authorities, but complicates the definition of a capital market.*

- *The simple, clear-cut financial contracts that we once know are now a thing of the past. The task of conjuring "two hides out of one sheep", as the Turkish proverb goes, is no longer a task for butchers but for that new breed financial engineers. Interest coupons and their certificates that were once valid for just a single contract, may now not only be marketed separately, but their interest and exchange risks marketed separately in the form of futures and options.*

- *Banks can transform their liabilities and/or receivables into independent money or capital market instruments, so introducing a new era known as securitization. By this they both disperse their risk, and at the same time increase the depth and volume of the markets.*

- *These developments naturally affect the behaviour of savers and thereby of investors. In the face of such complex and sophisticated investment alternatives, institutional as opposed to individual investors are accounting for an increasing share of investment activity. Institutional investors are shouldering the expert mediator role formerly played by banks between creditors and debtors. It is no coincidence that mutual funds, pension funds and other professionally managed savings and investment institutions are on the increase.*

At this point we should refer back to the factors which have brought these changes about:

- *Ours is an age of technology, in which communications and information technology have developed to the point where financial and other information can be conveyed and evaluated anywhere in the world in an astoundingly short space of time, at a cost lower than anyone could have envisaged. Over the last few years alone the time taken to convey information has been cut to one twentieth, and the cost of doing so to one fiftieth, and the end of this process is not yet in sight.*

- *The national, geographical and time boundaries and zones which until recently constituted obstacles to financial services, no longer have the same significance. The sun no longer sets on financial markets. For 24 hours a day at any point in the world, services can be performed and purchased. What is even more striking is that the markets which were once driven by new financial services and instruments, have*

transferred their allegiance to the dynamism of unpredictable customer demands for new services. The system depends for its continuing profitability on this dynamism and power of renewal. The rise in economic uncertainty and variability of indicators and policies have boosted investor awareness and prompted a search for alternatives, which in turn have forced the system to renew itself in order to compete.

- *Finally, a third factor underlying all this changes is the new instruments and transactions, the "financial inventions" created by the capital and service sectors in their efforts to overcome the national restrictions and control which fetter them. Moreover, monetary and financial authorities have felt obliged to take a series of deregulation decisions and implement legislative reforms in order first to catch up with these changes and thereafter to facilitate them. As a result the job of super vision, which once belonged to national bodies has been raised to the international level. In fact, the activities of a multinational financial organization such as the Bank for International Settlements in Basle, is gaining momentum. "The Cook Committee" and "Cook Ratios" are the clearest examples of this.*

Shaking up the patient!

Preserving competition and ensuring transparency in a financial sector which is developing, integrating and globalizing so rapidly, is as difficult as it is essential. Undoubtedly all these developments have already been reflected and will keep on reflecting on the Turkish financial sector.

It is particularly important that the Turkish financial markets, which have been integrating with international financial markets since 1980, continue to do so and to keep up the process of self renewal.

All these factors must be taken into consideration among the fundamental criteria of the stability programme now being drawn up. The buttons which can be pressed by the public authorities in order to achieve economic development and combat inflation are now fewer in number; this is the inevitable outcome of free market economy. Moreover, their characteristics and functions have also changed.

I wish to make two other points where the success of the economic stability programme is concerned. The bitter flavour of stability programme remedies cannot be disguised by any name. Whereas doctors shake the bottle before giving the medicine to their patient, in economics you have to shake the patient first.

This is because markets i.e. patients of the economy, are attached to the status quo. They would prefer to assume that the current situation will continue indefinitely, because the players have adapted themselves to the system and are reluctant to change. To break down this resistance the patient must first be shaken out of this comfortable expectations by convincing that in the not so long term the system will work better with the new adjustment policies.

The state machine must come in first for this rough treatment in so far as over the past decade it was the state and state owned enterprises, the budget administration and the bureaucracy, which have stuck most persistently to the past and resisted change. Only then comes the turn of the market place. My second point is that as the market economy has taken root and international economic relations and integration institutionalized, the quality, form and priorities of management problems have also altered. Although administration, investment, technology and finance continue to be primary issues, companies face still more urgent fundamental problems of,

- *Uncertainty, and*
- *Instability*

The prudent, conservative businessman image once so admired is no longer acceptable under today's conditions. The prudent businessman regards instability and uncertainty as a given fact of life, so instead of taking risks he takes counter measures. Yet what is needed today is entrepreneurs, ready to take calculated risks and go ahead with investment. If the dimensions of instability and uncertainty are known, risk can be calculated.

The primary duty of the state in a free market economy is to provide this calculable environment, so that those tempted to follow a cautions policy in the 1990s are encouraged into risk taking enterprises.

An interim assessment

The last decade undoubtedly has witnessed unprecedented and even more important, unreversable changes on the Turkish economy. Nearly 70 years after the foundation of the Republic we can at last look forward to both a healthy and sustainable free market oriented growth and a gradual integration of the Turkish economy to the European Community and the World economy.

No one today challenges the achievements on market orientation in Turkey. Therefore majority of the people agree that Ozal has done a great job in the 80's. But with this acquired momentum of the 80's people are looking for new dimensions, new weaves and wondering where to go from her i.e. specially after the cold war is over, the question of identity has re-emerged with force.

At this juncture, on the way to the full membership of the European Community, Turkey's challenge is that she must pursue her uninterrupted transformation and adjustment for market economy and democratization to secure a sustainable but rapid growth in order to provide the living standards that Turks have come to except. However the real challenge, it seems, is "keeping the dynamism going". It is to believe that this dynamism looks solid, deep rooted, but it can be lost if it is mismanaged. Due to this awareness there is a society today where everybody wants to move up, and there is no question about lack of ambition, desire to learn, to be trained, to produce

to service, therefore to achieve the "deserved status". This interim assessment fits very well with the historical assessment because Turks are proved to be culturally good learners, traditionally heavy workers and currently they have become new age entrepreneurs.

A proposal:

In conclusion I wish to stress that stability policies consist, on the whole, of short-term measures. However not only short-term errors, but the lack of medium and long-term strategy and vision always number among the causes of instability. If this vacuum is not filled, the economy may well enter a new bottleneck before very long. To avoid this I propose a three way formula which I dub T.E.P.

T: Technology

The mainstay of Turkey's industrialization policy should not just be the idea of catching up with the industrialized nations, but to compete with and even surpass them in specific selected areas.

Possible sectors which might be picked out are,

- *Information technology*
- *Genetics and bio tech*
- *Agro industry and organic foods*
- *Services, for example, there is a new opportunity to seize in services; logistics*

E: Education and Productivity

A comprehensive educational reform programme, including population control policy, could solve a large number of problems; from labour relations to urbanization and environmental conservation. While taking full advantage of the brain drain from the former Soviet Union, an intensive domestic education programme for vocational education and an overseas education programme in skills required by chosen priority sectors should be launched.

P: Public Sector Reform

The means of achieving this can be summed up as follows:

• *Public financing reform*

Budget discipline, Tax reform, Redefinition of spending priorities

• *Reform of State Economic Enterprises*

Depolarization, Privatization

• *Identifying capitalism with capital markets:*

Government pension funds, social security funds and recently established extra budgetary funds are currently administered (not run) by the state and/or state banks. Some of these funds, wholly or partially, should be brought to the Capital Market and quoted on the Stock Exchange and managed not administrated by professional institutions so imparting additional institutional weight to the Capital Markets and the Stock Exchange.

** Yavuz Canevi, Managing Director, EuroturkBank*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 1992

Key Decision Makers For Economy and Finance in Turkey:

Key Decision Makers For Economy and Finance in Turkey:
President, Turgut Ozal
Prime Minister, Suleyman Demirel
Deputy prime Minister, Erdal Inonu
Minister of Finance, Sumer Oral
Minister of Foreign Affairs, Hikmet Cetin
Undersecratary of Treasury (PM), Tevfik Altınok
Undersecretary of Ministry of Finance, Okmen Mecdi Atamyıldız
Governor, Central Bank of Turkey, Dr. Rustu Sracoglu

TO WHOM IT MAY CONCERN: MISTAKES AS MUCH AS EXPERINECES CAN BE OUR MOST VALUABLE ASSETS*

We have to accept today that there are two fundamental challenges to the world community in the 1990s which are different to those of the 1960s, 70s and even 80s.

- *Part of the world which represents 15-20% of the World population is moving backwards. As Prof. Louis Emmerij of OECD puts it, an involuntary detaching of the LDCs from the main stream is occurring. The rest of the world is changing track. It is not a two-speed growth story any more. This is the main challenge.*

- *Emergence of Eastern European states and former Soviet Republics with the aim of free market orientation and eventually integration to the world economy is the second major challenge of the 1990s and onward.*

The world geo-political and economic map has been virtually redrawn, and with this comes the need for equally radical change in the worlds of investment, industry and commerce. For it is

evident that a simple extrapolation of past experiences and thinking will not be an appropriate basis for future decisions.

I repeat, the above challenges are not only for the countries in question but for the whole world, i.e. "if the members of the world community do not hang together, they will be hanged together."

Why we still face the first challenge?

One can mention some classical indigenous factors such as, lack of clear development strategies, wrong priorities, wrong incentives, lack of timely introduced adjustment policies etc. One should also add to the above, some well known exogenous factors such as unstable oil and other commodity prices, foreign exchange and debt crisis, protectionism, lack of development aid etc. Both challenges will have to be taken more seriously than before by both the nations concerned and by the world, the western world that is. Indeed we are witnessing the emergence of the institutional foundations of a "New World Order".

Therefore, it is reasonable to assert that these changes have raised the expectations of world public opinion to a great extent. The process we are going through, despite all the uncertainties involved, creates new opportunities and hopes, and enables humanity to harbor a justifiable optimism. We are living through an era when the universal values that we have been defending all along are finally being incorporated into international treaties.

It is clear today that there is no short cut to the integration of the world economy in which globalization of the markets takes the lead. Access to these markets without a well trained, human resource, which is the base stone for an institutionalized market culture is unthinkable. That is why development of market orientation view from both South and North is essential. There is no short cut. However this realistic assessment implicitly assumes that a gradual increase of the market share of the developing countries in the world economy. In this vein, the new world order will be fully realized when a sustainable atmosphere of confidence is created and everyone involved takes part in sharing the responsibility.

If one considers the fact that in the western world today more than 2/3 of GNP comes from the services sector and not from goods then it can easily be concluded that in the 21st century competition will be in services. In other words human resource and its quality will make the difference. In fact, technology oriented services in general and high tech services in specific are the new kids in town on the global market in more and more sectors. Access to high tech is the way to these markets, so as to create competitive advantage for yourself to design latecomer strategies to enter the global market.

Indeed economic growth is an imperative not a choice. Without growth you cannot achieve more. But what is important today is the model of growth which links growth with the life of people. That is development of the people, for the people and by the people i.e. inclusive growth. So, the problem is now how to

survive, not how to grow sufficiently, for the new concept of sustainable development is based on structural economic and environmental constraints. In this context, the dimension of human development elaborated by the UNDP appears as the only way out, as a means of salvation. Only the creative capacity of well educated human beings can seize the opportunities offered by and, overcome the difficulties arising out of the integration with the world economy.

Only they can compensate for the lack of increased competition. Only they can raise foreign savings and investments and import and adapt appropriate technologies and create new innovative solutions. Only they can reach the global market.

Turkey is a much luckier developing country than many others in this respect. Paradoxically, the fact that it was one of the first which went virtually bankrupt in the late 1970s led it to a major policy shift in the early 1980s, hence gaining very valuable time. I wish only to stress one point. Success in a free market economy depends squarely on private initiative.

In this process, Turkey discovered that it had some very good entrepreneurs, disciplined and productive man-power and a service sector highly adaptive to new technologies. In other words, the new era found Turkey quite ready for new challenges in terms of human development. Our decade old structural adjustment and economic transformation program were in fact intended to build on the achievements and mistakes of the past. Similarly to impart a new element of dynamism and to inject a

new momentum to the Turkish economy in which the problems are less severe and fundamentals are much stronger, all we have to do to look back and take stock of the developments and develop the skill to convert our mistakes into our assets, because that is what they are. This does not mean that we do not have shortcomings. We still do, but one can easily identify them and reach the conclusion that we are also not short of solutions.

In conclusion, what is striking today is the awareness of the Turkish people that to avoid in increasing marginalization of the country within the context of the 1992 Europe and evolving world economy, not only will the reforms have to be consolidated as they go along but new attempts in reforming the public sector activities, including privatization, will have to be accelerated to take full advantage of global opportunities.

* *Yavuz Canevi, Managing Director, EuroturkBank*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 1993

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel (from May 1993)
Prime Minister, Tansu Ciller
Deputy Prime Minister, Erdal Inonu
Minister of Finance, Ismet Atilla
Minister for Foreign Affairs, Erdal Inonu
Undersecretary of Treasury (PM), Kemal Kabatas
Undersecretary of Ministry of Finance, Talat Saral
Governor, Central Bank of Turkey, Bulent Gultekin

RESPONDING TO GLOBAL TRENDS *

Interview with Yavuz Canevi, Managing Director, Euroturk Bank

On the occasion of the IBRD/IMF Annual Conference where representatives from throughout the World's financial sector gather, if you could give them one message about the Turkish Financial industry, what would it be?

I would say that our financial industry is working hard to increase its competitiveness through financial liberalization and deregulation. As the world trend of financial liberalization and integration continues, despite some hick ups in European Monetary System, and as the Uruguay Round negotiations are getting close to an end, we will witness a shift towards an era of borderless and limitless competition if not in all areas, definitely in financial services before the turn of the century. And Turkey will be part of this shift.

Do you think Turkey's current macro-economic balances will accommodate this shift?

It is true that Turkey is currently suffering from economic difficulties such as increased inflationary pressures, high PSBR and a deficit in the current account. These difficulties stem from a number of factors. In recent years aggregate demand has exceeded supply capacity despite an impressive 5-6 % growth achievement. The overheating of infrastructural investments in energy, transportation and telecommunications has been one of the major factors.

But a more fundamental factor is the decline in industrial competitiveness caused by the developments in domestic and international environments such as wage hikes, the appreciation of the Turkish Lira against major convertible currencies, an increasing lack of efficiency in State Economic Enterprises and rapid progress in the opening and internationalization of the economy.

Current government, in the short run, has no choice but will have to tighten aggregate demand through a stable supply of money. That is the challenge that new Governor of the Turkish Central Bank, Prof. Gultekin will face for a good reason. In the medium and long term, the governments will have to encourage capital investment, both domestic and foreign, through a financial and tax incentive system enforced with R&D support to increase our growth potential and competitiveness.

Do you feel that Turkey has done enough on liberalization?

As you know, Turkey has been pursuing opening of markets to the international competition since 1980. On the financial markets front, especially in banking, capital market and stock exchange operations, and insurance markets considerable steps have been taken in order to respond to the global trend of financial liberalization and promote the advancement of the domestic financial sector.

The best proof of these positive developments is to see the global professional players such as stock-pickers, IPO hunters and EMF (Emerging Market Funds) in Istanbul nowadays. Even IFC recently entered into a joint venture with a local securities firm to be closer to the market. Having said all these we should be reminded, however, that the financial and real sectors may be looked upon as two wheels of a cart, and just as the cart can only move smoothly when both wheels are well balanced, an economy can continue to grow only when equilibrium is maintained between the real and financial sectors. It is true that the competitiveness of domestic firms falls behind that of foreign counterparts in terms of financing costs due to domestic real interest rates being higher than international level. This may be some extent reflect the inefficiency of our financial sector. However, a more fundamental reason is that with a continuous high PSBR and crowding out effect of public sector financing coupled with an inadequate accumulation of financial capital, the supply of liquidity (credits) cannot meet the increasing demand for funds arising from an active and dynamic growing economy.

Don't you think there is a missing link in all these liberalization efforts? To be more specific would you consider the existence of a foot dragging attitude on public sector financial reform in general and SEE Reform Privatization in particular?

You are quite right. There has been a political shyness if not foot dragging in privatization. However, for the first time, the Ciller government is demonstrating a decisive and committed approach towards privatization.

As the Istanbul Stock Exchange Shows a strong sign of maturity and gaining a healthy depth, the Ciller government's determined attitude in pursuing long delayed privatization programme presents new opportunities in this young but growth driven dynamic emerging market. To me the privatization will be a new "Turkish Delight" that investors in both domestic and international markets will be busy with.

Do you think the politicians and general public have already been convinced about the merits of a privatization programme in Turkey?

Some extra work seems to be still needed to that effect, and the government is prepared to take this challenge. Bad news is we don't have any more time to waste. Good news is we have the results of the previous experiences. If properly evaluated and assessed, they are telling us the truth that there is nothing to be afraid of privatization.

Are you referring to a specific study?

Yes, precisely. The most rigorous and objective analysis of the relative benefits and dis-benefits of privatization is a World Bank study published in June 1992. "Welfare Consequences of Selling Public Enterprises". (The U.K., Chile, Mexico and Malaysia).

The Bank compared the privatized firms' actual results with careful estimates of what would have happened had they remained in state hands, calculating the gains and losses for all relevant constituencies (employees, taxpayers and consumers) as well as the gains to governments (e.g. macroeconomic, capital market factors) and shareholders.

- *In 11 of the 12 privatization there was a net "global gain" compared to leaving the firm in government ownership. Altogether, the 12 privatizations produced net gains worth, each year, approximately 26% of the firms' pre-privatization revenues, The largest gain (155 %) was in a telecom company, CPC (Chile)*
- *In almost every case privatization made the firms more efficient and led to economic benefits for shareholders.*

This study clearly offers the most persuasive evidence that privatization does, indeed, work.

Could you be more specific about this report, especially on the effects of the privatization in relation to the issues such as labour/employee, consumers, competition/monopoly, capital markets?

Of course, the Bank's study is far more detailed, and more rigorous, than most other research on the subject. Carefully estimating what would have happened if the privatized firms had remained in state hands, the Bank tried to measure the economic gains and losses to employees, taxpayers and customers, both at home and abroad, as well as the gains to governments and shareholders.

The study looks at three privatizations in each of four countries: Britain, Chile, Malaysia and Mexico. The sale of four airlines, three telecoms firms, two electricity utilities, a road freight transporter, a container port and a lottery business are examined. The sample is small, and it does not include any mining or manufacturing firms. But it does cover a range of different circumstances in both rich and poor countries. And, as most of the firms were sold between 1984 and 1988, enough is known about their performance both before and after privatization to justify a detailed analysis.

Labor/Employee issue

In all 12 cases, the study finds that employees on balance benefited from the privatization through:

- *Level of wages and other compensation*
- *The fight to buy shares*
- *Where necessary, generous redundancy terms and retraining schemes.*

In three cases productivity rose without any significant reduction in the workforce. In Telmex, employees also benefitted from the steep rise in the value of their shares (106 % between first and second offerings).

Recognizing these benefits, the unions of Malaysia's privatized container-port have become vigorous champions of further privatizations. None of the 12 privatized firms has experienced serious labour troubles, reflecting the successful balance which can be achieved between social objectives, and commercial interests in a well structured privatization.

Consumers

The World Bank report demonstrates that consumers also benefitted from the improvements in the quality of service provided by the privatized companies notably in the case of British Telecom, Telmex (Mexico) and CTC (Chile). Since 1984, BT's noncompletion rate on calls has been reduced by eight times, the number of pay-phones has increased by 35% and many new services have been introduced. Contrary to what many critics had assumed, investment also increased substantially after privatization.

- *CTC of Chile doubled its capacity within 4 years of privatization,*

- *BT's average investment since 1984 is double that of the previous 5 years*

- *Although prices rose in some cases, the study showed that consumers gained from four of the privatizations and were neutral in three.*
- *For example, in BT's case, although local call rates increased, long-distance prices fell so that on balance consumers benefitted,*
- *Since 1984, BT has reduced the prices of its main services by around 26%, on average, relative to inflation.*

Competition

One unexpected result of the study was that the success of privatization did not always, depend upon the introduction of competition into previously monopolistic markets. Morley transferring state-owned entities to the private sector created benefits for the company and consumers.

The study emphasized the importance of a carefully designed regulatory structure to supervise competition, tariffs, etc., in the interests of consumers while also permitting an acceptable return for the company's shareholders.

Stimulus to Local Capital Markets

In many cases privatization has provided an enormous stimulus to the local capital markets, bringing in its wake many other macro-economic benefits.

- *With the Telmex offering the Mexican government sent a clear message to the international investment community that it was committed to privatization and other market reforms,*

- *This led to a massive influx of foreign capital into the country (a gain which was not included in the World Bank's calculations), helping to stabilize the Mexican economy, reduce interest rates, stimulate investment and create new jobs,*

- *Between the first and second Telmex offerings, the Mexican stock market index increased by approximately 300%*

- *In 2 years, privatization attracted $ 15 billion of foreign capital to the country.*

- *In Latin America as a whole, foreign investment increased from $ 5 million in 1989 to $ 13 billion in 1990 and $ 40 billion in 1991.*

Stimulus to other Privatization

One important outcome of the World Bank Study was that a successful major privatization may set the stage for further sales of state-owned entities.

- *In Mexico, the sale of Telmex played a crucial role in the country's privatization programme.*

- *In the wake of the first Telmex sale in 1990 total privatization receipts increased by approximately 250% in 1991.*

You seem to be optimistic about the future of the privatization in Turkey?

Certainly. The reason for my optimism is two fold. First, there is a government whose head is firmly committed to the idea and she looks like a go-getter. Second there is no doubt that privatization is becoming more and more popular among the general public while the time to act is getting shorter and shorter. When Turkey is facing with the European Community Customs Union in 1995 there is no way we can postpone this program further and I know we will not. That is where my optimism comes from.

Distributed at the IMF-WB Annual Meeting, Madrid, Spain

Special Issue September 1994

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel
Prime Minister, Suleyman Demirel
Deputy prime Minister, Erdal Inonu
Minister of Finance, Sumer Oral
Minister for Foreign Affairs, Hikmet Cetin
Undersecretary of Treasury(PM), Osman Birsen – Ayfer Yılmaz
Undersecretary of Ministry of Finance, Kemal Kabatas
Governor, Central Bank of Turkey, Yaman Toruner

AN INTERVIEW WITH MR. YAVUZ CANEVI

Managing Director of Eutoturk Bank and the Chairman of Foreign Investment Association – YASED

Economic Dialogue – Mr. Canevi, 1994 has been, so far, an exciting and challenging year in Turkey for every market player including the main player, i.e. the Government. Do you think the worst is over?

Canevi – It is true that 1994 did not start off in a way that most Turkish businessmen were expecting. The January money market crisis, followed by a sharp overnight devaluation, clearly caught the market with a big surprise. However, Government was quick enough to accept the fact and introduced a very strong austerity package on April 5th and this program also gained the IMF/IBRD support through a standby Agreement. The results so far at least in the first half of the year were very promising. Achieving a current account improvement, building up reserves up to the same level as that of the end of 1993, bringing monthly inflations to 1 to 2%, turning budget deficits first time into surplus. What can we ask more? Well, we must ask more:

I am afraid we have probably been "lulled into false sense of optimism by the recent fall in prices and budget deficits". It seems that underlying policies of these relative price falls and budget performances are not sustainable. A strong break in the economic activities already sent a dramatic signal in terms of GNP growth as 10.6% in the second quarter of 1994.

Another area of concern is the following: although progress has been made in cutting inflation, and curbing the budget deficits as we have already mentioned, Ciller Government has less room to maneuver now because of higher levels of domestic debt and the constraint of unemployment. These facts, coupled with the constraints of international borrowing inability due to the credit ratings of the Republic, creates a real challenge for the government.

It seems to me that we don't even have to start again from scratch in terms of political consensus on major liberal economic policies, such as real interest rate policy, realistic foreign exchange policy, privatization etc.

In fact, if you go back to 1986-1987, we were very much worried about the slippages and the lack of productive investments even then, wondering when we were going to see the corrective policies and increases in investments. It is not any different now. The problem is that this time round we've got that very large overhang of domestic debt and inability to go out and borrow internationally.

Economic Dialogue – What do you think the most important challenge Turkey is facing today?

Our biggest challenge is to act in a timely way to overcome the political and bureaucratic obstacles and frankly we are mostly all aware of what these are:

Thanks to the dynamic entrepreneurial class, self-driving domestic market coupled with an easy expansion potential and room for further productivity increases, we have in this country very diverse resources and capabilities to develop them.

We have large reserves of all the raw materials including the human resources required to satisfy the potential demands so far as they are known and contemplated.

Both in general terms and also relative to Europe we are a low cost producer and we are geographically well placed in most respects to deal with other low cost producers in the region.

We must let Turkish people know truthfully, honestly, earnestly, just what sort of an international and domestic "dark tunnel" Turkey will have to cross in order to survive this global competitivity test. Therefore, Turkey should not, and will not relax and should not and will not, ever look back, because we know that some countries might be gaining on us.

I believe we were in a much worse position in the early 1980's than we are in now. No one can deny that Turkey today is more

competitive, more productive and efficient and more integrated to the world markets.

More important, there are today, more people prepared to take a new challenge than in the early 1980's.

Economic Dialogue- As the Chairman of the Foreign Investments Association, what is your assessment as to the foreign investors' attitude to the recent developments?

Canevi- There is no doubt that foreign investors have been and are concerned with short-term crisis. However, both foreign institutional portfolio investors and foreign direct investors are usually medium and long-term oriented.

Therefore, despite what happened in the early part of 1994, there is believed to be a new window of opportunity in Turkey for long-term oriented international investors for the following reasons:

- *M & A business is much more attractive today in Turkey for both parties, i. e., local and international,*

- *ISE presents very attractive value and selection alternatives,*

- *After the January currency correction, Turkey is no longer seen as an importer's heaven. So, most of the multinationals feel that they have to have a manufacturing base in this growth oriented emerging market.*

On top of these developments, Customs Union by the end of 1995 will completely change, to the better of course, Turkey's strategic, political and economic competitive and comparative advantages. A totally new generation of investors' base will be triggered and mobilized for a larger and integrated Turkish market. We have already equipped ourselves at EUROTURK BANK to cope with this new wave of business opportunities.

Economic Dialogue- How do you see ISE and its future?

Canevi- "Turkish delight" is getting sweeter again:

After suffering in the first quarter of 1994 due to a short-term financial crisis, Istanbul Stock Exchange marked the best performing Emerging Market again in the second quarter of 1994. The followings are just few aggregates indicating the current level of the market:

Total daily trading volume	USD 100 Million
Total market capitalization	USD 20 Billion
Total stock ownership	USD 3 Billion
Retail investors' share	60%
Foreign investors	20%
Domestic institutional investors	20%
Free float	15%

It is true that the confidence is coming back to the economy. As a matter of fact investors with long-term perspectives, specially the international institutional investors have never given up on

ISE. Please note that with its P/E ratio of around 17 on 1994 earnings ISE is still among the cheapest Emerging markets.

It should be noted that along the macro economic stability measures, such as April 5th program and IMF Standby Agreement, ISE Management also has taken some positive steps to give further impetus to the securities trading activities.

First of all, screen based trading system called ELIT, has been introduced and by mid October all shares, 167 so far, will be included in the system. No doubt this will create a new rally.

Secondly, the total trading hours have been lengthened and presently there are two sessions with a total of four hours, one in the morning and the other in the afternoon. Therefore, ISE now has been linked on real time basis to markets from TOKYO to LONDON and NEW YORK in the same business day.

Thirdly, the settlement which was on a T + 1 basis has also been changed to T + 2 to make life easier specially for overseas investors.

Fourthly, in the last week of September, ISE and Turkish Radio and Television Administration, TRT, inaugurated a joint project which allows TRT Teletext market coverage with a maximum 2 minutes time lag throughout Turkey. It is believed that this innovation will give big boost to the market. When you consider that what counts in Turkey today are retail domestic investors

and not institutional ones, this will be a very valuable service to them.

The next step is to extend TRT's Teletext services on European transmissions which are followed by guest workers living and working mainly in Germany and other countries.

The last but not the least, there is the construction 'of the new modern ISE Head office which is expected to be inaugurated next spring with a state of the art technology. It is believed that real impetus will come after that.

Economic Dialogue- What do you think about the privatization program?

Canevi- Frankly I don't want to think about it anymore. I want to see some action, and I don't think I am alone in this rally. Since 1984 during which a Master Plan had been designed by an International Consultant we have been struggling to put something into action. This is one area to which I already referred when I say "We are not even starting from the scratch, but we are falling behind the scratch". A recent World Bank team even put it rather bluntly by saying that "neither the legal nor the political environment in Turkey is conducive for such a privatization program".

Already there are signs that we are not far away, finally, from a pragmatic political consensus with the participation of major political parties represented in the parliament. By the end of

September we may even have a clear cut, constitutionally unchallenged privatization law in place. Then nobody will have any excuses. The real test of implementation will be on POAS (oil distribution) TUPRAS (refineries) and PTT (Turkish Telecom). As one banker puts it, POAS will be the "prize", TUPRAS will be the "price". I may add to this that PTT may very well turn into a crisis; and the rest will be the surprise. I would like to remind you that Turkish economic history is full of pleasant surprises.

Economic Dialogue – Do you expect Turkey's Customs Union negotiations will open a new era for FDI and M & A's in Turkey?

Canevi – Yes, certainly. I think a totally new playground is going to be opened soon. It seems that Turkish Government is determined to follow the time table which will lead to, by the end of 1995, a Customs Union Agreement with the European Union although full membership still remains on the agenda. With this new status as the member of the Customs Union, Turkey will enjoy a greater predictability and a totally new and large base for foreign direct and portfolio investors and M & A activities.

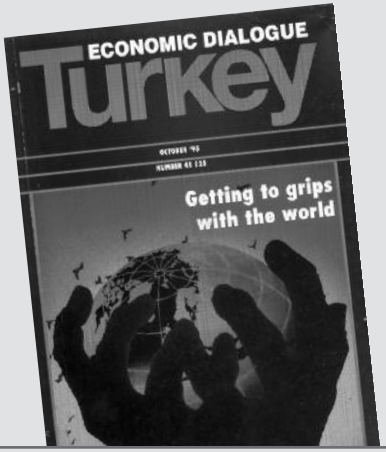
Economic Dialogue- You still sound as if you 'did not loose your optimism since last year. How do you explain this?

Canevi- Explanation comes from the Turkish heritage where Turkey's main advantage lies. Because Turks are;

Historically pioneers,
Traditionally heavy workers,
Culturally good learners,

They like to experiment, they like to take risk, they like to venture. The only problem is they are impatient and stubborn. They are not prepared to wait and give up. They learn as they perform, they think as they act and they re-think once they fail. They are not familiar with contingency plans. They are both strongly self confident, or culturally convicted to progress. That is why they are bound to succeed.

** Yavuz Canevi, Managing Director, EuroturkBank*



Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 1995

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel
Prime Minister, Süleyman Demirel
Deputy Prime Minister, Erdal Inonu
Minister of Finance, Sumer Oral
Minister for Foreign Affairs, Hikmet Cetin
Undersecretary of Treasury(PM), Nevzat Saygılıoglu
Undersecretary of Ministry of Finance, Kemal Kabatas
Governor, Central Bank of Turkey, Yaman Toruner

TURKEY: AN OLD PARTNER WITH A NEW DETERMINATION*

"To trade is one thing but to invest in each other's economies implies a lasting political involvement, a stake that we take in other societies"

Sir Leon Brittan

Turkey's emergence as an increasingly important and crucial Western partner over the past 70 years and particularly since the collapse of former USSR and Gulf War has been based on her contributions to regional stability and free market economy. The region needs intensive efforts for further peace and stability with an atmosphere conducive to economic and social development. Those who rushed to conclude that Turkey's geostrategic importance faded away now admit the fact that may be the opposite is true after all.

These strategic regional developments have drawn Turkey into a closer relationship with US and EC. Turkey's increased relevance and her decision to become part of the Customs Union of the EU starting January 1996, is bound to generate a new wave of productive and predictable trade and investment relations in the region.

First of all, with these recent developments and specially with the EU/CU decision Turkey has wiped out prevailing uncertainties about regional identity i.e. Turkey declared herself a Western and market oriented, culturally and economically, and secular and democratic country, and she has committed herself in improving the standards in all these fronts.

There is no doubt in my mind Turkey will enjoy an additional stimulus to its economy as trade opens up with EU; and CU with EU will definitely spur in spending, both domestic and international direct investment.

Secondly, with her traditional average high rate of growth through several decades, expanding purchasing power, very dynamic and well educated entrepreneurial and managerial class in the private sector coupled with a very promising and potentially strong and well diversified neighboring new emerging markets. TURKEY has become one of the most dynamic and strategic country in the region.

Thirdly, given the current low level of FDI, still fraction of 1 % of GDP and realizing the much higher absorption capacity of the country and the above favorable developments one can positively forecast a new era of FDI into TURKEY in the coming years from various sources such as:

- *Customs Union induced FDI from the EU member countries: Marketing, cost structure, R&D etc. concerns will induce many European companies to shift their production base either by relocation or greenfield operations.*

- *U.S. and Japanese companies will try to protect their competitive positions from the European rivals due to their preferential access to the Turkish market after the CU. The best way in achieving this goal is to enter J.V.'s, licensing or coproduction arrangements between American, Japanese companies and Turkish firms. This approach can provide the needed blend of resources to not only expand sales in Turkey but also in the EU and adjoining markets. Any businessman who looks at the regional map would detect that Turkey is and will be a natural regional distribution hub. Turkey's geographical, cultural and historical position as well as Turkish businessmen's entrepreneurial spirit definitely creates a competitive edge in this area.*

Today's strong Japanese Yen, just like it occurred in 1985 after the Plaza Accord, might spur another massive Japanese investment into the Emerging Markets. After 1985 Japanese, discovered ASEAN region, and thanks to the mainly Japanese, ASEAN countries have realized an economic take-off with several years of double digit economic growth. Off-shore production facilities in these countries were the end result of that FDI spree. With the new appreciated Japanese currency a new wave of direct investment from Japan in Turkey will not be a surprise development for many observers. (TOYOTA, Bridgestone, MAZDA, Honda, are already here).

• *And last but not least, there is the new trend of portfolio and direct investments towards the emerging markets in recent years due to the lower interest rates and lower yields in home countries and also a series of rather attractive privatization programs around the world.*

During the last decade world direct investment flows increased at around 30% annually, more than three times the rate of world exports and four times as fast as the world's GDP, over 50% of the world investment now goes to developing countries, compared to less than one fifth as recently as 1989.

What is more, investment is spreading as well as growing. Small and medium sized enterprises now account for 1 in 10 of all international investments. The same trend is true for Turkey specially as Turkey approaches the CU.

It seems that global investment will be the next great boost to the world economy, following the powerful impulse given by the removal of trade barriers in the Uruguay Round. Offering the appropriate investment environment will be the key factor for any host country in this respect.

It seems that Turkey has not benefited fully in this new wave of capital flow and certainly there is ample room to catch up in the near future.

In Turkey, the issue of foreign investment has been largely divested of the ideological overtones of the 60's. Today, investment is recognized for what it is: a source of extra capital, a contribution to a healthy external balance, additional employment, effective competition, rational production, technology transfer and a source of managerial know how. Investment is no longer seen as a treat.

USD 16.0 billion dollar foreign direct investment which has been received since 1980 is the best proof of this new trend. Today foreign investors attest to the creativity of the Turkish technicians and the willingness of their workforces to accept new ideas. Employees also are eager to put forward their own proposals for improving productivity and quality in a strongly pro-active and constructive approach. Indeed today, TUSIAD estimates that 30% of Turkish businesses are involved with Total Quality Management (TQM) in some way or another, an impressive figure in a country where 65% of all businesses are small and medium sized.

Motivation, creativity, a high level of education, rapid learning abilities and a willingness to take on leadership and entrepreneurship responsibilities are among characteristics of the new generation of this country that earning Turkey a distinct inter-national reputation vis a vis the other emerging markets for their strong work ethic and proactive enthusiasm.

However one should be aware of the fact that although the international FDI trend has been upward between 1990-94 since the Mexican crisis, a slow down of the trend is very obvious. That means while capital exporters will be more selective capital importers will be facing much strong competition in attracting these capital. I can assure you that Turkey is aware of this challenge.

Table 1

EMERGING MARKETS SHARE OF PRIVATIZATION

	Total (Billion USD)	Developed World	Emerging Market
1988	39.5	37.1	2.4
1989	24.7	21.7	3.0
1990	25.3	17.3	8.0
1991	53.3	38.2	15.1
1992	43.5	22.2	21.3
1993	53.7	38.4	15.3
1994	60.00	-	-

Table 2

FLOW OF FUNDS TOWARDS EMERGING MARKETS (Billion USD)

	1990	1991	1992	1993	1994
Net FDI	20	31	46	86	81
Private Sector Credits	21	34	78	101	79
Official Credits	34	37	36	18	17
Total	75	102	160	205	178
1/4	27%	30%	29%	42%	46%

Note: 1993 IIF Estimates. 1994 IIF Estimates

PRIVATE CAPITAL FLOWS TO ASIA AND LATIN AMERICA 1990-93

	Asia in billion of US Dollars	Share of Asia in total in present	L. America in billion of US Dollars	Share of L. America in total (%)
Bank Loans	55.6	30.4	6.6	5.6
Bonds	30.9	16.9	49.8	42.5
Equity	12.5	6.8	14.0	12.0
Funds	4.3	2.3	1.8	1.5
FDI	79.3	43.4	45.0	38.4
Total	182.6	100.0	117.2	100.0

Source: International Monetary Fund, private market financing for developed countries various issues

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 1996

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel
Prime Minister, Necmettin Erbakan,
Deputy Prime Minister, Tansu Ciller
Minister of Finance, Abdullatif Sener
Minister for Foreign Affairs, Tansu Ciller
Undersecretary of Treasury (PM), Mehmet Kaytaz
Undersecretary of Ministry of Finance, Kemal Kabatas
Governor, Central Bank of Turkey, Gazi Ercel

MEETING THE BOTTOM LINE

AN ASSESSMENT OF THE CURRENT SITUATION

After months of political vacuum, Turkey's parliament was able to come up with a vote of confidence for a surprisingly structured coalition government: Ciller's Liberal Conservative Party, DYP and Erbakan's religiously oriented "Muslim Democrat" Party, REFAH, finally joined forces to govern reform hunger Turkey in order to establish political, economic and social stability in the country.

We all know that there has been an ongoing debate as to the underlying sources of instability in the political scene; therefore a change in the Constitution, Election Law and Governing Legislation's of the political parties are on the agenda of the any new government.

When it comes to the social stability key issues are the following: PKK related terrorism and Kurdish problem, labor relations and unemployment, fast urbanization induced problems, and of course human rights problems.

Finally, the issue of economic stability is still considered as the most challenging issue in front of this government.

In recent years, the Turkish economy has been characterized by instability and high inflation. Economic growth has been in a nature of "boom and bust". Repeated and only partially successful stabilization efforts were not sustained, and needed structural reforms have met with entrenched political opposition.

It is obvious that Turkish economy is not free of structural problems. Two major structural deficiencies of the Turkish economy seem to be dominating the scene for the last 7-8 years without any serious successful effort to cure it. First, high and volatile real interest rates resulting chronic high inflation rates. We should, however, underline that these are only the symptoms of a more fundamental problem in the Turkish economy.

That is the high financing requirement of the public sector. Therefore, Turkey's high and downwardly rigid interest rates are a direct result of the government's demand for fund. To put it differently, Turkey's financial markets have been infected by the above "over crowding" malaise. In fact, high real interest rates are just one of the symptoms.

Another negative results of this ‘`crowding out effect" has been the low level of gross domestic saving which is clearly not sufficient to finance in a non-inflationary way gross domestic investment to sustain Turkey's desperately needed rapid

economic growth of 6-7 percent per annum. Another text book indicator of this phenomenon is the ongoing current account deficit of the country. In fact, the decline in the net inflow of foreign capital during the first half of 1996 which made less funds available for financing real investment, together with a potentially high Balance of Payments deficit, provided a strong reminder of the urgent need for a significant improvement in the propensity of the economy to save.

Needless to say it is in this government's agenda to address these issues by taking the necessary files out the shelves and implement them. These files include privatization, tax reforms, social security reforms, financial sector reforms.

Second major structural deficiency in Turkey's economy is the inefficiency of the public sector. This inefficiency is the result of the size. Because of the large size and wide spread structure of the public sector enterprises they suffer lack of investment funds to upgrade technology and expand to optimum capacity. This in turn results lower productivity. When lower productivity is combined with government subsidies or protections it results unfair competition and market distortion.

OUTLOOK FOR THE FUTURE

The above short assessment indicates that, Turkey after making striking progress towards revitalizing and restructuring of its economy during the 1980's, has not been able to consolidate the

situation after 1990. Throughout these biting inflationary years public sector with its finance, economics, politics and management has been the number one target to blame.

From the foregoing it is clear that macroeconomic environment in Turkey today is a complex and uncertain one, reflecting not only the major political, economic and social reforms that are being planned but also the integration of Turkey, since the beginning of 1996, to the Customs Union of the European Union which is a totally new environment that exposes the economy to greater volatility in the short run. However CU/EU is expected to contribute the long-term stability once the agreement reaches a full fledged implementation.

In fact, CU/EU issue should not and is not seen as a simple and narrowly defined "Trade Agreement" in which custom duties and other equivalent taxes are eliminated and some common tariff structure are put in place visa vis to third countries. Instead, CU/EU issue is seen a vehicle which will influence,guide and shape up; social values and political and institutional structure in a way to adopt the European if not global standards and harmonization efforts in every field of social and economic life.

On the other hand CU/EU move is bound to open a totally new window as far as the FDI is concerned in this country:

Few new dimensions are the followings:

- *With this Agreement Turkey resolved, once for all, the long questioned "regional identity "issue as to "where does Turkey belong?" and "where is she heading?" Now the answer is clear:*

- *Turkey belongs to the Western system and she is heading West. Turkey is clearly seen now as a regional "Hub" for American, Japanese and EU industries for "relocation", "marketing" and "supervision" as far as her rich hinterland is concerned.*

- *If and when CU and the implementation of privatization program properly synchronized a valuable synergy is expected for the success of both.*

- *This integration to EU will improve the investor's medium term perspective and infrastructural investments in key sectors like energy, transportation, telecom will be boosted, especially with the help of new BOT and BOO regulations.*

- *With the help of financial Protocol attached to the CU Agreement SMEs will be the first beneficiaries. This will bring a new wave of Joint Ventures between European and Turkish companies.*

- *CU Agreement has been very much instrumental in putting in place the required and long awaited regulations on Patent Law and Intellectual Property Rights. Therefore, it is expected that many multinational companies will consider part of their R & D operations be done in Turkey due to relative cost advantage and abundance of quality brain power for R & D.*

Despite these favorable expectations, however, there is a danger that the downward spiral of deficit and domestic debt may and will eventually "consign" Turkey permanently to Europe's economic margins. This is the last thing Turkey even would not consider to speculate. The whole purpose of being

plugged in to EU is to escape from marginalization. It is essential that, in this volatile financial environment, financial markets remain flexible which forces the system to play short term. Banking institutions in particular must be able to adjust their lending volumes and their interest rates at short notice in accordance with changes in the underlying flow of funds. In a rigid market situation the profitability of banks, and therefore their future capacity to grant loans, will be restrained.

For monetary policy purposes it is of the upmost importance that the fiscal deficit and dissaving by government be reduced further. This will alleviate the burden on monetary policy to maintain financial stability and thereby also allow for lower interest rates. It should be underlined that the choice for monetary policy, in the country, is not only between higher or lower interest rates, but rather between high interest rates now and high inflation in the future.

Although private sector is driving so much of what is going on in Turkey everyone in the country is in the opinion that without Public Sector related structural reforms strong inflationary inertia cannot be eliminated.

TURKEY NEEDS A" HOME RUN"

Achieving growth while maintaining a stable currency and lower inflation in TURKEY will only be possible if there is growing investor confidence by way of key structural reforms.

To be successful, such a reform program has to address three issues:

- *a major fiscal tightening*
- *structural reform focused on sustaining the fiscal adjustment over the medium term and improving economic efficiency mainly by way of privatization.*
- *measures designed to break inflationary inertia and entrenched inflationary expectations.*

This type of program's credibility, both domestic and international, can greatly be enhanced if it is backed up with an IMF three year Extended Fund Facility. An EFF program based on long-term stability and growth measures would definitely raise the investor confidence, increase capital inflows and strengthen the incipient recovery currently underway.

In addition to the above, TURKEY urgently needs to finalize the harmonization of the regulatory base which is required and/or necessitated by the Customs Union Agreement with the EU. More importantly, Turkey has also to speed up the implementation of a concrete program regarding the Law and order corruption and terrorism.

Of course, these are not the components of a run of the mill IMF program. But they are the policies that TURKEY urgently needs to move forward in order to defeat the current wave of skepticism and gain broader support from both national and

international arena for stronger integration to the global community.

What is urgently needed therefore is an effective implementation of such medium term macroeconomic policies, ingredients of which are no more secrets to the Central Bank and Treasury technocrats. This will indeed relieve monetary policy of much of the burden that it must now carry to maintain overall financial stability. In particular, a successful reduction of the fiscal deficit to eliminate government dissaving, a further harmonization to the EU regulations, an effective promotion of exports and last but not least, an aggressive, determined, decisive and speedy public sector asset restructuring program, i.e. privatization and on the other hand, further improvements in the labor market aimed at achieving higher productivity, more competition and greater flexibility, together with progress towards establishing a sound social security system and a lasting social accord to facilitate wage and price moderation, will reduce inflationary pressures in the economy and lead to a lowering of interest rates in general.

In summary what Turkey needs to try and eventually will try to consolidate is the "momentum" which has started and proved to be fit to the country in the early 1980's for creation of an "S.O.S." public sector i.e. "Stronger, Open and Smarter public Sector".

- *Stronger will mean smaller but and efficient public sector*
- *Open will mean transparent and intolerant for unfair competition.*
- *Smarter will mean globalized and technologically upgraded and competitive public sector.*

Consequently, the balance of payments deficit at its present level is obviously not sustainable, particularly after the substantial decline in the net capital inflow, both direct and portfolio, since the beginning of the year. (Expected end year Trade Deficit is USD 20.0 billion, and Current Account Deficit is USD 6.0 billion). The challenge for macroeconomic policy at present is to judge whether the slowdown in the second half of the year (10.3 % GNP Growth four the first the half) in economic growth will be sufficient to correct the external imbalance, and whether the current monetary policy stance is restrictive enough to underpin this unavoidable adjustment process.

The challenge is an important one and Turkey is prepared and well equipped to face this challenge. When late Secretary Brown of US decided to choose Turkey as one of the ten Big Emerging Markets he did this not out of sympathy, but because he believed the fundamentals were right. We also believe that fundamentals are right in this country and therefore we remain loyal to our hopes that within this ten Big Emerging Markets Turkey is determined to stay as a strong, stable, secure and free market oriented secular democracy which is plugged in or rather anchored to the European Union.

In fact, in designing "The New Adjustment Plan" Turkey has to and will use CU with EU as an outside reference for achievement and success. It has already been perceived by the dynamic forces of the private sector as an instrument of modernization, as an agent of change and a competition.

In fact, Europe has been and will continue to be an external stimulus to carry out further reforms both in economic and the political field.

That is why this "New Adjustment Plan" has to integrate the efforts of IMF, IBRD like multinational financial organizations on the one side and EU and OECD like umbrella organizations on the other for a 3 to 5 year medium term horizon.

Through this new and well thought effort Turkey will be able to achieve a second jump in parallel to the one in 1980's and will aim to achieve to become a production center, a stepping stone and a key penetration point for the surrounding emerging markets, particularly, CIS countries and Black Sea Economic Cooperation Council countries.

Turkey needs to multiply and increase the value added of its co-operation with these multinational institutions by concentrating an intensive and ambitious medium term program.

This is a unique opportunity to all parties involved to bring Turkey on its deserved status. It is no secret that Turkey's growth potential and her reserve of productivity is much greater than other countries in the region.

In conclusion, one can say that Turkey has been uniquely successful in converting adjustment pains to successful gains.

Thanks to the fact that Turks are culturally good learners, traditionally heavy workers and currently became the "new kids on the block"! i.e. new age entrepreneurs. After all adoptions of new ideas, adjustment to the new concepts, introduction of new institutions and last but not least integrations to the new markets have become part of an ongoing process in this country.

Distributed at the IMF-WB Annual Meeting, Hong Kong, China

Special Issue October 1997

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel
Prime Minister, Mesut Yilmaz
Deputy Prime Minister, Ismet Sezgin
Minister of Finance, Zekeriya Temizel
Minister for Foreign Affairs, Ismail Cem
Undersecretary of Treasury (PM), Mahfi Egilmez
Undersecretary of Ministry of Finance, Erdogan Oner
Governor, Central Bank of Turkey, Gazi Ercel

BAD NEWS AND GOOD NEWS*

There is a natural human tendency, magnified by the political process in every country to regard good news as permanent and bad news as temporary. Due to the political tensions and coalition crisis which over the last couple of years in Turkey, unfortunately what is dangerously becoming a misleading perception by the outsiders is the reverse; that is to say, to regard bad news as permanent and good news as temporary. This is the worst thing that can happen in an emerging market where people's productive expectations can form the dynamics of the development process. I am convinced that Turkey has entered an era during which the above perception is bound to change.

Bad News: It is true that the average term of governments since the foundation of the Republic is not even two years with 55 governments in 75 years. So no one is in a position to claim that there has been political stability.

Good News: Against this background, most people believe that this is the price Turks do not mind paying in order to establish

their permanent democratic, secular and market oriented economy in an extremely volatile geography.

Moreover, investors in Turkey both domestic and international should not be intimidated by Turkish politics. If they understand what is at stake, they are likely to sleep better over the months and years ahead. In fact this volatility which is an integral part of any emerging market opens its own window of opportunity and gives a chance to take advantage of any market overreaction to events.

Although the political risks are real, those who are close to the Turkish scene, i.e. particularly foreign investors in the country, all agree that those risks need to be kept in proportion given the proven ability of the Turkish private sector to continue to generate growth even in difficult periods. It is crucial to understand that the private sector's role as a new "power house" both in economics and politics has been on the rise since 1980 and particularly since January 1996 together with the Customs Unions Agreement with the EU. Today 85% of the GNP has been generated by the private sector in Turkey.

Bad News: There is a general consensus that the 1990-1997 period was not only a period of political instability but also a period of economic instability or rather a period of inability to make progress namely on inflation, budget discipline: PSBR and privatization fronts, not to mention the 1994 serious short term liquidity crisis.

Good News: As the new liberal-left coalition government came into power, issues on the national agenda shifted away from debates regarding fundamental characteristics of the Turkish political system to the more immediate problems facing Turkey. Thanks to the vote of confidence, political tensions dropped significantly. Most economic observers foresee that the new government's priority will be to exercise close control on the macroeconomic balances in the short term and the speed up restructuring of the state sector, through a continuation of the current halfhearted progress towards mastering Turkey's immediate economic problems, and finally if they are able to find a way to extend their term, then they are expected to tackle the long awaited structural reforms.

Bad News: With the Refahyol coalition government Political Islam has entered into the mainstream of politics in Turkey. The way Refah behaved during its short stay (about one year) in power not only surprised but scared the secular forces in the country, including military circles. Particular concern was aroused by Refah's success in attracting children to religious schools outside the national educational system, and to its ability once in government to insert its supporters into the bureaucracy at the municipal and central government level, and also spread its influence in smaller and medium-sized businesses.

In the longer term the fear was that Turkey might move to an Iranian inspired political system based on sharia law which would have been rejected by the majority of the population as an extreme and fundamentalist move.

Good News: First of all, to most outside observers it seems these fears do not take sufficiently into account that at least half of Relates supporters seemed to like it for non-religious reasons, such as its attraction as an untried option to those disillusioned with the old politics, as well as its success in running Istanbul, and some other big cities efficiently and relatively speaking, incorruptly. Therefore, when one considers the non-fundamentalist supporters and reactionary votes, then the strict observers of Islam may not number more than 10% of the electorate.

Second of all, there has been a strong movement in favour of eight years lengthened compulsory state schooling system in order to block the way for the pro-Islamic parties to abuse the system and this is expected to be implemented starting from this educational year.

Bad News: When Refah decided not to mask its fundamentalist long term strategies toward a pro-Islamic state structure, this was seen as a dangerous challenge to Turkey's non Islamic constitution, first unfortunately not by politicians and civilians but by army. So the military lost patience before the rest of secular society had woken up.

Good News: It is a fact that historically, in Turkey, the armed forces see themselves as the guardians of Turkey's secular constitutional order, and in 1960, 1971 and 1980 carried out political interventions for this purpose. But despite many observers' expectations, the armed forces this time cleverly used

a constitutional platform, the National Security Council, to express their feelings and opinions about the challenge. What is more interesting is that military experts have been briefing business organizations, NGO's, journalists and judges on the dangers, as they see them, of fundamentalism. This is the first time the military has used civilian secular forces to defend the constitution rather than force. We have to admit that today's liberal left coalition is a product of this hybrid effort which is unique to Turkey and perfectly acceptable to the average citizen.

Bad News: After making striking progress towards revitalizing and restructuring of its economy during the 1980's, Turkey has not been able to consolidate the situation since 1990. Throughout these biting inflationary years, the public sector with its financial burdens, excessive size, vulnerability to political manipulation and management inefficiency has been the number one target of blame for not achieving long term economic progress. From the foregoing it is clear that the macroeconomic environment in Turkey today is a complex and uncertain one, reflecting not only the major political, economic and social reforms that arc being planned but also the integration of Turkey, at the beginning of 1996 in customs union with the European Union, which is a totally new environment that exposes the economy to greater volatility in the short run.

Good News: As agreed by many economists the customs union agreement is expected to contribute to long-term stability, both economic and political, once the agreement reaches a full fledged

implementation. In fact, this should not be and is not seen as a simple and narrowly defined trade agreement in which custom duties and other equivalent taxes are eliminated and some common tariff structures are put in place visa vis third countries. Instead customs union issue is seen as a vehicle which will influence, guide and shape social values and political and institutional structure, in a way to adapt to European if not global standards and bring harmonization efforts in every field of social and economic life. On the other hand customs union is bound to open a totally new window as far as foreign direct investment is concerned in this country. A few new dimensions are as follows:

- *With this agreement Turkey resolved, once and for all, the long questioned regional identity issue as to "where does Turkey belong?" and "where is she heading?" Now the answer is clear. Turkey belongs to the Western system and she is heading Westwards.*

- *Turkey is clearly seen now as a regional hub for American, Japanese and EU industries, where relocation, marketing, supervision, in the region are concerned.*

- *When customs union and the privatization program are properly synchronized a valuable synergy is expected for the success of both.*

- *This integration in the EU will improve the investor's medium term perspective and infrastructural investments in key sectors like energy, transportation, telecom will be boosted specially with the help of new Build-Operate-Transfer and Build Own Operate regulations.*

- *One of the most striking features of the current Turkish business scene is the number of strong companies that are now located outside Istanbul, Turkey's traditional economic and business capital, in Ankara, Gaziantep, Denizli, Kahramanmaras, Adana, Kayseri etc. cities dubbed Anatolian Tigers.*

- *Quality consciousness has become one of the leading concern for Turkish companies since customs union. Therefore, it was not surprising that in 1996, Brissa, a member of the Sabancı Group won the European Quality Award. Another Turkish company, NETAS, a telecommunications specialist, shared the Quality Award with British Telecom and TNT Express.*

- *With the help of the Financial Protocol attached to the CU Agreement small and medium sized enterprises will be the first beneficiaries. This will bring a new wave of joint ventures between European and Turkish companies.*

- *The CU Agreement has been very much instrumental in putting in place the required and long awaited regulations on Patent Law and Intellectual Property Rights. Therefore, it is expected that many multinational companies will consider transferring part of their R & D operations to Turkey due to the relative cost advantage and abundance of quality brain power. Consequently, Europe has been and will continue to be an external stimulus to carry out further reforms, in the economic and political field.*

Bad News: There is a belief that due to the frequent changes of government, bureaucracy and technocracy have been subject to a great deal of erosion and politicians are gaining more and more controlling power of the state apparatus.

Good News: There has been a fundamental shift in Turkish political structures as far as its power houses are concerned. Today politicians still think that they have power in day to day economics, but thanks to 10 years of liberalization, deregulation and market orientation efforts, a good many of the tools that were used by politicians to exercise power have disappeared and market forces have taken over that power. Today we can talk about two distinct market powers which are heavily influential on decision making process in Turkey:

- *Domestic business' awareness and commitment to the market economy. Any diversion from rational market behavior will face a strong market reaction which will have a heavy cost attached to it for the politicians.*

- *Due to the customs union integration process there are heavy international pressures to stay within the boundaries of international agreements. A lot of check and balance mechanisms are involved, as in any similar multinational trade arrangement. Therefore, politicians are not as free as they wish to throw favors at their constituencies any more. Turkey's real powerhouse today is the people. People who are involved in the market economy and people who enjoy being involved in the market economy.*

In fact, as in many rapidly growing emerging markets, Turkey's economic reach is exceeding her political grasp. So market forces, rather than populist political forces are guiding the economy today.

Bad News: Due to the level of savings rate and the need for higher sustainable GNP growth rate, Turkey needs more foreign direct investment. Yet during recent years we have witnessed a decrease in the amount of FDI inflow. The reasons are twofold: first domestic economic and political instability, and second very strong competition abroad for FDI.

Good News: Most observers admit today that Turkey represents a "good story" which has been told so far in a most inefficient way abroad. The challenge today, is to be more convincing and more time conscious than your competitors in the Far East and Eastern Europe. Now that the pro-Islamic clouds are gone, there is an able team to tell the story properly. And what is important there is an audience who are interested in listening. It is true that the roller coaster ride in the Turkish market may appear fearsome for many investors. To others, however, particularly those who care to take the trip to Turkey to meet her people, and experience the dynamism of the country and the entrepreneurial drive of the people, the story may be somewhat different. Palatable investment choices and prospects abound. The fundamentals look appealing. Considering the emerging new markets around Turkey one can also easily identify Turkey as the most suitable regional hub in the area.

Bad News: There is a danger that fragile coalitions and heavy social and financial costs might continue to lead to avoidance of the initiation of long-needed structural reforms.

Good News: Turkey and the Turks have been uniquely successful in converting adjustment pain to successful gain, thanks to the fact that they are culturally good learners, traditionally heavy workers and have currently became the new kids on the block i.e. new age entrepreneurs. After all adoptions of new ideas, adjustment to new concepts, introduction of new institutions and last but not least integration to new markets have become part of an ongoing process in this country.

Bad News: The financial sector as a proportion of GNP and capital markets in terms of market capitalization to GNP are still modest in Turkey. Both ratios are around 20%. These ratios are even smaller than some major emerging market ratios not to mention the EU standards.

Good News: Given the existing liberal and deregulated environment, banking and standards of corporate governance, risk management and securities regulation along with a very intensive harmonization effort in terms of the EU regulator), environment.

As Turkey continues its structural reforms and seeks to upgrade its infrastructure, Istanbul will be in a good position to be a financial center with its services, skilled experts, listing

experience, integrated stock exchanges, economic intelligence and international financial strength.

Bad News: Although the private sector is driving so much of what is going on in Turkey, experts in the country are of the opinion that without public sector related structural reforms inflationary inertia cannot be eliminated.

Good News: The new coalition government has made known to the general public that an effective implementation of a medium term macroeconomic policies is inevitable. The contents of such a program are no more secrets to the Central Bank and Treasury technocrats who have already given the first signal of a harmonized work by signing a protocol recently. This will indeed relieve monetary policy of much of the burden that it must now carry to maintain overall financial stability.

In particular a successful reduction of the fiscal deficit, effective promotion of exports, an aggressive, determined, decisive and speedy public sector asset restructuring program, i.e. privatization and on the other hand, further improvements in the labor market aimed at achieving higher productivity, more competitions and greater flexibility, together with progress towards establishing a sound social security system and a lasting social accord to facilitate wage and price moderation, will reduce inflationary pressures on the economy and lead to a lowering of interest rates in general. The challenge is an important one, and Turkey is prepared and well equipped to face this challenge. One

should admit that the fundamentals are right in this country and therefore remain loyal to hopes that Turkey is determined to stay as a strong, stable, secure and free market oriented secular democracy which is plugged in or rather anchored to the European Union.

** Yavuz Canevi, Chairman of the Board Turk Ekonomi Bankası, TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue October 1998

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel
Prime Minister, Mesut Yılmaz
Deputy Prime Minister, Ismet Sezgin
Minister of Finance, Zekeriya Temizel
Minister for Foreign Affairs, Ismail Cem
Undersecretary of Treasury (PM), Mahfi Egilmez
Undersecretary of State Planning Organization, Necati Ozfırat
Undersecretary of Ministry of Finance, Erdogan Oner
Governor, Central Bank of Turkey, Gazi Ercel

HERE COMES THE EURO*

EURO IS EXPECTED TO LEAD TO REVOLUTIONARY DEVELOPMENTS. IN THIS RESPECT, COMPARISONS OF THE EU WITH THE USA ARE GRADUALLY INCREASING

In Turkish, we refer to "the disparate five" (meaning the fingers of one hand). In Europe, the disparate eleven have come together and resolved to carry out reforms in an area which has had the most complicated, complex and intractable structure in economic life since the Second World War, and which has been the most testing area for the culture of "sovereignty symbolism" or the ethos of "our money is our honour". In other words, they have decided to carry out reforms in respect of a "European Currency", for which they have not even been able to agree on how to pronounce its name; or rather, they have agreed to "construct" a new currency.

The architect of this construction is French, the materials are German, and the foreman is Dutch. The others will be treated as plain labourers.

If you look carefully, the progress of this construction is rather unusual. As of 1.1.1999, the Euro will be introduced in the form of accounting unit, and on 1.1.2002, Euro coins and Euro banknotes will be brought onto the market; whereas if we remember our economic history, we see that the opposite has always happened. This of course means that what we see here is not a natural birth of a money but rather a synthetic structure. However, a lot of effort has been made for Euro to be born healthy, the authorities have acted with determination and many sacrifices have been made.

The Maastricht Agreement was the most important step in this direction. The states signatory to this agreement have undertaken serious commitments and interpreted the Maastricht criteria as veritable commandments from the "sacred book" of the monetary union. Even more important is the effectiveness of their marketing of this concept, in other words of the new Euro currency. At present, they have guaranteed that the markets will buy this currency. The best indicator of this is that, to date, there has been no flight of capital from the EU, demand for high risk premiums has not risen awkwardly and in general, an atmosphere of patient expectancy prevails. It is common knowledge that there are four key prices used in managing the economy:

- *Interest rates (the price of money)*
- *Competitive devaluation (the price of foreign exchange)*
- *The price of goods and services*

- *Wages (the price of labour) The first three of these instruments have been locked inside defined limits in the frame of the Maastricht Agreement, and the freedom of movement of the member countries has been voluntarily curtailed.*

Only the fourth instrument remains at the members' own discretion. Thus Euro is founded on these three basic sacrifices. Its survival is also dependent on the continuation of these sacrifices.

EUROLAND (USA DOLLARS)

	EU	USA	JAPAN
Population	290 million	250 million	120 million
GNP	8.5 trillion	7.2 trillion	5.1 trillion
Share of Global Trade	21%	19%	10%
Gross National Savings	1.7 trillion	1.2 trillion	1.5 trillion
Private and public loan Certificates (Bills,bonds,etc.)	7.5 trillion	12 trillion	5.0 trillion
External deficit of the economy (as percentage of GNP)	10%	8%	9%
Share of transactions on foreign exchange markets	30%	41%	20%
Number of companies in the Top 500	170	153	140
Number of companies whose shares are available to the public	8.000	8.000	3.000
Market Cap of above companies	4.0 trillion	6.8 trillion	3.5 trillion

Historically, the owner of money held in reserve always turns out to be the winner. It was no coincidence that until the Second World War, Britain and the pound Sterling were dominant, whereas after the War, the USA and the dollar came to the fore,

and especially after the 1980s, Germany and the Deutschmark's star rose in Europe. Thus the success of Euro and its capacity to bring an added value to its owner, that is the EU, will be directly related to its ability to be a Reserve Currency. However, for the Euro to become a Reserve Currency will be the result of a sequence of events. We will try to make an objective examination of what might happen on the way to this result, looking at both the positive and negative aspects of the potential events.

Negative expectations or ' misgivings

- *A real subject of concern is how the new Master of Euro, the Central Bank of Europe, will ensure "price stability". Indeed, if we look at for example the short term interest limits of Italy and Ireland, in comparison with those of France, Germany and Belgium, which are double those of the former, the question raised is how a monetary policy can be defined for the financial region, will it be set according to the low interest rates or according to the high interest rates? This question will cause tensions for both groups from the point of view of its effects on employment and inflation levels. But the middle way will satisfy neither of the groups. So the Central Bank of Europe will have its work cut out until harmonization is achieved in the macro indicators.*

- *The Ministers of Finance of the eleven countries that are members of the EMU are endowed with such powers that if France and Germany, which are aware of the basic propensity of these powers towards interventionism, were to use them to encourage rather than to refrain*

their ministers of finance, the result could be serious problems. 'Indeed, these ministers could force the limits of the Maastricht Agreement and use the ECOFIN forum to introduce foreign exchange controls, and to put limits on the movement of capital not just within the Union, but also towards the rest of the world.

- *Even though the expectation is that as a result of the "two E factor", in other words, "Euro-Efficiency", Europe will experience a new period of expansion and employment, experts also accept that they will have to wait a few years before enjoying these results. But it cannot be said that politicians and the man on the street in Europe are patient. Until they forget their populist habits, no one can tell what politicians will do, once they have relinquished that important weapon, money printing, to the Central Bank of Europe, and once they are at the mercy of the Maastricht criteria with regard to setting interest and foreign exchange rates.*

- *In the first instance, Euro will unavoidably have the effect of increasing unemployment. The transparency of prices will place companies in a more competitive environment. Historically, in the USA this competitive pressure has to a large extent been turned into a downward pressure on real wages. But in Europe, where the rigidity of the labour unions and of the social policies are well known, this pressure will be reflected in unemployment rather than reduced wages.*

- *Since the Euro age will consign to history the practice of playing with exchange rates in order to increase exports in other words of using*

devaluation to increase competitive advantage in international markets, the problems connected with expansion and unemployment will lead to friction between members at such times and will cause difficulties for the expansion of the monetary union and for political unification.

- *Euro will cause the closing down of firms which struggle in the new competitive environment, restructuring, including the downsizing of numerous firms, and in particular, lead many to try mergers and take-overs, not only with the aim of establishing a monopoly, but also in a search for productivity and efficiency.*

- *Especially in the banking sector, a large scale earthquake is expected. Banks which have worked with comfortable profit margins within their own national markets will not find the same ease in the more transparent and competitive PAN-EUROPEAN financial mega-market. Merging of banks and closing down of branches will therefore be widespread. Just in Italy, it is estimated that in the first stage, the number of banks will decrease from 967 to 100 by the year 2000. The negative effect of this on employment is alarming to all concerned.*

- *Euro will give a significant shake up to the capital markets, and in particular to the national markets, which extremely confused and nationalistic efforts are trying to protect. In fact, in many European countries (and in Turkey also), insurance companies, pension funds and investment funds have been obliged to invest in national certificates (such as bonds and bills, etc.) in accordance with national regulations.*

As of 1 January 1999, many investment instruments and assets will cease to be "foreign" and will be treated as "national certificates". A PAN-EUROPEAN market will emerge for bonds, bills and shares and the transfer of capital will be accelerated. This development can also be interpreted as the Americanization of Euroland capital markets. But the other face of the medal is that European politicians, company owners and directors will have to get used to the Anglo Saxon concept of "shareholder value" (i.e. the value created for shareholders) and they will have to carry out whatever is necessitated by this concept with the utmost sincerity. In other words, they will have to abandon the bank oriented and union controlled methods predominant in European industrial enterprises and move over to a style of management that gives priority to the interests of the shareholders.

Positive expectations and hopes

We mentioned above that the construction of Euro embodied a "synthetic" approach, whereby a transition from securities to bank notes is planned. This really is a clever plan. In accordance with the agreement reached on 2 May 1998, the parity between national currencies was fixed and a resolution was passed to the effect that on 1 January 2002, Euro will be put into circulation and national currencies will be withdrawn from the market. If we assume that Euro will complete the transition phase successfully, we can summarize two significant components of this plan as follows:

- *Under these conditions, it will be highly difficult for a member country to be pushed out of the "Euro System" by the markets.*

- *It will be equally difficult for a member country to leave the "Euro System" of its own accord.*

- *If a country within Euroland starts to live beyond its means and to have excessive budget deficits, it will be confronted with pressure and warnings from the countries who made the Maastricht Agreement and the Stability Pact. According to the agreement, there will be no bailing out within the alliance and in no way will financial support provided to wrongdoers.*

- *Member countries have voluntarily forfeited their "competitive devaluation" powers. In fact, none of the 11 members has undertaken such devaluation in recent years. (Only Greece performed a 14% devaluation in order to be able to join Euro at a later date).*

- *Considering that after the integration and market deepening of the EU, intra-EU trade expanded faster than its GNP and extra EU trade, it is not exaggerated to expect that the deepening that will come with the implementation of the Euro will cause an explosion of intra EC trade.*

- *With the implementation of the Euro on the Pan-European market,*

- *Foreign exchange costs will be reduced (Estimated amount: USD65 billion)*

- *Hedging costs will become obsolete.*

- *The risk of Competitive Devaluation will be removed. In other words, as well as creating a larger integrated market, EMU will be better protected as a block against global shocks than the 11 members individually. Similarly, the internally oriented management of monetary and budgetary policies as a block will enable measures to be taken that could not be taken individually by the members.*

- *If we look at the real economy. Euro is expected to lead to revolutionary developments. In this respect, comparisons of the EU with the USA are gradually increasing. It is true that if one accepts that the domestic market's depth is at the basis of the power of the US economy, it is clear that the depth and width that the Euro will create in the EU market will impress on all players, in particular companies, the need to reorganize their production, investment and marketing strategies and methods. This will cause a wave of renovation in the economy. Now, while expanding its economy as a Pan-European market, Europe will also be able to make it deeper; so, like the USA, it will be able to "run and chew gum" at the same time, so to speak.*

- *The transparency ensured by the Euro will be to the benefit above all of the consumer. But the pricing and labour problems this transparency will cause should not be underestimated. The wide variations from the average and between the above amounts themselves are certainly due to a number of causes: income distribution, tax regulations, costs, productivity, unions, etc.*

- *Euro and the EMU will make it possible for certain reforms that are critical for the future of Europe to be carried out as a block. In fact, due to their weaknesses, or to their populist approach, it was impossible for some member countries to carry out these reforms. If we assume that the movement of capital will be much faster than the circulation and movement of labour (because of the powerful and firmly rooted unionization of labour). It is natural to expect that capital is more likely to move to those places within the EU where labour is cheap.*

- *The ability of capital to move freely from high cost to low cost regions will encourage many trade-union members and leaders to think and act rationally, and will direct them to more flexible practices in these areas. This will also whip up competition. Since competition is the engine of development and expansion, this will be to everyone's benefit.*

And what about Turkey? An opportunity to restructure, a new hope

The above attempted explanation is like music to our ears. Certainly, Euro should not be seen simply as a change of monetary unit or an operation to gather the financial systems of the EU under a single roof: the Euro operation represents an operation by Europe, in the face of fierce global competition, to set its sights higher and find its rightful place. It is an operation to set its sights higher in all fields, from company productivity to the behaviour and attitudes of trade unions, from money and

capital markets to management and communication strategies. So where does Turkey set her sights? As the button is pressed for monetary reform, which is almost the last link in the chain of economic and financial integration of the European Union to which we are struggling so desperately to join in.

So Turkey rather than trying to force through reforms such as:

- *Education reform*
- *Tax reform*
- *Social insurance reform*
- *Legal and constitutional reform,*

There is an urgent need for a reform of "mind set and vision" to be put first on the agenda, in order to convince all of us in earnest of the need for these reforms.

Look at the extent of our society's sensitivity, or rather, insensitivity: During the 1990s,

- *The Latin American countries, which at one time were presented to Turkey as a model to be followed, one by one climbed out of their swamp of debts and achieved single digit inflation figures and growth trends.*

- *Also during the same period, Middle and East European countries abandoned their command economies and became champions of inflation-free liberal economy.*

- *Finally, with the Maastricht agreement, European Union countries voluntarily handcuffed their populist hands for the sake of macro-economic stability. These were the hands that had held inflation, budget deficits, public debts, long-term interest rates, foreign exchange rates. The result: the birth of Euroland in January 1999*

So, let us assume for the sake of argument that we, in Turkey, are unimpressed by these success stories. But how can we explain shutting off our eyes and our ears to the horror tales that took place over the same period of time. Let us remember the followings:

- *Presumably we have not forgotten the cost of our home-made, hand-crafted financial crisis of 1994,*

- *The panic and consequences of the Mexican-Tequila crisis which took place during the same period is fresh in our memories,*

- *We watch day by day the economic and political collapse caused by the waves of the most recent Far Eastern crisis, which is set to cause even further havoc by forcing the walls of Russia and China.*

Now just think: Turkey supposedly was neither affected by the success stories described above, nor worried that the splash caused by disasters spreading before our eyes might possibly stain us.

I wonder what is needed to put us into action?

Let us agree on certain matters:

- *Isn't Turkey aware of the obstacles on the way of economic and social stability? Yes, she is.*
- *Does she know what needs to be done to overcome these obstacles? Yes, she does.*
- *Does Turkey have the power, that is the potential to take these measures? Yes, she does. Nobody can claim the opposite.*

At high school our algebra teachers taught us how to solve equations with three unknown quantities. But today we are struggling to solve an equation with three KNOWN quantities.

At precisely this point, the emergence of EURO and PAN-EUROPE offers a new chance to Turkey. It is inevitably a cause for fear as much as for excitement. But all told, it is a golden opportunity to reorganize and reorientate ourselves, to the changing and transforming world.

In my opinion, the most serious problem of Turkish society is our tendency in the fields of politics, economics and in our communal and social life to become imprisoned in a short-term outlook and our failure to catch on with determination to an "aim" or a "target". We need to extricate ourselves from the series of "Protocols" that have been crammed into 9 month agendas and urgently find ourselves well defined medium term targets so that we can ensure that all strata of our society become focused on these targets as soon as possible. I believe that the community as a whole will be greatly relieved and that our fervor to work will be accordingly increased in our effort to achieve our aims, and

that there will be an explosion in our productivity and added value. “The Law of Commitment to National Conciliation” (Ulusal Mutabakat Taahhudu Kanunu – the initials of which spells UMUT/HOPE) is a suggestion made here in this context.

The aim of this law (Project HOPE) will be:

- *An independent Central Bank whose sole responsibility is ensuring price stability.*
- *Focus on and timetable for the fight against inflation.*
- *Focus on and timetable for the fight against budget deficit and improvement of the GNP.*
- *Focus on and timetable for privatization, and abolishing of legal obstacles.*
- *Focus on and timetable for reform of Social Security.*
- *By January 1, 2002 (At the VERY LATEST), 1 Euro=1 New TL (by discarding 5 or 6 zeros).*

This law needs to be placed under the responsibility of Parliament, that is the representatives of the people, because it constitutes the hope of the nation.

We must form a lobby of "hope" with the media, academic circles, the trade unions, professional bodies, voluntary associations and the people on the street in order to encircle the National Assembly and extract this national commitment from Ankara. This project "Hope" which I am proposing and the monetary discipline and three year vision it entails must in no

way be considered to be the price to pay for what has been done in the past or for what will be done in the future. On the contrary, it should be seen as a glimmer of hope, an opportunity, a choice for the future.

If Turkey fails to increase her efforts to approach EU standards by a project such as project "Hope", I fear that she risks leaving the orbit of the EU. If she comes out of this orbit, what will be the consequences?

- *We will be alienated from a block with which we at present carry out 50% of our foreign trade and which is the source of 40% of our foreign debt, which owns 70% of the Eurobonds we have taken out over the past 10 years (in DM), which is the direct owner of 70% of our foreign capital, is the source of 70% of our official reserves and on which we are 70% economically and fiscally dependent, in view of the activities of over 3 million Turkish citizens who live there; thus we will find ourselves having to seek a new equilibrium.*

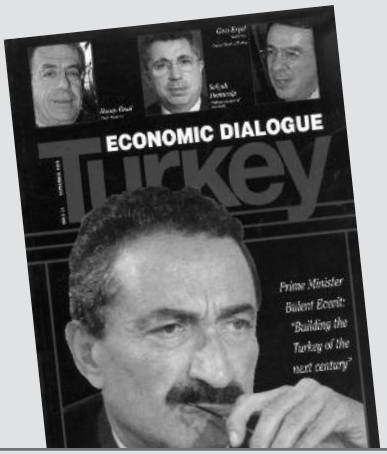
- *We will fall from the global system of block formations (the USA, Europe, the Pacific) and come face to face with the problems of isolation.*

- *We will go on ignoring the "references" and 'triangulation points" at the end of our nose (these have arisen not by chance, but are the result of informed study), or in other words, our potential medium-term targets that are parallel to and level with the norms of Maastricht; and we will continue hopelessly looking for short cuts.*

- *We will cause all the efforts of the last 75 years, to achieve Western values, to turn to alienation from the West or marginalization within the Western world. As a nation, surely we don't, we can't, and we must not see this as an option.*

The project "Hope" will form the basis of a long-term "restructuring strategy" to cover the period until the year 2010; the approach to carrying it out absolutely has to be above party politics. It is only then that Turkey will have secured her place in the "Global Block Formation".

** Yavuz Canevi, Chairman of the Board TEB*



Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue October 1999

Key Decision Makers For Economy and Finance in Turkey:

President, Suleyman Demirel
Prime Minister, Bulent Ecevit
Deputy Prime Minister, Devlet Bahceli
Minister of Finance, Sumer Oral
Minister for Foreign Affairs, Sukru Sina Gurel
Undersecretary of Treasury (PM), Selcuk Demiralp
Undersecretary of State Planning Organization, Akın Izmirlioglu
Undersecretary of Ministry of Finance, Erdogan Oner
Governor, Central Bank of Turkey, Gazi Ercel

WATCH OUT: DESPITE MOTHER NATURE, SERIOUS WORK IS IN PROGRESS

Reference is being made here to one of the most serious earthquakes that has shaken the country as a whole in 1999. However Turkey also managed simultaneously a difficult period of political uncertainty and foreign policy challenges .

The Asian crisis has proved that weak fundamentals make a country vulnerable to adverse shocks. And this was pretty much predictable because in economic and financial theory there is more or less a consensus on what the fundamentals are. However, economic models are less likely to be able to predict crises that arise because of either a unique chain of events or pure contagion effects because technology, new instruments, and new ways of doing business transform the financial system in unforeseen ways; or because some widely held belief proves to be false.

The Latin American debt crisis of the 1980's shattered the prevailing myth that sovereign states could not default. The 1989

Gulf War and subsequent embargo on Iraq had completely distorted the regional economic balances, which are not yet restored.

The 1992 crisis of the European ex-change rate mechanism showed that countries, even industrial ones, with high unemployment may prefer to exit a fixed exchange rate system rather than to live with the consequences of higher interest rates for a short time. The 1994 Mexican crisis taught us about vulnerabilities associated with short term sovereign foreign currency debt and a weak banking system.

The 1995 Turkish "homemade" crisis proved that any kind of mismanagement leading to a misintervention in the market forces could cause as high as 6% negative GNP growth in one year. Finally in 1997, The Asian crisis through the "contagion effect" on the one side and through the financial institutions' "herd behavior" on the other created a "phobia of Emerging Markets" which badly hit Russia and threatened seriously Latin America and Turkey.

As can be observed, Turkey has weathered all these regional and international crises in the last 10 years. Turkey also managed simultaneously a difficult period of political uncertainty and foreign policy challenges including the historical decision of joining the Customs Union of the European Union in 1996. At this juncture, it would be interesting to look at the following chart and observe the fundamentals of the Turkish economy and Far Eastern tigers before the crisis period.

Key Parameters	Turkey	Far East Countries
Currency Appreciation	No	Yes
Sizable Current a/c Deficit	No	Yes
FX Policy		
• Pegged to USD	No	Yes
• Pegged to Basket	Yes	No
High Ratings	No	Yes
Sizable External Borrowing	No	Yes
IMF/IBRD Umbrella	No	Yes
High Reserves (short positions) interested in:	Yes	No
• Real Estate	No	Yes
• Forward Contracts	No	Yes
• Liquid Assets (T.Bills & Bonds)	Yes	No
Size of the Financial Sector	30% of GNP	Over 75% GNP

The above parameters clearly explain why Turkey did not go through the same crisis path.

Just a quick look at the above chart would have been enough to demonstrate to the interested parties that there were and still are some fundamental differences between the Turkish economy and the Tigers. And yet Turkey could not escape from the International investors', rating agencies' and even Bretton Wood institutions' "next to fall syndrome".

Just think back and remember what has happened since July 1997. Dead! It is over! Done with! Next to fall, Do not these sum up the attitude of international investors (both portfolio and FDI) for the last two years towards Emerging Markets in general and towards Turkey in particular? There is no country in the world except Turkey with such inflation rates, enjoying the same level

of sophistication and infrastructure together with a drive for competitiveness and quality consciousness of its financial system and manufacturing base. And yet something happened in the last six months: Investors re-discovered those emerging markets which they recently avoided like the plague. What is interesting during this period was that Turkey was again completely forgotten or ignored. Asia has already started benefiting from the biggest dose of optimism. As of today, Turkey still stays an "undiscovered" emerging market, with others being rediscovered and reemerged once again.

The fact was that particularly since 1994 government management performance, due to frequent changes in parliamentary arithmetic and cabinet structure, has been adversely affecting the macro economic performance of the country.

The 57th Government finally realized that good managers cannot succeed in a bad system and bad managers cannot succeed in a good system. Both are required to be good. That is why this government, instead of taking one off or rather ad hoc measures has decided to improve the institutional framework by introducing some key reform laws and long delayed constitutional amendments.

Here are a few of that impressive list of regulations which were enacted before the summer break of parliament whose working calendar was extended almost two months at the request of this government.

- *Social Security Reform Law*

- *Constitutional Amendment which paves the way to International Arbitration and dispute-free privatization*

- *New Banking Law targeted to create an independent regulatory and supervisory agency*

- *New Capital Market Law*

- *A New Tax Law targeted to relax the artificial barriers to private initiatives.*

- *A radical law to upgrade the Customs Administration in alignment with EU. 7. A whole series of Laws and Decrees dealing with Law and Order, and human rights issues. Such serious institutional frame work builds up the confidence and improves the market sentiment of both domestic and particularly international investors. Because the underlying objectives of the government are declared as the implementation of an appropriately tight budget, a proper monetary programme consistent with rapidly decelerating inflation and laying out a foundation of macroeconomic stability with sustained structural reforms is being implemented. In fact, the following observations carry the elements of further encouragement:*

- *This is the first time we have witnessed an effort to change persistent high inflationary expectations. That is to say, forward targeting rather than backward adjustment is becoming one of the main pillars of the monetary and fiscal policies.*

- *It is the first time we have been observing a government policy which is moving away from short-term positioning.*

- *It is the first time we have seen a government that is willing to use other than monetary policy to tackle the fundamental inefficiencies of the economy. In fact, the monetary policy, quite inappropriately, has been for many years the single policy which is persistently used with an illusionary view that Central Bank or Monetary Policy would be a panacea for all economic problems. It seems that with this broader approach of the current government, the supply side benefits to the economy will take pressure off Monetary Policy. It is well understood that these reformist actions are enjoying, for the first time, cross party support.*

This is a clear indication of Turkey's embarkation on what I tend to call "the second generation of economic reform" which was put off for years. We know that the transformation which took place during the 1980's, that is, the first generation of reforms, helped Turkey to become a market oriented economy. The current reforms, while helping domestically the institutionalization process, will, on the international front, facilitate the transformation of this deregulated, market driven economy into a globally centered economy.

However we all know that these are all necessary, but not sufficient, conditions for effective political bodies in which high performance is enhanced by constant commitment, concern for social justice and fair distribution of burdens. Particularly in

coalition governments, the crucial additional factors are the capacity for effective strategic policy formulation in a transparent environment, adequate legal underpinnings and a frame-work for public accountability and the leadership skills of the politicians and their professional advisors and managers. In our view latest developments in Turkey appear to have considerable substance on both necessary and sufficient factors of success and therefore we believe there is good reason to be optimistic about the next century for a fresh start towards convergence with OECD countries in general and with EU countries in particular. Therefore, Turkey is ready and has prepared a three way challenge today:

- *The challenge of not being marginalized, both politically and economically, from an increasingly united Europe.*

- *The challenge of countervailing pull off fast developing Central Asia and Black Sea Economic Cooperation Council members, which is a Turkish initiative.*

- *The challenge of being a secularist, market oriented island of peace, stability and welfare in her geography.*

And subsequently, the time has come, I am confident, for Turkey to be recognized, and trusted by the European Union and ultimately by the Rating Agencies and International Investors' community and undeniably by Mother Nature, with whom Turkey definitely wants to be at peace.

Distributed at the IMF-WB Annual Meeting, Prague, Czech Republic

Special Issue September 2000

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Bulent Ecevit
Deputy Prime Minister, Devlet Bahceli
Minister of Finance, Sumer Oral
Minister for Foreign Affairs, Sukru Sina Gurel
Undersecretary of Treasury (PM), Selcuk Demiralp
Undersecretary of Ministry of Finance, Ertan Dikmen
Governor, Central Bank of Turkey, Gazi Ercel

"TURKEY: WE ARE HERE!" *

"……. A quite transformation has been taking place in Turkey that offers Europe the geopolitical chance of a life time. If the Turks stay on course and if the European Union can successfully nurture a "good Turkey" instead of observing about "bad Turkey", the shift could do more in the end to improve European security and spread Western values than NATO's expansion to Poland, Hungary and the Check Republic. Turkey, after all, is larger than all other twelve EU candidates combined, and it is the only Muslim one. It is a relative rock of stability in a rough neighborhood that includes three top countries on the terrorist watch list: Iran, Iraq and Syria"

F. Kempe *"The Fall of Turkish Wall"* **The Wall Street Journal**, June 14, 2000

Since July 1999, with the 57th coalition government, Turkey has implemented a series of economic reforms and engaged herself a three year IMF-World Bank backed anti-inflationary program to strengthen the country's fundamentals and increase its ability to cope with the new challenge: EU candidacy and membership.

Indeed the economic strategy for the next three years has been designed to achieve and maintain the positive trends in economic growth and job creation, continue to reduce inflation, and most

importantly achieve an orderly transition into the non-inflationary, less volatile economic environment. To ensure that these objectives along with Maastricht criteria and Copenhagen criteria are met the government firmly intends to maintain:

- *Sound public finance*
- *Structural reforms process*
- *Social, administrative and legal reforms process*

On the public finance considerable achievements are obtained as to the domestic and international debt management, especially as to the cost of borrowing and maturities. The government's fiscal policy is consistent with monetary and exchange rate policies. While the budget performance on the "Primary Surplus" is impressive for the first half of 2000, Central Bank's pre-announced "anchor" policy for the Turkish Lira seems to be working again. Well designed, gradual exit policy from 'the current system is well accepted by the market. Because at the end of the three year program it is assumed that floating exchange rate regime will be resumed in order to allow an orderly adjustment to external shocks, increase the proportion of long term capital inflows, improve the competiveness of the export sector and last but not least prevent misalignments of the real exchange rate as Turkey prepares herself for further EU integration.

On the structural reforms, it is true that this has been an ongoing process since the 1980's. The reforms Turkey so far has

implemented, which have focused on economic and financial liberalization, have enabled the economy to take advantage of the benefits of globalization while minimizing the risks inherent in this process. The reforms both before and after Customs Union with EU which have included trade and capital account liberalization, increased private sector participation in key sectors of the economy. Tax reforms, capital market liberalization, banking reforms including new supervisory authority have transformed a closed, heavily regulated economy with high government intervention into open, deregulated market-driven economy.

Because of the progress and achievements that have already been made and the government's reaffirmed commitments to maintain fiscal discipline generated enough confidence in the market place that despite its political difficulties this program is here to stay with the following mutual understanding of the public and private sectors:

- *It should be remembered, all the time, that this program has a medium term, three year strategy.*

- *Fighting inflation inertia and achieving one digit inflation is a longer complex process than expected that is why in order to avoid "Reform Fatigue Risk" the current program was frontloaded.*

- *To optimize and maximize the results, it is almost obligatory to institutionalize the reforms via sound regulatory framework.*

- *It is well understood by all segments of society today that, in the roots of the low productivity, lack of investment appetite, well-spread unfair competitive practices and many other market distortions, lie the high inflation of past over two decades. That is why all the stake holders in the economy are well prepared today to sacrifice to see the end of an inflation fatigue i.e.*

- *Industry, commerce and services:*

Higher reel tax burden

- *Blue and White color workers:*

Limited wage and salary increases

- *Savers:*

Lower reel interest rates

- *Politicians:*

Less populism, more realism

There comes a time when a nation has to stand up for a serious challenge i.e. serious enough to change the course of a nation. The fact is Turkey stood up twice in the past: 1920's and 1980's. Therefore people are not unaware of what it takes and what it gives.

So the current government, with their little over one year impressive performance, is building up our expectations. Indeed, there is still much this government needs to do to build some strength in the economy including further privatization, fiscal discipline, financial sector transparency, (both public and private) long-term investments in education and physical infrastructure along with some social reforms.

What are urgently needed and fortunately they are on the agenda of the government to be dealt with before the year end are the following reforms and some fine tunings. The country's social security system needs an urgent overall to establish a fully capitalized scheme and replace the current pay as you go system. Draft law is ready to strengthen the regulatory framework and the supervisory agency for pensions along with the framework for private pension funds to be established. This reform, besides representing a major advance in social benefits, will help balancing government budget while helping to increase domestic institutional long-term savings not to mention the contribution to deepening of capital market. Reforms in Commercial Code, Corporate bankruptcy Law, Patent Law, Intellectual Property Rights Law are still in need of fine-tuning.

Obviously, despite an impressive performance in the first half of year 2000, privatization business is an unfinished business in Turkey. Finally on the social, administrative and legal reforms government seems to be committed and the general public is behind all these reforms. What investors, both foreign and domestic, need to see, however, a greater and firmer commitment, sense of ownership (both public and private through social and economic council) to reforms and some tangible, hard but competitive incentives. In this fast globalized geography it is not enough to glow with faith in a solipsistic determinism: because we are what we are, investors must come. There is no precedent that this has worked. Yes Turkey has been lacking sponsors for FDI, and Turkey needs sponsors for FDI. But

let us face it, first, we, ourselves can and must be our own sponsors. (See the Road Map)

When all is said and done one thing cannot be denied: Turkey is on the move again and this time it is in the right direction. When it comes to the century's challenge i.e. EU membership, I can only say the following: "Never Mind the Economics; The EU Turkey is a political issue".

It is claimed that accession of 12 Eastern European countries to EU is an enlargement of Europe but accession of Turkey to EU is the reshaping and/or redefining of EU.

This statement although at first glance it sounds like a flattering comment is a case of a typical foreign policy argument which in certain circles creates its own facts by misrepresenting the existing facts. Europe's relationship with Turkey and vice versa, throughout the centuries has been the one outstanding element in the shaping of Europe. This is still the case today. The real question is that of whether this connection is to be cherished for the sake of posterity or denied for the sake of those unfair, unfounded if not biased and prejudiced attitudes that cannot accept Turkey's positive contribution in European affairs.

'Turkey can, must and eventually will pull itself up to the value added ladder since she opted to be part of EU and to recapture a pace of growth around 6 percent per annum. Therefore today, Turkey is ready, prepared and convinced that after having

transformed herself from a "third world mindset" to EU mindset, it is time now to go to global expectations, because after all, EU is not enough. Turkey has finally realized that it needs a special effort and strategy (private and public sector efforts combined) to create and build a bridge to the new economy, and engine of growth that would drag the rest of Turkey into the 21st century. Turkey's remarkably young demographics will not only facilitate but easily absorb this technical, and strategic shift but also offers a unique "window of opportunity" to spread Western values and democracy.

ROAD MAP FOR A ROUND TRIP JOURNEY TO REPOSITIONED TURKEY

DEPARTURE	ARRIVAL
Turkey needs to close its Savings GAP in order to achieve higher than 4-5% GNP Growth	External Anchor – EU Membership
This requires ↓	↑ This creates
FDI and International Capital Flow	Self Confidence, Competitiveness, Stability
This requires ↓	↑ This paves the way for
Higher Ratings	Further Structural Reforms, democratization and Integration
This requires ↓	↑ This induces
Sustained, Stable, Macroeconomic Policies and Further Structural Reforms Including democratization	↑ Higher Ratings
This requires	↑ This enables
↓ Sharing The Burden By All	↑ Achieve Higher Growth
Segments Of The Society	
This requires ↓ An "External Anchor" to Justify the Sacrifices which would Pave The Way For Further Prosperity and Integration to the World i.e. EU Membership	↑ To Fill The Saving GAP

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 2001

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Bulent Ecevit
Deputy Prime Minister, Devlet Bahceli
Minister of Finance, Sumer Oral
Minister for Foreign Affairs, Sukru Sina Gurel
Undersecretary of Treasury (PM), Selcuk Demiralp
Undersecretary of Ministry of Finance, Ertan Dikmen
Governor, Central Bank of Turkey, Gazi Ercel

PATHFINDER: FOUR WHEEL CHALLENGE FOR TURKEY*

No one can deny the current coalition government's ability of self-preservation. The fact is that this government impressively presides over the worst economic crisis that any elected government has faced. Again this is a government, which has witnessed the resignation of more ministers than any other government in the recent history without even causing a political crisis or even a censure motion. Then the logical question comes to mind: Why and how?

If one studies and follows carefully the performance of the 57th government, the progress achieved in structural reforms tends to be impressive.

Particularly, banking sector restructuring, including new Central bank Law, reforms in agricultural subsidiaries, Independent regulatory Agencies in line with the Privatization programme and the achievements in fiscal policy and budget discipline are amongst worth mentioning. With the expected passage of public procurement law and constitutional reforms in

October Turkey will set the scene for an era of transparent politics and governance as well. Despite all these positive notes some things are missing in this country. To start with moods are not positive. Lack of confidence in national currency, in politicians if not in government itself, in markets is undebatably high and visible.

Then one cannot escape asking the following questions. Is Turkey really willing to fly? The answer, there is no doubt in my mind, is a big YES. Then who is blocking it? Again, there is no doubt in my mind, the answer is a big US, ourselves!

Then it is time today, to step back and to take stock of what we have and what we don't. After that we should, one more time, remember the basics and have trust in ourselves and in each other without loosing time. This is what I call a "Four Wheel Challenge":

ECONOMY: The Ultimate goal is to reach "competitive free market environment"

We may have accomplished much but we know the list is not complete yet:

Drawing a decisive line between public and private sector and making a rational definition of the weight, dimension and place of these two sectors.

Developing the idea of fair competition which embraces and promotes increased productivity and compatibility.

MARKETS: The ultimate goal is to reach "shareholder's democracy"

To secure further deepening in markets and reduce volatility ways and means are to be created for medium and long-term institutional investors.

This should include a major and aggressive private pension fund reform. Mobilization of domestic savings should be given top priority.

POLITICS: The ultimate aim is to establish a "clean, transparent and participatory democracy" in which electorates rather than elected leaders dominate.

To fully and quickly implement Copenhagen Criteria is the easiest recipe to accomplish the above goal. Turkey should leave this agenda behind her once and for all.

CIVIL INITIATIVE: Ultimate goal is to build up and protect the "Civilian Democracy" without diluting it, as we often tend to do.

Self confident, individual based NGO movement is the best insurance to assure civilian democracy. Increase the consciousness of being a citizen as opposed to being a subject.

With her accumulated energy and new generation of entrepreneurs with resilient but quality, productivity and

competition oriented private sector, this new EU candidate, as a regional powerhouse is prepared to have its cake and eat it too.

Turkey, indeed learned during her short history of democracy, to become a "consensus driven society" and "consensus driven economy". Otherwise we cannot explain the current coalition government's successful standing as of today.

I believe if we were to follow the above path, Turkey would be ready and prepared to face the challenge. Needless to say, the fine balance between improving the adaptability to the global dynamics without weakening the resiliency of the domestic political and economic structures can only be achieved in an environment of confidence. Again, this is up to us.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 2002

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Abdullah Gul
Deputy Prime Minister, Abdullatif Sener
Minister of Finance , Kemal Unakıtan
Minister for Foreign Affairs, Yasar Yakıs
Undersecretary of Treasury (PM), Faik Oztrak
Undersecretary of State Planning Organization (PM), Ahmet Tıktık
Undersecretary of Ministry of Finance, Ertan Dikmen
Governor, Central Bank of Turkey, Sureyya Serdengecti

THE BIRTH OF FORUM ISTANBUL*

At the brink of a severe political crisis, followed by a serious economic meltdown in 2001, Turkey's horizon for predictability shrank dramatically overnight. It is not easy to remain positive when negativity surrounds you, but in real life, if you try hard, you might have full control over what you choose to believe.

Under this widespread shortermism, a group of business people, academicians and civil society representatives, as part of the Finans Dunyası Advisory Board, including myself assembled around a table and tried to find an exit from this negativity trap by adapting simple, yet powerful and creative beliefs that support a positive outlook and vision. That was how we decided to form a platform called "Forum Istanbul-Towards 2023" which would organize annual conferences to expand and extend public's horizon. Our aim was to bring together key business and opinion leaders from all over the world, in addition to our own, to discuss what the future holds for the world at large and Turkey in particular.

One major objective we were planning to achieve was to support Turkey's efforts to hammer out a longer-term strategy for reforms and projects in economy, democratization, rule of law, foreign/security policy, and human capital/governance improvement.

We knew there were no short cuts to any place worth going. We were and still are for a prosperous, peaceful and democratic Turkey, to be reckoned with not only in its own region but also in the global arena by 2023, a target year which marks the 100th Anniversary of the Republic's founding by ATATURK.

This year, 2014, Forum Istanbul is organizing its 13th Annual Conference. It is not an exaggeration to say that over the years, Forum Istanbul has come to be known as the most influential gathering about Turkey's future course with a recognition of its strong impact on the decision makers, both in public and private sector, and it has become a venue for summit dialogue between the powerful stakeholders.

Today, as the Chairman of FORUM ISTANBUL, I am happy to report that 13 years ago what we were considering as dreams, have become crucial targets to be achieved not only for private sector such as Exporter Association Assembly (TIM) and other private sector professional organizations and individual corporations but also for public sector such as the various ministries even the government as a whole, as well as the political parties programmes and the NGO's

I have no doubt that 2023 plans and strategies have become now the most serious and effective "ANCHOR" which has filtered in the society. This makes FORUM ISTANBUL team anything but happy.

As FORUM ISTANBUL we also feel obliged and grateful from day one to our institutional sponsors who believed in the vision of 2023 and to Seref Ozgencil and his team for their dedication to the idea without which these Annual Events would not have been organized professionally.

The following declaration was shared in the year 2002 with the public through Finans Dunyası and Economic Dialogue-TURKEY.

The ideas and principles set forth in this statement at the beginning of our initiative are what we still uphold as the FORUM ISTANBUL platform.

** Yavuz Canevi, Chairman of the Board TEB*

FORUM İSTANBUL

YARININ KURULMASI-HEDEF 2023
MARCHING TOWARDS

FORUM ISTANBUL
ESTABLISHING THE FUTURE – MARCHING TOWARDS 2023

Criticism, criticism and criticism... Opportunism instead of putting a constructive attitude, putting a mortgage on the future of a society for the sake of personal and trivial interests, planning a future without the contribution of young generations.

Let us get together to help people avoid such improper attitudes. Let us get together to determine the principles for the development of a vast country that has a population of 65 million of mostly young people. Let us evolve from negative criticism to constructivism. And let us do it with your personal involvement. Let us speak out our wishes at the correct platforms and plan the future through mutual thinking, exchanging ideas and establishing dialogue.

Let us come together and work for the benefit of Turkey and Turkish economy.

Forum Istanbul has decided to hold a series of annual conferences in light of the above enthusiasm. Below is our mission; vision and action plan for tomorrows that our children deserve.

The Mission

Our mission is to direct the Turkish society and specifically, the academic, business and bureaucratic circles to consider Turkey's situation at the present and in the long run in order to generate solutions to the country's issues on national and international platforms...

The Vision

We believe that a formula, which we call the "3x3 Formula", will be instrumental for Turkey's long-term road map and also most beneficial for her to catch up with global standards.

Three challenging targets

- *Sustainable economic growth without neglecting the human dimension within a stable environment…*

To beat high inflation which has long been a hindrance to the country's long-term economic growth and to save the country from high real interest rate spiral by improving macro-economic standards and implementing a sustainable financial sector reform including the public finances, and to become one of the respected and transparent members and successful global players of the world.

- *Upgrading the legal and administrative infrastructure...*

Conventional state subsidies create inefficiencies, unfair competition and are generally costly. Our aim is to promote private sector investments by improving the corporate and legal

infrastructure; thus increasing efficiency and improving productivity.

More importantly, it is believed that transparency, accountability, institutionalization, democratization and in the sum governance quality which are the guaranteeing factors of human development and wellbeing are the essential part of this vision.

- *Making the principle of equal opportunity as part of the backbone of the society... An inseparable part of our vision is the emphasis we put on to enable the distribution of income and wealth and sacrifices to be made on a national level during the restructuring phase in a fair manner to be shared equally in all layers of the society.*

Three Anchor Points…

- *Membership to the European Union and the Customs Union with EU...*

The existing membership to the Customs Union and the proposed membership to the EU should be reinstituted as an anchor to motivate the society to attain social and political ripeness and economic prosperity. Time should be used efficiently to make use of such an anchor. The theme of membership should be cleared off the economic, social and political motives, which often distracts the society from his ultimate aim. The sheer idea of this membership should be used as a jumping board for new reforms as the other member countries have successfully managed to do lately.

• *Creation of ownership in the society to the economic reform program...*

To enlighten the inflation-weary society about the positive effects of the disinflationary program and to win public support for the long awaited sustainable stability.

• *The destination is the year 2023...*

Making Turkey a respected, strong and leading country not only in her region but also in the world in the year 2023, which will mark the 100th anniversary of the foundation of the Republic of Turkey. This target alone will be the strongest, the most morally stimulating and exciting long-term anchor for our society...

Public support must be attained...

The choice for free market enterprise and the principles of a secular and democratic state are the strongest proofs for our country's determination to beat all possible obstacles in the process of globalization. Therefore, what the public needs to see now, is a sensible, coordinated and extensive PR work utilizing the three anchor points on both national and international platforms.

Three Channels

• *A young population...*

One of the most important assets we have in order to achieve our national aims is our young and dynamic population 50% of which are women. These young Turks, man and woman will

help Turkey to meet the challenges of the future with their adaptability and quick learning skills.

• *An entrepreneurial generation...*

Especially the liberal economic climate, which ripened after 1980, has helped to bring about a new and young generation of professionals, businessmen and businesswomen.

This new generation has been schooled intensively, has a strong inclination to quality and productivity, has a global outlook, and is competitive as well as hard working. It is the most appropriate asset for necessary renewals and take-offs.

• *Technological upsurge...*

Turkey's crucial chance lies in the fact that she has not yet fully exploited the opportunity of a "technological upsurge". We have the chance to compensate the time we have lost by transferring the latest technologies. Turkey ought to find a way to be part of "information age".

Action Plan

• *The "Conference Council Board of Initiators" and the "Honorary Board of Advisors", whose names are given below, will meet and/or communicate periodically in order to increase the effectiveness of the platform, to enrich its content, and to provide for its impartiality and respectability in the Forum Istanbul.*

- *The theme and time of the "Annual General Meetings", to be held until 2023, will be announced six month prior to the events. The minutes of each meeting will be summarized in a report and presented to the public. Parallel to the annual meetings, an event titled, "Job Market" / "The Market of Qualified Workforce for the Financial Industry" will be organized.*

- *The council will also organize special conferences and seminars on micro and macroeconomic issues throughout the year.*

AS AN "OLD" EUROPEAN, TURKEY HAS A CASE FOR "NEW" EUROPE (*)

The EU enlargement to 25 members is scheduled for 2004. But the only country that started her alliance with EU 40 years ago (1963) is excluded from this expansion plan. Despite the fact that Turkey's Association Agreement dates back to 1963-64 and its application to become a full member dating from April 1987, in December 1997 at the Luxembourg meeting of the European Council the EU did not include Turkey on the list of candidates for enlargement. It is expected that this situation will be remedied before the year end and Turkey will be given at least a date for starting negotiations leading to full membership.

As the latecomers, the Balkan States who have made it in EU will face a delicate but essential challenge about the Europe's long-term and final boundaries. As we all know the negotiation of Turkey's candidate status on an equal footing with the other candidate countries at the Helsinki European Council of December 1999 has opened a new chapter in Turkey's relations with the community. The approval of the Accession Partnership and the preparation of the National Program have definitely

imparted a new dimension to this process. However, considering the ups and downs occurred during the last forty years, Turks are extremely cautious and also suspicious about the future of Turkey EU relations. And yet many Turkish people have fully taken on board the fact that Turkey never came this close to the doorsteps of EU in terms of both meeting the requirements of negotiating the membership and almost 75- 80 percent of public and over 90 percent political support joining the EU club.

Turkey shares a long common history with Europe. OECD, NATO and most importantly Customs Union with EU since 1996 put the country in a unique and distinct position in terms of integration. 55 percent of Turkey's trade takes place in this region. This momentum has been efficiently picked up by the passage of an "EU harmonization package" of legislation in early August. Obviously this is not the end of the homework. Turkey is aware that a great deal still has to be done to meet the so called Copenhagen Criteria on political, cultural and human rights, this is an ongoing process of progress.

Therefore, as the saying goes: better a diamond with a flaw than a pebble without one. So EU should make up her mind: Diamond or Pebble?

Given Europe's looming demographic problems, in fact, a pool of young, skilled and entrepreneurial Turkish people will be a bonus for EU, not to mention the cultural enrichment which this integration will be bringing in.

Turkey, for years, has been fighting terrorism in and outside of its territory. Therefore during the post Sept. 11 era, she was one of the first countries to cooperate in the US led global war on terrorism. This event, one more time has shed light on Turkey's, often talked but not well appreciated, strategic position in the region.

Therefore perceptions of have been much more crystallized after this event on Turkey's role as a lynchpin of regional stability with a strong potential of for economic expansion. In fact, EU commission's own documents for Turkey have recognized this importance and identified long-term goals of integration.

- *Establishment of a common area of peace, stability and prosperity.*
- *Gradual establishment of a Euro-Mediterranean free trade zone.*
- *Accelerated sustainable socioeconomic development within the zone leading to improved living conditions for the inhabitants.*
- *Increased regional co-operation.*
- *Intensified socio-cultural dialogue and cooperation between the Euro-Mediterranean partners.*

Despite these rational goals on papers, it seems that Turkey has still to work with a solid perseverance to improve and enhance the awareness the EU of what she has to offer. If the EU has been sincere about her own vision of the future there is no better time than now to act. Because of the dynamics of the EU, Turkey and the region can create the maximum value added out of such an action. After all, Turkey neither feels herself nor intends to be a

new member of old Europe, but an old member of New Europe. The biggest challenge for the post Nov. 3 election government in Turkey will be to create a "fast track" platform to draw a road-map for integration which is realistic and sustainable.

I don't see any potential government partner on the election scene who is not ready to face with this challenge. That is why Turkey has a case for EU.

** This article is published in the "The New Europe", a sister magazine to Economic Dialogue-Turkey, on the November 2002 issue*

Distributed at the IMF-WB Annual Meeting, Dubai, UAE

Special Issue September 2003

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Abdullah Gul
Minister of Finance, Kemal Unakıtan
Minister for Foreign Affairs, Abdullah Gul
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Hasan Basri Aktan
Governor, Central Bank of Turkey, Sureyya Serdengecti

DO YOU SEE WHAT I SEE?*

As early as April 2003, i.e. six months after the last election which brought a dual party parliament and a single party majority government to the Turkish political scene, first time in 25 years, TUSIAD, the respected businessmen association of the country, published the following observation and assessment in its Quarterly Economic Survey:

"Turkish Economy's crave for stability is typically interrupted throughout the expansion periods following the economic program, which started in 2000, lost its drive on the eve of executing major structural transformations, as well. The program was later delayed with crises, then restructured, then faced with significant inertia and played the main role in the break-up of the coalition government.

Finally soon after the elections, its left idle for a long time since the focus was shifted to the reigning international conjuncture. However, the primary motive behind the extreme optimism after the elections was the expectation that the new government will act decisively towards the implementation of the economic program".

Although the implementation of the well designed and co-authored with IMF/World Bank economic program was affirmed to be the safest harbor ahead of the unfavorable global conjuncture, government's stance and hesitant attitude was far from fulfilling the impatient business community's expectations in the first five months of the new government term.

However, the recovery of the loss of momentum has been very quick and strong. Since then economic program and EU related harmonization packages have been almost relaunched and executed one after another. Both governments and parliament's performance in the last four months in terms of decisiveness and commitment have been unprecedented.

Turkey needed good news;

Turkey has started to get good news,

- *IMF completed the overdue fifth review of Turkey's Stand-by Arrangements on the back of the progress in the structural reforms.*

- *IMF also came up with a rather surprising as well as motivating move by announcing a favorable rescheduling of Turkey's repayment plan by extending the obligation dates of part of the repayments due in 2004 and 2005 by one year each. That meant one-year extension of Turkey's IMF obligation of an aggregate amount equivalent to about USD11.0 billion. This decision of IMF also gave another positive message to the markets that:*

- *IMF seems to be fairly comfortable with the government's commitment to the- program and willingness to maintain relations with the Fund beyond the current year.*

- *Real interest rates on TRL instruments are still high and remain a threat to the success of the program, and the IMF wanted to provide a boost to the market sentiment.*

- *Two major international credit rating agencies, after a long period of silence, finally announced, although modest, their upgrading decisions:*

Fitch : From outlook "stable" to "positive"

S&P: From B(-)/C, to B/B. JCR and Moody's has said that they are considering the similar move. It seems highly likely that new rating upgrades are to follow in August or September.

- *Central Bank of Turkey has just announced its second rate cut by 3 percent as a sign of a drop in the inflation expectations of the business community.*

- *July Wholesale Price Index and Consumer Price Index came out just like in June negative indicating that a downward rigidity of the prices started to melt down.*

- *Although due to the de-dollarization and the seasonal abundance of the foreign exchanges appreciation of the Turkish Lira is upsetting the exporters, no one can deny the byproduct of this development. That is the productivity increase in the export sector in order to keep the competiveness and improve the profit margin. However, there are signs that a gradual correction may occur in the exchange rate once the "summer effect" wears off.*

- *On the Balance of Payments; year on year performance in exports marked a 35% increase in the January-July period and it is expected that this trend will continue. On the import side, first half of the year the increase was due to the appreciation of the Turkish Lira and to the slight revival of the domestic demand. However the growth rate of imports could diminish with the expected correction of the exchange rate in the coming months. Therefore the current account deficit for the year forecasts ranges between USD 6.5-7.5 billion dollars, which is considered financially bearable, in other words, financing this gap from the international market will be possible.*

- *The rise in the capacity utilization and industrial production is undeniable and the most pessimist estimate of GNP growth rate for the year is %5.5 - 6.0. Things could be even better, based on the following developments:*

External Benchmarks:

- *It is clear that the present economic program does not take into account the USD 8.5 billion dollar U.S. bilateral support. However, government knows and we all know that this bilateral support will seriously reduce the pressure in the domestic market and the BOP and further stimulate the rally in the markets. In this connection deployment of Turkish troops in Iraq could very well improve the Turkish US strategic alliance and this would lead to a stronger involvement of Turkey in the restructuring of Iraq, which is, another boosting news for the markets. Recent developments of a possible involvement of the United Nations is improving this scenario's likelihood.*

- *Another benchmark, which will position Turkey to a more forward looking spot, is the development in the EU relations. First, the October-2003 progress report and second December-2004 EU summit and obtaining a date for negotiations. We know that government does not want to take any chances on this issue. Although expectations are positive for a EU hook-up this is not enough for those who are seeking much more visible and structural "anchor", like Foreign Direct Investments (FDI). That is why the October 2003 and December 2004 are the most important benchmarks.*

Domestic Benchmarks:

- *Restoring and reforming public finance still remains on top of the agenda. Government needs not to show any sign of weakness in dealing with this issue.*
- *Privatization program still need a success story to be convincing for the markets.*
- *Municipal elections of April 2004, although no surprise is expected, will be a showcase for the markets and for the government.*

The degree of populism on the way to the election will determine the government's commitment to a longer term structural policy actions and stability.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 2004

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Abdullah Gul
Minister for Finance, Kemal Unakıtan
Minister for Foreign Affairs, Abdullah Gul
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Hasan Basri Aktan
Governor, Central Bank of Turkey, Sureyya Serdengecti

TURKEY'S OLD CHALLENGES WITH NEW EU ANCHOR *

Politics and Human Rights

Turkey is in a notable confidence cycle, backed by political stability, sound economic policies and fiscal discipline. So the questions comes to mind is why are and should things be any different this time?

- *First time in three decades Turkey has been enjoying a single party with a majority as opposed to the coalitions. This is a new asset in Turkish Parliamentary democracy enabling to form a strong and secure government. This, in turn, has provided a political stability, parliamentary efficiency and improved decision making and law making ability. Day by day we are witnessing that increased stability is bringing increased predictability.*

- *Despite the contrary expectations, particularly of those EU's Turkey skeptics, government has worked hard virtually since day one, at cultivating good relations with the global financial community by breaking the political taboos and ushering through a series of unprecedented democratic reforms. Market sentiment has been extremely important for them.*

- *First time, an IMF Three Year Stand-by Program, out of 16 in the previous decades, has been successfully implemented without any casualty and interruption by the current government.*

- *At the EU's Copenhagen summit in December 2002, Turkey was offered a tangible perspective: If it demonstrated full commitment to the political principles of the EU, it would receive an invitation to start EU membership negotiations by the end of 2004.*

Turkish government's primary aim is to join the EU and it is currently embarked on a serious of wide-ranging political reforms aimed at persuading EU that it has met the "Copenhagen" criteria which is a precondition to start the accession negotiations. Due to its history of volatility and continued structural problems, it could take even a decade for Turkey to achieve required economic social convergence with the EU. However, the EU's acceptance that recent changes to the constitution, and their full implementation by public officials, have fulfilled the state's political commitments is vital to Turkey's chances of gaining a positive response in December.

- *Although Turkey's EU candidacy is not contingent on a resolution of the Cyprus issue, Turkish government's firm standing for the Cyprus referendum should ensure that the issue will not present any downside risk when the EU Council of Ministers meet to discuss "date of negotiations with Turkey" in December.*

Just a few years ago, most Europeans would not have expected Turkey to join the EU within the next generation. Now the start

of the Turkish EU accession process in 2005 has become a realistic proposition.

- *Council of Europe Parliamentary Assembly voted on a resolution last month to close the monitoring procedure for Turkey which started in 1996. This practically meant that Turkey has resolved its problems in democratization and human rights violations. This is very important for Turkey's aspirations to start negotiations with the EU in 2005.*

- *The recent NATO summit in Istanbul was a unique platform to register the strong expressions of support from the EU leaders and from its NATO ally, United States for Turkey's EU membership.*

ECONOMY AND FINANCE

Earned Good News and Expected Good News
Earned Good News:

- *Turkey driven by a surge in exports and a boom in consumer confidence and spending has recovered from a disastrous recession that severely jolted the country three years ago and left its economy in shambles.*

- *Inflation rates are as low today as they have been over 30 years. Despite the recent financial volatility, the new inflation figures endorse our view that disinflation is definitely not a temporary trend and that Turkey's inflation dynamics converge towards the EU average. What is more noteworthy is that credibility gap between*

inflation target and market expectations has become negative. In other words expectations regarding the 12 month inflation as measured by the Central Bank every quarter, fell to a record low of 11.2 percent lately which is lower than government target of 12%.

Decline in inflation was mainly due:

- *Improved policy implementation, both on the fiscal and monetary sides,*

- *The TRL's large nominal appreciation during 2003 also contributed to the decline in inflation.*

- *The Turkish economy has gathered further momentum, as real GDP already increased by a cumulative rate of 12.4 % during the first quarter. Based on this performance annual rate may reach as high as 7-8%.*

- *However, the unemployment is still not decreasing. The good side of this trend is that Turkey has entered an era of productivity growth higher than the historical trend. (From 3.8% in the 1990's to 10.3% in the last 3 years). This is positive both for the competitive power of Turkish industry and for the disinflation program. This new trend together with macro stabilization and institutional reforms were powerful enough to raise the ceiling of potential output.*

- *Freely floating exchange rate policy has helped to bring the stability and prevented speculation in the exchange markets. This policy, now, remains central to the country's ability to adjust promptly to*

changing global circumstances, such as higher oil prices and squeeze in international capital flow which creates pressures on the current account balance.

Now business sector in general and export sector in particular had to focus other ways and means than exchange rates to improve and diversity their competitiveness.

- *Capacity utilization reaching 85-90%, which is the highest in the last 10 years, is a good indication of business investment's strong response to improving economic fundamentals.*
- *Thanks to the government's positive and constructive approach towards the IMF and WB relations 3 year standby program brought in considerable fiscal discipline to the government budget and long needed consumer and investor confidence to the markets. This positive mood tends to be strengthened by the declaration of the P.M. Erdogan and the Economy Minister Babacan about a new three year economic program with the cooperation and/or coordination of IMF.*

In addition the consensus view is that from 2005 onwards, the EU convergence process may work as a catalyst in boosting economic growth.

- *Banking sector consolidation and clean-up operations of ailing banks has been a major challenge. New and independent supervisory authority (BSRA) proved to be an efficient organization. It has strengthened the enforcement of banking regulations and brought them much closer to international standards. Also, more than 20 weak*

private banks have been taken out of the system since 2001. However, the sector will be confronted with further changes as it adapts to the new low-interest environment. Balance sheets remain weak and it will still take some years for the sector to function effectively. It is worth nothing that Turkish financial sector is only 68% of her GNP. What is more worrying is that credits to the reel sector is only 14% GNP. In sum this sector has to be bigger and deeper. Nevertheless, the entry of foreign players could jump-start the required developments.

- *Last but not least, an independent Central Bank has been finally identified as an important pillar of the macroeconomic stabilization by the market players and politicians also. It is believed that Central Bank's increasing credibility will help tame inflationary inertia.*

The real challenge for the coming years for everybody, including the government, is to achieve the sustainability of what has been gained so far.

Expected Good News

- *Debt stock of the government is still very high and both the amount or its share to GNP and its maturity structure (short-term) are the main sources of vulnerability and causing serious concerns.*
- *Due to the above the real interest rates in the domestic markets are 13-15%, and the risk premium in the international markets are still high.*
- *Privatization program due to the legal infrastructure, bureaucracy and political reasons has not been a success story, and has not taken off as it was expected.*

- *Balance of payments performance, namely trade Deficit and Current Account Deficit are signaling some warnings so far. The development and new policy measures expected to cool down these warnings. So the recent concerns appear exaggerated.*
- *Despite the IMF and World Bank programs, additional and enduring structural reforms, particularly in social security system, tax system and tax administration, public sector including legal infrastructure reforms were lagging behind. It is agreed that government needs to show its determination in these structural reforms as it has shown in the EU and the Cyprus Affairs.*

- *Turkey still suffers from a "developing country" disease of "gray economy" which amounts to over 40% of the GNP. Just to give an example, in Turkey the state collects just 64% of the VAT (value added tax) revenue. If it increased enforcement and collected 90%, the VAT rate could be lowered to 13% (from 18%) without decreasing government revenues.*

It is worth nothing that, in Turkey, tax employees per 1000 population is 0.03 as against 1.3 in Poland. That is why for every 1 unit of tax collected, 2.25 units are evaded.

- *One of the black halls is still the social security system. The whole system collects 6% of GNP and pays out 11% of GNP i.e. the deficit is equal to 5 % of GNP. Therefore 6.5% of primary surplus barely finances this deficit rather than helping to reduce the country's debt stock.*

- *Last but not least, FDI performance of the country has been very poor for years and never showed a signal of take off. Today it is believed that even if the economy is managed well and privatization is given a new momentum, without an EU anchor this take off will never happen.*

Historically, accessions have almost always been accompanied by robust increases in FDI. The Central European example shows that the flow can start well ahead of accession. ABN-Amro projects an annual FDI flow EUR 4-5 billion in the pre-accession phase and EUR 11 to 14 billion in the post accession decade.

NEW ANCHOR
Old Challenges

In the months ahead concrete steps already taken towards EU membership will work as an ANCHOR in Turkey's long road to stability and growth but the challenges in terms of structural reforms will be the same. For a government who has demonstrated its determination to end the "stop-go" economic policies of the past years, meeting this challenge with the new ANCHOR seems to be not very difficult. There are three scenarios:

"THE GOOD": The EU starts the negotiations with Turkey. History repeats itself and the convergence applies to Turkish economy as it had done to the acceding countries. That means the government will have a strong incentive to formulate the policies required to sustain its existing strategy of disinflation and debt reduction and to take structural reforms much more

seriously to achieve robust and sustainable growth. Besides, such a Turkey may very well be a "positive momentum" for EU.

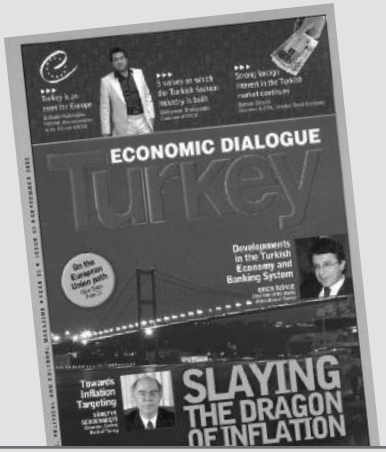
"THE BAD": The EU does not start the negotiations and does not give a firm date about it. However, it praises Turkish efforts and encourage Turkish membership. AKP government carry on with economic and political reforms. However prevailing uncertainties reduces government policies effectiveness and EU-Turkish relations becomes sour.

"THE UGLY": The EU does not start the negotiations and does not say anything about the future of the relationship. Turkish government looses its EU angle.

KEY MACROECONOMIC VARIABLES 2004-2013

	Inflation (CPI, %YoY)	Real Interest Rate (Annual Average)	GDP Growth (% YoY)
"The Good"			
End of Period	3.50%	5.00%	
Ten years average	6.50%	6.00%	6.50%
"The Bad"			
End of Period	7.00%	7.00%	
Ten years average	9.00%	7.50%	4.50%
"The Ugly"			
End of period	15.00%	20.00%	
Ten years average	14.00%	15.00%	3.00%

** Yavuz Canevi, Chairman of the Board TEB*



Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 2005

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Abdullah Gul
Minister of Finance, Kemal Unakıtan
Minister for Foreign Affairs, Abdullah Gul
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Hasan Basri Aktan
Governor, Central Bank of Turkey, Sureyya Serdengecti

DID YOU KNOW THAT...*

- Turkey's last three years average annual GDP growth rate is 7.7%.

- Again, last four years average annual export growth rate is 15%. (Remember that during the same period Turkish Lira has been appreciated against the Dollar and Euro)

- Given the new "floating exchange rate" policy coupled with fiscal consolidation and abolition of most market distortions, current account deficit risk will be curtailed. This will be the real "stress test" for Turkey and markets are aware of it.

- Labor productivity increase during the same period has been the highest in the last 10 years, reaching 8.3%. Factor productivity also reached almost 5% from an average 0.5% in the 1990s.

- Turkey's inflation rate has come down from over 60% in 2001 to 9% in 2005. One digit inflation would not have been even dreamed of five years ago.

- Turkey's budget management and fiscal discipline has been so tight that "primary surplus" marked 6.5% for the last three years in a row.

- Domestic interest rates have come down from the over 70% to 15%.

- Turkey's indebtedness (Domestic debt + external debt/GNP) has been reduced from 90% in 2001 to 63% in 2004. As a result S&P rating has been upgraded from (B-) to (BB-) as of December 2004 and this has enabled Turkish Treasury to pay much less spread for external borrowing. (e.g. 385 bps rather than 1000 bps over 30 years US Treasury Bonds)

- Central Bank of Turkey, first time in the history of the Republic, as part of one of the first steps on the road back to economic heath, has been enjoying its independence since 2002 focusing only price stability and planning to introduce "inflation targeting" starting from January 2006.

- Starting from January 2005, Central Bank of Turkey introduced "New Turkish Lira" by eliminating six zeros without causing any technical and practical implementation problem.

- BSRA (BDDK), a new independent Regulatory and Supervisory Authority for the banking system proved to be an efficient single watchdog.

- A somewhat radical bank consolidation and restructuring in both public and private sector has been accomplished and as a result number of commercial banks came down today from 80 to 48.

- FDI, annual inflow since 1954, has barely exceeded USD 1.0 dollar level. First time, in 2005 realization of FDI inflow will be more than USD 5.0 billion dollars. At least 35 mergers and acquisitions transactions have been completed so far this year and biggest ones invariably involve foreign investors including BNP Paribas, Fortis, Unicredito and Rabobank. Amro projects an annual FDI flow of EUR 4-5 billion in the preaccession phase and EUR 11-14 billion in the post accession decade, provided, intended and declared improvement in the legal infrastructure and bureaucracy is pursued.

- 1496 Turkish firms have invested over USD 7.5 billion during the last five years abroad and Turkish contractors undertakings abroad has reached $50 billion.

- There is a new tendency for multinational companies to choose Turkey as a regional hub e.g. automotive, logistics, IT, retail, and energy.

- Turkish private sector, be it industry or services, has become so quality and value added conscious that for the last four years, out of every 6 quality awards given within EU, 1 is being earned by a Turkish company. Turkey, today, in Europe is the:

1st *largest TV manufacturer*
1st *largest artificial fertilizer producer*
6th *largest refrigerator manufacturer*
7th *largest automotive manufacturer*
7th *largest iron and steel producer*

- Tourism sector is about to break a record this year with 20 million tourists and USD 15 billion revenues.

- Turkey has, in the last three decades, first time, fully implemented a 3 year "IMF Stand-by Agreement" between 2001-2004, and what is more important, another 3 year Stand-by Agreement signed in 2005. Please remember that the previous 16 Stand-by's interrupted one way or another and never completed.

During the new stand-by period, the authorities are determined to extend Turkey's strong economic performance by continuing to implement, in full, their ambitious reform program. The near term priorities under the authorities' program include: passage of the pension legislation and associated administrative reform law as soon as Parliament reconvenes; reform of income taxes; implementation of measures to strengthen tax administration; establishment of a framework for dealing with social security arrears; technical preparations by the Central bank of Turkey to implement inflation targeting in January 2006; and continued implementation of the ambitious privatization program, including for state banks.

- Turkey EU love affair goes back all the way to 1963 Ankara accord. First time in 41 years, December 17, 2004, Brussels admitted and announced officially Turkey's candidacy and a date for the membership negotiations has been set up as October 3rd, 2005.

  In order to reach this point Turkey's performance in the last 3 years has been unprecedented, particularly in the area of Copenhagen Criteria. It should be underlined that this parliament has enacted more laws than any other previous parliament. Of course we cannot claim, yet, the best practice of these laws.

- What matters to business today is less the joining to EU than the process of joining. Indeed through this journey still more structural reforms will be delivered and the business circles will be assured and protected from the repeat of the ruinous 2001 financial crisis.

- Turkey is a unique EU candidate country who entered customs union with the European Union in 1996 when even her candidacy for the membership was not officially recognized.

NOW YOU KNOW!

Even if you have not yet heard the above facts, now you have. Then wouldn't you agree that this performance has not been achieved by accident and therefore the credit for this continued

stability has to be given to the structural reforms, the adaptation of prudent macroeconomic policies which have been pursued in the last three years and institutional integration with the EU. It is true that these policies have reduced economic and financial volatility and thereby lessened the country's systemic vulnerability to financial crisis. Therefore, thanks to the reinvented and reactivated built in dynamism of the Turkish free enterprise the country's economy and financial markets are now on a stronger and sounder balance.

Let us remember all, one more time Turkey can really not afford to survive a permanent debate about her place in Europe. The Turkish political and economic agenda is set in accordance with the full membership to the EU. This is the driving force in mobilizing the society in favor of further political and economic reforms.

From this perspective, being a "convergence country" is fundamental for Turkey, regardless of the duration of the convergence.

Because, it is the traveling not arriving makes Turkey moving. Therefore Turkey can neither change her geography nor her direction.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Singapore

Special Issue September 2006

Key Decision Makers For Economy and Finance in Turkey:

President, Ahmet Necdet Sezer
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Abdullah Gul
Minister of Finance, Kemal Unakıtan
Minister for Foreign Affairs, Abdullah Gul
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Hasan Basri Aktan
Governor, Central Bank of Turkey, Durmus Yılmaz

THERE IS SOMETHING NEW*

Bretton Woods Institutions are facing nowadays a serious challenge: Playing an efficient role in correcting global imbalances. In this respect IMF's decision to set up a multilateral consultation process is welcomed by market representatives such as IIF (Institute of International Finance). On the one side, windfall cash stemming from the oil price boom and the need to increase the domestic spending to boost the import demand and on the other, the pressure for greater currency flexibility, seems to be creating some tension between oil producing countries and western leaders.

Moreover, the fact that China's holding of the bulk of US Treasury papers also creates a tension and makes US policy makers vulnerable towards China.

Against this big picture, we all agree that emerging countries have generally enjoyed sustained growth during the last 3-4 years without visible macroeconomic imbalances. The overall reduction in country risk since 2001/2002 continues. However, in May, new uncertainty over the future of the US economic cycle and Federal Reserve monetary policy created some turmoil on the leading financial markets as well as on emerging markets, including Turkey regardless of their vulnerabilities. However, it is true that Turkey has been hit a bit harder than other emerging markets.

So the question, how much was it due to changes in global or external conditions as opposed to domestic vulnerabilities? There is a general consensus among the Turkey watchers that

the current government, with the help of dual anchors, IMF as short-term and EU as medium term, has done a lot to reduce its macroeconomic vulnerabilities by improving the fundamentals:

- *a primary surplus of over 6%*
- *a tight budgetary policy and reduced fiscal deficit*
- *a single digit inflation level*
- *a high average growth of around 7.5%*
- *a serious banking capitalization consolidation and internationalization*
- *a sound institutionalization through creating an independent and respected CBT, BSRA, CMB and well organized ISE*
- *an attack in privatization*
- *Opening the door for FDI*
- *a build-up of foreign exchange reserves*
- *a freely floating exchange rate regime*
- *opening the dead-locked EU negotiation process*

Thanks to the above achievements Turkey was able to weather the recent storm but at the same time realized the importance of vulnerabilities in other areas such as political climate, EU negotiation strategy, election issues, secularism and faith dispute, even appointments to the key government positions and regulatory institutions.

As a conclusion one can say that Turkey after having lived through three major crisis between 1994-2001, and weathering the recent turbulence has already taken her guard for further crisis and turmoils and established a "New Path" to move forward.

TURKEYS NEW PATH

- *From inward looking to outward looking*
- *From import substitution to export-led growth*
- *From public sector oriented economy to free market oriented economy*
- *From populism to rationalism*
- *From negative reserves to over USD 60 billion reserves*
- *From being local to regional, from regional to global*
- *From "Stop and Go" democracy to stable and sustained western style democracy*
- *From Boom and Bust Cycles to Business Cycles*
- *From an inflation inertia to an expectation of lower core inflation targeting*
- *From subsistence level living to consumerism*
- *From individualism to institutionalism (CBT,BDDK,CMB..)*
- *As for M&A and FDI from Buyers Market to Sellers market*
- *From stand alone status to "being anchored" status to EU*
- *From short-term worries to medium term vision*
- *From bridging East & West economically and commercially to being Life-Style-Corridor culturally*
- *From Emerging to Converging*
- *From marginalization to integration*

Turkish public opinion at large and business community in particular have come to a firm understanding today that this "path" is the right path and any divergence or slippage will not be easily tolerated. I am strongly convinced that this message has clearly reached to the relevant parties in the country.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 2007

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Abdullah Gul
Minister of Finance, Kemal Unakıtan
Minister for Foreign Affairs, Abdullah Gul
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Hasan Basri Aktan
Governor, Central Bank of Turkey, Durmus Yılmaz

A NEW ERA FOR POLITICAL AND ECONOMIC REVITALISATION *

Turks were preoccupied with their past non-performing years even decades, in the early period of the first AKP term. Then they began to enjoy what they were experiencing in the second half of that term in terms of political and economic stability. Now the time has finally come, with the results of the July 22nd election, to prepare the country for the future and enjoy the outcome.

Looking back, one can easily come to the conclusion that the recent election results is a clear sign of the consolidation of the political power by AKP, and not without reasons: An uninterrupted and impressive rate of economic growth for the last five years, successful disinflationary policies leading to one digits, more than doubled per capita income, strong currency and yet productivity driven impressive export growth. Last but not least FDI performance of the country for the last three years has been unprecedented and is a proof of fundamental change of the perception of the country. Turkey is finally seen as a "converging country".

Turkish voters attitude was also another sign of the will for further political liberalization and/or normalization which will be the base for sustained economic stability.

This is the strongest mandate, since several decades, any democratically elected government has received so far, with a forward looking agenda.

What is new?

On AKP's standing:

- *Independent observers believe that new composition of the AKP representatives in the parliament is much more moderate i.e. cleared of radical or conservative deputies.*

- *This may indicate the new face of AKP representing an image of tolerance for secular principles.*

- *AKP is likely to find a support both in and outside of the parliament for so-called a "civilian constitutional" reform.*

- *The "new political paradox" will continue to be there for this term also. This means "Islamist" AKP is the pro-EU and reformist while old secular parties standing against this.*

- *Both for domestic and EU internal politics (Sarkozy etc.) EU accession process is not expected to move speedily. However the process will continue without serious interruption. Because Turks made it clear from the beginning, traveling on this route does matter,*

not arriving. Therefore, it is most likely that 10 years from now Turks will have to be convinced, not the EU.

What is not new?

An unstoppable and irreversible convergence story is what the markets want to keep hearing.

For the last five years, Turkey, being fully anchored and committed to the EU reform process and ownership and cooperation of the IMF programs, has been able to make a transition from an emerging market status to a converging market status. In this transition both anchors played a crucial role in improving policy discipline and fostering market confidence.

In achieving above mentioned macroeconomic successes the following elements were essential and worth mentioning.

- *Countries' entrepreneurial sprits and capacity*
- *Resilience of the private sector*
- *Productivity, quality and brand orientation*
- *Activation of NGO movement*
- *Embarking on institutionalization*

Creating an independent Central Bank and other regulatory bodies both financial and other sectors.

What is expected to be new?

We all agree today that crisis management programme was successful to reverse the decades old chronicle disappointments into real accomplishments such as sustained growth over and above 5%, fiscal discipline to the government budget and achieving over 6% primary surplus, and last but not least bringing inflation to single digits level.

However there are still some outstanding issues waiting for solutions: Unemployment, income distribution, current account deficit are the most popular ones.

As the globalization has shifted power from governments to markets, in Turkey also, stability has shifted power from politics to economics, in other words, we are experiencing a divorce of politics and economics i.e. markets.

In fact in this sense the adherence of the AKP government to market stability and prudence has already been seriously tested twice in May 2006 and July – August 2007.

Therefore, any government, including the newly appointed one, has to realize by now that financial markets would not tolerate any divergence from the reform path, all the more so, given Turkey's vulnerability to externalities as it is witnessed during the most recent global mortgage related liquidity crisis.

These vulnerabilities stemming from the large current account deficit can only be contained if the new government moves to restore momentum towards the following constructive policies. I believe the markets have already priced these moves:

Reforms in Economic Life

Not only the politicians but even man on the street appear to have a good angle on the range of second/third generation reforms which need to be carried out on the economic policy front.

- *Social security and health care reform*
- *Tax reform and gray economy*
- *Labor market reform*
- *Privatization (In particular energy and water distribution)*
- *Improvement in unemployment*
- *New incentives for productivity increase and R & D*
- *Improvement in business environment (Commercial Code, Bankruptcy Law etc.)*
- *Education (In particular vocational education)*
- *Reforms in Political Life*
- *Constitutional reform*
- *Reform in Judicial System*
- *Reforms in Public Administration and Bureaucracy*

Back to the future

To meet these expectations will be the major challenge for the AKP in the new term and it seems July 22nd election result is the best incentive for the time being to meet this challenge.

Besides, future orientation and visionary perspectives are building up in the country. The more politicians and business representatives are finally and sincerely extending their horizon and more frequently references are being made to the year of 2023. Turks are beginning to be obliged to prepare themselves for the "centennial" of their Republic and first time they feel confident about it.

In fact, Turkey has been trying too hard to show to the world that a "pious" Muslim world view is compatible with a first rate secular democracy and western alliance.

Considering the fact that the general elections and in particular presidential election have been smoothly handled, Turkey's over 80 years of investment, after the independence, for a "Home Grown Democracy" has been, after all, a worthwhile investment. That is why Turks' attachment to their past and proud commitment to their young Republic is leading a new feeling today: Excitement about their future.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, İstanbul, Turkey

Special Issue October 2008

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Cemil Cicek
Minister of Finance, Mehmet Simsek
Minister for Foreign Affairs, Ahmet Davutoglu
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Hasan Basri Aktan
Governor, Central Bank of Turkey, Durmus Yılmaz

WHAT IS WAITING FOR US?*

GLOBAL PICTURE:
Crunch Versus Mild Recession

After Latin America, Asia, Russia had their turn, this time it was North America, the USA to be precise, to spread a crisis throughout the world financial systems. And this time it was not like the technology boom or the "com bubble". Starting with its origination in the USA, the subprime crisis, has shaken the financial institutions in USA and Europe and threatened the very credibility of the regulatory bodies and ministries in charge. It was the costliest crisis of the last couple of decades. No one can claim yet that it is over. We are living through uncertain times.

Understanding where we are and where we are headed will be critical to future success of the global financial architecture. This will be the major challenge for the global system. Are we moving from self regulation to re-regulation?

Everybody agrees now on the need for a better quality supervision. But what are the borders of over regulation?

A sharp rise in the cost of risk, high pressure on the capital adequacy ratios, the collapse of securitizations are already built into the system. Expectations are that there will be more and diversified damages. Therefore, valuing risks and opportunities when markets are under financial stress takes more time and eventually, more effort and slows down the growth.

This will require better skilled investors, and decision makers who mix and match intelligence and imagination, experience and flexibility, intuition and prudence rather than pure numbers and quantitative data.

When we consider that the whole crisis took place in an environment of historically high oil and commodity prices we should give the global financial system some credits. Rather than collapsing and being virtually paralyzed, the system weathered the storm well in 2007 and up to now in 2008; even though it is rather difficult to say who will end up paying the bill at the end.

It is from this crisis that we identified and rediscovered the terms like "excessive creation of credit and leverage", "toleration of general lowering of credit standards", "misreading and/or underestimating the evils of originate and distribute model", "too big to fail", "too complex to fail", and ultimately "too important to fail", and last but not least, Bernanke's "macro prudential supervision".

The global picture would not be complete if you don't mention the new "power brokers". These re-emerged players i.e.

petrodollar investors, Asian central banks, hedge funds, Sovereign Investment Funds and Private equity, are playing an increasingly important role in the world's financial markets. Except the Sovereign Investment Funds, none of the above is new to the financial markets, but what is new is their unprecedented clout due to their recent growth. Of course the relative opacity of these players is another serious concern to the regulators.

EMERGING COUNTRIES:
Coupling or Decoupling

After a short period of hesitancy majority of the economists agree that "yes there is resilience but no decoupling" on the part of emerging markets. It is true that the economic slowdown in the major developed countries will put a downward pressure on world trade. However, thanks to the BRIC and oil and commodity exporting countries, emerging markets benefit from relatively favourable financing conditions. On the other hand uncertainty about the future of oil prices may create the major downside risk for a moderate growth in these markets.

It should be underlined that the impact of the faltering growth in the developed world trade, and the direct repercussions on growth in the emerging countries, should be much milder this time than during the 2001 global slowdown. This is due to the fact that emerging countries have been enjoying a rising domestic demand for the last 4-5 years and the vitality of trade between these countries provided a solid foundation for world trade

growth. In fact the non-OECD countries' contribution to the world trade of goods and services increased 20% in the last 6 years, from 28% to 35%.

As for the capital flows into the emerging markets, the impact again was mild despite the strong contagion expectations.

TURKEY:
Back To Basics

While the global markets have been busy with the USA based sub-prime crisis and have been trying to build mechanisms to block its spreading, Turkey has been busy tackling with a domestic political and constitutional issue. If it were not the sound economic and financial fundamentals which have been strengthened by the current government during its first term in 2002-2007, any observer with a memory of previous political crisis would have expected paralyzed market conditions during this process. Fortunately nothing similar has occurred, instead, except for a little bit of nervousness, market players have played cool and business as usual continued.

Now that the Supreme Court decision is behind us, markets (and the government on account of the markets' pressure) are back measuring the impact of the global crisis, and are concentrating on the real issues: political and economic reforms which were believed to have lost their speed and priority as compared to the previous term.

Anchor-Matic

Turkey cannot perform without anchor whether it is self-made-national or adopted-international. It seems that for the coming years government's major focus will be on EU accession programs. IMF will still continue to be, whatever its format turns out, a guiding anchor for the economic policies and further structural reforms.

Challenges and/or Concerns

- *EU accession reforms will get to be increasingly serious and hard to accommodate therefore there is need to build a national consensus across the various stake holders.*

- *Pillars of the economic and fiscal reforms and their priority should be identified properly. This can be done quicker, safer and in a much more convincing way with IMF than without it. Whatever format this relationship takes is irrelevant.*

These policy issues will have to include, but not be limited by, the following:

- *Fiscal discipline structured as a set of medium term fiscal rules.*

- *Social security, employment, tax and energy related sectorial reforms designed to enhance the competitiveness of the corporates and SME's and reduce parallel economy, by improving financial deepening,*

- *Insist on export led growth policy, keep the door open for the recent unprecedented FDI flow, do not allow any slippage from the unwavering anti-inflationary policies,*

- *Dealing properly with the current account deficit,*

- *With an important period of municipal elections ahead of us in March 2009 the real challenge for the Erdogan Government will be to focus on the solid medium-term prospects of the country rather than to fall into the near term trap of vulnerability, namely, populism.*

Overall regional geopolitical-strategical movements and global economic developments strongly signal that Turkey now needs to rise to the occasion.

So "we may ask the question what is waiting for us?" But instead of worrying about it, we have to concentrate on keeping our house in order in the strictest sense of the term.

Just like our country which is in an earthquake zone can nonetheless be prepared and take measure so as to survive the worst earthquakes with minimal damage, so can it be prepared to sail through any economic and fiscal crisis with marginal loss.

What is waiting for us is precisely this readiness to face the future whatever it may bring in terms of economic developments.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, İstanbul, Turkey

Special Issue October 2009

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Cemil Cicek
Minister of Finance, Mehmet Simsek
Minister for Foreign Affairs, Ahmet Davutoglu
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Naci Agbal
Governor, Central Bank of Turkey, Durmus Yılmaz

"ISTANBUL DECLARATION/ISTANBUL CONCENSUS" *

After more than 60 years Istanbul is hosting another IMF/World Bank Annual meeting. Compared to 60 years earlier, Turkey and the world, neither of them obviously is the same. Then, in the 50's, a young democratic, free market oriented Turkey today is the 16th largest economy in the world. Then, in the 50's, strongly divided by an iron curtain into two camps, the world is today almost fully globalized under the umbrella of free market, including China with a "state capitalism" hat. But the same world is testing for the last two years its ability to survive a unique financial and economic crisis that reminds us of the 1930's.

- *How did the world arrive here? Remember that this period was a period of massive growth in the scale and profitability of the financial sector, of, as Warren Buffet's terms "financial weapons of mass destruction", frenetic financial innovations, of growing global macroeconomic imbalances, of huge household borrowing and of bubbles in asset prices.*

- *In the US, the aggregate debt of the financial sector jumped from 22 percent of GDP in 1981 to 117 percent in 2008. In the UK, gross debt of the financial sector reached almost 250 percent of GDP.*

- *The huge flows of capital, on top of the traditional surpluses of a number of high income countries and the burgeoning surpluses of oil exporters, largely ended up in number of high income countries and particularly in the USA. At the peak, America absorbed about 70 percent of the rest of the world's surplus savings.*

- *The most popular question nowadays is the following: Are we dealing with a crisis of capitalism or a crisis caused by capitalists? FT's chief economics commentator Martin Wolf's answer to this question is noteworthy: His article, "The Seeds of Destruction" casts the financial crisis in broader historical terms, with its roots lying in the neo liberal era of deregulation launched a generation ego by Ronald Reagan and Margaret Thatcher.*

- *In Mr. Wolf's analysis, this era is drawing to a close, to be replaced by the growing role of the state in managing financial capitalism and exercising an accountability previously absent in the system.*

- *Not only the financial and monetary architecture but social and political architecture have gone through a gradual but, at the end, fundamental transformation. We are not at the Bretton Woods days any more. Also we do not talk "iron curtain" any more. Just thinking where the IT revolution has taken the world today, is itself complicated but also impressive enough.*

- *It is true that the global economy is faced its deepest downturn in 80 years. Moreover, the countries of the world are more integrated and became more interdependent today through trade, financial flows and FDI than in the 50's. Today, emerging and developing countries constitute a much larger share of global output and growth; much stronger global trade and financial linkages. This is how we can explain why this severe downturn is also the most synchronized one with its tremendous potential for spillover and contagion effects.*

"The degree of synchronicity of the current recession is the highest to date over the past 50 years.

Although it is clearly driven by declines in activity in the advanced economies, recession in a number of emerging and developing economies are contributing to its debt and synchronicity"

- *We were taught at the Economics-101 that the most rational distribution of resources can be achieved through the market mechanism. Yes but with one reservation: As long as there is no asymmetric information among the market participants and full transparency is maintained. For example, the proposition that sophisticated finance was able to transfer risk to those best able to manage it has failed. The paradigm is, instead, that risk has been transferred to those least able to understand it. Therefore to ensure the transparency and prevent asymmetry, the responsibility lies with the regulators. (Central Banks, Treasury, Supervisory Agency etc.)*

- *Financial engineering is good provided ultimate risk bearer and the size of the risk is defined properly. The responsibility lies with the rating agencies and ultimately with regulators.*

- *In case of emergency, stimulus packages are inevitable, but the size, the distribution and the duration of these measures determine its successes. If these packages are transformed into protectionist policies that would become the worst outcome. It is essential that politicians, investors and bankers must learn to live with the uncertainties inherent in a system of free market capitalism. The responsibility lies with the governments and parliaments.*

- *Confidence in local and global elites, in the markets is weakened with potentially devastating social and political consequences. What is crucial for the future in order to witness the reemergence of the sustainable growth for the world as a whole, is the restoration of the erosion of confidence on the financial markets and sustained policy support.*

- *It is also important to note one more time that the protectionist interventions are likely to extend well beyond the cases seen so far. Therefore policy makers should contemplate structural remedies without pushing the system into the "deglobalization".*

- *Now we don't have to be an economist to guess that we are going to live for some time to go, in a less globalized world than that of the recent years, barriers to trade may make something of a political comeback, a greater risk aversion in capital markets and therefore flow of funds will be less across the borders, and particularly towards*

emerging markets. This is extremely important to countries like Turkey where domestic saving rate is low leading to reliance on foreign saving and corresponding current account deficits and external debt to finance national investment.

- *Good news is, leaders of global financial services firms, under the auspices of the IIF (International Institute of Finance) felt the responsibility, formed a high level special committee and on July 23, in New York, announced their comprehensive report through a press conference. The title of the published report is self explanatory: "Restoring confidence, creating resilience:*

Chairman of IIF, Dr. Ackerman, at the press conference, said: "…business as usual is not an option for us. We are operating in a globally interconnected world where we need to strengthen the system's capacity to minimize the risk and to maximize the benefits of the interconnected global marketplace……. We recognize that the industry and the public sector have to build a system that can weather storms"

- *Since there is no credible alternative as of today to the market economy and international cooperation and integration efforts filtered in this is the proper time to strengthen and expend and reinstitute the platforms such as G-20, WTO, OECD etc.*

In this connection, supporting emerging economies through a crisis for which most have no responsibility whatsoever is also a type of "changed mind set" that the world needs to see.

- *It is already, two years since the current crisis hit the world. Therefore in this period of financial and political turmoil, when the future remains uncertain, it is time to sit back and look forward as if this is a time of upheaval. It is not a matter of where we did go wrong anymore but rather how we will do it right.*

Is there a better place than Istanbul to sit back, relax, join forces, be creative and constructive and accomplish this task?

Istanbul and Bosphorus should inspire those who gather here both from public and private sectors to set out the principles of a better institutional architecture and a well thought regulatory framework for a better future. Is it really too much to expect this commitment as an outcome of this IMF/WB Annual meeting?

** Yavuz Canevi, Chairman of the Board, TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue October 2010

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Cemil Cicek
Minister of Finance, Mehmet Simsek
Minister for Foreign Affairs, Ahmet Davutoglu
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Naci Agbal
Governor, Central Bank of Turkey, Durmus Yılmaz

TWO "GENIES" TWO "BOTTLES" *

While at the global level discussions and heated debates ignited by the recent financial crisis, on current global growth model, the large size of the financial sector fuelled with massive stimulus packages and the future of dollar as a reserve currency are still being questioned, Turkey's PM Erdogan has been able recently to tell a better story to an international audience;

At IIF Annual meeting in Istanbul in his introductory remarks PM Erdogan was proudly and comfortably making the following remarks to the international bankers and regulators:

"Turkey had gone through a major crisis in 2001 and has since undertaken significant reforms and restructuring, which made it much more resilient to external shocks as demonstrated by Turkey's ability to weather the current crisis".

He indicated that no government support was extended to any of the Turkish banks, and he believed that TURKEY IS ONE OF THE FEW COUNTRIES IN THE OECD THAT DID NOT REQUIRE SUPPORT TO ITS BANKING SYSTEM DURING THIS CRISIS.

In fact there is a general consensus among the analysts that Turkish banking system is now stronger, sounder and more immune to contagion.

WHERE IS GENIE IN POLITICS?

With the words of economist O. Cevdet Akcag:

"The country is normalizing on a daily basis, and will continue to do so, and this is and will remain beyond the control of whoever is in power! The governing body can either accelerate or decelerate the process, but the process has assumed a life of its own, and there is no reversing it".

WHERE IS GENIE IN ECONOMY?

Due to the global financial and economic troubles, particularly in EU and USA Turkey has found itself in the rising EM camp and was pointed out as one of the preferred alternatives of investment destinations for international funds. Thanks to her stable, sound financial sector, robust public finance, low inflation, and high and sustainable growth prospects and environment. Again based on the concept of "zero problems with neighbours and strategic depth" in her new foreign policy challenge it has been possible to open up and diversify export markets in the Middle East, Caucasia and Africa, thus reducing her dependence on EU. During this period Turkey has been an object of envy if not of jealousy.

In UK Prime Minister David Cameron's words "Turkey has become Europe's BRIC". In fact, Turkey's MSCI index outperformed the MSCI emerging market index by 10 percent in 2009 and around 14 percent in the first 8 months of 2010. Foreign investors own around 65% of the stocks on ISE. For some analysts close to markets ***"Turkey is emerging as a safer bet".***

Sometimes the end of an affair marks the beginning of a new era in societies. September 12 Referendum in this sense is the beginning of a new era. It will be remembered as the real "sliding of axes" toward normalization, democratization. Remembering the fact that these axes were sliding in the opposite directions in 1960 and 1980.

In short we can say that "genie" in politics is now out of the bottle on its way to a more civilian society and as of September 12, 2010 referendum further constitutional reforms are in sight. September 12, 2010 has given the start for the launching of upgrading measures in Turkey's Democracy.

Considering the following expected year end macroeconomic performance parameters this is not surprising at all:

2010 Real GDP, % y/y	6.1
2010 CPI, % y/y	7.0
2010 Net Public Debt, % GDP	30.2
2010 Current Account Deficit, % GDP	-5.0
2010 CBT FX Reserves, months of import	5.6
2010 Unemployment Rate	12.0
Sept. 2010 CDS Spread	163.0
Banking System Capital Adequacy Ratio	19.2
Banks' Leverage Ratio	8
Household Debt % GDP	15.4

However there are recent indications that "Fiscal Rule" may be diluted and even postponed. This may unfortunately delay Turkey's investment grade status.

In this sense we can say that "genie" has been out of the bottle and has been in operation since 2001 and almost ready to go back into the bottle. This puts Turkey in a new distinct category of countries among the G-20 along with China, Brazil and India.

WHERE IS EU IN THIS PICTURE FOR TURKEY?

Turkey although in general disappointed of the EU's current "foot dragging" is not giving up and will not give up pushing the negotiation process. We do not know what type of Europe will exist when Turkey reaches the threshold, or what type of international landscape will prevail, and we do not know what role Turkey will be in a position to play in those new environments. So Turkey is not distracted but it is determined to make progress and so far is interested in the accession process to put our house in order rather than the end result for the time being.

One thing is clear though that Turkey, while she is determined not to welcome any "strategic alliance" model with the EU, still willing to seriously pursue structural reforms to strengthen the EU membership perspective.

On the other hand, September 12, 2010 referendum was "a clear wakeup call" for Brussels to reconsider its position visa vis

Turkey. We are, in fact, confident that if the EU plans to assume global responsibilities it cannot do so without Turkey.

CHALLENGES AHEAD

- *No distraction from the EU adjustment process*

- *No distraction from the normalization and further democratization i.e. let the "genie" accomplish its mission with a clear out mandate on September 12, 2010.*

- *After the recent postponement of the "FISCAL RULE", the voluntary anchor of the current government, sticking the already declared 2010-2012 medium-term adjust program gains more importance. A convincing and committed approach is necessary to keep the market sentiments undisturbed.*

- *To concentrate and ensure private sector led sustainable growth based on productivity, innovation and use of technology.*

- *More emphasis on increasing domestic savings, improving the quality of financing current account deficit and fighting with unregistered economy. Knowing that current financing structure of Turkish growth makes TRY (and bond rates) vulnerable to changes in global risk perceptions, this will be one of the key policy parameters in the coming years.*

- *Continue further to export market diversification.*

- *To further strengthen the strategy and action plan for making Istanbul a regional financial center, specialized in certain segments, with the cooperation of local banking and business community.*

- *To capitalize and make further use of the G-20 status by being pro-active and making positive contribution.*

- *Last but not least, the real challenge for the authorities from today onward will be to "decorate" Turkey with an "investment grade".*

TO CONCLUDE

This is the moment to defend specific actions of structural reforms which will help us to continue to move forward achieving a more competitive and productive industrial base on the one hand and fine tune the system with micro solutions on the other, so that we can create and capture new opportunities.

We should bear in mind that particularly after the current global financial crisis, in a more interconnected and interrelated world more and more sustainable productive economic systems will have better chances to survive.

We all know and are convinced that to speed up this process what we need most is a secular democratic and civilian environment and the loyalty to the rule of law. Therefore let the "GENIE" accomplish its task!

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue October 2011

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Cemil Cicek
Minister of Finance, Mehmet Simsek
Minister for Foreign Affairs, Ahmet Davutoglu
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Naci Agbal
Governor, Central Bank of Turkey, Erdem Bascı

NEW TURKEY: ERA OF ENGAGEMENT *

We should all better be convinced that there is a new world order being shaped up. From USA to China, from Europe to Japan, from Russia to Latin America, from Africa to the Middle East there are new balances occurring in every field of the human life, be it social and/or economic. Therefore it is time for taking stock of the achievements and missing links, it is time for adjusting the mindset, it is time to get involved and to share. It is time to moving from fine tuning to structural policies. It is time for building up soft power on top of hard power.

That is why Turkey's July 12, 2011 general elections have become very important and crucial for the country's future. Both in terms of timing and outcome. This election gave P.M. Erdogan not only a clear mandate to govern the country but also a challenge to forge Turkey's future with an imbedded new global order and balances in the years, may be decades to come.

P.M. Erdogan's declared immediate ambition is to prepare Turkey for the year 2023, Republic's Centennial, so as to become

the 10th largest economy of the world. His success in the last two terms under the worst global financial and economic circumstances understandably has given him this confidence. However, since then the world has become dangerously volatile in all fronts. Therefore we have to have a focused plan of action so that we use the time available to us efficiently in order to upgrade our productivity level in industry and the quality of our democracy to achieve sustainable development.

By focused approach I mean inward focus and outward focus.

INWARD FOCUS

- *Constitutional Reforms and other related reforms to strengthen our democratization process.*

Turkey's relatively long democratic tradition since 1946 and the diversity of the Turkish political elite demonstrate that Turkey remained committed to democratic participation in political life as a necessary component of development. In time with political will, Turkey is determined to build on the already strong foundations of her democracy.

Therefore Turkey can no longer afford to have the"Owl of Minerva" to leg behind the movement of history, but must take action for the "Patron Goddess" of Athenian democracy to take over the writing of history in our beautiful country.I believe she is ready now to take upon herself that responsibility.

- *Redesigning industrialization policy and export led growth strategy with a determined and realistic execution plan.*

Turkey needs to improve its productivity in almost all sectors. This requires reforms starting from education, R&D, energy efficiency, agro-industry and services including financial services and unregistered economy and improving the investment environment in general and FDI in particular to a globally competitive level.

It should be understood that educational reforms do not only help productivity improvements but quality of democracy also heavily depends upon it. In this context, according to the U.N. statistics, Turkey has a unique demographic advantage or rather window of opportunity. In 2025 Turkey will become the country with the highest young population in the world. Nevertheless, this potential can be meaningful if sufficient quality education is offered to the young and dynamic population including, particularly, women.

In fact, one distinct feature of the AKP's two terms in power has been to give rise or to mobilize a hidden entrepreneurial power, called "Anatolian Tigers". This has been the result of the matching characteristics of both AKP and this group of business sector as "devout and conservative".

It should be reminded that the term "Anatolian" refers to not necessarily inland Anatolian cities but cities like Istanbul, Ankara, Izmir, Bursa also have given birth to these "Tigers".

Therefore we can say that with these focused reforms a widespread hidden dynamics may be activated to sustain the desired growth and development by 2023.

With a 2008 global financial crisis still not settled down and with the widespread existence of global interdependency, Turkey has to protect herself against all kinds of contagion effect. What is important at this juncture is to keep the confidence of markets, investors, producers and consumers both at home and abroad. Managing the expectations of the stakeholders will be the key factor here for success.

OUTWARD FOCUS

- *Turkey's immediate focus will be to contribute actively to the establishment of a stable, peaceful and democratic region. Thanks to her new self confident and proactive foreign policy model, she will not hesitate to use for this purpose multinational institutions like U.N., OECD, NATO.*

As once rightly said by Owen Matthews of Newsweek, "Turkey is remaking itself as the center of the politics and economics of its own region". In other words, when it comes to U.S., EU, Muslim world or Russia, all are parts of a new, heavily Turkey centered policy that rests on generating security and stability in its region and beyond based on its democratic and secular political system, vibrant economy and its tradition of reconciling modernity with its cultural identity.

- *Turkey, as part of the G-20, will be more active and constructive:*

It should be underlined that while EU remains Turkey's top foreign-policy priority, it is not the only one. Turkey's own national interests, political and economic, combined with the regional and global responsibilities in this new and volatile world order requires and imposes upon new roles to play. Turkey is prepared and well equipped to play that role at the G-20 platform As Davutoglu has said once; "Now it is time for Turkey to be European in Europe and Eastern in the East, because we are both" and of course globally minded as and when it is required.

- *Turkey will be more focused on EU-Turkey relations (including Cyprus issue) and will be after concrete results aligned with the public expectations in Turkey.*

Turkey's continued interest in Europe is fueled by a powerful sense of belief that this alliance is mutually beneficial. Demographically, aging Europe will need a young workforce. Global competitiveness can only be increased in Europe with an ambitious, hardworking entrepreneurial class. Democratic institutions building can help to enhance the stability of the region. Despite the fact that Germany and France continue to pour cold water on Turkish EU relations, Erdogan Government has been pressing on with deep, lasting, EU inspired reforms and lastly has even included a ministerial post to be in charge of EU Affairs in the Cabinet.

To conclude, it is the comprehensiveness, the quality and the sequence of the policies that matters now. It is exactly at this point that the principle of "it takes two to tango" applies. The ruling party, AKP, should be open for engaging others to come up with creative and sustainable solutions in these "focused areas".

Engaging opposition parties, NGO's, Academia, business stake-holders, market players will be the key in this era. Therefore we have ahead of us an "Era of Engagement" for AKP and an "Era of Contribution" for all.

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Tokyo, Japan

Special Issue October 2012

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Bulent Arınç
Minister of Finance, Mehmet Smsek
Minister for Foreign Affairs, Ahmet Davutoglu
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Finance, Naci Agbal
Governor, Central Bank of Turkey, Erdem Bascı

CONVERGENCE by DIVERGENCE *
GLOBAL OUTLOOK:

One of the most obvious outcomes of the current so called "Global Crisis" is the growth gap between emerging and mature economies. As IIF recent report puts it, many of the problems that have held back growth in mature economies since the 2007 crisis seems likely to persist, or even intensify further, while emerging economies seem well-placed to be able to fend off persistent problems of external weakness and foreign financial turmoil by maintaining a solid pace to domestic demand.

What does this mean really?

It means simply that there is divergence in the growth rates and convergence in the material living standards and wealth between the two blocks. Therefore, we need to see the so called capitalist world, i.e. mature economies, regain its self-confidence to open its economies to competition and not hide behind the crypto protectionist language of reciprocity.This is the only way to eliminate or at least reduce the divergence in growth. We need to see the G-20 to strengthen and/or redesign the architecture of

those institutions such as WTO, GATT, IMF, WB and even create new ones to show that global markets are governed by global rules.

At this juncture, joining the views of "Capitalism in Crisis" would be a greater threat. Remember that the worst consequences of the 1929 Great Depression was anti trade, anti market isolationist policies.

It would be a catastrophe if any such response occurred. Therefore avoiding the "deglobalization, protectionism" at any cost would be everybody's interest.

Global financial crisis and its contagion effect on Eurozone has exposed flaws in the design of the Eurozone. In fact EMU when it was established, is included virtually no economic union, no fiscal union, no economic governance institutions and no meaningful coordination of structural economic policies. As a result significant divergences in competitiveness, current account deficits and domestic consumption have occurred among members of the EU:

	Competitiveness	CAD	Consumption
Average 2000-2011			
Greece	-11%	-9.2%	+4.5%
Germany	+7.4%	+5.1%	+1.85%

Ultimately Europe's choice for rebalancing will be made in BERLIN, and BERLIN is faced with three fundamental questions:

Where the Eurozone is going?
Where Germany wants the Eurozone to go?
Where the euro-zone needs to go?

Obviously there are two theoretical options:

Full breakup of Euro, with all its economic and political repercussions

Full federalism: An unprecedented transfer of wealth across Europe's border and in return, corresponding surrender of sovereignty, for a "super state"!

It is easier said than done!

Therefore, what is needed today is a "sophisticated pragmatism" (i.e. politically feasible, economically workable) together with a visionary political leadership. Because the costs of failure are so large that the possibility of domestic and Eurozone reform must be kept alive. There is no way designing a "flawless" breakup scenario. Even a limited version of federalism is a less miserable solution than break-up of the Euro. Eurozone exit would be a lot more expensive, with widespread and difficult-to-calculate consequences, not just for Greece.

Europe is unlikely to generate quick fixes to the Eurozone crisis. Therefore a "Rescue Plan" is immediately needed. The plan should seek to fill in two holes in original design:

Financial: (To prevent the fire to expand) Euro wide bank supervision and regulation, including deposit insurances, Union of EU banks, European Union Bonds etc. are part of this.

Remember that in 2007 the "Top 1000 banks" list, European banks accounted for 58% of the total assets and 46% of the profits. In the 2012 List European banks account for 45% of the assets but only 6.3% of the profits. The crisis has clearly been devastating for many EU banks.

Fiscal: (To put out the fire) Reducing debt burden of the countries with limited mutualization without transferring everything to EU level. Common fiscal authority for synchronization of budgets and debts is part of this proposal.

Recently, the four European presidents have come up with a "vision" of where Europe is going. In the plan published, they are pushing for first base to be a banking union supervised by ECB, and a deposit guarantee fund and a European resolution authority backstopped by the ESM (European Stability Mechanism). So far it is good news to prevent the fire to expand. However still no mention is made of the direct recapitalization of banks by the ESM/EFSF and fiscal integration.

So, for the European leaders, "Decision Time" is approaching, they are near the "moment of truth". EU summit which was held on June 28-29 accomplished an historical task.

What is at doubt is the willingness and ability of politicians to deliver, and over what timescale. As RUBINI puts it; "you have on one side austerity fatigue in the periphery of the euro zone, on the other side you have bailout fatigue in the core."

Can the guardians of the increasingly fragile EU, master the will and resources to keep the euro-zone from breaking apart, leading a sort of "Euro Winters"!

In fact Germany's success stems from strong export sector, which has thrived in "single currency" and a "common market". The collapse of one, if not both would have hugely negative repercussions for German industry, wages and employment. UBS recently has attempted to quantify the cost of a euro zone break-up for Germany only, estimating it at some 20-25% of GDP or the equivalent of Euro 7000 per citizen.

More realistically, can the "core" (Germany) afford to see the disruption of its backyard export market by a meltdown of Eurozone? Because, Germany sends just 5% of its exports to China, compared with 42% to the rest of the Eurozone.

Obviously, German leaders will have the choice between a shipwreck and a change in the course! The fate of Europe depends on this choice.

However we should pay enough attention to the following observation: There is a dangerously biased but hidden optimism in Europe that in case of crunch, both Germany and ECB will pay whatever is necessary to avert the "disaster".

In fact, one should not forget that the current European crisis is not simply a problem of liquidity and debt but it is one of

solvency and growth. But economic growth of recent years was debt fuelled. Therefore, even the most successful financial engineering in the euro area will ultimately fail. Without ensuring that debt stocks and bank's balance sheets become sustainable today, the crisis will continue to worsen and indeed the region as a whole will never restore at least a modest growth in the fairly near future.

Those who are thinking that Japan has been able to survive with almost zero growth and zero interest rates for almost 10 years, so Europeans also struggle with their problems for another decade, are wrong! Japan has one government to govern and Japanese people are thrifty. Europe has 27 governments and except Germany they like to spend. So Europe does not have a decade to decide.

CHALLENGES

It is important to realize that by 2050, the world population will be around 9 billion. 98% of this increase will be generated by the developing world. Again urban population will be doubled and 60% of the world population will be living in the cities. Just to give you an idea of how a serious dilemma we are faced with just assume for a moment that same consumption pattern will continue until 2050. We will see that the world will be needing 23 times of today's planet to survive! Clearly there will be no such planet. Therefore we will be required a complete redefined world in terms of climate, environment, population,

consumption, distribution of wealth, energy, economic power etc. That is to say the whole value and pattern systems have to be overhauled.

In a world of progressively more multipolar with a more diffuse distribution of economic power, economic growth and financial centers, policy makers from East to West, from North to South, will need to equip themselves with the tools and capabilities to effectively capitalize on opportunities while simultaneously safeguarding their economies against the risks that remain stubbornly high as the global economy struggles to find a stable footing.

Therefore acting alone is no longer a viable option; a collective global leadership and a robust framework for policy coordination is sorely needed. Failing to achieve this goal will undoubtedly lead to deglobalisation and protectionism.

TURKEY:
LOOKING BACK
Turkey had lived through four "Restoration" period.

- *Republic, 1923*
- *Democracy, 1946-50 (Turkish Spring!)*
- *Global Integration plus orientation*

80's: Liberalization and Deregulation
90's: We don't want to remember
2000 plus: Economic, Legal and Political Restoration

The latest restoration has been going on both inside and outside of the country. In this asymmetric and multipolar world environment we are trying to secure a sound and stable place.

CHALLENGING VISION-2023

Turkey, as historically proven, performs better with an anchor. This anchor, since 1995, has been the EU accession process and related reforms. It is widely accepted that EU accession process has provided the transformational engine for economic and political modernization and further democratization of the country. Due to the unknown political reasons on part of the Brussels the weight of this anchor has lost its effectiveness and TURKEY-EU relationship has been unfortunately, the hostage to the domestic politics and Brussels bureaucracy.

However, Turkey has come up with a more attractive and motivating anchor recently. That is VISION-2023, 100. Anniversary of the Republic. Not only the official sector but private sector equally, may be even strongly, committed to this anchor so that Turkey is promoted to the "Premier League Economies", that is moving from one of the world's top twenty economies to the top ten.

After years of "being the next big thing", Turkey's time has come. For years there was once a sarcastic saying "Turkey has a future and will remain that way". That is no longer true. For the last ten years with a solid and motivating "2023 vision" Turkey is already on the way building her future. In the past, that is at

least until 1980's Turkey had been a region that international business people would usually just fly over from west to east or from east to west, on the way their home. Now, particularly after the 2001, the country is exactly the kind of place when investors can take advantage of Turkey's consumer boom as much as her regional "hub" position. Recent FDI flows and robust M&A activities are the best indications of this new image. According to UNCTAD World Investment Prospects Survey, 2008-2010, Turkey is the 15th most attractive destination for FDI in the world. As of the end of 2010, more than 25.800 companies with foreign capital were operating in Turkey. Two thirds of them were established in the last seven years.

Over the past decade, the country's GDP rose, on average more than 5% each year. Turkey's GDP levels more than tripled in 2010 to USD 736 billion, an incredible jump from USD 230 billion in 2002 and the GDP per capita soared to USD 10.080, up from USD 3500 in the same period.For years, structural problems had been identified as the key road blocks to the fulfillment of Turkey's economic potential and aspirations. Thanks to the widespread reformist efforts with this new vision the role of the private sector, particularly SMEs, substantially increased in the economy, the efficiency and durability of the financial sector was made sustainable.

After EU accession anchor, this new 2023 vision has created a dynamic growth momentum to Turkey's transformation into a regional powerhouse.In fact the country has one of the most

diversified economies of all emerging markets, with a relatively strong industrial base, growing service sector and strength in agricultural base. Therefore, there is no single sector that we could point out as dominant.

THE BURGEONING MIDDLE

Two shifting dynamics in Turkey is currently the most talked-about phenomenon. First, we must not fail to recognize that the "rising Turkey" story rests on its youth and its demographic advantage. It is the post-global crisis era that created a "revolution of perceived possibilities" that has made our entrepreneurs venture out aggressively and successfully in every corner of the world, including Africa. In fact, a new class of entrepreneurs called "Anatolian Tigers" have emerged and they have become Turkey's new export drivers and strongest defendants of "Vision-2023".

Second, with an average per capita income level of USD 10.000 a new voracious consumer class has emerged. 40% of the computers, 55% of the mobile phones sold in Turkey go to this segment. The number of credit cards sold in Turkey is the highest among EU countries. In mobile network coverage Turkey is number one among 138 countries. Foreign interest particularly piqued by the key themes of the growth of the middle class and logistics. A rapid process of consolidation is underway in many sectors. The banking industry has been the fore runner after the 2001 liquidity crisis at home.

THE WAY FORWARD

With rebalancing and CAD awareness a "soft lending" period is ahead of us.

In Turkey, we remain mindful of very large CAD and a sticky inflation. Nonetheless, thanks to lower oil prices, CBT's implicit exchange rate targeting regime and base effects, economic fundamentals will seem to improve.

After an outstanding 8.5% growth in 2011, the Turkish economy slowed down substantially in 2012 H1, as consumers were tapped out, the EU crisis undermined confidence and CBT engaged in a very tight monetary policy.The substantially lower rate of credit growth is the best indication of the sharp slowdown.

However, expectations are that economic activity will regain its pace later in the year due to:

- *The falling CBT average funding rate.*
- *Positive consumer and real sector confidence data.*
- *Lowest unemployment rate since the 2001.*
- *Adjusted for one-off revenue items such as social security and tax amnesty and privatization proceeds, central budget still produces a meager non-primary surplus, and remain expansionary.*

On Inflation Targeting, CBT has allowed inflation to over shoot the target by 5pp last year (11.4% vs. 5.5%) That means monetary

policy has been rather loose and unorthodox nature is continuing. Inflation forecast is 6.5% for 2012.

Turkish export diversification of markets, products and quality is expanding very fast. Latest incentive package is encouraging. M&A activities have picked up last year. 241 deals worth USD 15 billion. Foreign investors with 138 deals was 74% of the total. Turkish investors abroad also made 68 M&A deals worth USD 7.5 billion (2007-2011) Banking sector is continuing to be the best performer with 16-17% CAR and very low NPL level. With 26 million adults not having bank account, meaning 50% penetration rate, sector has plenty of room to grow. The number of potential bank customers in Turkey will exceed those in England, France, Spain, Italy and Germany combined by 2020.

Government is determined to improve domestic savings rate by the recent Private Pension Fund (BES) regulation and additional tax incentives. These measures will also help to curtail CAD problem.

CHALLENGES

In the short term, with risk coming from the Eurozone and increased vulnerability with large CAD to "sudden stops" of capital. In the longer term, with focusing on further structural reforms geared to productivity and efficiency and boosting education and "human capital" in order not to fall into the so called "middle income trap".

To conclude, a huge local market, a thriving economy, an open culture and growing economic sophistication can all outweigh the cons of Turkey's regulatory environment which is still on the way of being adjusted to the EU standards.

In sum, I am moderately optimistic that Turkey's soft landing and rebalancing will continue to be in progress. And Turkey (so far) is and will be one of the rare countries with a recovering growth and declining inflation story in Europe. In other words as Financial Times puts it "in the Western world, particularly in Europe it feels like the best years are behind us, in Turkey it feels like the best years are yet to come".

** Yavuz Canevi, Chairman of the Board TEB*

Distributed at the IMF-WB Annual Meeting, Washington DC, USA

Special Issue September 2013

Key Decision Makers For Economy and Finance in Turkey:

President, Abdullah Gul
Prime Minister, Recep Tayyip Erdogan
Deputy Prime Minister, Bulent Arınc
Minister of Finance, Mehmet Simsek
Minister for Foreign Affairs, Ahmet Davutoglu
Undersecretary of Treasury (PM), Ibrahim Halil Canakcı
Undersecretary of Ministry of Development (PM),
Kemal Madenoglu Undersecretary of Ministry of Finance, Naci Agbal
Governor, Central Bank of Turkey, Erdem Bascı

THERE IS NO SHORT CUT TO DEMOCRACY *

In fact there is no short cut to do and to accomplish something valuable and worthy. In Turkey we have a story, rather a joke about this. A man enters the bar with full excitement and says: Hey, fellows, listen, drinks are on me today! What are we celebrating then, the crowd asks? He says I just ran 100 meters in 5 seconds.

They all laugh at him and say, it is impossible, world record is 9 seconds. The man says, I found a shortcut! It is not as simple as that, we all know. Even to run 100 meters in 9 seconds, requires endless practice, preparation, determination, dedication, sacrifice, tolerance, compromise, adherence, perseverance and patience.

This is the one lesson at least we can draw from the recent, what is called "Arab Spring" movements and following incidents. The young and impatient population in those countries present policy makers and repressive autocratic regimes with many challenges, especially where income inequality clashes with high youth unemployment.

True, policy makers in those countries have to deal with younger and thus more dynamic and demanding population, as we have seen in numerous public upheavals recently. And, there are probably still more negative surprises to come, especially where the combination of high income inequality and youth unemployment and the lack of democratization is at its highest. It is also true that economic vitality, financial stability and secular democracy is a rare combination these days.

WHERE DOES TURKEY STAND?

Republic of Turkey's 90 years of history speaks for itself. It is definitely not a "short cut" story. In fact Turkey has lived through four constructive restoration periods:

1923: Birth of the Republic
1946: Turkish Spring
Introduction to Parliamentary secular democracy
1980: Introduction to Market Economy
(Deregulation, Liberalisation)
2001: Stability and Growth

Despite the 3-4 hiccups along the way, Turkey always tried to stay on the path of democracy and managed to do so. That means Turkey has set its priorities right to find and enjoy that rare combination. Particularly, since 2001 with a dual anchor, that is 2023 vision and EU membership ambition, progress has been unprecedented.

During this period, the Turkish economy and political agenda has undergone crucial developments. In addition to the progress made on the lines of Copenhagen criteria for democratization and rule of law, the economic fundamentals show an honest improvement. Yet the change in Turkey is so overwhelming and the structural transformation so rapid, that there is much that escapes the eye.

In fact, Turkey has turned from a shaky into a solid emerging market country.

Turkey's economy has displayed unprecedented growth since the beginning of the 2000s, and incredible durability and stamina in these past few tumultuous years. A carefully thought out macroeconomic strategy as well as prudent fiscal policies and major structural reforms, in effect since 2003, have all combined to help Turkey assimilate its economy into the globalized world.

Over the past decade, Turkey has emerged as one of the world's most dynamic economies. Turkey's GDP expanded at an average rate of 4.5% from 2000 to 2011.

It is no surprise that Turkey with two investment grades given by two international rating agencies is being recatagorized as one of the Global Swing States along with Brazil, India and Indonesia.

As far as the banking sector is concerned today, on top of the current strong position, with CAR around 16-18% and very low NPL level and loan to deposit ratio, potential to grow vertically

and horizontally is very high. In fact, 26 million adults do not have yet bank accounts in Turkey. That means penetration rate is about 50%, therefore there is plenty of rooms to grow. No wonder we observe new entries to the market from Russia, Qatar, Lebanon, China, India.

Despite the current asymmetric and multipolar global developments Turkey is proud of its achievements and shows no intention to loose pace of this hard gained momentum.

In retrospect, behind this impressive performance, thanks to the penetration of liberal market economy principles into the Anatolian cities, there is a completely new and hardworking entrepreneurial power of SMEs, called "Anatolian Tigers". They have, indeed, spread integration inland.

This segment of the economy creates 78% of the employment, 60% of the exports, 55% of the value added production and 15% of the total R&D expenses.

In fact, Turkey has climbed up the stairs with full dedication to reach the stability plateau and obtained investment grades. Today whoever acts, even unintentially, to disturb this stability and causes an erosion to the confidence in the markets is bound to go down with an elevator and obviously should be prepared to take the responsibility which will carry a high cost.

That is why it is believed that Turkey's success is based on economic integration, both internal and external, and social

inclusion. Further integration and improved quality of institutions will be the key for Turkey to join the ranks of high income and advanced democratic countries.

It should be underlined that although after 50 years of Ankara Agreement while EU still remains Turkey's top foreign policy priority, it is not the only one. Turkey's own national interests, political and economic, combined with the regional and global responsibilities in this new and volatile world order requires and imposes upon the country new roles to be played. Turkey is prepared and well equipped today to play those roles at the G-20 platform, with a view to achieving a global, sustainable and balanced growth.

Let us emphasize that EU membership negotiations, despite its slow progress, mainly due to Brussels unjustified violations of "Pacta Sunt Servanda" principle, constitute a strategic priority for upgrading Turkey's democratic values and achieving a sustainable and inclusive growth. This strategic priority is certainly in line with Turkey's position within the G-20 and EU-2020 vision.

Today for Turkey, with its 10 year stability, both in political and economical terms, and on the verge of 10th Five Year Plan, it makes sense to capture the unique opportunity to front load reforms with 2023 vision in mind in order to secure another jump start in the area of structural economic, social and political fields including a liberal "social contract" imbedded with proper

checks and balances that members of the society at large agreed upon, i.e. "Constitution". This is the real challenge for Turkey on the road to 2023.

With the introduction of a third anchor, that is "PKK peace Process" one expects even more encouraging results. As the coexistence of electoral secular democracy and a Muslim majority population is a distinguishing characteristics of Turkish politics, the ultimate aim should be to achieve an inclusive democracy, not to stay with the hard core constituency for policy decisions and implementation purposes. This is and this will be the safest way to attain inclusive economic growth and development in Turkey.

When one considers the above settings, as YKB Chief Economist Dr. C. Aykac puts it, the recent events on Taksim Square "could be viewed as yet another forward step in Turkey's normalization" and democratization process regardless of the short term volatility it may cause in financial markets. In fact, as history has proved, democracy is built up and improved through the bottom-up efforts and demands, whereas autocracy and /or theocracy is built-up through the top-down orders and instructions.

In retrospect, one can conclude that Turkish economy's fundamentals, supported by two investment grades, do not deserve the double hit it has been subjected to within the last few months, though a single hit, that is FED impact, was inevitable.

WHAT ARE THE PROSPECTS FOR GOING FORWARD? *GLOBAL SETTING*

World Bank published a report in 2011 which was called "Global Development Horizons, Multipolarity: The New Global Economy". The title of the report summarizes the issue we are confronted today. The world economy is in the midst of a transformative change. It is likely that, by 2025, emerging economies called BRIC plus, that is Brazil, Russia, India, China, Turkey and Indonesia will be major contributors to global growth. International Monetary system is likely not to be dominated by one single currency. In short, a new world order with a more diffused distribution of economic power is emerging. This is called "MULTIPOLARITY".

Let us look at the Eurozone

The task before euro area leaders today ranges far beyond putting together a big enough financial bailout to restore market confidence. They must rewrite the euro area rule book and complete the half built euro house. This means they must combine creative financial engineering, to resolve the immediate crisis, with a wave of new institutions to strengthen the real economy and restore sustained growth.

But economic growth of recent years was debt-fuelled. Therefore, even the most successful financial engineering in the euro area will ultimately fail, if the debtor countries, and indeed

the region as a whole, are unable to restore at least modest economic growth in the fairly near future. Therefore, the current crisis is not simply a problem of debt, it is one of growth.

It seems that the gap between the economic vitality of Europe and the United States is the main determinant of the future of the world economy. If this gap further widens with the same pace during the coming years, the strength of the American economy cannot alone contribute much for the salvation of the global economy.

Having said all these, let us look at China. In fact China's surplus is not any more bilateral issue between US and China. It is not possible for an integrated global economy to function smoothly when the second largest and fastest growing economy consistently runs such large surpluses and consumes so little. (Savings rate: 50%, consumption 35%)

For that reason by accepting the "Multipolarity" as of today's reality it is critical for the G-20 to do more to "Multilateralize" the China issue.

Therefore, in a world of progressively more multipolar economic growth and financial centers, policy makers will need to equip themselves with the tools and capabilities to effectively capitalize on opportunities while simultaneously safe guarding their economies against the risk that remain stubbornly high as the global economy struggles to find a stable footing.

TURKEY: ECONOMIC FRONT

- *Turkish growth is associated with expanding middle class, a significant support to the consumer segment and revitalized SMEs, an added strength to the manufacturing segment. It is, indeed, a rare case of integration and inclusion among emerging markets.*

- *Reducing inflation, interest rates to single digits and managing currency and price stability removed the most important obstacle to Turkish growth prospects.*

- *There is room still for further benefits from integration as part of Europe's convergence machine.*

But the sources of growth and social progress will need to come increasingly from productivity growth and efficiency gain and less from the macro policies and increased coverage.

The only exception to this principle is the necessity to increase the ratio of female population into the labor force which is 30% currently as compared to EU average of 60%.

TURKEY : POLITICAL FRONT

- *The quality of institutions and institution building both in the economic and political fields is likely to be the key for Turkey to reach high income cum advanced democracy status.*

- *In this respect, constitution process offers a historic chance to strengthen the civilian rights, parliamentary checks and balances and government accountability.*

- *With a determined position to "the peace process", and committed to stay as EU's convergence machine, Turkey definitely is not after a "short cut" to success. How she fares in this challenging road will hold lessons for far beyond her borders.*

** Yavuz Canevi, Chairman of the Board TEB*

ABREVIATIONS

ASEAN: Association of South East Asian Nations
AKP: Justice and Development Party
BES: Private Pension Fund (Bireysel Emeklilik Sigortası)
BOT: Built Own Transfer
BOO: Built Own Operate
BSRA: Banking Supervisory and Regulatory Agency
BT: British Telecom
CAD: Current Account Deficit
CAR: Capital Adequacy Ratio
CIS: Countries of Independent States
CU: Customs Union
COMECON: Council for Mutual Economic Assistance
COMCEC: Committee for Economic and Commercial Coop. (OIC)
CMB: Capital Market Board
CP: Commerical Paper
CTC: Chilie Telecom Corporation
CTLD-DCM: Convertible Turkish Lira Deposit
EU: European Union
EEC: European Economic Cooperation
ECB: European Central Bank
EMU: European Monetary Union
ESM: European Stability Mechanism
ECOFIN: Economy and Finance Ministerial Committee
EFTA: European Free Trade Area
EFT: Electronik Fund Transfer
FDI: Foreign Direct Investment
FX: Foreign Exchange
FTCC: Foreign Trade Corporate Companies
GAP: Grand Anatolian Project (Guneydogu Anadolu Projesi)
GATT: General Agreement on Tariffs and Trade
GNP: Gross National Product
GDP: Gross Domestic Product
IIF: Institute of International Finance
ISE: Istanbul Stock Exchange
IT: Information Technology
IMF: International Monetary Fund
IBRD: International Bank for Reconstruction and Development
LCD:Less Developed Country
M&A: Mergers and Acquisition
NPL: Non-Performing Loan
NGO: Non-Governmental Organization
OECD: Organization for Economic Cooperation and Development
OPEC: Oil Producing and Exporting Countries
R&D: Research and Development
SAL: Structural Adjustment Loan
SEE: State Economic Enterprize
SME: Small and Medium Size Enterprise
T/T: Terms of Trade
TUSIAD: Turkish Industrialist and Businessmen Association
UNDP: United Nations Development Program
UNCTAD: U.N. Conference on Trade and Development
VAT: Value Added Tax
WTO: World Trade Organization

Teşvikiye Cad. Alhambra Apt. 28/2
Teşvikiye, 34365 İstanbul - Turkey
Phone: +90 212 241 70 84
Fax: +90 212 241 72 11
Email: info@forumistanbul.com

Free publication of Forum İstanbul Institute.
Forum İstanbul Enstitüsü yayınıdır, para ile satılmaz.